Auditing Culture: Challenges and Proven Techniques

IIA SuperConference at UTD
March 23, 2018
The connection between fraud and culture

Fraud
1. Wrongful or criminal deception intended to result in financial or personal gain.
2. A person or thing intended to deceive others, typically by unjustifiably claiming or being credited with accomplishments or qualities.

All three conditions must be present for fraud to occur

Rationalization
Rationale made by employees to commit fraud, such as lacking awareness of wrongdoing, low temptation threshold and self denial of consequences to company.

Motive
What drives employees or management to commit fraud, such as greed, pressure or recognition.

Opportunity
Culture or environment that enables fraud to occur, such as complex organizations or transactions that can be used to hide fraud and lack of strong controls or values to prevent it.
**US regulatory focus on conduct and culture**

“The banking community as a needs to repair the damage done by failures in culture, values, and behaviors, and should tackle the challenge with renewed vigour and purpose to achieve tangible outcomes in outcomes and reputation”.

**Banking Conduct and Culture, A Call for Sustained and Comprehensive Reform, G30, July 2015**

“This workshop focused on reforming culture and behavior in the financial services industry. Topics of discussion included the roles that size, complexity, and incentives play in promoting certain behaviors and, collectively, how these factors may affect firm-specific and industry-wide culture. It also examined industry-driven and government solutions, with a focus on reinforcing expectations for behavior and overcoming collective action issues.”

**Workshop on Reforming Culture and Behavior in the Financial Services Industry, FED, Nov 2015**

“Boards and senior management have the prime responsibility for establishing the right organizational culture by promoting their ethics and values and the behaviors these require across their organizations.

**Audit Committee Briefing, CIIA, 2014**

Internal audit can be a key player in giving assurance and confidence to boards as organizations come under increasing pressure to demonstrate their commitment to improving standards of behavior.”

Efforts should be made by financial institutions and by supervisors to understand an institution’s culture and how it affects safety and soundness. Supervisors are focussing on the institutions norms, attitudes and behaviors related to risk awareness, risk taking and risk management, or the institutions risk culture

**A Framework for Assessing Risk Culture, FSB, 2014**
Creating a strong culture
Alignment of behavior is key

We consider three elements of culture. Organizations who forge winning cultures are those who have an aspirational culture which is clear and supported by all employees. Further, that this aspiration is expressed throughout all organizational actions, policies and processes – that expected behaviors are reinforced. Finally, we consider the culture and behaviors as actually manifested in the organization.

**Level 1 - Aspirational Culture**
What we want – purpose, vision, values and behaviors (PVVB)

**Level 2 - Expressed Culture**
How we set ourselves up – using behavioral reinforcers.
(See next slide)

**Level 3 - Actual Culture**
What we get – The behavior displayed by employees, driven by the reinforcers but also intrinsic motivation and personal alignment to PVVB
**Reinforcing behaviors**

Culture is pervasive and is driven by many formal and informal mechanisms. Below we have outlined a number of behavioral reinforcers which we may focus on in assessments, we work with organizations to determine the ones that are most important to them.

<table>
<thead>
<tr>
<th>Leadership</th>
<th>Communications</th>
<th>People practices</th>
<th>Reward and recognition</th>
<th>Organization structure</th>
<th>External environment</th>
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<tr>
<td>Strategic alignment to customer agenda</td>
<td>Two way dialogue and communications</td>
<td>Recruitment and on-boarding</td>
<td>Balanced scorecard - customer focus</td>
<td>Team interaction e.g. Compliance/Customer</td>
<td>Regulatory compliance and relationships</td>
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<tr>
<td>Leadership tone on customer</td>
<td>Cultural symbols and stories on customers</td>
<td>Learning, experiences and customer training</td>
<td>Recognition for good customer behaviors</td>
<td>Key customer policies and standards</td>
<td>Customer experience - key touch points</td>
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<td>Role Modelling of customer behavior</td>
<td>Employee feedback mechanisms</td>
<td>Knowledge sharing and collaboration</td>
<td>Customer objectives and touchpoints</td>
<td>Governance &amp; decision frameworks</td>
<td>Wider society and perception</td>
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<tr>
<td>Visibility</td>
<td>Escalation / resolution channels</td>
<td>Diversity and inclusion</td>
<td>Calibration</td>
<td>Organizational design</td>
<td>Charity work</td>
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<td>Competence and capability</td>
<td>Volume and frequency</td>
<td>Succession planning</td>
<td>Behavioural measures</td>
<td>Risk Management and Lines of defense</td>
<td>Third party vendors and service providers</td>
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<td>Leadership development</td>
<td>Strategy and planning</td>
<td>Wellbeing and resilience</td>
<td>Performance framework</td>
<td>Business ethics</td>
<td>Reporting and disclosures</td>
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<tr>
<td>Consistency</td>
<td>Variety of channels</td>
<td>Talent programs</td>
<td>Calibrations</td>
<td>Virtual teams</td>
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<tr>
<td>Recognizing aligned behaviors</td>
<td>Common language</td>
<td>Career development and promotions</td>
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<td>Control environment</td>
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</table>

