Improving In-Lieu Fee Program Implementation: Programmatic Audits
Acknowledgements
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Improving In-Lieu Fee Program Implementation

Since 1990, the overall goal of the Clean Water Act section 404 program has been the “no net loss” of aquatic ecosystems. Ensuring that the area and functions of aquatic ecosystems are maintained depends on effective compensatory mitigation. In-lieu fee (ILF) programs are an important mechanism to provide compensatory mitigation and thus contribute to the “no net loss” goal.

The following is part of a series of comprehensive guides on some of the most challenging components of ILF program implementation identified through extensive research and interviews with operating ILF programs and other mitigation stakeholders. These guides help address perennial problems for ILF programs by identifying specific challenges, providing detailed recommendations on ways to meet these challenges, and including examples or case studies of programs to illustrate effective approaches.

The guides cover the following topics:

1) Full cost accounting
2) Project approval and the three-year growing season
3) Long-term management
4) Programmatic audits

Programmatic Audits

The 2008 Compensatory Mitigation Rule (2008 Rule) grants the Corps authority to audit the ILF program account, including all related “books, accounts, reports, files, and other records.”\(^1\) These financial audits are important to ensure that all funds are being used appropriately and are properly tracked and accounted for within the program. Beyond examining the fiscal health of a program in a financial audit, a programmatic audit can be equally important to examine programmatic operations (e.g., credit/debit tracking, full cost accounting, long-term management) and assess compliance with relevant regulatory requirements and the program instrument. While a programmatic audit involves a review of documents, including monitoring reports, it generally does not involve site visits to confirm ecological gains.

Although not explicitly required in the 2008 Rule, programmatic audits can help provide confidence to regulators, purchasers, and the public that the ILF program is meeting its substantive requirements and actually offsetting permitted impacts per the requirements in the program instrument. The audit process thus provides credibility to ILF programs that they are doing what they purport to do and meeting their programmatic and regulatory objectives. Audits can also identify necessary improvements and can provide a third-party analysis of program operations and Interagency Review Team (IRT) processes. This could help the program

\(^1\) 33 CFR § 332.8(i)(4).
proactively deal with IRT concerns and potentially clear roadblocks due to concerns related to transparency or trust. Based on the results of an audit, programs can identify changes to improve practice and outcomes, and regulators can pinpoint sticking points in the process to help ensure that decisions are made in a timely fashion.

ELI has conducted programmatic audits of ILF programs. The goals of these programmatic audits were to assess the programs’ compliance with the mandatory, objective program criteria established by applicable regulations and the program instruments, determine whether systems were in place to enable programs to track their management of required processes, and verify that material representations contained in public reports were supported by documentation. The findings of the audits identified areas of program compliance, as well as areas of noncompliance (e.g., the requirement that site acquisition and initial physical and biological improvements be completed by the third growing season after the first sale of advance credits in a service area). We also provided additional observations for program improvement. This guide is based on our experience conducting audits, as well as comprehensive research on program operation. The findings might not apply consistently across all programs. For example, programs operated by state agencies may have their own state auditing department and thus may have less control over timing or substance of the audit.

Challenges Faced by Programs

Given that relatively few ILF programmatic audits have been conducted to date, many programs may not appreciate the benefits of a programmatic audit. Furthermore, programs may not know how to properly craft audit language in program instruments or how to determine what documents are needed to prepare for a programmatic audit.

This guide addresses these challenges by providing information on what to expect from a programmatic audit, including guidance on what information programs should include in their program instruments regarding programmatic audits, as well as model language for audit provisions. It also includes information on how programs can prepare for a programmatic audit, such as common questions auditors may ask and a list of the documents programs can prepare in advance.

Objectives of the Programmatic Audit

Programmatic audits in particular will focus on evaluating whether a program is operated in accordance with federal and state regulations and the program instrument. To address these objectives, a programmatic audit seeks to:

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1. Determine substantial compliance with all required program elements under the 2008 Rule, state law/regulations, and the program instrument;
2. Determine whether material representations made in the program’s reports are supported by documentation; and
3. Determine whether any procedures or practices warrant additional attention.

