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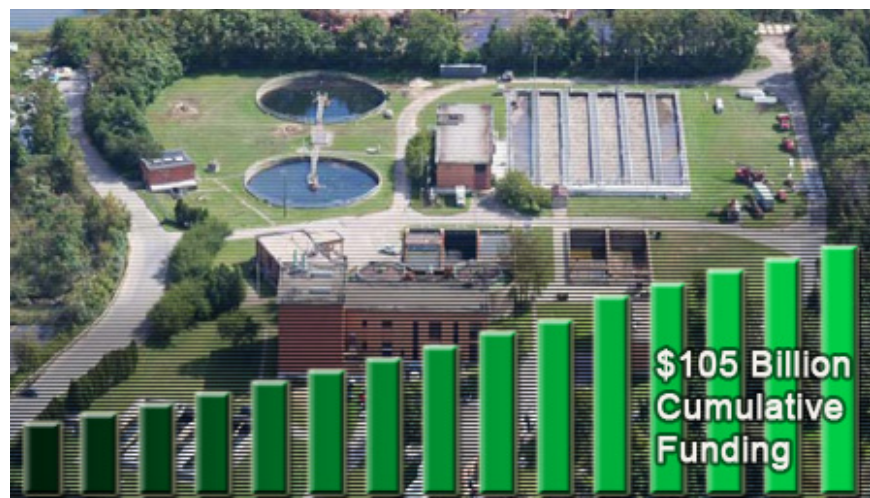
OFFICE OF INSPECTOR GENERAL

Spending Taxpayer Dollars

EPA Regional Offices Need to More Consistently Conduct Required Annual Reviews of Clean Water State Revolving Funds

Report No. 16-P-0222

July 7, 2016



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Abbreviations

CFR	Code of Federal Regulations
CWSRF	Clean Water State Revolving Fund
EPA	U.S. Environmental Protection Agency
FY	Fiscal Year
OARM	Office of Administration and Resources Management
OIG	Office of Inspector General
PER	Program Evaluation Report
SRF	State Revolving Fund

Cover photo: A wastewater treatment plant in Stratford, Connecticut (EPA photo), with an OIG-prepared overlay showing how CWSRF funding has cumulatively exceeded \$105 billion since 2000. A more detailed bar graph is provided as Figure 1 within the report.

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At a Glance

Why We Did This Audit

We performed this audit to determine whether the Clean Water State Revolving Fund (CWSRF) annual reviews are achieving their intended purpose.

The CWSRF has provided more than \$100 billion to states since its inception to help improve water quality. The U.S. Environmental Protection Agency (EPA) allotted \$1.4 billion in fiscal year 2014 to the CWSRF program. The EPA issued guidance for annual reviews of CWSRF programs in November 2013 to reflect a more focused, risk-based approach to conducting the annual review. The Water Quality Act of 1987 requires an annual review to be conducted for each state plan, and the annual review guidance says that EPA regions are responsible for conducting annual reviews of each of their states once per year.

This report addresses the following EPA goals and cross-agency strategies:

- *Protecting America's waters.*
- *Protecting human health and the environment by enforcing laws and assuring compliance.*
- *Embracing EPA as a high-performing organization.*

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EPA Regional Offices Need to More Consistently Conduct Required Annual Reviews of Clean Water State Revolving Funds

What We Found

The EPA did not always perform annual reviews of state CWSRF grants as required, which may lead to undetected misuse of federal funds. Regions did not always review Single Audit reports or include Single Audit findings in Program Evaluation Reports.

Annual reviews are an opportunity to identify program risks. Not comprehensively and accurately conducting the reviews increases the possibility that critical issues and deficiencies will not be identified, and the risk that misuse of funds will go undetected. We found that up to \$156.5 million in fiscal year 2013 grant awards could be at risk of misuse due to EPA regions not properly assessing state CWSRF performance. When funds are misused, states lose opportunities to improve water quality, achieve and maintain compliance with environmental laws, protect aquatic wildlife, protect and restore drinking water sources, and preserve the nation's waters for recreational use.

Also, administrative baseline monitoring reviews for fiscal years 2010 through 2013 were not conducted as required. These are periodic reviews of a recipient's progress in, and compliance with, a specific award's scope of work, terms and conditions, and regulatory requirements. Failure to complete required reviews may not provide reasonable assurance that state performance is fully evaluated and EPA dollars are used responsibly and for intended purposes.

Conducting annual reviews in accordance with applicable guidance allows EPA regions to assess state CWSRF performance, and helps identify opportunities to improve clean water infrastructure and provide for better use of the billions of dollars in CWSRF funding.

Recommendations and Agency Planned Corrective Actions

We recommend that the Assistant Administrator for Water make improvements to the CWSRF annual review guidance, and that Regions 3 and 4 require project officers to conduct the annual review according to the CWSRF annual review guidance. We also recommend that the Assistant Administrator for Administration and Resources Management develop and implement a plan to ensure administrative baseline monitoring reviews are completed as required.

The agency agreed with eight of the 10 recommendations, and provided estimated and actual completion dates. Corrective actions for Recommendations 1 through 5 and Recommendation 7 are completed. Corrective actions for Recommendations 8 and 10 are planned to be completed by the end of 2016. Region 3 provided an alternative for Recommendation 6 that does not meet the intent of our recommendation. Further, the agency did not provide intended corrective actions or planned completion dates for Recommendation 9. Therefore, Recommendations 6 and 9 are unresolved.



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

THE INSPECTOR GENERAL

July 7, 2016

MEMORANDUM

SUBJECT: EPA Regional Offices Need to More Consistently Conduct
Required Annual Reviews of Clean Water State Revolving Funds
Report No. 16-P-0222

FROM: Arthur A. Elkins Jr.

A handwritten signature in black ink, appearing to read "Arthur A. Elkins Jr.", is written over the printed name.

TO: *See Below*

This is our report on the subject audit conducted by the Office of Inspector General (OIG) of the U.S. Environmental Protection Agency (EPA). The project number for this audit was OA-FY15-0153. This report contains findings that describe the problems the OIG has identified and corrective actions the OIG recommends. This report represents the opinion of the OIG and does not necessarily represent the final EPA position. Final determinations on matters in this report will be made by EPA managers in accordance with established audit resolution procedures.

The EPA offices responsible for the issues in this report are the Office of Water's Office of Wastewater Management; the Office of Administration and Resources Management's Office of Grants and Debarment; and EPA Regions 3 and 4.

Action Required

In accordance with EPA Manual 2750, your offices provided planned and completed corrective actions and completion dates in response to OIG Recommendations 1, 3, 4, 5, 7, 8 and 10. During the exit conference, your offices agreed to a corrective action for Recommendation 2 that we believe meets the intent of our recommendation. Recommendations 1 through 5 and Recommendation 7 are considered closed because the corrective actions have already been completed. Recommendations 8 and 10 are considered open pending implementation of the corrective actions.

Region 4 agreed with Recommendation 6 and provided corrective actions and a planned completion date. However, Region 3 did not explicitly agree with Recommendation 6 and proposed an alternative recommendation that only partially addresses the issue we identified. Therefore, in accordance with EPA Manual 2750 regarding unresolved recommendations, Region 3 is required to provide a written response to Recommendation 6 within 60 calendar days. The planned corrective actions and a completion date should be included.

The agency agreed with the intent of Recommendation 9, but it did not provide intended corrective actions and a planned completion date. The agency explained that it plans to wait for the results of an ongoing evaluation prior to addressing our recommendation. The estimated completion date of the

evaluation is October 2016. In accordance with EPA Manual 2750 regarding unresolved recommendations, the Office of Administration and Resources Management is required to provide a written response to Recommendation 9 within 60 calendar days. The planned corrective actions and a completion date should be included.

The responses will be posted on the OIG's public website, along with our memorandum commenting on your responses. The responses should be provided as an Adobe PDF file that complies with the accessibility requirements of Section 508 of the Rehabilitation Act of 1973, as amended. The final responses should not contain data that you do not want to be released to the public; if your response contains such data, you should identify the data for redaction or removal along with corresponding justification.

This report will be available at www.epa.gov/oig.

Addressees:

Joel Beauvais, Deputy Assistant Administrator, Office of Water

Donna Vizian, Acting Assistant Administrator, Office of Administration and Resources Management

Shawn Garvin, Regional Administrator, Region 3

Heather McTeer Toney, Regional Administrator, Region 4

Robert Kaplan, Acting Regional Administrator, Region 5

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Chapter 1

Introduction

Purpose

We conducted this audit to determine whether the U.S. Environmental Protection Agency's (EPA's) Clean Water State Revolving Fund (CWSRF) annual reviews are achieving their intended purpose. The purpose of the annual review is to assess the success of the state's performance of activities identified in the intended use plan and annual report, and determine compliance with the terms of the capitalization grant agreement.

