

The EPA Should Improve Annual Reviews to Protect Infrastructure Investment and Jobs Act Grants to Clean Water State Revolving Funds

March 14, 2024 | Report No. 24-P-0028



Report Contributors

Brenda Carey-DiGregorio

Ethan Celsa

Kevin N. King

Judith Reilly

Ginger Reynolds

Abbreviations

C.F.R.	Code of Federal Regulations
CWSRF	Clean Water State Revolving Fund
EPA	U.S. Environmental Protection Agency
FY	Fiscal Year
IIIA	Infrastructure Investment and Jobs Act
OIG	Office of Inspector General
OMB	Office of Management and Budget
SFY	State Fiscal Year
SRF	State Revolving Fund
U.S.C.	United States Code

Cover Image

Beach with water infrastructure and discharge. (EPA image)

Are you aware of fraud, waste, or abuse in an EPA program?

EPA Inspector General Hotline

1200 Pennsylvania Avenue, NW (2431T)

Washington, D.C. 20460

(888) 546-8740

(202) 566-2599 (fax)

OIG.Hotline@epa.gov

Learn more about our [OIG Hotline](#).

EPA Office of Inspector General

1200 Pennsylvania Avenue, NW (2410T)

Washington, D.C. 20460

(202) 566-2391

www.epaoig.gov

Subscribe to our [Email Updates](#).

Follow us on X (formerly Twitter) [@EPAoig](#).

Send us your [Project Suggestions](#).



At a Glance

The EPA Should Improve Annual Reviews to Protect Infrastructure Investment and Jobs Act Grants to Clean Water State Revolving Funds

Why We Did This Audit

To accomplish this objective:

The U.S. Environmental Protection Agency Office of Inspector General conducted this audit to determine whether the EPA is prepared to oversee, through its annual review process, the Infrastructure Investment and Jobs Act funds invested in the Clean Water State Revolving Fund Program.

Since its inception in 1987, this program has provided more than \$172 billion to states to help improve water quality. And in 2021, as part of the Infrastructure Investment and Jobs Act, Congress provided supplemental appropriations of about \$12.7 billion for the program. Congress appropriated these funds from fiscal year 2022 through 2026, and the money is available until expended.

The Clean Water Act, as amended, requires the EPA to conduct an annual oversight review of each state's Clean Water State Revolving Fund. EPA regional offices perform these reviews under the guidance of the Office of Water.

To support this EPA mission-related effort:

- *Ensuring clean and safe water.*

To address this top EPA management challenge:

- *Managing grants, contracts, and data systems.*

Address inquiries to our public affairs office at (202) 566-2391 or OIG.PublicAffairs@epa.gov.

[List of OIG reports.](#)

What We Found

The EPA's Office of Water has not always ensured the EPA regional offices adhered to the Clean Water State Revolving Fund, or CWSRF, annual review guidance. For example, EPA regions did not always answer review checklist questions completely or support their recommendations in their checklists. The Office of Water also does not consistently monitor annual reviews performed by the regional offices. Region 6, for example, identified a growing \$98.7 million balance of loan origination fees in the Texas CWSRF in state fiscal year 2021. While the region recommended that the state spend the fees annually, the Office of Water did not follow up or provide additional guidance regarding the funds.

Additionally, the Office of Water's annual review guidance on CWSRF audit requirements is inconsistent with program regulations at 40 C.F.R. § 35.3165(d), which implement the Clean Water Act audit requirements, codified at 33 U.S.C. § 1386(b). Those regulations require an annual audit of the CWSRF's financial statements and its compliance with state revolving fund program requirements. The Office of Water's existing annual review guidance advises regional staff that a state can substitute a statewide audit for an audit of the CWSRF; however, a statewide audit does not always include testing of or reporting on the CWSRF's financial statements or compliance with CWSRF program requirements.

During fiscal year 2022 through 2026, the EPA will receive about \$12.7 billion in Infrastructure Investment and Jobs Act funds for CWSRF grants, in addition to an estimated \$4.2 billion in regular annual appropriations. Without proper oversight of the annual review process, these funds will be more susceptible to fraud, waste, and abuse, and the success of the CWSRF Program may be at risk.

Recommendations and Planned Agency Corrective Actions

To improve annual reviews, we recommend that the Office of Water implement procedures to ensure consistent oversight, including creating a system for tracking the resultant recommendations. We recommend that the Office of Water update the annual review guidance regarding fees and audits. We also recommend that the assistant administrator for Water, in coordination with the associate administrator for Policy, update the EPA's regulations implementing the CWSRF audit requirement at 33 U.S.C. § 1386(b) to ensure that they clearly articulate the requirements and the EPA's expectations regarding audits of state revolving funds. The Office of Water agreed with our recommendations and provided acceptable corrective actions and estimated completion dates. We consider the recommendations resolved with corrective actions pending.

Noteworthy Achievements

As a result of our audit, the Office of Water took immediate action to implement processes for improving oversight, including reviewing all program evaluation reports and tracking and monitoring required action items year to year. The Office of Water also informed us that it is in the process of updating the CWSRF regulations to ensure that they are reflective of oversight needs.



OFFICE OF INSPECTOR GENERAL
U.S. ENVIRONMENTAL PROTECTION AGENCY

March 14, 2024

MEMORANDUM

SUBJECT: The EPA Should Improve Annual Reviews to Protect Infrastructure Investment and Jobs Act Grants to Clean Water State Revolving Funds
Report No. 24-P-0028

FROM: Sean W. O'Donnell, Inspector General *Sean W O'Donnell*

TO: Bruno Pigott, Acting Assistant Administrator
Office of Water

This is our report on the subject audit conducted by the U.S. Environmental Protection Agency Office of Inspector General. The project number for this audit was [OA-FY23-0047](#). This report contains findings that describe the problems the OIG has identified and corrective actions the OIG recommends. Final determinations on matters in this report will be made by EPA managers in accordance with established audit resolution procedures.

The EPA's Office of Water develops the policy, guidance, and checklists for the Clean Water State Revolving Fund Program that the EPA regions use to conduct the annual reviews of each of their states. In addition, the Office of Water trains the regions on the laws, regulations, policies, and guidance related to the Clean Water State Revolving Fund annual reviews. The Office of Water collects the annual review checklists, worksheets, and program evaluation reports and follows up with the regions on select findings and recommendations made to the states.

In accordance with EPA Manual 2750, your office provided acceptable planned corrective actions and estimated milestone dates in response to OIG recommendations. Your office also provided an appendix with additional comments from the regions, which we reviewed and addressed in this report as appropriate. All recommendations are resolved, and no final response to this report is required. If you submit a response, however, it will be posted on the OIG's website, along with our memorandum commenting on your response. Your response should be provided as an Adobe PDF file that complies with the accessibility requirements of section 508 of the Rehabilitation Act of 1973, as amended. The final response should not contain data that you do not want to be released to the public; if your response contains such data, you should identify the data for redaction or removal along with corresponding justification.

We will post this report to our website at www.epaoig.gov.

Table of Contents

Chapters

1	Introduction	1
	Purpose.....	1
	Background.....	1
	Responsible Offices	8
	Noteworthy Achievements.....	8
	Scope and Methodology.....	8
	Prior Reports.....	9
2	The Office of Water Did Not Consistently Monitor the Performance and Results of Annual Reviews	11
	The Office of Water’s Annual Review Guidance	11
	The Quality of Checklist Answers Was a Recurring Issue	12
	The Annual Review Checklists Did Not Always Support Program Evaluation Report Recommendations	13
	A Potentially Excessive Fee Account Balance Was Not Identified and Addressed in a Timely Manner	14
	The Office of Water’s System for Monitoring the Annual Review Process Is Inadequate	15
	Conclusions.....	16
	Recommendations.....	17
	Agency Response and OIG Assessment.....	17
3	The Office of Water’s Annual Review Guidance Was Inconsistent with Regulatory Requirements for Annual Audits.....	18
	Regulations Require an Annual Audit of the CWSRF’s Financial Statements and Compliance with Title VI of the Clean Water Act	18
	States Did Not Meet the Regulatory Requirements for Financial Statement Audits.....	19
	States Did Not Meet Compliance Audit Requirements	20
	The Office of Water Provided Regions with Improper Guidance	21
	Regions Lacked Information “Necessary or Appropriate” to Perform Annual Reviews	22
	Conclusions.....	22
	Recommendations.....	23
	Agency Response and OIG Assessment.....	23
4	Status of Recommendations and Potential Monetary Benefits.....	24

–continued–

Appendixes

A	CWSRF Infographic.....	25
B	Additional Information About the Different Types of Government Audits	26
C	Compliance Supplement for Single Audits.....	28
D	Agency’s Response to the Draft Report	30
E	Distribution	37

Chapter 1

Introduction

Purpose

The U.S. Environmental Protection Agency Office of Inspector General [initiated](#) this audit to determine whether the EPA is prepared to oversee, through its annual review process, the Infrastructure Investment and Jobs Act, or IIJA, funds invested in the Clean Water State Revolving Fund, or CWSRF, Program.

Top Management Challenge Addressed

This audit addresses the following top management challenge for the Agency, as identified in *The EPA's Fiscal Year 2024 Top Management Challenges [report](#)*, issued November 15, 2023:

- Managing grants, contracts, and data systems.

Background

Since its inception in 1987, the CWSRF Program has provided more than \$172 billion in low-cost financing for water-quality infrastructure projects around the nation. The IIJA resulted in a significant increase in congressional appropriations to the CWSRF Program. In 2021, as part of the IIJA, Congress provided appropriations of about \$11.7 billion for CWSRF general supplemental grants and an additional \$1 billion for CWSRF grants specifically to address emerging contaminants. As shown in Table 1, Congress appropriated these funds for fiscal years, or FYs, 2022 through 2026, and the money is available until it is expended.

Table 1: IIJA and baseline CWSRF appropriations by fiscal year (in millions)

Appropriation	FY 2022 (\$)	FY 2023 (\$)	FY 2024 (\$)	FY 2025 (\$)	FY 2026 (\$)	Five-year total (\$)
IIJA General Supplemental	1,902	2,202	2,403	2,603	2,603	11,713
IIJA Emerging Contaminants	100	225	225	225	225	1,000
Annual Baseline	1,169	758	*758	*758	*758	*4,201

Note: Annual baseline appropriations are appropriations made through the annual appropriations process rather than through the IIJA. IIJA appropriations supplement the annual baseline appropriations for FYs 2022 through 2026. The annual baseline figures above are rounded to the nearest million.

Source: OIG analysis of EPA data. (EPA OIG table)

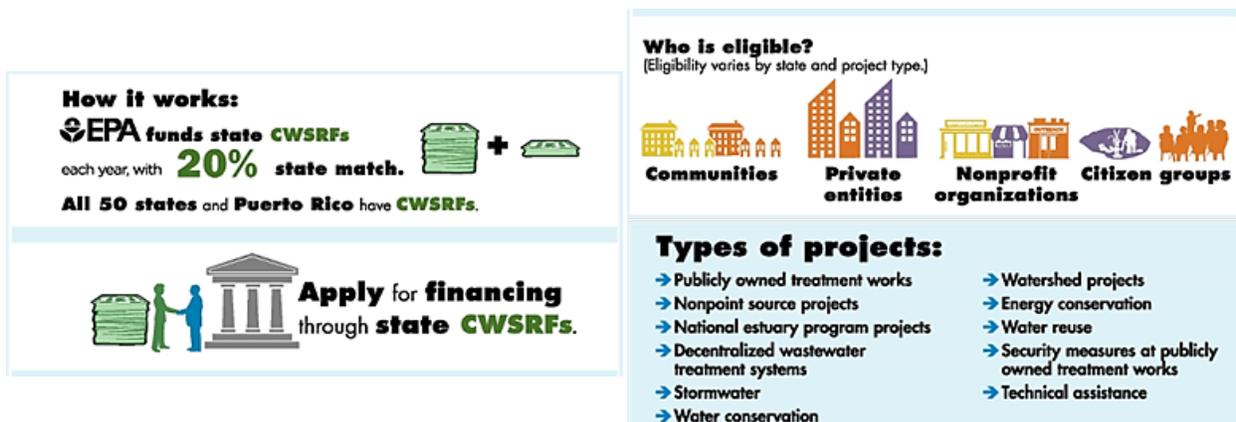
* Based on the assumption that the level of funding from FY 2023 is carried forward into FYs 2024 through 2026.

