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

APR 30 2007

ASSISTANT ADMINISTRATOR
FOR ENFORCEMENT AND
COMPLIANCE ASSURANCE

MEMORANDUM

SUBJECT: Issuance of "Audit Policy: Frequently Asked Questions" (2007)

FROM: Granta Y. Nakayama

TO: Regional Administrators

It has been more than ten years since EPA began offering compliance incentives through the Audit Policy.[1] Over the course of the implementation of the Audit Policy, over 4,000 entities have discovered and disclosed violations at more than 11,300 facilities (through FY 2006). Seven years ago, EPA issued a revised Audit Policy following extensive outreach and stakeholder input.

Today, I am issuing the "Audit Policy: Frequently Asked Questions," a series of questions and answers designed to further aid EPA in implementing, and the regulated community in using, the Audit Policy. This document highlights interpretations of the Policy that have arisen in recent years and responds to requests for clarification by the regulated community; it is intended to supplement EPA's "Audit Policy Interpretive Guidance" (January 15, 1997).

As part of the Agency's Strategic Plan, EPA has set a FY 2011 goal of increasing the number of facilities that use EPA incentive policies to conduct environmental audits or take other actions that reduce, treat, or eliminate pollution or improve environmental management practices. Additionally, EPA's FY 2008 Annual Performance Plan and Congressional Justification (EPA's Budget) sets a target to reduce, treat, or eliminate 400,000 pounds of pollutants as a result of audit agreements. The Office of Enforcement and Compliance Assurance (OECA) anticipates that clarification of the Audit Policy will help to achieve EPA's Strategic Plan goals, as well as yield increased pollutant reductions through the resolution of Audit Policy disclosures.

[1] Formally entitled as the policy on "Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations," 65 Fed. Reg. 19,618 (April 11, 2000), the 2000 Policy revised the original, issued in 1995 (60 Fed. Reg. 66,706 (December 22, 1995) and effective January 22, 1996).

In recognition of the numerous acquisitions occurring within the regulated community today, I am identifying *new owners* as an opportunity to meet OECA goals related to the use of the Audit Policy. The Frequently Asked Questions document recognizes owners of newly acquired facilities as uniquely situated to examine and improve performance at newly acquired facilities. Specifically, the answers to the questions posed provide that:

**** Violations discovered at newly acquired facilities as part of the new owner's re-examination of facility compliance under Title V of the Clean Air Act are considered voluntarily discovered for purposes of the Audit Policy provided the owner notifies EPA prior to submission of its first annual compliance certification. (Question 2);***

**** New owners may be eligible for penalty mitigation under the Audit Policy for violations at newly acquired facilities irrespective of the disclosing entity's compliance history (Question 5); and***

**** EPA is committed to examining the appropriate assessment of economic benefit in the acquisitions context. In the near future, EPA intends to seek public comment on whether the Agency should offer tailored incentives to new owners that self-disclose violations pursuant to the Audit Policy. (Question 9)***

In addition to recognizing new owners, I want to encourage regulated entities interested in assessing and maintaining compliance with federal environmental requirements to enter into *corporate-wide auditing agreements* with EPA. Corporate-wide auditing agreements provide an advance understanding between EPA and the entity regarding audit and disclosure schedules, and other aspects of Audit Policy conditions. Such agreements may help to eliminate redundancies by consolidating transactions, provide additional time to determine whether suspected violations have occurred or are occurring, and maximize penalty certainty.

EPA is committed to working with entities interested in proactively managing their facilities and operations to correct violations with minimized costs or risks. I encourage you to assist the regulated entities to avail themselves of the incentives offered under EPA's Audit Policy.

I very much appreciate the efforts of the Audit Policy Coordination Team (ACT) in developing this Guidance. If you have questions regarding the Audit Policy: Frequently Asked Questions, you may contact Phil Milton at (202) 564-5029 or milton.philip@epa.gov. This document may be found on EPA's Audit Policy webpage at http://www.epa.gov/compliance/incentives/auditing/auditpolicy.html.

