



U.S. ENVIRONMENTAL PROTECTION AGENCY

OFFICE OF INSPECTOR GENERAL



The EPA Should Improve Monitoring of Controls in the Renewable Fuel Standard Program

Report No. 13-P-0373

September 5, 2013



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Abbreviations

CAA	Clean Air Act
CFR	Code of Federal Regulations
EISA	Energy Independence and Security Act of 2007
EMTS	EPA Moderated Transaction System
EPA	U.S. Environmental Protection Agency
EPAct	Energy Policy Act of 2005
OECA	Office of Enforcement and Compliance Assurance
OIG	Office of Inspector General
OTAQ	Office of Transportation and Air Quality
QAP	Quality Assurance Plan
RFS	Renewable Fuel Standard
RIN	Renewable Identification Number

Cover photo: Photos taken from the EPA's Renewable Fuel Standard website:
<http://www.epa.gov/otaq/fuels/renewablefuels/>.

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At a Glance

Why We Did This Review

The U.S. Environmental Protection Agency Office of Inspector General conducted an audit of the Renewable Fuel Standard program as a result of millions of dollars of fraudulently generated Renewable Identification Numbers. We sought to determine whether the EPA has assessed program risks and designed necessary controls in the RFS program. RFS program regulations require that independent third parties complete certain reporting requirements.

According to the EPA, the RFS program lays the foundation for achieving significant reductions in greenhouse gas emissions from the use of renewable fuels. The EPA's Office of Air and Radiation listed RFS program implementation as a priority in fiscal year 2013.

This report addresses the following EPA Goals or Cross-Cutting Strategies:

- *Taking action on climate change and improving air quality.*
- *Enforcing environmental laws.*

For further information, contact our Office of Congressional and Public Affairs at (202) 566-2391.

The full report is at:
www.epa.gov/oig/reports/2013/20130905-13-P-0373.pdf

The EPA Should Improve Monitoring of Controls in the Renewable Fuel Standard Program

What We Found

The EPA has worked with external RFS program stakeholders to develop additional controls to reduce fraud in the program. The EPA has assessed risks and implemented a number of control activities in the RFS program through regulations. The main control activities we identified include independent third-party engineering reviews, the EPA Moderated Transaction System, and attest engagements. However, the agency does not meet the control standard for monitoring some of these control activities. The EPA does not track submission of third-party engineering reviews or annual attest engagements because the agency lacks an electronic monitoring system for these reports. Until the EPA tracks submitted materials, the agency cannot be sure that program participants comply with applicable regulations, which affects program integrity and could lead to additional fraud cases. The EPA recently implemented electronic reporting requirements for attest engagements and has stated that it intends to implement electronic reporting for engineering reviews by the end of this year.

We could not determine whether overlap existed in parties completing third-party engineering reviews and attest engagements. Program regulations require that independent third parties complete third-party engineering reviews and attest engagements. Additionally, the EPA's quality assurance program proposed in a new rule would require that independent third parties complete voluntary quality assurance plans to validate RIN generation. Current and proposed regulations do not preclude the same third party from completing multiple requirements as well as other reporting responsibilities for renewable fuel producers or importers, allowing for possible overlap. The EPA does not track and monitor independence, including whether the same party completes multiple reporting requirements for a renewable fuel producer or importer. If the same third party completes multiple reporting requirements, the party could potentially review its own work, which could result in a conflict of interest.

Recommendations and Planned Corrective Actions

We recommend that the Office of Air and Radiation modify existing electronic systems to track the submission of reporting requirements to ensure that all participants comply with applicable RFS program regulations. To assist with tracking, we recommend requiring electronic submittal of all reporting requirements for the RFS program, particularly third-party engineering reviews and attest engagements. We also recommend that the office determine whether potential conflicts of interest exist from allowing the same third party to complete multiple reporting requirements and monitor potential conflicts for any negative impacts to program integrity, and revise regulations as appropriate to include specificity on independence requirements. The Office of Air and Radiation agreed with our recommendations and is taking steps to address them.



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

THE INSPECTOR GENERAL

September 5, 2013

MEMORANDUM

SUBJECT: The EPA Should Improve Monitoring of Controls in the
Renewable Fuel Standard Program
Report No. 13-P-0373

FROM: Arthur A. Elkins Jr.

A handwritten signature in black ink, appearing to read "Arthur A. Elkins Jr.", is written over the printed name.

