

Audit Committee Leadership Network

December 2019

ACLN

VIEWPOINTS

Oversight of corporate culture

Companies are under pressure to root out bad behavior and promote positive cultures to enhance long-term value. Executives set the tone at the top, but increasingly directors are expected to understand, monitor, and influence company culture too. It can be difficult, though, for non-executive directors to meet this expectation, as they lack regular exposure to the workplace. Boards are eager to enhance the ways they oversee this emerging governance priority. On November 1, 2019, members of the Audit Committee Leadership Network (ACLN) met in New York to discuss oversight of corporate culture. They were joined by Angela Travagline, senior director, audit and assurance, at GlaxoSmithKline (GSK), who runs an innovative culture audit program, and by Micah Alpern, a partner/principal in EY's people advisory services and Americas Culture Leader.¹ *For biographies of the guests, see Appendix 1 on page 10. For a list of meeting participants, see Appendix 2 on page 11. For a list of discussion questions for audit committees, see Appendix 3 on page 12.*

Executive summary

- **Key stakeholders are focusing on corporate culture** (page 2)

In recent years, major institutional investors and corporate governance policymakers have been focusing on corporate culture, in part to create and preserve long-term value. While acknowledging that management is responsible for corporate culture, they are looking to boards to better understand, monitor, and even influence culture.

- **Companies employ a variety of methods to assess and influence culture** (page 3)

Ms. Travagline described GSK's culture audit program, which is embedded in the corporate audit group and conducts regular assessments of key business units. These assessments include a mix of both information reviews and in-person interviews. ACLN members considered ways to assess and influence culture at their own companies. Culture audits and new approaches to old assessment tools like surveys can yield positive results.

- **Board oversight of culture** (page 7)

Most audit committees do not have a defined role in overseeing culture, although many audit committee chairs said they provide some form of culture oversight. Committees dedicated to ethics and culture provide an alternative, though they are still uncommon. Wherever culture oversight resides, members stressed that it is incumbent upon the board to look for management to maintain a positive culture throughout the company by being visibly aware, committed, and thorough in aligning behaviors with values.

Key stakeholders are focusing on corporate culture

Institutional investors and policymakers increasingly consider corporate culture as part of a company's long-term value proposition and purpose. They are looking for management and the board to align corporate purpose and strategy with culture and the operating model levers, such as incentives, structure, and decision rights.

Investors want a clearer picture of culture governance

The world's largest asset managers indicate that they believe positive corporate culture, like any intangible asset, affects value, and that corporate boards should work to shape and evolve it. Their recent statements encourage boards to consider this issue:

- **State Street Global Advisors.** Earlier this year, Cyrus Taraporevala, president and CEO of State Street Global Advisors (SSGA), issued an open letter to board members announcing SSGA's 2019 intention to focus on corporate culture as one of the "growing intangible value drivers that affect a company's ability to execute its long-term strategy."² Mr. Taraporevala said that despite the value that lies in corporate culture, "we have found that few directors can adequately articulate their company's culture or demonstrate how they assess, monitor and influence change when necessary."³ He called on companies to analyze corporate culture to test its alignment with strategy, initiate mechanisms to monitor progress, and improve reporting to aid directors in determining their role in culture oversight.
- **BlackRock.** In his 2019 letter to CEOs, BlackRock's Larry Fink said: "Over the past year, our Investment Stewardship team has begun to speak to companies about corporate purpose and how it aligns with culture and corporate strategy ... We have no intention of telling companies what their purpose should be—that is the role of your management team and your board of directors. Rather, we seek to understand how a company's purpose informs its strategy and culture to underpin sustainable financial performance."⁴
- **Vanguard.** In its Investment Stewardship 2019 Annual Report, Vanguard reported, "Unfortunately, we've witnessed instances in which risks turned into governance failures ... If a company's practices, organizational culture, or products put people's health, safety, or dignity at risk, they can pose a financial risk to investors too."⁵ Vanguard acknowledged the challenges board members face: "We understand that it is difficult for boards to assess company culture. Yet we have had constructive conversations exploring how both positive and negative news gets elevated to a board swiftly, what steps the board takes to ensure that company culture aligns with the espoused values, and how the board can identify and mitigate potential areas of cultural concern."⁶

