

## ENVIRONMENTAL PROTECTION AGENCY

### CFDA 66.458 CAPITALIZATION GRANTS FOR CLEAN WATER STATE REVOLVING FUNDS

### CFDA 66.482 DISASTER RELIEF APPROPRIATIONS ACT (DRAA) HURRICANE SANDY CAPITALIZATION GRANTS FOR CLEAN WATER STATE REVOLVING FUNDS

#### I. PROGRAM OBJECTIVES

Capitalization grants are awarded to States to create and maintain Clean Water State Revolving Funds (CWSRFs) to (1) enable States to encourage construction of wastewater treatment facilities to meet the enforceable requirements of the Clean Water Act (Act); (2) increase the emphasis on nonpoint source pollution control and protection of estuaries; and (3) establish permanent financing institutions in each State to provide continuing sources of financing to maintain water quality. The CWSRF provides loans and other types of financial assistance (but not grants) to qualified communities and local agencies. The CWSRF is a permanent revolving fund to provide loans and other assistance (40 CFR section 35.3115).

#### II. PROGRAM PROCEDURES

The CWSRF program is established in each State by capitalization grants from the Environmental Protection Agency (EPA). Since the enabling legislation was enacted in 1987, capitalization grants have been available to States in most years. EPA implements the CWSRF in a manner that preserves a high degree of flexibility for States in operating their revolving funds in accordance with each State's unique needs and circumstances.

States are required to provide an amount equal to 20 percent of the capitalization grant as State matching funds in order to receive a grant. Capitalization grant applications must include (1) an Intended Use Plan (IUP), which lists proposed projects eligible for financing from CWSRF loans; (2) an identification of the source of the matching amount; (3) a proposed payment schedule; and (4) certain certifications and demonstrations. States may transfer an amount up to 33 percent of its Drinking Water State Revolving Fund (DWSRF) (CFDA 66.468) capitalization grant to the CWSRF or an equivalent amount from the CWSRF to the DWSRF program.

The Disaster Relief Appropriations Act (Pub. L. No. 113-2) provided funds for awards to the States of New York and New Jersey for wastewater facilities impacted by Hurricane Sandy. EPA awarded these funds under CFDA 66.482. Those funds are subject to all of the compliance requirements that apply to CFDA 66.458 except as indicated in III, "Compliance Requirements" of this program supplement.

#### Source of Governing Requirements

The CWSRF program is authorized under Title VI of the Clean Water Act (33 USC 1381 *et seq.*) (Act), Subtitle A: Provisions in Title VI of the Water Resources Reform and Development Act of 2014 (WRRDA) (Pub. L. No. 113-121), amending the Federal Water Pollution Control Act (FWPCA) and which became effective on October 1, 2014, and the Disaster Relief

Appropriations Act, 2013 (Pub. L. No. 113-2). The implementing regulations are found in 40 CFR part 35, subpart K.

Guidance on cross-collateralization is found in the policy statement entitled *Transfer and Cross-Collateralization of Clean Water Revolving Funds and Drinking Water State Revolving Funds*, published in the October 13, 2000 *Federal Register* (65 FR 60940). Guidance on fees collected under the CWSRF program is found in the policy statement entitled *Fees Charged by States to Recipients of Clean Water State Revolving Fund Assistance*, published in the October 20, 2005 *Federal Register* (70 FR 61039). This guidance supplements the coverage of 40 CFR part 35.

### Availability of Other Program Information

General information about the program is available on the EPA Clean Water State Revolving Fund home page (<http://www.epa.gov/owm/cwfinance/cwsrf/index.htm>).

## III. COMPLIANCE REQUIREMENTS

**In developing the audit procedures to test compliance with the requirements for this Federal program, the auditor must determine, from the following summary (also included in Part 2, “Matrix of Compliance Requirements”), which of the 12 types of compliance requirements apply, and then determine which of the applicable requirements is likely to have a direct and material effect on the Federal program at the auditee. For each such requirement, the auditor must use Part 3 (which includes generic details about each compliance requirement other than Special Tests and Provisions) and this program supplement (which includes any program-specific requirements) to perform the audit.**

<i>A.</i> <i>Activities Allowed or Unallowed</i>	<i>B.</i> <i>Allowable Costs/Cost Principles</i>	<i>C.</i> <i>Cash Management</i>	<i>E.</i> <i>Eligibility</i>	<i>F.</i> <i>Equipment and Real Property Management</i>	<i>G.</i> <i>Matching, Level of Effort, Earmarking</i>	<i>H.</i> <i>Period of Performance</i>	<i>I.</i> <i>Procurement and Suspension and Debarment</i>	<i>J.</i> <i>Program Income</i>	<i>L.</i> <i>Reporting</i>	<i>M.</i> <i>Subrecipient Monitoring</i>	<i>N.</i> <i>Special Tests and Provisions</i>
Y	Y	Y	N	N	Y	Y	Y	Y	Y	Y	Y

The audit focus is on a State’s CWSRF program, rather than individual capitalization grants awarded to States by EPA.

