



Office of Inspector General

Audit Report

FINANCIAL MANAGEMENT

EPA'S Fiscal 1998 Working Capital Fund Financial Statements

March 29, 2000

Inspector General Division

Conducting the Audit:

Financial Audit Division
Washington, D.C.

Assist Staff:

ADP Audits and Assistance Staff
Washington, D.C.

Southern Audit Division
Research Triangle Park, NC
Atlanta, GA

Regions Covered:

Agency-wide

Program Offices Involved:

Office of the Chief Financial Officer
Office of Environmental Information

March 29, 2000

MEMORANDUM

SUBJECT: EPA's Fiscal 1998 Working Capital
Fund Financial Statements
Audit Report No. 00100239

FROM: James O. Rauch */signed/*
Assistant Inspector General for Audit (2421)

TO: Michael W. S. Ryan
Acting Chief Financial Officer (2710A)

Margaret N. Schneider
Deputy Assistant Administrator for
Office of Environmental Information (2810A)

Attached is our audit report on EPA's fiscal year 1998 Working Capital Fund Financial Statements. The report contains recommendations designed to improve the financial reporting and overall operations of the Agency's Working Capital Fund. We discussed our findings with your staff and issued a draft report on October 29, 1999. On February 16, 2000, we received your written comments on the draft report and in a March 9, 2000, telephone conference we received additional comments on the draft report. These comments are summarized in the final report. We also included the complete written response in Appendix II. We appreciate the cooperation your staff provided in completing this audit.

ACTION REQUIRED

In accordance with EPA Order 2750, we are requesting the Acting Chief Financial Officer, as the primary action official, coordinate with the Deputy Assistant Administrator for Office of Environmental Information and provide this office a written response to the audit report within 90 days of the final audit report date. For corrective actions planned but not completed by the response date, reference to specific milestone dates will assist us in deciding whether or not to close this report in our audit tracking system.

The audit report contains findings that the Office of Inspector General (OIG) has identified and corrective actions the OIG recommends. This audit report represents the opinion of the OIG, and the findings in this audit report do not necessarily represent the final EPA position. Final determinations on matters in this audit report will be made by EPA managers in accordance with established EPA audit resolution procedures.

We have no objections to the release of this report to the public.

Should you or your staff have any questions about the report, please contact Ed Gekosky, Divisional Inspector General for Audit, Financial Audit Division at 260-1072, or Paul Curtis of his staff at 260-8442.

Attachment

cc: See Report Distribution List

EXECUTIVE SUMMARY

INTRODUCTION

During fiscal 1997, the Environmental Protection Agency (EPA or the Agency) established a Working Capital Fund (WCF or the Fund). The WCF provides EPA offices with postage, computer and telecommunication services. Customers are responsible for determining their WCF service requirements, planning and budgeting for these services, originating WCF Service Agreements, monitoring consumption of WCF services and providing feedback on service quality.

OBJECTIVES

Our objective was to determine if EPA's fiscal 1998 WCF financial statements are fairly presented. We also determined whether adequate internal controls over the Fund were in place, and whether the Agency complied with applicable laws and regulations.

RESULTS IN BRIEF

We could not determine if EPA's fiscal 1998 WCF financial statements are fairly presented. Weaknesses in the Agency's accounting for its property resulted in our being unable to determine the proper balances for property and equipment net of accumulated depreciation and various expense and equity accounts. This internal control weakness impacted not only the financial statements, but also the overall management of the WCF operations. It resulted in WCF managers and WCF Board members not having accurate or timely financial information on the results of the Fund's operations. We consider the weaknesses in accounting for WCF property to be a material weakness. The Office of Management and Budget (OMB) defines material weaknesses for financial statement purposes as situations where internal controls do not reduce to a relatively low level, the risk that errors, fraud or noncompliance in amounts material to the audited financial statements may occur and not be detected in a timely manner by employees in the normal course of performing their assigned functions.

In evaluating compliance with laws and regulations, we found that the Agency's development of fiscal 1998 WCF billing rates was inconsistent with the requirement that WCF rates be established to return, in full, all expenses of operations. This requirement was established in EPA's fiscal 1997 Appropriations Act. EPA's rates for fiscal 1998 did not include rent, electricity, WCF staff salaries and benefits, and finance and security costs associated with the operation of the Fund.

RECOMMENDATIONS

To correct the weaknesses we identified, we recommend the Acting Chief Financial Officer and the Deputy Assistant Administrator for the Office of Environmental Information direct the Financial Reports and Analysis Branch, the National Technology Services Division and the WCF Staff to work together to improve the process of adjusting the WCF property accounts by:

- a. maintaining clear documentation explaining the necessity of all adjusting entries and how the adjustment amounts were computed, and
- b. requiring the WCF Staff concur with all WCF adjusting entries prior to the adjusting entries being made.

We are not including a recommendation concerning the fiscal 1998 WCF billing rates because during our fiscal 1997 WCF audit we made recommendations that when fully implemented should correct weaknesses in this area.

AGENCY COMMENT AND OUR EVALUATION

In a memorandum dated February 2, 2000, the Acting Chief Financial Officer responded to our draft report. In the response, he agreed with our recommendations; however, he disagreed with some of the supporting information. Where appropriate, we made minor changes to the body of the report to address these concerns. The Agency's complete response is included as Appendix II to this report.

