



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OFFICE OF
THE INSPECTOR GENERAL

September 28, 1999

MEMORANDUM

SUBJECT: Administration of Superfund Special Accounts Needs Improvement
Final Audit Report Number 99P0214

FROM: Michael Simmons /s/ *Michael Simmons*
Deputy Assistant Inspector General
for Internal Audits

TO: Sallyanne Harper
Chief Financial Officer

Steven A. Herman
Assistant Administrator
for Enforcement and Compliance Assurance

Attached is a revised final report prepared by the EPA's Office of Inspector General (OIG). This report replaces the final report we issued September 17, 1999. This report revises pages 13 and 30 to address some recent concerns of the Office of Enforcement and Compliance Assurance. This report contains the results of our audit of certain activities related to Superfund Special Accounts. We initiated this audit to provide the agency with an independent assessment of the implementation and use of Superfund special accounts. The cooperation and assistance provided by your staffs during the audit are greatly appreciated.

Based on this audit, we concluded that the Environmental Protection Agency (EPA) was establishing Superfund special accounts and using them as an incentive for Potentially Responsible Party (PRP) settlements of outstanding claims as the special accounts reform provided. However, EPA needed to make improvements in its use and administration of the accounts. We found that reconciliations of special account transactions/balances were not sufficient to ensure identification and correction of errors in these accounts, that regional personnel were not always sufficiently aware of the existence and intended use of these accounts, and that language used in PRP settlement agreements could be improved. These and other issues are further discussed in the Audit Results section of this report.

This report contains findings that describe problems the OIG has identified and corrective actions the OIG recommends. Final determinations on matters in this report will be made by EPA managers in accordance with established EPA audit resolution procedures. Accordingly, the findings described in this audit report do not necessarily represent the final EPA position.

Action Required

This report makes recommendations to both the Chief Financial Officer and the Assistant Administrator for Enforcement and Compliance Assurance. Because the majority of recommendations are made to the Chief Financial Officer, we request that the Chief Financial Officer serve as the primary action official and take the lead in coordinating the Agency's response. In accordance with EPA Order 2750, the primary action official is required to provide us with a written response within 90 days of the final report date. Your response to the final report should identify any completed or planned actions related to the report's recommendations. For corrective actions planned but not completed by the response date, reference to specific milestone dates will assist in deciding whether to close this report.

We issued a draft report to you on April 14, 1999, and received your responses on June 11 and June 15, 1999. With a few exceptions, your responses generally concurred with the findings and recommendations presented in the draft report. Changes were made in the final report, as deemed appropriate, to address any concerns or disagreements expressed in your responses to the draft report. Portions of your response were incorporated into the report. Your responses have been included in their entirety as Attachments 1 and 2.

We have no objections to the further release of this report to the public. Should your staff have any questions, please have them contact Mary M. Boyer, Divisional Inspector General, Southern Audit Division, at (404) 562-9830 or Bill Samuel, Office of the Inspector General (OIG) Headquarters, at (202) 260-3189.

PURPOSE, SCOPE AND METHODOLOGY

We initiated this audit to provide the Agency with an independent assessment of the implementation and use of Superfund special accounts. Our primary objectives were to determine if EPA: (1) effectively oversaw the establishment and use of Superfund special accounts; and (2) used Superfund special accounts as an inducement to PRPs to settle Superfund claims.

To accomplish these objectives we: (1) obtained EPA policies pertaining to Superfund special accounts; (2) reviewed a judgmental sample¹ of 40 of the 112 Superfund special account files and associated records at the Cincinnati Financial Management Center (CFMC) and 5 of 7 account files and related records at Region 4; (3) reviewed receipt of settlement funds, accounts receivable

¹ The judgmental sample of 40 special accounts was primarily selected based on dollar value and account usage.

and billing information related to Region 4 special accounts; and (4) interviewed Financial Management Division (FMD) staff, Region 4 Remedial Project Managers (RPM), Region 4 Project Officers (RPO), Region 4 Financial Management Office (FMO) personnel, CFMC personnel, OIG audit staff responsible for the FY1998 Region 4 Financial Statement audit, and OIG legal counsel.

The audit fieldwork was conducted from May 1998 through January 1999. The audit primarily addressed special account activities for Fiscal Years 1996 and 1997. However, older transactions were reviewed where considered necessary to accomplish the audit objectives.

This audit was conducted in accordance with Government Auditing Standards. The scope of the audit was limited to the objectives cited above and the specific management controls related to these objectives. Therefore, no opinion is expressed on the overall adequacy of management controls for activities pertaining to Superfund special accounts. However, we did identify weaknesses in the processes of account reconciliation, use of available site specific account funds, and language in settlement agreements. Actions recommended to address these and other weaknesses are included in the Audit Results and Recommendations sections of this report.

BACKGROUND

Congress established the Superfund program in 1980 with the passage of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). CERCLA was amended in 1986 by the Superfund Amendments and Reauthorization Act (SARA). The Superfund program provided Federal authority and funds to identify and clean up hazardous waste sites. Improper disposal of hazardous wastes has resulted in approximately 1,300 National Priorities List (NPL) sites posing threats to human health and the environment. EPA also interpreted that CERCLA provided the Agency authority to retain PRP payments that were intended to fund future site cleanup costs. EPA established site specific, special accounts to identify and control these funds. In 1996, the Office of Management and Budget and the Treasury Department authorized EPA to accrue interest on special account balances.

In June 1993, EPA initiated a series of administrative reforms to improve the Superfund program. The objectives of the reforms were to: (1) protect public health and the environment while increasing the pace and lowering the cost of cleaning up hazardous waste sites; (2) promote fairness in holding parties who are responsible for contaminated sites liable for cleaning them up while also reducing litigation and its associated costs; (3) involve local communities, states, and tribes in the program's decision-making; and (4) promote economic redevelopment at Superfund sites.

One of these administrative reforms promoted the increased use of site specific special accounts. These accounts represented PRP payments received by EPA to pay for future costs at specific Superfund sites. In October 1995, EPA announced its intention to encourage greater use of special accounts as a means to ensure that both the settlement funds received from a specific site

and the interest earned by accounts created to hold such funds were available for future response actions at that site. This reform was intended to assist EPA in providing an incentive for early settlement with PRPs and to reduce litigation costs. Since this reform was implemented in October 1995, the number of special accounts has grown from 35 to 112 and special account receipts have grown from about \$227 million to \$383 million.

EPA provided guidance to regions and supporting offices for the establishment, maintenance and use of Superfund special accounts through a memorandum, dated February 7, 1997, from the Office of the Chief Financial Officer (OCFO) and the Office of Enforcement and Compliance Assurance (OECA). Additional guidance was provided in Resources Management Directives System (RMDS) 2550D, Chapter 14, Superfund Accounts Receivable and Billings, and draft Chapter 15, Financial Management of Cash Out Special Accounts². Draft Chapter 15 has served as interim policy for two years and had not been finalized at the time of our review. The CFMC has EPA-wide responsibility for the establishment, maintenance, and oversight of special accounts. To track and control special accounts, CFMC created a database in 1996 that documented receipts, disbursements, and interest earned. This database is not currently interfaced with the Integrated Financial Management System (IFMS). CFMC must manually post interest earned by special accounts to the appropriate IFMS general ledger account.

AUDIT RESULTS

We concluded that Agency procedures and internal controls, with a few exceptions, were adequate to ensure that settlement receipts, disbursements, and accrual of earned interest were properly recorded. The transactions reviewed were generally consistent with EPA requirements for the establishment, maintenance, and use of Superfund special accounts. In addition, the Agency had used special accounts to provide an incentive for PRP settlement of outstanding claims. We recognize that the use of special accounts as an administrative reform is relatively new to the Agency. We identified some opportunities to improve processes in the areas of special account reconciliation, use of available account funds, and language used in settlement documents. Since the use of Superfund special accounts is growing at a significant rate, it is important that the Agency take this opportunity to improve the processes associated with special accounts.