**Box A: Requirements Under the 2008 Rule for Financial Audits**

Each ILF program must have a program account, which “may only be used for the selection, design, acquisition, implementation, and management of in-lieu fee compensatory mitigation projects, except for a small percentage . . . that can be used for administrative costs.” A program sponsor must receive written authorization from the Corps before making disbursements from the account, and the sponsor is required to provide annual reports on the program account to the Corps and the Interagency Review Team (IRT). The 2008 Rule provides that the Corps may audit an ILF program account: “The district engineer may audit the records pertaining to the program account. All books, accounts, reports, files, and other records relating to the in-lieu fee program account shall be available at reasonable times for inspection and audit by the district engineer.”

Audit Provisions in Program Instruments

Many programs lack key information about audits, financial or programmatic, in their program instruments. ELI and the Institute for Biodiversity Law and Policy at Stetson University College of Law have identified the essential components programs should include in their instruments regarding financial audits. These recommendations could similarly apply to programmatic audits, which are the focus of this guide. Among other possible components, program sponsors should consider including language related to the following:

- Who (other than the Corps) may perform the audit or review;
- How frequently an audit may occur;
- What form of notice is required;
- How far in advance notice must be given; and
- Who will pay for the audit and how much will it cost.

Programs may also choose to include how confidential information will be handled in an audit, and when and where the audit should occur (e.g., during normal business hours at the sponsor’s office or at the independent auditing entity’s office). Programs should also identify auditing costs as a program expense to allow for a meaningful opportunity for an audit to occur. The Nature Conservancy’s Virginia Aquatic Resources Trust Fund and The National Fish

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3 33 C.F.R. § 332.8(i)(1).
4 33 C.F.R. § 332.8(i)(2)–(3).
5 33 C.F.R. § 332.8(i)(4)
and Wildlife Foundation Sacramento District California ILF Program provide examples of ways programs can address audits in program instruments (see Boxes B and C). While these provisions may have originally been intended primarily for audits of the program account (financial audits), some of the language may be repurposed for programmatic audits to help programs prepare for either audit as needed—in particular, any applicable language related to who will perform the programmatic audit, the timeline for advance notice for such an audit, and ways to account for auditing costs.

### Box B: Model Language for an Audit Provision in a Program Instrument:
The Nature Conservancy’s Virginia Aquatic Resources Trust Fund

Payments made to this Program by permit applicants, permittees or other parties as approved by the USACE, DEQ, and/or VMRC to compensate for losses to aquatic resources will be deposited into an interest-bearing account at a financial institution that is a member of the Federal Deposit Insurance Corporation. . . . The Conservancy shall account for the funds so held in accordance with generally accepted accounting principles. The IRT shall have oversight of and the ability to audit the Account. The USACE and DEQ may review Account records at reasonable times and after providing fourteen (14) days written notice to the Conservancy. When so requested by the IRT, the Conservancy shall make available to the IRT all books, accounts, reports, files, and other records relating to the Account.

* * *

[T]he Program shall be audited once every five (5) years by an independent auditor, the cost of which shall be a programmatic expense of the Program. The audit shall consist of a fiscal audit, a program audit, and such other programmatic aspects as determined by the Conservancy, USACE, and DEQ.

### Box C: Model Language for an Audit Provision in a Program Instrument:
The National Fish and Wildlife Foundation Sacramento District California ILF Program

In addition, the Program Sponsor applies generally accepted accounting principles (“GAAP”) to all of its financial accounts, which will include the ILF Program Account. . . . The Program Sponsor’s conformance with GAAP will thus be audited on an ongoing basis as part of the Program Sponsor’s annual independent financial audit.

* * *

Upon request, the Program Sponsor shall also provide to any requesting IRT Member copies of its audited financial statements for any completed fiscal year. The IRT may inspect and review Program Account records by giving 30 days advance written notice to the Program Sponsor. When so requested, the Program Sponsor shall make available for inspection all books, accounts, reports, files, and other records relating to the Program Account.

