



**REVIEW OF  
DEPARTMENT OF NATURAL RESOURCES  
CLEAN WATER STATE REVOLVING FUND**

**From The Office Of State Auditor  
Claire McCaskill**

**Report No. 2004-17  
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**PERFORMANCE AUDIT**



**Missouri wastewater treatment needs should be addressed in a more efficient manner**

The Department of Natural Resources (DNR) implemented the state's Clean Water State Revolving Fund (SRF) in 1992. It is a federally subsidized, low-interest, leveraged-loan program, which assists Missouri communities desiring to build, expand or improve their wastewater treatment facility. The SRF balance has grown to \$260 million in fiscal year 2003. This excessive balance is a result of inadequate outreach to communities, an untimely application process and an overly complicated financing process.

**State's wastewater treatment needs not completely assessed or quantified**

DNR did not maintain a comprehensive inventory of communities with inadequate wastewater treatment systems, or have sufficient outreach efforts to identify communities' wastewater needs. As a result, DNR's ability to determine wastewater treatment needs in the state and then target those communities needing assistance is limited. (See page 4)

**Untimely application process contributed to the excessive cash balance**

DNR did not require a facility plan to be submitted with a project application, which extended the average application processing time to 3 years. Delays in the application process causes disbursements to communities to lag. Subsequently, fund receipts have outpaced disbursements resulting in the growth of the fund's cash balance during each of the three fiscal years ended June 30, 2003. In addition, inaccurate financial projections have hindered DNR's ability to manage some financial aspects of the program. (See page 5)

**DNR could more proactively serve communities with increased outreach**

DNR should enhance outreach to communities determined to have wastewater treatment needs by offering information and assistance prior to the submission of the application and facility plan. This information would inform communities of the financing options, give community leaders the information they need to move forward with the application while potentially reducing the excessive application processing time. (See page 6)

**Use of SRF interest earnings should be re-evaluated**

The benefits of issuing short-term bonds instead of long-term debt for the match portion of the Clean Water SRF Capitalization Grant should be evaluated. Short-term bonds would allow the state to utilize more of the fund's interest earnings for matching purposes. This method could reduce additional long-term debt issuances by up to \$10 million annually. (See page 9)

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**ABBREVIATIONS**

DNR	Department of Natural Resources
SRF	State Revolving Fund
EPA	Environmental Protection Agency
NIMS	National Information Management System
IUP	Intended Use Plan



**CLAIRE C. McCASKILL**  
**Missouri State Auditor**

Honorable Bob Holden, Governor  
and  
Stephen Mahfood, Director  
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Missouri's Clean Water State Revolving Fund (SRF) is to help communities obtain adequate wastewater systems. Because of the importance of meeting Missouri's environmental needs, this report focuses on factors affecting the SRF's increasing cash balance and utilization.

The Department of Natural Resources (DNR) did not effectively utilize the SRF. In part, DNR did not effectively outreach to or identify all communities with inadequate wastewater treatment systems. We found the cash balance increased substantially due to an untimely application process and an overly complicated financing process. Improvements in DNR's financial management procedures could result in cost savings and/or a greater impact on meeting the state's wastewater treatment needs. We make recommendations to address these areas, and to help DNR better serve communities.

We conducted our work in accordance with applicable standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and included such tests of the procedures and records as were considered appropriate under the circumstances.

A handwritten signature in black ink that reads "Claire McCaskill".

Claire McCaskill  
State Auditor

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## **RESULTS AND RECOMMENDATIONS**

### **A More Efficient Use of Resources Would Better Address Wastewater Treatment Needs**

The state's Clean Water State Revolving Fund (SRF) balance has grown in excess of \$260 million in fiscal year 2003—a 19 percent increase from \$218 million in fiscal year 2002. DNR allowed these funds to accumulate without identifying all communities with inadequate wastewater treatment systems. Several factors affected this excessive balance accumulation such as inadequate outreach to communities needing funds, an untimely application process, and an overly complicated financing process. DNR could assist more communities needing these funds if it used resources restricted for sanitary wastewater systems more efficiently.

