



September 4, 2017

Ms. Ursula Lai
Lead Staff, Verification
California Air Resources Board
1001 "I" Street
Sacramento, CA 95812

Re: Comments of Weaver and Tidwell, L.L.P. regarding proposed regulatory amendments to the Low Carbon Fuel Standard to add third party verification requirements

Dear Ms. Lai:

Weaver and Tidwell, L.L.P. (hereafter, "Weaver" or "the Firm") appreciates the opportunity to provide comments and feedback on the California Air Resources Board's ("ARB") recent pre-rulemaking concept paper and related public workshop concerning amendments to the Low Carbon Fuel Standard ("LCFS") regulations. While this rulemaking effort touches upon a number of important issues vital to the LCFS program, Weaver, in its capacity as a public accounting firm providing advisory, attestation and audit services to a broad array of regulated parties, is commenting solely herein on the validation and verification provisions addressed in the concept paper (hereafter collectively referred to as the "Verification Program"). We believe the proposed Verification Program will provide significant improvements to the transparency and reliability of the LCFS market. Weaver has been an active stakeholder concerning these proposed changes since their introduction, participating in public workshops, meeting formally and informally with ARB staff, and submitting prior written public comments in June 2016. Our comments in this letter build upon the feedback previously shared with the ARB. We look forward to continuing to be part of this rulemaking process.

Firm Background

Originally founded in 1950, Weaver is a full service public accounting firm offering assurance, tax and advisory services. Weaver has offices throughout Texas (Fort Worth, Dallas, Houston, San Antonio, Midland and Austin), as well as Stamford, Connecticut and Los Angeles, California. With more than 500 employees and firm revenue exceeding \$100 million, Weaver is ranked among the top 50 public accounting firms in the U.S. by *Inside Public Accounting*.

Weaver's Energy Compliance Services ("ECS") practice is dedicated to helping businesses navigate compliance with evolving regulations. Transportation fuels regulated by the U.S. Environmental Protection Agency ("EPA"), Environment Canada, ARB and other state agencies are a substantial focus for the practice. We help companies of all sizes understand their regulatory requirements and maintain compliance. We have approximately 35 professionals within the ECS practice that have a wide variety of backgrounds, including accounting, engineering, chemistry and law. Weaver is one of the largest providers of EPA attest engagement services in the U.S. and one of only a few firms whose Renewable Fuel Standard ("RFS") Quality Assurance Plan (RIN-tegrity®) is approved by the EPA.

To-date in calendar year 2017, Weaver has verified over 500 million RINs under its Quality Assurance Plan (“QAP”) program, including over 75% of all cellulosic (D3) RINs generated for biogas-based transportation fuels this year. Our primary goal within the ECS practice (and the Firm, in general) is to continuously build on our expertise with talented and dedicated professionals, so that we can best serve our clients.

Professional Standards and Independence

As a public accounting firm, Weaver is subject to strict professional standards. The American Institute of Certified Public Accountants (“AICPA”) is the national professional organization for Certified Public Accountants (“CPAs”) in the United States. Founded in 1887, the AICPA represents the CPA profession nationally regarding rule-making and standard-setting, and serves as an advocate before legislative bodies, public interest groups and other professional organizations. The AICPA’s mission is to provide members with the resources, information and leadership that enable them to provide valuable services in the highest professional manner to benefit the public, employers and clients. To achieve this mission, the AICPA develops professional standards for audit and other services provided by CPAs, provides educational guidance materials to its members, creates and grades the Uniform CPA Exam, and monitors and enforces compliance with the profession’s audit, technical and ethical standards.

As a governing body, the AICPA provides guidance surrounding independence (ET Section 101 – Independence) for public accounting firms. If a public accounting firm is planning to offer non-attest services (i.e., consulting) to an attest/audit client, the firm is required to check for any independence issues. Certain non-attest services for an attest client may be performed, provided that certain threats to independence are reduced to an acceptable level. Key threats to independence that must be mitigated in order to perform certain non-attest services for an attest client include self-review (in other words, reviewing your own work) and assuming management responsibilities. The AICPA provides substantial resources, information and guidance to CPAs, so that appropriate evaluation of services to be offered can be performed and independence issues and concerns can be avoided.

