



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

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OFFICE OF WATER

MEMORANDUM

SUBJECT: Questions and Answers on the SRF Cash Draw Proportionality Requirements

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TO: State Revolving Fund Branch Chiefs
Regions I - X

This memorandum provides questions and answers on the cash draw proportionality requirements affecting the Clean Water and Drinking Water State Revolving Fund (SRF) programs. The document includes answers to questions raised by the Regions regarding the proportionality requirements and will serve to ensure consistency across the nation.

Inquiries regarding the questions and answers should be directed to the respective program contacts for the Clean Water SRF (Sheila Platt, 202/564-0686) and for the Drinking Water SRF (Peter Shanaghan, 202/564-3848)

Attachment

Qs/As – SRF Cash Draw Proportionality Requirements

Introduction

On May 8th, 2013, EPA held a webcast to review the correct procedures for cash draw proportionality. As a follow-up to this webcast, and in order to provide further documented clarification regarding cash draw procedures, a set of questions and answers have been assembled and presented below.

When reading the Qs/As it is important to remember related cash draw definitions that are unique to the DWSRF and CWSRF programs:

- Cash draw: The transfer of funds from the Federal Treasury into the state's SRF.
- Disbursement: The transfer of cash from an SRF to an assistance recipient.
- Payment: An action by the EPA to increase the amount of SRF capitalization grant funds available for cash draw.¹

It is also important to remember that the phrase "improper payment" has a very specific definition under The Improper Payments Elimination and Recovery Act – (IPERA) that requires under- and overpayments to be reported by EPA. Please note that a "payment" under the SRF program differs from IPERA's use of the word in defining "improper payment:"

- Improper Payment: Any payment (cash draw) that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. Incorrect amounts are overpayments or underpayments that are made to eligible recipients (including inappropriate denials of payment or service, any payment that does not account for credit for applicable discounts, payments that are for the incorrect amount, and duplicate payments). An improper payment also includes any payment that was made to an ineligible recipient for an ineligible good or service, or payments for goods or services not received (except for such payments authorized by law). In addition, when an agency's review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation, this payment must also be considered an improper payment. Source: The Improper Payments Elimination and Recovery Act – (IPERA)²

Cash draw proportionality rules for the CWSRF program are based in the following sections from the CWSRF Regulations [emphasis added]:

§35.3155 (d) (5)

(5) A State may draw cash from the LOC equal to the proportional Federal share at which time the State will provide its proportional share. *The Federal*

¹ 40 CFR section 35.3135(d-h)

² Improper Payment Act, Section 2f(2)

proportional share will be 83 1/3 percent of incurred costs and the State's proportional share will be 16 2/3 percent of the incurred costs, except as described below.

(i) Where the State provides funds in excess of the required 20 percent match, the proportional Federal share drawn from the LOC will be the ratio of Federal funds in the capitalization grant to the sum of the capitalization grant and the State funds. Alternatively, the State may identify a group of activities approximately equal to 120 percent of the grant amount, and draw cash from the LOC for 83 1/3 percent of the incurred costs of the identified activities.

(ii) The Federal proportional share may exceed 83 1/3 percent where a State is given credit for its match amount as a result of funding activities in prior years (but after March 7, 1985), or for banking excess match in the SRF in prior years and disbursing these amounts prior to drawing cash. *If the entire amount of the State's required match has been disbursed in advance, the Federal proportional share would be 100 percent.*

The regulations governing cash draw proportionality for the DWSRF program can be found at **§35.3560 (g)**

(g) Calculation of proportionate Federal share—

(1) *General.* The proportionate Federal share is equal to the Federal monies intended for the Fund (capitalization grant minus set-asides) divided by the total amount of monies intended for the Fund (capitalization grant minus set-asides plus required State match). A State may calculate the proportionate Federal share on a rolling average basis or on a grant by grant basis.

(2) *State overmatch.* (i) The proportionate Federal share does not change if a State is providing funds in excess of the required State match. (ii) Federal monies may be drawn at a rate that is greater than that determined by the proportionate Federal share calculation when a State is given credit toward its match amount as a result of funding projects in prior years (but after July 1, 1993), or for crediting excess match in the Fund in prior years and disbursing these amounts prior to drawing cash. If the entire amount of a State's required match has been disbursed in advance, the proportionate Federal share of cash draws would be 100 percent.

