

US EPA ARCHIVE DOCUMENT

**FISCAL YEAR 2011 PROGRAM EVALUATION REPORT**  
**California Safe Drinking Water State Revolving Fund Program**  
**And American Recovery and Reinvestment Act Review**  
**Conducted April 2012**

**I. Introduction**

The Drinking Water State Revolving Fund (DWSRF) rules require EPA to conduct an annual oversight review of the State's DWSRF Program. The purpose of the annual review process is to assess the cumulative program effectiveness; fiscal health of the DWSRF program in California since the program began (May 1998); compliance with the statutes and regulations; Operating Agreement (OA); and grant conditions governing the DWSRF.

EPA conducts transaction testing, file reviews and a program review as part of the annual review. In most years, EPA has conducted all three activities in the same week. For this annual review, which addresses the year 2011, EPA conducted the transaction testing and file reviews in one week, April 16-18, 2012 (Phase 1) and the program review the following week, April 23-26, 2012 (Phase 2). To ensure that the annual review addressed all of the major review elements for both base program and ARRA requirements, EPA staff completed the SRF Annual Program and Financial Review checklist, **Attachment E**.

Region 9 is addressing unliquidated obligations (ULOs) in our state SRF programs commensurate with our level of concern and based on the specific circumstances with those programs. The California Safe Drinking Water State Revolving Fund (SDWSRF) program has the highest rate of ULOs in the country, and a detailed on-site program review (i.e. Phase 2 approach) was an appropriate step to help us understand the situation.

Phase 2 was an expanded version of EPA's normal annual review of the SDWSRF. During this phase, EPA staff from Region 9 and HQ together took a strategic look at the State's operations, policies and procedures to better understand the causes of the high rate of ULOs in the SDWSRF. EPA's assessment and observations from Phase 2 are summarized in the "*EPA Management Discussion of the California Safe Drinking Water Program*" (*EPA Management Discussion*), and will be sent to CDPH in a separate letter.

Certain topics addressed in the PER are also discussed within the *EPA Management Discussion*, which is written and structured to complement the PER. The comments included in the PER specifically address the State's performance in achieving the intent of the DWSRF program and compliance with the grant agreement. In turn, the *EPA Management Discussion* summarizes findings, options and opportunities to reduce ULOs to reasonable levels in the short-term (i.e., 1-2 yr timeframe) and long-term, and potential SDWSRF program enhancements, which will be issued in a separate report.

In conjunction with the annual oversight review of the base DWSRF program, the Region conducted an annual review of ARRA grant and project activities to ensure compliance with ARRA grant conditions and requirements.

## II. Background and Scope

The SDWSRF uses Federal capitalization grants, state match funds, loan repayments, and interest earnings to make loans for construction of drinking water treatment facilities and support several Safe Drinking Water Act (SDWA) programs. Based on information received from CDPH and since the program began in May 1998 through June 30, 2011, the SDWSRF has executed base and ARRA loans totaling 244 and equal to \$1.22 billion.

Table 1 illustrates the federal grant awarded in SFY 2011.

**Table 1. Federal Grant Awarded in SFY 2010/11.**

| <b>Federal Fiscal Year Allotment</b> | <b>Date of Award</b> | <b>Federal \$\$\$</b> | <b>State 20% Match \$\$\$</b> | <b>Total Award</b> |
|--------------------------------------|----------------------|-----------------------|-------------------------------|--------------------|
| 2010                                 | 9/29/10              | \$126,958,000         | \$25,391,600                  | \$161,668,316      |

The following conditions and assurances regarding the required Base and ARRA program and financial elements have been reviewed. Elements noted with an \* are discussed in Section III of this report. The other elements do not require further discussion.

