

Prioritizing Process: How Poor Process Contributes to Compliance Failures

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May 4, 2018



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Today

- Volkswagen Emissions Scandal
- Volkswagen's Governance Structure
- Process Oriented Approach (POA)
- Volkswagen's Poor Process
- Prioritizing Process
- Questions and Discussion



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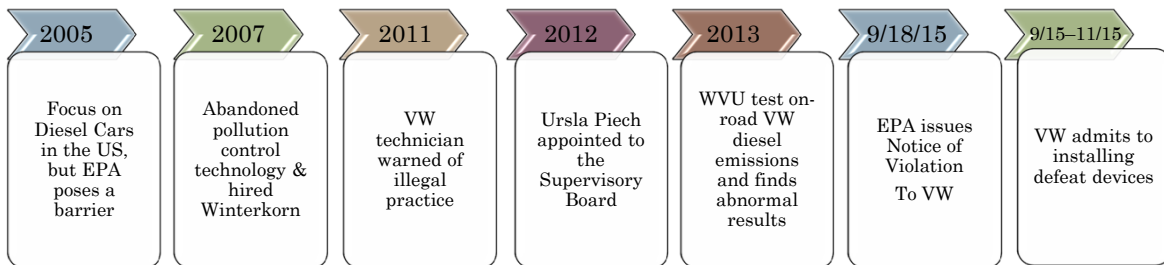
Staggering Statistics

- 11 million vehicles
- \$30 billion in fines and buybacks
- 48 hours
- 6 executives
- 7 years in prison
- 3 years



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Timeline



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How Did VW Do It?

- Volkswagen, Porsche, and Audi Models
- 2009-2016
- 2.0L and 3.0L diesel engines
- Puts children, elderly, and those with respiratory diseased at risk



THE VEHICLES EMIT UP TO
40 TIMES
THE LEGAL LEVELS OF NOX

which can cause
emphysema, bronchitis, and
other respiratory diseases.



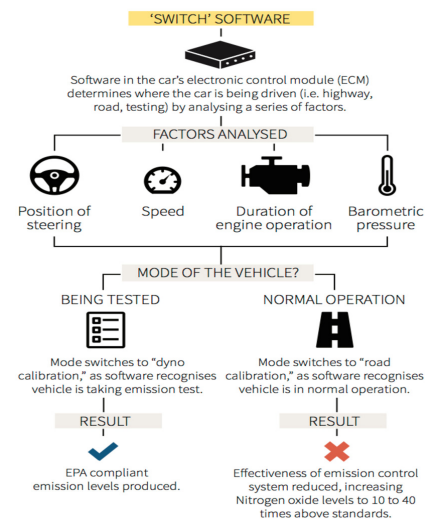
Source: Weitz & Luxenberg
<https://www.weitzlux.com/consumer-protection/volkswagen-defeat-device/>



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How Volkswagen's defeat device works



Source: U.S. Environmental Protection Agency
J. Wang, 22/09/2015

REUTERS



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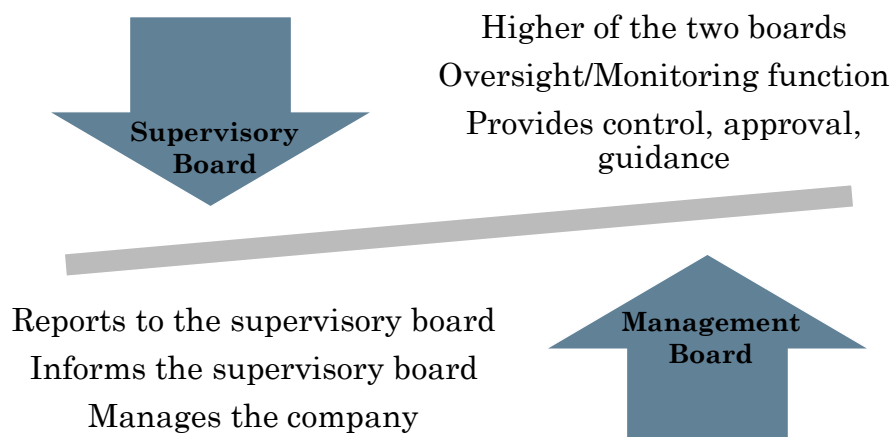
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German Dual Board Structure



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Deutscher Corporate Governance Kodex (DCGK)

- **Standards of independence**

- Non-independent if a supervisory board member has a conflict of interest
- Limits the number of former management board members to two

- **Volkswagen lacked independence**

- Porsche and Piech members have significant influence over the supervisory board
- State of Saxony holds two seats
- Qatar holdings has two seats
- Guaranteed jobs for over half of the supervisory board



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VW's Risk Management System

- Funneled through Management Board
- Management Board decides whether to inform the Supervisory Board



THE THREE LINES OF DEFENSE MODEL



Source: Volkswagen 2014 Annual Report



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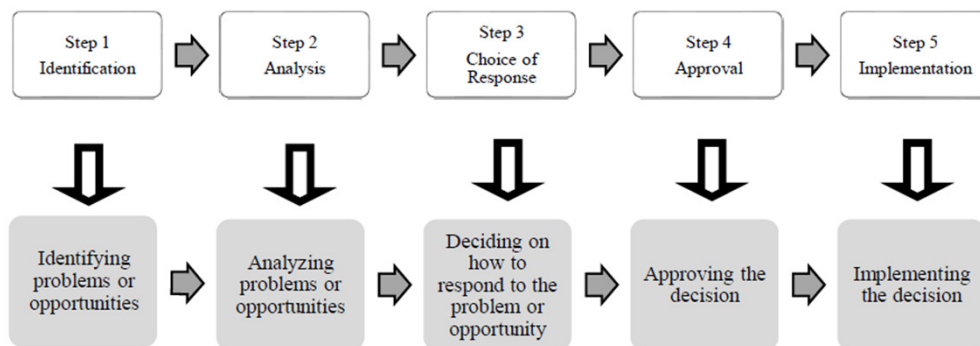
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Process Oriented Approach



