

Auditing risk culture

Art or science?



PRICEWATERHOUSECOOPERS 

Auditing risk culture, Art or science?

Whenever there is a major corporate scandal – fraud, unexpected losses, inappropriate selling practices, and safety failures – the finger is inevitably pointed at organisational culture. So it is not surprising that there is a strong desire throughout Australian businesses to measure and evaluate a company's risk culture, so that action can be taken to reduce potentially major exposure.

Risk culture refers to the culture of the organisation, or 'the way things are done here' in relation to risk taking. When assessing risk culture, we consider those aspects of company culture that have the greatest potential impact in terms of managing risk.

This assessment exercise – a risk culture audit – constitutes a major opportunity for internal auditors. An assessment of the culture identifies the actions and practices in the company that may directly contribute to issues arising in the future. By providing predictive insights to the board and senior management, and by reinforcing desirable cultural traits and practices, Internal Audit can make a significant contribution to corporate performance and integrity.

However, risk culture audits are uncharted territory for most internal auditors: There are no established standards and, as yet, no generally accepted practices.

At PwC, our approach is to reach below the surface of the traditional internal audit to shed some light on the culture and behaviours that underpin effective corporate controls. We include behavioural psychologists – and their methodologies – as an integral part of the team in a range of audits and reviews, providing both qualitative and quantitative risk culture feedback.

Art and science

In our experience, risk culture auditing is both an art and a science. It takes a combination of the experienced auditor's intuition (the art), and adds behavioural, process, controls and other organisation findings (the science), to deliver a view that enhances traditional audit analysis and provides powerful insights.

Mixing art and science in this way is not as radical as it might sound. How often does a sixth sense prove to be right, or how often do we make incorrect assumptions about the reasons for others' behaviour – and how much better to be able to turn a 'gut feeling' into an objective audit finding?

If you are thinking of incorporating risk culture auditing into your approach, we offer some suggestions based on our experience.

1. Is your organisation ready?

Most large organisations already measure their culture, although the concept of auditing risk culture may not be so familiar. It is vital there is some discussion with the board and management about the objectives, the benefits, the implications and the steps needed to implement or even pilot risk culture auditing.

2. Can the internal audit mandate be broadened?

Internal Audit can sometimes be pigeonholed into a narrow area of focus. If this is the case in your organisation, then this is an opportunity to demonstrate real added value and display the breadth and adaptability of the Internal Audit team's knowledge and approaches.

3. Are the main internal stakeholders on board?

A key part of the risk culture audit process is tapping into the organisational indicators that are already in place, for example performance management and reward approaches, employee surveys and other employee-related data. These tools are typically managed by HR and it is therefore important to work collaboratively with HR – they will also bring value to the process. Similarly, working with Risk and Compliance will ensure the most effective use of data collected and analysed by each part of the company.

Doing this successfully involves communicating with all key stakeholders throughout the organisation the value of auditing risk culture, agreeing the proposed approach and desired outcomes, and establishing respective roles in the process.

4. Do you have the skills you need?

Some specialist skills are likely to be needed to develop and implement these approaches. You may need to team with particular individuals in HR, bring in external specialists, or recruit directly into your team to get access to the models and psychology skills required. In addition, while some Internal Audit team members may be comfortable working with less tangible cultural issues, many are likely to require additional support and assistance.

5. How are you going to conduct the audit?

We recommend a pilot approach first, perhaps covering only a part of the business. A combination of desktop data reviews and targeted in-depth reviews, including interviews and perhaps focus groups to validate findings from the data analysis, might be sufficient. This will allow both the organisation and the Internal Audit team to test the approach and provide feedback to each other before embarking on a more extensive implementation.

In selecting a pilot, you might want to focus on a core business area, or an area with a history of major changes (instability), or an area where management is particularly concerned about audit findings, or employee feedback. Techniques that examine existing business data and organisation cultural indicators, as well as behavioural interviews to validate findings, will provide the 'science' element of the audit.

6. What are the outcomes?

The typical output from a risk culture audit is key findings that describe the culture in terms of controls effectiveness, or risk management. These findings can be incorporated into a board or management report in the form of a controls report, audit assignment findings or a risk review. Typical questions addressed by these findings include:

- Do you really know the risks in your culture?
- How confident are you in the behaviours of your managers and staff?
- You have invested a lot in processes and controls – are people using them effectively?
- When something goes wrong, will people do the right thing?
- Where is the next ‘hot spot’ likely to be?

The value of a risk culture audit

In the current highly challenging economic environment, the same questions greet any new corporate initiative: What does it cost? What value does it add?

