



U.S. ENVIRONMENTAL PROTECTION AGENCY

OFFICE OF INSPECTOR GENERAL



Financial Management

Over \$774 Million of Puerto Rico State Revolving Funds at Risk

Report No. 17-P-0186

April 26, 2017



Report Contributors:

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Abbreviations

CFR	Code of Federal Regulations
CRS	Congressional Research Service
CWSRF	Clean Water State Revolving Fund
DOH	Puerto Rico Department of Health
DWSRF	Drinking Water State Revolving Fund
EPA	U.S. Environmental Protection Agency
EQB	Puerto Rico Environmental Quality Board
FY	Fiscal Year
GDB	Puerto Rico Government Development Bank
IUP	Intended Use Plan
OIG	Office of Inspector General
PRASA	Puerto Rico Aqueduct and Sewer Authority
PROMESA	Puerto Rico Oversight, Management, and Economic Stability Act

Cover photo: Government Development Bank Headquarters, San Juan, Puerto Rico.
(EPA OIG photo)

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At a Glance

Why We Did This Audit

The U.S. Environmental Protection Agency (EPA), Office of Inspector General (OIG), received a hotline complaint from the EPA regarding financial irregularities with Puerto Rico's Clean Water and Drinking Water State Revolving Funds. The complaint reported that the revolving funds had a combined balance of approximately \$188 million at the Puerto Rico Government Development Bank, but the complaint also alleged that the bank did not have the funds to honor the balance. The EPA was concerned about recovering the balance and the potential commingling and/or misuse of the funds. The OIG conducted an audit to address the EPA's concerns.

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

- *Protecting America's waters.*
- *Launching a new era of state, tribal, local and international partnerships.*

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Over \$744 Million of Puerto Rico State Revolving Funds at Risk

The OIG confirmed that over \$188 million of state revolving funds is not available because the Puerto Rico Government Development Bank does not have the assets (cash) to honor the balance. This situation resulted from the severe, ongoing financial crisis faced by the government of Puerto Rico and the Puerto Rico Government Development Bank.

Over \$774 million of state revolving funds is at risk due to Puerto Rico's ongoing financial crisis. Restoration of the revolving funds in the near future is highly unlikely.

We saw no indication that the managing agencies—the Puerto Rico Department of Health, Department of Environmental Quality, and Infrastructure Financing Authority—commingled or misused the funds. The revolving fund balance in question—which had grown to \$194.5 million by November 7, 2016—consisted of loan repayments and associated interest earnings, not any EPA capitalization grant funds. The government of Puerto Rico recognizes its obligations and has included restoration of the revolving funds in its 10-year plan; nonetheless, withdrawals of any significance in the near future are highly unlikely. In addition, our audit determined that approximately \$580 million in repayments owed by the revolving funds' largest loan recipient is at risk of nonpayment for at least 2 to 3 years, perhaps longer. As a result, over \$774 million of funds may not be available for an extended period of time. Without access to the revolving fund balance and a steady stream of loan repayments, Puerto Rico's Clean Water and Drinking Water State Revolving Funds cannot plan for or meet project needs.

Our audit found that the EPA could not have predicted or prevented this situation. Prior to 2016, neither the EPA nor the managing agencies received any indications that the revolving funds were at risk. We did not identify any actions that could have been taken to safeguard the balance and/or secure the loan repayments. Furthermore, as soon as the irregularities were discovered, the EPA provided adequate oversight to address the issues and worked with the managing agencies to safeguard future revolving fund transactions.

Recommendation and Recipient's Response

We recommend that the Regional Administrator, Region 2, evaluate options to restore the viability of Puerto Rico's Clean Water and Drinking Water State Revolving Funds or implement strategies better suited to the financial, programmatic, public health and environmental needs of the government of Puerto Rico. On March 2, 2017, we discussed our audit results with Region 2, which concurred with our findings and recommendation.



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

THE INSPECTOR GENERAL

April 26, 2017

MEMORANDUM

SUBJECT: Over \$774 Million of Puerto Rico State Revolving Funds at Risk
Report No. 17-P-0186

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: Catherine McCabe, Acting Regional Administrator
Region 2

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-FY17-0067. 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.

In accordance with EPA Manual 2750, you are required to provide a written response to this report within 60 calendar days. You should include planned corrective actions and completion dates for all unresolved recommendations. Your response will be posted on the OIG's public website, along with our memorandum commenting on your response. Your response 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 response 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.

We will post this report to our website at www.epa.gov/oig.

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Chapter 1

Introduction

Purpose

On September 16, 2016, the U.S. Environmental Protection Agency (EPA), Office of Inspector General (OIG), received a hotline complaint from the EPA. The complaint identified financial irregularities with Puerto Rico's Clean Water State Revolving Fund (CWSRF) and Drinking Water State Revolving Fund (DWSRF). The complaint reported that there was a combined balance of approximately \$188 million¹ for the two revolving funds at the Puerto Rico Government Development Bank (GDB) but the bank did not have the assets to honor the balance. The EPA was concerned about recovering the balance and the potential commingling and/or misuse of the funds.

We conducted this audit to accomplish the following objectives:

- 1) Identify the source of funds that make up the \$188 million in question.
- 2) Determine the current status of the \$188 million and the potential for recovery.
- 3) Identify causes for the alleged financial irregularities (other than the bank failure).
- 4) Determine when the agencies responsible for administering the Puerto Rico revolving funds knew or should have known about the financial crisis and the bank's failure, and determine what actions or measures, if any, these agencies could have taken to secure the funds in question.
- 5) Determine if the EPA performed adequate oversight.

Background

According to the EPA, the Revolving Fund Program is the EPA's largest single grant program, accounting for over 50 percent of all assistance awards (i.e., grants and cooperative agreements). The EPA provides funds to states and territories in one of two ways:

- *Revolving fund capitalization grants.* There are 102 state revolving funds nationally; all 50 states and Puerto Rico individually operate two state revolving funds: CWSRF and DWSRF.

¹ The \$188 million stated in the hotline complaint included only the balances of the repayment portion of the CWSRF and DWSRF as of August 31, 2016. As of November 7, 2016, due to state matches, additional disbursements, transfers and interest accruals, the combined balance totaled \$194.5 million. See the "No Commingling, Misuse or Other Causes Identified" section in Chapter 2 of this report.

- *Direct grants.* The EPA provides direct grants to the District of Columbia, the U.S. Virgin Islands, American Samoa, Guam and the Commonwealth of Northern Mariana Islands.

Direct grants comprise only a fraction of the Revolving Fund Program; the majority of the funds are used to capitalize the revolving fund grants.

Revolving funds function like environmental infrastructure banks by providing low interest loans from available funds to eligible recipients for water and wastewater infrastructure projects. When loan recipients repay the loan principal and interest, this money is recycled back into the fund to “revolve” over time and finance new state projects. The revolving funds operate with a high degree of flexibility to meet each state’s unique needs and circumstances. The EPA provides guidance and oversight to the state agencies to operate their revolving funds in accordance with applicable regulations.

Clean Water State Revolving Fund

Title VI of the Clean Water Act of 1987 established the CWSRF program, which replaced the EPA’s Construction Grants Program. As outlined in 40 CFR Part 35, Subpart K, *State Water Pollution Control Revolving Funds*, and EPA guidance, the CWSRF is a federal-state partnership financial assistance program that enables each state to design and operate its own revolving fund to provide assistance for water pollution control activities in perpetuity.