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ABBREVIATIONS

CFO	Chief Financial Officer
EPA	Environmental Protection Agency
ETSD	Enterprise Technology Services Division
FAS	Fixed Asset Subsystem
FMFIA	Federal Managers' Financial Integrity Act
FMSD	Facilities Management and Services Division
FRAB	Financial Reports and Analysis Branch
IFMS	Integrated Financial Management System
OARM	Office of Administration and Resources Management
OC	Office of the Comptroller
OIG	Office of Inspector General
OMB	Office of Management and Budget
OTOP	Office of Information Technology Operations and Planning
RTP	Research Triangle Park
WCF	Working Capital Fund

INTRODUCTION

PURPOSE

We performed this audit to determine if:

- (1) the Working Capital Fund (WCF) financial statements are fairly presented;
- (2) EPA management had established an internal control structure which provided reasonable assurance that the Fund was properly accounted for, its assets were safeguarded, and its transactions were executed in compliance with laws and regulations which could have a material effect on the financial statements; and
- (3) EPA management complied with applicable laws and regulations which, if not followed, could have a direct and material effect on the financial statements.

BACKGROUND ON THE WORKING CAPITAL FUND

EPA's WCF was established on October 1, 1996, to supply common administrative support services to Agency customers which can be provided most economically and efficiently through centralized coordination, direction and supervision. The WCF provides postage services, which include all routine, day-to-day U.S. Postal services and special services; and Enterprise Technology services, which include computer and telecommunication services. Current WCF customers include EPA Headquarters and Regional offices. Customers determine service requirements, plan and budget for WCF services, originate WCF Service Agreements, monitor consumption of WCF services, and provide feedback on service quality.

PRIOR AUDIT COVERAGE

During last year's WCF financial statement audit, we reported weaknesses in the areas of:

- ! recording Fund revenue and expenses,
- ! developing WCF rates,
- ! accounting for Fund property, and
- ! developing procedures to timely return customer overbillings.

Attachment 1 summarizes the status of these prior audit report recommendations in each of these areas. The Chief Financial Officer (CFO), as the Agency's Audit Follow-up Official, oversees

EPA's follow-up on audit findings and recommendations, including resolution and implementation of corrective actions. Final action on the recommendations occurs when the Agency completes implementation of the corrective actions to remedy weaknesses identified in the audit. We acknowledge that the Agency has taken actions to address some fiscal 1997 WCF financial statement issues, and we will continue to work with the Office of the Chief Financial Officer in helping to resolve outstanding issues.

INSPECTOR GENERAL'S REPORT ON THE FISCAL 1998 FINANCIAL STATEMENTS FOR THE WORKING CAPITAL FUND

The Administrator
U.S. Environmental Protection Agency

We undertook an audit of the fiscal 1998 financial statements for the Working Capital Fund (WCF). The results of our audit work, including our evaluation of internal controls and tests of compliance with laws and regulations follow.

DISCLAIMER OF OPINION ON THE FINANCIAL STATEMENTS

We have examined the accompanying Statement of Financial Position of EPA's Working Capital Fund and the related Statement of Operations and Changes in Net Position as of September 30, 1998, and for the year then ended. These financial statements are the responsibility of EPA management.

WCF staff could not determine the proper balance of property and equipment, net of accumulated depreciation; capitalized expenses; operating expenses; and the property transferred in component of equity due to the lack of supporting documentation for property related adjustments made to those accounts. WCF records do not permit the application of other auditing procedures to property and equipment and related accounts.

Since the WCF staff could not support the balances and adjustments made to property and equipment and related accounts, and we were not able to apply other auditing procedures to satisfy ourselves as to the net book value of property and equipment and balances in capitalized expenses, operating expenses, and equity, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements.

EVALUATION OF INTERNAL CONTROLS

We evaluated the Agency's internal control structure to determine: (1) the audit procedures necessary to express an opinion on the WCF financial statements, and (2) whether the internal controls provided reasonable assurance that:

- ! transactions are properly recorded, processed and summarized to permit the preparation of reliable financial statements and to maintain accountability over assets;

- ! transactions, including those related to obligations and costs, are executed in compliance with applicable laws and regulations; and
- ! assets are safeguarded against loss from unauthorized acquisition, use or disposition.

Our objective in evaluating controls was not to express an opinion on controls. Accordingly, we do not express such an opinion. Our evaluation would not necessarily disclose all matters in the internal control structure that might be reportable conditions or material weaknesses. Because of inherent limitations in any internal control structure, losses, noncompliance, or misstatements could occur and not be detected. Also, projecting our evaluation of internal controls to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or the degree of compliance with such controls may deteriorate.

Material Weakness

OMB Bulletin 98-08, "Audit Requirements for Federal Financial Statements," defines a material weakness as a situation where internal controls do not reduce to a relatively low level, the risk that errors, fraud or noncompliance in amounts material to the audited financial statements may occur and not be detected in a timely manner by employees in the normal course of performing their assigned functions. We consider weaknesses in the Agency's accounting for its WCF property to be a material weakness. These weaknesses resulted in our being unable to determine the proper balance of property and equipment, net of accumulated depreciation; capitalized expenses; operating expenses; and the property transferred in component of equity. More importantly, weaknesses in accounting for WCF property affected the reliability and timeliness of financial information available throughout the year to manage the Fund's operations. Monthly Net Operating Results (NOR) Reports are prepared from the general ledger for the WCF Staff to monitor costs and profits. The NOR reports were inaccurate because of the weaknesses in accounting for WCF property. Without accurate financial information, appropriate management decisions cannot be made. For example, the rebate amount had to be revised since property cost information was originally understated. The initial rebate amount exceeded the Fund's profit margin. This material weakness is more fully described below.

Further Improvements Are Needed in Accounting for WCF Capitalized Property

We have been reporting, for a number of years, that EPA needs to improve its accounting for property. Weaknesses in the Agency's accounting procedures and supporting documentation for property resulted in the Agency being unable to determine the value of WCF property as of September 30, 1997. The results of this year's audit show that the Agency needs to continue to improve its accounting for property. The finance staff made numerous adjusting entries to property and equipment (general ledger accounts 1750, 1759, 1770, and 1779), related expense accounts (610E and 612E), and equity accounts (3220). The entries made were to record, expense, write-off, and reverse various amounts for beginning balances, property transferred in, and current year activity in an attempt to arrive at fairly presented balances. However, in this

process, an imbalance in offsetting object class amounts in the expense accounts was created with corresponding effects on property and equity. The audit trail supporting these entries is unclear, and we could not use alternate means to reconcile the accounts. Accordingly, we could not determine whether property and equipment, net position, and operating expenses were fairly presented.