Because of the wide variation in the ways different states operate their CWSRF and DWSRF programs, the implementation of proportionality in cash draws has continued to create confusion. The following Qs&As will help to explain what is allowed and respond to specific questions raised during the webcast.

Questions and Answers

Q. What are the options a CWSRF has under the proportionality rules?

A. As specified by the regulations CWSRF must use an 83.33% federal/16.67% state ratio on each draw. Alternatively, a CWSRF may choose to deposit and disburse 100% of its total required match for eligible project costs and then, after all match funds are disbursed, draw federal funds using a proportionality ratio of 100% federal/0% state funds. The only exceptions to this are when federal capitalization grant funds are used for a leveraged program debt service reserve or transferred to/from SRF programs. In those cases the proportionality ratio should be adjusted to reflect the actual new federal funds divided by the total new funds available for that grant year (federal capitalization +/- transfers + state match + leveraged bond proceeds).

Q. What are the options a DWSRF has under the proportionality rules?

A. The options are as follows:

- DWSRF regulations specify that states must establish a federal proportionality share to reflect the new funds available for Fund assistance (federal capitalization +/- transfers - set-asides + state match + leveraged bond proceeds).
- Alternatively, a DWSRF may choose to deposit and disburse 100% of its total required match for eligible project costs and then, after all match funds are disbursed, draw federal funds using a proportionality ratio of 100% federal/0% state funds.
- A State may also establish, in the IUP, a proportionality ratio that assumes the State takes the maximum set-aside, regardless of actual set-aside taken. The State would draw for the loan fund based on that ratio, and when match dollars were fully drawn, would then draw 100% federal funds. Draws would need to be consistent with the established ratio until State funds were fully drawn.
- The only exceptions to this are when federal capitalization grant funds are used for a leveraged program debt service reserve, transferred to/from SRF programs or if set-asides are transferred back to the program fund. In those cases the proportionality ratio should be adjusted to reflect the actual new federal funds divided by the total new funds available for that grant year.
- All set-aside funding is 100% federal funds; none of the 20% state match is used for set-asides.

Q. Where must the CWSRF/DWSRF document the proportionality ratio it will follow for a given capitalization grant?

A. The ratio must be stated in the Intended Use Plan or the grant application/award. If the ratio changes during the course of the year due to new fund management decisions (such as leveraging or transfers), the EPA Region should be notified of the change immediately and the adjusted ratio should be described in the state's Annual Report.

Q. If the calculated federal proportionality ratio is 83.33% can the federal share of a cash draw ever be less than 83.33% for a CWSRF direct loan program?

A. No. The share must always be 83.33%. A lesser share would constitute an underpayment of federal funds defined as an improper payment under IPERA (see above). For example, if the region in its transaction testing finds a draw using an 80% federal/20% state ratio, it would be an improper payment. This would need to be reported even if it had been corrected by the state prior to its identification as an improper payment during the Annual Review.

Q. Can a state overmatch the capitalization grant – i.e., deposit more than 20% of its capitalization grant in its CWSRF/DWSRF?

A. Yes. At any time a state can deposit additional funds exceeding 20% of its capitalization grant. The additional funds are not part of the calculation of the state match proportion required at the time of a draw *if* the state has indicated it would like to bank that overmatch for future match requirements in its IUP. Overmatch is never part of the federal share calculation in the DWSRF because the DWSRF regulations specifically state that the proportionate federal share does not change if a state is providing funds in excess of the required state match (§35.3560 (g) (2)). However, overmatch can be credited toward future grants. Overmatch could be match funds the state is providing early (for example, if a state deposits two years of match in a single year). Overmatch could also be additional funding that the state wishes to provide to the SRF in the current, and which it will not use as a credit toward a future match requirement. In the CWSRF program, to avoid needing to modify the cash draw proportionality ratio due to additional state funds being provided to the SRF programs, states should always claim those additional state funds as overmatch to be banked for future match.

Q. What is overmatch?

A. Overmatch is defined as any state funding deposited into a CWSRF or DWSRF that is greater than the total annual 20% match required. It should be banked (CWSRF) or claimed (DWSRF) for credit in the state's IUP if the state would like to use it towards meeting match requirements associated with future capitalization grants.