Each state’s CWSRF is funded by a combination of sources: EPA capitalization grants, state matches, repayments and accrued interest. The states have the authority to use the CWSRF to provide various types of assistance to recipients, including issuing and refinancing loans, purchasing or guaranteeing local debt, and purchasing bond insurance. States may set specific terms on any loans they issue using the CWSRF, such as interest rates and repayment periods. In 2009, Congress authorized states to provide further financial assistance via the CWSRF program, including grants, principal forgiveness and negative interest rate loans.

Eligible uses of the CWSRF include the construction of publicly owned wastewater treatment works, implementation of a nonpoint source pollution control management program, and development and implementation of an estuary conservation and management plan. The passage of the Water Resources Reform and Development Act in 2014 authorized nine additional CWSRF eligible uses.

Drinking Water State Revolving Fund

The Safe Drinking Water Act Amendments of 1996 (the Safe Drinking Water Act) established the DWSRF program to help states implement the public health protection objectives of the act and provide safe drinking water. The regulations promote the efficient use of all available funds “in perpetuity.” The DWSRF

program is a federal-state partnership financial assistance program that enables states to establish a permanent loan fund that provides low-interest loans to public water systems to comply with federal drinking water standards. States may provide assistance to recipients by issuing and refinancing loans, purchasing and guaranteeing local debt, and purchasing bond insurance.

States can use the DWSRF to provide assistance to disadvantaged communities in the form of loan subsidies, including principal forgiveness, negative interest rate loans, and loan repayment up to 30 years. In addition, funds can be used to provide financing for privately owned water systems.

The Revolving Fund Process

Congress provides the EPA an annual appropriation for funding the CWSRF and DWSRF. The EPA then awards CWSRF and DWSRF capitalization grants to each state based on its applications and intended use plans (IUPs). The intended use plans provide information on the proposed use of federal and state funds, loan repayments, and interest earnings. Each plan also includes details on key aspects of the state's CWSRF or DWSRF, including the long- and short-term goals, priority setting criteria, a fundable projects list, and the expected project funding schedule.

States are required to provide funding that is equal to at least 20 percent of federal funds. The state match can be made by direct appropriation, general obligation bonds, revenue bonds or other methods.

The revolving funds operate on a reimbursable basis, whereby loan recipients receive a line of credit and present to the state a request to draw cash for the reimbursement of expenditures. The line of credit may consist of the annual federal grant award, the state match, bond proceeds, and/or repayments. Both CWSRF and DWSRF require that draws from federal grant funds be made in proportion to the total funds. Figure 1 depicts the general funding/repayment process.

Figure 1: Revolving fund general loan/repayment process

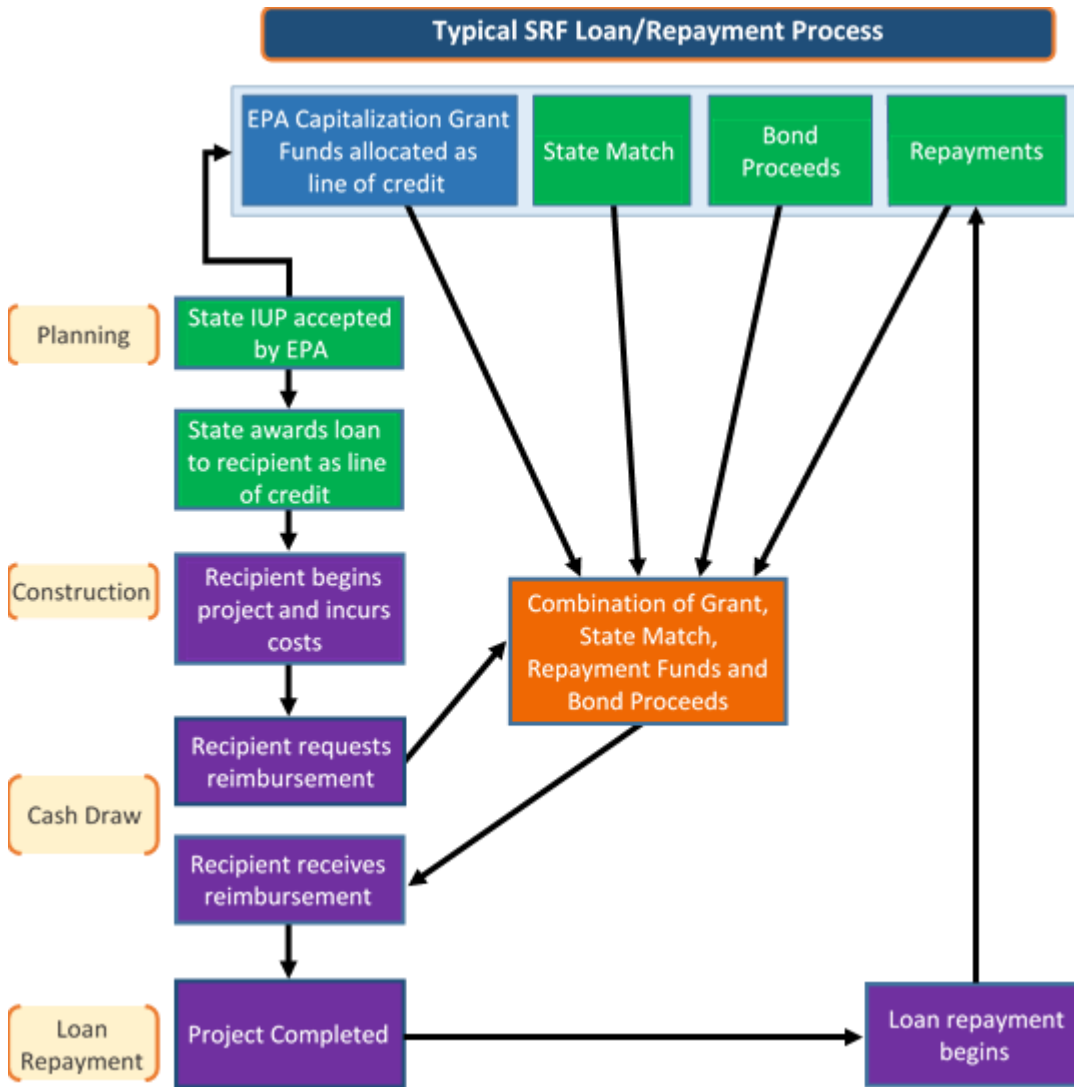


Figure 1 Abbreviations
 EPA—U.S. Environmental Protection Agency
 IUP—Intended Use Plan
 SRF—State Revolving Fund

Figure 1 Color Key
 EPA— [Blue bar]
 State— [Green bar]
 Loan Recipient— [Purple bar]
 Combined Funds— [Orange bar]

Source: OIG-generated diagram.

