



ICAS RESPONSE TO FRC

CORPORATE CULTURE

Introduction

1. ICAS welcomes the subject of this FRC project and the opportunity to contribute. We are a leading professional body for chartered accountants with over 20,000 members working across the UK and internationally. Almost two thirds of our working membership work in business; others work in accountancy practices ranging from the Big Four in the City to the small practitioner in rural areas of the country.
2. ICAS' Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.
3. ICAS has constituted a specific working party to contribute to this FRC project.
4. Given the relative immaturity of corporate culture as a topic, we have approached our response differently. We established a working party to seek the views from a number of members in different organisations. We have therefore provided a combination of comparative practice, learning experiences, shared views and thoughts on areas for further debate.
5. We look forward to our forthcoming meeting with representatives from the FRC on this topic and may update our response in light of that discussion.

Key messages

6. Corporate culture is very much an emerging area of focus in business. It is still quite early to identify good practice in action and to offer formal recommendations on how boards should behave, develop and monitor an organisation's culture although we recognise the range of research and literature on the topic. We are not convinced that actual good practice is really determinable at this early stage, although there are inevitably pointers to be explored.
7. We note that the timescales for this project are very short for such a complex and evolutionary topic. We view this as part of a much longer development project. A useful first step would be for the FRC, through this project, to offer a common understanding of corporate culture, to define key terminology and to offer some ideas for boards to consider when discussing this topic.
8. We strongly believe that a prescriptive approach should be avoided in such a complex and amorphous area and we certainly do not believe it would be appropriate to regulate. We welcome the FRC's initiative to help UK boards' awareness in this area by starting to consolidate and share case studies, educational material and developments.
9. Although guidance may seek to identify principles and guidelines that could apply across all organisations, flexibility for a proportionate approach will be needed as the range of complexities of large multi-nationals will not apply to most small and mid-cap UK corporates.
10. Gathering perspectives from across the organisation (perhaps also stakeholders), not just at board level, would be really helpful. Identification of any disconnects between perceived and actual "culture" can be very informative.
11. The board is ultimately responsible for defining culture and deciding how it wishes to obtain assurance; the CEO is responsible for implementation and embedding. It is a joint initiative to embed the desired corporate culture, at both the organisational and individual level. Leadership is the prime shaping force, however, the role of the individual lies at the heart of providing the catalyst for change and promoting ethics and corporate values.

12. ICAS is willing to share with the FRC our bank of case studies including ethical dilemmas (on icas.com) and director dilemmas (a research report). We have also developed a draft definition of ethics and a conceptual paper on the public interest (which are not yet publicly available) in addition to a policy paper on the role of the Chartered Accountant, to help drive ethical behaviour in their organisations (The Power of One)¹.

A starting point

13. We recognise that various organisations are exploring and developing approaches but it is still early days, so we would caution the FRC against taking a definitive stance on what is good practice as it is unlikely to be tried and tested and likely to be subject to further evolution. Given the nature of the topic, what works for one organisation may not necessarily be quite so effective in another. At this exploratory stage, it is helpful to share what others are doing and what appears to be helpful or otherwise to stimulate development but outputs will need to be appropriately caveated – i.e. this is not a tick box exercise and a standard approach will be unlikely to deliver effective change, if change is required. Each organisation will need to make its own judgement.
14. Corporate culture is ill defined and there is no common understanding. A useful first step would be for the FRC to offer a common understanding of corporate culture and define key terminology. This would help to facilitate a consistent debate and help to identify what changes are needed to improve. Our preference would be to move away from the amorphous term ‘culture’ and focus more on ‘behaviour and values’ which includes ethics and integrity.
15. We also suggest that the FRC could further clarify the objectives of this project, for example, is the purpose about instilling in the boardroom the primacy of integrity, social responsibility, moral courage and fairness as important attributes to drive sustainable success? If so, what can be done to ensure that business leaders exhibit and embrace these attributes irrespective of other drivers of corporate culture?
16. ICAS sees culture and ethics as intricately related. We reviewed a selection of FTSE 100 companies (in a range of sectors) and identified that most identify their values on their websites and although there was a wide array of values, the one common theme was that organisations generally cited at least certain values with some form of ethical connotation.
17. We have developed a draft definition of ethics (focused on Chartered Accountants) to be used in combination with our [Code of Ethics](#). This could serve as a starting point for broader business use. Although we are not able to formally or publicly share the definition at this stage, we can say that in essence, it is a combination of judgement regarding what is the right thing to do and having the moral courage to follow through with the appropriate actions. We would hope to be able to share the final agreed definition in due course.

