

A BETTER WAY TO MANAGE THE RISK OF REGULATORY COMPLIANCE



Stephane Lagut

Carmakers and their suppliers are accustomed to the strict and well-defined rules of financial reporting. But now the industry faces a very different but no less important issue—dealing with regulatory focus on non-GAAP measures, such as their fuel economy and emissions compliance—that demands a less traditionally structured and more holistic response, according to Stephane Lagut, EY’s Global Automotive Assurance Leader. But he notes that few companies have applied the management tools they need for effective results.

Lagut says organizations have two options for addressing regulatory challenges. One is simply to respond when an issue arises. But he believes an innovative and proactive approach could avoid the negative impact of a crisis on the company’s market valuation and brand reputation.

Why should companies be more proactive about regulatory compliance?

All companies have policies and procedures in place to meet regulatory targets, but we know by experience that such mechanisms may be affected by social and political pressure. Further, few organizations have processes in place to handle an investigation if something goes wrong. Their ability to timely respond and defend may be limited. More important, almost no company has a system in place to monitor its own internal data to reveal compliance issues before they become a crisis.

The time to prepare is now. It’s obvious in the recent actions of regulatory agencies in the US, Europe and elsewhere that the industry faces far closer scrutiny over such issues as narrowing the gap between emissions measured in the lab and on the road. How these issues will be resolved remains to be seen, but regulators have made it clear they intend to write new rules to reduce the discrepancies.

Smart companies will recognize the strategic advantage in setting mechanisms in place to manage the risk represented by these emerging trends and better understand the pressures on their people to position themselves to help shape the rule making itself. Fortunately, they have access to more data about these matters than anyone else. The industry needs to tap its big data to respond more effectively—and to help regulators establish realistic and sustainable goals.

How should a company get started on the process?

The first step is to assess existing compliance programs. This evaluation could be performed by an internal or external team. The process should include engineers and data processing people who understand the data and how it is produced, as well as resources who understand employees’ beliefs. The team’s goal would be to look beyond the processes in place to meet specific regulatory rules and focus on how those procedures and their people are responding to the task.

We at EY believe companies should be using their internal big data to determine whether compliance issues exist before an outside entity discovers a problem. And if there is an external investigation, companies should be able to immediately launch their own internal probe and identify the issue to quickly develop and implement a response.

Does this mean applying well-known risk management techniques?

Not exactly. Assessing and managing regulatory risks requires different techniques because compliance isn’t just about setting limits and taking measurements. Public perception and political reaction introduces an element of irrationality. Yes, risk management is part of the solution. But the answer is a holistic approach that considers such factors as investor relations, brand management and the management of intangible value in addition to the basic technical issues.

Are companies clear about how to proceed?

There is some confusion about what is expected. Many companies are inclined to withhold information or hide from the issue. Their reluctance to be more open is understandable regarding emissions and fuel economy, especially in key developed markets, because the performance requirements there suddenly aren’t as clear as the industry thought they were.

Regulators in other major markets are expressing similar interest in revisiting standards and test methods. Unless carmakers take a stronger leadership position, they will have limited influence over how these revised regulations are set.

What is EY’s role in the process?

We would like to help the auto industry develop a broader approach to regulatory compliance. Companies must meet whatever regulations are set, of course. But they need to look at regulations as more than simply meeting target numbers. There should be better alignment between regulatory performance and what the organization stands for. If financial performance is plotted on a horizontal axis and honesty of employees on a vertical axis, the objective is to be in the upper-right quadrant, which is high performance and high integrity.

EY is developing new measuring tools and techniques to help, including those to gauge the social environment and assess conduct risks. Our objective is to help companies gain better alignment between corporate image and staff performance. This doesn’t alleviate the existing rules, but a broader perspective on the part of management could help balance cost of control and cost of risks to improve performance.

Click [HERE](#) to learn more about EY or visit ey.com/automotive.

