Culture and the Role of Internal Audit

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Learning objectives

Understand:

— **Why the soft stuff matters**
  - Describe why culture matters to Internal Audit, including the economic, regulatory, and professional context driving changes in expectations.
  - Describe the current state of considering culture across Internal Audit departments.

— **What to do about it […and how to get started]**
  - Describe ways that Internal Audit departments are tackling culture audits.
  - Tackle common challenges that Internal Audit departments can face as they venture into the culture space.
  - Bring insights to your organization about the critical connection between culture and risk.
What is culture?

Culture is “how we do things around here” and is the product of mindsets, behaviors, and informal norms. This is distinct from organizational values, codes, and policies.

### Signals/Symbols of Desired Culture

- **VALUES**
- **CODES**
- **POLICIES/SOP**

### Indicators/Drivers of Actual Culture

- **BEHAVIORS**
- **MINDSETS**
- **INFORMAL NORMS**

**RESULTS**
What are culture audits?

**Culture Audit [Definition 1]:**
An audit that takes into account culture data points. Consideration of soft controls within the workplace when assessing departments, processes, or other key risk areas.

**Culture Audit [Definition 2]:**
An audit that helps assess whether the culture you want is the culture you have. Provides organizational context by explaining the environment, informal norms, and key enablers or barriers to effective working practices.
Research shows why the “soft stuff” matters

— Brand & reputation
— Financial performance & value
— Impact on misconduct
— War for talent
— Increasing regulatory and investor attention
— Growing expectations of Internal Audit, Compliance and Risk Functions
“Culture eats strategy for breakfast”

Peter Drucker, has been described as “the founder of modern management”
Tip of the iceberg – traditional approach to Internal audit

Formal values, governance, and management practices

AKA “Hard stuff”

Focus of many compliance and audit programs

Leadership, informal practices, and norms

Beliefs, mindsets, and behaviors

AKA “Soft stuff”

Incomplete picture (tip of the iceberg) – Inherent limitations in the design of traditional compliance and audit programs – focusing on formal policies, systems, and practices.

Looking below the surface – Risks associated with culture should be a critical area of focus for boards and senior leaders.

Often missed
“The need is not only to focus on hard risk, where the world is now in a much better place, but also to focus on soft risk or culture.”

Source: Comments from Sir David Walker (author of the 2009 Walker Report) in 2014 saying that he would include several new points if he were writing the report today… the main addition being culture, which was nearly absent from the previous report.
NACD: Recommendations

1. Role of the Board –
   - importance of forward-looking, proactive approach to culture oversight
   - Board, along with CEO and senior management, are responsible for establishing clarity on values and culture

2. Board oversight responsibilities – active monitoring of culture is a full-board responsibility

3. Assess boardroom culture – regular review (formal and informal) of the culture of the whole board and subcommittees

4. Positioning of key risk, compliance, legal, and Internal Audit roles

5. Integrate culture into strategy, risk, and performance discussions; emphasis on how results are achieved

6. Expectation of regular culture assessments with information from inside and outside the organization

7. CEO selection and evaluation – culture as an explicit criterion for selection of CEO, and expectation for management to adopt similar criterion in their selection processes

8. Reward and recognition systems – review of rewards, recognition, and/or promotion processes for impact on culture

9. Communication with shareholders and stakeholders – communication of how board carries out its responsibilities for culture
IA’s Role in Culture is critical.

Change is coming because the soft stuff is just as important as the hard stuff.
KPMG framework: Soft controls model

The fundamentals of organizational culture: 8 soft controls

- Clarity
- Role modelling
- Commitment & ownership
- Enabling Environment
- Information Flow
- Detection
- Prevention
- Response
- Reward & enforce
- Speak-up
- Ability to Discuss
- Behavior

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Red flags – illustrative

— Strong hierarchy, power imbalances, arrogance
— Focus on the letter of the law only, without regard to spirit
— Low levels of engagement between leadership and employees
— Intensive pressures – financial and operational
— High levels of stress and burnout
— Risk management and controls regarded as an inconvenience
— Lack of prompt, proper management action to address known issues
— Repeat issues
— Lack of openness and transparency
— Lack of access to information
— Tolerance of breaches by star employees or leadership
— Misaligned incentives and flawed remuneration practices
## Practices for auditing culture – making it stick

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### Culture root causing
A deeper level of examination of the causes underlying audit results or other risk signals.

### Expanded universe
Perform new or deeper audits of areas not historically covered to get a clearer view of culture. Pay attention to the “soft stuff”.

### Greater use of tools such as surveys, maturity models, and workshops.

### Observed behaviors
Auditors provide perspective on behaviors observed through the audit process.

### Direct measurement
Audits of culture against defined measures that look across qualitative and quantitative data points to assemble a picture.
Techniques

Tools that internal auditors can use to conduct culture related assessments include the following:

— Documentation review – charters, policies, SOPs that outline the company’s expectations
— Surveys – with key stakeholders at all levels of the organization
— Data analytics – compliance, financial, and operational reports
— Focus groups – open, honest discussion for stakeholders to raise concerns
— Interviews – present opportunity for confidential discussion
— Facilitated workshops – identify root cause and ideas/solutions that work for the organization to help minimize risk
— Systems reviews – is access to company data (including customers) appropriate with the legitimate business need
Common challenges

— Lack of clarity
— Lack of confidence and capability
— Lack of organizational buy-in
— Competing priorities
— Confidentiality and gaining trust
Practical first steps

— **Start talking:** Initiate the dialogue within your companies – Board and Management

— **Work together & build advocacy:** Get everyone onboard – Work cross functionally. Consider how culture applies across the lines of defense (e.g., ERM, Compliance, etc.); and identify champion(s)

— **Be smart:** Understand not only the opportunity, but the risks and pitfalls; build capability and credibility; start where there is interest and advocacy; know your limitations.
Questions?
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