THE INSTITUTE OF INTERNAL AUDITORS – AUSTIN CHAPTER

Improving Organizational Governance

Through Implementing Internal Audit Standard 2110

The Austin Chapter Research Committee

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The IIA Research Foundation

The Austin Chapter Research Committee

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Executive Summary

"Do all the good you can, by all the means you can, in all the ways you can, in all the places you can, at all the times you can, to all the people you can, as long as you ever can."

--- *John Wesley, 1703-1791*

Effective governance includes systems and associated processes and controls that promote: ethics and values; performance and accountability; risk communication; and coordination and communication among the board, external and internal auditors, and management. In implementing Internal Auditing Standard 2110 (improving the organizational governance process) internal audit promotes effective governance through organizational involvement, assessment, training, professional guidance, and associated communication at all levels within the organization.

This research paper identifies and helps to explain the practices and associated activities used by internal audit operations to promote improvement in their organization's governance process. The survey results, analytical comments, organizational case studies, and the resulting conclusions emphasize the practices and level of performance success of internal audit in improving the governance processes in their organizations.

The survey results and case studies indicate internal audit activities are having some success in assessing and improving their organizational governance processes. It is also significant to note that constant, routine, and multiple lines of communication between internal audit and the organization's top management and the board is one of the more important elements in meeting the objectives of effective governance.

Introduction

The governance process lays the foundation for preservation and communication of values and goals, including monitoring and accountability of those goals. Implementing the 2110 Governance Standard is usually the most challenging and therefore, the least developed, for many internal audit functions, however it is important to acknowledge the positive impacts Internal Audit can make in their organization by assuring good governance practices.

The Institute of Internal Auditor's (IIA) *International Standards for the Practice of Internal Auditing* define Standard 2110 on Governance as an "internal audit assessment" of an entity's accomplishment of the following objectives:

- Promoting appropriate ethics and values within the organization;
- Ensuring effective organizational performance management and accountability;
- Communicating risk and control information to appropriate areas of the organization; and,
- Coordinating the activities of and communicating information among the board, external and internal auditors, and management.

Internal auditors should be living and promoting the organization's values. Their role may include providing advice, assisting with ethics training sessions, monitoring through compliance audits, investigating violations, evaluating policies, and other governance practices. Internal audit efforts in these areas demonstrates a commitment to meet the requirements of the Standard.

The concept of governance is well grounded in the Standards but has evolved from previous versions where governance was related to the primary objectives of internal control. Stakeholder expectations related to the roles of Internal Audit in assessing and making recommendations on governance have increased and various organizations are at different points in governance maturity as they have different auditing practices and needs.

Assurance = Governance + Risk Management + Internal Control

Governance, risk management and internal control are all interrelated; effective organizational governance involves a partnership between the governing body, executive management, internal auditing and external auditing. When these partnerships are working well together, internal controls are strong which also translates to a climate of ethical behavior and oversight, mitigation of risks, safeguarding of assets, and accurate reporting.

A periodic evaluation of an organization's governance practices is good business. Additional work in the governance area may be necessary to fully comply with the

Standards and to meet the needs of the organization. According to the Standards, "the Internal Auditor must evaluate the design, implementation and effectiveness of the organization's ethics related objectives programs and activities and must also assess whether the information technology governance of the organization supports the organization's strategies and objectives".

Literature Review

Our review of professional auditing literature included a wide range of articles pertaining to auditing ethics and governance. The profession could benefit from further sharing of audit approaches, methodologies, and experiences to assist practitioners in more fully complying with Standards.

This research builds on the work of the IIA Austin Chapter in completing a 2010 research project on "Internal Audit's Role in Promoting a Positive Tone at the Top." That research provided suggestions for chief audit executives to broaden their contributions to the organization and influence with key decision makers.

<u>IIA References on Auditing Ethics</u>

The IIA is a leading source for ideas and information on this evolving area for Internal Audit assurance work. The IIA has made a significant contribution to ethics and governance awareness via journal articles, books, research reports, and professional seminars.

Many of the references in the following section were published in the *Internal Auditor*, the premier journal for internal audit practitioners. Further information and links to these articles and other references may be found in the Selected Bibliography section of this report.

A 1993 article by Sears[1] suggested auditors "should consider all functional areas within the entity including those functions and activities where ethics implications present the greatest risks." The author further listed a number of risks to be considered and a methodology to be used in conducting a business ethics audit.

Orsini (2004)[2] provided information on a Canadian government initiative pertaining to governance and change management. He emphasized the need for auditors to develop "clear and practical criteria to provide credible assessments" and he discussed three key audit risks: missing the big picture, missing the dynamics of change, and subjective second-guessing of management.

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[1] Sears, Brian. "Auditing Business Ethics – The Ethical Environment."
[2] Orsini, Basil. "Auditing Governance: The Canadian Government Offers an Audit Tool for Addressing Risks in Implementing Management Reform."

Waring (2004)[3] summarized efforts at auditing the ethical culture within the city government of Austin, Texas. This audit engagement used survey data collected by the municipal government human resources function for selected financial and administrative indicators. The focus was on four measures: damage claims, complaints, lost-time injuries, and sick leave usage. Significant statistical correlations were established in city departments where surveyed employees reported greater awareness of unethical conduct.

Adamec (2005)[4] identified seven ways Internal Audit activities can provide support to their audit committees including auditing the corporate governance process and benchmarking the organization's performance with best practices.

Servage (2006)[5] identified the typical problems with developing organizational governance policies, ways of improving the process, and an appropriate advisory role for Internal Audit.

Jackson's article (2006)[6] had one of the more lengthy and intriguing titles of those surveyed: "Keeping the Company Clean: Internal Auditors Who Conduct Ethics Audits Can Help Prevent Inappropriate Activities from Being Swept Under the Rug and Ensure the Organization's Reputation Remains Spotless." He described Internal Audit's oversight responsibility and provided several suggestions for an ethics auditing system such as using quantitative and qualitative data, taking into consideration the dimensions of human behavior, and reevaluating what's expected of an ethics audit.

Baggett (2007)[7] provided seven recommendations for improving the quality and depth of ethics training programs. He recommended that codes of ethical conduct be regularly assessed and be incorporated into the organization's strategic planning activities.

Verschoor's (2007)[8] writings included useful advice for auditing ethics. The projected audience for this publication was audit committee members, executive management, corporate counsel, and external auditors as well as internal auditors.

The *Internal Auditor* journal includes a recurring "Governance Perspectives" column devoted to governance issues and concerns and edited by Norman Marks. He authored an article (2007)[9] noting the real concern of many auditor professionals that "Assessing organizational governance can be complicated and may involve political risk, but it still should be given strong consideration in the audit plan." He also referenced an IIA

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[3] Waring, Colleen. "Measuring Ethical Climate Risk."
[4] Adamec, Bruce A. "Getting A Leg Up."
[5] Servage, John A. "Policy and Governance."
[6] Jackson, Russell. "Keeping the Company Clean: Internal Auditors Who Conduct Ethics Audits Can Help Prevent Inappropriate Activities from Being Swept Under the Rug and Ensure the Organization's Reputation Remains Spotless."
[7] Baggett, Walter O. "Seven Criteria for Ethics Assessments."
[8] Verschoor, Curtis. "Ethics and Compliance: Challenges for Internal Auditing."
[9] Marks, Norman. "Internal Audits of Governance."

Position Paper on "Organizational Governance: Guidance for Internal Auditors" – a tool developed to help practitioners better understand the requirements of the IIA Standards.

Burch (2008)[10] advocated regular audits of the corporate compliance program as a means to reducing the organization's regulatory violations. The author listed the program's key components including compliance risk assessments, the establishment of standards, policies, and procedures, periodic compliance training, code of conduct reviews, a whistleblower hotline, investigation policies and procedures, and other mechanisms.

Baker (2010)[11] reported on the governance reviews conducted in South Africa over the past 15 years under the direction of governance advocate Mervyn King. The King III report advocated that internal audit plans should be risk-based, audit committees should ensure a coordinated approach to assurance work, internal auditors should provide two written assessments per year on the organization's internal controls and risk assessment systems, and internal auditors should have "a standing invitation" to attend executive committee meetings of their organizations.

Kramer (2010)[12] stated Internal Audit should be involved (1) in assisting management develop and/or strengthen the codes of conduct and (2) in periodically evaluating the effectiveness of ethics codes.

Marks (2010)[13] noted there is "no single, commonly accepted definition of "GRC" – governance, risk management, and compliance. He referenced the comprehensive definition developed by the Open Compliance and Ethics Group (OCEG) that lists some 14 functions and processes including legal, information technology, business ethics, quality management, human capital, audit and assurance, and others. The author urged internal auditors to better understand the many components involved in GRC and to promote the OCEG definition.

Roth (2010)[14] provided evaluation methodologies and other insights into auditing an organizational culture and specifically in evaluating "soft controls" such as tone at the top, the organization's ethical climate, and management's philosophy and operating style.