Leadership and the Power of One

18. The complexity of culture means that leadership action is the key driver, although processes and controls have a role. Whilst there is a need to establish an appropriate “tone at the top”, it is equally important for this tone to be cascaded down through the rest of the organisation and embraced by all those who work in the organisation. This needs to be accompanied by clearly communicated and understood consequences for breaches/ rewards for good behaviour. It is a joint initiative, to change and implement culture, both at the organisational and individual level.
19. An organisation is perceived and remembered by the way its employees behave². Corporate values often have ethical connotations. Although organisations set the corporate values, it is the employees who follow them and who are likely to have their own values which could influence how the corporate values are practiced and who ultimately determine whether or not the ethical values which the organisation seeks to emulate are actually realised. This distinction is important in creating the right environment for change and clarifying how employees observe and practice the corporate values.

¹ See our note in Annex A

² Power of One - paragraph 4.5

20. ICAS has published a policy paper called the 'The Power of One'³ which is intended to highlight the importance of the leadership role that each individual has to play in regard to culture, values, ethics and integrity. It is focused on CAs but the principles have wider applicability across business. A fundamental principle is the emphasis on the role of the individual as the catalyst for change and their role in promoting ethics and integrity, and corporate values, in the workplace.
21. The themes of the 'The Power of One' (i.e. personal responsibility, ethical leadership and moral courage) operate in practice by CAs having a professional and moral obligation, both individually and collectively, to comply with a professional code of ethics. To broaden this across business, there would need to be some other code to guide / support the individual in that organisation and stress the importance of the role of the individual. We appreciate and welcome that many organisations already have a Code of Ethics (or Code of Conduct) which could serve as a potential benchmark
22. A Code is something which individuals can be held accountable against and also something which they can refer to for guidance as appropriate. The process of embedding this in an individual's daily habits is important so that it is not just signposted at induction and forgotten about. How ICAS embeds its Code of Ethics is detailed in Annex A. We would stress that this process is evolving and ongoing.
23. We are supportive of transparency as an effective means of informing stakeholders (internal and external) as well as being an effective driver of change. A published code of ethics and values can help to engender trust by increasing predictability of behaviour and communication – its sets the expectation, both internally and externally. It can also help to embed the importance of trust and integrity across the organisation and be used to support the decision making process.

A Code of Ethics

24. As part of developing the environment for embedding the desired culture, we would encourage those companies who have not already done so to develop their own Code of Ethics as part of a framework for communicating expectations on standards of behaviour and guiding individual employees to "do the right thing".
25. As a comparative, ICAS adopted a Code of Ethics to set expectations publicly as well as across the membership. It serves to guide and encourage CAs to "do the right thing" and to act in the public interest. To contribute to the development of thinking on board culture, we can offer details of how our professional body has incorporated ethical considerations and our framework for embedding specific ethical principles across our membership. This framework may provide the bones of a transferable model, which is relevant across business, not just for professional accountants. Further details are provided in Annex A. Please note that this area is currently evolving within ICAS to adapt to changing needs and expectations.

Embedding tone at the top

26. It is essential that those in charge of organisations set the appropriate tone and corporate culture, and in particular 'walk the talk'. Nothing is more destructive than to be told to behave one way and seeing your immediate boss ignoring the very same corporate policies and values. Given the level of responsibility directors have in the organisation and the essential role they play in setting and embedding the right corporate culture, we believe it is critical that directors should act with integrity (to lead by example) and probity (representing their duty to challenge).
27. This is what they should be doing anyway, so these duties are not controversial as such, but to help embed this more broadly across UK listed companies, it is worth discussing whether the UK Corporate Governance Code "the Code" has a role to communicate this responsibility and ethical expectation.
28. Just to illustrate how it might operate, the introduction of a principle pertaining to the directors' ethical duty could be included in the Code. This would develop the Code principle A.1 (para 5.3),

³ The Power of One – Annex A

slightly extending it to introduce the principles of integrity and probity. This could form part of the organisation's own code of ethical principles which in turn, set out an expectation that directors not only set and observe values but also live by them, to help embed them in the workplace. Setting their own values and a code of ethics could provide a benchmark against which businesses could report.