Under the CWSRF Program, the EPA provides grants to all 50 states and Puerto Rico to capitalize state revolving loan funds.¹ In this report, we use **states** in relation to the CWSRF to refer to the 50 states and Puerto Rico, except as indicated. For annual baseline appropriations, the Clean Water Act, as amended, requires that each state make an annual contribution to its state revolving fund, or SRF, in an amount equal to at least 20 percent of its annual federal capitalization grant.²

States make loans to eligible recipients and recycle loan repayments into the CWSRFs to fund additional water-quality projects. Money revolves through the states' CWSRFs, which are intended to be permanent sources of low-cost financing. In addition to issuing low-interest loans, states may subsidize projects through CWSRF grants and principal forgiveness. States can also charge fees to recipients when providing CWSRF assistance. These fees can include loan origination, annual loan-servicing, and application or processing fees. While states often hold the fees that they collect in accounts outside their CWSRFs, the money within these fee accounts is restricted to water-quality activities.³

States operate the CWSRFs and fund a wide range of water-quality infrastructure projects that address their local priorities. Figure 1 shows an overview of the CWSRF Program and a list of types of eligible projects. Appendix A contains the full EPA infographic that is the source for Figure 1.

Figure 1: Overview of the CWSRF Program and types of eligible projects



Source: EPA infographic. (EPA image)

States provide CWSRF assistance to eligible recipients, such as local governments, private entities, and others. States can provide a variety of financing options through the CWSRF. This variety allows each state the flexibility to focus on its specific water-quality needs. The EPA provides oversight for the CWSRFs and is responsible for ensuring that each state program operates in a lawful and effective manner.

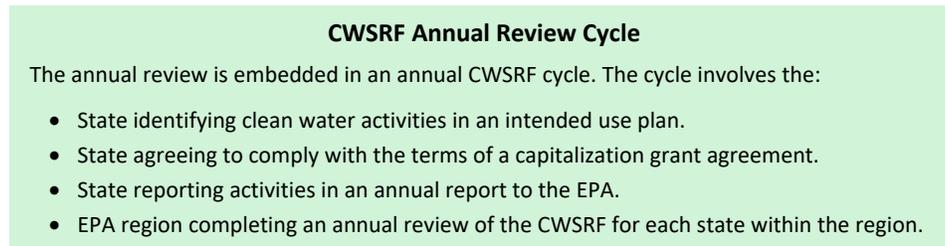
¹ The EPA also provides [direct grant funding](#) for the District of Columbia, U.S. Virgin Islands, American Samoa, Guam, and the Commonwealth of Northern Marianas.

² 33 U.S.C. § 1382(b)(2).

³ Guidance on Fees Charged by States to Recipients of Clean Water State Revolving Fund Program Assistance, 70 Fed. Reg. 61,039, October 20, 2005.

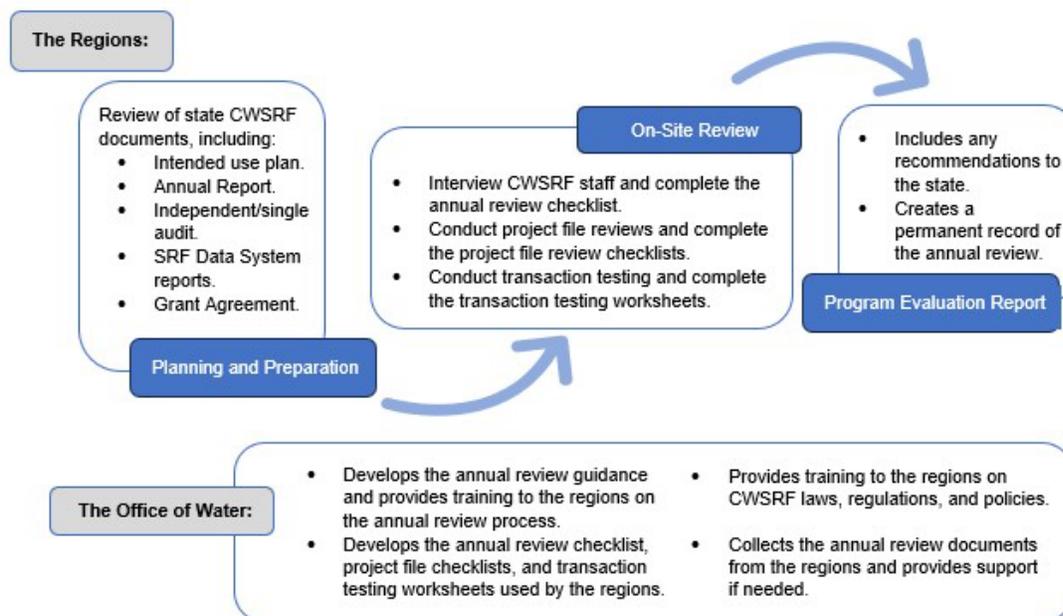
The Oversight of the Program

Title VI of the Clean Water Act, as amended, [33 U.S.C. §§ 1381–1387](#), established the CWSRF Program and governs its operations. One of the requirements of Title VI is that the EPA conduct an annual review of each state’s intended use plan, annual report, and any other materials that are necessary and appropriate to oversee the CWSRF. The EPA views the annual review as a critical piece of oversight.



The ten EPA regions conduct the annual reviews. The annual review process includes the planning of and preparation for the review; an on-site interview and document review; and a written report to the state from the region, which is also known as the **program evaluation report**. Figure 2 depicts the EPA’s annual review process.

Figure 2: The EPA’s annual review process



Source: OIG depiction based on the *SRF Annual Review Guidance*. (EPA OIG figure)

The Office of Water annually updates the *SRF Annual Review Guidance* to help the regions conduct their annual reviews. According to the 2022 *SRF Annual Review Guidance*, the annual review combines a “prescriptive, checklist-based portion” with a “framework for regions to develop risk-based protocol for

the interview portion of the review.”⁴ In addition to updating and issuing the *SRF Annual Review Guidance*, Office of Water staff periodically participate in the annual review process by accompanying the regions to on-site visits of the states.

To prepare for completing the CWSRF annual review checklist, each region reviews and analyzes several program documents, including annual, audit, and SRF Data System reports. Each state inputs data about its CWSRF projects and project disbursements into the national SRF Data System. As part of the annual review, the region conducts an on-site visit with the state. The purpose of the on-site visit is for the region to interview state CWSRF staff and to review the documents necessary for completing the annual review checklist, project file review checklists, and transaction testing worksheets. The transactions are the EPA’s capitalization grant disbursements to the states.

Upon completion of the annual review process, the region writes a program evaluation report addressed to state officials. If the region identifies issues, challenges, or areas for improvement, it includes a summary of the findings and its recommendations in the report. The region also submits the completed annual review documentation to the Office of Water, including the program evaluation report, annual review checklist, project file review checklists, and transaction testing worksheets.

In April 2022, the Office of Management and Budget, or OMB, issued a memorandum stressing that agencies should, at each planning, implementation, and oversight step, consistent with statutory requirements, leverage existing agency processes with respect to IIJA-funded activities. The OMB directed departments and agencies to devise implementation plans for IIJA-funded programs.⁵ Furthermore, the memorandum stated that “programs should be designed to collect and use data or use existing data that are needed for measuring progress and building evidence of program effectiveness, including implementation activities, performance reporting, and program evaluation as appropriate.”

When federal executive branch entities design, implement, and operate internal control systems, such as the CWSRF annual review process, the Federal Managers’ Financial Integrity Act requires them to do so in accordance with the *Standards for Internal Control in the Federal Government*. The *Standards for Internal Control in the Federal Government* outlines 17 principles. Three of the principles state that management should (1) implement control activities through policies, (2) establish and operate monitoring activities to monitor the internal control system and evaluate the results, and (3) remediate identified internal control deficiencies on a timely basis.

The Office of Water has updated the annual review process to prepare for the oversight of IIJA-funded projects and to monitor the progress toward IIJA-specific goals, such as increasing investment in disadvantaged communities and addressing emerging contaminants. Specifically, the Office of Water has added new IIJA-related fields to the SRF Data System to assist in tracking the IIJA goals, as well as

⁴ EPA, *SRF Annual Review Guidance*, October 2022.

⁵ OMB, Executive Office of the President, [M-22-12](#), *Advancing Effective Stewardship of Taxpayer Resources and Outcomes in the Implementation of the Infrastructure Investment and Jobs Act*, April 29, 2022.

new questions to the annual review checklist to help guide discussions of IJA implementation during the regions' on-site visits with the states. Additionally, it has directed the regions to include IJA projects in project file reviews and transaction testing and to document IJA-related observations, findings, and corrective actions in program evaluation reports.

The Role of Different Types of Audits in the Annual Review Process

Audits are one method of promoting the accountability and transparency of government programs. A government audit provides “an independent, objective, nonpartisan assessment of the stewardship, performance, or cost of government policies, programs, or operations, depending upon the type and scope of the engagement.”⁶ The annual reviews performed by EPA regions are not audits. However, the regional reviewers make use of audit reports to inform their annual reviews. The reviewers rely on independent audits to identify and assess financial or compliance risks to an SRF.

The Clean Water Act, specifically 33 U.S.C. § 1386(b), requires an annual audit of each CWSRF:

Annual Federal Audits—The Administrator shall, at least on an annual basis, conduct or require each State to have independently conducted reviews and audits as may be deemed necessary or appropriate by the Administrator to carry out the objectives of this section. Audits of the use of funds ... shall be conducted in accordance with the auditing procedures of the Government Accountability Office, including [single audit requirements].

In 1990, to implement the Clean Water Act annual audit requirements, the EPA issued 40 C.F.R. § 35.3165(d), which states that “at least once a year the [Regional Administrator] (through the Office of the Inspector General) will conduct, or require the State to have independently conducted, a financial and compliance audit of the SRF and the operations of the SRF.”⁷ Further, the audit report “must contain an opinion on the financial statements of the SRF and its internal controls, and a report on compliance with Title VI.” The independent external auditors who perform the audit must meet the U.S. Government Accountability Office’s independence standards. The audit “may be done in conjunction with the Single Audit Act.”

Implementing the 33 U.S.C. § 1386(b) requirement, 40 C.F.R. § 35.3165(d) requires each CWSRF to undergo two types of audits each year: a financial statement audit and a compliance audit examining its compliance with Title VI of the Clean Water Act. The Office of Water’s annual review guidance requires the regions to read relevant audit reports and document any findings in the program evaluation reports. The regions must also document details of the states’ plans to resolve the findings. Findings might

⁶ Government Accountability Office, [GAO-21-368G](#), *Government Auditing Standards: 2018 Revision, Technical Update April 2021*, April 2021.

