

# Auditing Culture - Making Intangible, Tangible & Auditable

Refresher Course on IA of SMEs by SMPs – Joint session by WIRC & IIA BC

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## Setting the tone

In order to succeed, every Organisations need a Business strategy, which includes both;

**'what' the organisation is seeking to achieve, but more important,**

**'how' it is going to achieve it - That's about culture.**

## Setting the tone

Internal audit, acting as the **eyes and ears of the board but independent of management** is in a unique position to judge and advise whether the **tone at the top** is being adhered to across an organisation.

Richard Chambers: **Culture is “how we do things around here”**

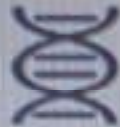
In simple words, Auditing Culture is assessing **‘Control Environment’** of the Organization, as one of the component of COSO Internal Control – Integrated Framework.

# Culture .. Some reality & myths



## Culture is EVERYWHERE

Culture is on everybody's lips, on every regulator's agenda. Board members cannot ignore it.



## Culture is COMPLEX

There is no universal definition in a business context. It touches the most intangible of intangibles.



## Culture is SUBJECTIVE

You will all have your own views on culture, what it is, whether it is good or bad and how much it matters.



## Culture is CONTEXTUAL

Culture changes in the lifecycle of companies, and is affected by the macro-environment (industry, country, etc.)



## Culture is not RISK CULTURE

Culture is broader and includes risk culture.



## Culture is not INTEGRITY

Integrity is a critical value but is distinct from culture.



## Culture is not CONDUCT

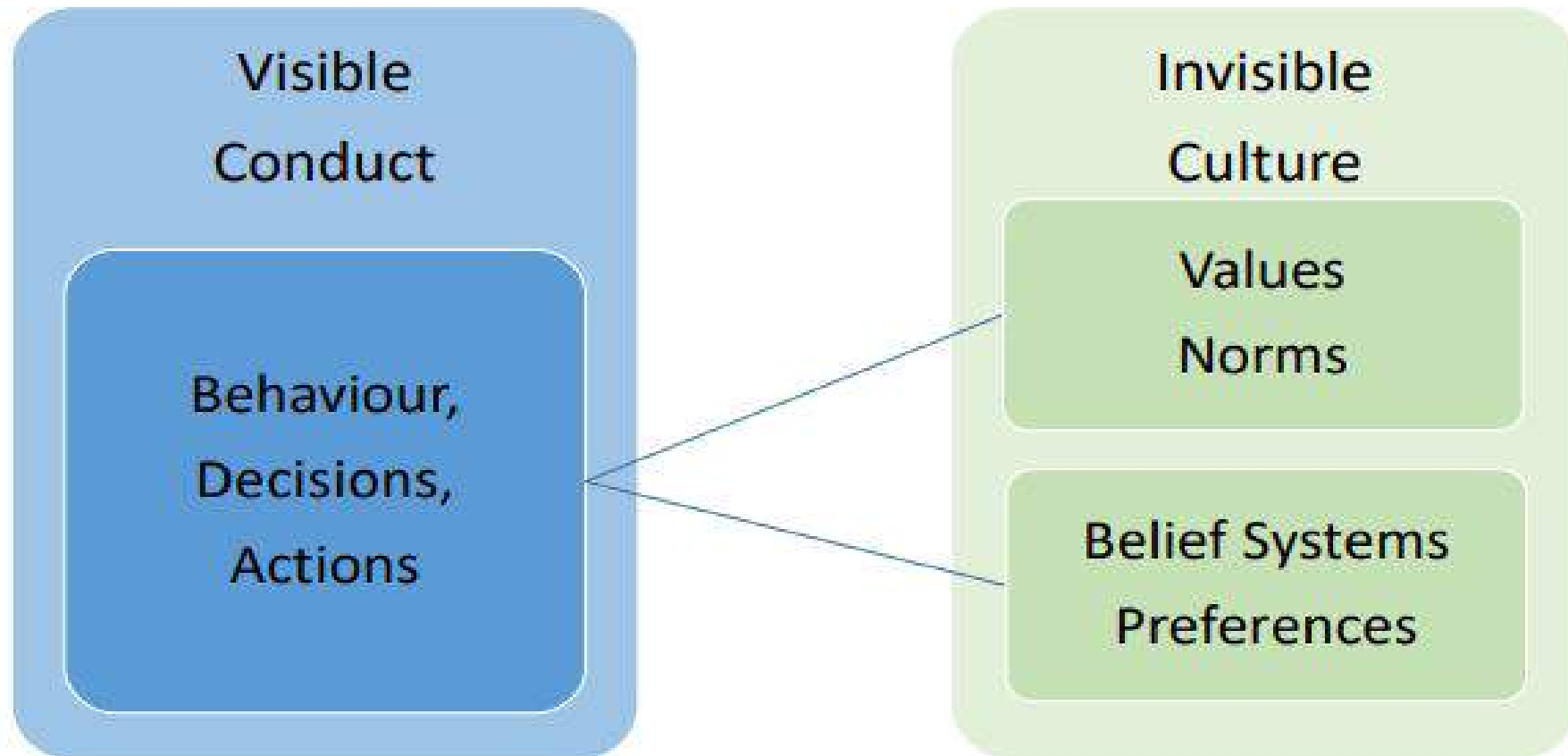
Conduct is defined in the Financial Services Regulations. It is part of culture but not it.



