



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY

REGION IX

**75 Hawthorne Street
San Francisco, CA 94105-3901**

APR 19 2013

**OFFICE OF THE
REGIONAL ADMINISTRATOR**

Dr. Ron Chapman, Director
California Department of Public Health
1615 Capitol Ave
MS 0500
Sacramento, California 95899

Dear Dr. Chapman:

The U.S. Environmental Protection Agency has determined that the California Department of Public Health is in non-compliance with the Safe Drinking Water Act. As described in the enclosed notice of non-compliance, the California Department of Public Health has not administered the California Safe Drinking Water State Revolving Fund in accordance with applicable EPA requirements.

To date, Congress has provided California with \$1.5 billion to capitalize the Safe Drinking Water State Revolving Fund. States are required to make timely loans or grants using all available drinking water funds to eligible water systems for necessary projects, and California has failed to meet this standard. Additionally, the California Department of Public Health has issued loans or grants to many projects which are not "shovel ready", resulting in funds not being paid out for years. As of October 2012, the drinking water fund had an unspent balance of \$455 million in federal funds. This sum is the largest unliquidated obligation of any state in the nation.

Furthermore, states are required to manage their fund in a sound and prudent manner by having dedicated accounting and financial staff to track commitments, calculate balances, and plan expenditures. California's Department of Public Health has not met these requirements nor applied the modeling tools needed to integrate financial and project activities. One result has been that California's Department of Public Health has not accurately accounted for revenue from ongoing loan repayments into the fund. These revenues add at least \$260 million in loan capacity that has not yet been committed. At the same time, many of California's critical drinking water infrastructure needs remain unmet. According to the EPA's most recent national assessment of public water system infrastructure, California needs \$39 billion in capital improvements through 2026 for water systems to continue to provide safe drinking water to the public. Given this tremendous need, it is crucial that California fully utilize the Safe Drinking Water State Revolving Fund.

The Safe Drinking Water Act, passed by Congress in 1974, is the main federal law that ensures the quality of Americans' drinking water. In 1996, Congress established and funded the DWSRF program for states to provide low interest loans and grants to eligible water systems for design and construction of infrastructure to help systems comply with national drinking water standards. Consistent with the priorities of the Safe Drinking Water Act, states can provide additional subsidies to communities with the greatest economic need.

The EPA recognizes California's commitment to protecting public health and the environment. We acknowledge your recent efforts to address some of the above areas. However, much work remains to be done. EPA continues to be available to support the state as you move forward in addressing the matters raised in this action.

The enclosed notice of non-compliance requires the California Department of Public Health to remedy the areas of non-compliance and submit a plan to the EPA within 60 days of receipt of this notice. Please feel to call me at 415-947-8702 if you have questions.

Sincerely,

A handwritten signature in blue ink, appearing to read "Jared Blumenfeld", with a horizontal line at the end of the signature.

Enclosure

cc: Diana Dooley, Secretary, California Health and Human Services Agency



NOTICE OF NON-COMPLIANCE TO THE CALIFORNIA DEPARTMENT OF PUBLIC HEALTH

I. Introduction

The U.S. Environmental Protection Agency is issuing this notice to the California Department of Public Health for non-compliance with the requirements of the Safe Drinking Water Act, its implementing regulations, and the terms and conditions of the California Safe Drinking Water State Revolving Fund grant agreements funded by the EPA for federal fiscal years 2009-2011. The EPA has determined that the CDPH has not timely and efficiently committed and expended the funds in the SDWSRF, nor employed adequate financial resources to operate the SDWSRF in a sound financial manner, in violation of the terms and conditions of the grant agreements, 40 C.F.R. §35.3550(c) and (l), and 40 C.F.R. §35.3560(d).

