

# Culture and behavioural control auditing

Why soft controls are as important as hard controls

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## The importance of culture and behaviour

People are at the heart of every organisation, and it is human error which often results in non-compliance.

Stimulated by the recent global financial crisis, regulatory interest in culture and behaviour has increased over the last few years. As a result, **internal audit** (IA) functions are being faced with both challenges and **opportunities**. They are uniquely positioned to **bring value** to the organisation by **auditing culture and behaviour**.

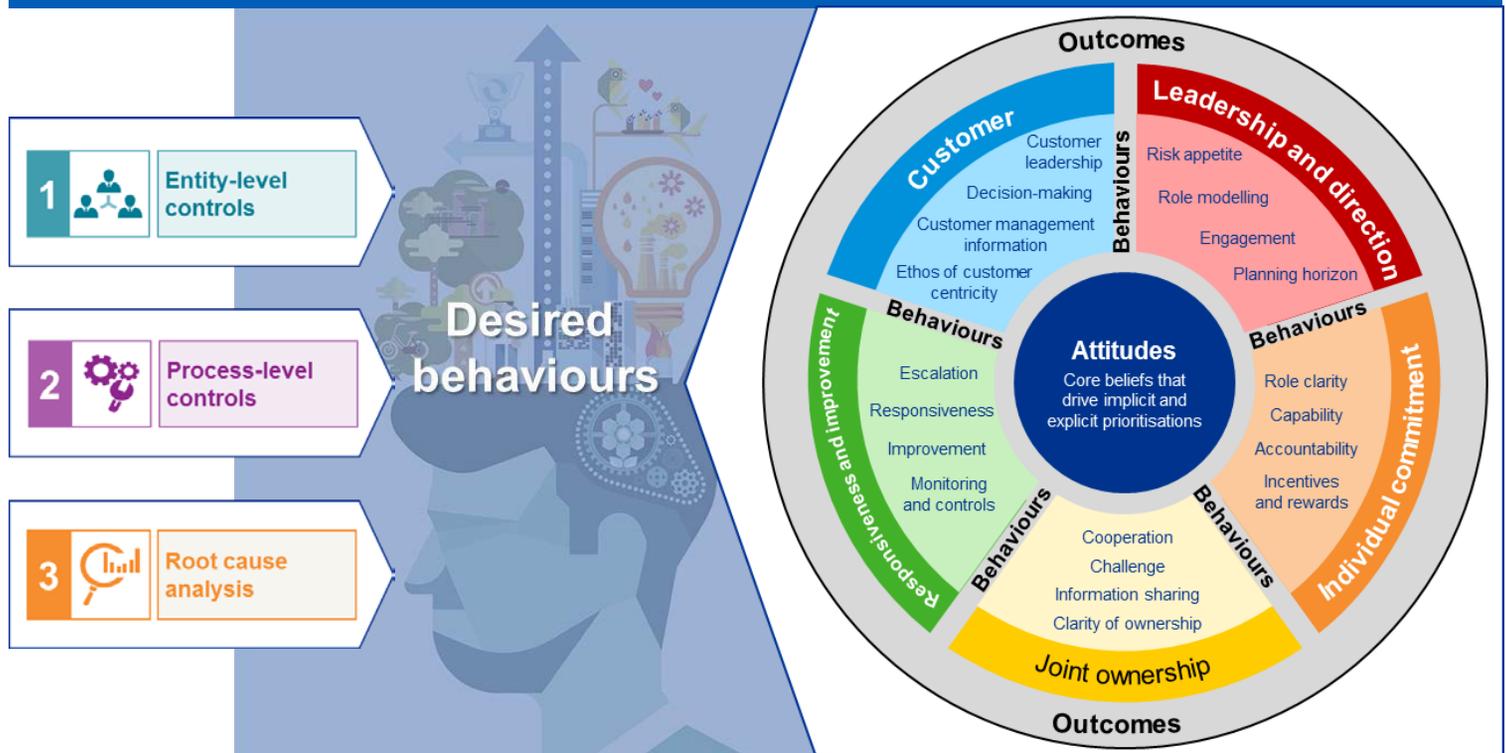
Auditing culture supports the **delivery of stakeholder value** by enabling organisations to proactively manage risk and **correct internal control failings** before things go wrong.