## Culture is not STATIC

Culture is evolving with the organization and is never set for the entire business lifecycle.

# Conduct vs. Culture



# Toxic Culture

## CRITICALITY OF TOXIC CULTURE & ITS INDICATORS



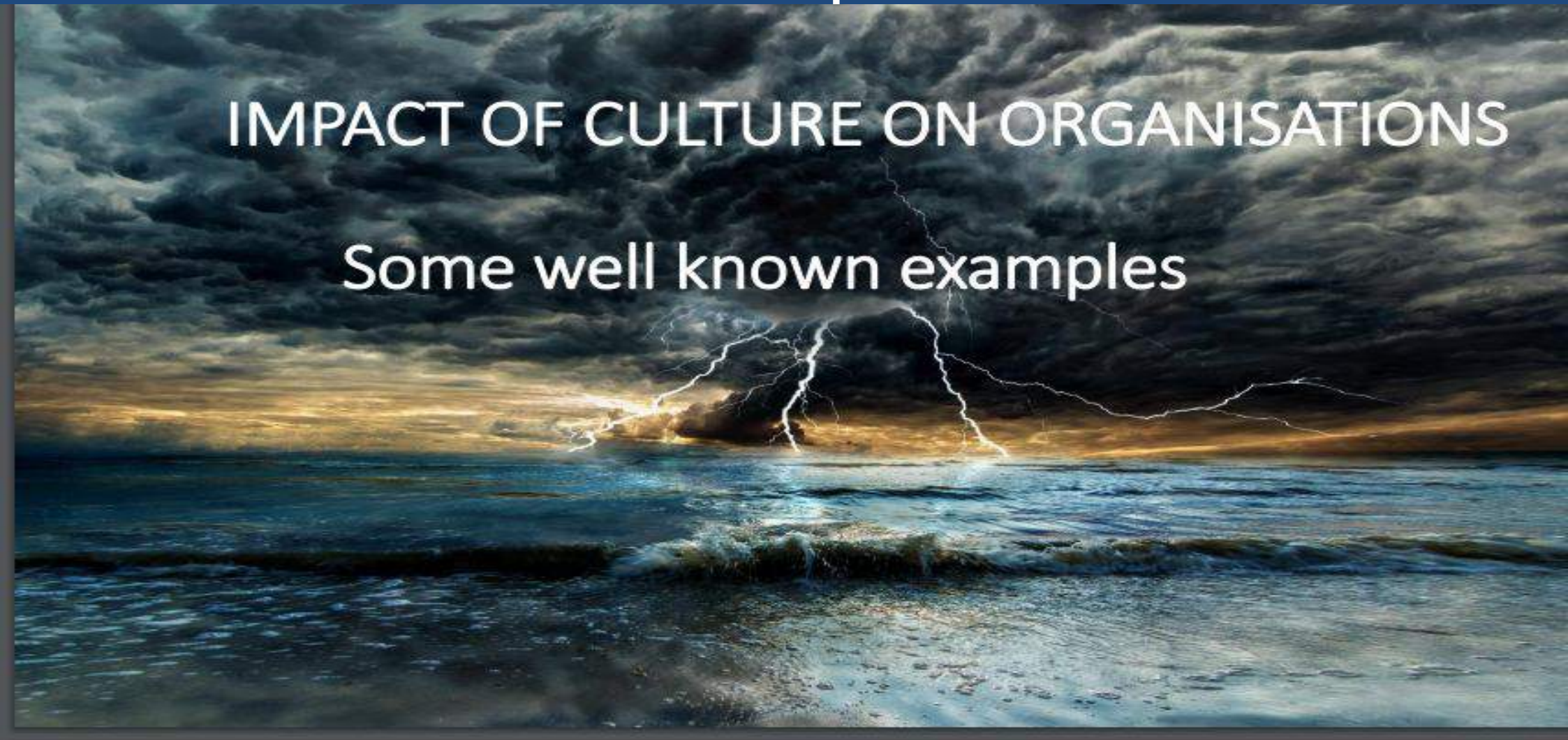
**Peter Drucker: “Culture eats strategy for breakfast”**

“If the culture of an organization is toxic, it erodes the effectiveness of all other control layers”. IIA.

