

CLAYTON UTZ

Briefing Paper on
Governance, Risk and Compliance



Briefing Paper on Governance, Risk and Compliance (GRC)

What is GRC, what is its impact on compliance practices and where is GRC heading?

1. Background

Well established governance, risk and compliance functions have for many years formed a key part of corporate practice in both the private and public sectors in Australia. However, what has recently emerged is a new concept "GRC" which seeks to stress the close inter-relationship between governance, risk and compliance and how these functions can be further integrated to increase their effectiveness.

The purpose of this briefing paper is to examine GRC and to outline its current impact on compliance practices in both the public and private sectors in Australia. This briefing paper will also sketch where GRC is heading and give an indication of likely future developments.

2. What is GRC?

In most organisations there exists functions for overseeing governance, risk and compliance frameworks and policies.

In many organisations these functions or frameworks have a separate operation and focus. Generally, the persons who have oversight of these functions are different officers who may not interact closely. For example governance is often the province of the company secretary, risk is overseen by the chief risk officer and compliance by the head of compliance or such like.

This model has traditionally been seen as having a distinct advantage of being able to quickly establish controls and policies specific to the organisation relating to the particular governance, risk or compliance failures or key risk areas (e.g. TPA or environmental licence requirements).

A limitation with this approach is that it may create:

- (a) a disconnect between governance, risk and compliance functions themselves and their interaction with their relevant organisational silos;
- (b) inefficiencies or duplication of corporate effort with multiple approaches to managing the same or similar risks and controls;
- (c) inconsistency within the governance, risk and compliance frameworks themselves;
- (d) lack of transparency and uniformity in approach across the frameworks and organisation; and
- (e) an increased risk of unidentified gaps in these frameworks and controls.

An integrated GRC framework is almost a reversal of the traditional approach described above. A GRC framework does not simply centralise the GRC functions but rather seeks to integrate all relevant policies, processes, procedures and controls. Specifically, this approach is designed to identify and standardise common processes, procedures and controls and ensure that they are consistently rolled out throughout the organisation.

3. **The path to integrated GRC**

Whilst there does not appear to be one path for successful GRC integration, there are a number of key factors that need to be considered when doing so.

These matters include:

3.1 Strategy

Steps need to be put in place to ensure that there is a standard approach to implement corporate strategy that take into account organisational performance, goals and objectives as well as GRC conformance matters (for example balanced scorecards, complimentary integrated targets and the like).

3.2 Reporting and Audit

A key aspect of implementation of these initiatives is monitoring and reporting on their effectiveness. Central to this is establishing appropriate goals and targets (perhaps expressed as Key Performance Indicators (KPIs), Key Result Areas (KRAs) or the like) and their related reporting frameworks. A further important step is determining how internal and external audit interacts with these arrangements and leveraging synergies to ensure maximum benefits for all GRC aspects are derived from the audits undertaken.

3.3 Legal function

Many organisations ensure that the senior in-house lawyer has a general counsel role which includes, in effect, providing advice on the management of the legal aspects of the reputation of the organisation. The legal section often is also involved in key strategy decisions and implementation of major corporate initiatives (for example mergers and acquisitions, restructuring, adoption of new products and services). The legal group is also responsible for providing detailed advice in delicate and difficult circumstances. Therefore most have been established using structures that are designed to ensure that legal professional privilege applies to particular advisings and investigations. It is therefore crucial to ensure that the legal group have a clearly understood role in the GRC frameworks.

3.4 Information technology

A further factor is the ease with which information is available and managed across the organisation. In particular, a key issue is whether there are common IT platforms for use throughout the organisation to facilitate the sharing of information. This is often the province of the chief information officer whose role must also be considered with implementation of GRC frameworks.

3.5 Ethics and corporate social responsibility

Increasingly, organisations are adopting ethical and corporate social responsibility underpinnings for their organisational goals, values and desired behaviours. If this is the case, these key drivers both for corporate performance and behaviour management models (particularly remuneration and incentive arrangements) will need to be factored into the GRC model.

3.6 Corporate culture

Some leading organisations are recognising the importance of planning and mapping their organisational cultures and having in place planned culture change programs to achieve stated organisational cultural objectives and targets. There is increasing evidence that the culture of the organisation can significantly support or hinder achieving corporate objectives. In our view, at the very least, organisational culture needs to be closely considered to ensure the smooth implementation of GRC initiatives throughout the organisation. From another

perspective, GRC initiatives should be designed to also achieve significant beneficial cultural outcomes.

3.7 Business process management

Any integration of frameworks, policies, procedures or processes call for consideration of how the best outcomes can be most easily achieved. Business process management is being used or examined by many as an important tool to achieve the greatest synergies and efficiencies.

4. Common elements

Organisations that have embraced GRC have found that there are a range of common elements that go right across successfully integrated governance, risk and compliance policies, processes and procedures.