Culture is a complex aspect of business. Many companies are unfamiliar with how to quantify or measure it. However, a company's **inability to audit and monitor culture** consistently and continuously can send a clear – and most likely, unwelcome – message to its stakeholders about its priorities.

## Why the 'soft stuff' matters

- The International Standards for the Professional Practice of Internal Auditing stipulates that the internal auditor must pay explicit attention to soft controls.<sup>1</sup>
- It is **fundamental** to risk management and employee conduct.
- Increasing **regulatory attention** is being paid to (risk) culture and conduct.
- In the Institute of Internal Auditors (IIA) surveys, over 50% of chief audit executives (CAEs) see organisational culture as an **inherent high risk**; however, 58% state that they do not audit organisational culture.<sup>2</sup>
- Integrity is positively related to financial performance.<sup>3</sup>
- Over 90% of CEOs and CFOs believe that improving culture would **improve the value** of their company. Only 15% believe their culture is where it needs to be.<sup>4</sup>

## How can culture and behavioural controls be audited?



Our **approach to auditing culture and behaviour** is primarily focused on three aspects:

- 1) Entity-level controls:** These include governance, organisational set-up, tone at the top, risk awareness and openness, and training (also called behavioural controls instruments).
- 2) Process-level controls:** We scrutinise the quality of behavioural controls that are conditional for the operational effectiveness of hard controls.
- 3) Root cause analysis:** A thorough behavioural controls root cause analysis enables you to not only discover the root cause of audit findings, but also enhance the recommendations to improve the quality of controls.

Core beliefs that drive implicit and explicit prioritisations influence organisational behaviour and can be grouped into five categories. These aspects can be used as the starting point of our analysis.

<sup>1</sup> 'International Standards for the Professional Practice of Internal Auditing (Standards)', The Institute of Internal Auditors, 2012, <https://na.theiia.org>

<sup>2</sup> 'IIA Financial Services Audit Center poll' and 'IIA Audit Executive Center poll', The Institute of Internal Auditors Hong Kong, North American Pulse of Internal Audit, 2016, <https://theiahk.org>