### **Required Program Elements**

- A. Annual/Biennial Report\*
- B. Funding Eligibility\*
- C. Compliance with DBE Requirements
- D. Compliance with Federal Cross-Cutting Authorities
- E. Compliance with Environmental Review Requirements
- F. Operating Agreement
- G. Staff Capacity\*

### **Required Financial Elements**

- H. State Match
- I. Binding Commitment Requirements\*
- J. Rules of Cash Draw
- K. Timely and Expeditious Use of Funds\*
- L. Compliance with Audit Requirements\*
- M. Assistance Terms
- N. Use of Fees
- O. Assessment of Financial Capability and Loan Security\*
- P. Financial Management\*
- Q. Other Program and/or Financial Elements related to ARRA

The scope of the annual review includes consideration of the legal, managerial, technical, financial and operational capabilities of the State of California (State) specifically the California Department

of Public Health (CDPH) to manage the SDWSRF program. EPA Region 9 used the SRF Annual Review Guidance, base SRF Annual Review Checklist, ARRA Semi-annual Review Checklist, ARRA Project File Review Checklist and data collected in NIMS to ensure that all major elements of the program were reviewed and discussed with the SDWSRF management and staff. Transaction testing of base and ARRA DWSRF cash draws as required by EPA's HQ SRF policy was also performed.

Following the review, EPA prepared a Program Evaluation Report (PER). This 2011 PER correlates to California's SDWSRF Annual Report for the period ending June 30, 2011 and relevant activities through April 1, 2012. This PER highlights the review findings and identifies follow-up actions to be addressed in SFY 2013.

### III. Observations, Follow-up, and State Comments

EPA's review assessed certain program, financial and project management practices as they relate to the State's ability to effectively administer base and ARRA DWSRF program activities. Section III presents specific observations and required follow-up action items to be incorporated into the future operations or management of the program. The State may comment on the stated observations and suggestions contained in the PER.

#### A. Program Management (Base and ARRA activities)

**1. Annual/Biennial Report** – EPA requires the state to submit a biennial or annual report on the DWSRF program. Historically, California has prepared an annual report. The CDPH submitted the Annual Report for SFY 2011 (July 2010-June 2011) on February 3, 2012. The audited financial statements and the report on the financial and compliance audit for the SDWSRF were submitted in March 16, 2012.

The SDWSRF Annual Report provided a general description of the SDWSRF program status and activities, however, the report should provide more detail to demonstrate that the S DWSRF program had met these critical requirements:

- Made binding commitments in an amount equal to the Federal capitalization grant less set-asides funds plus the State match funds within one year after receiving the grant payment as required under 40 CFR section 35.3550(e);
- Complied with the Operating Agreement, and EPA grant regulations and specific conditions of the grant (such as Davis Bacon);
- Complied with cash draw rules and proportionality; and
- Complied with open audit report findings and recommendations.

**Required Follow-up:** EPA would like to see comprehensive, thorough and timely Annual Reports. Currently, the capitalization grant agreements specify the schedule for submitting the Annual Report to EPA as January 30 of each year. To ensure that the information reported in the Annual Report and PER is timely and relevant, EPA would like to negotiate with CDPH an earlier date for the submission of future Annual Reports to EPA. EPA suggests a new schedule date be established by the 2013 capitalization grant award.

In addition to the constructive information provided in Appendix C, “2010 Executed Funding Agreements” of the SDWSRF Annual Report, it would be useful for this table to provide a brief project description along with a symbol (e.g., \*) indicating which projects count toward the additional subsidization or green requirements. The Annual Report should also include a full explanation of the SDWSRF financial status and activities, and any programmatic changes or upcoming policy or procedural modifications that affect the performance of the SDWSRF program. For example, in August 2012, SDWSRF initiated several internal program changes in an effort to expedite the processing of project claims and payments and enhance the performance of the program. This is a noteworthy effort by the program whose benefits should be highlighted in the 2012 Annual Report. CDPH should also take steps to verify or clarify the financial information in the Annual Report. Portions of the financial information of the Annual Report did not reconcile with information reported in the NIMS report. CDPH should make it a program priority to update program and project information in NIMS within the next calendar year.

To assist states with the development of a comprehensive Annual Report, EPA Region 9 recently created an Annual Report Checklist, **Attachment A**. This checklist categorizes the programmatic and financial elements that should be covered in the SDWSRF Annual Report. EPA recommends CDPH use this guideline when developing the SFY 2012 SDWSRF Annual Report to ensure that the report addresses all the requirements listed in the checklist.

