

U.S. ENVIRONMENTAL PROTECTION AGENCY,
REGION 10
CLEAN WATER STATE REVOLVING FUND PROGRAM

PROGRAM EVALUATION REPORT

WASHINGTON WATER POLLUTION CONTROL REVOLVING FUND
SFY 2003-2004



Clean Water
State Revolving Fund



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
REGION 10
1200 Sixth Avenue
Seattle, WA 98101

FEB 23 2006

Reply to
Attn Of: OWW-137

David Peeler, Manager
Water Quality Program
Washington Department of Ecology
P.O. Box 47600
Olympia, Washington 98504-7600

RE: Washington Water Pollution Control Revolving Fund
Program Evaluation Report for SFY 2003-2004

Dear Mr. Peeler:

In cooperation with the Water Quality Financial Assistance Program staff of the Department of Ecology (Ecology) the U.S. Environmental Protection Agency Region 10 (EPA) has completed a periodic review of Ecology's continuing administration of the Washington Water Pollution Control Revolving Fund (Fund). I have enclosed the results of this review in the EPA's Program Evaluation Report (PER) for state fiscal years 2003 and 2004.

The PER documents that Ecology continues to operate a well-managed water pollution control revolving fund. It also notes how Ecology has proceeded to address each of the findings that the EPA published in the PER for SFY 2002, last spring. For example, Ecology has completed an evaluation of the interest rates charged by the Fund and the ability of the Fund to meet its "perpetuity obligations" under the Clean Water Act. In response to this evaluation, Ecology is raising the interest rates it will charge for loans executed in SFY 2007 to the current maximum allowed by Ecology's program regulations.

Similarly, Ecology is already addressing the recommendations contained in the enclosed PER. It is starting a rule revision process that will revise the Washington Administrative Code provisions governing the operation of the Washington Water Pollution Control Revolving Fund to provide more flexibility in establishing loan interest rates and make other changes directed at improving the operation of the Fund. It is also already working with the EPA to develop a new Operating Agreement. (By agreement, the EPA is developing a first draft for Ecology to review.)

The PER reiterates our concern about long-term financing for the administration of the Washington Water Pollution Control Revolving Fund. We understand that Ecology is continuing to examine options for addressing this fiscal challenge.

I would be glad to discuss the PER with you. I can be reached at (206) 553-7151. Similarly, Daniel Steinborn, the region's Project Officer for our oversight of the Washington Water Pollution Control Revolving Fund, would be glad to discuss the report and our recommendations with the Ecology staff at their convenience. Dan can be reached at (206) 553-2728.

Sincerely,

A handwritten signature in black ink, appearing to read "M. Gearheard". The signature is fluid and cursive, written over a white background.

Michael Gearheard, Director
Office of Water and Watersheds

Enclosure

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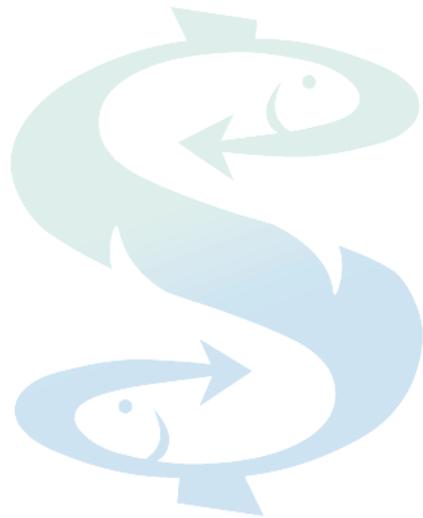
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Clean Water

State Revolving Fund

EXECUTIVE SUMMARY

This report presents the Environmental Protection Agency's (EPA's) evaluation of the performance of the Washington Department of Ecology (Ecology or DOE) in its administration of the Washington Water Pollution Control Revolving Fund during State Fiscal Year (SFY) 2003 and SFY 2004. Our review was conducted pursuant to the *Annual Review Guidance for the State Revolving Fund Programs (Interim Final)* published by the EPA's Office of Water in March 2004.

In accordance with that guidance, this report is organized into the following components:

- This Executive Summary
- A narrative statement that summarizes program highlights and discusses the follow-up actions that Ecology has implemented since the EPA's most recent Program Evaluation Report (PER) on the Washington Water Pollution Control Revolving Fund was published.¹
- An annotated program review checklist for both programmatic and financial elements of revolving fund administration (attached).
- Explanatory notes for those items in the review checklist the merit additional discussion (following the program highlights).
- Project file review checklist.

This report reflects the EPA's examination of the following types of records:

- The Operating Agreement between the EPA and Ecology governing the administration of Washington's Water Pollution Control Revolving Fund.
- The grant agreements associated with each of the open EPA capitalization grants to Ecology.
- The Intended Use Plans (IUPs) for the Washington Water Pollution Control Revolving Fund for SFY 2003 and SFY 2004.
- Records of financial transactions maintained by the EPA and Ecology
- The annual reports submitted by Ecology for SFY 2003 and SFY 2004.
- Project loan files maintained by Ecology

¹ That report was published March 15, 2005 and evaluated the program's performance for SFY 2002.

- The independent financial audit of Washington's Water Pollution Control Revolving Fund for SFY 2003 completed by the EPA's Office of Inspector General-Audit.
- Discussions held between Ecology's management and program staff, representatives of the Washington State Auditor's Office and the EPA in early December 2005.

As part of our review, the EPA also visited the Department of Ecology for a few days during the week of March 21, 2005. During that visit, we met with Ecology staff to discuss and review several components of Ecology's financial management system. We also reviewed loan files for two recently originated loans. As noted above, the results of these loan file reviews appear later in this report.

In addition to the two meetings specifically focused on the Washington Water Pollution Control Revolving Fund, the EPA is a member of Ecology's Water Quality Financial Assistance Advisory Council. Both the regional SRF Grants Project Officer and the regional CWSRF Financial Analyst attend and participate in the quarterly meetings of the Council. The Council serves as a consultative body for Ecology in its administration of all of its water quality financial assistance programs. Council meetings continue to provide a collegial forum in which program issues and problems are discussed.

The Washington Department of Ecology continues to operate an effective water pollution control revolving fund. Ecology has a dedicated and competent staff in both its central and regional offices. It uses an integrated planning and priority setting system to rank projects that are candidates for funding and uses an integrated solicitation process that allows project sponsors to submit one application for consideration for assistance from the SRF, the state's Centennial Clean Water program and the state's nonpoint source grants program under §319 of the Clean Water Act. This system, unique to Washington State, makes Washington's program especially effective at both maximizing the number of projects receiving assistance in any one year and at maximizing the water quality benefits that the state is obtaining from its water quality financial assistance programs.

Based on our review of the Washington Water Pollution Control Revolving Fund's performance in SFY 2003 and SFY 2004, we have identified a few matters for which corrective action by the Department of Ecology is warranted:

1. The Department needs to complete the actions necessary in order to adjust loan interest rates so that the purchasing power of the Fund is being maintained. As part of this process the Department needs to

develop and implement a cooperative water infrastructure financing strategy with the Public Works Board. See the discussion at page 7.

2. The Department must complete the work necessary to allow it to complete and document in the record a creditworthiness evaluation on each loan application considered in SFY 2007. See the discussion at page 7.
3. The Department must work with the EPA to develop a new Operating Agreement governing the administration of the Fund which reflects changes to state program regulations and procedures that have been developed and implemented since 1989. This new Operating Agreement should specifically incorporate changes to the Washington Administrative Code (WAC) that will be developed in SFY 2006. During our December 2005 discussions the EPA agreed to develop a draft shell of a new Operating Agreement for Ecology to use as a starting point to develop the full agreement. Ecology and EPA agreed to aim to have the new agreement signed by June 30, 2006. See the discussion at page 13.
4. Ecology should revise its loan agreement language and the program's WAC provisions to reference accounting standards that loan recipients are required to conform to, instead of the current reference to audit standards. The simplest way to correct the reference would be to require compliance with the requirements of RCW 43.09.200 "Local Government accounting-Uniform system of accounting." Ecology should establish adequate procedures to ensure that SRF borrowers are monitored to verify that they are in compliance with applicable accounting standards and that borrowers continue to be in good financial condition. See the discussion at page 14.
5. Before the next biennial budget is developed, the Department needs to resolve how it will acquire the funds necessary to continue paying the costs of administering the Fund as it draws down the current funding source. Any proposed legislative changes should be submitted to the 2007 legislative session for action during the development of the 2008-2009 biennial budget. See the discussion at page 10.
6. The Department should take the steps necessary to address the understaffing that is compromising its ability to conduct essential program management work in a timely and effective manner. To start, it should create and fill a Loan Officer position in Ecology's Headquarters. See the discussion at page 9.

PROGRAM HIGHLIGHTS

The Washington Water Pollution Control Revolving Fund received its first capitalization grant from the Environmental Protection Agency (EPA) in September 1989. Through the end of SFY 2004 it had received a total of approximately \$365 million in EPA capitalization grants². These grants were matched by the State with approximately \$76.5 million in capital contributions. All of the state's matching capital contributions have been derived from appropriated funds (no bonds have been issued or sold to generate the state's matching capital contribution). Total capitalization through the end of SFY 2004, ignoring Fund interest earnings over the life of the program, was approximately \$441.5 million. The Fund has always been operated as a direct loan program (The state has never leveraged the Fund by issuing bonds to increase the annual dollar volume of assistance that it could provide to eligible projects).

The Washington Water Pollution Control Revolving Fund has always offered assistance to all three types of projects that are eligible for assistance under the Clean Water Act. As noted earlier, the loans are coordinated with other Ecology managed water quality financial assistance programs in order to maximize the volume of projects that eligible recipients are able to build in any one year. Additionally, Ecology works diligently to coordinate its water infrastructure financial assistance with other infrastructure financiers such as the U.S. Department of Agriculture's (USDA) Rural Utilities Service (RUS) and the Washington Public Works Board managed Public Works Trust Fund.

The Fund develops a one year project priority list (offer list) each year that serves as the foundation for its annual Intended Use Plan (IUP). Project owners have one year from the publication of the Intended Use Plan to sign a loan agreement with Ecology. This often results in loans being executed during the first quarter of the following state fiscal year. Ecology typically accounts for this in its IUP by including a separate list of projects that are "carried forward" from the prior year's IUP for early execution. These projects are carried forward without the need to compete in the new year's solicitation process.

