Industry Practice Note

Internal Audit on Culture and Conduct

ABS Culture and Conduct Steering Group
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1. Introduction

The MAS Information Paper on Culture and Conduct Practices of Financial Institutions contains information on culture and conduct outcomes that financial institutions should work towards. Particularly for Outcome 7 of the MAS Information Paper, banks are expected to incorporate assessments of behaviour and culture as part of internal audit.

This Industry Practice Note ("IPN") captures key observations from member banks of the Culture and Conduct Steering Group ("CCSG") on a diverse range of practices by Internal Audit to provide independent assessment of the state of culture and conduct in a bank. It also outlines some good practices which banks may reference and adapt accordingly.

2. Outcomes to Achieve

The MAS Information Paper recognises that Internal Audit can provide an independent assessment of the state of culture and conduct in an organisation. The function can play an important role in the early identification of potential areas of concern, and flag them for management attention.

In this regard, Internal Audit can assess the bank's management of conduct risk and control awareness, as well as receptiveness to audit findings.

In addition, Internal Audit can implement targeted culture audit programmes by explicitly targeting "soft" aspects like leadership, group dynamics and quality of decision-making. Internal Audit can also consider engaging organisational psychologists or behaviour scientists to design and implement culture audit programmes.

3. Industry Practices

While the member banks of CCSG have deployed various approaches to meet the outcomes, it was observed the following practices are more widely adopted.

- **Audit Methodology** – Assessment of behaviour and culture are commonly incorporated in several banks' audit methodology. This includes:

    - Embedding the assessment of culture by using surveys, focus group discussions or interviews to gauge employees' perception of the bank's culture.
    - Identifying observable indicators and conducting direct observations to assess if employees' behaviours are in line with expectations.
    - Latest market developments include embedding culture evaluations into regular audits and conducting standalone culture assessments as advisory engagements.

- **Complementary Rating on Culture and Conduct** – Through audit engagements, the Internal Audit function of many banks would evaluate the following areas:

    - Components of risk culture framework
    - Management ability, awareness and attitude towards risk and controls
    - Prevailing behaviours indicators
    - Effectiveness of behavioural reinforcers and culture initiatives
    - Culture and conduct related information

    These areas are assessed on top of the control environment and do not necessarily mandate an audit rating.

- **Governance** – Audit findings (including observations on culture and conduct) are reported to Audit Committee and senior management regularly. This may include highlighting material aspects on culture and conduct risks that are emerging or observed.

In addition to these common practices, member banks of CCSG also made observations on some good practices that may be useful in overcoming practical challenges in conducting audit on culture and conduct.

Observation 1

Culture and Conduct monitoring are important but distinct aspects of audit methodology

While the monitoring of culture and conduct are quintessential in preventing misconduct, each aspect forms a distinct component which may require different audit considerations. This means that Internal Audit can be sensitive to the interactions between these aspects and flag potential concerns for management attention.

Culture Monitoring: Analyses the broader organisational climate, values, and attitudes that influence employee behaviour. Identifying a set of behavioural drivers that are aligned with the desired organisational culture may help to facilitate the monitoring. Examples include:

Value	How values are actively embraced by employees to shape desirable norms and behaviours
Leadership	How leadership behaviours shape desired organisational culture
Engagement	How committed employees feel towards their work and influence one another towards desirable norms and behaviours
Work Environment	Degree of psychological safety and respect within and between teams, and level of collaboration
Risk Management	Risk-informed decision-making and corrective measures

Conduct Monitoring: Focuses on individual behaviours and practices towards adherence with regulations, standards, and ethical norms. Examples include:

Regulatory Compliance	Employees follow relevant laws and regulations
Sales Surveillance	Customer interactions and sales practices
Policy Adherence	Compliance with internal policies and procedures
Consequence Management	Misconduct and fair consequence management

Observation 2

Leveraging tools and human behavioural expertise to monitor and assess culture

Internal Auditors can monitor and assess culture hotspots more effectively by combining various tools with human behavioural expertise, which may include:

- **Surveys as part of fieldwork** – Incorporate anonymous surveys to gauge employee perceptions of the culture, values, leadership, as well as observable behaviours amongst colleagues, managers and leaders. Include questions that assess psychological safety.

- **Focus group discussions** – Conduct focus group discussions (if necessary) to obtain a deeper understanding of the survey results, and to generate additional insights that may not have been possible to obtain via surveys alone.

- **Observable indicators** – Gather evidence that could indicate that team members are showing (or not showing) desired behaviours.