Attachment

cc: OECA Office Directors
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Audit Policy Coordination Team

**Audit Policy Coordination Team (ACT)**

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# Audit Policy: Frequently Asked Questions

April 2007

Office of Civil Enforcement
Office of Enforcement and Compliance Assurance
U.S. Environmental Protection Agency
Washington, D.C.

Explanatory Note

This document was prepared by EPA's Audit Policy Coordination Team (ACT). The ACT is chaired by the Office of Civil Enforcement, and it is charged with making fair and nationally consistent recommendations concerning the applicability of the April 11, 2000 policy on "Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations" (referred to in this document as the Audit Policy).

The "Audit Policy: Frequently Asked Questions" highlights policy interpretations that have arisen in the Audit Program in recent years and responds to requests for clarification by the regulated community; it is intended to supplement EPA's "Audit Policy Interpretive Guidance" (January 15, 1997) (referred to as the 1997 Guidance). This frequently asked questions document, presented as a series of Questions and Answers (Qs and As), is intended to aid in implementation of the Audit Policy. It includes discussion of many of the most significant issues raised to the ACT's attention. The ACT welcomes comments on this document, and on additional interpretive issues that may be appropriate for resolution in future guidance. A list of ACT members is provided in the cover memo to this document.

This document provides information about how the Agency exercises its enforcement discretion. It is not final agency action and it does not create any rights, duties, obligations, or defenses, implied or otherwise, in any third parties.

This document can be found on the Internet at http://www.epa.gov/compliance/incentives/auditing/auditpolicy.html. Revisions or additions to this document also will be made publicly available at the internet.

# Audit Policy: Frequently Asked Questions

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**Q1:** ***What revisions were made to the original Audit Policy when EPA revised the Audit Policy in April 2000?***

**A1:** After a two-year evaluation, EPA revised the Audit Policy based on extensive public outreach and the Agency's experience in handling self-disclosure cases. Key revisions to the Audit Policy included: (1) lengthening the amount of time from 10 to 21 days that entities have to disclose a violation after it is discovered; (2) clarifying that a facility may qualify for Audit Policy credit even if another facility owned or operated by the same parent organization is already the subject of an inspection, investigation or information request; (3) clarifying that entities will have at least 21 days after acquisition to disclose violations discovered at newly acquired facilities; and (4) clarifying that repeat violations will not disqualify newly acquired facilities for Audit Policy credit if the violations existed prior to acquisition. See 65 Fed. Reg. 19618, 19623 (April 11, 2000).

**Q2:** ***To meet Condition 2 of EPA's Audit Policy, disclosed violations should be discovered "voluntarily." Are there circumstances in which violations discovered during the Clean Air Act (CAA) Title V permit application and annual compliance certifications could be eligible for penalty relief under the Policy?***

**A2**: Generally, CAA violations discovered during activities supporting Title V certification requirements are not eligible for penalty mitigation under the Policy. The regulations implementing the Title V permit program (40 C.F.R. § 70.5) establish a legal duty for permit holders to analyze comprehensively the source's compliance status and certify annually as to CAA compliance. Condition 2 of the Audit Policy requires that disclosed violations must not be discovered through a legally mandated monitoring or sampling requirement prescribed by statute or regulation; therefore, examination of CAA compliance accompanying a Title V annual certification is not voluntary.

In 1999, EPA clarified that in some instances, certain CAA violations discovered, disclosed, and corrected by a company *prior* to issuance of a Title V permit may be eligible for penalty mitigation (see "Reduced Penalties for Disclosures of Certain Clean Air Act Violations," dated September 30, 1999, http://www.epa.gov/compliance/resources/policies/incentives/auditing/caa-tit.pdf). The 1999 memorandum states that the Policy may apply where a company "(a) reviews its prior decision regarding the application of New Source Review (NSR) and Prevention of Significant Deterioration (PSD) requirements that was made in good faith and (b) discloses to EPA a violation discovered through such a review and agrees to correct it prior to Title V permit issuance, and (c) otherwise meets conditions 3 through 9 of the Audit Policy."

