Audit
Organizational culture
IF company boards are in any doubt about the importance of an organization’s culture on their profits and reputation, they should consider the lasting damage the Libor scandal, exposed in 2012, inflicted on the British bank, Barclays. At the time the “entitlement” culture at the bank was such that the bank’s then chief executive officer, Antony Jenkins, said that reading the review, led by Anthony Salz, a corporate lawyer and investment banker, into the culture and ethics at Barclays made for great discomfort. But it is likely any chief executive would also shudder at the findings.

In his report, Salz said Barclays became dominated by an entitlement culture, particularly in the investment banking division, which in turn encouraged an overemphasis on short-term financial performance rewarded by a bonus culture.

In the wake of market abuses like the rate rigging scandal and rogue traders at Societe Generale and UBS, public and regulatory scrutiny of ethics and behaviour has moved up the agenda. Regulators in the United States, Europe and Asia are increasingly asking boards for hard evidence to prove that organizational culture and behaviours are ethically robust.

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In response, boards have been engaging the services of auditors – both internal and external – to carry out so-called culture audits. It is still too early to say that such audits are becoming a firm trend, but more and more boards are seeing their benefits. While certain sectors like financial services are facing strict demands from regulators to show hard facts on culture, other companies are starting to realize the benefits of clear management of corporate culture.

**Espousing values, embedding ethics**

Many organizations have a framed set of well-articulated values, typically in pride of place in the office’s reception area. But as regulators point out, it is not just about companies espousing values, but how those ethics are embedded into everyday business practices, and then further hardwired into a company’s underlying systems and processes.

Evidence of the worrying disconnect can be found in a recent study by the United Kingdom’s Chartered Institute of Internal Auditors. The IIA research discovered that almost a third of boards have not established or articulated what sort of corporate culture they want. Just over a third have examined how staff behaviour illustrates these values. Last December the global IIA issued a paper “Auditing Culture – A Hard Look at the Soft Stuff” in which it offered some guidance on how to approach an audit of culture.

The Institute of Internal Auditors Hong Kong has also stepped up its focus on culture.
“Culture is often ignored by auditors because it is one of those soft skills which is thought to be just too difficult, especially as it changes with different societies, within society’s many sub-groups and indeed over time. However, understanding cultural impacts is to understand the foundations for effective governance within organizations,” says Stephen Lee, IIA Hong Kong President.

Certain sectors are more active than others when it comes to analyzing organizational culture. “What I have seen – mainly at banks and financial institutions – is that there are seldom independent culture audits but there is a trend of explicit assessment of culture in other audits,” says Paul McSheaffrey, Partner and Head of Internal Audit and Risk Compliance Services, Hong Kong at KPMG China.

**Differing methodologies**

Given that auditing culture is a new and emerging concept, methodologies differ. Despite its lack of scientific basis – something auditors are more used to – the need for boards to understand the impact of a company’s culture is vital to ensure their companies are sustainable and trustworthy, especially if markets are to avoid future abuses.

As experts in risk assessment, internal auditors are seen as the most qualified professionals to conduct an audit of culture. Not only are internal auditors the “insiders” and experience company culture first-hand, they have the skills to provide evaluation and assurance to boards if measures that have been put in place to change culture and behaviour actually work, and if the tone at the top is reflected at all levels. Ian Peters, Chief Executive of the U.K. IIA, puts it well: “Auditing culture is not an exact science. Many organizations struggle to define their culture, let alone incorporate it effectively into their risk evaluation and assurance processes. But it is essential that they do so.”

Given that culture is a nebulous concept and there are hundreds of companies with varying cultures, the task for auditors would be complex. But regulators and auditors are defining key indicators of culture and how to assess them in order to provide boards with valuable data.

Some of the regulators that are currently adopting a collaborative approach to tackling culture audits include the U.K.’s Financial Reporting Council, the Financial Conduct Authority and the Banking Standards Board. The Hong Kong Securities and Futures Commission is keeping culture as a watching brief in 2016.

Auditing culture has been “an area of continued focus” for PwC Hong Kong. Loretta Fong, Assurance Partner, Entrepreneurial Group at the firm, says, “To the extent possible, we have been drawing expertise and experience from our network firms upon developing the audit of culture.”

KPMG Hong Kong has been partnering with organizations to conduct cultural audits using its global methodology and approach that is tailored to local needs. “Organizations are proactively thinking about culture. It varies depending on the organization, and there are many methods to go about auditing culture. Typically following a review, the board recommends issues that need to be addressed and the organization builds solutions into operating plans, for example in training, to improve culture,” says Susie Quirk, Partner and Head of People and Change Advisory at KPMG China.

