The reality of risk: culture, behaviour and the role of accountants

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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.

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The reality of risk is that most is managed through everyday management activities, not separate activities focused on lists of risks. Accountants play a key role in helping people manage risk well.

The survey described in this report explored the risk-related practices used by accountants, their willingness to use more, and the dysfunctional behaviours that can undermine management of risk.

The results reveal an opportunity to improve the way risk is managed by focusing on how core management activities are done and the support provided by accountants.

The Reality of Risk: Culture, Behaviour and the Role of Accountants

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ABOUT THE AUTHOR

Matthew Leitch is an independent consultant, author, educator, and researcher specialising in risk and control. He has served on the risk management committee of the British Standards Institution and his contributions to the British Standards on risk management, BS 31100:2008 and BS 31100:2011, have led to his being awarded two Distinguished Service Certificates. Matthew is the author of two books about risk and control (*Intelligent Internal Control and Risk Management* and *A Pocket Guide to Risk Mathematics*) and the website *www.WorkingInUncertainty.co.uk*.

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Foreword

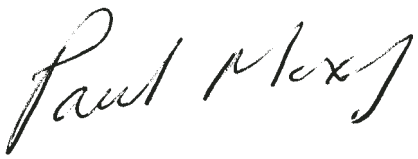
Risk and how not to fall victim to it are probably more topical than ever before. This is especially so for those who run organisations. Much attention, rightly, is being given to risk management and such things as risk appetite and tolerance, risk registers, and risk committees. But there is much more 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 those with such specific responsibilities; instead, it looks at how accountants contribute, as part of their normal work, to managing risk. Often, an accountant's role is to provide the right financial and other information so that the right decisions can be taken, and this includes avoiding taking decisions that would expose an organisation unnecessarily to risk.

This is a report of a survey on how accountants contribute to managing risk. It looks at management accounting, financial forecasting, internal reporting and other things that support decision making. These activities do not advertise themselves as 'risk management' but specialists in risk management recognise them as just that – properly integrated into core activities, as they should be. The survey sought accountants' 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 deliberate understatement of risks or overstatement of benefits to get approval for a proposal. The survey found that these behaviours are worryingly common and are often at the root of unpleasant surprises.

Over 2,000 accountants from around the world and in a variety of functions, including board members and risk managers, took part in the survey. Their responses give 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.

We are grateful to everyone who responded to the survey and to Matthew Leitch who designed it for us and analysed the results.



Paul Moxey
Head of Corporate Governance and Risk Management, ACCA

Executive summary

The reality of risk is that we are all risk managers. At work we face almost continual uncertainty around questions like 'What is really going on?', 'Should we change our plans or approaches?', 'What can we do now?', and 'Which is our best course of action?' The future remains stubbornly unpredictable and hard to control. Sometimes we handle this uncertainty well, but not always.

The survey on which this report is based looked at the practices accountants use to help managers deal with that uncertainty effectively. Risk specialists would call this risk management that is integrated, as it should be, into core management activities. The survey asked no questions about risk maps, risk models, or risk departments. Instead, the focus was on how the core activities of accountants support the core activities of managers and the board in such a way that risk is managed.

Many of the practices studied in the survey have been in use for years, but may have become gradually more common as computer power has allowed accountants to do more. For example, where an accountant might once have laboured for hours to produce just one financial forecast, now forecasts for several alternative scenarios can be produced in a few clicks. The ability to explore alternative futures effectively and efficiently is the foundation of managing risk.

Leading guidance and regulations on risk management have been saying for years that risk management should be integrated within management and most people agree. The survey results clarify what this looks like in practice, reveal that a lot is being done already, and show that accountants think they should do more.

Sadly, the survey results also confirm that there is a great need for more progress. Dishonest and biased behaviour was reported by nearly all respondents, often of the sort that has led to failed strategies in the past.

The survey was sent to ACCA members around the world in September 2011 and 2,121 responses were received.

CULTURAL PREFERENCES

Asked about the main causes of failed strategies in organisations over the past three years, respondents most often selected underestimating risks (68%), followed by overestimating ability to predict and control the future (59%), then bias by personal interests (41%). Only 4% of respondents put failure down mainly to luck.

Asked what had led leaders to false accounting, misleading accounting, and desperate risks, most respondents preferred the idea that they had most often found themselves in financial difficulty and taken increasingly desperate steps to get out of it (55%). The next most commonly selected reason was opportunistic abuse of power (36%). Respondents who were non-executives were, however, much more likely than other respondents to think that opportunistic or even pre-planned abuse of power was the main reason.

These first two questions established that, for most respondents, misjudgement (especially of risks), possibly leading to unexpected financial difficulty, is a crucial problem.

Their responses to the next set of questions clarify how accountants might address this challenge. An overwhelming 92% thought that where accountants support decision making they should help people understand the alternative possible futures rather than just detail the most likely outcome. This crucial preference is consistent with good management of risk achieved in a way that is integrated with management.

Respondents' preferences for the effects accountants should have on decision making cultures were also consistent with this. Respondents strongly endorsed items related to a culture of objective, evidence-driven, uncertainty-aware decision making (a risk-management culture) and items related to a culture of honesty and fairness (a morality culture). In contrast, they gave little support to items related to baseless conviction, consensus, and advocacy (a conviction culture).

Women were particular negative towards a conviction culture while respondents from North America were more likely to endorse it (though even here conviction culture was unpopular among respondents).

TECHNICAL GOOD PRACTICES

The survey included questions about 39 good practices for integrated risk management that are used in the core activities of accountants in specific technical areas:

- core management tasks
  - management accounts
  - regular financial forecasts
  - other decision support
  - reporting process quality, and
- financial compliance and ethics.

All these practices were supported by a majority of respondents, and usually by a very large majority. Either the practices were in use already and respondents thought they should continue to be used, perhaps more, or the practices were not already in use but respondents thought they should be.

The least common practices involved Monte Carlo simulation, which is a simple technique for combining uncertainties, but 48% indicated they did not know if it was used, suggesting that many respondents did not know what Monte Carlo simulation is. Even here, once these respondents were excluded, approval for the practices was high.

The most common practices were related to budgetary control. Additional questions showed that most respondents thought budgetary control contributed positively or strongly positively to risk management, though 28% thought its contribution was neutral or worse. Risk managers were particularly likely to think budgetary control had a negative contribution, while non-executives were particularly positive towards budgetary control.

Some 21% of respondents indicated that the numbers in budgets were viewed in inconsistent ways within their organisation (eg as aspirational targets and as reasonable planning assumptions).

Longer-range forecasting was more common among organisations under financial pressure from high gearing or low liquidity, but otherwise greater pressure and organisation size were linked to forecasting only as far as the next financial year end.

DYSFUNCTIONAL BEHAVIOURS

The survey asked respondents about the frequency of 14 dysfunctional behaviours and a large majority indicated that each of the behaviours happened sometimes, usually, or always. Out of 1,127 respondents who answered all relevant questions only eight thought none of the dysfunctional behaviours ever happened in their organisation.

Although all groups of respondents recognised that dysfunctional behaviours happened in their organisation, board-level respondents were more likely than others to think the behaviours were infrequent, with non-executives having the most rosy view.

Most respondents thought that the leaders of their organisation felt under financial pressure that was ‘intense’ (28%) or ‘strong’ (46%). This pressure is related to the frequency of dysfunctional behaviours, which was nearly 17% higher where ‘intense’ pressure was seen compared to only ‘moderate’ pressure. (Too few respondents reported ‘low’ pressure for a reliable comparison.) However, this pressure is far from the only driver of dysfunctional behaviour, which remains common in all conditions of pressure and sizes of organisation.

The dysfunctional behaviours include those thought to be the cause of strategy failures, such as deliberately understating risks or overstating benefits to gain approval for a proposal. Many of the behaviours involve dishonesty, while some are mere bias.

IMPACT OF GOOD PRACTICES

A survey such as this cannot prove that good practices lead to better behaviour or better outcomes. The data are the perceptions of respondents, most of whom work as accountants and are likely to have a positive view of their own work. Also, the connections are statistical rather than causal. However, the statistical connections are encouraging.

The number of good practices used in decision support correlates highly with the extent to which the impact of accountants on decision making is seen as positive on three items related to good management of risk. The link is not dramatic but it is clear.

In general, the more good practices are in use, the less often dysfunctional behaviours occur, according to respondents. Nearly all the good practices are linked to better overall behaviour.

However, there are some exceptions that cannot be fully explained by the data. Organisations using Monte Carlo simulations in regular financial forecasting or decision support, or using risk-adjusted performance measures, tend to report slightly worse behaviour. Since the practices themselves are technically good and dysfunctional behaviours were not higher on average in financial services organisations (typical users of these practices), this is anomalous.

These practices are unfamiliar to many who are not specialists in risk. Could it be that the organisations reporting unusually frequent dysfunctional behaviours, given their high use of good practices, have *separate* risk management functions staffed by risk specialists? Perhaps, like drivers who drive faster when they wear seatbelts, people are less careful themselves when they think a risk-management function is taking care of risk. This is far from the only possible explanation and more research might explore it in future.

Another interesting connection is that seeing dysfunctional behaviour frequently was linked to thinking that the good practices should be used more.

Overall, the results show that accountants play an important role in the management of risk through the practices used in their core activities, and would like to do more, using practices such as those included in the survey. The results also show that there is a need for them, and others, to do more because dangerous dysfunctional behaviours are common in core management activities.

1. Introduction

When is risk management natural, efficient, effective, and applied when and where it really matters? What role do accountants have in this, and do they understand the principles and practices needed? How prevalent are the behaviours that can prevent good management of risk and how are they linked to ethics?

EVERYDAY MANAGEMENT OF RISK

Risk management is important, most people agree, and around the world efforts are continuing to understand what works and what does not when it comes to managing risk.

One topical issue is how risk management can be integrated into the core management processes of organisations. Most people agree that this is preferable to risk management being a separate activity.[1] Leading guidance has been saying this for years. COSO (the Committee of Sponsoring Organizations of the Treadway Commission), in its frameworks for internal control (COSO 1992) and for enterprise risk management (COSO 2004), describes their elements as being integrated 'with the management process'.

More recently, ISO 31000:2009 *Risk Management Principles and Guidelines*, the international standard on risk management, recommended that risk management should not be a management system, but should be integrated into the management processes of organisations.

It is becoming increasingly clear that this, often (and perhaps typically), does not involve writing lists of risks and trying to manage them.[2] The focus is on monitoring, planning, and decision making more broadly. Most decisions affect the risk faced by an organisation in some way, but only a few decisions primarily concern a specific response to a perceived risk.