Under 40 C.F.R. §35.3585, the EPA may invoke compliance assurance procedures if the Agency determines that a state has not complied with its capitalization grant agreement, other requirements under 42 U.S.C. §300j-12, or 40 C.F.R. Part 31, or has not managed the Drinking Water State Revolving Fund in a financially sound manner. Upon issuance of a notice of non-compliance, the Agency may prescribe appropriate corrective action. Within 60 days of receipt of the notice of non-compliance, the state must remedy the specific instances of non-compliance or submit an acceptable corrective action plan to achieve the prescribed corrective actions. If within 60 days of receipt of the non-compliance notice, the state fails to take the necessary actions or submit a corrective action plan to achieve the results required, the EPA may suspend payments. Additionally, in accordance with 40 C.F.R. §31.43, the EPA may take other enforcement actions such as withholding further grant awards, wholly or partly suspending current awards, or wholly or partly terminating current awards.

II. Background

The EPA has provided the CDPH with a series of grants, starting in 1998 and totaling approximately \$1.5 billion, to capitalize the California Safe Drinking Water State Revolving Fund. The EPA Drinking Water State Revolving Fund program requires states to make timely loans or grants using all available funds to eligible water systems for necessary projects. The EPA conducts an annual review of the SDWSRF and provides the results to the state in the Program Evaluation Report. Beginning in 2009, the EPA raised concerns in the PERs that the CDPH needed to make program improvements to commit and expend funds efficiently and in an expeditious and timely manner. At that time, there were over \$400 million in unspent federal funds. Since 2009, the EPA and the CDPH have met quarterly to discuss ways to improve program operations and reduce the amount of unspent federal funds. While the CDPH took some positive steps to improve program operations, the amount of unspent federal funds (also referred to as unliquidated obligations (ULOs)) remained high and the disbursement rate remained low.

In April 2012, the EPA conducted a more extensive annual review to more fully understand the interactions among the different processes and procedures in the SDWSRF and identify the causes of

program deficiencies. The expanded review culminated in a report entitled *EPA Region 9 Management Discussion of the CDPH SDWSRF*, issued on September 27, 2012, which included 25 recommendations to streamline or otherwise improve the CDPH operations and the SDWSRF program's ability to efficiently commit and expend funds.

In August 2012, the CDPH identified actions to reduce ULOs including spending \$123 million of the over \$400 million of ULOs by December 31, 2012. However, the CDPH failed to meet the spending target by about \$23 million. The SDWSRF continues to experience poor disbursement rates compared to the national average and has the highest ULOs in the nation (see Tables 1 and 2).

Table 1	2010	2011	2012	
CDPH SDWSRF Total Cumulative Dollars spent as a percentage of Loans/Grants issued	67%	60%	63%	Based on State Fiscal Year ending June 30
National Average of Cumulative Dollars Spent as a Percentage of Loans/Grants issued	90%	87%	81%	Based on Year ending June 30

Table 2	2010	2011	2012	
CDPH SDWSRF Total Unspent Federal Dollars/ ULOs	\$505,352,525	\$525,191,738	\$455,437,385	Based on Federal Fiscal Year Ending September 30

III. Scope of Non-compliance

Based on the EPA reviews, the EPA has concluded that the CDPH is in non-compliance with the following requirements:

1. Non-compliance with expeditious and timely use of the funds. In accordance with 40 C.F.R. §35.3550(I), and the terms and conditions of the capitalization grant agreements, the CDPH is required to commit and expend all funds in the SDWSRF as efficiently as possible and in an expeditious and timely manner.
 - a. *Commitment of funds.* Under 40 C.F.R. §35.3550(I), and the terms and conditions of the capitalization grant agreements (including the Expeditious and Timely Use of SRF Funds policy memoranda 95-03, 99-05 and 99-09), all funds (federal, state match, repayments and investment income) must be committed efficiently and in an expeditious and timely manner. In the event the state does not have sufficient projects ready to receive commitments, it must identify in its Intended Use Plan how and when the funds will be used. The CDPH currently has the financial capacity to execute approximately \$500 million in new funding agreements. The CDPH has not committed its SDWSRF funds expeditiously or identified in its IUP an adequate plan for committing its funds. The CDPH is unable to process sufficient loan/grant commitments due to inadequate staffing levels and procedural constraints.
 - b. *Expenditure of funds.* Under 40 C.F.R. §35.3550(I) and the terms and conditions of the capitalization grant agreements, the CDPH is required to expend all funds as efficiently as possible and in an expeditious and timely manner. The CDPH has not expended its federal funds, state match, loan repayments, and interest earnings in an efficient or in a timely and expeditious manner.

