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Environmental Protection Agency

Clean Water and Drinking Water State Revolving Funds ARRA Program Audit

Audit Period: December 1, 2009 to February 12, 2010

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Executive Summary

Background

The American Recovery and Reinvestment Act (ARRA), signed into law on February 17, 2009, include the following statement of purposes:

- To preserve and create jobs and promote economic recovery.
- To assist those most impacted by the recession.
- To provide investments needed to increase economic efficiency by spurring technological advances in science and health.
- To invest in transportation, environmental protection, and other infrastructure that will provide long-term economic benefits.
- To stabilize State and local government budgets, in order to minimize and avoid reductions in essential services and counterproductive state and local tax increases.

The State of Ohio has applied for over 90 ARRA programs with expected total grant awards to exceed $8.5 billion during the next two years. These applications have been initiated by 21 state agencies in the form of formula, competitive, and discretionary grants. The grant awards are distributed in the following four spending categories:

- Countercyclical Funds: The two largest components of the State's budget that is exposed during a recession, while state revenues decline, are health care and education. The State has been awarded two formula grants (Medicaid and State Fiscal Stabilization) to assist the State's budget. The State Fiscal Stabilization Fund is primarily for education.
- Appropriated Funds: These grants represent additional funding for existing programs such as transportation, labor, and justice programs which will assist in job creation.
- Safety Net Funds: These grants provide relief for lower-income families in the form of supplemental nutrition assistance, child care, and extension of unemployment benefits.
- Economic Growth Funds: These awards focus on new technologies such as alternative energy, health information technology, broadband, and research initiatives.

The Ohio Environmental Protection Agency (EPA) has applied for four awards. This audit focused on the Clean Water and Drinking Water State Revolving Funds ARRA Programs which are formula grants. As of December 31, 2009, the EPA had disbursed $15,771,949 of the awarded $220,623,100 for the Clean Water State Revolving Fund program and $15,301,168 of the awarded $58,460,000 for the Drinking Water State Revolving Fund program. A total of 402.97 jobs were reported (250.34 under Clean Water and 152.63 under Drinking Water) as of December 31, 2009 in accordance with OMB Guidance issued prior to December 18, 2009. This report focused primarily on the internal control design and operating effectiveness for both programs.

The Clean Water State Revolving Fund (CWSRF) grant (CFDA[1] 66.458) is a formula grant awarded by the U.S. Environmental Protection Agency to fund wastewater infrastructure projects and actions to implement non point source water pollution management plans and estuary conservation / management plans.

The Drinking Water State Revolving Fund (DWSRF) grant (CFDA[1] 66.468), also a formula grant awarded by the U.S. Environmental Protection Agency, is designed to protect public health by providing financial assistance to eligible public water systems to attain and maintain compliance with the Safe Drinking Water Act and Ohio statutes and regulations.

EPA administers the CW/DWSRF and directs the Ohio Water Development Authority (OWDA) regarding their fiscal administration. Fiscal administration includes reviewing and approving requests for payments from recipients, executing federal draws, issuing payments to contractors, and fund reconciliation.

During the audit, OIA identified opportunities for EPA to strengthen internal controls and improve business operations for the administration of ARRA funds. Summary and detailed observations have been provided. OIA would like to thank EPA and OWDA staff and management for their cooperation and time in support of this audit.

This report is intended for the information and use of EPA management and the State Audit Committee.

[1] Catalog of Federal Domestic Assistance

Scope and Objectives

OIA staff was engaged to perform assurance work related to the Clean Water and Drinking Water State Revolving Funds ARRA Programs. This work was completed between December 1, 2009 and February 12, 2010. The scope of this audit included the following areas:

- Program planning
  - Program risk assessment; and
  - Internal control process documentation
- Application process
  - Public award announcement; and
  - Applicant evaluation and award notification
- Program administration and monitoring
  - Communication of grant requirements; and
  - Program oversight and monitoring
- Reporting
  - Financial reporting; and
  - Non-financial statistical reporting

The following summarizes the objectives of the audit along with a conclusion on the design and effectiveness of management's internal controls.

Objective	Conclusion[2]
Evaluate the adequacy of EPA's ARRA program risk assessment and internal control documentation based on guidance provided by the Office of Budget and Management.	**Well-Controlled with Improvements Needed**
Evaluate the adequacy of the awarding process for ARRA funds to subrecipients and vendors.	**Well-Controlled**
Evaluate the design and adequacy of EPA's communication related to ARRA program requirements, state guidance, and federal compliance requirements to grant recipients.	**Well-Controlled**
Evaluate the design and effectiveness of controls over the timeliness, accuracy, and completeness of ARRA disbursements.	**Well-Controlled**

Objective	Conclusion[2]
Evaluate the design of the controls over ARRA subrecipient and vendor monitoring process for the program.	**Improvements Needed – See Observation 1**
Evaluate the design of controls over complete, accurate, and timely reporting of ARRA financial and non-financial information.	**Improvements Needed – See Observation 2**

[2] Refer to Appendix A for classification of audit objective conclusions.

