Auditing Culture

2nd Edition

Global Practice Guide

Aligns with the Global Internal Audit Standards

The Institute of
Internal Auditors

GENERAL GUIDANCE

Acknowledgements

Guidance Development Team

Jose Esposito, CIA, CRMA, Peru (Chairman)

Stacey Schabel, CIA, Project Lead, United States

Trevor Brookes, CIA, CRMA, Bermuda

Ian Stuart Lyall, CIA, CCSA, CGAP, CRMA, Australia

John J. Mickevice, CIA, CRMA, United States

Juergen Rohrmann, CIA, Germany

Teis Stokka, CIA, CRMA, Norway

Guidance Contributors

Thomas Bang van Dijk, CIA, CFSA, CRMA, Denmark

Tan Dang, CIA, Vietnam

Najeeb Haq, CIA, CFSA, Canada

Adrian Kyburz, CIA, CRMA, Switzerland

Silvia Tapia Navarro, Mexico

Global Guidance Council Reviewer, 2nd Edition

Taizo Ikeda, CIA, CRMA, Japan

International Internal Audit Standards Board Reviewers, 2nd Edition

Hussein Isingoma, CIA, Uganda

W. Charles Johnson, Jr., CIA, QIAL, CFSA, CGAP, CRMA, United States

IIA Standards and Guidance

Benito Ybarra, CIA, CFE, CISA, CCEP, Executive Vice President

Katleen Seeuws, CIA, CGAP, CRMA, CFE, Vice President

George Barham, CIA, CRMA, CISA, Director (Project Lead)

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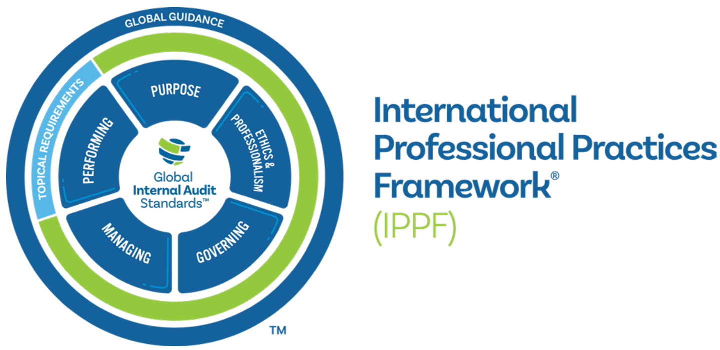

A framework provides a structural blueprint and coherent system that facilitate the consistent development, interpretation, and application of a body of knowledge useful to a discipline or profession. The International Professional Practices Framework® (IPPF)® organizes the authoritative body of knowledge, promulgated by The Institute of Internal Auditors, for the professional practice of internal auditing. The IPPF includes Global Internal Audit Standards™, Topical Requirements, and Global Guidance.

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Global Guidance

Global Guidance supports the Standards by providing nonmandatory information, advice, and best practices for performing internal audit services. It is endorsed by The IIA through formal review and approval processes.

Global Guidance provides detailed approaches, step-by-step processes, and examples on subjects including:

- Assurance and advisory services.
- Engagement planning, performance, and communication.
- Financial services.
- Fraud and other pervasive risks.
- Strategy and management of the internal audit function.
- Public sector.
- Sustainability.
- Global Technology Audit Guides® (GTAG®) provide auditors with the knowledge to perform assurance and advisory services related to an organization's information technology and information security risks and controls.

Global Guidance is available as a benefit of membership in The IIA.

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Executive Summary

An organization's culture drives how it conducts business and executes its strategies. All organizations have a culture, whether intentionally created or not. If an organization has multiple locations or campuses, it is probable that each has a unique culture. Each department may even have its own individual subculture aside from the overarching organizational culture. Global cultural differences can affect the desired objectives of an intentional organizational culture. Further, elements of an organization's culture may be in a continuous state of flux. All these cultures mixing together may work, but it is more likely to introduce risks.

Poor organizational culture has been identified as the root cause of many serious issues across numerous industries worldwide. In response, key business stakeholders, including boards and regulators responsible for overseeing the control environment, have heightened their focus on the role of organizational culture and the actions that arise from that culture. According to Standard 9.4 Internal Audit Plan, the internal audit plan must be dynamic and updated timely in response to changes in the organization's business, risks, operations, programs, systems, controls, and ultimately, the organizational culture.

One of the internal audit function's responsibilities, as the third line in an organization's governance structure, is to assess the adequacy and effectiveness of the internal control environment directly impacted by culture and the conduct that arises from employees acting out and exhibiting their interpretation of the organization's cultural values (see also The IIA's position paper, "Three Lines Model: An update of the Three Lines of Defense"). This can be difficult to do because internal auditors are employees of the organization themselves (unless the function is outsourced), so they must be cognizant of remaining objective when performing this type of engagement. In addition to objectivity, internal auditors are required to conform with the the principles and standards in Domain II: Ethics and Professionalism of The IIA's Global Internal Audit Standards.

This guidance is intended to assist internal auditors in understanding and evaluating an organization's overarching culture.

Introduction

Culture is difficult to define; however, for the purposes of this practice guide, organizational culture and the conduct that occurs within that culture is defined as follows:

"Culture represents the invisible belief systems, values, norms, and preferences of the individuals that form an organization. Conduct represents the tangible manifestation of culture through the actions, behaviors, and decisions of these individuals."[1]

This definition captures the complexity of identifying and assessing an intangible organizationwide quality or aspect that comprises human belief systems, social norms, and other psychological factors.

Internal audit functions operating in certain industries and/or jurisdictions are required to assess and regularly report on the appropriateness of their organization's culture and the effectiveness of conduct **risk management** activities. However, even without regulatory guidance, internal auditors can add value by objectively assessing and reporting organizational culture and conduct risk management.

Note

Terms in **bold** are defined in the glossary in Appendix B.

The Global Internal Audit Standards use certain terms as defined in the glossary. To understand and implement the Standards correctly, it is necessary to understand and adopt the specific meanings and usage of the terms as described in the glossary.

The Standards use the word "must" in the Requirements sections and the words "should" and "may" to specify common and preferred practices in the Considerations for Implementation sections.

This work is consistent with the **internal audit function**'s responsibilities identified in Standard 9.1 Understanding Governance, Risk Management, and Control Processes. By applying this standard, the internal audit function can provide management with opportunities to develop robust internal **control processes** that align with **stakeholder** expectations and support the **board** and **senior management** in their oversight roles.

