

EPA Guidance Removed States' Responsibilities for Monitoring State Revolving Fund Borrowers' Single Audit Reports

August 15, 2023 | Report No. 23-N-0028



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Abbreviations

C.F.R.	Code of Federal Regulations
CWSRF	Clean Water State Revolving Fund
DWSRF	Drinking Water State Revolving Fund
EPA	U.S. Environmental Protection Agency
MSDH	Mississippi State Department of Health
OIG	Office of Inspector General
U.S.C.	United States Code

Cover Image

States use their EPA-funded Drinking Water State Revolving Funds to give low-interest loans to nonfederal entities to perform infrastructure projects, such as improvements to water treatment systems like the one pictured here. (EPA photo)

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OFFICE OF INSPECTOR GENERAL
U.S. ENVIRONMENTAL PROTECTION AGENCY

August 15, 2023

MEMORANDUM

SUBJECT: EPA Guidance Removed States' Responsibilities for Monitoring State Revolving Fund Borrowers' Single Audit Reports
Report No. 23-N-0028

FROM: Sean W. O'Donnell, Inspector General

TO: Radhika Fox, Assistant Administrator
Office of Water

The U.S. Environmental Protection Agency Office of Inspector General [initiated](#) an audit to identify federal funding and spending decisions related to drinking water in Jackson, Mississippi. While conducting work on that audit, which remains ongoing, we found that the EPA Office of Water issued a policy memorandum titled *Updated Single Audit Act Borrower Audit Collection Policy* in September 2021, which incorrectly advised states that they do not have to review single audits of nonfederal entities that borrow money from state revolving funds. This policy memorandum contradicted the Single Audit Act, as amended, 31 U.S.C. chapter 75, and misinterpreted 2 C.F.R. part 200, *Uniform Administrative Requirements, Cost Principle, and Audit Requirements for Federal Awards*, which is commonly referred to as the *Uniform Guidance*.

Key Terminology

Single audits: The Uniform Guidance and the Single Audit Act require any nonfederal entity that expends \$750,000 or more in federal funds in a fiscal year to undergo an organizationwide audit for that year. This is known as a single audit.

State revolving funds: These federal-and-state-partnership financial assistance programs function like infrastructure banks by providing eligible recipients low interest loans for infrastructure projects.

We decided to issue this management alert regarding this finding, so that the Agency could immediately take corrective actions, as appropriate. In fiscal year 2022 alone, the EPA provided \$3.2 billion and \$6.4 billion to nonfederal entities through the Clean Water State Revolving Fund, or CWSRF, and Drinking Water State Revolving Fund, or DWSRF, respectively. Reviewing the results of single audits is one oversight tool that states can use to minimize and prevent waste, fraud, and abuse of these EPA funds.

This management alert supports these EPA mission-related efforts:

- Ensuring clean and safe water.
- Partnering with states and other stakeholders.

This management alert addresses a top EPA [management challenge](#):

- Managing business operations and resources.

You are not required to respond to this report because this report contains no recommendations. If you submit a response, however, it will be posted on the OIG's website, along with our memorandum

commenting on your response. Your response should be provided as an Adobe PDF file that complies with the accessibility requirements of section 508 of the Rehabilitation Act of 1973, as amended. The final response should not contain data that you do not want to be released to the public; if your response contains such data, you should identify the data for redaction or removal along with corresponding justification.

Background

On July 5, 1996, the Single Audit Act was amended to, among other things, promote sound financial management and ensure that federal departments and agencies rely on and use single audits as an oversight tool to the maximum extent possible. Pursuant to the amended Single Audit Act, independent nonfederal auditors are to conduct single audits and write reports summarizing the results of their audits. Reviewing these single audit reports, which are maintained in a repository called the *Federal Audit Clearinghouse*, is one way federal agencies can perform oversight of entities that receive and expend federal funds.

The Office of Management and Budget, under the authority granted in the Single Audit Act, developed governmentwide guidelines for performing single audits. In December 2013, to streamline grants management guidance, which includes guidance related to single audits, into a single comprehensive document, the Office of Management and Budget issued the Uniform Guidance. The Uniform Guidance requires any nonfederal entity that expends \$750,000 or more in federal funds in a fiscal year to undergo a single audit of its financial statements and federally funded programs.

In 1996, Congress created the DWSRF under the Safe Drinking Water Act. The EPA annually provides grants to each state's DWSRF, which the state then uses to give low-interest loans to nonfederal entities to perform infrastructure projects. The states are referred to as *passthrough entities*, as they pass the funds from the EPA to eligible nonfederal entities. The nonfederal entities are referred to as *subrecipients*, and the awarded funds are referred to as *subawards*.

As part of our ongoing audit, we assessed the internal controls that the Mississippi State Department of Health, or MSDH, has in place to administer the Mississippi's Drinking Water System Improvement Revolving Loan Fund, generally known as the Mississippi DWSRF. Among other things, we looked at how the MSDH uses single audits as a tool for monitoring its subrecipients.