Summary of Observations and Recommendations

The Summary of Observations and Recommendations includes only those risks which were deemed high or moderate. Low risk observations and recommendations were discussed with individual agency management and are not part of this report. However, the low risk observations and recommendations were considered as part of the audit objective conclusions above.

No.	Observation	Recommendation	Risk[2]
1.	**Subrecipient Monitoring** – EPA does not have risk-based selection of projects for on-site and desk review monitoring. There are not documented procedures for distribution of on-site visit reports to the subrecipient receiving the visit or OWDA who is responsible for issuing payment to the CW/DWSRF subrecipients. Although EPA performs program monitoring, a review by EPA of vouchers paid by OWDA was not apparent during our review.	Management should develop a comprehensive, risk-based monitoring program that aligns controls with risks associated with disbursing ARRA funds to subrecipients.	**Moderate**
2.	**ARRA Reporting** – Although EPA has documented a process for reporting the ARRA 1512 data, the agency has not developed or documented formal procedures for validating the non-financial information (number of jobs created/retained under ARRA), before submission for state and federal reporting.	Procedures should be developed that define the process of validating the subrecipients' non-financial information that is required for state and federal reporting.	**Moderate**

Due to the limited nature of our audit, we have not fully assessed the cost-benefit relationship of implementing the observations and recommendations suggested above. However, these observations reflect our continuing desire to assist EPA in achieving improvements in internal controls, compliance, and operational effectiveness.

[2] Refer to Appendix A for classification of audit observations.

Detailed Observations and Recommendations

Observation 1 – Subrecipient Monitoring

OMB Circular A-133, Subpart D, requires EPA to monitor the activities of subrecipients to reasonably ensure that laws, grant agreements, and performance goals are achieved. Additionally, based upon guidance from the Auditor of State, ARRA-CW/DWSRF will not be included on the federal schedule of the subrecipients. Therefore, this program will not be subject to audits performed in accordance to the Single Audit Act at the local level, rather the ARRA CW/DWSRF will be audited at the state level. Furthermore, EPA was required to sign an assurance statement indicating a risk-based subrecipient monitoring process would be in place to ensure achievement of program and economic outcomes.

EPA is responsible for monitoring the use of the ARRA-CW/DWSRF for approximately 300 subrecipients. EPA's current monitoring procedures consist of a planned desk review, an on-site programmatic review (i.e. site visit), and a review by OWDA of vouchers prior to disbursement of ARRA funds. The planned desk reviews consist of completing a monitoring checklist for each project to ensure the agency's compliance with the requirements set forth in the ARRA. At the time when this report was prepared, no desk reviews had been performed; therefore, we were unable to evaluate the process implementation. An on-site programmatic review is performed by EPA staff by utilizing a standard checklist to verify adherence to ARRA requirements, project plans and environmental measures. The EPA staff person documents the results of the visit in a report and sends to EPA management for review. There are not documented procedures for distribution of on-site visit reports to the subrecipient receiving the visit or OWDA who is responsible for issuing payment to the CW/DWSRF subrecipients.

Although EPA performs program monitoring, a review by EPA of vouchers paid by OWDA was not apparent during our review. Current procedures require each subrecipient's project coordinator and/or local certified engineer to review/approve the project invoices before submitting payment requests to OWDA for reimbursement. OWDA engineers then review the payment request and invoices to ensure appropriate signatures are documented and purchases and work invoiced align with the subrecipient's project plan before payment is authorized. However, EPA does not receive copies of the invoices submitted and are, therefore, unable to validate the expenditures are actual and accurate for the project.

While EPA does have monitoring procedures in place, they do not reflect a risk-based selection of projects for on-site and desk review monitoring. The lack of a risk-based, coordinated monitoring process increases the risk of subrecipient noncompliance or questioned costs. EPA monitoring is important because the A-133 audit of these monies is limited to the state level.

Recommendation
Management should develop a comprehensive, risk-based monitoring program that aligns controls with risks associated with disbursing ARRA funds to subrecipients. The program should prioritize monitoring activities to minimize risk to an acceptable level as established by EPA management. The procedures should include planning for the frequency and scope of on-site visits, desk reviews, communication and training, and remediation processes for subrecipient issues identified. Additionally management should consider utilizing the payment request documentation (include obtaining the supporting invoices) to validate the expenditures in conjunction with conducting program reviews of projects. Results of monitoring (financial and program) conducted should be communicated to appropriate parties within EPA, OWDA, and the subrecipient.
Management Response
Ohio EPA will write and implement a formal ARRA State Revolving Loan Fund monitoring plan that includes the following: • Documentation of its standards for the frequency of on-site construction monitoring. • Risk based selection of projects for desk reviews. • Require OWDA to supply invoices to Ohio EPA as they are received and Ohio EPA to review ARRA payment requests and vouchers that were submitted to OWDA. • Communication of results of ARRA on-site construction visit reports to loan recipients, OWDA and OEPA managers. • Distribution of the monitoring plan to all persons responsible for on-site monitoring, desk reviews and remediation.