### A. Activities Allowed or Unallowed

#### 1. *Financial Assistance*

- a. The CWSRF may provide financial assistance (1) to municipalities, inter-municipal, interstate, or State agencies for the construction of publicly owned treatment works, as defined in section 212 of the Act that are on the State’s project priority list; (2) for implementing nonpoint source management programs under section 319 of the Act; (3) for developing and implementing estuary management plans under section 320 of the Act (33 USC 1383(c)); (4) for the construction, repair or replacement of

decentralized wastewater treatment systems that treat municipal wastewater or domestic sewage; (5) for measures to manage, reduce, treat, or recapture stormwater or subsurface drainage water; (6) to any municipality, or intermunicipal, interstate, or State agency for measures to reduce the demand for publicly owned treatment works capacity through water conservation, efficiency, or reuse; (7) for the development and implementation of watershed projects meeting the criteria set forth in Section 122 of the Act; (8) to any municipality, or intermunicipal, interstate, or State agency for measures to reduce the energy consumption needs for publicly owned treatment works; (9) for reusing or recycling wastewater, stormwater, or subsurface drainage water; (10) for measures to increase the security of publicly owned treatment works; and (11) to any qualified nonprofit entity, as determined by the EPA Administrator, to provide assistance to owners and operators of small and medium publicly owned treatment works to

- (1) plan, develop, and obtain financing for eligible projects under this subsection, including planning, design, and associated preconstruction activities; and,
- (2) assist such treatment works in achieving compliance with the Act.

b. The allowable types of financial assistance under CFDA 66.458 (33 USC 1383(d)) are:

- (1) Making loans (not grants) for eligible projects;
- (2) Buying or refinancing of debt obligations of municipal, intermunicipal, and interstate agencies incurred after March 7, 1985;
- (3) Guaranteeing or purchasing insurance for local debt obligations;
- (4) Using as a source of revenue or security for CWSRF debt obligations (providing that the net proceeds of the sale of such bonds are deposited in the CWSRF); and
- (5) Guaranteeing loan guarantees for similar revolving funds established by municipalities or intermunicipal agencies.

c. Funds awarded under CFDA 66.482 may be used only for projects to reduce flood damage risk and vulnerability or to enhance resiliency to rapid hydrologic change or a natural disaster (Pub. L. No. 113-2, Division A, Title X, 127 Stat. 31).

2. CWSRF funds may be used by States for the reasonable costs of administering and managing the CWSRF (33 USC 1383(d)(7)). See III.G.3.a, “Matching, Level of Effort, Earmarking – Earmarking.”

3. CWSRF funds may be used by States to provide additional subsidization in the form of principal forgiveness, grants, and negative interest loans to municipal, intermunicipal, interstate or State agencies receiving CWSRF assistance. Additional subsidy may be provided to (a) implement a process, material, technique or technology to address water or energy-efficiency goals; (b) mitigate stormwater runoff; (3) encourage sustainable project planning, design and construction; or (4) a municipality that meets the State's affordability criteria or seeks additional subsidization to benefit individual ratepayers in the residential user rate class who would otherwise experience significant financial hardship (33 USC 1383(i)(1). See III.G.3.b, "Matching, Level of Effort, Earmarking – Earmarking."

### **C. Cash Management**

The State may draw cash from EPA through the Automated Clearinghouse (ACH) or the Automated Standard Application for Payments (ASAP) system for:

1. *Loans* – when the CWSRF receives a request from a loan recipient, based on incurred costs, including pre-building and building costs.
2. *Refinance or Purchase of Municipal Debt* – generally, when at a rate no greater than equal amounts over the maximum number of quarters that payments can be made, and up to the amount committed to the refinancing or purchase of the local debt.
3. *Purchase of Insurance* – when insurance premiums are due.
4. *Guarantees and Security for Bonds* – immediately, in the event of imminent default in debt service payments on the guaranteed/secured debt; otherwise, up to an amount dedicated for the guarantee or security based on incurred construction costs.
5. *Administrative Expenses* – cash can be drawn based on a schedule that coincides with the rate at which administrative expenses will be incurred.

(40 CFR section 35.3160)

### **G. Matching, Level of Effort, Earmarking**

#### **1. Matching**

States are required to deposit into the CWSRF from State monies, an amount equal to 20 percent of each grant payment. If the State provides a match in excess of the required amount, the excess balance may be banked toward subsequent match requirements. States generally report the total amount of their matching for a capitalization grant in an annual CWSRF report to EPA. The match is required to be made on or before the time that EPA funds are drawn (40 CFR section 35.3135(b)).

**2. Level of Effort – Not Applicable**

**3. Earmarking**

- a. The maximum amount allowable for administering and managing the CWSRF is an amount equal to 4 percent of the cumulative amount of capitalization grant awards received (less any amounts used in previous years to cover administrative expenses), \$400,000, or 1/5 percent of the current valuation of the fund, whichever is the greatest. The valuation of the fund is defined as the Total Net Position in the most recent year's audited financial statements for the State CWSRF program. When the administrative expense of the CWSRF exceeds the largest of these amounts, the excess must be paid from sources outside the CWSRF (40 CFR section 35.3120(g)).
- b. The FY 2014 appropriation (Pub. L. No. 113-76), which amended provisions in Title VI of the WRRDA of 2014 (Pub. L. No. 113-121), and the Disaster Relief Appropriations Act (Pub. L. No. 113-2, Division A, Title X, 127 Stat. 31) each have requirements to provide subsidies in amounts found in the table below. The FY 2015 appropriation (Pub. L. No. 113-325) allows for, but does not require, a subsidy; the FY 2016 appropriation (Pub. L. No. 114-113) includes both a requirement and an option. The subsidy can be provided in the form of grants, principal forgiveness, or negative interest as specified in III.A.3, "Activities Allowed or Unallowed."

<b>Disaster Relief Funds</b>	<b>FY 2014 Funds</b>	<b>FY 2015 Funds</b>	<b>FY 2016 Funds</b>
Not less than 20 percent and not more than 30 percent of the capitalization amount	Not less than 20 percent and not more than 30 percent of the capitalization amount over \$1 billion	Option of up to 30 percent of the capitalization grant amount	Not less than 10 percent of the capitalization grant amount, in addition to the option of up to 30 percent of the capitalization grant amount for recipients that are municipal, intermunicipal, interstate, or State agencies

- c. To the extent that there are sufficient eligible project applications, no less than 10 percent of appropriated funds shall be used for projects to address green infrastructure, water or energy efficiency improvements or other environmentally innovative activities (Pub. L. No. 112-74; Pub. L. No.113-121; Pub. L. No. 114-113).