Cultural symbols and stories on customers:
- Leadership tone on customer
- Role Modelling of customer behavior
- Visibility
- Competence and capability
- Leadership development
- Consistency
- Recognizing aligned behaviors

Two way dialogue and communications:
- Strategic alignment to customer agenda
- Leadership tone on customer
- Role Modelling of customer behavior
- Visibility
- Competence and capability
- Leadership development
- Consistency
- Recognizing aligned behaviors

Recruitment and on-boarding:
- Balanced scorecard - customer focus
- Recognition for good customer behaviors
- Customer objectives and touchpoints
- Calibration
- Behavioural measures
- Performance framework

Learning, experiences and customer training:
- Knowledge sharing and collaboration
- Diversity and inclusion
- Succession planning
- Wellbeing and resilience
- Talent programs
- Career development and promotions

Recognition for good customer behaviors:
- Recognition for good customer behaviors
- Customer objectives and touchpoints
- Calibration
- Behavioural measures
- Performance framework

Customer objectives and touchpoints:
- Calibration
- Behavioural measures
- Performance framework

Calibrations:
- Behavioural measures
- Performance framework

Behavioural measures:
- Performance framework

Performance framework:
- Calibration
- Behavioural measures
- Performance framework

Examples of cultural symbols and stories on customers:
- Leadership tone on customer
- Role Modelling of customer behavior
- Visibility
- Competence and capability
- Leadership development
- Consistency
- Recognizing aligned behaviors

Examples of two way dialogue and communications:
- Strategy and planning
- Variety of channels
- Common language

Examples of recruitment and on-boarding:
- Strategic alignment to customer agenda
- Leadership tone on customer
- Role Modelling of customer behavior
- Visibility
- Competence and capability
- Leadership development
- Consistency
- Recognizing aligned behaviors
Auditing culture – success factors

• Organizational culture needs to have been analyzed, properly defined and disseminated by the board/ senior management i.e. what is required behavior in the organization has been made explicit.
• Appetite from the top of the organization.
• Internal audit being given a clear mandate.
• Writing the mandate into the audit charter.
• A relationship of trust between the audit committee chair and the HIA that allows informal discussion about subjective judgements (gut feel) on culture.
• Position, treatment and regard for internal audit, and non-adversarial relationships with their clients.
• The ability for clients to report or respond to surveys confidentially.
• A good level of risk maturity in the organization.

From “Culture and the Role of Internal Audit: Looking Below the Surface”
Organizational culture principles

Our experience in helping organizations define and assess their cultures led to the development of a number of key principles. We believe that following these principles will put organization’s in a strong position to develop a culture and conduct framework which is representative of the organization and its people.

Defining your aspirational culture

1. **Clearly tie to your purpose, strategy and business objectives**
   - Culture is a key driver of performance, conduct and sustainable growth. In order to effectively drive this it is important to clearly articulate how your aspirational culture links to and drives your strategy and business objectives.

2. **Top down and grass roots approach**
   - The tone on culture needs to be set and role modelled by leaders, but it is equally important to engage and gain buy in from people at all levels of your organization to gather feedback and collaboratively define what your aspirational culture means to them.

3. **Focus on the critical few**
   - Identify and focus on the critical few behaviors that are most impactful to your business and align them to the conduct framework. Focussing on too many behaviours or initiatives will dilute impact and interest.

Assessing your current culture

1. **Build a tailored framework**
   - Culture can be approached from a number of angles, being inherently tied to every decision and action in an organization. Our approach tailors an assessment framework to fit the values or behaviors which are most important to the organization.

2. **Employ a multi-faceted approach to assessment evidence**
   - We deploy a variety of techniques for gathering quantitative and qualitative evidence. Pulling these evidence points together allows us to arrive at concrete conclusions with a holistic view of both root cause and potential recommendations.

3. **Independently assess**
   - Those within an organization will inherently be influenced by, and contribute to, the culture itself. Getting an independent perspective can help to ensure an un-biased view when assessing the current state of organizational culture.
# Key techniques we use

A mixture of quantitative and qualitative evidence is used. The following techniques can be employed:

<table>
<thead>
<tr>
<th>Desktop reviews</th>
<th>Walkthrough</th>
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<td>Interviews and focus groups</td>
<td>Observations</td>
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<td>KPIs and data</td>
<td>Inspection</td>
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<td>Surveys</td>
<td>Psychometric testing and other tools</td>
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What are the moments that matter?
Understanding where to look

It is impossible to examine all behaviors at all times. You need to have a focus.

This can be achieved by looking at the *moments that matter* – explicit interactions and decision points where behaviors have a disproportionate effect on outcomes.