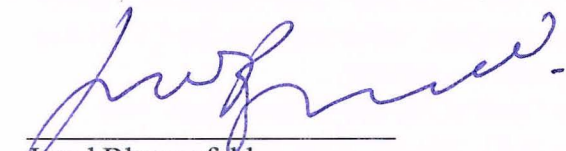
- i. Unexpended funds in the SDWSRF have lost millions of dollars of purchasing power for public health purposes because of inflation. The SDWSRF's unspent funds do not support the revolving nature of the fund and reduce the long-term purchasing power of the fund.
- ii. As shown on Table 2, the CDPH has had substantial unexpended federal funds for a number of years. Some of the key reasons for the CDPH's failure to timely expend funds were (1) its practice of committing funds to projects that were not shovel ready; (2) allowing recipients to withhold reimbursement claims until completion of construction; and (3) the lack of guidance to recipients on how to submit claims. Having over \$400 million in unspent federal funds over an extended period clearly indicates the CDPH has not dispersed its funds in an expeditious and timely manner.
- iii. At the end of state fiscal year 2012, the CDPH had more than \$190 million in loan repayments and interest earnings sitting idle in the SDWSRF. This represents several years of accumulated repayments and interest earnings, indicating that the CDPH has not expended these funds in a timely and expeditious manner.

In summary, the CDPH had disbursed only 63 percent of its funds at the end of state fiscal year 2012, whereas the national average for DWSRF programs was 81 percent. Thus, while we acknowledge that the CDPH took some steps to improve its commitment and disbursement of funds, it has not developed a workable plan to significantly reduce the accumulated ULOs. The CDPH needs to (1) improve its SDWSRF program operations, including reassessing its project selection process; (2) increase commitments and use full funding capacity to execute new assistance agreements; and (3) increase disbursements and reduce unliquidated funds.

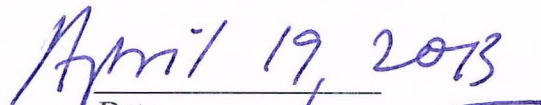
2. Non-compliance with the technical capability to operate the SDWSRF program, and with the requirement to provide and follow a cash draw schedule. In accordance with 40 C.F.R. §35.3550(c) and 35.3560(d), and the terms and conditions of the capitalization grant agreements, the CDPH must demonstrate (1) it has adequate personnel and resources to establish and manage the SDWSRF program; and (2) must provide and follow a cash draw schedule.
 - a. *Technical Capability.* As documented in the 2011 PER and the *2012 EPA Management Discussion of the CDPH SDWSRF*, the CDPH has inadequate personnel and resources to manage the SDWSRF program pursuant to 40 C.F.R. §35.3550(c). A program the size and complexity of the SDWSRF, with over \$1.5 billion in assets, demands dedicated accounting and financial staff with the expertise to establish fiscal controls and financial planning systems sufficient to manage SDWSRF program activities. The CDPH needs managerial and financial expertise to develop and use a financial tracking system and modeling tools to analyze, coordinate and integrate the program's financial and project activities. The lack of dedicated financial and accounting expertise and financial modeling tools has resulted in errors or confusion in tracking commitments, calculating outstanding balances, and determining the program's funding capacity. The CDPH needs to properly measure and track (1) assets and liabilities; (2) revenues earned (including loan repayments, capitalization grants, interest earnings, and state match); and (3) expenses incurred (including loan disbursements and other expenditures).
 - b. *Cash Draws.* The CDPH has not provided the EPA with a quarterly schedule of estimated cash draws on a yearly basis, which is contrary to 40 C.F.R. §35.3560(d). Such quarterly schedules are critical for maintaining cash draw forecasts and for the CDPH to keep the EPA aware of significant changes in program implementation. Various factors have contributed to the CDPH's inability to meet this requirement, including the lack of (1) a financial planning model and project tracking system; (2) essential project budget information; (3) effective operating procedures; and (4) key financial and managerial staff.