Site Specific Account Reconciliation and Related Controls Were Not Effectively Implemented

The Agency had not implemented sufficient procedures to ensure that site specific Superfund special accounts were being properly reviewed and reconciled. Receipt, disbursement, and interest transactions in older special accounts did not reconcile between the CFMC database and IFMS general ledger reports. CFMC had not posted earned interest to general ledger accounts

² Draft Chapter 15 was issued EPA-wide in early 1997. The draft was to serve as interim policy until the final version was processed through the Agency's Directives Clearance Process.

for six months and accounting errors made at the regional level had not been identified. In addition, periodic account reports forwarded by the CFMC to the regions were not received or reconciled by regional personnel responsible for oversight of site operations.

CFMC Data Base Did Not Reconcile With General Ledger Reports

Reconciliation of special account transactions/balances at the CFMC level was not sufficient to ensure identification and correction of errors in these accounts. The CFMC did not adequately reconcile its special account database with the IFMS general ledger for special accounts.

During our review, CFMC provided its data base of special account transactions, as of July 16, 1998, and special account general ledger reports, as of June 30, 1998. We accepted these reports for review since there was no material difference in balances resulting from transactions between these dates. Based on a comparison of these reports, the following differences were noted:

	<u>Millions of Dollars</u>			
	<u>Settlement Receipts</u>	<u>Interest Earned</u>	<u>Disbursements</u>	<u>Balance</u>
CFMC Database	\$383	\$64	\$132	\$315
General Ledger Report	<u>290</u>	<u>56</u>	<u>36</u>	<u>310</u>
Difference	<u>\$ 93</u>	<u>\$ 8</u>	<u>\$ 96</u>	<u>\$ 5</u>

Based on conversations with CFMC staff, CFMC had no process for reconciling the special account database with the IFMS general ledger. After we informed CFMC that we could not reconcile the database to the general ledger, CFMC attempted to reconcile these accounts. CFMC agreed that the data base and general ledger did not reconcile. However, they disagreed that the net difference in account balances was \$5 million as shown above. CFMC personnel believed that the time interval between the data base and general ledger reports we used would account for some of the difference. However, as stated above, we did not identify any material transactions in these accounts between June 30 and July 16, 1998.

CFMC and FMD staff informed us that part of the differences resulted from accounting procedures used for older special accounts prior to implementation of the IFMS and changes due to receiving authority to earn interest on these accounts. Under past accounting procedures, receipts and disbursements were netted against each other within the same general ledger account. This procedure resulted in inaccuracies when IFMS was installed because past receipts and disbursements could not be separated and listed for IFMS purposes. Because of past netting of disbursements against receipts, differences in the receipt and disbursement categories as shown above were almost equal. Differences in reported interest earned are discussed below.

The IFMS is the Agency's primary financial management and reporting system. As long as differences between the special account database and general ledger accounts exist, the Agency has no positive assurance of the accuracy of the IFMS general ledger balances and the financial

reports produced from these accounts. The Agency should bring the IFMS into reconciliation with the CFMC database as soon as possible.

Earned Interest Not Posted To General Ledger Reports

As part of CFMC's responsibilities for maintenance of special accounts under RMDS 2550D, draft Chapter 15, interest on outstanding balances was to be calculated and posted to IFMS on a monthly basis. The Treasury provides a monthly interest percentage to EPA headquarters and it is then forwarded to the CFMC for the purpose of calculating interest earned on each special account. There is normally a one to two month delay receiving the monthly interest rates from the Treasury and CFMC's calculations of interest earned. As of July 16, 1998, CFMC had made interest calculations through May 1998 and added these figures to their special account database. However, there was no indication that interest had been posted to the IFMS for the months of December 1997 through May 1998. Approximately \$8 million in earned interest was not reflected in CFMC General Ledger reports as of June 30, 1998. CFMC would have identified this problem if it had been reconciling the IFMS to their special accounts database.

CFMC staff indicated that the Treasury rates for April and May were not received until early July 1998 and the related interest (\$2.8 million) was included in a July 21, 1998 special account data base report. However, the fact remains that none of the interest had been posted to the general ledger account. It is important that interest is entered into the special accounts general ledger promptly so regions will have these funds available for any site costs incurred.

In response to the draft report, OCFO indicated that they planned to change special account procedures to specify quarterly rather than the current monthly posting of earned interest. We agreed that quarterly postings would be adequate as long as monthly compounding of interest was included in calculating the interest earned.

Regional Accounting Errors Were Not Detected

Regions 6 and 8 posted disbursements to the IFMS special account general ledger for five sites for which there had been no receipts/deposits. This resulted in negative account balances. CFMC had not established special accounts for these sites. Region 8 informed us that the entries were made in error and the Region subsequently reversed these entries. Also, one special account established by CFMC in the special account database was later closed because the applicable Region had deposited the funds for the wrong site. Interest earned on the account balance had been posted to IFMS general ledger. However, CFMC had not reversed this entry in the general ledger account when the account was closed in the special account database. Reconciliation of the database to IFMS would have detected these errors.

CFMC staff contended that they had limited ability to identify regional errors and felt that regions should be accountable for their own errors. We agree that regions should be accountable for their

errors. However, CFMC has overall responsibility for the accuracy of special accounts and periodic reconciliations to detect errors is a necessary control.

Regions May Not Be Using Available Special Account Balances Efficiently

Special Accounts Are Established With Minimal Settlement Funds

Three of the 112 special accounts at the time of our review showed initial deposits ranging from \$100 to \$6,000. No additional deposits were made to the accounts since their establishment in FY 1997 and there was no indication or documentation that additional funds would be forthcoming. Procedures in draft RMDS 2550D, Chapter 15, Section 6a, indicate that the RPO and FMO should decide if it is cost effective to establish a special account when the settlement amount is minimal. We believe that it was not cost effective to establish and maintain accounts with such small balances. These funds should have been deposited directly to the Superfund Trust Fund.

Special Account Funds Are Not Being Utilized

Special account balances have existed for years without any disbursements for site costs. Sixteen special accounts established prior to 1997, with balances totaling \$54 million, had no disbursements since the accounts were established. All five of Region 5's special accounts, totaling \$40 million, were 3 to 4 years old with no disbursements. This situation could be due to regional policies that these funds will only be used for certain phases of clean up or because settlements have not been reached with major responsible parties. Also, regions may need to retain funds to ensure PRP compliance with settlement agreements. However, RPOs and RPMs interviewed had little knowledge of the existence or balances of special accounts for their sites or for what specific purposes these monies were set aside. A Region 4 RPM, who had requested numerous disbursements from a particular special account, indicated that she had no idea of the current balance available in this special account. Use of special accounts has been significantly inconsistent between regions. Using special account funds for applicable site costs, allows appropriated funds to be used for other sites. This could reduce delays in the cleanups of those sites.

A review of disbursement activities in all special accounts was conducted to determine whether there was consistency in disbursement of special account funds between regions. Our analysis indicated the percentages of all accounts with distributions varied widely by Region. Six regions had distributions in 75 to 100 percent of accounts established prior to fiscal 1997 while three regions had 28.57 percent or less in distributions from similar pre-1997 accounts. Region 5 had no distributions from accounts established prior to fiscal 1997 but had distributions from 50 percent of accounts established after fiscal 1996. Region 6 had distributions from all of their accounts, without regard to when they were established.

The CFMC special account database reflected approximately \$315 million in settlement funds and earned interest currently available for use by the regions. Based on our analysis, some regions may not be charging EPA expenses against the accounts until remedial actions begin and others are charging the accounts as soon as they are established. Therefore, the use of special account monies has not been consistent between regions. Previous OIG audits have disclosed that the agency has been reluctant to charge PRP funds for oversight costs. The draft of RMDS 2550D, Chapter 15, Section 8, indicates that all site costs (direct and indirect) incurred should be charged to the special accounts.