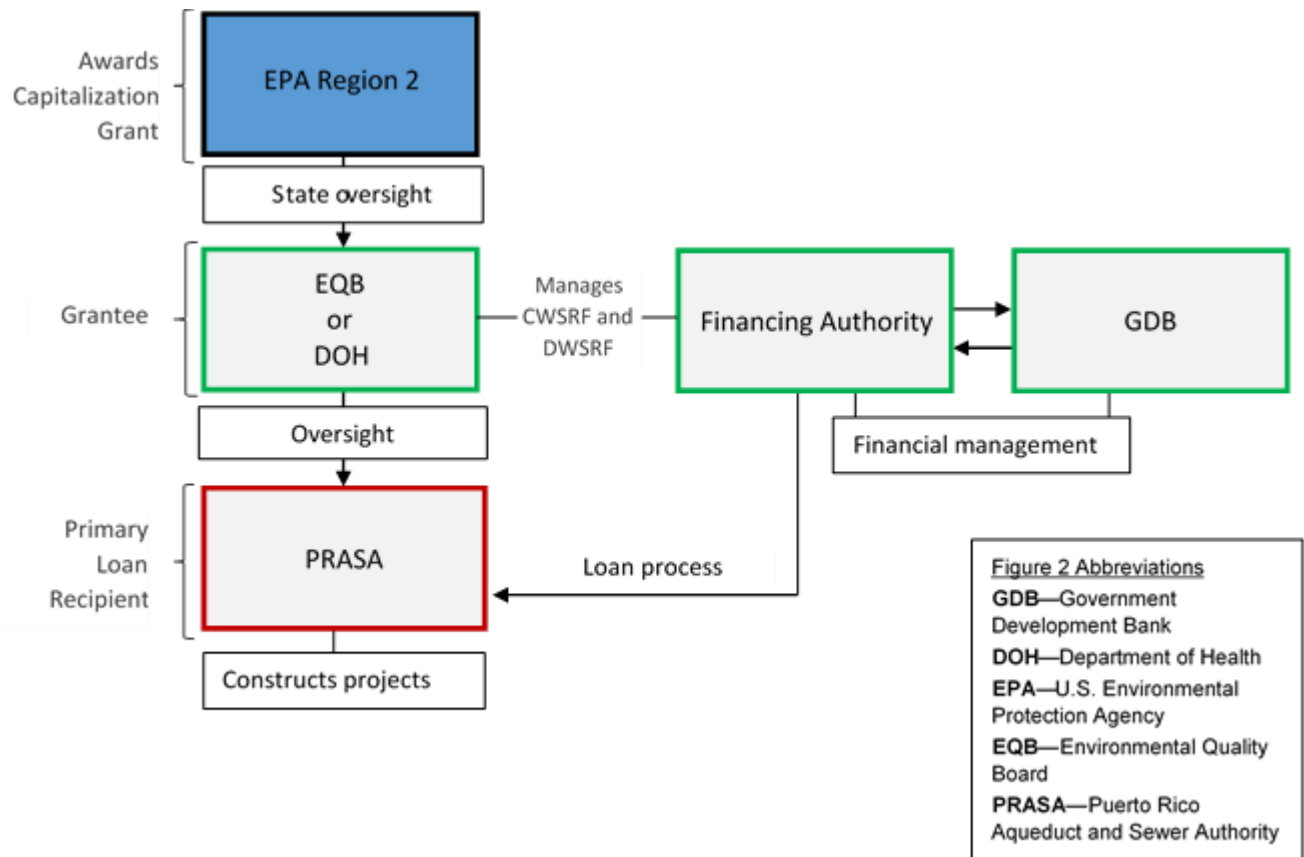
Puerto Rico’s Revolving Funds

In 1991, the EPA and the Puerto Rico Environmental Quality Board (EQB) entered into an operating agreement for implementing and managing the CWSRF. In May 1998, the EPA entered into a similar agreement with the Puerto Rico Department of Health (DOH) for the DWSRF. The EQB and DOH, in turn,

established memorandums of understanding with other entities that assist in the administration of the CWSRF and DWSRF, including the Puerto Rico Infrastructure Financing Authority (Financing Authority), Puerto Rico Aqueduct and Sewer Authority (PRASA), and the GDB. The memorandums of understanding delineate the primary responsibilities of the different entities, which are described below and shown in Figure 2.

- *EQB* and *DOH* are responsible for managing their respective revolving funds, developing IUPs, and meeting other reporting requirements. They are also responsible for coordinating and collaborating with the Financing Authority on the loan process and with PRASA on project needs.
- The *Financing Authority* participates in the development of the intended use plan and other reports. It is responsible for monitoring the financial health of the revolving funds, as well as developing accounting and financial management practices. It recommends loan terms and negotiates loan agreements. The Financing Authority also processes certified loan disbursement requests, makes cash draws, collects all loan repayments, and invests all monies in the revolving fund.
- *PRASA* participates in the development of the IUPs and other reports. PRASA generates cost estimates and distribution schedules for proposed projects, prepares loan applications, and negotiates loan terms and conditions. PRASA also constructs projects and maintains project cost records. According to the Financing Authority, PRASA holds 96 percent of the loans issued under the CWSRF and 100 percent under DWSRF.
- The *GDB* holds the revolving funds, participates in the development of reports, and provides resources to enable the Financing Authority to carry out its obligations. Although not listed as part of its responsibilities in the memorandums of understanding, the GDB, along with the Financing Authority, maintains the official accounting records and prepares the annual financial statements for the CWSRF and DWSRF.

Figure 2: Responsibilities delineated in the CWSRF and DWSRF memorandums of understandings



Source: OIG-generated diagram.

As of October 2016, Puerto Rico’s CWSRF and DWSRF had received over \$633 million in EPA capitalization grants: \$443 million for the CWSRF and \$190 million for the DWSRF. As of November 7, 2016, the GDB’s records showed a combined revolving fund balance (consisting of state matches, repayments and interest) of over \$194.5 million.²

As of August 31, 2016, the Financing Authority reported a total loan balance of approximately \$583 million. This amount consists of over \$1.1 million owed by the Puerto Rico Electric Power Authority, almost \$0.8 million by municipalities, and over \$580 million by PRASA.

Puerto Rico’s Revolving Fund Project Needs

As discussed above, the EPA awards capitalization grants based on project needs that are identified in the annual CWSRF and DWSRF intended use plans. In their fiscal year (FY) 2015 IUPs, EQB and DOH described 46 projects ready to

² As discussed in Chapter 2, these balances have been impaired by the lack of bank assets and are therefore not available for use.

proceed for both the CWSRF and DWSRF, with a total value of over \$270 million (Table 1).

Table 1: Summary of FY 2015 revolving fund projects ready to proceed

Revolving Fund	Number of projects	Total estimated project costs	Total considered for funding
CWSRF	15	\$86,044,408	\$86,044,408
DWSRF	31	184,663,968	20,651,588
Total	46	\$270,708,376	\$106,695,996

Source: IUPs submitted by EQB and DOH for FY 2015 CWSRF and DWSRF capitalization grants.

According to its FY 2015 IUP, EQB planned to commit funds for all of the CWSRF projects by September 30, 2016. In DOH’s FY 2015 IUP, there were many projects ready to proceed as early as FY 2009 but remained unfunded until FY 2015. In addition, only 14 of the 31 ready-to-proceed DWSRF projects were intended to receive funding.

Some of the projects identified in the FY 2015 IUPs are needed to address violations of the Clean Water Act and Safe Drinking Water Act. As a result of various violations identified in some of its facilities prior to 2016, PRASA had entered into several consent decrees with the EPA. The latest consent decree—filed in federal court on September 15, 2015, and entered on May 23, 2016—included a claim for relief based on the following violations:

- Failure to comply with National Pollutant Discharge Elimination System effluent limits at water and wastewater treatment plants.
- Failure to properly operate and maintain various wastewater treatment plants.
- Illegal and unauthorized discharges from the Puerto Nuevo Regional Wastewater Treatment Plant and waste water collection system.
- Failure to submit sanitary sewer overflow notifications.
- Unauthorized discharges at wastewater pumping stations.
- Imminent and substantial endangerment to the public resulting from the failures and unauthorized discharges discussed in the above bullets.