As of the end of fiscal 1997, all WCF property was not identified in the Agency's Fixed Asset Subsystem (FAS). In fiscal 1998, property was transferred to the WCF in FAS through manual transactions. The WCF property transfer to FAS and the discrepancy with the fiscal 1997 balances required numerous adjusting entries be made to Equipment (account 1750), Accumulated Depreciation for Equipment (1759), and Depreciation Expense-Exchange (671E) accounts. Twenty adjusting entries were made to account 1750, 33 adjusting entries were made to account 1759, and 55 adjusting entries were made to account 671E. These adjusting entries such as: AV 90, AV 91, AV 97, SV 85 and JV 01, resulted in numerous debits and credits to account 610E, account 612E, and the Prior Year Adjustment - Appropriation account (7403). Many of the entries have unclear supporting documentation and detail, and do not provide a clear audit trail. The result of these entries were balances (\$17,846,499 and \$19,839,930 in accounts 612E and 610E, respectively) without supporting object class codes. We believe the balances in accounts 610E and 612E are misstated, but because of incomplete documentation, we are unable to determine the proper balances in these accounts.

The balance in account (3220) should be equal to the net book value of all property that was transferred into the Fund from other appropriations at the Fund's inception, October 1, 1996. We do not believe that Financial Reports and Analysis Branch (FRAB) personnel properly accounted for all EPA-held or contractor-held property that was to be transferred into the Fund at its inception or considered the effects of the change in depreciation method because of the use of FAS.

Further, at Research Triangle Park, we identified 36 WCF property items including components, totaling \$5,961,980 that met the capitalization criteria, that were either not recorded in FAS or were not recorded timely or accurately in FAS. When property acquisitions are not recorded timely or accurately in FAS, the available property data is not reliable and additional work must be performed to reconcile the IFMS general journal with FAS. Items were not recorded timely or accurately in FAS because: (1) property was delivered directly to a location where there were no designated receiving personnel, (2) property personnel were not informed that the property had been received, (3) procurement requests did not contain accurate and complete accounting information, and (4) procurement requests for component pieces did not include information on the parent property items.

At RTP, we also identified WCF property items costing \$188,360, which were improperly capitalized when they should have been expensed. These items were not properly expensed because incorrect or incomplete information was included on the procurement request. Subsequent to our audit work FRAB personnel corrected this error.

To correct the weaknesses with regards to procurement requests, the Agency issued guidance during October 1998 on how to prepare procurement requests for property, which was effective immediately. We commend the Agency for establishing detailed instructions and examples on how to prepare procurement requests to remedy these problems. In our report on the Agency-wide fiscal 1998 financial statements, we recommended that the CFO and the Assistant Administrator for Administration and Resources Management, continue to work to strengthen controls designed to ensure that property is timely and accurately recorded in FAS by reemphasizing to the appropriate Agency personnel their property management responsibilities.

In response to this recommendation, the Facilities Management Services Division (FMSD) will issue a memorandum to remind Agency Senior Resource Officials: (1) to follow Agency property management policy, and (2) to distribute Transmittal Notice No. 99-03, "Guidelines on Preparing Requisitions for Property and Related Goods and Services," to their respective project officers, ordering and fund certifying officers. Also, the Enterprise Technology Services Division¹ (ETSD) is scheduling a joint review session with Research Triangle Park-Financial Management and Services Division (RTP-FMSD), RTP-Office of Acquisition Management, and FMD to address WCF property accounting problems. ETSD is developing a plan of action for correcting these problems. We concur with the Agency's planned corrective actions in this area.

Reportable Conditions

We identified the following two reportable conditions. OMB Bulletin 98-08 defines a reportable condition as an internal control weakness that could adversely affect EPA's ability to ensure: (1) transactions are executed in accordance with applicable laws; (2) assets are safeguarded against unauthorized acquisition, use, or disposition; and (3) transactions are properly recorded, processed, and summarized to permit the preparation of reliable financial statements in accordance with Federal accounting standards.

Better Coordination and Sharing of Financial Information Between the WCF Business Office and the WCF Staff Would Improve Fund Operations

ETSD Activity Managers are responsible for providing and overseeing all service delivery, except postage. ETSD established a WCF Business Office to perform many of the administrative functions for the Activity Managers. Agency WCF guidance documents do not specifically mention the existence of the Business Office; therefore, the roles and responsibilities of the Business Office are not clearly defined in the authoritative and policy documents of the WCF. The lack of clearly defined roles and responsibilities for the Business Office has led to inadequate coordination and sharing of financial information between the Business Office and the Comptroller's WCF Staff which has affected the efficient and effective management of Fund operations.

¹ As of October 24, 1999, the Enterprise Technology Services Division is now called the National Technology Services Division.

There are clearly defined roles and responsibilities for the CFO, WCF Board, WCF Staff, Comptroller, and Activity Managers. However, the WCF Business Office, which manages the administrative side of the service delivery process, does not have a clearly defined role. The lack of clearly defined roles and responsibilities for the WCF Business Office has complicated and hindered the development of effective coordination mechanisms between ETSD entities and the WCF Staff. The lack of coordination between ETSD and the WCF Staff impacts the ability of the Financial Management Division to prepare timely and fairly presented WCF financial statements. The sharing of management and financial information between the ETSD entities and the WCF staff is also needed for the successful management of the Fund.