## **B. Financial Management (Base and ARRA)**

**1. Compliance with Audit Requirements** - On March 16, 2012, the California Office of the Controller completed its compliance audit of the SDWSRF for the fiscal year ended June 30, 2011. The summary of findings and questioned costs as a result of the Audit are as follows:

*1. The auditor’s report dated January 10, 2012, expresses an unqualified opinion on the financial statements of California Department of Public Health’s Safe Drinking Water State Revolving Fund (SDWRF).*

*2. No significant deficiencies relating to the audit of the financial statements are reported in the financial statement audit of the SDWSRF for the fiscal years ended June 30, 2011 and 2010.*

*3. No instances of noncompliance material to the financial statements of SDWSRF were disclosed during the audit.*

*4. One significant deficiency in internal control over the federal award program disclosed during the audit is reported in Section III. The deficiency is not reported as a material weakness.*

As stated in finding 4, the Controller noted that CDPH had used two different time accounting output reports in the preparation of local water system invoices and federal grant payment requests, and as a result some of the employee hours charged to the SDWSRF federal grant were also billed to the water systems. By receiving reimbursement from both the federal grant and the water systems, CDPH received revenue twice for the same expenditure.

To prevent the future payment of unallowable payroll expenses the Audit recommended that:

*“CDPH should ensure that payroll hours billed to the water systems are not included as SDWSRF payroll expenditures. Correction of this problem will likely require reprogramming the time accounting system. Although timesheets are properly reviewed by supervisors, CDPH should reinstitute the internal control procedures of reviewing payroll expenditures charged to the SDWSRF program.”*

CDPH agreed to correct the problem by reprogramming the Time Accounting System by March 30, 2012. Likewise CDPH agreed that the internal control procedures should be reinstated. Effective March 1, 2012, SDWSRF agreed to reinstitute reviewing payroll expenditures charged to the program on a monthly basis followed by supervisory review. CDPH has trained additional staff to help review the monthly payroll expenditures.

**Required Follow-up:** EPA acknowledges CDPH’s intent to implement the Audit’s recommendation and requests CDPH confirm the status of the corrective action.

**2. Binding Commitment Requirements** - 40 CFR § 35.3550(e) (1) requires states, on a cumulative basis, to make binding commitments greater than or equal to grant payments and accompanying State match, within one year of payment receipt.

In reviewing CDPH’s cumulative schedule of binding commitments, EPA took into account changes made by CDPH to the definition of binding commitment. From 1999 through June 30, 2009, CDPH defined binding commitment as an executed Notice of Application Acceptance (NOAA); from July 1, 2009 to the present, binding commitments are defined as executed loan agreements.

EPA’s analysis (**Attachment C**) showed that CDPH has a history of nonconformance with the binding commitment requirement. Since inception of the SDWSRF program through federal FY 2011 (i.e., 13 years), the program only met the cumulative annual binding commitment requirement for FFYs 2000 and 2011. This indicates that there are significant shortfalls in the overall management of the program and that there has been serious nonconformance with conditions of the grant award.

**Required Follow-up:** CDPH must ensure that it consistently meets the binding commitment requirement in the future. EPA is requiring CDPH to submit **to EPA by November 1, 2012:** (1) evidence that it has met the binding commitment requirement for FFY 2012; and (2) a monitoring plan to track compliance with the binding commitment requirement on an annual basis. SDWSRF should routinely track and monitor binding commitments and grant payments. This should be done on a quarterly basis to ensure that sufficient binding commitments are made relative to EPA payments. In the event that SDWSRF thinks it may not be able to meet the binding commitment requirement, it should notify EPA immediately so that a proper course of action can be taken to amend the grant payment schedule.

### **3. Timely and Expeditious Use of Funds**

A State must agree to commit and expend all funds as efficiently as possible and in an expeditious and timely manner. Timely and expeditious use of the funds is critical to maximizing the use and effectiveness of DWSRF assets and in meeting the public health needs of the State per 40 CFR § 35.3550(i).



**a. Fund Utilization:** Fund utilization rate or pace of the program represents the cumulative assistance provided as a percent of cumulative SRF funds available for projects. It is one indicator of how quickly funds are made available to finance DWSRF eligible projects and reflects a state’s ability to utilize funds in a timely and expeditious manner.

