
Reflections on a Monitorship

Lessons for EHSS Audit and Management

I was fortunate to spend three years of on the Volkswagen Monitor Team. Many colleagues have asked about the experience. Details of the Monitor Team’s work is confidential, as is anything related to activities at Volkswagen. Some of the background and the effort of the Monitor and team are public record. This provides a convenient starting point to offer perspectives on environmental, health and safety and sustainability (EHSS¹) management and auditing. **Readers should not assume that the perspectives in this document originated with VW Monitor Team efforts, or necessarily apply/ applied to Volkswagen.**

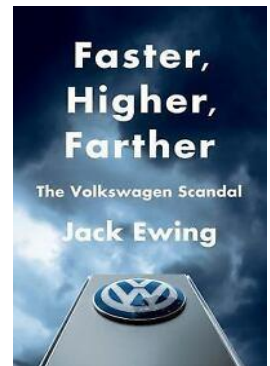
THE PUBLIC RECORD

Faster, Higher, Farther: the Volkswagen Scandal

This book, by Jack Ewing provides an excellent background to the Volkswagen diesel emissions saga. The review on Amazon says, in part:

“In mid-2015, Volkswagen proudly reached its goal of surpassing Toyota as the world’s largest automaker. A few months later, the EPA disclosed that Volkswagen had installed software in 11 million cars that deceived emissions-testing mechanisms. By early 2017, VW had settled with American regulators and car owners for \$20 billion, with additional lawsuits still looming.

“Unable to build cars that could meet emissions standards in the United States honestly, engineers were left with no choice but to cheat. Volkswagen then compounded the fraud by spending millions marketing “clean diesel,” only to have the lie exposed by a handful of researchers on a shoestring budget, resulting in a guilty plea to criminal charges in a landmark Department of Justice case.”



Third Partial Consent Decree

Volkswagen entered into several agreements with regulatory authorities. Among these was the Third Partial Consent Decree. Some excerpts² are provided below.

¹ “ESG” – for Environmental, Social and Governance – is now a common term for “Sustainability”. This tip sheet was developed for an Environmental, Health & Safety professional audience. Perspectives apply to all of ESG.

² For the full document, see <https://www.epa.gov/enforcement/volkswagen-clean-air-act-civil-settlement>



(paragraph 24) “ ... the VW Defendants shall contract with and retain an independent third party to conduct an EMS³ audit pursuant to an industry-recognized standard for product development processes for vehicles ... “ and “ ... the EMS audit shall include (1) an assessment of the VW Defendants’ processes to comply with U.S. environmental laws and regulations; and (2) a recommendation for corrective actions. “

(Paragraph 25) “ ... the VW Defendants shall post a copy of the annual EMS audit report ... on the public website ...” [and] (Paragraph 51) “ ... shall be accessible to the public website www.VWCourtSettlement.com And a link to such website shall be displayed at www.vw.com ...”

Reports at <https://www.vwcourtsettlement.com/en/published-reports>

PERSPECTIVES FOR THE EHS/S AUDIT COMMUNITY

Douglas Hileman Consulting LLC (DHC) offers perspectives on some themes relevant for the environmental, health and safety, sustainability (ESG) audit community.

Scope: ISO 14001:2015 was selected as the industry recognized standard for the EMS audit to fulfill the third partial consent decree. EHS professionals are familiar with ISO 14001. The 2015 version included changes – or additional emphasis – on principles that raised the bar significantly from the 2004 version.

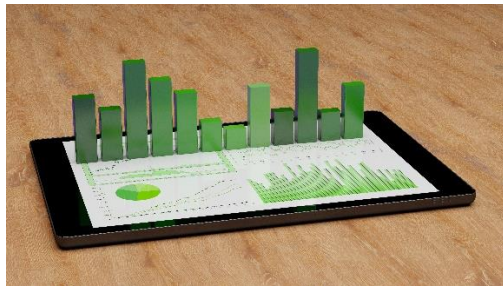
For example, the 2015 version emphasizes life cycle approach to an EMS. This reaches back to the supply chain, includes the organization’s operations, as well as the use of a product (or service) and what happens to it after the end of its useful life. This is a dramatic change from a traditional approach of focusing exclusively on the “four walls” of the operation within an organization’s control. Even the part of the organization within direct control has changed; it now involves contractors, part-time workers, labor from the gig economy, working from home and other practices not envisioned just 20 years ago. Organizations moved in this direction precisely to limit the scope of their control (and responsibility), yet now they have the responsibility to exert influence as part of their EMS. Engagement with the supply chain and value chain is difficult, yet the organization must consider this in an EMS. DHC notes that this extension of scope extends beyond the EMS. Conflict minerals rules, product conformity rules, modern day slavery/ labor rights laws (including reporting) require organizations to exert influence – and report on it – up and down the value chain.



