OVERVIEW

• What is all the talk about culture?
• What is culture?
• Why is it hard to audit?
• Does Internal Audit have a role?
• Audit Approaches
• Parting thoughts
WHAT IS ALL THE TALK ABOUT CULTURE?
IT IS A TOP OPERATIONAL RISK

Figure 1: Top 10 Risks for 2016

Our organization’s culture may not sufficiently encourage the timely identification and escalation of risk issues that have the potential to significantly affect our core operations and achievement of strategic objectives.

Source: Protiviti’s Executive Perspectives on Top Risks for 2016
IT IS THE CULPRIT IN DEBACLES

Source: “When Culture Is the Culprit”, 2016 IIA Leadership Academy, Richard Chambers
### CAE Results, General Technical Knowledge

<table>
<thead>
<tr>
<th>“Need to Improve” Rank</th>
<th>Areas Evaluated by Respondents</th>
<th>Competency (5-pt. scale)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Big data/business intelligence</td>
<td>2.7</td>
</tr>
<tr>
<td>2</td>
<td>ISO 31000 (risk management)</td>
<td>2.4</td>
</tr>
<tr>
<td>3</td>
<td>ISO 9000 (quality management and quality assurance)</td>
<td>2.6</td>
</tr>
<tr>
<td>4</td>
<td>GTAG 17 – Auditing IT Governance</td>
<td>2.5</td>
</tr>
<tr>
<td>5</td>
<td>Auditing corporate culture</td>
<td>2.9</td>
</tr>
</tbody>
</table>

*Source: Protiviti’s 2016 Internal Audit Capabilities and Needs Survey*
AND BECAUSE...

• How organizations, and individuals within them, behave has become a matter of public concern
• Regulators are expecting internal audit to review
• Boards realize there is an increasing need to focus on the risks culture presents
• CEOs and CFOs see culture as critical to success

Source: IIA The Uncharted Territory of Auditing and Organization’s Culture
And “Corporate Culture: Evidence from the Field,” Graham, Harvey, Popadak, and Rajgopal; Duke University, 2015
WHAT IS CULTURE?
“…the reason why great organizations have sustained success. Culture drives expectations and beliefs. Expectations and beliefs drive behavior. Behavior drives habits. Habits create the future.

- Jon Gordon
CULTURE IS NOT...

WHAT IS SAID...

BUT WHAT IS DONE
CULTURE DEFINED

• **Merriam Webster** – a way of thinking, behaving, or working that exists in a place or organization (such as a business)

• **Investopedia** - Corporate culture refers to the beliefs and behaviors that determine how a company's employees and management interact and handle outside business transactions.

• It is the values and behaviors that contribute to the unique social and psychological environment of an organization
SIMPLY SAID IT IS…

“The way we do things round here.”
IS DEFINING CULTURE THAT EASY?

NO...

Looks can be deceiving.
Audit your organization’s culture.
“I want the public to think of us as ‘The Company With A Heart’. But I want you to think of us as the company that will chew you up, spit you out and smear you into the carpet if you screw up.”
WHY IS A DEFINITION IMPORTANT?

• So everyone is on the same page - definition must be shared
• You understand where the culture gap is
• KEY in connecting it to critical corporate elements such as:
  – Organizational structure
  – Incentives
  – Strategic planning
  – Brand development

• With no definition, linking culture to strategic elements is a challenge

Source: IIA Audit Executive Center Pulse Solutions – Perspectives on Auditing Culture
IS EVERYONE ON THE SAME PAGE?

“Perkins, we need to talk about your understanding of company culture.”
DOES IT FIT WITH WHO WE ARE?
Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.
• Risk Management processes are monitored through ongoing management activities; separate evaluations or both
  – Achievement of the organizations strategic objectives
  – Reliability and integrity of financial and operational information
  – Effectiveness and efficiency of operations and programs
  – Safeguarding of assets
  – Compliance with laws, regulations, policies, procedures, and contracts
YES, IT SURE DOES

• Culture will directly impact how successful an organization is
• Culture can be a key enabler to meeting the business objectives
• It is one way to add value and improve organization’s operations
WHY IS IT HARD TO AUDIT CULTURE?
CULTURE IS SQUISHY AND SOFT

• Soft controls (control environment, tone at the top, culture) are more difficult to audit
  – Strong leadership
  – Trust and Openness
  – High expectations
  – Shared values
  – High ethical standards

• Auditing culture is a complex and amorphous concept

• There isn’t a standard model audit program or checklist that we can use
HOW DO WE AUDIT CULTURE?
CAREFULLY

• What do we want to achieve?
• Is your organization ready?
• Does your team have the right skills?
• Do you have patience?
• Are you willing to have difficult conversations?
• Comfortable with making judgment on intangibles?
ASSESS CURRENT STATE

- Do we have a healthy or toxic culture?
- Does current culture or sub-cultures promote behavior alignment?
- What are the hard controls? Formal codes of ethics—policies—organizational structure—defined roles—training
- What are the soft controls? Less Tangible competence—trust—leadership—expectations—shared values—ethical standards
UNHEALTHY CULTURE

The way things should be done around here...