## **H. Period of Performance**

1. “Grant payments” from a capitalization grant shall begin in the quarter in which the grant is awarded, and end no later than eight quarters after the grant is awarded, not to exceed 12 quarters from the date of allotment of grant funds to the States (40 CFR section 35.3155(c)).
2. Funds made available for disaster relief activities under CFDA 66.482 are available until expended (Pub. L. No. 113-2, Division A, Title X, 127 Stat. 31).

## **J. Program Income**

1. If States collect fees as a result of loans made with grant funds (i.e., funds awarded by EPA in the capitalization grant) and the fees are not included as principal in the loan, they are considered program income and must be accounted for as indicated below.

The permissible use of fees resulting from loans awarded from a particular capitalization grant varies depending on when the fee is collected.

- a. Regardless of when the funds are used, if the fee is collected during the grant period, i.e., before all funds are disbursed, it may be used under either the addition or cost sharing or matching alternatives for use of program income. Under either alternative or combination of alternatives, use of program income is limited to (1) the activities allowed under section III.A.3, “Activities Allowed or Unallowed;” (2) administrative expenses exceeding the limitations in WRRDA-amended Section 603(d)(7) of the FWPCA (see III.G.3.a, “Matching, Level of Effort, Earmarking – Earmarking”); and (3) State match if program income is deposited outside of the CWSRF Fund.
  - b. Fees collected after the grant period may be used as indicated under paragraph 1.a, above, as well as for other water quality-related purposes and combined financial administration of the CWSRFs and DWSRFs where the programs are administered by the same State agency, provided that the State’s grant conditions include this provision (*Fees Charged by States to Recipients of Clean Water State Revolving Fund Assistance*, (October 20, 2005 *Federal Register*, 70 FR 61039), section II.C).
2. Fees included in loan principal are not considered program income (see III.N.3, “Special Tests and Provisions – Fund Establishment, Loan Repayments, Fund Earnings, and Use of Funds”).

**L. Reporting****1. Financial Reporting**

- a. SF-270, *Request for Advance or Reimbursement* – Not Applicable
- b. SF-271, *Outlay Report and Request for Reimbursement for Construction Programs* – Not Applicable
- c. SF-425, *Federal Financial Report* – Applicable

**2. Performance Reporting** – Not Applicable**3. Special Reporting** – Not Applicable**N. Special Tests and Provisions****1. Environmental Review Requirements**

**Compliance Requirement** – Beginning October 1, 2014, the State must conduct reviews of the potential environmental impacts of all treatment works projects receiving assistance from the CWSRF, including nonpoint source pollution control and estuary protection projects that are also treatment works projects (40 CFR section 35.3140 and the WRRDA (Pub. L. No. 113-121)).

**Audit Objective** – Determine whether the State is performing environmental reviews before construction proceeds.

**Suggested Audit Procedures**

- a. Inquire of CWSRF management about the environmental review procedures in place.
- b. Select a sample of projects that began during the year to ascertain that the decisions were rendered prior to the project proceeding and were approved in the State environmental review process.

**2. Binding Commitments**

**Compliance Requirement** – A “binding commitment” is a legal obligation by a State to a local recipient that defines the terms for assistance under the CWSRF. Cumulative binding commitments must equal at least 120 percent of cumulative capitalization grant payments received one year earlier. Binding commitments requirements are intended to help ensure that the State utilizes grant funds in a timely manner. EPA may withhold future payments and require adjustments to the payment schedules before releasing further payments if the State does not meet the binding commitment requirement. States generally report the total amount of their binding commitments in an annual CWSRF report to EPA (40 CFR sections 35.3135(c) and 35.3165(a)).

**Audit Objective** – Determine whether States have complied with the requirement to make binding commitments equal to or greater than 120 percent of the amount of the capitalization grants.

**Suggested Audit Procedures**

- a. Review binding commitments in conjunction with EPA payment schedules to ascertain if the State entered into cumulative binding commitments in an amount at least equal to 120 percent of the cumulative grant payments received one year earlier (i.e., cumulative binding commitments in the current year should be equal to or greater than 120 percent of cumulative grant payments made through the previous year).
- b. Test a sample of binding commitments reported by the State to verify that the amount and date agree with supporting documentation.

**3. Fund Establishment, Loan Repayments, Fund Earnings, and Use of Funds**

**Compliance Requirements** – The State shall establish a separate account or series of accounts that is dedicated solely to providing loans and other forms of financial assistance. All loan repayments (including principal and interest), interest earnings on investments, capitalization grants, State match, and transfers from the DWSRF must be credited directly to the CWSRF. Repayment of loans shall begin within one year after project completion, and loans shall be fully amortized over not more than 30 years after project completion or the useful life of the project (40 CFR sections 35.3110(b) and 35.3120(a); the policy statement titled *Transfer and Cross-Collateralization of Clean Water Revolving Funds and Drinking Water State Revolving Funds* published in the October 13, 2000, *Federal Register* (65 FR 60940; and WRRDA, Section 5003)). Fees included in loan principal must be used as provided in *Fees Charged by States to Recipients of Clean Water State Revolving Fund Assistance*, section I.

**Audit Objectives** – Determine whether the State has a separate account or series of accounts for the CWSRF. Determine whether principal and interest payments, interest earnings on investments, capitalization grants, State match, and transfers from the DWSRF, were properly credited to the CWSRF. Determine whether fees included in loan principal were used for authorized purposes.

**Suggested Audit Procedures**

- a. Ascertain if the CWSRF is a separate account, or series of accounts, dedicated solely to purposes of the program.
- b. Test a sample of projects funded by the CWSRF and for which repayments were due during the year to determine that principal and interest payments were properly credited to the CWSRF accounts and, if spent, were used for authorized purposes.



