Overview

• Why does culture matter and what is it?
• The emerging mandate to audit culture
• Effective strategies for auditing culture
• Practical considerations for internal audit
• Parting thoughts
Culture Is Increasingly the Culprit in Organizational Debacles

Culture: The “Moral Fabric” of an Organization

“Culture is the self-sustaining pattern of behavior that determines how things are done.”

- Katzenbach, Oelschlegel, and Thomas

A Simpler Definition of Culture

Culture is “how we do things around here.”
It's Not What Is Said. It's What Is Done!

“As officers and employees of Enron Corp., its subsidiaries, and its affiliated companies, we are responsible for conducting the business affairs of the companies in accordance with all applicable laws and in a moral and honest manner.”

A Good Strategy Is Seen As a Path to Success

“Business strategy is the battle plan for a better future.”

- Patrick Dixon

But A Good Strategy Isn't Enough!

“Culture eats strategy for breakfast.”

- Peter Drucker
### Culture Is on the Radar of Regulators

- U.S. and global financial services regulators expect internal audit coverage.
- Financial Industry Regulatory Authority: 5 culture indicators
  - Control functions are valued
  - Policy or control breaches are not tolerated
  - Risk and compliance events are proactively identified
  - Immediate managers are effective role models
  - Non-conforming sub-cultures are identified and addressed

### How Can a Healthy Organizational Culture Contribute to Success?

### Characteristics of a Healthy Culture

- Ethical tone at the top
- Clearly defined values
- Teamwork & collaboration
- High employee morale
- Honesty & transparency
- Ownership & accountability
Results of a Healthy Culture

- Encourages a long-term focus
- Promotes healthy risk-taking
- Mitigates myopic behavior
- Incubates new, challenging ideas
- Affords quick resolution of differences

What Happens When Organizational Culture Is Not Healthy?

When Walk Diverges From the Talk, Culture Can Go Toxic
Characteristics of an Unhealthy Culture

- The ends justify the means
- Different standards for different people
- Poor communication
- Blaming others & defensiveness
- Distracted, unproductive employees
- The talk isn’t walked!

What Happens When the Culture Is Toxic

- Loss of confidence in leadership
- Groupthink and judgment errors
- Unethical or illegal behavior
- Erosion of the brand and reputational damage
- Erosion of shareholder value

Addressing Culture As a Critical Risk Is an Emerging Mandate
CEOs and CFOs See Culture As Critical

- Over 90% believe culture is important
- 92% believe improving their culture would improve value of the company
- Over 50% believe culture influences:
  - Productivity
  - Creativity
  - Profitability
  - Firm value and growth rates
- Yet, only 15% believe their corporate culture is where it needs to be

CAEs Also Grasp the Risks That Culture Presents

- In IIA surveys, more than half of CAEs see organizational culture as high risk
- But, 58 percent say organizational culture is not audited

How Do We Audit Culture?
Three Lines: Defending the Organization Against Cultural Risks

Mitigating Organizational Culture Risks

- **Hard Controls: Within Our Comfort Zone**
  - Codes of ethics/conduct
  - Human resources policies and practices
  - Other policies, rules, and defined procedures
  - Organization’s structure
  - Defined roles, responsibilities, and authorization levels

Mitigating Organizational Culture Risks

- **Soft Controls: We Must Use Our Judgement**
  - Competence
  - Trust and openness
  - Strong leadership
  - High expectations
  - Shared values
  - High ethical standards
Strategies for Auditing Culture

- Auditing Culture Is a Journey
- An enterprise-wide assessment of culture
- Issuing capstone or trending reports based on multiple inputs
- Auditing culture within lines of service, business units, or geographies
- Identifying culture as the "Root Cause" in individual conclusions/findings

The “Root Cause” Can Often Be Culture

- It is tempting to only look at specific issues and how to correct
- Did certain behaviors cause the problem?
- Is culture a fundamental root cause?
  - When controls fail
  - When risks aren’t managed
  - When regulations or laws are violated

Business Units Can Develop Their Own Cultures

- Focus on specific business units/locations
- Are values and conduct aligned with those of corporate?
- Focus on indicators such as:
  - Systemic failures in controls/compliance
  - Hotline or “whistleblowing” activity
  - Unusual deference to leadership
- Are compensation and performance metrics aligned with organization's policies and values?

"Culture manifests itself locally and employees in distant locations, regions, or geographies may be hesitant to contact a headquarters operation to report real or perceived problems with culture or ethics.”
Pulling Together Multiple Perspectives

- “Connecting the dots” can reveal culture as a systemic cause
- Based on behaviors, is culture consistent with the stated values?
- The “dots” can be audits, observations, tone of discussions, etc.
- Draw conclusions…but be prepared to cite examples

Enterprise-wide Audit of Culture

- Most comprehensive, most challenging, and most rarely used approach
  - Is there a code of conduct and articulated set of organizational values?
  - Are values communicated and widely understood?
  - Do employees see management behavior as being consistent with values?
  - Do performance plans and the compensation framework align with values?

Strategies for Addressing Culture

<table>
<thead>
<tr>
<th>Percentage Who Believe They Are “Very” or “Extremely Effective”</th>
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<tbody>
<tr>
<td>Raise as separate topic with the board or audit committee</td>
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<tr>
<td>Coordinate efforts with other governance functions</td>
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<tr>
<td>Raise as separate topic with management</td>
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<tr>
<td>Provide an anonymous reporting mechanism (e.g. whistleblower hotline)</td>
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<tr>
<td>Focus on organizational culture issues in audit reports</td>
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Strategies for Auditing Culture

Auditing Culture Is a Journey

- An enterprise-wide assessment of culture
- Issuing capstone or theme reports based on multiple inputs
- Audits of culture within lines of service, business units, or geographies

Identifying culture as the “Root Cause” in Individual conclusions/findings

Audits of culture within lines of service, business units, or geographies

Issuing capstone or themeing reports based on multiple inputs

An enterprise-wide assessment of culture

Lack of Support Can Be a Hurdle

Practical Considerations: Lack of Support Can Be a Hurdle

- Has full support of the board to assess all levels
- Has full support of the executive management to assess all levels
- Has freedom to assess the entire organization & staff

- Strongly Disagree
- Disagree
- Neither
- Agree
- Strongly Agree

Get Everyone on Board, Set Expectations

- Communicate with senior executives about their views of culture
- Develop trust with audit committee that allows subjective judgments
- Find a champion who supports auditing organizational culture
- Define the roles
- Consider incorporating auditing culture into internal audit's charter

Assess Internal Audit’s Skills and Fill the Gaps

- Need ability to identify and assess hard and soft measures of organizational culture
- Need to combine subjective and objective information
- Be confident in relying on qualitative factors or intuition

Parting Thoughts
Cultures Can Change

- Most believe an organization’s culture takes a long time to change
- A strong culture can take a long time to establish
- It takes less time for elements of a toxic culture to take over

How an Organization Responds to Internal Audit Says a lot About Culture

- How receptive is management to an audit of their area?
- How open and cooperative is management during an engagement?
- How receptive and responsive is management to findings and recommendations?

Culture and Internal Audit

Culture clearly presents risks in organizations. What are you doing to assess them?