



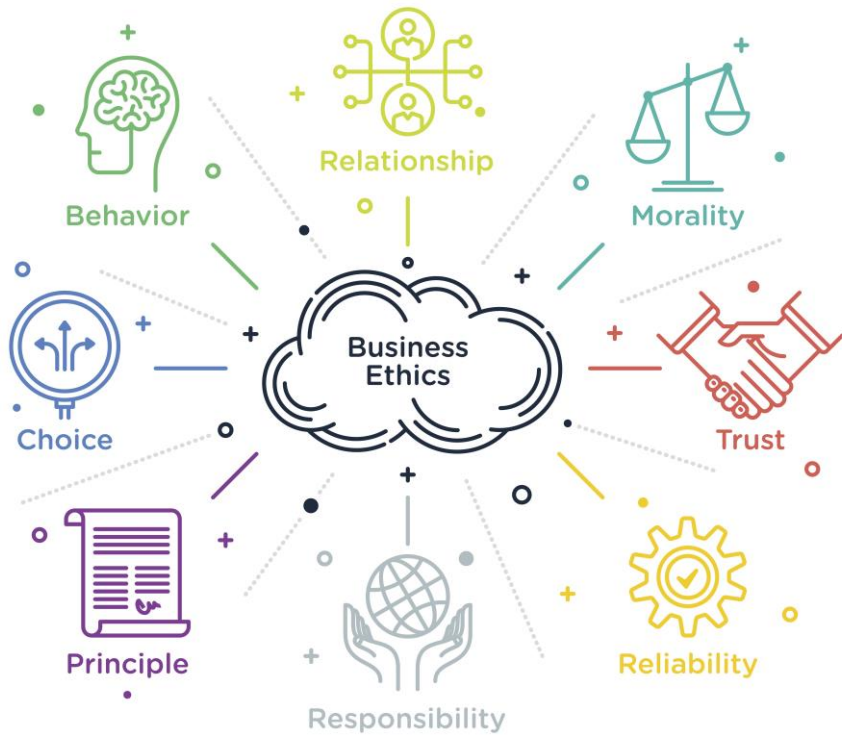
**The Institute of
Internal Auditors**

When Culture is the Culprit

Richard F. Chambers,
CIA, QIAL, CGAP, CCSA, CRMA
IIA President and CEO

Overview

- The essence and implications of culture
- The mandate to audit culture
- Effective strategies for auditing culture
- Practical considerations for internal audit
- Parting thoughts



Organizational Culture: Why Does It Matter?

Culture Is Increasingly the Culprit in Organizational Debacles

THE WALL STREET JOURNAL.

Volkswagen Pleads Guilty to Criminal Charges in Emissions-Cheating Scandal

Volkswagen AG pleaded guilty to criminal charges for rigging diesel-powered vehicles to cheat on government emissions tests, capping the final significant U.S. legal settlement expected in a long-running deception that hammered the German auto company's reputation and finances.

44%

THE WALL STREET JOURNAL.

Barclays to Pay \$100 Million to Resolve States' Libor Manipulation Claims

Barclays PLC agreed to pay \$100 million to end investigations by 43 states and the District of Columbia into its alleged manipulation of the London interbank offered rate benchmark in the mid-2000s, authorities said.

15%

TIME

Takata Pleads Guilty in Air Bag Scandal and Agrees to Pay \$1 Billion in Penalties

Japanese auto parts maker Takata pleaded guilty to fraud Monday and agreed to pay \$1 billion in penalties for concealing an air bag defect blamed for at least 16 deaths, most of them in the U.S.

The scandal, meanwhile, seemed to grow wider when plaintiffs' attorneys charged that five major automakers knew the devices were dangerous but continued to use them for years to save money.

\$1B
Fine



REUTERS

Wells Fargo fires four executives amid probe into account scandal

Wells Fargo & Co has fired four mid-level executives and stripped them of bonuses and stock awards as a result of an investigation into improper sales practices in its retail bank, the company announced on Tuesday.