This practice guide will help internal auditors understand **risks** associated with an organization's culture, how effectively managing those risks supports a successful **control** environment, and how to approach an assessment of culture. After reading this guidance, internal auditors should be able to:

1. St-Onge, Gürdeniz, and Belov, *Measuring Conduct and Culture: A How-To Guide for Executives.*

- Understand the business **significance** of culture and conduct risk in an organization's control environment.
- Identify the key components of culture and conduct risk.
- Understand key stakeholder concerns and expectations related to culture and conduct risk.
- Recognize the internal audit function's role in assessing and reporting on organizational culture.
- Understand potential approaches to assess and report on an organization's culture and management of conduct risk, based on examples, tools, and guidance.

Purpose of Internal Auditing

"Internal auditing strengthens the organization's ability to create, protect, and sustain value by providing the board and management with independent, risk-based, and objective **assurance**, advice, insight, and foresight."

Global Internal Audit Standards, 2024 Edition

Business Significance

People often behave differently in the corporate environment than they do at home. Culture and conduct have business significance because they are elements of the control environment, which is the foundation for all other layers of control, such as IT general controls and business process controls. A toxic organizational culture erodes the effectiveness of all other control layers.

A common factor cited when discussing an organization's culture is "tone at the top." Many studies have shown that most people who change jobs do so because of their immediate boss.[2,3] Common reasons to change jobs include the desire for better compensation and benefits, a hybrid or flexible work schedule, opportunities to pursue education, boredom, struggling with work/life balance, and feeling unheard and unappreciated. Interestingly, many of these factors are at least somewhat in the supervisor's control. Intentionally or not, supervisors set the cultural tone for their team and contribute by operating within the culture of the broader organization. Many leaders are unaware of the importance of their role in setting and modeling an appropriate culture. Thus, employees may be confused, unmotivated, or see opportunities to take advantage.

Studying the corporate failures of the last few decades indicates identifiable key risk factors arising from cultural problems. Those risk factors include but are not limited to:

- Management has unreasonable expectations, including those related to deadlines, profitability, or levels of efficiency.
- Employees (including internal auditors) lack knowledge of key risk management activities and potential risk **impact**.
- The organization's hierarchy is inflexible, impeding the flow of information up, down, and across the organization.
- The environment is characterized by pervasive mistrust toward auditors and regulators, including a lack of understanding of the role of control processes in achieving business objectives.
- Employees exhibit an attitude of hubris (for example., "That will not happen here," or "That has never happened to us before.")
- Employees, especially those at senior management levels, lack accountability.
- The organization fails to enforce codes of conduct and related policies and procedures.

2. Mengjiao, Arshad, Yating, "The Relationship Between Organizational Culture and Turnover Intention," 1.
3. Hastwell, "Toxic Company Culture."

- Management and/or the board refuses to acknowledge information contrary to their opinions.
- Management disregards laws and regulations that are not conducive to achieving its objectives.

For example, in an environment of fear and blame, if employees are penalized for mistakes that may or may not be the result of their actions, management regularly overrides key controls, and challenging management is discouraged; bad actors can operate freely until their behavior becomes the norm. Employees who behave honestly may leave the organization or become corrupt themselves, resulting in further deterioration of the culture.

Management should be clear on what it will and will not tolerate in terms of its **risk appetite**. This includes culture-related risks. An organization may choose to define actions, situations, or risk impacts related to culture that constitute a breach of its risk appetite parameters and develop a system to facilitate reporting on the remediation status of internal audit or risk management's **findings** regarding these breaches. (See Appendix D for an example.)

Conversely, a positive, affirmative, open culture supports the organization's attainment of its goals and objectives because it generally creates a more enjoyable place to work, enhances productivity, and leads to overall improved performance in addition to reducing risk exposure.

Healthy organizations have several common cultural characteristics including:

- Positive tone from the top – The board and senior management work together to define the organization's values and proactively emphasize and model those values, ensuring strategies are consistent with the values, and holding management accountable to executing their duties within the organization's risk appetite.
- Clear communication – Management reinforces the values and culture through clear communication of expectations across the organization. Methods include formal communications, day-to-day interactions, and meetings with employees, customers, and third parties.
- Open dialogue – Management actively gathers and listens to feedback. All levels are open to constructive criticism and problem-solving through methods including information obtained from second- and third-line functions via inputs such as well-received and acknowledged employee suggestion/question program, ethics hotlines, open-door policies, employees' events and meetings, and more.
- Employee engagement – All employees (to the extent possible) are engaged in objective setting and strategy discussions. In larger organizations, this may be accomplished through two primary methods: input into setting personal goals and objectives and understanding how those individual goals and objectives align with the overall organization's strategy and objectives. Employees engagement in setting objectives improves the probability that they will support the objectives and strategies. People working toward a mutually agreed upon objective require less external motivation.

- Incentives aligned with core values – All employees' compensation, variable compensation, promotions, and other talent management are governed by a clear understanding of the organization's core values and risk appetite.

The following sections will describe methodologies and options internal auditors may use to assess an organization's culture.

Role of Internal Auditing

Some regulators, mostly in the financial services industry, have issued guidance on their expectations for internal auditors regarding their assessments of culture and related cultural issues. For example, most organizations in industries such as manufacturing and energy, have no regulatory requirements relevant to culture and conduct.

An organization's board and senior management are responsible for managing culture and conduct risks. They may request that the internal audit function provide assurance and advice related to these topics including:

- Identifying **root causes** not only for areas that have received observations and recommendations from internal auditors regarding culture but also for areas judged as operating with best practices. Identifying and analyzing root causes from both perspectives results in powerful tools to gauge frequency and assess how cultural elements are drivers of results in the improvement of affected areas.
- Assessing the **governance** structure (roles and responsibilities) related to culture and conduct.
- Assessing the organization's programs for communicating values, strategies, and objectives.
- Assessing the effectiveness of culture-related training, including code of conduct, ethics, sexual harassment, etc. (for example: How seriously do employees take the training? Are the delivery methods effective?)
- Performing internal audit **engagements** that consider employee incentive and hiring programs, disciplinary actions, and escalation protocols, treatment of "whistleblowers" or employees that speak up and escalate issues, and other key performance indicators (KPIs) or key risk indicators (KRIs) that may be relevant to the organization's culture.
- Analyzing information related to culture gathered for other purposes in the organization (for example, analyzing and trending employee survey data).

