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Providing senior management, boards of directors, and audit committees with concise information on governance-related topics.

MORE THAN JUST SETTING THE TONE: A LOOK AT ORGANIZATIONAL CULTURE

Organizational culture. It can be difficult to define. It's nebulous, yet, over time, culture greatly influences the long-term success of an organization, separating the ethical performers from the unethical; the valuable organizations from the questionable; those that achieve their mission from those that do not.

The long list of recent corporate scandals reinforces the need for executives to keep an eye on culture. "It's critical," says Jim Key, managing partner of the Shenandoah Group and a director of Coastal Banking Company. "At their core, most business failures are culture problems." Securities and Exchange Commission Chair Mary Jo White made a similar point in a 2014 speech at the Stanford University Rock Center for Corporate Governance, when she characterized deficient corporate cultures as "often the cause of the most egregious securities law violations."

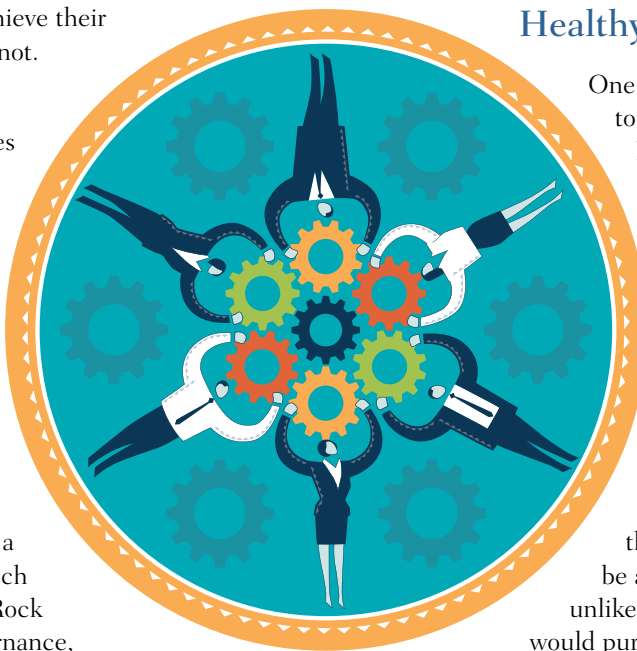
Organizational culture is more than just company picnics or corporate perks. Culture encompasses the organization's values, and how employees act

out those values. At its finest, culture helps an organization retain great employees and motivates them to do their best and most productive work. At its worst, it can destroy a company.

Healthy vs. Toxic Cultures

One *Forbes* article tied culture to a company's DNA, guiding how the company makes decisions, solves problems, and communicates across functions. In this context, it is easy to see how a healthy organizational culture can be a business asset and a source of competitive advantage.

It is equally evident that a toxic culture can be a business liability. It is unlikely that a corporate leader would purposely set out to create a toxic culture. However, mismanagement or neglect of culture can lead to that outcome. Employees become demotivated, or incentivized to make unethical decisions. No one is held accountable. Productivity drops. Left unchecked, it can lead to severe negative business impacts and even failure.



The Role of Executives, Boards, and Audit Committees

The pervasive impact of culture on long-term organizational success is a compelling reason for audit committees, boards, and executives to concern themselves with the topic. But how?

Success starts at the top. Generally speaking, executives establish the culture and lead by example. Those in senior leadership must articulate and model the organization's culture and values, demand the highest standards of ethical behavior from themselves and others, encourage transparency, and be willing to make difficult decisions. At the same time, "the board of directors must ensure that the senior leaders they put in place have the right ethical compass, tact, and communication style to instill the most effective culture," says Craig Robinson, senior director of finance at Miami Valley Gaming.

The right attributes are so important — and their absence so damaging — that IIA President and CEO Richard F. Chambers, CIA, QIAL, CGAP, CCSA, CRMA, recently wrote that "a strong yet inappropriate tone at the top can easily render even viable internal control processes and policies virtually irrelevant."

Beyond having the right leaders whose actions align with the organization's core values, some tactics used by enterprise leaders to inspire a healthy culture are to:

- Make sure that culture, values, and ethics appear directly or indirectly on board and audit committee meeting agendas, and talk about them candidly and explicitly.
- Ensure that culture — including the tone at the top — is evaluated using observable and measurable behaviors.
- Demand frequent reporting. Some organizations create a culture dashboard that reports data such as employee feedback, ethics violations, hotline calls, and customer complaints.
- Pay special attention to the selection, compensation, and termination of the CEO and other senior executives. Ensure that compensation packages or reimbursement policies do not encourage inappropriate behaviors. Key points out, "Don't reward short-term thinking when your strategy is long-term."