The lack of a clearly defined role for the Business Office and the lack of effective coordination between ETSD and the WCF Staff has resulted in the Fund not having timely and reliable financial information. For example, on September 30, 1998, the CFO authorized the issuance of a significant revenue rebate to WCF customers. Without timely, reliable financial information, the WCF Staff did not know whether or not it should recommend this rebate until the last few days of fiscal 1998. After the CFO approved the rebate methodology, the WCF staff and the Business Office worked to develop September's estimated revenue and costs and rebate percentage to be applied to the WCF services. Initial rebate amounts were then recorded in the September 1998 Billing Statements. Subsequently, the WCF Staff had to revise and decrease the rebate amount due to errors in the depreciation expense. Because ETSD did not have all the WCF property entered in the Agency's Fixed Asset System (FAS), WCF depreciation computations were understated and had to be adjusted. When WCF depreciation expenses were increased it created a loss situation that then led to the reduction of the rebate to cover the loss. The revised rebate was recorded as an adjustment to the September Billing Statements. Having to rebate funds and then later revise such rebates, hurts the customers confidence in the reliability of the Fund's management reports.

Fund customers and managers need timely and reliable financial information; however, monthly WCF Billing Statements and Consumption Reports were not available for customers or Activity Managers use until April 1998. The lateness of the Billing Statements and Consumption Reports was due to contractor problems, but it was not clear whose responsibility it was to see that the contractor resolve these problems. Because these problems were not resolved in a timely manner, critical information for fiscal 1998 operations was not available until half way through fiscal 1998. Until these reports were available, customers did not know if their WCF services were being billed as expected, or if their rate of service consumption was as anticipated. This caused frustration and discontent among customers because they were unable to determine the proper funding allocation needed for WCF services. Activity Managers also rely on these reports. The mainframe activity manager stated that because he did not have these reports he was not aware of the significant under-recovery of mainframe costs until he reviewed the Billing Statements.

Although the Office of the Comptroller (OC) and the Office of Information Technology Operations and Planning (OTOP) do not agree that inadequate coordination and sharing of

financial information between ETSD and the WCF Staff affected the efficiency and effectiveness of WCF operations, they did agree improvements were needed in the WCF processes. OC and OTOP are in the process of examining all aspects of WCF operations and will ensure that all functions and responsibilities within the WCF operations are clearly defined and delineated.

Automated Application Processing Controls for the Integrated Financial Management System Could Not Be Assessed

We continue to be unable to assess the adequacy of the automated internal control structure for accounting transactions contained in the Agency's Integrated Financial Management System (IFMS). During past audits, we reported that the Agency's documentation for the system did not contain the level of detail necessary to construct tests of automated internal controls necessary for a financial statement audit. Agency management believes the documentation is sufficiently detailed in the context of their legacy system although they acknowledge that the IFMS data dictionary could be improved. However, management also believes that data dictionary enhancements would not be cost effective considering the system's maturity, and concurs with a recent Department of Treasury review which recommends that the Agency defer development of a detailed data dictionary until it is ready to transition to a new system. We plan to obtain and access the Treasury review team's analysis concerning documentation requirements, as part of our fiscal 1999 financial statement audit. In addition, we will continue to participate as a consultant on the Agency's workgroup to replace the payroll system. Our report on EPA's fiscal 1998 Agency-wide financial statements (Report Number 99B0003) issued September 28, 1999, provides further detail on this issue.

Comparison of EPA'S FMFIA Report with Our Evaluation of Internal Controls

As required by OMB Bulletin 98-08, we compared EPA's Federal Managers' Financial Integrity Act (FMFIA or the Integrity Act) Report with our evaluation of the Agency's internal control systems. For reporting under FMFIA, material weaknesses are defined differently than they are defined for financial statement audit purposes. OMB Circular A-123, "Management Accountability and Control" defines a material weakness as a deficiency that the Agency head determines to be significant enough to be reported outside the Agency. OMB Bulletin 98-08 defines a material weakness as a weakness in controls that creates a risk that errors, fraud or noncompliance in amounts material to the financial statements could occur and not be timely detected.

As a part of the fiscal 1998 Integrity Act process, the Agency reported a material weakness in the Agency's information security planning that could impact the WCF. Information security programs must include the development and maintenance of information security plans, and a strategy to conduct management reviews. To date, this has not occurred. Without effective information security plans, EPA is vulnerable to unauthorized access, use, modification or

destruction of its information resources. The Agency is in the process of implementing corrective action strategies.

The material weakness we identified that affected the WCF financial statements was not reported in the Agency's FMFIA report. We do not believe this weakness meets the criteria for reporting of material weaknesses under FMFIA.

TESTS OF COMPLIANCE WITH LAWS AND REGULATIONS

We tested compliance with those laws and regulations that could either materially affect the WCF Fund financial statements, or that OMB or we considered significant to the audit. The objective of our audit, including our tests of compliance with applicable laws and regulations, was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

In testing the Agency's compliance with laws and regulations during our fiscal 1997 audit, we found the Agency's development of fiscal 1997 WCF billing rates was inconsistent with EPA's fiscal 1997 Appropriations Act which required WCF rates to be established that would return in full all expenses of operations. The Working Capital Fund Board decided to exclude certain costs, including rent, electricity, WCF staff salaries and benefits, and finance and security costs in developing the fiscal 1997 billing rates. The WCF also excluded those costs as expenses and related payables in the fiscal 1997 financial statements. For fiscal 1998, the Agency did record these costs as expenses in the WCF financial statements; however, the WCF rates established for fiscal 1998 still did not return in full all expenses of operations. We made recommendations concerning this issue during our fiscal 1997 WCF financial statement audit. The Agency is currently implementing these recommendations, so we are not making any additional recommendations concerning the development of WCF billing rates. The Agency expects, during fiscal 2000, to consider all costs in the development of the WCF rates.