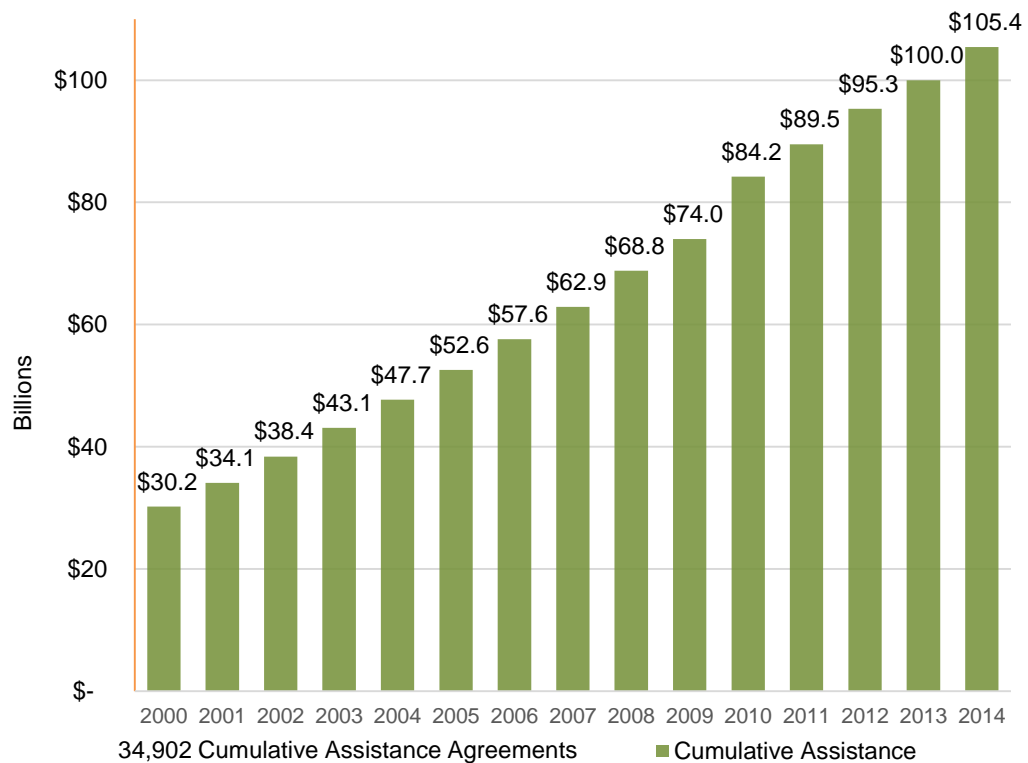
Background

The Water Quality Act of 1987 established the CWSRF program, which has helped communities, homeowners, farmers and non-profit organizations nationwide meet the goals of the Clean Water Act by improving water quality, protecting aquatic wildlife, protecting and restoring drinking water sources, and preserving our nation's waters for recreational use.

CWSRF programs operate much like environmental infrastructure banks that are funded with federal and state contributions. CWSRF monies are loaned to communities to address water infrastructure needs, and loan repayments are recycled back into the program to fund additional water quality protection projects. All states and Puerto Rico maintain revolving loan funds to provide independent and permanent sources of low-cost financing for a wide range of water quality infrastructure projects. The revolving nature of these programs is intended to provide an ongoing funding source that will last far into the future.

As of fiscal year (FY) 2013, building on a federal investment of over \$37.4 billion, the state CWSRFs have provided more than \$100 billion in funding to communities to ensure public health, protect valuable aquatic resources, and meet environmental standards. The more than 32,800 low-interest loans to approximately 4,880 communities have provided benefits to hundreds of millions of people. Through 2014, the CWSRFs have provided over 34,000 assistance agreements to communities, financing \$105.4 billion in projects (see Figure 1 for CWSRF cumulative funding).

Figure 1: CWSRF cumulative assistance exceeds \$105 billion (2000–2014)



Source: EPA’s Office of Water data.

The CWSRF program is one of the largest federally funded water infrastructure assistance programs. In FYs 2014 and 2013, the CWSRF program allotments were approximately 18 and 17 percent of the EPA’s enacted budget, respectively (see Table 1).

Table 1: EPA-enacted budgets and CWSRF allotments in FYs 2014 and 2013

FY	Total EPA enacted budget	CWSRF program allotment
2014	\$8,200,000,000	\$1,448,887,000
2013	\$7,901,104,000	\$1,376,082,000

Source: EPA data.

During FYs 2014 and 2013, Region 5 had the highest regional CWSRF allotment, with approximately \$303 million and \$289 million, respectively.

Annual Review Guidance

The EPA issued its *Annual Review Guidance* for CWSRF Programs in November 2013 to reflect a more focused, risk-based approach to conducting the annual review. The Water Quality Act of 1987 requires an annual review to be conducted for each state plan, and the annual review guidance says that EPA

regions are responsible for conducting annual reviews of each of their states once per year. It also states that the purposes of the annual review are to:

- Determine how the State Revolving Fund (SRF) is achieving the intent, overall goals and objectives of the Clean Water Act.
- Assess the state's performance of activities identified in the intended use plan and annual report, and how the state manages risk.
- Determine compliance with the EPA capitalization grant agreement.
- Assess the financial status of the SRF based on the long-term goals of the fund.
- Assess the strategic management of the fund.

The annual review guidance combines a framework for regions to develop risk-based protocol for the interviews and instruction on the checklist-based portion of the annual review, including the transaction testing worksheet, annual review checklist, and project file review checklist.

In FYs 2014 and 2013, the EPA Office of Water's Office of Wastewater Management headquarters staff participated in at least one onsite phase of the annual review in each region to gain an understanding of the region's implementation of the annual review guidance and to assess state performance. Also, the Office of Wastewater Management uses the transaction testing worksheets, completed during the annual reviews, to collect improper payment data and to report annually to the Office of the Chief Financial Officer.

As part of the annual reviews, regions perform the following activities:

- Review financial indicators.
- Conduct onsite reviews to complete checklists and conduct interviews.
- Follow up on corrective action.
- Write the Program Evaluation Report (PER).

In addition, the annual review guidance says that regions should review independent audit reports and Single Audit reports in advance of the onsite phase of the annual review.

Single Audit Act

A single audit is an organization-wide audit of an entity performed in accordance with the Single Audit Act and generally accepted government auditing standards. These audits are conducted by a public accountant or a federal, state or local government organization selected by the auditee, and provide assurance to the EPA on the management and use of funds by recipients, such as states. The Single Audit report includes both an audit of an entity's financial statements and a review of compliance with relevant federal regulations.

As of December 26, 2014, the Code of Federal Regulations (CFR) in 2 CFR Subpart F 200.501 stated that a nonfederal entity that expends \$750,000 or more during the nonfederal entity's fiscal year in federal awards must have a single audit conducted for that year. At the time regions completed the annual reviews included in our sample, the threshold for nonfederal entities was only \$500,000.¹

As of January 2014, 2 CFR Subpart F 200.516 stated that an auditor must report audit findings, including material noncompliance with the provisions of federal statutes, regulations, or the terms and conditions of federal awards related to a major program. The auditor's determination of whether to report a material noncompliance finding is in relation to the type of compliance requirement for a major program identified in the compliance supplement. This standard was also in effect for the FY 2013 Single Audit findings included in our review, as Office of Management and Budget Circular A-133 included similar language as of June 2007.

Responsible Offices

The Office of Water's Office of Wastewater Management develops the policy, guidance, standard operating procedures, checklists and worksheets that regions use to conduct required annual reviews of each of their states. In addition, the Office of Wastewater Management trains regional and state staff on the laws, regulations, annual review guidance and policies related to the CWSRF annual reviews. The Office of Wastewater Management also reviews checklists, worksheets and PERs, and follows up with the EPA regions on findings and recommendations made to the states. In addition, the Office of Wastewater Management assists the EPA regions in conducting as many state annual reviews as possible.

The Office of Administration and Resources Management's (OARM's) Office of Grants and Debarment develops policy and guidance for completing administrative baseline monitoring for active grant awards. While the annual review guidance addresses programmatic and financial aspects of an SRF grant, EPA Order 5700.6A2 requires EPA administrative baseline monitoring. Administrative baseline monitoring is the periodic review of a recipient's progress in, and compliance with, a specific award's scope of work, administrative terms and conditions, and regulatory requirements.

The regions are to assess the success of the states' performance of activities identified in the intended use plan and annual report, and determine compliance with the terms of the capitalization grant agreement. Grants specialists are responsible for completing administrative baseline monitoring for active grant awards. Further, the EPA regional staff use baseline monitoring as a tool to evaluate the progress of the project and performance of the recipients, assess

¹ Office of Management and Budget Circular No. A-133, June 26, 2007.

financial status of the award, and ensure that EPA dollars are used responsibly and for the intended purpose. Grants management officers ensure grants specialists complete baseline monitoring as instructed and provide necessary and appropriate guidance.

Scope and Methodology

We conducted this performance audit from April 2015 to March 2016 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To determine whether the EPA’s CWSRF annual reviews are achieving their intended purpose, we reviewed the relevant laws, regulations, policies, procedures, and financial and allotment reports, as well as the *Annual Review Guidance For EPA Annual Review of Clean Water State Revolving Fund Programs*. Our audit focused on CWSRF annual reviews of six states in three regions, as shown in Table 2.

