

Risk-Based Environmental Auditing at Bulk Fuel Terminals



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Objective

Describe how one company applied risk management principles to upgrade the environmental auditing program, resulting in:

- More efficient, effective, consistent, & thorough program
- Compliance & risk reduction of “hard-to-audit” items
- Cost-effectiveness

Agenda

1. The Traditional Environmental Auditing Program
2. Risk-based Environmental Auditing Program
3. Benefits & Limitations
4. Suggestions & Discussion

A Few Key Terms

- “Risk” = any departure (negative or positive) outside an expected range of results
- “Audit” = any comparison of an “actual” to a “standard”, using a formal process; identifying gaps; enabling Management to close gaps.
- “Compliance” = conformance to any enforceable standard: statutes; laws; regulations; contracts; company policies
- “Facility” = plant, equipment, operations, staff
- “Site” = real property [only]

I. The Traditional Environmental Auditing Program



The Traditional Environmental Auditing Program

Audit Scope includes:

- Laws and regulations
- Permits and permit conditions
- Include (but may fall short on) written plans:
 - SPCC
 - OPA 90
 - Stormwater

Less likely to include:

- Industry standards
- Company policies
- Contracts

The Traditional Way

Or...

Environmental Compliance Audits may include a bunch of “stuff” – and you can’t tell which is which!

*If you want to change something, how can you tell
if you can (company policy) or
if you can’t (regulation)?*

Traditional Environmental Auditing Programs

Program Parameters & Decisions

- Attorney-client privilege
- Staffing: internal, external, or both
- Audit reporting
- Audit findings: agree; close out; verify
- Frequency between audits
- Scoring/ measuring facility performance on audits

Any of these look familiar?

Traditional ECA Programs: Limitations

Traditional ECA programs – and the audits themselves – are a “one size fits all” approach.

- Facilities are different.
 - the extent of regulations
 - their neighborhoods
 - the suppliers
 - the way regulators enforce
 - staffing levels

Traditional ECA Programs: Limitations

What's so bad about tradition?

- Small/ low-risk facilities may be “over-audited”; inefficient use of resources
- Large/ high-profile facilities may be neglected; higher risk of incident
- Facilities have no incentive to improve compliance/ audit performance

Traditional ECA Programs: Limitations

What else can go wrong?

- Items out of scope are enforceable (contract claims)
- Items out of scope pose risk (conformance to industry standard)
- Facilities demoralized, b/c no incentive
- Facilities with poor performance get to “skate” to next audit
- Same/ repeat findings
- No personal/ career growth for auditors or auditees

Traditional ECA Programs: Limitations

What else can go wrong?

- In-house auditors: independence; too familiar w operations, staff, & subject areas
- Does not align with organizations' move towards enterprise risk management (since Enron)
- Incomplete reporting of findings
- Poor follow-up on findings
- Response to Management/ Board inquiry in the event of an incident (“we’ve been doing the same audits for 15 years...”)

2. Risk-Based Environmental Auditing Program



Risk-Based Environmental Auditing Program

Goals of New ECA Program

- Devote more attention to facilities that pose greater risk
- Provide relief from “audit fatigue” for facilities that pose much less risk
- Apply basic auditing principles (independence, audit evidence)
- Increase focus on documents & records (subject of audit, and of the audit activities)
- Report **all** gaps & track them (relentlessly) to closure

Risk-Based Environmental Auditing Program

Goals of New ECA Program

- Provide incentives to facilities with excellent compliance records (“the carrot”)
- Reserve the right to audit at any time (“the stick”)
- Obtain independent perspective, but maximize use of in-house resources
- Create rigorous, “business-class” program at the cost of “coach”

...and, it supports the CEO's Environmental Policy Statement.

Risk-Based Environmental Auditing Program

Applying Risk Management principles to ECAs

- Enterprise Risk Management (ERM) can be done for everything, company-wide
- OR ERM principles can be applied to a business unit, or activity – like ECAs.
- There are several frameworks for ERM principles & techniques (COSO, ISO 31000)
- BUT... you need not be a risk guru to use ERM principles; use “common” sense.

Remember to document, document, document.

Risk-Based Environmental Auditing Program

Getting Started

- Began with issues noted above, and asked “What else could go wrong? What else could be optimized? What do our stakeholders need?”
- Transition from “high-level compliance assessments” to audits:
 - More focus on documents & records
 - Audit training (auditors and auditees)
 - Features of independence
 - Some independent perspective
- Visit facilities on a schedule w/ supported basis

Risk-Based Environmental Auditing Program

This can be done concurrently with a Quality Assurance Review (QAR), which is required by the Institute of Internal Auditors' (IIA) International Professional Practices Framework (IPPF).

This is all standard for companies transitioning to a new or emerging ECA program!

You are in good company!