TO: Janet McCabe, Acting Assistant Administrator
Office of Air and Radiation

This is our report on the subject examination conducted by the Office of Inspector General of the U.S. Environmental Protection Agency. This report contains findings that describe problems the OIG has identified and corrective actions the OIG recommends. This report represents the opinion of the OIG and does not necessarily represent the final EPA position. In accordance with established audit-resolution procedures, EPA managers will make final determinations on matters in this report.

Action Required

You are not required to provide a written response to this final report because you agreed to all recommendations and provided corrective actions and planned completion dates that meet the intent of our recommendations. The recommendations remain open with corrective actions ongoing. Please update the EPA's Management Audit Tracking System as you complete the planned corrective actions for these recommendations and notify my staff if there is a significant change in the agreed-to corrective actions. We will post this report on our website at <http://www.epa.gov/oig>.

If you or your staff have any questions regarding this report, please contact Rich Eyermann, acting assistant inspector general for the Office of Audit, at (202) 566-0565 or Eyermann.Richard@epa.gov; or Patrick Gilbride, director for Risk and Program Performance Audits, at (303) 312-6969 or Gilbride.Patrick@epa.gov.

Table of Contents

Chapters

1	Introduction	1
	Purpose	1
	Background.....	1
	Noteworthy Achievements	4
	Scope and Methodology	4
2	The EPA Should Improve Monitoring of Control Activities in the RFS Program	6
	The EPA Does Not Currently Monitor Some Internal Control Activities	6
	Conclusion	9
	Recommendations	9
	Agency Comments and OIG Evaluation.....	10
3	Independence Requirements for Reporting May Not Be Met in the RFS Program	11
	The EPA Does Not Currently Monitor Overlap in Independence Requirements	11
	Conclusion	12
	Recommendation.....	12
	Agency Comments and OIG Evaluation.....	13
	Status of Recommendations and Potential Monetary Benefits	14

Appendices

A	Agency Comments on Draft Report	15
B	Distribution	18

Chapter 1

Introduction

Purpose

The U.S. Environmental Protection Agency Office of Inspector General conducted an audit of the Renewable Fuel Standard program as a result of millions of dollars of fraudulently generated Renewable Identification Numbers. We sought to determine whether the EPA has assessed program risks and designed necessary controls in the RFS program.

Background

Laws and Regulations

The Energy Policy Act of 2005

The Energy Policy Act of 2005¹ amended Section 211 of the Clean Air Act to create the Renewable Fuel Program.² The EPAct established the first renewable fuel volume mandate in the United States. The original RFS program created under the EPAct was referred to as RFS1 and required that 7.5 billion gallons of renewable fuel be blended into gasoline by 2012. The EPAct required the EPA to promulgate RFS program regulations to ensure that gasoline sold or introduced into commerce in the United States contained an “applicable” volume³ of renewable fuel. The EPAct required the EPA’s regulations to include a credit program that allowed for the generation of an appropriate amount of credits by any person who refines, blends or imports gasoline that contains a quantity of renewable fuel. These credits are referred to as Renewable Identification Numbers, or “RINs.”

According to the EPA, the RIN system was developed as a market-based alternative to a direct blending requirement. The RIN system provides obligated parties⁴ with flexibility in satisfying their responsibility to ensure that a specified volume of renewable fuels is used as transportation fuel in the United States each year. Each RIN generated by a producer or importer of renewable fuel represents a volume of renewable fuel measured in terms of ethanol-equivalent gallons, and each RIN can be transferred from one party to another. The RIN system within the RFS program is a “buyer beware” program, meaning all parties must take

¹ Pub.L. 109-58.

² The EPA’s website refers to this program as the Renewable Fuel Standard program, which is what we refer to throughout our report.

³ Applicable volume refers to the number of billion gallons of renewable fuel required to be used in a calendar year.

⁴ An obligated party is any refiner that produces gasoline or diesel fuel within the 48 contiguous states or Hawaii, or any importer that imports gasoline or diesel fuel into the 48 contiguous states or Hawaii during a compliance period.

steps to verify the validity of RINs they acquire. Additionally, all parties are liable for transferring or using invalid RINs.