For example, a recent ACCA research study (McNulty et al. forthcoming), revealed some of the behaviours that senior executives engage in when big decisions are to be made. In interviews they described considering the implications of alternative scenarios and examining the possible consequences of events that might happen.

THE ROLE OF ACCOUNTANTS

Almost certainly accountants have an important role here. Most important decisions have at least a financial aspect and it is accountants who most often are asked to estimate the financial implications of alternative courses of action. Furthermore, accountants have importance through sheer numbers. Accountants outnumber those designated as risk managers, and chief finance officers outnumber chief risk officers.

MANAGEMENT CULTURE

The working practices of accountants may be crucial to successful management of risk, and they may also have an influence on the management culture of organisations.

Are accountants instruments of the chief executive, using tight budgetary control to enforce a strategy based on nothing more than conviction? Are they there to report whatever profit figure the chief executive would like to report? Or are they more interested in promoting honesty, objectivity, and thoughtful use of evidence?

1. For example, 82% of 45 respondents in Leitch 2011a and 87% of 100 respondents in Leitch 2008.

2. In an online survey with 111 participants, approaches to risk management in common business situations that did not involve listing risks were seen as more 'integrated' and were preferred more frequently. Results are available in Leitch 2011b.

BAD BEHAVIOUR

Irrational, self-interested, manipulative behaviour happens in organisations. This can undermine good management of risk and, indeed, all management.

The study distinguished between behaviour that is illegal (eg fraud, money laundering, bribery) and behaviour that is dysfunctional in other ways. Some of this dysfunctional behaviour is caused by unintentional bias, but a lot of it is dishonest and, therefore, unethical. For example, offering a low financial forecast to reduce expectations is dishonest and unethical, even though it is so common we tend to accept it so long as we feel we can detect it and make allowances.

It seemed likely that dysfunctional behaviour would be related to the financial pressure felt by leaders, so the study also asked about financial pressure.

THE SURVEY

The survey was designed to explore all these issues, with a focus on accountants. Over 2,000 ACCA members responded during September 2011, providing over 162,000 data points. This massive body of data provides fascinating insights.

The survey questions covered views about how risk mismanagement happens, and how accountants should support good management of risk and develop a healthy decision-making culture.

The questions then addressed technical areas within accountants' core activities, each time asking about practices that should help to support good management of risk and about dysfunctional behaviours that those practices might help to reduce. The results show the extent to which good practices are already in place, should be (in the opinions of respondents), and how often various dysfunctional behaviours are believed to occur.

The technical areas covered were management accounts, regular financial forecasts, other decision support, reporting on process quality, and controlling unethical and illegal behaviour.

2. Views on risk management and culture

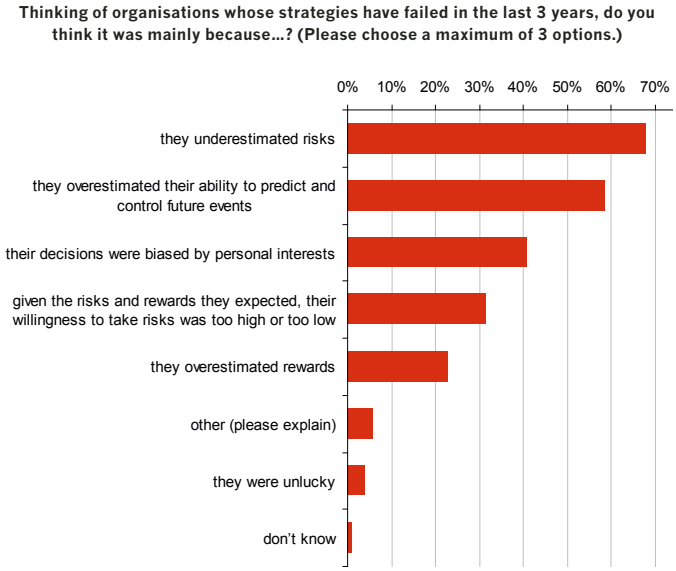
The first section of the survey asked respondents questions about their views on issues related to the management of risk. The answers show the extent to which respondents understand and support the principles underlying good management of risk. They also reveal some interesting differences in perspective between people in different roles.

CAUSES OF STRATEGIC FAILURE

What people think to be the main causes of strategic failure should influence what they think they should do to avoid failure. Differences in opinion might be reflected in differing priorities for managing risk.

The survey asked respondents to think about occasions where organisations' strategies have failed in the last three years and select up to three main causes from a list. The wording of the question, the explanations offered, and the distribution of respondents' answers are shown in Fig. 1.

Figure 1: Main reasons for failure of strategies



The explanations fell into three groups: luck, personal interests, and poor judgement. The least favoured explanation was that such organisations were unlucky. That is, their judgement and motives may have been satisfactory, but events went against them. Just 4% of respondents selected this.

A much more frequently selected explanation was that decisions were biased by personal interests. Perhaps individuals stood to gain at the expense of the organisations they were supposed to be serving. This was selected by 41% of respondents.

The remaining four explanations focus on judgement. The most selected explanation was that organisations underestimated risks, and this was selected by 68% of respondents. Overestimating rewards was selected by just 23%, though it is known that this is also a common problem, at least with decisions on large infrastructure projects (Flyvbjerg et al. 2003).

The more subtle explanation, that people overestimated their ability to forecast and control the future, was selected by 59% of respondents. This suggests an understanding that in uncertain situations optimism combines with overconfidence to produce poor judgements. This is consistent with leading guidance on risk management, such as ISO 31000:2009, and with studies of the psychology of judgement under uncertainty (Kahneman et al. 1982).

Another subtle explanation offered was that, given the perceived risks and rewards, people were too willing to take risks, or not willing enough. This was selected by just 31% of respondents. The idea that faulty attitudes to risk are a problem has inspired the recent interest in 'risk appetite', but it seems that most accountants are more concerned with the problem of correctly assessing risks.

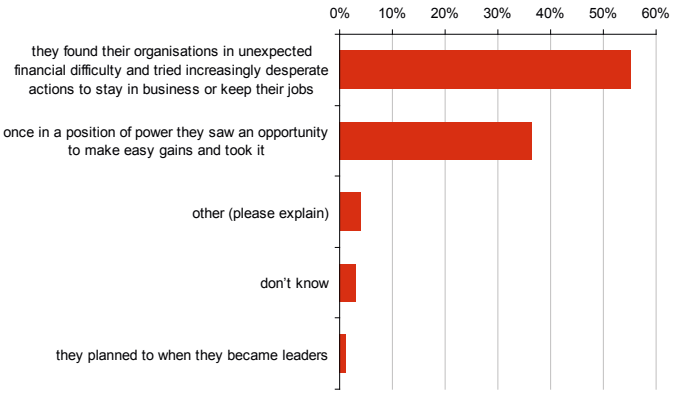
In general, respondents in different roles showed similar views, but there was one exception. Senior non-executives were more likely to select bias due to self-interest and less likely to select explanations based on misjudgement. A similar pattern is visible in responses to the next question.

Overall risk needs to be considered; you cannot view any one risk in isolation as combined they may be enough to put the business in serious difficulty, tempting those with shaky ethics to try to find a way around the ethical expectations people should have for those in control/ power and those advising them, to maintain the business position or bonus level they expect to achieve.
Financial accountant, corporate sector, England, UK[3]

BAD CORPORATE BEHAVIOUR

The next question also sought to understand what respondents saw as the main challenges to good risk management and a healthy management culture generally. It asked respondents to think of past corporate scandals and select the explanation for them that they thought was most typical. The results are shown in Fig. 2.

Figure 2: Reasons for corporate scandals



The most selected explanation was that people found themselves in unexpected financial difficulty and tried increasingly desperate actions in an attempt to keep their companies going and save their jobs. This was particularly true for respondents in Canada. This is the pattern identified in COSO's report on financial fraud back in 1999 (COSO 1999).

The next most selected explanation was the idea that leaders had spotted opportunities to make easy gains once in a position of power, and had taken them. This was particularly common for respondents in the Republic of Ireland, the USA, China, Malaysia, and the Rest of the World. With the exception of Ireland these broadly seem in line with scores on the Corruption Perceptions Index (Transparency International 2010).

Just 1% of respondents selected the explanation that the leaders had planned their misdeeds from the start.

However, once again senior non-executives took a markedly different view from others, seeing deliberate, planned dishonesty and opportunistic abuse of power as bigger problems. Either they know something others do not or perhaps non-executives see their role as one of protecting against dishonest executives and therefore emphasise the risks in this area.

Corporate decisions tend to be made reflecting the selfish ambitions of the decision makers rather than the legitimate interests of the organisation's stakeholders. This is tantamount to deliberate attempts to cheat, hiding behind the cloak of respectability.
Consultant, public practice, Malaysia

THE CRITICAL QUESTION

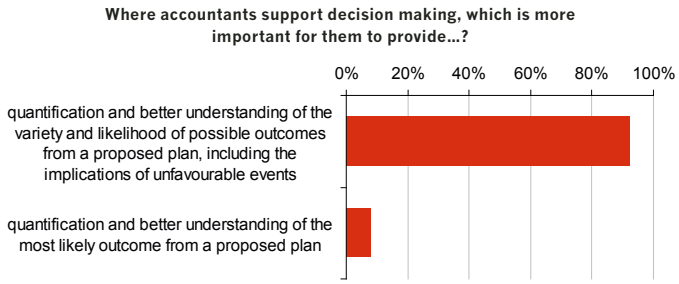
Risk assessment is, in effect, prediction, but done in such a way that alternative possible outcomes are explored rather than just one best guess at the future. The extent to which accountants perceive the value of exploring alternative futures is critical to their ability and willingness to support good management of risk.

The question in Fig. 3 and the responses given show that nearly all accountants recognise the value of helping people think more widely about the future. A reassuring 92% of respondents selected this approach. This preference was found regardless of age, sex, role, industry sector, size of organisation, and country. It was slightly more emphatic where organisations felt higher financial pressure and slightly less so in public practice firms and among those who thought luck was a main factor in strategic failure.

3. This and other comments made in survey responses have been used to illustrate findings of the survey.

This finding is explored in more detail in the later section of this report on decision support, which gives details of the practices that are used and should be used more to provide better understanding of potential outcomes.

Figure 3: Show alternative outcomes or just one?



