RCRA Subtitle C Financial Assurance Instrument Fact Sheet
CORPORATE FINANCIAL TEST

Regulatory Resources:
- Code of Federal Regulations~~,~~ Title 40, Volume 22, Chapter 1, Part 264
- Code of Federal Regulations, Title 40, Volume 22, Chapter 1, Part 265
- Federal Register

EPA Resources:
- RCRA Financial Assurance Training Module
- RCRA Financial Assurance for TSDFs
- RCRA Online: Financial Assurance

Instrument Summary: The owner/operator of a Subtitle C facility ("the Company") may demonstrate its ability to pay for the cost of closure and/or post-closure care by passing one of two alternatives under the financial test. The Company is allowed to cover its obligations by demonstrating its own ability to pay as long as it continues to pass either alternative. In other words, the Company is not required to arrange with a third-party to guarantee payment of closure and/or post-closure costs, nor is the Company required to set aside funds, provided they continue to pass either test. When closure and/or post-closure costs need to be paid, the Company is solely responsible for paying them.

By design, the alternatives are intended to screen out companies with insufficient tangible net worth or other financial constraints that may impair their ability to meet the costs of closure and/or post-closure care. Only companies with large net assets (i.e., net worth) relative to the total estimated costs of closure and/or post-closure are likely to pass either of the two alternatives. Each alternative has four parts that must be met. The two alternatives for the financial test are the following:

ALTERNATIVE I	ALTERNATIVE II
Part 1, pass 2 of 3 ratios ƒ Total Liabilities to Net Worth < 2.0 ƒ Ratio of the Sum of Net Income plus Depreciation, Depletion and Amortization to Total Liabilities > 0.10 ƒ Current Assets to Current Liabilities > 1.5	Part 1 ƒ Rating for "most recent bond issuance" • Standard & Poor's ≥ BBB • Moody's ≥ Baa
Part 2 ƒ Net Working Capital and Tangible Net Worth each at least six (6) times the sum of all environmental obligations.	Part 2 ƒ Tangible Net Worth at least six (6) times the sum of all environmental obligations.
Part 3 ƒ Tangible Net Worth > $10 million	Part 3 ƒ Tangible Net Worth > $10 million
Part 4 ƒ U.S. Assets amount to at least 90% of Total Assets or six (6) times sum of all environmental obligations.	Part 4 ƒ U.S. Assets amount to at least 90% of Total Assets or six (6) times sum of all environmental obligations.

The first alternative analyzes the financial strength of the Company by measuring several financial ratios. These ratios assess: 1) the magnitude of the Company's outstanding debts; 2) its ability to convert assets into cash; and 3) its working capital (or amount of cash invested in short-term assets). The second test relies on the Company's bond ratings.

In addition to measuring financial solvency, both tests require that the Company have at least $10 million in tangible net worth and rely on a 'six-times multiple'. By virtue of this multiple, the Company must demonstrate that its tangible net worth is at least six times the sum of the current closure and post-closure cost estimates for all facilities covered by the mechanism. In addition, the Company must maintain U.S. assets equal to at least six times the sum of the current closure and post-closure cost estimates for all facilities, or U.S. assets that amount to at least 90% of the Company's total assets.

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Regulatory Requirements: The RCRA hazardous waste regulations prescribe the requirements for the use of the corporate financial test by a Company demonstrating financial assurance for closure and post-closure at §264.143(f) and §264.145(f), respectively. Key regulatory requirements include:

- The Company must submit the following information to the Regional Administrator 60 days before the initial receipt of hazardous waste and every subsequent year within 90 days of the end of each fiscal year (see §§264.143(f)(3) - (5) and/or §§264.145(f)(3) - (5)):
  - An original letter signed by the Company's Chief Financial Officer (CFO) that conforms to the Federal regulatory wording specified in §264.151(f) or the equivalent state regulatory wording (see §264.143(f)(3)(i) and/or §264.145(f)(3)(i));
  - A copy of an independent Certified Public Accountants (CPA's) report on examination of the Company's financial statements for the most recent fiscal year (see §264.143(f)(3)(ii) and/or §264.145(f)(3)(ii)); and
  - A special report from an independent CPA regarding findings pursuant to his comparison of data in the CFO's letter and the audited financial statements (see §264.143(f)(3)(iii) and/or §264.145(f)(3)(iii))(Also see Frequently Asked Question #1 below).
- The Company must maintain accurate and current cost estimates and is required to adjust these cost estimates for inflation within 30 days after the end of the fiscal year and before submission of updated information to the Regional Administrator (see §264.142(b) and/or §264.144(b)).
- If for any reason, the Regulator believes the Company may no longer meet the financial test, the Regulator can require that the Company submit reports of its financial condition. Among other things, this helps to ensure that continuous financial assurance coverage is maintained (see §264.143(f)(7) and/or §264.145(f)(7)).
- If the Company no longer meets the requirements of the financial test, then it must notify the Regulator within 90 days after the end of the fiscal year for which the year-end financial data show that it no longer meets the requirements. The Company must provide alternate financial assurance within 30 days after notification (i.e., 120 days of the end of the fiscal year) using one or more of the other financial assurance mechanisms allowed (see §264.143(f)(6) and/or §264.145(f)(6)).
- A Company may also use a corporate guarantee and the guarantor must meet the requirements of the financial test (e.g. minimum tangible net worth and bond rating). (see §264.143(f)(10) and/or §264.145(f)(11)).

Recommended Best Practices: Note: The following best practices are not required under the regulations.

- Proofread all documents to ensure that the language conforms to the stipulated regulatory wording.
- Review the Company's annual submissions and check their timeliness.
- Confirm that the financial data used in the CFO's letter are that of the owner or operator and not an affiliated company.

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- Where appropriate, recalculate the Company's financial ratios and verify the bond ratings on an annual basis. Be cognizant if the buffer by which a company passes the financial test begins to decline.
- Check that estimated closure/post-closure costs for all of the Company's facilities, not assured by a third party, are reported. Ensure that cost estimates are correctly summed across all facilities and regulatory requirements.
- Where appropriate, monitor the business press for adverse news about the Company, including decreases in reported net income or cash flow, decreases in bond ratings or stock prices, de-listing from a public exchange, mergers and acquisitions, and bankruptcy proceedings.
- Be wary of changes in the Company's fiscal year-end; this may be a signal of financial distress. Note that the fiscal year need not map to the calendar year.

Frequently Asked Questions:

1. **How can a Company comply with the special report requirement under §264.143(f)(3)(iii) and/or §264.145(f)(3)(iii)?**
The Company must submit a copy of a special report from a CPA which presents the findings of the CPA's comparison between the financial data contained in the CFO's letter and the firm's independently audited financial statements for the latest completed fiscal year. The purpose of the CPA's special report is to ensure that the data relied upon in the CFO's letter is consistent with the firm's audited financial statements. The regulations require the CPA's special report to state:

> "In connection with that procedure, no matters came to his attention which caused him to believe that the specified data should be adjusted." §264.145(f)(3)(iii)(B)

This statement is known by the accounting profession as a "negative assurance." In performing audits and other accounting services, CPAs must follow a series of professional guidelines maintained by the American Institute of Certified Public Accountants, Inc. (AICPA). Changes in the AICPA's Statement on Auditing Standards no longer allow independent auditors to express statements of negative assurance (i.e. "no matter came to his attention which caused him to believe that the specified data should be adjusted.") as part of Special Reports. In place of a CPA report stating that "no matter came to his attention," firms may submit an Agreed Upon Procedures Engagement report that describes the procedures performed and related findings, including whether or not any discrepancies were found. The agreed-upon procedures engagement must be performed in accordance with AICPA's Statement on Auditing Standards No. 75, Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement.[1]

[1] In an agreed-upon procedures engagement an accountant is engaged by a client to issue a report of findings based on specific procedures performed on the specific items of a financial statement. For more detail, see EPA Memorandum "Obsolete Language in the Financial Test for Subtitle C Treatment Storage and Disposal Facilities," dated February 27, 1997, available at: http://yosemite.epa.gov/osw/rcra.nsf/ea6e50dc6214725285256bf00063269d/C68C99D730932BE28525670F006C2B4A/$file/14066.pdf

2. **What if the Company changes its corporate status?**
Changes in the ownership or operational control of a facility may be made as a Class 1 permit modification with prior written approval of the Regulator in accordance with §270.42. The former owner or operator will not be released from the financial assurance requirements until the successor company has met the criteria of the Financial Test or provided alternate financial assurance using one or more of the other financial assurance mechanisms, is in compliance with §264 Subpart H, and the Regulator has notified the old Company that it no longer needs to provide financial assurance. The successor Company must demonstrate compliance within six (6) months of the date of the change in ownership or operational control of the Company (§§270.40(b), 270.72(a)(4)).