Table 2: EPA regions and states audited

Region	States
Region 3	Pennsylvania
Region 4	Kentucky North Carolina Tennessee
Region 5	Michigan Ohio

Source: Office of Inspector General (OIG) analysis.

During preliminary research, we selected Region 4 because the region has oversight of eight states, the largest number of any region. We judgmentally selected Tennessee and Kentucky as Region 4 states based on audit work performed.

For fieldwork, we selected a judgmental sample based on an analysis of FY 2013 CWSRF-related Single Audit findings, selecting states with significant findings (Pennsylvania in Region 3, North Carolina in Region 4, and Michigan and Ohio in Region 5). For the six states, we audited project file checklists, PERs, state Single Audit reports, administrative baseline monitoring reviews, transaction testing worksheets, and annual review checklists. We also submitted a questionnaire to the EPA regional project officers responsible for the annual reviews, which addressed how the project officers determined compliance with key terms and conditions of the grant agreements.

We conducted interviews with Office of Wastewater Management staff to determine how headquarters expected regional offices to:

- Ascertain how the SRF is achieving the intent, overall goals and objectives of the Clean Water Act.
- Evaluate whether the state achieved the goals in the intended use plan via the state's annual report.
- Determine how the state managed risk.
- Determine whether the state complied with the terms and conditions of the capitalization grant.
- Evaluate the financial condition of the SRF based on the long-term goals.
- Assess the strategic management of the fund.
- Report major findings in the PER.

We conducted interviews with the EPA regional project officers to obtain an understanding of how they perform the annual review, determine their understanding of Single Audit findings, and determine how those findings should be reported in the PER.

We interviewed grants specialists to determine their management and processing of Single Audit findings, their coordination and communication of those findings with project officers, and management of administrative baseline monitoring.

Prior Audit Coverage

We reviewed OIG Report No. [16-P-0162](#), *EPA Needs to Assess Environmental and Economic Benefits of Completed Clean Water State Revolving Fund Green Projects*, issued May 2, 2016. We did so because the findings in the report identified opportunities to improve clean water infrastructure and provide for better use of the billions of dollars in CWSRF funding. We reported routine measurement and reporting of the benefits of completed projects can improve the EPA's ability to effectively oversee, manage and monitor the environmental and economic benefits of the substantial investment of \$3.24 billion in public funds for Green Project Reserve projects.

Chapter 2

Single Audit Findings Not Reviewed or Reported in PER

The EPA did not always review and discuss Single Audit findings, resolutions and corrective actions with states, nor did the EPA consistently include Single Audit findings and corrective actions in state PERs. The EPA's CWSRF annual review guidance says that regions should review independent and Single Audit reports and include a discussion of both positive and problematic findings in state PERs. Single Audit reports were not reviewed due to project officers depending on other sources to obtain reports, not reviewing all available reports, or reviewing reports from the wrong fiscal year. We were also told that Single Audit findings and corrective actions were not included in PERs because the annual review guidance does not explicitly include Single Audit findings as problematic findings. Failure to review the Single Audit findings results in the regions not properly assessing performance of state SRF programs and the risk to federal funds, including a risk of misuse of \$156,544,000 in FY 2013 grant awards for the three states we reviewed. Not including the findings in PERs prevents the EPA from communicating issues that put the CWSRF program at risk.

Regions Should Review Audit Reports and Include Problematic Findings in PER

Section 606.b of the Clean Water Act of 1987 requires each state to have independent reviews and audits conducted in accordance with the auditing procedures that include Chapter 75 of Title 31, United States Code.² Section 606.e of the act says the EPA shall conduct an annual oversight review of each state's plan and other such materials as are considered necessary and appropriate regarding the act. The EPA's CWSRF annual review guidance says that regions should review independent audit reports and Single Audit reports in advance of the onsite phase of the annual review.

The annual review guidance also says that if the state has failed to comply with the terms of the SRF grant agreement or requirements, a corrective action plan may be prescribed in conjunction with a Notice of Noncompliance from the EPA. The term "finding" is often used to describe major, significant issues identified during the annual review. Such issues can put a state SRF program at risk for noncompliance or misuse of funds.

The annual review guidance says that, "If the State is violating terms of the SRF grant or SRF program requirements and refuses to make changes to correct the

² 31 U.S.C. § 7502.

issue, the Region may have no choice but to issue a Notice of Noncompliance.”³
The following are grounds for a Notice of Noncompliance:

1. Failure to comply with the SRF program requirements under Title VI of the Clean Water Act.
2. Failure to satisfy the terms of the federal capitalization grant agreement.
3. Failure to manage the SRF in a financially sound manner.

The PER is the final product of the annual review process and serves as a permanent record of the annual review. The PER discusses the most significant issues and risks identified during the review; a useful PER will serve as an ongoing reference document for both the region and the state. The region is expected to follow up on issues identified in the PER during the year and at the next annual review, if needed. The state should be able to rely on the PER to provide useful information on the SRF program’s strengths and areas needing improvement. The PER should report that the region confirmed the state is meeting all SRF requirements.

The annual review guidance says the primary contents of the PER will be a discussion of the positive and problematic findings noted during the review, and should include the following types of issues:

- Systemic issues and risks that were observed across several projects.
- Issues related to the state’s standard process for implementing requirements.
- The status of issues and risks noted in the prior year’s PER and the state’s progress toward resolving those issues.
- Issues arising from the state not following EPA guidance on specific requirements.

Single Audit Findings Not Always Considered or Reported in the PER

The EPA did not always review and discuss Single Audit findings, resolutions and corrective actions with states. In addition, the EPA did not consistently include Single Audit findings and corrective actions in the states’ PERs. Specifically, we found that:

- In Region 3, the project officer for Pennsylvania did not review the Single Audit report. Three of the five findings listed in the Single Audit report were repeat findings and were addressed in a previously issued Notice of Noncompliance. Region 3 said it discussed a draft Single Audit finding regarding internal control weaknesses in subrecipient monitoring of

³ Annual Review Guidance for EPA Annual Review of Clean Water State Revolving Fund Programs, page 40 of 47, November 2013.

Davis-Bacon requirements with the state, and the finding was discussed in the FY 2013 PER. One finding was not addressed.

- In Region 4, the project officer for Kentucky only reviewed the audited financial statements and not the Single Audit report findings. The project officer for North Carolina reviewed the Single Audit report but did not consider the findings in the review. In Tennessee, the project officer reviewed a Single Audit report, but it was not the most current report. The Region 4 project officers for the three states did not include the Single Audit findings in the PER.
- In Region 5, the project officers for Michigan and Ohio reviewed the Single Audit reports and discussed the findings, resolution and corrective actions during the onsite phase of the annual review. The Michigan Single Audit report did not include any Single Audit findings; thus, the project officer did not have any to include in the PER. However, the Ohio Single Audit report did include findings, which were not included in the PER.

For FY 2013, the state Single Audit reports for Pennsylvania (Region 3), North Carolina (Region 4) and Ohio (Region 5) included findings categorized as significant deficiencies, material weaknesses and instances of noncompliance applicable to the CWSRF. Findings considered significant deficiencies relate to designs and operations of controls that do not prevent, detect or correct misstatements on a timely basis. In some states, the findings were considered material weaknesses, which are deficiencies in internal controls. Material weakness, material noncompliance and/or significant deficiency findings listed in a Single Audit report should be considered major findings in accordance with the review guidance and included in the PER. Only one of the Single Audit findings shown in Table 3, as well as the corrective actions and proposed resolutions, were reported in the states' FY 2013 CWSRF PER. Six of the nine findings were repeat findings.

Table 3: FY 2013 Single Audit findings impacting the CWSRF program

Region–State	Single Audit findings	Type of finding
Region 3 - Pennsylvania	1. Internal control weaknesses in subrecipient monitoring of Davis-Bacon requirements.	Material weakness and material noncompliance
	2. Internal control weakness and noncompliance with loan amortization requirements.	Significant deficiency and noncompliance
	3. Internal control improvements needed in subrecipient loan monitoring system (repeat finding).	Material weakness and material noncompliance
	4. Noncompliance and control deficiencies exist in the commonwealth’s subrecipient audit resolution process (repeat finding).	Material weakness and material noncompliance
	5. Significant deficiencies in information technology controls at Pennsylvania Infrastructure Investment Authority.	Significant deficiency
Region 4 ^{a b} – North Carolina	1. Federal funds expended after the period of availability.	Significant deficiency
	2. Failure to monitor subrecipients’ cash management (repeat finding for 4 years).	Material weakness and material noncompliance
Region 5 ^c – Ohio	1. Lack of invoice reviews (repeat finding).	Material weakness
	2. Lack of subrecipient monitoring (repeat finding).	Material weakness

Source: OIG analysis of EPA information

- ^a Tennessee – The FY 2013 Single Audit Report was not issued prior to the onsite phase of the annual review, and the Region 4 project officer should have reviewed the issued FY 2012 Single Audit report. However, the project officer incorrectly reviewed the FY 2011 Single Audit report.
- ^b Kentucky – The FY 2013 Single Audit Report did not have any findings.
- ^c Michigan – The FY 2013 Single Audit report was unavailable prior to the onsite phase of the annual review, and the region correctly reviewed the FY 2012 report, which had no Single Audit findings.