The Energy Independence and Security Act of 2007

The Energy Independence and Security Act of 2007⁵ further amended CAA Section 211 and expanded the RFS program to include diesel in addition to gasoline, and increased the volume of renewable fuel required to be blended into transportation fuel to 36 billion gallons by 2022. EISA also established new categories of renewable fuel and set volume requirements for each one. Additionally, it required the EPA to ensure that each category of renewable fuel emits fewer greenhouse gases than the petroleum fuel it replaces. The RFS program expanded under EISA is referred to as RFS2.

Code of Federal Regulations – Regulation of Fuels and Fuel Additives

As mentioned above, the EPAct required the EPA to promulgate regulations for the RFS program, which the agency codified in the Code of Federal Regulations in Title 40 – Protection of the Environment, Part 80 – Regulation of Fuels and Fuel Additives, Subpart M – Renewable Fuel Standard (40 CFR 80). The regulations detail RFS program requirements and include some of the controls we discuss later in this report.

Proposed Rule – RFS RIN Quality Assurance Program

On January 31, 2013, the EPA issued a notice for proposed rulemaking to establish a voluntary quality assurance program for verifying the validity of RINs. The EPA published the proposed rule in the Federal Register on February 21, 2013. The EPA proposed this rule as a result of cases of fraudulently generated RINs which led to inefficiencies and a significant reduction in the overall liquidity in the RIN market. The proposed rule establishes an additional control in the RFS program that would create a new category of regulated entities – third-party auditors – that can execute the EPA-approved Quality Assurance Plans to validate RIN generation. QAP auditors would register with the EPA and have their QAPs approved by the agency.⁶ A QAP is a list of elements that an independent third-party auditor would check to verify the validity of the RINs generated by a renewable fuel producer or importer. The QAPs would be facility specific and could be performed under two voluntary alternative compliance approaches – Option A and Option B. The current “buyer beware” approach in the RFS program continues as an option under the proposed rule. The following provides a brief overview of both QAP options:

⁵ Pub.L. 110-140.

⁶ The EPA is proposing that the quality assurance program would be applicable at the beginning of 2013 and, as of June 19, 2013, the EPA has already pre-registered QAPs for six companies.

- Option A**
 - More rigorous – much of the monitoring performed on a continuous basis.
 - Provides obligated parties with an affirmative defense⁷ if they meet certain criteria.
 - Obligated parties would not replace invalid RINs; instead, RINs not replaced by the producer or importer would be replaced by the auditor who verified the RINs up to a certain threshold.⁸
- Option B**
 - Continuous monitoring not required – most of the monitoring would be done on a quarterly basis.
 - Also provides obligated parties with an affirmative defense if they meet certain criteria.
 - Obligated parties would be required to replace any invalid RINs not replaced by the renewable fuel producer or importer.

The EPA is also proposing a number of new regulatory requirements that will modify exporter provisions of the RFS program to try to ensure that an appropriate number and type of RINs are retired whenever renewable fuel is exported. Also, the EPA is proposing new regulatory provisions to address RINs that become invalid after being sold by a renewable fuel producer or importer.

Fraud Cases

The EPA has pursued and is continuing to pursue enforcement actions against renewable fuel producers and importers that generated invalid RINs. The following describes three cases involving fraudulently created RINs:

- Clean Green, LLC** The owner generated and sold over 32 million RINs, amounting to approximately \$9 million, without producing or importing any renewable fuel. The owner was found guilty of wire fraud, money laundering, and violating the CAA on June 25, 2012, and was sentenced to 12 years in prison.
- Absolute Fuels, LLC** The owner generated over 48 million invalid biomass-based diesel RINs without producing any qualifying renewable fuel and transferred the majority of these RINs to others. The owner pled guilty to an indictment on counts of wire fraud, money laundering, and violating the CAA, and was sentenced to 188 months (nearly 16 years) in prison for selling more than \$40 million in fraudulent RINs.
- Green Diesel, LLC** The EPA issued a Notice of Violation on April 30, 2012, alleging the company generated more than 60 million invalid biomass-based diesel RINs without producing any qualifying renewable fuel and transferred the majority of these invalid RINs to others.

⁷ An affirmative defense means that the obligated party would be held harmless against civil violations for transferring or retiring invalid RINs if the RINs were verified under a QAP.

⁸ To reduce the costs associated with the Option A QAP, the EPA is proposing a cap on RIN replacement for Option A auditors. The EPA is proposing to cap the auditor's RIN replacement responsibility at 2 percent of Option A RINs verified by the auditor in the current year and the previous 4 years.