² The EPA capitalization included approximately \$1.2 million in Title II (Construction Grants) funds that were deposited in the Fund in accordance with state requests under §205(m) of the Clean Water Act. The state, as required by law, provided a 20% matching capital contribution for these funds, as well.

As of the end of SFY 2004 the Fund had executed approximately \$670.8 million in loans. Within this universe of projects, the Fund offered approximately \$54.5 million in assistance to projects that implemented the state's nonpoint source water quality strategy. Of the \$670.8 million in projects, approximately \$238.7 million worth of projects were either publicly owned treatment works projects or nonpoint source projects that also protected or enhanced one of Washington's two national estuaries.³ \$377.6 million worth of loans were for publicly owned treatment works outside of these national estuary areas.

In SFY 2004 the Washington Water Pollution Control Revolving Fund continued to offer some of the lowest interest rates in the nation available from state water pollution control revolving funds. Loans with a maturity of five years or less were offered at an interest rate of 0.5%. Loans with a maturity of six to 20 years were offered with an interest rate of 1.5%. Washington also continued its practice of reducing the interest rate to as little as 0%, in circumstances in which the loan applicant demonstrated that it met the Department's economic hardship criterion.⁴ To date, roughly 25.5% of Ecology's funds have been committed to these 0% hardship loans. The weighted average interest rate of new loans executed in SFY 2004 was 1.34%. The corresponding figure for SFY 2003 was 1.032%. As of the end of SFY 2004, the weighted average interest rate for the entire loan portfolio, (all current loans) declined to 1.99% from 2.24% in SFY 2003. We assume this reflects some older, higher interest rate loans completing repayment.

In SFY 2004, Ecology continued to refine its water quality financial assistance program. The most significant improvement made was that Ecology started the development of the SFY 2005 IUP earlier in the year. The idea behind this change in schedule was to allow the Department to provide the Washington State Legislature with a more complete picture of how Ecology would use appropriated funds in its water quality financial assistance programs as the legislature developed the state budget for the biennium. Ecology continued this effort (moving the IUP development process further forward) in SFY 2005 so that

³ All of these data are derived from the Clean Water National Information System data developed and submitted by the Washington Department of Ecology.

⁴ If resulting users rates exceeded 1.5% of median household income (MHI), Ecology would reduce the interest rate to produce user charges equal to 1.5% of MHI. If even a 0% loan would result in charges that exceeded 1.5% of MHI, Ecology would attempt to offer a grant from the Centennial Clean Water program sized to reduce resulting user charges to the hardship threshold. Ecology's grant offers are, of course, limited by the amount of money available in the Centennial Fund.

a draft project list was available for the legislature's consideration as it developed the 2006-2007 budget.

In both fiscal years, Ecology's program continued to be successful executing loans for projects that implement the state's nonpoint source water quality strategy. There were 11 such projects with a value of approximately \$9.7 million. These projects will help implement Total Maximum Daily Loads (TMDLs) in water quality limited stream segments, repair failing septic systems and implement conservation tillage practices in the state.

During SFY 2004 and SFY 2005 the EPA started a pilot effort at better documenting the environmental results being obtained from its water infrastructure finance programs. The Washington Department of Ecology was one of several states that was an active participant in that pilot effort. Based on Ecology's experience with the pilot, as well as the experiences of the other pilot states, the EPA was able to incorporate a simplified system for reporting environmental results for state revolving fund programs into the SFY 2006 grants management guidance.

FOLLOW-UP FROM THE EPA'S LAST PROGRAM EVALUATION

The EPA issued a Program Evaluation Report of Washington's Water Pollution Control Revolving Fund for SFY 2002 on March 15, 2005. That report identified two topics where prompt action by the Department of Ecology is necessary. Additionally, it reinforced recommendations that the EPA had offered in a previous PER. Ecology provided the EPA with a letter the following month that articulated its current response to these recommendations. The current status of the subjects addressed in the SFY 2002 PER is discussed below.

CREDITWORTHINESS EVALUATIONS

The Department of Ecology contracted with Boise State University's Environmental Finance Center (EFC) to conduct creditworthiness evaluations for each loan applicant offered funding in SFY 2005 and SFY 2006. The EFC is also developing an appropriate Excel worksheet model that can be used as a tool in creditworthiness evaluations beginning in SFY 2007. Ecology expects that Ecology staff will perform the actual evaluations, instead of EFC staff.

MBE/WBE REPORTING

The PER noted that Ecology was continuing to have difficulty reporting on the MBE/WBE contracting successes of its borrowers. It asked that Ecology examine its process for developing the required quarterly reports as it prepared its SFY 2004 Annual Report to the EPA. Ecology did that and found that it had only been reporting on contracting in support of its administration of the Fund; that is, it had not been reporting any data on the successes of its borrowers. Ecology has developed a corrected database and effective with the first quarter of SFY 2005 will be reporting on the successes of its borrowers. Additionally, Ecology has put a protocol in place that prohibits SRF payments to borrowers on invoices that are not accompanied by an MBE/WBE Contractor Participation Report that will be required of borrowers.

PERPETUITY

The PER expressed EPA's concern that the Fund's current interest rates are too low to keep it in compliance with the Clean Water Act's perpetuity requirement. Although the Agency has never published guidance regarding the meaning of this statutory requirement or how states might demonstrate compliance, the Region believes that one useful metric is to determine whether a Fund is maintaining its purchasing power as measured by an index such as the Engineering News Record's

"Twenty City Construction Cost Index" over an extended period of time (in order to dampen the effects of large short term variations in inflation rates).

In response to this continuing concern, Ecology retained a financial consultant to evaluate interest rates within the context of different metrics for perpetuity. That analysis confirmed that current interest rates are too low. Ecology is evaluating the results in consultation with its Water Quality Financial Assistance Advisory Council and intends to make appropriate adjustments to interest rates effective with its SFY 2007 funding cycle (loans originated in SFY 2007 would carry the new, higher interest rates).

One of our conclusions from that analysis is that even if Ecology raises interest rates in SFY 2007 to the maximum allowed by the program's regulations⁵, the growth in the value of the Fund would not keep pace with construction cost inflation rates that we have been seeing over the last several years. We believe that, especially given the potential increases in construction costs that may result from the massive rebuilding effort after Hurricane Katrina and Hurricane Rita, this may be, for all practical purposes, an insurmountable problem.

During discussions of the perpetuity challenge between the EPA and the Department of Ecology, Ecology has noted on several occasions that it must compete with the Washington Public Works Board's (PWB) Public Works Trust Fund (PWTF) in offering low interest loans to finance publicly owned treatment works projects. The EPA does recognize that the PWB's PWTF offers relatively low interest rate loans and that the PWB's loan terms can be more attractive financially to a project owner.

We would note that Washington State has a huge backlog of unmet water infrastructure needs (for both publicly owned treatment works and projects that would implement the state's nonpoint source water quality plan). We believe that the circumstances warrant the development of an agreement between the Public Works Board and the Department of Ecology that would:

- Divide up the market between the two banks so that the state's overall water infrastructure financing needs are being addressed in a timely and effective manner;

⁵ This is, indeed, what Ecology is currently (February 2006) proposing in the preliminary project priority list for SFY 2007.

- Articulate a protocol for coordinating the financial terms of the two banks' loans so that project sponsors are facing economically equivalent terms between the two lenders;
- Agree on interest rates (and loan fees, if any) so that those rates are high enough to allow the Fund to come significantly closer to meeting its basic perpetuity obligation.

SRF STAFFING

The PER also expressed the EPA's continuing concern that current staff at Ecology's central office is overloaded with work due to the increasing size and complexity of the loan portfolio. Ecology acknowledged this concern and indicated that in the near term it will be evaluating options for increasing staff at its headquarters office. As an interim measure it was able to assign a new professional employee on a term appointment to work on the Fund and fund management issues. This action essentially replaced another career employee who accepted an appointment at another state agency. The EPA understands that this position has been extended and will be filled. Although, as this report is being written (December 2005), the EPA has not seen an Ecology options evaluation, we have been giving more thought to the subject of how Ecology might increase the staff assigned to manage the Fund on a long-term basis.

We believe that one effective way of addressing the staffing challenge directly would be for Ecology to create a new position for a Loan Officer in the Financial Assistance Section. Although the state's personnel classification system does not contain an exact position, we believe one could modify an economist or financial analyst position description to fit the circumstances.

A Loan Officer would:

- Review the financial information in loan applications and complete and document credit worthiness evaluations for each loan application.
- Negotiate the loan terms with the loan applicant and work with Ecology's attorney to develop the loan agreement.
- Recommend action on proposed loans (approve or deny) to the Ecology official who signs the loans.
- Monitor the financial condition of borrowers with loans in repayment and verify that these borrowers are maintaining compliance with the security provisions of their loans (debt service reserves, coverage requirements, prior written clearance from Ecology for new debt issues with equal or higher parity).

- Monitoring experimental loans such as the two design/build projects currently under way.

Relieving the SRF Coordinator of these duties would allow him to devote time to such responsibilities as:

- Updating the 1989 Operating Agreement between the EPA and Ecology that governs the operation of the Fund.
- Reviewing and evaluating the environmental benefits being produced by infrastructure projects receiving assistance from the Fund.
- Updating the program regulations (Washington Administrative Code). An update cycle is expected to start soon.
- Doing long term strategic planning for the Fund to maintain its ability to finance water infrastructure projects in spite of continuing construction cost inflation.
- Doing the work necessary to gain authority to assess, manage and use loan fees.

ADMINISTRATIVE FUNDS

Finally, the PER noted that Ecology has started on a trend of spending more on the administration of the Fund than it is receiving in new "appropriations" available from the EPA capitalization grants. This is the result of a combination of two factors. First, the EPA capitalization grants are continuing to shrink as Congress reduces appropriations for SRF capitalization. Second, the inherent costs of administration are increasing as the job becomes more labor intensive and as prices, in general, increase. The net result is that Ecology is gradually exhausting the surplus in administrative dollars built up over many years. The PER recommended that Ecology begin the work necessary to gain the authority required to assess loan fees and manage the resulting income so that it may be used to pay the costs of administering the Water Pollution Control Revolving Fund. This is consistent with advice that the EPA has offered in prior years.