There were no noncompliance Single Audit findings in Region 5 states (Michigan and Ohio), but in Regions 3 and 4 there were five findings of noncompliance, as highlighted in Table 3, with North Carolina’s Single Audit finding of noncompliance repeated for 4 consecutive years.

Region 3 sent a Notice of Noncompliance to Pennsylvania dated July 9, 2013, with two follow-up letters dated September 25, 2013, and November 4, 2013, because Pennsylvania had not completed corrective actions for findings identified in the Pennsylvania FYs 2011 and 2012 Single Audits (Findings 3, 4 and 5 for Pennsylvania in Table 3 above). In addition, Region 3 said it met with Pennsylvania on March 1, 2013, and November 10, 2013, to ensure corrective actions were fully implemented and the resolution of the July 9, 2013, noncompliance letter was resolved in the same federal fiscal year as the state fiscal year 2013 audit.

The FY 2013 Single Audit report for North Carolina included a finding of the state’s failure to monitor subrecipients’ cash management. This finding was

reported in the state’s Single Audit reports for 4 consecutive years. The Region 4 project officer said she reviewed the Single Audit report, but was not aware that the finding was reported for 4 consecutive years, and did not consider issuing a letter of noncompliance. However, the lead environmental specialist in the headquarters’ Office of Wastewater Management said the region should have issued a letter of noncompliance when the finding was not corrected after the first year.

Regional Staff Unclear as to Which Reports to Review and Findings to Include in PER

Regions should review the Single Audit report prior to the onsite phase of the annual review. The EPA project officers for North Carolina (Region 4) and Michigan and Ohio (Region 5) reviewed the report prior to the onsite phase of the annual review. However, that was not the case in Pennsylvania (Region 3) and Kentucky and Tennessee (Region 4). Table 4 includes the reasons why project officers did not review Single Audit reports and findings:

Table 4: Reasons Single Audit reports not reviewed

Region - State	Description
Region 3 - Pennsylvania	The project officer did not have the Single Audit report at the time and waited for the state or EPA OIG to provide the Single Audit report. Region 3 told us that the onsite phase of the annual review was conducted April 1–3, 2014, and that the FY 2013 Single Audit report was signed on March 20, 2014. We confirmed that the report was posted to the Federal Audit Clearinghouse on March 19, 2014.
Region 4 - Kentucky	The state only provided the Kentucky Infrastructure Authority audited financial statement component, and key components of the Single Audit report, such as, audit findings, were missing. The project officer did not review the state’s Single Audit report.
Region 4 - Tennessee	The project officer reviewed the FY 2011 Single Audit report rather than the FY 2012 report, even though the FY 2012 report was issued prior to the onsite phase of the annual review.

Source: OIG analysis of EPA information.

The annual review guidance caused confusion when the state had a financing authority, since two separate reports are issued and the guidance does not say both reports should be reviewed. In addition, the guidance does not instruct users to obtain the Single Audit reports from the Federal Audit Clearinghouse. All auditees are to submit a reporting package, to include the auditor’s reports, to the Federal Audit Clearinghouse. The clearinghouse, operated on behalf of the U.S. Office of Management and Budget, maintains a database of completed audits and provides appropriate information to federal agencies.

Region 3 said that regional staff were to retrieve the Single Audit report from the OIG based on EPA Manual 2750’s section on Single Audit management procedures. However, the OIG has confirmed that there is nothing in EPA Manual 2750 that precludes EPA staff from obtaining Single Audit reports and using that information in conducting annual reviews. Obtaining the Single Audit report does not circumvent the EPA Manual 2750 process. In addition, EPA Manual 2750 does not include a time requirement for the OIG to begin the Single Audit report

review and issuance process. Thus, by waiting on the OIG to review and issue a report, valuable information may be missed in conducting the annual reviews.

The EPA's Standard Operating Procedure on Compliance with Audit Requirements says that EPA staff should review state Single Audit reports for any findings. It also says that regions are responsible for obtaining and reviewing the audits to identify areas of concern. However, this guidance was not issued until September 2014, and does not fully address the issues identified, such as multiple reporting entities, documentation of actions the project officer takes, and discussions with the state or (if applicable) finance authority.

The annual review guidance does not specifically address including Single Audit findings and corrective actions in the PER. However, Office of Wastewater Management staff said that while it is not exclusively identified in the guidance to include Single Audit findings in the PER, it is expected, and the criteria implies it should be included. As a result, Region 4 waits to discuss Single Audit findings in the PER until the audit resolution process in the EPA Manual 2750 has been completed, as in North Carolina. This process may take several years to complete.

For the remaining states in Region 4 (Kentucky and Tennessee), as well as Pennsylvania in Region 3, project officers did not review the Single Audit findings in the most recently issued reports, and were unable to report the findings in the PER. In Ohio, the Single Audit findings were not reported in the PER because the corrective actions had already been implemented prior to the onsite phase of the annual review. In Michigan, there were no findings to report in the PER.

According to the agency, when an issue of noncompliance is reported for consecutive years, a Notice of Noncompliance should be issued. However, in the case of North Carolina's repeat finding of 4 consecutive years, the notice was not issued because Region 4 was not aware the finding had repeated for 4 years.

Regions Cannot Properly Assess State CWSRF Performance

By failing to review Single Audit findings, the regions cannot properly assess performance of a state's SRF program or the risk to federal funds. For Pennsylvania, North Carolina and Ohio, the findings in the FY 2013 Single Audit reports were repeat findings on failure to monitor subrecipients. The sum of the FY 2013 grant awards for the three states was \$156,544,000. A portion of these funds could be at risk of misuse. Although we did not identify the misuse of funds, when funds are misused, states lose opportunities to improve water quality, achieve and maintain compliance with environmental laws, protect aquatic wildlife, protect and restore drinking water sources, and preserve the nation's waters for recreational use.

Single Audits help to provide assurance to the EPA that states are in compliance with the grant agreement, and help ensure that grant recipients are using funds appropriately. EPA regional staff may miss critical information about a state's management and performance of the CWSRF by not being aware of audit findings and addressing the findings during the annual review. Also, EPA staff may not be able to determine whether corrective actions are implemented if the EPA staff are unaware of audit findings. When dollars are neither used responsibly nor for the purpose intended, opportunities to improve clean water infrastructure are missed. When the region fails to issue a Notice of Noncompliance, the state does not have to take any required actions and the region is unable to withhold capitalization grant payments to the state.

The PER should discuss the most significant issues and risks identified during the annual review. The Single Audit reports reviewed for the six states sampled included nine findings of either material or significantly deficient internal control weakness and noncompliance with federal laws and regulations. These findings are the types of issues that can put a state SRF program at risk for noncompliance or misuse of funds. By not including the findings in the PERs, the EPA has not communicated issues that put the program at risk, as well as issues of noncompliance.

Recommendations

We recommend that the Assistant Administrator for Water:

1. Revise CWSRF annual review guidance to instruct program staff to obtain the statewide Single Audit from the Federal Audit Clearinghouse prior to the onsite phase of the annual review, or, if not available from the clearinghouse, obtain it from the state.
2. Revise CWSRF annual review guidance to include a description of both statewide Single Audits and independent audits of state finance authorities that operate the SRFs.
3. Revise CWSRF annual review guidance to require EPA staff to review and discuss with the state and, if applicable, finance authority, all findings, resolutions and corrective actions from audit reports that review implementation of state CWSRF programs, and document these actions in the annual review checklist.
4. Revise CWSRF annual review guidance to include requirements for discussing Single Audit findings—including findings, resolution and corrective actions—in the PER.

5. Revise CWSRF annual review guidance to require project officers to document the decision to issue or not issue to a state a Notice of Noncompliance if a Single Audit finding identifies a recurring noncompliance issue.

Agency Response and OIG Evaluation

The agency agreed with Recommendations 1, 3, 4 and 5, and indicated that corrective actions for the recommendations were already complete. In December 2015 the agency revised its annual review guidance, and we verified that the revisions made to the guide address the recommendations. As a result, we consider Recommendations 1, 3, 4 and 5 to be closed.

The agency's initial response to Recommendation 2 did not address the intent of the recommendation. However, during the exit conference, the agency agreed to revise the name and number of the standard operating procedure to match the name and number in the annual review guidance. The agency provided the revised standard operating procedure on May 23, 2016. We reviewed the new standard operating procedure and, as revised, it meets the intent of our recommendation. As a result, we consider Recommendation 2 to be closed.

Chapter 3

Annual Review Checklists and Worksheets Not Completed Consistently Across Regions

EPA regions were not consistent in fully and accurately completing the checklists and worksheet portions of the annual review guidance. Specifically, for the regions and states in our sample:

- Region 3's annual review checklist for one state was incomplete.
- Region 4's transaction testing worksheets for two states were incomplete and inaccurate.
- Region 5 fully completed the checklists and worksheets for its two states.