Weaver’s Processes, Procedures and Internal Controls

As indicated above, Weaver has talented and dedicated professionals who focus on certain ECS practice areas. We ensure that all team members have the industry knowledge, experience and training needed to meet the requirements and expectations of our clients. Not only is this good business practice, but it is also required by our professional standards. Regardless of needing to abide by standards set forth by certain regulatory bodies (e.g., EPA or ARB) or regulations, all consulting services are performed in accordance with the Statements on Standards for Consulting Services and all attest services are performed in accordance with the Statements on Standards for Attestation Services, issued by the AICPA.

Our internal controls process begins with the on-boarding of our employees and independent contractors. All employees are required to sign a job description, which is specific to their position and the practice area(s) in which he or she will be working. The job description also covers adhering to the Firm’s policies and procedures and being familiar with and adhering to the relevant ethical requirements of the AICPA (contained in the Code of Professional Conduct) and the relevant State Boards of Public Accountancy in discharging professional responsibilities. Likewise, all independent contractors are required to sign a consulting services agreement, which

covers, among other issues, ethical requirements and client confidentiality. Independence confirmations are also required to be signed on an annual basis, indicating that personnel are both aware of and in compliance with our independence requirements.

Weaver also has a formal process for evaluating and accepting new clients and new services offered to existing clients. This process requires accumulating relevant information about the company and the services to be provided, as well as information about the services already being performed for the company, if any (including the type of engagement – attest, non-attest). A Prospect Evaluation Form is then completed and submitted for formal review and approval to three Firm Partners: the Partner-in-Charge of the practice area, the Service Line Leader and finally, the Risk Management/Quality Control Partner. Work does not commence until the company and/or new services are properly evaluated and approved.

We believe that ARB should consider both the AICPA standards and the internal controls adopted to implement them, in evaluating firms' independence for performing verifications under the proposed LCFS amendments. We elaborate on these independence requirements further below.

Comments on Proposed Verification Program Concepts

ARB's proposed Verification Program represents an important step in ensuring the validity of qualifying fuels and credits in the LCFS market. With LCFS credits predicted to be in increasingly shorter supply as the LCFS program matures, the incentives for fraudulent credit generation will only grow, notwithstanding ARB's robust enforcement authority and oversight. A well-designed Verification Program can help deter bad actors from entering the market and also shorten the timespan for detecting improperly generated credits. To that end, we support ARB's decision to add an initial third party validation prerequisite prior to the certification of a new fuel pathway. This would raise the bar for new market entrants and help weed out those that are doing so with a malicious intent, and would also act as a valuable safeguard against improper if not fraudulent LCFS credit generation prior to the first annual verification.

We recognize that the concept paper was primarily intended to introduce the framework of the initial validation and ongoing verification requirements, and not to spell out each such requirement in detail. Ultimately, the specific approach(es) and procedure(s) adopted by ARB to implement these concepts should and undoubtedly will be the subject of further meetings and outreach with potential validation/verification service providers and other stakeholders. With that in mind, we have focused below only on certain items to flesh out the framework introduced in the concept paper.

- *Standardization of Verification Procedures.* The concept paper states that “[v]erifiers [would] design and update sampling plans to assess the validity of calculated CI values, fuel pathway quantities and other data reported.... To inform the sampling strategy, a verifier assesses the risk of failure to detect errors according to the professional judgment of the uncertainty of reported data and its relative contribution to the calculated CI, fuel pathway quantity, or project data.”¹ While we appreciate flexibility to design and implement a verification plan according to the needs of a particular fuel or pathway, we believe that ARB ultimately should establish standards – either via regulation or agency

¹ See Low Carbon Fuel Standard 2018 Amendments Pre-Rulemaking Concept Paper, July 24, 2017, pp.9-10

guidance materials – that must be met to ensure an appropriate baseline of verification activity. Understanding these baselines upfront can inform the design of initial verification plans and help promote consistency between verifiers. In particular, we believe it is important for ARB to establish standards for (1) sample selection for relevant data inputs (both the methodology and the number of samples), and for (2) the number of site visits in a given review period. These are two critical areas that affect both the quality and costs of the verification audit. By establishing standards, ARB can effectively ensure a baseline level of service while still allowing auditors to exceed this baseline based on their judgment of the needs of a particular pathway or fuel type. ARB has already indicated that it intends to prepare “risk assessment and sampling requirements for verification of certain feedstocks that staff considers higher risk”²; we believe that ARB should expand the “high risk” concept and apply it more broadly to better inform the design of verification plans that service providers will submit to the agency.