RECOMMENDATIONS

1. We recommend the Acting Chief Financial Officer and the Deputy Assistant Administrator for the Office of Environmental Information direct the Financial Reports and Analysis Branch, the National Technology Services Division and the WCF Staff to work together to improve the process of adjusting the WCF property accounts by:

- a. maintaining clear documentation explaining the necessity of all adjusting entries and how the adjustment amounts were computed, and
- b. requiring that the WCF Staff concur with all WCF adjusting entries prior to the adjusting entries being made.

2. We recommend that the Comptroller and the Director, OTOP continue to work toward improving WCF operations and ensuring that all aspects of WCF operations are clearly defined and delineated.

Agency Comments and OIG Evaluation

The Acting CFO agreed with our recommendations. His staff plans to: (1) develop WCF specific standard operating procedures for WCF property adjusting entries, and (2) will conduct an organizational study to evaluate the NTSD Business Office to ensure that all WCF functions and responsibilities are clearly delineated among all appropriate parties conducting WCF Business (the audit report refers to the NTSD Business Office as the WCF Business Office).

While agreeing with our recommendations, the Acting CFO disagreed with some of our supporting documentation. Where appropriate, we made minor changes to the body of the report to address these concerns.

RESPONSIBILITIES AND METHODOLOGY

EPA MANAGEMENT RESPONSIBILITIES

EPA's management is responsible for:

- ! preparing annual financial statements;
- ! establishing and maintaining a system of internal controls; and
- ! complying with applicable laws and regulations.

OIG RESPONSIBILITIES

We are responsible for:

- ! auditing the financial statements to determine if the statements are free of material misstatements and presented fairly in accordance with the basis of accounting described in Note 1 to the financial statements, and
- ! evaluating related internal controls and testing compliance with applicable provisions of laws and regulations.

AUDIT METHODOLOGY

In order to fulfill our responsibilities we:

- ! examined on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- ! assessed the accounting principles used and significant estimates made by management;
- ! evaluated the overall presentation of the financial statements;
- ! obtained an understanding of the significant internal control structure policies and procedures and assessed the level of control risk relevant to the following significant cycles, classes of transactions, and account balances:
 - ! Billings and Receivables

- ! Disbursements and Operating Expenses
- ! Payroll
- ! Property
- ! Budget and Obligations
- ! Accounts Payable and Accrued Liabilities
- ! General Accounting and Financial Reporting

! tested significant manual controls to determine whether the controls were effective;

! obtained an understanding of management's process for evaluating and reporting on internal controls and accounting systems as required by FMFIA;

! compared the material weaknesses reported in the Agency's FMFIA report to the results of our evaluation of internal controls; and

! tested compliance with applicable sections of laws and regulations that could either materially affect the financial statements or that OMB or our office considered significant to the audit.

Detailed system documentation was not available that would allow us to develop an understanding of the IFMS automated control structure and to test these controls.

Details of Audit Field Work

We selected statistical and non-statistical samples from EPA's detailed accounting records supporting various financial statement amounts. We tested these sample transactions to determine if they were adequately supported by documentation and were recorded in accordance with internal control policies and procedures and applicable laws and regulations. We also reviewed other supporting documentation, such as worksheets and schedules, that the Agency used in preparing its financial statements. In addition, we applied certain analytical review procedures to account balances.

The financial management records and supporting documentation we reviewed were maintained by offices in Research Triangle Park, the Office of the Chief Financial Officer, various offices within the Office of Information Technology Operations and Planning, and by Headquarters program offices. To gain an understanding of established internal control procedures, and to evaluate these controls, we also interviewed personnel in these offices and reviewed applicable policies and procedures.

Our fieldwork for the audit was performed from June 15, 1998 through July 8, 1999. Except as previously discussed in this report, we conducted our audit work in accordance with: generally accepted auditing standards; the standards applicable to financial audits contained in the Government Auditing Standards (1994 Revision), issued by the Comptroller General of the

United States; and OMB Bulletin No. 98-08, as amended January 25, 1999. These standards require that we plan and perform our audits to obtain reasonable assurance that the financial statements are free of material misstatement. We believe that our audit work provides a reasonable basis for our disclaimer of an opinion.

James O. Rauch */signed/*
Assistant Inspector General for Audit
U.S. Environmental Protection Agency
July 8, 1999

STATUS OF PRIOR AUDIT REPORT FINDINGS

Report Findings and Recommendations	Management Comments and Corrective Action Plans	Target Date	Status
<p>AUDIT OF EPA'S FISCAL 1997 WCF FINANCIAL STATEMENTS (Audit Report No. E1AML7-20-8100166)</p> <p>We recommended that the Chief Financial Officer:</p> <p>1.0 Direct the WCF Staff to record a WCF Revenue accrual entry, so WCF service revenue will be recognized at the time the service is performed.</p> <p>2.0 Allocate rent, utilities, WCF salaries and benefits, and finance and security costs to the WCF and include these costs in the WCF financial statements. Revise the Agency's policy on the WCF rates to state that they must return in full all expenses of operations.</p> <p>3.0 Direct the WCF Staff to reconcile the differences between the value of EPA's WCF property recorded in the general ledger and on the Enterprise Technology Service Division's Capital Asset Listing.</p> <p>4.0 Direct the WCF Staff and WCF Board to prepare an Agency policy on when and how to issue WCF service refunds so that excess revenues can be returned in a timely and efficient manner.</p>	<p>WCF Staff will work with FSD, FMD and service providers to develop procedures for recognizing revenue and associated costs.</p> <p>WCF staff will work with service providers to identify costs associated with the WCF operations and will consider all costs in the development of the rates.</p> <p>WCF Staff will work with ETSD, FMD, and FSD to ensure the WCF property listing in the general ledger is accurate for WCF operations.</p> <p>OIG Note: Problems continue to exist with EPA's WCF property. See material weakness on WCF property.</p> <p>WCF staff will ensure policy changes regarding rebates and refunds generated by WCF operations are developed and promulgated to EPA community.</p>	<p>08/31/98</p> <p>10/31/99 revised to 12/15/99</p> <p>08/31/98</p> <p>09/15/98 revised to 12/15/99</p>	<p>Completed 08/11/98</p> <p>Open</p> <p>Completed 09/30/98</p> <p>OIG Note</p> <p>Open</p>