Special account funds can be used to expedite site cleanups. The funds can be used in lieu of appropriated monies and to fund actions that may be delayed due to insufficient funds in a particular fiscal year. If regions do not effectively use available special account funds for needed response actions, site cleanups may be unnecessarily delayed.

Reviews Are Not Made To Determine If Accounts Should Be Closed

Currently, no clear requirements exist for the closure of special accounts. Draft RMDS 2550D, Chapter 15, Section 9 provides closeout procedures, but these procedures do not specify at what point accounts should be closed. This is left up to the discretion of RPOs. We identified seven accounts, totaling \$325,090, where all responsible party payments had been disbursed and interest only balances remained. These interest only balances had been outstanding for significant periods. For example, two Region 2 accounts have had interest only balances since May 1993 and July 1994, respectively. The CFMC should notify applicable regions of these interest balances and determine if the accounts need to be closed and the remaining balances deposited to the trust fund for use at other sites.

Special Account Balances Are Not Received Or Reconciled By Appropriate Regional Staff

Based on procedures in draft RMDS 2550D, Chapter 15, Section 8c, the CFMC should be forwarding special account balances to the regions in July and September of each year. These reports are provided to the regions for the purpose of allowing the regions the opportunity to review the accounts for accuracy and to provide them with balances for determining reimbursable authority for the following year. However, these reports were not being timely forwarded to the regions in July and September as specified in Chapter 15. The report due in September 1998 was not issued until November 20, 1998, almost two months late. Regions are supposed to use the September reports to determine the amount of reimbursable authority to request for the next fiscal year. A report two months late does not serve this purpose. We could not find any evidence that the report due in July 1998 was ever issued to the regions. Also, the reports were not reaching the regional personnel who needed to act on them. Discussions with responsible personnel in Region 4 indicated that they were not aware of this report and had never seen one. We subsequently confirmed that the Region 4 Comptroller had at least seen the November 1998 report. In addition, CFMC had no process for confirming that regions had received the reports and reconciled the data to their records.

During the audit, CFMC indicated they would review their distribution list and take action to ensure that these reports get to the regions timely and to the individuals who need them. To ensure that the regions are receiving and acting on these reports, CFMC should request regional confirmation of reconciliation of this report on at least an annual basis.

Settlement Documents Did Not Always Clearly Delineate Between Past and Future Costs

According to EPA's interpretation of CERCLA at the time of our review, CERCLA provided EPA the authority to only retain PRP payments for future site costs. PRP reimbursements for past costs were to be deposited to the Superfund Trust Fund. Therefore, the allocation of payments between past and future costs was required to be clearly documented in settlement agreements to ensure EPA's use of the funds was consistent with applicable law. Our review of 35 CFMC special account files³ disclosed that settlement documents for nine special accounts did not clearly delineate between past and future costs. In some cases, there was no mention of how the funds would be applied or whether the work to be paid from these funds was a past or future action. For five special accounts, settlement documents contained no clear cutoff date for past and future costs, i.e., where past cost reimbursements will end and future cost payments will begin. These dates are needed because long periods can occur between document preparation, settlement execution, and receipt of funds by EPA. Finally, 4 of the 35 files did not contain any settlement documents and two files had undated settlement documents. RMDS 2550D, Chapter 15, Sections 2.c and 6.c, require that regions forward copies of settlement documents to CFMC along with their request that a special account be established. CFMC uses this documentation to determine if a special account is appropriate for the funds received. Based on our file review, the regions have not consistently provided the required supporting documentation to CFMC and CFMC has not always ensured that it received the information needed to establish the propriety of special accounts.

EPA has long recognized problems in properly identifying past and future cost payments in settlement documents. For this reason, RMDS 2550D, Chapter 15, Section 2.a, required that Regional Counsels ensure that settlement agreements having both future and past cost amounts contain language which clearly defines and allocates these amounts either in dollars or percentages. This requirement was also included in model settlement language issued by OECA and the Department of Justice in February 1997. However, we identified seven settlement documents executed after this criteria was issued of which four either did not properly define past and future costs or did not clearly allocate PRP payments between past and future work.

In response to the draft report, OECA indicated that recent legal interpretations of CERCLA provided that EPA had the legal authority to retain cost recoveries, as well as payments for future costs. Therefore, delineation of past and future costs in settlement agreements may no longer be

³ Original sample of 40 special accounts were selected from an IFMS general ledger report. However, CFMC did not have files on five accounts selected because the regions had erroneously established these accounts in IFMS as special accounts.

an issue. OECA's response and the new legal opinion received by OECA are discussed further in the Agency Comments and OIG Evaluation section of this report.

Data Provided in the Annual and Superfund Highlight Reports Is Misleading

Superfund annual highlights and reforms reports have only included special account receipts and earned interest to date in their briefs. No discussion has been included concerning disbursements from these accounts. Without data on disbursements, a reader of these reports could be misled into thinking that the dollar amounts presented represent current special account balances available for site cleanups. For instance, the Superfund Reforms Annual Report for FY 1997 stated: "The total balance of available funds in Special Accounts is \$405 million, representing \$353 million in principal and \$52 million in interest." However, the \$405 million is not the balance available. It represents total special account receipts plus interest earned. The \$405 million would have to be reduced by total disbursements from these accounts to determine the balance available. As of July 16, 1998, special accounts receipts and interest totaled about \$447 million; however, the balance available in special accounts was about \$315 million. If the Agency included a discussion concerning disbursements from these accounts, along with receipts and interest, the reader would be able to better understand how these accounts are used and to what extent they are being utilized.

RECOMMENDATIONS

We recommend that the Chief Financial Officer:

- ! Expedite the approval and issuance of the RMDS 2550D, Chapter 15.
- ! Require CFMC to reconcile the special account database with the IFMS and make appropriate adjustments to IFMS on at least a quarterly basis. In addition, a quarterly review of special accounts should be made for the purpose of detecting regional accounting errors.
- ! Instruct CFMC to post earned interest to the IFMS on at least a quarterly basis.
- ! Require CFMC to distribute special account status reports to RPOs and/or RPMs for each site or request that regions provide a copy to the applicable RPMs.
- ! Require Regions to confirm reconciliation of their special account balances to the CFMC at least annually.
- ! Require CFMC to establish a process for identifying accounts with interest only balances, advising regions of these balances, and closing these accounts when requested to do so by the applicable regions.

- ! Set a minimum dollar limit for establishing special accounts except where evidence of potential future payments has been received from the regions.

We recommend that the Assistant Administrator for Enforcement and Compliance Assurance:

- ! Instruct regional staffs responsible for the day to day activities of overseeing site cleanups on the existence, purpose, and usage of special accounts related to their sites.
- ! Remind regions that special accounts are to be used for all site costs, including direct and indirect oversight costs, unless otherwise restricted by the settlement agreements or the retention of funds is necessary to obtain PRP cooperation/compliance.
- ! Until interim guidance can be promulgated based on recent legal interpretations of CERCLA, continue the requirement that special account settlement agreements clearly define past versus future costs, identify the cutoff date between past and future costs, and clearly disclose terms for usage of the special accounts to be established.
- ! Include special account disbursement information in the Superfund annual reports on program highlights and reforms.

AGENCY COMMENTS AND OIG EVALUATION

A draft audit report was provided to OCFO and OECA on April 14, 1999. OCFO and OECA responses, dated June 15 and June 11, 1999, respectively, are included as Attachments 1 and 2 to this report. Responses by OCFO and OECA to draft report recommendations are summarized below along with our evaluation of their comments. Our responses to OCFO and OECA comments on draft report findings have been incorporated into their responses in Attachments 1 and 2. An exit conference was held with OCFO and OECA staff on July 20, 1999. Based on the OCFO and OECA responses to the draft report and discussions at the exit conference, changes were made to the final report as deemed appropriate.