CEO
Fired

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



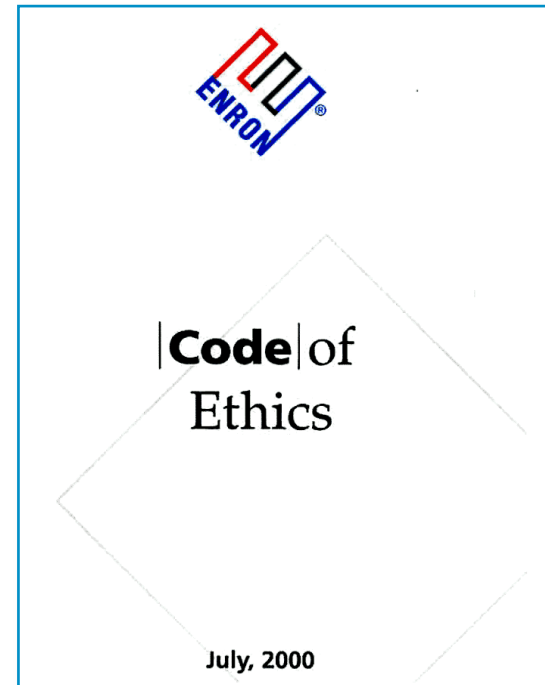
A Simpler Definition of Culture



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.”**

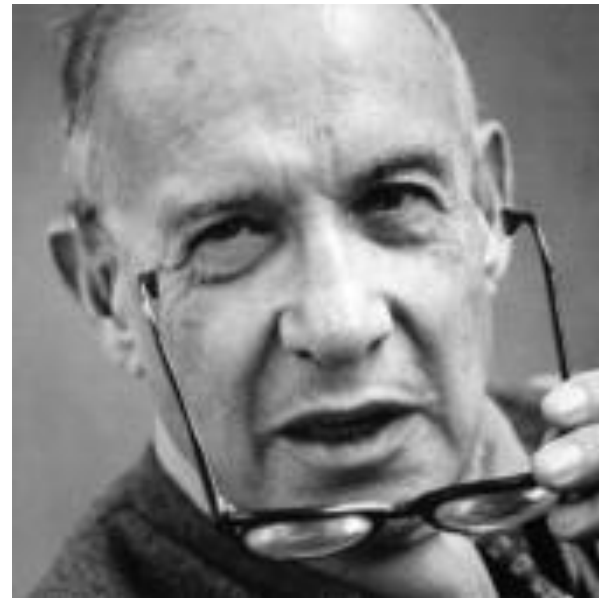
- Patrick Dixon

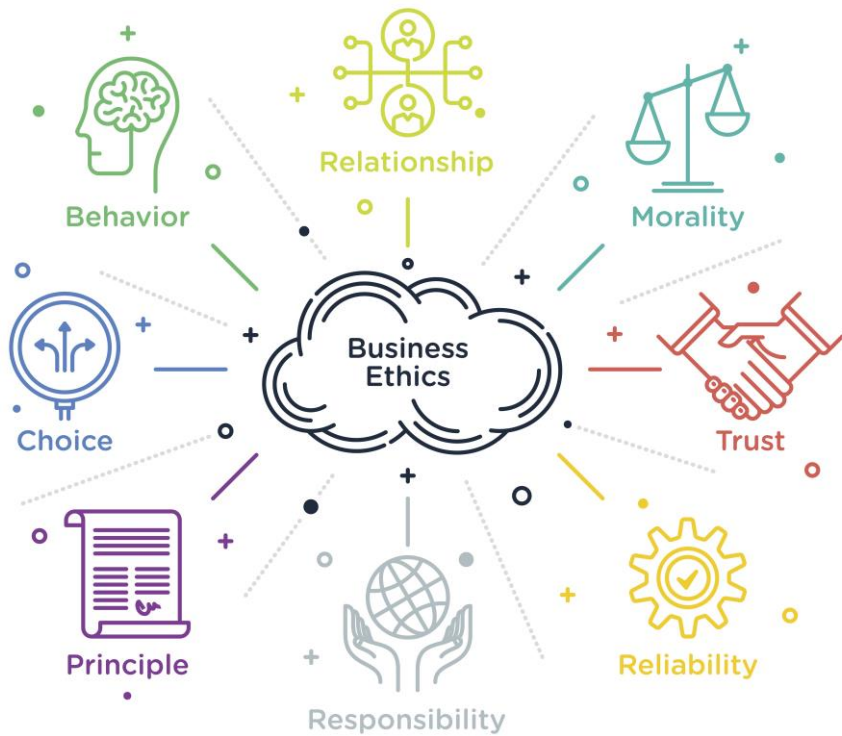


But A Good Strategy Isn't Enough!