The purpose of the consent decree was to resolve the claims in the complaint and address the requirements in prior consent decrees that had not been achieved.

In May 2016, DOH submitted an IUP and application for FY 2016 requesting some \$8 million in federal funds. The IUP includes 10 DWSRF projects, with a total of \$133 million in estimated costs. Per the EPA, EQB did not submit a CWSRF IUP for federal FY 2016.

Puerto Rico's Financial Crisis

A Congressional Research Service (CRS)³ report prepared for members and committees of Congress in 2016 summarizes the series of events leading to the government of Puerto Rico's severe financial position. According to the report, the government of Puerto Rico is facing serious fiscal and liquidity challenges and has therefore lost normal access to credit markets. The report discloses that most of the liquidity challenges stem from the substantial debt service costs facing the central government and its public corporations. Per the report, Puerto Rico's gross public debt was about \$72 billion at the end of March 2015, which the government of Puerto Rico said was beyond its ability to pay. The report states that, in late March 2016, a federal district court judge held that the government of Puerto Rico was insolvent and unable to pay its obligations on time.

Puerto Rico's Moratorium and Executive Order

Prompted by the territory's impending debt service payments, the Governor of Puerto Rico issued Act 21-2016 (also known as the Puerto Rico Emergency Moratorium and Financial Rehabilitation Act) on April 6, 2016. The moratorium gave the Governor the power to declare a state of emergency for the government of Puerto Rico and its instrumentalities,⁴ including the GDB, and to suspend the payment of certain obligations, including bank deposits. The moratorium did not discharge debts; rather, it sought to delay payment on certain obligations while protecting creditor rights.

The moratorium also created a new fiscal agency: the Puerto Rico Fiscal Agency and Financial Advisory Authority (Advisory Authority). The Advisory Authority replaced the GDB as the new fiscal agent, advisor and reporting agent of the government and its instrumentalities. The Advisory Authority assists with the economic emergencies of these activities and oversees the restructuring of all covered obligations.

In conjunction with the moratorium, the Governor issued Executive Order 2016-10 on April 8, 2016.⁵ This order authorized the GDB to "take any and all actions that are reasonable and necessary to continue carrying out its operation," including limiting withdrawals and payments only to what was reasonable and necessary to fund essential services. The executive order also imposed a weekly disbursement limit. According to the GDB, the weekly disbursement limit started at \$10 million but had been reduced to \$2 million at the time we interviewed its

³ The CRS report, *Puerto Rico's Current Fiscal Challenges*, dated June 2016, was prepared for members and committees of Congress by D. Andrew Austin, Analyst in Economic Policy.

⁴ An instrumentality is defined as an organization that serves a public purpose and is closely tied to government but is not a government agency. Instrumentalities are private companies, and some are chartered directly by the government.

⁵ Executive Order 2016-10 expired on June 30, 2016. All provisions were renewed under Executive Order 2016-14.

representatives on November 1, 2016. The weekly disbursements are to be made in order of priority, as listed below:

- 1) Federal funds received after April 8, 2016, for the benefit of third parties.
- 2) Payroll, salaries, commissions or other similar payments.
- 3) Amount required to cover ordinary course expenses related to the provision of police, firefighting, medical, education, disaster recovery and related services.
- 4) Other essential services.

The moratorium expired on January 31, 2017. Based on liquidity projections conducted as of October 21, 2016, by Conway MacKenzie Inc. (a consultant for the government of Puerto Rico), the expected cash position for the Puerto Rico Department of Treasury in January 2017 was \$104 million.

On January 29, 2017, the Governor signed the Puerto Rico Financial Emergency and Fiscal Responsibility Law, which allows the Governor to define which services are essential to health, safety and welfare, and to set aside money to ensure payment for those services. This new law is set to expire on May 1, 2017.

Puerto Rico Oversight, Management and Economic Stability Act

To address the financial crisis in Puerto Rico, the U.S. Senate enacted the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) on June 30, 2016. PROMESA established a Federal Oversight and Management Board (Oversight Board) to help the designated entities of the government of Puerto Rico achieve fiscal responsibility and access capital markets. These entities include all agencies of the government of Puerto Rico, as well as its instrumentalities. The instrumentalities include, but are not limited to, the entities involved with the CWSRF and DWSRF: the GDB, the Financing Authority, PRASA and the newly established Advisory Authority.

The Oversight Board's power prevails over all laws and regulations of Puerto Rico. All future financial budgets and debt restructuring plans for the covered entities must be approved by the Oversight Board. For example, the entities must submit fiscal plans covering at least five fiscal years for review and approval by the Oversight Board prior to submitting their budgets to the Puerto Rico's legislature. The fiscal plans must identify, among other things, financial and cash flow projections to support essential government services, promote economic growth, and improve fiscal governance and accountability.

During its first meeting on September 30, 2016, the Oversight Board requested various documents from the Governor of Puerto Rico, including a fiscal plan. The government of Puerto Rico submitted its 10-year fiscal plan, *Commonwealth of Puerto Rico Fiscal Plan*, to the Oversight Board on October 14, 2016.

Responsible EPA Offices

The EPA's Office of Wastewater Management administers the CWSRF program and its Office of Ground Water and Drinking Water administers the DWSRF program; both are in the EPA Office of Water. EPA Region 2's Caribbean Environmental Protection Division provides oversight of the CWSRF and DWSRF in Puerto Rico.

Scope and Methodology

We conducted this audit from October 31, 2016, to February 15, 2017. We conducted our audit in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To determine the funding sources and current status of the revolving funds at the GDB, we reviewed bank statements and obtained clarifications from the Financing Authority.

To determine the recovery potential of the revolving funds at the GDB, the causes for the impairment of the funds, and the oversight conducted by the various entities responsible for the oversight and management of the revolving funds, we reviewed the following documentation:

- 1) The hotline complaint, to obtain an understanding of the background related to the status of Puerto Rico's revolving funds and the EPA's concerns.
- 2) State revolving fund laws and regulations, as well as program implementation guidance, to understand state requirements.
- 3) Puerto Rico's operating agreements and memorandums of understanding for the CWSRF and DWSRF, to obtain an understanding of the roles and responsibilities of the entities charged to oversee and manage the funds.
- 4) Enabling acts of the GDB and the Financing Authority, to understand their relationship, responsibilities and authorities.
- 5) Recent laws and executive orders of the government of Puerto Rico relating to the CWSRF and DWSRF, to understand the guarantee for the funds and determine the restrictions these laws place on banking options and funding disbursements for the CWSRF and DWSRF.
- 6) Documents and communications regarding the current status of Puerto Rico's CWSRF and DWSRF, including notices of noncompliance issued by the EPA and PRASA's consent decrees, forbearance requests and agreements.
- 7) Puerto Rico's IUPs for the CWSRF and DWSRF, to understand funding needs and identify priority projects.

We interviewed representatives of all parties involved in Puerto Rico's CWSRF and DWSRF: the EPA, DOH, EQB, Financing Authority, GDB and Advisory Authority. In addition, we interviewed Northbridge, an EPA consultant, to obtain an understanding of the work it performs in Puerto Rico and to determine the current status of the CWSRF and DWSRF.

We interviewed Puerto Rico's current single audit contractor, LLM&D PSC, to obtain an understanding of the status of the CWSRF and DWSRF, and of the financial outlook of the GDB and the government of Puerto Rico. We were briefed by the government of Puerto Rico's lead debt restructuring adviser, Millstein & Co., on the government's plans to restore the CWSRF and DWSRF.