OCFO Comments on Draft Report Recommendations

Expedite the approval and issuance of the RMDS 2550D, Chapter 15. The OCFO agreed with the recommendation and indicated that the document would be finalized as soon as language in the draft policy concerning identifying past and future costs in settlement agreements was approved.

Require CFMC to reconcile the special account database with the IFMS and make appropriate adjustments to IFMS on a monthly basis. In addition, a monthly review of special accounts should be made for the purpose of detecting regional accounting errors. The OCFO has agreed to reconcile the special account database with the IFMS general ledger on a quarterly basis and notify the regions of any errors detected during reconciliations.

Instruct CFMC to post earned interest to the IFMS on a monthly basis. The OCFO has agreed to post interest to the IFMS on a quarterly basis.

Require CFMC to distribute special account status reports to RPOs and/or RPMs for each site or request that regions provide a copy to the applicable RPMs. The OCFO will instruct the regions to distribute quarterly account reports to RPMs.

Require Regions to confirm reconciliation of their special account balances to the CFMC at least annually. The OCFO agreed to require the regions to confirm reconciliation of balances as part of the year-end close out process.

Request that Regions report on the status and proposed use of each account on an annual basis. OCFO disagreed that this additional reporting requirement was needed since each region must estimate the amount in special accounts that will be needed in the coming fiscal year and request corresponding reimbursable authority through EPA's budget office.

Require CFMC to establish a process for identifying accounts with interest only balances, notifying regions of these balances, and closing these accounts where appropriate. The OCFO has agreed to advise the regions of accounts having interest only balances and request their review of those accounts.

Set a minimum dollar limit for establishing special accounts. The OCFO indicated that RPOs and FMOs have the discretion to decide when it is cost effective to establish an account. They agreed that accounts should not be opened with minimal funds unless the region anticipates receiving future settlement funds.

OECA Comments on Draft Report Recommendations

Instruct regional staffs responsible for the day to day activities of overseeing site cleanups, on the existence, purpose, and usage of special accounts related to their sites. OECA and OCFO will work with the regions to ensure offices are sharing information regarding the status of available account funds.

Remind regions that special accounts are to be used for all site costs, including direct and indirect oversight costs, unless otherwise restricted by the settlement agreements. OECA agreed on how accounts should be used but indicated that they can make better decisions regarding what specific site costs the account funds should be used for at certain critical decision points in the remediation process.

Ensure that special account settlement agreements clearly define past versus future costs, identify the cutoff date between past and future costs, and clearly disclose terms for usage of the special accounts to be established. OECA disagreed and indicated that the Office of General Counsel had provided recent opinion that both past and future costs received in settlements may

be placed in a special account. As a result of this opinion, the Agency is reviewing the issue of whether past costs should be deposited in the Trust Fund or whether these funds can be retained within the special accounts.

Include special account disbursement information in the Superfund annual reports on program highlights and reforms. OECA agreed that information on special account disbursements would be meaningful and should be included in annual reports.

OIG Evaluation

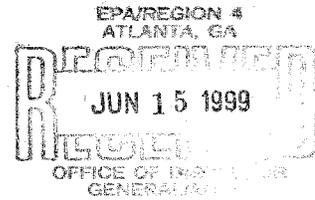
We consider the OCFO and OECA comments to be generally responsive to our findings and recommendations. As a result of discussions with agency staff after receiving their responses to the draft report, we were able to generally agree on the findings and recommendations presented in the final report. For example, based on agency comments and actions, we agreed that reconciliation of accounts on a quarterly versus a monthly basis would provide an adequate solution to the problems identified in the draft report. Also, based on comments made by the Agency, we agreed that the draft report recommendation requiring OCFO to request annual regional reports on the status and proposed use of each special account would not be included in the final report.

OECA disagreed with our recommendation that PRP payments for past and future costs be specifically delineated in settlement agreements, even though current policy requires that such delineations be made to ensure that payments for past costs are deposited in the Superfund Trust Fund. OECA's disagreement was partly based on a new legal opinion received from the Office of General Counsel (OGC), dated March 24, 1999, which indicated that EPA had the legal authority to retain cost recoveries, as well as payments for future costs. However, the fact remains that current EPA policy requires that past and future costs be specifically defined in settlement documents and that recoveries of past costs should be deposited in the Trust Fund.

Although OECA received an OGC legal opinion indicating that cost recoveries can be retained by EPA, implementing this opinion will change the Agency's current policy which requires placement of cost recoveries in the Trust Fund. Internal Revenue Code Section 9507(b) [26 U.S.C. 9507(b)] indicates that any amounts recovered by EPA shall be deposited in the Trust Fund. SARA amended Section 122 of CERCLA to indicate that EPA may, "notwithstanding any other provision of law," retain and use PRP payments for purposes of carrying out settlement agreements. OGC attorneys based their recent opinion primarily on the premise that "notwithstanding any other provision of law" meant that Section 122, as amended, superseded the requirements of the Internal Revenue Code and allows EPA to retain any monies received from PRPs, including cost recoveries, in a special account. Therefore, we suggest that OECA carefully consider any proposed procedures or guidance based on this new interpretation of CERCLA. We further suggest that OECA establish interim guidance and procedures to implement the new legal opinion before allowing regions to retain cost recoveries in special accounts. The recommendation in the final report was modified to reflect this recent legal opinion.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460



JUN 11 1999

OFFICE OF THE
CHIEF FINANCIAL OFFICER

MEMORANDUM

SUBJECT: Administration of Superfund Special Accounts Needs Improvement - Draft Audit Report EISF88-04-0015

FROM: *[Signature]*
Michael W. S. Ryan
Comptroller

TO: Michael Simmons
Deputy Assistant Inspector General
for Internal Audits

This memorandum responds to the subject audit report prepared by EPA's Office of Inspector General. Thank you for providing us with the opportunity to review and comment on this document.

For the past several years, the Office of the Chief Financial Officer (OCFO) has worked closely with the Office of Enforcement and Compliance Assurance (OECA) and the regional offices to develop and implement Agency guidelines for establishing and managing Superfund Special Accounts. Despite the audit findings in this report, the OCFO and OECA have worked hard to ensure that Special Accounts are properly established and managed. Further, the OCFO successfully assisted OECA in implementing the Superfund Administrative Reform promoting the increased use of Special Accounts and obtaining the authority to accrue interest to these accounts. There are currently 121 Special Accounts totaling over \$480 million -- of this amount, \$73 million represents interest.

Along with our response, we would like to use this opportunity to offer suggestions concerning the process which, if followed, would have facilitated a better understanding of the OIG's concerns and allowed the Office of the Comptroller (OC) to more expeditiously resolve the issues raised. We were initially advised that the OIG would be conducting a Special Accounts survey. However, when the focus changed from a survey to an audit, we were never formally advised of this change. There was no entrance, or exit, conference held to formally announce the

impending audit. Also, position papers were not issued during the audit. Had position papers been issued, the information contained in these papers would have given the OC staff an opportunity to provide further background or explanations of the processes in question. If the normal protocol for an audit had been followed, we believe that there would have been fewer findings and there would have been a much clearer understanding of the Special Account process. Greater adherence to the audit process would have eliminated many of the issues early on.

We have reviewed the audit findings and recommendations in this report and have responded to each as provided in the attachment. We do not agree with several recommendations and have provided explanations as to why we disagree. OECA will respond separately to their findings and recommendations.

If you have any questions concerning our response, please contact Jack Shipley, Director, Financial Management Division, at (202) 564-4905, or Ron Bachand, Director, Financial Services Division, at (202) 564-4801.

Attachment

cc: Sallyanne Harper

Steve Herman (2201 A)
Sandra Connors (2272A)
Jack Shipley
Ron Bachand
FMD Branch Chiefs

OCFO Response to Audit Findings and Recommendations
Administration of Superfund Special Accounts Needs Improvement
Draft Audit Report E1SFB8-04-0015
April 14, 1999

Provided below is the Office of the Chief Financial Officer's response to the findings and recommendations contained in the subject audit report.

