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

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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
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.
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

• 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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