Q. Can overmatched funds be “banked” (CWSRF) or “credited” (DWSRF) to meet future match requirements?

A. Yes. The state should indicate in its IUP that it would like to use deposits into the fund that exceed 20% to meet match requirements associated with future capitalization grants. The overmatch must be clearly tracked and, when used as match during a year, the state should report on the funds used and remaining balance of banked or credited overmatch in the Annual Report. Banked or credited match may be claimed as match regardless of whether it has been disbursed from the fund.

Q. Do the proportionality rules apply to cash draws from the 4% administration funding?

A. Yes, but for the CWSRF program only.³ Proportionality rules do not apply to the DWSRF 4% administration set-aside.

Q. If a CWSRF or DWSRF chooses to disburse 100% of its match up front, can these funds be used to reimburse the CWSRF/DWSRF for previous disbursements from repayments and other non-federal funds?

A. Yes. States will often pay for invoices from available funds and then draw federal funds and combine them with state funds to reimburse the CWSRF/DWSRF for the appropriate amount of funding. If a state were using the 83.33% federal ratio, it would draw 83.33% of the invoiced amount from the appropriate grant as reimbursement and combine it with match funds as the full reimbursement. If a state wishes to disburse 100% of state match first the state should claim the reimbursement for previous disbursement as being covered by state match. The state must document which disbursements are being covered by the state match amount in its Annual Report.

Q. Can a state "underdraw" from the federal treasury by applying a less than required (e.g., 80%) federal proportionate federal share to cash draws from capitalization grants?

A. No. The CWSRF and DWSRF regulations explicitly state what the proportionate federal share must be and, as a result, a state may not "underdraw" by applying a cash draw proportionality ratio that is less than required. Such a draw is also defined as an improper payment under IPERA and should be reported if detected during transaction testing.

Q. Can a state vary the federal and state proportionate shares used for cash draws from a grant as long as it periodically (quarterly, annually, end of grant, etc.) comes into compliance with the required federal cash draw ratio?

A. No. The regulations for both programs clearly require that the approved cash draw proportionality ratio be used for each cash draw; as a result the ratio should not vary over the life of the grant unless there is an action that requires that it be changed after the grant has been awarded. For example, if a state leverages its program during the year and after grant award it may be required to modify the proportionality ratio that was established in the IUP/Grant Agreement. Once the Region has been notified and reviewed the change, the state must use the new ratio for cash draws going forward.

Q. Is a state required to use the cash draw proportionality ratio included in the IUP/Grant Agreement for all cash draws from that grant?

A. Yes. The established ratio should be used unless there is an action that requires that it be changed. For example, if a state leverages its program during the year and after grant award it may be required to modify the proportionality ratio that was established IUP/Grant Agreement. The proportionality ratio may also be changed if federal funds are transferred between programs, or if DWSRF set-aside funds are

³ EPA CWSRF Memo 90-28 (August 3, 1990)

deposited back into the program fund. Once the Region has been notified of the change, the state may use the new ratio for cash draws going forward. Also, a DWSRF program may apply the rolling average proportionality approach that would result in modifications to cash draw ratio annually for all open grants. For more on rolling average proportionality see: EPA's "Guide to Using EPA's Automated Clearing House for the Drinking Water State Revolving Fund Program"

Q. Does using a rolling average approach mean that proportionality will not be consistent over the year?

A. Rolling average proportionality is calculated and established in the IUP. It will only change under the conditions general proportionality will change (transfers, leveraging, etc.)

Q. Can a state vary the cash draw ratio used for federal funds during the year?

A. Once the ratio is set in the IUP/Grant Award it should be used for all federal cash draws associated with that grant, unless it must be changed due to new funding coming into the program (see above). Otherwise, the cash draw ratio used for a grant should not vary during the year.

Q. Why must a state be in compliance with the cash draw proportionality ratio at any point in time?

A. The regulatory language explicitly indicates the cash draw ratio and that the state will provide associated state match at the time of cash draw:

For the CWSRF program:

"(5) A State may draw cash from the LOC equal to the proportional Federal share at which time the State will provide its proportional share. The Federal proportional share will be 83 1/3 percent of incurred costs and the State's proportional share will be 16 2/3 percent of the incurred costs, "

For the DWSRF program:

"The proportionate Federal share is equal to the federal monies intended for the fund (capitalization grant minus set-asides) divided by the total amount of monies intended for the fund (capitalization grant minus set-asides plus required State match). A state may calculate the proportionate federal share on a rolling average basis or on a grant by grant basis." [35.3560(g)(1)]

Applying this requirement means that the state should be in compliance at any point in time. The same requirement is in place for both the CWSRF and the DWSRF programs. The DWSRF program requirement language indicates that the ratio is adjusted for the state's use of set-asides.