#### **Background**

DNR implemented the SRF Program in 1992. It is a federally subsidized, low-interest, leveraged-loan program coordinated with the Environmental Protection Agency's (EPA) Capitalization Grant which is matched with state funds equal to 20 percent of the annual grant amount. DNR administers the federal funds and generates matching funds with state water pollution control bonds proceeds. The federal government requires funds to be used for eligible projects and low interest loans.<sup>1</sup> State law also authorizes DNR to administer several other related state grant and loan programs.

To determine eligibility, DNR reviews communities'<sup>2</sup> applications for the SRF Program, Forty-Percent Grant Program, and Hardship Grant and Loan Program each year. The Missouri Water and Wastewater Review Committee (MWWRC)<sup>3</sup> evaluates project proposals prior to the submission to DNR. DNR then determines whether to include the projects in the SRF leveraged loan program or grant program based upon the communities' application and financial information. From the financial information, DNR selects programs that best meet the applicants' needs and financial capacity.

Communities desiring to build, expand, or improve their wastewater treatment facility can borrow money after their voters approve the proposed debt—generally general obligation or revenue bonds. DNR provides local communities reserve funds as a loan guarantee. DNR deposits funds equal to 70 percent of construction costs into reserve funds as construction costs are incurred. Loan repayments are deposited in the SRF and used to provide additional loans.

#### **Scope and Methodology**

To determine what factors affected the fund balance, we reviewed DNR's application process, construction process oversight, and financial management procedures. We randomly selected and reviewed 56 of the 120 SRF projects that received funding from 2001 to 2003. We interviewed DNR officials responsible for this program and our selected projects. We also

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<sup>1</sup> Clean Water Act, Title VI (33 USC 1381 et seq).

<sup>2</sup> A community may be several forms of political subdivisions such as a village, city, or sewer district.

<sup>3</sup> The MWWRC is a 20 member committee that is made up of individuals from the Departments of Natural Resources and Economic Development, and the U.S. Department of Agriculture.

reviewed the Clean Water State Revolving Fund project files and interviewed officials from 48 of 90 communities that had applied for but did not obtain SRF funding for various reasons during fiscal years 2000 through 2003.

We obtained data from the federal Environmental Protection Agency and interviewed state environmental agency officials from Illinois, Iowa, Kansas, Michigan, Nebraska and Ohio to provide context on the application process' timeliness. During our interviews and research, we obtained information on each state's approach to administering their programs such as leveraging percentages and application processes.

The department provided us comments in a meeting on December 17, 2003, and in a letter dated January 12, 2004. We have incorporated these comments as appropriate. We conducted our work between January and October 2003.

### **Fund cash balance outpaces funds to communities**

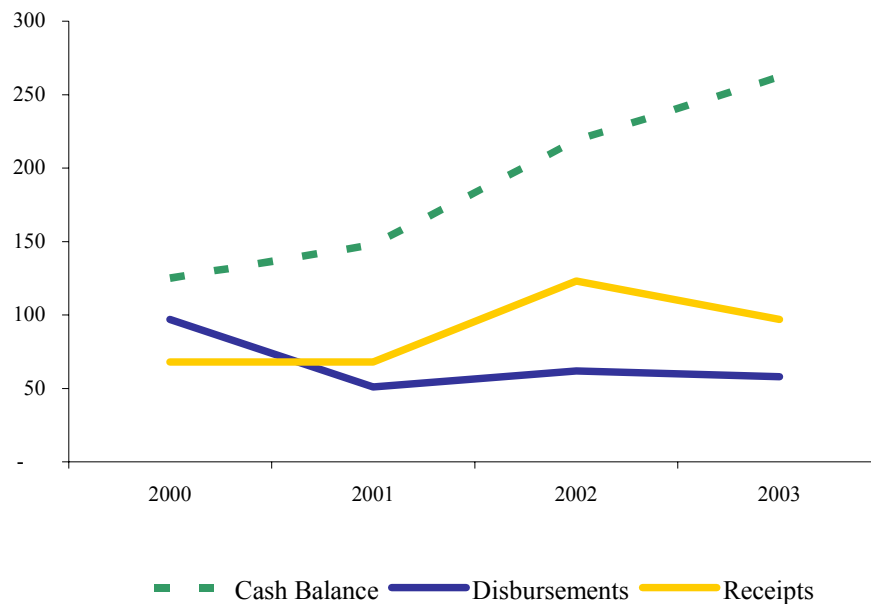
The SRF cash balance has increased substantially and outpaced annual disbursements on obligated funds. Figure 1 illustrates a relationship between weaknesses noted in DNR's ability to identify communities' needs, process community funding applications, and the limited funding (or disbursements) actually provided to communities. As a result, the cash balance as of June 30, 2003 would sustain the SRF program obligations (based on fiscal year 2003 disbursements) for four years with no receipts during that period. For example, if average disbursements to communities' loan reserves continue to total about \$58 million<sup>4</sup> each year, the total outstanding loan commitments<sup>5</sup> would be paid over four years with additional cash available for new loan disbursement obligations during that same period.