For the period ending June 30, 2011, the NIMS shows the rate of utilization for the SDWSRF was 79% compared to the national average of 86.6%<sup>1</sup>. According to NIMS, CDPH has increased its fund utilization rate progressively and substantially over the past three years. This improvement in performance is a result of a number of program changes implemented by CDPH such as segregating planning and construction loans to create a larger pool of executed loans. Providing funding for planning helps small or disadvantaged communities develop projects instead of a single loan for planning and construction whereby construction funding could sit for years waiting for planning to be completed. CDPH has also hired an additional attorney to assist with the review and processing of funding agreements, and increased the use of third party assistance providers to work with public water systems to ready their projects for SDWSRF funding. Lastly, CDPH has notified water systems to submit pre-applications for the installation of new water meters. CDPH anticipates these types of projects will move quickly through the funding process and result in executed assistance agreements.

These actions have helped improve pace, however SDWSRF still lags considerably below the national average, as shown in Table 2.

**Table 2. Fund Utilization Rate (Note: Includes ARRA funds)**

| SDWSRF Fund Utilization Rate                    | June 2011        |            | June 2010        |            | June 2009        |            |
|---|------------------|------------|------------------|------------|------------------|------------|
|   | National Average | California | National Average | California | National Average | California |
| <i>NIMS</i>                                     | 86.6%            | 79%        | 89.7%            | 71.5%      | 80.5%            | 57%        |
| <i>CDPH 2011 Annual Report (page 5, para.B)</i> |                  | 78%        |                  |            |                  |            |
| <i>EPA PER Calculations</i>                     |                  | 73%        |                  | 72.0%      |                  | 55%        |

Furthermore, EPA believes the calculated NIMS fund utilization value for the SDWSRF program may be incorrect. EPA’s calculations made as part of this review (**Attachment D**) indicate the value may be closer to 73%, based on discussions with CDPH staff during the on-site review and a closer look at SDWSRF records, including a spreadsheet of executed funding agreements. EPA found significant discrepancies in the dollar values reported for executed loans and funds available for loans identified in the NIMS report, the Annual Report and CDPH’s executed funding agreement spreadsheet. It is critical for CDPH to accurately and consistently report the correct dollar values of its SDWSRF activities for internal and external reporting purposes. Without correct information, EPA is unable to properly calculate and assess the actual performance and effectiveness of the SDWSRF program.

**Required Follow-up:** (1) EPA requires that CDPH correct for the SFY 2012 NIMS reporting cycle all program and project information from inception of the program (such as dollars of executed loan agreements and funds available for loans).

6.

<sup>1</sup> As of August 30, 2011, and as reported in the DWSRF National Information Management System (NIMS)

(2) EPA recommends that SDWSRF continue to develop and fully implement a working Loans and Grants Tracking System (LGTS) that will calculate and track accurate and current program and project information to generate internal and external reports. EPA recommends that SDWSRF staff use LGTS and that SDWSRF try to extend its usage to the regional offices in a more seamless fashion.

(3) EPA recommends that SDWSRF have a fund utilization rate that is, at a minimum, no more than 5% below the national average. The national average is currently approximately 86.6%. To achieve a fund utilization rate of 81.6% in SFY12, CDPH would need to have approximately \$1.37 billion in cumulative executed assistance agreements on June 30, 2012 (calculation based on 2011 cumulative funds available for loans  $\$1.37/\$1.69 = 81\%$ ).

(4) EPA recommends that SDWSRF explore and develop both short-term and long-term strategies that address various processes that will improve and maximize its management of the fund, including, but not limited to, strategic actions that will broaden the universe of eligible recipients under the project selection process so as to commit SDWSRF monies to assistance recipients as quickly and efficiently as possible. Consideration should be given by CDPH to revise its SDWSRF processes so that it quickly identifies and funds a sufficient number of projects that are truly ready to proceed such that available funds are fully utilized.

**b. Unliquidated Obligations:** On May 9, 2011, EPA, Region 9 sent an email to all SRF State coordinators that included a memorandum from Mike Shapiro, Deputy Assistant Administrator, Office of Water (**Attachment B**) that described new fund utilization expectations for water programs, consisting of two inter-related elements.

The first element is to accelerate the pace of fund obligation with a long-term goal of obligating all funds during the fiscal year in which they are appropriated. For the past three years, CDPH has successfully applied for (and EPA has therefore obligated) all funds during the fiscal year in which they were appropriated.

The second element is to encourage and monitor the prompt and full utilization of federal funds. One measure of the prompt and full utilization of funds is unliquidated obligations (ULOs). Funds that EPA has awarded to a state in a capitalization grant, but that the state has not yet drawn from the U.S. Treasury, are considered ULOs. Although not a formal performance indicator under the DWSRF program, EPA has placed an increasing emphasis on managing ULOs in response to the attention ULOs have received in Congress during budget discussions. At this time, EPA considers prompt and full utilization of federal funds to be a high priority.