These include:

- (a) **Objectives:** There needs to be a clear understanding of organisational objectives and an ability to demonstrate how GRC targets support achieving these organisational objectives within the mandates of the law and organisational policies. Of vital importance is the "breakdown" of these objectives into departmental or functional goals that form part of each staff members individual objectives.
- (b) **Identification of boundaries:** An organisation must be able to identify and articulate the applicable boundaries of acceptable organisational conduct to its stakeholders, particularly its staff and contractors. These include the identification of specific mandatory boundaries that apply to the organisation, such as laws and externally imposed codes of conduct. These boundaries also need to extend to voluntary organisational boundaries that apply, for example adopted codes of practice, industry standards, contractual provisions and internal policies and procedures.
- (c) **Identification and assessment of key risks:** The GRC frameworks should seek to identify, analyse and prioritise the organisation's key events and controls. The focus should be upon those events or controls that are necessary to be assessed and monitored so as to ensure that the organisation can meet its performance goals and objectives within its established boundaries (mandatory and voluntary).
- (d) **Detect, check and prevent:** Organisations need to specifically develop their GRC mechanisms to put in place policies, processes and controls to ensure that they can detect and check that the organisation is keeping on a track to achieve its goals and objectives. Importantly, this should focus on not only ensuring that there are adequate procedures in place to guide the organisation but also needs to ensure that appropriate conduct and behaviours are being evidenced and inappropriate conduct prevented. It is therefore necessary to have separate processes to evidence, monitor and check for performance as against targets and ensuring that undesirable conduct is not occurring. Examples of these processes include whistleblower hotlines, workforce surveys, control and trigger monitoring and assessment.
- (e) **Continuous improvement and adjustment:** Organisations are constantly changing and therefore the GRC frameworks need also continuously strive and improve and adjust. If weaknesses are discovered or a scan of emerging issues indicates that a more fundamental change to the organisation objectives or GRC frameworks are required, then an organisation needs to be focussed on identifying ways of responding and adjusting organisational structures. Examples of this approach include regular "healthchecks", analysis of complaints and queries, routine reviews of emerging risks and opportunities and root cause analysis.

- (f) **Communication and reporting:** Throughout all these processes ongoing communication with all appropriate internal and external stakeholders is required. This includes the establishment of clear reporting lines and reporting frameworks to ensure that both management and the board have a "clear line of sight" on organisational performance and emerging issues.

Implicit in all of the above is that there is a common vocabulary, approach and organisational appetite for all GRC initiatives. This way, matters identified in one organisational area can be quickly replicated across the entire organisation. The key questions such as "What are the most important risks that we face?" or "Is our organisation compliant?" can then be answered uniformly across the organisation.

Of assistance in this process is the sharing of a common technology infrastructure to facilitate these processes, particularly GRC "friendly" software.

5. **What are the benefits of an integrated GRC approach?**

Many who are seeking an integrated GRC approach cite focusing on achieving significant benefits including:

- (a) an improvement in the quality and availability of information;
- (b) a reduction in breaches and errors;
- (c) a reduction in costs and greater efficiencies;
- (d) a more flexible and externally focussed workforce capable of rapid change to meet customer and organisational needs;
- (e) a greater assurance for the organisation and its Board and senior management that GRC issues are being appropriately dealt with and the organisation remains "on target" with its performance objectives; and
- (f) improved levels of communication across the organisation.

6. **Key challenges**

Given these benefits as described above, what then are the key challenges to GRC integration?

Those who have sought to integrate GRC have identified the following challenges in implementation:

- (a) A perception by staff that the initiative may have an ulterior motive, for example a cost recovery drive or head count reduction.
- (b) Business unit managers or middle management are fearful of losing control of their decision making or loss of power generally.
- (c) Business units and middle management are fearful of being marginalised as GRC responsibilities are devolved to those in lower levels of the hierarchy.
- (d) Organisations are sometimes sceptical regarding the targeting and measurement systems proposed and are concerned that there will not ultimately be an appropriate return on investment given the establishment and maintenance costs involved.
- (e) Corporate cynicism and scepticism around the outcomes and results achieved from past planned organisational change (and management "fads" generally).

These are key challenges indeed. This is particularly the case given that successfully integrated GRC initiatives are still fairly isolated and few have occurred in Australia.

This being said, overseas experience is indicating that an increasing number of organisations are considering GRC initiatives and those that have embraced GRC report positive benefits ((See "A pathway to principled performance®: The OCEG Framework Approach to Integrated GRC", (Mitchell, S., 2008. Available at <http://www.oceg.org/View/20055>. Accessed on 22 August 2008 and the 2007 OCEG GRC Strategy Study Findings Report).

It is therefore vitally important to ensure that the GRC integration process is carefully scoped and benchmarked to ensure that the return on investment is targeted and hopefully achieved. Given the nature of these challenges, the strategy of implementation must also be carefully thought through to ensure the implementation continues notwithstanding the inevitable difficulties and challenges that will be faced.