IV. Corrective Actions and Consequences of Non-Compliance

In accordance with 40 C.F.R. §35.3585(c), within 60 days of receipt of this non-compliance notice the CDPH must submit a corrective action plan that addresses the results specified in this notice and the attached table of required components. The CDPH must take these corrective actions and adjust program management to avoid non-compliance in the future in accordance with 40 C.F.R. §35.3585(b). If within 60 days of receipt of this non-compliance notice, the CDPH fails to provide an acceptable corrective action plan to achieve the results required or subsequently fails to implement an element of a plan that the EPA approves, the EPA may suspend grant payments until the CDPH has taken acceptable actions. Pursuant to 40 C.F.R. §31.43, the EPA may take other actions, including withholding further grant awards, wholly or partly suspending current awards, or wholly or partly terminating current awards.



Jared Blumenfeld
Region 9
Regional Administrator



Date

Attachment

Attachment to EPA Notice of Noncompliance to the California Department of Public Health

Pursuant to 40 CFR 35.3585 (b) and (c), within 60 days of receipt of the notice of non-compliance, the CDPH must submit a Corrective Action Plan to remedy the non-compliance. The corrective action plan must address the following components:

Number	Required Components of the Corrective Action Plan	Deadline	Action Area
1	The CAP must include the CDPH's certification that it is utilizing a cash flow model that accurately represents their financial position (including but not limited to complete and accurate loans and amortizations schedules).	60 days from the receipt of Notice of Non Compliance	Data and Reporting
2	The CAP must contain a strategy and milestones to ensure NIMS data is complete and accurately represents the CA SDWSRF.	60 days from the receipt of Notice of Non Compliance	Data and Reporting
3	The CDPH and the EPA will meet monthly to discuss progress on the CAP components. Prior to each meeting CDPH will provide in writing an update on CAP components.	July 2013 - June 2016	Data and Reporting
4	Submit to the EPA a list of all executed funding agreements made in SFY13 (7/1/12-6/30/13) to verify \$240M in commitments (the CDPH target to reach 95% pace). Any shortfall of the \$240M to be added to SFY14 available capacity total.	June 30, 2013	Loan Commitments
5	Identify \$356M, or more if necessary, worth of viable and shovel ready projects on the 2014 fundable list (\$260M, available capacity +\$80M*, FY13 Cap Grant + \$16M* State Match). o \$260M plus any SFY13 shortfall to be committed by 30 June 2014. o \$96M* in 2013 funds to be committed by 30 Sept 2014 (Date subject to change if grant award held up).	June 30, 2013	Loan Commitments
6	Submit to the EPA a quarterly schedule of estimated federal cash draws for federal fiscal year 2014.	June 30, 2013	Disbursements
7	Submit to the EPA a staffing plan including job descriptions and timeline to address at a minimum the following three deficiencies the EPA has identified: (1) Financial analysis: expertise is needed with respect to financial modeling, forecasting, and cash flow management to support the SRF program to create an understanding of the long term implications of funding decisions and determining funding capacity; (2) SRF program management: expertise is needed for managing the SRF in a manner so as to integrate program, accounting and financial activities; and (3) Management position in Drinking Water Technical Programs Branch.	July 30, 2013	Staffing Strategically
8	Submit a plan or Statement of Work to assess the project priority system focusing on ways to streamline and expedite project selection, including readiness to proceed and bypass procedures. Assessment to be complete in 18 months.	August 30, 2013	Management Review and Implementation
9	Using cash flow model determine appropriate commitment level for SFY15. (Appropriate means commit all available funds Federal capitalization grants, state match, loan principal repayments and all interest earnings).	May 31, 2014	Loan Commitments
10	At a minimum commit 100% of the \$260M (more if SFY 13 shortfall) in SFY 14 available capacity.	June 30, 2014	Loan Commitments
11	Identify viable and shovel ready projects on the 2015 fundable list to meet commitment level for the year.	June 30, 2014	Loan Commitments
12	Submit to the EPA a quarterly schedule of estimated federal cash draws for federal fiscal year 2015.	June 30, 2014	Disbursements
13	Achieve a cumulative loan disbursement rate of 70% (i.e., percent of cumulative funds disbursed to cumulative assistance agreements as calculated in NIMS).	June 30, 2014	Disbursements
14	Achieve a cumulative set-aside spending rate of 70% (i.e., cumulative set-aside expenses as a % of cumulative net amount awarded for set-asides as calculated in NIMS).	June 30, 2014	Disbursements