“Culture eats strategy for breakfast.”

- Peter Drucker





What Happens When
Organizational
Culture Is Not
Healthy?

When Walk Diverges From the Talk, Culture Can Go Toxic



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 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

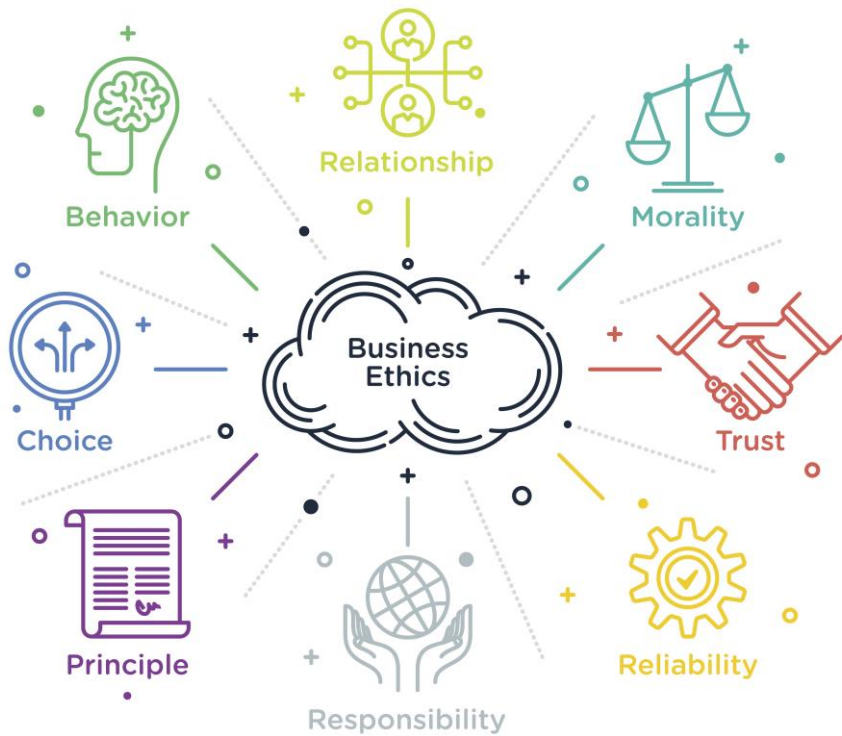
Audit Committees See Internal Audit's Role



27 percent of audit committee members believe internal audit can help maximize its value to the organization by helping to assess/audit organizational culture