All these activities are consistent with Domain I: Purpose of Internal Auditing, Domain V: Performing Internal Audit Services and these Standards:

- 1.2 Organization's Ethical Expectations.
- 6.1 Internal Audit Mandate.
- 9.1 Understanding Governance, Risk Management, and Control Processes.
- 9.4 Internal Audit Plan.

- 13.2 Engagement Risk Assessment.
- 13.3 Engagement Scope and Objectives.
- 13.4 Evaluation Criteri.
- 13.6 Work Program.
- 14.1 Gather information for Analyses and Evaluation.
- 14.2 Analysis and Potential Engagement Findings.
- 14.3 Evaluation of Findings.
- 14.4 Recommendations and Action Plans.
- 14.5 Engagement Conclusions.
- 15.1 Final Engagement Communication.

In addition, individuals assigned to audit culture-related risks should have certain attributes, such as:

- Familiarity with the organization's unwritten rules including hierarchical norms and how employees from different levels communicate with each other.
- Skill at reading body language and other nonverbal cues.
- Sufficient experience and respect in the organization to be able to ask hard questions that may touch on uncomfortable subjects.
- Ability to focused on an engagement's objective facts rather than personal feelings about the people or processes involved.

These elements are critical and necessary for internal auditors in all assignments, but particularly in the sensitive areas associated with an organization's culture and any **subcultures** that may exist within departments and individual locations. The internal audit mandate, authorized by the board and senior management, provides the internal audit function unrestricted access to execute assurance engagements, which may include the topic of culture (Standard 6.1 Internal Audit Mandate).

As stated by Standard 2.1, "Internal auditors must maintain professional **objectivity** when performing all aspects of internal audit services." Principle 7 Positioned Independently states, "The board establishes and protects the internal audit function's **independence** and qualifications. The board is responsible for enabling the independence of the internal audit function." Standard 2.1 also states, "Professional objectivity requires internal auditors to apply an impartial and unbiased mindset and make judgments based on balanced assessments of all relevant circumstances. Internal auditors must be aware of and manage potential biases." For example, internal auditors who may have been involved with the development and/or implementation of any relevant programs (such as employee engagement groups and creating ethics training or codes of conduct) should not be assigned to these engagements. However, small internal audit functions may have limited options in this regard. If this occurs, Standard 2.3

Disclosing Impairments to Objectivity requires that impairment in fact or appearance be appropriately disclosed.

These issues must be carefully considered before assigning employees to embark on audits of culture.

Planning and Performing the Engagement

Gather Information

The **chief audit executive** or internal auditors assigned by the chief audit executive should be involved as observers in various organizational meetings regarding values and strategic planning. Internal auditors attending these meetings should be conscious of the information that pertains to or may affect culture. This information will also help internal auditors identify where culture-related risk information is retained in the organization.

An insurance company chief audit executive offers the following advice:

> "An internal auditor increases their chances of understanding whether the culture is good or bad by being involved as observers in committees where management discusses information key to the organization's strategies. Internal auditors should be on the enterprise risk management (ERM) committee. Ideally, it is beneficial for chief audit executives to attend executive committee meetings as observers. Internal auditors must develop the ability to use their eyes, ears, and minds to watch people interact and think. If internal auditors are not engaged or embedded in the organization's governance entities to see those behaviors on a regular basis, then KPIs and KRIs related to culture may deteriorate unbeknownst to management."

This chief audit executive also suggested attending meetings in which executive management presents financial and performance results. He states internal auditors should watch what people do and say when they talk about risk occurrences.

While gathering information to understand the cultural factors that are relevant to the engagement, internal auditors should also review prior assessments (for example, **risk assessments**, reports by **assurance** and **advisory service** providers), process flows and controls, and interviews of relevant stakeholders. To identify key risks and controls for a culture assessment, internal auditors thoroughly understand how the organization sets, communicates, and expresses its values (Standard 1.2). Documents internal auditors may want to review while gathering information include:

- Any value statements (may be labeled mission or vision statements or contained within these documents) published by the organization. Many times, these are public and appear on the organization's website.
- Top-level, business-line level, and process-level strategies, objectives, and business plans.
- Risk appetite statements.

- Organization charts (high-level and business units) and related reporting lines.
- Roles, responsibilities, and accountabilities of control functions (for example, **compliance**, risk management), and senior management.
- Governance framework.
- Tone at the top and leadership communications with employees.
- Products/services approvals and selling processes.
- Risk-escalation protocols.
- Exceptions and management overrides.
- Codes of conduct/ethics, including policies and procedures on speaking up, nonretaliation, and treating customers fairly.
- Ethics hotline information and training materials.
- Results of culture-related training and testing programs (for example, sexual harassment, ethics, code of conduct).
- Employee survey results.
- Exit interview data.
- Board and relevant committee meeting minutes (for example, governance, risk, nomination and remuneration, and ethics committees).
- Management's risk and control self-assessments (RCSAs) including management's action plans and their status.
- Relevant culture-related and risk management policies including incentives and compensation policy, requirements, reports, and expectations.
- Recruitment, onboarding, performance management, retention, and exiting processes.
- Status of issues raised by internal auditors or other control functions, **external service providers**, and regulators taking into consideration repeated and long outstanding issues and root causes that may be related to culture.
- External auditor's report on the audited financial statements and letter of representation.

Resources

For detailed instructions on how to plan and scope an audit engagement, see IIA Practice Guide "Engagement Planning: Establishing Objectives and Scope."

For more information on how to perform a risk assessment, see IIA Practice Guide "Engagement Planning: Assessing Fraud Risks."

This guide includes a risk assessment "how to" guide that can apply to any topic.

When planning an engagement related to culture risks, internal auditors should consider the risks posed by the organization's third-party relationships.

For more information, see IIA Practice Guide, "Auditing Third-party Risk Management."

Some of these elements are public knowledge and can be obtained easily. Others will be more difficult and the internal audit function may have to come to an **engagement conclusion** based on the available data.

Considering Culture and Conduct Risks in the Audit Plan

The Business Significance section of this guide lists risk factors that may make an organization more vulnerable to culture-related incidents. Each risk factor – individually or aggregated – can manifest in a risk occurrence that may damage the organization's ability to meet its objectives. Since these risk factors are strategic, they originate at the organization's senior management level and should be integrated into the risk assessment portion of audit planning.

