

## ENVIRONMENTAL PROTECTION AGENCY

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

#### I. PROGRAM OBJECTIVES

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

#### II. PROGRAM PROCEDURES

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

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

The State shall provide an annual report to EPA on its CWSRF program.

#### Source of Governing Requirements

The CWSRF program is authorized under Title VI of the Clean Water Act (33 USC 1381 et seq) and the implementing regulations are found in 40 CFR part 35, subpart K. Guidance on cross-collateralization are found in the policy statement titled *Transfer and Cross-Collateralization of Clean Water Revolving Funds and Drinking Water State Revolving Funds* published in the October 13, 2000, *Federal Register* (65 FR 60940).

### III. COMPLIANCE REQUIREMENTS

**In developing the audit procedures to test compliance with the requirements for a Federal program, the auditor should first look to Part 2, Matrix of Compliance Requirements, to identify which of the 14 types of compliance requirements described in Part 3 are applicable and then look to Parts 3 and 4 for the details of the requirements.**

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

#### A. Activities Allowed or Unallowed

1. *Financial Assistance*
  - a. The CWSRF may provide financial assistance: (1) to municipalities, inter-municipal, interstate, or State agencies for the construction of publicly owned treatment works, as defined in section 212 of the Act that are on the State's project priority list; (2) for implementing nonpoint source management programs under section 319 of the Act; and (3) for developing and implementing estuary management plans under section 320 of the Act (33 USC 1383(c)).
  - b. The allowable types of financial assistance are (33 USC 1383(d)):
    - (1) Making loans (not grants) for eligible projects;
    - (2) Buying or refinancing of debt obligations of municipal, intermunicipal, and interstate agencies incurred after March 7, 1985;
    - (3) Guaranteeing or purchasing insurance for local debt obligations;
    - (4) Using as a source of revenue or security for CWSRF debt obligations (providing that the net proceeds of the sale of such bonds are deposited in the CWSRF); and
    - (5) Guaranteeing loan guarantees for similar revolving funds established by municipalities or intermunicipal agencies.
2. CWSRF funds may be used by States for the reasonable costs of administering and managing the CWSRF (33 USC 1383(d)(7)).

## C. Cash Management

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

1. *Loans* - when the CWSRF receives a request from a loan recipient, based on incurred costs, including pre-building and building costs.
2. *Refinance or Purchase of Municipal Debt* - generally, when at a rate no greater than equal amounts over the maximum number of quarters that payments can be made, and up to the amount committed to the refinancing or purchase of the local debt.
3. *Purchase of Insurance* - when insurance premiums are due.
4. *Guarantees and Security for Bonds* - immediately, in the event of imminent default in debt service payments on the guaranteed/secured debt; otherwise, up to an amount dedicated for the guarantee or security based on incurred construction costs.
5. *Administrative Expenses* - cash can be drawn based on a schedule that coincides with the rate at which administrative expenses will be incurred (40 CFR section 35.3160).

## G. Matching, Level of Effort, Earmarking

### 1. Matching

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

### 2. Level of Effort - Not Applicable

### 3. Earmarking

The maximum amount allowable for administering and managing the CWSRF is 4 percent of the cumulative amount of capitalization grant awards received. When the administrative expense of the CWSRF exceeds 4 percent, the excess must be paid from sources outside the CWSRF (40 CFR section 35.3120(g)).

## H. Period of Availability of Federal Funds

“Grant payments” from a capitalization grant shall begin in the quarter in which the grant is awarded, and end no later than eight quarters after the grant is awarded, not to exceed 12 quarters from the date of allotment of grant funds to the States (40 CFR section 35.3155(c)).

## L. Reporting

### 1. Financial Reporting

- a. SF-269, *Financial Status Report* - Applicable
- b. SF-270, *Request for Advance or Reimbursement* - Not Applicable
- c. SF-271, *Outlay Report and Request for Reimbursement for Construction Programs* - Not Applicable
- d. SF-272, *Federal Cash Transactions Report* - Applicable

### 2. Performance Reporting - Not Applicable

### 3. Special Reporting

The State must provide an Annual Report to EPA according to the schedule in the grant agreement (*OMB No. 2040-0118*) (40 CFR sections 35.3165(a) and (b)).

## N. Special Tests and Provisions

### 1. Environmental Review Requirements

**Compliance Requirement** - The State must conduct reviews of the potential environmental impacts of all Section 212 construction projects receiving assistance from the CWSRF, including nonpoint source pollution control and estuary protection projects that are also Section 212 projects (40 CFR section 35.3140).

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

#### Suggested Audit Procedures

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

## 2. Binding Commitments

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

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

### Suggested Audit Procedures

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

## 3. Fund Establishment, Loan Repayments, and Fund Earnings

**Compliance Requirements** - The State shall establish a separate account or series of accounts that is dedicated solely to providing loans and other forms of financial assistance. All loan repayments (including principal and interest), interest earnings on investments, capitalization grants, State match, and transfers from the DWSRF must be credited directly to the CWSRF. Repayment of loans shall begin within one year after project completion, and loans shall be fully amortized over not more than 20 years after project completion (40 CFR sections 35.3110(b) and 35.3120(a) and the policy statement titled *Transfer and Cross-Collateralization of Clean Water Revolving Funds and Drinking Water State Revolving Funds* published in the October 13, 2000, *Federal Register* (65 FR 60940)).