AUDIT FINDINGS

1. Site Specific Account Reconciliation and Related Controls Were not Effectively Implemented

a. *CFMC Data Base Did Not Reconcile With General Ledger Reports.* The Special Accounts general ledger report used by the OIG to reconcile to the Special Accounts data base included year-to-date transactions as of June 30, 1998, while the Special Accounts data base report used by the OIG included year-to-date transactions as of July 21, 1998. Consequently, most of the \$5 million difference results from timing gaps between the accounting transaction dates and report dates. As you are aware, there will always be some lag between the time when IFMS transactions are posted to the general ledger and when the same transactions are reflected in the Special Accounts data base. Although the information contained in the Special Accounts data base is driven by IFMS, CFMC must routinely extract, or upload, this information from IFMS, and download it to the Special Accounts data base after the close of a monthly accounting period.

We believe that the paragraph following the OIG's difference table, on page five of the report, is vague. This paragraph does not fully explain the methodology used by the OIG to identify the differences. The OIG's comments fail to discuss some of the complexities affecting CFMC's ability to accurately reconcile the amounts in the Special Accounts data base to the general ledger. The OIG and CFMC staff held two conference calls, after the OIG's site work was completed, to discuss the differences. Some of these problems could have been mitigated had the OIG performed additional site work to fully understand the reconciliation process.

Interest calculations for Special Accounts, are based on the Department of the Treasury's (Treasury) monthly Superfund Income Statement and Balance Sheet. This information is delayed by two to three months since the income statement and balance sheet are usually received by the Agency two months after the close of Treasury's reporting period. EPA has discussed the timing issue with Treasury and has been informed that they cannot provide this information any earlier.

CFMC has been tasked with completing a reconciliation of the Special Accounts data base reports with the general ledger. Due to the extensive amount of research that must be done, we do not expect the reconciliation to be completed until the end of the fiscal year.

OIG Comments: *As stated in the draft report, we reviewed all transactions that occurred between the dates of the general ledger and data base reports that had been posted to the special account data base and found no significant transactions had occurred that would explain the \$5 million difference between the balances of the special account data base and the IFMS general ledger. Therefore, timing gaps between the reports does not account for the difference and CFMC has not presented any documentation that such transactions existed.*

The Agency indicates that additional on-site fieldwork by the auditors would have provided more understanding of the complexities in reconciling the special account data base to the IFMS general ledger. At the time of our on-site fieldwork at CFMC there was no reconciliation process. Only after we discussed the account differences with CFMC did they attempt to reconcile the account balances. We understand the reconciliation of these balances will be complex and difficult because of differences in past and current accounting practices. However, the purpose of this finding was to recognize the need for reconciliation and establish a periodic process for reconciling the subject accounts. Regardless of how complex, reconciliation will be necessary. Therefore, additional knowledge of the complexities involved would not have changed the subject finding or the recommendation.

The delay in EPA's receipt of Treasury interest rates is not relevant to any finding presented in this report. Our findings address the problem that, once interest rates were received, the interest was posted only to the special account data base. The interest had not been posted to the IFMS general ledger for six months.

b. Earned Interest Not Posted to General Ledger Reports. While it is true that CFMC did not post the amount of interest earned during the period from December 1997 to May 1998 to the general ledger, the impact was insignificant. The reason for the delay was that the automated system that calculated the interest and generated the accounting entries was not available during that time. Manually calculating and posting interest to IFMS is not only time consuming and complex, but also introduces the potential for errors. More importantly, CFMC posted the interest and entered a year end accrual to insure the accuracy of the financial statements. Since there is no negative programmatic effect on the Special Accounts, and since it does not adversely impact the general ledger until the end of the fiscal year when the Agency closes its books, the posting of interest, though not timely, was not determined to be critical.

Posting interest monthly has been and will continue to be a problem for CFMC until our automated program has been fixed and improved. The current program, though accurate, has not proven robust and is difficult to maintain. Consequently, CFMC is currently developing an easier and more reliable automated program which we anticipate completing by the end of 1999. Once this is done, posting interest quarterly will be possible. Finally, it should be noted that no matter how frequent the postings, there will always be a two month lag due to the delay in receiving Treasury's income statement and balance sheet which is used to calculate the monthly interest rate.

OIG Comments: *The interest that had not been posted to the general ledger was \$8 million dollars. In terms of impact on the Agency's financial statements as a whole, the materiality would be insignificant. However, the impact on Agency reporting on special accounts and available funds for site cleanup was significantly impacted. We do not understand the Agency's comments that interest was not posted to the IFMS general ledger because the automated system that calculated interest and generated accounting entries was not available. We found that the interest had already been calculated and posted to the special account data base, and, therefore, the amounts only needed to be posted to the general ledger.*

c. Regional Accounting Errors Were Not Detected. CFMC's primary responsibilities are to establish and maintain Special Accounts, and to report on the status of funds within these accounts. The regions are responsible for managing their own Special Accounts and for posting and tracking all related accounting transactions. Accordingly, if any accounting errors are identified by the region, or CFMC, the responsible region will correct their own errors. Based on CFMC's past and current communications with the regions, we are confident that the regions are identifying and correcting their own accounting errors. The audit report specifically identifies two of these regions, Regions VI and VIII, that detected and corrected their errors. Furthermore, CFMC does notify and work with the regions to resolve issues as errors are detected during the reconciliation process. For example, CFMC notified Region V of several collection entries that had been posted incorrectly to IFMS. After the region researched the transactions, they agreed that these entries had been incorrectly posted and corrections were needed.

Although Special Account funds require the issuance of matching reimbursable authority before they can be used, the actual use and management of these funds is basically the same as appropriated funds. Therefore, the regions are required to exercise the same fiduciary controls and responsibilities with Special Account funds as they would with appropriated funds.

OIG Comments: *The draft report did not indicate that CFMC should correct regional accounting errors. We agree that regions should correct their own errors. The report only pointed out that CFMC did not detect regional errors due to the lack of a reconciliation process between the special account data base and the IFMS general ledger. The report recommends that CFMC initiate a reconciliation process and report any regional errors identified during the process to the appropriate region for correction.*

2. Regions Are Not Using Available Special Account Balances Efficiently

a. Special Accounts Are Established With Minimal Funds. As a general matter, the Agency should establish Special Accounts when it's cost effective to do so. While at first glance an issue could be raised concerning the small dollar amount used to establish a few Special Accounts, upon further examination, it becomes clear that there is a rational explanation for such actions. In the case of the \$100 Special Account, the region established the account now to ensure that future settlement amounts could be placed in the account when received and to assure the Potentially Responsible Parties at the site that all of their settlement proceeds have been set aside for use at that site. This region anticipates receiving future settlement amounts. Consequently, we believe that it is both beneficial and cost effective to establish Special Accounts in these

situations. Further, the draft RMDS 2550D, Chapter 15, *Financial Management of Cashout Special Accounts*, provides the Regional Program Offices (RPOs) and Financial Management Offices (FMOs) with discretion to decide when it's cost effective to establish a Special Account.

OIG Comments: *The accounts with small balances as shown in the draft report had been established almost three years before our review and no additional amounts had been deposited. In addition, CFMC records for these accounts did not indicate that any additional deposits would be forthcoming.*

b. Special Account Funds Are Not Being Utilized. As of October 1998, approximately 38% of the total balance (principal and interest) in Special Accounts has either been obligated or disbursed. Considering that most Special Accounts have been established within the past few years, we believe that regional use of these accounts is appropriate. Several reasons may exist for maintaining funds in Special Accounts for an extended period of time. When funds are received prior to the performance of work, Special Account funds can not be used until site work actually commences. In other situations, if a Potentially Responsible Party (PRP) is performing a remedy pursuant to a Unilateral Administrative Order, funds are maintained in a Special Account in case the PRP does not comply with the order and to provide the Agency with immediate access to these funds in the event of a work takeover.