One alternative suggested by Ecology's management was that Ecology might work with the Governor's budget office to obtain authority (an appropriation) from the legislature to use some of the funds in the state Water Quality Account (the source of the state's matching capital contribution) to pay for fund administration. Funds should be available given that the size of the required matching capital contribution is shrinking in parallel to the size reduction in the EPA capitalization grant. We understand that Ecology's management is continuing to explore this option. We recommend that Ecology complete corrective action on this in time to submit a full proposal to the 2007 session of the Washington State Legislature.

Assuming that legislative approval is enacted, this should allow the Fund to acquire the funds necessary to replace the declining EPA grant funds when they are needed.

CURRENT PROGRAM EVALUATION TOPICS

REQUIRED PROGRAM ELEMENTS

ANNUAL REPORT

The annual reports are unusually thorough and provide informative discussions of the progress that Ecology made during the fiscal year towards achieving the program's short-term and long-term goals. The extensive set of included exhibits (tables) provides a useful picture of how the Fund's loan portfolio is currently structured and how that structure has changed during the fiscal year. The EPA has provided a separate set of suggestions regarding exhibits with duplicative information that might be removed from future annual reports. The updated Operating Agreement being developed by Ecology and the EPA will contain a revised deadline for Ecology's submission of its annual report to the EPA.

The annual report for each fiscal year (SFY 2003 and SFY 2004) was received over six months late. This long delay appears to be one of the direct results of Ecology's Headquarters office SRF staff being seriously overworked.

COMPLIANCE WITH CROSS-CUTTERS

We assessed the Fund's compliance with Federal cross-cutting authorities as a part of our review of project loan files. To see those reviews, look at the Project File Review Tables, following page 20. Of the two projects reviewed, only the Stanwood Wastewater Treatment Plant Upgrade Project is subject to the Federal cross-cutting authorities.⁶ In our review of the Stanwood project we note several cross-cutting authorities for which no compliance documentation was found in the files that we reviewed. Due to the fact that some of the authorities for which no compliance documentation could be found in the file are equivalency requirements

⁶ Ecology, in its SFY 2003 Intended Use Plan, identified a list of projects that would be required to comply with "Title II requirements" of the Clean Water Act. This serves as a proxy for the Federal cross-cutting authorities in that both sets of requirements were originally applied to projects receiving Fund financial assistance from funds directly made available from the EPA capitalization grants. The Title II requirements only applied to projects executing binding commitments (loans) before October 1, 1994. Ecology no longer applies the Title II requirements to projects because it has concluded that it has met its statutory obligation under §602(b)(6) of the Clean Water Act. The EPA has not yet officially confirmed that conclusion, yet. The Federal cross-cutting authorities continue to apply to all projects receiving assistance directly made available from the EPA capitalization grants.

under §602(b)(6) of the Clean Water Act, this project could not be used to help satisfy Ecology's equivalency obligation if that proved necessary. We will be conducting additional file reviews as part of our annual review for SFY 2005. If we find this omission in these files, we will recommend appropriate corrective action to Ecology in our SFY 2005 PER.

OPERATING AGREEMENT

The Washington Water Pollution Control Revolving Fund continues to be managed in accordance with the original Operating Agreement between the Department of Ecology and EPA, Region 10. This Operating Agreement, dated September 11, 1989, is seriously outdated. It does not reflect current practices and it does not account for the changes that have been made to the program as it has evolved over more than a decade.

The EPA recognizes that the Department of Ecology is planning on completing a periodic update to the program regulations governing its administration of the Washington Water Pollution Control Revolving Fund (Washington Administrative Code [WAC] 173-98). Similarly, we are aware that the procedures that Ecology and its borrowers follow in conducting environmental reviews under Washington's State Environmental Policy Act have changed considerably since 1989.

Based on discussions we held with Ecology in December 2005, the EPA has agreed to provide the shell of a draft revised Operating Agreement which Ecology and EPA can use as the starting point to develop a full Operating Agreement. Our goal is to have the new agreement signed by June 30, 2006. This agreement would be revised to incorporate any changes made to Ecology's loan program regulations during SFY 2007.

REQUIRED FINANCIAL ELEMENTS

The EPA's review of the financial elements of Ecology's management of the Washington Water Pollution Control Revolving Fund, as summarized in the checklist, found a well-managed Fund. We noted a few elements where comment is warranted:

1. The program does not have an annual independent audit;
2. the rate of return on fund investments was very low for SFY 2004;
3. financial capability assessments were not completed for loan recipients in SFY 2003 and SFY 2004;
4. the system that is used to conduct financial oversight of Fund borrowers merits improvement;
5. and there is no long-term plan or planning process for the Washington Water Pollution Control Revolving Fund.

Additional discussion of these financial elements is presented below.

COMPLIANCE WITH AUDIT REQUIREMENTS

Financial Statements and Reporting

EPA's Office of the Inspector General conducted an audit of Washington's CWSRF program for SFY 2003. The audit report affirmed that the financial statements were prepared in accordance with generally accepted accounting principals. The audit report noted no matters involving the internal control system; nor were any compliance issues noted. In conducting the annual review for SFY 2004, we used the OIG's 2003 audit report as a reference for evaluating the un-audited financial statements provided for SFY 2004.

The financial statements presented as part of the SFY 2004 annual report were presented in the same format and provided materially the same content as those presented for SFY 2003. Overall, the financial statements, annual reports, and CWNIMS provide a good presentation of the financial condition and operational results of the Washington State Water Pollution Control Revolving Fund. We concluded that the SFY 2004 financial statements appear to have been prepared and presented in accordance with GAAP.

Borrower Accounting & Financial Oversight

The Clean Water Act, at §602(b)(9) specifies that the state must require that recipients of assistance from the Fund "maintain project accounts in accordance with generally accepted government accounting standards." EPA's Clean Water

State Revolving Fund Program Regulations, at 40 C.F.R. §35.3135(i), specifies that the "State must . . . require recipients of (CW)SRF assistance to maintain project accounts in accordance with generally accepted government accounting standards as these are promulgated by the Government Accounting Standards Board. These accounts must be maintained as separate accounts."

Ecology's program regulations for the Washington Water Pollution Control Revolving Fund have sought to carry out this requirement by specifying at WAC §173-098-070(4) that:

Recipients must maintain accounting records in accordance with generally accepted government accounting standards.. These standards are defined as, but not limited to, those contained in the United States General Accounting Office (GAO) publication Standards for Audit of Governmental Organizations, Programs, Activities, and Functions.. For example, charges must be properly supported, related to eligible costs, and documented by appropriate records. These accounts must be maintained as separate accounts.

Similarly, Ecology's standard loan agreement implements this requirement in "Attachment 6" with the following language:

Accounting Standards. The RECIPIENT [sic] shall maintain accurate records and accounts for the PROJECT [sic] ("PROJECT Records") in accordance with generally accepted government accounting standards including those contained in the Standards for Audit of Governmental Organizations, Programs, Activities, and Functions promulgated by the U.S. General Accounting Office.

These PROJECT Records shall be separate and distinct from the RECIPIENT's other records and accounts (General Accounts). Eligible costs shall be audited annually by an independent, certified accountant and/or state auditor, which may be part of the annual audit of the General Accounts of the RECIPIENT. If the annual audit includes an auditing of this PROJECT, a copy of such audit, including all written comments, recommendations and findings, shall be furnished to the DEPARTMENT [sic] within thirty (30) days after receipt of the final audit report.

As part of our review of these requirements, we discussed them with a representative of EPA's Office of Inspector General-Audit Division and a representative of the GASB. Based on these discussion the region reached two key conclusions:

1. The GASB has not issued any pronouncements that address project level accounting. All of the GASB pronouncements address different aspects of how a financial entity as a whole presents (and therefore tracks) its financial information. Thus, they speak to how the wastewater utility as a whole should maintain and present financial information on the entire enterprise. Thus, the EPA has not, in fact, specified how borrowers must track and account for the funds used on the capital project being financed with SRF assistance.
2. Because the current language in the WAC and in the standard loan contract specify auditing standards rather than accounting standards, Ecology has not yet provided direction to borrowers regarding how they must account for funds received from the Washington Water Pollution Control Revolving Fund.

In our view the Federal statutory and regulatory language has a limited set of primary goals:

1. To insure that borrowers from a state water pollution control revolving fund maintain project financial records that properly document the costs incurred in completing the project being financed with assistance from the Fund;
2. To insure that the borrowers' financial records demonstrate that all the costs incurred for a project are eligible under the rules and guidelines established by the State;
3. To insure that borrowers' financial management and record keeping systems provide the information necessary for the State to verify that:
 - a. The borrower has adequate internal controls in place;
 - b. The borrower's financial statements are free from material misstatements or omissions;
 - c. The borrower continues to be a "going concern" and continues to be able to meet all of its financial obligations including its debt service obligations for SRF loans.
4. To insure that the State revolving fund agency is periodically reviewing borrower financial records in order to meet the above goals.

Ecology establishes an assistance recipient record keeping obligation in its standard loan agreement. As noted above, at page 15, the standard loan agreement also requires that project costs be subject to an annual audit by an independent auditor or the State Auditor. This audit may be as a part of an audit of the general accounts of the borrower. The loan agreement, in turn, incorporates by reference Ecology's "Administrative Requirements for Ecology Grants and Loans." This document identifies eligible costs and specifies standards for fiscal management and accounting records.

Our review of audits by the Washington State Auditor of SRF assistance recipients revealed that smaller municipalities (cities with population under 25,000 and counties with population under 50,000) and some other public entities such as conservation districts (with gross revenues below \$5,000,000 per year) are using a form of accounting not strictly conforming to generally accepted accounting principles - GAAP. The State Auditor, in accordance with state law [RCW 43.09.200 "Local Government accounting-Uniform system of accounting"] allows these governments to use a different system to prepare their financial statements. This format is denoted as the Washington State Budgeting and Accounting Reporting System - BARS.

This system is one that the State Auditor's Office (SAO) considers to be an "Other Comprehensive Basis of Accounting." The EPA briefly reviewed the requirements that are specified for "Category 2" entities in the published manual with an auditor on our Office of Inspector General-Audit Division staff. Based on that review and our review of SAO completed audits for Category 2 communities that are Washington Water Pollution Control Revolving Fund borrowers, we have concluded that this suite of financial management systems meets the financial oversight goals of the Clean Water Act's requirements for borrowers that are subject to an SAO audit.