> *There is considerable danger in single-point estimates.*
> Financial controller, financial services, USA

> *There will always be uncertainty around decisions to enter new markets or to try new ideas, but the accountant should be able to highlight the potential risks and rewards of various actions, and to seek ways to mitigate the impact of any risks, in order that informed decisions can be made.*
> Financial controller, corporate sector, England, UK

DECISION-MAKING CULTURE

The culture of risk management is one of thoughtfulness, evidence, and objectivity, combined with some creativity. The principles of risk management as stated in ISO 31000:2009, the international standard on risk management, emphasise this style of management.

Is this also the culture of accountants? Fig. 4 shows that it is. Respondents were asked to think about what accountants should encourage, where they are able to influence the culture around decision-making. The behaviours offered for consideration fall into three groups, representing three cultures:

1. Conviction culture: this group concerns baseless conviction and consensus, in which plans have to be sure fire before they can be accepted – something that is rarely feasible and can lead to overstated business cases.

2. Morality culture: this group concerns honesty, and the drive to adopt courses of action that are fair, ethical, and legal.

3. Risk-management culture: this group is most closely matched to the culture of risk management, emphasizing evidence, objectivity, and open exploration of uncertainty.

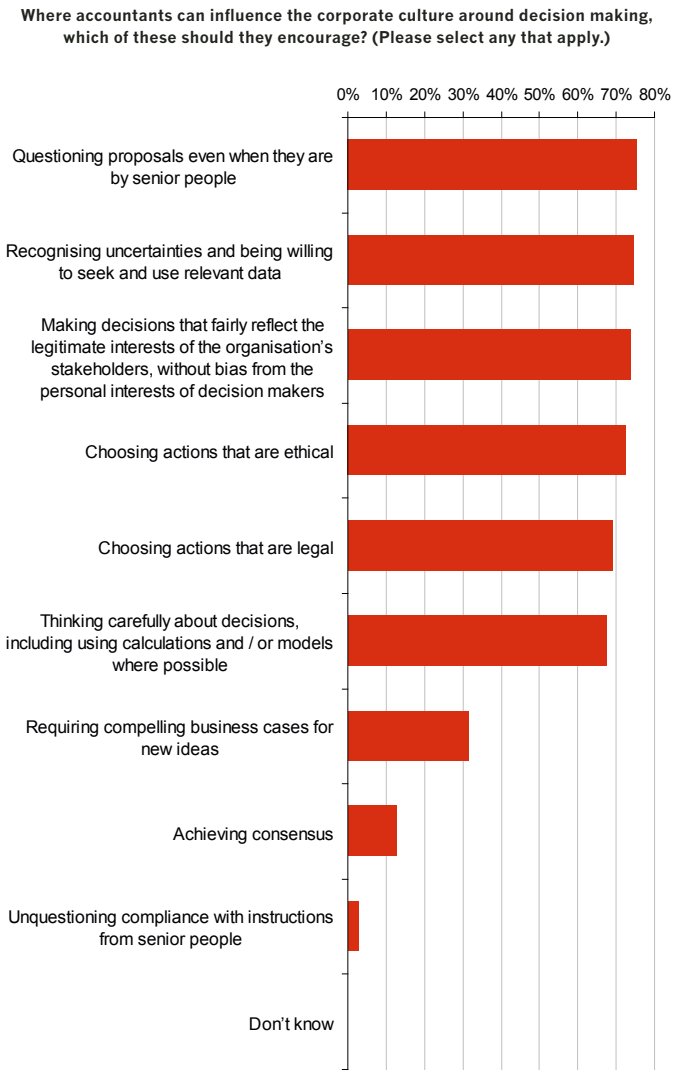
Although respondents were able to select as many of the options as they liked, the items related to conviction culture were rarely selected. The most selected item in this group, with 32%, was the requirement for convincing business cases. This perhaps attracted some support because it calls for evidence, but many respondents presumably saw the danger of being paralysed by demands for certainty, or understood that the demand for compelling cases can lead to overstated claims and a focus on advocacy at the expense of objectivity. Respondents' comments on this question most often mentioned the risk of not approving any business cases.

The two most selected behaviours were part of risk-management culture, but were very closely followed by the three morality culture items.

> *An accountant should strive to take out the emotional interest surrounding business decisions, especially in smaller businesses in which there may be owner/shareholder involvement in the management of the organisation.*
> Finance Director, Corporate sector, Malta

> *While a 'compelling' business case for a new idea would be perfect in an ideal world, the best anyone can do is provide a 'substantial' business case using as much analysis, modelling, and risk assessment as possible to enable an informed decision to be made. Requiring a compelling case can stifle initiative, which in turn could mean the business stagnates or, worse, goes backwards when competitors are willing to take a calculated risk on a new idea or project.*
> Financial controller, corporate sector, England, UK

Figure 4: Decision-making cultures to encourage



These preferences were consistent over all job roles, age groups, both genders, and across all sectors and sizes of organisation, and all countries for which an adequate number of responses was gathered. This is the global culture of accountants everywhere.

However, women selected conviction culture items somewhat less than men. This is true even when the tendency for men to select more options overall is adjusted for.

Also, respondents in Canada and the USA selected conviction culture items somewhat more often than respondents from other countries. Support for questioning leaders was strongest in the UK, Ireland, and the USA, and weakest in Malaysia and the Rest of the World. Support for thinking carefully about decisions, using calculations and models where possible, was strongest in the UK, Ireland, Canada, Australia, and the USA, but somewhat weaker in China, Malaysia, Singapore, Hong Kong SAR, and the Rest of the World.

Finally, respondents in larger organisations tended to select risk management culture items slightly less often and conviction culture items a lot more often (though still rarely).

3. Management accounts

Survey respondents were asked to choose an organisation they knew well and to give details of practices and behaviours in connection with five technical areas. Details of the organisations they chose are given in section 9, but they spanned all sectors and various types of entity. In the majority of cases respondents thought their leaders felt financial pressure. That pressure was thought to be 'intense' by 28% and 'strong' by 46%.

The first technical area covered by the survey was perhaps the most traditional contribution of accountants to management – the production of management accounts.

Management accounts were extremely common, with 89% of respondents indicating that they are produced for their chosen organisation.

> *Management accounts contribute to identification of risks. Particularly ratios such as cost–volume–profit analysis, decision trees, capital-asset pricing models, discounted cash flows and hedging techniques not only help management identify risks, but also help them take reasonable steps and measures to prevent, avoid or reduce them. Finally, management accounts design long-term solutions to long-term prevention of risks.*
> CFO, corporate sector, Greece

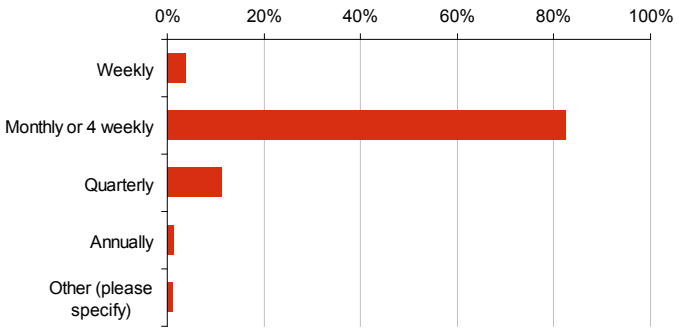
FREQUENCY

The frequency with which management accounts are produced is related, in principle, to risk management. Frequent accounting reflects an attitude of wanting to gain information rather than assuming that events are unfolding as predicted and desired.

As shown in Fig. 5, by far the most common frequency was monthly or four-weekly (82%) but this was related to organisation size. Very small organisations were more likely than large ones to produce management accounts quarterly.

More organisations produced management accounts weekly than annually.

Figure 5: The frequency with which management accounts are produced



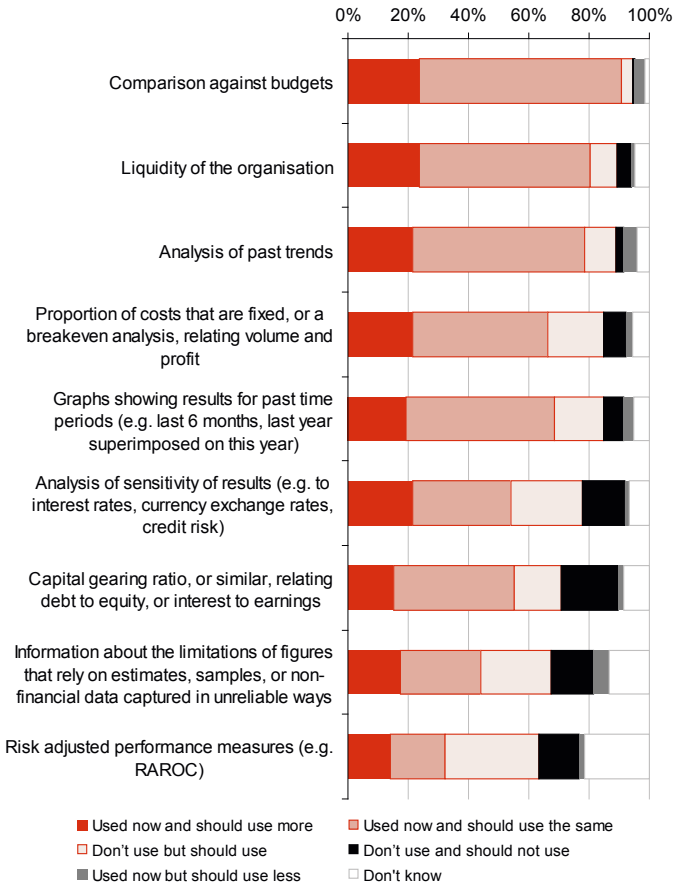
> *The primary area of control is to use the right risk models to measure exposure to commodity price fluctuations and FX exposure. The budget at best serves only as a guide. The real world is very dynamic and you can't wait too long to make a decision.*
> Senior executive, public sector, Singapore

GOOD PRACTICES FOR MANAGEMENT ACCOUNTS

Many simple, and some not so simple, management accounting practices can contribute to good management of risk. Fig. 6 shows the extent to which some selected practices are already in use and respondents thought they should be used more. The practices are shown in descending order of popularity but were presented in a different order in the survey.

The most striking thing about these results is that most respondents approved of every practice. They indicated either that the practice was already in use and should continue or increase, or that the practice was not in use but should be.

Figure 6: The practices used in management accounts



Even risk-adjusted performance measures, which were not familiar to some respondents, had overwhelming approval (once you exclude respondents who answered 'don't know'.)

Risk-adjusted performance measures are most well known in the financial services sector, with 53% of respondents indicating that they were used already, against 34% overall.

