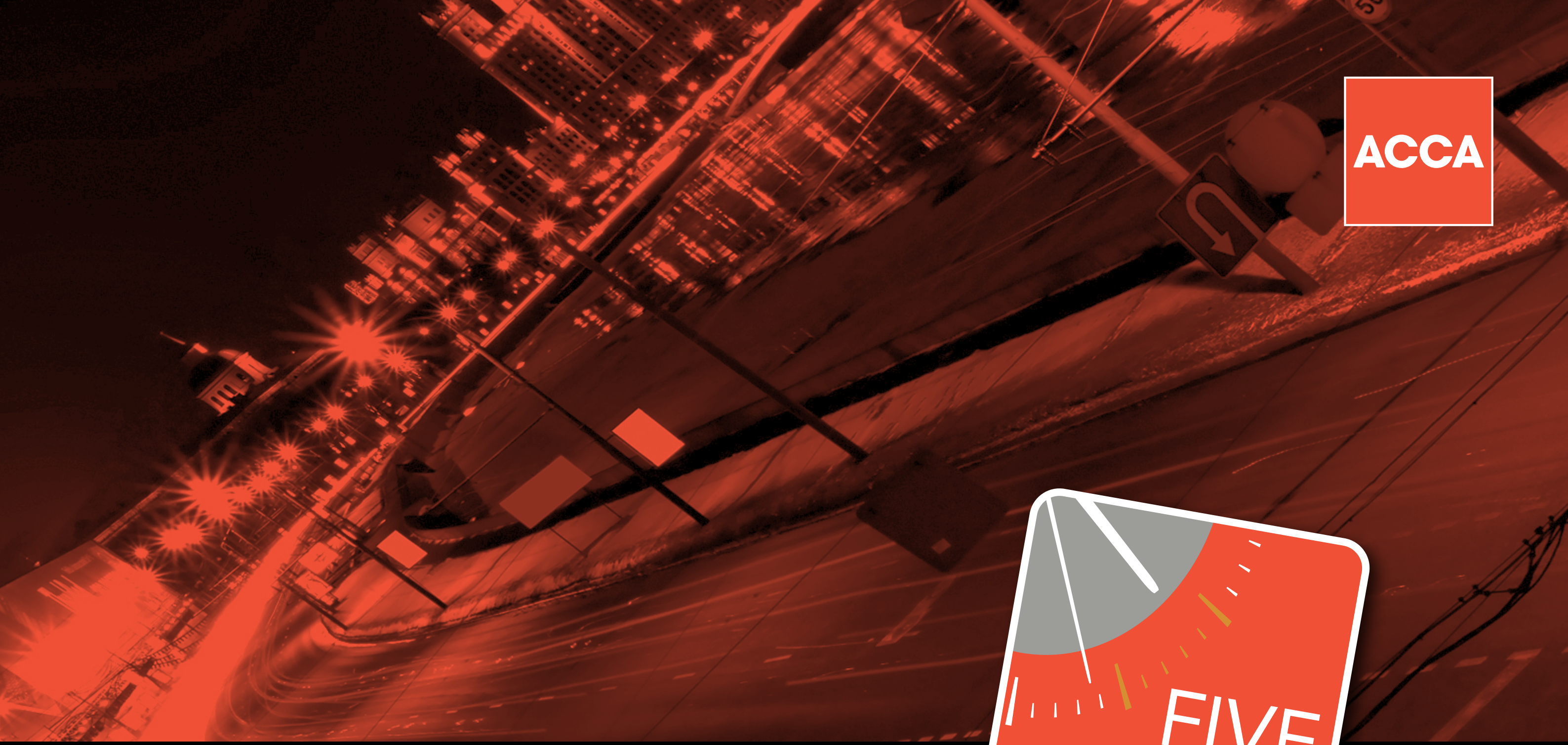