Bahrman (2010)[15] discussed the building blocks in the governance process, a typical organizational governance framework, and more than 20 common internal processes for audit review.

Ethics audits and corporate governance are two important future focus areas for audit practitioners over the next five years. Such was the conclusion of the IIA's *Global*

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[10] Burch, Susan. "Auditing for Compliance."
[11] Baker, Neil. "Equipped for Governance."
[12] Kramer, Bonita K. Peterson, et al. "Do the Right Thing."
[13] Marks, Norman. "Defining GRC."
[14] Roth, James. "Best Practices: Evaluating the Corporate Culture."
[15] Bahrman, Dean. "Evaluating and Improving Organizational Governance."

Internal Audit Survey that was explained in the *Characteristics of an Internal Audit Activity*.[16] The report concluded that internal audit practice would differ significantly from today with less emphasis on operational and compliance audits, internal control evaluations, and fraud investigations.

A second report from the *Global Internal Audit Survey* pertained to *Core Competencies for Today's Internal Auditor*.[17] The survey results confirmed the continuing importance of knowledge of auditing, internal auditing standards, ethics, and fraud awareness. The report also illustrated that "governance and ethics sensitivity becomes more important as internal auditors progress through the professional ranks."

The IIA issued a Practice Guide (2010) regarding *Evaluating Corporate Social Responsibility/ Sustainable Development*.[18] CSR is defined as "the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large." The guide suggests that the following be included as components of an ethics audit: ethics advice and training activities, the conflict of interest disclosure process, the reporting system for ethics violations, and the ethics program performance measures.

The IIA's *Tone at the Top*[19] newsletters have regularly provided information that professional auditors use as background for developing ethics audit programs. The following are among the articles relevant to ethics and governance audits:

- "Taking Governance to the Next Level" (June 2002)
- "A Call for Character and Integrity" (June 2005)
- "A Big-picture Perspective" (July 2006)
- "Doing the Right Thing" (February 2009)
- "What's on Your (Corporate) Conscience? (November 2009)

For several years the IIA has also offered a seminar beneficial to practitioners planning ethics and governance audits. The *Corporate Governance* training program includes discussion of topics such as roles and responsibilities, legal and regulatory requirements, enterprise risk management, monitoring responsibilities, and communication strategies. The MIS Training Institute and other professional sources offer similar development opportunities for audit practitioners.

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[16] IIA Research Foundation. *Characteristics of an Internal Audit Activity*.
[17] IIA Research Foundation. *Core Competencies for Today's Internal Auditor*.
[18] Institute of Internal Auditors.
[19] Institute of Internal Auditors. *Tone at the Top* newslettersissued several times each year.

Ethics Resource Center References on Auditing Ethics

The Ethics Resource Center[20] provides useful information that is recommended reading for auditors planning reviews of ethics and governance. Navran (2003)[21] discussed seven characteristics of an effective ethics program that led to a series of questions executives should ask to determine whether the organization has an effective compliance-oriented program. One of the areas pertained to the monitoring, auditing, and reporting systems.

Two other articles released via the Ethics Resource Center can be useful to audit practitioners. Gilman, et al (2009)[22] provided "the things your company can do to prevent being the next Enron." First on the impressive list was advice to "examine your ethical climate and put safeguards in place." The second concept was also intriguing: "Don't just print, post, and pray" the code of ethics.

A research brief from the National Business Ethics Survey (2009)[23] provided perspectives about ethics pertaining to three key demographic groups: the baby boomers (born 1946-1964), Generation X (1965-1980), and Generation Y (1981-present). The study illustrated significant world events and trends shaping each group's ethical perspective. The report further detailed both positive and negative traits and workplace attributes common to each generation.

Other References on Auditing Ethics

The Open Compliance Ethics Group[24] published a guide to auditing compliance and ethics in recent years. This organization provides high quality information and references of use to Board members, executive managers, and audit practitioners.

A sprinkling of ethics audit advice and methodologies were located via various Google searches on the Internet. The following are among the diverse organizations and publications providing advice on ethics and governance audit techniques:

- Council of Nonprofits
- Society for Human Resource Management
- Social Work Today
- Association of Chartered Accountants (Canada)
- International Society of Business, Economics, and Ethics (The Netherlands)
- International Journal of Government Auditing

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[20] Web address is www.ethics.org.
[21] Navran, Frank. "Specific Points for a Director to Examine in Determining the Effectiveness of an Ethics Program."
[22] Gilman, Stuart et al. "Ten Things You Can Do to Avoid Being the Next Enron."
[23] Ethics Resource Center, National Business Ethics Survey. "Millennials, Gen X and Baby Boomers: Who's Working at Your Company and What Do They Think about Ethics?"
[24] Web site is www.oceg.org.

Further information and links to the above organizations may be found in the Selected Bibliography section of this report.

Hill (1992)[25] was an early advocate for management accountants to play a leading role in drafting ethical codes of conduct and assisting with code enforcement via periodic ethics audits. He stated such involvement is particularly important because of "the central role that accounting measures play in corporate control systems."

Hardman (1996)[26] noted the expansion of the government focus around the world to include ethics audits. He stated "ethical issues are probably best understood in the context of what is considered to be morally correct by the standards prevailing in particular societies." The author reasoned that ethics audits are needed when public sector policies and decisions "show that the government has departed from prevailing moral standards and societal values."

Protiviti's *Knowledge Leader* service provided an excellent "Ethics Program Audit Work Program in 2003.[27] The program is a structured, well-reasoned approach with sections on audit objectives, planning, fieldwork – understanding and documentation, fieldwork – testing, and reporting.

Reamer (2007)[28] provided advice to social workers about core ethical issues. He offered four purposes of an ethics audit including the identification, assessment, adjustment, and monitoring of ethical issues in the workplace. He also provided seven key steps in conducting such an audit through an organization audit committee mechanism.

Ferrell (2008)[29] and his co-authors have revised their popular college textbook on business ethics now in its seventh edition. The text included useful business cases illustrating ethics issues and concerns for problem solving and discussion.

Ethics Audit Reports

Few Internal Audit activities publish reports readily available on the Internet or more specifically on the web pages of their respective organizations. In recent years a limited number of public sector organizations have conducted ethics and governance audits and made them available to the public via the Internet and in other ways.

The discussion below summarizes ethics audit objectives and issues found in a few available reports. There are significant research opportunities in further exploring this topic in the future.

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[25] Hill, John W. et al. "How Ethical is Your Company?"
[26] Hardman, Donald J. "Audit of Ethics in Government."
[27] Protiviti Knowledge Leader, "Ethics Program Audit Work Program."
[28] Reamer, Frederic. "Conducting an Ethics Audit."
[29] Ferrell, O. C. et al. *Business Ethics: Ethical Decisions Making and Cases*, 7th edition.

The City of Austin's (Texas) ethics audit (2002) was the subject of the *Internal Auditor* article by Waring (2004) mentioned above. The audit report summarized efforts at evaluating the ethical culture in a large municipal government.

The Texas Department of Community Affairs ethics audit (2010)[30] had two objectives: to evaluate the effectiveness of the ethics program, and to determine if the Department's employees were aware of the ethics program. The results were generally positive and the auditors provided several recommendations including the following:

- Develop an ethics communication strategy to include training, periodic communication from management regarding ethical issues, and annual acknowledgement that employees have read and are aware of the ethics policy.

- Enhance the ethics policy to prohibit the appearance of impropriety in all situations, not just those related to outside employment and community service.

The Teacher Retirement System of Texas ethics audit (2006)[31] involved an examination of Board member, management, and employee compliance with State law and pension fund policies and procedures. The review further included a review of the compliance of pension fund agents, brokers, consultants, and service providers with state and pension fund requirements.

Internal auditors are using numerous approaches, tests, and methodologies to assess ethics and governance within their organizations. The professional literature on this subject will grow in the years ahead as more Internal Audit activities better serve their organizations and at the same time comply more fully with the requirements of Standard 2110.

Research Methodology

The Institute of Internal Auditors Austin Chapter Research Committee conducted a survey using the listserv for the IIA Austin Chapter in December 2010 to obtain ideas on conforming to the IIA Performance Standard 2110 on Governance and asked the ten Chapter members who serve on International Committees or governing bodies to forward it for further distribution. The International Committees represented were:

- Academic Relations
- Board of Regents
- Board of Research and Education Advisors
- Professional Issues
- Public Sector

[30] Texas Department of Community Affairs. Report on "An Internal Audit of the Ethics Program."
[31] Teacher Retirement System of Texas. Report on "Ethics Program Follow-up Review."

- Regional Conference Advisory Board
- Research Foundation Board of Trustees

The Committee received 84 responses to the survey of which 24 indicated they would be willing to participate in further study.

The survey administered on-line through Survey Monkey was a combination of 23 yes/no and open ended questions. The open ended questions were used primarily to gather additional information or clarification pertaining to answers indicating "Other". The survey summary indicates that not all of the respondents answered every question. Respondents had the option to identify their organizations on the last question, and to volunteer to participate in a case study. Two case studies were completed; one with a small (1 – 5 audit staff) and one with a large (more than 20 audit staff) internal audit function.