Capital gearing ratios are not meaningful for organisations that do not have debt funding. This probably explains the relatively high proportion of respondents whose chosen organisation did not and should not include these ratios in management accounts.

BUDGETARY CONTROL

Making comparisons with budgets was the most frequent practice in use now and this really deserves a survey of its own. In principle, budgetary control can be the opposite of risk management.

If budgets are set after months of negotiations, unsupported by evidence, and remain unchanged throughout a whole year then the budget can become a straightjacket. Variances can become obsolete quickly. If people see no need to look ahead at possible outcomes, but instead wait for variances to signal that attention is needed, then budgetary control really is the opposite of risk management.

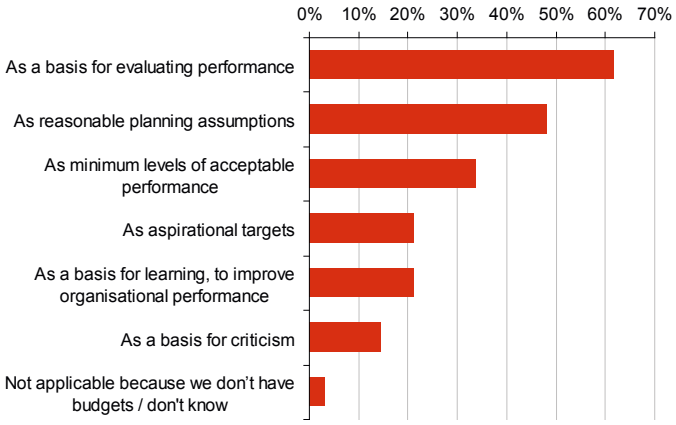
Problems with budgetary control have led some to call for the end of budgetary control and its replacement by more adaptive systems (Hope and Fraser 2003). However, some research (Marginson et al. 2006) suggests that most organisations are reluctant to stop budgeting and instead cope by applying their budgets more flexibly, updating them more often during the year, and accepting variances on details as long as overall numbers are not greatly affected.

This survey asked just two follow-on questions about budgetary control. The first asked how respondents thought people in their chosen organisation viewed the numbers in the budgets (Fig. 7). By far the most common was to see the numbers as the basis for evaluating performance (62%), though only 15% indicated that people saw them as a basis for criticism.

One group of respondents was markedly more likely to see the budget as a basis for evaluating performance; non-executives selected this 77% of the time.

Arguably, one of the strengths of budgetary control is that variances are a form of reporting by exception. They represent surprises that deserve attention. However, although 48% indicated that the numbers were seen as reasonable planning assumptions, only 21% thought they were viewed as a basis for learning and improving performance.

Figure 7: How numbers in budgets are viewed



Some of the views are mutually incompatible. Specifically, the numbers cannot truly be both aspirational targets and minimum acceptable levels of performance within the same organization without some confusion. It is also hard to see how either of these views is consistent with the view that the numbers are reasonable planning assumptions.

When respondents selected incompatible views this presumably indicates that different people in their chosen organisation have different views. Such incompatibilities between views should tend to undermine the value of budgetary control.

Overall, 21% of respondents selected views that indicated one or more of these incompatibilities.

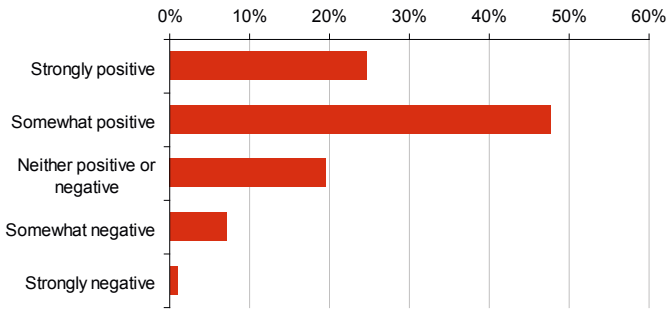
Respondents were also asked what contribution they thought budgetary control made to the management of risk in their chosen organisation (Fig. 8). In general they indicated a positive contribution. Again, non-executives were the most enthusiastic, more so than chief finance officers, for example.

Risk managers were the least positive about the contribution of budgetary control (though still positive overall), with 45% indicating that its contribution was neutral or worse.

> *Budgetary pressures can lead to people taking unnecessary risks to achieve targets and therefore can undermine compliance with procedures in place to minimise identified risks.*
> Risk manager, corporate sector, England, UK

Ratings of the contribution of budgetary control also declined slightly for larger organisations.

Figure 8: The contribution of budgetary control to risk management



> *More work needs to be done on 12-month rolling budgets so that we can integrate risk management more.*
> CEO, not-for-profit, England, UK

4. Regular financial forecasts

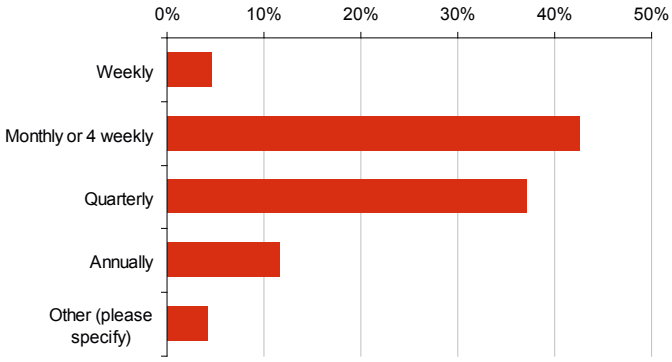
Another important technical area where accountants can contribute to effective risk management is through regular financial forecasting. Risk assessment is, in principle, forecasting that explores multiple possible outcomes rather than just one best guess. So, financial forecasting can be a prime example of risk management happening within core management activities.

Regular financial forecasts were common, with 80% of respondents indicating that they were produced for their chosen organisation.

FREQUENCY

As with management accounts, the most popular frequency of production was monthly or four weekly, but overall it seems that forecasts are less frequent on average than management accounts.

Figure 9: Frequency of producing financial forecasts

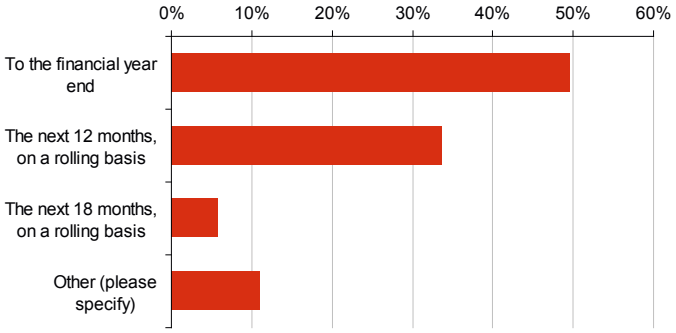


Larger organisations forecast slightly more frequently. Organisations feeling more financial pressure forecast more often. The organisation's sector also plays a role, with not-for-profit organisations more likely to forecast annually compared with accountancy firms, even though the firms were slightly smaller on average.

FORECAST PERIOD

The period for which organisations forecast also varies in interesting ways. Fig. 10 shows the overall results.

Figure 10: Time periods covered by financial forecasts



The most common is forecasting to the financial year end, with 50% of respondents selecting this. It is more common still for large organisations and for organisations feeling greater financial pressure.

However, organizations feeling financial pressure due to low liquidity or high gearing were much more likely to be forecasting on a rolling basis, with high gearing prompting 18-month forecasting.

> *Management accounts provide a snapshot of how the organisation has performed at any particular time, but they enable corrective action to be taken where items are not going to plan. By using rolling 12- or 24-month forecasts they also help to highlight areas of concern in the future to enable suitable risk mitigations to be put in place.*
> Financial controller, corporate sector, England, UK

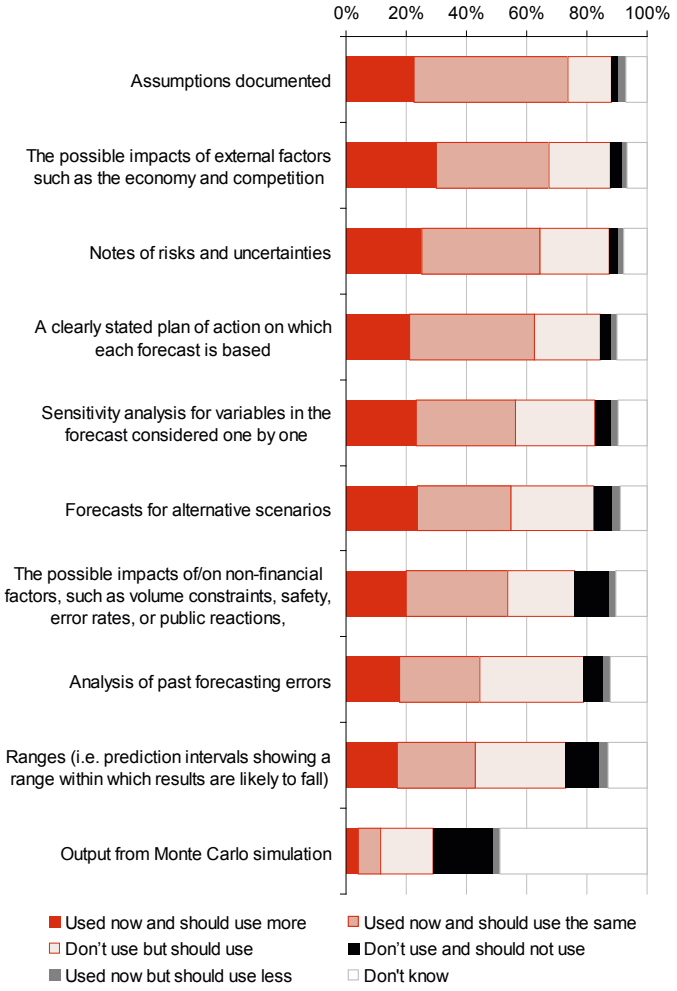
FORECASTING PRACTICES

Many practices supporting management of risk are applicable to regular financial forecasts. Fig. 11 shows how often a selection of these were in use and where respondents thought they should be used more, or less, in their chosen organisation.

As with management accounts, approval of these practices was overwhelming in all cases (once 'don't know' responses were excluded). Most respondents indicated that the practices were used or should be.

Nearly half (49%) of respondents did not know if output from Monte Carlo simulation was used and an unusually large proportion of respondents (20%) thought it was not used and should not be used. This pattern is perhaps an indication that many respondents did not know what Monte Carlo simulation is and others guessed from its name that it is a complicated procedure requiring special skills and perhaps also expensive software. In fact, Monte Carlo simulation is a more useful and easier alternative to ordinary sensitivity analysis and in simple cases can be done with standard spreadsheet software. It shows how uncertainty in estimates of inputs to a forecast translates into uncertainty about the outputs of that forecast.