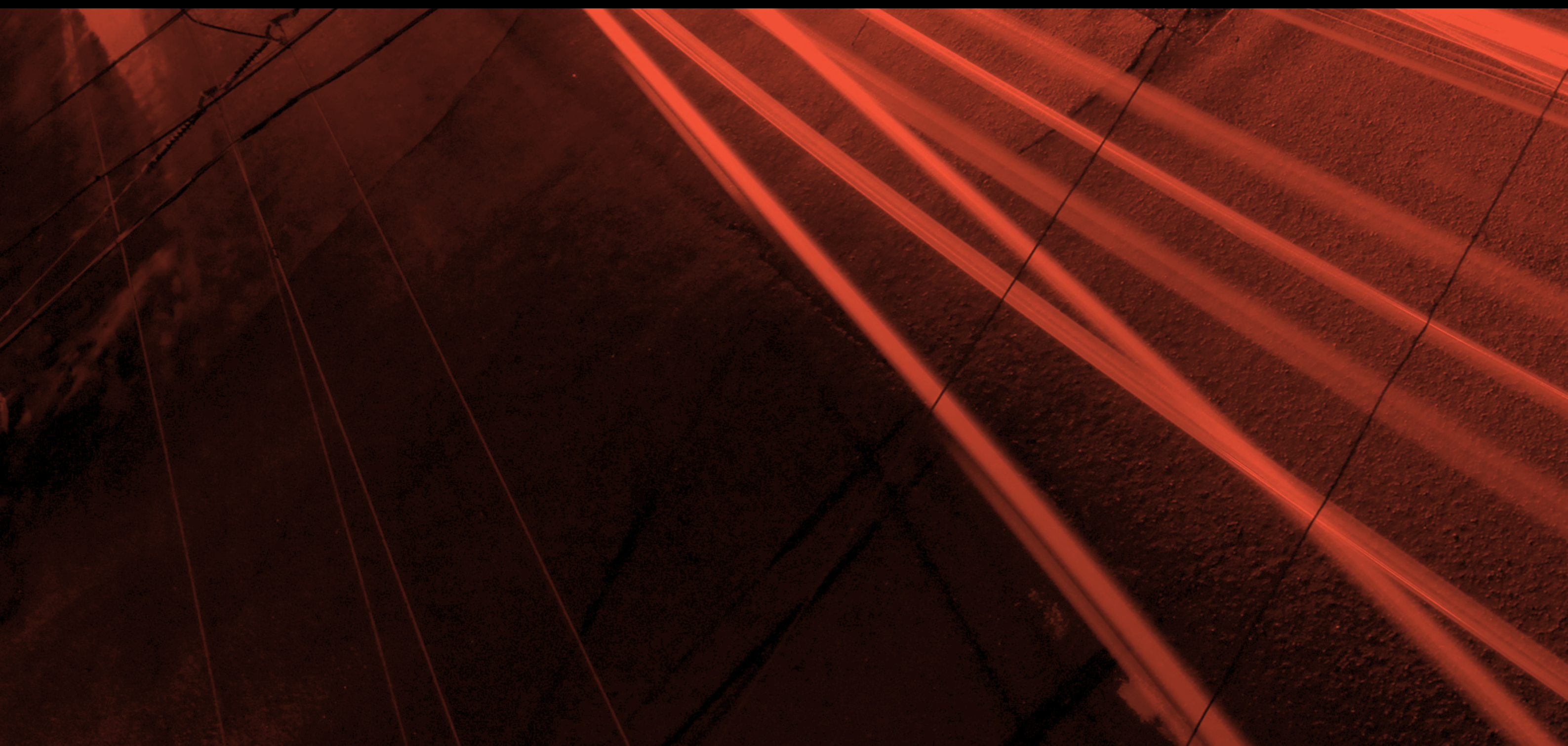