This research report is organized to provide the activities of respondents in complying with Standard 2110. Survey questions pertained to the four objectives in the Standard:

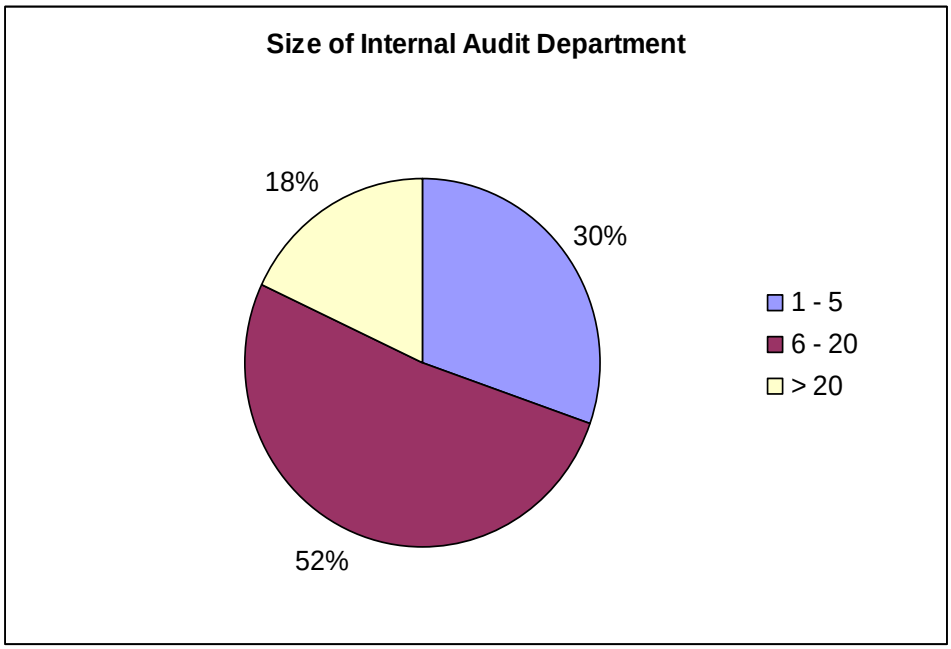
- Promoting appropriate ethics and values within the organization;
- Ensuring effective organizational performance management and accountability;
- Communicating risk and control information to appropriate areas of the organization; and
- Coordinating the activities of and communicating information among the board, external and internal auditors, and management.

Respondent Demographics

To help understand the perspectives of the respondents, several demographic-related questions were asked.

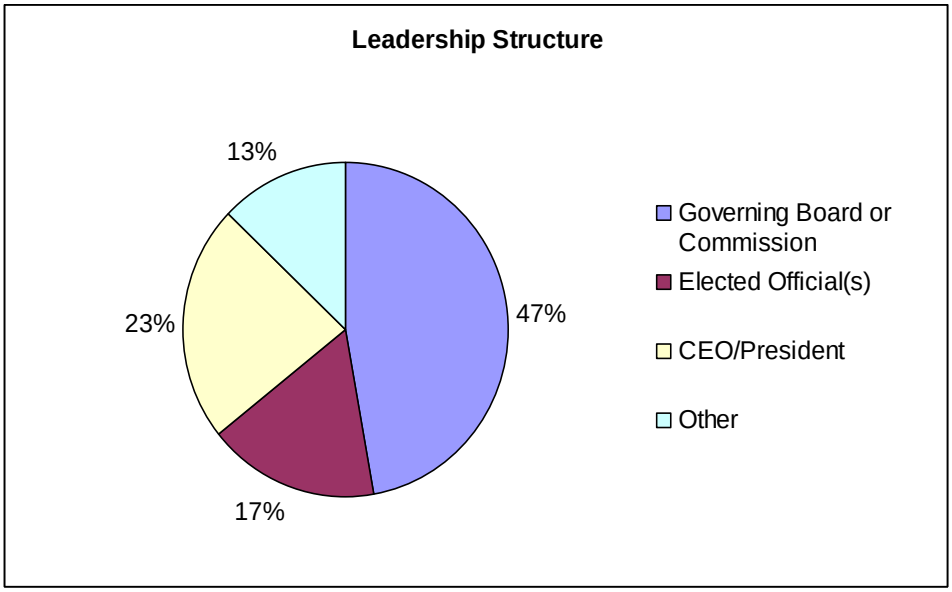
Number of staff in the Internal Audit Department

To allow for analysis and comparison based on the size of internal audit functions, respondents were asked how many staff were assigned to the department. Of the 66 respondents who answered this question most reported having 20 or fewer staff, with just over half having between 6 and 20.



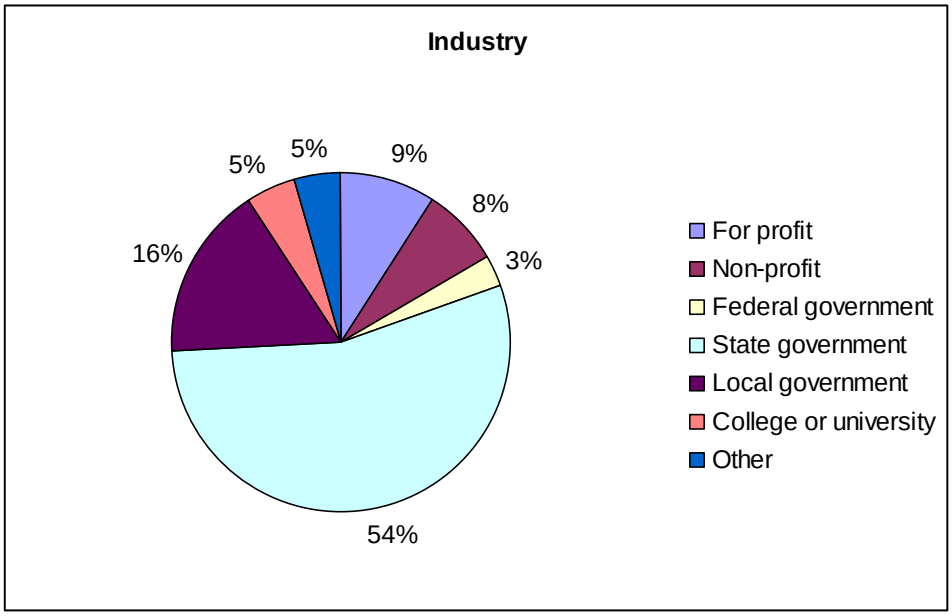
Leadership Structure

Of the 66 respondents who answered this question, almost half of them report under a governing board or commission-style leadership structure and almost a quarter of them have a CEO or President.



Industry

Of the 66 respondents who answered this question, 49 were employed at some level of government with the largest number of them (36) being at the state level.



Survey Results

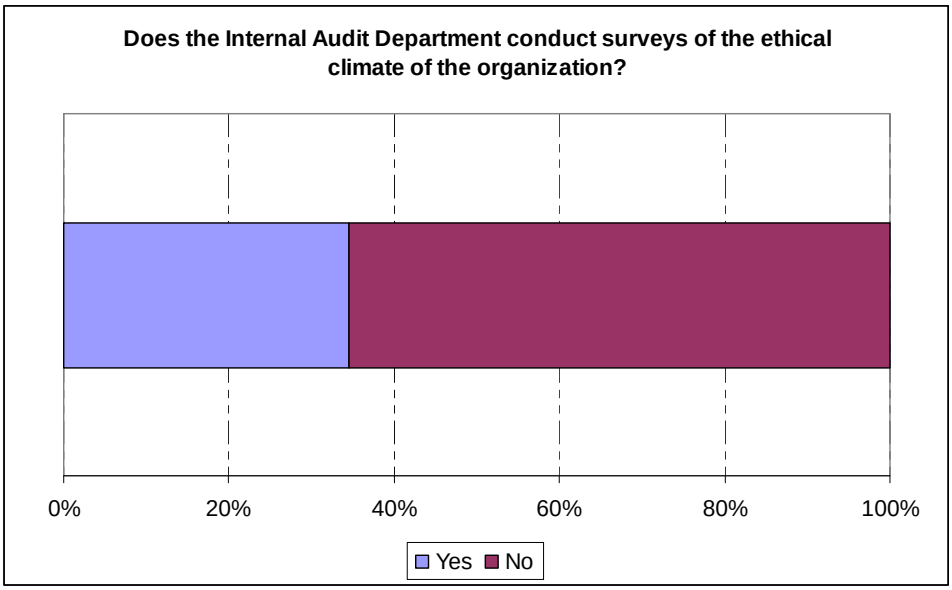
In addition to understanding the demographics of the respondents, it was important to identify what types of activities the Internal Audit Departments conduct related to the requirements of Performance Standard 2110. At the end of the survey respondents were asked what their department has done to comply with the standard as well as to rate their success in meeting the four bulleted points of Standard 2110.