Figure 11: Practices used for financial forecasts



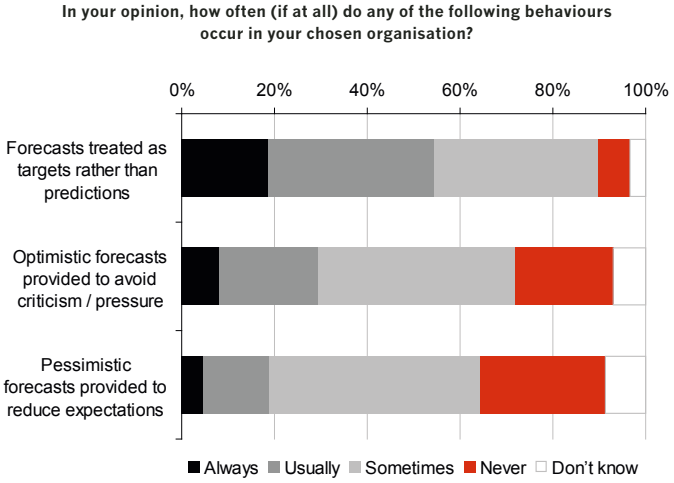
Financial forecasts give a heads-up on the likely risk of failure on some financial KPIs.
Internal auditor, corporate sector, Switzerland

UNETHICAL FORECASTING GAMES

Extensive research has probed the biases that lead to poor forecasts. Part of the problem seems to be that pressures in organisations lead to dishonest 'gaming' of forecasts. These are forms of unethical behaviour so common that we tend to see them as normal.

Respondents were asked how often they thought each of three such behaviours occurred in their chosen organisation and the results are shown in Fig. 12, in descending order of frequency. All the behaviours are ones that ought to reduce the accuracy of forecasts, turning the forecasts into something else.

Figure 12: Frequency of dysfunctional behaviours in forecasting



All the behaviours happen often enough to be a concern. Answers on each behaviour tended to correlate, with respondents often reporting similar frequencies for each behaviour. Despite this, just 3% of respondents reported that none of the behaviours ever happened.

Respondents working at board level tended to think these behaviours were less frequent than did others, though they still recognised them as frequent. Non-executives rated them least frequent, on average, with a majority thinking that optimistic forecasts to avoid criticism never happen in their chosen organisation. This contrasts with the views of other respondents. For example, only 20% of financial controllers, accountants, and management accountants thought it never happened and, presumably, they are better placed to know.

> *Forecasts are more often constructed to meet expectations; seldom to reflect actual foreseeable events.*
> Financial controller, corporate sector, Australia

> *Forecasting tends to be excessively optimistic. The business knows that if the forecasts are realistic the chances are they won't get funding, therefore they budget what they think will be accepted then rebaseline part way into the project; the company is woeful at killing projects that should never have passed the blue sky thinking stage.*
> Internal auditor, corporate sector

5. Other support for decision making

Where accountants support decision making they are often required to help predict the possible consequences of alternative courses of action. As with regular financial forecasts, this is a prime example of an activity where management of risk should be integrated.

Many accountants have been trying to provide support for decision making and 78% of respondents indicated that in their chosen organisation accountants provide such support.

> *Accountants need to be business partners. They need to be involved in decision making and help other functions see the possible implications of the decisions that they are about to make or have made in the past.*
> CFO, corporate sector, Republic of Ireland

> *The role of accountants has increased due to the effects of economic and financial instability.*
> Public sector, England, UK

PROVISION OF TOOLS

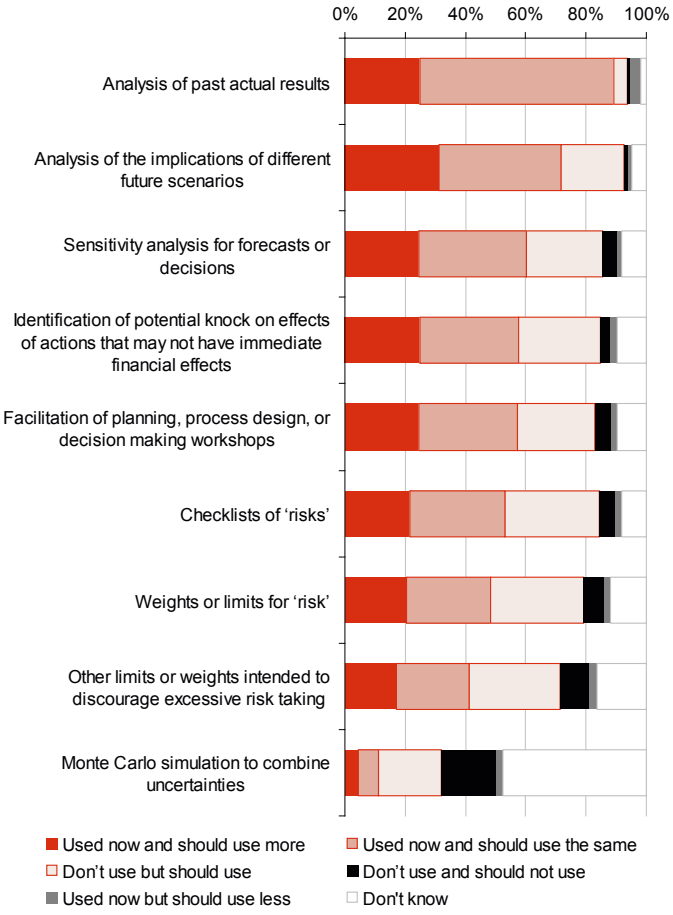
Not all support for decisions is provided by accountants in person. Asked 'Do accountants provide a tool or tools for others to use in the decision making (e.g. spreadsheet, software, checklist, template, policies and procedures)?' 94% of respondents indicated that they did.

DECISION SUPPORT PRACTICES

Fig. 13 shows which good practices were used for managing risk in decision support, and which respondents thought should be used more. As before, all practices were strongly supported, with Monte Carlo simulation unfamiliar to many, and hampered by its intimidating name.

> [Forecasts are] *a key tool for risk management; all key proposals are modelled before a decision is made.*
> CEO, not-for-profit, England, UK

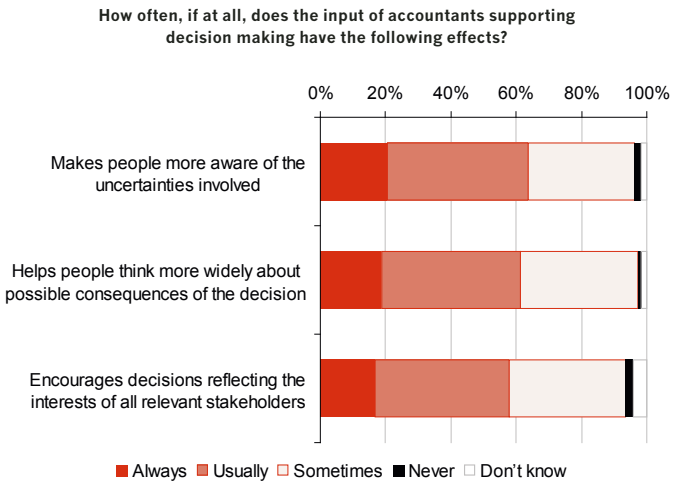
Figure 13: Practices used in decision support



EFFECTS ACHIEVED

What effect does accountants' support for decision making have? Fig. 14 shows how often it has each of three effects directly related to integrated risk management, according to respondents.

Figure 14: Frequency of helpful effects on decision making



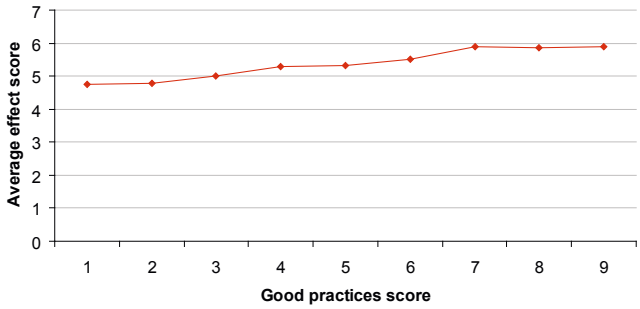
If respondents are often the ones providing that decision support it would not be surprising to find that they think they have a positive effect on decision making. Indeed, other roles below board level do take a very slightly less positive view. However, it is board level respondents who are most positive, and non-executives in particular. It could be that they are unaware of the extent of dysfunctional behaviours.

CONTRIBUTION OF GOOD PRACTICES

Do the good practices improve decision-making behaviour? It seems that in decision support, there is at least a link between respondents' answers. Fig. 15 shows the relationship between two summary scores. The 'Good practices score' is the number of decision support good practices used now. The 'Average effect score' reflects the frequencies of each of the helpful effects on decision making achieved by accountants. Although the graph is not steep, the trend is quite clear: the use of more good practices correlates with more positive effects.

> [Forecasting] *makes people think outside of the box and consider possible actions that may have a direct impact, and their results should unforeseen events happen. It encourages a more pro-active approach, rather than reactive.*
> Financial accountant, public sector, England, UK

Figure 15: Use of good practices and the effect on decision making



> *Good, unbiased financial planning certainly goes a long way to effect good risk management.*
> Consultant, public practice, Malaysia

> *An accountant's input can move the decision away from passionate ideas to more of a sound business footing, also considering costs of administration such as setting up foreign VAT registrations and making returns.*
> Financial controller, corporate sector, England, UK

DECISION-MAKING GAMES

A number of behaviours can undermine good decision making under uncertainty. Fig. 16 shows how often respondents thought each of a selection of these behaviours happens in their chosen organisation.

Again, the behaviours are common, with few respondents saying they never happen. Just 4% of respondents thought none of the behaviours ever happen in their chosen organisation.

Again, it is board members who are most likely to be unaware of these games, especially non-executives, though only a minority of board members are in this position of ignorance.