Policymakers want companies to think more about culture

Asset managers are not the only stakeholders focusing on corporate culture. In June 2018, U.S. Securities and Exchange Commission Chair Jay Clayton delivered a speech focused on “[t]he importance of developing, improving and reinforcing positive culture in our financial institutions.”⁷ The message could apply to any public company and its board:

Every organization has a culture, and in some cases, the firm’s culture is in fact a collection of many sub-cultures ... Culture is not just what is said by management to the work force, but what is done, i.e., what actions are taken, day in and day out throughout the organization, with colleagues, customers, suppliers and regulators ... If culture is defined by the collection of countless daily actions taken across the organization, how do you ensure those actions are consistent with the organization’s cultural objectives?⁸

Foreign governance rules urging board oversight of culture

Some countries have recently revised their corporate governance rules to expressly require boards to consider culture:

- In 2018, the Financial Reporting Council revised the UK Corporate Governance Code to include the following principle: “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.”⁹
- Also in 2018, the Tokyo Stock Exchange released Japan’s revised Corporate Governance Code, which includes this general principle: “The board and the management should exercise their leadership in establishing a corporate culture where the rights and positions of stakeholders are respected and sound business ethics are ensured.”¹⁰
- In 2016, the Dutch Corporate Governance Code Monitoring Committee issued an amended code that reads: “The management board should adopt values for the company and its affiliated enterprise that contribute to a culture focused on long-term value creation, and discuss these with the supervisory board.”¹¹

Companies employ a variety of methods to assess and influence culture

Boards have shown increasing interest in assessing and shaping corporate culture. A full assessment of the firm’s culture can be challenging for non-executive directors, as their work within the organization and interactions with rank-and-file employees are limited.

GSK's approach to auditing culture

Ms. Travagline explained how GSK's dedicated internal culture audit process was developed and how its team works. The process began when GSK leadership asked Ms. Travagline, then a human resources (HR) leader at the company, to develop a culture assessment process for use by the internal audit function. *"We spent about a year developing and testing a methodology,"* Ms. Travagline said. *"It worked well, and we decided to embed it formally in the audit program."* She then left her HR role to lead the unit full time and build out a seven-person team with a mix of audit, human resources, compliance, and consulting backgrounds. This diversity is good for the program, Ms. Travagline said, because *"members of the team see things differently."*

Considering risk areas in particular business units, the audit team identifies units that could benefit from audit; it conducts 15 to 18 culture audits of business units or functions around the world each year. The team evaluates how well practices align with the company's values, which include "patient focus" and "transparency," and expectations, which include "accountability" and "courage." Some culture audits are standalone, while others are integrated into traditional internal audit reviews. Culture audits comprise approximately 10-15% of GSK's annual assurance plan.

Each audit begins with the selected business unit providing a self-assessment. The audit team gathers data about the business unit and then proceeds with its fieldwork. Ms. Travagline said that in addition to gathering quantitative data, the team elicits *"a large volume of qualitative data."* Interviews are a vital piece of the process because they bring context and meaning to the quantitative data. *"The interview data tells us how well the hard data matches up with systems and processes. Sometimes, you just have to talk to people to understand their beliefs and what drives behavior."* The process involves in-person interviews and one-on-one meetings with a random sample of the employee population within the selected business unit, across all levels of seniority.

For example, in evaluating "health and wellbeing," the audit team looks at quantitative data about overtime, absenteeism, and paid time off, while also asking open, qualitative questions such as: "Tell me about workload and how you prioritize. What do you do to have a healthy work/life balance?" Ms. Travagline said the audit team is able to gain rich exposure to the experiences of employees throughout the organization. *"We make visits around the company—not just in the headquarters. We understand the messages people hear and see, and the pressures they're under."*

GSK's culture audits conclude with a final report for auditees and senior management, which prompts action plans. The team's reports provide an overall audit outcome along with themes that are drawn from the qualitative and quantitative data. In narrative form, the audit team rates the maturity of the organization on several cultural dimensions. The maturity model *"defines*

the concepts in behavioral terms,” Ms. Travagline said. “This model is the backbone of our approach.”