- c. Test a sample of loan agreements and other project records to ascertain if the repayments began within one year of project completion and the loans are scheduled for full amortization within 30 years or the useful life of the project.
- d. Obtain a list of investments made during the year and ascertain if earnings on investments were properly recorded in the CWSRF.

#### 4. CWSRF as Security for Bonds

**Compliance Requirement** – When funds from the CWSRF are used as security or as a source of revenue for the payment of principal and interest on revenue or general obligation bonds issued by the State, the net proceeds (i.e., funds raised from the sale of bonds less issuance costs) of the sale of such bonds must be deposited in the CWSRF (40 CFR section 35.3120(d)). Generally, bond proceeds are deposited in accounts established by the bond trust indenture and identified in the Official Offering Statement. This requirement includes the situation where the State employs the cross-collateralization process permitted by the CWSRF program. Cross-collateralization allows for certain assets of both the DWSRF and the CWSRF programs to be pledged as collateral for a single or joint bond issue in proportion to the assets offered as collateral. Proportionality may be achieved at different levels of security: (1) at reserve level; (2) at loan repayment level; or (3) using an alternative structure approved by EPA (40 CFR section 35.3530(d)) and the policy statement titled *Transfer and Cross-Collateralization of Clean Water Revolving Funds and Drinking Water State Revolving Funds* published in the October 13, 2000, *Federal Register* (65 FR 60940)).

**Audit Objective** – Determine whether the State placed the net proceeds from the sale of bonds guaranteed by the CWSRF into the CWSRF.

#### Suggested Audit Procedures

- a. Review bond documentation and trace amounts qualifying as net proceeds to accounts in the CWSRF.
- b. Ascertain that the net bond proceeds were deposited into the CWSRF.
- c. If the State has employed a cross-collateralization technique, ascertain that the net proceeds deposited into the CWSRF were proportionate to the assets offered as collateral.

#### 5. American Iron and Steel (AIS)

**Compliance Requirement** – Pub. L. No. 113-76, Consolidated Appropriations Act, 2014, Section 436, requires that, unless exempted by the Administrator of the Environmental Protection Agency, all iron and steel products used for a CWSRF project for the construction, alteration, maintenance or repair of treatment work are produced in the United States. This requirement does not apply with respect to a projects prior to January 17, 2014 if a State agency approved the engineering plans and specifications for the project, in that agency's capacity to approve such plans and specifications prior to a

project requesting bids. Additional information is available at [http://water.epa.gov/grants\\_funding/aisrequirement.cfm](http://water.epa.gov/grants_funding/aisrequirement.cfm).

**Audit Objective** – Determine whether treatment works funded by the CWSRF used only iron and steel produced in the United States, unless the EPA Administrator has issued a waiver of this requirement.

### **Suggested Audit Procedures**

#### *State Agencies*

Select sample of CWSRF loan agreements and determine if AIS contract language has been included in the agreement(s). If not, ensure that the State made a proper determination that AIS requirements were not applicable.

#### *Subrecipients*

- a. Select a sample of treatment works disbursement invoices.
- b. Review invoices and supporting documentation from suppliers, vendors, and contractors to identify the source of iron and steel materials used in project construction.
- c. If any iron or steel material was not manufactured in the United States, determine whether a waiver has been issued by the EPA Administrator.

### **6. Fiscal Sustainability Plans**

**Compliance Requirement** – WRRDA-amended FWPCA section 603(d)(1)(E) requires a recipient of a loan for a project that involves repair, replacement or expansion of a treatment works to develop and implement a fiscal sustainability plan (FSP) or certify that it has developed and implemented such a plan. This requirement applies to all loans for which the applicant submitted an application to the State CWSRF program on or after October 1, 2014. The FSP must include (1) an inventory of critical assets that are part of the treatment works; (2) an evaluation of the condition and performance of inventoried assets or asset groupings; (3) a certification that the recipient has evaluated and will be implementing water and energy conservation efforts as part of the plan; and (4) a plan for maintaining, repairing, and as necessary, replacing the treatment works and a plan for funding such activities. At a minimum, State CWSRF programs must require loan recipients to certify that an FSP has been developed and is being implemented. CWSRF programs are not required to collect FSPs, but may choose to review the FSP during onsite inspections, if deemed necessary.

**Audit Objective** – Determine whether the State obtains FSP certifications from loan recipients or is confirming FSPs through on-site inspections.

### **Suggested Audit Procedures**

- a. Select a sample of CWSRF loans awarded during the audit period.
- b. Verify that FSP certifications were submitted to the State by the loan recipients or were obtained by the State obtained during on-site inspections.

### **7. Cost Effectiveness Analysis Certification**

**Compliance Requirement** – Beginning October 1, 2015, States are required, as a condition of providing a subaward to a municipality or intermunicipal, interstate, or State agency, to obtain a certification that the receiving entity has conducted a cost and effectiveness analysis (33 USC 1382(b)).

CWSRFs can provide assistance for planning and/or engineering activities that would be covered by this analysis before receiving the certification; however, the certification must be provided before CWSRF assistance is provided for final design or construction. If planning, design and construction activities are combined into one subaward, the subaward must be conditioned such that the certification is provided before a subrecipient is allowed to proceed with final design or construction.

**Audit Objective** – Determine whether the State obtains a cost and effectiveness certification from subrecipients prior to providing CWSRF assistance for final design or construction.

### **Suggested Audit Procedures**

- a. Determine if the State has developed written procedures that require a cost and effectiveness analysis as part of the subaward process, including the need for a certification, how that certification is to be provided, and the required timing of submission.
- b. Select a sample of CWSRF loans awarded during the audit period for which applications were received after October 1, 2015 and verify that cost and effectiveness certifications were submitted to the State by the subrecipients prior to the State providing CWSRF assistance for final design or construction.

