

IDAHO's State Revolving Fund

#7100147

**INSPECTOR GENERAL
DIVISION CONDUCTING THE AUDIT: WESTERN AUDIT DIVISION**

REGION COVERED: REGION 10

EPA HEADQUARTERS PROGRAM OFFICE INVOLVED: OFFICE OF WATER

REGION 10

PROGRAM OFFICE: OFFICE OF ECOSYSTEMS AND COMMUNITIES

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY

OFFICE OF THE INSPECTOR GENERAL

WESTERN AUDIT DIVISION

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March 31, 1997

SUBJECT: Audit of Idaho's State Revolving Fund

Audit Report No. E1HTF5-10-0038-7100147

FROM: Truman R. Beeler

Divisional Inspector General for Audit

Western Audit Division

TO: Chuck Clarke
Regional Administrator

EPA Region 10

PURPOSE

The Office of Inspector General, Western Audit Division, has completed an audit of Idaho's State Revolving Fund (SRF). The purposes of the audit were to determine whether: (i) there was sufficient demand from local communities to use all of the SRF funds available; and (ii) the State's reporting systems were adequate.

SCOPE AND METHODOLOGY

We conducted a performance audit of selected elements of Idaho's SRF program. We also did a limited test to determine whether the amount of cash reported in Idaho's SRF financial statements agreed with its general ledger. We did not perform a financial audit of SRF cash or other accounts. Our audit was conducted in accordance with Government Auditing Standards issued by the Comptroller General. Our field work was conducted from March 1996 through June 1996. The audit covered Idaho's SRF program from its inception in fiscal 1989 through the year ended June 30, 1995.

We discussed Idaho's SRF Program with officials of EPA Region 10's Office of Ecosystems and Communities and Idaho's Department of Health and Welfare, Division of Environmental Quality (DEQ). The audit included reviews of SRF Intended Use Plans (IUPs), SRF Annual Reports, loan files, and the Wastewater Facility Loan Account of the State's general ledger system. The audit was performed giving consideration to SRF statutes and regulations, Idaho's program information, and discussions with EPA Office of Water officials. No previous performance audits of Idaho's SRF Program had been performed.

BACKGROUND

The SRF Program was established in 1987 by Title VI of the Federal Water Pollution Control Act (commonly referred to as the Clean Water Act-CWA). The intent of the SRF program was to replace the Wastewater Treatment Facilities Construction Grants Program with self-sustaining revolving funds in each State. The SRFs provide loans for construction of wastewater treatment facilities and other activities authorized under the Act. Capitalization Grants were authorized to initially fund SRFs. Annual appropriations were allotted to the States using a fixed formula of percentages from the CWA. As of January 1995, EPA had awarded \$11.3 billion in grants to the States.

Title VI of the CWA requires that States annually prepare IUPs that identify the intended uses of amounts available in their SRFs. The IUPs include a description of the State's program goals, a list of projects that are expected to receive funds, and a description of the activities to be supported.

Title VI also requires that all funds be expended in an expeditious and timely manner. SEC. 602. (B) requires States to enter into binding commitments to provide assistance within 1 year after the receipt of a grant payment.

Grant funds are to be obligated, made available, and loans awarded within established time limits.

Idaho received seven SRF Capitalization grants totaling \$50.4 million during the period August 1989 through April 1995. When combined with State matching funds, \$60.5 million in SRF funds was available for loans to local communities and for administrative expenses. As of June 30, 1995, the State made binding commitments⁽¹⁾ of \$40.9 million (68 percent) for loans and administrative expenses, and had disbursed \$25 million (41 percent).

RESULTS IN BRIEF

Local demand for loans was not sufficient to use SRF funds available during the first 6 years of the program. A gap between demand and available funds reached a high point of more than \$25 million at July 1, 1994. This gap of \$25 million represented more than double the largest annual grant ever awarded to Idaho. The gap was reduced to \$17 million at June 30, 1995 by two large loans totaling \$14 million. However, the \$17 million still exceeded more than double the fiscal 1995 grant.

