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Providing senior management, boards of directors, and audit committees with concise information on governance-related topics.

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Auditing Culture

An organization's culture is pivotal to how it conducts its business and carries out its strategies. "Culture has evolved from a somewhat nebulous topic to one that is considered a central component of risk management and business success," according to a speech by James Hennessy, head of the Governance and Culture Reform Initiative at the Federal Reserve Bank of New York.

During the last decade, internal audit teams have increasingly implemented culture audits to determine how their organizations' cultures are defined, how they work in practice, and what impact they have on the business, for better or worse. These independent audits can provide boards with an objective analysis of problem areas and best practices. Here's a look at what boards need to know about auditing culture.

Key Culture Considerations

The benefits of a strong culture include:

- Improved performance and productivity driven by highly engaged employees.
- More effective communication and collaboration around strategic goals and values.
- A strong recruiting position and enhanced retention.
- A positive reputation for the organization.
- More adaptability due to greater clarity about the organization's mission, expectations, and practices.

Getting the most from culture audits requires understanding what makes culture considerations unique.

- Culture and conduct are elements of the control environment. A toxic culture can undermine other controls and expose the company to unnecessary risk.
- Because it is so multifaceted, culture can be hard to define, but The IIA practice guide, Auditing Culture, offers this definition: "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."
- Every organization has a culture, no matter whether leadership has intentionally created and nurtured one or not. If the organization isn't proactive in shaping, monitoring, and correcting its culture, it will have to wrestle with a culture that grows by default.
- An organization may have many subcultures within different departments, campuses, or geographies. Each one may be a positive or negative reflection of that function's work environment or ethical practices and attitudes.
- Culture is not static, but may adjust regularly to new conditions, practices, and attitudes. As a result, regular assessments are necessary.

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Risk Factors to Watch

Getting culture right can require a delicate balance. "An open culture that lacks proper governance could lead to malpractices, costly penalties, and reputational damage," according to "Corporate Governance and Culture" from the Corporate Governance Institute. "Yet, rigid governance could result in workplace dissatisfaction, employee complaints of micromanagement, and turnover."

Breakdowns in culture can result in compliance failures, fraud, and other illegal activities. According to The IIA, cultural risk factors can include:

- Unreasonable expectations about deadlines, profitability, or levels of efficiency.
- Failure to use incentives, such as compensation, promotions, and other strategies, to support core values.
- Employees' lack of knowledge of key risk management activities and potential risk impacts.
- An inflexible hierarchy that doesn't allow information to flow up, down, and across the organization.
- A misunderstanding of how controls help the organization achieve its objectives. Mistrust of auditors and their feedback is a related risk concern.
- Hubris, or the belief that the organization is immune from culture-related risks.
- Lack of accountability, especially at senior levels of the organization, for upholding culture and core values.
- Failure to enforce codes of conduct and related policies and procedures.
- Failure to promote a speak-up culture or to take whistleblower complaints seriously.
- Refusal by management or the board to accept information that contradicts their opinions.
- Disregard of laws and regulations that can prevent the organization from achieving its objectives.

Evaluating Culture

Culture is intangible and can't be evaluated using traditional financial measures, but it is still possible —and important — to take its measure. In his speech, Hennessy asserted that culture measurement and assessment play a vital role in driving change. Emerging technologies, such as natural language processing (NLP) and network analysis, make it possible to gather information from new sources and can offer real-time feedback and trend analysis about an organization's culture.

NLP, for example, "can be used to gauge employee sentiment following training sessions to identify areas of opportunity for improvement," according to "Using Natural Language Processing for Sentiment Analysis" from the Society for Human Resource Management. "During the talent acquisition process, it can be used to identify potential 'red flag' issues in applicant materials. From an employee engagement standpoint, it can be used to assess employee buy-in on topics related to company culture and strategy."

Mapping patterns of collaboration in a network analysis can identify silos within the organization and determine which employees are opinion leaders and which are on the periphery, and who is well-suited to connect people and drive acceptance of organizational values, according to "Use Networks to Drive Culture Change" in the MIT Sloan Management Review. "Once leaders know all that, they can pursue cultural change in a more targeted manner," the article adds.