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<sup>4</sup> Total disbursements made to loan recipients reserves during fiscal year 2003.

<sup>5</sup> DNR estimates its current total outstanding loan commitments to be in excess of \$173 million.

**Figure 1: SRF Cash Balance, Disbursement, and Receipt Trends, Fiscal Years 2000 to 2003 (Dollars in millions)**



Source: Prepared by SAO based on cash balances obtained from DNR SRF annual reports, the Missouri State Treasurer's List of Fund Balances, and DNR receipt and disbursement data.

### **Potential wastewater treatment needs were not completely assessed or quantified**

DNR cannot ensure all communities with inadequate or antiquated wastewater treatment systems were considered in its short- or long-term plans. DNR did not maintain a comprehensive inventory of communities with inadequate wastewater treatment systems, or have sufficient outreach effort to identify communities' needs. DNR prepared a Clean Water Needs Survey Report every four years. This report compiled information submitted to the EPA, and was used by Congress to appropriate federal funds for the SRF program. In commenting on our draft audit report, DNR noted its survey was detailed and met federal requirements. However, according to DNR personnel, this survey did not generally include communities with populations less than 3,000 unless DNR had been made aware of wastewater treatment problems. Nor did this listing include the existing treatment facilities' age or condition.

DNR officials told us it annually conducts mass mailings to all communities, is active in municipal association activities, and meets with some individual communities. As noted in DNR's response, it relies on the communities to identify wastewater treatment needs and submit funding applications. However, DNR did not specifically target or outreach to communities who may be having wastewater treatment problems or potential needs. DNR officials told us management did not use the EPA needs report or maintain an inventory of communities because DNR bases financial needs on its Intended Use Plan (IUP). This plan consists of project lists of current and previous project applications submitted by communities and management's long and short-term goals for the program. DNR officials told us they expect communities to contact them when they need financing, including those instances where enforcement activities occur.

Further, DNR’s SRF program staff did not coordinate with enforcement staff to identify or target communities needing assistance.

According to the EPA's SRF Fund Management Handbook, a complete inventory of existing wastewater treatment plants as well as communities without adequate wastewater treatment facilities is necessary when planning for present and future financing needs to correct or prevent environmental or health problems. The Management Handbook also stated the inventory could help in developing short and long-term goals, evaluating the program by assessing the state's progress toward achieving those goals and objectives, and identifying adjustments necessary to improve the program. DNR officials told us they use their IUP as a management tool to set their long and short-term goals and plan future financing needs rather than maintaining a complete inventory.

### **An untimely application process contributed to the excessive cash balance**

We found it took DNR an average of 3 years to process communities’ applications. Of the 56 projects reviewed, 6 (11 percent) took over 5½ years to process while the shortest time took 1 year. The untimely application process contributed to delays in disbursing SRF funds, which then caused delays in starting construction of new, or the upgrade of existing facilities. The application process includes review and approval of the various required documents such as the facility plan and plans and specifications. Table 1 compares Missouri's application processing time, the federal grant allocation, and the SRF year-end cash balance to other states.