## Culture Impacts ..

# IMPACT OF CULTURE ON ORGANISATIONS

Some well known examples



# Some examples of culture failures at ..



**TESCO**



**TOSHIBA**

CULTURE & PUBLIC MONEY



## Impact of Culture failures ..

# WHY?: THE BACKGROUND

- ENRON : Shareholders lost \$ 74 Billion. SPVs created
- WORLDCOM: Inflated assets by \$ 11 Billion. Mkt. value dropped from \$ 180 Billion to \$ 350 Million
- VOLKSWAGON: Stocks dropped 30%. The CEO quit after the firm admitted diesel cars were designed to cheat in tests. Could face upto \$ 18 billion in suits in the US.
- SATYAM: Example of corporate culture Failure. Founder arrested. Stock dropped from \$29 to \$1.8 in March 2009. Auditors penalized. Removed from Nifty & Sensex.
- Groupon. Public shareholders lose \$9 Billion. Revision of earnings in the 1<sup>st</sup> quarter after public issue
- Wells Fargo : Fines \$ 185 Million & Civil/Criminal suits of \$ 2.7 Billion
- TOSHIBA: overstatement of profits by \$ 1.2 Billion
- Tesco: Overstatement of Profits by Pounds 263 Million
- Also cases of FIFA, General Motors, Parmalat, Arthur Andersen, Tyco, Barings Bank (Nick Leeson), Bernie Madoff (Ponzi Scheme) etc.

## Culture Causes ..

### Corporate Scams & Failures

Unethical Leadership

Unscrupulous Accounting

Corruption

Conduct Issues

**Cultural  
Causes**

Poor Risk Management

Poor Governance



## What does it look like



# Culture Red flags

## RED FLAGS FOR CULTURE

These red flags may indicate that the tone in the middle isn't aligned with the tone at the top.

- Nobody is talking about culture.
- Controversial deals & encouragement of risk taking to hit short-term targets.
- Lack of financial discipline.
- Employees constantly fear being fired.
- Lack of knowledge sharing among employees.
- A focus on blame or covering for each other rather than fixing the problem.
- A perceived disconnect between words and action.
- Risk management and controls are regarded as an inconvenience.
- Lack of prompt follow through on commitments.
- Failure to escalate identified issues and active concealment of problems.
- Dress rehearsals for leadership visits that are focused on appearance.



## Different Ways to Audit Culture

### Culture framework

- Policy aspects
- Code of Conduct/  
Code of Ethics
- ERM/  
Whistleblower  
policy
- POSH

### Culture assessment

- Surveys
- Face to face  
interviews
- Questionnaires
- GPTW

### Integrating cultural aspect in every audit

- Evaluation of soft control in each hard core processes
- Root cause analysis in each process

# Culture Audit in Bite Size ..

## An Alternate Approach: Bite Sized Audits




Instead of the holistic approach, an effective way is to break culture down into bite-size chunks including:

- **Risk culture:** the organization's attitude toward risk-taking & control activities e.g. What processes are in place to ensure a bank's investment risk remains within tolerance levels? In a retail set-up is there a risk appetite around individual store performance?
- **Cyber culture:** Are employees concerned with security? Are there training and awareness programs around passwords?
- **Fraud culture.** Is employee theft it tolerated? Do employees understand that the intellectual property belongs to the organization and not them?
- **Safety culture.** Do we track workplace injuries ? Is safety ever discussed in staff meetings? Are employee safety policies in place?
- **Compliance Culture:** Do we track delays & non-compliances? Are regulator's reports taken seriously.
- **Conduct Culture:** Is management held accountable for their personal actions and for the actions of people under their control? Is breaking of rules considered acceptable?

Pay attention to things you might already be doing that highlight the impact of culture. By breaking culture into meaningful components and creating focal points, auditors can keep their audiences focused on specific positive actions.