⁷ On March 16, 2006, the EPA OIG notified the EPA that we would no longer conduct audits of the financial statements of the CWSRF. In April 2023, the EPA OIG sent a letter to the states that annual and financial compliance audits of each state’s CWSRF and its operations, in accordance with 40 C.F.R. § 35.3165(d), must be provided to the EPA OIG within 30 days of completion.

include questioned costs, noncompliance with program requirements, or deficiencies or weaknesses in internal control.⁸

The Government Accountability Office's *Standards for Internal Control in the Federal Government* states that management should identify and use quality information that is needed to achieve objectives and address risks. When the EPA issued 40 C.F.R. § 35.3165(d), it was identifying quality information needed to achieve CWSRF objectives and address risk, as well as implementing 33 U.S.C. § 1386(b) by identifying the audits necessary or appropriate to carry out the objectives of Title VI of the Clean Water Act.

Because there are different types of government audits, regional reviewers may read several audit reports, including reports for financial statement, compliance, and Single Audit Act audits, which are described below. Appendix B contains an expanded explanation of the different types of audits and their applicability to the annual review process.

Financial Statement Audits

The objective of a financial statement audit is to determine whether the auditee's financial statements are presented fairly, in all material respects, in accordance with recognized criteria, such as generally accepted accounting principles. Auditors are required to design and perform a financial statement audit to obtain reasonable assurance of detecting instances of noncompliance with provisions of the laws, regulations, contracts, and grant agreements that are significant within the context of the audit objective. In other words, the audit should detect instances of noncompliance that could affect whether the financial statements are presented fairly.

Compliance Audits

The objective of a compliance audit is to determine whether the auditee complied with specified criteria. The criteria could be established by laws, regulations, contracts, and grant agreements or by other means. For example, a compliance audit could determine whether a state's CWSRF complied, in all material respects, with Title VI of the Clean Water Act.

Single Audit Act Audits

Under the Single Audit Act of 1984, as amended, a nonfederal entity may choose to have a single organizationwide audit conducted in lieu of multiple audits of individual federal programs. A single audit must be conducted by an independent external auditor in accordance with the Single Audit Act, as amended, and 2 C.F.R. part 200, subpart F, "Audit Requirements" for nonfederal entities that expend \$750,000 or more in federal awards during a fiscal year. A single audit includes a financial statement audit of the entity as a whole, as well as compliance audits of the entity's federally funded programs that are identified by the auditor as major federal programs. However, the auditor is required to test

⁸ Internal control is a process used by management to help an entity achieve its objectives. For example, issuing financial statements that are free from material misstatement is an objective.

only a limited number of compliance areas for the major federal programs, and the single audit may not automatically satisfy the requirements for the annual CWSRF audit.

The Single Audit Act, as amended, states that federal agencies should rely on and use single audits to the extent that they provide information that the agencies need to carry out their responsibilities. The Act does not preclude an agency from requiring additional audit work if such work is necessary for the agency to carry out its oversight responsibilities. The single audit regulations at 2 C.F.R. § 200.503(d) require that “[a] Federal agency that conducts or arranges for additional audits must, consistent with other applicable Federal statutes and regulations, arrange for funding the full cost of such additional audits.”

As part of a single audit, the independent external auditor uses the OMB’s risk-based methodology to determine which federal programs listed on the auditee’s schedule of expenditures of federal awards are major federal programs for the year in question.⁹ The auditor then determines and reports whether the auditee has complied with provisions of laws, regulations, and contracts or grants pertaining to federal awards that have a direct and material effect on the major federal programs.¹⁰ The OMB issues an annual *Compliance Supplement* that identifies the compliance requirements that the federal government expects to be considered as part of a single audit. Federal agencies, such as the EPA, advise the OMB on the contents of the *Compliance Supplement* subsections that are dedicated to their programs.

The OMB’s risk-based methodology can result in a particular program being identified as major in one fiscal year but not in another. Accordingly, auditors would not test and report on a program’s compliance for years when they did not determine the program to be a major federal program. The single audit regulations allow for an awarding agency to request that its program be included as a major federal program, regardless of the independent external auditor’s determination, if the agency pays for the incremental cost of adding the program to the audit.

Beginning in 2019, the OMB limited federal agencies to selecting a maximum of six out of 12 compliance areas per program for inclusion in *Compliance Supplement* subsections. In general, this resulted in a smaller scope for the audit work. The EPA eliminated the compliance areas of program income, reporting, subrecipient monitoring, and special tests and provisions from its subsection of the *Compliance Supplement*. Before the EPA eliminated the special tests and provisions as a compliance audit area for CWSRFs, the EPA used this area to advise auditors about which tests to perform to determine whether funded projects met specific EPA or federal requirements. Appendix C contains more information about the history of this change to the *Compliance Supplement* subsection for CWSRFs.

⁹ 2 C.F.R. § 200.518.

¹⁰ 2 C.F.R. § 200.514.

Responsible Offices

The Office of Water develops the policy, guidance, and checklists for the CWSRF Program that the regions use to conduct the annual reviews of their states. In addition, the Office of Water trains the regions on the laws, regulations, policies, and annual review guidance related to the CWSRF. The Office of Water collects the annual review checklists, worksheets, and program evaluation reports and follows up with the regions on select findings and recommendations made to the states.

Noteworthy Achievements

As a result of our audit, the Office of Water took immediate action to implement processes for improving oversight, including reviewing all program evaluation reports and tracking and monitoring required action items year to year. Based on its reviews, the Office of Water is also planning to provide written feedback and recommendations to the regions. The Office of Water also informed us that it is updating the CWSRF regulations to ensure that they are reflective of oversight needs.

Scope and Methodology

We conducted this performance audit from February to December 2023 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

We assessed the internal controls necessary to satisfy our audit objective.¹¹ In particular, we assessed the internal control components—as outlined in the Government Accountability Office’s *Standards for Internal Control in the Federal Government*—significant to our audit objective. Any internal control deficiencies we found are discussed in this report. Because our audit was limited to the internal control components deemed significant to our audit objective, it may not have disclosed all internal control deficiencies that may have existed at the time of the audit.

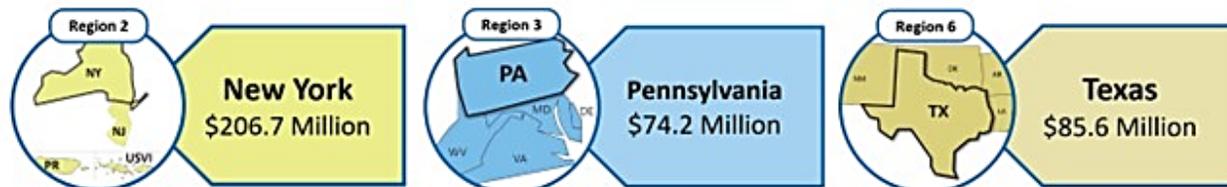
To obtain an understanding of the criteria applicable to the CWSRF and to the Office of Water’s annual review process, we reviewed several relevant federal statutes, regulations, policies, and guidance documents. These included the (1) Clean Water Act and CWSRF regulations; (2) Single Audit Act and regulations; (3) IJJA; and (4) relevant Office of Water guidance documents and forms, including the *SRF Annual Review Guidance* and standard operating procedures, memorandums, and CWSRF annual review checklists and worksheets.

We judgmentally selected three regions and examined the annual review process to determine whether the EPA is prepared to oversee the IJJA funds invested in the CWSRFs. We judgmentally selected three

¹¹ An entity designs, implements, and operates internal controls to achieve its objectives related to operations, reporting, and compliance. The Government Accountability Office sets internal control standards for federal entities in [GAO-14-704G](#), *Standards for Internal Control in the Federal Government*, issued September 10, 2014.

states, one in each of the three selected regions: New York, Region 2; Pennsylvania, Region 3; and Texas, Region 6. Pennsylvania was also the subject of a prior EPA OIG audit that was detailed in Report No. [16-P-0222](#), *EPA Regional Offices Need to More Consistently Conduct Required Annual Reviews of Clean Water State Revolving Funds*, issued July 7, 2016. Figure 3 shows each selected state, as well as its FY 2022 IJJA allotment.

Figure 3: Allotments of the FY 2022 CWSRF IJJA appropriation for audited states



Source: EPA Office of Water [Memorandum](#), *Implementation of the Clean Water and Drinking Water State Revolving Fund Provisions of the Bipartisan Infrastructure Law*, dated March 8, 2022. Amounts displayed are truncated. (EPA OIG image)

To determine whether the Office of Water is prepared to oversee IJJA funds, we examined whether recent annual reviews complied with statutory, regulatory, and Office of Water policy requirements. We interviewed staff from the Office of Water to understand their expectations for how regions should be performing annual reviews, how they perform oversight of the regions regarding the annual review process, and how they are preparing to adapt the annual review process for the oversight of IJJA money.

We reviewed completed checklists, worksheets, and program evaluation reports for state fiscal year, or SFY, 2019 through 2021. SFYs can differ from federal fiscal years and vary by state. We accompanied EPA Region 2 CWSRF staff to observe the annual review on-site visit with the State of New York. We interviewed EPA regional staff to understand:

- How they perform the annual review.
- How they complete annual review checklists and worksheets.
- What process they use for reviewing project files.
- How they use single audit and financial statement audits.
- What process they use for transaction testing.
- What process they use for completing program evaluation reports.

Prior Reports

In EPA OIG Report No. [16-P-0222](#), we found that the Office of Water did not always perform annual reviews of state CWSRF grants as required. Annual reviews are an opportunity to identify program risks, but if the Office of Water does not comprehensively or accurately conduct these reviews, it may not identify critical issues and deficiencies. We made ten recommendations, including that the Office of Water (1) revise its annual review guidance to eliminate inconsistencies, (2) require regions to conduct annual reviews according to the CWSRF annual review guidance by fully completing all checklists and other requirements of the review, and (3) evaluate regional approaches to conducting annual reviews

and ensure that regions perform consistent annual reviews in accordance with EPA guidance. In response to our recommendations, the Office of Water revised the *SRF Annual Review Guidance* and informed us that it had participated in 13 state annual reviews in 2016 and would, for the first time, send a memorandum to each regional director detailing headquarters observations and any related recommendations for improvement. In 2017, the Office of Water issued follow-up memorandums for its visits to three regions. The Office of Water discontinued the practice of participating in on-site visits and issuing follow-up memorandums after 2017. In 2023, the Office of Water resumed participation in on-site visits but did not plan to issue follow-up memorandums.

In EPA OIG Report No. [23-N-0028](#), *EPA Guidance Removed States' Responsibilities for Monitoring State Revolving Fund Borrowers' Single Audit Reports*, issued August 15, 2023, we found that the Office of Water issued a policy memorandum in September 2021 that incorrectly advised states regarding single audits. This policy memorandum, titled *Updated Single Audit Act Borrower Audit Collection Policy*, said that states did not have to review single audits of nonfederal entities that borrow money from SRFs, contradicting the Single Audit Act and misinterpreting 2 C.F.R. part 200. On July 19, 2023, in response to our audit findings but before we published our final report for that audit, the EPA issued a memorandum titled *Clarification of Single Audit Requirements Under the Clean Water and Drinking Water State Revolving Fund Programs* that clarified the requirements for single audits and federal funds and the responsibilities of recipients of SRF assistance and state programs. That memorandum addressed our concerns, and we made no recommendations in our audit report.