APPENDIX I

**FISCAL 1998 FINANCIAL STATEMENTS
FOR THE WORKING CAPITAL FUND**

Environmental Protection Agency Working Capital Fund
Statement of Financial Position
As of September 30, 1998
(Dollars in Thousands)

ASSETS:

Entity Assets:

Intragovernmental Assets:

Balance with Treasury (Note 2)	\$41,040
Advances and Prepayments	1

Governmental Assets:

Operating Materials and Supplies, Net (Note 3)	13
Advances and Prepayments	3
Property and Equipment, Net (Note 4)	15,379
Other Governmental Assets	<u>5,319</u>

Total Assets \$61,755

LIABILITIES:

Intragovernmental Liabilities:

Accounts Payable	\$ 1,303
Other Intragovernmental Liabilities (Note 5)	12,962

Governmental Liabilities:

Accounts Payable	18,316
Other Governmental Liabilities (Note 5)	<u>719</u>

Total Liabilities 33,300

NET POSITION (Note 6)

Balances:

Paid in Capital	23,293
Cumulative Results of Operations	<u>5,162</u>

Total Net Position 28,455

Total Liabilities and Net Position \$61,755

Environmental Protection Agency Working Capital Fund
Statement of Operations and Changes in Net Position
As of September 30, 1998
(Dollars in Thousands)

REVENUE AND FINANCING SOURCES

Revenues from Services to the Public	\$118,309
Other Revenues and Financing Sources	6,584
Less Rebate - WCF	<u>6,696</u>
Total Revenues and Financing Sources	<u>118,197</u>

EXPENSES

Program or Operating Expenses (Note 8)	98,748
Imputed Expenses	6,584
Depreciation and Amortization	8,570
Funded Accrued Annual Leave	135
Loss on Sale of Assets	<u>53</u>
Total Funded Expenses	<u>114,090</u>

Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	<u>\$ 4,107</u>
----------------------------------------------------------------------------	-----------------

NET POSITION

Net Position, Beginning Balance	\$ 20,550
Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	4,107
Plus (Minus) Non Operating Changes (Note 7)	<u>3,798</u>
Net Position, Ending Balance	<u>\$ 28,455</u>

Environmental Protection Agency Working Capital Fund
Notes to Financial Statements
(Dollars in Thousands)

Note 1. Summary of Significant Accounting Policies:

The WCF provides common administrative support services to Agency customers which can be provided most economically and efficiently through centralized coordination, direction and supervision.

The WCF was authorized pursuant to Section 403 of the Government Management Reform Act (GMRA) of 1994, Public Law 103-356 as one of six franchise fund pilots. Subsequent authorization contained in the EPA 1998 Appropriations Act, Public Law 105-65, established permanent WCF authority.

The WCF operates in accordance with EPA and Federal policies, procedures and guidelines, including those of the Office of Management and Budget (OMB), Treasury, Federal Accounting Standards Advisory Board (FASAB), and Joint Financial Management Improvement Program (JMFIP). The WCF accounting is accomplished through the Agency's Integrated Financial Management System (IFMS) which meets Federal financial management standards. The WCF Board has the authority to recommend adoption of other procedures and guidance to the Chief Financial Officer (CFO) for approval.

The Agency's CFO oversees development, implementation and operation of WCF policies and systems. The CFO makes final WCF decisions and is ultimately responsible for the financial health of the WCF. The CFO also approves WCF rates and the addition or elimination of WCF services based on recommendations made by the WCF Board and provides final ruling on appeals that cannot be resolved at a lower level.

The WCF Board is an advisory body to the CFO. It provides policy and planning oversight and advises the CFO relative to the financial condition of the Fund. The Board is chaired by the Deputy CFO. Board membership consists of senior executives from the Headquarters offices, the lead Region for Management, the backup Region for Management and two ad hoc Regional representatives. Specific membership is delineated in the WCF Board Charter which also defines specific roles and responsibilities.

The WCF Staff is organizationally located in the Immediate Office of the Comptroller (OC). The WCF Program Manager serves as the WCF Staff team leader and reports to the Comptroller. The WCF Staff provides overall management and coordination of the WCF and provides administrative support to the WCF Board. Responsibilities include overseeing management of Fund operations, coordinating formulation of the WCF budget and monitoring execution, and acting as liaison to the WCF service providers and customers.

WCF Activity Managers, designated by the appropriate Office Director, have management responsibility for providing service delivery to the customer community.

Current WCF customers include EPA Headquarters offices and Regional offices and can also include other Federal agencies. Customers determine service requirements, plan and budget for WCF services, originate WCF Service Agreements, monitor consumption of WCF services and provide feedback on service quality.

All financial management activities of the WCF are conducted at the highest level of integrity through disclosure of current and accurate financial information to include appropriate documentation. All actions and financial activities of the WCF will be subject to independent review and audit under the supervision of the Office of the Inspector General.

DEFINITIONS.

a. Working Capital Fund. A Working Capital Fund is a type of intra governmental revolving fund. It is a funding mechanism and accounting entity that is authorized by law to finance a cycle of operations in which the income needed to cover the costs for goods or services provided is recovered through offsetting collections from the users. The income is available without fiscal year limitation.

b. Franchise Fund. An intra governmental revolving fund similar in concept to a WCF. Franchise Funds were authorized pursuant to Section 403 of the Government Management Reform Act (GMRA) of 1994. Services are competitively provided to Federal entities in compliance with the guidelines provided through GMRA.

c. WCF Activity Service Provider. An Agency organizational unit that provides goods or services to customers with the subsequent offsetting collections from the customers received by the WCF to recover the costs incurred to provide the goods and services.

d. WCF Service Agreement. A document which represents the customer's order for WCF goods or services and the agreement to fund those services and the service provider's agreement to provide those services.