3. **What if the cost estimates change?**
Regardless of whether such changes have an impact on the Company's ability to meet the criteria of the Financial Test, the Company must notify the Regulator of changes to the cost estimates due to inflation within 30 days of the Company's fiscal year end (see §264.142(b) and/or §264.144(b)). Upon notification, the Regulator should confirm that the Company still meets the Financial Test criteria.

4. **How can the Regulator tell if the Company is required to file a form 10K with the SEC?**
A Form 10K is a company's annual report that is required by the Securities and Exchange Commission (SEC) for all publicly traded companies. It provides a comprehensive overview of a company's state of business and must be filed within 90 days after the end of the fiscal year. Whether a company is required to file a Form 10K with the SEC is disclosed in the second to last paragraph of the CFO's letter before the Financial Test data (see §264.151(f)). Generally, companies must file reports with the SEC if they have $10 million or more in assets and 500 or more shareholders, or list their securities on an exchange or NASDAQ.

5. **What if there are differences between the Company's audited financial statements and the CFO's letter?**
If differences are identified, these should be explained in the special report provided by the Company's independent CPA (see §264.143(f)(3)(iii) and §264.145(f)(3)(iii)). If an explanation is lacking, the Regulator can require additional information from the Company. The Regulator may disallow use of the financial test on the basis of qualifications in the opinion expressed by the independent CPA in his report on examination of the Company's financial statements. An adverse opinion or a disclaimer of opinion is among the causes for disallowance (§264.143(f)(8)).

6. **What if the CFO's letter is using financial data derived from the Company's "general ledger account" and does not match the Company's audited financial statements?**
The data in the CFO letter must be derived from the independently audited year end financial statements, not a general ledger account, and meet Generally Accepted Accounting Principles (GAAP). Data from a general ledger account cannot be accepted by the Regulator. The Company must submit the special report from its independent CPA comparing the CFO's letter to the audited financial statements (see §264.143(f)(3)(iii) and §264.145(f)(3)(iii)).

7. **What if the Regulator believes that the Company no longer meets the financial test requirements?**
If the Regulator believes that the Company may no longer meet the financial test requirements, the Regulator may at any time request the Company to submit additional reports detailing its financial condition (e.g., quarterly financial statements or audited financial statements for the most recent fiscal period)(see §264.143(f)(7)).

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If on the basis of such reports or other information, the Regulator determines that the Company no longer meets the Financial Test requirements, the Company must provide alternate financial assurance within 30 days after notification of such a finding using one or more of the other financial assurance mechanisms allowed (see §264.143(f)(7) and/or §264.145(f)(7)).

For More Information:

- **General Resources**
  - Securities Exchange Commission (SEC) regulates the securities market and provides copies of the financial filings of publicly-traded corporations through EDGAR http://www.sec.gov/edgar.shtml
  - Financial Accounting Standards Board (FASB) establishes standards of financial accounting and issues statements/guidance to educate the public (including auditors) on generally accepted accounting principles www.fasb.org
  - American Institution of Certified Public Accountants (AICPA) www.aicpa.org
  - Value Line gathers financial information on publicly-traded corporations http://www.valueline.com/
- **Corporate Bond Ratings**
  - Moody's www.moodys.com
  - Standard and Poor's www.standardandpoors.com
- **Mergers and Acquisitions**
  - U.S. Mergers and Acquisitions Calendar http://biz.yahoo.com/me/
- **Other Resources**
  - The Financial Times www.ft.com
  - Cornell Legal Information Institute www.law.cornell.edu
  - Environmental Law Net http://lawvianet.com/enforcelit.html

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