Promoting appropriate ethics and values

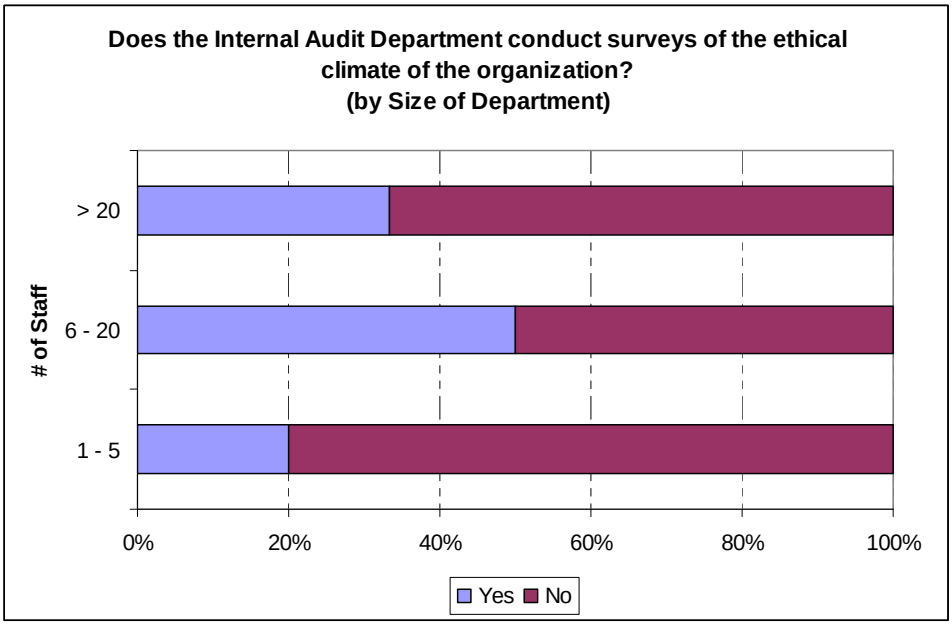
The first group of questions related to respondent's organization's requirements for ethics and fraud training as well as the Internal Audit Department's role in this training and other activities related to this area. Standard 2110 includes "promoting appropriate ethics and values within the organization" as one of the governance objectives Internal Audit is responsible for assessing and making recommendations.

To understand how the respondents meet this requirement, the survey asked about organizational training requirements in the areas of ethics and fraud awareness as well as various activities of the Internal Audit Department to include surveys of ethical climate, involvement in ethics and fraud training, provision of input to the ethics policy, advice or guidance, and other activities.

Respondents were asked whether the Internal Audit Department conducts surveys of the ethical climate of the organization, and if so, what level staff is requested to complete the survey. Of the 78 respondents who answered the question, just over one-third (27) answered "yes" with all but three reporting that all staff are included in the survey.

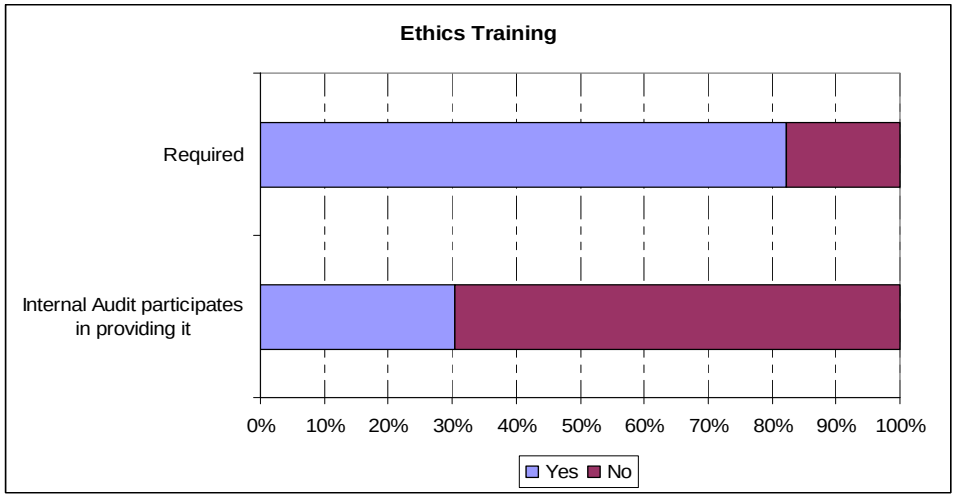


Further analysis identified that respondents with between 6 and 20 staff were more likely to conduct an ethical climate survey and those with fewer than six staff were least likely. While this could be a factor of available resources in the Internal Audit Departments, it could just as likely be a factor of the size of the organization or even its industry.

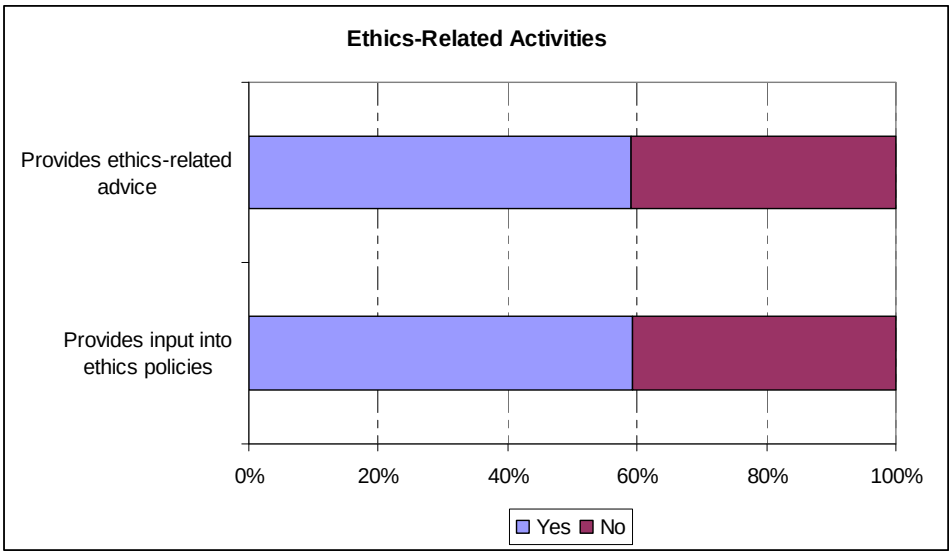


Ethics training is often required as a process of communicating the organization's values and expectations of ethical conduct. To understand the organization's requirements and Internal Audit's involvement, respondents were asked whether training is required, and if so, whether Internal Audit participates in providing such training. Of the 84 respondents

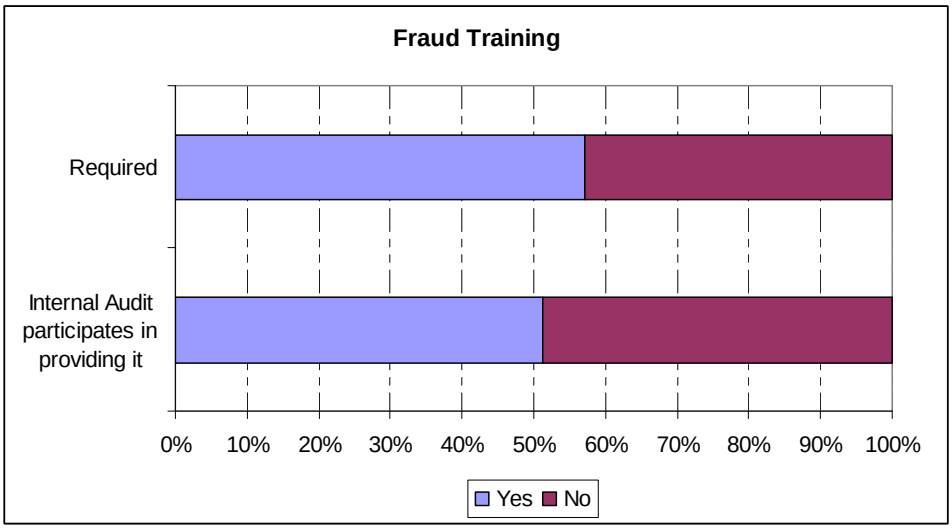
who answered the question, 69 responded "yes" that ethics training was required, and of those, 21 responded "yes" that Internal Audit participates in providing the training.