Note 2. Fund Balances with Treasury:

The Treasury maintains EPA's Working Capital Revolving Fund account and processes all of EPA's receipts and disbursements. The available balances are for payment of EPA's obligations under its Working Capital Fund program. The restricted balances pertain to Working Capital Fund advances received but not earned.

Fiscal Year	Available	Restricted	Total
1998	<u>\$ 28,078</u>	<u>\$ 12,962</u>	<u>\$ 41,040</u>

Note 3. Operating Materials and Supplies, Net:

Fiscal Year	Items Held for Use	Value	Valuation Method
1998	General Operations Supplies -WCF	<u>\$ 13</u>	Actual Cost
	Total	<u>\$ 13</u>	

Note 4. Property, Plant, and Equipment: Fiscal Year 1998

WCF property, plant and equipment consists primarily of computer and related equipment items held by the Agency and contractors. In 1997, the WCF was created by GMRA and the assets held by the other appropriations were transferred to the fund via manually maintained spreadsheets. Also, the Agency implemented the Fixed Assets Subsystem (FAS). The FAS replaced the Personal Property Accountability System (PPAS) as the system of record for EPA-held personal property.

Purchases of EPA-held and contractor-held personal equipment are capitalized if the equipment is valued at \$25 thousand or more and has an estimated useful life of at least two years. With the implementation of the FAS, all EPA-held personal equipment converted were assumed to have an estimated useful life of five years. New acquisitions of EPA-held personal equipment are depreciated using straight-line method based on the asset's specific useful life, ranging from two to 15 years. Contractor-held personal equipment is depreciated on a modified straight-line basis over a period of six years, depreciating 10% the first and six years and 20% in years two through five.

The fiscal 1997 ending balances were adjusted because of certain over/under statements. Further information obtained in fiscal year 1998 revealed that: 1) property inventoried was determined to be WCF property that had not been transferred to WCF in fiscal 1997 as desired, and 2) a

reconciliation between the manually maintained spreadsheets supporting fiscal 1997 property figures and property converted and subsequently entered into FAS revealed differences.

The cumulative effect of the above mentioned fiscal 1997 items resulted in a total net adjustment to property, plant and equipment for WCF of \$3.6 million, with a corresponding adjustment to the capital asset component of equity. There was no effect to the Statement of Operations and Changes in Net Position.

EPA-Held Equipment - Fiscal Year **1998**

Beginning Balance - Equipment	\$ 42,091
Adjustments	1,516
Property, Plant and Equipment-Transferred from Pred. Appro.	—
Adjusted Beginning Balance - Equipment	43,607
Purchases - Fiscal 1998	4,190
Disposals - Fiscal 1998	(8,105)
Ending Balance - Equipment	\$ 39,693

Beginning Balance - Accumulated Depreciation	\$ (31,775)
Adjustments	2,109
Depreciation Transferred from Pred. Appro.	—
Adjusted Beginning Balance - Accumulated Depreciation	(29,665)
Depreciation - Fiscal 1998	(5,524)
Disposals	8,051
Ending Balance - Accumulated Depreciation	\$ (27,138)
Net Book Value	\$ 12,555

Contractor - Held Equipment **1998**

Beginning Balance - Equipment	\$ 25,690
FY-96 and Prior Years PP&E Trans. From Pred. Appro.	—
Adjustments	(3,065)
Ending Balance - Equipment	\$ 22,625

Beginning Balance - Accumulated Depreciation	\$ (21,165)
Depreciation Transferred From Predecessor Appropriations	—
Adjustments	4,410
Adjusted Beginning Balance	(16,754)
Current Year Depreciation	(3,046)
Ending Balance - Accumulated Depreciation	<u>(19,801)</u>
Net Book Value	<u>\$ 2,825</u>
Total Net Book Value	<u><u>\$ 15,379</u></u>

Note 5. Other Liabilities - Federal:

Fiscal Year	1998
Intragovernmental Liabilities	<u>\$ 12,962</u>
Governmental Liabilities: Funded	
Accrued Funded Payroll	380
Accrued Annual Leave	<u>339</u>
Total Governmental Liabilities	<u><u>\$ 719</u></u>

Note 6. Total Net Position:

The total net position of EPA's Working Capital revolving fund represents the financial position of this fund after consideration of the net effects of operations in the current year and the cumulative effects of all prior years. These amounts are not based on appropriated capital, but on reimbursable obligation authority. Invested capital represents the book value, net of depreciation, of Working Capital Fund resources invested in equipment. Cumulative Results of Operations represents the cumulative deficit or surplus from the funds' operations.

Fiscal Year	1998
Invested Capital	\$ 23,293
Cumulative Results of Operations	<u>5,162</u>
Total Net Position	<u>\$ 28,455</u>

Note 7. Non-Operating Changes:

The Non-Operating Changes resulted from fixed assets transferred-in from other Treasury symbols within EPA and other non-operating increases and decreases.