- *Material Misstatement Threshold:* We noted some ambiguity in the concept paper concerning the threshold for a material misstatement that could lead to an adverse or negative verification result for the party responsible for reporting annual fuel pathway data. For example:
 - On p.10: “Material misstatement is the sum of errors that may cause a verifier to believe that the key reported value(s) contain errors greater than 5 percent. Material misstatement would be defined for each type of reported data.”
 - On p.11: “ ‘Material Misstatement means any discrepancy, omission, or misreporting, or aggregation of the three ... that leads a verification team to believe that the reported CI calculation (gCO₂e/MJ) or reported fuel quantity per FPC per quarter contains errors greater than 5 percent as applicable.”

ARB elsewhere indicates in the concept paper that for ongoing verification of annual fuel pathway reports, the “verifier would evaluate validity of the site-specific operational data submittal and not evaluate conformance with the certified CI”³ (the latter being reserved to ARB). If the verifier is not responsible for evaluating conformance with the certified CI, then it would seem incongruous to establish a material misstatement threshold tied to the likelihood that the reported CI calculation contains errors above 5 percent (per the language on p.11). Furthermore, it will be more feasible for verifiers to design a sampling and review protocol aimed at detecting errors above 5 percent for objective inputs in the CI pathway calculation (e.g., feedstock quantities, mass and energy balances, co-product production, etc.), rather than detecting whether the aggregated review of all such inputs is likely to result in a +5 percent error in the CI calculation. Lastly, there may be value for ARB to know that a verifier has detected a greater than 5 percent error rate in these objective inputs, even if their weight would not result in a nonconformance with the certified CI. For these reasons, we ask that ARB clarify the material misstatement threshold in the forthcoming verification regulatory language.

² *Id.* p.10

³ *Id.* p.12

Comments on Proposed Verifier Accreditation Concepts

The concept paper indicates that the forthcoming verification regulation will contain accreditation requirements for LCFS verification bodies that “will likely be consistent with [the Mandatory Reporting Regulation], Cap-and-Trade Program, and ISO 14065 and 14064-3 [and that] staff is also considering establishing selection criteria for International Certification Systems (i.e., ISCC and Bonsucro)”.⁴

As we have noted in prior comments and in discussions with ARB staff, we appreciate that ARB wants a well-qualified pool of verification service providers, and agree that this will promote consistency between firms. However, considering that there is already a profession dedicated to performing the service being contemplated by ARB (that being public accountants), it seems unnecessary to re-invent the wheel with regards to accrediting verification bodies and individuals for certain roles related to the LCFS verification program. Certified Public Accountants (CPAs) receive years of training (classroom and on-the-job) and have to pass a very rigorous set of exams to be able to serve the public. Further, CPAs have to work under the direct supervision of other CPAs for a number of years, even after passing the CPA exam, prior to being licensed. Once the CPA license is obtained, AICPA professional standards require the CPA to obtain expertise on certain industries, regulations, etc. (via appropriate training), prior to taking on a particular engagement where the expertise is required. Further, the AICPA professional standards require CPAs to evaluate the need for (and involve) specialists/technical experts on certain parts of engagements, as needed/necessary (i.e., involving a professional engineer to assist in preparation or review of a mass balance). In light of this, we believe it would be appropriate for ARB to recognize that CPAs (and similar accounting professionals, such as a Certified Internal Auditors) meet the threshold for accreditation, either without further training or with a streamlined accreditation process overseen by ARB.

Comments on Proposed Verifier Conflict of Interest Concepts

We appreciate the significant emphasis that ARB places on avoiding conflicts of interest between the verification body and the company under review. For a public accounting firm, independence is at the core of our business. As described above, Weaver is subject to strict professional standards established by the AICPA, and we have implemented a multilayered set of procedures to ensure that we do not compromise the integrity and independence of our attest/audit services.