Region 10 recognized Idaho's problem with loan demand in its annual SRF reviews. While the Region has made reasonable efforts with Idaho to overcome the problem, we believe that more needs to be done. As noted by the Region, timely use of funds to high priority water quality projects is fundamental to the purpose for which SRF was established.

The low level of demand was primarily due to instances where local communities decided to delay or discontinue plans for SRF loans. The causes for this condition in local community demand included: (i) the inability to get authorization or support from their citizens to take on the debt and repayment burdens of SRF loans; (ii) delays in getting permits; (iii) obtaining funds for facilities from other sources; and (iv) changing priorities. We recommend that DEQ increase efforts to ensure that there are a sufficient number of qualified loan applicants.

Regarding the State's SRF related reporting systems, we concluded they were inadequate in two respects. First, Idaho's annual IUPs did not include enough projects to account for all of the expected SRF funds. To illustrate, the fiscal 1995 IUP listed projects in support of the \$6 million Federal grant, but did not identify projects for an additional \$14 million that was available. Second, amounts reported in the SRF financial statements were not adequately controlled by DEQ's general ledger and the cash balance reported in the fiscal 1995 financial statements was under-reported by \$91,295. To improve DEQ's accountability for the SRF, we recommend that the IUPs account for all funds and that DEQ obtain annual audits of the SRF financial statements.

AGENCY COMMENTS and OIG EVALUATION

We provided a draft report to Region 10 and DEQ on January 31, 1997 with a request that the Region incorporate DEQ's comments into its response. Region 10 responded on March 24, 1997 and its response is included as APPENDIX A to this report. The Region concurred with all of the recommendations and described corrective actions that have been taken or will be taken by the Region and DEQ. We agree that those actions will implement the recommendations in our report.

ACTION REQUIRED

In its response to the draft report, Region 10 concurred with the recommendations and described an action plan and milestone dates or activities which respond to all aspects of the recommendations. As a result, and as outlined in EPA Order 2750, we find the Region's response to the report acceptable. Therefore, we are closing this report in our tracking system as of this date. The Region should, however, track implementation of the action plan and milestone dates in the Management Audit Tracking System.

This report identifies corrective actions the Office of Inspector General (OIG) recommends involving EPA's SRF program. As such, it represents the opinion of the OIG. Final determinations on matters in the report will be made by EPA managers in accordance with established EPA audit resolution procedures. Accordingly, the findings described in this report do not necessarily represent the final EPA position.

We have no objections to the further release of this report to the public. Should you or your staff have any questions about this report, please contact me at (415) 744-2445 or Charles Reisig, Team Leader at (206) 553-4032.

FINDINGS AND RECOMMENDATIONS

Loan Demand has Improved - But More Improvement is Necessary

In the first 6 years of the SRF program demand for loans has not been sufficient to obligate all of the funds that were available. A chart for the period July 1989 through June 1995 shows that the demand for loans (cumulative loan awards and expenses) had not kept up with the amount of available funds. A gap between demand and available funds increased to more than \$17 million by October 1992, and exceeded \$25 million during the period October 1994 to mid-June 1995. The \$25 million represented more than double the largest annual grant that had ever been made to Idaho. While the gap was reduced to \$17 million at June 30, 1995 by two large loans totaling \$14 million, it was still sufficiently large to warrant attention. At the \$17 million dollar level, the gap still was more than double the fiscal 1995 annual SRF grant of about \$7 million.

EPA, Region 10, has appropriately recognized a growing problem with demand in Idaho's SRF program during its annual program evaluation reports over the last several years. Its 1992 report stated:

We are concerned that the SRF barely met the minimum Federal requirement for loan commitments in 1992. The slowdown in loan commitments is particularly troublesome in the current funding environment.... I urge you to take action to ensure that the SRF will be able to meet the minimum Federal requirements for commitments as well as meet the challenges that new Federal appropriations will mean.... This weakening of demand coupled with the anticipation of higher than expected levels of Federal funding created concerns that the State should look at new strategies and markets for using SRF funds.... Management of the program to commit available funds in a timely manner to high priority water quality projects is fundamental to the purpose for which the SRF was established.