> *Decision analysis is sometimes hijacked by higher-level political motivations, leading to poor decision making and unforeseen adverse impacts.*
> Financial controller, corporate sector, Republic of Ireland

Figure 16: Dysfunctional behaviours in decision-making (1)

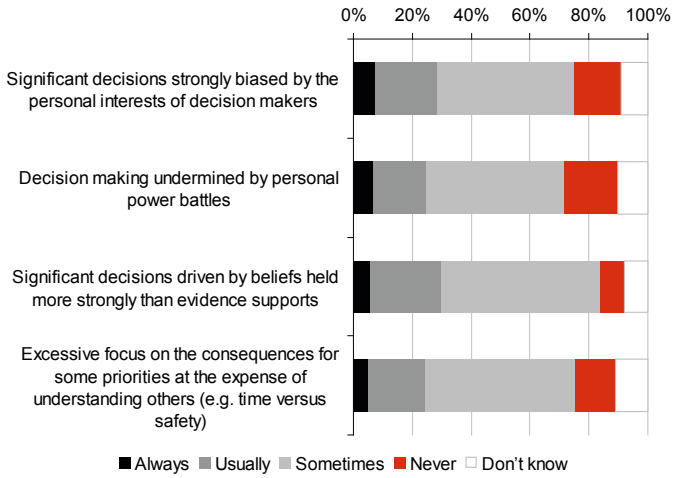
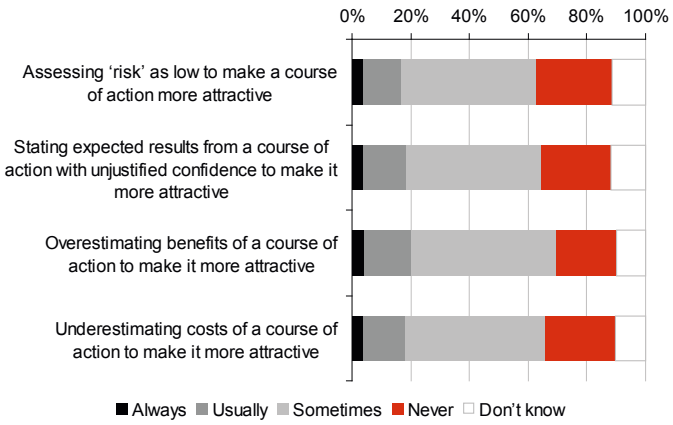


Fig. 17 shows the results of another group of questions about dysfunctional behaviours. This time the focus is on lies told to persuade others to accept a proposal. The overall frequency of occurrence is less than for the decision-making behaviours in Fig. 16, but still high. Three of these are the very behaviours that respondents cited as responsible for strategy failures generally.

Figure 17: Dysfunctional behaviours in decision-making (2)



As before, board-level respondents were aware of these behaviours but judged them slightly less prevalent than other respondents. Risk managers judged them to be most frequent. This is not because the board-level respondents were within smaller organisations because in fact their chosen organisations were often the larger ones.

6. Reporting process quality

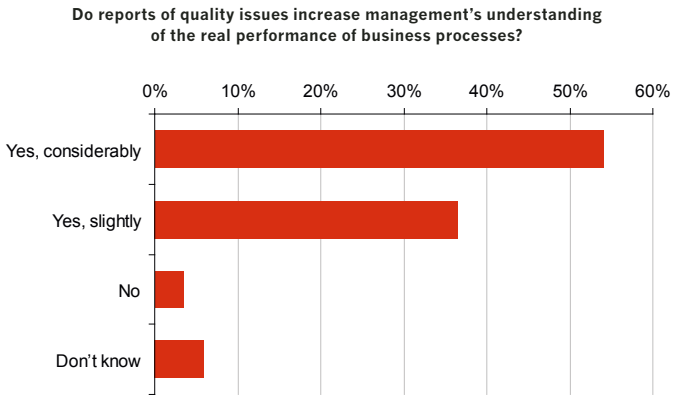
Risk management within core management activities is also concerned with routine 'risks' occurring in high volume business processes. In one sense these are not risks at all because their occasional occurrence is virtually inevitable, but when and where they will happen, and at what cost, are uncertain. This is a big part of operational risk. Some organisations have good reporting of quality problems in their business processes, while others remain unaware that the major driver of their productivity is in fact their rate of faults.

In the survey, 59% of respondents indicated that their chosen organisation uses 'reports of data on errors, backlogs, complaints, or other quality issues of business and/or financial processes (excluding debtors analysis)'. Of these, 67% were 'produced or collated by accountants/the finance function'.

EFFECT OF REPORTING QUALITY ISSUES

Fig. 18 shows how respondents viewed the impact of their process quality reporting. The respondents to value it most highly were the non-executives and the auditors. It may be that their relative distance from the organisation makes them particularly appreciative of this kind of information.

Figure 18: Understanding provided by reports on quality issues

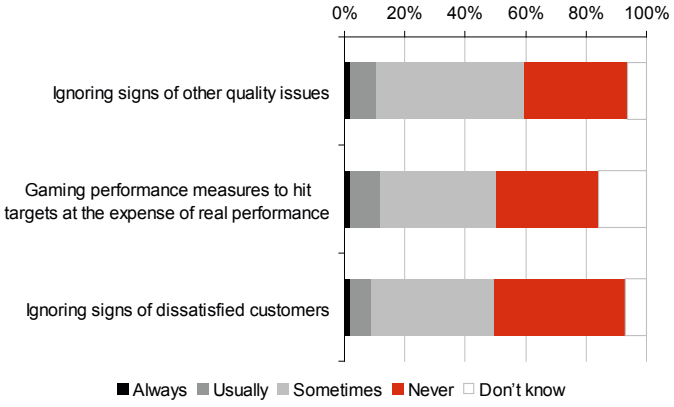


DYSFUNCTIONAL BEHAVIOURS

Three dysfunctional behaviours were explored and the results are shown in Fig. 19. While these behaviours are less common than others discussed above they remain common enough to be a major concern.

It is possible that some respondents are working in organisations where persistent quality issues are experienced but management, including accountants, remain unaware of them due to lack of information.

Figure 19: Dysfunctional behaviours related to quality



Although each behaviour never happens in around 37% of organisations on average, only 25% of respondents thought that *none* of these behaviours ever happen in their chosen organisation.

Once again, it is non-executives who are most likely to be unaware of these behaviours.

7. Controlling unethical and illegal behaviour

The final section of the survey covered other roles in risk management often taken on by accountants, from designing internal controls to scrutinising expense claims, and activities designed to reduce or respond to unethical behaviours.

TRADITIONAL CONTROL DUTIES

Fig. 20 shows the results of asking about the extent to which accountants in the finance function currently do various things designed to control financial non-compliance. Not surprisingly these activities are common, and equally so in all sizes of organisation.

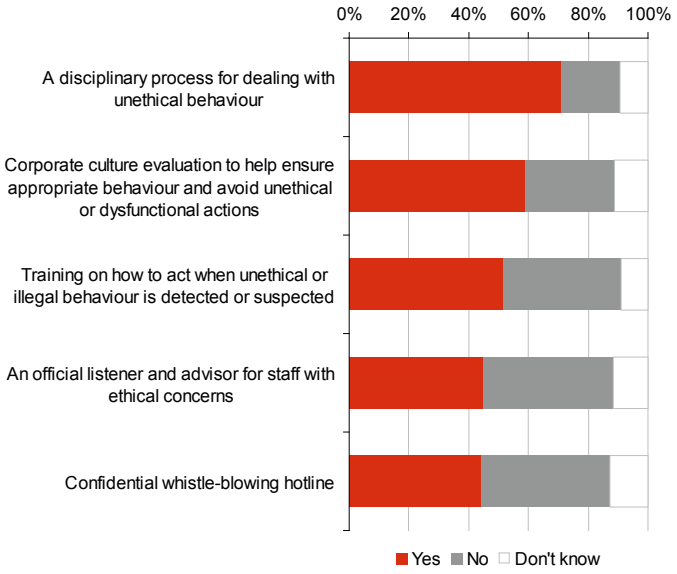
Figure 20: Practices for controlling financial non-compliance

Where these activities were not done by accountants in the finance function they might still have been done by others.

PROMOTING ETHICAL BEHAVIOUR

Fig. 21 shows the results of asking about activities specifically designed to tackle unethical behaviour. These are also common, though slightly less so. Also, they are much more common in larger organisations.

Figure 21: Practices promoting ethical behaviour



These practices were associated with lower frequencies of dysfunctional behaviours to a slightly greater extent than other groups of practices in the survey, suggesting that they may be particularly helpful.

Unfortunately, the survey did not ask what types of unethical behaviour were addressed by these controls. Fraud, theft, bribery, and false accounting seem obvious; unfair discrimination perhaps also. But what about the dysfunctional, frequently dishonest, behaviours explored earlier in this survey? Is deliberately biased forecasting a matter to take to the confidential whistle-blowing hotline?

8. Connections

So far this report has analysed the findings of each question, considering technical areas in isolation. This section considers observations across all technical areas, including some common themes.

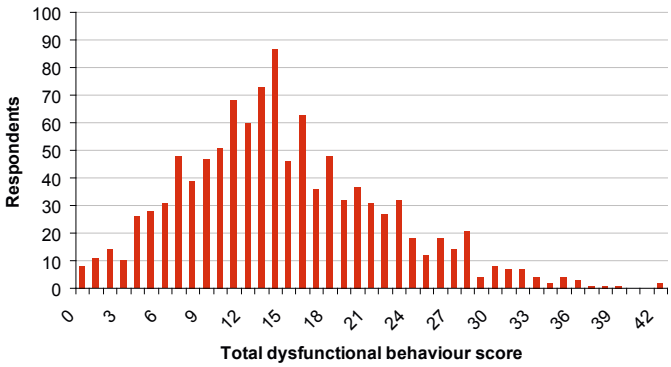
PREVALENCE OF DYSFUNCTIONAL BEHAVIOURS

There were four groups of questions about dysfunctional behaviours, most of which were dishonest though some were not. In each group there were some respondents who indicated that none of the behaviours in the group ever happen in their chosen organisation.

But what about all groups of behaviours taken together? How many respondents reported that none of the dysfunctional behaviours ever happen? The answer is eight, out of the 1,127 respondents who answered all the relevant questions. At the opposite extreme two other respondents reported that *all* the behaviours happen *always* in their chosen organisation. These respondents were an external auditor and a financial controller.

The survey asked about the frequency of 14 dysfunctional behaviours. Answers were converted into an overall dysfunctional behaviour score by allocating one point for 'sometimes', two for 'usually' and so on. Fig. 22 shows the distribution of these total scores, including only respondents who answered all relevant questions.