Responsible Offices

The Office of Ground Water and Drinking Water and the Office of Wastewater Management, both within the Office of Water, provide technical direction and support to regional offices for the DWSRF and CWSRF. Each of the EPA's regional offices provide funding and oversight of these state revolving funds for the states within their region.

Scope and Methodology

We conducted our work from November 2022 to August 2023. While our overall audit, which is still ongoing, is being conducted in accordance with generally accepted government auditing standards, the work related to this report does not constitute an audit done in accordance with these standards. However,

we did follow the OIG's quality control procedures for ensuring that the information in this report is accurate and supported.

As part of our work, we reviewed the Uniform Guidance and the Single Audit Act; Federal Register revisions associated with the Uniform Guidance; the EPA's *Updated Single Audit Act Borrower Audit Collection Policy* and other related guidance documents; the State of Mississippi's DWSRF Loan Program Operating Agreement; and single audit reports for the City of Jackson for the fiscal years ended September 30, 2015, through September 30, 2021. We also interviewed personnel from the MSDH, the City of Jackson, and the EPA.

Results

The MSDH did not review, as required by the Single Audit Act, the single audit reports for the City of Jackson, a nonfederal entity that borrowed money from Mississippi's DWSRF. The MSDH told us that it did not review these single audit reports because the EPA's September 2021 *Updated Single Audit Act Borrower Audit Collection Policy* advised states that they are not required to do so. Single audit reports that we reviewed for fiscal years 2017 through 2021, however, identified DWRSF and financial statement deficiencies for the City of Jackson. Because the MSDH was not reviewing single audit reports, it overlooked an important tool to ensure that its DWSRF subrecipients have sound financial management systems and comply with federal statutes, regulations, and the terms and conditions of their loan awards. Also, the MSDH would not be aware of and therefore would be unable to resolve single audit findings related to its DWSRF subrecipients, in contrast to Single Audit Act requirements. This means that federal dollars passing through Mississippi's DWSRF are at risk for waste, fraud, and abuse.

While our work focused on the DWSRF, the MSDH, and the City of Jackson, the EPA's *Updated Single Audit Act Borrower Audit Collection Policy* is relevant to both the DWSRF and CWSRF and applies to all DWSRF and CWSRF passthrough entities. If states are not using single audit reports as a tool to monitor federal funds that they distribute through the DWSRF and CWSRF, their ability, and by extension the EPA's ability, to protect DWSRF and CWSRF money against fraud, waste, and abuse is hampered. In fiscal year 2022 alone, the EPA provided \$6.4 billion for the DWSRFs and \$3.2 billion for CWSRFs. The Infrastructure Investment and Jobs Act is slated to provide an additional \$30.7 billion for the DWSRFs and \$12.7 billion for the CWSRFs from fiscal year 2022 through 2026.

Passthrough Entity Subrecipient Monitoring Responsibility

Per the Single Audit Act, 31 U.S.C. § 7502(f)(2), passthrough entities must, among other things, monitor subrecipients' use of federal awards and review the audits of subrecipients as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings. Consistent with the Single Audit Act, section 200.332 of the Uniform Guidance, *Requirements for passthrough entities*, requires passthrough entities, such as the MSDH, to monitor the activities of subrecipients as necessary to ensure that they use subawards for authorized purposes; comply with federal statutes, regulations, and the terms and conditions of the subaward; and achieve the performance goals of the subaward. The Uniform Guidance requires that passthrough entities monitor subrecipients by reviewing financial and performance reports, including single audit reports; follow up on all deficiencies that pertain

to federal awards; and issue written management decision letters on the adequacy of the proposed corrective actions to address the audit findings.

Issued in October 2006, the EPA’s provisional guidance, *Drinking Water State Revolving Fund Program Operation Manual*, reiterates the requirement for DWSRF passthrough entities to use single audits as a tool to monitor subrecipients. The manual states that the EPA must “[e]nsure the state has received and reviewed single audits from the designated DWSRF loan recipients” and that the state program office is to “[c]ollect Single Audits from loan recipients covered by the Single Audit Act” and “[f]ollow-up on audit findings if related to the recipient’s ability to repay the loan.”

In August 2020, the Office of Management and Budget revised section 200.332 of the Uniform Guidance to clarify passthrough-entity responsibility for single audit findings. This revision, which became effective on November 12, 2020, clarified that a passthrough entity is responsible for reviewing and resolving single audit findings related to a subrecipient but can rely on the cognizant federal agency to address entitywide issues. In other words, the cognizant federal agency, such as the EPA, is responsible for resolving crosscutting single audit findings that impact more than one federal agency, whereas the passthrough entity remains responsible for resolving single audit findings specific to a subrecipient. On September 30, 2020, the EPA promulgated its own rule at 2 C.F.R. § 1500.3, which stated that the section 200.332 monitoring requirements of the Uniform Guidance no longer apply to “loan ... or similar transactions with borrowers by recipients” of DWSRF and CWSRF grants because states have their own established processes for monitoring subrecipients. However, the EPA’s issuance of 2 C.F.R. § 1500.3 does not absolve passthrough entities of their monitoring and single-audit-review responsibilities under the Single Audit Act.