According to the annual review guidance, three primary documents (transaction testing worksheet, annual review checklist, and project file review checklist) must be completed for every review, and every item on the checklists must be completed in a useful manner. The inconsistencies stem from some regions choosing alternative approaches to completing the checklists, or not having adequate staff and time. When regional offices perform reviews using different methods, it may impede the EPA's ability to identify programmatic and financial risks to the CWSRF program. In addition, not comprehensively and accurately conducting the annual review increases the possibility that critical issues and deficiencies will not be identified. As a result, misuse of grant funds may go undetected.

Regions Should Complete Checklists and Worksheets as Part of Annual Review

The State Revolving Fund Program Implementation Regulations in 40 CFR Part 35, define the statutory requirement for an annual review of SRF programs. The purpose of the CWSRF annual review is to assess the success of the state's performance of activities identified in the intended use plan and annual report, and determine compliance with the terms of the capitalization grant agreement.

The annual review guidance combines instructions on the prescriptive, checklist-based portion of the annual review, as well as a framework for regions to develop risk-based protocol for the interview portion of the review. The annual review is the critical opportunity to identify risks to the program, which should influence how the region makes decisions on (1) determining topics for interviews with state SRF managers, (2) selecting projects for review, and (3) selecting cash draws for transaction testing.

During the onsite phase of the annual review, the region should complete the annual review checklist, project file review checklist, and transaction testing worksheet:

- The annual review checklist is intended to be a discussion guide for the region to lead an in-depth conversation about the management and operations of the state's SRF program. Open-ended questions require the *region* to enter a detailed response.
- The project file review checklist is required to be completed by regions for CWSRF projects every year. The regional review team may select the projects they wish to see and inform the state in advance of the review. Ideally, the review team should select projects that appear in the state's annual report for the SRF program year under review.
- The transaction testing worksheet is used by the regions to review SRF funds drawn from the U.S. Treasury and disbursed to SRF assistance recipients to ensure that no improper payments occurred.

The guidance says that every item on the checklists must be completed in a useful manner, as the checklists serve as a written record of the annual review. Further, if an improper payment is discovered, a description of the payment—including the date, amount, assistance recipient, reason for the error, and the state's plan for correcting the error—should be noted in the PER. It is important that the cash draw and improper payment amounts stated in the transaction testing worksheet match the amounts reported to EPA headquarters and in the PER.

Inconsistency in Completion of Checklists and Worksheets

The EPA did not consistently complete annual review checklists and worksheets across three regions reviewed. While Region 5 fully completed the checklists and worksheets for the two states in our sample (Michigan and Ohio), we found that Region 3's annual review checklist for Pennsylvania was incomplete, and Region 4's transaction testing worksheets for two states—Kentucky and Tennessee—were incomplete and inaccurate. Specifically:

- In **Region 3**, Pennsylvania's annual review checklist was incomplete.
 - Region 3 answered one-third of the questions requiring a narrative response, and deferred answering two-thirds of the questions (approximately 22) until either the FY 2015 or FY 2016 annual review. Staff in the EPA's Office of Wastewater Management knew that Region 3 was taking this approach, and while the office did not promote the approach it did not object either.

- For the questions in which the annual review checklist required a response documenting the state’s process (as opposed to evaluation questions), we determined that the region provided the checklist to Pennsylvania staff to complete, rather than answering the questions itself. However, in the agency’s response to the draft report, Region 3 stated that the project officer reviewed the information prior to the site visit and discussed it in detail during the review. In addition, Region 3 stated that edits were made by the project officer to the final description as a result of these discussions. We did not verify that the project officer made edits to the final description.
- In **Region 4**, the transaction testing worksheets for Kentucky and Tennessee were incomplete or inaccurate. The issues we identified are discussed below and in Table 5.
 - Two of Kentucky’s cash draws had numerous fields that were either incomplete or inaccurate.
 - Improper payments were identified for three of four transactions tested in Tennessee. However, there was no indication as to the amount, date, assistance recipient, or plan for correcting the error for the improper payment associated with this cash draw on the transaction testing worksheets.

Table 5: Incomplete or inaccurate data in Region 4’s transaction testing worksheets

State	Issues identified
Kentucky – issues identified in two of the four cash draws tested	<ul style="list-style-type: none"> ● There were 26 projects, all of which included improper payments. For all 26 projects, the "Improper Payment Resolution" field was blank. ● The "Explanation If Paid Amount is Different from Invoiced Total" field was missing required information for 25 of 26 projects. ● The "Total SRF Disbursements" field was inaccurate, as it should have included the state match but did not. ● The "Improper Payment Amount" field was blank, meaning the project officer did not calculate the amount of the improper payment, despite identifying numerous improper payments. <ul style="list-style-type: none"> ● There were 54 projects that made up the funds drawn for this cash draw. For 21 of 54 projects, the transaction testing worksheet indicated there was an improper payment. However, the "Improper Payment Resolution Field" for each of the 21 improper payments was blank. ● For 33 projects, there was no indication of whether the regional office identified an improper payment or not, as the "Improper Payment (Yes/No)" field was blank. ● The "Total SRF Disbursement" field was inaccurate, as it should have included the state match but did not. ● The "Improper Payment Amount" field was blank, meaning Region 4 staff did not calculate the amount of the improper payment, despite identifying numerous improper payments.
Tennessee	<ul style="list-style-type: none"> ● An outdated checklist was used for all four of the transactions tested, which led to missing information and/or incomplete information (e.g., blank and missing data fields). ● Three of four transactions indicated that the proportionality ratio was incorrect—80/20, not 83.33/16.77—as per the capitalization grant regulations, and should have been reported as an improper payment. However, there was no indication as to the amount, date, assistance recipient, or plan for correcting the error for the improper payment.

Source: OIG analysis of EPA data.

Additionally, the PERs for Kentucky and Tennessee did not include required information on improper payments.

Inconsistency Due to Alternative Methodology and Insufficient Resources

The Office of Wastewater Management's lead environmental protection specialist believed there was inconsistency between the regions due to lack of resources. The specialist said some regions do not have adequate staff to perform the onsite phase of the annual reviews and, thus, are not able to spend sufficient time on the onsite phase of the annual reviews called for by guidance. Interpretations of guidance also differed.

Region 3 Took a Different Approach to Conduct Annual Reviews

Region 3 interpreted the annual review guidance differently than intended by the headquarters Office of Wastewater Management. Region 3 indicated that to make the most of the time invested onsite, and to focus on critical management areas, regional project officers made an informed, professional judgement to stagger responses to certain questions. The project officer for Pennsylvania stated that their approach was acceptable because the EPA's annual review guidance says that a risk-based approach should be taken when conducting annual reviews of state CWSRF programs. The project officer also said that because there were so many new questions on the checklist, it made sense to defer answering all questions during that review cycle, particularly since the project officer said she had 15 years of experience and personal knowledge of state processes. However, this approach opposes the annual review guidance, which explicitly says that every item on the checklists must be completed in a useful manner, as the checklists serve as a written record of the annual review. It was unclear whether the selection of questions addressed in the review was risk based. In the agency's response to the draft report, Region 3 said that a total of 26 out of 149 questions were deferred. However, this information was provided as an attachment to the response, and we did not confirm the numbers.

Also causing confusion is that instructions on the annual review checklist—an appendix to the annual review guidance—says that:

all of the topics must either be specifically addressed or noted as not being covered during this review. If an area was not reviewed, note the reason for not reviewing it and any future review activities.

In the checklists discussion summary, Region 3 provided information as to which fiscal year the questions would be addressed. However, this contradicts the annual review guidance. Office of Wastewater Management staff confirmed that while they were aware of Region 3's alternative approach to the annual review, they did

not oppose it. However, the intent of the annual review guidance was that all questions be completed each year.

Region 4 Cited Limited Resources to Perform Annual Reviews

Region 4 followed the annual review guidance but stated that, due to limited resources, transaction testing worksheets were incomplete or inaccurate. Currently, Region 4 has two project officers covering eight states for both the Clean Water and Drinking Water SRF programs. Each project officer also serves as a financial analyst for the annual reviews. For FY 2013, the reviews for each state were staffed by:

- **Kentucky:** One CWSRF staff member, assisted by one engineer.
- **North Carolina:** Two CWSRF staff members.
- **Tennessee:** Two CWSRF staff members and one contractor.

Region 4 indicated the required fields were not completed in Kentucky because either the project officer did not have enough time to complete all the fields or human error occurred. In Tennessee, none of the reviewers brought the correct forms to the onsite phase of the annual review to conduct both the transaction testing and project file review. While Region 4 has the most states to review, it does not have the most CWSRF staff available to conduct the reviews.

The improper payment information was excluded from the PER because Region 4 was waiting for a resolution from Office of Wastewater Management as to whether the error was or was not an improper payment. The PER was finalized before a decision was made.