Ecology has indicated that it relies on the Washington State Auditor's periodic audits of units of local government to verify compliance with accounting requirements. Ecology reviews the results of any audits performed by the State Auditor affecting entities that are SRF loan recipients. We contacted the State Auditor's Office in April 2005 to inquire about the scheduling and prioritizing of CWSRF loan recipient audits conducted by their staff. Loan recipients of CWSRF loans are not necessarily higher or lower on the priority list for audit schedules. If an entity is subject to Single Audit Act requirements (because it receives more than \$500,000 per year in federal dollars), then the State Auditor's staff will sometimes look at the SRF loan accounting as part of its audit. Subsequent discussions with staff from the State Auditor's Office confirmed that all public entities meeting the Single Audit Act threshold are in fact audited by it.

Any audit findings related to the SRF loan, or findings that could affect the entity's ability to meet the SRF debt obligation, are reported to DOE for further investigation by DOE staff. For example, one case of improper payments for costs not-yet-incurred was reported in a State Auditor's Office report in September 2004, and DOE followed up with the loan recipient to resolve the issue.

In order for Ecology's financial oversight of SRF borrowers to fully meet the intent of the Clean Water Act's borrower accounting and financial oversight provisions, Ecology should implement a few key changes in its current practices:

- 1) Ecology should modify the program's regulatory language concerning project accounting by loan recipients at WAC §173-098-070(4). It actually may want to eliminate this language and simply require that the borrower's overall financial accounts be maintained in accordance with the applicable requirements of state law, cited above, at page 17.
- 2) In past years, DOE had been providing a list, to the SAO, of all CWSRF loan recipients that were subject to Single Audit requirements. DOE needs to resume doing this and make this a regular part of its loan recipient monitoring program.
- 3) Ecology should establish a process that checks that every loan recipient subject to Single Audit requirements is, in fact, having a Single Audit conducted.
- 4) For loan recipients not subject to Single Audit, Ecology should establish a method of checking that an independent financial audit is being completed each year as required by the terms of the loan. Given that Ecology might not receive these independent audits from the SAO, Ecology should arrange to receive and review these audits.

FINANCIAL CAPABILITY ASSESSMENTS

The Department of Ecology did not have a process in place for assessing applicant financial capability during the SFY 2003 and SFY 2004 funding cycles. A financial capacity assessment tool (Excel program) developed and used by the Environmental Finance Center at Boise State University is being applied to SFY 2005 fundable projects. In SFY 2006, Ecology has contracted with the EFC at Boise State to provide training to Ecology staff on the use of the assessment tool and the tool's data requirements so that Ecology may begin completing these assessments with its own staff.

FINANCIAL MANAGEMENT

Financial Indicators

Financial indicators for the Washington CWSRF show positive improvement in CWSRF program performance during SFY 2003 and SFY 2004. The return on federal investment increased from 134% at the end of SFY 2002 to 145% by end of SFY 2003, and further increased to 160% by the end of SFY 2004. This indicator is an important measurement of the success of the Fund in leveraging the funds provided by federal capitalization grants. Additionally, the Washington CWSRF contributes to the national results for return on federal investment which is one of the key measurements by which the EPA's CWSRF Program is evaluated by the President's Office of Management and Budget (OMB). Please refer to the following chart for a comparison of recent fiscal year performance according to financial indicators by which state CWSRF programs are evaluated. The decline in estimated subsidy (indicator # 6) reflects both a decrease in the market interest rate and an increase in the Washington CWSRF loan rate that occurred during the 2002 through 2004 time period.

WASHINGTON STATE WATER POLLUTION CONTROL REVOLVING FUND
FINANCIAL INDICATORS

Description	WA State SFY 2003	WA State SFY 2004	Regional Average for FY2004	National Average for FY2004
# 1- Return on Federal Investment - Shows the amount invested in water quality beneficial projects for each federal dollar invested	145.20%	159.82%	145.96%	142.00%
# 2-Percentage of Closed (executed) Loans to Funds Available For Loans - Shows the amount of signed loan agreements compared to the amount of funds available for loans	90.29%	95.94%	99.00%	91.00%
# 3-Percentage of Funds Disbursed to Closed Loans - Shows the amount of funds actually disbursed compared to the amount of signed loan agreements	75.30%	74.56%	73.19%	79.00%
# 4-Benefits of Leveraging - (generating additional SRF funds by issuing bonds)	N/A	N/A	N/A	N/A
# 5-Perpetuity of Fund - Demonstrates whether the program is maintaining its contributed capital. A positive result indicates the Program is maintaining its capital base	\$88,446,793	\$97,946,768	N/A	N/A

Description	WA State SFY 2003	WA State SFY 2004	Regional Average for FY2004	National Average for FY2004
# 6-Estimated Subsidy - An estimate of the CWSRF interest rate subsidy, stated as a percentage of the market rate.	79.1%	72.1%	49.3%	52.7%

Long-range Planning

No formal long-range plan or planning process exists for the Washington CWSRF program. However, DOE staff and management meet "as needed" to discuss the implications of SRF policy decisions and loan terms. To address the issue of maintaining the perpetuity of the fund, mentioned in EPA's SFY 2002 Program Evaluation Report, DOE initiated a study using an economist consultant to evaluate the Fund's projected performance in future years. We have offered to work together with DOE in reviewing the results of their contracted studies and also comparing results from the EPA developed Financial Planning Model to evaluate interest rate impact on future Fund performance. We encourage DOE to establish a more regular process of long-term planning that includes consistent use of financial modeling tools and loan portfolio cash flow analysis.

ANNUAL REVIEW CHECKLISTS

Worksheet 1

Required Program Elements

Review Item and Questions to Answer reference to guidance manual	Yes	No	N/A	Comments	Data Sources (check all that apply)
1.1 Annual / Biennial Report					
1 Does the State's Annual / Biennial Report meet all requirements?	X			Annual reports for both fiscal years were submitted very late. The long delay in the SFY 2004 annual report's completion delayed EPA's performance review.	Report Date 05/10/2005_____
a. Reports on progress towards goals and objectives	X			The annual reports both contain extensive discussions of the State's progress towards achieving the programs goals and objectives.	
b. Reports on use of funds and binding commitments	X			Each report presents information on binding commitments as well as on the funds expended on administrative costs.	
c. Reports on the timely and expeditious use of funds	X			Ecology has regularly been committing funds at an expeditious pace. It both SFY 2003 and SFY 2004 it set new records for the dollar volume of new loans executed.	
d. Identifies projects and types of assistance provided.	X			Each annual report provides a narrative summary of the new loans executed as well as tabular information on all loans (new and existing).	
e. Includes financial statements and cross-references independent audit report	X			Each annual report includes financial statements. For SFY 2003, the state's annual report was followed by an EPA-OIG audit report which audited the financial statements for SFY 2003, examined internal controls and checked compliance with Federal legal requirements. There was no EPA-OIG or other independent audit of the SFY 2004 financial statements.	
f. Provides overall assessment of the SRF's financial position and long-term financial health	X			Like the EPA, Ecology is becoming concerned that the program's continuing low interest rates are too low to allow the Fund to meet the Clean Water Act's perpetuity mandate. Ecology is currently evaluating this issue and expects to adjust the program's interest rates for the SFY 2007 IUP.	
g. Demonstrates compliance with all SRF assurances	X			The annual reports note 22 conditions in the Operating Agreement and the EPA capitalization grants and indicate compliance with all of those conditions, with one exception.	
h. Demonstrates compliance with SRF program grant conditions	X			Ecology is not yet in compliance with the reporting requirements for DBE contracting. As part of developing its SFY 2004 annual report it examined how it had been reporting and found errors in the process which it has committed to correct for SFY 2005.	
i. Demonstrates that the highest priority projects listed in the IUP were funded (DW only)			X		
j. Documents why priority projects were bypassed in accordance with state bypass procedures and whether state complied with bypass procedures.			X	Washington establishes a new one year priority list each year and attempts to complete loan agreements with each loan applicant on the list within a one year period.	
k. Documents use of set-aside funds (see set-aside sheet for details)			X		
2 Was the Annual / Biennial Report submitted on time?		X		For both years, the annual reports were submitted over six months late. This, in our view, is another demonstration of Ecology's understaffing of the program.	

Required Program Elements

Review Item and Questions to Answer <i>reference to guidance manual</i>	Yes	No	N/A	Comments	Data Sources (check all that apply)
3 If the State assesses the environmental and public health benefits of projects, are the benefits discussed in the Annual/Biennial Report? If the answer is yes, the comment section should contain an explanation.	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	Ecology does not do such a formal assessment, yet.	

