



## Corporate governance and culture

This is the fourth of five pieces from an internal audit perspective on the 2018 UK Corporate Governance Code: **Non-executive recruitment** (1), **Viability statements** (2), **Audit committee effectiveness** (3), Culture (4) and the **Workforce voice** (5).

Culture is never far from the headlines. Two **select committees** found “the problems that caused the collapse of Carillion were long in the making, as too was the rotten corporate culture that allowed them to occur.” And despite winning awards for its entrepreneurial culture, Google has admitted to issues of a ‘bro-culture’ as global employees **protested** the treatment of women.

This piece focuses on the governance requirements related to corporate culture. It encourages audit leaders to think about the importance of culture assurance and the plethora of guidance that is available.

RECAP. On 16 July 2018 the Financial Reporting Council (FRC) published its long awaited update to the UK Corporate Governance Code together with revised Guidance on Board Effectiveness.

The revisions support the government’s vision of restoring trust in the corporate organisations and the broader social reform agenda which aims to improve the standard of living and quality of life for ordinary working people.

## Culture defined

The Code leaves no room for ambiguity stating that “a company’s culture should promote integrity and openness, value diversity and be responsive to the views of shareholders and wider stakeholders.”

Across the two documents, the Code and Board Effectiveness, culture is mentioned over forty times. It is difficult to think of a single more influential element of good governance, making it of critical importance for internal audit.

The theory behind culture and why it’s so important is explained in an audit leaders **thought piece**.

## Principles and Provisions

There are specific requirements detailed in the Code that audit leaders should think about in relation to the provision of culture assurance.

*“Principle B. The board should establish the company’s purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture.”*

- What steps/process does the board take to define its values and culture?
- When the board revisits its strategy does it also consider culture, values etc?

- As audit leaders are your relationships robust enough to intervene if directors fail to act with integrity, lead by example or promote the right culture?

*“Provision 2. The board should assess and monitor culture. Where it is not satisfied that policy, practices or behaviour throughout the business are aligned with the company’s purpose, values and strategy, it should seek assurance that management has taken corrective action.”*

- How does the Board gain assurance that corporate values are embedded?
- Should internal audit provide commentary on cultural alignment in all engagements?
- What assurance does internal audit provide in relation to corporate surveys and other such cultural assessment/development instruments?

*“Principle F. The chair leads the board and is responsible for its overall effectiveness in directing the company. They should demonstrate objective judgement throughout their tenure and promote a culture of openness and debate.”*

- Has internal audit observed group think or different opinions being discussed at board level?
- Does the chair allow sufficient agenda time for major decisions or close down debate?
- Could your board benefit from internal audit consulting services (facilitating, education, training, advice) to encourage a more open culture?

*“Provision 33. The remuneration committee should...review workforce remuneration and related policies and the alignment of incentives and rewards with culture, taking these into account when setting the policy for executive director remuneration.”*

- When providing assurance over executive incentive schemes is it about accuracy and compliance or does it extend to the behaviours that it drives and the consistency with values?
- Does the wider performance management process encourage the desired corporate culture?
- Has the board defined the grounds on which it would withhold or reduce rewards to prevent reputational damage as seen at housebuilders **Persimmon**?

These questions are the tip of the iceberg and have hopefully encouraged you to think about how to use the Code to inform internal audit engagements.

## Monitoring culture

The board is accountable for setting the tone for the culture of the organisation and monitoring that it is thriving as intended. The Guidance on Board Effectiveness includes a series of questions encourages boards to think about culture, from an internal audit perspective they also form the basis of the scope for an assurance engagement. The Chartered Institute has added to this with additional questions for audit leaders to consider.

Questions for boards	Questions for audit leaders
Is the board clear on what sort of culture is needed to underpin the company’s purpose and its long-term success?	Is there evidence that the desired culture aligns to strategic goals and stakeholder needs?