Risk Assessment

To audit culture-related subjects, internal auditors may start with the risk assessment on which the **internal audit plan** is based, where they can identify risks to the organization's culture generally. Then, they can narrow the focus of their preliminary risk assessment to identify the specific risks they intend to cover in the audit engagement. Culture-related risks can be identified anywhere in the organization, so it is important that internal auditors conduct a thorough risk assessment when planning an engagement, as described in Standard 13.2.

As internal auditors conduct their engagement-level risk assessments, they should review past **workpapers** and consider any past engagements that may contain information relevant for an organizational culture audit. Risks and controls may be gathered from the information available to internal auditors during the information-gathering phase.

The results of this risk assessment will assist the chief audit executive in determining the appropriate engagement approach, objectives, and scope. It will also assist the chief audit executive in determining whether the available internal audit resources are appropriate and sufficient.

Example of Talent Acquisition Engagement Including Cultural Risk Factors, part 1

Choosing talent acquisition as an example of an auditable unit, Figure 1 shows how internal auditors may map the risks of the talent acquisition process to the cultural risk factors.

Based on internal auditors' judgment, the talent acquisition risks that correspond to a particularly concerning cultural risk factor may be included in an engagement, even though their impact and **likelihood** scores may not indicate they are key risks.

After internal auditors have identified and prioritized the risks, the next step is determining whether any controls are in place to mitigate those risks and designing tests for the identified controls. All documents generated by the risk assessment (for example, heat map, **risk and control matrix**) should be included in the engagement workpapers.

Figure 1 offers an example of mapping the talent acquisition risks in the strategic risk category to the cultural risk factors.

Figure 1: Talent Acquisition Risks and Cultural Risk Factors

Talent Acquisition Risks	Cultural Risk Factors
• Restrictions on work visas and immigration. • Failure to identify skill sets required for key or specialized positions. • Reactive hiring strategy. • Misalignment between the organization's and the human resources department's strategies, goals, and objectives. • Competition between business lines for personnel.	• Management (and, in some cases, the board) refuses to acknowledge information contrary to their opinions. • Inflexible hierarchy impedes the flow of information up, down, and across the organization. • An attitude of hubris (for example, "That will not happen here." or "That has never happened to us before.")

Planning the Engagement

Auditors may use information from previous engagements, including process documentation and internal controls related to culture to develop an engagement covering broad measures of an organization's culture. This **engagement work program** could be constructed in a variety of ways. Three examples are:

1. Integrating culture risk factors into all engagements (integrated approach).
2. Selecting a set of key processes and controls related to culture, developing an engagement work program, and performing targeted testing on the selected areas. This testing may be supplemented with interviews of a sample of employees in which auditors ask questions targeted to assess culture (targeted approach).
3. Top-down culture assessments that start with tone at the top and move down through all layers of the organization to individual employees (top-down approach).

Any of these approaches would allow internal auditors to develop a list of relevant cultural risk factors and map their **engagement results** to those factors. They may spot trends or common themes that could be presented to the board and senior management.

A Common Risk Language

One key factor internal auditors should keep in mind is that they must speak the same language as their organization and move in the same direction regarding culture.

Management can and should decide what works for them in terms of establishing and communicating culture.

Internal auditors should not feel they are compromising by designing culture-related audits within management's processes. That is making the internal auditor's job easier. It makes it more powerful because findings are communicated back in words the organization understands.

Internal auditors should be mindful of the terminology they use when identifying and assessing cultural issues within their organization. The words "culture," "ethics," or other related terms may be inappropriate or imprecise given the organization's social and cultural context. These words may also be difficult to translate accurately. If this is the case, internal auditors should use words and phrases that have clear and understandable meaning for their stakeholders.

The chief audit executive should consult with human resources, legal, and/or the relevant board member (for example, audit committee chair) to discuss the engagement plan before beginning the audit.

Standards 13.3 Engagement Objectives and Scope and 13.4 Evaluation Criteria

If the chief audit executive is using the integrated approach and embedding testing of cultural issues in a regular audit, specific culture-related objectives would not be needed unless requested by management or the board. However, if the chief audit executive is using the targeted approach focusing on cultural factors, then the **engagement objectives** should be tied to the organization's stated core values (Standard 13.3).

Prior to the engagement, the chief audit executive should discuss how internal auditors will approach interviewing management due to the sensitivity of cultural issues. Preferably, interviews would be conducted by experienced internal auditors. Less experienced team members may benefit by attending planning sessions of this type to complement and develop their skill sets.

From a scope perspective, internal auditors should integrate discussions and testing related to the organization's core values. The approach selected will help guide execution. If no core values statements exist, the chief audit executive should consider proxies such as ethics policies, the code of conduct, risk appetite statements, etc., as discussed in the Gather Information section of this guide. It is also important to identify the most relevant and appropriate **criteria** to be used to evaluate and assess culture, which often includes critical conversations led by the chief audit execcutive.

Objectives of Assurance Engagements

- Reflect risks to the business objectives of the area or process that were assessed as significant during the preliminary risk assessment (Standard 13.2).
- Consider the probability of significant errors, **fraud**, noncompliance, and other exposures (Standard 13.2).
- Identify the most relevant criteria to be used (Standard 13.4).

Standard 13.5 Engagement Resources

Certain skills are needed for those assigned to culture-related risk audit engagements. In conformance with Standards 3.1 Competency, the chief audit executive should assess the skills of internal audit team members **periodically** to ensure that the internal audit function has the appropriate skills to provide meaningful information and insight to management on culture-related risks. This would also conform with Standard 13.5 Engagement Resources. Additionally, Standard 12.3 Oversee and Improve Engagement Performance states that "Assessing the skills of the internal audit staff is an ongoing process extending beyond reviewing engagement workpapers. Based on the results of skill assessments, the chief audit executive may identify which internal auditors are qualified to supervise engagements and assign tasks accordingly."

A key factor in determining resource allocations is integrating new auditors into engagements where culture or cultural risk factors will be assessed. If the internal audit function has high turnover, new auditors may require briefing on these issues. As such, it may be beneficial to have new auditors sit in on interviews conducted by more experienced ones, specifically when sensitive cultural issues will be discussed with management. This can be a training tool to aid new auditors in becoming familiar with an organization's jargon or familiar terms and to observe the nuances of such discussions. This is also a suitable tactic for auditors who may encounter unique situations, such as language barriers with an employee's native language.