The Financial Management Division and OECA continue to provide information and updates to regions concerning the establishment and use of Special Accounts. This information is disseminated at annual Superfund Technical Workshops and during OECA's monthly Special Accounts conference calls with the Regional Program Offices and the Financial Management Offices. Also, OECA has transmitted several documents to the regions reminding them to use their Special Accounts where appropriate. We believe that these actions have increased the regions' use of Special Accounts.

OIG Comments: *The accounts referred to in the draft report had been established almost 4 years prior to our review and none of the funds had been disbursed. Our review of some the inactive accounts at Region 4 revealed that site work was in process and the Region was incurring oversight and indirect costs; however, Trust funds were being used, in some cases, to pay these costs when special account monies were available. We recognize that OCFO and OECA provide information to regions on special accounts. However, our review indicated that RPMs, who are responsible for payments of cleanup costs, were not always aware of the special account monies available or the purpose(s) for which this money had been retained in a special account.*

Overall, use of special account funds may appear to be substantial. However, this is not true when you look at each region individually. As shown in the draft report, there is great disparity in regional use of special account funds and certain regions have not used available special account balances that have existed for many years. This non-use exists despite the fact that the funds can be used to pay oversight and indirect costs associated with a Superfund site.

c. Reviews Are Not Made To Determine If Accounts Should Be Closed. As discussed earlier, the regions are responsible for initiating and conducting work at sites having Special Accounts, and for initiating, posting, and correcting their own accounting transactions related to those accounts. The regions are also responsible for maintaining the status of funds for these accounts through their own means and by way of the Special Accounts data base report prepared by CFMC. When an interest only balance remains in a Special Account, it does not necessarily mean that the account can be closed. The interest balance in this account, whether small or large, can be used for additional or ongoing site work. Therefore, the region will determine when all site work under a particular Special Account is completed and the Special Account can be closed. Once this determination has been made, the region may begin closing out the Special Account in accordance with the closeout guidance provided in the draft RMDS 2550D, Chapter 15, and with assistance from CFMC and the Program and Cost Accounting Branch (PCAB), FMD. The regions are actively involved in closing these accounts. For example, Regions IX and X recently contacted PCAB asking for assistance in closing out Special Accounts. When a Special Account is closed, any funds that remain will revert to the Superfund Trust Fund.

OIG Comments: *We recognize that regions should be responsible for determining when accounts should be closed. The draft report did not indicate that CFMC should have this responsibility. However, based on draft Chapter 15 of RMDS 2550D, CFMC has overall responsibility for maintaining and ensuring the accuracy of special accounts. Therefore, we believe CFMC should review accounts periodically to determine if any accounts appear to be ready for closure and notify the regions of such accounts. This is especially true for accounts with interest-only balances. The regions can then make the final decision as to whether accounts should be closed and the balances deposited to the Trust Fund.*

d. Special Account Balances Are Not Received Or Reconciled By Appropriate Regional Staff. The July 1998 Special Accounts reports were not produced and September 1998 Special Accounts reports were delayed. In November 1998, these reports were distributed by CFMC to regional and Headquarters staff via e-mail. In the specific case of Region IV cited in the audit, CFMC discussed the issue of non receipt of this report with the Comptroller in Region IV and was advised that the reports were received. When the Region IV Comptroller informed the OIG staff that they had received their reports, this issue should have been resolved at that time.

Concerning the general distribution of these reports, CFMC reviews their distribution list on an ongoing basis to ensure that the reports are being disseminated to the proper individuals and offices. For example, CFMC recently added OECA to this list. These reports are correctly disseminated and are being used by the regions to reconcile their accounting.

OIG Comments: *The July 1998 Special Accounts status report was produced. We were provided a copy of the report during our fieldwork. However, no evidence was found that the report was ever distributed to the regions for reconciliation purposes. We were told subsequent to our fieldwork at CFMC and Region 4 that, contrary to initial statements by Regional personnel, the status report issued in November 1998 was received by the Region 4 Comptroller. The final report was changed to reflect that the November status report was received by Region 4. However, there is still no evidence that appropriate Region 4 RPMs and other responsible*

parties were provided a copy of the report. Furthermore, the report was two months late. The report is supposed to be issued in September each year so regional personnel can determine the amount of reimbursable authority to request for the coming fiscal year. However, a report issued in November does not serve this purpose.

OCFO indicates that CFMC reviews its distribution lists for the special account status reports on an ongoing basis and knows that regions are using the reports to reconcile their special accounts. We found no evidence during the fieldwork that CFMC was updating their distribution list. It took CFMC personnel a significant amount of time to find the list and make us a copy of the list. In addition, CFMC did not receive a confirmation from regions on status report reconciliations. Therefore, we do not know how CFMC can be sure that regions were properly using the status reports.

3. Settlement Documents Did Not Always Clearly Delineate Between Past and Future Costs

OECA will respond separately to this finding.

4. Data Provided in the Annual and Superfund Highlight Report is Misleading

OECA will respond separately to this finding.

OCFO RECOMMENDATIONS

1. Expedite the approval and issuance of the RMDS 2550D, Chapter 15.

Response: We agree with the OIG's recommendation. The Financial Management Division (FMD) circulated Chapter 15 last year for Agency-wide review and comment under the *Directives Clearance Process*. Comments were received and subsequently incorporated into the draft, but the document was never published due to ongoing discussions between all of the appropriate offices concerning the need for past and future cost delineation language in settlement agreements. When an agreement is reached on this issue, FMD will work with OECA to determine how Chapter 15 should be amended. Once Chapter 15 is revised, it must be reissued under the *Directives Clearance Process* for review and comment before it can be published.

2. Require CFMC to reconcile the special account data base with the IFMS and make appropriate adjustments to IFMS on a monthly basis. In addition, a monthly review of special accounts should be made for the purpose of detecting regional accounting errors.

Response: We agree with the OIG that the Special Accounts data base should be reconciled to IFMS. However, we take exception to the frequency for preparing these reconciliations and making IFMS adjustments. CFMC has begun the task of reconciling the data base to the general ledger and expects the reconciliation to be completed by the end of FY 1999. Beginning in FY 2000, CFMC will reconcile these systems quarterly and provide reports to the regions.

In regard to the second recommendation, concerning monthly reviews to detect regional accounting errors, we must reiterate that CFMC is not responsible for detecting regional errors. The regions are responsible for both detecting and correcting their own errors as stated in paragraph 1.c. of this document. CFMC will notify, however, the respective regions of any errors detected as they compile their Special Accounts data base report and perform their quarterly reconciliations to the general ledger.

3. *Instruct CFMC to post earned interest to the IFMS on a monthly basis.*

Response: We agree with the OIG's recommendation, but take exception to the frequency for posting interest due to delays in receiving Treasury's monthly income statement and balance sheet. The Program and Cost Accounting Branch (PCAB), FMD, uses these reports to calculate the monthly Special Account interest rate. These delays prevent CFMC from posting interest to individual Special Accounts on a monthly basis.

Given that the recording of interest for these accounts is complex, and the process at this point is partially manual and labor intensive, CFMC is developing a more reliable automated system so updates can be made efficiently and more frequently. Once the automation effort is complete, CFMC will be able to post interest on a quarterly basis. As previously mentioned, interest postings will always be for the accounting period ending two months prior because of the lag time in determining the monthly interest rate.

After reviewing the draft policy provided in RMDS 2550D, Chapter 15 concerning the monthly posting of interest, we have decided to change the policy to require a quarterly posting. This change will be reflected in the new proposed policy. By taking this action, we will be able to align the reconciliation of the accounts, the posting of interest, and the production of reports to a quarterly basis. We firmly believe this action will provide the regions with additional opportunities to reconcile their accounts and improve management controls.