Since issuance of the 1999 memorandum, EPA has considered whether CAA violations discovered by a new owner during a compliance examination conducted subsequent to permit issuance, but prior to submission of the first Title V annual certification following acquisition, could be considered eligible for penalty mitigation under the Policy. EPA wants to encourage new owners to re-examine facility compliance and facility operations, correct violations and upgrade deficient equipment and practices. Thus, for new owners that in good faith undertake such efforts and inform the Agency of such actions, either by disclosure in writing or entry into

an Audit Agreement, prior to submission of its first annual Title V certification, the violations disclosed would be considered voluntarily discovered for purposes of the Audit Policy. In creating an opportunity for new owners to use the Audit Policy for violations discovered during compliance examinations, EPA is not attempting to define "reasonable inquiry"[1] or suggest that sources are not under obligation to disclose CAA violations detected while a Title V permit is pending or during annual certification after permit issuance. For instance, nothing within the opportunities afforded through the Audit Policy relieves a source of the ongoing obligation to comply with PSD/NSR requirements. Rather, to encourage further assessment of the compliance status of operations with which a new owner may have limited familiarity and to encourage the disclosure and correction of violations and improvement in operations at the facility, EPA is clarifying that a new owner can potentially use the Audit Policy up until the first Title V annual certification due date.

The following are examples of disclosures which EPA would consider to meet the voluntary discovery condition of the Audit Policy, if disclosed prior to the first Title V certification due date: a new owner discovers and discloses a CAA violation at a recently acquired Title V source (*e.g.*, the prior owner had relied on inaccurate calculations and/or used an incorrect formula to make its Title V certifications, or the prior owner failed to apply for a Title V permit). Such a discovery after purchase could have resulted from re-examination of in-house documentation and/or observation of daily operations. Another example may be where a new owner discovers that a gauge relied upon by the prior owner to establish or maintain operating parameters was not properly calibrated.

EPA will consider violations such as these on a case-by-case basis to ensure that the disclosing entity is a "new owner" and qualifies for consideration under the Audit Policy. In addition, in these situations, as with all Audit Policy disclosures, if a particular disclosure does not qualify for credit under the Audit Policy, it may still be eligible for penalty mitigation pursuant to the applicable enforcement response or penalty policy.

**Q3:** ***To meet Condition 5 of EPA's Audit Policy, an entity must correct and remediate a violation within 60 days of date of discovery. Are there instances in which the 60-day correction period may be extended? What happens when correction is not possible?***

**A3**: The Audit Policy requires that violations be corrected within 60 days of discovery. However, EPA recognizes that not all violations can be corrected within that time frame. EPA may allow an extension for corrections that require significant expenditures, involve technically complex issues, or involve decisions for which an entity seeks or is required to obtain EPA or State input or approval. As stated in the Audit Policy (65 Fed. Reg. at 19626), if more than 60 days will be required for correction, an entity must notify EPA in writing prior to the conclusion

[1] Under the regulations governing Title V permit applications and annual compliance certifications, any application form, report or compliance certification is required to contain a certification by a responsible official of truth, accuracy, and completeness. The regulations further provide that "[t]his certification and any other certification required under this part shall state that, based on information and belief formed after reasonable inquiry, the statements and information in the document are true, accurate, and complete." 40 CFR § 70.5(d).

of the 60-day period. Examples of instances for which extensions might be sought include corrections involving changes to emissions treatment technology and restoration or replacement of certain containment systems.

Moreover, EPA also recognizes that certain violations that involve parties, facilities, or wastes over which an entity no longer has control (*e.g.*, the transport of hazardous waste without a RCRA manifest) may not in fact be correctable by the entity. In these circumstances, violators will still be eligible for Audit Policy consideration even if the violation cannot be corrected, provided the violator adopts specific and appropriate measures to prevent recurrence and takes any other steps necessary to address the violation (*e.g.*, carrying out any removal or remedial actions required by law).

**Q4:** ***Condition 7 of EPA's Audit Policy excludes violations considered to be repeat violations. The condition includes as repeat violations those disclosed as part of a "corporate pattern." How does EPA interpret the corporate pattern exclusion?***

**A4:** Condition 7 ("No Repeat Violations") of the Audit Policy excludes the situation in which the disclosed violation is the same as or closely related to another violation (or violations) that has occurred "within the past five years as part of a pattern at multiple facilities owned or operated by the same entity." That exclusion is often referred to as the "corporate pattern" exclusion (although it applies to any type of entity). The repeat violation exclusion "ensures that penalties are not waived for those entities that have previously been notified of violations and fail to prevent repeat violations." 65 Fed. Reg. 19618, 19623 (April 11, 2000).

