Assessing Ethical Culture

IIA Calgary Chapter

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Today’s Presenter – Robert Kuling

• Leads MNP’s Enterprise Risk Services practice in Saskatchewan
• +30 years of senior leadership and consulting experience
• Helps organizations develop internal audit, risk management, financial compliance, governance, and regulatory requirements
• Developed leading edge practices for audit and compliance groups including planning, risk assessment, value-for-money, analytics, program evaluation, talent strategies, quality, corporate culture, fraud/ethics, and performance reporting.
• Former Deloitte partner and Chief Audit Executive at major organizations (e.g. Tervita, Viterra, TransAlta and Precision Drilling)
• Internationally recognized leader with the Institute of Internal Auditors (IIA) serving on the Global Board and Chairman of the North American Board
• National spokesman for the internal audit profession with regulators, professional groups, training firms, and government organizations
• Globally recognized training provider for appraising corporate culture
MNP : Who Are we?

Our Values
At MNP, we pride ourselves on our values, which we are reminded of daily on our desktops. Our values ring true to the team members and Partner of our firm.

- Founded in 1958, we are the 5th largest national accounting and business consulting firm in Canada
- We are a premier partner with the IIA and proudly serve and respond to the needs of our internal audit clients in the public, private and not-for-profit sectors.
Learning Objectives

• Understand the principal elements of culture
• Explore creative tactics and strategies for analyzing an organization’s culture
• Understand the characteristics of a strong ethical culture
Elements of Culture
Polling Question #1

What is the size of your internal audit function (including co-sourced full-time employees)?

- 1
- 2 to 5
- 6 to 10
- 11 to 15
- 16 to 25
- 26 to 50
- 51 to 100
- More than 100
- Not applicable/not sure
Elements of Culture
Why is Culture Important

• Constantly ranked as a “top risk”
• Profound impact on the organization
• Relevant to any type of organization
• Competitive advantage
• Generally the root cause of corporate scandals
• Biggest determinant of how employees behave consciously and subconsciously, internally and externally
• Influenced by history, environment, structure, tone at the top and management styles

Source: Understanding and Auditing Corporate Culture, (IIA 2021)
Market Factors driving attention to Culture

Heightened regulatory scrutiny
For example, Office of Superintendent of Financial Institutions (OSFI) released guidance on how firms establish, communicate and implement cultural values and whether these guide appropriate conduct.

Digitization is changing the workplace
For example, business leaders will need to evolve their current talent strategies and workforces for the changes brought on through automation, artificial intelligence, and other advanced technologies.

Board and Executive accountability & expectations
For example, the National Association of Corporate Directors (NACD) issued Blue Ribbon Commission Report on Culture as a Corporate Asset.

Institutional investors
Canadian and US institutional investment firms (e.g., CALPERS) require disclosure of settlements and complaints as part of their due diligence.
Culture versus Conduct

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, behaviours, and decisions of these individuals.

Oliver Wyman
Measuring Conduct and Culture: A How-To Guide for Executives
Culture and Engagement

CULTURE
The way things work around here

• Behaviors aligned with strategy.
• Includes values, beliefs, behaviors, artifacts, and reward systems influencing behavior.
• Driven by top leadership and is deeply embedded in processes, reward systems, and behaviors.

Culture predicts Company performance

ENGAGEMENT
The way people feel about the way things work around here

• Way of describing employees’ level of commitment.
• When engagement is poor, employees feel uneasy or uncommitted.
• Declining engagement leads to decline in productivity.

Engagement predicts Individual performance

LEADERSHIP
The driving force behind setting and maintaining culture and engagement via modeling behaviors and expectations for the workforce

Culture predicts Company performance

Engagement predicts Individual performance

Culture and Engagement
# High Quality E&C Principles

<table>
<thead>
<tr>
<th>Principle 1</th>
<th>Principle 2</th>
<th>Principle 3</th>
<th>Principle 4</th>
<th>Principle 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ethics and compliance is central to business strategy</td>
<td>Ethics and compliance risks are identified, owned, managed, and mitigated</td>
<td>Leaders at all levels across the organization build and sustain a culture of integrity</td>
<td>The organization encourages, protects and values the reporting of concerns and suspected wrongdoing</td>
<td>The organization takes action and holds itself accountable when wrongdoing occurs</td>
</tr>
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Corporate Culture – The Rocket Fuel

- The higher the program quality, the stronger the culture
- Organizations with high-quality programs (shown here as optimizing) demonstrate a **546% increase in culture strength** over organizations with the lowest level of program quality.

Source: Global Business Ethics Survey (ECI 2021)
Corporate Culture – The Rocket Fuel

• As the culture strengthens, employee conduct improves.
• Organizations with strong cultures are **467% more likely** to demonstrate positive impact on employees than organizations with weak-leaning cultures (adherence to values, handling of key risks, reporting wrongdoing, and reduced overall misconduct).

Source: Global Business Ethics Survey (ECI 2021)
E&C Program Maturity Model

A new or existing E&C program that has not progressed in embedding high quality practice elements.

An E&C program that has a few high quality elements, but still lacks many important attributes.