Best Practices by Region 5, Where Annual Review Guidance Was Followed

Region 5 followed the annual review guidance and completed all of the documentation. Region 5 has a team of five CWSRF staff members, including a financial analyst, who perform the annual review for Ohio and Michigan. Region 5 has the most number of staff conducting annual reviews of the three regions we reviewed. The Michigan project officer stated that for every annual review, she reviews two reports: the latest Single Audit report available and the current financial authority's financial audit. In addition, during the annual review, the project officer asks the state about anticipated issues for the current Single Audit and correction of past findings. Also, the Region 5 financial analyst said that the region tries to streamline the annual review checklist by performing tasks ahead of the onsite visits, and also has ongoing conversations with the states.

Misuse of Funds May Go Undetected

Region 3's process for answering one-third of the narrative questions, and electing to answer the remaining two-thirds in subsequent reviews, is not a risk-based approach because there is no risk analysis performed in deciding which

questions to address. Rather, this approach defers answering all questions over a 3-year period. A risk-based approach would allow the EPA to identify potentially high-risk areas within state CWSRF programs, and answer only those questions. When regional offices elect not to answer numerous questions during the annual review, it may impede their ability to identify programmatic and financial risks to the CWSRF program. Additionally, there is a risk that misuse of grant awards may go undetected; Pennsylvania received \$52.9 million in FY 2013.

The annual review is the opportunity to identify risks to the program. Not comprehensively and accurately conducting the review increases the possibility that critical issues and deficiencies will not be identified. By Region 4 providing inaccurate and incomplete answers to the transaction testing worksheets, there is a risk that misuse of grant awards may go undetected; Kentucky received \$17.0 million in FY 2013, while Tennessee received \$19.4 million in FY 2013. The EPA uses the transaction testing worksheets to collect and report improper payments for the CWSRF program. Inaccurate reporting of this information on the worksheets or in the PER put the EPA at risk of reporting inaccurate information to Congress.

Recommendations

We recommend that the Regional Administrators, Regions 3 and 4:

6. Require CWSRF project officers to conduct the annual review according to the CWSRF annual review guidance, fully completing all checklists and other requirements of the review.

We recommend that the Assistant Administrator for Water:

7. Review and revise the annual review guidance to eliminate inconsistencies between guidance and the instructions in the checklists.
8. Evaluate regional approaches to conducting the annual reviews of CWSRF programs, and address issues to ensure regions perform consistent reviews in accordance with the annual review guidance.

Agency Response and OIG Evaluation

Recommendation 6 was a combined recommendation to both Regions 3 and 4. Region 4 provided corrective actions, including back-filling the additional project officer position, assigning administrative project officer duties to additional staff members, immediately requiring peer reviews of all checklists and transaction worksheets for each annual review, and making the first-line supervisor responsible for ensuring peer reviews have been completed. The proposed completion date for the corrective actions in Region 4 is September 30, 2016. When implemented, the corrective actions should address the recommendation for

Region 4. However, Region 3 did not explicitly agree with Recommendation 6, and did not provide a corrective action plan with milestone dates to address the recommendation. Instead, Region 3 provided an alternative recommendation that does not fully address the issue identified. As a result, we consider Recommendation 6 unresolved.

The agency agreed with Recommendation 7 and indicated that it had already revised the annual review guidance in December 2015 to address the recommendation. We verified that the revisions to the guidance addressed the recommendation, and consider this recommendation closed.

For Recommendation 8, the agency indicated that EPA headquarters participated in 13 state annual reviews in 2016. Also in 2016, for the first time, EPA headquarters will send a memo to the Regional Water Division Directors on what headquarters observed while participating in the reviews. The proposed completion date for the corrective actions is September 2016. When implemented, the corrective actions should address the recommendation.

Region 3 provided technical comments in an attachment to the EPA's response to the draft report. We made revisions to the report to address Region 3's technical comments where appropriate.

Chapter 4

Administrative Baseline Monitoring Not Conducted as Required

For FYs 2010 through 2013, grants specialists for four of the six states we reviewed completed less than 60 percent of the required administrative baseline monitoring reviews. In addition, a number of the reviews were not completed within the required timeframe. EPA policy states that awards with project periods longer than 18 months must have an administrative baseline monitoring review completed within the first year of the award date, and on an annual basis until the grant ends. Other tasks took priority over completing the administrative baseline monitoring reviews. By failing to either complete the reviews or complete them timely, the EPA cannot fully evaluate the performance of the state, ensure state compliance with the approved scope of work, and ensure that dollars are used responsibly and for intended purposes.

Initial Administrative Baseline Monitoring Needed Within First Year

Administrative baseline monitoring is the periodic review of a recipient's progress in, and compliance with, a specific award's scope of work, terms and conditions, and regulatory requirements. Documented administrative baseline monitoring is required for all awards covered by EPA Order 5700.6A2, "Policy on Compliance, Review and Monitoring." The order requires that for awards with a project period longer than 18 months, the initial administrative baseline monitoring must take place within the first year (no later than 1 year from the project award date), and then on an annual basis until the grant ends. The EPA guidance *IGMS Post-Award Database: Administrative Baseline Monitoring For Grants* recommends that the initial baseline monitoring be completed in the latter part of the first year.

The EPA OARM's Office of Grants and Debarment serves as the National Program Manager for administrative grants management, and has responsibility for assistance regulations, policy, and guidance and for assistance-related training.

Regions 4 and 5 Grants Specialists Not Conducting Required Reviews

The EPA grants specialists for Regions 4 and 5 did not conduct administrative baseline monitoring reviews in accordance with EPA policy. We obtained the administrative baseline monitoring reviews for CWSRF grants awarded in FYs 2010 through 2013 for Region 3 (Pennsylvania); Region 4 (Kentucky, Tennessee and North Carolina); and Region 5 (Ohio and Michigan). We found that for four of the six states, less than 60 percent of the required administrative baseline monitoring reviews were completed, as highlighted in Table 6.

Table 6: Administrative baseline monitoring reviews completed for grants by fiscal year

Region - State	FY 2010 grant	FY 2011 grant	FY 2012 grant	FY 2013 grant	Total
Region 3 - Pennsylvania	2 of 3	2 of 2	2 of 2	1 of 1	7 of 8 – 87.5% complete
Region 4 - Kentucky	1 of 2	1 of 4	2 of 3	1 of 2	5 of 11 – 45.5% complete
Region 4 - North Carolina	1 of 2	2 of 3	2 of 3	0 of 1	5 of 9 – 55.6% complete
Region 4 - Tennessee	4 of 4	3 of 3	2 of 2	2 of 2	11 of 11 – 100% complete
Region 5 - Michigan	0 of 3	No cap grant	1 of 3	1 of 2	2 of 8 – 25% complete
Region 5 - Ohio	N/A	0 of 4	0 of 4	0 of 3	0 of 11 – 0% complete

Source: OIG analysis of EPA data.

In addition to not conducting the required administrative baseline monitoring reviews, a number of completed reviews were not finished within the required timeframe. In several cases, the initial review was not conducted within the first year, and subsequent reviews were not completed on an annual basis, as shown in Table 7.

Table 7: Timeliness of initial and subsequent administrative baseline monitoring reviews

Region - State	FY 2010 grant	FY 2011 grant	FY 2012 grant	FY 2013 grant
Region 3 - Pennsylvania	<ul style="list-style-type: none"> Initial review: late 2nd review: late 3rd review: not completed 	<ul style="list-style-type: none"> Initial review: late 2nd review: late 	<ul style="list-style-type: none"> Initial review: on time 2nd review: on time 	<ul style="list-style-type: none"> Initial review: on time
Region 4 - Kentucky	<ul style="list-style-type: none"> Initial review: on time 2nd review: not completed 	<ul style="list-style-type: none"> Initial review: late 2nd review: not completed 3rd review: not completed 4th review: not completed 	<ul style="list-style-type: none"> Initial review: on time 2nd review: late 3rd review: not completed 	<ul style="list-style-type: none"> Initial review: late 2nd review: not completed
Region 4 - Tennessee	<ul style="list-style-type: none"> Initial review: on time 2nd review: late 3rd review: late 4th review: late 	<ul style="list-style-type: none"> Initial review: late 2nd review: late 3rd review: late 	<ul style="list-style-type: none"> Initial review: late 2nd review: late 	<ul style="list-style-type: none"> Initial review: on time 2nd review: late
Region 4 - North Carolina	<ul style="list-style-type: none"> Initial review: late 2nd review: not completed 	<ul style="list-style-type: none"> Initial review: on time 2nd review: late 3rd review: not completed 	<ul style="list-style-type: none"> Initial review: on time 2nd review: late 3rd review: not completed 	<ul style="list-style-type: none"> None completed
Region 5 - Ohio	<ul style="list-style-type: none"> N/A 	<ul style="list-style-type: none"> None completed 	<ul style="list-style-type: none"> None completed 	<ul style="list-style-type: none"> None completed
Region 5 - Michigan	<ul style="list-style-type: none"> None completed 	<ul style="list-style-type: none"> No capitalization grants 	<ul style="list-style-type: none"> Initial review: late 2nd review: not completed 3rd review: not completed 	<ul style="list-style-type: none"> Initial review: late 2nd review: not completed

Source: OIG analysis of EPA data.