- Talk to employees. Go to their workplace and engage with them and their management. Observe how they interact with each other.
- Review pertinent executive communications to employees. Make sure the content reinforces the importance of ethical behavior and that the tone encourages a blame-free environment to surface concerns.

There is a world of guidance for those who seek it. However, as helpful as it may be, Doug Anderson, managing director of CAE Solutions at The IIA and a former chief audit executive (CAE), notes that culture is not a checklist. Judgment and experience are required to see what's going on and to understand the implications.

"Culture is critical to the good governance of an organization, and inattention to it can have devastating effects," he says. "Unfortunately, we won't run out of bad examples anytime soon." Nonetheless, organizations that have the foresight and savvy to take steps that support a healthy culture will likely experience the corresponding benefits, and avoid the pitfalls of straying into a toxic culture.

The Role of Internal Audit in Organizational Culture

Anything that is critical to an enterprise's long-term viability merits oversight and assessment. Executives can look to internal auditors to provide a pulse check on the culture of the organization because of their interaction and candid conversations with middle management and supervisors.

Further, internal auditors are experts on the organization's internal controls and its compliance programs. Over time, they build a well-informed perspective on the credibility of the company's practices. They know which departments experience recurring problems, troublesome management issues, or unwillingness to respond to inquiries or consider findings.

Anderson characterizes internal audit as the only function in the organization that is charged with monitoring and providing assurance over organizational activities without having responsibility for those activities. "Because of this, internal auditors can truly be objective and independent.

“When you add in their direct line to the audit committee, they are in a perfect position to provide observations, assurance, and insight.” That said, because organizational culture can be difficult to measure, internal auditors should be equipped to exercise a greater degree of judgment when making assessments.



Internal audit can play an “early warning” function and enable the organization to correct issues before they have a serious impact on culture. However, this advance identification cannot result from a once-a-year audit; it depends on an ongoing baseline of monitoring, against which meaningful trends and anomalies stand out.

Whatever approach is taken to assess culture, it is important that it be done on a systemic basis, as part of virtually every audit. Culture doesn’t exist in discrete locations or at finite times; it is pervasive every day, in every department, in every undertaking. Its assessments must follow suit.

Without a healthy culture, an organization is likely to encounter trouble delivering on its core mission. By assuring that actual culture aligns with desired culture, internal audit can make a significant contribution to long-term organizational value.

Quick Poll Question

In the past 12 months, how frequently has culture been a meeting agenda topic of either the board or audit committee at your organization?

Visit www.theiia.org/tone to answer the question and learn how others are responding.

5 Signs of a Toxic Corporate Culture

Here are some characteristics that may suggest your organizational culture is trending toward toxicity:

- **Favoritism.** Managers have favorites, who receive special treatment (sometimes not held to rules that apply to everyone else) and are often the only ones given the opportunity to work on special projects.
- **Walking on eggshells.** Employees constantly fear being rebuked or, worse, fired. Meetings consist of one-way communication because the fear of reprisal shuts down healthy debate. Employees feel disrespected and ignored. Transparency is eroded.
- **Bad behavior.** Cliques abound, especially those that thrive on negativity. Employees become competitors and engage in cutthroat behavior to get ahead. Malice replaces courtesy and respect.
- **Lack of development.** Management does not see the value of training and developing employees at all levels and across the organization.
- **Information hoarding.** Managers fail to share the information others need to do their jobs. They release information only when required to get a task done or when it is too late to be helpful to anyone else.
- **Lack of accountability.** Transgressions may surface, but business goes on as usual and employees, managers, or executives face no consequences for rule-breaking.

About The IIA

The Institute of Internal Auditors Inc. (IIA) is a global professional association with more than 180,000 members in more than 170 countries and territories. The IIA serves as the internal audit profession's chief advocate, international standard-setter, and principal researcher and educator.
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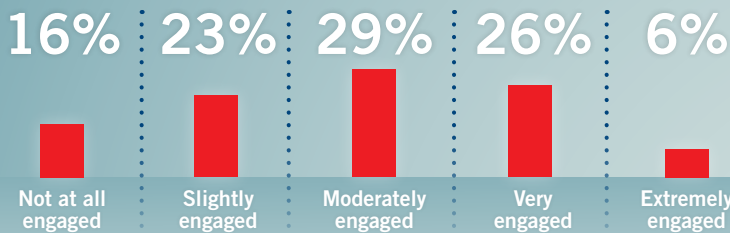
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How engaged is your internal audit function in assuring reliable nonfinancial reporting in your organization?



Based on 336 respondents. Source: The IIA's Tone at the Top December 2015 survey.