As of April 20, 2012, CDPH had approximately \$462.3 million in ULOs, including ARRA (see Table 3). The open capitalization grants to CDPH total approximately \$724.6 million. Thus, as a percentage of open capitalization grants, CDPH has a ULO rate of about 64%. The SDWSRF program has the highest amount and rate of ULOs in the nation.



**Table 3 Cumulative Summary of SDWSRF ULOs from Open Cap Grants: current as of 4/20/12**

|   | Cumulative           | \$724,588,178.00 | \$262,306,724.52   | \$ 462,281,453.48   | 64%         |
|---|----------------------|------------------|--------------------|---------------------|-------------|
|   |                      | Approved Funding | Funds Paid to Date | Remaining funds/ULO | Percent ULO |
| 1 | Loans                | \$631,989,690.00 | \$214,326,813.47   | \$ 417,662,876.53   | 66%         |
| 2 | 4% admin             | \$27,996,602.00  | \$21,550,467.95    | \$ 6,446,134.05     | 23%         |
| 3 | 2% Small systems     | \$14,184,801.00  | \$11,274,481.49    | \$ 2,910,319.51     | 21%         |
| 4 | 10% Prog Mgmt        | \$41,468,245.00  | \$15,154,961.61    | \$ 26,313,283.39    | 63%         |
| 5 | 15% local assistance | \$8,948,840.00   | \$0.00             | \$ 8,948,840.00     | 100%        |
| 6 | Total set aside      | \$92,598,488.00  | \$47,979,911.05    | \$ 44,618,576.95    | 48%         |

Table 3 identifies not only ULOs in the loan program, but also those in the set-aside programs. CDPH has a high rate of ULOs in the 15% local assistance set-aside, in particular. EPA understands that CDPH was not able to use this set-aside in the manner intended and will transfer these funds to the loan fund.

As requested by EPA during the on-site annual review, EPA received a letter from CDPH, dated June 3, 2012, describing its preliminary proposal for the short-term liquidation of federal SDWSRF funds. In response to EPA comments, dated June 22, 2012, CDPH submitted a revised proposal, dated August 2, 2012. As described in their August 2 letter, CDPH in the past 6 to 12 months has taken several internal program steps to reduce ULOs, including 1) requiring each new funding recipient to submit quarterly reimbursement claim requests; 2) training recipients in the preparation of and submittal of claims; and, 3) providing hands-on assistance by CDPH staff to resolve claim payment questions or errors. Based on these program changes, CDPH projects that it will disburse \$138 million in federal funds between April and December 2012.

**Required Follow-up:** While these actions by CDPH are commendable, further steps need to be taken to reduce ULOs. It is critical that CDPH continue to seek ways to reduce ULOs quickly and also identify and implement longer-term changes to the SDWSRF program to maintain an accelerated and steady course of obligating and disbursing funds.

If there are set-asides or loan funds from cap grants open from more than two years earlier than the creation of that IUP, the SDWSRF Annual Report must provide a discussion on each unique cap grant regarding the state's strategy to responsibly and expeditiously make use of these unliquidated funds within one year.

**c. Return on Federal Investment:** represents the cumulative assistance disbursed as a percentage of cumulative federal cash draws. This indicator is designed to show how many dollars of assistance were disbursed to eligible borrowers for each federal dollar spent. States with a direct loan program should have an expected value for this indicator of 120%, which reflects the 83% federal and 17% state contribution ratio for funding projects. States that leverage should have a higher value than 120% because they have more funds available relative to the amount of federal and state match funding than non-leveraged states.

This indicator essentially estimates how many dollars in environmental investment have been generated for every federal dollar spent through the program. In the case of the SDWSRF, its

2011 return of federal investment was 100.6%. Based on this performance, EPA concluded that for every federal dollar spent by SDWSRF there was 1.006 dollars of environmental investments created. CDPH's use of federal dollars to resolve drinking water problems and improve infrastructure is well below the expected standard of 120% and the national average for non-leveraged states of 123%.

**Suggested Follow-up:** The actions needed to address return on federal investment are the same as those listed above to increase fund utilization and reduce ULOs.