Members were interested in learning how the program adds value beyond the insight derived from traditional employee surveys. One member asked, *“Our company is built on culture. We do things like engagement surveys to track it. What’s the incremental value of a culture audit?”* Ms. Travagline explained how her team’s process brings information about risk to light: *“Our audit process looks so broadly at culture, so we often come to different ways of looking at risk. It’s a way for people to share things in a safe, confidential environment, and it’s quite surprising how open people are when sharing views.”*

Other means of culture assessment

Few members reported personal experience with full-blown culture audits like the ones at GSK. *“We’re launching culture audits,”* one member said, *“but it’s early days.”* More typical approaches leverage Internal audit teams, along with HR, compliance, and other functions to execute a variety of assessment techniques. Widely used tools include:

- **Surveys.** Surveys are one of the prevalent culture assessment tools. *“My company uses a slew of surveys covering things like employee engagement, but with an integrated approach,”* a member said. Members and guests agreed that crafting surveys thoughtfully with an eye to actionable results increases their utility. Mr. Alpern reported a shift in how companies use surveys: *“We are seeing companies move away from the usual five-point surveys to a more open-ended approach. Shorter surveys, with questions like ‘Here are 30 traits, pick the five that exist in the company.’”* Ms. Travagline added that survey data helps her culture audit team identify risk areas and allocate limited resources: *“We get a lot out of surveys. We use the people survey to identify places that have gone through change or where people raise concerns about culture. It helps us set our priorities.”* Mr. Alpern observed that traditional surveys may fail to capture revealing anecdotes from employees: *“What’s missing in many surveys is stories. You have to understand where collaboration is at its best. I’ve heard stories from employees that I couldn’t have gotten from surveys.”*
- **Focus groups.** Focus groups let employees discuss their experiences at the company and contribute to internal cultural awareness. These interactions take place in a more structured feedback environment than social-media platforms and can lead to more constructive dialogue. Mr. Alpern said, *“Focus groups can be very targeted. Using story-telling and having employees describe when the culture is at its best and worst allow companies to prioritize what to change, how to change it, and what would motivate employees to adapt new ways of working.”*
- **Social media and internet monitoring.** Social media sites, company intranet message boards, and other electronic communication channels house valuable employee feedback about company culture. *“Social media shows real stories on the ground,”* a member said.

“Employees communicate internally and externally, which can lead to useful cross checking,” Ms. Travagline said. “We are starting to scan posts to look for any recurring messages about the company.” Mr. Alpern reported that “some companies are procuring sentiment analyses, which look through instant messages and emails to see how people are talking about the organization.”

- **Ethics or whistleblower hotlines.** Ms. Travagline and members said hotline reports can provide insights into company culture. Voluntary feedback about bad behavior does not reveal a complete picture of company culture, but it can highlight trouble spots or patterns of risk.
- **Site visits.** Many members visit company worksites to see how the company operates and hopefully get some exposure to its true culture. Unscheduled visits and meetings with a range of managers and employees often reveal more about true workplace culture than scheduled visits with choreographed tours and presentations.

Mr. Alpern said companies conducting assessments often fail to see how the operating model design, such as incentives, creates behavior. He encouraged members to look for a connection between employee behaviors, the incentives that motivate them, and the connection to the company’s operating model: *“With those three, you can see what’s being lived.”* One commentator said, “Financial and non-financial incentive programs may exist that do not support the core values of an organization and, in some cases, may be extremely harmful. Internal auditors should examine whether compensation and performance metrics are aligned with the organization’s policies and values.”¹²

Methods of influencing culture

Assessing culture effectively is just the first step toward changing it. Surveys, interviews, and hotline reports can reveal major issues, but using those results to maintain, refine, or even revamp culture is the objective. Companies often struggle to close the gaps between the culture they want and the culture they have.

Ms. Travagline said it is important to target specific issues; transforming culture requires identifying what characteristics are most important. She noted that companies can get tripped up if they try to satisfy too many objectives. *“It’s the clarity of focus in what you go after that allows you to make meaningful change,”* she said.

Changing culture may require reconciling two priorities within a company, like efficiency and safety, that conflict with each other. Mr. Alpern said he has observed misalignment: *“We see lots of organizations say they want to be more innovative, for example. We look at their operating model and discover that a new innovation has to get 20 levels of approval. They’re basically stifling the creativity they say they want. It ends up creating a real ‘say-do’ issue.”*

Board oversight of culture

Directors want to promote good company culture, but boards do not always have a clear idea of how to provide useful oversight. Members and guests discussed several oversight models and other considerations for directors looking to play a bigger role.