A Toxic Culture

The way things are done around here...

Source: “When Culture Is the Culprit”, 2016 IIA Leadership Academy, Richard Chambers
WHAT DOES IT LOOK LIKE

• Different standards for different people
• Groupthink and judgment errors
• Unethical or illegal behavior
• Poor communication
• Blaming others & defensiveness
• The talk isn’t walked!

Source: “When Culture Is the Culprit”, 2016 IIA Leadership Academy, Richard Chambers
WATCH OUT – SUBCULTURES MAY EXIST

- Cultures develop locally within business units or teams
- Employees will follow actions of their direct leaders
- Behaviors may not align with main culture
  - Are there systemic failures in controls/compliance?
  - Is there hotline or whistleblowing activity?
  - Is there unusual deference to leadership?
## Toxic Culture Red Flags

<table>
<thead>
<tr>
<th>No.</th>
<th>Red Flag</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Nobody talks about culture.</td>
</tr>
<tr>
<td>2</td>
<td>Controversial pay deals which encourage risk-taking to hit short-term targets.</td>
</tr>
<tr>
<td>3</td>
<td>Complex and unclear legal and reporting structures.</td>
</tr>
<tr>
<td>4</td>
<td>Poorly executed takeovers that allow “pockets” of bad behavior thriving beyond the control of the board.</td>
</tr>
<tr>
<td>5</td>
<td>Lack of financial discipline.</td>
</tr>
<tr>
<td>6</td>
<td>Employees are constantly on edge about the fear of being fired.</td>
</tr>
<tr>
<td>7</td>
<td>Employees execute projects without a clear lack of vision or direction from company leaders.</td>
</tr>
<tr>
<td>8</td>
<td>Lack of knowledge sharing among employees.</td>
</tr>
<tr>
<td>9</td>
<td>Focusing on “blame” or “covering for each other” rather than fixing the problem.</td>
</tr>
<tr>
<td>10</td>
<td>Risk is a four letter word.</td>
</tr>
</tbody>
</table>

Source: IIA The Uncharted Territory of Auditing and Organization’s Culture
AUDIT APPROACHES
CULTURE AUDIT ENABLERS

1. Organizational culture needs to have been analyzed, properly defined and disseminated by the board/senior management.

2. Appetite and support from the top of the organization.

3. Internal audit being given a clear mandate.

4. Writing the mandate into the audit charter.

5. A relationship of trust between the audit committee chair and CAE that allows informal discussion about subjective judgements (gut feel) on culture.

6. Position, treatment and regard for internal audit.

7. Confidential employee surveys.

8. Strong risk maturity in the organization.

Source: IIA The Uncharted Territory of Auditing and Organization’s Culture
IT IS A JOURNEY

- Use Data Analytics to look for themes
- Don’t just look at the specific issue and how to correct it
- An enterprise-wide assessment of culture
- Issuing capstone or theming 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

Source: “When Culture Is the Culprit”, 2016 IIA Leadership Academy, Richard Chambers
AUDIT APPROACHES – BABY STEPS

Horizontal – Each Engagement

Annual Summary Report

- Assess culture each audit
- Assess management tone each audit
- 2nd Line Coordination


The Closed Minded – The Autocrat – The Deflector
AUDIT APPROACHES – GIANT LEAP

Vertical – Enterprise Wide

- Massive undertaking
- All components and elements
- One culture audit – enterprise wide
• Incorporate culture into each engagement
• Supplement with audits of certain key components of culture, through either vertical or horizontal approaches
  – Employee Development
  – Employee Retention
  – Whistleblowing/Hotline Activity
  – Compensation Plans and Strategy
• Identify culture as a metadata point in root cause attributes and discussions and be ready to have *courageous* conversations
• Perform surveys or host workshops to ascertain cultural elements
• MORE THAN LIKELY, you are already auditing certain elements of culture.
• This is not a new concept – just a new package.
PARTING THOUGHTS
SO NOW WHAT?

• Understand your company’s appetite for auditing culture
• Communicate the value
• Identify the right audit approach
• Get everyone on board
• Start small
RESOURCES

• IIA – The Uncharted Territory of Auditing an Organization’s Culture (2015)
• IIA – Auditing Corporate Culture Training and Resources at https://na.theiia.org/standards-guidance/topics/Pages/Auditing-Culture.aspx
• IIA - “When Culture Is the Culprit” Leadership Academy, Richard Chambers (2016)
• FINRA – Establishing, Communicating and Implementing Cultural Values, FINRA 2016 Regulatory and Examination Priorities Letter.
• Protiviti – Executive Perspectives on Top Risks for 2016 - http://www.protiviti.com/toprisks
HAVE YOU HEARD ABOUT?

IIA ALL STAR CONFERENCE

ALL STAR The Mirage
CONFERENCE Las Vegas, NV