Chapter 2

The Office of Water Did Not Consistently Monitor the Performance and Results of Annual Reviews

The Office of Water did not consistently monitor the performance or results of annual reviews and did not always act in a timely manner to address risks identified by annual reviews, which is contrary to the purposes of the annual review process as established by regulation and guidance. In fact, we found that the Office of Water did not consistently monitor the performance or results of the annual reviews for any of the three states that we reviewed (New York, Pennsylvania, and Texas), each of which is located in a different EPA region (Regions 2, 3, and 6), in the time period we examined (SFYs 2019 through 2021). Furthermore, the Office of Water did not ensure that Regions 2, 3, and 6 followed the annual review guidance. It also did not review all supporting checklists and program evaluation reports. As a result, the Office of Water did not identify that the regions did not always provide quality responses to checklist items, and checklist items had potential contradictions to program evaluation report recommendations that should have been clearly identified as proactive suggestions. Additionally, the Office of Water did not act in a timely manner to address the risk of a substantial and potentially excessive fee account balance that Region 6 identified during the annual review process. This occurred because the Office of Water considered its reliance on regional elevation of concerns to be an appropriate risk-based oversight strategy.

The Office of Water should improve its annual review process to be better prepared to protect federal grants, including the significant investment made through IJJA grants to CWSRFs. For FYs 2022 through 2026, the CWSRFs will receive about \$12.7 billion in IJJA funds in addition to an estimated \$4.2 billion in regular appropriations.¹² As a result of weaknesses in the annual review process, the Office of Water may not identify or correct in a timely manner instances of poor performance, noncompliance, fraud, waste, or abuse in the CWSRF Program that could put the success of the program at risk.

The Office of Water's Annual Review Guidance

To implement the requirements of the Clean Water Act and associated regulations, the Office of Water's *SRF Annual Review Guidance* provides detailed instructions to the regions for conducting their annual reviews of the CWSRFs. Among other things, the *SRF Annual Review Guidance* states that regions should complete every annual review checklist item in a useful manner. Reviewers should support yes and no answers with written comments. Questions marked as not applicable should include explanatory comments detailing why. The annual review checklists serve as a written record of the annual review and support the program evaluation report. The *SRF Annual Review Guidance* also states that the program evaluation report is the final product of the annual review process that serves as a permanent record of the annual review and discusses the most significant issues and risks identified. The guidance further states that "excessive fee balances," especially in fee accounts separate from CWSRF funds, are

¹² See Table 1 in Chapter 1 for assumptions made to arrive at the estimated regular appropriation amount.

at risk for misuse. States should closely tie fee rates to revenue needs, and effective management of fee programs is an area vital to a successful SRF. Additionally, excessive balances may indicate that a state’s fees are unnecessarily high and could be lowered to keep the SRF loan terms competitive. Balances also represent funds that should be used for clean-water activities.

The Quality of Checklist Answers Was a Recurring Issue

Counter to *SRF Annual Review Guidance* instructions, Regions 2, 3, and 6 did not always answer annual review checklist questions completely. As summarized in Table 2, we identified incomplete answers for checklist questions in which the regions left items blank or did not include the required explanatory comments, including answers that referred to a separate document that was not included with the checklist. Across the three years we reviewed, the percentage of incomplete answers ranged from 7 percent for Region 2’s 2019 review of New York to 23 percent for Region 3’s 2021 review of Pennsylvania.

Table 2: Number of annual review questions with incomplete answers

SFY ending in	Region 2: New York	Region 3: Pennsylvania	Region 6: Texas
2019	7	15	15
2020	8	18	13
2021	8	26	13

Note: The total number of questions per year was 107 for 2019, 111 for 2020, and 114 for 2021.

Source: OIG analysis of answers to annual review checklist questions. (EPA OIG table)

Examples of incomplete answers to annual review checklist questions from SFY 2019 through 2021 include:

- Listing types of subsidies to a checklist question that asked for criteria for providing additional subsidies.
- Relisting the state’s long- and short-term goals in response to a checklist question that asked for the state’s progress toward long- and short-term goals.
- Failing to list types and amounts for some checklist questions that asked for that information.
- Answering “not applicable” to questions without providing the required explanatory comments.

The annual review checklists serve as the main underlying support for the program evaluation report and recommendations for improvements. If regional staff fail to accurately and completely answer checklist questions, the regions might miss opportunities to identify issues, challenges, or areas for improvement of state SRF programs. There were also checklist responses that did not address the intent of the question. For example, Region 6 responded to questions about loan recipients’ civil rights compliance with answers about the Texas Water Development Board’s employment practices. When answering the checklist question about state oversight of loan recipients’ handling of nondiscrimination

notices, Region 6 noted that “notices are provided on the TWDB [Texas Water Development Board] career web page, on job vacancy postings, within the employee handbook, and there are EEOC [Equal Employment Opportunity Commission] notices posted in the break room.”

There were further issues with the regions’ responses in their annual review checklists. For example, Region 2 answered one question by indicating that the state did not promote resiliency and then contradicted that answer in the following question by indicating that “the state promotes resiliency.” In a checklist section pertaining to the calculation of maximum administrative costs, Region 2 recorded a net position of the New York CWSRF that did not agree with its audited financial statements. If this discrepancy was not an error, Region 2 should have provided an explanation for the alternative figure. Region 3 created and maintained separate documents that supported its responses in its annual review checklists for Pennsylvania for SFYs 2019 through 2021; however, those documents were not attached to or included with the checklists. This was contrary to the instructions for completing the checklists, which state “pertinent attachments should be added to the checklists and referred to as is appropriate. The checklists must be used as your work papers for the overall evaluation and a reference document in the future to prepare for the next annual review.” In another example, Region 6 appeared to have reused its 2019 checklist for 2020 instead of using the 2020 annual review checklist provided by the Office of Water. This resulted in the 2020 checklist having answers that were identical to the 2019 checklist for many questions, including notes and dates relevant to 2019. This accounted for the annual review checklist not accurately reflecting the state’s CWSRF in 2020.

The quality of the regions’ answers to the Office of Water’s checklists is an ongoing challenge. Our 2016 audit [report](#) on the annual review process found that EPA regions were not fully and accurately completing the annual review checklists. We recommended that the assistant administrator for Water evaluate regional approaches to conducting annual reviews and address any identified issues to ensure that regions perform consistent reviews in accordance with annual review guidance. Although the Office of Water certified that corrective actions addressing our recommendations were completed, the fact that we identified similar deficiencies in this 2023 audit—more than seven years later—indicates that the EPA still has opportunities to improve oversight of the annual review process.

The Annual Review Checklists Did Not Always Support Program Evaluation Report Recommendations

To meet the Office of Water’s oversight responsibilities, it is critical that regional staff fully complete the annual review checklists and develop program evaluation reports that accurately reflect any issues identified.¹³ These checklists serve as support for the program evaluation reports; therefore, the recommendations that regional staff make in the program evaluation reports should be supported by documentation in the checklists.

Of the three regions that we selected for this audit, we found that Region 2 and Region 3’s checklists supported their report recommendations. For Region 6, we found inconsistencies between the annual

¹³ EPA Memorandum, *FY 2022 State Revolving Fund Annual Review Guidance*, October 2022.

review checklists and the program evaluation reports. Specifically, Region 6 made a recommendation in its 2020 and 2021 program evaluation reports encouraging the Texas Water Development Board to continue to take appropriate actions to fill engineer vacancies. However, the annual review checklists for those two years indicated that staffing was sufficient to manage the program. Region 6 also included a recommendation in its 2021 program evaluation report that the state water board process invoice payments in a timely manner, but the region did not note the issue in the transaction testing worksheets. As a result, the program evaluation reports for Region 6 did not always accurately represent the annual review process as recorded in the checklists and, therefore, are not accurate records of the annual reviews. The inconsistencies do not provide assurance that the program evaluation reports are addressing the most significant issues and risks that the states' CWSRFs face.

We found two other instances in which a recommendation in a program evaluation report did not appear to be supported by the annual review checklist, but the regions were able to clarify that these were, in fact, proactive suggestions and not inconsistencies. The first instance relates to Region 3 including an ongoing action item from its 2018 program evaluation report in its 2019 program evaluation report, even though the 2019 checklist indicated the item was resolved. Specifically, in the 2018 report, Region 3 stated that Pennsylvania should consider hiring contractors if the project inspector positions would take longer than three months to fill. However, even though the 2019 program evaluation report indicated that the positions had not been filled, the 2019 checklist stated that staffing was sufficient. The second instance relates to Region 6's recommendation in its 2020 program evaluation report that the Texas state water board continue to evaluate the program's capacity to manage and safeguard all projects against fraud and abuse. The region did not note the program's capacity as an issue in the 2020 checklist.

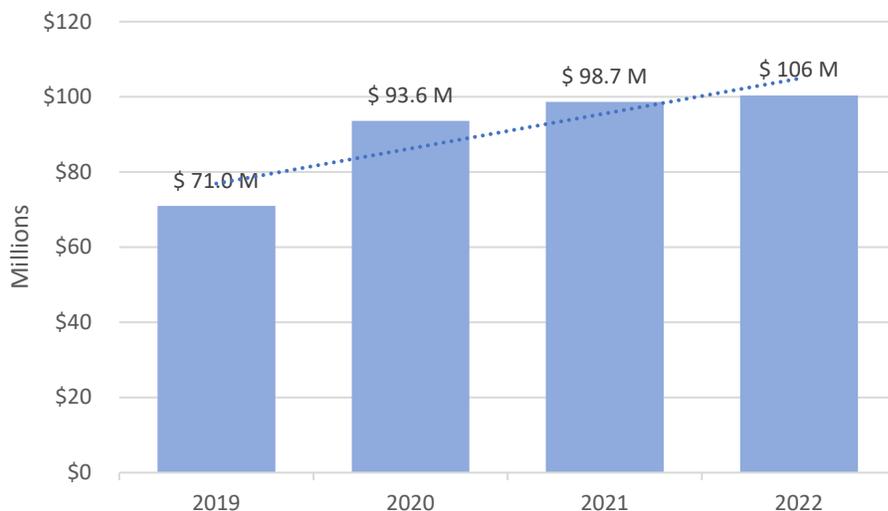
During our discussions with the regions regarding these two instances, we determined that the regions had intended the action item and recommendation as proactive suggestions and not as identifications of current significant issues or risks. For this reason, there was no true contradiction between the program evaluation reports and the annual review checklists. However, just the appearance of a contradiction points to the need for the Office of Water to ensure that its regions use consistent, well-defined terms in their program evaluation reports. When the region is making a recommendation to the state to resolve an issue or risk, the region should clearly identify the recommendation as a required action item rather than a proactive suggestion so that the state, the region, and the Office of Water have a shared understanding of what is required.

A Potentially Excessive Fee Account Balance Was Not Identified and Addressed in a Timely Manner

Texas charges its CWSRF recipients a loan origination fee to recover reasonable costs for administering the CWSRF. The loan origination fee is a percentage of the CWSRF loan amount. The loan recipient pays the loan origination fee in full at closing, and the fees are deposited into a fee account held outside the

CWSRF. As shown in Figure 4, Texas’s fee account balance grew each year from SFY 2019 through 2022, reaching approximately \$106 million by the end of SFY 2022.¹⁴

Figure 4: The CWSRF fee account balance for the State of Texas



Source: OIG analysis of Texas state fiscal year-end fee account balances. Amounts displayed are rounded. (EPA OIG image)

The annual review checklist contains questions intended to promote a discussion of fee management during the on-site visit. Region 6 considered the state’s continued charging of CWSRF loan-origination fees to be reasonable, despite the growing substantial fee account balance. In the 2019 checklist, Region 6 noted that the state was accumulating a balance in its fee account “in case of a reduction in the annual capitalization grant.”