Region 10's 1993 report stated:

Our review has shown that the Idaho State Program had serious periods of noncompliance regarding commitment levels during SFY1993. This unsatisfactory performance in the area of loan commitments and several related areas as detailed in our findings.... The State and EPA identified several measures during the onsite visit that could better ensure future compliance with the commitment requirement...

Region 10's 1994 report stated:

The Idaho SRF program showed significant improvement from last year by meeting the Federal Binding Commitment requirement during all of 1994. However, we remain concerned about the pace at which the program is able to make new commitments.... Please note that the need for timely commitments extends beyond the discussion of the Federal binding commitment requirement. At the end of 1994 the Idaho SRF had

accumulated about \$1.2 million in interest revenues. These revenues will accumulate at an increasing rate in the years to come as more and more loans begin repayment...

While the Region's efforts are recognized, we believe that the \$17 million of unused funds at June 30, 1995 shows that more needs to be done. In addition, as noted in the Region's 1993 report, Idaho failed to meet its binding commitment requirement in fiscal 1993. This is a statutory requirement that can lead to sanctions against a State.

The CWA establishes minimum requirements for the timely award of loans to local communities. Title VI, SEC. 602. (B) states that "the State will enter into binding commitments to provide assistance in accordance with the requirements of this title in an amount equal to 120 percent of the amount of each such grant payment within 1 year after the receipt of such grant payment."

As shown below for 3 quarters in fiscal 1993, the total amount of loan awards fell below the required minimum level for binding commitments:

Quarter-State Fiscal Year	Cumulative Loans	Binding Commitment Requirements	Requirements Not Met
1-1993	\$17,837,912	\$17,868,383	(\$30,471)
2-1993	\$17,862,912	\$23,590,098	(\$5,727,186)
3-1993	\$18,381,428	\$23,590,098	(\$5,208,670)

While the Region and the State identified some measures and took some actions to improve future compliance, we attempted to focus our effort on causes for the gap between loans awarded and SRF funds available. We found a common cause was that several local communities failed to follow through with their original plans to obtain SRF loans. During the 6-year period covered by our audit, there were 43 potential projects for which loans were planned. However, of these potential projects, 16 projects (37 percent) totaling \$15 million did not result in loans. We interviewed Idaho's regional project engineers to find out why these 16 planned loans had not been made. They provided the following as reasons:

- Local communities could not get authorization or support from their citizens to take on the debt and repayment burdens of SRF loans (two projects totaling \$2.4 million).
- Local communities could not obtain National Pollutant Discharge Elimination System permits from EPA to set allowable waste levels (three projects totaling \$4.1 million).
- Local communities obtained other sources of funds from block grants from other governmental agencies or self funding (seven projects totaling \$4.8 million).
- Local communities decided to pursue other priorities (four projects totaling \$3.7 million).

Conclusions

While Idaho has made improvements in meeting the minimum Federal requirement for loan commitments, a

significant amount of funds was still available to fund additional projects. Further improvements can be made to ensure that available funds are committed to high priority water quality projects in a timely manner.

We encourage Region 10 to continue to focus on demand in its annual plan reviews of Idaho's SRF program. In addition, while the causes as to why local communities do not ultimately obtain SRF loans may not be directly within the control of DEQ, we believe that DEQ should place a greater emphasis on: (i) early screening of potential applicants for their readiness to proceed for a loan; and (ii) expanding the list of potential loan applicants so that if a potential applicant is unable to proceed, another can take its place.

Recommendations

We recommend that the Regional Administrator:

1. Continue to focus on demand during the Region's annual reviews of Idaho's SRF Program.
2. Request DEQ to identify the steps that it is taking to ensure a sufficient number of applicants that are ready to accept loans, and other steps it is taking to accelerate the timely use of funds to high priority projects.