Risk	Remediation Owner	Estimated Completion Date
Moderate	Chief, Division of Environmental Financial Assistance	May 2010

Observation 2 – ARRA Reporting

An effective reporting process includes documented procedures that define roles and responsibilities as well as details the process steps to achieve the ARRA reporting objectives as described in Office of Budget and Management Guidance Memo #9, issued to state agencies on July 30, 2009. Furthermore, the federal Office of Management and Budget (OMB) Guidance M-09-21, issued June 22, 2009, provided guidance to recipients on the 1512 reporting elements, including an approved methodology for calculating the jobs created/retained.

EPA is responsible for compiling and validating the information of both the department and its subrecipients submit to the state and federal government. Although EPA has documented a process for reporting the ARRA 1512 data, the agency has not developed or documented formal procedures for validating the non-financial reporting information (number of jobs created/retained under ARRA) before submission for state and federal reporting.

Without a formal validation process for the jobs data information received from the approximate 300 ARRA-CW/DWSRF subrecipients, incomplete and /or inaccurate information could be reported to federal oversight agencies, thereby lowering public confidence in the eventual achievement of overall ARRA program objectives.

Recommendation

Procedures should be developed that define the process of validating the subrecipients' jobs data information that is required for state and federal reporting. The data quality review and validation process could include procedures that define:

- who validates the data (i.e. ARRA jobs created/retained);
- from where the data is obtained; and
- how management ensures the subrecipients submit accurate, complete, and timely data.

Management Response

Ohio EPA will include and implement the following jobs data validation as part of the ARRA State Revolving Loan Fund monitoring plan:

- Within the 30 day period following the close of each quarter, Ohio EPA will review the quarterly 1512 reports from sub-recipients and identify reports with jobs numbers that appear to be outside the norm based on a comparison of jobs reported to disbursements and percentage of project completion.
- Validation requests will be sent to the identified sub-recipients.

- Ohio EPA will require the sub-recipients to provide the supporting calculations for the number of hours worked by employees of the contractor and sub-contractors and the resulting quarterly FTEs.

Ohio EPA will review the method used to calculate the jobs. If the method is incorrect, Ohio EPA will work with and instruct the sub-recipient to correctly calculate the jobs and then amend the 1512 report.

Risk	Remediation Owner	Estimated Completion Date
Moderate	Chief, Division of Environmental Financial Assistance	May 2010

Appendix A – Classification of Audit Objective Conclusions and Observations

Classification of Audit Objective Conclusions

Conclusion	Description of Factors
Major Improvements Needed	Weaknesses are present that could potentially compromise achievement of its overall purpose. The impact of weaknesses on management of risks is widespread due to the number or nature of the weaknesses.
Improvements Needed	Weaknesses are present that compromise achievement of one or more control objectives but do not prevent the process from achieving its overall purpose. While important weaknesses exist, their impact is not widespread.
Well-controlled with Improvements Needed	The processes have design or operating effectiveness deficiencies but do not compromise achievement of important control objectives.
Well-Controlled	The processes are appropriately designed and/or are operating effectively to manage risks. Control issues may exist, but are minor.

Classification of Audit Observations

Rating	Description of Factors	Reporting Level
High	Observation has broad (state or agency wide) impact and possible or existing material exposure requiring immediate agency attention and remediation.	Audit Committee, Senior Management, Department Management
Moderate	Observation has moderate impact to the agency. Exposure may be significant to unit within an agency, but not to the agency as a whole. Compensating controls may exist but are not operating as designed. Requires near-term agency attention.	Audit Committee, Senior Management, Department Management
Low	Observation poses relatively minor exposure to an agency under review. Represents a process improvement opportunity.	Department Management, Senior Management (Optional), Audit Committee (Not reported)

Appendix B – Audit Follow-up Procedures

OIA will periodically follow-up on management's plans to remediate high and moderate risk audit observations. Follow-up activities may generally be broken down into three categories:

Detailed Detailed follow-up is usually more time-consuming and can include substantial audit customer involvement. Verifying and testing procedures implemented as well as substantiating records are examples. The more critical audit observations usually require detailed follow-up.

Limited Limited follow-up typically involves more audit customer interaction. This may include actually verifying procedures or transactions and, in most cases, cannot be accomplished through memos or telephone conversations with the audit customer but requires onsite observation or testing.

Informal This is the most basic form of follow-up and may be satisfied by review of the audit customer's procedures or an informal telephone conversation. Memo correspondence may also be used. This is usually applicable to the less critical observations.

Low risk audit observations will not result in an OIA audit follow-up, although these observations will be factored into the continuous risk assessment process for future OIA engagements.