Figure 22: Distribution of total dysfunctional behaviour scores

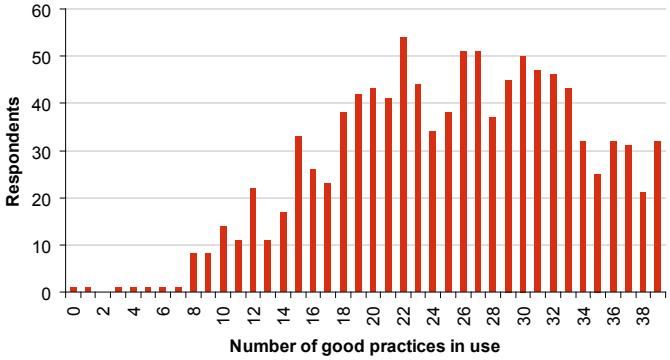


The UK and Ireland had noticeably lower dysfunctional behaviour scores than all other main countries and the Rest of the World.

USE OF GOOD PRACTICES

The survey asked about the use of 39 good practices, of which 28 were within core management activities and the remainder were other types of control. The total number of these practices in use was calculated for each respondent and the distribution of those scores is shown in Fig. 23, which includes only respondents who answered all relevant questions.

Figure 23: Distribution of the number of good practices in use



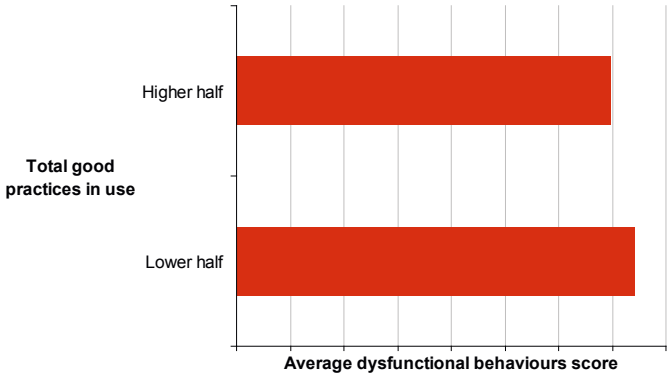
The extent to which practices were in use was roughly similar in all parts of the world, but the extent to which people thought more of the practices should be used was highest in Malaysia, Canada, and the Rest of the World.

The extent to which respondents thought the practices should be used more was related to their role, but not strongly. People in roles that involved producing accounting outputs (eg financial accountant, management accountant) were only slightly less interested in doing more than people in other roles.

IMPACT OF GOOD PRACTICES

Organisations using higher numbers of good practices did have lower scores for overall dysfunctional behaviour, but the relationship is not linear. Fig. 24 shows the average total dysfunctional behaviour scores when respondent organisations were split into two equal-sized groups on the basis of the number of good practices in use.

Figure 24: The impact of good practices



With each group of practices and each group of dysfunctional behaviours a similar pattern can be seen. As the number of practices used increases, the dysfunctional behaviour score reduces, but when the number of practices used is at or near the maximum possible the dysfunctional behaviour score jumps up. Without this anomalous rise the overall impact of good practices would be much clearer.

Use of each good practice is individually associated with lower overall dysfunctional behaviour scores for all practices except for:

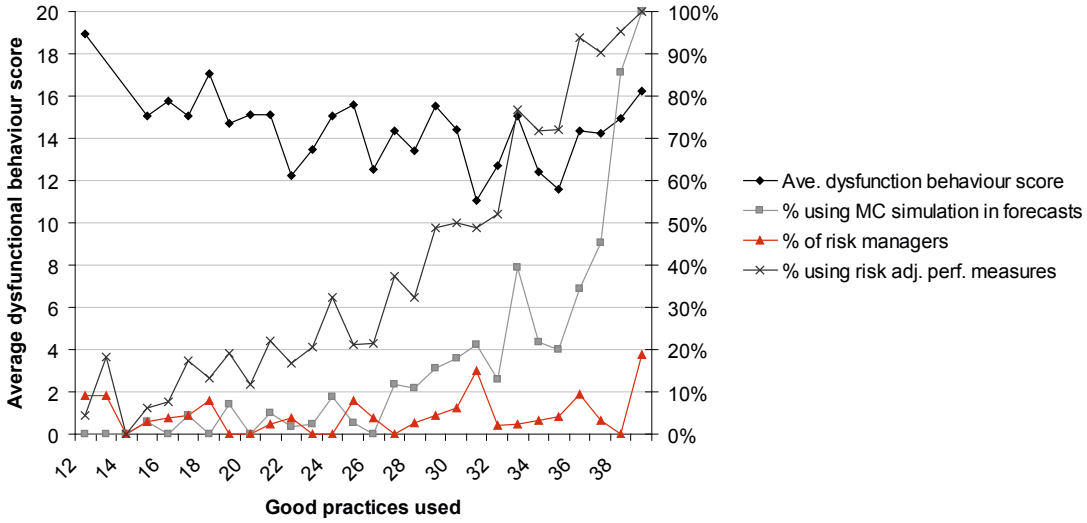
- use of Monte Carlo simulation in decision support
- use of Monte Carlo simulation in regular financial forecasting
- showing risk-adjusted performance measures in management accounts, and
- showing capital gearing in management accounts (though the association is very weak).

This is another anomaly, because these are technically strong practices and ought to be helpful rather than having a pervasive negative effect on behaviour.

What is the reason for these two odd patterns? Fig. 25 shows four variables together that may be a clue to the explanation. The top line shows how the dysfunctional behaviour score drops as the number of good practices used increases, but at 36 practices in use the trend reverses. This is simply a more detailed view of the anomaly already mentioned. (Averages of small groups have been eliminated to show the main trend clearly.)

The line below it shows the proportion of respondents saying that risk-adjusted performance measures are used in their chosen organisation in management accounts. Below that is a line showing the proportion who say that Monte Carlo simulation is used for regular financial forecasting. (Use of Monte Carlo simulation in decision support is very similar indeed, so not shown.) The lowest line shows the proportion of respondents whose job role is ‘risk manager’.

Figure 25: Detailed analysis of the impact of good practices on dysfunctional behaviour



These are methods one would expect to see more often used in financial services and where a specialist risk-management team exists. The total dysfunctional behaviours score for financial services organisations is about the same as for other corporates, so the sector is unlikely to be the explanation.

Could it be that the organisations whose higher scores for dysfunctional behaviour have caused the two anomalies are also organisations with a *separate* risk management function? Unfortunately, this was not something asked about directly in the survey so we cannot be certain. Nonetheless, it does seem to suggest that either (1) when risk management is not integrated it is less effective in countering dysfunctional behaviours, or (2) when risk management is not done by accountants they see it as less effective in countering dysfunctional behaviours.

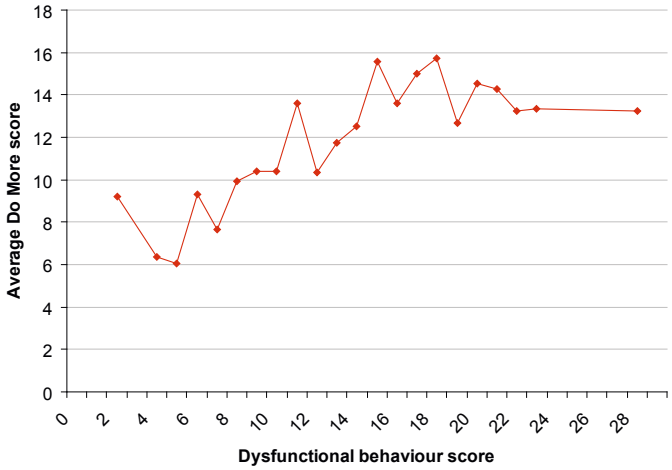
> *There is also a 'risk and compliance' function in our organisation, leaving the finance function mainly for financial control purposes.*
> Financial services, England, UK

INTEREST IN DOING MORE

Respondents seem to think that using the good practices should reduce dysfunctional behaviour. The number of good practices that respondents thought should be used more in their chosen organisation was strongly related to the frequency of dysfunctional behaviours (Fig.26). In the analysis there are too few respondents with very high dysfunctional behaviour scores to calculate reliable averages, but these unreliable averages (not shown) tend to continue the rising trend. Furthermore, the relationship is far too steep to be explained simply as meaning that organisations with few practices in place are more interested in adopting more practices.

> *The general economic climate has forced the organisation to strengthen the role of the finance function in risk management as the risks themselves have proportionately increased.*
> Public sector, England, UK

Figure 26: Interest in using good practices more as a function of dysfunctional behaviour



BOARD-LEVEL AWARENESS

In general the survey shows that most board members who responded were well aware of the dysfunctional behaviours, but still a consistent finding was that they were less aware of these than others further down organisations. Non-executives, in particular, seemed to be most likely to think the behaviours did not happen, though there were only 26 non-executives among the survey respondents.

SIZE, PRESSURE, AND DYSFUNCTIONAL BEHAVIOUR

An obvious pair of hypotheses to explore is that dysfunctional behaviour is more common in larger organisations and more common when there is high financial pressure on leaders.

Unfortunately, the leaders of larger organisations were seen as feeling more financial pressure, making more complicated analysis necessary to separate the effects of these two factors. When this was done it emerged that size is not linked to dysfunctional behaviour, but pressure is, though not strongly. The average overall dysfunctional behaviour score where pressure was 'intense' was almost 17% higher than where pressure was only 'moderate'. (Too few respondents reported 'low' pressure for a reliable comparison.)

What we might think of as 'big company' politics is perhaps just human behaviour observable in groups of any size. If you want to escape big company politics you have to work for yourself.

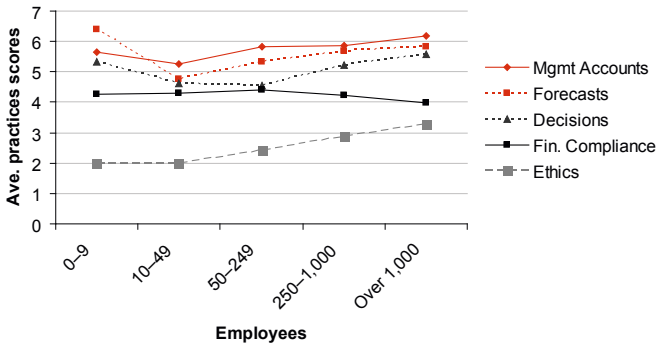
Furthermore, although the financial pressure felt by leaders does seem to increase reported dysfunctional behaviour, it is far from the main driver; it just makes a poor situation a bit worse.

SIZE AND GOOD PRACTICES

Another plausible hypothesis is that we should expect more good practices for integrated risk management in larger organisations, because they need them (due to the higher financial pressure) and because they have the resources to use those practices.

In fact, organisation size, as measured by number of employees, does not link strongly to good practice scores either, except for the elements of ethics programmes, which seem to be more common in larger organisations (Fig. 27).