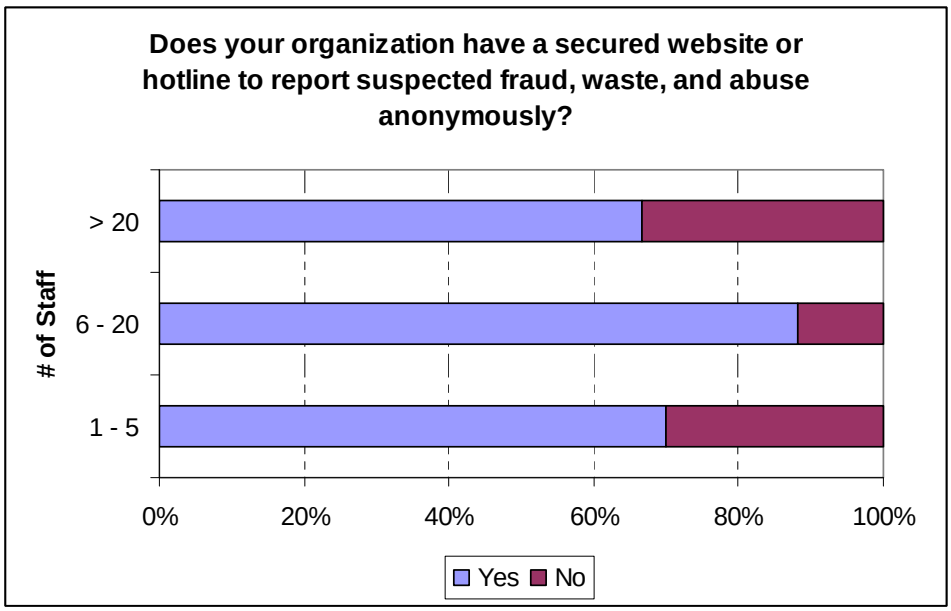
While most respondents do not conduct ethical climate surveys or participate in providing ethics training, questions about providing other ethics related services identified more involvement. Respondents were asked whether they provided advice or guidance on ethics-related issues or input into ethics policies. For both areas respondents reported a higher level of involvement than the first two.



While more of the respondents' organizations require ethics training than fraud awareness training, Internal Audit is more likely to be involved in training for fraud awareness and prevention. Respondents were asked whether their organization required fraud awareness training, and if so, was the Internal Audit Department involved in providing the training. Of the 42 respondents who answered "yes" that training was required, 24 (57%) responded that they were involved in providing fraud training compared to 30 percent for ethics training.



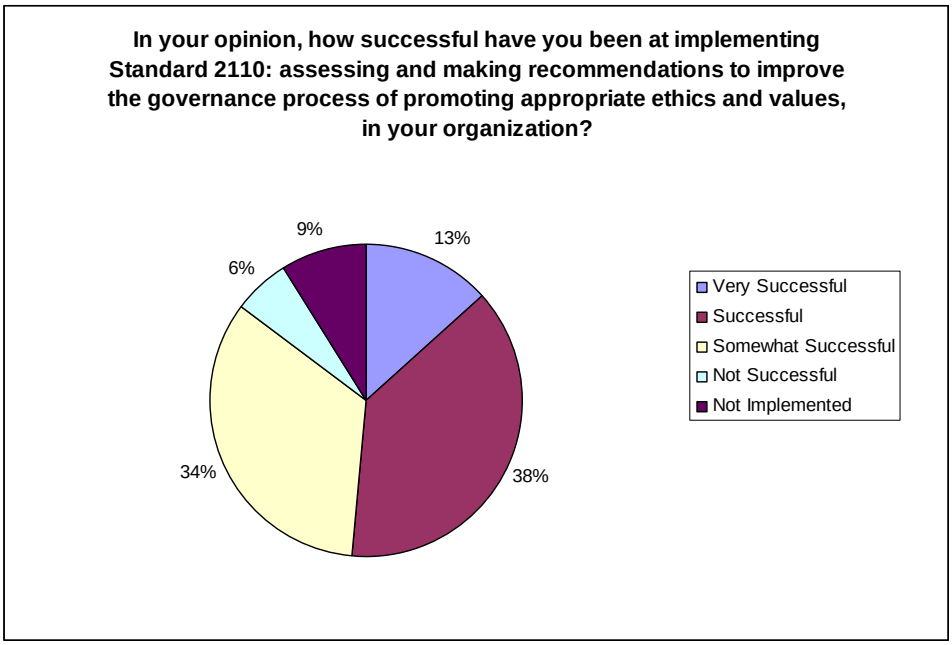
Also related to fraud, respondents were asked whether their organizations had a secured website or hotline to report suspected fraud, waste, and abuse anonymously. More than 80 percent of the respondents that answered this question responded "yes" and many of them included participating in developing, investigating, or receiving reports regarding information received through this tool. Analysis of responses by the size of the Internal Audit Department identified that organizations with between 6 and 20 audit staff were more likely to have an anonymous way to report suspected fraud, waste, and abuse; however a significant percentage of those with more or fewer audit staff also had these resources available to their staff.



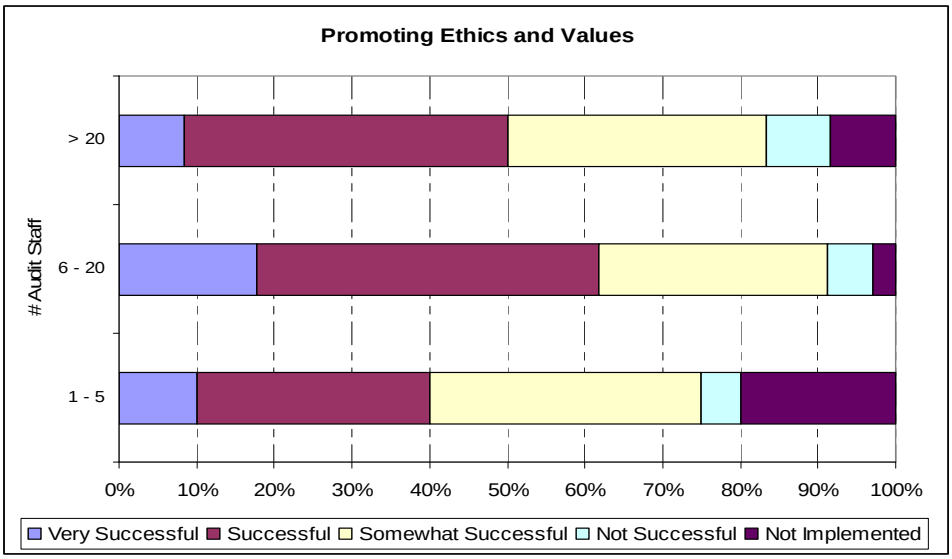
In addition to the activities specifically included in the survey respondents identified a number of others they conduct to meet the requirements in this area. Some of these include:

- Participating on fraud panels
- Membership on ethics committees
- CAE is a member of the Executive Team
- Member of investigative committee which follows up on hotline calls
- Led the implementation of a fraud hotline
- Audit staff attend various committee and staff meetings to observe and share information
- Conducting ethics audits
- Facilitates control self-assessment and focus groups on fraud vulnerabilities
- Include examination of promotional items/gifts as part of supplier audits

While these activities include formal assurance services, many rely on participation on various committees and ongoing communication with management. The variety of practices implemented by Internal Audit Departments indicates that audit professionals are working to apply the principle of the standard in a manner that best fits the purpose, size, complexity, and structure of their individual organization.

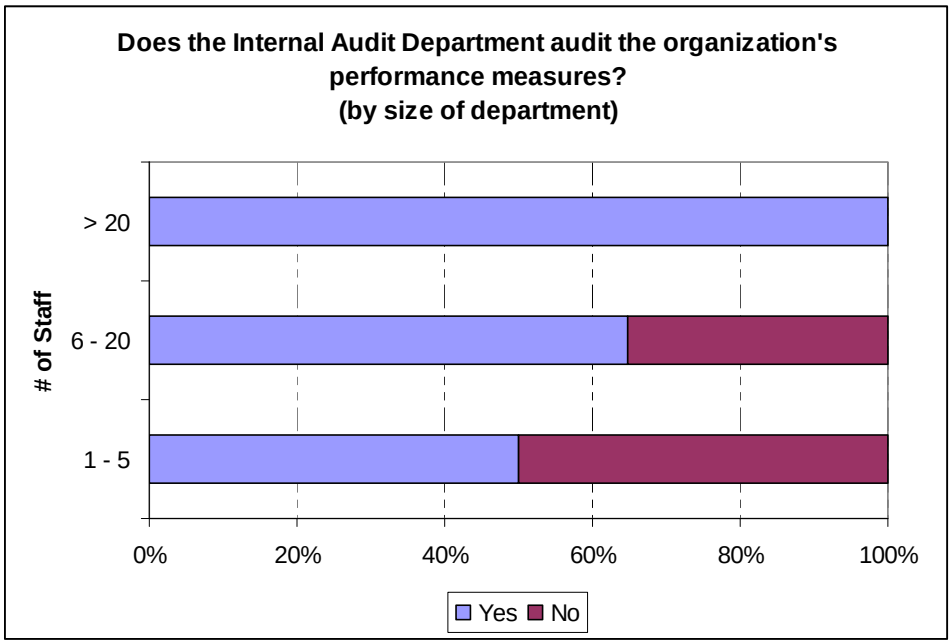


Overall, 35 of the 68 (51%) respondents that rated their level of success at implementing this part of the standard consider themselves “successful” or “very successful” with another 23 selecting “somewhat successful”. As illustrated below, respondents with between 6 and 20 staff responded more positively than those with more or fewer staff.