An E&C program that contains a number of high quality elements reflecting important attributes, but with room to further grow.

An E&C program that is effective and has adapted many high quality elements.

An E&C program that contains the majority of, if not all, high quality elements.

Five Principles
- Strategy
- Risk Management
- Culture
- Speaking Up
- Accountability

Maturity
- Strategic Value
  - 1: Underdeveloped
  - 2: Defining
  - 3: Adapting
  - 4: Managing
  - 5: Optimizing
Polling Question #2

Based on the E&C Maturity Model described, what would you assess your organization’s level to be:

1. Underdeveloped
2. Defining
3. Adapting
4. Managing
5. Optimizing
Multiple Layers of Stakeholders

Board/ Governance
- Seek assurance and “level of comfort”
- Inundated with governance trends and emerging risks
- Tend to focus on the high-profile failures

Executive Leadership
- Short term focus – ethics and culture may be regarded as “soft” business challenges
- Usually preoccupied with strategic issues, transformation, and current performance

Second Line of Defense
- Develop policies and standards based on industry, regulatory or corporate needs
- Deliver training and guidance, essentially setting the tone
- Ensuring compliance, putting out fires, mixed management reporting lines

Operations Shop Floor
- Driven by leader’s objectives and style
- Generally, follow supervisors’ examples – subculture characteristics?
- “Ground level” view of organization and leadership
Navigate the Corporate Jungle
Functional Behaviors
Cultural Artifacts

• Specific behaviors and norms
• Powerful predictive capability
• Intangible asset or liability
• Massive components of culture
Tactics and Strategies to Appraise Culture
Cultural Assessment Model

Common Governance Spirit
- Widely held system of shared meanings
- Rules are adhered to

Strong pressure to conform to shared system of meanings
- Rules are set to guide behaviour

Weak Governance Spirit
- Private system of meanings
- Rules are not implemented

Independence
- Increasingly independent of other people’s pressure to conform
- Staff are left to be guided by their own values

System of Control
- Minimalist Governance
- Tactical Governance
- Engaged Culture
- Chaotic Culture
- Complier Culture
- Sleep-walking Culture

Wherever business takes you
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Considerations for your Approach

Consider the following questions as part of the annual internal audit risk assessment to determine and understand the elements and the overall maturity of your organization’s culture:

- **Does the company have a defined culture?** If so, what words can be used to describe the company’s culture?
- **If the company has a mission statement and/or value statement**, how well is it/are they communicated among employees?
- **What methods does the company utilize to understand the company’s culture?** (surveys, conduct monitoring, risk sensing, etc.)
- **What activities does the company engage in to reinforce the tone at the top?** (code of ethics, communications, training, etc.)
- **What channels to raise issues and concerns** are available to employees and other stakeholders (e.g., speak up mechanisms, hotline)?
- **Who leads or drives these practices?**
Culture Specific Audits

**Identify sources of evidence**
Identify the sources of evidence for each element of the culture assessment framework, components applicable to various areas, functions, or business units under review.

**Review sources of evidence**
Obtain and review the sources of evidence identified (e.g. people survey results, programs, relevant documentation for sample reviews.)

**Develop a Point of View (pilot or case study)**
Select a unit, artifact or other organizational element for deeper review and analysis, review documentation, metrics, and business information to evidence the root cause.

**Diagnose, conclude and report**
Assess the evidence in relation to the culture assessment framework. Could be used to extrapolate the overall culture in that area, function of business unit.
"Bolt on" Audit Approach (cultural insight)

Ongoing audit observations
Part of audit planning, fieldwork and reporting, observe examples of individuals’ behaviours, actions and attitudes that may be examples of desired or undesired behavior:
(e.g. lack of commitment from staff to respond to audit requests)

Root cause analysis
Carry out a root cause analysis for each of the findings identified as part of your audit work using a “culture lens.”
Consider impact of inadequate actions or behaviours of employees as potential primary or secondary causes; provide rationale for your decision.

Diagnose, conclude and report
At the end of the audit work, consider all the information gathered as part of the audit and provide insights on the overall culture (in line with the culture assessment framework components).
Provide rationale for your finding including examples observed.
Note: Specific questions to assess culture can be designed and included in all audits.
Top 5 Methods and Proxies

The Top 5

Methods used to audit behaviours and culture are:

- Interviews (64%)
- Surveys (51.2%)
- Assessment of the timely and effective resolution of audit issues and/or risk exposures (50%)
- Behavioural observation (48.8%)
- Root cause analysis (48.8%)

Proxies for auditing culture are:

- Staff surveys (73%)
- Whistleblowing activity (69.7%)
- Governance structures (64%)
- Values statements and their incorporation into recruitment and performance management (60.7%)
- HR grievance data and exit interviews (56.2%)

Source: Chartered Institute of Internal Auditors
Polling Question #3

In your organization, which is the most feasible strategy to appraise corporate culture:

1. Planned project(s) on the IA plan
2. Bolt onto planned projects
3. Through an “entity-level” assessment (e.g., SOX compliance)
4. Partnering with a second line of defence function (e.g., Human Resources)
5. Recent response to a major breakdown
6. Forget it – too much hassle!!
Characteristics of Strong Ethical Culture
OECD Model of Ethical Culture