**Table 1: Fiscal Year 2002 Grant Allocations, Cash Balances and Processing Time by State**

<b>State</b>	<b>Grant allocation</b>	<b>SRF Cash balance</b>	<b>Months to process application</b>
Missouri	\$ 37,205,784	\$ 216,852,386	18-48
Illinois	60,293,970	255,400,000	24-36
Michigan	57,322,782	11,164,408	6-18
Nebraska	6,855,000	33,592,544	12
Iowa	18,002,853	42,909,264	12
Ohio	75,050,712	6,437,218	4-12
Kansas	12,033,450	58,462,736	6

Source: Prepared by SAO based on data obtained from the states in the EPA's Region 5 and Region 7 and National Information Management System (NIMS) data obtained from the EPA.

### Documents required to process applications were not received or approved timely

DNR policies and regulations did not require a facility plan to be submitted with the application. We found this extended the application processing time. Of the 56 communities tested, DNR processed 11 communities’ applications in an average of 383 days when the application included the facility plan. On the other hand, it took 787 days to receive, review, and approve applications of 34 communities that did not initially submit facility plans. These communities took an average of 505 days to submit their facility plans after their initial applications, and it took an additional 282 days to review and approve the plans. For the 11 remaining communities,



the project files did not contain sufficient information to determine if the facility plan accompanied the application.

A facility plan contains information about the community and the proposed treatment facility. This plan includes existing conditions and projections, existing facility evaluation or evaluations of un-sewered communities, and the basic project development. The project development consists of the three most cost-effective and environmentally sound alternatives to alleviate the problem, with the preferred system noted in the conclusion of the facility plan.

Kansas, Michigan, and Ohio officials told us they provide assistance up-front through outreach and avoid delays in the application process by requiring certain documents, including the facility plan, to be submitted with the application. DNR officials told us requiring the facility plan with the application might expedite the process, it could also result in unnecessary costs to communities if the project is not completed. DNR officials also told us it is the communities' responsibility to ensure timely submittal of appropriate documentation.

#### DNR could better communicate funding or other requirements to communities

DNR could better coordinate with other state and federal agencies to provide adequate information about the different sources of funding available for wastewater projects. DNR brochures did not include information about funding sources available through the state Department of Economic Development and the U.S. Department of Agriculture. DNR officials told us they did not feel it was necessary to include this information in the application packet because most communities contacted or obtained the information from a local rural or economic development official or engineer prior to submitting the proposal.

However, one-fourth of the community officials we contacted who applied for SRF funding were not aware of the other funding sources. At the time the project proposal was completed, 12 of the 48 community officials we interviewed were not aware of available funding sources; what funding their community qualified for; the amount available from each funding source; and/or their communities' most beneficial funding source. Six of the 12 officials told us their local engineers advised them of the funding source after the application was complete, 2 found the information on their own, and 4 were never made aware other types of available funding existed. One official stated, "how ... are we supposed to know how much we want from each of the funding sources?" In addition, one community official told us DNR did not advise the community of its SRF ineligibility until one year after starting the design process. This community subsequently completed its project without SRF funding.

Kansas sends engineering and other staff to communities determined to have sewage treatment problems. A Kansas official said this outreach is to inform the community about the program, and the officials and their contracted engineers exactly what is required prior to submitting the application.

### DNR staffing issues affected timeliness

DNR officials told us delays in the application process attributable to DNR were due to the lack of staff and because project engineers work on other programs. These engineers were also responsible for other Water Pollution programs, including reviewing and approving operating licenses and permits. DNR is allowed 4 percent of the annual capitalization grant award to be used for administering and managing the SRF program. DNR has not spent all of the administrative funding in previous years and did not use any of these funds in fiscal year 2003. On average, DNR spent \$948,217 of the \$1,485,511 available per year in the three fiscal years ending in 2002. Instead of utilizing funds from the capitalization grant for administrative costs, DNR plans to continue funding these costs from a 1 percent fee charged on balances held in reserve accounts. These fees provided an average of \$2.6 million in revenue between fiscal years 2001 and 2003 for administrative costs. For that period, expenditures from these funds averaged \$2.2 million. As a result, additional funds to administer the SRF fund were available. However, DNR did not consider whether savings from resource specialization and up-front outreach would eliminate the need for additional staffing.

Kansas project engineers work solely on SRF projects. This allows the engineer more time to work with the community before submitting an application, during the application process, and after construction is complete. Each Kansas engineer works on 20-25 active projects at one time. DNR did not maintain this type of engineer workload information.