Promoting organizational performance management and accountability

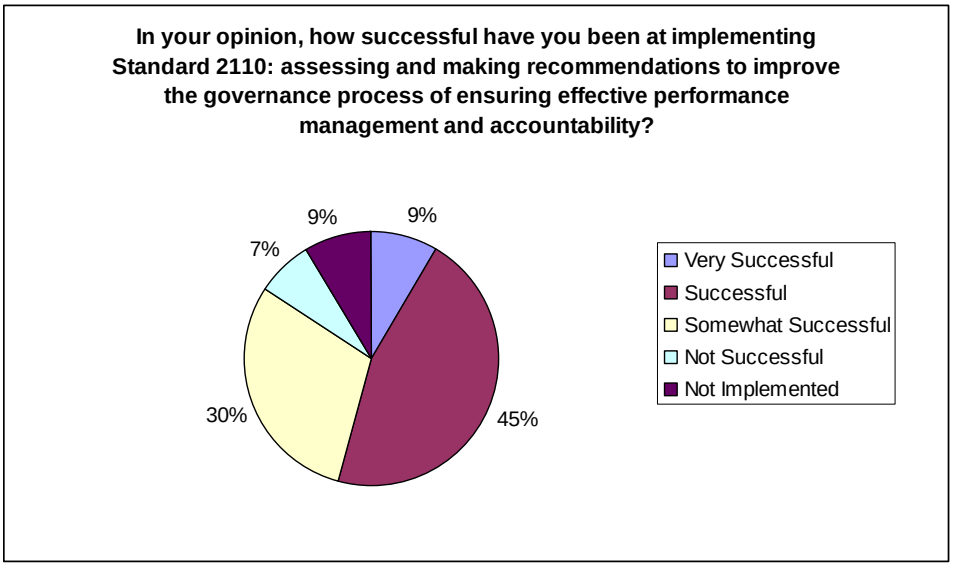
Another requirement of Standard 2110 is to ensure "effective organizational performance management and accountability". When asked whether the Internal Audit Department audits the organizations performance measures, 52 of the 78 that responded to the question answered "yes" with all of the respondents from audit departments with more than 20 staff answering "yes". Some of the respondents who answered "no" to this question included comments in the open-ended question inquiring about what the audit function has done to comply with the standard indicating that there is another function in the organization responsible for performance measures or that performance measures are included as part of every audit as applicable. Consequently the numbers alone may not be a good indication of respondents' true activities in this area.



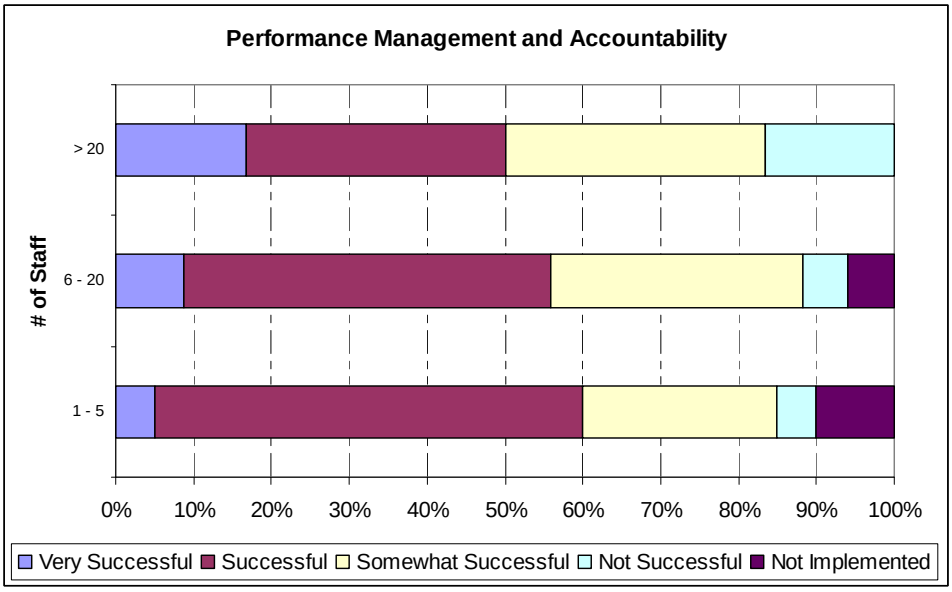
Respondents also provided additional activities that they perform to meet this standard. Some of those include:

- Provide training on performance management and accountability
- Facilitate control self-assessment
- Introduced "lean government"
- Participates in annual planning to develop goals and objectives
- Self-assessed compliance of the Audit Oversight Committee in meeting the requirements of its by-laws.

Overall, 38 of the 68 (56%) respondents that rated their level of success at implementing this part of the standard consider themselves "successful" or "very successful" with another 21 selecting "somewhat successful".

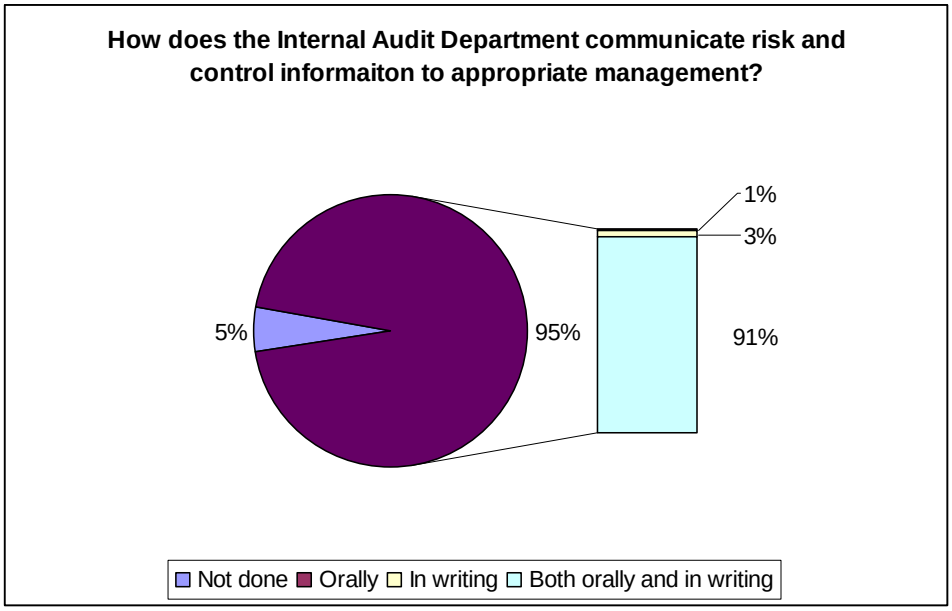


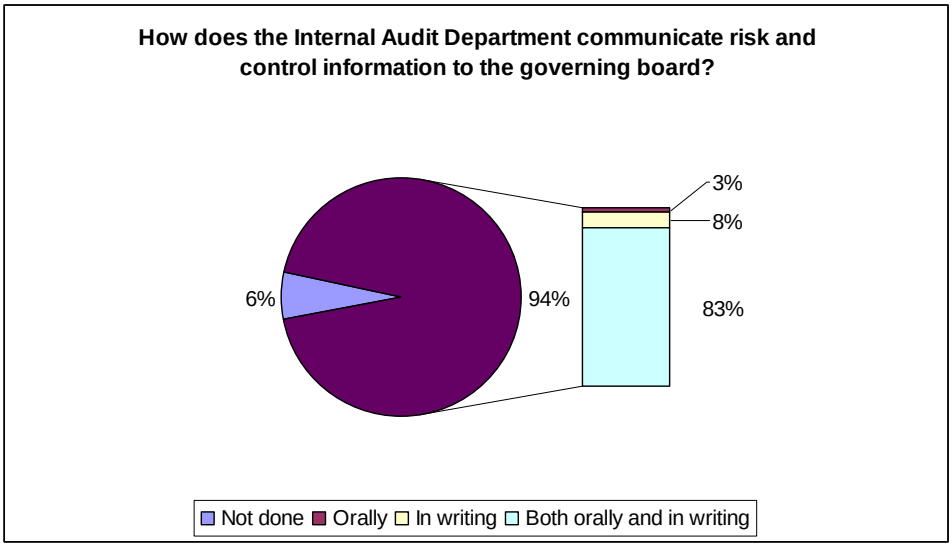
As illustrated below, while a significant percentage of all respondents reported some level of success at meeting this part of the standard, those with fewer than six staff reported a higher level of success. Also of interest is that the percentage of respondents indicating that this has not been implemented at all decreases as the size of the audit department increases. This could be a reflection on available resources in the department; the risks of the organization, or the level of support and emphasis on the importance of internal auditing from the oversight body.



Communicating risk and control information

Standard 2110 also includes "communicating risk and control information to appropriate areas of the organization" as one of its bulleted items. When asked about whether and how they communicate risk and control information to appropriate management and the governing board most respondents responded that both oral and written communication is used.