The OECD created a Two-Factor Model of Ethical Culture, which includes positive aspects (Qualifiers) that will motivate employees to exhibit ethical behavior and negative factors (Disqualifiers) that are likely to increase unethical behavior.¹⁴

**QUALIFIERS**
- Organizational trust
- Ethical leadership
- Benevolent orientation
- Empathy
- Efficacy and speaking out

**DISQUALIFIERS**
- Organizational unfairness
- Abusive manager behavior
- Selfish orientation
- Lack of awareness
- Fear of retaliation

Source: Global Business Ethics Survey, ECI, 2020
Psychological Health

• aka - Psychological safety
• Emerging area of focus and research
• Culture eats training for breakfast
• Pandemic effects on workforce productivity are significant - statistics on mental health are jarring (depression, burnout, etc.)
• Challenge is visibility and exposure without message fatigue
• Creativity is needed here– entertainment is helpful
**Externalities** refers to the impact of employee misconduct beyond the individual and even the organization.

**Adverse selection** occurs when those particularly ill-suited for something are the most likely to participate.

**Principal-agent problems** occur when the incentives of employees don’t align with the broader interests of management or shareholders.

Source: https://hbr.org/2018/03/the-economics-of-why-companies-dont-fix-their-toxic-cultures
Global Business Ethics Survey, ECI 2021

The Good News

• Slightly more than one in five US employees were in workplaces with a strong ethical culture (one in four in 2009). Largely unchanged over the past 10 years.
• Employees who observed misconduct in 2020 were more likely to report their observation than they did in 2017 (86% vs. 69%).

The Bad News

• More pressure on employees to compromise their organization’s ethics standards (e.g., to “bend the rules”) was at the highest it has been since 2000 and doubled since 2017.
• Rate of observed misconduct slightly increased in 2020 and has remained largely steady.
• Employee perceptions regarding retaliation after reporting misconduct is the highest it has ever been – doubled since 2017.

Source: Global Business Ethics Survey (ECI 2021)
### Corporate Culture is under Pressure

#### MOST COMMON TYPES OF OBSERVED MISCONDUCT—U.S.

<table>
<thead>
<tr>
<th>Misconduct</th>
<th>2017</th>
<th>2020</th>
<th>PERCENTAGE POINT CHANGE SINCE 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Observed favoritism toward certain employees</td>
<td>--</td>
<td>35%</td>
<td>-</td>
</tr>
<tr>
<td>Observed management lying to employees</td>
<td>21%</td>
<td>25%</td>
<td>+4</td>
</tr>
<tr>
<td>Observed conflicts of interest</td>
<td>15%</td>
<td>23%</td>
<td>+8</td>
</tr>
<tr>
<td>Observed improper hiring practices</td>
<td>12%</td>
<td>22%</td>
<td>+10</td>
</tr>
<tr>
<td>Observed abusive behavior</td>
<td>21%</td>
<td>22%</td>
<td>+1</td>
</tr>
<tr>
<td>Observed health violations</td>
<td>15%</td>
<td>22%</td>
<td>+7</td>
</tr>
</tbody>
</table>

Source: *The State of Ethics & Compliance in the Workplace: A Look at Global Trends (ECI, 2021)*
Polling Question #4

Which organizational level is the most pressured in your organization to “bend the rules”?

1. Board of Directors
2. Executive Management
3. Middle Management
4. First-line direct supervisor with direct reports
5. Employee – front line
Survey Says

The Incidence of Pressure Was Almost 2X as High Among Top Management Compared with Individual Contributors

Percentages shown are based on the global median.

Source: Global Business Ethics Survey, ECI, 2020
Polling Question #5

Which of the following six specific types of misconduct is your organization most at risk for?

1. Abusive behaviour
2. Conflicts of interest
3. Corruption
4. Discrimination
5. Sexual harassment
6. Violations of health and/or safety regulations
Survey Says

Employees Who Feel Pressure Are About 2X as Likely to Observe Various Types of Misconduct

- Abusive behavior: 52% vs. 25%
- Conflicts of interest: 55% vs. 27%
- Corruption: 43% vs. 19%
- Discrimination: 37% vs. 16%
- Sexual Harassment: 30% vs. 13%
- Violations of health and/or safety regulations: 45% vs. 24%

Percentages shown are based on the global median.

Source: Global Business Ethics Survey, ECI, 2020
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Wherever business takes you

Mandate for Internal Audit

• Cultural appraisal is high value for internal audit
• Aligns internal audit priorities with the organization’s principal risks
• Builds reputation of internal audit as a savvy business advisor (builds a high level of trust)
• Continually surveil key metrics and controls that might raise flags (includes continuous auditing and/or data analytics to high-risk areas)
• Build constant communication lines with the second line (air cover support to help them)
• Deliver culture-related assurance and advisory services (e.g., pulse checks, ethics training)
• Contribute to a combined assurance approach (assurance mapping and facilitate coordination)
Final Thoughts & Questions?