What does the workforce say about 'the tone from the top' and the 'tone from the middle'?	How well do engagement surveys address cultural issues? Are results reliable? Is it possible to generate meaningful actions from the information obtained? Do hierarchies support or hinder the desired culture?
What evidence do we have that the chief executive is willing to listen, take criticism and let others make decisions?	What behaviours has internal audit observed formally in meetings and in corridor conversations? Is bad news avoided or watered down – project reporting is a good source of evidence for this?
What do examples of communications from leadership and middle management tell us about the commitment to values, openness and accountability?	How do directors translate the desired culture into practical day-to-day activities? Are invitations to briefing meetings by job need or hierarchy? Is the tone/media channels appropriate to the culture?
What action do we take against leaders or top performers who do not uphold the company's values?	Does the board have a policy in relation to this? Can compliance be demonstrated?
How are key promotions decided?	How robust is the recruitment process? Are internal candidates treated fairly or favoured?
Is management using root cause analysis where cultural issues are found, examining not just what went wrong but why?	How does management react to audit findings? Is there a preference for quick, easy solutions to fix the symptom rather than the cause? Does cultural commentary feature as part of the overall internal audit opinion (often provided annually)?
How can we use technology to analyse, interpret and present information?	What big data can be mined to provide evidence in relation to cultural assurance – turnover, complaints, surveys, reviews, performance reviews.....?
Do we need to invest in human resources or internal audit, develop skills and capabilities or encourage the use of multi-disciplinary teams?	How does internal audit demonstrate it is worthy of investment and invaluable to the organisation? Is sufficient cultural assurance provided? If not, why?
How does the company deal with breaches of company rules or codes of conduct?	Does the board have a policy in relation to this? Can compliance be demonstrated? Who is accountable for the ethics policy; is it appropriate for the digital age?
Does internal audit have the degree of independence needed and a clear mandate to look at culture?	How detailed is the internal audit charter? Would it be beneficial to specifically include culture?
How will we address any negative trends or misalignment between values and behaviours?	Has the board delegated responsibilities clearly? Does HR have the necessary skills to deliver a major cultural programme? Is the completion of board actions sufficiently evidenced?

## Ongoing assurance

Point 21 of the Guidance advises boards that the “focus on culture needs to be continuous.”

Culture audits are normally started on the premise of being confirmatory or diagnostic but they are time bound. Continuous monitoring and assurance of financial controls is not uncommon. So why not culture?

In an era of big data and data mining, audit leaders and boards might want to consider how this could be achieved. The Guidance helpfully provides a start point for sources of data through its cultural analysis; sources of insights and signs of problems. Can audit leaders create programmes to identify trends or trigger points to move towards the provision of continuous cultural assurance?

Sources of Culture Insight	Signs of a Cultural Problem
<ul style="list-style-type: none"><li>• Turnover and absenteeism rates</li><li>• Training data</li><li>• Recruitment, reward and promotion decisions</li><li>• Use of non-disclosure agreements</li><li>• Whistleblowing, grievance and ‘speak-up’ data</li><li>• Employee surveys</li><li>• Board interaction with senior management and workforce</li><li>• Health and safety data, including near misses</li><li>• Promptness of payments to suppliers</li><li>• Attitudes to regulators, internal audit and employees</li><li>• Exit interviews</li></ul>	<ul style="list-style-type: none"><li>• Silo thinking</li><li>• Dominant chief executive</li><li>• Leadership arrogance</li><li>• Pressure to meet the numbers/overambitious targets</li><li>• Lack of access to information</li><li>• Low levels of meaningful engagement between leadership and employees</li><li>• Lack of openness to challenge</li><li>• Tolerance of regulatory or code of ethics breaches</li><li>• Short-term focus</li><li>• Misaligned incentives</li></ul>

Internal auditors have inherent curiosity. What cultural insights could be gained from analysis of sickness data; stress, harassment, bullying, lack of support or training needs? Also where employees consent to their internet use being monitored on corporate devices, what can search statistics reveal; job hunting, mental health concerns, seeking legal advice/support on issues, etc.? Internal audit is also objective and diligent, triangulating results with training data and complaints or exit interviews could lead to influential findings and actions.

## Integrated assurance

Point 24 of the Guidance advises boards that *“human resources, internal audit, risk and compliance all have a role to play; an integrated approach is likely to yield a more sophisticated understanding of how behaviours and culture impact performance.”*

What are you doing as audit leaders to support the board in taking an **integrated approach**?

Is internal audit taking the lead, producing an **assurance map**, working with stakeholders to produce an integrated report?

Culture is intangible. It cannot be assured in the same way as a set of accounts. Although surveys and interviews are instrumental, observation is key; to notice or perceive (something) and register it as being significant. Do all of your audit team have this heightened skill, looking for that undefined element that sits between the lines of the test plan?

Using specialists to broaden the assurance reach of trusted eyes and ears should be more than a

consideration for audit leaders; they all have a role to play.

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## Closing Thoughts

It's widely recognised that auditing culture is not easy. But working in an organisation with a negative culture is far harder. Whether taking small steps by assuring the quality of surveys and the work of others or leaping into the detail of the processes that enable and drive culture, audit leaders must take action. Your board should be demanding it. What is on your audit plan?

*"Culture eats strategy for lunch"*

**Peter Drucker**

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## Further Reading

**Research** on auditing culture

**Guidance** on how to audit culture

**Insights** on auditing culture from a chief audit executive

**Case studies** on auditing culture

**Top tips** on auditing culture