In general terms, the Audit Policy defines a violation as one that is identified by a regulator in a settlement or order, or that has otherwise been the subject of penalty mitigation. The corporate pattern exclusion does not preclude an entity from disclosing numerous violations discovered as part of a single audit. This is because the Agency's analysis in determining whether a "pattern" exists relates more to the nature, timing and context of discovery and disclosure than to the number of violations disclosed at any one time. Thus, for example, an entity could conduct an audit that yields the discovery and disclosure of 40 violations of the same type at numerous facilities. If those violations are discovered as part of one effort and disclosed together, EPA views those violations (as defined in the Policy and discussed in the Preamble) as one disclosure and views them as "one violation" for purposes of evaluating subsequent disclosures for corporate pattern. The reason for this view is that the disclosure and supporting audit represent one time at which the entity became aware (or was put on notice) of noncompliance - whether involving one violation or numerous violations.

Similarly, if an entity discovers violations at one facility and has reason to believe that the same or similar violations exist at other heterogeneous[2] facilities, the corporate pattern prohibition would generally not preclude an entity from disclosing the additional violations sequentially, if

[2] Question 3 of EPA's "Audit Policy Interpretive Guidance" (1997) notes that the Agency will consider disclosures to be untimely where factual inferences can be drawn about other probable violations (*e.g.*, where the violator's operations and practices are homogeneous in nature) and they are not promptly disclosed.

the disclosures are part of a single, comprehensive look at similar violations across all of an entity's facilities. In order to be considered part of a single comprehensive look, entities are encouraged to make use of EPA's corporate auditing agreements, which provide a means of addressing potential noncompliance on a corporate-wide basis. Auditing agreements also allow an entity to plan a corporate-wide audit with an advance understanding between the entity and EPA regarding schedules for conducting the audit and disclosing beyond the 21-day disclosure requirement for single-facility disclosures. For more information, see the September 2000 *Audit Policy Update* Special Issue, "Corporate -Wide Agreements: An Effective Approach for Companies to Improve Environmental Compliance" http://www.epa.gov/compliance/resources/newsletters/incentives/auditupdate/fall2000.pdf and "Use of Corporate Auditing Agreements for Audit Policy Disclosures" (May 7, 2001). Entities disclosing violations at different facilities in more than one EPA Region should make such disclosures to EPA Headquarters.

Some companies have opted not to disclose newly discovered violations following a prior disclosure (or enforcement action) for the same or closely related violations. These companies elect not to disclose a violation, but rather to "save" their use of the Audit Policy for a yet to be discovered "more significant" closely related violation. EPA believes that companies make their decision, at least in part due to uncertainty over whether one or more past violations constitute "a pattern." EPA encourages disclosures as a vehicle for assuring compliance with the nation's environmental laws and evaluates the facts relevant to "corporate pattern" with that objective in mind. EPA will not deny Audit Policy treatment to subsequent violations if the disclosing company has, after being put on notice by its prior disclosure(s) or enforcement action(s), taken appropriate actions to address comprehensively the cause or causes of the previous violations. If a company has taken such actions, and a subsequent violation nevertheless occurs, EPA will not view the subsequent violation as part of a corporate pattern. Accordingly, there is no specific number of prior violations that will automatically exclude a violation from Audit Policy consideration under the corporate pattern exclusion. In the eleven year history of the program, EPA has only invoked the "corporate pattern" bar in a fraction of one percent of all cases. EPA will continue to apply this exclusion narrowly, with national oversight to ensure consistency, and with a goal of encouraging those who violate the law to disclose and correct those violations promptly. It is important to note that disclosures of any sort may be eligible for penalty mitigation, even if the Audit Policy consideration is unavailable.