In its program evaluation report for SFY 2021, issued in July 2022, Region 6 recommended that the state spend the fees annually. Region 6 noted that the fee account is not intended for continued growth but for CWSRF activities to benefit the program and communities. The Office of Water’s annual review process did not identify or address this issue until the annual review for SFY 2021, when the fee account balance was about \$98.7 million. The Office of Water did not take separate action on the region’s recommendation despite having identified excessive fee balances as a risk area in the *SRF Annual Review Guidance*.

The Office of Water’s System for Monitoring the Annual Review Process Is Inadequate

The Office of Water does not have a system to review all completed checklists and program evaluation reports annually or on another recurring cycle. Instead, Office of Water staff explained that they had been reviewing annual review documentation and monitoring the resolution of recommendations using

¹⁴ The annual reports for the years in question can be found on the Texas Water Development Board’s “Administrative Reports” [webpage](#).

a risk-based methodology. Additionally, Office of Water staff stated that, regardless of risk, they did not have a process for tracking every recommendation noted during annual reviews. The Office of Water's risk-based methodology for regional oversight relies on there being a perceived problem or regional engagement with EPA staff regarding concerns. However, Office of Water staff do not perform an assessment of risk independent of the regions. The staff indicated that they believed that their monitoring approach had been reasonable and adequate but stated that "a more systematic approach to reviewing all [program evaluation reports] could be considered."

The lack of a consistent, systematic approach to reviewing program evaluation reports and other annual review documents could delay the identification of problems. For example, had the Office of Water reviewed the checklists for New York, Pennsylvania, and Texas, it could have provided feedback to the regions on how to improve their answers to checklist questions. The Office of Water could have then used those improved answers to better oversee the CWSRFs and the annual review process. Further, had the Office of Water conducted a thorough review of the 2019 checklist for the Texas CWSRF, it might have raised questions that could have led to an earlier detection of the substantial and potentially excessive fee account balance. The \$106-million fee income account balance points to the opportunity to clarify guidance on what constitutes an excessive balance and to gather data on the fee income account balances in other CSWRFs. The Office of Water may not be able to fulfill its oversight obligations without systematic monitoring because the process in place as of October 2023 relied on the regions alerting Office of Water staff of issues.

Even if Office of Water staff had reviewed all the program evaluation reports in our audit scope, the lack of a consistent reporting format could have hindered that review. Regional staff stated that a program evaluation report template would be helpful to them. A template designed to elicit desired information in a consistent format could also aid the Office of Water in reviewing the individual program evaluation reports. The template could allow the Office of Water to identify systemic trends more easily across states and regions and improve the timeliness of addressing issues. Additionally, a template, along with appropriate definitions and instructions, could help identify when regions are making proactive suggestions or when they are making recommendations to address issues or risks that already exist.

Conclusions

The Office of Water's annual reviews of CWSRFs are vital to safeguarding federal investments and to promoting the CWSRF Program's success. The Office of Water should improve its oversight of CWSRF annual reviews to protect federal funds awarded to CWSRFs, including the significant infusion of IJJA-funded capitalization grants. Although our audit only covered the annual reviews for three states' CWSRFs, the annual review process applies to all states and all regions. Therefore, our findings apply to the Office of Water's oversight of the annual review process conducted nationwide.

In accordance with the OMB's governmentwide IJJA strategy, the Office of Water leveraged an existing process, the annual review process, to implement and oversee IJJA-related spending.¹⁵ However, to

¹⁵ [M-22-12](#), *supra* note 10.

oversee IJJA funds effectively, the Office of Water must ensure that the annual review process is operating as intended. Additionally, for internal control systems like the annual review process, the *Standards for Internal Control in the Federal Government* requires management to monitor the system, evaluate the results, and remediate internal control deficiencies on a timely basis. For monitoring activities to be effective, they must be able to detect issues and be used consistently and systematically.

Without consistent, systematic monitoring by the Office of Water, the annual review process may not detect poor performance; noncompliance; or fraud, waste, and abuse, or such circumstances may go uncorrected for a longer time. Additionally, the Office of Water could miss opportunities to improve oversight by not modifying the *SRF Annual Review Guidance* in response to the regions' recommendations and observations. Improvements to the annual review guidance, including defining what constitutes an excessive fee account balance and providing instructions for resolving such balances, could result in tangible benefits to human health and the environment. For example, states could spend fee account balances on eligible CWSRF activities that could help local communities, rather than accumulating those balances indefinitely.

Recommendations

We recommend that the assistant administrator for Water:

1. Implement procedures to ensure consistent Office of Water oversight of the annual review process in all regions and states, including reviewing checklists and all program evaluation reports and tracking recommendations made by the regions.
2. Create a program evaluation report template and implement procedures to ensure that regions present results in a consistent format.
3. Coordinate with Region 6 to implement a resolution plan for the Texas Water Development Board's \$106 million in its origination fees account and ensure that the water board is evaluating its need for Clean Water State Revolving Fund fees appropriately.
4. Clarify annual review guidance regarding fee accounts and collect data on states' fee account balances through the annual review process.

Agency Response and OIG Assessment

The Office of Water agreed with these four recommendations and provided acceptable planned corrective actions and estimated milestone dates. We consider these recommendations resolved with corrective action pending. Appendix D contains the Agency's response to the draft report.

Chapter 3

The Office of Water's Annual Review Guidance Was Inconsistent with Regulatory Requirements for Annual Audits

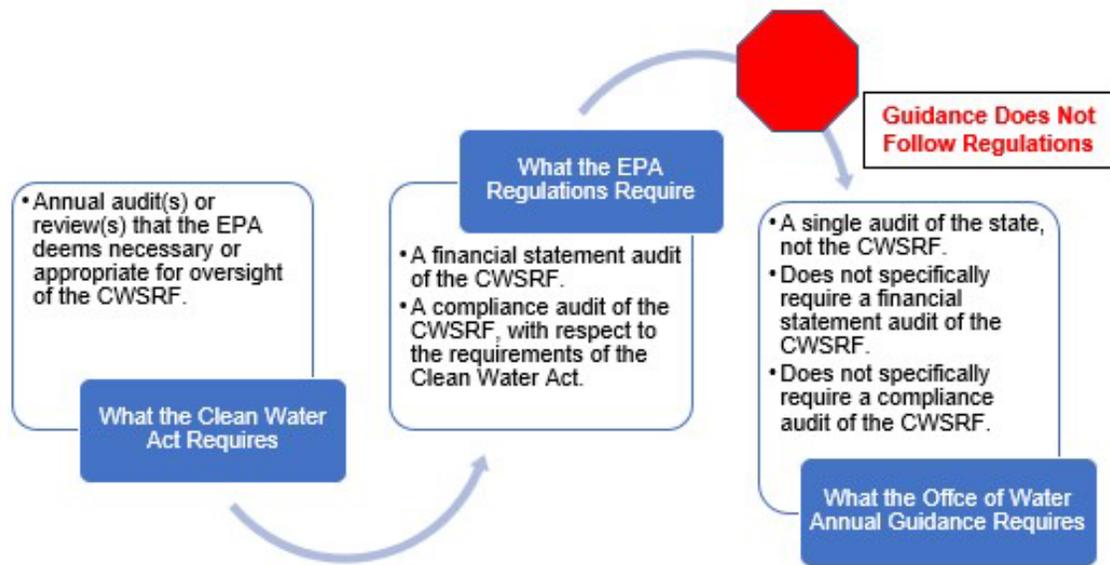
During the annual reviews, regional EPA staff did not ensure that audits were performed of the state CWSRF financial statements and of the CWSRFs' compliance with Title VI of the Clean Water Act. Such audits are required by the Clean Water Act and associated regulations. Of the three states (New York, Pennsylvania, and Texas) that we reviewed for this audit, we concluded that none of them had audits conducted for their CWSRFs in SFYs 2019 through 2021 that met the regulatory requirements. Rather, the three states completed different types of audits that were accepted by their respective regions as fulfilling applicable requirements. This occurred because the Office of Water's annual review guidance is inconsistent with the regulations requiring the CWSRF annual audits and because the Office of Water does not direct the regions to ensure that each state obtains the appropriate audit. The guidance instead directs regional reviewers to accept a statewide single audit as a substitute for the audits required by the CWSRF regulations. The lack of appropriate audits may leave oversight gaps in the annual review process. If the Office of Water does not ensure that the states undergo the required audits, material financial misstatements and noncompliance with Title VI of the Clean Water Act may go undetected.

Regulations Require an Annual Audit of the CWSRF's Financial Statements and Compliance with Title VI of the Clean Water Act

EPA regulations establish the types of annual audits that the EPA considers necessary or appropriate for oversight of the CWSRF program, but Office of Water annual review guidance contains different, conflicting requirements. For example, the Office of Water's Standard Operating Procedure 2.8, *Guide for Assessing Financial and Programmatic Risk in the Review of Independent and Single Audits of CWSRF Programs*, dated September 30, 2014, summarizes the statutory and regulatory requirements for audits and states that "regions must ensure that state CWSRF programs are undergoing thorough audits." However, it also states that "a statewide single audit that includes the SRF can also meet the requirements of an SRF Annual Audit." The procedure does not say that a statewide single audit always meets the requirement but that it can.

Figure 5 illustrates the differences between the Clean Water Act requirements, EPA regulations, and Office of Water annual review guidance.

Figure 5: CWSRF oversight requirements, related regulations, and Office of Water guidance



Source: OIG analysis of the Clean Water Act requirements, EPA regulations, and the Office of Water annual review guidance. (EPA OIG image)

States Did Not Meet the Regulatory Requirements for Financial Statement Audits

The EPA regions did not ensure that their respective states met the regulatory requirements for CWSRF financial statement audits during the annual review process. For example, the audited financial statements of the State of Texas did not list the specific Texas CWSRF accounts. Rather, the CWSRF accounts were contained within the larger category of Texas Water Development Board Funds. Therefore, the CWSRF account balances were not individually listed in the financial statements. The New York and Pennsylvania CWSRFs also did not meet the regulatory requirements for financial statement audits. However, the audits performed for those states came closer to the regulatory requirement than the audit performed for Texas because the larger entities' financial statements presented the CWSRF accounts separately. In the basic financial statements for both the New York State Environmental Facilities Corporation and the Pennsylvania Infrastructure Investment Authority, the CWSRF accounts were presented in the "Other Supplementary Information" section of the financial statements. Also, when conducting the financial statement audits of the New York State Environmental Facilities Corporation and the Pennsylvania Infrastructure Investment Authority, the independent external auditors subjected the "Other Supplementary Information" to additional audit procedures to opine on whether the CWSRF-specific statements presented under "Other Supplementary Information" were fairly stated in all material respects in relation to the parent entities' financial statements as a whole. The auditors' additional procedures included comparing and reconciling the "Other Supplementary Information" directly to the underlying accounting records or the parent entities' basic financial statements.

Table 3 summarizes the regulatory requirements versus the financial audits performed for New York, Pennsylvania, and Texas.

Table 3: Were these types of audits performed for SFY 2019 through 2021?

