Applying a behavioural lens in assessing internal controls

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Current Governance & Compliance Landscape

Recent events arising from corporate governance, compliance and cultural failings have resulted in increased scrutiny across the public and private sectors, and increased focus on organisational culture and behaviours.

**Hayne Royal Commission**
- Does conduct, practices, behaviours or business activities fall below community standards and expectations?
- Culture can – and must – be assessed by financial services entities themselves
- APRA should build a supervisory program focused on building culture that will mitigate the risk of misconduct and assess the cultural drivers of misconduct in entities

**APRA CBA Prudential Inquiry**
- “CBA’s continued financial success dulled the senses of the institution”, particularly for management of non-financial risks
- Prominent cultural themes such as a widespread sense of complacency, a reactive stance in dealing with risks, being insular and not learning from experiences and mistakes, and working environment which lessened the opportunity for constructive criticism, timely decision-making and a focus on outcomes.

**ASX Principles updates**
- Proposed changes respond to various enquiries and reviews since 2014 that have highlighted governance issues arising from poor conduct or culture and a perceived lack of accountability.
- The Council considers it important to address these issues around corporate values and culture in the Principles and Recommendations as a way to help arrest the loss of trust in business.

**Edelman’s Trust Barometer**
- In 2018, trust in Australia continues to decline across all four key institutions: media, business, government and NGOs.
- This has resulted with Australia sitting just four percentage points above the world’s least trusting country, Russia.
Hayne Royal Commission

Culture and governance

Recommendation 5.6 – Changing culture and governance

All financial services entities should, as often as reasonably possible, take proper steps to:

• assess the entity's culture and its governance;
• identify any problems with that culture and governance;
• deal with those problems; and
• determine whether the changes it has made have been effective.

‘Managing culture is not a one-off event, but a continuous and ongoing effort that must be integrated into day-to-day business operations.’

‘While cultural norms and beliefs cannot be explicitly measured, the behaviours and outcomes that culture drives can and should be measured’.
APRA Prudential Inquiry

Key APRA focus areas and findings

Role of the Board
- Need to be more diligent in policing the closure of issues
- Insufficient focus on non-financial risks
- Gaps in communication between committees and lack of clarity of committee roles

Senior Leadership Oversight
- Lack of collective accountability at Executive Committee for group risks
- Unclear accountabilities due to silos & layers

Risk Management & Compliance
- Lack of Line 1 ownership of risk & compliance
- Line 2’s influence inconsistent & low
- Too reactive rather than pre-empting issues & risks

Issue Identification and Escalation
- Critical issues not escalated
- Too much focus on process rather than outcomes
- Adversarial, defensive and legalistic engagement with Regulators

Financial Objectives and Priorities
- Prioritisation of investments on financial objectives over Risk and Support functions
- Excess focus on short-term, aggregate view of customer satisfaction metrics

Accountability
- No end to end accountability for risks across business units
- Inadequate consequence management

Remuneration
- Reluctance to apply remuneration adjustments for poor outcomes
- Weaknesses in remuneration framework to reinforce desired behaviours

Culture and Leadership
- Reactivity rather than pre-emption
- Widespread complacency
- Leadership not ‘walking the talk’ in risk management
- Group think leading to poor outcomes
Behavioural Drivers & Controls Model
What are Behavioural Controls?

How can we evaluate something as vast and intangible as culture?

The term “Behavioural Controls” is used to refer to informal, intangible levers of control such as tone at the top, the organisation’s ethical climate, and management’s philosophy and operating style that together make up an organisation’s culture.

Considering behavioural controls provides an indicator or red flags of cultural issues.
What are Behavioural Controls?

**Business Risks**
Including integrity and fraud risks

<table>
<thead>
<tr>
<th>Traditional “Hard” controls</th>
<th>Procedures</th>
<th>Segregation of duties</th>
<th>Measures</th>
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</thead>
<tbody>
<tr>
<td>Risk analysis</td>
<td>(Physical) security</td>
<td>Internal control</td>
<td></td>
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<tr>
<td>Training</td>
<td>Monitoring</td>
<td>Whistleblower guidelines</td>
<td>Safety net</td>
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<tr>
<td>Code of conduct</td>
<td>Performance reviews</td>
<td>Raising awareness</td>
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Fundamental for every organisation is: behaviour of its employees and management
KPMG’s Behavioural Controls Model

**Enforcement** is the extent to which staff are valued and rewarded for desired behaviour and sanctioned for undesirable behaviour.

**Role modelling** means people read the norms applicable to them from the behaviour of others, line managers, senior management and Executives.

**Clarity** is the extent to which the organisation establishes clear expectations, values, behaviour and responsibilities.

**Commitment** is the motivation to invest effort in the interests of the organisation and involves the extent management and employees feel called to actively uphold the organisation’s interests.

**Achievability** is the degree to which the organisation enables everyone to act appropriately in line with established targets.

