The Why and How of Auditing Corporate Culture

INSIDE THIS PUBLICATION:

> Auditing Corporate Culture: A New Imperative
> A Pragmatic Approach to Auditing Corporate Culture
> Making Culture into A Hard Science Tied to Risk Management
About MIS Training Institute:

MIS Training Institute (MISTI) is the international leader in audit, IT audit, and information security training, conferences, and content with offices in Boston and London. MISTI’s expertise draws on experience gained in training more than 200,000 delegates across five continents. Helping audit and info security professionals stay at the top of their game has always been at the core of MISTI’s mission. To that end, MISTI has developed and focused its vast variety of training courses, events, newsletters, and other informational products on the wide-ranging needs of internal and IT auditors and information security practitioners. MISTI’s unparalleled course curriculum covers the most up-to-the-minute topics, provides proven audit and security practices, and delivers the information needed to be successful in today’s organizations. www.misti.com

About Experis:

Experis™ Finance has built a reputation for results-driven project solutions, thought leadership and professional resourcing to address complex client issues. Our methodology, combined with our experienced staff, allow us to provide customized solutions to meet clients’ needs. Our advisory expertise includes internal audit, regulatory compliance, data analytics, construction services and IT audit. A division of ManpowerGroup, our clients include Fortune 500 and Global 1000 companies, as well as emerging and middle market companies. www.experis.us/finance
Auditing Corporate Culture: A New Imperative

By Jose Tabuena

Companies—and regulators—are paying more attention to getting culture right, including conducting assessments of its efficacy.

The emerging flavor of the month in regulatory circles is the “culture of compliance” with recognition that corporate culture has a profound influence on how an organization conducts its business. A culture that consistently places ethical considerations and client interests at the center of business decisions helps protect employees as well as investors and the integrity of the markets. Conversely, significant cultural failures can impose substantial harm on companies themselves including fines, penalties, and loss of reputation.

This growing attention is good news for the compliance professional and internal auditors. Compliance officers have already been attuned to the importance of corporate culture, especially since the 2004 amendments to the Federal Sentencing Guidelines paid special attention to it. The revised guidelines stated that in order to have a truly effective compliance program an organization needed to “promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.”

The latest regulator to take notice is the Financial Industry Regulatory Authority (FINRA). In its 2016 Regulatory and Examination Priorities, FINRA stressed that assessing firm culture would be a major focus. A Targeted Exam Letter that followed made good on that promise by questioning the firms it oversees on how they communicate, reinforce, monitor, and measure organizational values, including indicators of a firm’s culture, such as:

- whether control functions are valued within the organization, including having key policies and processes by which the firm establishes cultural values;
- whether policy or control breaches are tolerated;
- whether the organization proactively seeks to identify risk and compliance events;
- whether immediate managers are effective role models of firm culture; and
- whether sub-cultures that may not conform to overall corporate culture are identified and addressed.

Companies have started to get the message. In particular, the CEO who must run the company in a light-speed-paced environment (with a trend toward shorter tenures) will want to stay attuned to the organization’s culture. When there is high turnover, for example, employee dissatisfaction, or other turmoil impacting the bottom line, poor culture is often the culprit.

A ROLE FOR AUDITORS

Internal audit has now entered the corporate culture game. The Institute of Internal Auditors (IIA) published a new white paper encouraging its members to take a closer look at the culture that can impact its business. The paper makes the case that too many high-profile compliance failures in recent history can be tied to cultures that encouraged, allowed, or looked past illicit behavior. The IIA pointedly observes that culture needs to be added to the internal audit workload, “Because auditing culture helps the organization manage it”.

The paper provides recommendations on how internal auditors can forge more formal entry into what has until now been a relatively uncharted area for the audit profession. As culture is a key contributor to corporate performance, both positive and negative, it is important for auditors to either figure out how to periodically perform a corporate culture audit or to incorporate consideration of culture in each and every audit project being done.

Auditing culture has been an area viewed with hesitation by the profession. Culture can be so subjective that it can take auditors—who are process oriented and seek objective measures—out of their comfort zone. Yet evaluating culture and the effectiveness of a compliance program certainly fits within the bailiwick of the audit skill set. It is much more than a checklist, however, and requires consideration of the qualitative aspects of the business. Still, it can be approached in a systematic and methodological manner.