Required Program Elements

Review Item and Questions to Answer <i>reference to guidance manual</i>	Yes	No	N/A	Comments	Data Sources (check all that apply)
1.2 Funding Eligibility					
				Ecology uses a thorough screening process in developing its IUP to insure that projects are eligible under both the Clean Water Act and Washington State program requirements. The EPA's review of project files and of the Annual Reports for SFY 2003 and SFY 2004 confirmed that projects receiving assistance continue to be eligible. EPA also reviewed the list of actual binding commitments to confirm that each project was on the state's current IUP when its loan was executed. Due to the timing of the publication of the SFY 2004 Intended Use Plan (published August 15, 2003), there were several loans executed from the SFY 2003 IUP that were no longer on the state's IUP priority list. This occurred because the SFY 2004 IUP was published nearly a full month before the one year period allowed for executing loans based on the SFY 2003 IUP had expired. Ecology is aware of this "glitch" in its process and has corrected it in the SFY 2005 IUP and in the SFY 2006 proposed IUP by including a separate list of projects "carried over" from the prior year.	X
1 Are projects receiving assistance eligible for funding?	X				<input type="checkbox"/> Project Files <input checked="" type="checkbox"/> Priority List <input checked="" type="checkbox"/> Project ranking and selection process
2 Is documentation being received from assistance recipients to support the amount and eligibility of disbursement requests?	X			Invoices for work performed / materials for loan projects are reviewed for eligibility and signed off for approval by either an SRF Program Project Officer in a Regional Office or Ecology HQ or a Financial Managers at Ecology HQ, or both.	<input type="checkbox"/> Project Files - Pay Request Documentation <input checked="" type="checkbox"/> Approval documentation <input type="checkbox"/> Inspection reports
3 Does the State have controls over SRF disbursements to ensure that funds are used for eligible purposes?	X			The state has a protocol in place to review borrower incurred costs before approving payment of invoices from the borrowers. The standard loan terms include a condition that applies OMB Circular A-87 costs principles to borrowers as sub-recipients of Federal assistance.	
4 Is the state meeting the 15% small system requirement? (DW only)			X		
5 Does the State have procedures to ensure that systems in significant noncompliance with any NPDWR are not receiving assistance, except to achieve compliance? (DW only)			X		
1.3 Compliance with DBE Requirements					

Required Program Elements

Review Item and Questions to Answer <i>reference to guidance manual</i>	Yes	No	N/A	Comments	Data Sources (check all that apply)
1 Is the State complying with all DBE requirements (setting goals, six affirmative steps and reporting)?	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	The state and EPA have agreed to goals and the state is communicating the goals and requirements to borrowers. Borrowers, in turn, are implementing the six affirmative steps. The state is reporting progress incorrectly and is fixing this problem in SFY 2005.	<input checked="" type="checkbox"/> Grant / Operating Agreement <input checked="" type="checkbox"/> Annual / Biennial Report <input checked="" type="checkbox"/> Project Files <input checked="" type="checkbox"/> DBE Reporting Forms
2 Are assistance recipients complying with all DBE requirements?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		

Required Program Elements

Review Item and Questions to Answer <i>reference to guidance manual</i>	Yes	No	N/A	Comments	Data Sources (check all that apply)
1.4 Compliance with Federal Cross-Cutting Authorities (Cross-Cutters)					
1 Is the State complying with applicable federal cross-cutting authorities?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Loan recipients are bound my loan conditions that require compliance with Federal cross-cutting authorities. Ecology's IUP each year identifies the affected recipients (loans that refinance existing debt are typically financed out of Fund earnings in order to avoid having to deal with the cross-cutters). We reviewed one POTW project loan that was subject to the cross-cutters and found adequate documentation of compliance in the project file.	<input checked="" type="checkbox"/> Project Files <input checked="" type="checkbox"/> Grant / Operating Agreement <input checked="" type="checkbox"/> Annual / Biennial Report
2 Is the State ensuring that assistance recipients are complying with all applicable federal cross-cutting authorities?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	As noted above this is covered by a loan condition. The state provides updated guidance each year to potential applicants on the requirements applicable to borrowers.	
3 Were there any issues which required consultation with other State or Federal agencies?	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>		
a. What did the consultation conclude with regard to compliance with the cross-cutter?					
1.5 Compliance with Environmental Review Requirements					
1 Are environmental reviews being conducted in accordance with the State's approved environmental review procedures (SERP)?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Washington's SERP is tightly integrated with the facilities planning process for §212 projects. T	<input checked="" type="checkbox"/> Project Files <input checked="" type="checkbox"/> State Environmental Review Procedures <input type="checkbox"/> Annual / Biennial Report
2 Does the State document the information, processes, and premises leading to decisions during the environmental review process?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	The requirements of the process are defined in detail in the Washington Administrative Code. The facilities plan and its Environmental Information Document provide most of the required information.	<input checked="" type="checkbox"/> Project Files <input type="checkbox"/> Staff interviews
a. Decisions that projects meet requirements for a categorical exclusion (CE) or the State equivalent?			<input checked="" type="checkbox"/>		
b. Environmental Assessment (EA)/Findings of No Significant Impacts (FONSI) or the state equivalent.	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		

Required Program Elements

Review Item and Questions to Answer <i>reference to guidance manual</i>	Yes	No	N/A	Comments	Data Sources (check all that apply)
c. Decisions to reaffirm or modify previous SERP decisions.	_____	_____	X		
d. Environmental Impact Statement (EIS)/Records of Decisions (RODS) or the State equivalent.	_____	_____	X		

Required Program Elements

Review Item and Questions to Answer <i>reference to guidance manual</i>	Yes	No	N/A	Comments	Data Sources (check all that apply)
3 Are public notices and meetings, as required by the SERP, provided during the environmental review process?	X	_____	_____	_____	_____
4 Are documented public concerns being addressed/resolved by the State in the environmental review process?	X	_____	_____	_____	_____
5 Do environmental reviews document the anticipated environmental and public health benefits of the project?	X	_____	_____	_____	_____
1.6 Operating Agreement					
1 Is the State's Operating Agreement up to date reflecting current operating practices?	_____	X	_____	Never updated. It's on our "list." However, Ecology has not yet been able to devote any time to the effort. _____ Last update date _____	_____
a. Program administration	X	_____	_____	The Operating Agreement does not truly reflect Ecology's interactions with other infrastructure funding agencies in the state.	_____
b. MOUs	_____	X	_____	_____	_____
c. Description of responsible parties	X	_____	_____	The Operating Agreement does not reflect current operating protocols for the Department.	_____
d. Standard operating procedures	_____	X	_____	_____	_____

Required Program Elements

Review Item and Questions to Answer <i>reference to guidance manual</i>	Yes	No	N/A	Comments	Data Sources (check all that apply)
1.7 Staff Capacity					
1 Does the State have staff, in terms of numbers and capability, to effectively operate the SRF?		X		Ecology continues to be understaffed for this program. It has added one temporary staff person and is attempting to make that person a permanent employee of the program. It is also considering other steps that it can take to address staffing needs.	<input type="checkbox"/> Program Budget <input type="checkbox"/> Organization Chart <input type="checkbox"/> Staff interviews
a. Accounting & Finance	X				
b. Engineering and field inspection	X				
c. Environmental review / planning	X				
d. Management		X			
e. Management of set-asides (DW only)			X		
2 Does the program have an organizational structure to effectively operate the SRF?	X				
1.8 DWSRF Withholding Determinations					
1 Did the State document ongoing implementation of its program for ensuring demonstration of new system capacity?			X		
2 Did the State document ongoing implementation of its capacity development strategy?			X		
3 Did the State document ongoing implementation of its operator certification program?			X		

Required Financial Elements

Review Item and Questions to Answer	Yes	No	N/A	Comments	Data Sources (check all that apply)
2.1 State Match					
1 Has the State provided match equal to 20 percent of the grant amount?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Review of accounting records confirms deposit of state match funds coincidental with federal cash draws. The annual report shows that the state, each quarter, is drawing cash from the state match and the EPA capitalization grant on a coordinated schedule.	<input type="checkbox"/> Audited Financial Statements <input checked="" type="checkbox"/> Annual / Biennial Report <input checked="" type="checkbox"/> State Accounting Records Review
				Cumulative state match total differs between annual report and CWNIMS. Will work with the state to rectify.	
2 Was each match amount deposited at or before the federal cash draw?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	See the comments in the above answer.	<input type="checkbox"/> Audited Financial Statements <input checked="" type="checkbox"/> Annual / Biennial Report <input checked="" type="checkbox"/> State Accounting Records Review
3 What is the source of the match (e.g., appropriation, State GO bonding, revenue bonds, etc.)?				Appropriated state funds in the state water quality account	<input checked="" type="checkbox"/> Grant Application <input type="checkbox"/> Audited Financial Statements <input checked="" type="checkbox"/> Annual / Biennial Report
4 Are match funds held outside the SRF until the time of cash draws?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	State match is transferred from the state water quality account to the SRF at the time of federal cash draw(s).	
5 If bonds are issued for state match, and the SRF is used to retire these bonds, do the bond documents clearly state what funds are being used for debt service and security?			<input checked="" type="checkbox"/>		
a. Has the state match structure been approved by Headquarters?			<input checked="" type="checkbox"/>		
6 Is the state match bond activity consistent with the approved state match structure?			<input checked="" type="checkbox"/>		

Required Financial Elements

Review Item and Questions to Answer	Yes	No	N/A	Comments	Data Sources (check all that apply)
2.2 Binding Commitment Requirements					
1 Are binding commitment requirements being met?	<u>X</u>	_____	_____	WA program has binding commitments equal to over 130% of grants and state match totals as of end of SFY03. At the end of SFY04, BCs were 152% of total grants and state match.	<u>X</u> Binding commitment worksheet <u>X</u> Annual / Biennial Report _____ Project files <u>X</u> National Information Management System Data
a. Are cumulative binding commitments greater than or equal to cumulative grant payments and accompanying State match within one year of receipt of payment?	<u>X</u>	_____	_____	WA program has binding commitments equal to over 130% of grant payments taken and state match totals as of end of SFY03; 152% at the end of SFY04.	
2 Are binding commitments documented in the project files?	<u>X</u>	_____	_____	All project files reviewed included copies of the original loan agreement and any amendments or addendums.	
a. Do the commitment dates match reported commitments in the Annual/Biennial report?	<u>X</u>	_____	_____		
3 Is there a significant lag between binding commitments, loan execution, or the actual start of the projects?	_____	<u>X</u>	_____	Standard language in WA loan agreements stipulate that construction begin within 4 months after the loan agreement is signed , unless a different time frame for start of construction is mutually agreed upon. One project under the pilot Design/ Build pilot program that had a loan agreement signed in SFY2002, has experienced delayed project starts- (Spokane County).	<u>X</u> Project Files _____ Record of binding commitment dates <u>X</u> Loan documents _____
a. What is the typical and longest lag from binding commitment to project start?	_____	_____	_____	Standard language in WA loan agreements stipulate that construction begin within 4 months after the loan agreement is signed , unless a different time frame for start of construction is mutually agreed upon.	
b. How many projects have never started?	_____	_____	_____	Did not identify a specific number of projects that have never started.	
c. How many projects have been replaced because they never started?	_____	_____	_____	Did not identify a specific number of projects that may have been replaced, but noted during staff interviews that WA IUP process allows for moving other projects onto the funding list when / if originally selected projects are unable to proceed with start of construction.	
d. If this problem exists, is it recurring? If so, what steps are the State taking to correct the situation?	_____	_____	<u>X</u>	Staff Interviews and review of the IUP and Annual report do not show this to be a problem.	