Q. If a cash draw approach is not mentioned or excluded by the CWSRF/DWSRF regulations, can a state assume that it is allowable?

A. The regulatory language is explicit in detailing cash draw proportionality requirements. It must be followed. Other potential approaches are not allowed.

Q. Can a state draw 100% federal funds if the state has deposited but not expended state match?

A. No. The regulations require that the match be deposited and disbursed prior to drawing 100% federal. The CWSRF regulations state:

“If the entire amount of the State's required match has been disbursed in advance, the Federal proportional share would be 100 percent.”

The DWSRF regulations are nearly identical in this statement:

“If the entire amount of a State's required match has been disbursed in advance, the proportionate Federal share of cash draws would be 100 percent.”

A single exception exists for the DWSRF where, due to state-level laws, a state may only use federal funds for private borrowers. There are separate DWSRF rules on how this process works.

Q. If a state has deposited all required state match but has disbursed some, but not all, of the match funds, can the state draw 100% federal funds for a portion of its capitalization grant?

A. No. The regulations state that the entire amount of match must be disbursed. However, a state does not have to track the state match funds once deposited into the SRF. At that point, any non-federal disbursements for eligible project or other eligible costs may be viewed as state match and count toward disbursing the entire amount of state match.

Q. If a state has a state match subaccount in the SRF program that holds state match deposits must it use only those funds if the state wishes to document that it has disbursed state matching funds first, thereby allowing it to use a federal proportionality cash draw ratio of 100%?

A: No. From a federal perspective, funds lose their source identity once deposited into the SRFs. A state may designate project funding (from repayments or interest earnings) in an amount equivalent to the state match to meet the objective of documenting that state match is full disbursed. This approach is consistent with the application of the “equivalency” concept that is a standard feature of the CW/DWSRF programs.

Q. If a state deposits state match directly into the SRF account, how can it show that it has disbursed all state match first prior to drawing federal funds at a proportionality ratio of 100%?

A. State accounting records should be used to demonstrate compliance. Accounting records must show the required state match being deposited into the SRF Fund account. Next, they must show an equivalent amount being disbursed from the Fund

account to assistance recipients prior to making cash draws using a ratio of 100% federal funds.⁴

Q. How is cash draw proportionality affected if the state transferred funds from the DWSRF to CWSRF or vice versa?

A. Cash draw proportionality may be impacted if federal funds are transferred between the CWSRF and DWSRF programs. For instance, DWSRF federal funds transferred into a CWSRF will increase the federal ratio for the CWSRF and decrease it for the DWSRF. If repayment or interest funds are transferred, the ratio is not impacted.

EPA's "Guide to Using EPA's Automated Clearing House for the Drinking Water State Revolving Fund Program" (on the CIFA CD) includes the formulas that should be used for recalculating the cash draw ratio.

Q. If, in using the FIFO (First-In First-Out) method of grant management, funds from several different grants are used to pay a disbursement request, what proportionality ratio should be used?

A. If a state is using grant-specific proportionality, each grant will have a specific cash draw ratio. Disbursements made with funds from multiple grants must use the appropriate proportionality ratio associated with each grant that the funds are drawn from. As a result, one disbursement may have several cash draw ratios associated with it.

If a state is using rolling average proportionality as defined in EPA's "Guide to Using EPA's Automated Clearing House for the Drinking Water State Revolving Fund Program", a single cash draw ratio is calculated each year which can be applied to all open grants.

If the state disburses the entire required state match for all open grants before drawing federal funds, it can draw 100% federal funds for any open grant.

Q. If a state operates a combined leveraged and direct loan program, how must it calculate cash draw proportionality?

A. Some states leverage a portion of their program and also provide direct loans for other assistance recipients. Under some conditions, these states may have two different cash draw ratios for one grant.

In the CWSRF, if the state does not use the capitalization grant as security on the leveraged bonds, both the leveraged and direct loan sides of the program will use an 83.33/16.67 ratio. If the state uses the capitalization grant as security on the leveraged bonds, the leveraged portion of the program may have a different cash draw ratio depending on whether the state uses the "All Projects" or "Group of Projects" method to calculate proportionality.