Agency Comments and OIG Evaluation

Region 10 concurred with the recommendations and stated that subsequent to the audit, actions have been taken to improve demand and accelerate the timely use of funds to high priority projects. DEQ has made several binding commitments which substantially reduced the gap between funds available and funds committed to projects. DEQ has also identified specific steps that it is taking to accelerate the program pace. The Region stated that it will continue to follow these improvements in its program reviews. We are pleased at the positive steps that have been taken and believe that they will result in more timely and effective use of SRF funds.

Idaho's Reporting on Intended Use Plans Was Incomplete

Idaho's IUPs did not identify intended uses for all available SRF funds as required. In fiscal 1995, Idaho's IUP only accounted for \$6 million of the \$20 million in available SRF funds. Idaho's IUPs listed projects for only the amount of Federal funds requested for the current year. The State did not identify projects for: (i) the amount of the State's matching funds; (ii) funds available from interest earned on SRF funds; and (iii) SRF funds that became available as a result of canceled projects that were on prior IUPs.

We believe that the failure to identify intended uses for all available SRF funds could be a contributing factor to Idaho's limited success in using all SRF funds timely. When we inquired as to causes for the above condition, a State SRF program official said that they had been doing it the same way for years, and EPA had never questioned their approach of only reporting intended uses of the Federal funds portion of the SRF.

To illustrate our concern with Idaho's approach to identifying the intended use of the SRF, the following discussion of its IUP for Federal fiscal 1995 funds is provided. The IUP reported projects and a reserve for administrative expenses that totaled about \$6 million, the amount of the Federal allotment. However, Idaho's SRF (Idaho's Wastewater Facilities Loan Account) had about \$20 million in funds available. Thus, about \$14 million in SRF funds were not identified to any projects. It is noted that Idaho's IUP stated that its primary purpose "is to identify the proposed annual intended use of the funds available in Idaho's Wastewater Facilities Loan Account." The \$20 million available in Idaho's SRF was determined as follows:

As of

June 30, 1995

Sources of Funds:

Federal grants (1989 through 1995)	\$50,445,915
State match (1989 through 1995)	10,089,183
Interest from loan repayments	1,230,525
Interest on unused funds	<u>83,946</u>
Total Funds Provided	\$61,849,569

Uses of Funds (prior to the 1995 IUP):

Reserve for administrative expenses	\$ 2,007,109
Principal on outstanding loans	<u>40,030,918</u>
Total Funds Reserved and Used	\$42,038,027

Funds Available \$19,811,542⁽²⁾

Federal regulation 40 CFR 35.3150 specifies requirements for annual IUPs. Under subparagraph(a), *Purpose*, it states that "The State must prepare a plan identifying the intended uses of the funds in the SRF and describing how those uses support the goals of the SRF."... The IUP "must be prepared annually and must be subjected to public comment and review before being submitted to EPA. EPA must receive the IUP prior to the award of the capitalization grant." Under subparagraph(c), *Amending the IUP*, the regulation states that "The IUP project list may be changed during the year ... as long as the projects have been previously identified through the public participation process." An EPA Headquarters program official stated that the intent of the regulation was that IUPs should account for all funds in the SRF, not just anticipated Federal grant awards.

We asked an Idaho program official why the State's IUPs included projects for only the amount of the Federal allotment. We were told that they had been doing it the same way for years, and that EPA had never questioned their approach of only reporting the anticipated Federal allotment amount.

Conclusions

By excluding significant amounts of SRF funds from the IUPs, Idaho is not complying with the SRF regulations. In our view, one purpose for the requirement is to assist EPA, at the time of a new capitalization grant award, in assessing the effectiveness of a State's planned use of SRF funds. We also believe that the failure to identify intended uses for all available SRF funds could be a contributing factor to Idaho's limited success in using all SRF funds timely.