29. Introducing the expectation for a Code of Ethics in companies and even an ethical duty for directors is one mechanism which could help to ensure that the correct 'tone at the top' is in place within UK plcs.

Delivering sustainable success

30. Building and retaining trust in business is vital given its important role in our economy and society. It is essential that businesses maintain their reputation, public confidence and support - corporate culture undoubtedly has an important role in this regard. Organisations which are trusted are likely to see more repeat business, potentially are able to charge a premium for their products or services and will be seen as a good place to work by existing and prospective employees. Building a positive corporate culture, embedding and communicating corporate values are an increasingly important facet to achieving trust and sustainable success.
31. Culture is an important but challenging concept for boards. The role of the board is vital and it is unlikely that culture has had enough "air time" around the board room table. It is important that this changes going forward. At this stage it would be helpful to encourage greater discussion of corporate culture at board level. This is a cross-cutting and multi-faceted topic across many unconnected areas and will require a contribution from different departments and specialists to take forward.
32. "Company purpose" is an important aspect that comes from and is agreed by the board. It is vital that this goes beyond purely financial goals. This is something concrete and enduring that can be used as a benchmark to determine whether organisational behaviours are in line with the stated purpose. Most companies also have value statements, again, these are concrete and can be used as a guideline to judge behaviours. We would encourage board members to look at the company's purpose and those values and challenge the executives as to whether the decisions they are making and the way they are implementing them is in line with those values and the purpose. Organisations are normally very good at ensuring that financial returns from a proposed investment are in line with financial guidelines but it is far less certain how often investment decisions are challenged against the business purpose and more value based guidelines.
33. Whilst a company's culture is often developed over years it can be changed over a relatively short period of time by a change at the top of the organisation. The Board must understand this and make sure it monitors what is changing and why. This must start with the Chairman/CEO relationship. The Chairman is with the CEO regularly and is in the business more than the NEDs and so is best placed to sense when things may be changing. It is vital this relationship is functioning well. If not, the role of the board is often severely challenged and this is where the Senior Independent Director (SID) has an important role to play. Some questions that should be asked at this level include:
- Is the Chairman/CEO relationship a good one? If not, can the Senior Independent Director play a role here?
 - How often in Chairman/NEDs meetings does culture come up in the conversation?
 - When the Chairman/NEDs return from site visits, how often is culture discussed.
 - Is culture included on the Board agenda?
 - How sensitive the Board is to 'soft' issues? - This seems an important aspect of understanding culture. Examples include diversity, social and environmental impact, and community integration.

People issues

34. Corporate Culture is equal to the sum of the values of all the people within an organisation, which is guided and influenced by leadership, behaviour, personal responsibility, integrity, ethics and

moral courage. For each individual, ICAS would encourage the principles of 'The Power of One' to be followed.

35. We see some of the main challenges as follows:

- Identifying the wider consequences of pushing through change to culture, where change is found to be needed and having the moral courage to see it through;
- Encouraging and empowering people to do the ethical⁴ thing and inculcating the habit of ethical behaviour;
- Encouraging and empowering ethically-driven individuals with the confidence to speak out and influence others, to assist in the promotion of good behaviours and the resolution of ethical dilemmas arising in day-to-day business activities. 'The Power of One' offers an example of how this could be done;
- Moving the debate from remuneration to reward, e.g. including non-financial matters;
- Defining business purpose and linking peoples' objectives to business purposes;
- Discussing and understanding the people risks relating to conflicts of interest and putting in place the necessary controls to manage those risks;
- Getting people, especially the business leaders, to focus on leading by example and living the company's values;
- Adapting to the changes in how people now lead their lives, including the blurring between their business and social lives in today's world of digital communication; and
- Considering the impact on 'good' corporate culture of certain shareholder groups who may be more focused solely on short-term financial return.