WHAT IS CORPORATE CULTURE?

In basic terms, culture is the set of enduring and underlying assumptions and norms that determine how things are actually done in the organization. A coherent culture is based on shared values and beliefs, and the evidence they are shared is that they shape behavior across the organization. The challenge for leadership is knowing how to instill or modify those assumptions and norms in the direction that is needed.

Culture is not simply the articulation of an organization’s mission and values. It turns out that simply stating your values does nothing for performance. Studies, including a recent one on the Value of Corporate Culture among S&P 500 companies, found that the existence and prominence of a defined set of corporate values made no difference to short- or long-term financial performance. But, the study found that the behavior of a company’s senior managers (and the values their behavior embodied) made a huge difference in determining performance.

In other words, the organization needs to be deliberate and diligent about making sure those values are reflected in its team’s attitudes and interactions. Anyone can pay a marketing firm to develop a mission statement for them. A common tale for compliance professionals is that Enron had a fabulous mission statement along with an award winning code of conduct. When rigorously evaluating corporate culture, auditors will need to make sure that these values, as reflected in written procedures, are actually demonstrated in how the business operates. When demonstrating and measuring success, it is often not so much whether a compliance violation happens, as to how the company responds once it does.

YES, CULTURE CAN BE MEASURED

Culture is a challenge to measure, in part, because of the built-in structural and behavioral forces that can keep CEOs and senior management from having their finger on the cultural pulse of the organization. Employees often have a difficult time sounding off to management. Their livelihood depends on keeping their jobs, and if the culture in the organization is the kind where, “we don’t talk about our problems,” then employee will shut down and keep their opinions to themselves. Executive leaders also have a vested interest in getting the CEO’s approval, and if that approval only goes to people who report what leadership wants to hear, it can mean the true state of affairs is not known.

Enter internal audit, which has the independence and objectivity to evaluate corporate culture. There are a number of ways internal auditors have already historically looked at aspects of culture within the context of audit engagements. While there’s no specific framework for auditors to conduct an audit of culture, the COSO Internal Control – Integrated Framework provides a starting point. The evaluation of the control environment is one that should already be leveraged by internal audit to apply to compliance program effectiveness as well as to fraud control standards. Auditors can refer to the points of focus in the new framework to enhance their understanding.

Keep in mind that the points of focus under the first principle that, “the organization demonstrates a commitment to integrity and ethical values,” aligns with the promotion of ethical conduct under the Federal Sentencing Guidelines. The updated framework provides four points of focus:

- Sets the “tone at the top”
- Establishes standards of conduct
- Evaluates adherence to standards of conduct
- Addresses deviations in a timely manner

Auditors have used several techniques to evaluate corporate culture as areas of focus of the control environment. Most audit projects should already look at the tone at the top of whatever functional area is in scope of the audit, including communication among senior managers, middle managers, and rank-and-file employees to help gauge that tone. Some audit departments integrate soft control evaluations into their everyday audit procedures. Others conduct structured, entity-level interviews and may combine those with the use of focus groups.

Employee surveys that allow anonymity, however, are becoming acknowledged as one of the most effective and efficient ways to measure corporate culture. Compliance and
Other activities of the compliance program further reveal cultural aspects. Auditors can also look at hotline activity, consistency of discipline, and incentives, like sales commissions. Each activity on its own may not be indicative of culture, but when you're looking at multiple incidents and issues you can start to identify trends.

There are instances where organizations have taken hardline approaches to how they remediate certain compliance violations. In a check-the-box culture, where there isn't a good tone at the top, employees will pay lip service to compliance. They cannot be expected to uphold the company's ethical and legal standards. When rigorously evaluating corporate culture, auditors will need to make sure that these values as reflected in written procedures are actually demonstrated in how the business operates. When demonstrating and measuring success, it is often not so much whether a compliance violation happens, as to how the company responds once it does.

When rigorously evaluating corporate culture, auditors will need to make sure that these values as reflected in written procedures are actually demonstrated in how the business operates. When demonstrating and measuring success, it is often not so much whether a compliance violation happens, as to how the company responds once it does.