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<tr>
<th>Escalation of issues</th>
<th>Supplier interactions</th>
<th>Board and committee meetings</th>
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<td>‘raising your hand’</td>
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<th>Reputational incident</th>
<th>Promotions selection and moderation</th>
<th>Recruitment of key staff</th>
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<th>Induction and education</th>
<th>Performance management checkpoint</th>
<th>Personal safety routine</th>
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A strategic framework for the internal audit of conduct and culture

Developing a strategic cultural framework for the Internal Audit allows the function to consider culture in every audit to give breadth and discrete reviews to give depth across the organization.

Enterprise Ethics and Compliance
Review of consideration of business strategy and linkage to ethics and compliance policy, process, training and reinforcement.

Annual Consolidation Review
Annual consolidation of emerging cultural themes and findings from culture assessment ratings across internal audit reviews and discrete culture reviews to give a view on culture and behaviors across the organization.

Discrete Business As Usual Reviews – Sub-division, Division and Group
Discrete business as usual reviews included in the audit plan to assess culture and behaviors in each sub-division and division as well as Group.

Culture Change program Review
Reviews may also consider the effectiveness of culture change programs as appropriate.

Culture Assessment
On every internal audit, a high level culture assessment is made this may include measures such as the source and severity of issues raised, attrition, turnover of leadership. This could lead to a deeper assessment in this specific area. These ratings will be consolidated to create a divisional culture assessment with the discrete review.
**Approaches to conduct and culture in Internal Audit**

Approaches in the marketplace are evolving. Increasingly a consolidation of approaches are being used to ensure that breadth and depth of coverage is achieved across the organization.

### Component Review

Consideration of culture and behaviors built into each internal audit review as appropriate.

**Types:**
- Dual Ratings
- Analysis on where issues were raised
- Additional culture metrics/questions

### Discrete Review

An Internal Audit assessment with a specific remit of culture and behaviors, scoped according to appetite.

**Types:**
- Group level review to understand culture framework
- Divisional/specific department review
- Culture program

### Consolidation Review

An Internal Audit assessment that consolidates component and discrete reviews to provide an organization-wide view.

**Types:**
- Integrated into annual risk management framework review
- Stand alone culture report

**Considerations:**
- Outcomes-focused
- Quick
- Lacks richness
- May need enterprise issues management system/ link to HR data

**Considerations:**
- Gives depth in a specific area
- Lacks breadth
- Need up- skilling
- Time and resources

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Assessing organizational ethics and compliance

Business strategy
Understand the approach and tenor the organization takes to align and manage ethics risk lies with its business strategy. This includes profiling its actual risks, comparing it to its target risk profile and determining strategies to manage and mitigate risk, including how capital is managed and allocated. In order for these strategic components to be effective they need to be operationalized through governance frameworks, with key risk indicators and monitoring processes established.

Business management
Ethics risk management is owned by the business and should be integrated in the business processes and culture. This includes documenting foundational expectations and processes, providing instruction and guidance on the job requirements. In order for business management to be effective, we check for established mechanisms to publish process documentation, communicate expectations and exchange information (including questions or potential issues).

Business performance
Measurement of operational and programmatic performance is essential to determining the effectiveness of ethics risk management processes and identifying potential blind spots in oversight or management. This includes retrospective reviews of operational execution, organizational responses to ethical breaches and feedback to personnel and third parties.
**COSO ERM – Focus on culture**

Culture forms an integral part of ERM and is instrumental in influencing how people make decisions on managing risk.

Culture is becoming **more focused on decision-making** and the alignment to expected behaviors in line with the core values of the organization.

The importance of aligning the core values and risk **appetite** of the organization to promote consistent and risk-based decision making.

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**Considerations in getting started**

- Articulate both the desired and actual risk culture
- Consider where you have a healthy, natural tension that balances out the culture and where there may be an unhealthy, dominant culture in place
COSO ERM – Risk appetite

• Risk appetite for many organizations is a challenge, and for some is simply “shunned” as part of ERM
• In practice, and when done well, it provides significant advantage in harmonizing decisions across the entity
• The relationship between appetite, tolerance, indicators and triggers

**Considerations in getting started**

• Discuss whether an evaluative or decision-making approach best fits your organization needs
• Communicate risk appetite using business language, not risk-centric language
• Consider risk appetite in the context of risk profiles and portfolio view

**Appetite**

- Applies through development of strategy and setting of objectives
- Focuses on overall goals of the business (objective-centric)
- Aids in decision-making and evaluation at the portfolio
- Ties strategy to measures

**Tolerance**

- Applies in the implementation of strategy
- Focuses on objectives and variation from plan (objective-centric)
- Aids in decision-making and in evaluation
- Ties strategy to measures

**Indicators and triggers**

- Applies at any level of the business
- Considers specific risks, usually in isolation (risk-centric)
- Ties risks to measures (e.g., key indicators)
Internal auditors turn focus to organizational culture

Global Perspectives and Insights: Auditing Culture A Hard Look at the Soft Stuff

Auditing the Organizational Culture: A New Frontier for Internal Audit

Culture and the Role of Internal Audit: Looking Below the Surface
Questions
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