Required Financial Elements

Review Item and Questions to Answer	Yes	No	N/A	Comments	Data Sources (check all that apply)
2.3 Cash Draws					
1 Has the State correctly adhered to the "Rules of Cash Draw" ?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Cash draws in SFY03 were 83.3% Federal , 16.7% state match, for any and all projects using Federal SRF cap grant funds. Cash Flow totals reported in SFY04 financial statements likewise show a 83.3% federal, 16.7% state match cash draw mix.	<input checked="" type="checkbox"/> Project disbursement requests <input checked="" type="checkbox"/> Accounting transactions <input type="checkbox"/> Approved leveraging structure <input type="checkbox"/> Federal draw records (IFMS) <input type="checkbox"/> Audits <input checked="" type="checkbox"/> Exhibit 6 " SRF Cash Flows" in Annual Report
2 Does a review of specific cash draw transactions confirm use of correct proportionality percentages?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
3 For leveraged states, what proportionality ratio is the state using to draw federal funds?	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>		
4 Have any erroneous payments/cash draws/disbursements been discovered and, if so , what corrective steps are being taken?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	WA DOE worked with recipient whereby eligible costs were submitted and used to offset the previously reimbursed amount for ineligible costs. Total of ineligible costs was \$722,112.	WA State Auditor's Report on King County for period January 2003 thru Dec 2003.
5 Does a review of specific Project cash draw transactions confirm the use of federal funds for eligible purposes?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	8 disbursements from different loans were checked (disbursements totaling \$3, 890, 087.); all included appropriate documentation confirming eligibility of costs.	
6 Does a review of specific Administrative cash draw transactions confirm the use of federal funds for eligible purposes?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	EPA Financial Analyst conducted a review of administrative charging processes and cost documentation with state fiscal staff and state CWSRF program staff.	
2.4 Timely and Expeditious Use of Funds					
1 Is the State using SRF funds in a timely and expeditious manner?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	WA improved its percentage of cumulative loans to funds available from 85% in SFY02 to over 86% for SFY03, and 96% in SFY04	<input type="checkbox"/> IUP <input type="checkbox"/> Binding commitments <input type="checkbox"/> Annual / Biennial Report <input checked="" type="checkbox"/> CWNIMS
a. Does the fund have large uncommitted balances?	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Uncommitted Balance of approx \$14M (SFY03 IUP) carried over to SFY04 IUP was subsequently committed in SFY04 IUP. Approx \$27M of early repayments and / or deobligations during SFY04 were subsequently committed in the SFY05 IUP.	
b. Does the fund have large balances of undrawn federal and state funds?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	At end of SFY03 WA had approx \$64 M in undrawn fed grant funds; at end of SFY04, they had \$71M undrawn fed grant funds. Proportional state funds are also undrawn. Considering that WA did \$68 million in new loans for SFY03 and \$128 million for SFY04, these undrawn amounts are not at levels of concern.	
c. Are the uncommitted balances growing at a faster annual percentage rate than the growth of the total assets of the SRF?	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Although uncommitted balances grew from SFY02 to SFY03, uncommitted balances diminished from SFY03 to SFY04.	

Required Financial Elements

Review Item and Questions to Answer	Yes	No	N/A	Comments	Data Sources (check all that apply)
2 Does the State need to improve its use of funds to ensure timely and expeditious use? Has the state developed a plan to address the issue?		X			
3 If the state was required to develop a plan demonstrating timely and expeditious use of funds, is progress being made on meeting this plan?			X		

Required Financial Elements

Review Item and Questions to Answer	Yes	No	N/A	Comments	Data Sources (check all that apply)
2.5 Compliance with Audit Requirements					
1 Are annual audits being conducted by an independent auditor?		X		WA does not conduct independent audits for their SRF program.	
a. Who conducted the most recent audit?				U.S. EPA, Office of the Inspector General (OIG) conducted an audit for SFY03.	
b. Did the program receive an unqualified opinion?	X				
c. Were there any significant findings? (Briefly discuss the findings.)		X		The EPA's OIG-Audit office audited the program for SFY 2003 and stated that the financial statements were prepared in accordance with GAAP and noted no material weaknesses. EPA Reg 10 Financial Analyst reviewed the financial statements for SFY04 and it appears that SFY04 financial statements are in accordance with GAAP.	
d. Is the program in compliance with GAAP?	X				
2 Does the annual audit confirm compliance with State laws and procedures?	X			The EPA's OIG-Audit office audited the program for SFY 2003 and opined that the program was in compliance with applicable requirements.	
a. Did the audit include any negative comments on the state's internal control structure?		X		No problems with the internal control structure were identified in the last EPA, OIG audit.	
b. Did the audit identify any erroneous payments/cash draws/disbursements?		X		OIG Audit did not identify any erroneous payments. (see element 2.3_4 for discussion of erroneous payment discovered by State Auditor's Office during review of assistance recipient). (see element 2.3_4 for discussion of erroneous payment discovered by State Auditor's Office during review of assistance recipient)..	
c. Has the State taken action to recover the improperly paid funds?	X				
3 Has the program implemented prior audit recommendations and/or recommendations in the "management" letter?			X	No recommendations were made	
4 Are the states cash management and investment practices consistent with State law, policies, and any applicable bond requirements?	X			All cash is managed and invested by the State Treasurer. Per State law, the Treasurer is responsible for cash balances and investing excess cash of the Fund.	X Audit
a. Is the SRF earning a reasonable rate of return on invested funds?	X			SFY03 Rate of Return on invested funds = 2.6%. SFY04 Rate of Return on invested funds was only 1.48% yet low ROI was commom among Region X states for SFY2004.	
5 Are State accounting procedures adequate for managing the SRF?	X			Staff and management interviews provided consistent explanation of standard operating procedures for SRF accounting. Financial transaction review confirmed that procedures are being followed.	Accounting procedures manual Internal controls documentation

Required Financial Elements

Review Item and Questions to Answer	Yes	No	N/A	Comments	Data Sources (check all that apply)
				OIG Audit SFY03 note " no material weaknesses involving the internal controls and operations".	<input checked="" type="checkbox"/> Audit report
a. Do the State's accounting procedures include internal control procedures for state-purchased equipment?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		

Required Financial Elements

Review Item and Questions to Answer	Yes	No	N/A	Comments	Data Sources (check all that apply)
6 Are loan recipients providing single audits?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Standard requirements in WA loan agreements include language requiring audits in accordance with OMB Circular A-133. DOE staff report that the state auditor conducts audits that recognize OMB Circular A-133 and the Single Audit Act's requirements.	<input checked="" type="checkbox"/> Project files
a. Is the State reviewing the loan recipient audits and resolving issues?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	DOE does not have a regularly scheduled process of monitoring the accounting of projects funded by CWSRF loans. DOE relies on State Auditor's Office borrower audits to evaluate loan recipient accounting practices. State Fiscal department staff looks at every audit produced by the State Auditors and recognize any issues involving SRF loan assistance recipients. If an issue is noted in the State Auditor's report, fiscal staff notifies SRF program staff. Program staff determine if any action is warranted to protect the assets of the SRF program.	Review of loan documents; and discussions with State Auditor's Office, and with EPA's Office of the Inspector General, OIG.
b. Does the State ensure that assistance recipients are adhering to GAAP accounting requirements?	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	The EPA regulations require that loan recipients maintain project accounts in accordance with generally accepted government accounting standards as promulgated by GASB. None of the GASB pronouncements speak to project level accounting. The regulation does NOT require that the borrowing entity as a whole present its financial information in accordance with GAAP as promulgated by GASB. Standard requirements in WA loan agreements stipulate that recipients maintain project accounts in accordance with generally accepted governmental accounting standards. The reference given in the WAC and in the standard loan contract language is to GAO standards for audit rather than accounting (There are no GAO accounting standards). Thus DOE has not yet specified how borrowers must account for project funds. It does have recording keeping and record submission requirements aimed at insuring there is adequate documentation for incurred costs.	
2.6 Assistance Terms					
1 Are the terms of assistance consistent with program requirements?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Standard language observed in project files / loan agreements is consistent with program requirements.	<input type="checkbox"/> IUP <input checked="" type="checkbox"/> Loan Agreements <input type="checkbox"/> Repayment transactions
a. Are interest rates charged between 0% and market rates? (except as allowed for principal forgiveness)	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	SFY03 Weighted Avg interest rate = 1.032%; SFY04 = 1.340% Market rate= 4.8% for both 2003 and 2004	
b. Do principal repayments start within one year of project completion and end within 20 years, for all non-extended term projects with non-extended loan repayment terms?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	WA does structure some loan agreements to lengthen repayments to the maximum 20 years and/ or lower interest rates to 0% for communities that meet financial hardship criteria	
c. Does the program use extended terms or principal forgiveness to the extent it is allowable? (If so report the percentage of project funding in these categories.)	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		

Required Financial Elements

Review Item and Questions to Answer	Yes	No	N/A	Comments	Data Sources (check all that apply)
2 Does the State periodically evaluate the terms of assistance offered relative to the supply and demand for funds and the long-term financial health of the fund?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	WA CWSRF program evaluates its rates in terms of market conditions, and competitive levels compared to the Washington Public Works Board, (which provides low interest loans for water infrastructure projects). EPA is encouraging WA DOE to regularly evaluate the effect of loan interest rates charged on the perpetuity of the fund as well.	
2.7 Use of Fees					
1 Does the program assess fees on their borrowers?	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Washington is considering the possibility of initiating loan fees to provide for administrative expenses as the availability of funds from capitalization grants continues to decrease.	<input type="checkbox"/> IUP <input type="checkbox"/> Loan Agreements <input type="checkbox"/> Repayment transactions <input checked="" type="checkbox"/> EPA discussions with WA DOE staff/ mgmt.
a. What is the fee rate charged and on what basis (e.g., percentage of closing amount, principal outstanding, principal repaid, etc.)?	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>		
b. Are fees being used in accordance with program requirements?	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>		
2 Does the State periodically evaluate the use of fees relative to loan terms to set appropriate total charges to borrowers and assess long-term funding needs to operate the program?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	WA is considering the possibility of initiating a fee policy to provide for SRF program administrative expenses in the event of continued reductions in dollar amounts of federal grants and /or the end of federal capitalization grants.	EPA discussions with WA DOE staff/ mgmt.