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A percentage of each Advance Credit Transfer will be assessed and collected by the Program Sponsor as an administrative fee for the general administration of the Program, which includes tasks associated with the planning and operation of the overall ILF Program, which may be performed by the Program Sponsor or by third parties under professional services contracts. These activities may focus on the overall ILF Program or may be associated with activities related to undifferentiated ILF Projects. They include, without limitation, the following: . . . Internal and External Audits. . . .

The Rule does not specify a frequency with which an audit may occur. Where programs have described an audit frequency in their instrument, some describe in vague terms when they may be audited in general (e.g., “from time to time,” “periodically,” or at a “frequency deemed appropriate”), while others are more specific and provide for an audit annually or every five years. A five year audit may make sense for many programs, but the frequency may depend on a variety of factors (e.g., age of the program, outstanding liability, need to identify operational sticking points, instrument requirements, etc.).

Most program instruments do not include information about who will bear the cost of the audit or how much the audit will cost. It is recommended that the sponsor factor in the cost of audits up front as a program expense. An audit could cost around $50,000 or more, depending on the complexity of the program and the scope of work.

Steps in the Programmatic Audit Process

Based on ELI’s experience in conducting programmatic audits, we have developed a general overview of the systematic process of an audit. Once a program has decided to conduct a programmatic audit, programs should prepare for the following steps:

1. **Determine who will conduct the audit.** Auditors may include IRT or Corps members or an independent third party.
2. **Determine the scope of the audit.** This process will most likely involve review and input from the IRT and the auditor.
3. **Review program documentation.** This may involve site visits and desk review. Key documents reviewed will include the program instrument, credit ledger, and standard operating procedures, among other documentation.

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8 National Fish and Wildlife Foundation Sacramento District California ILF Program. (2014). *Sacramento District California In-Lieu Fee Enabling Instrument*.
10 *Id.*
4. **Analyze and assess compliance.** The auditors will determine whether the program is in substantial compliance with the program instrument and relevant laws and regulations. This involves verification that documentation supports any material representations made by the program sponsor in required public reports. The auditor may also identify key areas for program improvement.

5. **Prepare the audit report.** Typically, the program is allowed an opportunity to review the draft program audit report. The auditor may include the program’s written responses in the final program audit report, including a description of steps to be taken to remedy any instance of noncompliance.

### Potential Components of a Programmatic Audit

Depending on what a program has agreed upon with the IRT, auditors may examine a number of program components. Based on ELI’s previous audits, we identified the types of questions auditors might consider and what documents they might need. While each audit may differ based on what questions the IRT and the program prioritize, the following list captures many possible components of a programmatic audit:

- **Credit tracking**
  a. Maintenance of a credit-tracking system that accurately reflects determination of credits, generation and release of advance and released credits, and documentation of credit transactions (e.g., credit purchase receipts), credit releases, and project approvals
  b. Calculation and allocation of advance credits
  c. Determination of land acquisition and initial physical and biological improvements by third full growing season after the first advance credit in each service area is sold or debited\(^\text{11}\)
  d. Determination of current deficits and identification of points of delay
  e. Identification of time-efficient practices and plans
  f. Documented approval of mitigation project sites

- **Compensation planning framework**
  a. Compliance of projects with the approved compensation planning framework

- **Individual projects**
  a. Site development plans (mitigation plans) include all required elements
  b. Documentation of basis for amounts of financial assurances
  c. Monitoring plans consistent with instrument and regulatory requirements

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\(^{11}\) Some programs may have established procedures for addressing cases where it is not possible to meet this standard, in which case it would be beneficial to review these records/documents/approvals.
d. Long-term management and maintenance plans consistent with instrument and regulatory requirements

e. Documentation of basis for amounts of long-term management costs

f. Adaptive management plans consistent with instrument and regulatory requirements

g. Recorded land protection documents

• Credit costs
  a. Credit cost calculation system reflects full cost accounting
  b. Methodology for evaluating and updating credit fees

• Reporting
  a. Satisfaction of required reporting protocols

• Additional elements, as agreed
  a. Creation and maintenance of standard operating procedures

Potential Audit Documents to Prepare

Below is a list of program documentation that auditors will seek to review in order to address the elements listed below (Table 1). In general, the key documents for review will include mitigation plans, monitoring reports, annual reports, credit ledgers, budget ledgers, long-term management plans, and written standard operating procedures. Documents posted to RIBITS12 or a file sharing platform will allow easier access for the IRT and auditors.