Heads of internal audit in the U.K. are adopting two main approaches to auditing culture. The first is to incorporate culture into each audit using techniques like root cause analysis. The IIA U.K. says auditors have to be “comfortable with combining hard data with gut feel” in this approach. And arguably, it requires a more subjective judgment and enhanced communication skills.

**Gathering evidence**

The second approach auditors use is auditing cultural indicators such as personal behaviours as a substitute for culture. The main issue here concerns how best to gather evidence to illustrate their findings.

Gilly Lord, PwC U.K.’s Head of Regulatory Affairs, says that culture is something that auditors have always subconsciously considered. For them the push from regulators is simply formalizing what they have always known – that culture matters.

Nonetheless Lord says: “It felt like a really difficult thing to do at first because we are used to auditing tangible facts – things you can touch and test. Culture is a lot less tangible but you can touch it when it turns into behaviours,” she says.

Some organizations that have grasped the nettle on measuring and assessing culture include pharmaceutical giant GlaxoSmithKline (see *GlaxoSmithKline: a culture audit case study* on page 29), Marks & Spencer, Tui Travel, international aerospace company BAE Systems, TV, broadband, mobile and phone provider TalkTalk, Fortune 200 car supplier Lear Corporation and L’Oreal, the world’s largest cosmetics group.

“It is definitely an increasing area of focus for enterprises that are fast expanding globally, undergoing generational change, and/or looking for ways to improve relationships with their third parties, joint ventures, with an aim to enhance organization resilience,
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and to ultimately direct the enterprises towards cost effective initiatives,” Fong at PwC Hong Kong says.

As to be expected in the wake of the rate manipulation, Barclays has integrated culture as part of every audit and conducts thematic reviews of individual audit reports and assessments of business areas. Aberdeen Asset Management looks at culture across the organization, as well as considering culture as part of individual audits. Old Mutual Group, the international investment and banking conglomerate, measures and assesses its culture regularly, and ensures culture audits are central to how it assesses and manages cultural risk.

In its latest report published in July, the U.K.’s FRC found that defining and measuring culture is not just vital in avoiding corporate scandals but also in adding long-term value to businesses.

The study, which was partly based on interviews with FTSE chairmen, CEOs and company secretaries, reiterates that it is boards’ responsibility to evaluate and report on corporate culture. The chief executive should embody and demonstrate the desired culture but if the CEO fails in this duty, the ultimate accountability falls to the board, the FRC said.

Cultural change does not happen overnight. Boards together with internal auditors and other stakeholders must set out on the journey for positive change together.

What is clear from all the recent research into corporate culture is that little enduring change can be achieved unless boards understand the pressures, internal and external, on staff at all times and a “just" culture is embedded so that people are not afraid to “speak up” when needed. Only then will corporate culture evolve to ensure value for businesses.

GlaxoSmithKline: a culture audit case study

Ensuring high ethical standards across the 150 countries in which GlaxoSmithKline, a British pharmaceutical company, operates is vital to its sustainability and success. The business is at the forefront of prioritizing culture as part of its business practices. GSK’s “values assurance programme” has led the way on this change. As part of GSK’s “culture audit,” internal and external auditors assess the maturity level of each of the four GSK cultural values – patient focus, integrity, respect for people and transparency – and ensure the values are embedded in a meaningful way into everyday business practices.

Its culture audit methodology is similar to a 360 degree feedback process. It includes a leadership self-assessment backed up by an independent evaluation conducted by audit and assurance. The process combines both quantitative and qualitative data to form a holistic view of the culture, values maturity and behaviours.

The “values assurance programme” is carried out in commercial markets and manufacturing sites across Europe, Asia and the United States. As an added benefit, executives find that the culture audit also drives positive organizational change.

The company says the programme can be used to identify issues and correct them as well as capturing good practices and recognizing leaders who are making a difference.

Off the back of the programme GSK has created values-based case studies for training; integrating values into recruitment and selection processes; implementing recognition programmes to reinforce values-based behaviour; storytelling to role model the values; and conducting resiliency programmes to sustain energy and good health during change.

At an organizational level, the programme is used to drive cultural change across emerging markets. GSK has developed a multidisciplinary team to conduct its culture audit, which includes auditors, psychologists, operational staff and those with Lean Six Sigma experience.

Auditors working on GSK’s culture audits need to demonstrate interpersonal skills, strategic and systems thinking, advanced analysis and emotional intelligence.

Source: GSK / IIA research

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