Chapter 2

Revolving Funds Not Available for Use

Our audit confirmed that the \$188 million of state revolving funds discussed in the hotline complaint is not available for use because GDB does not have the assets (cash) to honor the balance. This situation resulted from the severe, ongoing financial crisis faced by the government of Puerto Rico and the GDB. We did not identify any other reasons or abuse by the managing agencies (Puerto Rico DOH, EQB, and the Financing Authority)—including commingling or misuse of funds—that resulted in the funds not being available for use.

The \$188 million specified in the hotline complaint consisted of loan repayments and associated interest earnings as of August 31, 2016. With state matches, additional disbursements, transfers and interest accruals, the revolving fund balance totaled over \$194.5 million as of November 7, 2016. This amount did not include any EPA capitalization grant funds. The balance of the revolving funds is recognized by the government of Puerto Rico and included for restoration in its proposed 10-year fiscal plan; nonetheless, withdrawals of any significant amounts in the near future are highly unlikely.

In addition, our audit determined that revolving fund loan repayments owed by PRASA—the primary loan recipient for the CWSRF and DWSRF—are at risk of nonpayment for at least 2 to 3 years, perhaps longer. This determination is based on PRASA's financial condition. In a presentation to the Oversight Board on November 18, 2016, PRASA reported outstanding debt of about \$5 billion, including over \$580 million of revolving fund loans. As of July 2, 2016, PRASA was unable to meet its financial obligations, including an \$18.5 million loan repayment to the revolving funds. Any significant repayment in the near future is also unlikely due to a 6-month forbearance agreement agreed to by the EPA and signed in June 2016 by the managing agencies of the revolving funds (EQB, DOH and the Financing Authority). The agreement was amended on December 14, 2016, to include an additional 6 months. It is now set to expire June 30, 2017. The EPA is also considering supporting a longer term (2-to-3-year) forbearance agreement.

As a result, over \$774.5 million of revolving funds—the \$194.5 million balance at the GDB and the \$580 million in future loan repayments owed by PRASA—may not be available for an extended period of time. Also, due to PRASA's lack of financial capacity to pay back the loans, it is highly unlikely PRASA will be approved for any new loans in the near future. Without access to the revolving fund balance and a stream of loan repayments, the CWSRF and DWSRF cannot plan for or meet current and future needs.

Given the severe financial situations of the government of Puerto Rico and PRASA, it is questionable as to when and whether the CWSRF and DWSRF will be restored to a position needed to sustain themselves in perpetuity, as intended by the Clean Water and Safe Drinking Water Acts.

No Commingling, Misuse or Other Causes Identified

The CWSRF and DWSRF regulations stipulate that the revolving funds must be maintained in separate accounts dedicated for revolving fund use. The OIG confirmed that the managing agencies deposited the CWSRF and DWSRF into separate bank accounts at the GDB and accounted for the revenues and expenditures separately.

We saw no indication that the managing agencies used the revolving funds for purposes other than those intended. The revolving fund balances at the GDB is not available for use due to the government of Puerto Rico’s financial crisis and the bank’s resulting lack of cash. Consistent with the requirements of the moratorium, the government and the bank continue to recognize the revolving fund balance, along with interest earned. As of November 7, 2016, the total combined revolving fund balance at the GDB was over \$194.5 million (Table 2).

Table 2: Detail of revolving fund balance at the GDB

Fund	Funding source			Total
	Loan repayment	State match	Set aside ^a	
CWSRF	\$140,478,189	\$30,236	\$0	\$140,508,425
DWSRF	47,357,831	6,679,889	370	54,038,090
Total	\$187,836,020	\$6,710,125	\$370	\$194,546,515

Source: GDB statements and November 2016 transaction data provided by the Financing Authority.

^a According to the Financing Authority, the \$370 was interest earned over time on federal funds for set-aside activities.

The GDB’s records show the revolving fund balance is held in demand-deposit and time-deposit accounts.⁶ According to the GDB, if not for the lack of cash, the balance would be available for use. Also, even though the time-deposit accounts have a 90-day maturity, the GDB waived all restrictions on the accounts, including the early withdrawal penalty. Per the GDB, the balance in both accounts are the same in terms of disbursement priority under the moratorium. Details on the balance are in Table 3.

⁶ A demand deposit is an account that allows the depositor to withdraw funds without warning, while a time deposit is an interest-bearing account that has a specified date of maturity and requires notice to withdraw funds.

Table 3: Details of revolving fund accounts

Fund	Demand deposit	Time deposit	Interest	Total
CWSRF	\$12,049,663	\$128,393,602	\$65,160	\$140,508,425
DWSRF	7,803,101	46,207,290	27,699	54,038,090
Total	\$19,852,764	\$174,600,892	\$92,859	\$194,546,515

Source: GDB statement and November 2016 transaction data provided by the Financing Authority.

Government Structure and Financial Crisis Caused Liquidity Issues

The GDB's lack of available cash stemmed from the structure of the government of Puerto Rico and its ongoing financial crisis, as well as the financial challenges of the bank itself. The bank was created under the Puerto Rico Act 17 of 1948 to be the fiscal agent and depository or trustee of funds for the government of Puerto Rico and its instrumentalities. As a result, the GDB served as bank, fiscal agent and financial advisor to the government and other public corporations.⁷ The GDB also functioned as a financial reserve, providing emergency funding to the government. To fulfill its chartered responsibilities, the GDB often took or was directed by the government to take actions that have been detrimental to its liquidities, such as granting loans without repayment sources.

As a result, loans to the government of Puerto Rico and its instrumentalities became a huge portion of the GDB's holdings. Because the government of Puerto Rico and its instrumentalities are faced with significant fiscal and financial challenges, loan repayments were often seriously delayed, affecting the GDB's liquidity and credit ratings, which in turn limited its access to capital markets.

In 2013, the government of Puerto Rico directed the GDB to transfer \$245 million of bank funds or funds obtained from third-party financing to the Puerto Rico Treasury's Fiscal Recovery Fund, which was created to finance the shortfall in the government's budget appropriations. This action further depleted GDB's assets. Although the government of Puerto Rico took measures to preserve GDB's liquidity, the situation continued to deteriorate. On May 1, 2016, the GDB failed to make principal payments of approximately \$367 million on a debt service payment of \$423 million.

Restoration of Revolving Funds Unlikely in Near Future

Even though the government of Puerto Rico and the GDB continue to recognize their obligations for the CWSRF and DWSRF, any significant restoration of funds in the near future is highly unlikely. This is primarily due to continued liquidity

⁷ The Advisory Authority assumed the fiscal agent and financial advisor responsibilities of the GDB in April 2016 after the issuance of the moratorium (Act 21-2016).

issues, restrictions imposed by the moratorium and related executive orders, and the involvement of the Oversight Board. The Puerto Rico Department of Treasury also has requested that all entities determine the impaired value of their account balances at the GDB, raising further questions about the recovery potential of the revolving funds.

Disbursement Activity Since Moratorium and Executive Order

In November 2016, the GDB advised the OIG that the legislature approved a \$100 million appropriation for Puerto Rico’s fiscal year 2017 to specifically honor deposits at the GDB. The GDB received \$11.2 million per month from August 2016 to November 2016, for a total of \$44.8 million under the appropriation. GDB representatives said they expect to continue to receive \$11.2 million each month and will continue to disburse funds in accordance with the limitations and priorities of the moratorium. Disbursements from the CWSRF and DWSRF balances fall within priority three of the moratorium, as outlined in the “Puerto Rico’s Moratorium and Executive Order” section of this report in Chapter 1.