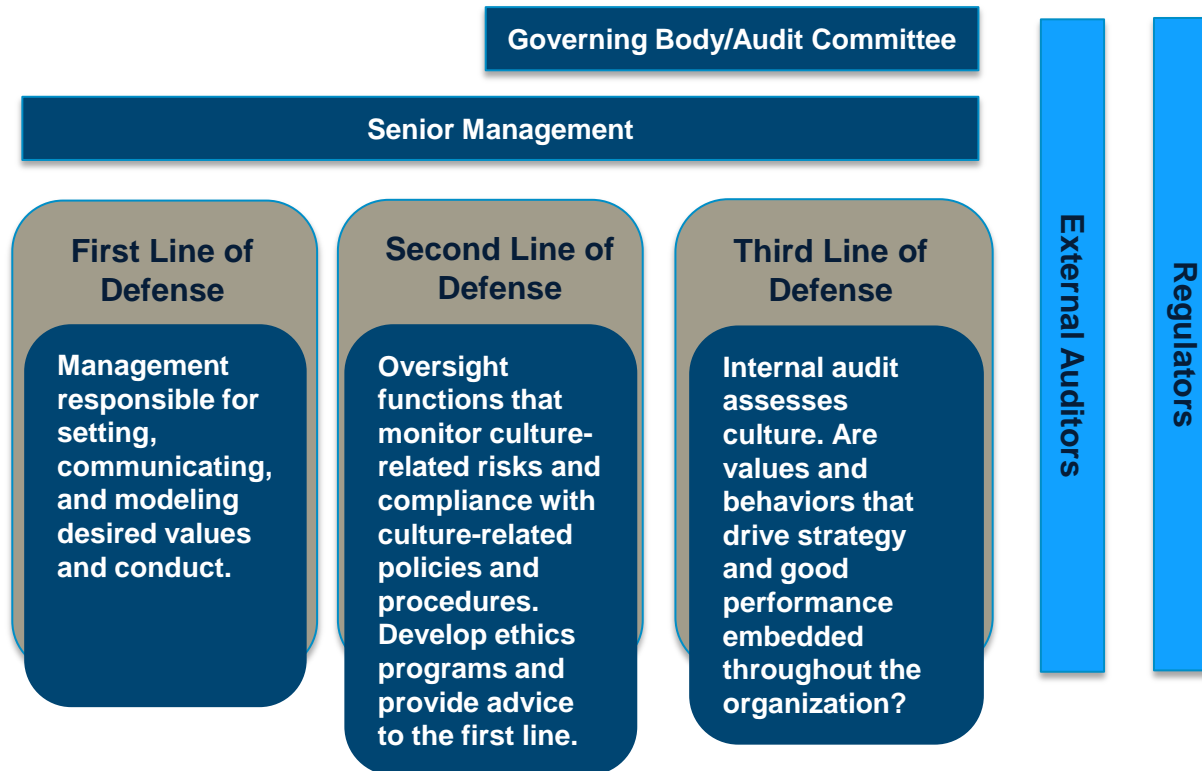
Source: KPMG's Audit Committee Institute – “Is Everything Under Control?” 2017 Global Audit Committee Pulse Survey, © 2017 KPMG LLP





How Do We Audit Culture?

Three Lines: Defending the Organization Against Cultural Risks