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

### **Suggested Audit Procedures**

- a. Ascertain if the CWSRF is a separate account, or series of accounts, dedicated solely to purposes of the program.
- b. Test a sample of projects funded by the CWSRF and for which repayments were due during the year to determine that principal and interest payments were properly credited to the CWSRF accounts.
- c. Test a sample of loan agreements and other project records to ascertain if the repayments began within one year of project completion and the loans are scheduled for full amortization within 20 years.
- d. Obtain a list of investments made during the year and ascertain if earnings on investments were properly recorded in the CWSRF.

### **4. CWSRF as Security for Bonds**

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

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

### **Suggested Audit Procedures**

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

**IV. OTHER INFORMATION**

*Subrecipients* - In years after the subrecipient has expended loan proceeds and completed construction, and the subrecipient's only ongoing financial activity of the program is the payment of principal and interest on outstanding balances, the prior loan balances at the subrecipient level are not considered to have continuing compliance requirements under OMB Circular A-133 §\_\_\_\_.205(d). Prior loans that do not have continuing compliance requirements other than to repay the loans are not considered Federal awards expended and therefore are not required to be audited under OMB Circular A-133.

## ENVIRONMENTAL PROTECTION AGENCY

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

#### I. PROGRAM OBJECTIVES

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

#### II. PROGRAM PROCEDURES

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

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

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

The State also must provide a Biennial Report to the EPA containing detailed information on how the State met the goals and objectives of the previous two fiscal years as stated in its IUP and grant agreement. Such report must cover the State's entire DWSRF program, including its set-aside activities. EPA conducts Annual Review of State programs to assess the success of each program, including activities identified in the IUP and Biennial Report.

### **Source of Governing Requirements**

This program is authorized under Section 1452 of the Public Health Service Act (Title XIV), commonly known as the SDWA (42 USC 300j-12). The implementing regulations for the program can be found at 40 CFR part 35, subpart L.

### **Availability of Other Program Information**

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

## **III. COMPLIANCE REQUIREMENTS**

**In developing the audit procedures to test compliance with the requirements for a Federal program, the auditor should first look to Part 2, Matrix of Compliance Requirements, to identify which of the 14 types of compliance requirements described in Part 3 are applicable and then look to Parts 3 and 4 for the details of the requirements.**

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

### **A. Activities Allowed or Unallowed**

1. The DWSRF program may provide the following financial assistance to publicly- or privately-owned community water systems and non-profit non-community water systems for eligible drinking water infrastructure projects (40 CFR sections 35.3520 and 35.3525):
  - a. Making loans for eligible projects (40 CFR section 35.3520(b)).
  - b. Purchasing or refinancing existing debt obligations of municipal, intermunicipal and interstate agencies entered into on or after July 1, 1993.
  - c. Guarantee of or purchasing insurance for local debt obligations.
  - d. Providing a source of revenue or security for DWSRF debt obligations, provided that the net proceeds of the sale of such debt obligations are deposited in the DWSRF.

2. A State may set aside funds for the following designated set-aside activities (40 CFR section 35.3535):
  - a. Administrative expenses (including technical assistance).
  - b. Technical assistance to small water systems that regularly serve 10,000 or fewer persons (40 CFR section 35.3505).
  - c. State program management.
  - d. Local assistance and other state programs.
3. The DWSRF may not provide assistance for (40 CFR sections 35.3520(d) through (f)):
  - a. Dams or reservoirs, water rights, laboratory fees for monitoring, system operation and maintenance, or projects that are primarily fire protection.
  - b. Expansion projects pursued solely in anticipation of future growth.

### **C. Cash Management**

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

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

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

### **1. Matching**

- a. States are required to deposit into the DWSRF from State monies an amount equal to 20 percent of each grant payment. The match is required to be made on or before the time that EPA funds are drawn. When a letter of credit (LOC) mechanism or similar financial arrangement is used for the State match, payments to the LOC account must be made proportionally on the same schedule as payments for the capitalization grant. Monies from this State match LOC must be drawn into the DWSRF as monies are drawn on the Federal automated clearinghouse account. A State may issue general obligation or revenue bonds to derive the State match. If the State provides a match in excess of the required amount, the excess balance may be banked toward subsequent match requirements (40 CFR section 35.3550(g)).
- b. In the case of the State Program Management set-aside, the State must also provide an amount equal to 100 percent of said payments. A State is authorized to use the amount of State funds expended on its Public Water System Supervision (PWSS) program in fiscal year 1993 (including PWSS match) as a credit toward meeting its match requirement. The value of this credit can be up to, but not greater than, 50 percent of the amount of match that is required. A State must provide the additional funds necessary to meet the remainder of the match requirement. The sources of these additional funds can be State monies (excluding PWSS match) or documentation of in-kind services. Although required PWSS match cannot be used as a source of additional State monies, State overmatch can be used (40 CFR sections 35.3535(d)(2) and 35.3550(h)).
- c. For grant payments to the State from funds appropriated in Federal fiscal year 1997, the State could defer deposit of the matching amount until no later than September 30, 1999.

