Culture: Surveys vs. Root cause analysis
By James C Paterson

I've just been to Stockholm working with a number of companies on a workshop about understanding and auditing culture. As some readers may know, I am a firm believer that culture cannot simply be captured by surveys, This is one of the reasons that the IIA UK guidance on auditing culture (which I helped to draft) contains a warning about the use of culture surveys. After all, a survey of the culture of a particular department might suggest a reasonable culture according to the 75% of staff that completed the survey, but what about the 25% that did not complete the survey?! And what about the views of temporary or contract staff who are asked to carry out administration tasks but who are not company employees?

In addition, the fact that overall a survey gives a reasonable result does not mean important issues will not arise – a credit department may have well documented procedures, reasonable training and a reasonable working environment overall, (and therefore have a satisfactory culture according to a survey), but in some instances, when there is pressure to sell, a credit department may not have the capacity to check the background of potential customers quickly enough, leading, for example, to internal audit observations of incomplete credit checks with the risk of potential bad debt write offs in the future.

However, in the case we examined the audit team had seen weaknesses in credit control, on other occasions (as many audit teams do), suggesting deeper cultural issues with effective credit management on an ongoing basis.

This is where Root Cause Analysis can play a key role in unpicking the cultural and organizational factors at play. The points below emerged from a discussion with the auditors involved in a recent credit department audit.

1) Why were no credit checks carried out?
   - A) A sales initiative was started without checking whether there were sufficient staff available in the credit department to carry out the background checks that were needed; as a result:
   - B) A backlog built up that could not be processed properly because of resource constraints within the credit department, so to address this some "override" codes were entered allowing sales to proceed without full background checks being done.

2) Why wasn't there a greater interest in stopping sales that had not had credit checks?
   - A) Sales staff were incentivized to sell – getting bonuses for meeting sales targets – with no claw back (for anyone) concerning bad debts
   - B) Management were also incentivized to meet sales targets so they could to meet analyst expectations – again with no immediate consequences that sales may have been made to riskier customers

C) The credit department was "not expected to be a barrier to sales", hence implicit pressure to shortcut checks – ostensibly on an "exceptional basis" but in practice for numerous periods and even if carried out later, too late to correct a sale to a customer with a poor credit history.

3) Were there no other ways the Credit department could have managed better?

A) Well, the Credit manager could have been expected to flag up to their manager whether they had concerns about resources, but:

i) they reported to the same management team who were incentivized to sell and had been told there was no extra money for "back office" functions;

ii) they were keen to show that they could "manage" and did not want to suggest that they were no capable of doing their job;

iii) There was no explicit expectation for the credit manager to report on their workload and backlog, nor a clear process to address this.

B) The Credit manager could have asked for some staff in other departments to have been trained on credit risk and made available during peak periods, but there was limited appetite to carry out secondments like this from other managers, and no additional resource available to hire in temporary help. This lack of sharing of resources was reinforced by functional priorities (in all areas) and a reluctance from any manager to suggest they could not cope themselves.

4) Could the compliance department have spotted the absence of checks?

A) In principle, yes, but the compliance department normally carried out a routine cycle of checks from time to time and not on a timely enough basis to have spotted the problems of resource shortages;

B) Compliance were not informed about up and coming sales promotions;

C) Compliance was not seen as a "safety valve" who should be alerted when procedures were not being completed.

5) Was the absence of some credit checks in fact an implicit risk appetite statement by the business?

A) Potentially this was the case, but without any sort of formal analysis – and much more likely a post rationalization of the status quo, rather than a deliberate choice;

B) However, it was thought that, if pressed, no one would formally take accountability for signing off an explicit risk appetite.

In summary ,the absence of credit checks is the result of a complex combination of cultural and organizational factors and a simple suggestion that "staff should complete credit checks" glosses over the reason that credit checks do not get done.

Thus gathering evidence during the audit assignment about why the checks were not carried out (looking for Root Causes) will enable audit to identify and raise key cultural factors that result in problems. In this instance, the most important issues to raise relate to what should be done to monitor the workload of the credit department (to check it is coping with its task) and to allow the credit department to cope with peaks in demand (by hiring temporary staff or seconding existing staff). Contributing factors such as communication and co-ordination between sales and the credit department, and the need to budget for support resources, alongside resources for promotional campaigns are clearly areas to bear in mind.

Other factors such as the behaviour caused by bonus schemes is also something that could be mentioned by audit but – in my experience – this sort of area is normally only changed when there is a strong body of evidence across a range of areas that the bonus scheme is contributing to issues.

If you are interested to learn more about Root Cause Analysis and how it can help Internal Audit's understanding of culture contact jcp@RiskAI.co.uk