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

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

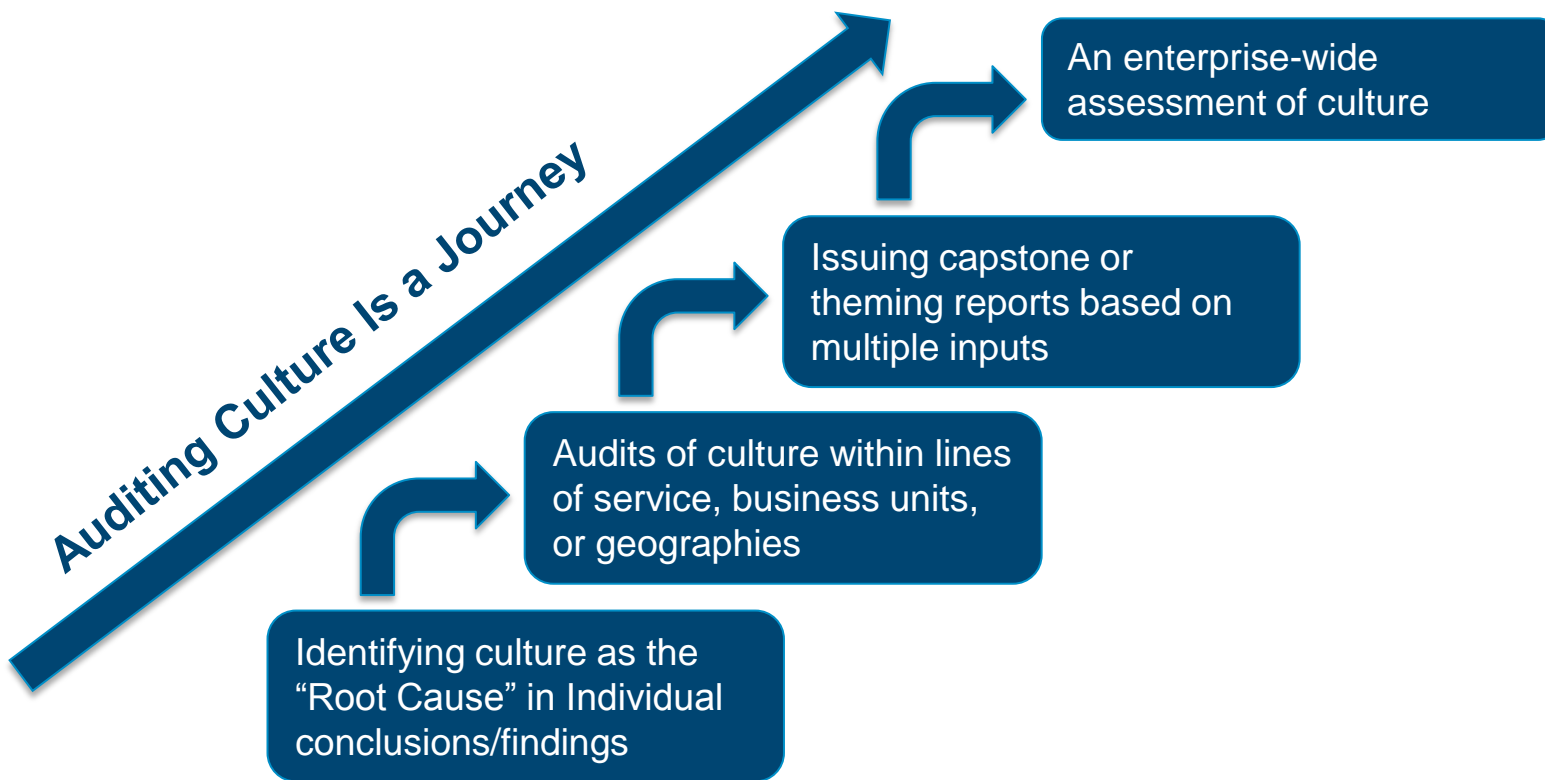
Source: Organizational Culture, © 2015 Chartered Institute of Internal Auditors