Figure 27: Organisation size and good practice scores



Some of the highest scores for good risk management practices are from very small organisations. The stereotype of small and medium-sized enterprises as unsophisticated and uninterested in intelligent management techniques is at best an oversimplification. Presumably some, at least, are small groups of highly educated people, perhaps making decisions about large amounts of wealth.

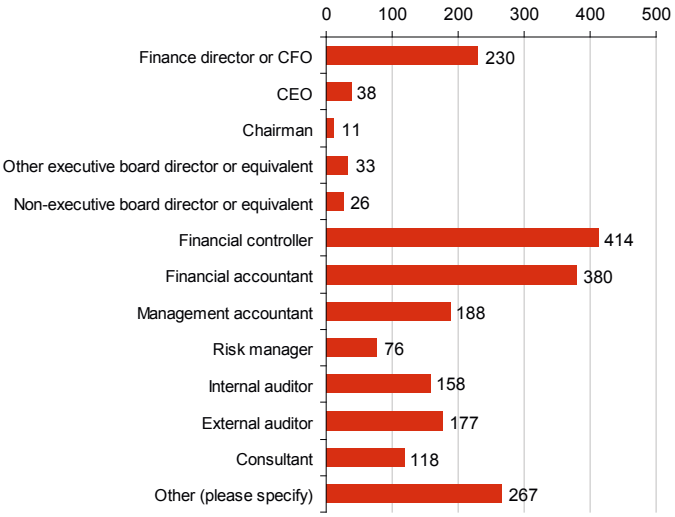
9. Survey respondents and organisations

An invitation to participate in this survey was sent to around 100,000 ACCA members worldwide and over 2,000 generously responded. They come from many countries and work in many roles.

JOB ROLES

The job roles of respondents are shown in Fig. 28. With the exception of chairmen, enough representatives of each role were available for useful conclusions to be drawn.

Figure 28: Job roles of respondents

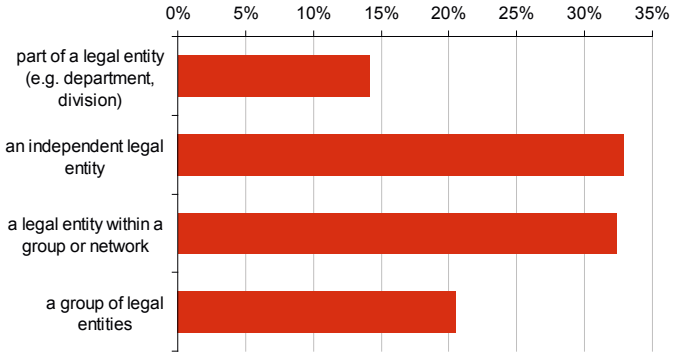


For some analyses, the job roles were put into groups on the basis of similarity.

TYPE OF ORGANISATION

In the interests of collecting good-quality data, respondents were instructed to choose to answer for an organisation they knew well. This did not have to be a legal entity. Fig. 29 shows the types of organisation they chose.

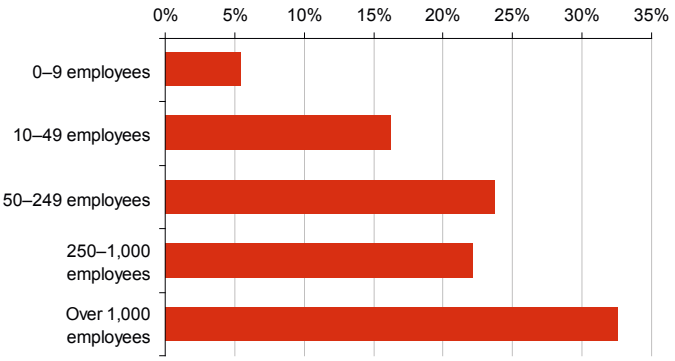
Figure 29: Types of organisation



SIZE OF ORGANISATION

There are many ways to characterise the size of an organisation. Since the survey questions focused on how people work together, number of employees was selected as the measure of size. Fig. 30 shows the distribution of size.

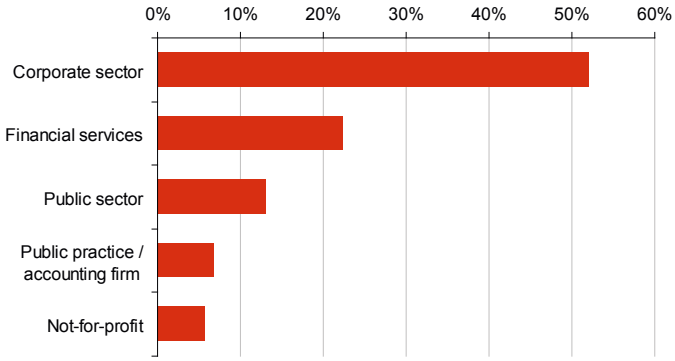
Figure 30: Size of organisations



SECTOR

Most respondents chose to answer for an organisation in the corporate sector, but other sectors were well represented, as shown in Fig. 31.

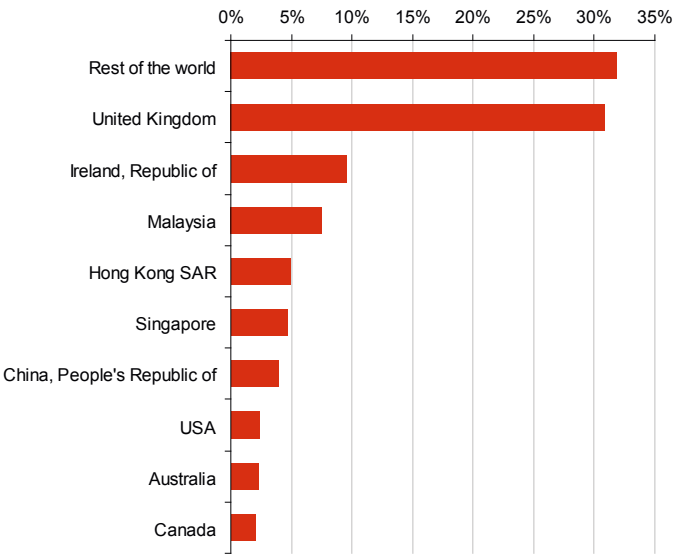
Figure 31: Organisations by sector



INTERNATIONAL COVERAGE

Respondents came from 109 countries. The countries providing 50 or more respondents are shown individually in Fig. 32, with all others in the largest group, 'Rest of the world.'

Figure 32: Organisations by country



FINANCIAL PRESSURE

Chosen organisations varied in how much financial pressure respondents believed was experienced by their leaders. Fig 33 shows the intensity of that financial pressure. Financial pressure on leaders was thought highest in Ireland and the UK, but lowest in Hong Kong SAR.

Figure 33: Intensity of financial pressure

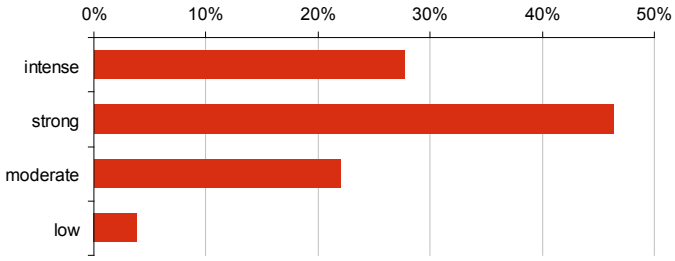
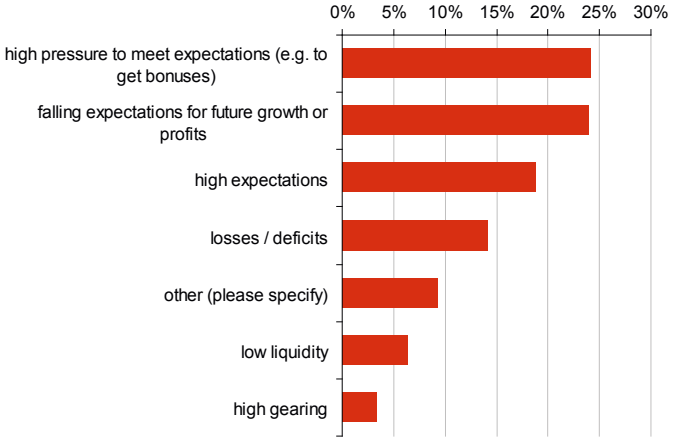


Fig. 34 shows the main reason for that financial pressure.

Figure 34: Reasons for financial pressure



Real pressure caused by falling expectations, losses/ deficits, low liquidity, or high gearing was only slightly more common at 48% collectively than pressure generated by high expectations and high pressure to meet expectations, at a combined 43%.

10. Conclusion

The survey results paint a coherent picture. Respondents attributed organisational failure to poor decisions driven by bias and, to some extent, self-interest. They recognised these behaviours as common in their own organisations. They had a clear view that the contribution of accountants to the culture of decision making should encourage honesty and objectivity, but not baseless conviction, consensus, and advocacy over evidence.

They understood that it is better, from this point of view, to explain a range of possible outcomes from a course of action than to detail just the most likely outcome. This is the essence of risk management.

There was strong support for a wide range of practices that accountants use and that should improve management of risk in core management activities. These practices are often in use already and respondents mostly thought they should be used more.

A survey such as this cannot prove that good practices cause real improvements in behaviour and resulting outcomes. Most respondents will have been giving answers about their own activities and naturally will have a positive view of the contribution they make. In addition, the analysis shows statistical correlations but not particular causal mechanisms.

Nonetheless, the statistical links are encouraging.

- Respondents thought that reporting process quality does indeed provide a better understanding of process quality problems.
- There is an un-dramatic but clear link between using good practices for decision support and helpful impacts by accountants on decision making on items specifically related to managing risk.
- Respondents who reported higher frequencies of dysfunctional behaviours were also more likely to think that more good practices should be used. This suggests that they do see such practices as being at least part of the antidote to the dysfunctional behaviours.
- Overall, the more good practices are used the lower the scores for dysfunctional behaviours. However, this connection is weakened by a correlation we do not understand between particularly sophisticated risk management practices and more frequent dysfunctional behaviours. Very possibly there is also a tendency to try to address bad behaviour by using more of the good practices, which would also cloud the statistical connections.

Overall, this all indicates that accountants are already playing a role in successfully practising risk management in core management activities, but there is still a need for them to do more of the same and they think they should.

The reality of risk is that it has to be managed in day-to-day management activities, especially in big decisions. Accountants have an important role to play.

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