ACCA

FIVE MINUTES ON...

ACCOUNTANTS FOR BUSINESS

Rules for risk management: culture, behaviour and the role of accountants



FIVE MINUTES ON...

Rules for risk management: culture, behaviour and the role of accountants

Risk and how not to fall victim to it are probably more on everybody's mind than ever before. This is especially so for those who run organisations. Rightly, much attention is being given to risk management and such things as risk appetite and risk tolerance, risk registers and risk committees. But there is much more to managing risk and, to a great extent, anyone and everyone in an organisation is, or should be, a risk manager.

This is particularly true of accountants. Many accountants have specific responsibility for particular aspects of risk management and often the company risk manager or head of risk is an accountant. But this report is not about that. Instead it looks at how accountants contribute as part of their normal work to managing risk. Often, an accountant's role is about providing the right financial and other information so that the right decisions can be taken. This includes avoiding taking decisions that would expose an organisation unnecessarily to risk.

This survey report is about how accountants contribute to managing risk. It looks at management accounting, financial forecasting, internal reporting and other things that support decision making. These activities are not normally thought of as risk management, but they are. Accountants were asked their views on the causes of strategic failure, on risk management and risk culture and the extent to which they witness various dysfunctional and self-interested behaviours such as the deliberate understatement of risks or overstatement of benefits so as to obtain approval for a proposal. These behaviours are worryingly common and they are often are at the root of unpleasant surprises.

The report gives a unique insight into what goes wrong in organisations and the vital contribution accountants make to sound decision making and thus to managing risk and to their organisations' sustainable success.

Paul Moxey

Paul Moxey
Head of corporate governance and risk management

About the report

Rules for risk management: culture, behaviour and the role of accountants is based on a global survey of ACCA members carried out in September 2011. The 2,000 members who responded to the survey included CFOs, finance directors, financial controllers and financial accountants, from many types and sizes of organisation in 109 countries. Their responses provide a broad insight into the accountancy profession's expert views and opinions on risk management. They indicate the linkage between effective, integrated risk management and improved organisational performance – and reveal the central role of accountants in promoting improvements in this area. The responses also show that there is much to be done to achieve good practice. One key area for improvement relates to ethical behaviour.

The concept of integrating risk management with general management policies and processes has a strong objective foundation. The importance of this was first established by COSO (the Committee of Sponsoring Organisations of the Treadway Commission). It is also endorsed in the recommendations of ISO 31000:2009, the international standard on risk management; this ACCA survey is based on key elements of the standard.

The report shows that it is most important for accountants to behave ethically, effectively and without personal bias or prejudice. This means that, in their professional actions, accountants should base their conclusions on evidence, not on opinion that is not properly supported. Decision making should avoid 'conviction culture' – which relies on the power of argument rather than the weight of supporting fact. Accountants should rely on their professional skills to analyse risk situations, and to reach sound conclusions.

The report points the way for finance executives in all kinds and sizes of organisation to benchmark current performance, and to determine the improvements that are most urgently needed.

Headline findings

OVERVIEW

More than 70% of respondents reported that their leaders were currently under great pressure as a result of their organisation's financial position or performance. The results provide an in-depth analysis of current risk-management practices and behaviours in this stressed environment, as perceived by a significant sample of ACCA members. They offer evidence of dysfunctional, unethical and illegal behaviours. They support finance executives' efforts to identify essential improvements in the practice of risk management for their organisation. Only a very small proportion of respondents regard pure luck as having a significant impact on outcomes.

THE CAUSES OF STRATEGIC FAILURES

The survey clearly shows that there is one simple reason behind most strategic failures: people tend to overestimate their ability to forecast risks, and to influence the outcomes of uncertain future events.

So why do strategic failures occur? Reading behind the statistics, there are clear pointers to two classic influencers of dysfunctional human behaviour: fear and greed. Many survey respondents think that malpractice results from pressure to perform better in financially stressed organisations. Fear for the viability of the business or of job loss, or desire to secure a bigger bonus, are seen as primary catalysts that can lead directly to extreme events such as the reporting of misleading or false accounting results.

There is clear indication that accountants should objectively analyse, quantify and communicate the probabilities of the different possible outcomes of a course of action – and should conscientiously identify unfavourable possibilities in a working environment, on the basis of integrated risk management policies and procedures.

IDENTIFYING A SUPERIOR DECISION-MAKING CULTURE

The survey results include a striking series of six decision-making practices and behaviours which all receive approval rates of about 70%:

- **questioning proposals** – regardless of the seniority of their authors
- **recognising uncertainties** – and measuring and managing them
- **making unbiased decisions** – irrespective of personal interests
- **acting ethically** – and encouraging an ethical culture
- **acting legally** – and challenging failure to do so
- **thinking carefully** – and using applicable quantitative techniques.

Accountants judge that decision-making based on these good practices is significantly superior to that based simply on consensus, on short-term self-interest, on unsubstantiated opinion – or on following orders without question.

ISO 31000:2009 recommends a style of integrated risk management based on a creative culture that emphasises thoughtfulness and objectivity, and the use of supporting evidence. Survey respondents strongly endorse the adoption of a risk-management culture that embraces the ISO recommendations. They also advocate high standards of morality, leading to decisions on risk that are fair, ethical and legal, as opposed to those founded on objectively baseless convictions and individual bias.