Technology advancements improve on previous methods of taking occasional snapshots of culture that may be misleading, Hennessy said in his presentation. At the same time, qualitative evidence, including anecdotes, focus groups, interviews, and other people-focused techniques, offer perspectives that go beyond the numbers.

About The IIA

The Institute of Internal Auditors (IIA) is a nonprofit international professional association that serves more than 245,000 global members and has awarded more than 200,000 Certified Internal Auditor (CIA) certifications worldwide. Established in 1941, The IIA is recognized throughout the world as the internal audit profession's leader in standards, certifications, education, research, and technical guidance. For more information, visit theiia.org.

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1035 Greenwood Blvd.
Suite 401
Lake Mary, FL 32746 USA

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Internal Audit's Approach

Internal auditors use a variety of indicators to measure and assess culture, many of which are already available. For example, they may consider people management data, such as employee turnover, exit interview data, grievances raised by employees, ethics hotline information, and absence data, as well as details on customer complaints. If the organization does not have this information available, internal audit can determine what data would be of value and where the gaps in data collection occur, according to "Conducting a Cultural Audit: Concluding the Analysis," from Wolters Kluwer.

Internal auditors in some industries or jurisdictions may be required to assess and report on specific aspects of the organization's culture and the effectiveness of conduct risk management efforts. However, even without a regulatory mandate, internal auditors can add value through an unbiased evaluation of culture and its impact.

According to The IIA, culture audits can encompass:

- Spotting the root causes for identified deficiencies and best practices in culture.
- Assessing the governance structure (roles and responsibilities) related to culture and conduct.
- Evaluating the effectiveness of efforts to communicate values, strategies, and objectives and of training on the code of conduct, ethics, and related concerns.
- Assessing the effectiveness of employee incentive and hiring programs, disciplinary actions and escalation protocols, treatment of whistleblowers, and other key performance indicators relevant to the organization's culture.
- Analyzing information related to culture gathered for other purposes, such as analyzing and trending employee survey data.

In addition to gathering and analyzing this data, internal audit also can provide comprehensive advice on how to address risk areas and promote successful efforts to address culture concerns.