The RFS Program's Effect on Greenhouse Gas Emissions

According to the EPA, the RFS program lays the foundation for achieving significant reductions in greenhouse gas emissions from the use of renewable fuels. The agency estimates that the RFS program will reduce greenhouse gas emissions by 138 million metric tons by 2022. The EPA's Office of Air and Radiation listed the implementation of the RFS program as a priority in fiscal year 2013.

The EPA's Organization

The mission of the Office of Transportation and Air Quality, within the EPA's Office of Air and Radiation, includes reducing air pollution and greenhouse gas emissions from mobile sources and the fuels that power them as well as advancing clean fuels. OTAQ administers the RFS program.

The EPA's Office of Enforcement and Compliance Assurance works with the regional offices, state and tribal governments, and other federal agencies to enforce the nations' environmental laws, including the CAA. Within OECA, the Office of Civil Enforcement develops and prosecutes administrative civil cases. OECA's Office of Criminal Enforcement, Forensics, and Training provides investigative services on violations of environmental laws.

Noteworthy Achievements

The EPA has worked with external RFS program stakeholders to develop additional controls to reduce fraud in the program. Prior to issuing the notice for proposed rulemaking, the EPA sought industry perspectives on possible controls to include in the new rule. In addition, the EPA continues to work with industry as it pre-approves QAPs prior to the agency's issuance of the final rule.

Scope and Methodology

We conducted this audit from November 2012 to June 2013 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

To determine whether the EPA has assessed program risks and designed necessary controls in the RFS program, we reviewed relevant laws and regulations to understand the complexities of the program as well as the EPA's responsibilities over it. These laws and regulations include the CAA, EPAct, EISA, and 40 CFR 80 Subpart M. We also interviewed staff from OTAQ, as well as OECA's Office of Civil Enforcement and Office of Criminal Enforcement,

Forensics, and Training, to further understand the RFS program and each office's roles and responsibilities. In addition, we reviewed information from the closed fraud cases and also reviewed the proposed rule on the RFS RIN quality assurance program. We also reviewed previous OIG and Government Accountability Office reports relevant to our audit.

We focused the scope of our audit on internal controls over RINs created by producers and importers of renewable fuel. We focused on this because producers perpetrated the fraud in the three cases discussed earlier in this chapter. To test key controls we selected two samples:

1. ***Documentation of third-party engineering reviews.*** We selected a random sample from a list of renewable fuel producers who produced renewable fuel in calendar year 2012 and determined whether documentation of third-party engineering reviews existed for selected producers.
2. ***Documentation of attest engagements.*** We selected a random sample from a list of renewable fuel producers and importers who generated RINs in calendar year 2011. We determined whether attest engagements were documented and whether they contained information specified within the RFS program regulations.

We pulled both samples from lists based on information entered into the EPA Moderated Transaction System. We did not perform testing over data entered into EMTS or the quality of the data because we only used this information to identify samples for our verification of documentation. We do not believe this limitation affected our findings and conclusions.

Chapter 2

The EPA Should Improve Monitoring of Control Activities in the RFS Program

The EPA has assessed risks and implemented a number of control activities in the RFS program through regulations. The main control activities we identified are independent third-party engineering reviews, the EMTS, and attest engagements. However, we identified that the agency does not meet the control standard for monitoring some of the control activities. The EPA does not track submission of third-party engineering reviews or annual attest engagements because the agency lacks a monitoring system. Until the EPA tracks submitted materials, the agency cannot be sure that program participants comply with applicable regulations, which affects program integrity and could lead to additional fraud cases.

The EPA Does Not Currently Monitor Some Internal Control Activities

The Government Accountability Office's *Standards for Internal Control in the Federal Government*⁹ describes the implementation of internal control as a key factor in helping achieve agencies' missions and program results. Internal control provides reasonable assurance on effective and efficient operations, and that the agency complies with applicable laws and regulations. Internal control also serves as the first line of defense in safeguarding assets and preventing and detecting fraud. Control standards include assessing program risk, establishing control activities to ensure actions are taken to address risk, and monitoring performance.

The EPA has assessed risks and implemented a number of control activities through regulations. Based on a review of regulations and relevant laws, we identified the following as main control activities in the RFS program: independent third-party engineering reviews, the EMTS, and attest engagements.