**4. Financial Management** - To comply with a U.S. Office of Management and Budget (OMB) policy requirement to evaluate improper payments, each Region is required to perform transaction testing on four separate payments for State base DWSRF funded transactions and two separate payments for State ARRA DWSRF funded transactions annually.

EPA tested four base funded financial transactions that drew a total of over \$1.7 million from the federal Treasury between October 28, 2009 and June 1, 2010. Our review of three of the base program financial transactions found that there were no improper payments, **Attachment F**. The fourth base draw examined was a set-aside draw and EPA could not determine whether it was improper or not, for lack of back up and supporting documentation to justify the draw. Unlike the loan program draws, which are primarily processed by the Administration & Financial Section of the Technical Programs Branch and submitted to the Financial Management Branch for execution, the set-aside draws rely on the Financial Management Branch for payroll and cost allocation. As of the date of this PER, the selected base set-aside draw will be considered an erroneous payment until the Financial Management Branch is able to provide adequate back up documentation to justify the draw. In addition to not being able to provide adequate documentation, the time and staff required to produce what the Financial Management Branch was able to produce was of concern. After four months of inquiry and EPA receiving portions of the information from the State, the Financial Management Branch was never able to walk EPA staff from beginning (expense origination) to the end (federal draw) of the process. That CDPH was unable to produce supporting documents to justify the set-aside draw calls into question the adequacy of CDPH's accounting records and procedures. A program the size and complexity of the SDWSRF should have dedicated accounting staff with the necessary skills and abilities to track and produce financial information.

EPA tested 2 ARRA funded transactions from the ARRA SDWSRF grant, which drew a total of over \$3.9 million from the federal Treasury between October 14, 2010 and June 27, 2011. Our review of these ARRA financial transactions found that there were no improper payments, **Attachment G**.

EPA noted a few points that CDPH should address:

1. Claims documentation from assistance recipients is sometimes incomplete. The following cash draws had claims that because of insufficient supporting documentation from the recipient did not allow CDPH to begin the SDWSRF program's warrant issue process: ARRA \$3,456,365.96, 6/27/11; Base \$1,361,434.66, 3/4/11; and Base \$14,144.63, 9/14/10. State law requires all claims to be processed within 45 days of receipt of a fully documented claim, which is the standard practice followed by CDPH for CA DWSRF payments. The assistance recipients failed to submit to SDWSRF

- adequate supporting claims documents or correct information thereby delaying the commencement of the payment process.
2. In some instances the CDPH financial analyst had not signed the draw schedule cover sheets. Signing the cover sheets is a newer process which will likely be standardized going forward.
  3. A set-aside draw for Administration and Small System Technical Assistance in the amount of \$382,339.46 could not be verified by EPA. CDPH Financial Management Branch was unable to produce the reconciliation time sheets for payroll and reconcile the rest of the admin (4%) portion against source documents. Furthermore, the Financial Management Branch was unable to reconcile any of the 2% (DE set aside) back to source documents.

It is EPA's assessment that CDPH needs to strengthen the overall financial management of the SDWSRF program. EPA assessed the accounting support situation within SDWSRF during the annual review and concluded that the support provided by the Financial Management Branch should be improved. The Financial Management Branch does not have dedicated SRF accounting staff familiar with the basic requirements of the SDWSRF program. A program the size and complexity of the SDWSRF should have dedicated accounting staff. Although, the "Administration and Financial Section" of the Technical Programs Branch was able to produce the timesheets and source documents submitted to the Financial Management Branch as well as the roll-up documents from the Financial Management Branch used to draw from the Treasury, EPA was unable to reconcile the SDWSRF set-aside draw from the federal Treasury. The point of non-reconciliation was with the Financial Management Branch, which could not reconcile timesheets and source documents to the amounts in the roll-up documents used to draw from the Treasury.

Furthermore, the SDWSRF program is in the process of developing and implementing a loans and grant tracking system (LGTS) that will track project and financial information. This system is currently used by SDWSRF technical and program staff but not by Financial Management Branch staff, resulting in a lack of accurate loan, set-aside and grant information from which to reconcile financial information. The strength of a LGTS is that it links accounting data to each loan and thus program requirements and elements. To help meet EPA reporting requirements in the future, we strongly encourage SDWSRF staff, including accounting staff, use LGTS to correct historical reporting errors in NIMS and monitor project financial activity. See "Required Follow-up" item 2 under 3.a. "Fund Utilization" above. CDPH has the responsibility to establish and maintain an accounting system and control environment that both encourages and requires accurate financial information, and is capable of producing accurate reports.