The right question asked the wrong way may hamper a productive interview. Chief audit executives should consider including new auditors in brainstorming sessions, risk assessments, and so on, to improve their knowledge and understanding, specifically regarding issues of culture. This can be particularly important for auditors conducting interviews in the field for organizations with a global footprint, which may have particular and broader cultural protocols.

If work regarding culture is performed by another assurance provider, Standard 9.5 Coordination and Reliance states the following: "The chief audit executive must coordinate with internal and external providers of assurance services and consider relying upon their work. Coordination of services minimizes duplication of efforts, highlights gaps in coverage of key risks, and enhances the overall value added by providers. If unable to achieve an appropriate level of coordination, the chief audit executive must raise any concerns with senior management and, if necessary, the board. When the internal audit function relies on the work of other assurance service providers, the chief audit executive must document the basis for that reliance and is still responsible for the conclusions reached by the internal audit function." Domain II: Ethics and Professionalism highlights the importance of **integrity**, ethics, professionalism, objectivity, **competency**, due professional care, and confidentiality, which should all be considered when evaluating the reliance of other assurance providers.

Behavioral Interviewing

Interview techniques attempt to assess not only the subject's actions but also to determine their motivations, beliefs, and underlying values that create the subconscious filter through which they make decisions.

Some organizations work with organizational psychologists and/or general psychologists to either perform the interviews and analysis of the data or to assist in the process.

For further information on behavioral interviewing and other related techniques, see "Supervision of Behaviour and Culture: Foundations, practice & future developments" by DeNederlandscheBank (2015).

Standard 13.6 Engagement Work Program

During planning, internal auditors must develop and document an appropriate work program to achieve the engagement objectives (Standard 13.6 Work Program). The process of establishing the engagement objectives and scope may produce any or all the following workpapers:

- Process maps.
- Summary of interviews.
- Preliminary risk assessment (for example, risk and control matrix and heat map as noted in Standard 13.2).
- Rationale for decisions regarding which risks to include in the engagement.
- Criteria that will be used to evaluate the area or process under review (required for assurance engagements, according to Standard 13.4).

Given the sensitivity of some of the views expressed when auditing culture-related risks, safeguards may be necessary to ensure that working papers are only accessible to those in the audit function who need to know (for example, anonymizing the interviewees and limiting access to identify who is represented).

Performing the Engagement

As indicated, there are three main approaches to auditing an organization's culture. The integrated approach considers culture risk factors in all engagements. The targeted approach involves selecting a set of key processes and controls related to culture and developing an engagement work program that tests them across the organization. The top-down approach is a comprehensive audit of all culture-related activities within an organization.

1. Integrated Approach

Example of Talent Acquisition Engagement and Cultural Risk Factors, part 2

Returning to the example of a talent acquisition audit engagement, Figure 2 illustrates the integration of cultural risk factors. As shown in these examples, consideration of cultural risk factors may result in additional testing, expanded samples, or cross-referencing other engagements.

The risk "Reactive Hiring Strategy" was selected from the Talent Acquisition Risks listed in Figure 1, including hypothetical results of control testing, and observations and recommendations.

Figure 2: Example of a Talent Acquisition Process Audit

Risk Category: Strategic	Risk: Reactive Hiring Strategy

Audit Process

Key Controls

- Adequate and timely budget creation, review, and approval process mandated by time limits in the budgeting policy.
- Hiring requests matched to budget information.
- Timely posting of positions.

Control Test Steps

- Review budgets and hiring plans for business lines and discuss the process to develop a plan with management.
- Ask management how they approach the recruiting and hiring process, specifically to determine at what point they determine additional resources are required. Verify management's comments with HR representatives.
- Review a sample of requests for resources communicated from management to HR. Determine the reasonableness of the time lag between this communication and posting a position.

Control Test Results

- Walk-through of budgeting process completed.
- Budget creation, review, and approval within the required time limits of the budgeting policy.
- Management reports they submit hiring requests within 10 days after budgets are approved, which is within the required time limits of the budgeting policy.
- Total hiring requests submitted for audit year: 100.
- Sample size: 20.
- Obtained evidence that all requests are submitted timely and matched budgetary expectations.
- Obtained evidence of posting for 20 sampled positions. Postings were available an average of 90 days after requests received.

Observations and Recommendations

Observations

- Requests are submitted to the business line HR director. Directors are taking an average of 60 days to review requests, approve them, and send them to the unit's HR representative for posting.
- By the time positions are posted, the business has lost 25% of the resources they budgeted for the year, negatively impacting production. HR directors report heavy workloads as the root cause of the delay between request and posting.

Recommendations

- Review resource levels, job descriptions, and organizational charts for HR department. Obtain benchmarking information for similar organizations. Analyze people, processes, and technology to determine whether additional resources are needed or process streamlining/reengineering is appropriate.
- See "Cultural Risk Factors" for further recommendations.

Once the work program is complete, internal auditors may identify risks, controls, observations, and recommendations that relate to the cultural risk factors. This analysis may lead to internal auditors completing additional procedures, root cause analysis, and, perhaps, additional observations and recommendations as shown in Figure 3.

Figure 3: Extended Recommendations for Cultural Risk Factors

Risk Category: Strategic	Risk: Reactive Hiring Strategy
Cultural Risk Factors	
Factors Present	
• Unreasonable expectations including deadlines, profitability, levels of efficiency, etc. • Employees lack knowledge of key risk management activities and potential risk impact. • Inflexible hierarchy impedes the flow of information up, down, and across the organization.	
Recommendations	
• Test whether business units are hiring temporary employees to fill gaps during the wait for hiring or are utilizing other less desirable methods to obtain their production goals. Methods could include: unapproved (or inadequately reviewed and approved) **outsourcing** to third parties, illegal labor, pushing junior personnel into positions they are not trained to execute. • Determine whether HR directors have a grasp of the nature and importance of the positions they are asked to fill. • Measure/monitor associated KRIs, such as injury-free days, production performance, overdue projects, reserve accounting results, vendor exception reports (accounts payable), denied purchase orders, etc.	