## **IV. OTHER INFORMATION**

### *Subrecipients*

CWSRF amounts are awarded by EPA to States as grants. The States then makes subawards in the form of loans to its subrecipients. Therefore, in determining the amount of Federal funds expended to be reported on the Schedule of Expenditures of Federal Awards (SEFA), subrecipients receiving CWSRF loans should include project expenditures incurred under these loans during the audit period as provided in 2 CFR section 200.502(a). These are subawards—not direct Federal loans—and, therefore, neither 2 CFR sections 200.502(b) or (d) apply when calculating the amount of Federal funds expended.

It also is important to appropriately identify these CWSRF loans as subawards because of the impact on which Federal agency is the cognizant or oversight agency. When completing the SF-SAC, the subrecipient should indicate that a CWSRF loan received from the State is not a direct award by showing an “N” in Part III, Item 6(h).

### *Equivalency*

To achieve consistency in meeting program requirements and eliminate the possibility of over-reporting information under the Federal Funding Accountability and Transparency Act (Transparency Act), State CWSRF programs must use the same group of loans for the purpose of meeting Federal cross-cutting, single audit, procurement, and Transparency Act reporting requirements.

## ENVIRONMENTAL PROTECTION AGENCY

### **CFDA 66.468 CAPITALIZATION GRANTS FOR DRINKING WATER STATE REVOLVING FUNDS**

### **CFDA 66.483 DISASTER RELIEF APPROPRIATIONS ACT (DRAA) HURRICANE SANDY CAPITALIZATION GRANTS FOR DRINKING WATER STATE REVOLVING FUNDS**

#### **I. PROGRAM OBJECTIVES**

Capitalization grants are awarded to States to create and maintain Drinking Water State Revolving Funds (DWSRF) programs. States can use capitalization grant funds to establish a revolving loan fund (DWSRF) to assist public water systems finance the costs of infrastructure needed to achieve or maintain compliance with Safe Drinking Water Act (SDWA) requirements and protect the public health objectives of the Act. The DWSRF can be used to provide loans and other types of financial assistance for qualified communities, local agencies, and private entities. States may also set aside certain percentages of their capitalization grant or allotment for various activities that promote source water protection and enhanced water systems management.

#### **II. PROGRAM PROCEDURES**

The DWSRF program is established in each State by capitalization grants from the Environmental Protection Agency (EPA) and State match equaling 20 percent of the EPA capitalization grants. EPA implements the DWSRF program in a manner that preserves flexibility for States in operating their program in accordance with their unique needs and circumstances. States have the flexibility to set aside up to 31 percent of their capitalization grants for other related activities. States may also transfer an amount up to 33 percent of its DWSRF capitalization grant to the Clean Water State Revolving Fund (CWSRF) (CFDA 66.458) or an equivalent amount from the CWSRF to the DWSRF program. A State may transfer capitalization grant dollars, State match, investment earnings, or principal and interest repayments.

Capitalization grant agreements include (1) an application; (2) an Intended Use Plan (IUP), which describes how the State intends to use funds made available to it, including a list of proposed projects eligible for financing and a description of the financial status of the program; (3) a proposed payment schedule; (4) certain certifications and demonstrations which can be included in an optional operating agreement; and (5) workplans containing a least a general description of the use of set-aside funds.

The State must annually provide an IUP which describes how the State will use available DWSRF program funds for the year to meet the objectives of the SDWA and further the goal of protecting public health. The IUP explains how all of the funds available to the DWSRF program (including bond proceeds, interest earnings, loan repayments, Federal capitalization grants, State match, etc.) will be expended (40 CFR section 35.3555).

EPA conducts Annual Review of State programs to assess the success of each program.

The Disaster Relief Appropriations Act (Pub. L. No. 113-2) provided funds for awards to the States of New York and New Jersey for drinking water facilities impacted by Hurricane Sandy. EPA awarded these funds under CFDA 66.483. Those funds are subject to all of the compliance requirements that apply to CFDA 66.468 except as indicated in III, “Compliance Requirements,” in this program supplement.

### Source of Governing Requirements

This program is authorized under Section 1452 of the Public Health Service Act (Title XIV), commonly known as the SDWA (42 USC 300j-12) and the Disaster Relief Appropriations Act, 2013 (Pub. L. No. 113-2). The implementing regulations for the program can be found at 40 CFR part 35, subpart L.

### Availability of Other Program Information

Other general information about the program is available on the EPA Drinking Water State Revolving Fund home page (<http://www.epa.gov/safewater/dwsrf.html>).

## III. COMPLIANCE REQUIREMENTS

**In developing the audit procedures to test compliance with the requirements for this Federal program, the auditor must determine, from the following summary (also included in Part 2, “Matrix of Compliance Requirements”), which of the 12 types of compliance requirements apply, and then determine which of the applicable requirements is likely to have a direct and material effect on the Federal program at the auditee. For each such requirement, the auditor must use Part 3 (which includes generic details about each compliance requirement other than Special Tests and Provisions) and this program supplement (which includes any program-specific requirements) to perform the audit.**

<i>A.</i> <i>Activities Allowed or Unallowed</i>	<i>B.</i> <i>Allowable Costs/Cost Principles</i>	<i>C.</i> <i>Cash Management</i>	<i>E.</i> <i>Eligibility</i>	<i>F.</i> <i>Equipment and Real Property Management</i>	<i>G.</i> <i>Matching, Level of Effort, Earmarking</i>	<i>H.</i> <i>Period of Performance</i>	<i>I.</i> <i>Procurement and Suspension and Debarment</i>	<i>J.</i> <i>Program Income</i>	<i>L.</i> <i>Reporting</i>	<i>M.</i> <i>Subrecipient Monitoring</i>	<i>N.</i> <i>Special Tests and Provisions</i>
Y	Y	Y	N	N	Y	Y	Y	Y	Y	Y	Y

The audit focus is on a State’s DWSRF program, rather than individual capitalization grants awarded to States by EPA.