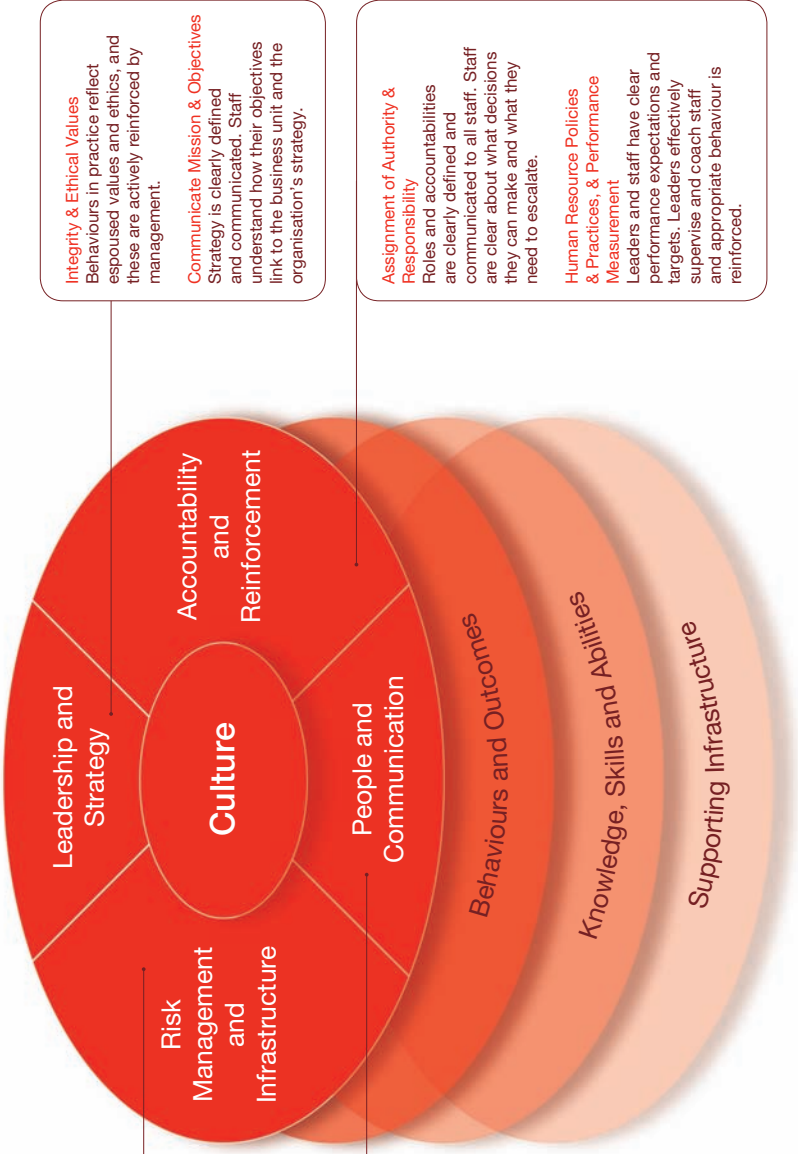
At a time when the business is likely to be under increased pressure, focusing on the risk culture makes commercial sense. Using a combination of art (experience and intuition) and science (knowledge, skills and tested approaches), Internal Audit will be in position to quickly provide insights about how the business is coping with the external and internal challenges it faces.

This proactive input means the board and senior management are informed about their risks and equipped to take appropriate action. The value that Internal Audit brings is reinforced and enhanced, to the benefit of the entire organisation.

Getting started

1. Determine your objectives for reviewing risk culture, including initial stakeholder engagement
2. Agree the model of risk culture you will use (where you want to focus)
3. Agree the measurement framework (what you want to review)
4. Approach (how you will conduct the reviews, including using other information sources)
5. Decide on the information sources (what exists, what's new)
6. Agree reporting (style, audience, timing, how reports will be used)
7. Engage stakeholders again to support outcomes and approach
8. Identify team members and build the necessary skills
9. Protect the integrity of the risk culture audit (establish protocols to protect confidentiality including data storage, access and use)
10. Establish quality assurance approach (how you will monitor the ongoing effectiveness of the risk culture audit)

Risk Culture model



Established Processes & Controls
 Business processes are effectively controlled and controls keep pace with change and complexity in the business.

Identify & Assess Risk
 There are clear processes to identify and assess risk. There is a clear framework with which risks are evaluated and controls are managed.

Integrity & Ethical Values
 Behaviours in practice reflect espoused values and ethics, and these are actively reinforced by management.

Communicate Mission & Objectives
 Strategy is clearly defined and communicated. Staff understand how their objectives link to the business unit and the organisation's strategy.

Commitment to Competence
 Staff are appropriately qualified, skilled and experienced to effectively perform their role. There is a focus on continuous improvement.

Information & Communication
 Communication and symbols reinforce the organisation's values, ethics and behavioural expectations. Communication between functions is effective.

Assignment of Authority & Responsibility
 Roles and accountabilities are clearly defined and communicated to all staff. Staff are clear about what decisions they can make and what they need to escalate.

Human Resource Policies & Practices, & Performance Measurement
 Leaders and staff have clear performance expectations and targets. Leaders effectively supervise and coach staff and appropriate behaviour is reinforced.

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