4. *Require CFMC to distribute special account status reports to RPOs and/or RPMs for each site or request that regions provide a copy to the applicable RPMs.*

Response: We agree with the OIG's recommendation that the regions provide copies of Special Accounts status reports to RPMs and will instruct the regions to ensure appropriate distribution as part of our cover e-mail sent with the reports. Because of the current number of Special Accounts and related sites, sending this information to individual RPMs as well as to current recipients would create additional work for CFMC and is not an effective use of CFMC's limited resources. CFMC is currently transmitting an adequate number of Special Accounts status reports to appropriate regional management staff. Therefore, the regional recipients of these reports should be responsible for distributing them within their regions to RPMs and other staff needing this information. OECA also forwards copies of the reports to their Special Account contacts in the Regional Program Offices. The regional Special Account contacts can provide copies of these reports to the RPMs as required.

5. *Require Regions to confirm reconciliation of their special account balances to the CFMC at least annually.*

Response: We agree with the OIG's recommendation. When CFMC transmits the Special Account reports, the regions are advised in the cover memo to review the reports carefully and to notify CFMC if they detect any discrepancies between their accounting data and CFMC's information. Beginning in FY 2000, these reports will be provided to the regions on a quarterly basis which will give them additional opportunities to detect discrepancies. In addition, the cover memo for the year end report will instruct the regions to reconcile their accounting records with this report as part of their year end close out process.

6. *Request that Regions report on the status and proposed use of each account on an annual basis. This report should include estimates of disbursements from the accounts and the reasons for these anticipated disbursements.*

Response: We disagree with the OIG's recommendation that additional reporting requirements are needed. Further, the OIG has failed to indicate where or to whom this report should be directed. As discussed earlier, using Special Accounts funds is basically no different than using appropriated funds. The only difference between the two is that Special Account funds must be matched with corresponding amounts of reimbursable authority, issued by the Headquarter's Annual Planning and Budget Division (APBD), before they can be used. When the regions request reimbursable authority to establish a new Special Account or at the beginning of a new fiscal year, the Regional Program Office must estimate, similar to an outlay plan, the amount of reimbursable authority required for the fiscal year. Once the estimate has been made, the region will complete a Reprogramming Request form for the amount requested broken down by budget object class codes. The completed form is then transmitted to the APBD for approval and processing. Once APBD approves the request, reimbursable authority is issued to the requesting office in accordance with the Reprogramming Request.

7. *Require CFMC to establish a process for identifying accounts with interest only balances, notifying regions of these balances, and closing these accounts where appropriate.*

Response: We disagree with the OIG's recommendation. As discussed in paragraph 2.c. of the of this document, the regions are responsible for administering their own Special Accounts and for determining when work at a site is complete and the Special Account can be closed. Further, having interest only balances in Special Accounts does not mean that work at related sites is complete and the accounts can be closed. In CFMC's e-mail which accompanies their report, they will advise the regions of Special Accounts having interest only balances and request they pay special attention to these accounts. CFMC, however, lacks the knowledge required to close these accounts. Consequently, CFMC would have to consult the respective region first to determine if a Special Account can be closed.

8. *Set a minimum dollar limit for establishing special accounts.*

Response: We partially agree with the OIG's recommendation. Please see paragraph 2.a. of this document for further clarification.

OECA RECOMMENDATIONS

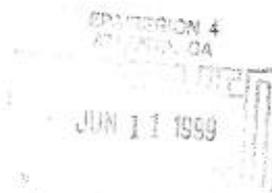
The four OECA recommendations provided in this report will be addressed separately by OECA.

(This page intentionally left blank.)

OECA Response to Draft Audit Report E1SFB8-04-0015
Superfund Special Accounts
April 1999 Draft Audit Report



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
 WASHINGTON, D.C. 20460

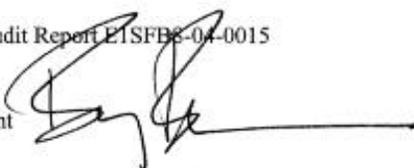


OFFICE OF
 ENFORCEMENT AND
 COMPLIANCE ASSURANCE

JUN 4 1999

MEMORANDUM

SUBJECT: Superfund Special Accounts - Draft Audit Report E1SFB8-04-0015

FROM: Barry Breen, Director
 Office of Site Remediation Enforcement 

TO: Michael Simmons
 Deputy Assistant Inspector General
 for Internal Audits

Attached to this memorandum is the Office of Enforcement and Compliance Assurance (OECA) response to the draft audit report regarding administration of Superfund special accounts prepared by the Office of Inspector General. Thank you for providing us with the opportunity to review and comment on this document.

The draft report makes recommendations to both the Office of the Chief Financial Officer (OCFO) and OECA. This response only addresses matters relevant to OECA. I understand that OCFO will be providing comments under separate cover.

Please note that OECA issued the "Interim Final Guidance on Disbursement of Funds from EPA Special Accounts to CERCLA Potentially Responsible Parties" on November 3, 1998. This guidance addresses the circumstances under which a PRP may receive funds, timing and amount of disbursements, and disposition of special account proceeds after completion of the response action. Attached to this memorandum is a copy of that guidance.

If you have any questions concerning our response, please contact me or Sandra Connors, Director, Regional Support Division, at (202) 564-4200.

Attachments

We appreciate your review and are pleased that your audit found we are establishing and using special accounts as the special account reform provided. In general, we believe that the authority provided in section 122(b)(3) of CERCLA provides the Agency with great discretion on the establishment and use of special accounts for fund-lead or enforcement-lead actions. The decision to establish, maintain and disburse funds from a special account is made based on site-specific considerations, including: the amount of money received, the expected past and future remedy costs, whether a potentially responsible party (PRP) has agreed to perform work under a settlement, and the site risks.

A few of the areas where you have identified concerns are the result of our preference to retain money in special accounts to deal with the various unknowns that may exist at a site. Typically, special account funds are collected through early cash-out settlements. The money is placed in a special account often well before a remedy has been selected and prior to knowing whether PRPs will perform work at the site. Maintaining proceeds in the special account allows EPA to be more informed before making decisions regarding how special account funds should be used to secure or facilitate cleanup. It keeps the funds available for use as an incentive for PRPs to settle when we negotiate for performance of work, as leverage to ensure that a PRP performs the work required under an order, or for an EPA-lead cleanup (preserving Trust Fund money for other sites). EPA may choose to disburse special account funds to a PRP prior to addressing EPA past costs, perhaps because there are other PRPs to pursue for such costs. Even when EPA agrees to disburse special account funds to a PRP, EPA will retain a certain amount to address the remaining risks at the site; after site risks are adequately resolved, any remaining special account funds can be transferred to the Trust Fund.

As a result, EPA has not directed the regions to spend all of the money in a special account prior to accessing appropriated funds. While it may make sense in some cases to use the special account money first, making that the rule would inappropriately limit EPA's flexibility to use the funds as a settlement incentive or to reserve them for potential risks remaining at the site.

AUDIT FINDINGS

Regions Are Not Using Available Special Account Balances Efficiently

Special Accounts Are Established With Minimal Funds. In determining whether to establish a special account several factors are considered, including: whether a PRP has agreed to perform the response action, anticipated future work, remaining risks at the site, and potential for additional settlements. Generally, a special account should be established only when it is cost effective to do so. However, there may be reason to establish an account with a small amount. For example, at the site where a special account was established for \$100, the Region is working on additional settlements where funds received will be placed in the same special account.

This issue highlights each site's fact specific nature concerning the establishment and use of special accounts. As the OIG has noted, this is an area which is undergoing significant growth. As we gain more experience with special accounts more uniform practices will become more apparent, and will achieve greater consistency.