⁴ DWSRF set-asides are always funded with 100% federal funds

In DWSRF, the principles are the same, but the proportionality calculation would include set-asides taken.

If the state disburses its entire state match prior to drawing any federal funds, the federal proportionality ratio will be 100% in all cases.

Q. What is the procedure if it is discovered that the state has been calculating proportionality ratios incorrectly until today?

A. If the state has been using the incorrect proportionality ratio the Region should first determine whether the state is in overall compliance with the proportionality ratio today by considering the total grant funds drawn and the total state match funds disbursed. If the state is in overall compliance, it should be recorded in Regional records and the state should begin using the correct proportionality ratio going forward.

If the state is not in overall compliance, and it has not disbursed the correct federal grant or match funds, correct this deficiency as soon as possible (e.g., by disbursing only state match funds until the correct ratio is reached). Once the state is in overall compliance it can begin using the correct proportionality going forward.

Q. If a state receives its state match incrementally via a line of credit system, what are the options for disbursing state match first and pulling 100% federal draws?

A. Once the entire state match amount associated with a grant has been disbursed to projects, states may draw 100% federal funds from that grant to pay subsequent disbursements. If a state receives its match via a letter-of-credit system (similar to the Automated Clearinghouse approach used for federal funds), the state may only be able to draw a portion of state match funds for each disbursement, slowing the rate at which state match funds are disbursed to projects. The rules on how quickly state match funds may be drawn are often determined by the State Treasurer or other entity outside of the SRF program. The SRF program might consider discussing options with this state match management entity to determine whether state match funds may be drawn at a faster rate.

However, the acceptable proportionality ratios for a direct CWSRF loan program (without transfers) are 83.33% federal funds combined with 16.67% state match funds, or 100% state match funds (until these are all expended), followed by 100% federal funds (see the CWSRF Regulations at 40 CFR § 35.3155 (d)(5)(ii)). If state match funds can be drawn from a letter-of-credit system at a rate faster than 16.67% but less than 100% of each disbursement, they should be combined with recycled funds until all state match funds have been expended. At that point, the state may draw 100% federal funds for all subsequent disbursements. Alternately, the state may continue to draw 16.67% of each disbursement from the state match letter-of-credit system and combine those funds with 83.33% of the disbursement amount drawn from the federal treasury.

Q. Does the 1:1 state match requirement for the DWSRF State Program Management set-aside require a proportionality approach to be used when drawing those funds?

A. No, the 1:1 match requirement for the State Program Management set-aside does not affect the cash draw procedures for this set-aside. States may draw federal funds to cover 100% of eligible costs under the State Program Management set-aside. States must simply document that they have contributed the matching amount at the time of grant award or in the same year that the State Program Management Set-Aside funds are expended.

Q. What types of proportionality (mis)calculations are considered to be improper payments?

A. Any deviation from a correctly calculated ratio established in the EPA-approved Intended Use Plan/Grant Agreement will be considered an improper payment. If the state makes a fund management decision during the course of the year that will change the ratio established in the IUP/Grant Agreement (such as transferring funds between programs, transferring set-asides back into the project fund, or deciding to leverage), the state should immediately inform EPA of the new cash draw ratio and should describe the new ratio in the Annual Report.

If a Regional Office incorrectly approves an Intended Use Plan/Grant Agreement with the wrong proportionality ratio, it will still create an improper payment.

If a state draws federal funds using a ratio other than the one established in the EPA-approved Intended Use Plan/Grant Agreement, it will be considered an improper payment. However, if a subsequent draw is made to bring the state into compliance with the established cash draw ratio, this "adjustment" draw will not be considered an improper payment. Keep in mind that a state must be in compliance with the cash draw ratio at any point in time, and may not use frequent adjustment draws to maintain an overall average rate of cash draw compliance.

Q. If a CWSRF program is prohibited from using state funds for certain activities (such as additional subsidization), may it draw 100% federal funds for those projects?

A. No, this is not an acceptable practice in the CWSRF program. DWSRF programs may use 100% federal draws where state law prohibits state funds from being used for disbursements to private entities. [See: 35.3565(f)] If a CWSRF program has a state law prohibiting state funds from being used for certain activities, EPA recommends that the state first expend its entire state match on disbursements to other projects, then use 100% federal draws for disbursements for those activities.