Table 1: Program Documentation for Audits

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<thead>
<tr>
<th>Category</th>
<th>Documents</th>
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<tbody>
<tr>
<td>Credit ledger spreadsheet and tracking system, organized by service area and individual projects</td>
<td>• Credit ledger showing tracking of liability, number and type of credits sold (debits), date of credit sale, permit numbers associated with credit sale, project approvals (date, number of credits), released credits available, advance credits, debits, etc.</td>
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12 RIBITS (Regulatory In lieu fee and Bank Information Tracking System) is an online tracking system for information on mitigation and conservation banking and in-lieu fee programs across the country.
| Documentation to support credit ledger spreadsheet | • Close-out letters—release of project credits  
• Documents for credit transaction authorizations, including:  
  ○ Credit sale (receipt) or other official document of transfer of credit responsibility  
  ○ Conflict disclosure form  
  ○ Credit payment voucher  
  ○ Preliminary authorizations (reservation of credits)  
  ○ Invoices  
  ○ Receipts/proof of payment  
  ○ Credit authorization certificates  
• Request for credits from permit applicants  
• Records relating to sale of advance credits and satisfaction of regulatory requirements |
| Budget ledger spreadsheet | • Budget ledger (for analysis of full cost accounting, long-term financing, administrative costs, and financial assurance requirements)  
• Supporting documentation |
| Documentation supporting decisions for fee adjustments | • Notices to the Corps/IRT of each change, if specified in the program instrument  
• Documentation of methodology for analyzing project budgets and sufficiency of credit costs |
| Written standard operating procedures (SOPs) | • Program instrument  
• Written formal Quality Assurance/Quality Control protocol for:  
  ○ Data entry, timely signing and submittal of credit transaction certificates to the Corps, and reconciling close-out credit releases from projects with the number of potential credits on the program’s credit ledger  
• Standard letters used in implementing the program  
• Internal databases used by the program to manage and track the status of projects |
| Documents pertaining to compliance of mitigation projects to compensation planning framework | • Compensation planning framework  
• Documentation of approvals for authorized deviations from service area (e.g., use of secondary service area) or out-of-kind mitigation |
| Documents pertaining to specific mitigation projects | • Compensation planning framework  
• Plans and assessments  
• Project proposals  
• Permit applications/approvals  
• Initial evaluation letters |
- Mitigation plans (site development plans), including date approved/date of initial credit release and mitigation plan approval letters
- Monitoring reports
- Progress reports
- Contractual documents
- Adaptive management plan
- Long-term management plan (see below)

### Documentation of land protection
- Site/land protection documents (e.g., conservation easement)

### Documentation for appropriate types of financial assurances listed under the 2008 Rule
- Documentation of performance bonds, escrow accounts, casualty insurance, letters of credit, and legislative appropriations for government-sponsored projects, or formal, documented commitment from a government agency or public authority as a form of financial assurance
- Administrative record for the permit, program instrument, or mitigation plan, documenting rationale for amount of financial assurances (including negotiations between IRT and the program)