**Q5:** ***How is a new owner's disclosure of a violation at a newly acquired facility affected by an existing "corporate pattern," established pursuant to Condition 7 ("No Repeat Violations") of the Audit Policy?***

**A5:** Question 15 of EPA's "Audit Policy Interpretive Guidance" (1997) provides that separate entities are considered independently, and applicability of the Audit Policy is based on the merits of each entity's actions. More specifically, the 1997 Guidance states that a previous owner/ operator's actions will not be imputed to the successor. That guidance does not address the impact of the successor's history of violations on the applicability of the Audit Policy with respect to the successor's newly acquired facility.

EPA generally considers successors that undertake examinations of newly acquired facilities to be eligible *irrespective of* the successor's history of violations at other facilities. EPA's primary interest is to encourage newly acquired facilities to undergo a comprehensive examination of and improvements to its environmental compliance and management systems. Notwithstanding a successor's history of violations at their other facilities, if its efforts to examine and improve upon an acquired facility's environmental operations are thorough and are likely to result in improved compliance, EPA's intent is to encourage such examinations.

**Q6:** ***Condition 8 of EPA's Audit Policy excludes violations that result in serious actual harm to the environment or which may have presented an imminent and substantial endangerment to public health or the environment. How does EPA interpret this condition*****?**

**A6:** Although many environmental violations involve the release of pollutants, such violations do not necessarily result in serious actual harm or present an imminent and substantial endangerment. In the context of EPA's Audit Program, EPA takes a case-by-case approach and has rarely excluded disclosures on this basis. Of the nearly 3,500 disclosures to EPA made to date, EPA is aware of only two instances in which the Agency denied Audit Policy credit based on serious actual harm or an imminent and substantial endangerment. One of those instances involved a release that required community evacuation of the surrounding area; the other instance involved the death of an employee.

**Q7:** ***Condition 9 of EPA's Audit Policy provides that an entity seeking penalty mitigation under the Policy must cooperate "as required" by EPA. Does that condition mean that those entities that have litigated against EPA in the past on other matters are precluded from using the Policy? What about entities with ongoing disputes with EPA on other matters?***

**A7**: EPA considers Condition 9 solely in the context of EPA's consideration and resolution of disclosures made pursuant to the Audit Policy. EPA's Audit Program is a transactional one, meaning that the nature and the extent of the disclosure determines the scope of the transaction (and federal relief granted mirrors that scope), in that the relief granted is limited to the facts specific to the disclosure. With respect to this condition, EPA looks only to whether an entity cooperated with the Agency in the Agency's consideration of the entity's request for treatment under the Audit Policy; not whether the entity has cooperated with the Agency in past matters or whether the entity is in litigation with the Agency on other matters.

Also, where conditions of the Audit Policy require specific consideration of prior or ongoing enforcement activity (*e.g.*, Condition 4: Discovery and Disclosure Independent of Government of Third-Party Plaintiff, or Condition 7: No Repeat Violations), such consideration is narrowly tailored for the purposes of that condition only.

Because one public benefit of the Audit Policy is the potential for conserving government resources, excessive delay or non-responsiveness by an entity is one indicator of limited cooperation. EPA may determine that an entity has not been responsive, timely, or open within the context of the disclosure transaction and may deny credit on that basis.

**Q8:** ***Should a disclosure be made to the U.S. EPA, or the State in which the violation occurred?***

**A8**: Whether an entity should make a disclosure to EPA, the State, or both, depends on the type of regulation violated, availability of a State audit program, and the scope of legal relief sought by the entity. The answer is based, in part, on what the entity aims to achieve.

For violations of federal laws for which no State authorized program exists (*e.g.*, the Emergency Planning and Community Right to Know Act), because a State possesses no legal authority to resolve violations under those statutes, disclosures should be made to EPA. For violations of federal statutes for which a State-authorized program exists (*e.g.*, the Clean Water Act), an entity may choose to disclose to either regulator or both; however, if a resolution of the federal claim for that violation is desired, disclosure to EPA is the only means to secure it.