**Transparency** relates to the extent to which staff are able to see the effects of their own behaviour as well as the behaviour of others.

**Openness to discuss** the extent to which opinions, feelings, issues and dilemmas can be openly discussed internally.

**Call someone to account** is the extent to which staff can be held accountable by others in the organisation for misconduct.

**Enforcement** is the extent to which staff are valued and rewarded for desired behaviour and sanctioned for undesirable behaviour.

**Role modelling** means people read the norms applicable to them from the behaviour of others, line managers, senior management and Executives.
Behavioural Controls Model – In Balance

**Enforcement**
- Too Little = Tolerant
- Too Much = Callous

**Call someone to account**
- Too Little = Avoidant
- Too Much = Meddlesome

**Openness to discuss**
- Too Little = Distrust
- Too Much = Conformity

**Transparency**
- Too Little = Invisible
- Too Much = Overexposed

**Clarity**
- Too Little = Normless
- Too Much = Paternalistic

**Role modelling**
- Too Little = Poor Role Model
- Too Much = Pompous

**Commitment**
- Too Little = Taboo
- Too Much = Dependent

**Achievability**
- Too Little = Pressure
- Too Much = Leisure

**Behavioural Drivers**
- Clarity
- Role Modelling
- Commitment
- Achievability
- Transparency
- Openness to discuss
- Call someone to account
- Enforcement
Behavioural Controls Model – Approaches

1. Entity level controls
   Builds understanding of how the control environment supports behaviour. The focus is on the control instruments which the organisation can use to promote desirable behaviour and prevent undesirable behaviour.

2. Process level controls
   Provides insight into the quality of behavioural controls and how they impact on the effectiveness of the overall controls within a specific process.

3. Root cause
   Analyses identified issues for their root cause and traces it back to an ineffective or lacking behaviours in order to provide more specific and impactful recommendations.
Behavioural Controls Model – Benefits

Get answers to the “hard” questions about controls
Considering behaviour as part of control self assessment will enable management to understand what is “really” going on in the mitigation of its material risks in a more structured and objective way than has been historically possible.

Uncover hidden behavioral drivers to key issues
By applying a behavioural lens we can trace identified process or hard controls gaps or weaknesses to a root cause/s of behaviour to enable management to further develop specific impactful risk treatments.

Challenge management insights
Used as a validation tool to:
• Determine whether existing controls support desirable behaviour, despite significant gaps in the control environment; or
• Identify behavioural issues despite structured hard controls being in place – increasing the risk of something going wrong.

Provide thematic analysis
Performing behavioural control analysis over time will show trends and themes to highlight where human factors may need strengthening and greater management focus.
## Applying behavioural controls – COI case study

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<tr>
<th>What we did</th>
<th>How we did it</th>
<th>What we found</th>
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| This review considered the design and operating effectiveness of processes and internal controls which the organisation had in place to identify, escalate and manage COIs (perceived, potential, actual), and the culture towards COI management. | **Traditional IA approach**  
- Document review and stakeholder discussions to understand current COI processes and controls  
- Distribution of a behavioural controls survey to 500+ Team Manager level staff and above.  
- Responses collated and analysed to understand cultural and behavioural drivers impacting the success of current state COI processes. |  
- Staff are not receptive to criticism on their own actions and behaviours,  
- Staff do not learn from mistakes and are reluctant to report COI breaches for fear of retaliation.  
- Staff lack confidence in the way COI breaches are handled, indicating concerns around confidentiality and the perceived fairness,  
- Staff saw a lack of transparency and consistency of disciplinary processes related to COI |

### How did behavioural controls add value?

- Irrespective of the strength and maturity of overarching governance models, systems and processes, where organisational culture fails to support staff to act with integrity and promote ethical behaviour, an effective COI management process cannot be achieved.
- The use of behavioural controls enabled us to look beyond process and control gaps identified through traditional internal audit. This provided our client with insights into cultural and behavioural drivers of non-compliance with COI processes, and an action plan to guide COI management, aimed to enhance operating effectiveness.
Example behavioural controls analysis

3.1 Detailed survey results

Q4.1 Are positive role models for the organisation

Q4.2 Would respond appropriately if they became aware of non-compliance with the COI process

Q4.3 Would set the right ‘tone at the top’ on the importance of the COI process

Q4.4 Are sufficiently critical towards each others behaviour

Whilst the majority of respondents believe that line managers and supervisors are positive role models who set the right ‘tone at the top’ and would respond appropriately in the event of COI non-compliance, of 166 survey participants:

- 57% do not believe that line managers and supervisors are sufficiently critical towards each others behaviours.

Of this cohort, 23% disagreed, indicating that line managers and supervisors do not consistently hold each other (and potentially their direct reports) to account in order to address unethical behaviour. This contradicts the above favourable responses and suggests that in practice, senior management may not be setting the right example or “tone at the top” in promoting an ethical culture.
Thank you
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