

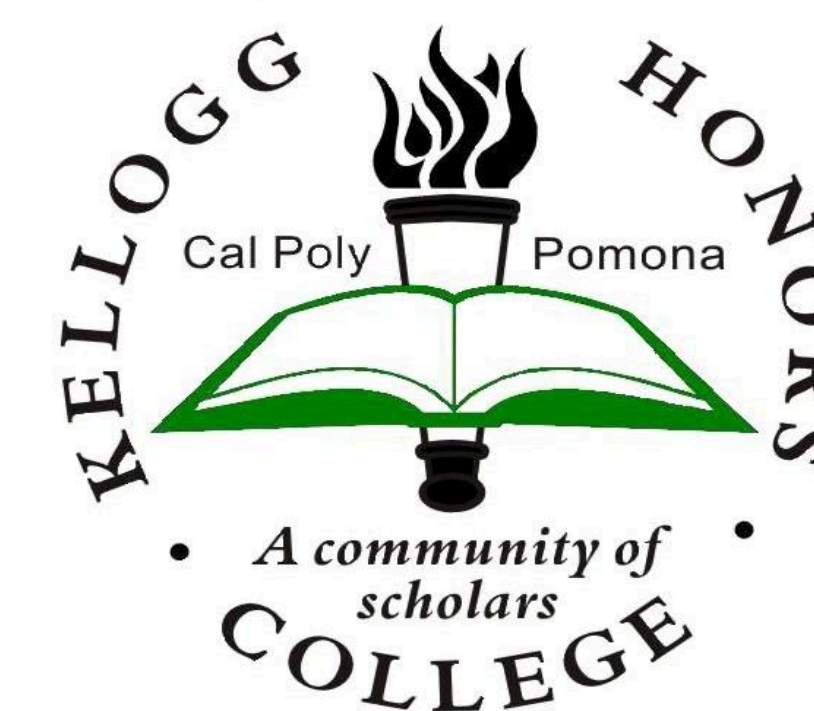
Auditing Corporate Culture: How Culture Affects Fraud



Tyler Fong, Accounting

Mentor: Jason Nishiyama CIA, CISA, CGAP

Kellogg Honors College Capstone Project



Abstract

Corporate Culture is a critical aspect of a company. Culture affects how a company is run, how employees will react, and determine ultimately its success. A healthy culture includes clearly defined values listed not only on the company website but instilled in all employees, strong teamwork and collaboration at all levels, honesty and transparency from employees including ownership and accountability for any work done. When looking at toxic cultures, we see that there is imbalance within the company and leads to processes of that don't run well. Culture is plays a core function in companies and we have seen over history cases of toxic culture leading to unethical and illegal actions in large corporations in America

In our comprehensive capstone study we endeavored to help show that culture played a key role in some of the biggest scandals in business today. Our approach included the following:

- Study of various articles documenting history of recent unethical corporate fraud.
- Using the COSO Internal Controls framework to analyze key components.
- Creating a scoring system, to analyze which COSO component had greatest impact to the fraud.
- Create a potential audit program to help companies identify culture risk.

We analyzed several companies that have had bigger fraud cases in recent years to identify how culture played a role in these fraud cases. After analyzing, we predict that culture plays a huge role in a company's control environment which I how employees act in the company which in turn can lead to fraud

What is Culture?

A healthy culture includes clearly defined values listed not only on the company website but instilled in all employees, strong teamwork and collaboration at all levels of employees, honesty and transparency from all employees and ownership and accountability for any work done. The results of a healthy culture can lead to many positive outlooks for a company including but not limited to encouraging long term focus, promotes healthy risk taking, and creates quick resolution of differences. This is all good and all but what happens if a culture is toxic? When looking at a toxic culture, we can see that there is imbalance within the company and that the process of the company just don't run well. Some characteristics of a toxic culture include having separate standards for different people, poor lines of communication, unproductive employees, and not being able to work to their potential. With these characteristics, the results of a toxic culture can lead to loss of confidence in leadership, erosion of brand and reputation damage, and unethical and illegal behavior.

The Fraud Triangle



What is Fraud?

Fraud consists of activities undertaken by an individual or company that are done in a dishonest or illegal manner, and are designed to give an advantage to the perpetrating individual or company. Corporate fraud schemes go beyond the scope of an employee's stated position, and are marked by their complexity and economic impact on the business, other employees and outside parties. Corporate fraud can be difficult to prevent and to catch.

