Auditing Organisational Culture: When Culture is the Culprit

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Organisational Culture: Why Does It Matter?
Overview

- The essence and implications of culture
- The mandate to audit culture
- Effective strategies for auditing culture
- Practical considerations for internal audit
- Parting thoughts
What Happens When Organisational Culture Is Not Healthy?
When Walk Diverges From the Talk, Culture Can Go Toxic

A Toxic Culture

The way things should be done around here…

The way things are done 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.”
What Happens When the Culture Is Toxic

- Loss of confidence in leadership
- Groupthink and judgement errors
- Unethical or illegal behaviour
- Erosion of the brand and reputational damage
- Erosion of shareholder value
Addressing Culture As a Critical Risk Is an Growing 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

Source: "Corporate Culture: Evidence from the Field," Graham, Harvey, Popadak, and Rajgopal; Duke University, 2015
CAEs Also Grasp the Risks That Culture Presents

- 89 percent of audit leaders said they understand the risks associated with culture
- But, 72 percent say they do not audit culture
- Auditing governance and culture was expected to account for 4 percent of the average North American audit plan in 2017

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

First Line of Defence
Management responsible for setting, communicating, and modeling desired values and conduct.

Second Line of Defence
Oversight functions that monitor culture-related risks and compliance with culture-related policies and procedures. Develop ethics programmes and provide advice to the first line.

Third Line of Defence
Internal audit assesses culture. Are values and behaviours that drive strategy and good performance embedded throughout the organisation?

Source: Global Perspectives: Auditing Culture – A Hard Look at the Soft Stuff; © 2015 The Institute of Internal Auditors, Inc.
Mitigating Organisational Culture Risks

• **Hard Controls: Within Our Comfort Zone**
  – Codes of ethics/conduct
  – Human resources policies and practises
  – Other policies, rules, and defined procedures
  – Organisation’s structure
  – Defined roles, responsibilities, and authorisation levels

Source: Organizational Culture, © 2015 Chartered Institute of Internal Auditors
Mitigating Organisational Culture Risks

• **Soft Controls: We Must Use Our Judgement**
  – Competence
  – Trust and openness
  – Strong leadership
  – High expectations
  – Shared values
  – High ethical standards

Source: Organizational Culture, © 2015 Chartered Institute of Internal Auditors
Strategies for Auditing Culture

- Identifying culture as the “Root Cause” in Individual conclusions/findings
- Audits of culture within lines of service, business units, or geographies
- Issuing capstone or theming reports based on multiple inputs
- An enterprise-wide assessment of culture

Auditing Culture Is a Journey
The “Root Cause” Can Often Be Culture

• It is tempting to only look at specific issues and how to correct
• Did certain behaviours 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 organisation’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.”

Source: Global Perspectives: Auditing Culture – A Hard Look at the Soft Stuff; © 2015 The Institute of Internal Auditors, Inc.
Pulling Together Multiple Perspectives

• “Connecting the dots” can reveal culture as a systemic cause
• Based on behaviours, 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 organisational values?
  - Are values communicated and widely understood?
  - Do employees see management behaviour as being consistent with values?
  - Do performance plans and the compensation framework align with values?

“Auditing culture as a separate issue across a whole organisation is a massive undertaking which internal audit, in many organisations, is unlikely to have the time, skills, and resources to dedicate itself to.”

Source: Culture and the Role of Internal Audit – Looking Below the Surface; © 2014 The Chartered Institute of Internal Auditors
### Strategies for Addressing Culture

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<tr>
<th>Percentage Who Believe They Are “Very” or “Extremely Effective”</th>
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<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 organisational culture issues in audit reports</td>
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Pulse of Internal Audit, 2016. CAEs/Directors, North America. Q12 Rate the effectiveness of the following methods for addressing a toxic culture in an organization.
Strategies for Addressing Culture

AUDITING PRUDENTIAL’S CONTROL ENVIRONMENT: AREAS OF FOCUS

**Incentivization:** Do our HR and talent practices reinforce the desired behaviors throughout the organization?

**Incentivization:** Providing the right motivations

- Total Rewards
- Talent Management

**Leadership:** What do our leaders communicate to us about risk, ethics, and how we should be doing our work?

- Core Values
- Tone

**Risk Practices:** Does our business manage risk appropriately and in line with our risk appetite?

**Risk Practices:** Taking the right risks

- RISK PRACTICES
- Managing Risks

**Organization:** Does the company’s environment promote accountability for desired risk behaviors?

- Governance Structure
- Establishing the right environment

- Roles and Responsibilities
Auditing Culture: Practical Considerations
Get Everyone on Board, Set Expectations

- Communicate with senior executives about their views of culture
- Develop trust with audit committee that allows subjective judgements
- Find a champion who supports auditing organisational 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 organisational culture
- Need to combine subjective and objective information
- Be confident in relying on qualitative factors or intuition

Only 45 percent of CAEs who don’t audit culture agreed that they are able to identify and assess measures of organisational culture

Parting Thoughts
How an Organisation 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?
Cultures Can Change

• Most believe an organisation’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
Culture clearly presents risks in organisations. What are you doing to assess them?
Thank You!

The Institute of Internal Auditors

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