Additional procedures to integrate cultural risk factors into regular engagements for testing in this manner may include:

- Reviewing the results of employee surveys for the activity under review.
- Gathering documentation regarding ethics complaints, whistleblowing situations, or other incidents involving management as individuals or as a group for the activity under review.
- Gathering documentation illustrating management taking ownership of recommendations issued by the internal audit function and ensuring the associated action plans are completed in a timely way and with quality.

Recording observations regarding management's complete and timely participation in audit engagement interviews and/or document requests, etc.

2. Targeted Approach

A targeted engagement may consist of choosing a key process related to culture and building an engagement around the culture-related controls. Areas to cover under the targeted approach may include:

Tone at the Top

- Reviewing congruence between how executive management presents financial and performance results at regularly scheduled meetings (and/or analyst calls) and how those results are discussed internally with employees.
- Reviewing senior management's employee presentations to ensure slides on the organization's desired culture and "doing the right thing" are included.

- Reviewing the results of employee surveys paying particular attention to the questions related to ethical behavior, organizational culture, management expectations, tone at the top, and responses to open-ended questions.
- Reviewing comments obtained in recent exit interviews.

Accountability

- Examine performance review documents for assurance that disciplinary actions are invoked as outlined in the organization's code of conduct, employee manual, and/or compensation policy.
- Review complaint management processes and assess or determine:
    - How complaint information is gathered, stored, and reported, including those investigated, where action was taken, and complaints that are pending accompanied by their aging status.
    - Whether proper segregation of duties and access controls are in place and functioning.
    - The quality and timeliness of complaint information reported to management.
    - Whether complaint information results in organizational change.
- Review exception reports for applicable processes and/or controls to determine whether:
    - Management overrides of controls are recorded on exception reports.
    - Management overrides are consistently reviewed and approved by an independent party.
    - One unit has more management overrides than other similar units. If so, determine the cause.
- Review how many audit issues are open, past due, or reopened since the last engagement. If managers are closing audit issues or action plans to meet deadlines without fully resolving issues, that should be noted in terms of culture and conduct.

Ethics Programs and Code of Conduct

- Assess the process(es) used to develop and/or update the organization's ethics program and code of conduct including:
    - Subject matter coverage is reviewed and updated according to best practices.
    - Appropriate parties are included in the review process.
    - Input is obtained from the board and senior management.
    - Input from related committees (audit, ethics, risk, compensation, and others) is considered.
    - Audit committee review and approval is documented and validated.

- Review documentation demonstrating that ethics complaints, whistleblowing situations, or other incidents involving management as individuals or as a group are investigated and addressed promptly and in a manner consistent with the organization's ethics policies, escalation protocols, code of conduct, and others. Internal auditors should consider:
    - Whether there is any evidence that management or other employees retaliate against those who report issues.
    - Statistical trending of complaints, whistleblowing situations, or other incidents to determine the effectiveness of controls in place.
- Review rates of completion and pass rates for electronic training programs, including ethics, code of conduct, core values, and others.

Whistleblowing/Complaint Audit

The internal audit function's primary objective when assessing an organization's culture is to evaluate governance, how it manifests within the culture, and how employees conduct business and themselves. Questions to ask include:

- Are questionable issues reported?
- If issues are reported, is there a defined escalation protocol depending on the type of issue (ethics, sexual harassment, and others)?
- Are issues escalated according to an established protocol?
- Is there a "speak up" culture that makes employees comfortable escalating issues that may occur on any level of the organization?

At the conclusion of an audit engagement, the internal audit function is advised to praise positive conduct. "Considerations for Implementation" in Standard 11.3 Communicating Results states, "The chief audit executive should encourage internal auditors to acknowledge satisfactory and positive performance in engagement communications. Examples of good practices identified across engagements may be transferable to other parts of the organization or serve as a benchmark throughout the organization." For example, after a culture audit and obtaining permission from the parties involved, one bank chose to publish case studies of complaints that had positive outcomes. These were posted in elevators, break rooms, and other areas where employees gather to foster an atmosphere of transparency.

3. Top-down Approach

Performing a top-down approach to auditing culture may be a difficult task in most organizations due to the sensitivity of the topic and the difficulty of obtaining reliable information. However, there are internal audit functions that develop culture audit programs and cover the key aspects of their organizational culture, as shown in this case study:

A Case Study

One global bank chose to blend all three approaches to perform a comprehensive top-down assessment of its culture. The first step was to distribute questionnaires to assess the level of cooperation, openness, and ethical standards as perceived by employees at all levels of the organization. A quarterly snapshot of the state of the organization's culture was gleaned from the questionnaire results, which were then presented to management.

Subsequently, the internal audit function integrated information gathered from the questionnaires into engagements that were not culture-focused by including a statement regarding the same factors (cooperation, openness, and ethics) in every engagement. For planning purposes, internal auditors gathered all the questionnaires and snapshots completed within the last audit cycle and aggregated the responses. Responses were included in the top-down culture audit report.

At the senior management level, a Conduct and Values Committee assessed situations such as internal **fraud** risks, harassment claims, and more. This committee also examined risk management, compliance, compensation, and sales practices, and used metrics they evaluated monthly.

To compile their top-down culture audit report, the chief audit executive took the committee's information and integrated it with the questionnaire results and other culture-related audit activities.

In the end, the organization had a comprehensive view of its cultural risks and how the organization managed those risks. Data trends from these activities are now analyzed on an ongoing basis, enabling the organization to determine its success rate or failure to improve according to its own cultural metrics.

Additional Considerations

In testing culture risk management activities, chief audit executives should ask, "What is the objective of this control? Is it to investigate the incidents and find a solution, or is it to institute better controls to prevent the behavior?" The objective should be to institute better controls to prevent bad behavior.

Information and testing protocols regarding these culture risk management activities may not be obvious. The chief audit executive should ensure the auditors' workpapers include sufficient information to support the audit. Standard 12.3 states that, “The chief audit executive or an **engagement supervisor** must provide internal auditors with guidance throughout the engagement, verify work programs are complete, and confirm engagement workpapers adequately support findings, conclusions, and recommendations.”

Reporting

Standard 15.1 states that engagement results must be communicated. Standard 15.1 further states, “For each engagement, internal auditors must develop a final communication that includes the engagement’s objectives, scope, recommendations and/or action plans if applicable, and conclusions. Assurance engagement conclusions must include the internal auditors’ judgment regarding the effectiveness of the governance, risk management, and/or control processes of the **activity under review**, including an acknowledgment of when processes are effective.