Audit committee oversight

Since culture is so closely connected to key areas of audit committee oversight, many members have experience with some aspect of culture oversight. *“You always think about culture,”* one member said. *“You look at the motivational side, the production side, and when you do the audit.”* Another member said, *“There’s a link between culture, compliance, conduct, and ethics. There are a lot of things the audit committee cares about. That link is something we find very important.”* Some members welcomed the opportunity to play a bigger role in driving culture reform from the audit committee. One said, *“If incentives are causing wrongful action, I could see the audit committee saying it wants a culture check on compensation. I’d want to see the values issued on letterhead. I could see that being an audit measure.”*

Other members alluded to the practical limits of audit committee oversight. One asked, *“If safety is a goal, and the company isn’t spending enough money on it, what’s the audit committee’s responsibility to look at the risks of these things?”* Another member said that just because a culture generates a key risk, it is not necessarily an audit committee issue.

The GSK culture audit team incorporates results into broader internal audit reports that are presented to the audit committee and full board. Ms. Travagline observed, *“We’re on the front end of keeping the board more accountable for culture.”* She noted the challenge of assessing the board’s appetite for discussing issues flagged in the culture audits as board members are not likely to review individual audits at a granular level. But, she said, each audit can reveal strengths or weaknesses in the connection between values and expectations and the corresponding desired behaviors throughout the company. *“If a unit scores high, we look to see how the desired result was achieved. At least once a quarter, we bring auditors together and ask, ‘What is something to put on the radar?’ and try to bring every voice out so we can stay abreast of any emerging trends they see in their work.”*

Other efforts at board oversight

Like any emerging board topic, culture oversight might not yet be delegated by the full board to a specific committee. Regardless of where on the board culture is discussed, members were eager for advice on how to improve oversight. Input from members and guests revealed some things to look for in the company:

- **Tone at the top backed by vigilance and awareness.** Members said that the success or failure of any effort to improve company culture depends on the signals sent by the board, CEO, and other senior leaders. Ms. Travagline encouraged members to ask management a

fundamental question: *“How do you really know that the culture is what you think it is?”*
Senior management has taken the findings seriously and set objectives in response.

- **Highly visible, well-supported initiatives.** GSK’s program and those like it depend on buy-in and consistent support across the organization. Even with support, not every effort to assess and improve culture will succeed on the first try, but the attempt sends a compelling message inside and outside the company that its leaders take culture seriously. After Ms. Travagline described the positive internal reaction to culture audits, one member observed with approval, *“You’ve made the audit part of the culture.”*
- **Alignment of inputs with desired outputs.** Many companies list their values and goals on posters and websites but do little more to promote a desired culture. Mr. Alpern encouraged members to ask management, *“Is the operating model reinforcing the behaviors and culture we want?”*
- **Values and principles that can be adapted to all parts of the company.** *“It’s important to have the same values across the organization,”* a member said. While many companies espouse a handful of tenets to guide culture, they often struggle to get those concepts to take root throughout the organization—especially if the company operates in a variety of local geographic cultures. Acknowledging the challenge, Ms. Travagline explained that, *“It’s not just the words. You need people to help translate what they mean. It may be difficult, depending on how different two parts of the business are.”* Consistency can be particularly difficult to achieve after a merger. Mr. Alpern said that where two successful companies with very different cultures merged, *“They met in the middle. One company was used to moving quickly but making too many mistakes. The other company was consensus oriented, bureaucratic, and focused on purpose. They arrived at a culture of moving with speed and purpose.”*

Conclusion

ACLN members are interested in discovering ways for their boards to engage more actively in culture oversight. While they consider culture in a variety of ways, they see opportunities to enhance their understanding of company culture through assessments and other techniques. Creative approaches to qualitative and quantitative assessment and alignment of processes and incentives with cultural goals helps companies move in the right direction. These approaches work best when deployed holistically and with the support of leaders at all levels of the organization.