Fiscal Year	1998
Property Transferred in from other Appropriations	\$ 3,360
Unfunded Annual Leave Transferred In	(135)
Other	<u>573</u>
Net Non-Operating Changes	<u>\$ 3,798</u>

Note 8. Program or Operating Expenses:

Operating Expenses by Object Classification	1998
(1) Personal Services and Benefits	\$ 4,978
(2) Travel and Transportation	492
(3) Rental, Communication and Utilities	21,598
(4) Printing and Reproduction	99
(5) Contractual Services	65,996
(6) Supplies and Materials	340
(7) Equipment not Capitalized	5,016
(8) Land and Structures	—
(9) Grants, Subsidies and Contributions	<u>229</u>
Total Expenses by Object Class	<u>\$ 98,748</u>

APPENDIX II

AGENCY'S RESPONSE TO THE DRAFT REPORT

February 2, 2000

MEMORANDUM

SUBJECT: Draft Audit Report of EPA's Fiscal 1998 Working
Capital Fund Financial Statements

FROM: Michael W. S. Ryan /s/
Acting Chief Financial Officer (2710A)

TO: James O. Rauch
Assistant Inspector General for Audit (2421)

Thank you for providing us the opportunity to comment on the draft audit report of the Fiscal Year 1998 Working Capital Fund Financial Statement and to provide our response to the recommendations made in that document. We appreciate the Office of the Inspector General's assistance in identifying areas where we can make improvements in the management of the Fund.

Attachment I contains comments on the draft audit report. Attachment II contains the Agency consolidated response to the recommendations made in the report, including planned actions and dates. Attachment III is a revised action plan for the items remaining open from the Fiscal Year 1997 Working Capital Fund Financial Statement Audit.

The various organizations having responsibilities affecting the Working Capital Fund recognize the need for improvements in our policies, procedures and processes and, as the action plans described in the attached documents attest, we are working together to make those improvements. We welcome your continued participation in our efforts.

If you have any questions regarding our response, please contact Juliette McNeil, Acting Director of the Financial Management Division at 202-564-4905.

Attachments

**COMMENTS ON THE DRAFT AUDIT REPORT OF EPA'S
FISCAL YEAR 1998 WORKING CAPITAL FUND FINANCIAL STATEMENTS**

Draft Audit (page 5, paragraph 4): The report states "At RTP, we also identified WCF property items costing \$188,360, which were improperly capitalized when they should have been expensed. As a result, the value of EPA's WCF property and equipment was overstated, and its expenses were understated".

Comment: This is an erroneous statement. An adjusting entry was made to expense the \$188,360 in property prior to the end of fiscal year 1998. Consequently, the 1998 property balance was not overstated by that amount nor expenses understated.

Draft Audit (page 7, paragraph 3): The report states "Until these reports were available, customers did not know if their WCF services were being billed as expected, or if their rate of service consumption was as anticipated. This caused frustration and discontent among customers and may have been a factor leading to the unwillingness of customers to fully fund their service agreements until late in fiscal 1998".

Comment: OCFO did not require full funding of FY1998 service agreements until September 11, 1998, when the Comptroller issued a memo calling for full funding. Until that time, OCFO guidance (Comptroller memo dated February 9, 1998) asked customers to fund the service agreements at the 85% level.

**CONSOLIDATED RESPONSE TO RECOMMENDATIONS IN
THE DRAFT AUDIT REPORT OF EPA'S
FISCAL 1998 WORKING CAPITAL FUND FINANCIAL STATEMENTS**

RECOMMENDATIONS/RESPONSE

1.0 We recommend the Chief Financial Officer and the Deputy Assistant Administrator for the Office of Environmental Information direct the Financial Reports and Analysis Branch, the National Technology Services Division and the WCF Staff to work together to improve the process of adjusting the WCF property accounts by:

- a. maintaining clear documentation explaining the necessity of all adjusting entries and how the adjustment amounts were completed, and**
- b. requiring that the WCF Staff concur with all WCF adjusting entries prior to the adjusting entries being made.**

RESPONSE: We agree that all adjustments to the property accounts need to be fully documented by the individuals and offices making the adjustments and concurrence obtained beforehand from all applicable parties.

Corrective Action

Target Date

Develop WCF specific standard operating procedures for WCF property adjusting entries.

May 15, 2000

2. We recommend that the Comptroller and the Director, OTOP continue to work toward improving WCF operations and ensuring that all aspects of WCF operations are clearly defined and delineated.

RESPONSE: We recognize that close coordination among the offices that share responsibility for various aspects of the WCF is essential for the successful operation of the WCF. We will continue to work together to identify and implement improvements. The WCF staff is leading an effort, in cooperation with all affected offices, to review the full range of WCF operations to improve these processes. As an outcome of this review, we will ensure that all functions and responsibilities within the WCF operations are clearly defined and delineated.

Corrective Action

Target Date

Conduct an organizational study to evaluate the NTSD Business Office to ensure that the WCF functions and responsibilities among all appropriate parties conducting WCF business are clearly delineated (the audit report refers to the NTSD Business Office as the WCF Business Office).

June 1, 2000

Facilities Management Services Division (FMSSD) to issue a Notice to all Agency Senior Resource Officials asking them to ensure that project officers, ordering officials and fund certifying officers follow Agency property management policy and Comptroller Transmittal Notice No. 99-03, "Guidelines on Preparing Requisitions for Property and Related Goods and Services" to their respective project officers, ordering, and fund certifying officers.

December 31, 1999

Attachment III

WCF AUDIT ACTION PLAN FOR REMAINING FY97 ACTIONS

RECOMMENDATION	COMMENTS	MILESTONE DATE
Allocate rent, utilities, WCF Staff salaries and benefits and finance & security costs to the WCF and include these costs in WCF financial statements. Revise the Agency's policy on the WCF rates to state that they must return in full all expenses of operation.	Agree	August 15, 2000
Direct the WCF Staff and the WCF Board to prepare an Agency policy on when and how to issue WCF service refunds so that excess revenues can be returned in a timely & efficient manner.	Agree	June 15, 2000

APPENDIX III

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For additional copies of this report, please contact:

**Environmental Protection Agency
Office of the Inspector General
Financial Audit Division
Mail Code 2422
1200 Pennsylvania Avenue, NW
Washington, D.C. 20460**

Telephone: 202-260-1397

FAX: 202-260-1398