

Organisational culture from IA perspective



Organisational culture is an invisible thread that influences governance, risk management and internal control, and internal audit. Understanding culture, the DNA of any organisation, helps internal audit to examine systemic issues to find the root cause. It is vital that audit leaders understand the fundamentals of the theory to steer and support the delivery of effective assurance.

- Are you culturally astute?
- Do you evaluate using knowledge or instinct?

Chief audit executives have been talking about culture for the last ten years.

Action is needed.... NOW.

Use this reading time to maximum effect as we revisit some long-forgotten theories, highlight their relevance to internal audit and explain how you can use them today. This thought leadership brings you bitesize insights to enrich your input into audit scope, findings and those all-important actions.

While you're here, take a look at our live virtual course on how culture is changing with COVID-19.

What is organisational culture?

Culture is ever-present; whether acknowledged or not, it exists in all organisations regardless of size, sector, age or achievements. It is the essence, the DNA, that runs through everything. A powerful, invisible force that impacts the behaviours and decisions of people at all levels of the organisation. It is the sum of the beliefs and values of people in positions of power or influence yet maintained by every individual, every new

recruit and every interaction within the organisation.

In 1961, President Kennedy announced to Americans that “this nation should commit itself to achieving a goal, before this decade is out, of landing a man on the moon and returning him safely to Earth.” In 1969 Neil Armstrong took that ‘giant leap’ and when Kennedy asked a cleaner at NASA what he was doing he replied “I am helping to put a man on the moon”.

- What is the narrative in your organisation?
- If there isn’t one, what are the controls in place to prevent people making up their own?

Culture starts at the very top and cascades down through the organisation.

The phrase “the way we do things around here” was used by management guru, Charles Handy, to describe organisational culture. Its variants ‘because we do’ and ‘we’ve always done it that way’ are the nemesis of constructive internal audit discussions; all the more reason why it’s vital for audit leaders to have a good understanding of the topic

Audit leaders often shroud culture in mystery and say it is too nebulous to provide any meaningful assurance over. The study of culture features on many degree syllabi but it is easily forgotten when the reality of being part of an organisational culture takes over.

There is no place for such rhetoric in today’s internal audit world.

The textbook the Fundamentals of Strategy* explains that culture is made up of six elements. These are all practical and auditable with the ability to capture and report on evidence.

1. **Stories** – The past events that people talk about inside and outside the company. Who and what the company chooses to immortalise says a great deal about what it values, and perceives to be great behaviour.
2. **Rituals and Routines** – The daily behaviour and actions of people that signal acceptable behaviour. This determines what is expected to happen in given situations, and what is valued by management.
3. **Symbols** – The visual representations of the company including logos, how plush the offices are, and the formal or informal dress codes.
4. **Organisational Structure** – This includes both the structure defined by the organisation chart, and the unwritten lines of power and influence that indicate whose contributions are most valued.
5. **Control Systems** – The ways that the organisation is controlled. These include financial systems, quality systems, and rewards (including the way they are measured and distributed within the organisation).
6. **Power Structures** – The pockets of real power in the company. This may involve one or two key senior executives, a whole group of executives, or even a department. The key is that these people have the greatest amount of influence on decisions, operations, and strategic direction.

*From **Fundamentals of Strategy** by G. Johnson, R. Whittington, and K. Scholes, published by Pearson Education, 2012.

Culture can exist within individual functions as well as across an organisation. It may be advantageous for an innovation centre within a highly structured manufacturing company to operate differently, conversely managers could create chaos by forming subcultures that to an outsider, or independent internal auditor, appear to conflict and compete.

Importance to internal audit

Culture, these six elements lie at the heart of governance, risk management and internal control.

It is not possible for good audit leaders to ignore their influence on the organisation, its leadership team or its stakeholders.

- Are you an effective chief audit executive?
- How does culture feature on your audit plan?

Culture and governance

Individuals and groups with influence exist at all levels within and outside an organisation, however, the governing body (board/audit committee) is usually the most powerful.

Culture and governance both set the 'tone from the top.'

Handy defined four types of culture which internal auditors can see reflected in different approaches to governance; understanding this helps to put governance into context.

- **Power** cultures have few rules and policies as decisions are controlled by a few individuals, quick decisions; Sports Direct-Mike Ashley, RBS-Fred Goodwin, GE-Jack Welch.
- **Role** cultures are typically bureaucratic based on rules and roles, hierarchical, long chains of command, centralised often slow decisions; government, large banks, public sector, retail chains/supermarkets.
- **Task** cultures focus on the outcome, teamwork, achieving the common purpose, work in projects or matrix style, agile ways of working; Tesla, London 2012 Olympics, Cisco, Red Bull Racing, Metro Bank.
- **Person** cultures exist in small consultancies, professional practices, where individuals are the focus of power and talent, organisation exists to look after the needs of the individual. For example, a group of solicitors or journalists forming a collective to share office space and administrative support. It is unlikely that such organisations would have an internal audit function due to their size.

Which of these cultural types fits with your organisation?

Do some functions have their own culture?

Also consider the culture of strategic partners or key suppliers/clients. All of the typologies can lead to success or failure depending on how they are deployed, in some power cultures governance mechanisms may be shunned by an autocrat like **Mike Ashley**, while others develop their own such as Mark Zuckerberg, **Facebook**.

Audit leaders looking to address ineffective elements within their organisation's governance will often find the root cause of issues within the complexities of culture: power struggles, unclear accountabilities or disingenuous values. Always be sceptical about an agreed action that simplifies a deeper issue for example, an agreed action to increase the priority/time available to discuss a topic on a standard meeting agenda, such as Health & Safety reporting, may hide the facts as to why it wasn't seen as important in the first place.