36. Corporate integrity is ultimately dependent on the application of the right values in day to day decision making. In our view, organisations that empower their people to act with integrity will likely have more engaged, motivated and inspired employees who will require less oversight by way of rules and policies in delivering growth and value.

37. To succeed in changing culture will inevitably involve changing some of the people and minimising the influence on business decision-making of those who do not have high integrity and who disrupt efforts to embed the desired ethical behaviours. The easier answer for individual business leaders is often to move those behaving badly on. It could be argued however, that attempting to tackle behavioural change first, is in the wider public interest as such individuals can easily transfer and influence the culture of another organisation. This area requires further consideration and it would be helpful to share case studies with examples of how organisations have successfully tackled personnel problems.

38. Each organisation has to make its own judgements however, a common definition of ethics could offer a useful starting point for business along with access to case studies to refer to and use for staff training. ICAS has published a series of business ethical case studies⁵ on our website which can be freely accessed. We are also due to publish a research report called "Directors Dilemmas" which contains a collection of case studies. A copy will be forwarded to the FRC when this is published which we anticipate to be in March 2016.

39. Clearer communication and understanding of the value generated by the business to its customers and stakeholders is another initial step forwards.

40. A well communicated strategic purpose which is aligned with incentives and rewards is important to truly align people and culture and help move business behavior forwards. An important aspect of people issues is to understand where conflicts may arise which could generate behaviours that are inconsistent with the corporate values. As part of this, we would encourage a central focus to the debate on culture to be around how it can be influenced by the approach to reward.

⁴ ICAS definition of ethics to be shared once authorised

⁵ <https://www.icas.com/ethics/shades-of-grey> & https://www.icas.com/?f.Popular_topics|C=Ethical_dilemmas&f.Categories|B=Ethics

41. The term “remuneration” is too narrowly focused on financial emoluments. This can have the negative consequence of tempting individuals through self-interest toward unethical actions and outcomes. We would encourage a broader interpretation using the word ‘reward’ to consider wider factors driving appropriate and ethical behaviour. This needs to extend into non-financial matters for example the types of objectives set for individuals, the terms of performance bonus plans, the qualities sought when recruiting senior managers, the attributes of the recruitment process, the integration of all aspects of reward and recruitment with corporate values etc.
42. Introducing an element of discretion into reward or incentive structures can assist in mitigating these effects; and also over the longer-term, if well implemented, build trust between managers and employees. However, investors can be critical of this, as it diminishes the focus on short term financial rewards at the expense of longer term sustainable success. Demonstration of this through examples or case studies would be a useful output from this project. We are also aware that shareholder groups are looking at the whole issue of reward structures. We believe it would be beneficial if they considered these cultural issues as part of that exercise.
43. Shareholders/owners are the principal group to whom boards of directors have been answerable, because they exercise voting control and have provided the financial capital to seed and sustain the business. However, voting control is based solely on relative financial investment and financial return is the key driver with no set mechanism to make allowance for non-financial aspects. More broadly, we are supportive of a rethink on the shareholder centric company law model, as described by the Bank of England⁶.
44. In terms of culture, consideration of particular types of shareholders (e.g. vulture funds) and the effect on the behaviours of business leaders needs to be assessed against the values the business chooses. This is also a consideration for recruitment and for what values are considered to be important for business leaders to possess to ensure that as employees/directors they 'do the right thing' for all stakeholders on a proportionate basis when financial investors are pursuing an aggressive short-term financial return agenda.
45. The impact of the pace and prevalence of mobile communications and connectivity, its impact on blurring the boundaries between business and the wider world, as well as the opportunity to drive ethical behavior and portray good corporate culture, needs further consideration.