### **DNR needs to re-evaluate financial management procedures**

We found weaknesses in four procedures, which increased costs to the state or adversely affected communities' ability to meet environmental needs. For example, DNR has not simplified the loan process for communities and has no program to loan monies to individual homeowners for wastewater treatment. Furthermore, certain financial aspects of Missouri's program, including management procedures, differ significantly from other states. Most SRF financial management procedures have not changed since the program's 1992 genesis. Inadequate financial projections also hindered DNR's ability to manage the program's financial aspects, including the fund balance.

### Alternative methods for issuing loans may be more attractive to communities and individuals

DNR only makes leveraged and interim loans to communities. Interim loans are used to meet project costs incurred prior to loan closing in the Leveraged Loan Program. As noted in DNR's response to this report, funding is provided to individual farmers for animal waste management systems. However, DNR has not expanded its loan programs to include loans to communities or to individuals for construction of human wastewater management systems.

Seven of the 48 community officials we interviewed stated they chose not to obtain funding through the SRF program because they "had to go through too many hoops" and/or the SRF application process would have taken too long. One community chose to obtain its funding through a lease purchase agreement instead of the SRF. The community made this decision

because a DNR abatement order<sup>6</sup> only allowed three years to fix sewage problems and the community did not believe it could obtain funding and finish construction within the required timeframe if it attempted to obtain SRF funding.

The leveraged loan program provides funding that secures bond proceeds issued by communities to fund construction, and results in an interest rate subsidy for communities. This financing process can be a complex, expensive, and onerous task for some communities. However, if DNR issued construction loans directly to communities, similar to DNR's Storm Water Grant and Loan Program, communities could eliminate some bond issuance costs. In addition, according to DNR personnel direct loans could expedite wastewater treatment projects. Although DNR would assume communities' repayment risk on direct loans, this risk could be low since no community has ever defaulted on a leveraged loan. Other states, including Kansas, Nebraska and Iowa, offer construction loans directly to communities.

In addition, DNR does not offer loans to individuals for upgrade and replacement of individual treatment systems due to its perception of a greater risk of default. DNR officials stated they investigated, but have not yet developed, different funding mechanisms offering these loans. Ohio and Pennsylvania provide individuals with assistance through linked deposit loans. The commercial lending institution takes on the default risk by an individual with linked deposit loans. Delaware provides loans directly to individuals up to \$10,000 with an interest rate of 3 percent and repayments for up to 20 years.

#### Past funding projections have been faulty

DNR projects a decrease in funding available to communities in the future. However, federal program evaluations have found weaknesses in DNR's past projections. According to the EPA's Program Evaluation Report, DNRs' projected IUP binding commitments<sup>7</sup> have fallen short since 1996. DNR projected new binding commitments totaling \$319.1 million in fiscal year 2001, but only accomplished commitments totaling \$56.1 million (18 percent).<sup>8</sup> This erroneous projection was caused by projects listed on the IUP failing to move to the construction phase in a timely manner. DNR has not developed basic criteria, such as completed facility plans and authority for communities to incur debt, to be met to ensure projects are viable and ready for construction prior to placing the projects on the IUP. Nor has DNR considered using more reliable information for financial forecasting purposes. DNR officials told us its new accounting system will better track loan commitments and help maximize use of available funds.

Under Missouri's leveraged loan program, the reserve fund is 70 percent of the bonds outstanding. According to EPA officials, this is the highest percentage in the nation. These reserves provided enhanced security for the bonds and sizeable interest earnings, which paid off

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<sup>6</sup> The term abatement order means an order issued by DNR, requiring the community to repair, correct, or reduce the effluents or discharges from its wastewater treatment facility.

<sup>7</sup> The term binding commitment is a legal obligation by a state to a local recipient that defines the terms for assistance under the SRF. Cumulative binding commitments must equal at least 120 percent of cumulative capitalization grant payments received one year earlier. Binding commitments requirements are intended to help assure the state utilizes grant funds in a timely manner.

