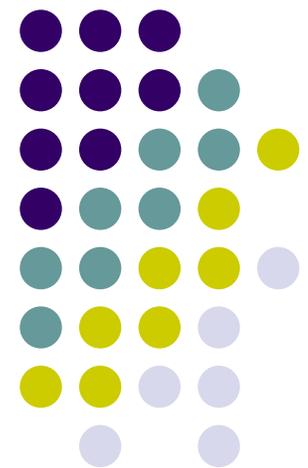
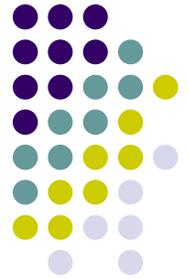


RCRA Financial Test and Corporate Guarantee



Financial Test and Corporate Guarantee



Based upon current financial condition, it is assumed a facility owner/operator will have the financial capacity to fund future closure and post-closure work and corrective action activities as they become necessary.



Alternative I Criteria

- tangible net worth of at least \$10 million;
- assets located in the United States amounting to at least 90 percent of total assets or at least six times the sum of the current closure and post-closure cost estimates;

AND TWO OF THREE OF THE FOLLOWING RATIOS

- total liabilities to net worth less than 2.0
sum of net income plus depreciation, depletion and amortization to total liabilities greater than 0.1
- current assets to current liabilities greater than 1.5
- Net working capital and tangible net worth each at least six times the sum of the current closure and postclosure cost estimates



Alternative II Criteria

- Standard and Poor's rating of AAA, AA, A or BBB or Moody's rating of Aaa, Aa, A or Baa for most recent bond issuance

AND

- Tangible net worth at least six times the sum of the current closure and post-closure cost estimate
- tangible net worth of at least \$10 million;
- assets located in the United States amounting to at least 90 percent of total assets or at least six times the sum of the current closure and post-closure cost estimates;

Workshop Objective



To continue the use of the financial test as a financial assurance mechanism while making changes to the components of the financial test in order to reduce risk of the use of the financial test to levels of risk posed by the other financial assurance mechanisms.

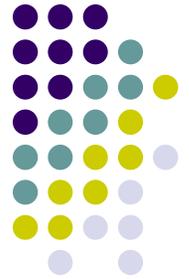
Comparative Measures of Assurance Risk Between Financial Assurance Mechanisms



Net Worth (millions)	Financial Test	Surety Bonds	Standby LOCs	Insurance
\$1 - \$10	1.067	0.015	0.018	0.014
\$10 - \$20	0.644	0.014	0.017	0.013
\$20 - \$100	0.330	0.010	0.013	0.009
\$100 +	0.233	0.007	0.008	0.006

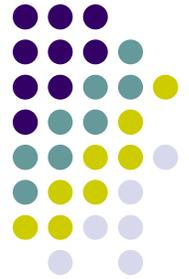
Source: US EPA Issue Paper on Financial Test dated March 18, 1996

Risk Factors Associated with the Financial Test



- Only mechanism which does not involve an independent third party ensuring the sufficiency and availability of funds for completing required work
- All other mechanisms, require both the facility owner/operator and the independent third party to fail at the same time in order to present a risk of having use to public funds to complete the required work
- Current financial condition does not guarantee sufficient resources will be available in the future
- Recent corporate accounting problems have negatively impacted the reliability of audited financial statements
- Bankruptcy process is drawn out and public funds would likely be required in the interim
- Financial skills required for ongoing monitoring of a firm's financial condition is not a typical strength of an environmental regulatory agency

Possible Changes to the Financial Test



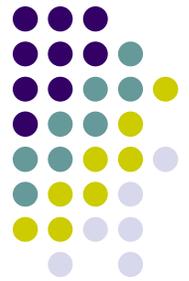
- Increase in tangible net worth amount
- Adoption of bankruptcy prediction model such as Altman's Z Score
- Eliminate assets pledged as security for other liabilities from tangible net worth
- Ensure amounts included on Line 1 of DTSC financial test forms include amounts for all financial test obligations

Increase Tangible Net Worth Requirement



- Tangible net worth is defined as tangible assets (total assets less intangible assets such as goodwill, patents and intellectual property) minus total liabilities;
- Current TNW requirement of \$10 million was established in 1982;
- The TNW requirement would have to increase to over \$17.5 million to account for inflation since 1982 using the GDP Implicit Price Deflator as a measure of inflation.

Comparative Measures of Assurance Risk Between Financial Assurance Mechanisms



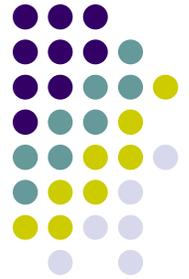
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What is Altman's Z-Score?

- It is a bankruptcy prediction model which uses a multivariate formula to forecast the probability of a company entering bankruptcy in the coming two years.
- Developed in 1968 by Dr. Edward I. Altman, Ph.D., a professor at New York University's Stern School of Business and updated since that time

Altman's Z-Score Model



Working Capital/Total Assets x 1.2

Retained Earnings/Total Assets x 1.4

EBIT/Total Assets x 3.3

Market Cap./Total Liabilities x 0.6

Sales/Total Assets x .999

Interpretation of Z-Score Results



Score above 2.99 means bankruptcy is highly unlikely.

Score between 1.81 and 2.99 is called zone of uncertainty with an increasing risk of bankruptcy the lower the score.

Score below 1.81 means bankruptcy is highly likely.

In 1999 Altman found a cutoff of 2.675 was between 82% and 94% accurate.

Application of Z-Score Model to Financial Test



- Owners/Operators with Z-Score above 2.675 would have full use of the financial test.
- Owner/Operators with Z-Score between 1.80 and 2.675 would have partial use of the financial test.
- Owner/Operators with Z-Score 1.80 or below could not use the financial test.



Exclusion of Pledged Assets

- Assets pledged as security for other liabilities are not available for satisfaction of environmental obligations.
- Definition of Tangible Net Worth would be
Total Assets less Intangible Assets less
Pledged Assets less Total Liabilities

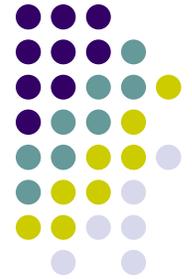


Ensure amounts included on Line 1 of the DTSC financial test form include amounts for all financial test obligations of the owner/operator regardless of type of facility or location of facility.



Other Possible Changes

- Require a certain level of unpledged assets to be located in California
- Different financial test requirements for different types of facilities
- Increase financial assurance multiplier factor of six times current environmental costs



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