### Long-term management and maintenance plan
- Long-term management and maintenance plan documents that include the following information:
  - The parties responsible for long-term management
  - The long-term management and maintenance requirements
  - The party responsible for long-term ownership
  - Annual cost estimates for carrying out long-term management needs
  - The funding mechanism that will be used to meet those needs
  - The party responsible for managing the funding mechanism
  - Objectives to address long-term management requirements of a site
  - Provisions for periodic patrols of the site for signs of trespass/vandalism and maintenance actions to deter trespass and repair vandalized features
  - Provisions for monitoring the condition of structural elements and repair/maintenance of these elements as necessary
  - Requirements to submit status reports to the IRT on a regular basis
<table>
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<tr>
<th>Documents used to calculate long-term management costs</th>
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<tr>
<td>• Spreadsheets used to calculate long-term management costs</td>
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<tr>
<td>• Computer-generated reports from long-term management costs calculators, such as from the Property Analysis Record (PAR) and The Nature Conservancy’s Stewardship Calculator</td>
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<tr>
<td>• Documentation for analyses of long-term management costs of previous projects or neighboring program procedures</td>
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<td>• Documentation for calculating credit percentages based on average long-term management costs</td>
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<td>• Discussion of inflationary adjustments or other contingencies for long-term management funding</td>
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<td>• Documentation of investment strategy</td>
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<td>• Account statements for long-term management fund</td>
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<th>Annual reports</th>
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<tr>
<td>• Program instrument</td>
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<td>• Reports that include the following information and supporting documentation (as described above):</td>
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<td>o All income received, disbursements, and interest earned by the program account</td>
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<tr>
<td>o A list of all permits for which ILF program funds were accepted. This list should include: the Corps permit number (or the state permit number if there is no corresponding Corps permit number, in cases of state programmatic general permits or other regional general permits), the service area in which the authorized impacts are located, the amount of authorized impacts, the amount and type of required compensatory mitigation, the amount paid to the ILF program, and the date the funds were received from the permittee.</td>
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<tr>
<td>o A description of ILF program expenditures from the account, such as the costs of land acquisition, planning, construction, monitoring, maintenance, contingencies, adaptive management, and administration</td>
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<td>o An annual report ledger showing the balance of advance credits and released credits at the end of the report period for each service area. These should include liabilities and outstanding liabilities.</td>
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<td>o Any other information required by the Corps in C.F.R. § 332.8(i)(3)</td>
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<tr>
<td>o Financial assurance accounts and balances</td>
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<td>o Long-term management report</td>
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Case Study: Programmatic Audit of the Virginia Aquatic Resources Trust Fund

In 2016, ELI conducted the first programmatic audit of an ILF program, the Virginia Aquatic Resources Trust Fund. In its review, ELI examined records provided by the program and on RIBITS, including the program credit ledger spreadsheet, budget spreadsheet, standard operating procedures (SOPs), standard letters in implementing the program, internal databases for tracking projects, and annual reports, as well as documents related to specific mitigation projects. Following the program audit agreement with The Nature Conservancy as approved by the IRT, ELI reviewed the program’s performance of requirements under federal and state regulations and the program instrument (see “Potential programmatic audit elements” above). Upon review, ELI found that the program demonstrated substantial compliance with all required program elements under review, with one exception. The requirement that site acquisition and initial physical and biological improvements be completed by the third growing season after the first sale of advance credits in a service area was not met for all basins and service areas in which advance credits were sold by the program. A financial audit was conducted concurrently with ELI’s programmatic audit, so ELI did not review the financial records of the program.

The audit informed the Corps’ reauthorization of the program, and the program undertook actions to fulfill outstanding mitigation obligations and reexamined current practices. The Virginia Aquatic Resources Trust Fund’s programmatic audit serves as an example of how programmatic audits can help programs and agencies identify and get on the same page about programmatic issues a program may be facing and steps needed to revise operating procedures and reach compliance with federal, state, and program instrument requirements.

Conclusion

Beyond the components and documentation provided above, programs may be required to prepare additional documentation depending on the circumstances of the audit and the challenges faced by the program. Audits provide an important opportunity to assess the fiscal and operational health of a program and allow the IRT to identify sticking points to improve a program’s practice and outcomes. To prepare for this process, programs may consider including language related to programmatic audits in their instrument—including discussing frequency and scope of audits and including related costs in their full cost accounting analysis, reviewing key steps and audit elements, and putting systems in place to track and archive documentation that may be reviewed by auditors.

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