Jim Pelletier - IIA

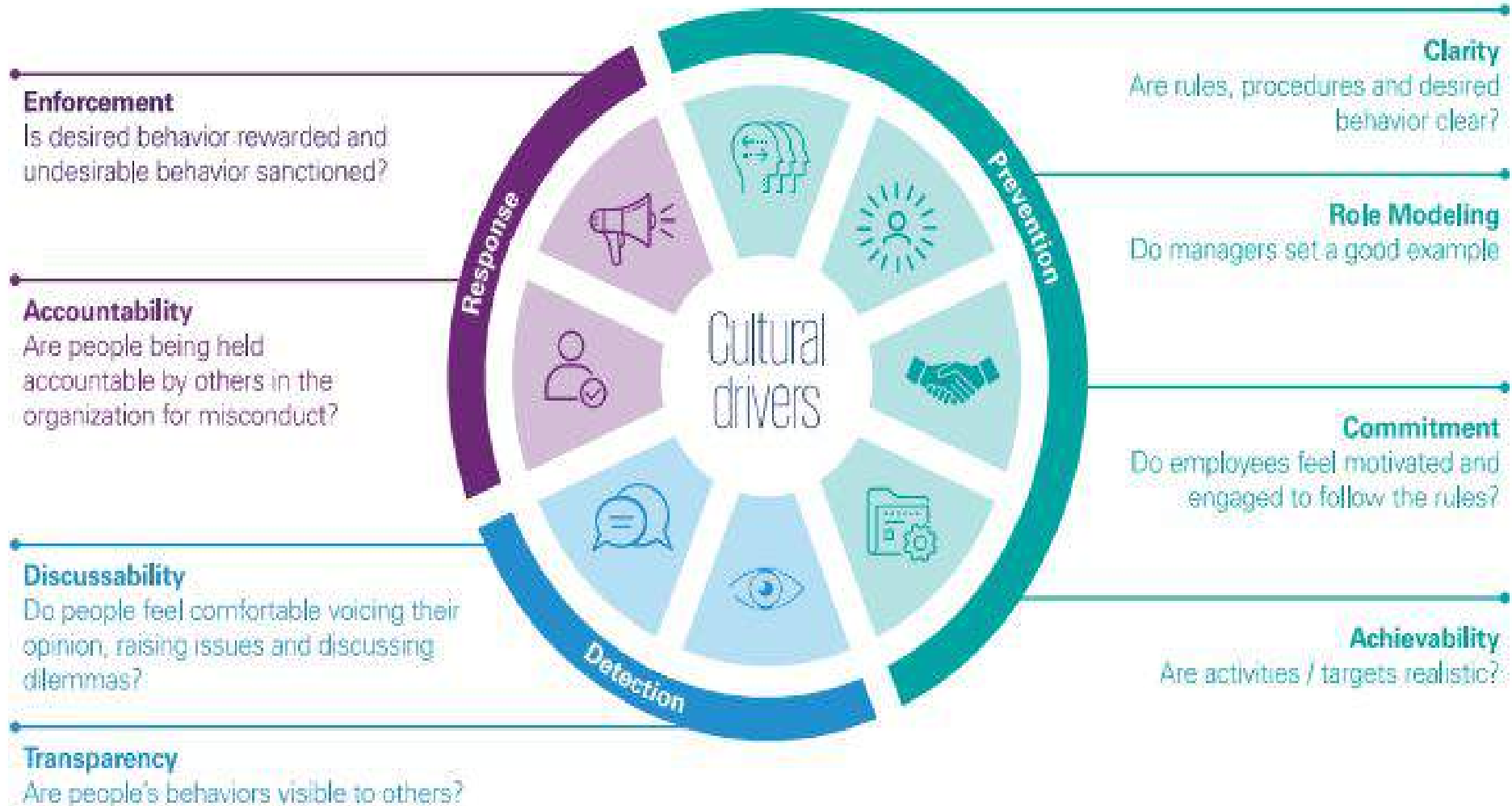
# Review Hard Controls

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- Internal Controls
  - Risk Analysis

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- Rules & Procedures
  - Segregation of Duties

- 
- Code of Ethics
  - Code of Conduct

# Review Soft Controls





## Parting Thoughts ..

company's  
appetite for  
auditing culture

Identify the  
right audit  
approach

Communicate  
the value

Get everyone  
on board

Start small

## Acknowledgements/some reference points ..

- IIA Inc. (Practice Guide)
- KPMG
- Grant Thornton
- Harvard Business Review
- Google



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