- **Observations of behaviours** – Directly observe team members and assess the extent to which they are consistently demonstrating desired behaviours to understand the prevailing state of organisational culture.

- **Interviews** – Perform one-on-one interviews with employees at various levels to obtain insights about the culture. The interviews may follow a structured methodology to ensure consistency and fairness in gathering insights about the organisational culture.

- **Techniques** – Consider indirect questioning techniques (e.g., open-ended, and probing questions) to encourage responses that may support cross validation of insights obtained, and assess the following aspects of the auditee:
  - Feels comfortable to raise issues with the team.
  - Knows when material issues should be escalated.
  - Understands the importance of root cause analysis when things go wrong.
  - Engages in constructive discussion to address control deficiencies.
  - Provides insights that unveil the behavioural root causes, especially those associated with the interim audit findings (where applicable).
  - Provides sentiments from the ground on key areas of concerns.

- **Culture Risk Monitoring** – Use data indicators to identify areas showing heightened culture risk. Consider comparison of audit results between departments or current and prior audit results relating to culture risk.

- **Human Behavioural Expertise** – Enhance competence of Internal Audit function to better understand psychological factors that drive employee behaviour. Consider leveraging the expertise of other key control functions like Risk Management, Human Resources and Compliance.

Observation 3

Overcoming challenges in enhancing the human behavioural competencies and skillsets for Internal Audit functions

By understanding the psychological and sociological factors that drive employee behaviour, Internal Auditors can identify the root causes of misconduct and improve cultural assessments.

There are however practical challenges that Internal Audit teams must navigate to improve competencies and skillsets in this area:

- Integrating behavioural insights into existing audit methodologies can be complex, requiring some re-evaluation of current frameworks.

- Talents with specialised human behavioural skills are not widely available. It may be challenging to upskill existing auditors through in-house training.

To navigate these challenges, Internal Audit teams can start by strengthening human behavioural competence and bench strength at the senior levels, as this approach can help to better achieve the following to drive better results:

- Engage in more meaningful conversations with senior management on issues and improvements on culture matters, especially on areas requiring interventions or closer oversight and supervision.

- Lead and drive transformations within Internal Audit to integrate behavioural science into audit methodology.

Observation 4

Incorporate organisational strategic priorities into the internal audit program on culture and conduct

Internal Audit should combine strategic priorities and feedback from senior leadership to better align the relevance of culture and conduct agenda in the internal audit program:

- **Alignment with Strategic Objectives** – Internal Audit teams should first understand the bank's overarching strategy and objectives. This involves engaging with senior management to identify key priorities and risks that align with the bank's strategic goals.

- **Behavioural Risk Assessment** – Focus on identifying risks associated with strategic initiatives, and how effectively the risks related to conduct and culture are managed. This requires an understanding of the key drivers that influence behaviours and attitudes to achieve these strategic priorities, such as incentives, rewards and consequence management, etc.

Developing audit objectives with the above considerations ensures that the audit function is not only reactive but also proactive in addressing areas where behaviours can derail strategic goals of the bank.

Observation 5

Incorporate culture considerations into audit methodology via thematic audits and complementary culture ratings

Banks should explore enhancing their internal audit methodologies with culture considerations. The latest market practices include:

- **Thematic culture audits** – Internal Audit teams have started embarking on advisory engagements focused on thematic culture assessments. These engagements have typically focused on an independent assessment of the existing culture framework, the prevailing culture, the effectiveness of behavioural reinforcers / culture initiatives, behavioural drivers, and possible outcomes of the culture ecosystem, etc. with the ultimate output of key management action themes and focus.

- **Complementary rating on culture and conduct** – Some banks have evolved their complementary rating (focusing on Management Control Awareness) to a Risk Culture and Conduct Rating. This rating constitutes Internal Audit's assessment of the existence and quality of a Risk Culture Framework established by Management to foster the desired risk culture. Internal Audit's assessment is performed as part of regular audit engagements, and tends to be less immersive than full-scale thematic culture audits. In some situations, banks have embarked on similar initiatives, but without a rating.

4. Conclusion

Internal Audit plays a critical role in managing culture and conduct risks within banks. By implementing good practices, leveraging data-driven insights, and addressing challenges, Internal Audit teams can effectively assess and improve the cultural and behavioural landscape of their organisations.

Looking ahead, the integration of behavioural science principles into audit methodologies has the potential to enhance the role of Internal Audit functions in fostering each bank's desired culture, thereby strengthening and building a more resilient financial ecosystem.

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