Required Financial Elements

Review Item and Questions to Answer	Yes	No	N/A	Comments	Data Sources (check all that apply)
3 Does the State have procedures for accounting and reporting on its use of fees?	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>		
2.8 Assessment of Financial Capability and Loan Security					
1 Does the State have procedures for assessing the financial capability of assistance recipients? (CW only)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Previously, no standard process has been followed. A financial capacity assessment tool (Excel program) developed and used by the EFC at Boise State, is being applied to SFY05 fundable projects. In SFY06, Boise State is contracted to provide training to WA DOE staff in the data gathering and use of the assessment tool.	<input type="checkbox"/> Financial Capability Review Procedures <input type="checkbox"/> Loan applications <input type="checkbox"/> Project Files
2 Are the financial capability policies and procedures being followed? (CW only)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	A tool developed by the EFC at Boise State is supposed to be implemented in the SFY06 process. This tool would be used by Ecology staff during SFY 2007.	<input type="checkbox"/> Financial Capability Review Procedures <input type="checkbox"/> Loan approval documentation <input type="checkbox"/> Project Files
3 Does the state have procedures for assessing the technical, financial, and managerial capability of assistance recipients? (DW only)	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/> Capability Review Procedures <input type="checkbox"/> Loan applications <input type="checkbox"/> Project Files
4 Are the technical, financial, and managerial review procedures being followed? (DW only)	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/> Capability Review Procedures <input type="checkbox"/> Loan approval documentation <input type="checkbox"/> Project Files
5 Do assistance recipients have a dedicated source of revenue for repayment or, for privately-owned systems, adequate security to assure repayment?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Loan agreements require that borrowers' have a dedicated source of revenue for repayment and require that borrowers with revenue secured debt to the Fund establish a debt service reserve during the first five years of the repayment period for loans with terms five years or greater.	<input type="checkbox"/> Financial Capability Review Procedures <input checked="" type="checkbox"/> Loan approval documentation <input type="checkbox"/> Project Files
6 Do assistance recipients have access to additional funding sources, if necessary, to ensure project completion?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/> Project Files

Required Financial Elements

Review Item and Questions to Answer	Yes	No	N/A	Comments	Data Sources (check all that apply)
2.9 Financial Management					
1 Is the SRF program's financial management designed to achieve both short- and long -term financial goals?	<u>X</u>	<u> </u>	<u> </u>	WA's Annual Report addresses progress towards both long and short-term goals. The goals are well reasoned and communicate the evolving nature of WA CWSRF program.	<u>X</u> Annual / Biennial Report <u> </u> Staff interviews
a. Do the Financial Indicators show progress in the program in funding the maximum amount of assistance to achieve environmental and public health objectives?	<u>X</u>	<u> </u>	<u> </u>	WA CWSRF program's financial indicators exceed Regional averages.	
2 Does the State have a long-term financial plan to direct the program?	<u> </u>	<u>X</u>	<u> </u>	WA does not have a long-term plan for managing the CWSRF.	
a. Was financial modeling used to develop the plan?	<u> </u>	<u> </u>	<u>X</u>		
b. Is the plan periodically reviewed and updated?	<u> </u>	<u> </u>	<u>X</u>		
c. Does planning address types of assistance and terms, use of leveraging, and transfers or cross-collateralization between programs?	<u>X</u>	<u> </u>	<u> </u>	WA State's CWSRF program is currently (during SFY2005) analyzing the impact of inflation, interest rates charged, loan terms and the potential for changes in Federal capitalization levels.	
3 Are funds disbursed to assistance recipients in a timely manner?	<u>X</u>	<u> </u>	<u> </u>		
4 Has the State resolved any issues related to loan restructuring, the potential for defaults, and the timeliness of loan repayments?	<u> </u>	<u> </u>	<u>X</u>	There have been no defaults to date in this program. Loan boilerplate contains language dealing with repayment requirements.	
5 Are net bond proceeds, interest earnings, and repayments being deposited into the fund?	<u>X</u>	<u> </u>	<u> </u>	Staff in the Fiscal Department checks SRF Fund earnings on monthly basis.	
6 If the State leverages, is its leveraging activity consistent with the accepted leveraging structure?	<u> </u>	<u> </u>	<u>X</u>		
7 Are leverage and state match bond documents consistent with SRF regulations?	<u> </u>	<u> </u>	<u>X</u>		

PROJECT FILE REVIEW TABLES

SPOKANE COUNTY CONSERVATION DISTRICT DIRECT SEED ASSISTANCE PROGRAM LOAN

Item Description	What, Where & How Met
Project Name	Spokane County Conservation District Direct Seed Assistance Program
Project Loan Number	L0200025
Date of Loan	August 13, 2002, Amended to include Adams County on October 27, 2004
Project Description	This loan is being used to capitalize a local loan fund that is being operated by the Spokane County Conservation District. The local loan fund is making loans to agricultural operators to buy direct seeding equipment and associated straw storage facilities. Direct seeding is a best management practice under the state's §319 nonpoint source water quality plan. The practice reduces stream sedimentation considerably. Straw removal (grass straw) is a necessary prerequisite for direct seeding to work. The removed straw must be stored until it can be sold or disposed of in some other manner.
Amount of Loan	\$4,000,000
Need for Project	Spokane County and Adams county watersheds are subject to excessive sediment loads from agricultural operations. These sediment loads significantly impair water quality. The project would directly contribute to substantial sediment load reductions and result in water quality standards compliance in affected watersheds.
Loan Terms (rate/amortization period)	1.5% interest rate. Interest begins accruing with the first loan disbursement to the borrower. Disbursements are only made when the borrower has incurred costs (disbursements to agricultural borrowers). The loan will be amortized over a 15 year period commencing one year after project completion.
Type of assistance under §603(d)	Direct Loan
Financial Capability Assessment/Repayment Source Evaluation	There is no indication in the file that a financial capability assessment or creditworthiness evaluation was completed.
Loan Security Provisions	The loan is written as a general obligation debt of the

Item Description	What, Where & How Met
	Spokane County Conservation District, a sub-unit of Washington state government. The District pledges its taxing authority for taxes that can be levied without a vote of the people to repay the loan. The loan includes a state-aid intercept provision.
Facility Plan available/Approved	The loan agreement requires that the borrower develop and submit a loan program plan for departmental review prior to commencement of the local loan program. This plan was not in the file. A program description, provided to the EPA by the SCCD during the file review, addresses most of the subjects that should have been addressed by the required program plan.
Plans & Specs Approval	N/A
Bid Advertisement and Approval	N/A
MBE/WBE Compliance	The loan articulates MBE/WBE goals for recipient contracting and requires the borrower to implement a series of five affirmative steps. Any contractor engaged by the borrower must also follow these affirmative steps. Borrowers from the local loan fund would not appear to be considered contractors.
Initiation of Operations/Performance Certification [§204(d)(2)] [equivalency]	N/A
BPWTT [Best Practical Wastewater Treatment Technology; §201(b)] [equivalency]	N/A
Eligible Categories [§201(g)(1)] [equivalency]	N/A
Reclaim, Reuse [Alternative management techniques; e.g., land treatment, small systems, reclamation and reuse of water must be considered] §201(g)(2) [equivalency]	N/A
Infiltration/Inflow §201(g)(3) [equivalency]	N/A

Item Description	What, Where & How Met
Innovative/Alternative Treatment Technology (§201(g)(5) [equivalency]	N/A
Recreation & Open Space [§201(g)(6)] [equivalency]	N/A
CSO Funding Limitations [§201(n)(1-2)] [equivalency]	N/A
Capitol Financing Plan [§201(o) [equivalency]]	N/A
Water Quality Management Plans [§204(a)(1)] [equivalency]	N/A
Operation and Maintenance [§204(a)(2)] [equivalency]	N/A
User Charge System [§204(b)(4)] [equivalency]	N/A
Collection Systems [§211] [equivalency]	N/A
Cost Effectiveness [§218] [equivalency]	N/A
Davis Bacon Act [§512] [equivalency]	N/A Loan requires borrower to require all contractors and subcontractors to pay prevailing wages rates in accordance with State regulations.
Environmental Review [§511(c)(1)] [equivalency]	N/A
Was the appropriate type of environmental review conducted	N/A
If another agency's environmental review was adopted, is the adoption process appropriately documented	N/A
Public Notice	N/A
Public Hearing	N/A
Was an appropriate range of alternatives evaluated	N/A
Were other environmental review considerations adequately addressed	N/A

Item Description	What, Where & How Met
Endangered Species Act	N/A
National Historic Preservation Act	N/A
Archeological & Historic Preservation Act	N/A
Wild & Scenic Rivers Act	N/A
Coastal Zone Management Act Compliance	N/A
Coastal Barriers Resource Act	N/A
Farmland Protection Act	N/A
E.O. 11990 Wetlands Protection	N/A
E.O. 11888 Floodplain Management Act	N/A
Clean Air Act Compliance	N/A
Safe Drinking Water Act	N/A
Civil Rights Act	No form in file
E.O. 11246	EEO language in the loan agreement. Obligation does not carry through to borrowers from the local loan fund.
MBE/WBE	No documentation from borrower. However, there is no indication that SCCD did any contracting.
E.O. 12898 Environmental Justice	No documentation in file
Small Business & Rural Communities Act	SBRA requirements included in loan agreement. No indication that the requirement was passed on to borrowers from the local loan fund. However, since most of the loans were used to buy direct seeding equipment in rural Spokane and Adams counties, it is reasonable to believe that the equipment purchases were made from small businesses in rural Spokane and Adams counties.
Uniform Relocation Act	N/A
Debarment & Suspension	The requirement is incorporated by reference into the loan agreement. No indication that either the Conservation District or its customers checked to see whether the sellers of the equipment were on the suspended and debarred list. On the other hand, we would not expect to see such businesses on the list given that the U.S. Government would not be expected to be a significant buyer of such equipment.
Project Accounts Maintained in	Washington program regulations (the Washington