Since the moratorium was issued on April 6, 2016, the GDB had disbursed approximately \$6.5 million from the CWSRF and DWSRF through November 7, 2016. This included \$4.8 million to PRASA, \$1.1 million to revolving fund accounts at Banco Popular,⁸ and \$0.6 million to the Puerto Rico Electric Power Authority and municipalities. Table 4 identifies these disbursements.

Table 4: GDB disbursements from April 6, 2016, to November 7, 2016

Payee	Amount (millions)	Funding source
PRASA	\$4.8	<ul style="list-style-type: none"> • \$3.3 million from CWSRF repayment and state match • \$1.5 million from DWSRF repayment
Transfer to funds at Banco Popular	1.1	CWSRF loan repayment and DWSRF state match
Puerto Rico Electric Power Authority and municipalities	0.6	CWSRF capitalization grant and state match
Total	\$6.5	

Source: Disbursement data provided by the Financing Authority.

According to the Financing Authority, the GDB has made no disbursements since November 7, 2016. GDB representatives had cautioned that the appropriated funds can stop flowing at any time depending on the financial status of the government.

⁸ New accounts for the CWSRF and DWSRF were established in June 2016 at Banco Popular, a commercial bank. As of April 2016, the EPA no longer had the capability to electronically transfer revolving funds to the GDB. All revolving fund payments from the U.S. Treasury are now sent to Banco Popular. The EPA has authorized Banco Popular to electronically transfer funds.

The moratorium expired in January 2017. According to liquidity projections conducted in October 2016 by Conway MacKenzie, a consultant for the government of Puerto Rico, the expected cash position for the Puerto Rico Department of Treasury at the expiration of the moratorium was \$104 million. This amount was far from enough to cover the government's expected debt service of \$1.3 billion, to provide essential services to the people of Puerto Rico, and to pay benefits to its government retirees.

On February 1, 2017, it was reported that the government of Puerto Rico was unable to pay \$312 million worth of bond payments, including \$279 million of bonds owed by the GDB. Officials also warned that the GDB only had about \$156 million in liquidity.

Although GDB representatives stated otherwise, the likelihood that the bank will continue to receive \$11.2 million each month in appropriated funds is not high; thus, the potential for the EQB and DOH to withdraw or transfer a significant portion of their revolving fund balances at the GDB in the near future is questionable. Also in question is the government of Puerto Rico's ability to secure the state match needed for future EPA capitalization grants.

Puerto Rico's Fiscal Plan for Restoration of Revolving Funds

According to the government of Puerto Rico's lead debt restructuring adviser, Millstein & Co., restoration of the combined revolving fund balance at the GDB is included in the government's 10-year fiscal plan submitted to the Oversight Board. The plan assumes that all Puerto Rican resources are pooled into one Treasury cash account (i.e., cash is shared among all entities within Puerto Rico). Under the plan, the principal for all non-municipality third-party deposits—including the combined state revolving fund balance—is expected to be fully restored in equal amounts over a 10-year period, which began on July 1, 2016, the start of the government of Puerto Rico's FY 2017. If the Oversight Board approves this plan, the GDB could restore \$18 million to \$19 million each year to the revolving funds. The fiscal plan did not consider any interest earned; therefore, full restoration, including interest, may be extended beyond 10 years.

The Oversight Board reviewed the initial plan, which was submitted on October 14, 2016, and requested various revisions, including further reduction of budgeted expenses. However, the Governor of Puerto Rico and the Oversight Board did not reach an agreement on the revisions. Also, Puerto Rico elected a new Governor since the initial fiscal plan was submitted and reviewed. The new Governor, who was sworn in on January 2, 2017, could further amend the plan.

Potential Impairment and Loss of Revolving Funds

The Puerto Rico Department of Treasury issued a circular letter on October 18, 2016, that required its public corporations and municipalities to determine the impairment of their balances at the GDB. Based on the Puerto Rico Department of Treasury's interpretation of the accounting standards issued by the Governmental Accounting Standards Board, the realizable balance of each account should be determined based on the corresponding repayments received at the end of the government of Puerto Rico's fiscal year on June 30, 2016. The circular letter instructs that the difference between the recorded balance amount and the realizable balance should be accounted for as an impairment loss. The letter further confirmed the government's and the bank's financial troubles and raised further doubt about the recovery potential of the revolving funds.

If applied to the revolving funds, this approach would result in a significant impairment loss to the CWSRF and DWSRF; as of June 30, 2016, the outstanding combined revolving fund balance at the GDB totaled at least \$194.5 million. It is unclear how or if the potential restoration of the revolving fund balance in the government's 10-year fiscal plan impacts the impairment analysis for the revolving funds.

PRASA's Financial Situation Further Impacted Revolving Funds

The primary loan recipient under Puerto Rico's CWSRF and DWSRF—PRASA—is experiencing serious financial difficulties that may significantly impact current and future revolving fund loan repayments. In a February 26, 2016, letter to the EPA Administrator, PRASA discussed its situation and asked the EPA to provide relief by restructuring PRASA's payment obligations related to the revolving funds. PRASA also asked that the relief be extended to the government of Puerto Rico, as it statutorily guarantees the revolving fund debts. According to PRASA, activation of the guarantee for the revolving fund loan debt—which was valued at over \$580 million on August 31, 2016—could have dire consequences for the government as it attempts to manage its financial crisis. PRASA also requested that the EPA not eliminate or reduce the current level of CWSRF and DWSRF grants.

The letter also disclosed that PRASA was forced to postpone or terminate virtually all of its active construction projects in 2015. PRASA stopped the execution of \$352 million in contracts for 55 projects under construction and \$247 million in contracts for 86 new projects. The letter reported that these delays could eventually result in noncompliance with PRASA's consent decree and in lawsuits filed by federal prosecutors against PRASA officials and the government of Puerto Rico. According to the letter, further delays could also have a negative impact on Puerto Rico's economy. In addition, PRASA stated it owes about \$140 million to its contractors and suppliers; most of these debts are over 180 days past due, with some more than a year past due.

On March 10, 2016, PRASA sent a follow-up letter to EPA Region 2 saying that PRASA was analyzing viable financing options, such as debt restructuring opportunities for its various funding programs, including the revolving funds. The letter noted that, as of January 1, 2016, PRASA had 108 outstanding CWSRF loans, including 17 for projects in the construction phase, with final maturities up to January 2035. In addition, as of January 1, 2016, PRASA had 63 outstanding DWSRF loans, including about 13 for projects in the construction phase, with final maturities up to July 2035. As a result, PRASA requested the following restructuring for the outstanding revolving fund loans:

- Interest forgiveness on all outstanding loans until July 1, 2021.
- Principal payment restructuring and extension to 30 years.
- Release of the government of Puerto Rico's guarantee.

On March 28, 2016, the EPA asked for additional documentation in response to PRASA's request, including a 30-year pro-forma financial projection that shows the impact of the restructured loans on its overall financial condition. On June 27, 2016, the EPA responded to a draft June 21, 2016, forbearance agreement between the Financing Authority and PRASA. The response stated that the EPA would support the proposed forbearance if the following conditions are met:

- EQB and DOH are added as signatories to the agreement.
- During the 6-month or potential 1-year forbearance period, PRASA submits a one-time principal payment of \$1,000 to each of the revolving funds.
- PRASA provides a 30-year pro-forma financial projection showing the impact of the restructured loans on its overall financial condition.
- Prior to any extension of the forbearance period, PRASA submits a recovery plan, including anticipated obstacles to implementing the plan. The plan should set forth a strong strategy—based on realistic projections and data—to raise and sustain sufficient resources and revenues, financial and otherwise; to pay debt service and contractors; to address other liabilities; and to manage water and sewer operations going forward.