The amount of time that the administrative baseline monitoring reviews were late varied, but we found 16 of 21 late reviews were 1 month late or more:⁴

- For Pennsylvania, one review was 3 weeks late, two were 1 month late, and one was 7 months late.
- For Kentucky, one review was 6 months late, a second was 9 months late, and a third was more than 2 years late.
- For Tennessee, four of nine reviews were less than 14 days late, while the remaining five were between 1 to 4 months late.
- For North Carolina, one review was 1 month late, while the remaining two were 3 months late.
- For Michigan, one review was 6 months late, and one was more than 1 year late.

When asked who was responsible for providing oversight of the administrative baseline monitoring process, a Region 4 grants management officer said that the team leader and grants management officer oversaw the process. The team leader and grants management officer pull reports, or email the grants specialists to remind them to complete the reports.

Reviews Not Completed Due to Competing Priorities and Workload

Grants specialists in Regions 4 and 5 indicated that workload was the reason that administrative baseline monitoring reviews were not completed or were not completed timely. The Region 5 section chief was aware that the work was not completed, but stated that four staff members left the group and the grants specialist took on additional work, including being the grants specialist for Indiana and portions of five other states.

The Region 4 grants specialist for Tennessee said administrative baseline monitoring reviews were not completed timely because her main concern in September was to issue grants, and the baseline reviews were put on hold until October, causing the reports to be late. The Region 4 grant management officer agreed that awarding grants in September took priority over completing administrative baseline monitoring reviews. However, the reviews can be completed prior to September, and she had completed reviews as early as July in the past.

In addition, the Region 4 grant management officer became aware that the grants specialist had not completed all required reviews when we brought the matter to her attention. She periodically pulled administrative baseline monitoring reports, but the reports only indicated the lag times between the last completed baseline monitoring review until the next one was due. When the grants specialist completes an administrative baseline monitoring review for any active award, the lag time is reset until the next scheduled baseline monitoring is due.

⁴ The time periods cited are approximate.

While team leaders were aware that administrative baseline monitoring reviews were not completed, there was no immediate action taken to complete the reviews. CWSRF project officers rely on regional grants specialists to review the administrative terms and conditions of CWSRF grants.

The administrative baseline monitoring is a tool used by EPA employees to:

- Evaluate the progress of the project and performance of the recipient.
- Ensure recipient compliance with the approved scope of work, administrative terms and conditions, and regulatory requirements.
- Ensure that EPA dollars are being used responsibly and for intended purposes.

By not completing administrative baseline monitoring reviews, the EPA cannot achieve the purpose of the monitoring.

Recommendations

We recommend that the Assistant Administrator for Administration and Resources Management:

9. Develop and implement a plan to ensure administrative baseline monitoring reviews are completed as required by scheduling reviews around peaks in workloads.
10. Improve the capability to monitor the timing of reviews by providing project officers with data regarding the timeliness of administrative baseline reviews.

Agency Response and OIG Evaluation

While the agency agreed with the underlying intent of Recommendation 9, its response indicated that, in March 2014, OARM convened a team to examine ways to streamline the unliquidated obligation and administrative baseline monitoring processes. OARM is currently evaluating whether to exclude CWSRF awards from administrative baseline monitoring. Thus, OARM believes that it would be premature to develop and implement the OIG's recommended plan. OARM did not provide a corrective action plan with milestone dates for this recommendation; it provided a completion date for the evaluation of October 2016. As a result, we consider Recommendation 9 unresolved.

For Recommendation 10, the agency agreed with the recommendation and stated that OARM will add a reporting capability to the Quik Reports tool to track the timeliness of administrative baseline reviews. The estimated completion date is December 31, 2016. When implemented, we believe the corrective actions will address the recommendation.

Status of Recommendations and Potential Monetary Benefits

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in \$000s)	
Rec. No.	Page No.	Subject	Status ¹	Action Official	Planned Completion Date	Claimed Amount	Agreed-To Amount
1	13	Revise CWSRF annual review guidance to instruct program staff to obtain the statewide Single Audit from the Federal Audit Clearinghouse prior to the onsite phase of the annual review, or, if not available from the clearinghouse, obtain it from the state.	C	Assistant Administrator for Water	12/31/15		
2	13	Revise CWSRF annual review guidance to include a description of both statewide Single Audits and independent audits of state finance authorities that operate the SRFs.	C	Assistant Administrator for Water	5/23/16		
3	13	Revise CWSRF annual review guidance to require EPA staff to review and discuss with the state and, if applicable, finance authority, all findings, resolutions and corrective actions from audit reports that review implementation of state CWSRF programs, and document these actions in the annual review checklist.	C	Assistant Administrator for Water	12/31/15	\$156,544	\$156,544
4	13	Revise CWSRF annual review guidance to include requirements for discussing Single Audit findings—including findings, resolution and corrective actions—in the PER.	C	Assistant Administrator for Water	12/31/15		
5	14	Revise CWSRF annual review guidance to require project officers to document the decision to issue or not issue to a state a Notice of Noncompliance if a Single Audit finding identifies a recurring noncompliance issue.	C	Assistant Administrator for Water	12/31/15		
6	20	Require CWSRF project officers to conduct the annual review according to the CWSRF annual review guidance, fully completing all checklists and other requirements of the review.	U	Regional Administrators, Regions 3 and 4			
7	20	Review and revise the annual review guidance to eliminate inconsistencies between guidance and the instructions in the checklists.	C	Assistant Administrator for Water	12/31/15		
8	20	Evaluate regional approaches to conducting the annual reviews of CWSRF programs, and address issues to ensure regions perform consistent reviews in accordance with the annual review guidance.	O	Assistant Administrator for Water	9/30/16		
9	25	Develop and implement a plan to ensure administrative baseline monitoring reviews are completed as required by scheduling reviews around peaks in workloads.	U	Assistant Administrator for Administration and Resources Management			
10	25	Improve the capability to monitor the timing of reviews by providing project officers with data regarding the timeliness of administrative baseline reviews.	O	Assistant Administrator for Administration and Resources Management	12/31/16		

¹ O = Recommendation is open with agreed-to corrective actions pending.
C = Recommendation is closed with all agreed-to actions completed.
U = Recommendation is unresolved with resolution efforts in progress.

Agency Response to Draft Report

May 5, 2016

MEMORANDUM

SUBJECT: Response to Office of Inspector General Draft Report No. OA-FY15-0153 “EPA Regional Offices Need to More Consistently Conduct Required Annual Reviews of Clean Water State Revolving Funds,” dated March 28, 2016

FROM: Joel Beauvais
Deputy Assistant Administrator

TO: Michael Petscavage, Director
Contract and Assistance Agreement Audits
Office of Audit

Thank you for the opportunity to respond to the issues and recommendations in the subject audit report. Following is a summary of the agency’s overall position, along with its position on each of the report recommendations. For those report recommendations with which the agency agrees we have provided high-level intended corrective actions and estimated completion dates. For your consideration, we have included a Technical Comments Attachment to supplement this response.

AGENCY’S OVERALL POSITION

The draft report makes ten recommendations – seven for the Assistant Administrator for Water, one for Regions 3 and 4 and two for the Assistant Administrator for Administration and Resources Management (OARM). Except for one recommendation for OARM, we agree with the OIG’s recommendations. In regard to the OW recommendations, the Annual Review Guidance used for this audit was developed in October 2013. Since that time, the guidance has been revised and we believe the most recent Annual Review Guidance dated December 2015, incorporates most of the OW recommendations. The two recommendations not covered by the revised Annual Review Guidance, are met by the SOP entitled, “Compliance with Audit Requirements,” dated September 2014 and by Headquarters participation in State annual reviews conducted by the Regions. This year Headquarters participated in thirteen reviews and hope to continue next year in participating in as many reviews as possible.