The concept paper articulates several issues related to the avoidance of a conflict of interest. First, it states that “[t]o mitigate potential bias due to longstanding familiarity with the client’s operations, a maximum continuous relationship of six consecutive years of LCFS validation/verification services would be specified, beginning with the effective date of the amendments, January 1, 2019, such that verification body rotation would be required in 2025.”⁵ This concept is in common with a firm rotation requirement that was included in draft regulatory language published by the ARB last year. As we stated in our public comments at that time, we believe a requirement to rotate *firms* is excessive, considering: (1) that there will be strict independence and conflict of interest requirements already in place governing the relationship between the firm and the party under review; and (2) responsible parties will likely want the ability to use a single service provider to perform verifications under the LCFS and other/similar

⁴ *Id.* p.15.

⁵ *Id.* p.16

regulatory compliance programs (e.g., QAP verifications under the RFS). While regulatory requirements may differ, the source documents reviewed and audit procedures performed across certain programs will be similar (or in some cases the same). Therefore, it makes sense to allow companies to use a single service provider to avoid duplications of effort, when appropriate. The six-year rotation requirement certainly hinders this opportunity. It is also likely that the pool of qualified verification providers will be somewhat limited. For instance, as previously noted Weaver currently provides QAP services to approximately 75% of the biogas-to-D3 RINs market, and our presence in this area continues to grow. If ARB finalizes a firm rotation requirement, it may effectively compel over three quarters of this market to find new LCFS verification and QAP service providers, which could cause considerable disruption. Even in the case of financial statement audits of publically traded companies, only *partners* are required to rotate not firms. A firm rotation requirement can reduce audit quality, increase incidence of undetected fraud and increase costs. For these reasons, we strongly urge ARB to revisit its plans to include a 6-year firm rotation requirement and instead opt for a 6 year (or shorter timeframe, if appropriate) partner or lead verifier rotation requirement.

The concept paper also indicates that ARB intends to implement a “look-back period for conflict of interest[s] ... beginning with a three-year look-back period in 2019 and 2020 and a five year look-back beginning in 2021”.⁶ Respectfully, we believe the proposed look-back periods could create unintended consequences (such as limiting market participants’ choice of verifier) and that ARB should generally avoid the retroactive application of new requirements. A one-year initial look-back period in 2019, expanding to two years in 2020 and ultimately three years for 2021 and beyond, may be more appropriate and less punitive to a firm that is engaged in certain consulting or other services in 2017 without the ability to fully evaluate what even the proposed prohibited activities may be. While the concept paper does state that the list of prohibited client services will be consistent with similar MRR and Cap-and-Trade requirements, it is still speculative at this point and therefore difficult for a provider of a diverse array of services (such as Weaver) to ensure that it has fully avoided engaging in a disqualifying act already by virtue of continuing to serve our clients’ needs this year.

Lastly, the concept paper indicates that prohibited client services would include “engaging in LCFS market activities, providing internal fuel audit services such as reviewing LCFS data before it is submitted to ARB, submitting LCFS data to ARB, recommending CI-reducing actions, or calculating CIs for validation/verification clients.”⁷ The prohibited activities outlined in the concept paper are fairly broad and open for interpretation, and as such we will reserve comment until we are able to review the forthcoming regulatory language and/or guidance from ARB that articulates these points. However, at this point, we respectfully request that ARB carefully distinguish between the types of prior activities that present the highest risk of conflict versus lower risk activities. For example, the preparation of the very CI calculations whose inputs would be under review in a verification presents a greater potential conflict than, again for example, performing an administrative function such as distilling client data into a reportable format for upload into the LCFS Reporting Tool. We believe it would be appropriate also for ARB to allow verifiers to prepare and submit a plan to mitigate lower risk conflicts prior to engagement by a client.

⁶ *Ibid.*

⁷ *Ibid.*

Comments of Weaver and Tidwell, L.L.P.

September 4, 2017

Page 7

Weaver appreciates the opportunity to comment on these important issues, and is grateful for ARB's efforts to address any concerns related to the proposed verification program. We believe that all parties benefit from efficient, thorough and well-devised requirements. We would be happy to discuss any questions concerning our comments or otherwise; please feel free to contact Greg Staiti at (203) 487-8091, or Greg.Staiti@Weaver.com.

Sincerely,

Weaver and Tidwell, L.L.P.

WEAVER AND TIDWELL, L.L.P.