Recommendation

We recommend that the Regional Administrator inform DEQ of the requirement that IUPs should account for all available SRF funds and that the Region include this requirement in its annual reviews of Idaho's SRF Program.

Agency Comments and OIG Evaluation

Region 10 concurred with the recommendation and stated that DEQ has implemented this recommendation and that no further action is required. We consider this corrective action to be satisfactory.

SRF Cash Was Not Properly Recorded or Reported

DEQ's accounting system did not have sufficient controls to ensure that SRF funds were recorded and reported accurately. Cash balances reported in SRF financial statements were from amounts on computer worksheets that did not agree with SRF general ledger cash balance maintained by the State. The cash balance reported in the fiscal 1995 financial statements was under-reported by \$91,295. Additionally, SRF funds were included with State funds in some general ledger accounts.

The cash balance reported in the SRF financial statements for the year ended June 30, 1995 did not agree with general ledger cash subaccounts for the SRF under the Wastewater Facility Loan Account. With the assistance of a Senior Accountant at DEQ, we obtained the following information on the SRF cash balance that should have been reported in the financial statements. We did not perform a financial audit of SRF cash or other accounts.

As of June 30, 1995 Notes

Cash Balance That Should Have Been Reported:

SRF accounts - Cash in Treasury	\$2,080,258	
Clearing Account - Cash in Treasury	72,842	1
SFR (STA REV LOAN FUND WW) - Cash in Treasury		1,239,235
SFR (STA REV LOAN FUND WW) - State Only		
Loans - Cash in Treasury	(1,113,148)	2
Subtotal - Cash recorded in SRF accounts	\$2,279,187	3
Interest earned on SRF fund balance	<u>83,946</u>	4
Total		\$2,363,133
Cash Balance Reported	\$2,271,838	5
Under-reported Cash	\$ 91,295	

Notes:

1. This account included SRF and State only funds. The amount shown is the amount the accountant identified as the SRF portion.
2. Even though the title contains "State Only Loans", the accountant stated that this account was actually SRF.
3. This subtotal agrees with a Summary of State Revolving Fund Loans as of June 30, 1995 prepared by DEQ which shows total loan repayments of \$2,279,187 (interest \$1,230,525 and principal \$1,048,662).
4. This amount is the total interest earned on SRF funds that was reported in the SRF financial statements. The accountant said that interest earned on SRF funds was recorded together with interest on State loan funds in the State loan accounts.
5. This total came from a computer worksheet.

The problems with the recording and reporting of SRF funds occurred because Idaho had two loan programs whose transactions were recorded in a series of subaccounts under the State's Wastewater Facility Loan Account. One program was a prior State Wastewater Facility Loan program for which payments were currently being received. Transactions for this State only program and the SRF program were recorded in subaccounts under the Wastewater Facility Loan Account. The subaccounts were not clearly titled, recording errors were made and not corrected, and some of the accounts contained commingled funds. SRF financial statement balances were kept on a separate computer worksheet because the general ledger did not accurately reflect SRF transactions.

Federal regulations under 40 CFR 35.3110(b) specify accounting requirements for a SRF. It states that "The SRF can be established within a multiple-purpose State financing program. However, the SRF must be a separate account or series of accounts that is dedicated solely to providing loans and other forms of financial assistance, but not grants." A capitalization grant agreement requirement is described in 40 CFR 35.3135(h)(1) which states that "The State must agree to establish fiscal controls and accounting procedures that are sufficient to assure proper accounting for payments received by the SRF, disbursements made by the SRF, and SRF balances at the beginning and end of the accounting period."

Conclusions

The size of the SRF, in excess of \$60 million, requires that adequate fiscal controls and accounting procedures be established to ensure accountability for the fund assets. We believe that it is a serious internal control weakness when the general ledger does not accurately reflect cash transactions and account balances in the SRF. Memorandum records and computer worksheets can be useful to expand upon or explain amounts in the general ledger, but they should be reconcilable to and be controlled by the general ledger.