The EPA’s 2021 Policy Memorandum Misinformed States About Their Subrecipient Monitoring Oversight Responsibilities

The EPA’s Drinking Water Protection Division and Water Infrastructure Division issued the *Updated Single Audit Act Borrower Audit Collection Policy* on September 13, 2021, to regional state revolving fund branch chiefs. This policy memorandum, which was intended to reflect the changes that the Office of Management and Budget made to the Uniform Guidance in August 2020, instructed that, effective immediately, states were no longer required to collect or review DWSRF- or CWSRF-related findings from single audit reports. According to the policy memorandum, the change was made to align with the Uniform Guidance part 200 cognizant federal agency responsibility.

The EPA, however, misinterpreted the Uniform Guidance revisions for resolving subrecipient audit findings as being the responsibility of the cognizant federal agency only. The issued policy memorandum also contradicts the Single Audit Act mandate that passthrough entities must review subrecipient audits and determine whether corrective actions have been made to address any audit findings. The EPA issued the *Updated Single Audit Act Borrower Audit Collection Policy* with inaccurate information, which places federal funds at risk.

The MSDH Is Not Obtaining or Reviewing Single Audit Reports of DWSRF Subrecipients

The City of Jackson received three loans from Mississippi's DWSRF from calendar year 2016 through 2021. Independent nonfederal auditors conducted single audits of the City of Jackson, as required under the Uniform Guidance and the Single Audit Act, and the auditee submitted the resulting reports to the Federal Audit Clearinghouse. According to the MSDH, however, it was not obtaining or reviewing single audit reports for any of its DWSRF subrecipients, including those for the City of Jackson, because it was following the EPA's September 2021 *Updated Single Audit Act Borrower Audit Collection Policy*. This lack of review contradicts the requirements set forth by the Single Audit Act. In addition, because the MSDH was not reviewing these single audit reports, any audit findings would remain undetected and unresolved.

EPA Funds Awarded to Subrecipients Through Mississippi's DWSRF Are Vulnerable to Fraud, Waste, and Abuse

Because the MSDH was following the EPA's policy memorandum, it would not be aware of any single audit findings associated with its DWSRF subrecipients, including the City of Jackson. This lack of awareness puts federal funds at risk for fraud, waste, and abuse.

Of the \$81 million that passed through Mississippi's DWSRF from 2015 through 2022, the City of Jackson received more than \$40 million in loans. We reviewed single audit reports for the City of Jackson for fiscal years 2017 through 2021 and identified a DWSRF-related finding in the fiscal year 2019 report. This DWSRF-related finding involves the City of Jackson failing to use an advance of award funds in a timely manner. The single audit reports that we reviewed also identified numerous findings related to the city's financial statements, including deficiencies in the city's financial management system.

Not reviewing these single audit reports means that the MSDH may be unaware of the City of Jackson's DWSRF and financial statement deficiencies, and it may not be monitoring or determining whether prompt and appropriate corrective actions have been taken. The lack of oversight is even more concerning given that the City of Jackson is in the process of receiving an additional \$600 million through appropriations under the Safe Drinking Water Act to address its drinking water state of emergency, which was declared in August 2022.

Conclusions

The impacts of the EPA's incorrect *Updated Single Audit Act Borrower Audit Collection Policy* may extend beyond Mississippi and the DWSRF. Because of this policy memorandum, any state and territory that administers a DWSRF or CWSRF may not be using single audit reports as tools to evaluate the risk for or detect fraud, waste, or abuse. Every year, the EPA awards more than \$4 billion in federal funding for grants to nonfederal entities, and the EPA will be providing an additional \$43.4 billion to the DWSRFs and CWSRFs from fiscal year 2022 through 2026, pursuant to the Infrastructure Investment and Jobs Act. As such, the potential lack of oversight is troubling.

Single audit reports are a valuable tool for ensuring that subrecipients comply with federal requirements and for protecting federal funds from fraud, waste, and abuse. Passthrough entities and federal agencies

should use single audit reports, as required by the Single Audit Act, as a way to cost-effectively monitor and protect taxpayer dollars.

We met with the Office of Water on June 9, 2023, and informed it of our findings and plan to issue this management alert with recommendations. On July 19, 2023, the EPA issued a memorandum titled *Clarification of Single Audit Requirements Under the Clean Water and Drinking Water State Revolving Fund Programs* to the regional state revolving fund branch chiefs. This memorandum clarified the requirement for single audits, federal funds, and the responsibilities of recipients of state revolving fund assistance and state programs. The memorandum addressed the concerns we identify in this management alert, and we make no recommendations.

Finally, the EPA's September 2021 policy memorandum references action to be taken by the OIG. As a reminder, the EPA should coordinate with us on any proposed guidance that would require action on our part. Had the EPA done so with the September 2021 policy memorandum, we would have had the opportunity to point out that the guidance was incorrect.

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