<sup>8</sup> Program Evaluation Report, Missouri Clean Water State Revolving Fund, fiscal year 2001, Environmental Protection Agency (February 26, 2003)

the communities' bond debt service. Per the EPA's SRF Fund Management Handbook, most states' leveraging percentage is between 40 and 60 percent. Kansas and Iowa leverage loans at 10 and 30 percent, respectively. Missouri's leveraging percentage was initially 50 percent in 1992, but DNR increased it to 70 percent to make the program more attractive to the few applicants at that time.

At the current 70 percent leveraging percentage, DNR forecasted funding to projects totaling \$248.4 million in 2003. In the 2004 plan, the funding available for projects decreased by \$76.4 million to \$172 million. The decrease in projected funds means fewer new projects can be funded. At a reduced leveraged rate of 40 percent, \$106.6 million more would have been available to fund wastewater projects on the 2003 Intended Use Plan (IUP).

#### Interest on the reserve accounts provided a subsidy for debt service

Unlike most states, DNR allows interest earning on the reserve accounts to help fund communities' debt service. In 2002, SRF reserve accounts earned approximately \$16 million. Communities already receive an interest rate subsidy because their debt is guaranteed by the amounts deposited in the reserve accounts. In addition, a community that obtained a \$1 million loan outside the SRF at a market interest rate of 5.1 percent<sup>9</sup> would have to pay \$597,182 in interest over a 20-year period. By obtaining financing through the SRF program the community would only pay \$167,860, a rate of 1.6 percent,<sup>10</sup> after allowing for interest earned on the reserve accounts.

Five of the six states we contacted stated they deposited the interest earned on their reserve accounts into the SRF and used the funds for additional loans or paid debt service on their state match bonds. Nebraska did not leverage loans and therefore did not maintain reserve accounts.

#### The use of SRF interest earnings should be re-evaluated

In addition to the interest earned on the reserve accounts noted above, the SRF earned interest on the SRF cash balance totaling \$4.6 million and received interest from loans totaling \$415,030 during fiscal year 2003. Federal regulations allow states to use interest earned by the SRF to retire state match funds.<sup>11</sup> However, in March 2002, EPA denied DNR permission to use approximately \$19 million of SRF interest earnings to pay state matched bonds because the net bond proceeds were not deposited directly into the SRF. As a result of the EPA's decision, DNR initiated action to change the methods used to handle state matched bond proceeds. DNR now plans to utilize interest earnings from the SRF in fiscal year 2005 for some debt service payments. These payments will be for the state matched bonds issued after funding methods were changed and will total \$987,647. This amount will increase as additional bonds are issued to provide the match.

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<sup>9</sup> The market rate was obtained from the EPA's 2002 NIMS data and is an average of the reported weekly Bond Buyer 20 year general obligation bond index for the fiscal year ending June 30, 2002.

<sup>10</sup> Fiscal year 2002 weighted average interest rate for Clean Water SRF Assistance for Missouri obtained from the EPA's 2002 NIMS data.

<sup>11</sup>40 CFR 35.3135(b)(2)

As noted in DNR's response, it had previously considered issuing short-term bonds to match its Public Drinking Water SRF Capitalization Grant. However, DNR has not evaluated the benefits of issuing short-term bonds instead of long-term debt for the match portion of the Clean Water SRF Capitalization Grant. With this option, the state would issue a 6-12 month short-term bond each year to provide the required state match for the federal grant and then re-pay the debt each year with SRF interest revenues. DNR was required to provide state match amounts totaling \$11.7 million and \$9 million for the years ended June 30, 2003 and 2002, respectively. The state provided this match through long-term debt. However, short-term bonds would allow the state to utilize more of the fund's interest earnings for matching purposes. This method could reduce additional long-term debt issuances by up to \$10 million annually. Nebraska issued short-term revenue bonds to provide its state match requirement and immediately paid the bonds off when the bonds came due with the revenues from the state's SRF. EPA performed a study on Missouri's capacity to issue short-term debt to provide state match and determined the SRF receives sufficient revenue to pay the debt off each year. In responding to a draft of this report, DNR officials stated they would have to implement the use of short-term bonds with the Office of Administration.