The EPA supported the temporary forbearance agreement; nevertheless, it would not consider the release of the government of Puerto Rico's guarantee. On June 30, 2016, a 6-month temporary forbearance agreement, without reference to a guarantee but with an option for a 6-month extension, was signed by PRASA, EQB, DOH and the Financing Authority.

On December 14, 2016, this agreement was amended to extend the forbearance period through June 30, 2017, despite the fact that PRASA did not submit a

recovery plan as mandated by the original agreement. The extension was granted because PRASA was in the process of preparing a fiscal plan for the Oversight Board, which was expected to contain substantially the same information required in the recovery plan. According to the EPA, PRASA originally reported that the fiscal plan would be available by December 31, 2016. The EPA advised us on January 26, 2017, that the due date for the fiscal plan had been extended to February 28, 2017.

The EPA also informed the OIG on December 7, 2016, that its contractor—Northbridge—was modelling various options for a longer term (possibly up to 2- to 3-year) forbearance agreement. In addition, the OIG learned from the EPA that, as of November 2016, PRASA’s contractor debt has been reduced from the \$140 million in February 2016 to about \$100 million. Per the EPA, temporary loan forbearances from the EPA (about \$40 million a year) and the U.S. Department of Agriculture (amounts unknown), along with repayments received from municipality loan recipients (amounts unknown), afforded PRASA the ability to pay out about \$5 million per month to its contractors for outstanding debt.

Conclusion

The \$194.5 million revolving fund balance at the GDB is not available for use solely because the bank does not have the assets to honor the amount. This is a result of the ongoing financial crisis of the government of Puerto Rico and the GDB. It is highly unlikely that the revolving funds will be recovered in the near future. Since the moratorium was issued in April 2016, the funds received from the government of Puerto Rico for the CWSRF and DWSRF have been limited. In addition, future funding from the government of Puerto Rico and loan repayments from the financially troubled PRASA are uncertain for at least the next 2 to 3 years.

The government of Puerto Rico faces numerous challenges as it moves forward and attempts to rebuild the revolving funds. These challenges include, but are not limited to, the following issues:

- Uncertainties associated with the Oversight Board’s approval of the government of Puerto Rico’s 10-year fiscal plan, which provides for the restoration of the revolving funds at the GDB.
- The government of Puerto Rico’s ability to secure funds to provide the required state matches for future EPA grant awards.
- PRASA’s ability to repay its large outstanding debts, including the revolving fund loans, and to provide the guaranteed source of repayment that is now required for new loans.

As a result of the financial crisis, PRASA has been forced to postpone or terminate virtually all of its active construction projects, as well as the start of new projects. With the exception of a few small municipality loans under the CWSRF, projects are not moving and may not move for some time. However, these projects are critical for PRASA to achieve and/or maintain compliance with the requirements of the Clean Water and Safe Drinking Water Acts. Furthermore, if these projects do not move forward, the potential exists for additional violations and serious threats to public health and the environment.

Recommendation

We recommend that the Regional Administrator, Region 2:

1. Evaluate options to restore the viability of Puerto Rico's Clean Water State Revolving Fund and Drinking Water State Revolving Fund or implement new strategies better suited to the financial, programmatic, public health and environmental needs of the government of Puerto Rico.

EPA Response and OIG Comment

A discussion document presenting our audit results and recommendation was issued to the agency on February 15, 2017. An informal meeting was held with the agency on February 24, 2017, to discuss the factual accuracy of the document and provide clarification. The OIG considered the agency's comments and suggestions and modified the report as needed. A formal exit conference was held on March 2, 2017. The agency provided no additional comments for consideration.

Chapter 3

EPA Performs Adequate Oversight in Response to GDB and PRASA’s Financial Situation

Although the EPA and the revolving fund managing agencies were well aware of the financial crisis of Puerto Rico, they had no reason prior to March 2016 to believe that the revolving funds at the GDB would be impaired. There was also no indication that the loan repayments by PRASA were at risk until February 2016. We did not identify any actions or measures that the EPA or the managing agencies could have taken to safeguard the revolving funds or to secure the repayment of loans by PRASA. Even if the EPA and the managing agencies had expressed concerns earlier about GDB’s liquidity, we saw no clear evidence of any actions or measures that could have secured the revolving funds.

Once the issues were identified, the EPA performed adequate oversight to address the GDB’s lack of liquidity and the inability of PRASA to repay its loans. The EPA also worked with the managing agencies to safeguard future revolving fund transactions. In addition, the Advisory Authority implemented requirements to guarantee new loan repayments.

Managing Agencies Had No Prior Indication That Funds Were at Risk

The EPA is responsible for general oversight of the CWSRF and DWSRF programs. Under the operating agreements and memorandums of understanding EQB and DOH are responsible for managing the CWSRF and DWSRF and complying with federal laws and regulations. EQB and DOH said they relied on the Financing Authority for cash management and financial advice. The Financing Authority is responsible for assessing the overall financial health of the funds.

Although EPA has no specific guidance regarding how this financial health assessment should be accomplished, CWSRF and DWSRF regulations and EPA guidance focus on the loan recipient’s financial capability and repayment sources. The Financing Authority personnel stated that since all of the loans were guaranteed by the government of Puerto Rico and recipients complied with loan repayment requirements in the past, they had no concerns about the financial health of the revolving funds. We did not identify any requirement or guidance for ensuring the liquidity of the funds’ depository institution (i.e., the GDB). As discussed in the “Government Structure and Financial Crisis Caused Liquidity Issues” section in Chapter 2, GDB’s liquidity issues can be attributed in part to actions directed by the government of Puerto Rico.

The Financing Authority confirmed that it did not receive any early indications that the availability of the revolving funds would ultimately be impaired. GDB

previously had made timely disbursements, and FY 2016 disbursements had been in line with prior years. It was not until March 31, 2016, when PRASA requested a draw of federal funds for a CWSRF project, that the Financing Authority and the EPA noticed a disbursement delay. After the EPA financial center in Las Vegas transferred the funds to the GDB for disbursement, the bank held onto the disbursement for an unusually long time.

OIG Analysis Confirmed Statements of EPA and Managing Agencies

To confirm the managing agencies' statements that there were no apparent issues regarding the flow of revolving funds from the GDB prior to March 2016, the OIG conducted an analysis of cash receipt and disbursement patterns from July 1, 2015, to October 30, 2016. The results of the analysis were consistent with the Financing Authority's statements that business was proceeding as usual, even though the bank was experiencing liquidity issues during that time period. The analysis showed that the GDB consistently had made disbursements, with no significant time lag between federal cash draws and actual disbursements.

Even if the EPA and the managing agencies had expressed concerns earlier about the GDB's liquidity, it is not clear whether any actions or measures could have been taken to secure the revolving funds. On February 13, 2014, Act 24-2014 was signed, giving the GDB the authority to require agencies, instrumentalities and other departments of the government of Puerto Rico to "deposit and maintain the total or a portion of their funds in deposit accounts, certificates or other instruments issued by Government Development Bank for Puerto Rico." Any attempt by the managing agencies to withdraw the revolving funds of approximately \$188 million in 2014 would have significantly impaired GDB's liquidity. To continue its operations, GDB would have been forced to exercise its authority to require the Financing Authority to maintain the funds.