Further, Standard 14.5 states, “Internal auditors must develop an engagement conclusion that summarizes the engagement results relative to the engagement objectives and management’s objectives. The engagement conclusion must summarize the internal auditors’ professional judgment about the overall significance of the aggregated engagement findings.” Additionally, sufficient documentation is required by Standard 14.6 Engagement Documentation.

Communicating Results of a Culture-focused Engagement

Aggregating results is challenging. How do you report results when it’s a more conceptual, less tangible engagement?

Internal auditors might conduct a session with the board to discuss culture-related observations once a year. This session could be an informal discussion, but chief audit executives should preview results with management before discussing them with the board.

Organizational culture is intangible, meaning it is not physical and can't be bought, sold, or touched. However, it's based on tangible things, such as artifacts and behaviors. Artifacts are visible and tangible elements of an organization's culture, like symbols, language, stories, rituals, architecture, communication style, rewards, physical layout of the workspace, and dress code. The chief audit executive should be free to communicate issues that may not rise to the level of a formal control deficiency/recommendation as well as recommendations that are formally written in a report.

Chief audit executives should be aware that the Global Internal Audit Standards do not require a specific reporting format. Not all internal audit reports must be written or include ratings. Alternatives to a traditional report may be considered specifically for issues of culture. Reporting on these issues may be sensitive, but the chief audit executive has a responsibility to openly communicate to the board and senior management.

Appendix A. Relevant IIA Standards and Guidance

The following IIA resources were referenced in this guide.

Standards
Standard 1.2 Organization's Ethical Expectations
Standard 2.1 Individual Objectivity
Standard 2.3 Disclosing Impairments to Objectivity
Standard 3.1 Competency
Standard 6.1 Internal Audit Mandate
Standard 9.1 Understanding Governance, Risk Management, and Control Processes
Standard 9.4 Internal Audit Plan
Standard 9.5 Coordination and Reliance
Standard 11.3 Communicating Results
Standard 12.3 Oversee and Improve Engagement Performance
Standard 13.2 Engagement Risk Assessment
Standard 13.3 Engagement Objectives and Scope
Standard 13.4 Evaluation Criteria
Standard 13.5 Engagement Resources
Standard 13.6 Work Program
Standard 14.1 Gathering Information for Analyses and Evaluation
Standard 14.2 Analyses and Potential Engagement Findings
Standard 14.3 Evaluation of Findings
Standard 14.4 Recommendations and Action Plans
Standard 14.5 Engagement Conclusions
Standard 14.6 Engagement Documentation
Standard 15.1 Final Engagement Communication
Global Guidance and Other IIA Resources
Practice Guide "Auditing Third-party Risk Management"
Practice Guide "Engagement Planning: Assessing Fraud Risks"
Practice Guide "Engagement Planning: Establishing Objectives and Scope"
The Institute of Internal Auditors: The IIA's Three Lines Model: An Update of the Three Lines of Defense

Appendix B. Glossary

Definitions are taken from the "Glossary" within The IIA's publication, *Global Internal Audit Standards, 2024 Edition*, unless otherwise noted.

activity under review – The subject of an internal audit engagement. Examples include an area, entity, operation, function, process, or system.

advisory services – Services through which internal auditors provide advice to an organization's stakeholders without providing assurance or taking on management responsibilities. The nature and scope of advisory services are subject to agreement with relevant stakeholders. Examples include advising on the design and implementation of new policies, processes, systems, and products; providing forensic services; providing training; and facilitating discussions about risks and controls. "Advisory services" are also known as "consulting services."

assurance – Statement intended to increase the level of stakeholders' confidence about an organization's governance, risk management, and control processes over an issue, condition, subject matter, or activity under review when compared to established criteria.

assurance services – Services through which internal auditors perform objective assessments to provide assurance. Examples of assurance services include compliance, financial, operational/performance, and technology engagements. Internal auditors may provide limited or reasonable assurance, depending on the nature, timing, and extent of procedures performed.

board – Highest-level body charged with governance, such as:

- A board of directors.
- An audit committee.
- A board of governors or trustees.
- A group of elected officials or political appointees.
- Another body that has authority over the relevant governance functions.

In an organization that has more than one governing body, "board" refers to the body/bodies authorized to provide the internal audit function with the appropriate authority, role, and responsibilities.

If none of the above exist, "board" should be read as referring to the group or person that acts as the organization's highest-level governing body. Examples include the head of the organization and senior management.

chief audit executive – The leadership role responsible for effectively managing all aspects of the internal audit function and ensuring the quality performance of internal audit services in accordance with Global Internal Audit Standards. The specific job title and/or responsibilities may vary across organizations.

competency – Knowledge, skills, and abilities.

compliance – Adherence to laws, regulations, contracts, policies, procedures, and other requirements.

control – Any action taken by management, the board, and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved.

control processes – The policies, procedures, and activities designed and operated to manage risks to be within the level of an organization's risk tolerance.

criteria – In an engagement, specifications of the desired state of the activity under review (also called "evaluation criteria").

engagement – A specific internal audit assignment or project that includes multiple tasks or activities designed to accomplish a specific set of related objectives. See also "assurance services" and "advisory services."

engagement conclusion – Internal auditors' professional judgment about engagement findings when viewed collectively. The engagement conclusion should indicate satisfactory or unsatisfactory performance.

engagement objectives – Statements that articulate the purpose of an engagement and describe the specific goals to be achieved.

engagement results – The findings and conclusion of an engagement. Engagement results may also include recommendations and/or agreed upon action plans.

engagement supervisor – An internal auditor responsible for supervising an internal audit engagement, which may include training and assisting internal auditors as well as reviewing and approving the engagement work program, workpapers, final communication, and performance. The chief audit executive may be the engagement supervisor or may delegate such responsibilities.

engagement work program – A document that identifies the tasks to be performed to achieve the engagement objectives, the methodology and tools necessary, and the internal auditors assigned to perform the tasks. The work program is based on information obtained during engagement planning.

external service provider – Resources from outside the organization that provides relevant knowledge, skills, experience, and/or tools to support internal audit services.

finding – In an engagement, the determination that a gap exists between the evaluation criteria and the condition of the activity under review. Other terms, such as "observations" may be used.

fraud – Any intentional act characterized by deceit, concealment, dishonesty, misappropriation of assets or information, forgery, or violation of trust perpetrated by individuals or organizations to secure unjust or illegal personal or business advantage.