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Necessary Tools

- Time
- Information
- Knowledge



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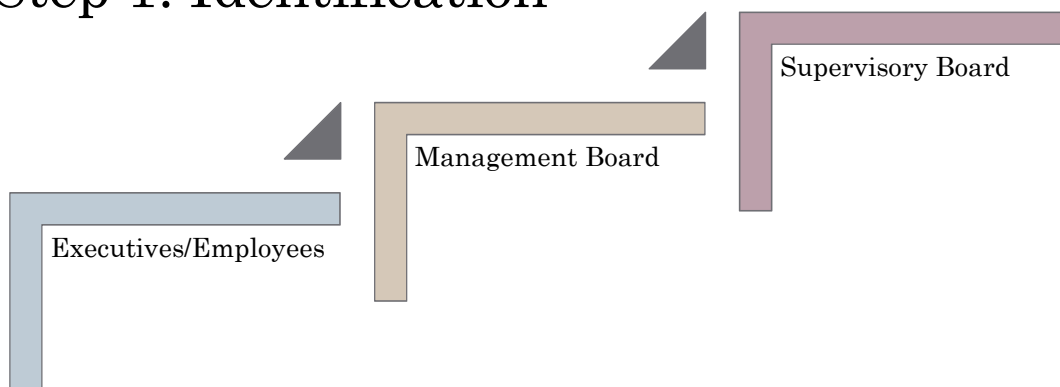
Cosmetic Independence

- **Time**
 - 5 to 6 meetings per year between 2008 and 2015
- **Information**
 - Lacked complete information
 - Engineers were insulated in designing the diesel products
 - Disseminated to executives but not the board
 - Autocratic leadership
- **Knowledge**
 - Lacked firm specific knowledge
 - Limited technical knowledge



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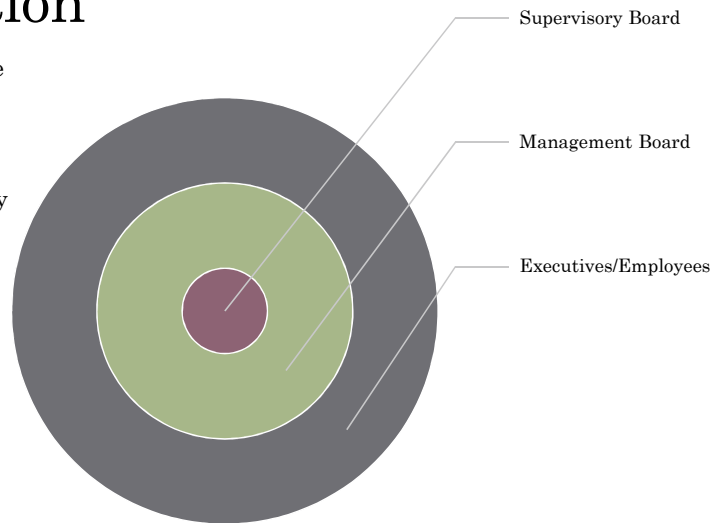
Step 1: Identification



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Step 1: Identification

- Executives and employees determine the information the Management Board received
- Management Board further filters the information passed on to the Supervisory Board
- These gatekeepers create the outer boundaries of the problems the Supervisory Board can identify
- Gatekeeper limitations include her:
 - Biases
 - Expertise
 - Goals



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Diesel Success Goals

- In 2009 Volkswagen rolled out “clean diesel in America”
- In 2011, Volkswagen “continued to write the success story of diesel engines in other areas”
- Executives’ motivation to obscure or highlight a problem



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Step 2: Analysis

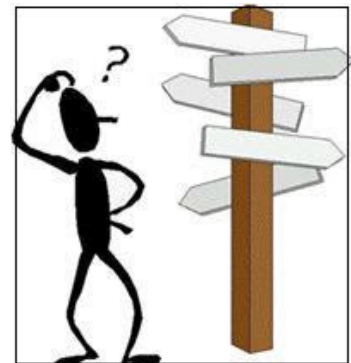
- German courts require that Supervisory Board members – individually and as a group – carry out “independent risk analysis.”
 - More complex transactions require more analysis
- Supervisory Board passively accepted the Management Board’s proposals
- Failure to verify



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Step 3: Choice of Response

- Decision to cheat was made over a decade before
- Organizational structure allowed culpable individuals to insulate themselves
- Management knew, but did not inform the Supervisory Board.



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Step 4: Approval

- Supervisory Board blindly approved Management Board's proposals
- Supervisory Board was more of a pawn than a monitor
- Supervisory Board composition made approval pro forma



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Step 5: Implementation

- Supervisory Board oversight
- Actual implementation is almost completely within the purview of management
 - Bias
 - Control over zealous or lazy implementation



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Improvements

- Culture of Compliance
- Transparency
- Constructive Conflict
 - Devil's Advocate
- Independent Information Gathering Channels
 - Corporate Ombudsperson
- Open Communication Channels Between Silos
 - Open Electronic Access to Information
- Technical Experts on the Board
- A Seat at the Table for Compliance Professionals



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Volkswagen Law

- Fails the test for codetermination
- Lacks independence
- Volkswagen's Poor Process
- Prioritizing Process



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