

## Internal audit set to be the key to Culture audits

After nearly a year, the Royal Commission's hearings have provided drama and headlines, yet the recommendations in the Final Report on improving culture and risk conduct are not a startling revelation.

Many of the 'shock and Orr' moments from the Royal Commission were based on, not surprisingly, internal audit reports.

There are numerous examples of governance failures arising from evidence presented to the Royal Commission, yet there is little forensic examination in the Final Report of the 'governance eco-systems' in which, for example, internal auditors operate in.

As the 'Third Line of Defense' or colourfully referred to as the 'policeman' in reviewing internal controls, it is now evident that the head of internal audit plays a critical role in achieving good governance.

The Commission highlighted that "sound management of conduct risk and improving entity governance" was critical to the performance of those entities.

And while much of the misconduct can be attributed to the 'greed' and culture factors, there also is the question of why the audit committees did not flag these issues, and if they did, why they were not act upon by the directors?

The Royal Commission highlighted that directors "did not do enough to seek further or better information where what they had was clearly deficient".

What the Royal Commission should have analysed further is the role of audit committees play, and how they can highlight misconduct.

In recommendation 5.7 in the Commission's Final Report – Supervision of culture and governance, the Commissioner said amongst other things "APRA should assess the cultural drivers of misconduct in entities, and encourage entities to give proper attention to sound management of conduct risk and improving entity governance".

The Royal Commission did refer to 'culture audits' conducted by internal audit teams at ANZ.

Australia is well behind other major western countries in auditing culture. For example, the UK Corporate Governance Code states that the board should assess and monitor culture. It goes on to say "Where it is not satisfied that policy, practices or behaviour throughout the business are aligned with the company's purpose, values and strategy, it should seek assurance that management has taken corrective action."

Internal auditors are ideally placed to provide this assurance.

There was also a cursory mention in the Final Report of reviewing Prudential Standards and guidance for entities.

The prudential standards and guidance materials from both APRA and ASIC have been principles-based and inconsistent, and while the Royal Commission was critical of the 'box-ticking' culture, it did not analyse or recommend 'best-practice' governance structures or a 'supervisory program'.

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The Commissioner said: “Supervision must extend beyond financial risk to non-financial risk and that requires attention to culture, governance and remuneration”.

APRA could start with reviewing CPS 220, and also CPS 510.

Under APRA’s Prudential Standard CPS 220, it states that the “Board must ensure it forms a view of the risk culture in the institution, and the extent to which the culture supports the ability of the institution to operate consistently within its risk appetite.”

ASIC and APRA, through the extended BEAR regulations, should hold those claiming to undertake internal audit accountable if they are not properly qualified.

Chief Audit Executives and Heads of Internal Audit at the banks and financial institutions should be appropriately qualified to perform those roles and be held accountable.

They should also be members of the Institute of Internal Auditors, and as a consequence, conform to the International Professional Practices Framework (IPPF), which contains The Standards governing the practice of internal auditing.

Now the blowtorch turns on the regulators and the Government to go further and put into effect the ‘spirit of the Royal Commission’.

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