**REWARDs AND INCENTIVES:** Recognition, reward, and incentive programs can convey positive cultural messages. If executives don't meet compliance objectives, do they risk having their annual bonuses reduced? A measure to develop is the degree to which ethical business practices have been factored into executive-level performance evaluations and/or compensation criteria.

**MANAGEMENT OPERATING STYLE:** Analyze the company turnover and retention for information where turnover has not achieved acceptable levels. Through employee interviews, auditors can ascertain whether the turnover rate is attributed to organizational transition or stress stemming from management's philosophy and operating style (e.g., inappropriate compensation packages, unreasonable sales goals requirements, etc.).

**TALENT MANAGEMENT SYSTEM:** A company can actively recruit new hires based on culturally consistent, desired behaviors and reinforce these when people join the company. To measure, sample the records of employees who have had poor performance evaluations in the past years, and determine whether those employees had appropriate qualifications relative to their job descriptions. Perform the review with an eye toward ascertaining whether the company's hiring practices appropriately matched employee qualifications, skill set, and delegated authority to their formal position and job description.

Achieving a high-performance culture deserves to be a top agenda item for every company hoping to stay competitive. The collective corporate culture can be an important driver of financial results and an element of other key business issues, such as talent acquisition and management and innovation-fueled growth.

Although auditors might meet some resistance when they take a discussion about culture to the highest levels of the organization, this is an opportunity to really step up and demonstrate the capabilities of a robust evaluation of your company's culture.

**TONE AT THE TOP:** It is often not so much things the right way? Did we fail to model appropriate behaviors throughout the organization? When demonstrating and measuring success, it is often not so much whether a compliance violation happens, as to how the company responds once it does.

The collective corporate culture can be an important driver of financial results and an element of other key business issues, such as talent acquisition and management and innovation-fueled growth.

Although auditors might meet some resistance when they take a discussion about culture to the highest levels of the organization, this is an opportunity to really step up and demonstrate the capabilities of a robust evaluation of your company's culture.

When rigorously evaluating corporate culture, auditors will need to make sure that these values as reflected in written procedures are actually demonstrated in how the business operates. When demonstrating and measuring success, it is often not so much whether a compliance violation happens, as to how the company responds once it does.

**REWARDs AND INCENTIVES:** Recognition, reward, and incentive programs can convey positive cultural messages. If executives don't meet compliance objectives, do they risk having their annual bonuses reduced? A measure to develop is the degree to which ethical business practices have been factored into executive-level performance evaluations and/or compensation criteria.

**MANAGEMENT OPERATING STYLE:** Analyze the company turnover and retention for information where turnover has not achieved acceptable levels. Through employee interviews, auditors can ascertain whether the turnover rate is attributed to organizational transition or stress stemming from management's philosophy and operating style (e.g., inappropriate compensation packages, unreasonable sales goals requirements, etc.).

**TALENT MANAGEMENT SYSTEM:** A company can actively recruit new hires based on culturally consistent, desired behaviors and reinforce these when people join the company. To measure, sample the records of employees who have had poor performance evaluations in the past years, and determine whether those employees had appropriate qualifications relative to their job descriptions. Perform the review with an eye toward ascertaining whether the company's hiring practices appropriately matched employee qualifications, skill set, and delegated authority to their formal position and job description.

Achieving a high-performance culture deserves to be a top agenda item for every company hoping to stay competitive. The collective corporate culture can be an important driver of financial results and an element of other key business issues, such as talent acquisition and management and innovation-fueled growth.

Although auditors might meet some resistance when they take a discussion about culture to the highest levels of the organization, this is an opportunity to really step up and demonstrate the capabilities of a robust evaluation of your company's culture.

When rigorously evaluating corporate culture, auditors will need to make sure that these values as reflected in written procedures are actually demonstrated in how the business operates. When demonstrating and measuring success, it is often not so much whether a compliance violation happens, as to how the company responds once it does.

**REWARDs AND INCENTIVES:** Recognition, reward, and incentive programs can convey positive cultural messages. If executives don't meet compliance objectives, do they risk having their annual bonuses reduced? A measure to develop is the degree to which ethical business practices have been factored into executive-level performance evaluations and/or compensation criteria.