Risk-Based Environmental Auditing Program

Risk factors for a Facility/Site

- Categorize facilities according to risk factors, including:
- Proximity to sensitive receptors
- Applicability of more regulations (marine terminals, DOT)
- Recent spill or incident at facility or neighbor
- Recent agency enforcement at facility or neighbor

Risk-Based Environmental Auditing Program

Risk factors for a Facility/Site

- Change in Facility Manager, or new Facility Manager
- Turnover in staff
- Changes planned in equipment (new tank, decommissioning tank, tank cleaning)
- Changes in products or services
- Ongoing corrective action

Building the Risk-Based Environmental Auditing Program: Key Steps

- Set default audit interval
- Criteria for deferring or accelerating an audit
- Build audit protocols; features include:
 - Modular approach, by regulatory focus
 - Includes modules for “hard-to-audit” areas (soil & groundwater, standards, contracts)
 - Guidance for auditors
 - Documentation of audit evidence
 - Range of acceptable options for auditor determination
 - Compile audit findings in the field
 - Tie to in-house system for corrective actions

Building the Risk-Based Environmental Auditing Program: Key Steps

- Management system for tracking audit findings to closure
- No audit score; metrics focus on achieving desired state
- Training: auditor and auditee
- Pilot test the new approach
- Quality Assurance of program
 - field procedures
 - annual review
- Audit analytics to improve compliance

3. Benefits & Limitations



Benefits: What the Auditors Say

- *“We spend a LOT more time on this paper stuff!”*
- *“It’s hard not to answer the question for them when I know the answer.”*
- *“After our first 3 or 4 audits, every Facility Manager in the company knew that this was a very different program.”*
- *“I’ve never looked at air quality – it scared me. But now that I’ve audited a couple Title V air permits, it’s not so bad. In fact, now I can help facilities on some air quality issues, in addition to my core expertise.”*

Benefits: What the Auditors Say

- *“I dreaded writing down every little thing I did on the audit; I thought it would be a hassle. It is. But it changed what I did during the audit – and what I found.”*
- *“Looking at things ‘through the eyes of an auditor’, and matching it all up, have made me catch things I didn’t see before. And not just on audits.”*

Benefits: What Facility Managers Say

- *“We try to keep up with this, but there’s so much – and we’re a small staff. If the agency comes in here, we’re outgunned. We appreciate all this attention and ‘tough love’ – after you’ve finished, we know we’re in good shape. And you guys can’t fine us!”*
- *“It’s funny to watch the auditors struggle with all these documents. Because we struggle with them all the time.”*

Benefits:

What Company Senior Management Says

- *(Operations Managers) “I depend on the auditing program to let me know how things are going. My staff is good, but the auditors are my second line of defense. I sleep better at night with this program.”*
- *(General Counsel) “We have a process where we actively look for problems, and the bigger problems can find their way to me fast. I’d rather hear about them from Company staff – and fix them! – than hear about them from someone else.”*

Benefits:

What Company Senior Management Says

- *(VP EHS) “Gaining auditing skills has helped our environmental staff look at everything they do differently. Whenever they apply for a permit, write a plan, or develop training materials, they now ask ‘how would this look to someone else?’”*
- *(Internal Audit) “It has become so important to have documented business process for everything we do in our company – sales, revenue recognition, financial reporting – the works. Environmental is a big issue for us, so compliance and risk management is critical. It’s great to see standard business practices being adopted in this area.”*

Benefits

If it's done well, Senior Management will recognize the value and support it.

Benefits:

What they Say about the Quality Assurance Role

- *“He keeps us honest as auditors.”*
- *“He noted some of the things we do as ‘best practices’; we just thought it was stuff we always did.”*
- *“When Internal Audit, the Board, and investors start asking questions about our environmental compliance, they get a lot of comfort knowing we have this ongoing QA resource.”*
- *“We’re a small department. The QA resource can help us deal with new/ emerging issues, and trends. Examples: Sarbanes-Oxley, accounting rules, and fraud.”*
- *“The comments about my interviewing skills were tough to hear. But they were right. Making a few changes helped at work – and at home.”*
-

Benefits: What the QA Professional Says

- *Many risks have been identified and reduced:*
 - *Delving into documents & recordkeeping*
 - *Auditors not taking things for granted*
 - *Audits of “hard-to-audit” issues*
 - *Deeper dive into written plans*
- *It’s been gratifying to see the professionals get more confident.*
- *When they say “we’re the auditors and we’re here to help you” – they mean it, and the facility managers know it.*

Benefits: What the QA Professional Says

- *Many risks have been identified and reduced:*
 - *Accurate documentation of the audit procedures*
 - *Range of “acceptable options” for auditor opinions means you get the honest answer*
 - *Repeat findings, and system-wide findings*
 - *Skewing audit program resources towards low-risk facilities*

Benefits & Limitations: Costs

- The initial impulse is to compare “version 2.0” to the traditional way, but this ignores substantial improvements.
- The better comparison is “version 2.0” to the costs of doing more of “version 1.0” (example: more frequent audits) and adding audits of non-traditional issues (soil/groundwater, contracts).
- Using this basis, there are qualitative and quantitative advantages to the risk-based approach.

Limitations

Limitations

- Once we saw the benefit, we were anxious to make the transition – and couldn't do it fast enough!
- Others - ???

4. Suggestions for Companies Starting on a Similar Journey



Suggestions for Companies Contemplating Risk-Based Environmental Auditing Programs

- Consider Quality Assurance Review (QAR) first, or concurrent
- Focus on documents & records
- Get third party perspective: from outset & throughout
- Include “hard to audit” issues
- Pilot test the new approach
- Provide incentives to good performers
- Allow time to do it right

Suggestions for Companies Contemplating Risk-Based Environmental Auditing Programs

- Document everything
- Get (and give) feedback on an ongoing basis
- Don't be shy about sharing your successes
- We got from Point A to Point B. Point C is next.

*We're the auditors.
We really are here to help!*

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