AGENCY’S RESPONSE TO REPORT RECOMMENDATIONS

Agreements

No.	Recommendation	High-Level Intended Corrective Action(s)	Estimated Completion Date
1	Revise CWSRF annual review guidance to instruct program staff to obtain the statewide Single Audit from the Federal Audit Clearinghouse prior to the onsite phase of the annual review, or, if not available from the clearinghouse, obtain it from the state.	The Annual Review Guidance was revised in December 2015. Page 12 of the guidance addresses this recommendation. A copy of the guidance is attached. In addition to obtaining a copy of the Single Audit from the state or the clearinghouse, Regions can request from the OIG, through their audit resolution liaison, an expedited issuance of Single Audits prior to state annual reviews.	December 2015
2	Revise CWSRF annual review guidance to include a description of both statewide Single Audits and independent audits of state finance authorities that operate the SRF.	In September 2014, CWSRF developed and distributed to the Regions a SOP entitled, “Compliance with Audit Requirements.” The SOP addresses this recommendation. A copy of the SOP is attached.	September 30, 2014
3	Revise CWSRF annual review guidance to require EPA staff to review and discuss the state and, if applicable, finance authority, all findings, resolutions and corrective actions from audit reports that review implementation of state CWSRF	The revised Annual Review Guidance contains two separate checklists – general checklist and the project file checklist. Section 2.6 of the general checklist addresses this recommendation. A copy of the checklist is attached.	December 2015

	programs, and document these actions in the annual review checklist.		
4	Revise CWSRF annual review guidance to include requirements for discussing Single Audit findings – including findings, resolution and corrective actions – in the PER.	This recommendation is addressed in the Annual Review Guidance on page 36.	December 2015
5	Revise CWSRF annual review guidance to require project officers to document the decision to issue or not issue to a state a Notice of Noncompliance if a Single Audit finding identifies a recurring noncompliance issue.	This recommendation is addressed in the Annual Review Guidance on page 39.	December 2015
6	Require CWSRF project officers to conduct annual reviews according to the CWSRF annual review guidance, fully completing all checklists and other requirements of the review.	Region 4 corrective action: <ul style="list-style-type: none"> - Back-fill additional project officer position, thereby decreasing the burden on the two current project officers; - assign administrative project officer duties to additional staff members within the Section, thereby freeing time for the SRF Coordinator POs to focus on other areas of the program; - immediately require peer review of all checklists and transaction worksheets for each annual review; and - the first line supervisor will be responsible for insuring the 	September 30, 2016

7	Review and revise the annual review guidance to eliminate inconsistencies between guidance and the instructions in the checklists.	<p>peer reviews have been completed. <i>Region 3: see OIG note at the end of the response.</i></p> <p>Annual Review Guidance revised.</p>	December 2015
8	Evaluate regional approaches to conducting the annual reviews of CWSRF programs, and address issues to ensure regions perform consistent reviews in accordance with the annual review guidance.	In 2016, EPA Headquarters CWSRF participated in thirteen State annual reviews This year, for the first time, Headquarters will be sending a memo to the Regional Water Division Directors on what Headquarters observed while participating in the reviews.	September 2016
9	Develop and implement a plan to ensure administrative baseline monitoring reviews are completed as required by scheduling reviews around peaks in workloads.	OARM agrees the underlying intent of this recommendation, namely to ensure that CWSRF awards receive effective EPA oversight. It is unclear at this time, however, whether administrative baseline monitoring of CWSRF awards adds independent value to the annual CWSRF review process. In this regard, in March 2014, OARM convened a LEAN team to examine ways to streamline the Unliquidated Obligation (ULO) and Administrative Baseline Monitoring processes. The Team's report contained a number of recommendations to simplify/consolidate the ULO and	October 2016

10	<p>Improve the capability to monitor the timing of reviews by providing project officers with data regarding the timeliness of administrative baseline reviews.</p>	<p>baseline monitoring processes, which OARM implemented in FY 2015. Significantly, the Team’s report also recommended that the agency revised the monitoring requirements in <u>EPA Order 5700 6a2</u> to exclude CWSRF awards from administrative baseline monitoring due to the extensive oversight already provided by the annual CWSRF review process.</p> <p>OARM is currently in the process of evaluating the recommendation to exclude CWSRF awards from administrative baseline monitoring. This evaluation includes comparing the administrative baseline monitoring questions with the CWSRF annual guidance and checklists to determine whether there is overlap between the two processes, and, if so, whether there are opportunities to reallocate administrative baseline monitoring resources to recipients with higher financial risk. OARM will share the results of the evaluation with the OIG.</p> <p>OARM agrees with this recommendation and will add a reporting capability to the Quik Reports tool to track the timeliness of administrative baseline reviews.</p>	December 31, 2016

Disagreement

No.	Recommendation	Agency Explanation/Response	Proposed Alternative
9	Develop and implement a plan to ensure administrative baseline monitoring reviews are completed as required by scheduling reviews around peaks in workloads.	Given the ongoing evaluation described above, OARM believes that it would be premature to develop and implement the plan recommended by the OIG. In coordination with the agency's Grants Management Council, OARM will assess the need for the plan once the evaluation is completed.	TBD

CONTACT INFORMATION

If you have any questions regarding this response, please contact George Ames, Chief of the State Revolving Fund Branch on (202) 564-0661 or Sheila Platt on (202) 564-0686.

Attachments

cc: Donna Vizian
Shawn Garvin
Heather McTeer Toney
Robert Kaplan
Andrew Sawyer
Howard Corcoran
Jon Capacasa
James Giattina
Tinka Hyde

OIG note: Subsequent to the submission of the EPA's response, we were notified that Region 3 offered an alternative to Recommendation 6. Region 3 proposed:

Based on the facts, a more appropriate recommendation regarding Region 3 is to recommend that the Regional Administrator of Region 3: Ensure that all of the deferred process documentation questions have subsequently been completed. Planned Completion Date: July 2016

We do not believe the alternative recommendation fully addresses the issue we identified.

TECHNICAL COMMENT ATTACHMENT

Region 3 Comments on the Factual Accuracy of the Draft Report

Chapter 1 Introduction Background

1. Communities are not the only borrowers. CWSRF non-point source projects include borrowers such as homeowners, farmers, and non-profit organizations which should be included.

Responsible Offices

1. The annual review guidance includes programmatic and financial aspects. The second paragraph of this section should include the financial aspects.

Chapter 2 Single Audit Findings - Single Audit Findings Not Always Considered or Reported in the PER

1. Please include in the draft that in preparation for the annual review, Region 3 proactively obtained and reviewed the financial statement audit which had an unqualified opinion and no findings were mentioned.

2. Table 3, the 3rd paragraph of page 12, and the paragraph above “Recommendations” on page 13: Please update the text to more accurately reflect the situation. The reported Pennsylvania findings were an error and not material weaknesses, non-compliance; the independent Certified Public Accountants who conducted the Single Audit did not have a complete understanding of the CWSRF program requirements. Region 3’s memo dated September 1, 2015 to the OIG, explained the inaccuracies. The OIG accepted the Region’s response and closed the audit in the tracking system on October 10, 2015 (within the scope of this audit (April 2013–March 2016)).

Regional Staff Unclear as to Which Reports to Review and Findings to include in PER

3. Table 4 – please update the first sentence of the Region 3-Pennsylvania language to reflect comments made previously i.e. “The project officer did not have the Single Audit report at the time and relied upon EPA OIG to provide the Single Audit report in accordance with EPA Manual 2750 audit resolution process”.

Second paragraph under Table 4 - EPA Manual 2750 does not preclude EPA from obtaining the audit reports, however, the 2750 Manual states “The OIG transmits single audit reports to the EPA, making recommendations for corrective action when necessary” and “The single audit process begins once the OIG has issued a final report to the agency.” (pages 89-101).

Chapter 3: Annual Review Checklists and Worksheets Not Completed Consistently Across Regions

1. The statement: “When regional offices perform reviews using different methods, it may impede the EPA’s ability to identify programmatic and financial risks to the CWSRF program”

overlooks the valued uniqueness of each State's program. The ability to approach each State's annual review in a flexible manner allows the regional offices to spend their limited staff resources on the highest priority areas in each State's program. Given the importance of this aspect of the SRF program, please consider omitting the sentence.

Regions Should Complete Checklists and Worksheets as Part of Annual Review Inconsistency in Completion of Checklists and Worksheets

1. Region 3's approach was consistent with the checklist guidance. The checklist states "*. . . all of the topics must either be specifically addressed or noted as not being covered during this review. If an area was not reviewed, note the reason for not reviewing it and any future review activities.*" Please clarify that postponed questions were all related to documenting vs. implementation, of state processes. Questions related to evaluating the state's program and determining compliance (historically high risk areas) were all answered.
2. The description of how process documentation questions were addressed is inaccurate. The Region only provided to the State the select process documentation questions from the checklist. Questions related to evaluating the States program and determining compliance were answered solely by the project officer. Further, although the state provided written input documenting their processes, the information was reviewed by the project officer prior to the site visit and discussed in detail during the review; edits were made by the project officer to the final description as a result of these discussions.

Inconsistency Due to Alternative Methodology and Insufficient Resources Region 3 Took a Different Approach to Conduct Annual Reviews

2. To balance the written account, please include in the final report that there were a total of 149 questions on the annual review checklist. 15 process documentation questions were deferred for one year and 11 process documentation questions deferred for two years for a total of 26 process documentation questions of 149 questions.

Misuse of Funds May Go Undetected

3. As stated above, 26 process documentation questions of 149 does not seem to equate to "numerous". Please insert the actual number or more appropriately quality using terms like "few" or "some".
4. Please balance the discussion by adding "The project officer reported that by using the risk based approach, the Region was able to focus its limited resources in higher risk areas such as ensuring compliance, evaluating the State's program and confirming implementation of State processes".

OIG actions: Based on our analysis of Region 3's comments on the factual accuracy of the draft report, we made revisions to Chapters 1 and 3 of our report as appropriate. Chapter 1 will now include additional information on CWSRF borrowers, and state that the annual review guidance includes financial aspects. Chapter 3 will include Region 3's response to the draft report, stating that the project officer reviewed written input prior to the site visit and that edits were made by the project officer as a result of discussions. Chapter 3 will also include Region 3's response to the draft report stating that a total of 26 questions out of 149 were deferred. No other changes were made to the report.

Distribution

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