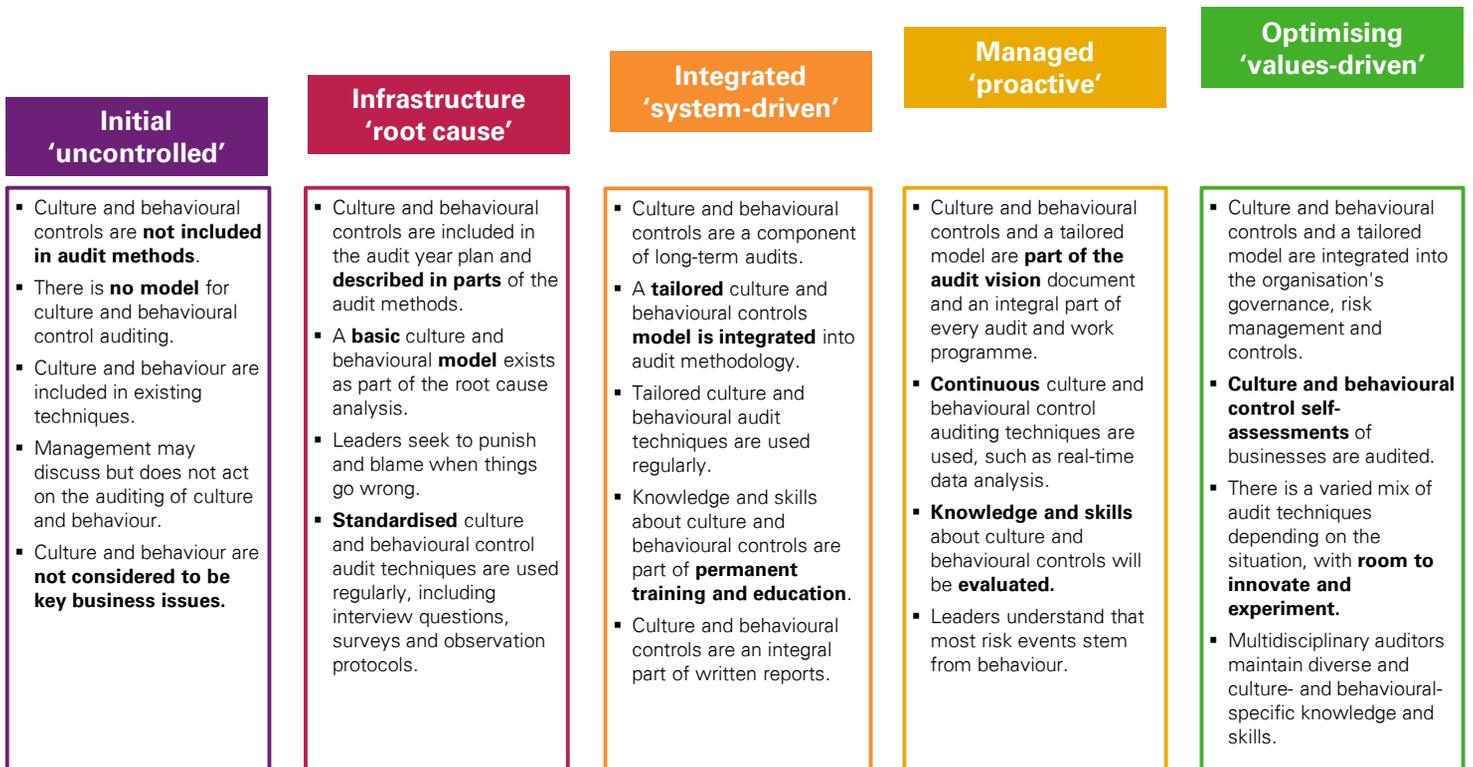
<sup>3</sup> 'The value of corporate culture', Luigi Guiso, Paola Sapienza & Luigi Zingales, Journal of Financial Economics, July 2015, [www.sciencedirect.com/](http://www.sciencedirect.com/)

<sup>4</sup> 'Corporate culture: Evidence from the field', John Graham, Campbell Harvey, Jillian Popadak & Shiva Rajgopal, Federal Reserve Bank of New York, October 2015, [www.newyorkfed.org](http://www.newyorkfed.org)

# How can KPMG help?

We can help you audit culture on a consistent and continuous basis by implementing culture and behavioural controls auditing in your IA methodology. The first step is to determine your organisation's stage of maturity. KPMG can support you at any stage of maturity.

## KPMG'S MATURITY EVALUATION MODEL FOR INTERNAL AUDIT



### Include specific soft controls tests in each audit

- Each audit team can obtain a view on culture and behaviour
- All IA personnel can be trained to do these audit tests
- Potentially limited information compared to a more focused review or audit

### Soft controls audits

- An internal audit focused purely on the testing of soft controls
- Potential to target specific areas, but could also give a wider view
- Client functions can be benchmarked against each other

### Data & analytics testing to identify instances of inappropriate culture

- Continuous monitoring of culture and behaviour in the trading function
- Regular reporting to identify potentially inappropriate behaviour
- Action can be taken in response to identified concerns

### 'Deep dive' culture review

- Targeted on areas or functions with specific risks regarding culture and behaviours
- Involves interviews, staff focus groups, and review of policies and leadership communications involved

Increasing maturity

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