governance – The combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives.

impact – The result or effect of an event. The event may have a positive or negative effect on the entity's strategy or business objectives.

independence – The freedom from conditions that may impair the ability of the internal audit function to carry out internal audit responsibilities in an unbiased manner.

internal audit function – A professional individual or group responsible for providing an organization with assurance and advisory services.

internal audit plan – A document, developed by the chief audit executive, that identifies the engagements and other internal audit services anticipated to be provided during a given period. The plan should be risk-based and dynamic, reflecting timely adjustments in response to changes affecting the organization.

internal auditing – An independent, objective assurance and advisory service designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes.

integrity – Behavior characterized by adherence to moral and ethical principles, including demonstrating honesty and the professional courage to act based on relevant facts.

likelihood – The probability that a given event will occur.

objectivity – An unbiased mental attitude that allows internal auditors to make professional judgments, fulfill their responsibilities, and achieve the Purpose of Internal Auditing without compromise.

periodically – At regularly occurring intervals, depending on the needs of the organization, including the internal audit function.

risk – The positive or negative effect of uncertainty on objectives.

risk and control matrix – A tool that facilitates the performance of internal auditing. It typically links business objectives, risks, control processes, and key information to support the internal audit process.

risk appetite – The types and amount of risk that an organization is willing to accept in the pursuit of its strategies and objectives.

risk assessment – The identification and analysis of risks relevant to the achievement of an organization's objectives. The significance of risks is typically assessed in terms of impact and likelihood.

risk management – A process to identify, assess, manage, and control potential events or situations to provide reasonable assurance regarding the achievement of the organization's objectives.

root cause – Core issue or underlying reason for the difference between the criteria and the condition of an activity under review.

senior management – The highest level of executive management of an organization that is ultimately accountable to the board for executing the organization's strategic decisions, typically a group of persons that includes the chief executive officer or head of the organization.

significance – The relative importance of a matter within the context in which it is being considered, including quantitative and qualitative factors, such as magnitude, nature, relevance, and impact. Professional judgment assists internal auditors when evaluating the significance of matters within the context of the relevant objectives.

stakeholder – A party with a direct or indirect interest in an organization's activities and outcomes. Stakeholders may include the board, management, employees, customers, vendors, shareholders, regulatory agencies, financial institutions, external auditors, the public, and others.

subculture – An ethnic, regional, economic, or social group exhibiting characteristic patterns of behavior sufficient to distinguish it from others within an embracing culture or society.[4]

workpapers – Documentation of the internal audit work done when planning and performing engagements. The documentation provides the supporting information for engagement findings and conclusions.

4. Merriam-Webster.com, accessed July 11, 2024.

Appendix C. Sample Culture Monitoring and Reporting Formats

Advisory Service Provider (Europe) – Culture Risk Monitoring and Reporting

A European provider of professional services developed a plan, which is revised and documented annually, to communicate business plan objectives to its employees. All employees have access to this plan on the company's intranet.

The plan lists each business objective and notes the corresponding communication objectives as shown in this excerpt.

Business Plan Objectives

- Continuously improve the quality and productivity of the service we provide.

Communication Objectives

- Ensure partners, clients, employees, and other stakeholders, such as directors and members, know and understand the expected service standards and the actual standards provided/received.
- Ensure partners, clients, employees, and other stakeholders, such as directors and members, have a means to communicate their expectations for service delivery standards.
- Ensure partners, clients, employees and other stakeholders, such as directors and members, have a means to give and/or receive feedback on whether the service delivery met their expectations .

This plan also identifies the different audiences for this communication including but not limited to employees, board of directors, partners, and clients. It further identifies which communication methods are most effective for each of those audiences individually. Some of the methods are noted in the following excerpt:

- Face to face (informal, or formal meetings and presentations).
- Telephone.
- Email.
- Social media.
- Website.
- Intranet.

Frequency of communications is described in the plan. All information is reflected in an additional document that lists processes the company has established to ensure its communication objectives are embedded within the organization as shown in the following excerpt:

Communication Process	Communication Objectives
Policies and procedures, guides, and manuals updated annually and available on the intranet for employees. Key messages posted for significant changes.	Ensure all partners, clients, and employees know and understand what standards of service are expected to deliver services as well as the actual standards they are providing/receiving. Ensure all partners, clients, and employees know and understand what we mean by sustainable. Ensure all employees know what working environment to expect.

Further, this communication plan extends to a manual for employees instructing them on how they are expected to communicate with each other and with the other audiences. For example, employees are coached to “respect each other’s opinions” and to “rely on each other to act as critical friends.”

The internal audit function can use policies and procedures such as this in an work program designed to assess the effectiveness of management’s plans for communicating the company’s core values.

Example: A Global Financial Technology Company on Risk Appetite

A financial technology company focused on digital platforms to facilitate multi-asset market access for traders and other investors has a rigorous culture assessment embedded into its operational risk management processes. This company measures any breaches of its risk appetite parameters and has a system to facilitate reporting on the remediation status of internal audit or risk management’s findings regarding these breaches.

A quarterly report on risk appetite breach indicators regarding culture is generated, and an excerpt is featured below.

These reports are used by various departments in the organization, including the internal audit function, on a quarterly basis to monitor key risk indicators related to culture. These reports are also produced as part of the escalation protocol should a breach occur that exceeds certain parameters.

Risk Category: Risk Culture

Risk Appetite Statement

- This department has no appetite for violation of the company's code of conduct, policies, and procedures.
- This department has a low appetite for high priority audit recommendations that are overdue.

Breach Indicators	Source	Status
Risk Appetite: Number of large events caused by failure to follow the code of conduct.	Operational Risk	
Training: Percentage of employees who have not completed mandatory ethics and compliance training.	Compliance	
Communication: Percentage of critical business activities where documentation has not been updated and approved according to policy.	Operational Risk	
Audit: Number of high priority audit recommendations more than 30 days overdue.	Internal Audit	
Number of violations resulting in disciplinary action.	Human Resources	1

Appendix D. References and Additional Reading

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The Institute of Internal Auditors

Global Headquarters
The Institute of Internal Auditors
1035 Greenwood Blvd., Suite 401
Lake Mary, FL 32746, USA
Phone: +1-407-937-1111
Fax: +1-407-937-1101