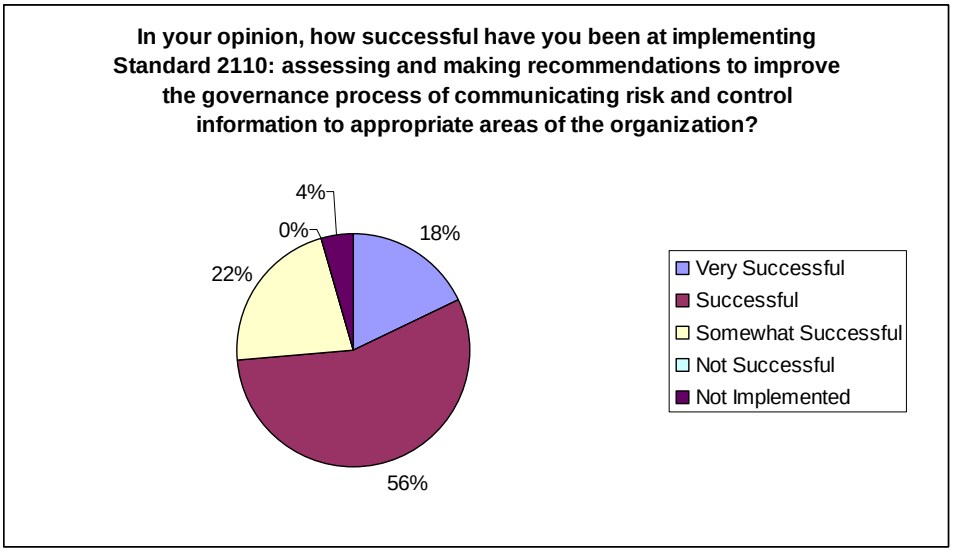


The difference in those who report risk and control information to the governing board in writing could be due to accessibility of the board where management is typically located in the same place as internal audit and can be seen on a daily basis.

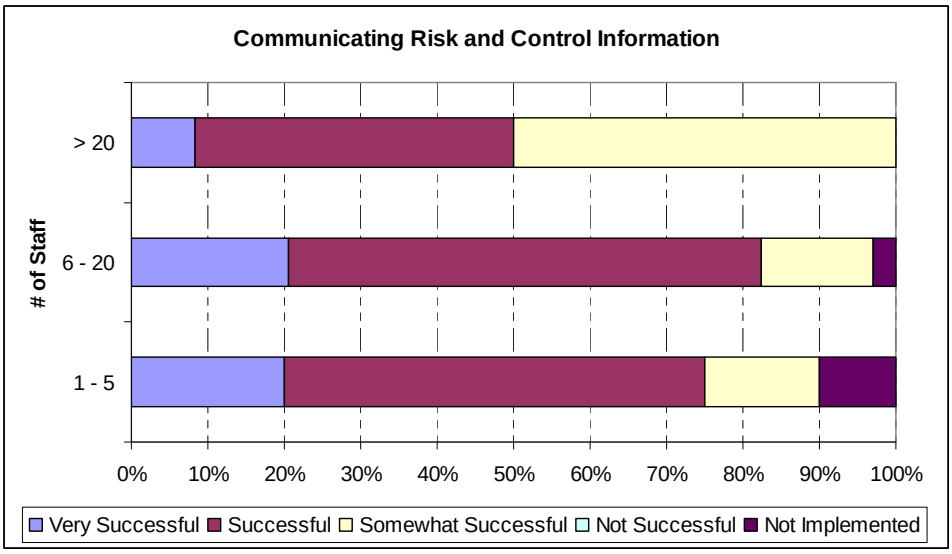
Respondents also provided examples of other activities related to communicating risk and control information. Some of these included:

- Facilitating Enterprise Risk Management activities
- Posting audit reports on the organizations intranet
- Preparing risk-based audit plans
- Internal control audits
- Continuous monitoring of IT projects and strategic plans
- Sharing educational articles with management
- Holding quarterly meetings with key stakeholders
- Conducting an annual review of risk management processes
- Attend various committee meetings and staff meetings to share observations and concerns
- Includes a significance statement outlining the risk with each audit observation
- Conducting workshops

Overall, 50 of the 68 (74%) respondents that rated their level of success at implementing this part of the standard consider themselves “successful” or “very successful” with another 15 selecting “somewhat successful”.



As illustrated below, respondents with between 6 and 20 audit staff consider themselves to be more successfully meeting this requirement and every respondent who reported that it has been implemented reports some level of success.

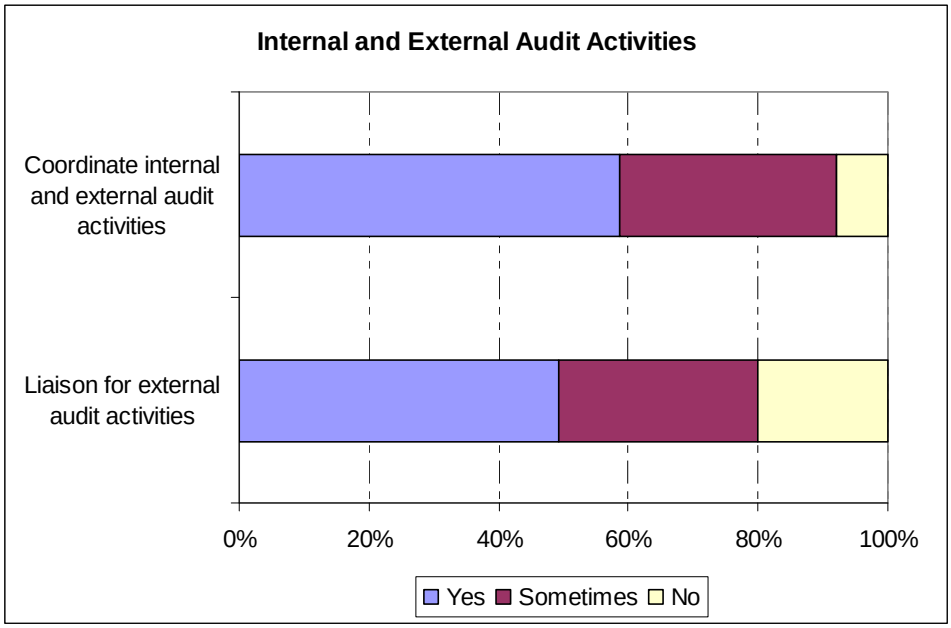


Coordinating and communicating activities

The last bullet under Standard 2110 requires internal audit activities to assess and make appropriate recommendations for improving the governance process through coordinating the activities of and communicating information among the board, external and internal auditors, and management.

Of the 75 who answered the question of whether they coordinated the organizations internal and external audit activities, 44 responded “yes” and 25 others indicated “sometimes.” When asked whether Internal Audit acted as the liaison for external audit

activities, 37 of 75 respondents said "yes" with another 23 selecting "sometimes." Internal Audit Departments with fewer than six staff were less likely to respond positively to either of these questions.

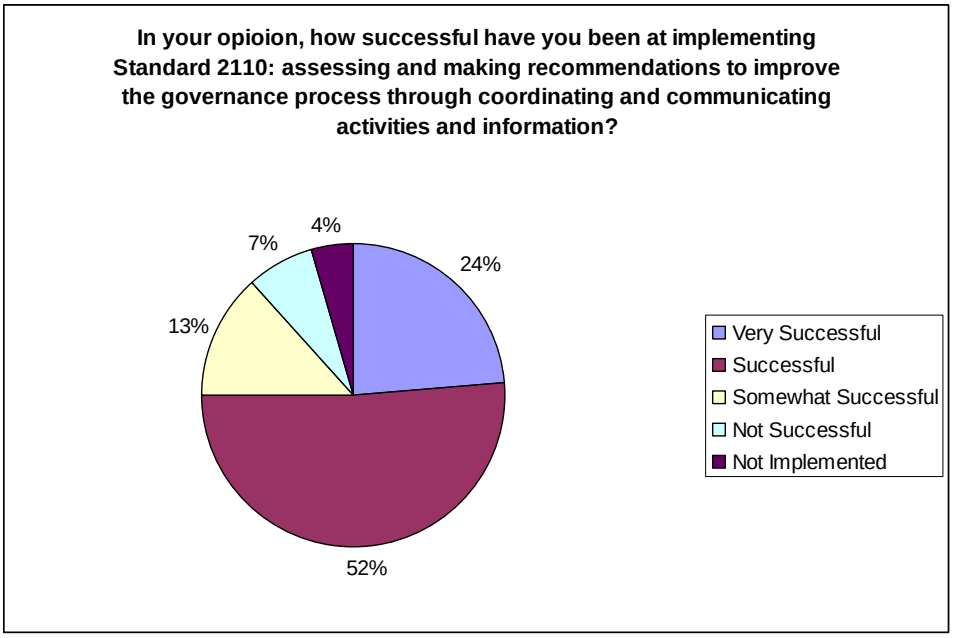


Seventy-one (71) of the 75 respondents who answered the question of whether the Internal Audit Department ensures adequate communication of audit activity to management and the board responded "yes". In response to how this is done respondents primarily indicated meetings with management and/or the board at a variety of frequencies to include but not limited to monthly and quarterly meetings and status reports and more frequently as needed. Further analysis of the four who responded "no" identified that all had fewer than six staff and two of them reported not having implemented the requirements of Standard 2110.

