

## REGULATION:

### Outside auditors curb pollution, expose conflicts of interest in India

Henry Gass, E&E reporter

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For 19 years, Prakash Vaghela has been auditing industry facilities in the state of Gujarat in northwest India to make sure they are meeting environmental standards. But he said it wasn't until around 2010 that most auditors in the state really began taking their jobs seriously.

Until that point, he said, environmental auditors in Gujarat didn't have much incentive to do their jobs well. They were selected and paid by the facility operators themselves, and their reports on pollution volumes were not verified for accuracy.

The Gujarat Pollution Control Board (GPCB) introduced this third-party audit system to India in 1996. But when the GPCB saw how it was failing, it tried revamping the system in 2009.

A new [study](#) from researchers at the Massachusetts Institute of Technology's Abdul Latif Jameel Poverty Action Lab (J-PAL) suggests the revamped system may be working. And its success has implications not only for Gujarat and the developing world, but for the developed world as well.

All power plants in Gujarat are required to submit a yearly environmental audit conducted by an external auditing firm.

In the past, these firms were hired directly by the plants themselves. Under the new test system that has been in place since 2009, industry pays a fixed fee to the GPCB, which then randomly selects auditors and sends them to individual plants.

Nicholas Ryan, a research fellow in the Sustainability Science Program at Harvard University, and other American researchers led a team examining how effective this new system has been. The team, in partnership with the GPCB, tested 233 of 473 plants in Gujarat under the new audit system, leaving the remainder under the old system as a control group. The team then collaborated with local research universities to double-check the results of around 20 percent of those new audits.

### Reporting dirty tricks

In the end, after more than two years of research on the ground in Gujarat, Ryan and his team found that randomly assigning auditors to plants, paying them a fixed fee from a pool of funds and double-checking their accuracy led auditors to report industrial pollution much more accurately.

Auditors were 23 percent less likely to falsely report a pollution reading as in compliance with regulatory standards, and their reported pollution readings were 50-70 percent higher on average than those of auditors working in the old system.

The J-PAL team also found that the highest-polluting plants facing the new audit system reduced pollution by an average of 0.21 standard deviation.

"It's critical that plants care," Ryan said. "The fact they respond here suggests there is enough will for enforcement, there's just not enough good information."

But will the changes help significantly reduce pollution? Or at least help put India's exploding energy consumption on a cleaner trajectory? Ryan doesn't think so.

"It could improve the operating efficiency for plants," he said. "Whether it actually drives wholesale-level changes in energy use, I'd be doubtful."

The GPCB system could still face some hurdles, however.

The J-PAL study drew a lot of its conclusions on the changes in audit accuracy from the university double-checks -- essentially an auditing of the auditors. Ryan said he thinks the system would need this kind of oversight permanently for it to continue to succeed.

"Over time you will lose the accuracy of auditors if they're not being benchmarked against some real value," he said.

The costs of so many levels of oversight could get high, however. David Rapson, an economics professor at the University of California, Davis, who wasn't involved in the study, said a marketplace solution could also be possible.

### **How a 'formality' caused health problems**

"Auditors of auditors is one way to do it, but also setting up a transparent marketplace where competitive forces are going to operate to reward truthful auditors and penalize untruthful and less-accurate ones might also work in that situation," Rapson said.

"It could be very costly to do good monitoring, and obviously the stakes are high," he added.

Health-wise, the stakes are high. The J-PAL study found that under the old system, auditors reported that 7 percent of plants violated government standards for particulate matter when in reality 59 percent did.

Rakesh Shah, another auditor at Gujarat-based Anand Consultants, thinks the GPCB should go a few steps further with its reforms. Industry used to regard environmental audits as a "formality and an unwanted nuisance," he wrote in an email to *ClimateWire*.

And he thinks the GPCB should not only randomly assign auditors and pay them independently but also not take immediate punitive action against violators -- at least until it can independently verify the report's accuracy -- and only submit reports to top-level management at plants.

"This will ensure that the lower management does not know the negative findings of the environmental audit report, which are generally a result of the lower management trying to show better productivity against bettering of the environment," he said.

A more delayed punishment for violations would also make industries more willing to be transparent with auditors about their pollution levels.

### **Better tracking needed in U.S.**

"These are really big problems, and they're not just in India, they're everywhere," Rapson said.

Several institutions in the United States are grappling with how to make third-party auditing systems fair and impartial. Financial regulators in particular suffer from a tangle of relations and incentives with hedge funds, investors and others in the financial industry, he added.

U.S. EPA also recently attempted to fix a similar problem with third-party auditors reviewing compliance with the renewable fuel standard (RFS).

The program requires renewable fuel producers to submit an independent, third-party engineering review 60 days before generating biofuel and to update the review every three years.

In a white paper published last month, EPA's Office of Inspector General reported that the agency does not track all these submitted materials because it lacks an electronic monitoring system for it.

EPA also doesn't track whether the same party completes multiple reporting requirements under RFS rules, meaning one third party could be reviewing its own work, which could result in conflicts of interest, according to the white paper.

Jeffrey Lagda, spokesman for the Office of Inspector General, wrote in an email to *ClimateWire* that the agency has "provided corrective action dates that range from May 31, 2013 to June 30, 2015 to address our recommendations."

Lagda said the inspector general's recommendations include requiring the electronic submission of RFS reporting requirements to enable easier tracking and revising requirements as to whether one third party can conduct multiple reviews for the same producer.

"This is not just a developing country environmental concern," Rapson said.

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