Independent Third-Party Engineering Reviews

The RFS program regulations require renewable fuel producers to submit to the EPA an independent third-party engineering review 60 days before generating RINs, and update the review every 3 years thereafter.¹⁰ The reviews must include a description of the types of renewable fuels or ethanol that the producer intends to produce at the facility, and that the facility is capable of producing these types of renewable fuels without significant modifications. Producers must also update engineering reviews if they make changes to their facility that would allow them to produce a type of renewable fuel not covered in their previous engineering review.

⁹ GAO/AIMD-00-21.3.1, November 1999.

¹⁰ Third-party engineering reviews are required under RFS2 but were not required under RFS1.

OTAQ has a process in place for receiving and reviewing independent third-party engineering reviews. A producer must first set up an account and self-register for the RFS program via the EPA's Central Data Exchange. The producer must then submit their registration package, including the third-party engineering review, to OTAQ via hard copy for review. OTAQ has a contractor conduct an initial examination of the engineering review and other registration information. OTAQ staff then performs a final review prior to approving the producer to conduct transactions within EMTS. We reviewed a sample of third-party engineering reviews and confirmed that all of the files contained an accepted engineering review.

Although OTAQ has a process for receiving and reviewing third-party engineering reviews, OTAQ does not currently track the submission of engineering reviews electronically. OTAQ has manually tracked the registration dates of producers in the past, but has not updated this list since early 2012. Additionally, OTAQ has not tracked the submission of required 3-year updates to engineering reviews. However, according to OTAQ, by the time we issued our draft report, OTAQ had developed a spreadsheet for tracking 3-year updates.

The EPA Moderated Transaction System

Under RFS1, the EPA tracked RINs using a 38-digit number. According to OTAQ, the agency found the 38-digit number confusing and management of the number cumbersome, prone to administrative errors, and susceptible to potentially illegitimate activity. Under the RFS2 regulations the EPA mandated the use of EMTS to screen the generation and transfer of RINs between renewable fuel producers, importers, exporters, obligated parties and other RIN-owners. Users must submit registration information, including independent third-party engineering reviews for producers, prior to EMTS registration. OTAQ explained that RINs can exist only in EMTS and compared it to a bank that holds accounts of RINs. OTAQ also explained that parties wishing to buy and sell RINs meet in an outside market and agree on a trade prior to entering it into EMTS. For EMTS to accept a RIN trade, the trade numbers must match on both the buyer's and seller's ends. According to OTAQ, EMTS has helped reduce data input errors that occurred when producers recorded the 38-digit RIN number.

An OTAQ director explained that EMTS allowed the agency to put additional controls in place for the RFS program. For example, EMTS only allows a renewable fuel producer to create RINs for a type of renewable fuel they are registered to create. EMTS also prevents an obligated party from using retired, expired or duplicate RINs to meet their renewable volume obligations. In addition, EMTS allows a party to lock its RINs, which prevents RINs from being sold to other parties so that a party does not trade an invalid RIN. Locking RINs also helps to ensure that an obligated party has enough RINs to meet its renewable volume obligation. EMTS also allows a party to block RINs from a specific fuel

producer, importer, or facility. Finally, as the RFS program is a “buyer beware” program, the EPA’s *EMTS User’s Guide*¹¹ includes the following language:

Regulated parties are urged to conduct due diligence investigations and exercise caution when conducting Renewable Identification Number (RIN) transactions. Neither EPA nor its systems, including the EPA Moderated Transaction System (EMTS), certify or validate RINs or make any provision for parties who, despite good faith, transfer or receive invalid RINs. As specified in the regulations at 40 CFR 80.1431(b)(2), invalid RINs cannot be used to achieve compliance with the Renewable Volume Obligations of an obligated party or exporter, regardless of the party’s good faith belief that the RINs were valid at the time they were acquired. Additionally, the regulations at 40 CFR 80.1460(b)(2) prohibit the creation or transfer to any person of a RIN that is invalid.

Attest Engagements

The RFS program regulations include annual attest engagement requirements that obligated parties, exporters, renewable fuel producers, RIN-generating importers and other parties that own RINs must complete. The requirements differ from party to party and must be completed by an independent certified public accountant or firm of such accountants. The certified public accountant or firm is to perform an agreed-upon procedures attest engagement of required documentation, including RIN generation reports, RIN transaction reports and product transfer documents, RIN activity reports, and third-party engineering reviews for renewable fuel producers. Each party subject to these requirements must submit the attest engagement to the EPA by May 31 of the year following the compliance year.