For States with audit programs that reflect the incentives and conditions contained in EPA's Audit Policy, EPA develops reciprocal agreements between an EPA Regional Office and a State. Such agreements typically establish an understanding that, although each agency maintains its sovereign legal authorities, each generally intends to defer to the other's resolution of disclosed violations. For entities not seeking a federal resolution with respect to the claim, this arrangement may provide enough assurance that it deems a disclosure to EPA unnecessary. Parties should inquire with the relevant Region or State for more information.

**Q9:** ***EPA's Audit Policy waives 100% of gravity-based penalties for disclosed violations that meet the nine conditions of the Policy. The Policy states that EPA retains discretion to recover any economic benefit gained as a result of noncompliance. How does EPA exercise that discretion?***

**A9**: EPA's general commitment to recapture economic benefit assures more widespread compliance with the law by reducing the incentive to avoid or postpone compliance. A violator generally derives economic benefit by investing the money that should have been spent on compliance. Assessment of economic benefit serves to level the playing field among law-abiding entities and those that have obtained an economic benefit from their noncompliance.

EPA recognizes that there may be circumstances in which recapturing economic benefit is neither efficient nor appropriate. As stated in the Audit Policy, EPA may forgive the entire penalty for violations that meet all of the conditions of the Policy and, in the Agency's opinion, "do not merit any penalty due to the insignificant amount of any economic benefit." 65 Fed. Reg. 19618, 19626 (April 11, 2000). In resolving disclosures made under the Audit Policy, EPA generally defers to the relevant program penalty policies (available at http://www.epa.gov/compliance/resources/policies/civil/index.html) governing the statutory or regulatory requirement at issue. Many of EPA's penalty policies establish *de minimis* penalty amounts under which collection is not routinely sought because of the resource demands that would be assumed by the Agency. Indeed, many disclosures involve recordkeeping and reporting violations which, unless numerous violations are disclosed, often do not have significant economic benefit and have thus been resolved without penalty under the Audit Policy.

In addition, it is EPA's intention that settlements under the Audit Policy assess economic benefit after consideration of all factors of settlement. EPA uses its enforcement discretion to assess a benefit amount that is consistent with its overall approach to sector-wide compliance. The central guiding principle underlying decisions regarding assessment of economic benefit in the Audit Policy context is fairness.

Guided by the principle of fairness, EPA is examining the question of whether and to what extent a new owner, in the context of business acquisitions, gains an economic benefit from noncompliance existing at its newly acquired facilities at the time of acquisition. In the near future, EPA intends to seek public comment on whether the Agency should offer tailored incentives to new owners that self-disclose violations pursuant to the Audit Policy. In particular, the Agency is interested in receiving public comment on whether and to what extent to assess economic benefit, if any, for violations at newly acquired facilities disclosed by new owners.

**Q10:** ***What happens if EPA conducts an inspection while an audit is being performed but before disclosure is made pursuant to an Audit Agreement with EPA?***

**A10:** EPA is unaware of any specific instances where inspections were conducted at an entity performing an audit under an audit agreement. If such an EPA inspection did take place and violations were discovered. EPA might allow Audit Policy penalty mitigation for the violations discovered, assuming such violations fell within the scope of the Audit Agreement with EPA.

While EPA may consider a facility known to be auditing to be a lower inspection priority than a facility that is not known to be auditing, whether and when to conduct an inspection does, and should, remain a matter of Agency discretion. If the Agency's inspection or other enforcement authorities were so limited, it could compromise the Agency's ability to respond to citizen complaints or site conditions posing a potentially serious threat to human health or the environment, its ability to assure the public as to the compliance status of a given facility, or provide the appearance that the audit shields an entity from inspection.

Audit Policy consideration in these circumstances would still require that the violation discovered by EPA fall within the scope of the regulated entity's proposed audit. EPA's discovery of such violations through its inspection will not preclude an entity from Audit Policy consideration on the basis on failing to meet Condition 4 – "Discovery and Disclosure Independent of Government or Third Party Plaintiff," provided the date of commencement of the inspection is after the date of the Audit Agreement. If there has not been an audit agreement with or prior notification to EPA, then any violations discovered by EPA during an inspection would not be eligible for Audit Policy mitigation, even if the facility had an on-going audit at the time of the inspection and subsequently disclosed those violations.