Item Description	What, Where & How Met
<p>accordance with GAAP (40 C.F.R. §35.3135(i))</p>	<p>Administrative Code, WAC) requires, at WAC 173-98-070(4) requires that "Recipients must maintain accounting records in accordance with "generally accepted government accounting standards."</p> <p>The WAC also requires that the project (loan) accounts be separate. Additionally the standard loan agreement, in Attachment 6, specifies: <u>Accounting Standards</u>. The RECIPIENT shall maintain accurate records and accounts for the PROJECT ("PROJECT Records") in accordance with generally accepted government accounting standards including those contained in the STANDARDS FOR AUDIT OF GOVERNMENTAL ORGANIZATIONS, PROGRAMS, ACTIVITIES, AND FUNCTIONS promulgated by the U.S. General Accounting Office.</p> <p>An independent audit for calendar year 2003 of the Conservation District completed by the Washington State Auditor states that the Conservation District maintains its accounts in accordance with the "Budget and Accounting Reporting System (BARS) manual prescribed by the State Auditor. The audit notes that this is a system other than GAAP (a cash based system rather than an accrual system) and is NOT compliant with GAAP.</p>

STANWOOD WASTEWATER TREATMENT PLANT UPGRADE AND EXPANSION LOAN

Item Description	What, Where & How Met
Project Name	Stanwood Wastewater Treatment Plant Upgrade and Expansion
Project Loan Number	L0300030
Date of Loan	September 20, 2002 (effective date set by prior authorization). Loan actually signed March 19, 2003. Authorization to incur costs before the effective date of the grant and loan was issued on December 1, 2002 by the Ecology Water Quality Program Director.
Project Description	Construction of a new 1.5 MGD activated sludge wastewater treatment facility including modifications to existing aerated lagoons and an emergency storage lagoon.
Amount of Loan	\$8,868,072. The project also received a \$2,592,400 hardship grant from the state's Centennial Clean Water Fund
Need for Project	The upgrade is required to bring the POTW into compliance with the terms of its current NPDES permit and to meet expected requirements in the waste load allocation in the TMDL being developed for the Stillaguamish River.
Loan Terms (rate/amortization period)	This is a hardship loan with interest rate set at 0% (zero). The loan has a 20 year amortization period.
Type of assistance under §603(d)	Direct loan
Financial Capability Assessment/Repayment Source Evaluation	To qualify for hardship assistance, the applicant requests and the Department of Ecology performs an evaluation that compares estimated required user charges to median household income in the service area. No other financial capability assessment or creditworthiness evaluation was completed.
Loan Security Provisions	The loan requires the creation and funding of a debt service reserve equal to one year's debt service during the first five years of the repayment period. There is no coverage ratio specified in the loan agreement. State-aid intercept is provided for in the event of a loan default.
Facility Plan available/Approved	Loan application indicates the Facility Plan was approved. Facility Plan approved May 30, 2000 (Letter attached to file copy of final Facility Plan).
Plans & Specs Approval	The design was approved on May 30, 2000 and the plans and specifications were approved on March 5, 2002 according to

Item Description	What, Where & How Met
	the loan application. Approval letter is in the project file. Plans and Specifications were not in the files that we reviewed.
Bid Advertisement and Approval	The project went out to bid before the grant and loan were signed. The project owner gave the contractor notice to proceed with construction as soon as it had received a final offer on the final offer list (Final IUP) for SFY 2003.
MBE/WBE Compliance	Requirements are incorporated into the loan agreement. No documentation in the file of the borrower's actions to address MBE/WBE requirements.
Initiation of Operations/Performance Certification [§204(d)(2)] [equivalency]	Required by loan agreement.
BPWTT [Best Practical Wastewater Treatment Technology; §201(b)] [equivalency]	A secondary treatment system was selected. That is, by definition, BPWTT. The selected treatment design provides for cost-effective nutrient removal if that is required by a TMDL that was under development at the time the Facilities Plan was completed. 50% of the BOD load is due to industrial and commercial sources discharging to the Stanwood collection, treatment and disposal system.
Eligible Categories [§201(g)(1)] [equivalency]	The project consists is a Publicly Owned Treatment Works expansion and upgrade. All elements are, by definition, eligible as they are components of a §212 project.
Reclaim, Reuse [Alternative management techniques; e.g., land treatment, small systems, reclamation and reuse of water must be considered] §201(g)(2) [equivalency]	Reclamation and reuse were examined and determined to be too expensive to be practical.
Infiltration/Inflow §201(g)(3) [equivalency]	The Facilities Plan included an analysis of infiltration and inflow. It concluded that based on EPA's criterion of 120 gpcd that excess infiltration was not occurring. The same analysis concluded that excessive inflow may be occurring. The Facilities Plan identifies approximately \$9.3 million in collection system upgrades and sewer system extensions (to extend service to more of the area within the Interim Urban

Item Description	What, Where & How Met
	Growth Boundary established pursuant to the state's Growth Management Act).
Innovative/Alternative Treatment Technology [§201(g)(5)] [equivalency]	Constructed wetlands were examined as treatment process. The analysis concluded that insufficient land was available for this to be a practical alternative.
Recreation & Open Space [§201(g)(6)] [equivalency]	N/A---the site description makes it clear that there was simply no land available for recreational/open space "services."
CSO Funding Limitations [§201(n)(1-2)] [equivalency]	Stanwood has separate sanitary sewers.
Capitol Financing Plan [§201(o)] [equivalency]	Facilities plan briefly discusses financing options for the "covered" facilities but does not analyze them in any detail.
Water Quality Management Plans [§204(a)(1)] [equivalency]	The facility is designed to comply with a state issued NPDES permit and to accommodate anticipated requirements of a TMDL being developed pursuant to §303 of the Clean Water Act.
Operation and Maintenance [§204(a)(2)] [equivalency]	A plan of operations was submitted on January 27, 2003. The loan agreement also requires completion of an O&M plan by the project owner.
User Charge System [§204(b)(4)] [equivalency]	Reviewed by Ecology as a part of doing the economic hardship assistance request that was ultimately approved by Ecology
Collection Systems [§211] [equivalency]	The Facilities Plan analysis (noted elsewhere) identified needed upgrades to the existing collection system.
Cost Effectiveness [§218] [equivalency]	The Facilities Plan compared the "present worth" of the costs of each of the alternatives. The lowest cost alternative was selected for treatment. UV disinfection was recommended in that the elimination of chlorine handling (and associated risks) was deemed to be worth the additional cost.
Davis Bacon Act [§512] [equivalency]	N/A, Loan agreement does require application of state equivalent.
Environmental Review [§511(c)(1)] [equivalency]	An environmental checklist was completed and included in the Final Facilities Plan.
Was the appropriate type of environmental review conducted	A Declaration of Non-Significance was issued and concurred in by Ecology. Based on the information in the checklists that appears to be the appropriate form of environmental review (there seem to be no environmental issues in dispute that an EIS could have helped resolve).
If another agency's environmental review was	N/A

Item Description	What, Where & How Met
adopted, is the adoption process appropriately documented	
Public Notice	A month's notice was given of the public meeting on the Draft Facilities Plan and DNS.
Public Hearing	A public meeting was held at the start of the facility planning process. Additionally, a public meeting was held on the draft Facilities Plan and an associated Declaration of Non-Significance under the State Environmental Policy Act.
Was an appropriate range of alternatives evaluated	A thorough range of alternatives is evaluated in the Facilities Plan
Were other environmental review considerations adequately addressed	Facilities plan thoroughly evaluated capacity needs and options to address them.
Endangered Species Act	Salmon may be present. No evidence of informal consultation with FWS, NMFS or WDF in the Facilities Plan.
National Historic Preservation Act	No evidence of SHPO contact in the Facilities Plan.
Archeological & Historic Preservation Act	The site consists of previously excavated and graded land. No "new" archeological or historical sites were anticipated.
Wild & Scenic Rivers Act	Other than the Stillaguamish River (the receiving waters), no wild or scenic rivers are present in the service area. No adverse impacts from the project were anticipated. In fact the project should improve water quality in the Stillaguamish River.
Coastal Zone Management Act Compliance	Shoreline development permit needed. No documentation concerning the permit was found in the files reviewed.
Coastal Barriers Resource Act	N/A
Farmland Protection Act	No farmlands involved in this project.
E.O. 11990 Wetlands Protection	Virtually the entire existing site is covered by treatment structures such as lagoons or constructed wetlands that were built as part of a pilot project.
E.O. 11888 Floodplain Management Act	The site is located within an earthen levee that protects it from a 100 year recurrence interval flood.
Clean Air Act Compliance	SERP checklist indicates air quality standards compliance will be maintained.
Safe Drinking Water Act	N/A no sole source aquifers in study area
Civil Rights Act	Incorporated in standard loan agreement (incorporated by

Item Description	What, Where & How Met
	reference). No documentation on compliance was found in the files reviewed.
E.O. 11246	Incorporated in standard loan agreement (incorporated by reference) No documentation on compliance was found in the files reviewed.
MBE/WBE	Incorporated in standard loan agreement (incorporated by reference). No documentation on compliance was found in the files reviewed.
E.O. 12898 Environmental Justice	Not discussed in the Facilities Plan or the environmental checklists.
Small Business & Rural Communities Act	Loan agreement incorporates requirement. No documentation on compliance was found in the files reviewed.
Uniform Relocation Act	No relocations required.
Debarment & Suspension	Requirement incorporated by reference in the loan agreement. Applicant certified that it was not suspended or debarred in a certification dated March 14, 2003. No certifications regarding contractors were in the files reviewed.
Project Accounts Maintained in accordance with GAAP (40 C.F.R. §35.3135(i))	<p>Washington program regulations (the Washington Administrative Code, WAC) requires, at WAC 173-98-070(4) requires that "Recipients must maintain accounting records in accordance with "generally accepted government accounting standards."</p> <p>The WAC also requires that the project (loan) accounts be separate. Additionally the standard loan agreement, in Attachment 6, specifies: <u>Accounting Standards</u>. The RECIPIENT shall maintain accurate records and accounts for the PROJECT ("PROJECT Records") in accordance with generally accepted government accounting standards including those contained in the STANDARDS FOR AUDIT OF GOVERNMENTAL ORGANIZATIONS, PROGRAMS, ACTIVITIES, AND FUNCTIONS promulgated by the U.S. General Accounting Office.</p> <p>An independent audit of the financial statements for calendar year 2004 of the City of Stanwood completed by the Washington State Auditor states that the City maintains its accounts in accordance with the "Budget and Accounting</p>

Item Description	What, Where & How Met
	Reporting System" (BARS) manual prescribed by the State Auditor. The audit notes that this is a system other than GAAP (a cash based system rather than an accrual system) and is NOT compliant with GAAP.