Culture and risk management

It is commonplace for internal audit to provide assurance over risk management practices; but does it get to the heart of the matter or is it limited to processes and compliance.

Think about your organisation.

- What are the risk stories?
- Who are the heroes and villains of risk management?
- Does their status fit with the values, ethics and risk appetite of the governing bodies?

An employee is hailed a hero at the annual awards ceremony for company Y. They 'went the extra mile' for a customer, delivering and setting up a DVD player for a vulnerable customer; doing so breached numerous policies, put the employee and the reputation of the company at risk.

- How do you react as the chief audit executive?

It speaks volumes about the influence of culture on risk management. The earlier NASA example shows the importance of a common purpose and values, clearly articulated and supported through the alignment of the six cultural elements. This is empowering for risk management and can clearly be seen in the dramatisation of the aborted Apollo 13 moon landing or the investigation following the Challenger space shuttle disaster.

For most organisations, 2020 challenged risk management capabilities like never before; a full-blown pandemic was a scenario test few had engaged with in the calm of the boardroom.

Culture influences risk maturity; the ability to embrace uncertainty, make and learn from mistakes.

- How is organisation respond to the pandemic?
- How is it positioned for the climate crisis?

Internal audit assurance over risk management finds comfort in focusing on the myriad of policies, procedures and technologies that enable it, particularly the way in which risk appetite is communicated and complied with.

However, internal audit must look beyond this superficial level. Prior to the financial crisis of 2008 banks were held in high regard for their risk management systems, yet these same policies, procedures and controls did nothing to prevent a toxic culture from overshadowing and stifling good practice. Likewise, culture was at the heart of the collapse of construction giant Carillion in 2018.

Good practice can exist within an ineffective or corrupt culture. Risk management is as much about the values and ethics of the governing body and of individual employees as it is about risk identification and assessment; as with culture it is fundamentally about shared understanding, underlying assumptions, basic perceptions and biases.

Culture and internal control

Audit leaders will be familiar with the **COSO Internal Control Framework** that defines the five elements of the internal control system.

- But what about the effect of culture?
- Do you think about culture in relation to the famous cube?



1. Demonstrates commitment to integrity and ethical values
2. Exercises oversight responsibility
3. Establishes structure, authority and responsibility
4. Demonstrates commitment to competence
5. Enforces accountability
6. Specifies relevant objectives
7. Identifies and analyzes risk
8. Assesses fraud risk
9. Identifies and analyzes significant change
10. Selects and develops control activities
11. Selects and develops general controls over technology
12. Deploys through policies and procedures
13. Uses relevant information
14. Communicates internally
15. Communicates externally
16. Conducts ongoing and/or separate evaluations
17. Evaluates and communicates deficiencies

COSO – Integrated Framework 2013

The control environment is a key part of the overall control system and is intrinsically linked to culture as demonstrated by the five principles that relate to it.

The control system determines the nature of and degree to which controls are required to achieve the organisation's goals, it informs the control environment.

Arguably the relationship between culture and the control system and indeed the control environment is like that of the chicken and the egg. Which came first is a matter of debate but one cannot exist without the other.

There are three main systems, some organisations may demonstrate dominance in one although many will employ them all in different parts of the organisation.

1. **Output systems** – focus on controlling outcomes, measuring performance. Governing bodies and executives determine what is acceptable and track against it. Expectations are known and managed.
2. **Behavioural** – focus on controlling actions. Rules and processes are used to dictate behaviour or structure activities; for example, a financial control requiring dual signatories.
3. **Clan** – this type of system is open. It is goal oriented; reliant on shared values, ethics and expectations.
 - Which system do you recognise within your organisation?

Understanding the relationship between culture and internal controls enables internal audit to maximise its assurance value.

Characterising your organisation's culture

There are many **models** which describe organisational culture including the McKinsey 7S model and the cultural web. A good team exercise for internal audit is to take one of the models and brainstorm the

elements to encourage awareness, debate and build confidence in auditing aspects of culture.

- Why not add it to the next team meeting agenda?

Your organisation may have used external professionals to work with management on its culture; maybe invite a guest project manager or sponsor to talk to the audit team about the findings? Use this knowledge to talk about things to look out for when auditing.

Check out the thought leadership on Adding Culture to your Audit Plan which includes examples of cultural cues.

It is also possible, without expenditure for the audit team to evaluate the organisation using a free online assessment tool, such as the [Organisational Culture Assessment Instrument](#), (OCAI© Kim Cameron) with a little budget this could be extended across the organisation. Research has shown that organisations have competing values across two axis, gravitating towards one end of either spectrum resulting in a cultural type; clan, adhocracy, hierarchy or market. The Chartered Institute does not endorse this product, it is an example of what can be achieved, others are available.

- Could tools such as this be a way to gather audit evidence?

Although culture starts with governing bodies, accountability for maintaining or changing it rests with all stakeholders, not just those at the top. Internal audit has a responsibility to report cultural issues that impact on effective governance, internal controls and risk management – regardless of the scope of the engagement. Just like the British Transport Police campaign “see it, say it, sorted”.

If this feels too daunting, perhaps start with an evaluation of the internal audit culture, build confidence and take the learns through to start auditing organisational culture.

Reading and procrastination are not an option.

As we said earlier chief audit executives have been talking about culture for the last ten years.

Are you going to act? NOW?

Closing thoughts

There are so many competing priorities for audit leaders. Taking time to reflect on the inner workings of your organisation may reap more benefits in the long-term than a series of back to back meetings that merely scratch the surface of what is really happening. Don't just work in an organisation; take the time to understand its culture to be truly effective.

"The only thing of real importance that leaders do is create and manage culture."

Edgar Schein, professor and management guru