EPA Responded to GDB's Delayed Payment of Funds

In response to the GDB's delayed payment, the EPA requested—in a letter dated March 31, 2016—information from EQB on the status of the revolving funds at the GDB. EQB did not respond to this request. On April 11, 2016, the EPA wrote a letter to EQB and the GDB, expressing concern with the status of the revolving funds and advising that use of the funds for purposes other than the CWSRF and DWSRF would be in noncompliance with federal statutes and regulations. The GDB responded on April 25, 2016, explaining the significance of the April 2016 moratorium and executive order but not clarifying the use or status of the revolving funds. On May 6, 2016, the EPA again requested information on the status of the revolving funds from EQB and GDB. The EPA received no response; however, on May 6 and May 23, 2016, GDB disbursed the federal funds that had been drawn on March 31, 2016, over a month after the federal cash draw.

The EPA met with representatives from the EQB, the Financing Authority and the GDB September 12–15, 2016, to discuss the status of the revolving funds. At these meetings, the EPA learned that the GDB did not have sufficient cash to honor the revolving funds, and that any future disbursements would be in limited amounts in accordance with the moratorium.

EPA Took Actions to Address Impaired Use of Funds

The EPA, as part of its oversight responsibilities, continued to be actively involved with the CWSRF and DWSRF and took the following actions:

- Reviewed PRASA’s loan forbearance agreement and financial plan (discussed in “PRASA’s Financial Situation Further Impacted Revolving Funds” section in Chapter 2 of this report).
- Stopped the flow of grant funds to the government of Puerto Rico.
- Requested new accounts at a commercial bank to safeguard future revolving fund transactions.
- Issued notices of noncompliance to EQB, DOH, the Financing Authority and the GDB for failure to meet their obligations and satisfy federal requirements to adequately manage the revolving funds. Requested corrective action plans.
- Worked with EQB and DOH to negotiate new operating agreements and memorandums of understanding.

EPA Stopped the Flow of Grant Funds to Puerto Rico

In April 2016, the U.S. Treasury revoked electronic transfers of all federal funds to the GDB. The EPA also stopped the release of grant funds to the CWSRF and DWSRF; the EPA’s finance center in Las Vegas released the last draw on March 31, 2016. These actions resulted in significant delays in the reimbursement of administrative costs to EQB and DOH, as well as the payment of invoices submitted by PRASA, the Puerto Rico Electric Power Authority, and several small municipalities.

As of December 19, 2016, PRASA submitted invoices to DOH for reimbursement under the DWSRF totaling over \$9.4 million. This amount includes about \$6.4 million⁹ sent by DOH to the Financing Authority for payment from March 3, 2016, to August 25, 2016, as well as an additional \$2.9 million in process at DOH.

⁹ This amount excludes the \$1.5 million DWSRF repayment disbursed to PRASA shown in Table 4.

As of December 27, 2016, PRASA submitted invoices to EQB for reimbursement under the CWSRF that totaled over \$19 million. EQB received the invoices between May 2015 and August 2016. Other entities, including small municipalities and the Puerto Rico Electric Power Authority, have submitted over \$4 million in invoices under the CWSRF. EQB received these invoices between November 2015 and November 2016.

The EPA plans to release grant funds to EQB and DOH for the reimbursement of administrative costs upon execution of the new operating agreements and memorandums of understanding. The EPA has not decided whether to release grant funds for the payment of invoices to PRASA and the other entities.

Actions Taken to Safeguard Future Transactions

The EPA is working with EQB and DOH to safeguard future revolving fund transactions. The Financing Authority opened new revolving fund accounts at a commercial bank, Banco Popular, in June 2016. The EPA requested that trust accounts be established to further protect the revolving funds. The EPA also instituted a new requirement for certification of the state match before any cash draw of federal funds.

EPA Issued Notices of Noncompliance and Negotiated New Operating Agreements

After the GDB alerted the EPA in September 2016 that it could not honor the revolving funds, the EPA issued notices of noncompliance to the managing agencies and the GDB on October 3, 2016. The EPA determined that the managing agencies were not in compliance with the following revolving fund requirements:

- Establish, maintain and credit the revolving funds with repayments, and ensure that the balances will be available in perpetuity.
- Maintain the revolving funds in a manner that ensures the funds are used for authorized purposes.
- Establish separate revolving fund accounts.

The notices required that EQB and DOH submit a corrective action plan for achieving the compliance requirements specified in the notice by November 2, 2016. EQB and DOH submitted their corrective action plans on November 2, 2016, and October 27, 2016, respectively.

In response to the notice, the GDB stated that it believed there were no corrective actions it could propose. The GDB stated that it had always held and distributed the revolving funds pursuant to instructions from the Financing Authority and that the Financing Authority has all of the account statements and records with respect to the balances that remained at the bank. The GDB further stated that the

moratorium and related executive orders established procedures and limitations for withdrawals of funds held at the bank. In addition, PROMESA established a stay on actions over the bank's property and indebtedness; therefore, any actions taken in response to the notices of noncompliance would have been a violation.

The Financing Authority did not respond to the notice. According to the memorandums of understanding established under the DWSRF and CWSRF, EQB and DOH are responsible for addressing noncompliance, not the Financing Authority. Actions taken to address the noncompliance, as noted in the corrective action plans submitted by DOH and EQB, incorporated actions taken by the Financing Authority.

The EPA responded to the submitted corrective action plans on December 29, 2016. The EPA found some of the information provided in the corrective action plans to be inadequate and required that additional information be submitted within 60 days. In addition, the EPA advised us that revised operating agreements for the DWSRF and CWSRF were signed on January 4, 2017. Revised memorandums of understanding for the CWSRF and DWSRF were also signed on December 27, 2016, and December 30, 2016, respectively.

It should be noted that the OIG began this audit after the EPA's issuance of the notices of noncompliance. As previously reported, the OIG concluded that the managing agencies had established and maintained the revolving funds in separate accounts. We also saw no indication that the managing agencies used the funds for any unauthorized purposes. The revolving funds are not available because the GDB does not have the assets (cash) available to honor the balances.

Conclusion

The EPA and the managing agencies had no indication, prior to 2016, that the CWSRF and DWSRF at the GDB or the loan repayments by PRASA were at risk. Further, there were no actions or measures that the EPA or the managing agencies could have taken to safeguard the revolving fund balances or secure the loan repayments. The EPA performed adequate oversight in response to GDB's and PRASA's financial situations and to safeguard future revolving fund transactions. Based on the results of our audit, we make no recommendations regarding the EPA's oversight of the matters discussed.

Status of Recommendations and Potential Monetary Benefits

RECOMMENDATIONS

Rec. No.	Page No.	Subject	Status ¹	Action Official	Planned Completion Date	Potential Monetary Benefits (in \$000s)
1	20	Evaluate options to restore the viability of Puerto Rico's Clean Water State Revolving Fund and Drinking Water State Revolving Fund or implement new strategies better suited to the financial, programmatic, public health and environmental needs of the government of Puerto Rico.	U	Regional Administrator, Region 2		\$774,000

¹ C = Corrective action completed.
 R = Recommendation resolved with corrective action pending.
 U = Recommendation unresolved with resolution efforts in progress.

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