### **Better oversight of projects is needed**

DNR did not perform and/or document quarterly construction site inspections as required by its informal policy. DNR officials told us they did not have sufficient staff to perform the inspections. Of the 56 projects tested, 35 had little or no documentation of the required quarterly inspections. A DNR project, which had an average construction time of about 16 months, would require 5 quarterly inspections. However, DNR personnel averaged 1.63 quarterly inspections per project. As such, DNR could not ensure construction projects met approved plans and specifications, or whether communities complied with applicable state and federal regulations.

### **Conclusions**

DNR expects communities to contact it regarding program eligibility, funding and assistance. DNR does not assess, or even consider, a communities' need unless the community submits an application. This approach limits DNR's ability to both assess and prioritize all wastewater treatment needs in the state and target communities needing assistance. Further, DNR has not attempted to determine ways to improve its ability to serve communities.

DNR could more proactively serve communities with outreach such as information or assistance to the communities prior to submitting their application and facility plan. This outreach could generate more complete and accurate information from communities, reducing the time needed to review and approve project applications. Improvements are needed to these processes to encourage more communities to construct or upgrade inadequate wastewater treatment facilities.

DNR's financial management procedures have also affected the increasing SRF balance and increased costs to the state and communities. For example, in addition to providing leveraged loans, DNR can enhance the program's effectiveness by providing construction loans to communities and individuals. In addition, based on our analysis, if DNR accurately forecasted and timely initiated projects so the existing fund balance was fully utilized, the 70 percent

leveraging percentage would have to be decreased and/or interest policies revised to provide additional funding to assist more communities. Absent any improvements, the SRF program will continue to not address Missouri's wastewater treatment needs in a timely manner.

## **Recommendations**

We recommend the Director, DNR:

1. Develop a comprehensive inventory of areas that lack adequate wastewater treatment systems and coordinate with enforcement staff to identify communities needing assistance.
2. Increase outreach activities, including meeting with local officials, to fully explain programs prior to the application process.
3. Require facility plans to be submitted with applications.
4. Analyze the workload of SRF staff to determine staffing needed to perform SRF duties and the benefits of staff specialization.
5. Provide construction loans directly to communities and individuals.
6. Develop basic criteria to be met before placing projects on the IUP, and monitor the accuracy of future financial forecasting, cash balances, and the demand for SRF funding to determine if changes to the leveraging percentage and/or interest on reserve account policies should be implemented.
7. Evaluate the benefits of using short-term debt financing for state match purposes.
8. Ensure quarterly inspections are performed.

## **Agency Comments and Our Evaluation**

We obtained comments on a draft of this report in a meeting on December 17, 2003 with DNR officials responsible for the SRF program. We have incorporated these comments in the sections of the report where appropriate. DNR also documented these comments in a letter dated January 12, 2004 as follows:

1. *We disagree. The Clean Water Needs Survey is a detailed inventory of wastewater treatment needs for the state, and Missouri has been recognized nationwide as a leader in assessing our wastewater needs.*

*As mentioned in our response to the draft audit report, our Clean Water Needs Survey is prepared according to federal requirements and has expanded over the years to identify and quantify Missouri's evolving needs. The Clean Water State Revolving Fund (CWSRF), Outreach and Assistance Center (OAC), enforcement, and regional office staff have routinely*

*worked together to either assist communities in maintaining compliance or gaining compliance, through construction, in a timely manner.*

- 2. We partially agree. Outreach activities can always be improved upon.*

*We would like to repeat that we market and provide technical and financial assistance to local communities and other audiences, from our regional offices and OAC by working directly and frequently with local communities. Our response to the draft audit report, provided many examples of outreach, from coordinating with other state and federal agencies that provide infrastructure funding, to more than 13,000 direct SRF marketing contacts to Missouri communities since 1999. In fact, a community need only identify their need and submit it to Missouri Water and Wastewater Review Committee (MWWRC). This group is composed of staff of the Department of Economic Development, Community Development Block Grant; United States Department of Agriculture, Rural Development; and the Department of Natural Resources, State Revolving Fund. The MWWRC will advise the community the funding program for which they are eligible. This approach relieves a community of the necessity to research funding opportunities.*