**A. Activities Allowed or Unallowed**

1. The DWSRF program may provide the following financial assistance to publicly or privately owned community water systems and non-profit non-community water systems for eligible drinking water infrastructure projects (40 CFR sections 35.3520 and 35.3525):
  - a. Making loans for eligible projects (40 CFR section 35.3520(b)).
  - b. Purchasing or refinancing existing debt obligations of municipal, intermunicipal and interstate agencies entered into on or after July 1, 1993.
  - c. Guarantee of or purchasing insurance for local debt obligations.
  - d. Providing a source of revenue or security for DWSRF debt obligations, provided that the net proceeds of the sale of such debt obligations are deposited in the DWSRF.
  - e. Funds awarded under CFDA 66.483 may be used only for projects to reduce flood damage risk and vulnerability or to enhance resiliency to rapid hydrologic change or a natural disaster (Pub. L. No. 113-2, Division A, Title X, 127 Stat. 31).
2. A State may set aside funds for the following designated set-aside activities (40 CFR section 35.3535):
  - a. Administrative expenses (including technical assistance).
  - b. Technical assistance to small water systems that regularly serve 10,000 or fewer persons (40 CFR section 35.3505).
  - c. State program management.
  - d. Local assistance and other State programs.
3. The DWSRF may not provide assistance for (40 CFR sections 35.3520(d) through (f)):
  - a. Dams or reservoirs, water rights, laboratory fees for monitoring, system operation and maintenance, or projects that are primarily fire protection.
  - b. Expansion projects pursued solely in anticipation of future growth.

## C. Cash Management

The State may draw cash through the Automated Clearing House (ACH) or the Automated Standard Application for Payments (ASAP) system for (40 CFR sections 35.3560 and 35.3565):

1. *Loans* – when the DWSRF receives a request from a loan recipient, based on incurred costs, including pre-building and building costs.
2. *Refinance or Purchase of Municipal Debt* – generally, at a rate not greater than equal amounts over the maximum number of quarters that payments can be made, and up to the amount committed to the refinancing or purchase of the local debt. A State may immediately draw cash for up to the greater of \$2 million or 5 percent of each fiscal year's capitalization grant to refinance costs.
3. *Purchase of Insurance* – when insurance premiums are due.
4. *Guarantees and Security for Bonds* – immediately, in the event of imminent default in debt service payments on the guaranteed/secured debt; otherwise, up to the amount dedicated for the guarantee or security based on actual construction cost.
5. *Set-Asides* – generally, on an incurred cost basis after workplans have been approved by EPA (40 CFR section 35.3560(e)).

## G. Matching, Level of Effort, Earmarking

### 1. Matching

- a. States are required to deposit into the DWSRF from State monies an amount equal to 20 percent of each grant payment. The match is required to be made on or before the time that EPA funds are drawn. When a letter of credit (LOC) mechanism or similar financial arrangement is used for the State match, payments to the LOC account must be made proportionally on the same schedule as payments for the capitalization grant. Monies from this State match LOC must be drawn into the DWSRF as monies are drawn on the Federal automated clearinghouse account. A State may issue general obligation or revenue bonds to derive the State match. If the State provides a match in excess of the required amount, the excess balance may be banked toward subsequent match requirements (40 CFR section 35.3550(g)).
- b. In the case of the State Program Management set-aside, the State must also provide an amount equal to 100 percent of said payments. A State is authorized to use the amount of State funds expended on its Public Water System Supervision (PWSS) program in fiscal year 1993 (including PWSS match) as a credit toward meeting its match requirement. The value of this credit can be up to, but not greater than, 50 percent of the



amount of match that is required. A State must provide the additional funds necessary to meet the remainder of the match requirement. The sources of these additional funds can be State monies (excluding PWSS match) or documentation of in-kind services. Although required PWSS match cannot be used as a source of additional State monies, State overmatch can be used (40 CFR sections 35.3535(d)(2) and 35.3550(h)).

**2. Level of Effort – Not Applicable**

**3. Earmarking**

- a. Up to 31 percent of the allotment can be earmarked for set-aside activities as follows:
- (1) *Administrative Expenses* – Not to exceed 4 percent of the cumulative allotment (40 CFR section 35.3535(b)).
  - (2) *Technical Assistance to Small Systems* – Not to exceed 2 percent of the cumulative allotment (40 CFR section 35.3535(c)).
  - (3) *State Program Management* – Not to exceed 10 percent of the cumulative allotment (40 CFR section 35.3535(d)).
  - (4) *Local Assistance and Other State Programs* – Not to exceed 15 percent of the capitalization grant and no more than 10 percent is used on any one of the defined activities (40 CFR section 35.3535(e)).
- b. A State cannot use more than 30 percent of any particular fiscal year's capitalization grant to provide subsidies in the form of principal forgiveness or negative interest rate loans to communities meeting the State's definition of disadvantaged, or communities the State expects to become disadvantaged as a result of the project (40 CFR section 35.3525(b)).
- c. EPA's DWSRF appropriations include the following requirements:
- (1) The Disaster Relief Appropriations Act (Pub. L. No. 113-2, Division A, Title X, 127 Stat. 31), the FY 2014 appropriation (Pub. L. No. 113-76), FY 2015 appropriation (Pub. L. No. 113-235), and the FY 2016 appropriation (Pub. L. No. 114-113), each have requirements to provide subsidy in amounts found in the table below. This subsidy can be provided in the form of grants, principal forgiveness, or negative interest.