***OIG Comments:** The special account established with a \$100 balance was almost three years old at the time of our review. No evidence was found during the audit that indicated that additional payments were forthcoming or would be deposited to this account.*

Special Account Funds Are Not Being Utilized. Special account funds are being used. As of October 1998, approximately 38% of the principal and interest in special accounts has either been disbursed or is obligated for disbursement. As most special accounts have been established in the past few years, we believe the regional use of special accounts is logical and appropriate. There are good reasons for maintaining settlement funds in a special account for a significant period of time. For example, funds received prior to performance of work cannot be disbursed until work commences (e.g., this is often the case for funds received from an early *de minimis* settlement). In other situations, where a PRP is performing a remedy pursuant to a unilateral order, funds are maintained in the special account in case the party does not comply with the order or to provide immediate access to funds in the event of a work takeover by the Agency.

Your findings also address the consistency of special account use by our regional offices. Evaluating consistency in this context is not meaningful. Timing for disbursement from a special account to a PRP or the Trust Fund is a site-specific determination and is governed by the terms of the settlement documents. Factors to consider in establishing a disbursement plan include what stage of cleanup a site (or operable unit) is in, whether PRPs are performing the work, whether there are other operable units, and whether there are unreimbursed costs.

***OIG Comments:** The special accounts specifically referred to in the draft report were 3 to 4 years old and none of the balances had been used. Therefore, the finding does not relate specifically to non-use of new accounts. Thirty-eight percent disbursed on an EPA-wide basis gives the appearance that special accounts are being substantially used to pay site costs. However, an analysis on a region by region basis, shows that some regions are not using special accounts at all while other regions are disbursing the funds almost immediately upon establishment of the special account.*

Settlement Documents Did Not Always Clearly Delineate Between Past and Future Costs

Pursuant to Section 9507(b) of the Internal Revenue Code of 1986, 26 U.S.C. §9507(b), amounts recovered by EPA on behalf of the Hazardous Substance Superfund (Trust Fund) are deposited in the Trust Fund. Section 122(b)(3) of CERCLA is an exception to the general rule, by allowing the Agency to retain and use settlement funds for response actions at the site. As a matter of law, the Office of General Counsel has opined that both past and future costs received in settlement may be placed in a special account.

Current EPA guidance, however, suggests that Regions identify in the settlement document how much of the settlement proceeds will be put in the Trust Fund and how much will be put in a special account. Because some settlements occurred prior to guidance being issued, regions have looked to supporting documents (e.g., 10-point settlement analysis) for allocating payments between the Trust Fund and special account.

The Agency is revisiting the issue of specifying at the time of the initial cashout how much of the settlement funds related to past costs should be deposited in the Trust Fund. EPA believes that it may be appropriate to place all of the initial cashout proceeds in a special account at the time of settlement and make decisions later about the amount to transfer to the Trust Fund when there is greater certainty about who will be responsible for response actions and future risks. Transfers of funds from the special account to the Trust Fund could occur at any point in the cleanup process depending on the risks remaining at the site. When special account funds are no longer needed to address site-specific response actions, the remaining money can be transferred to the Trust Fund to reimburse the Agency for past costs.

***OIG Comments:** OECA received an OGC opinion in March 1999, subsequent to our fieldwork, that indicated that there was a legal basis for the Agency retaining cost recovery payments. Prior to March 1999, the Agency's practice had been that cost recoveries were to be deposited to the Trust Fund. Hence, the current EPA policy that specifically requires that PRP payments for past and future costs be specifically identified in consent decrees and other settlement documents to preclude inconsistency with CERCLA requirements. The March 1999 OGC opinion was based primarily upon a new interpretation of CERCLA Section 122(b)(3) and a 1998 congressional conference report on EPA's FY 1999 appropriations act which indicated that EPA is entitled to a reasonable retention of special account funds received for past and future response costs.*

Data Provided in the Annual and Superfund Highlight Report is Misleading

Information provided in the FY 1997 annual report on the balance in the special accounts was potentially misleading. As the OIG report correctly points out, the amount shown was the total placed in special accounts plus the interest earned, not the balance available for disbursement. The FY1998 annual report correctly reported the total amount received in special accounts plus interest. We agree that disbursement information should also be included in our annual report highlights to provide a clearer picture of how much money is available in the special accounts.

RECOMMENDATIONS

1. *Instruct regional staff responsible for the day to day activities of overseeing site cleanups, on the existence, purpose and usage of special accounts related to their sites.*

OSRE and OCFO have undertaken and continue to undertake significant steps to disseminate information concerning the establishment and use of special accounts. Guidance includes: the March 27, 1996, updated on February 7, 1997, memoranda on special account establishment, maintenance and use; the draft Chapter 15 on financial management of cashout special accounts; and the November 1998 "Interim Final Guidance on Disbursement of Funds From EPA Special Accounts to CERCLA Potentially Responsible Parties," which provides direction to Regions on disbursing funds from special accounts to PRPs who undertake response actions at Superfund sites under a settlement agreement.

OECA has identified Regional Special Account Contacts who disseminate Special Account information to their regional colleagues and participate in a monthly conference call to discuss emerging issues. During the OECA Regional Evaluations, OECA staff met with the Regional Special Account Contacts to discuss the Region's implementation of this reform. In all these contacts, appropriate disbursements from special accounts is emphasized.

OECA also provides the Special Account Implementation Notebook and its periodic updates to the Office Director and the Center Directors in the Office of Emergency and Remedial Response to ensure they are aware of these accounts. Finally, when regional offices request Trust Fund money to finance response actions from the National Prioritization Panel, a cross-check is done at Headquarters on the availability of special account funds before appropriated funds are approved.

OECA and OCFO will work with the regions to specifically ensure that Regional Finance Offices are sharing information with the regional Superfund program offices regarding the status of special account funds available for their sites.

2. Remind regions that special accounts are to be used for all site costs, including direct and indirect oversight costs, unless otherwise restricted by the settlement agreements.

We agree that special account funds may be used to conduct or finance response actions at a site. However, we believe that we will be able to make better decisions regarding what specific site costs the special account funds should be used for at certain critical decision points in the remediation process. For example, once we have an agreement to do all of the site work, decisions regarding reimbursing our past costs will be more appropriately made. Or, if the remedy is innovative, retaining more funds for future oversight, including 5-year remedy reviews, may make sense. Again, how special account money is used is appropriately based on site-specific factors, some of which are not known until later in the remediation process.

3. Ensure that special account settlement agreements clearly define past versus future costs, identify the cutoff date between past and future costs, and clearly disclose terms for usage of the special accounts to be established.

OSRE disagrees with the recommendation. The current Agency language is sufficient to delineate the use of special account funds while providing flexibility to address unknown conditions. Model settlement language provides that the special account will be "used to conduct or finance the response action at or in connection with the Site. Any balance remaining in the special account shall be transferred by EPA to the EPA Hazardous Substance Superfund." The model language is clear that the funds can only be used for response actions related to the facility. It also addresses the final disposition of funds. However, flexibility is necessary because it may be unclear at the time of settlement who will be performing the response action, whether special account funds will be used to reimburse past costs or fund future oversight costs, or used to address emergency or other types of response actions. This flexibility in the use of the funds is critical to insuring that funds are available to address site-specific issues or circumstances.

4. *Include special account disbursement information in the Superfund annual reports on program highlights and reforms.*

We agree with this recommendation.

REPORT DISTRIBUTION

Office of Inspector General

Inspector General (2410)
Assistant Inspector General for Audit (2421)
Deputy Assistant Inspector General for Internal Audits (2421)
Headquarters Audit Liaison (2421)
Divisional Inspectors General for Audit

EPA Headquarters Offices

Chief Financial Officer
Assistant Administrator for Enforcement and Compliance Assurance (5101)
Comptroller (2731)
Director, Financial Management Division (2733F)
Agency Followup Official (2710)
Agency Followup Coordinator (2724)
Director, Regional Operations (1108)

Region 4

Regional Administrator
Assistant Regional Administrator
Director, Waste Management Division
Comptroller
Regional Counsel
Audit Liaison