About this document

The Audit Committee Leadership Network is a group of audit committee chairs drawn from leading North American companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisers as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

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Appendix 1: Guest biographies

- **Angela Travagline** is a human capital and organization development specialist. Currently, Angela is a senior director in audit and assurance focusing on GSK's culture audit program. This program addresses a critical gap in a traditional audit function, providing an independent perspective on leadership, mindsets, and behaviors that underlie the internal control framework. Angela leads a team of directors who deploy this innovative methodology across countries and business units. Prior to her role in audit and assurance, Angela was a director in the learning organization, where she was accountable for the deployment of GSK's leadership and management curriculum in the United States and the United Kingdom. She led a team of seven professionals dedicated to delivering high-quality professional development to a multinational audience. Her team managed the implementation of leadership programs, raised awareness of development resources at GSK, and consulted with the business on its learning needs. Angela has a passion for developing people and is a certified, internal coach at GSK.
- **Micah Alpern** is a partner/principal at EY who is the Americas Lead for EY's culture solution. Micah helps organizations build and deliver global leadership programs, culture evolution, and large-scale transformations, with a digital focus. He has published many articles on these topics and has been referenced as a thought leader in several major publications. In his current role, Micah is focused on EY's Culture Evolution and Transformative Leadership offerings. He also has extensive experience applying organization network analysis (ONA) to accelerate transformations. Micah works directly with clients and speaks at client and industry events. In his client work, Micah partners with executives to deliver leadership effectiveness, leadership culture, culture assessment and evolution, strategic change management, operating model design, digital transformation, and workforce engagement. Micah holds a master's in business management from the University of Florida and bachelor of science in economics and communication studies from Northwestern University.

Appendix 2: Participants

The following ACLN members participated in all or part of the meeting:

- Pam Craig, Merck
- Dan Dickinson, Caterpillar
- Sheila Fraser, Manulife
- Fritz Henderson, Marriott
- David Herzog, MetLife and DXC.technology
- Charles Holley, Amgen
- George Muñoz, Altria
- Tom Schoewe, General Motors
- Leslie Seidman, GE
- Jim Turley, Citigroup and Emerson Electric
- David Vitale, United Continental
- Robin Washington, Salesforce.com

The following European Audit Committee Leadership Network members participated in all or part of the meeting:

- Werner Brandt, Siemens
- Eric Elzvik, Ericsson
- Helman le Pas de Sécheval, Bouygues
- Jon-Erik Reinhardsen, Telenor Group
- Carla Smits-Nusteling, Nokia

EY was represented in all or part of the meeting by the following:

- Jim Estes, EY Americas Vice Chair of Professional Practice
- John King, EY Americas Vice Chair of Assurance Services

Appendix 3: Discussion questions for audit committees

- ? How are legal or regulatory changes affecting the conversation about corporate culture at your board?
- ? What questions are your management teams fielding from investors and other stakeholders about corporate culture?
- ? What are key stakeholders saying about corporate culture at your company?
- ? Is your company clear about the culture it wants? Does it have a standard or a vision against which to measure its progress?
- ? How does your company understand and shape culture? What roles do the board and audit committee play?
- ? Which corporate function(s) should be responsible for assessing and shaping corporate culture?
- ? Which tools are most useful for understanding a company's culture? How are your companies utilizing these tools?
- ? Are your colleagues on the board and audit committee open to taking a more active role in culture oversight? How might you meet resistance there?
- ? If management resists board efforts to see and influence culture at the company, what are possible responses?

Endnotes

¹ *ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Quotations in italics are drawn directly from conversations with network members in connection with the meeting.

² Cyrus Taraporevala, [letter to SSGA board members](#), January 15, 2019.

³ Taraporevala to SSGA board members, [letter](#).

⁴ Larry Fink, "[Purpose and Profit](#)," BlackRock, January 2019.

⁵ Vanguard, "[Investment Stewardship 2019 Annual Report](#)," 2019, 20.

⁶ Vanguard, "[Investment Stewardship 2019 Annual Report](#)," 2019, 11.

⁷ Chairman Jay Clayton, "[Observations on Culture at Financial Institutions and the SEC](#)," U.S. Securities and Exchange Commission, June 18, 2018.

⁸ Chairman Jay Clayton, "[Observations on Culture at Financial Institutions and the SEC](#)," U.S. Securities and Exchange Commission, June 18, 2018.

⁹ Financial Reporting Council, [The UK Corporate Governance Code](#) (London: Financial Reporting Council, July 2018), 4.

¹⁰ Tokyo Stock Exchange, [Japan's Corporate Governance Code: Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term](#) (Tokyo Stock Exchange, June 1, 2018), 2.

¹¹ Corporate Governance Code Monitoring Committee, [The Dutch Corporate Governance Code](#) (The Hague, Netherlands: Corporate Governance Code Monitoring Committee, December 8, 2016), 26.