**MANAGEMENT OPERATING STYLE:** Analyze the company turnover and retention for information where turnover has not achieved acceptable levels. Through employee interviews, auditors can ascertain whether the turnover rate is attributed to organizational transition or stress stemming from management's philosophy and operating style (e.g., inappropriate compensation packages, unreasonable sales goals requirements, etc.).

**TALENT MANAGEMENT SYSTEM:** A company can actively recruit new hires based on culturally consistent, desired behaviors and reinforce these when people join the company. To measure, sample the records of employees who have had poor performance evaluations in the past years, and determine whether those employees had appropriate qualifications relative to their job descriptions. Perform the review with an eye toward ascertaining whether the company's hiring practices appropriately matched employee qualifications, skill set, and delegated authority to their formal position and job description.

Achieving a high-performance culture deserves to be a top agenda item for every company hoping to stay competitive. The collective corporate culture can be an important driver of financial results and an element of other key business issues, such as talent acquisition and management and innovation-fueled growth.

Although auditors might meet some resistance when they take a discussion about culture to the highest levels of the organization, this is an opportunity to really step up and demonstrate the capabilities of a robust evaluation of your company's culture.

The collective corporate culture can be an important driver of financial results and an element of other key business issues, such as talent acquisition and management and innovation-fueled growth.

Although auditors might meet some resistance when they take a discussion about culture to the highest levels of the organization, this is an opportunity to really step up and demonstrate the capabilities of a robust evaluation of your company's culture.
The objective of this type of audit is to assess the steps being taken by senior management, the board, and internal audit and provide assurance relating to the overall acceptance, adherence, and understanding of corporate culture.

In this example, the CEO primarily wanted to determine why employees were choosing not to follow policy or who told or gave them the impression that it was OK not to do so. In short, the CEO wanted an audit of corporate culture. Ironically, had the CAE herself suggested this type of audit two months earlier, she believes there would have been pushback on the need to add a culture audit to the plan. The eventual common ground became everyone’s shared desire to understand potential culture breakdowns and prevent significant future financial losses when policies aren’t followed.

• Engage in formal and informal dialogue around the topic of culture to identify internal sponsors.
• Articulate why auditing culture is important in light of increased regulatory scrutiny and stakeholder expectations.
• Co-develop the scope of the culture audit. For example, will culture be audited at the entity level or embedded into individual audits within the annual audit plan?
• Identify an executive sponsor and key influencers to support the effort.
• Clearly explain the methodology used to perform the assessment.
• Agree on evaluation criteria and ratings to benchmark results and improvements.
• Develop an organizational communications plan to explain the audit’s audit focus and its importance.
• Once approved by management, share with the audit committee for final consensus.
• Formalize the mandate by incorporating it into the audit committee charter.

DEFINING THE APPROACH AND CONNECTING THE DOTS

A critical step in finding common ground is agreeing on the approach. Many CAE’s and audit committees question whether internal audit possesses the competency to audit culture and whether or not it has the mandate. The mandate question is easy to answer: when you look to the Three Lines of Defense Model (left), internal audit clearly has a role to play in providing assurance relating to corporate culture.

As to the question of competency, internal audit already has the required attributes of independence, objectivity, and trust within the organization. Objectivity and respect are critical attributes since auditors will find themselves discussing qualitative and quantitative assessments while evaluating culture that may test the boundaries of trust. Internal audit should also have a clear understanding of risk appetite, knowledge of core business processes, and be well versed in policies and procedures as well as compliance requirements.

Internal audit also has visibility into rich sources of data from which to assess corporate culture, including:
• Prior report findings
• Results of annual SOX and other compliance testing
• Data analytics and continuous controls monitoring
• ERM and internal audit risk assessments
• Ethics and whistleblower hot line reporting
• Trusted relationships within the organization

The challenge for internal auditors is to effectively audit culture they will need to draw upon core competencies related to critical thinking, problem solving, and root cause analysis. The ultimate task will be to connect the dots in order to identify patterns of findings or behaviors and ask the critical question, “why?” A leading practice is to bring audit teams together to brainstorm and create hypotheses to be discussed with process owners and management. The goal of these sessions should be to look for patterns:
• Are findings or results of testing consistent across processes?
• Are findings repetitive?
• Has management consistently performed remediation activities in a timely manner?
• Are findings unique to a business unit or geography?
• Can findings be attributed to a lack of training or elements of the hiring process?
• Does tracking employee responses to annual employee surveys vary by location or job type?
• Is local management open to discussion of specific audit findings?
• Are exceptions to following policy the rule?
• Do policies and procedures require modification?