OTAQ and OECA have a process in place for receiving and reviewing attest engagements. Parties mail attest engagements to the EPA in hard copy form with other reporting information. OTAQ receives attest engagements, scans all information into a mail log, and then boxes up the reports and sends them to the OECA Air Enforcement Division in the EPA’s Region 8 office in Denver, Colorado. The Air Enforcement Division has one environmental protection specialist who sorts through and reads attest engagements. The specialist might communicate with the auditor who performed the attest engagement, and in some instances the specialist may note potential violations.

While OECA maintains the attest engagements files, neither OTAQ nor OECA tracks whether all required parties submit attest engagements and if the engagements contained all required elements. We sampled 21 attest engagements from a list of producers and importers and found:

¹¹ EPA420-B-12-031a, August 2012.

- OECA was able to provide attest engagements for 16 of the 21 samples, with the other five missing. OECA stated that OTAQ's mail log does not indicate that the EPA received these missing reports and noted that it was possible that they were never submitted.
- Of the 16 attest engagements provided, three missed some requirements listed in the RFS regulations, such as information on feedstocks and third-party engineering reviews.

OTAQ stated that, in the past, they wanted to require electronic submissions for the 3-year updates to engineering reviews but could not accomplish this as resources were focused on other tasks. Both OTAQ and OECA indicated that they are resource constrained. Until the EPA tracks the submission of independent third-party engineering reviews and attest engagements, the agency cannot be sure that all participants of the program comply with applicable regulations. This affects program integrity and could lead to additional fraud cases.

The EPA is taking steps to better track RFS program submissions. The EPA recently published a Federal Register notice requiring that attest engagements for calendar year 2012 be submitted electronically by May 31, 2013, rather than hard copy submissions. OTAQ also indicated that they are moving toward electronic submission for engineering reviews and expect to implement this by the end of 2013. Electronic submissions could also allow OTAQ to run reports on submittals as well as additional queries to analyze data.

Conclusion

While the EPA has control activities in place over the RFS program, monitoring control activities is important to ensure that the program works as intended and parties submit required information. The EPA could more easily monitor control activities by requiring electronic submittal of all RFS reporting requirements.

Recommendations

We recommend that the assistant administrator for the Office of Air and Radiation:

1. Modify existing electronic systems to track the submission of reporting requirements to ensure that all participants comply with applicable RFS program regulations.
2. To assist with tracking, require electronic submittal of all reporting requirements for the RFS program, particularly third-party engineering reviews and attest engagements.

Agency Comments and OIG Evaluation

The agency agreed with our recommendations. The agency noted that as of May 2013 it began requiring attest engagement reports to be submitted electronically, and it is on track to begin the electronic collection of engineering reviews by the end of 2013. Appendix A contains the agency's complete response to our draft report.

Chapter 3

Independence Requirements for Reporting May Not Be Met in the RFS Program

During our audit, we could not determine whether overlap existed in parties completing third-party engineering reviews and attest engagements. The RFS program regulations and proposed rule require that independent third parties complete third-party engineering reviews, attest engagements and QAPs. The RFS program regulations do not preclude the same party from completing multiple requirements as well as other reporting responsibilities for renewable fuel producers or importers, allowing for possible overlap. The EPA does not track and monitor independence, including whether the same party completes multiple reporting requirements for a renewable fuel producer or importer. If the same third party completes multiple reporting requirements, the party could potentially review its own work, which could result in a conflict of interest.

The EPA Does Not Currently Monitor Overlap in Independence Requirements

Within the RFS program regulations, both third-party engineering reviews and attest engagements have independence requirements. The third-party engineering review is required to be conducted by a professional engineer who is independent of the renewable fuel producer or foreign ethanol producer, or any subsidiary or employee of the renewable fuel producer or foreign ethanol producer. RFS program regulations require an independent certified public accountant or firm to perform attest engagements. The accountant may complete requirements with the assistance of internal auditors who are employees or agents of the refiner or importer. A refiner or importer may satisfy the attest engagement requirements if an auditor who is an employee completes the attestation. The internal auditor must be certified by the Institute of Internal Auditors and complete the internal audits in accordance with the Codification of Standards for the Professional Practice of Internal Auditing.