Type of audit	New York	Pennsylvania	Texas
Financial statement audit of the CWSRF (regulatory requirement)	No	No	No
Financial statement audit of the entity housing the CWSRF, with CWSRF accounts presented in “Other Supplementary Information” subjected to additional audit procedures	Yes	Yes	No*

Source: OIG analysis of audit reports obtained during our audit work. (EPA OIG table)

* As stated above, the financial statements of the State of Texas were audited, but the CWSRF accounts were not separately presented in the state’s basic financial statements or in the “Other Supplementary Information” section.

States Did Not Meet Compliance Audit Requirements

The EPA regions also did not ensure that states met the compliance audit requirements. During SFYs 2019 through 2021, not one of the three CWSRFs that we reviewed underwent an audit examining their compliance with Title VI, consistent with 40 C.F.R. § 35.3165(d). However, for some years and states, independent external auditors subjected the CWSRFs to the testing required by the single audit *Compliance Supplement* subsection for CWSRFs.

The auditors considered the New York CWSRF for potential inclusion as a major federal program in two single audits for SFYs 2019 through 2021: the single audits of the state and the single audits of the New York State Environmental Facilities Corporation. Auditors considered the CWSRFs in Pennsylvania and Texas for potential inclusion as major federal programs in only the statewide single audits because there was no single audit of the Pennsylvania Infrastructure Investment Authority or the Texas Water Development Board. As shown in Table 4, the auditors’ considerations resulted in them treating CWSRFs as major federal programs for some years, but not others.

Table 4: Was the CWSRF determined to be a major federal program?

Single audit	SFY 2019	SFY 2020	SFY 2021
Single audit of the State of New York	No	Yes	No
Single audit of the New York Environmental Facilities Corporation	Yes	Yes	No
Single audit of the Commonwealth of Pennsylvania	Yes	No	No
Single audit of the State of Texas	No	No	No

Source: OIG analysis of audit reports obtained during our audit work. (EPA OIG table)

As noted above, auditors did not test and report the CWSRFs’ compliance for years when they did not determine them to be major federal programs. For the years when they did not include the CWSRFs as

major federal programs in a single audit, the auditors did not apply the audit procedures in the *Compliance Supplement* subsection for CWSRFs. As shown in Table 5, the regulatory requirement for a Title VI compliance audit was not met in any year, and the more limited *Compliance Supplement* audit was not performed consistently.

Table 5: Were these types of audits performed for SFYs 2019 through 2021?

Type of audit	New York	Pennsylvania	Texas
Compliance audit of the CWSRF with respect to Title VI (regulatory requirement)	No	No	No
Compliance audit of the CWSRF with respect to areas included in the <i>Compliance Supplement</i> subsection for CWSRFs	No*	No†	No‡

Source: OIG analysis of audit reports obtained during our audit work. (EPA OIG table)

* Not performed for SFY 2021.

† Not performed for SFYs 2020 or 2021.

‡ Not performed for SFYs 2019, 2020, or 2021.

The Office of Water Provided Regions with Improper Guidance

In 1990, the EPA issued the regulations describing the required annual CWSRF audits. Through those regulations, the EPA identified an annual audit of the CWSRF’s financial statements and the CWSRF’s compliance with Title VI as “necessary or appropriate” in accordance with the Clean Water Act. The regulations that the EPA issued are evidence of management’s identification of the “quality information” needed to achieve the program’s objectives and address risks per the Government Accountability Office’s *Standards for Internal Control in the Federal Government*. Accordingly, ensuring fulfillment of regulatory requirements is important to oversight.

The Office of Water’s *SRF Annual Review Guidance* provided regional reviewers with improper guidance and did not ensure that CWSRFs obtained audits that fulfilled the regulatory requirements. While the regulatory requirements have remained unchanged since 1990, the Office of Water updates the annual review guidance annually. The 2019 *SRF Annual Review Guidance* strongly encouraged states to have an annual independent audit, but it did not address whether a state’s single audit fulfilled the SRF audit requirements. Although the regulatory audit requirements at 40 C.F.R. § 35.3165(d) and the Office of Water Standard Operating Procedure 2.8 indicate that a single audit does not automatically satisfy the requirements for the annual CWSRF audit, the 2020, 2021, and 2022 editions of the annual review guidance state that:

The vast majority of states have an independent audit of the SRF [state revolving fund] An independent audit is not required, as EPA has determined that the state’s single audit fulfills the statutory requirement for an SRF audit.

The Office of Water’s annual review guidance is partially based on external input from states and other interested parties. In 1997, in its *Clean Water and Drinking Water State Revolving Fund Financial Audit Strategy* memorandum, SRF 98-01, the Office of Water wrote that “a few State program officials and the National State Auditors Association pointed out to us that the provisions of the Single Audit Act of 1996 necessitated changes” to the EPA’s audit strategy. After this input from the states and other interested parties, the Office of Water no longer required the audits described in the CWSRF regulations. However, as stated above, the Single Audit Act does not preclude an agency from requiring additional audit work if such work is necessary for the agency to carry out its oversight responsibilities.

Regions Lacked Information “Necessary or Appropriate” to Perform Annual Reviews

The regions did not ensure that the CWSRF audits required by statute and regulation were performed for SFYs 2019 through 2021. The regions followed the 2020 and 2021 annual review guidance, which stated that a statewide single audit unconditionally meets the statutory SRF audit requirements, and the 2019 annual review guidance, which did not explain the regulatory annual audit requirement. Accordingly, Regions 2, 3, and 6 lacked information that the EPA had determined was necessary or appropriate to achieve objectives and address risk, including annual audit reports on the CWSRFs’ financial statements and the CWSRFs’ compliance with Title VI.

Material misstatements may go undetected because of the lack of financial statement audits. This is less likely for the New York and Pennsylvania CWSRFs because the audit work approximated a CWSRF financial statement audit. However, the audit of the State of Texas did not closely approximate a CWSRF financial statement audit. Therefore, Region 6 faced added risks when performing annual reviews. For example, there was added risk when Region 6 accepted the state’s use of unaudited fund valuations to determine the maximum amount of CWSRF money available for administrative costs.¹⁶

When regions do not obtain the required compliance audits, they could potentially allow instances of noncompliance with Title VI to go undetected. For example, auditors would have tested funding for allowable versus unallowable activities, either when performing an audit covering all of Title VI as per 33 U.S.C. § 1386(b) or when performing an audit covering that topic in accordance with the *Compliance Supplement* subsection for CWSRFs. When those audits are not performed, however, federal funding used for unallowable activities could go undetected. Appendix C contains a list of the compliance areas in the CWSRF subsection.

Conclusions

The EPA could improve its oversight by reconsidering audit requirements and related guidance. Audits performed by independent external auditors provide valuable information to the regional reviewers.

¹⁶ Using an unaudited valuation was not in accordance with the interpretive guidelines issued in connection with 33 U.S.C. § 1383(d)(7), as amended in 2014. (*Interpretive Guidance for Certain Amendments in the Water Resources Reform and Development Act [of 2014] to Title I, II, V, and VI of the Federal Water Pollution Control Act*, issued by the director of the Office of Wastewater Management on January 6, 2015.)

Therefore, it is important that the EPA CWSRF audit regulations require what is needed for oversight and that the Office of Water implement the regulations as drafted or amend them as appropriate. Additionally, it is important that the EPA regularly update the single audit *Compliance Supplement* subsection for CWSRFs to include the audit topics that best leverage the auditors' work while supporting and complementing the regional reviewers' work.

Recommendations

We recommend that the assistant administrator for Water:

5. In coordination with the associate administrator for Policy, update EPA regulations implementing the Clean Water State Revolving Fund audit requirement at 33 U.S.C. § 1386(b) to clearly articulate requirements and current EPA expectations regarding audits of state revolving funds.
6. Ensure annual review guidance regarding implementation of audit requirements is consistent with 33 U.S.C. § 1386(b) and 40 C.F.R. § 35.3165.

Agency Response and OIG Assessment

The Office of Water agreed with these two recommendations and provided acceptable planned corrective actions and estimated milestone dates. We consider these recommendations resolved with corrective action pending. Appendix D contains the Agency's response to the draft report. With respect to the Office of Water's comment that "the Single Audit Act limits what can be required in terms of an audit," we refer the Office of Water to the "Single Audit Act Audits" subsection in Chapter 1 of this report, where we note that the Single Audit Act does not preclude an agency from requiring additional audit work if such work is necessary for the agency to carry out its oversight responsibilities. We also acknowledge in that subsection that, under the Single Audit Act, a federal agency may be required to bear the cost of additional audit work.

Status of Recommendations and Potential Monetary Benefits

Rec. No.	Page No.	Recommendation	Status*	Action Official	Planned Completion Date	Potential Monetary Benefits (in \$000s)
1	17	Implement procedures to ensure consistent Office of Water oversight of the annual review process in all regions and states, including reviewing checklists and all program evaluation reports and tracking recommendations made by the regions.	R	Assistant Administrator for Water	12/31/25	
2	17	Create a program evaluation report template and implement procedures to ensure that regions present results in a consistent format.	R	Assistant Administrator for Water	12/31/24	
3	17	Coordinate with Region 6 to implement a resolution plan for the Texas Water Development Board's \$106 million in its origination fees account and ensure that the water board is evaluating its need for Clean Water State Revolving Fund fees appropriately.	R	Assistant Administrator for Water	12/31/24	\$106,000
4	17	Clarify annual review guidance regarding fee accounts and collect data on states' fee account balances through the annual review process.	R	Assistant Administrator for Water	12/31/24	
5	23	In coordination with the associate administrator for Policy, update EPA regulations implementing the Clean Water State Revolving Fund audit requirement at 33 U.S.C. § 1386(b) to clearly articulate requirements and current EPA expectations regarding audits of state revolving funds.	R	Assistant Administrator for Water	7/31/24	
6	23	Ensure annual review guidance regarding implementation of audit requirements is consistent with 33 U.S.C. § 1386(b) and 40 C.F.R. § 35.3165.	R	Assistant Administrator for Water	12/31/24	

* C = Corrective action completed.

R = Recommendation resolved with corrective action pending.

U = Recommendation unresolved with resolution efforts in progress.

CWSRF Infographic

THE CLEAN WATER STATE REVOLVING FUND

Low-Cost Infrastructure Financing Since 1987

Totals:
\$172 billion in funding
 for water quality infrastructure projects

48,022 loan agreements
 (through FY2023)

How it works:

EPA funds state CWSRFs each year, with **20% state match.** +

All 50 states and Puerto Rico have CWSRFs.

Apply for financing through state CWSRFs.

Who is eligible?
 (Eligibility varies by state and project type.)

Communities

Private entities

Nonprofit organizations

Citizen groups

Terms:

Up to 30 years **or useful life of project, whichever is less.** May also include additional subsidies (e.g., principal forgiveness and grants)

Below-market rates:
1.46% average interest rate in 2023 (market rate 3.6%)

BILL
Due Date:
1 year

Repayment starts **one year after** project completion.

Types of projects:

<ul style="list-style-type: none"> → Publicly owned treatment works → Nonpoint source projects → National estuary program projects → Decentralized wastewater treatment systems → Stormwater → Water conservation 	<ul style="list-style-type: none"> → Watershed projects → Energy conservation → Water reuse → Security measures at publicly owned treatment works → Technical assistance
-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

Return on investment

For every \$1 from federal government ➔ \$3.28 has gone to help communities.

www.epa.gov/cwsrf

Source: The EPA, "About the Clean Water State Revolving Fund (CWSRF)" [webpage](#). (EPA image)

Additional Information About the Different Types of Government Audits

The Government Accountability Office publishes [GAO-21-368G](#), *Government Auditing Standards*, issued by the Comptroller General of the United States. These standards are commonly referred to as generally accepted government auditing standards, and they provide a framework for conducting high-quality audits with competence, integrity, objectivity, and independence. Entities that receive government funding are often required by law or regulation to engage auditors to perform audits that comply with generally accepted government auditing standards.