³ EMS is Environmental Management System



Compliance: “Compliance” began – at least in the EHS field – with contents of statutes and regulations. As organizations recognized the extent of possible fines, penalties and other risks, they developed contractual mechanisms to allocate risk and specify EHS performance. EHS provisions are common in contracts up and down the supply/ value chain, lease agreements, insurance policies, transaction agreements, and other contracts. EHS provisions have spread beyond EPA and OSHA (the initial rule makers) into accounting rules, GSA procurement, SEC disclosure requirements and guidelines, and others. Voluntary EHS reporting in Sustainability reports is now expected – it’s “voluntary” in name

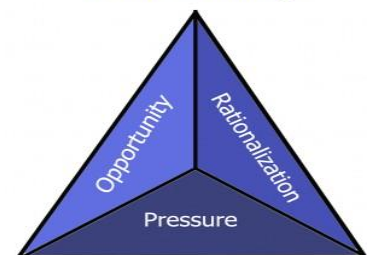


only. Demands from capital markets have led to the founding and explosive growth of organizations that developed standards for EHS reporting and disclosures in financial filings worldwide. Capital markets use these disclosures as a factor in making investment decisions, raising the stakes for complete, accurate and verifiable data and information.

Fraud: Fraud (in my view) is any intentional deceit – whether by commission or omission – for a benefit at the expense of other(s). Just this month, a renowned authority on risk management published a post on “The Auditor’s Responsibility for Fraud” and indicated that the first fraud he identified as an Internal Auditor was on safety statistics. This occurred when safety statistics were submitted to OSHA, and that was about it.

Flash forward a couple decades from this discovery. Safety statistics now influence contracting decisions in the supply chain. They can influence workers compensation premiums, with others (competitors, taxpayers) picking up the slack. They are a factor in public ESG reporting and disclosures, and may be a parameter in analyst ratings and rankings for socially responsible investment funds. How many stakeholders have been adversely affected? How many could claim financial or reputational harm? The risks are not just of OSHA enforcement. Safety statistics are one of hundreds of parameters that comprise ESG. There is incentive for sector-leading performance. Controls are still evolving and remain less mature than for financial reporting. Rationalization that “everybody does it” or “it’s not really a big deal” would be no different than any other topic. This is the perfect “Cressey storm”. EHS / ESG fraud is a thing. The Volkswagen case is a high-profile recent example, but it was not the first. And it won’t be the last. Financial audits, Internal Audits, compliance and risk management programs have incorporated procedures to prevent and detect fraud over the last two decades. Second line audit functions – environmental, safety, etc. – have largely not followed suit.

The Fraud Triangle





EHS/S Audit Programs: Environmental and health and safety audit programs arose in the 1990s to monitor compliance with EHS laws and regulations, and to mitigate risks arising from regulatory enforcement. Few EHS audit programs have evolved with the expanding scope of EHS/ ESG requirements and risks. EHS auditors are familiar with laws and regulations, operations, and audit tools and techniques. This serves as an excellent foundation for broader involvement in ESG risk mitigation.



CALLS TO ACTION FOR EHS/S AUDIT PROGRAMS

Douglas Hileman Consulting LLC (DHC) offers several calls to action for EHS/ Sustainability (or “ESG”) audit programs.

1. Adjust scope to align with dramatic changes in scope of EHS applicability, compliance, and risk.
2. Expand vision of “compliance” to all types of compliance.
3. Look beyond statutes and regulatory enforcement for risks.
4. Create/ expand the role for ESG/ non-financial reporting – especially as directed to capital markets.
5. Design and implement processes to prevent and detect EHS fraud. In your program, and in every audit. Acquire the skill sets.
6. Learn & interact more with other lines of governance, especially Internal Audit.



Doug Hileman’s Experience with Fraud and EHS/ ESG Auditing

2002: supporting financial audits, after Sarbanes-Oxley (contingent environmental liabilities)
2004: COSO Enterprise Risk Management, Internal Audit, on EHS audits
2005: Led audit of reserves for contingent environmental liabilities, and whistleblower program for fulfillment of consent decree with SEC
2008: Sustainability reporting assessments
2012 – 2016: IIA’s Guidance Development Committee (including Fraud Risk Assessment in Engagement Planning)
2014: Independent Private Sector Audits (Dodd-Frank Conflict Minerals)
2015: First IIA presentation on fraud in operations, compliance, EHS
2017: “Environmental Fraud” publication in Bloomberg BNA
2017 – 2020: Volkswagen Monitor Team