**Required Follow-up:** (1) CDPH should provide back-up documentation (which is in LGTS) in the claims file to identify all claim packets that were submitted as unacceptable and required further clarification before processing could commence. In the comment section please verify whether justification exists for the processing timelines on each draw, noting that there may be multiple instances per draw.

(2) CDPH SDWSRF financial analysts should date stamp and sign the submitted claim cover sheet. It is a good internal control to have every step in the process dated and signed (both received and processed).

(3) SDWSRF needs to verify and reconcile a set aside draw with Marie Ortesi of EPA's accounting staff (\$382,339.46 from grant FS98934910 on 1/24/12). As stated in 40 CFR § 35.3570 (c)(2), the State must make available such records as EPA reasonably considers pertinent to review and determine State compliance with the capitalization grant agreement and section 1452 of the Safe Drinking Water Act. EPA requests CDPH to provide supporting documents concerning this set aside draw to EPA by October 30, 2012. This will allow EPA to make a thorough evaluation of SDWSRF's accounting practices and cash transactions.

(4) The Financial Management Branch should assign an accountant dedicated to the SDWSRF program with a core job responsibility of integration and use of LGTS. With approximately \$2 billion in assets, the SDWSRF is a large, complex program that needs full-time professional financial and accounting staff and managers. With the SDWSRF planning to issue millions in state match revenue bonds in the near future, it is all the more important that CDPH have the systems and staff in place to manage and account for this complex program. EPA is required to approve the issuance of state match revenue bonds, therefore, it is important for the State to demonstrate that it has adequate financial capability.

(5) SDWSRF should continue its practice of providing assistance recipients with training materials and instructions on the preparation and submittal of claims to help ensure proper claim submittals and expedite processing.

#### IV. Project File Review

EPA project file review found the projects to be eligible and in compliance with the program requirements. Issues that were identified during the project file reviews have been resolved or will be addressed during the 2012 annual review; the State is implementing or reinforcing procedures to ensure compliance. The Project File Reviews for each of the below listed projects can be found in **Attachments H and I**:

##### **Base Program**

- (1) Armona Community Services District Project No. SRF10PX103 and 1610001-007P, \$500,000 in loan funding for a planning project.
- (2) Del Oro SRF 0410017, \$4,460,879 ; EPA will follow-up during the 2012 annual review to confirm that a Single Audit Report was submitted by Del Oro as required by the Single Audit Act.

##### **ARRA Program**

- (1) Pioneer Union Elementary School AR09FP07, \$1,505,467.
- (2) Town of Windsor AR09FP45 original amount \$1,101,276 later amended to \$1,208,501.18, 4910017-033.

#### V. Conclusion

We have conducted an annual review of the SDWSRF Program base and ARRA activities in accordance with EPA's SRF Annual Review Guidance. Based upon the file reviews, on-site project file reviews and interviews, EPA concludes that the State of California met all program requirements for the review period, except as noted in Section III of the PER:

- Annual Report – *Missing program detail and information.*
- Timely and Expeditious Use of Funds - *Insufficient information to determine accurate fund utilization values, and untimely and insufficient expenditure of federal funds.*
- Financial Management – *Unable to verify and reconcile set-aside draws.*
- Binding Commitments- *Inconsistent tracking and achievement of binding commitment requirement.*

**Attachments:**

**Attachment A** – EPA Annual Report Review Checklist

**Attachment B** – EPA Memorandum, Subject: Office of Water Funds Utilization Expectations, dated May 5, 2011

**Attachment C** – EPA Analysis of CA DWSRF Binding Commitments

**Attachment D** - EPA Analysis of SDWSRF Pace and SDWSRF Executed Funding Agreements Spreadsheet

**Attachment E** – EPA Annual Program and Financial Review Checklist

**Attachment F** – SDWSRF Base Transaction Testing

**Attachment G** – SDWSRF ARRA Transaction Testing

**Attachment H** – SDWSRF Base Project File Reviews

**Attachment I** – SDWSRF ARRA Project File Reviews