Partial lists of questions that should be asked:

• Is investment in tools and technology required to enhance and reinforce control culture?

SKILLS DEVELOPMENT AND TRAINING

While most internal auditors possess the core skills required to perform audits of corporate culture, there is also a need to sharpen and refine these skills. It’s important to remember that people learn in the classroom as well, as through experience. Hence, the more junior members of the team need to work with more senior members to fine-tune root cause analysis, interviewing, and communication skills. As for the more experienced team members, many of whom may be accustomed to thinking only in black and white and quantitative terms, they may need help going outside their comfort zone and learn to gain confidence in trusting their “gut” when formulating hypotheses relating to root cause and the effectiveness of the control culture. The goal is to move beyond determining that a control failed to a discussion of why it failed.

When assessing training for the audit team, it’s important to focus on the development of these core skills:

• Broadened understanding of the business and industry
• Root cause analysis
• Data analysis and analytics
• Facilitation and brainstorming techniques
• Investigative interviewing
• Communications
• Executive presence and leadership

Remember that training programs need not always or only be formal ones. Leading practice suggests a combination of formal training coupled with workshops, one-on-one developmental coaching, and experiential
learning. Many organizations are beginning to embed co-sourced resources on project teams to coach and teach these skills in real time.

COMMUNICATING RESULTS AND ONGOING MONITORING

Last, but far from least, a critical element to implementing a successful corporate culture audit program is gaining agreement up front from all parties engaged in the process on:
- Internal audit’s mandate
- Scope of the assessment
- Approach to be utilized
- Form and content of the report

In order to enhance acceptance of culture audits, some audit organizations agree in advance not to issue formal audit reports with detailed findings and recommendations. These groups instead elect to hold a formal closing meeting in the form of a facilitated workshop in which all involved agree on the meaning of the observations, benchmarks, actions, and milestones. These agreements are documented in memo form and shared with senior management and the audit committee.

Objectivity and respect are critical attributes since auditors will find themselves discussing qualitative and quantitative assessments while evaluating culture that may test the boundaries of trust.

Corporate culture audits can help provide assurance that senior management is held accountable for promoting an environment of integrity and ethical values. And, while organizations are rich in the data necessary to assess these behaviors, internal auditors may have to sharpen some of their core skills and learn to trust their gut to identify why breakdowns occur and why appropriate behaviors do not occur. In other words, “why?”

Like any successful audit program, the keys to success must include communicating expectations up front, engaging in analysis and dialogue to build a baseline, and then identifying actions that address observations and pinpointing milestones that will be used to measure progress going forward.

About the author: Alec Arons is the VP and National Practice Leader for Risk Advisory Services for Experis Finance. He has over 30 years of experience in the areas of corporate governance and internal audit. He is a frequent speaker at IIA events on matters relating to corporate governance and internal audit transformation.

CONCLUSION

Auditing corporate culture is the natural progression in evaluating tone at the top and the behaviors that drive activity within an organization. Corporate culture audits can help provide assurance that senior management is held accountable for promoting an environment of integrity and ethical values. And, while organizations are rich in the data necessary to assess these behaviors, internal auditors may have to sharpen some of their core skills and learn to trust their gut to identify why breakdowns occur and why appropriate behaviors do not occur. In other words, “why?”

Like any successful audit program, the keys to success must include communicating expectations up front, engaging in analysis and dialogue to build a baseline, and then identifying actions that address observations and pinpointing milestones that will be used to measure progress going forward.

About the author: Alec Arons is the VP and National Practice Leader for Risk Advisory Services for Experis Finance. He has over 30 years of experience in the areas of corporate governance and internal audit. He is a frequent speaker at IIA events on matters relating to corporate governance and internal audit transformation.
Making Culture into a Hard Science Tied to Risk Management

More companies are trying to bring corporate culture into focus with data analysis, monitoring, measures, and metrics

By Joseph McCafferty

The Financial Crisis of 2008 cemented what many risk management experts have known for years: You can have an army of risk managers and all the sophisticated risk-management models and tools you like, but if there is something wrong with the culture of the organization and what we all now call the “tone at the top,” they won’t work. That was clear at Bear Stearns and that was clear at Lehman Brothers.