The least favoured behaviour reflects the 'conviction culture' approach, where the winner, often by consensus, is the one who presents the best business case; this approach was rather more acceptable in larger organisations. Interestingly, the unpopularity of conviction culture was more pronounced among female respondents than male ones.

THE VALUE OF FINANCIAL FORECASTING FOR RISK MANAGEMENT

More than 80% of survey respondents confirmed the high importance of forecasting to their organisation, with most generating forecasts at monthly or quarterly frequency. Today's standard practice favours a forecasting horizon for the current financial year, but organisations that are severely stressed (for liquidity or through high levels of debt leverage) commonly forecast on a rolling basis, to extend their horizon of visibility.

The results identify the practical incidence of an extensive range of forecasting techniques. These findings will be of detailed interest to finance managers evaluating their own forecasting practices. The results show which techniques are generally in use and those that are not, but that this sample of the profession advocates as good practice.

The ethics of forecasting attracted a wealth of interesting responses; the statistical results seem to overlay much hard, practical experience in this field.

The results do show sufficient incidence of different kinds of unethical forecasting behaviour to warrant significant management concern. These behaviours include the treatment of forecasts as actual targets as opposed to predictions, and the provision of over-optimistic or over-pessimistic forecasts. The reasons for such behaviours range from attempts to avoid pressure or criticism, to the deliberate reduction of expectations to improve the impact of the actual results. Only 3% of respondents stated that they had never observed any of the dysfunctional forecasting behaviours identified.

CONTROLLING DYSFUNCTIONAL BEHAVIOURS

Just 4% of respondents believed that dysfunctional behaviours did not happen in their organisations. Such behaviours includes:

- allowing personal bias to affect risk decisions
- permitting political power battles to influence decisions
- excessively weighting the value of beliefs over evidence-backed information
- letting an unbalanced focus on subjectively selected priorities determine outcomes.

A number of reasons are revealed to lie behind the occurrence of these dysfunctions; and the survey links these behaviours generally to the major strategy failures that result from inadequate risk management practices.

The dysfunctional behaviours consistently used to promote a particular course of action include underestimating risk, overstating result expectations and benefits, and underestimating the related costs.

There is a range of self-seeking motivations underlying these results. In effect, the unethical – or even criminal – intent can cause individuals to warp and distort their input to decision-making processes, often leading to disastrous outcomes.

There are clear pointers to the real situations that are encountered, providing useful input for identifying, controlling and eliminating unethical and illegal behaviour. The survey reviews the application of traditional control operations such as investigating variations in actual results against budget, and scrutinising transactional costs and individuals' expense patterns. It continues by examining reports about the processes and policies in place to manage actual incidences of malpractice. There is a strong correlation between the deployment of these good-practice techniques and a reduction of malpractice incidence; but the reported levels of adoption show that there is scope for much more progress in this area.

In conclusion, accountants speak the right language on risk. They embrace the norms of risk management, and show overwhelming support for several effective risk management tools. They value the support they can provide to decision-makers, and the support they described ticks the boxes of integrated risk management: presenting risk management as part of every-day business decision-making.

Accountants have demonstrated their awareness of the issues, and a keenness to get involved. Businesses shouldn't waste this opportunity.

About ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies at all stages of their development. We seek to develop capacity in the profession and encourage the adoption of global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We seek to open up the profession to people of all backgrounds and remove artificial barriers, innovating our qualifications and their delivery to meet the diverse needs of trainee professionals and their employers.

We support our 147,000 members and 424,000 students in 170 countries, helping them to develop successful careers in accounting and business, based on the skills required by employers. We work through a network of 83 offices and centres and more than 8,000 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

Accountants for Business

ACCA's Accountants for Business programme of research and insights champions the role of finance professionals in all sectors as true value creators in organisations. Through people, process and professionalism, accountants are central to great performance. They shape business strategy through a deep understanding of financial drivers and seek opportunities for long-term success. By focusing on the critical role professional accountants play in economies at all stages of development around the world, and in diverse organisations, ACCA seeks to highlight and enhance the role the accountancy profession plays in supporting a healthy global economy.