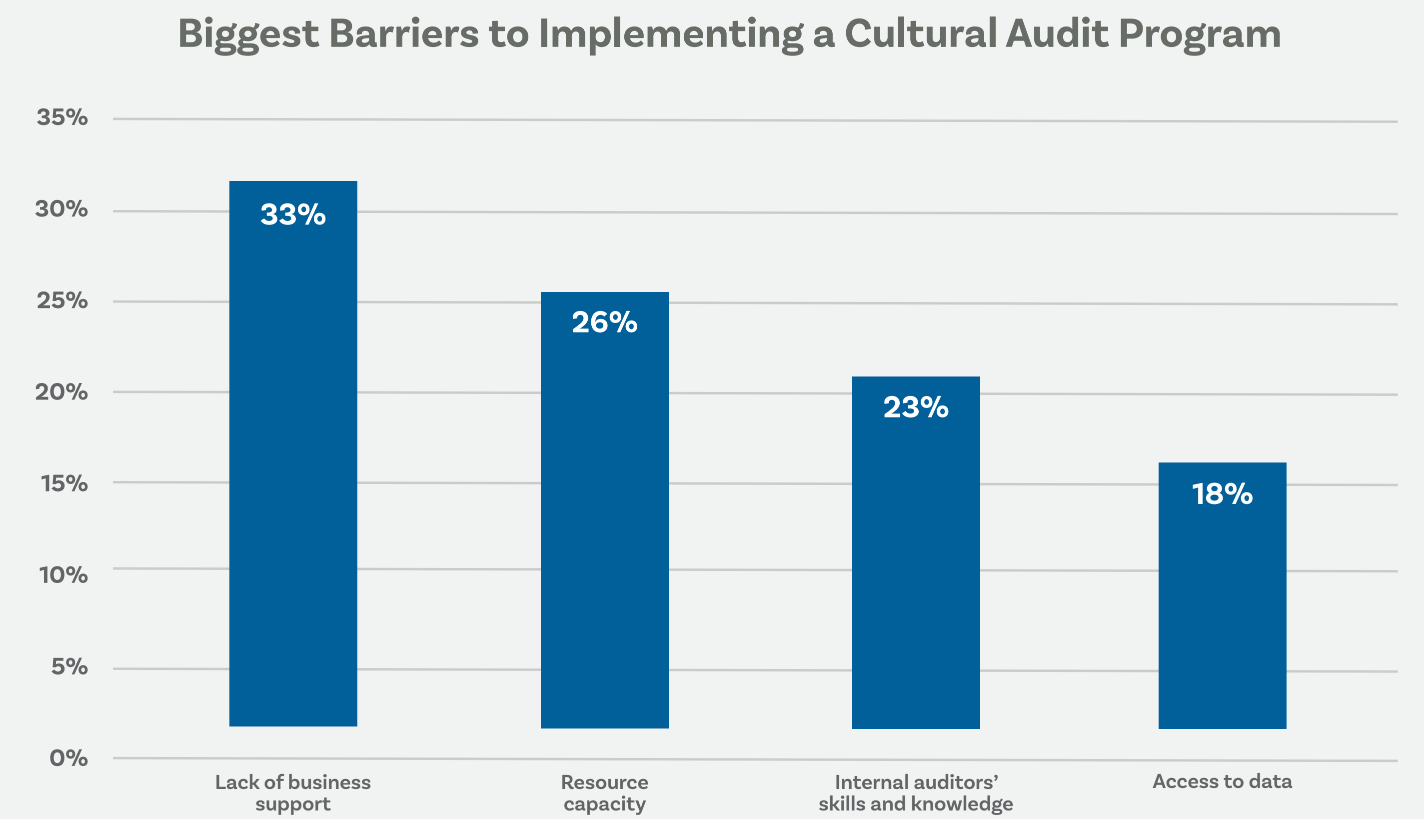
Culture and the Board

One of the culture characteristics shared by healthy organizations is a positive tone at the top, in which executive management and the board collaborate to define the company's values and intentionally model and promote them. Appropriate tone at the top and culture are particularly important "in a complex business environment, as companies move quickly to innovate and capitalize on opportunities in new markets, leverage new technologies and data, and engage with more vendors and third parties across complex supply chains," according to "The 2024 Audit Committee Agenda and the Questions Investors Should Be Asking" in the Harvard Law School Forum on Corporate Governance. In its Blue Ribbon Commission report, Culture as the Foundation: Building a High-Performance Board, the NACD recommends assessing current board culture and defining its optimal state.

Management, as well, should promote communications that support company values and encourage open dialogue. Recommended communication channels include programs that collect employee suggestions and questions, ethics hotlines, open-door policies, and employee events and meetings, according to The IIA. Management should aim for robust employee engagement in which workers, where feasible, are engaged in setting objectives and weighing in on strategy.

Investing in Culture

What prevents companies from benefiting from robust culture audits? In "Conducting a Cultural Audit: Concluding the Analysis," internal audit leaders cite insufficient support and resources from the business (see chart). They also point to limitations in internal auditors' skills, something that could be addressed with further training. Lack of access to the right data is another hurdle. Boards can promote the use of culture audits to ensure the information they are receiving is thorough and timely and that internal audit is called upon to provide valuable insights on culture data.



Source: "Conducting a Cultural Audit: Concluding the Analysis," Wolters Kluwer

QUESTIONS FOR BOARD MEMBERS

- How is the board or its committees involved in governance of culture?
- Does the board share a consistent understanding of the organization's culture?
- Is the culture, and understanding of it, consistent across the organization?
- Does the organization perform culture audits? If not, does the board receive information on issues related to culture, such as turnover figures, whistleblower complaints, investigations, ethics training, etc.?
- What are some of the critical strengths and weaknesses in the organization's culture?

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