COSO Cube

In 1992, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) developed a model for evaluating internal controls. This model has been adopted as the generally accepted framework for internal control and is widely recognized as the definitive standard against which organizations measure the effectiveness of their systems of internal control.

The COSO model defines internal control as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance of the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

In an "effective" internal control system, the following five components work to support the achievement of an entity's mission, strategies and related business objectives.

Components of COSO

Control Environment- Integrity and Ethical Values, Commitment to Competence, Organizational Structure, Human Resource Policies and Procedures

Risk Assessment- Company-wide Objectives, Process-level Objectives, Risk Identification and Analysis, Managing Change

Control Activities- Policies and Procedures, Security, Application Change Management, Business Continuity, Outsourcing

Information and Communication- Quality of Information, Effectiveness of Communication

Monitoring- Ongoing Monitoring, Separate Evaluations, Reporting Deficiencies



Analysis of Wells Fargo

In 2016, suspected misconduct was made known to the public when the Office of the Comptrollers fined Wells Fargo \$185 million. They were accused of 2.1 million fraudulent accounts that had been opened by their employees to meet quotas between May 2011 and July 2015.

- Control Environment- Top down process, Executives sent down quotas (negative), "Go for Gr-eight"
- Risk Assessment- Lack of process to control employee action, No controls on creating accounts
- Control Activities- No controls to carry out, Lack of control activities
- Information and Communication- Lack of information of fraud, No communication from upper management
- Monitoring- No monitoring of activities, "frontline employees could feel ungoverned and libertine enough"

Since the 1998 acquisition, Wells Fargo, "urged employees to 'Go for Gr-eight', meaning getting around 8 banking products per customer when the industry average was two to three." This mantra lasted until 2015 which matches the timeline of the fraud cases. Such a control environment and pressure from the top shows one of the stages of the fraud triangle "pressure". The culture of "Go for Gr-eight" greatly pressured employees to get results and when they couldn't reach those result, in order to escape consequences started creating false accounts. Another culture aspect of Wells Fargo that allowed employees to achieve the results they did was the lack of monitoring. According to fortune.com, "employees could feel ungoverned and libertine enough." This also links to the element of the fraud triangle of opportunity. If the employees were governed and didn't have the opportunity, they wouldn't have committed the fraud.

In the graph on the right, we scored each component based on several key factors of the controls such as being perceived as weak by employees on a scale of 1-5 with 5 being the highest possible score. The higher the score the more detrimental affect it has on the company.

(These points were assigned by me taking from research done for this project for our own purpose.)

As you can see, looking at how the COSO components are perceived as weak by employees, each COSO component is scored on the higher end of the scale meaning that the employees feel that these components could have major improvements. By looking at the how large the impact of each component is, we see that the control environment, which is culture, and control activities had the largest impact connecting to fraud. Analyzing the table, the control environment and the control activities have the greatest impact towards fraud.

Wells Fargo	Perceived as weak by employees	Impact Component has to fraud	Failure noted by regulators and/or audit	Total Score
COSO Component				
Control Environment	5	5	4	14
Risk Assessment	4	4	2	10
Control Activities	3	3	2	8
Info/Communication	4	4	2	10
Monitoring	4	4	3	11

Conclusion/Results

By looking and analyzing several companies, we can see a correlation between corporate culture and fraud. We can see that COSO components, especially control environment and control activities, have a huge impact in fraud. Corporate culture plays a huge role in the control environment which plans a huge role in how employees view and act in the company. Of the 6 companies that we analyzed, we found that any company with the score of over 10 had a huge fraud case and companies with a score of 6 or more were highly susceptible to fraud. Some things companies can do to audit their culture include: have regular meetings discussing company culture and employee understanding of company culture, make sure company culture doesn't bring pressure to employees, directly communicate with employees about their concerns about the company.

References

Inside Wells Fargo's Plan To Fix Its Culture Post-scandal <http://fortune.com/2017/06/11/wells-fargo-scandal-culture/>
Sharise Cruz - <http://info.knowledgeleader.com/bid/161685/what-are-the-five-components-of-the-coso-framework>
For other references, please ask

I'd like to thank Professor Nishiyama for introducing this awesome topic to me and supporting me through this project.