Signals of change and the risk agenda

October 2021: Culture Risk

Chief audit executives (CAEs) continuously assess how to deliver on their objectives to maintain the trust of shareholders and stakeholders. This includes considering signals of change in risks faced by their organization and, in turn, changing the focus of the internal audit plan if needed. Our complementary series, "On the CAE agenda," provides a full view of top risks highlighted this period.

Signals of change

A "good culture" is like an invisible hand that guides behaviors towards specific desired values—integrity, trust, and respect for the law—carried out with the spirit of a fiduciary-type duty toward customers, colleagues and other stakeholders and guided by a moral obligation aimed at instilling trust—which rests on a foundation of honesty, competence and reliability. It's the kind of behavior that people will engage in when they are not otherwise specifically told what to do. Along with maintaining a reputation with key stakeholders, culture also protects the brand and promotes creativity, innovation, and agility in the organization.

A 2021 report that features a survey of over 1300 C-level executives revealed that 91 percent of executives believe culture is "important" or very "important" at their organization, 79 percent of executives rank culture as a "top five" contributor to their firm's value while 92 percent believe improving culture would increase firm value. The report also revealed that 85 percent of executives believe poorly implemented or ineffective culture increases the chances of unethical or illegal behavior.

Despite the agreed-upon importance of culture, only 16 percent of executives believed their firm's culture is where it should be.[1]

Risk considerations

- The absence of employee engagement in objective setting and strategy discussions can lead to lack of ownership and accountability. Similarly, unreasonable employee performance expectations, including tight deadlines and stretch profitability targets coupled with inadequate resources, can result in low motivation and morale.
- An inflexible hierarchy impeding the flow of information up, down, and across the organization may result in risks going undetected or unreported, as well as conflicts between "micro cultures" and mistrust in the organization between employees and management.
- Failure to consistently reinforce desired behaviors, codes of conduct, and related policies and procedures can lead to a cancer of unethical behavior and wanton disregard of laws and regulations.
- Management refusing to acknowledge information contrary to their opinion can lead to employee mistrust of the organization.

Questions to ask/actions to take

- Do employees feel accountable for the proper implementation of policies, and do they take ownership of the strategy of the organization? Are employees' incentives governed by a clear understanding of your organization's core values?
- Does your organization promote and practice open communication on difficult subjects pertinent to the business? Do your employees feel comfortable discussing dilemmas and reporting errors and incidents of misconduct?
- Are policies and procedures accurate, concrete and complete, and do employees understand what is expected? Are desired organizational behaviors modeled by management and supervisors and visible to employees?

[1] Corporate Culture: Evidence From the Field, John R. Graham Duke University & NBER, Campbell R. Harvey Duke University & NBER, Jillian Popadak Duke University, Shivaram Rajgopal Columbia University | May 17, 2021

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