

Part three

# Metamorphosis

Auditing behaviours to make  
control change sustainable

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## Auditing behaviours to make control change sustainable

As internal audit transforms its delivery of value, a key focus is on improving processes and developing the right controls. To embed these changes and make them sustainable, it is important to understand cultural and behavioural impediments. Behavioural auditing and modelling become key skills in this context.



The first article in this series, ***Metamorphosis: Revitalising internal audit to drive performance***, introduced Ernst & Young's internal audit transformation model and established its value proposition. The second article, ***Metamorphosis: Assessing the maturity of your internal audit function***, looked at applying a "maturity model" to understand how to bridge the gap between current internal audit practice and the desired future level appropriate for your organisation.

This third article covers the next step in the transformation journey: aligning the function of internal controls with the actual behaviours across your organisation. Achieving such an alignment involves identifying gaps between what you want to happen and what is happening, and understanding how to drive culture change to make behaviours support your IA controls. While the following insights and tools form part of Ernst & Young's internal audit transformation process, they are equally applicable as a stand-alone application that can be used at any stage of maturity.

**Why audit behaviours in the context of the control environment?**

You could have the best, most comprehensive and most sensible controls, but if they run contrary to culture or “the way we work around here”, they won’t be effective. As Graeme Bignell, a Partner in Ernst & Young’s Advisory group with a background in change management, explains: “Ultimately culture is defined by behaviours, so the best way to assess your control environment is to look at behaviours.”

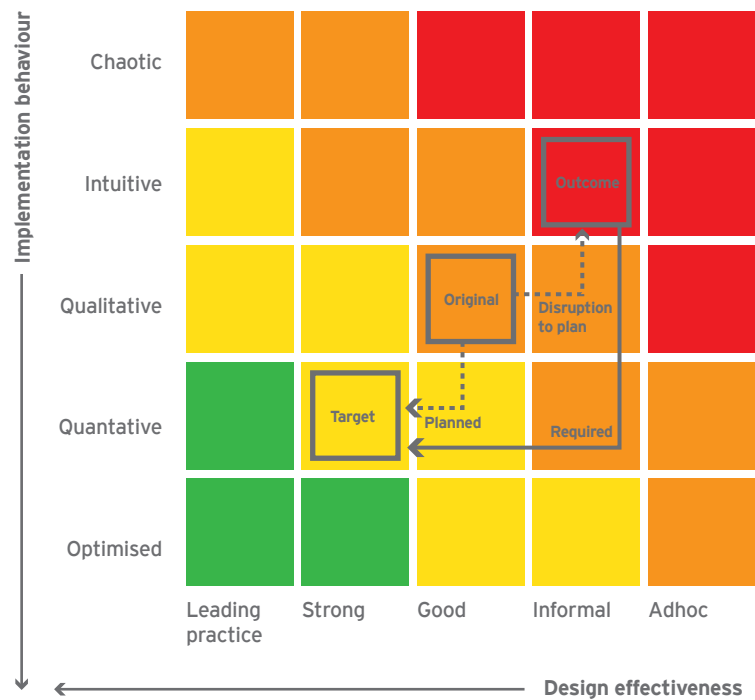
“For example, you may have delegations of authority in place (the design is good), but if people don’t escalate or act on breaches (the behaviour is bad), then the control is not working and it won’t work until the behaviour changes.”

Andrea Lester, Rio Tinto’s Global Practice Leader for Internal Audit, agrees: “It is important to recognise that it is people who implement processes, therefore if you truly want to assess the organisation you need to move beyond traditional audit methodology and consider people and behavioural aspects as well as processes and control design.”

“Every auditor will be able to recall an operation which didn’t have many formal policies or procedures, but still operated well because there was a strong, control-conscious culture. Conversely, every auditor will also be able to recall an operation which had excellently designed policies and procedures that sat on the shelf and were ignored.”

You can see the interdependence of control design with business behaviour in the Control Maturity Model (Figure 1 below). Controls become increasingly robust as you move from red to green and to make this progress, you need to move both horizontally and vertically. Despite best intentions, most organisations fail to strengthen controls because they concentrate on moving horizontally to the left (improving processes and systems), without moving vertically downwards (improving control culture and behaviours).

**Figure 1: Ernst & Young’s Control Maturity Model**



Peter Wilkinson, Manager of the Portfolio Risk Branch at the Department of Education and Early Childhood Development in Victoria, for whom Ernst & Young has applied this model, commented on the success of behavioural auditing in the first article in this series. "It transformed the impact of our report", he said. "The visual snapshot of behavioural findings was particularly important - a 'light bulb moment' for project committee members."

Wilkinson outlines three key elements when using a behavioural model approach:

- ▶ Flexibility - the importance of adapting behavioural criteria to fit the context of the review.
- ▶ Analysis - particularly regarding priority controls which need to be designed as well as analysis of the operational adequacy of existing controls.
- ▶ Action - using the visual tool to clearly plot the desired or predicted change as a result of proposed action and then encouraging rigorous discussion and debate on the options for implementation.

### **How do you assess and change behaviours to support controls?**

You can change behaviours to support controls by linking key performance indicators to performance and reward, training, organisational structures, lines of accountability and reporting, and policies and procedures.

Most internal auditors will have experienced some form of restructuring or change management, but they will probably have unconsciously managed their way through the journey. "It's unusual to find an internal auditor with formal training and skills in change management," says Gus Cummings, Ernst & Young Advisory Partner. "Without training, they may not have a clear understanding of the value they can bring in proactively identifying misaligned behaviours and driving culture change."

Internal auditors now have access to new tools to isolate the drivers of behaviour within an organisation that will help achieve the desired behaviour change. For example, the Behavioural Engineering Model<sup>1</sup> (Figure 2) allows you to diagnose and assess the impact of your current efforts to influence control culture, identifying the level of effort activities require and what impact they are going to make.