### **2. Level of Effort - Not Applicable**

### **3. Earmarking**

Up to 31 percent of the allotment can be earmarked for set-aside activities as follows:

- a. *Administrative Expenses* - Not to exceed 4 percent of the cumulative allotment (40 CFR section 35.3535(b)).
- b. *Technical Assistance to Small Systems* - Not to exceed 2 percent of the cumulative allotment (40 CFR section 35.3535(c)).

- c. *State Program Management* - Not to exceed 10 percent of the cumulative allotment (40 CFR section 35.3535(d)).
- d. *Local Assistance and Other State Programs* - Not to exceed 15 percent of the capitalization grant and no more than 10 percent is used on any one of the defined activities (40 CFR section 35.3535(e)).

A State cannot use more than 30 percent of any particular fiscal year's capitalization grant to provide subsidies in the form of principal forgiveness or negative interest rate loans to communities meeting the State's definition of disadvantaged, or communities the State expects to become disadvantaged as a result of the project (40 CFR section 35.3525(b)).

## **H. Period of Availability of Federal Funds**

Grant payments from a capitalization grant, which increase the ceiling of funds from which a State may draw cash for eligible costs, shall begin no earlier than the quarter in which the grant is awarded, and generally end no later than eight quarters after the grant is awarded, not to exceed 12 quarters from the date of allotment of grant funds to the States. State must obligate funds for eligible projects within one year of accepting a payment. States disburse, or liquidate, grant funds for projects in accordance with construction schedules. Funds are disbursed for set-aside activities in accordance with costs being incurred under approved workplans (40 CFR sections 35.3550(e) and 35.3560).

## **J. Program Income**

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

## **L. Reporting**

### **1. Financial Reporting**

- a. SF-269A, *Financial Status Report* - Applicable
- b. SF-270, *Request for Advance or Reimbursement* - Not Applicable
- c. SF-271, *Outlay Report and Request for Reimbursement for Construction Programs* - Not Applicable
- d. SF-272, *Federal Cash Transactions Report* - Applicable

### **2. Performance Reporting** - Not Applicable

### 3. Special Reporting - Not Applicable

## N. Special Tests and Provisions

### 1. Environmental Review Requirements

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

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

#### Suggested Audit Procedures

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

### 2. Binding Commitments

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

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

### **Suggested Audit Procedures**

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

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

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

Transfers between the DWSRF and CWSRF must be approved by the State Governor (40 CFR section 35.3530(c)). Repayment of loans shall begin within one year after project completion, and loans shall be fully amortized over not more than 20 years after project completion, with the exception that loans to qualified disadvantaged communities can be amortized over 30 years (40 CFR sections 35.3525(a) and (b)(3)).

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

### **Suggested Audit Procedures**

- a. Ascertain if the DWSRF is a separate account, or series of accounts, dedicated solely to purposes of the program and that the set-aside funds are deposited into a separate accounts identified for the use of set-aside activities.
- b. Test a sample of projects funded by the DWSRF and for which repayments were due during the year to determine that principal and interest payments were properly credited directly to the DWSRF.
- c. Test a sample of loan agreements and other project records to ascertain if the repayments began within one year of project completion and the loans are scheduled for full amortization within 20 years, or 30 years for loans to disadvantaged communities.

- d. Obtain a list of investments made during the year and ascertain if earnings on investments were directly credited to the DWSRF account.
- e. Obtain cash draw records or reports from the EPA Regional office and ascertain if cash draws were directly credited to the DWSRF account and the appropriate State match was deposited.
- f. Ascertain if a transfer of funds between the DWSRF and CWSRF programs occurred and if the transfer was approved by the State Governor.

#### **4. DWSRF as Security for Bonds**

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

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

#### **Suggested Audit Procedures**

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

#### **5. Repayment of Set-Aside Loans**

**Compliance Requirement** - Assistance from the Local Assistance and Other State Programs set-aside for assistance for land acquisition or conservation easements for source water protection of a public water system or for implementation of voluntary, incentive-based source water quality protection measures for a community water system must be made in the form of a loan which must be repaid within 20 years after

completion of the project. Principal and interest payments on these and other set-aside loans must be placed in the DWSRF or in a separate dedicated account or accounts for use of the same set-aside activity in accordance with 40 CFR section 35.3535(e)(2).

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

#### **Suggested Audit Procedures**

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

#### **IV. OTHER INFORMATION**

*Subrecipients* - In years after the subrecipient has expended loan proceeds and completed construction, and the subrecipient's only ongoing financial activity of the program is the payment of principal and interest on outstanding balances, the prior loan balances at the subrecipient level are not considered to have continuing compliance requirements under OMB Circular A-133 §\_\_.205(d). Prior loans that do not have continuing compliance requirements other than to repay the loans are not considered Federal awards expended and therefore are not required to be audited under OMB Circular A-133.