The Statements on Auditing Standards state that establishing and maintaining an internal control structure is an important management responsibility (ref. AU319A.69). We believe that DEQ's management could improve internal controls by: (i) using a separate series of accounts for the SRF; (ii) making a thorough reconciliation of the SRF to ensure that all assets are accounted for; and (iii) engaging an independent public accountant to render an opinion on the SRF financial statements after the above activities have been accomplished.

Recommendation

We recommend that the Regional Administrator request DEQ to obtain annual audited financial statements of the SRF in the future.

Agency Comments and OIG Evaluation

Region 10 concurred with the recommendation and stated that it will include an audit requirement as a grant condition when it awards the next capitalization grant. We consider this corrective action to be satisfactory.

APPENDIX A

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY

REGION 10

1200 Sixth Avenue

Seattle, Washington 98101

SUBJECT: Comments on Draft Audit

of Idaho's State Revolving Fund Audit

Report No. E1HTF5-10-0038

FROM: Janet Kesler

Grants and Acquisitions Unit

TO: Truman R. Beeler

Divisional IG for Audit

Western Division

Thank-you for the opportunity to comment on your Draft Audit of the Idaho State Revolving Fund (Report No. E1HTF5-10-0038) that was transmitted to us by your letter of January 31, 1997. We have reviewed the Draft Audit internally and we have reviewed the comments that were prepared by the Idaho Division of Environmental Quality and provided to me by letter dated February 24, 1997. Our comments on the recommendations to Region 10 contained in the Draft Audit are based on these reviews. They are as follows:

(1) Recommendation: Continue to focus on demand during the Region's annual reviews of Idaho's SRF Program.

Response: Concur with comment.

Demand was a problem during the audit period, but subsequent to the audit, the state made several binding commitments which reduced substantially the gap between funds available and funds committed to projects. EPA has made program pace a priority in their ongoing communication with Idaho and other states in the region. We will continue to follow these practices. No further special action is required.

(2) Recommendation: Request DEQ identify the steps that it is taking to ensure a sufficient number of applicants are ready to accept loans, and other steps it is taking to accelerate the timely use of funds to high priority projects.

Response: Concur with comment.

DEQ has identified the steps that they are taking to accelerate program pace in their February 24 letter. EPA will follow up on these in its routine reviews of the Idaho program. No further special action is required.

(3) Recommendation: Regional Administrator inform DEQ of the requirement that IUPs should account for all available SRF funds and that the Region include this requirement in its annual reviews of Idaho's SRF Program.

Response: Concur with Comment.

DEQ has implemented this recommendation. The 1996 IUP along with the capitalization grant application to the EPA Region 10 contained IUPs which account for available SRF funds. No further special action is required.

(4) Recommendation: We recommend that the Regional Administrator request DEQ obtain annual audited financial statements of the SRF in the future.

Response: Concur with recommendation.

EPA will include this requirement as a grant condition when it awards the Idaho FY 1998 capitalization grant.

Thank you again for the opportunity to comment on the Draft Audit. The directions that Idaho and EPA are taking with respect to the SRF program are consistent with the concerns expressed in the draft audit report. We will continue to make these a priority in our implementation of this program in Region 10.

If you have specific questions on our comments on the draft audit report for the Idaho SRF, please contact me at(206)-553-1192 or Lee Daneker at(206)-553-1380.

cc: Lee Daneker, SRF Coordinator, Region 10

Charles Reisig, Team Leader, Seattle Branch

APPENDIX B

REPORT DISTRIBUTION

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Region 10

Regional Administrator

Director, Office of Ecosystems and Communities

Supervisor, Geographic Unit

SRF Coordinator

Audit Coordinator, Grants Administration Unit

External

General Accounting Office

Footnotes:

1. In Idaho, a binding commitment is the equivalent of a loan to a local community.
2. Of this total, \$5.7 million was identified for projects in the 1995 IUP, leaving a balance of \$14 million not identified with specific projects.