Mitigating Organizational 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



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.”

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 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?

“Auditing culture as a separate issue across a whole organization is a massive undertaking which internal audit, in many organizations, 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

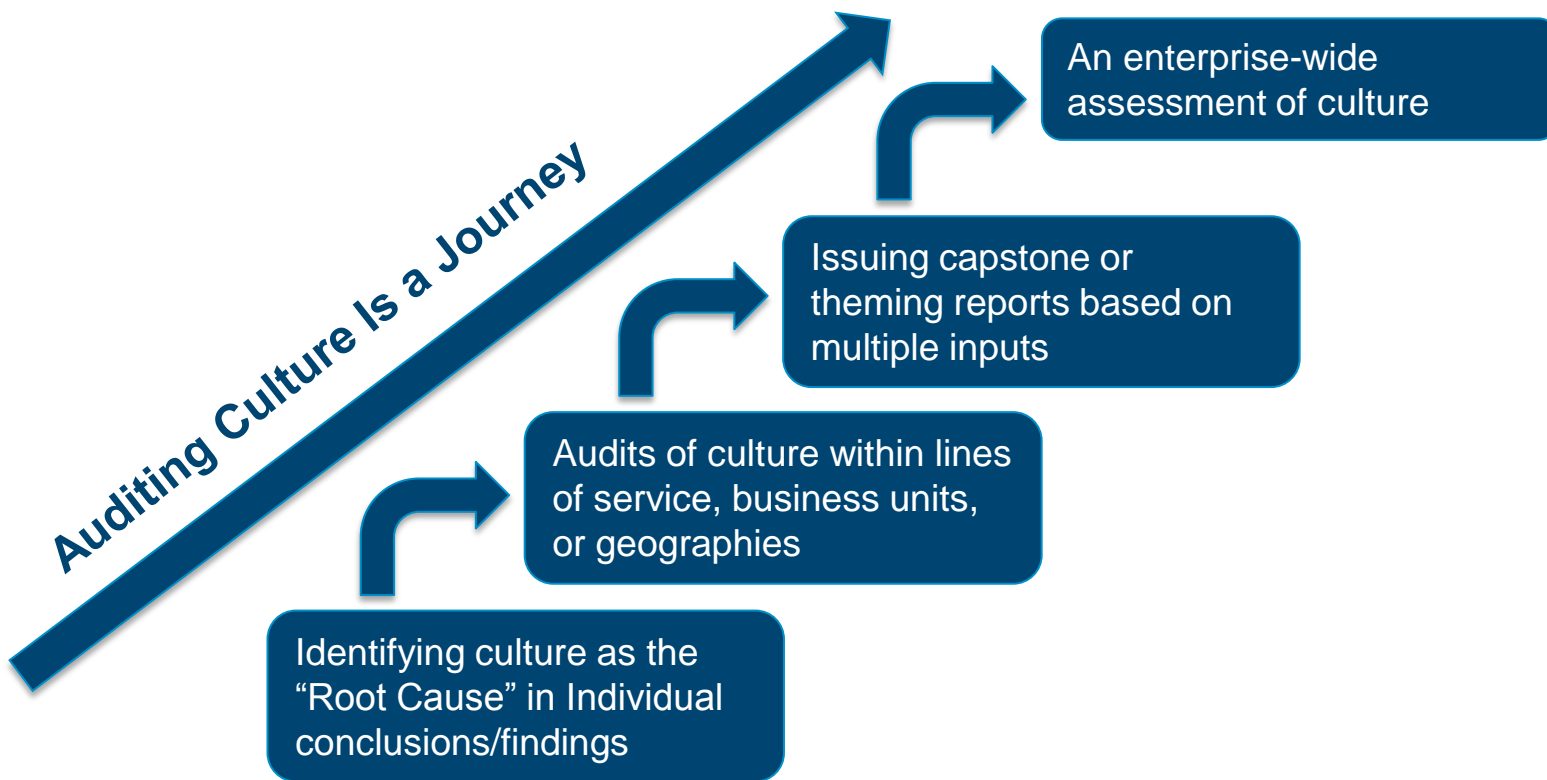
Strategies for Addressing Culture

Percentage Who Believe They Are “Very” or “Extremely Effective”

Raise as separate topic with the board or audit committee	54%
Coordinate efforts with other governance functions	48%
Raise as separate topic with management	42%
Provide an anonymous reporting mechanism (e.g. whistleblower hotline)	41%
Focus on organizational culture issues in audit reports	16%

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 Auditing Culture





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 judgments
- Find a champion who supports auditing organizational culture
- Define the roles
- Consider incorporating auditing culture into internal audit's charter



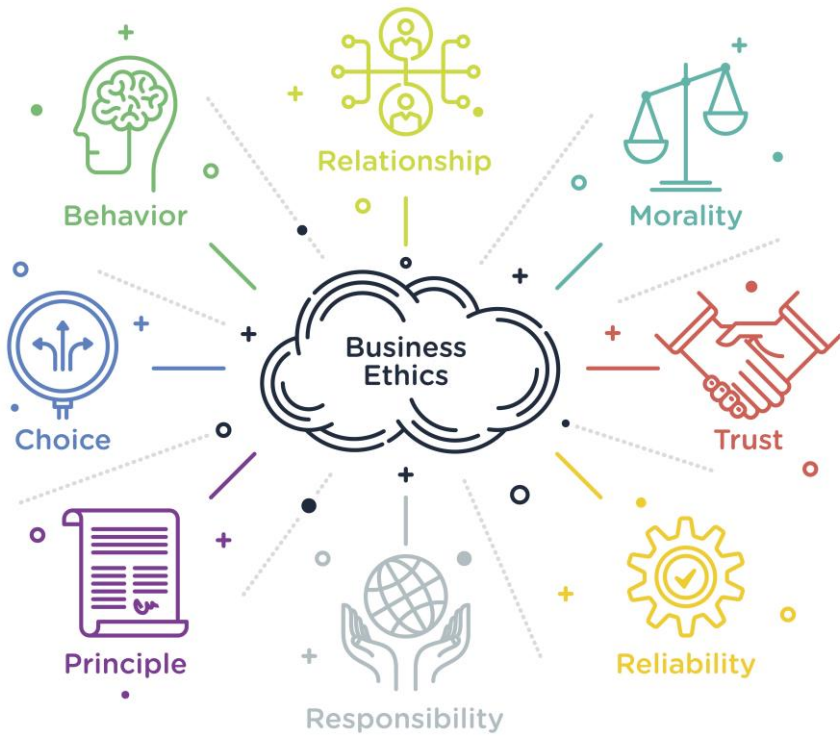
Assess Internal Audit's Skills and Fill the Gaps



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

- 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

Source: North American *Pulse of Internal Audit*, 2016



Parting Thoughts

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?



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



Culture and Internal Audit

Culture clearly presents risks in organizations.

What are you doing to assess them?



Thank You!

The Institute of Internal Auditors

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