

Many Hats: Audit and Risk Committee Series

Behavioural risk: How can Audit and Risk Committee members ensure the culture within your organisation isn't resulting in unnecessary risk? | September 2018



Overview



Over the past few years, organisations across all industries have enhanced their focus on the culture and conduct (or behaviours). This has been driven by regulation in some sectors, and also by the rising incidence and cost of incidents where poor behaviours played a key role.

There are many examples where these costs have been heavy on individuals health and well-being, on organisations through the financial and reputational cost of issues and claims, and on whole industries where systemic issues have been observed.

The two recent Australian Royal Commissions into institutional responses to child abuse and the financial services sector, as well as the APRA CBA report, have made it very clear that organisational culture and the conduct of individuals, once seen as the responsibility of HR, is a matter that needs to be firmly on the agenda of both senior management and the Board.

Nurturing a strong culture has important benefits including superior performance, the confidence to be proactive, increased organisational resilience as well as reputational enhancement and protection.

Therefore, more executives, Boards and their key Committees are wanting clarity over the culture and conduct they desire, and assurance that this is realised in practice.

Risk, culture, conduct and behaviours...

Behavioural risk is the possibility of undesirable risk outcomes caused by poor workforce behaviours (or conduct) and the cultural factors that drive them.

Organisational culture is the sum of employee behavior – it is complex, challenging to observe and difficult to change. It is established and influenced via multiple factors including leadership and communications, strategy and accountabilities, policies and processes, performance and reward, and even external and historic factors. Thus it is challenging to ensure the actual culture is what is intended and expressed.

A desirable culture is unique to each organisation. What is optimal depends on the purpose, strategy and values of the organisation overall, as well as external factors such as the competitive context and the environment. It may also have variations over time, by business unit or the country/culture in which it operates, for example.

The interaction of organisation culture with risk management is referred to as risk culture. This is a key focus area included in regulation, to ensure the organisation culture supports strategy execution within risk appetite and promotes sound risk responses and decisions.

It is often said that potential risks come to life as issues because of human behaviours – people either doing (or not doing) things that are inconsistent with the strategy, values and the risk appetite the organisation desires.

Intended

What we want – Purpose, Vision, Values and Strategy



Purpose



Vision



Strategy



Values



Behaviours



Risk appetite

Expressed

How we set ourselves up using behavioural reinforcers



Leadership
action



Communication



People
practices



Performance
management
and reward



Organisational
structure



External
Environment

Actual

What we get?

The behaviour displayed by employees, driven by the reinforcers but also intrinsic motivation and personal alignment to Purpose, Vision, Values and Strategy.

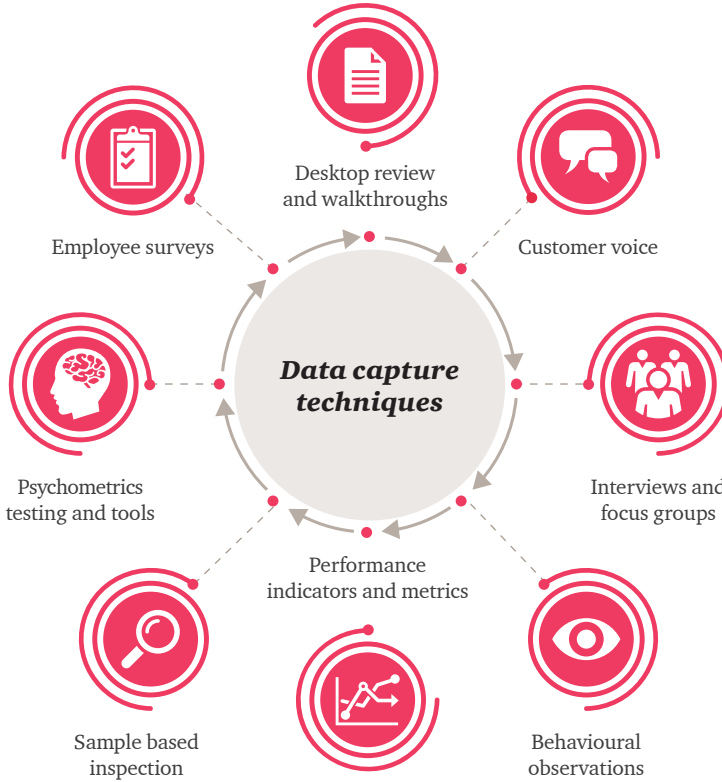


How do we monitor this?

Just as all other risks are assessed, understood and reported against – so too should behavioural risk. Behaviours of employees are a strong source of evidence of the actual culture in any organisation, and can show if the intended and expressed strategy, values, behaviours and risk appetite are being realised.

Just as risk management is not the domain solely of the risk function, culture and behaviours is not just the domain of HR. All executives and employees have a role to play, and a number of supporting functions such as the HR, risk, compliance and audit functions typically have specific roles. So coordination and alignment of these functions on this topic is key.

There are a range of techniques that can be used to consider culture and behaviours:



What are the questions Audit and Risk Committees should be asking?

- What role do behaviours play in executing the strategy within our risk appetite?
- Have we defined and articulated our desired culture and behaviours?
- What role do key organisation functions play in managing and monitoring this?
- What information does the Committee currently receive on the intended and actual culture and behaviours?

When it works well...

Committee role

- Responsibility for monitoring risk culture and any associated regulatory requirements is in the Audit and Risk Committee charter
- The role of other Committees and interactions on this topic, particularly the Remuneration Committee, is clear

Risk function

- Risk culture requirements are in risk management frameworks, processes and reporting
- Regular holistic reporting on risk culture to the Executive and Audit and Risk Committee

Compliance function

- Root cause analysis is conducted on compliance monitoring and breaches to identify behavioural causes and opportunities for systemic improvements

Internal Audit function

- Internal Audit reports comment on the role behaviour played for every audit issue (with root cause)
- 'Deep dive' audits focused on culture and behaviour are conducted using a combination of qualitative and quantitative techniques
- Holistic risk culture audits are performed, often in support of, or in coordination with regulatory requirements

People function

- Performance framework considers behaviours, including those relating to risk and compliance
- Risk incidents and compliance breaches are explicitly considered as part of performance outcomes

Pulling it together...

- Data on risk incidents, compliance breaches, audit findings and behavioural issues is shared between risk, compliance, people and audit functions

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