Stakeholders

46. Stakeholder groups are varied, however, the need to give appropriate consideration to the public interest and public perspective, is increasingly important. There are differing opinions on what public interest means; it is extremely difficult to define and a constantly evolving concept.
47. ICAS has drafted a conceptual paper, Public Interest - Quaere Verum⁷, which deliberately does not provide a single definition of the public interest, but rather has sought to remind CAs of their responsibilities with respect to the “the public interest” and to provide some practical guidance in meeting these.
48. Extensive internet connectivity and social media has allowed stakeholders to examine and comment on companies like never before. Stakeholders now demand more from companies and it is becoming more recognised that companies who embed stakeholder demands into their business model become more successful.

“In the era of unremitting transparency, the world requires much more from the private sector. The consequences of repeating the mistakes of the past are greater today than they have ever been. There is an enormous prize for companies which choose to meet these new demands with respect, authenticity and openness, making society’s needs part of their business model.” (John Browne⁸)

⁶ <http://www.bankofengland.co.uk/publications/Pages/speeches/2015/833.aspx>

⁷ See note in Annex A.

⁸ “Connected – How companies succeed by engaging radically with society”, John Browne 2015

49. Awareness of the wider impact of business on the economy, society and communities needs to be encouraged and views of wider stakeholders in the hierarchy of business/ investor decision making need clarified. Investors need to see the underlying purpose of their investment as something more than just financial return and have an awareness of the place the organisation has in wider society. Companies have a role to communicate their value to key stakeholders, more clearly and widely and those stakeholders have a responsibility to ensure such information impacts on their behaviour.
50. We understand that investors are questioning how corporate reporting should evolve to cover intangible capital. Currently, corporate reporting focuses on tangible assets yet, the proportion of company value related to intangible assets is increasing significantly. To illustrate the change, the proportion of stock market value attributable to tangible assets has reduced from more than 80% in 1975 to less than 20% today⁹. Investors report to us that culture is fundamental to a company's performance; it is part of the risk framework and contributes to the sustainability of an organisation's success. However, today, culture, understandably, is absent from most corporate reporting and we lack a common language and standards to facilitate effective communication. That said, there are a number of indicators of culture that could be reported, or maybe already are being reported, but the reader is not currently seeing those as indicators of culture per se.
51. Investors also report that diversity is an important input to the culture debate and that culture is fundamental to a company's performance.

Embedding and assurance

52. We are aware that structured approaches to assessing culture are starting to develop. There are many cultural indicators in businesses, however, they are usually not packaged as such or even used in any discussion of culture (if there is one). Whilst best practice has yet to emerge there are lots of thoughts and pointers that can be given to businesses to help them on their journey to develop best practice.
53. At a practical level, boards can start to consider two things to facilitate a dialogue within boards and organisations to help define what they should be trying to embed and identify what they should be trying to change:
- 1) What types of behaviour and values they want to see across their organisation?
 - 2) Review organisational levers, existing KPIs and other sources of information through a 'culture lens' to see what indicators of behaviours are apparent within their organisation today and what incentives or disincentives may exist.
54. There are various steps which can be taken to embed the desired behaviours and culture. These generally revolve around existing organisational levers. Boards may find it helpful to undertake a review to ensure that these organisational levers encourage, and are not inconsistent with, the desired behaviour. Examples include:
- Organisation structure – whatever types have been adopted in the organisation whether it is competing business silos, central overhead centres or profit centres, where power lies in the business, an understanding of how they can influence behaviours and culture will inform the process of adoption;
 - Objective setting, financial and non-financial performance goals, policies and procedures – how consistent these are with the type of behaviours envisaged;
 - Remuneration and reward structures – as discussed under 'people issues' (paragraph 41);
 - Communications both up and down within an organisation at many levels;
 - People priorities - for example recruitment, hiring/firing, how well lessons from exit interviews are gathered and used and indeed how interviews are conducted, recruitment centres which focus on values, annual appraisals which include assessment of performance against values;
 - Leadership – where power lies in the organisation and how it is deployed, leadership behaviour

⁹ See Tomorrow's Relationships – Unlocking Value pg 6& 38 <http://www.oceantomo.com/ocean-tomo-300/>