Since then, risk managers, internal audit leaders, and governance gurus have tried to make a stronger connection between culture and tone and risk management. What was once thought to be a squishy art better left to the feel-good folks in the human resources department is slowly becoming a hard science with monitoring, measures and metrics, and an emerging literature and research.

As part of this evolution, more companies are asking internal audit to play a role in measuring, monitoring, and improving their culture. Indeed, in a report issued earlier this year called “Time to Move Out of the Comfort Zone,” the Institute of Internal Auditors (IIA) suggested that auditing organizational culture was among the top challenges that internal audit needs to address. “High-profile scandals and organizational failures that have littered the landscape over the past year point to the critical role of culture in the governance of organizations. Unfortunately, only 42 percent of survey respondents are addressing the culture in their organizations,” the IIA wrote in its report.

Among those companies, according to the IIA survey, that don’t audit organizational culture, just 45 percent even agree that internal audit is able to identify and assess measures of organizational culture. That means many internal auditors still view culture as a nebulous element that is too difficult to distill out of the ether and put some meaningful quantifications around.

“Internal audit’s inability to identify and assess measures of organizational culture appears to be a major obstacle to auditing organizational culture,” the IIA wrote in its report. “Only 45 percent of respondents who do not audit organizational culture agreed or strongly agreed with the statement that internal audit is able to identify and assess measures of organizational culture. However, 80 percent of those who do audit organizational culture agreed or strongly agreed that they have this ability.”

MEASURABLE?

It’s easy to understand why some audit executives fret about the ability to define and measure culture. After all, culture doesn’t really exist on paper in the policies, procedures, codes, and standards a company writes, but in how its people interpret them along with other signals and incentives, and the actions of upper management. Those are harder things for an auditor to put his or her finger on.

Some auditors work to make distinctions to the quantifiable elements of culture and those that are unquantifiable. “I think that there are two ways to audit corporate culture. One addresses the codified culture, and involves looking at the management reporting and structure processes,” says William Haskell, an internal auditor at a health care company based in Buffalo. “This can be validated for compliance with documented management controls. The other is extremely subjective and is a rabbit hole. It can only work in an environment where management is very self-aware and open to feedback. It can be effective under optimal conditions, but those optional conditions seldom exist.”

He makes a good point and one that the IIA acknowledges: “Lack of management and board support for internal audit’s involvement with culture, and lack of internal audit’s ability to identify and measure organizational culture, are closely...”
associated with internal auditors avoiding this risk,” it writes in the report.

This is where the many efforts to audit corporate culture fall short. Culture is embedded in the formal and—perhaps more importantly—the informal communications, messages, and signals that senior management send down through the organization. Since they are informal, they are hard to get at. That doesn’t mean they are unmeasurable. Surveys and interviews about employee views and impressions of the culture and tone at the top can go a long way to substantiating informal messaging.

FEEDBACK BACKLASH?

The “big but…” comes when it is time to loop that feedback to senior management. They have to be very open to first, hearing unvarnished reports about how the rank and file are interpreting the communications (including informal) that they are receiving, and, second, committed to making changes if there is a disconnect between the policies and formal communications and the actual ethical environment that employees perceive.

One way to do that is to manage how information is reported and presented. Some reports suggest that informal communication of culture audit results might be better than formal reporting. This puts the emphasis on internal audit’s role as a trusted adviser.

“The difficulty in measuring and evaluating organizational culture presents a challenge,” the IIA writes in its report. “Whatever audit methods are used, the resulting information needs to be filtered through professional judgment and presented in a way that can influence change. To address issues around culture, survey respondents believe interpersonal communication is more effective than formal reports.”

Getting senior executive and board support won’t be easy, but it’s important for internal audit to push for it. One of the ways to do that is to demonstrate expertise on connecting culture to risk management. For the C-suite and the board to become receptive to the idea of involving internal audit in addressing issues around culture they must first be convinced of its role as a key element in the control environment. With the many scandals, including Toshiba, VW, Valeant, and others that point to a toxic culture, connecting those dots should be a lot easier.