- 3. We partially agree. Requiring facility plans with an application will present an additional financial burden on communities prior to knowing their funding eligibility, especially affecting the smaller communities. However, they are very beneficial for our review and prioritization. While we may not require facility plans for all applications, we will encourage applicants to provide this information with their application.*
- 4. We partially agree. Comparison of staffing between Missouri and different states does not give a true representation of our ability to perform SRF duties.*

*Missouri has one of the top State Revolving Fund programs in the nation. According to the Council of Infrastructure Financing Authorities, Missouri is ranked 11<sup>th</sup> in the nation for total assistance (1<sup>st</sup> in EPA region 7), and 12<sup>th</sup> in the nation in number of SRF loans (also 1<sup>st</sup> in region 7). This reflects favorably on the ability of Missouri to fund communities.*

*Staff and management are currently evaluating assignments to effectively decrease the time from application and document submittal to financing. The department's Water Pollution Control Program has undergone restructuring effective January 1, 2004 to further increase the efficiency of the program. An example would be the combining of the engineers who review construction plans with the SRF project officers. This will ensure a dedicated engineering staff to expedite project reviews.*

- 5. We agree. Our primary objective is to offer communities funding that provide the lowest interest rates, thereby providing savings to the communities while addressing environmental issues. By leveraging we are able to provide more funds to more communities at a lower cost than we can with direct loans.*

*There are a number of alternative methods for issuing financial assistance to communities and individuals that we are using. While leveraged loans and the associated interim direct*

*loans are our primary financial tools, direct loans have been made and are being utilized more. The department response to the draft audit report outlined instances in which the department is providing funding to individuals, such as through the Missouri Department of Agriculture by providing low-interest loans to individual farmers for animal waste management systems. As of June 30, 2003, there have been 98 loans totaling more than \$6.3 million to Missouri small farmers. In addition, the department is presently exploring different ways to expand the use of interim and direct loans as well as loans for individual home wastewater treatment needs.*

6. *We disagree. There is already basic criteria in place that must be met prior to being placed on the IUP. Since 1989 our financial forecasting has allowed the State Revolving Fund to provide more than \$1 billion to 300 Missouri communities to construct or improve wastewater facilities. These communities saved more than \$350 million in interest. The leverage percentage is calculated to be the most beneficial for Missouri communities.*

*Our past funding projections have allowed us to offer a quality nationally recognized program. The CWSRF projections are based on the annual IUP and the binding commitment dates contained therein.*

*The cash balance reported by the auditor did not take into consideration current obligations of the funds and projects planned in the near future. These issues need to be taken into consideration. The cash balance is fully obligated as outlined in our response to the draft audit report.*

**State Auditor Comments:** DNR contends our analysis of cash balances did not consider current obligations and projects planned for the near future. In addition, DNR notes it has or intends to obligate funding for projects totaling more than the amount of cash on hand. However, our analysis notes that because past projects have progressed so slowly, disbursements to communities have lagged and been outpaced by receipts consisting of loan repayments, federal grant receipts, and interest earnings. This trend is clearly illustrated by Figure 1 on page 4. As a result, it is clear DNR needs to better monitor the fund's cash balances and improve future financial forecasting.

*The interest subsidy for our leveraged loan CWSRF is among the highest leveraged loan subsidy in the nation and therefore offers the highest benefit of any such CWSRF to its participants. Many other states can offer loan programs with lower leveraged loan subsidies because they still have grant programs.*

*Decreasing the leveraging percentage or decreasing the use of the interest earnings for subsidy will increase the cost to the communities and their individual users. The purpose of the SRF is to provide low-interest loans for wastewater construction projects to protect public health and the environment and to make these facilities less costly to the users.*

7. *We agree. We have been evaluating the use of the SRF interest earnings. The department is working very closely with the Office of Administration and the Governor's Office on various options related to state match. The department has evaluated the use of short-term debt to*



*provide state match but after comments by bond counsel and financial advisors, we focused on other options. We will reevaluate this option.*

8. *We agree. We do require the recipient to have a resident engineer perform day-to-day construction inspections. In addition to this daily oversight, our staff perform quarterly inspections. We also receive payment requests documented and signed by the resident engineer, the community and the contractor. All these assurances attest projects meet approved plans and specifications.*