"Once you have a clear understanding of where you are in the journey of embedding control behaviour and control culture, the model will identify the activities and levers that will help you most effectively get to where you want to be, giving you the biggest bang for your buck. There are often quick wins and low effort/high return activities that will accelerate the change process," says Cummings.

The model works on a diminishing returns principle. Activities in box one will yield greater results for less effort than box two and so on. The model therefore helps to identify an efficient pathway to changing behaviours by focusing first on the areas that will have the greatest impact for the least cost.

The organisational factors - information, resources and incentives - are the aspects of an organisation that leaders can control, and are therefore the best place to focus initial efforts.

"Organisational factors are extremely important. The tone must be set from the top, with the right incentives in place. Unless this happens, even if all the other factors are in place, behaviour will not change," explains Cummings.

But how do you know what sort of incentives will work? A new behavioural change tool, called choice modelling, may help.

<sup>1</sup> Thomas F. Gilbert, "Human Competence: Engineering Worthy Performance", 1996

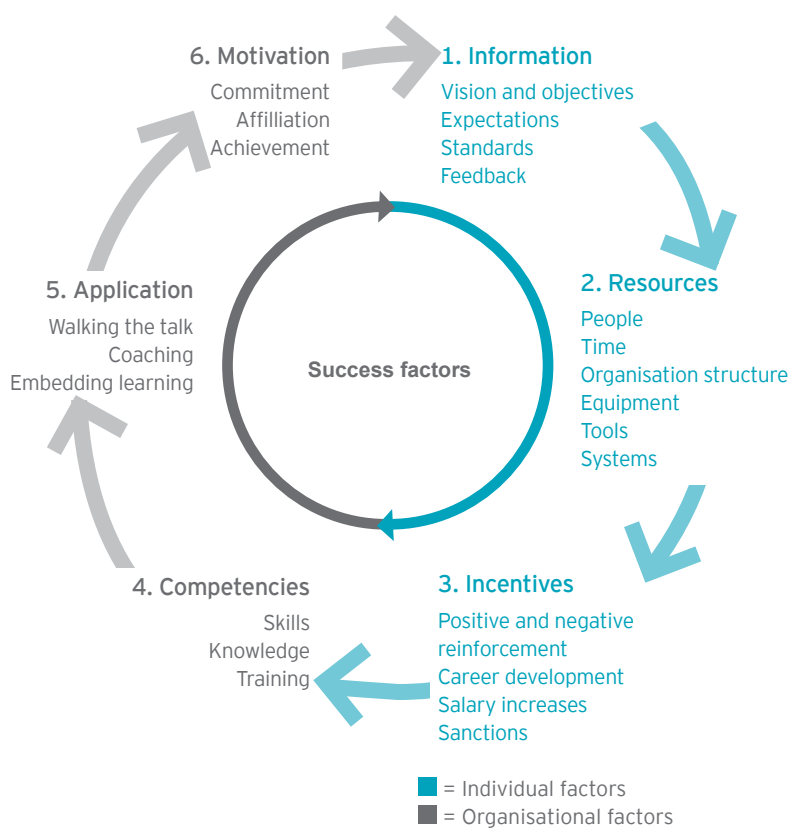
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Chris O’Hehir, an Executive Director in Ernst & Young’s Advisory group with a background in data analytics, relates choice modelling to his recent work with a human resources department: “If you ask an employee if they’d like more money, the answer would always be ‘yes’. If you ask that same employee if they’d like more annual leave, the answer would likely also be ‘yes’. But unless you asked them to compare the two options, how do you know which is more important to them? The solution is to bundle up multiple equivalent incentive packages and ask employees to compare the packages against each other. Choice modelling then enables you to analytically deconstruct the bundle, ranking each incentive in order of preference, according to the profile of the employee.”

At the other end of the spectrum, individual factors - competencies, application and motivation - are much harder for an organisation to influence, since these are largely under the control of individuals. Nevertheless, while it could be tempting to focus only on the organisational factors, Cummings stresses that these components are all interconnected. “You can’t look at one without looking at all of them in totality, but if you get the organisational factors right the individual factors almost fall into place with little effort.”

Figure 2: Behavioural Engineering Model



### Red flag

It is important to look out for behaviours, instructions or structural issues that contradict the control environment. For example, inappropriate delegations around benefits such as car allowances may present employees with moral or ethical dilemmas. There may also be issues when business unit and corporate functions overlap and there is a lack of clarity around roles, or metrics are misaligned. An example here might be measuring the performance of a service centre solely on transactional volume throughput and thereby creating a culture where quality and customer satisfaction are not valued.

### Conclusion

A crucial part of re-engineering the audit response is to assess not just the design of control processes, but also behaviours. Applying a behavioural assessment model helps internal audit teams to identify control risks and better understand their role and recommendations in managing and improving them. By considering behaviour, process improvements are more likely to become embedded into your culture and to be sustainable over time.

For those willing to tackle behavioural issues, the results are often very positive. Rio Tinto's Andrea Lester views behavioural auditing as a critical part of a comprehensive approach. "At Rio Tinto, we find root cause analysis, together with considering findings in the context of the COSO Internal Control Framework<sup>2</sup>, to be really powerful in identifying the cultural and behavioural issues driving audit findings. If you don't understand the behaviours behind your audit findings and you only make process-based recommendations, agreed actions may be ineffective and you could also be missing out on valuable contributions and improvements your internal audit function can make to the business."

<sup>2</sup> Committee of Sponsoring Organisations of the Treadway Commission (COSO), "Internal Control-Integrated Framework", 1992

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