* Amount subject to change based on actual FY 13 Allotment

Attachment to EPA Notice of Noncompliance to the California Department of Public Health

Number	Required Components of the CAP	Deadline	Action Area
15	Commit 100% of FFY13 federal cap grant (\$80M)* and 100% of the required state match (\$16M)*.	September 30, 2014	Loan Commitments
16	Submit to the EPA a list of all executed funding agreements made against SFY14 available capacity and FFY13 cap grant and state match.	September 30, 2014	Loan Commitments
17	Submit to the EPA completed assesment of the CDPH project priority process.	February 28, 2015	Management Review and Implementation
18	Using cash flow model determine appropriate commitment level for SFY16. (Appropriate means commit all available funds Federal capitalization grants, state match, loan principal repayments and all interest earnings).	May 31, 2015	Loan Commitments
19	Identify viable and shovel ready projects on the 2016 fundable list to meet appropriate commitment level for the year.	June 30, 2015	Loan Commitments
20	Submit to the EPA a list of all executed funding agreements made in the prior fiscal year (7/1/14-6/30/15) to verify targeted amount of commitments for SFY15 were made.	June 30, 2015	Loan Commitments
21	Submit to the EPA a quarterly schedule of estimated federal cash draws for federal fiscal year 2016.	June 30, 2015	Disbursements
22	Achieve a cumulative loan disbursement rate of 75% (i.e., percent of cumulative funds disbursed to cumulative assistance agreements as calculated in NIMS).	June 30, 2015	Disbursements
23	Achieve a cumulative set-aside spending rate of 80% (i.e., cumulative set-aside expenses as a % of cumulative net amount awarded for set-asides as calculated in NIMS).	June 30, 2015	Disbursements
24	Using cash flow model determine appropriate commitment level for SFY17. (Appropriate means commit all available funds Federal capitalization grants, state match, loan principal repayments and all interest earnings).	May 30, 2016	Loan Commitments
25	Identify viable and shovel ready projects on the 2017 fundable list to meet appropriate commitment level for the year.	June 30, 2016	Loan Commitments
26	Submit to the EPA a list of all executed funding agreements made in the prior fiscal year (7/1/15-6/30/16) to verify targeted amount of commitments for SFY16 were made.	June 30, 2016	Loan Commitments
27	Achieve a cumulative loan disbursement rate of 80% or within 5% of the national average, whichever is greater (i.e., percent of cumulative funds disbursed to cumulative assistance agreements as calculated in NIMS).	June 30, 2016	Disbursements
28	Achieve a cumulative set-aside spending rate within 5% of the national average (i.e., cumulative set-aside expenses as a % of cumulative net amount awarded for set-asides as calculated in NIMS).	June 30, 2016	Disbursements
29	Balance of available federal funds not to exceed \$160M (includes both loans and set asides).	June 30, 2016	Disbursements

* Amount subject to change based on actual FY 13 Allotment