Because there are different types of audits, reviewers may read several audit reports, including reports about financial statement, compliance, and Single Audit Act audits. They may also read audit reports for multiple entities, such as for the state and for another entity housing the CWSRF—for example, a state infrastructure authority.

Financial Statement Audits

When auditors conduct a financial statement audit, the generally accepted government auditing standards require them to assess and report on the auditee’s internal control over financial reporting. Auditors must explain the scope of their work when reporting on their assessment of internal controls over financial reporting. For example, a report might say:

In planning and performing our audit of the financial statements, we considered the Commonwealth’s internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Commonwealth’s internal control. Accordingly, we do not express an opinion on the effectiveness of the Commonwealth’s internal control.

When reporting their consideration of compliance with applicable laws, regulations, contracts, and grant agreements in a financial statement audit compliant with generally accepted government auditing standards, auditors explain the scope of their work. For example, a report might say:

As part of obtaining reasonable assurance about whether the Commonwealth’s financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

Compliance Audits

The objective of a compliance audit is to determine whether the auditee complied with specified criteria. The criteria could be established by laws, regulations, contracts, and grant agreements or by other means. For example, a compliance audit could determine whether a state's CWSRF complied, in all material respects, with Title VI of the Clean Water Act.

Government auditors performing a compliance audit in conformance with generally accepted government auditing standards must also consider internal controls that are significant to their audit objective, that is, to determining compliance with the specified criteria. In their audit report, the auditors must explain the scope of their work on internal controls, so that users can reasonably interpret the findings, conclusions, and recommendations in the audit report. For example, auditors might explain that they considered internal controls over compliance with Title VI of the Clean Water Act but not internal controls over other aspects of the auditee's operations.

Single Audit Act Audits

As of the issuance of this report in March 2024, a nonfederal entity that expends \$750,000 or more in federal awards during a fiscal year must have an audit performed in accordance with the Single Audit Act. Accordingly, states can be expected to have statewide single audits annually.

A single audit consists of several steps. The auditee prepares its financial statements and a schedule of expenditures of federal awards. The auditor is required to audit the financial statements in accordance with generally accepted government auditing standards and to determine and report whether the schedule of expenditures of federal awards is presented fairly in all material respects in relation to the financial statements as a whole.

Using the OMB's risk-based methodology, the auditor determines which federal programs listed on the schedule of expenditures of federal awards are "major federal programs" for the year in question.¹⁷ For each major federal program, the auditor determines and reports whether the nonfederal entity complied with the provisions of laws, regulations, and contracts or grants that could have a direct and material effect on the major federal program.¹⁸ The OMB provides a *Compliance Supplement* that identifies the compliance requirements that the federal government expects to be considered as part of a single audit. Federal agencies, such as the EPA, advise the OMB on the contents of the *Compliance Supplement* subsection for their programs.¹⁹

¹⁷ 2 C.F.R. § 200.518.

¹⁸ 2 C.F.R. § 200.515.

¹⁹ 2 C.F.R. § 200.513(c)(4).

Compliance Supplement for Single Audits

As we noted in the “Single Audit Act Audits” section of Chapter 1 and the “Conclusions” section of Chapter 3, every year the EPA considers which compliance areas to include as mandatory for EPA programs included in the *Compliance Supplement* for single audits. This consideration process is a recurring opportunity for the EPA to revise how it can leverage the work of independent external auditors to assist in its oversight of CWSRFs. This is true even though, because of its limited scope, a compliance audit of a CWSRF done according to the *Compliance Supplement* is not an audit of the CWSRF’s compliance with the entirety of Title VI of the Clean Water Act. We supply the historical information below as further background on the *Compliance Supplement* subsection for CWSRFs.

Required Audit Areas in the Compliance Supplement Subsection for CWSRFs

In the single audit annual *Compliance Supplement* for 2019 through 2023, the OMB instituted a major change. The OMB encouraged federal agencies to shift their focus in grants management from one “heavy on compliance” to one that balances compliance and performance by “establishing measurable program and project goals and analyzing data to improve results.”²⁰ To that end, starting in 2019 and continuing through 2023, the OMB limited agencies to choosing a maximum of six compliance areas per program for audit, as opposed to the former maximum of 12. According to the OMB, this reduction should focus “the agencies and the auditors on the areas that are most important for federal awarding agencies to manage programs more efficiently.”²¹ Each federal agency is responsible for identifying the six compliance areas that it wants tested per program. Table C-1 shows the compliance areas selected by the EPA, year by year, for the *Compliance Supplement* subsection for CWSRFs.

Table C-1: Areas of compliance requirements identified as subject to audit in the *Compliance Supplement* subsection for CWSRFs

Compliance requirement areas	2015 through 2018	2019	2020 through 2023
Activities Allowed or Unallowed	Yes	Yes	Yes
Allowable Costs/Cost Principles	Yes	Yes	Yes
Cash Management	Yes	Yes	Yes
Eligibility	No	No	No
Equipment and Real Property Management	No	Yes	No
Matching, Level of Effort, Earmarking	Yes	Yes	Yes
Period of Performance	Yes	Yes	Yes
Procurement and Suspension and Debarment	Yes	No	Yes
Program Income	Yes	No	No
Reporting	Yes	No	No
Subrecipient Monitoring	Yes	No	No

²⁰OMB, Executive Office of the President, 2 C.F.R. part 200, Appendix XI Compliance Supplement, 2022.

²¹ *Id.*

Compliance requirement areas	2015 through 2018	2019	2020 through 2023
Special Tests and Provisions	Yes	No	No

Note: Auditors are not expected to test requirements for areas that are marked “No.” For areas marked “Yes,” auditors must determine which are likely to have a direct and material effect on the federal program at the auditee and then must perform relevant audit procedures to test compliance.

Source: EPA OIG analysis of OMB *Compliance Supplements*. (EPA OIG table)

Before the EPA dropped “Special Tests and Provisions” as a compliance audit area for CWSRFs, the EPA used this area to direct auditors on which tests to perform to determine whether funded projects met federal funding requirements. If the EPA reinstates “Special Tests and Provisions” as a mandatory area, it could require that auditors test compliance with IJA-related CWSRF requirements, such as the Build America, Buy America Act.

Agency's Response to the Draft Report



ASSISTANT ADMINISTRATOR FOR WATER

WASHINGTON, D.C. 20460

MEMORANDUM

SUBJECT: Response to the Draft Report: *The EPA Should Improve Annual Reviews to Protect Infrastructure Investment and Jobs Act Grants to Clean Water State Revolving Funds*, OA-FY23-0047, January 16, 2024

FROM: Radhika Fox

For: Best-Wong, Benita

TO: Sean O'Donnell, Inspector General

Digitally signed by Best-Wong, Benita
Date: 2024.02.15
15:11:32 -05'00'

Thank you for the opportunity to provide comments on the U.S. Environmental Protection Agency Office of Inspector General draft report: *The EPA Should Improve Annual Reviews to Protect Infrastructure Investment and Jobs Act Grants to Clean Water State Revolving Funds*, OA-FY23-0047, dated January 16, 2024.

Recognizing the importance of protecting the substantial federal investment in the CWSRF, the Office of Water and the regions conduct robust oversight of the CWSRF programs. With the benefit of over 35 years of experience and a proven track record of programmatic and fiduciary oversight, OW has shepherded the CWSRF from inception to a program that has provided over \$170 billion in critical infrastructure investment at a current average rate of \$8.9 billion annually. The program has been such a success that, through the *Infrastructure Investment Jobs Act*, also known as the *Bipartisan Infrastructure Law*, Congress chose to provide an additional \$12.7 billion in capitalization in addition to regular annual appropriations.

OW's oversight and the regional annual reviews of state programs are important components to this success. To support regional annual reviews, OW provides detailed guidance that is updated annually based on internal observations, regional feedback, and new statutory or regulatory requirements. The guidance also includes checklists to ensure both consistency and that all requirements are covered by the annual reviews. And, as part of an annual review, the regions sample and review a subset of project files and transactions. The regions also use the annual reviews to conduct broad discussions with states

to address questions or discuss potential issues impacting Program Evaluation Reports. Additionally, the regions have multiple ad hoc meetings and phone conversations with states to address both short- and long-term issues.

OW reinforces the oversight expectations set through the annual review guidance with regional training on program oversight. This training covers how to prepare for the annual review, conduct interviews of state managers and staff, and write a PER, while highlighting that state oversight goes beyond just the annual review to include regular conversations and touchpoints throughout the year.

OW further supports regional staff in their oversight of state programs by providing direct assistance with the onsite annual reviews. OW staff attend at least one annual review in each region every year. This allows OW to both assist the region with conducting interviews and completing file reviews, as well as to observe the region and identify areas where oversight may need improvement. At the regions' request, OW has also provided contractor assistance to support some areas of the annual review. This frees up regional time to focus on interviews and other high priority oversight topics. OW staff has also attended annual reviews with regional staff, at their request, to assist states with particularly challenging issues.

OW uses a targeted approach to review a sample of PERs to determine findings, gaps, and capacity concerns. Additionally, informal feedback is provided to the regions when OW participates in annual reviews. However, more formal feedback on the regions' oversight of the state programs is needed. To that end, OW will develop a new structured review process that builds off of prior efforts such as the Management Assistance Reviews. These reviews will provide a deeper dive into regional staffing and oversight practices and will be conducted when OW believes that additional feedback should be provided to the regions.

A solid understanding of SRF requirements is critical to program oversight. To that end, OW conducts annual training workshops that cover a broad spectrum of SRF topics. These training workshops on SRF programmatic and financial requirements and best practices for program implementation are geared toward SRF practitioners in both the regions and states. Additionally, OW organizes a monthly coordinators' call with the regions which serves as an ongoing information sharing forum and discussion platform to raise questions or issues. The regions also jointly hold self-directed monthly calls in the areas of program oversight and financial oversight of the SRF programs. OW is supportive of these "grassroots" efforts and participates in and takes recommendation from the groups.

OW and the regions make every effort to ensure compliance with *Clean Water Act* audit requirements consistent with the limitations set by the Single Audit Act. While the Single Audit Act limits what can be required in terms of an audit, both the EPA and many state officials recognize that additional audit coverage, beyond the Single Audit Act, is beneficial in ensuring the financial integrity of these unique programs. OW and the regions continue to work with the states to have independent audits voluntarily conducted on an annual basis.

Finally, OW and the regions have taken numerous steps to protect the substantial investment provided by IJA, also known as BIL. Since the passage of this landmark legislation, OW has provided ongoing guidance to the regions and states, starting with the "*Implementation of the Clean Water and Drinking Water State Revolving Fund Provisions of the Bipartisan Infrastructure Law (BIL)*" memorandum in March 2022. This memorandum provided information and guidelines for awarding and administering

IJA funding consistent with Administration priorities. OW has built off this foundation by providing subsequent memoranda and additional guidance and trainings specifically targeted towards IJA implementation. As the regions award IJA capitalization grants, they directly support state efforts in developing Intended Use Plans that are consistent with the IJA guidance.