In addition to requirements currently in the RFS program regulations, in the notice for proposed rulemaking signed on January 31, 2013, the EPA proposes requiring that the auditor performing the QAP be independent of the renewable fuel producer or foreign ethanol producer, or any subsidiary or employee of the renewable fuel producer or foreign ethanol producer.

During our audit, we could not determine whether overlap existed in parties completing third-party engineering reviews and attest engagements. We sampled third-party engineering reviews and attest engagements and were unable to determine whether overlap existed in parties submitting these reports and whether any potential independence issues existed. We could identify the auditor that

completed the attest engagement, but we were not able to determine what other services, if any, the auditor provided. We could also identify the engineer that completed the third-party engineering review.

The regulations and proposed new rule do not preclude the same party from completing multiple reporting requirements, allowing for possible overlap and potential conflicts of interest. For example, the regulations and proposed rule allow the same individual or firm to conduct the third-party engineering review, attest engagement, and QAP audit for a renewable fuel producer as long as they meet the other requirements in the regulations. In addition, the regulations do not prohibit an agent who completes other reporting responsibilities (i.e., in EMTS and in quarterly and annual reports) for a renewable fuel producer from completing the other reporting requirements.

The EPA does not track and monitor overlap in services to determine whether potential conflicts of interest exist. An OTAQ compliance division director explained that there is a lack of a definition of independence. OTAQ staff also explained that some businesses which conduct attest engagements currently say they cannot perform a QAP for the same company because they are not independent, while others say they are independent and can complete both requirements. If the same third party completes multiple reporting requirements, the party could potentially review its own work, which could result in a conflict of interest.

Conclusion

To help ensure the goals and integrity of the RFS program, parties completing reporting requirements must be independent. Whether third parties must be independent from each other remains to be determined. By tracking the third parties that complete RFS program reporting requirements, the EPA could determine whether any potential conflicts between third parties adversely impact RFS program integrity and adjust the program accordingly, if needed.

Recommendation

We recommend that the assistant administrator for the Office of Air and Radiation:

3. Track reporting submissions to determine whether potential conflicts of interest exist from allowing the same third party to complete multiple reporting requirements and monitor the potential conflicts to determine whether they negatively impact RFS program integrity. Based on that determination, revise regulations as appropriate to include specificity on whether the same third party can conduct multiple reviews or reporting requirements for the same producer or importer.

Agency Comments and OIG Evaluation

The agency provided a qualified agreement with our third recommendation. In our draft report, our third recommendation required that the EPA:

Track reporting submissions to determine whether potential conflicts of interest exist as a result of allowing the same third party to complete multiple reporting requirements. Based on that determination, revise regulations as appropriate to include specificity on whether the same third party can conduct multiple reviews or reporting requirements for the same producer or importer.

We discussed that recommendation with agency staff and, based on that discussion, revised our language accordingly. As the EPA notes in its response to our draft report, we made this revision to our recommendation so that, in the future, the agency can determine whether it finds a greater degree of noncompliance where third parties are not independent from each other. If the agency decides that the same party may not fulfill multiple roles, the agency indicated that it will put in safeguards to ensure that parties meet independence requirements.

Appendix A contains the agency's complete response to our draft report.

Status of Recommendations and Potential Monetary Benefits

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in \$000s)	
Rec. No.	Page No.	Subject	Status ¹	Action Official	Planned Completion Date	Claimed Amount	Agreed-To Amount
1	9	Modify existing electronic systems to track the submission of reporting requirements to ensure that all participants comply with applicable RFS program regulations.	O	Assistant Administrator, Office of Air and Radiation	06/30/2015		
2	9	To assist with tracking, require electronic submittal of all reporting requirements for the RFS program, particularly third-party engineering reviews and attest engagements.	O	Assistant Administrator, Office of Air and Radiation	12/31/2013		
3	12	Track reporting submissions to determine whether potential conflicts of interest exist from allowing the same third party to complete multiple reporting requirements and monitor the potential conflicts to determine whether they negatively impact RFS program integrity. Based on that determination, revise regulations as appropriate to include specificity on whether the same third party can conduct multiple reviews or reporting requirements for the same producer or importer.	O	Assistant Administrator, Office of Air and Radiation	06/30/2015		

¹ O = recommendation is open with agreed-to corrective actions pending
 C = recommendation is closed with all agreed-to actions completed
 U = recommendation is unresolved with resolution efforts in progress

Agency Comments on Draft Report

August 1, 2013

MEMORANDUM

SUBJECT: Response to Office of Inspector General Draft Project No. OA-FY13-0009
“The EPA Should Improve Monitoring of Controls in the Renewable Fuel
Standard Program,” dated July 2, 2013

FROM: Janet G. McCabe
Acting Assistant Administrator

TO: Arthur A. Elkins, Jr.
Inspector General

Thank you for the opportunity to respond to the issues and recommendations in the subject audit report. Following is a summary of the agency’s overall position, along with its position on each of the report recommendations.