- Staff behaviour - what are the underlying relationships and what governs these e.g. whether relationships collaborative, harassing or a culture of fear exists. Psychometric tools and surveys can be useful tools to assess the power and people dimensions to better understand how these may impact on decision making and behaviours.
 - Training programmes (including training around the Code of Ethics).
55. The types of existing information which could be analysed for obtaining assurance on how well embedded particular aspects of corporate culture are varied. It is important that culture is not defined only by those aspects which can be measured and audited. Examples could include the results from employee engagement surveys, supplier and customer surveys, health and safety cultural surveys, health and safety statistics, compliance with legislation, codes of conduct, company policies and procedures, attitudes to audit findings and speed of follow up of audit recommendations, openness and transparency of the organisation including availability and content of management information, and also 'soft' observations by both external and internal auditors.
56. We would also include an attitude to adoption of good practice – whether the organisation is a leader or follower and whether it tends to investigate the root cause or just treat the symptom of issues reported. Psychometric and psychoanalytical tools could also be used.
57. Culture is a matter for the board. It is a board decision as to whether it wants to allocate some specific responsibility to the Audit Committee or another committee but it has to be mandated by the board in a structured way. As an example, the Audit Committee may be asked to report to the board on feedback from assurance providers on any cultural aspects they identified from their review. Our concerns would be that splitting responsibility for culture between the audit committee and board could generate complexities and confusion.
58. We believe it is too early to suggest a structured assurance role at this point in time, it is for the board to consider how best they wish to measure aspects of culture and gather assurance. However 'soft' observations and independent feedback from assurance processes on whether the desired behaviours are taking root across an organisation, the extent of any silos and whether there is evidence of undesirable cultural behaviours (as opposed to one or two rogue individuals behaving badly) can be useful. We believe it is important that most of the assurance provided to boards should be coming internally and probably from existing KPIs and corporate information (see 55 above).
59. We would also emphasise that reporting publicly on culture and the corporate performance is not recommended until the area matures, which could take many years, however it could be helpful to stakeholders for Boards to publish the corporate values¹⁰ and also their code of ethics.

¹⁰ As mentioned in paragraph 28.

Supplementary information

1 The Power of One

To date there are there specific publications in this series:

- The Power of One Policy Statement;
- Personal responsibility and ethical leadership; and
- Moral Courage.

Further papers on specific themes will be published later in the year.

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Additionally, we have also published the following related papers.

- Discussion paper on Ethics Principles
- Ethical decision making framework

2 ICAS Public Interest Paper – *Quaere Verum* (restricted - unpublished)

A copy of the report can be provided on request. Please note this is not yet published so we can only share with the FRC on a confidential basis.

3 ICAS Code of Ethics

Chartered Accountants must adhere to a Code of Ethics; we also share a public interest duty. This Code of Ethics includes the following fundamental principles:

- Integrity
- Objectivity
- Professional Competence and Due Care
- Confidentiality
- Professional Behaviour

As part of embedding the principle of 'The Power of One' initiative, ICAS is currently consulting on its proposal to also include a new principle:

- Moral courage - To exhibit fortitude and determination to exert professional scepticism, to challenge others who are behaving inappropriately, and to resist the exploitation of professional opportunity for private benefit rather than the public interest.

4 How ICAS embeds its Code of Ethics across the membership

Training in business ethics is incorporated in the students' professional training syllabus. To pass the test of professional competence requires recognition of the ethical dimension.

At graduation, new members are required to give an ethical oath at the admissions ceremony which reflects the fundamental principles of the Code of Ethics. These steps at the CA training stage have helped to generate a much greater awareness of ethics than in the past.

Members are all required to self-certify that they have met the requirements of the Code of Ethics in their annual return.

Although there is currently no on-going requirement within Continuing Professional Development (CPD), this is under consideration.

The Code of Ethics (which is substantively based on the IESBA Code of Ethics) is published on our website. This contains a section for members in business as well as those in practice. Our helpdesk also provides the opportunity for members to discuss ethical dilemmas on a confidential; basis.

Failure to comply with the Code of Ethics can lead to disciplinary action.

ICAS performs regulatory monitoring in both audit and general practice for its supervised firm population. It also provides a file review service for smaller CA firms. In both cases, the risk and control overview assessment includes consideration of the application, and risk of breaching, the Code of Ethics. The file review exercise also includes a more structured checklist.