<b>Disaster Relief Funds</b>	<b>FY 2014 Funds</b>	<b>FY 2015 Funds</b>	<b>FY 2016 Funds</b>
Not less than 20 percent and not more than 30 percent of the capitalization amount	Not less than 20 percent and not more than 30 percent of the capitalization grant amount	Not less than 20 percent and not more than 30 percent of the capitalization grant amount	20 percent of the capitalization grant amount

- (2) The decision to maintain a category of projects for green infrastructure, water and energy efficiency, and other environmentally innovative activities is at the State's discretion (Pub. L. No. 113-76, Pub. L. No. 113-235, and Pub. L. No. 114-113).

#### **H. Period of Performance**

1. Grant payments from a capitalization grant, which increase the ceiling of funds from which a State may draw cash for eligible costs, shall begin no earlier than the quarter in which the grant is awarded, and generally end no later than eight quarters after the grant is awarded, not to exceed 12 quarters from the date of allotment of grant funds to the States. State must obligate funds for eligible projects within one year of accepting a payment. States disburse, or liquidate, grant funds for projects in accordance with construction schedules. Funds are disbursed for set-aside activities in accordance with costs being incurred under approved workplans (40 CFR sections 35.3550(e) and 35.3560).
2. Funds made available for disaster relief activities under CFDA 66.483 are available until expended (Pub. L. No 113-2, Division A, Title X, 127 Stat. 31).

#### **J. Program Income**

The State may charge fees to process, manage, or review an application for Federal assistance. Such fees may be collected in an account outside the DWSRF and used to supplement administrative expenses and for other allowable purposes for which a grant is awarded under 42 USC 300j-12. However, if these fees are deposited into the DWSRF, they are subject to the uses of the DWSRF, which do not include the use of funds for administrative purposes (40 CFR section 35.3530(b)).

#### **L. Reporting**

##### **1. Financial Reporting**

- a. SF-270, *Request for Advance or Reimbursement* – Not Applicable

- b. SF-271, *Outlay Report and Request for Reimbursement for Construction Programs* – Not Applicable
  - c. SF-425, *Federal Financial Report* – Applicable
2. **Performance Reporting** – Not Applicable
  3. **Special Reporting** – Not Applicable

## N. **Special Tests and Provisions**

### 1. **Environmental Review Requirements**

**Compliance Requirement** – The State must conduct reviews of the potential environmental impacts of all infrastructure projects and those set-aside activities that impact the quality of the human environment receiving assistance from the DWSRF program. A State Environmental Review Process (SERP) that is equivalent to a National Environmental Policy Act (NEPA) review must be performed on projects and activities with cumulative costs equal to the annual capitalization grant. Other projects must be reviewed under an alternative SERP (40 CFR section 35.3580).

**Audit Objective** – Determine whether the State performed environmental reviews before projects and activities proceeded.

#### **Suggested Audit Procedures**

- a. Inquire of DWSRF management about the environmental review procedures in place.
- b. Select a sample of projects that began during the year to ascertain that decisions were rendered prior to the project proceeding and were reviewed in accordance with the SERP.

### 2. **Binding Commitments**

**Compliance Requirement** – A “binding commitment” is a legal obligation by a State to a local recipient that defines the terms for assistance under the DWSRF program. Cumulative binding commitments must be made in an amount equal to the amount of each grant payment plus the required State match that is deposited into the DWSRF within one year after the receipt of each grant payment. Payments for set-asides are not included in the binding commitment calculation. Binding commitment requirements are intended to help ensure that the State utilizes grant funds in a timely manner. A State may initiate an adjustment to payment schedules if the State believes that it will not meet the binding commitment requirement. States generally report the total amount of their binding commitments in the Biennial Report to EPA (40 CFR section 35.3550(e)).

**Audit Objective** – Determine whether the State complied with the requirements to make binding commitments in an amount equal to the amount of each grant payment plus the required State match deposited into the DWSRF within one year after the receipt of each grant payment.

### **Suggested Audit Procedures**

- a. Review binding commitments in conjunction with the EPA payment schedules to ascertain if the State entered into binding commitments in an amount equal to the cumulative amount of grant payments plus the cumulative required State match deposited into the Fund, less cumulative set-aside funds, within one year after the receipt of each grant payment.
- b. Test a sample of binding commitments reported by the State to verify that the amount and date agree with supporting documentation.

### **3. Deposits to DWSRF**

**Compliance Requirements** – The State shall establish a separate account, or series of accounts, that is dedicated solely to providing loans and other forms of financial assistance from the DWSRF. All loan repayments (including principal and interest) interest earnings on investments, capitalization grants (except that portion the State intends to use as set-asides), State match and transfers from the CWSRF must be credited directly to the DWSRF. A State must maintain separate and identifiable accounts for the portion of the capitalization grant to be used for set-aside activities (40 CFR sections 35.3550(f) and (g)).

Transfers between the DWSRF and CWSRF must be approved by the State Governor (40 CFR section 35.3530(c)). Generally, repayment of loans shall begin within one year after project completion, and loans shall be fully amortized over not more than 20 years after project completion, with the exception that loans to qualified disadvantaged communities can be amortized over 30 years (40 CFR sections 35.3525(a) and (b)(3)). A State's DWSRF program may extend term financing to a project through the purchase of municipal debt at terms of up to 30 years without the project being required to meet the State definition of "disadvantaged." However, a State DWSRF program must receive approval by its EPA Regional Administrator to do so (42 USC 300j-12).

**Audit Objectives** – Determine whether the State has a separate account or series of accounts for the DWSRF program. Determine whether principal and interest payments, interest earnings on investments, set-aside funds, applicable portions of capitalization grants, and State match were credited to the appropriate accounts.

### **Suggested Audit Procedures**

- a. Ascertain if the DWSRF is a separate account, or series of accounts, dedicated solely to purposes of the program and that the set-aside funds are deposited into a separate accounts identified for the use of set-aside activities.