OW and the regions appreciate the efforts undertaken by the OIG and believe that their recommendations will help strengthen the continued oversight of the CWSRF programs. OW would like to offer the following comments on the draft report. Additional perspectives from regions and notes to specific comments in the report text are included in an Appendix.

Chapter 2: The Office of Water Did Not Consistently Monitor the Performance and Results of Annual Reviews

“The Office of Water did not consistently monitor the performance and results of annual reviews and did not always act in a timely manner to address risks identified by annual reviews, which is contrary to the purposes of the annual review process as established by regulation and guidance. From SFY 2019 through 2021, the OW did not consistently monitor the performance or results of the annual reviews for New York, Pennsylvania, and Texas. The OW did not ensure that Regions 2, 3, and 6 followed the annual review guidance. It also did not review all program evaluation reports and supporting checklists. Additionally, the OW did not act in a timely manner to address the risk of a substantial and potentially excessive fee account balance that Region 6 identified during the annual review process. This occurred because the OW considered its reliance on regional elevation of concerns to be an appropriate risk-based oversight strategy.”

OW is committed to monitoring SRF performance and always acts in the best interest of the fund – both fiducially and environmentally. Notwithstanding, we also believe we can continuously enhance our processes. To that end, OW will implement the recommendations included in this chapter as proposed.

Agency Response to Recommendations

1) Implement procedures to ensure consistent Office of Water oversight of the annual review process in all regions and states, including reviewing checklists and all program evaluation reports and tracking recommendations made by the regions.

Response to OIG Recommendation 1 - Concur:

- OW will enhance our process for reviewing all PERs annually and track/monitor required action items year-to-year. This will ensure greater consistency in oversight and ensure that no required action items are overlooked in the ongoing oversight cycle. Reviewing all PERs and monitoring required action items year-to-year will inform development of annual review guidance and trainings, as OW can identify common practices, good or bad, adjust, and update as needed.
 - In calendar year 2024 OW will review all PERs and track required action items. Expected completion date: December 31, 2024.

The annual review checklists are a tool for regions to help facilitate consistency across reviewing programs and drafting PERs. They are considered working documents that the

regions use to develop the PERs. OW will continue to work with the regions to ensure that the checklists are completed in accordance with annual review guidance.

OW will continue to conduct regular, systematic reviews of regional oversight. This will include a review of each region's annual oversight process from preparation to the final PER. A two-step approach of clearly setting expectations and ensuring adoption of updated annual review guidance followed by a more formal review of regional performance will be undertaken.

- In calendar year 2024 OW will ensure regions understand and incorporate updates to the annual review guidance when onsite. Expected completion date: December 31, 2024.
 - In calendar year 2025 OW will undertake a more formal process (building off of MARs) to provide written feedback and recommendations to the regions. Expected completion date: December 31, 2025.
- OW will continue to invest in training for the annual review process, specifically regarding the recommendations of this report. Ensuring that checklists are filled out appropriately and completely and are adequately reflected in the PERs will be a topic elevated in our upcoming trainings. As a reminder, relevant trainings have been updated to reflect prior responses and current responses going forward:
 - Regional Financial Analyst Training held December 5-7, 2023.
 - Three Annual Oversight Training Workshops during first half calendar year 2024.

2) Create a program evaluation report template and implement procedures to ensure that regions present results in a consistent format.

Response to OIG Recommendation 2 - Concur:

- OW will convene a meeting of coordinators to discuss a plan for developing a program evaluation report template or model PER. Expected completion date: June 30, 2024.
- OW will develop a program evaluation report template or model PER with regional practitioners who are responsible for writing PERs. Expected completion date: December 31, 2024.

3) Advise Region 6 to implement a resolution plan for the Texas Water Development Board's \$106 million in its origination fees account and ensure that the water board is evaluating its need for Clean Water State Revolving Fund fees appropriately.

Response to OIG Recommendation 3 - Concur:

- OW will work with Region 6 to ensure we understand the full context of this issue and together will develop an implementation plan for addressing any identified issues regarding the Texas Water Development Board's origination fees account. Expected completion date: December 31, 2024.

4) Clarify annual review guidance regarding fee accounts and collect data on states' fee account balances through the annual review process.

Response to OIG Recommendation 4 - Concur:

- OW will review and update annual review guidance to clarify the review of fee accounts. Expected completion date: December 31, 2024.
- OW will continue to conduct annual review training and has already placed a greater focus on the topic of fee accounts and the appropriateness of their balances.
 - OW included the topic of fee collection in the Financial Analyst training held December 5-7, 2023, and stressed the need for fee collection to be commensurate with uses.
- Given the variation in approaches to collecting fees, use of fees, size of state programs, and need for fees, it is impossible to have a simple black and white benchmark. The checklists and annual review guidance thus require that regions review fee collection and balances from the perspective of determining if they are “commensurate with uses.” This is inherently a state-by-state assessment.
- Updated scheduling information of relevant trainings already conveyed to OIG:
 - Regional Financial Analyst Training held December 5-7, 2023.
 - Three Annual Oversight Training Workshops during early calendar year 2024.

Chapter 3: The Office of Water's Annual Review Guidance Was Inconsistent with Regulatory Requirements for Annual Audits

“During the annual reviews, regional EPA staff did not ensure that each state’s CWSRF underwent an audit of its financial statements and its compliance with Title VI, as required by the Clean Water Act and the associated regulations. We concluded that New York, Pennsylvania, and Texas did not have audits conducted for their CWSRFs in SFYs 2019 through 2021 that met the regulatory requirements. Rather, the three states completed different types of audits that were accepted by their respective regions as fulfilling applicable requirements. This occurred because the OW’s annual review guidance is inconsistent with regulations requiring those annual audits of CWSRFs and OW does not direct the regions to ensure that each state obtains the appropriate audit. The guidance instead directs regional reviewers to accept a statewide single audit. The lack of appropriate audits may leave oversight gaps in the annual review process. If the OW does not ensure that the states undergo the required audits, material financial misstatements and noncompliance with Title VI of the Clean Water Act may go undetected.”

OW’s current guidance is based on a 1998 audit strategy that was designed to align CWA statutory and regulatory requirements with the provisions of the Single Audit Act of 1996. The 1998 audit strategy was developed in coordination with representatives from Office of Wastewater Management, Office of Ground Water and Drinking Water, Office of General Counsel, Office of Inspector General, the EPA Regional Offices, and the Office of Management and Budget. Under this audit strategy, the regions work directly with each of their states to gain a voluntary agreement to have separate financial audits conducted on an annual basis. States can use CWSRF administrative funds to cover the costs of

conducting these audits. In addition, the OIG agreed to conduct audits of CWSRF programs which did not carry out separate financial audits on a regular and ongoing basis. As noted in the Statement of Findings, the OIG discontinued this practice in 2006.

The draft report, beginning page 7, also states that:

The Single Audit Act, as amended, states that federal agencies should rely on and use single audits to the extent they provide information that the agencies need to carry out their responsibilities. The Act does not preclude an agency from requiring additional audit work if such work is necessary for the agency to carry out its oversight responsibilities. The single audit regulations at 2 C.F.R. § 200.503(d) require that “[a] Federal agency that conducts or arranges for additional audits must, consistent with other applicable Federal statutes and regulations, arrange for funding the full cost of such additional audits.”

Deviating from the 1998 audit strategy by making independent audits a requirement would likely result in the EPA bearing the cost of conducting 51 separate audits. This would be a significant burden of time and resources, particularly because 42 CWSRF programs are willingly conducting independent financial statement audits under the current audit strategy. OW would like to explore the possibility of having the OIG resume the practice of auditing states that choose not to conduct an independent audit consistent with practices at the time of and following the 1998 audit strategy. This would be a simple way to ensure 51 separate financial audits are done, likely with the majority of states continuing to conduct their audits voluntarily.

Notwithstanding these observations, OW agrees with the OIG recommendations included in this chapter and will implement them as proposed.

Agency Response to Recommendations:

- 5) In coordination with the associate administrator for Policy, update EPA regulations implementing the Clean Water State Revolving Fund audit requirement at 33 U.S.C. § 1386(b) to clearly articulate requirements and current EPA expectations regarding audits of state revolving funds.**

Response to OIG Recommendation 5 - Concur:

- OW concurs with considering updating regulations and will evaluate and present to management options for updating the CWSRF regulations to ensure they are reflective of oversight needs. Expected completion date: July 2024.

- 6) Ensure annual review guidance regarding implementation of audit requirements is consistent with 33 U.S.C. § 1386(b) and 40 C.F.R. § 35.3165.**

Response to OIG Recommendation 6 - Concur:

- OW will continue to review and update annual review guidance to clarify the enforcement and oversight of audit requirements. Expected completion date: December 31, 2024.

- OW will continue to conduct annual review training and have updated training to ensure that audit requirements remain a topic, but with greater focus.
 - Updated scheduling information of relevant trainings already conveyed to OIG:
 - Regional Financial Analyst Training held December 5-7, 2023.
 - Three Annual Oversight Training Workshops during early calendar year 2024.

cc: Shelley Howes, OIG
Katherine Trimble, OIG
Kevin King, OIG
Brenda Carey-DiGregorio, OIG
Marcus Gullett, OIG
Benita Best-Wong, OW/DAA
Carla Hagerman, OW AFC
Macara Lousberg, OW/IO
Janita Aguirre, OW/IO
Nancy Grantham, OW/IO
Katherine Stebe, OW/OWM
Andrew D. Sawyers, OW/OWM
Wynne Miller, OW/OW
Raffael Stein, OW/OWM
Michael Deane, OW/OWM
Arlene Chin, R2 AFC
Lori Fleury, R3 AFC
Josephine Hah, R6 AFC
Faisal Amin, OCFO
Sue Perkins, OCFO
Andrew LeBlanc, OCFO

Distribution

The Administrator
Deputy Administrator
Chief of Staff, Office of the Administrator
Deputy Chief of Staff for Management, Office of the Administrator
Agency Follow-Up Official (the CFO)
Assistant Administrator for Water
Principal Deputy Assistant Administrator for Water
Agency Follow-Up Coordinator
General Counsel
Associate Administrator for Congressional and Intergovernmental Relations
Associate Administrator for Public Affairs
Deputy Assistant Administrators for Water
Senior Advisors, Office of Water
Director, Office of Continuous Improvement, Office of the Chief Financial Officer
Director, Office of Program Analysis, Regulatory, and Management Support, Office of Water
Associate Director, Office of Program Analysis, Regulatory, and Management Support, Office of Water
Director, Office of Wastewater Management, Office of Water
Office of Policy OIG Liaison
Office of Policy GAO Liaison
Audit Follow-Up Coordinator, Office of the Administrator
Audit Follow-Up Coordinator, Office of Water
Audit Liaison, Office of Wastewater Management, Office of Water



Whistleblower Protection

U.S. Environmental Protection Agency

The whistleblower protection coordinator's role is to educate Agency employees about prohibitions against retaliation for protected disclosures and the rights and remedies against retaliation. For more information, please visit the OIG's whistleblower protection [webpage](#).

Contact us:



Congressional Inquiries: OIG.CongressionalAffairs@epa.gov



Media Inquiries: OIG.PublicAffairs@epa.gov



EPA OIG Hotline: OIG.Hotline@epa.gov



Web: epaoig.gov

Follow us:



X (formerly Twitter): [@epaoig](https://twitter.com/epaoig)



LinkedIn: linkedin.com/company/epa-oig



YouTube: youtube.com/epaoig



Instagram: [@epa.ig.on.ig](https://www.instagram.com/epa.ig.on.ig)



www.epaoig.gov