7. What are the GRC impacts upon current compliance practices?

We observe that there are a number of current significant GRC impacts upon existing compliance practices in the Australian context. Those impacts include the following:

- (a) **Re-evaluation of functional boundaries:** Many organisations are now closely reviewing what their governance, risk and compliance functions are actually doing and examining the interaction between those functions. Many are concluding that there is unnecessary duplication and effort and are looking at ways of implementing further integration in order to reduce costs and the number of invasive activities of GRC on the organisation (eg. audit, monitoring, reporting and use of a single incident escalation system). Business process management methodologies are increasingly being used as a driver for these outcomes in GRC integration.
- (b) **Corporate culture:** There appears to be an increasing appreciation of the importance of corporate culture and the role that governance, risk and compliance plays in ensuring that there is a healthy corporate culture. We note that some clients are now undertaking exercises to map their corporate culture with a view to identifying potential "hotspots" where problems may exist. Leading organisations appear to be also looking at establishing corporate culture targets and putting in place planned corporate change mechanisms to achieve those targets. Most of these targets are operationalised within the GRC frameworks.
- (c) **Productivity, gains and dissatisfaction:** Our discussions with our clients during the last quarter and 2007 and the second quarter of 2008 both in the public and private sector from a range of different industries have indicated that there are currently a number of common drivers at work relating to their GRC frameworks. These drivers include the need to increase the "value add" delivered by GRC such that costs are controlled and greater performance and productivity is achieved by their GRC efforts and GRC integration.

Our discussions during this time with a number of key directors, middle management and compliance professionals across a range of our public and private sector clients indicate a rise in dissatisfaction with their non-integrated GRC efforts. This dissatisfaction appears in part to be referable to the inability to measure the impact that their GRC efforts are making and uncertainty as to whether those efforts are achieving the results intended in the most cost efficient manner.

The net result of these impacts together with the impact of challenging economic times and the resultant need for cost management is the implementation of a number of reviews and that many organisations are now reviewing their GRC framework. The object of the reviews is to achieve, at best, cost reductions but ideally identification of greater efficiencies and business improvement outcomes.

8. Where is GRC heading?

The above OCEG research supported by the latest SAI Global research (Practitioner Issues & Trends - Risk & Compliance in Australia 2008) seems to be generally consistent with the results that we are observing amongst our clients and GRC colleagues. Namely:

- (a) There are increasing numbers of organisations investigating or adopting a GRC model or at least seeking to combine elements of governance, risk and compliance.
- (b) Few have indicated that they have completed this task - many have indicated that they are only just beginning to identify how they can extract the greatest value out of their GRC efforts.
- (c) Those who have started only recently are generally finding the challenges much greater than they initially anticipated and resistance to change is far more deeply ingrained than was thought to be the case. In particular, many of those who sat at the head of the governance, risk and compliance silos who were supportive of a GRC approach subsequently raised previously unidentified issues and challenges that proved to be major obstacles.

GRC leaders have adopted a number of approaches to maximise benefits achieved including:

- (a) Upfront identification and ongoing measurement of detailed targets and metrics that were sought to be achieved as outputs of the GRC project.
- (b) Very clear cultural measurements that were sought to be an outcome of the GRC project with clear milestones as to how these were to be achieved.
- (c) These GRC and cultural milestones were of vital importance to keep momentum. There appears to be a general acceptance that organisation culture for larger organisations will only be changed over a long term (3 to 5 year) timeframe, so it was identified as important to renew focus on the long term goals during incremental challenges so as to not lose commitment just prior to the planned benefits being delivered.
- (d) Incremental change based around enterprise-wide projects appears to deliver greater immediate results than a one larger GRC "big bang" enterprise-wide project. Business process management initiatives are often also being used to drive "quick wins" in key processes that require updating.
- (e) A focus on ensuring there were *performance* measurements rather than merely *conformance* measurement. This approach reportedly appears to have achieved a greater perception of value for the organisation at all levels.

What this means is that organisations were measuring their performance as against corporate targets as well as ensuring they met their conformance boundaries (e.g. your business rates 3 out of a possible 5 across a balanced scorecard where 3-5 is a pass on a compliance scale and 5 represents best practice). Middle management in particular reported that this was a much more motivating metric since it provided feedback on how their area of responsibility was performing having to regard to organisational objectives rather than simply being told that they met a minimum compliance standard. Of course it was necessary that the performance targets included within them an appreciation of these conformance requirements, such that the minimum targeted outcome must by definition be compliant.

- (f) Greater use of organisational Codes of Practice. These codes appear to be used to focus attention on "principled" compliance whereby staff are encouraged to use their codes of practice to guide their decision making in circumstances where existing process and procedures are not of assistance. Increasingly, the use of "principles" to guide staff rather than detailed checklists appear to be deployed.

Codes need to be carefully drafted to assist with this process and business process management techniques are also adopted to ensure that staff obtain guidance and assistance with their decision making.

9. Conclusion

Whilst GRC initiatives appear to have become more widespread, in our view, for most Australian public and private sector organisations, they are still in the early stages of their development. It is encouraging therefore that many of the GRC "leading organisations" report that the further that they journey down GRC implementation the greater the value that they identify is delivered via this approach.

A further query is what this convergence of governance, risk and compliance will mean to the relevant professional bodies such as the Institute of Chartered Secretaries, the Risk Management Institution of Australasia and the Australasian Compliance Institute.

However, one thing that can be said with some degree of certainty is that whilst GRC is new it is not "a passing management fad" and appears something that is here to stay.

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