- b. Test a sample of projects funded by the DWSRF and for which repayments were due during the year to determine that principal and interest payments were properly credited directly to the DWSRF.
- c. Test a sample of loan agreements and other project records to ascertain if the repayments began within one year of project completion and the loans are scheduled for full amortization within the allowed time period (usually 20 years, 30 years for loans to disadvantaged communities, or up to 30 years for projects with approved extended term financing).
- d. Obtain a list of investments made during the year and ascertain if earnings on investments were directly credited to the DWSRF account.
- e. Obtain cash draw records or reports from the EPA Regional office and ascertain if cash draws were directly credited to the DWSRF account and the appropriate State match was deposited.
- f. Ascertain if a transfer of funds between the DWSRF and CWSRF programs occurred and if the transfer was approved by the State Governor.

#### 4. DWSRF as Security for Bonds

**Compliance Requirement** – When funds from the DWSRF are used as security or as a source of revenue for the payment of principal and interest on revenue or general obligation bonds issued by the State, the net proceeds (i.e., funds raised from the sale of bonds less issuance costs) of the sale of such bonds must be deposited in the DWSRF (40 CFR section 35.3525(e)). Generally bond proceeds are deposited in accounts established by the bond trust indenture and identified in the Official Offering Statement. This requirement includes the situation where the State employs the cross-collateralization process permitted by the DWSRF program. Cross-collateralization allows for certain assets of both the DWSRF and the CWSRF programs to be pledged as collateral for a single or joint bond issue in proportion to the assets offered as collateral. Proportionality may be achieved at different levels of security: (1) at reserve level; (2) at loan repayment level; or (3) using an alternative structure approved by EPA (40 CFR section 35.3530(d)).

**Audit Objective** – Determine whether the State properly deposited and recorded the net proceeds from the sale of bonds guaranteed by the DWSRF into the DWSRF.

#### Suggested Audit Procedures

- a. Review bond documentation and trace amounts qualifying as net proceeds to the appropriate accounts in the DWSRF.
- b. Ascertain that the net bond proceeds were deposited into the DWSRF.

- c. If the State has employed a cross-collateralization technique, ascertain that the net proceeds deposited into the DWSRF were proportionate to the assets offered as collateral.

## 5. Repayment of Set-Aside Loans

**Compliance Requirement** – Assistance from the Local Assistance and Other State Programs set-aside for assistance for land acquisition or conservation easements for source water protection of a public water system or for implementation of voluntary, incentive-based source water quality protection measures for a community water system must be made in the form of a loan which must be repaid within 20 years after completion of the project. Principal and interest payments on these and other set-aside loans must be placed in the DWSRF or in a separate dedicated account or accounts for use of the same set-aside activity in accordance with 40 CFR section 35.3535(e)(2).

**Audit Objective** – Determine whether principal and interest payments on set-aside loans were directly credited to the DWSRF or a separate account to be used for the same set-aside activity.

### Suggested Audit Procedures

Test a sample of set-aside loan repayments to ascertain that they were credited to the DWSRF or in a separate dedicated account or accounts for loans made under the set-asides.

## 6. American Iron and Steel (AIS)

**Compliance Requirement** – Pub. L. No. 113-76, Consolidated Appropriations Act, 2014, Section 436, requires that, unless exempted by the EPA Administrator, all iron and steel products used for a DWSRF project for the construction, alteration, maintenance, or repair of treatment work are produced in the United States. This requirement does not apply with respect to a projects prior to January 17, 2014 if a State agency approved the engineering plans and specifications for the project, in that agency's capacity to approve such plans and specifications prior to a project requesting bids. Additional information is available at [http://water.epa.gov/grants\\_funding/aisrequirement.cfm](http://water.epa.gov/grants_funding/aisrequirement.cfm).

**Audit Objective** – Determine whether treatment works funded by the DWSRF used only iron and steel produced in the United States, unless the EPA Administrator has issued a waiver of this requirement.

### Suggested Audit Procedures

#### *State Agencies*

Select sample of DWSRF loan agreements and determine if AIS contract language has been included in the agreement(s). If not, ensure that the State made a proper determination that AIS requirements were not applicable.

*Subrecipients*

- a. Select a sample of treatment works disbursement invoices.
- b. Review invoices and supporting documentation from suppliers, vendors, and contractors to identify the source of iron and steel materials used in project construction.
- c. If any iron or steel material was not manufactured in the United States, determine whether a waiver has been issued by the EPA Administrator.

**IV. OTHER INFORMATION***Subrecipients*

DWSRF amounts are awarded by EPA to States as grants. The States then makes subawards in the form of loans to its subrecipients. Therefore, in determining the amount of Federal funds expended to be reported on the Schedule of Expenditures of Federal Awards (SEFA), subrecipients receiving DWSRF loans should include project expenditures incurred under these loans during the audit period as provided in OMB Circular A-133 §\_\_205(a)/2 CFR section 200.502(a). These are subawards—not direct Federal loans—and, therefore, neither OMB Circular A-133 §\_\_.205(b) nor §\_\_.205(d)/2 CFR sections 200.502(b) or (d) apply when calculating the amount of Federal funds expended.

It also is important to appropriately identify these DWSRF loans as subawards because of the impact on which Federal agency is the cognizant or oversight agency. When completing the SF-SAC, the subrecipient should indicate that a DWSRF loan received from the State is not a direct award by showing an “N” in Part III, Item 6(h).

*Equivalency*

To achieve consistency in meeting program requirements and eliminate the possibility of over-reporting information under the Federal Funding Accountability and Transparency Act (Transparency Act), State DWSRF programs must use the same group of loans for the purpose of meeting Federal cross-cutting, single audit, procurement, and Transparency Act reporting requirements.