The agency agrees with report recommendations 1 and 2 and we have provided high-level intended corrective actions and estimated completion dates to the extent we can. The emphasis of these two recommendations is on electronic reporting and tracking of third-party controls in the Renewable Fuel Standard (RFS) program, specifically third-party engineering reviews and attest engagements. As reflected in the report, the Office of Transportation Air Quality has manually tracked these controls in the past but had limited resources to implement electronic tracking. As of May 2013, the agency began requiring attest engagement reports to be submitted electronically¹², and we are on track to begin the electronic collection of engineering reviews by the end of 2013. The system functionality that allows us to track the electronic submissions will be part of future EPA Moderated Transaction System (EMTS) development that has a targeted completion date of FY 2015 Q3.

With regard to recommendation 3, concerning independence requirements associated with the third-party reporting and the agency’s tracking of third-party submissions, the agency is in partial or qualified agreement with the recommendation, as explained below. Based on discussions with OIG staff, it is our understanding that the intent of this recommendation is not necessarily that the agency require third parties to be independent from each other (for performing services for a given producer or importer). Rather, our understanding is that OIG’s recommendation is that the agency track whether or not third parties performing such services for each producer or importer are independent from one another, so that in the future the agency can determine whether or not

¹² 78 FR 23927; April 23, 2013.

we find a greater degree of noncompliance in the RFS program where third parties are not independent from each other versus the degree of noncompliance that we find where third parties are independent from each other.

The agency expects to make a policy decision concerning third-party independence in the final rule to establish a voluntary quality assurance program (QAP) for verifying the validity of renewable identification numbers. In the QAP proposal, the agency sought comment on the value of requiring separate, independent third parties versus the benefit of reduced costs from consolidating roles and responsibilities and not requiring independence. If the agency decides that it may be appropriate for the same third party to conduct multiple reviews and reporting requirements (e.g., engineering reviews, attest engagements, and QAP audits) the Agency will track and monitor the potential conflicts to determine if they negatively impact RFS program integrity consistent with recommendation 3. On the other hand, if the Agency decides that the same party may not fulfill multiple roles, the agency will put in safeguards to ensure the independence requirements are met. EMTS development to support either approach has a targeted completion date of FY 2015 Q3.

AGENCY’S OVERALL POSITION

The OIG has worked collaboratively with my staff to make recommendations that we mutually agree are helpful to improve monitoring of controls in the RFS program.

AGENCY’S RESPONSE TO REPORT RECOMMENDATIONS

No.	Recommendation	High-Level Intended Corrective Action(s)	Estimated Completion by Quarter and FY
1	Modify existing electronic systems to track the submission of reporting requirements to ensure that all participants comply with applicable RFS program regulations	1. Incorporate into development and modifications to EMTS and associated data systems.	3 rd Quarter FY 2015
2	To assist with tracking, require electronic submittal of all reporting requirements for the RFS program, particularly third-party engineering reviews and attest engagements	2.1 Attest engagements completed. Electronic collection is already required as of May 2013. 2.2 Engineering Reviews – deployment of electronic template	2.1 May 31, 2013 2.2 1 st Quarter FY 2014

3	Track reporting submissions to determine whether potential conflicts of interest exist as a result of allowing the same third party to complete multiple reporting requirements. Based on that determination, revise regulations as appropriate to include specificity on whether the same third party can conduct multiple reviews or reporting requirements for the same producer or importer	3. Incorporate into development and modifications to EMTS, and associated data systems.	3 rd Quarter FY 2015
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CONTACT INFORMATION

If you have any questions regarding this response, please contact John Weihrauch, Fuels Compliance Center Director of the Office of Transportation and Air Quality’s Compliance Division, at (202) 343-9477.

Attachment

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