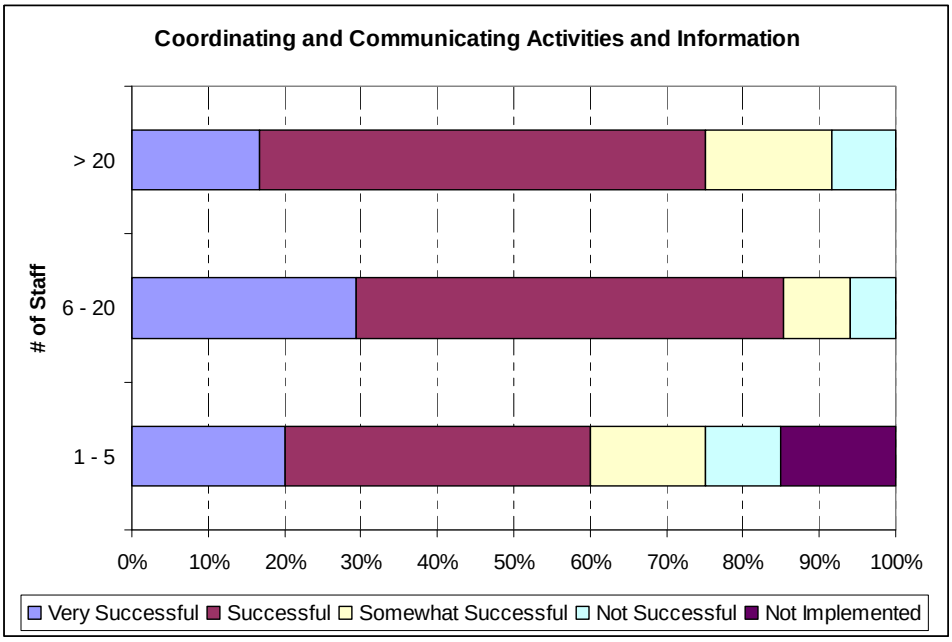
Respondents also provided examples of how they coordinate and communicate audit activities and information to management and the board. Some of these include:

- Serves as the point of contact for all external audits
- Assists with follow up reports to external auditors
- Participates in the year-end review with the external auditor
- Has formal procedures for communicating all audit activities

Overall, 51 of the 68 (76%) respondents that rated their level of success at implementing this part of the standard consider themselves "successful" or "very successful" with another nine selecting "somewhat successful".



Further analysis by the size of the Internal Audit Department identified that respondents with fewer than six audit staff consider themselves to be less successful at meeting this requirement than those with the larger staff with those having between 6 and 20 staff reporting as being more successful.



Case Studies

Case 1 – Capital Metropolitan Transportation Authority

I. Mission and Background

The Capital Metropolitan Transportation Authority (Capital Metro) was created in 1985. Their mission is to provide quality public transportation choices that meet the needs of a growing region in and around Austin, Texas.

To carry out its mission, Capital Metro provides a wide wage of transportation services including bus, paratransit, commuter rail, and freight rail.

1. **Bus Services –** Capital Metro provides bus services on regular routes, express bus services, park and ride services, and shuttle service for the University of Texas-Austin.
2. **Paratransit –** Capital Metro provides door-to-door paratransit service for people with disabilities who are unable to board, use, and disembark on the regular fixed-route bus service.
3. **Commuter Rail –** Capital Metro started commuter rail services in March 2010. These services included the design and construction of the first passenger line running from Austin to Leander.
4. **Freight Rail Operations –** Capital Metro operates freight rail including the maintenance of 162 miles of rail owned by Capital Metro that runs from Giddings to Llano.

Capital Metro's service area includes the City of Austin, the outlying communities of Leander, Lago Vista, Jonestown, Manor, San Leanna, Volente, Point Venture, and select unincorporated areas of Travis and Williamson counties. Capital Metro funds are provided through sales tax revenue (on eligible goods and services in the service area), fares, freight rail, federal funds, and investment income.

II. Key Elements of the Organization's Governance Program

1. **Organization's Governance Structure** – Capital Metro's eight member board (Board) is responsible for the management, operation, and control of Capital Metro and its property. Statute authorizes the Board to employ a General Manager and adopt rules for safe and efficient operations and maintenance of the transit system. Capital Metro employs about 200 staff to administer its responsibilities and programs and has over 900 employees (including 620 drivers and 120 mechanics) hired through its in-house non-profit service provider Star Tran, Inc. Fixed-route bus service includes 85 routes using about 400 buses, all of which are fully accessible per the

Americans with Disabilities Act (ADA). Paratransit services are for persons with disabilities that exceed the minimum ADA service requirements and operate 66 vans and 52 sedans using 167 drivers. Commuter rail service includes four trains on 32 miles of freight tracks between Leander and central Austin. Freight rail services include a 162-mile freight line and shares 32 miles of tracks with the commuter rail system, with commuter service running in the day and freight service at night.

2. **Organization's Governance Processes –** Capital Metro has developed clear objectives that help drive them to fulfill their mission including:
   a. customer driven service excellence,
   b. sustainable business growth, and
   c. strategic partnering.

   Capital Metro uses their policies and procedures as an important part of the agency's governance structure. They document expectations and standards including the respective roles of the agency staff. Capital Metro has a clearly-defined process for developing, approving, maintaining, and communicating policy to staff. Approved policies are available to staff online.

III. How Internal Audit is Implementing Standard 2110

Both the Audit Committee Charter and the Internal Audit Charter identify the respective roles of the Audit Committee and the internal audit function. The Chief Audit Executive reports directly to the board of directors through the Finance & Audit Committee. Internal Audit helps train the board and assists them in achieving their goals and objectives by providing independent and objective insights, analysis, and recommendations that assist management in making constructive change while effectively managing risk.

Promoting Ethics and Values – Internal Audit provides input to the ethics and fraud policies and participates in designing and delivering the required annual ethics and fraud training. Internal Audit evaluates the ethical climate of Capital Metro through surveys and monitoring of the secured website and hotline used to report suspected fraud, waste, and abuse (reporting can be done anonymously).

Ensuring Effective Organizational Performance Management and Accountability – In developing the FY2011 Internal Audit plan, Internal Audit linked auditable areas to Capital Metro organizational structure, budget, and strategic plan; normalized diverse auditable areas using pre-defined common risk and success factors; utilized participation and consensus of the internal audit team to identify auditable areas and relative risks; obtained input on risks from selected management and staff while maintaining ownership of the risk assessment; and compiled an integrated risk assessment for functional and IT-related auditable units. Internal Audit evaluates and monitors fifteen clear and concise objectives

of Capital Metro that focus on perspectives of the customer and community (2 objectives); stewardship and sustainability (3 objectives); internal processes (5 objectives), and people and tools (5 objectives). Clear and concise performance measures and strategic initiatives have been developed for each of these objectives and Internal Audit takes all of this information into consideration in developing their risk assessment, annual audit plan, and performing their audits.

Communicating Risk and Control Information to the Appropriate Areas of the Organization – In addition to providing written risk and control information to both management and the board, Internal Audit includes this type of information in their written audit reports and verbal presentation of audit results and additional briefings to the board and to specific Board Audit Committee members.

Coordinating the Activities of and Communicating Information among the Board, External and Internal Auditors, and Management – Internal Audit at Capital Metro has an overall board level perspective and has been assigned as one of the primary contacts when overall evaluations are conducted on the agency such as the one conducted by the Texas Sunset Commission. Internal Audit continues to provide written information to top management and provides briefings to the board as often as monthly.

IV. Closing

Although Capital Metro Internal Audit has been successful in promoting ethics and values; organizational performance management and accountability; communicating risk and control information to the appropriate areas of the organization; and coordinating and communicating activities and information to the board, external evaluators, and management, Internal Audit has identified methods that they plan to use to improve performance in each of these areas.

Case 2 – Texas Youth Commission

I. Mission and Background

The Texas Youth Commission, the States juvenile correctional agency, was created in 1949 and experienced its most recent significant reform in 2007. Its mission is to promote public safety by operating juvenile correctional facilities and by partnering with youth, families, and communities to provide a safe and secure environment where youth in the agency's care and custody receive individualized education, treatment, life skills and employment training, and positive role models to facilitate successful community reintegration.

The TYC operates ten secure facilities, nine medium security halfway houses, and 14 district offices and contracts with private vendors and counties for additional residential and parole supervision to provide services to approximately 2,800 young felony offenders. Funding for the TYC is a combination of general appropriations, federal funds, and grants.

II. Key Elements of the Organization's Governance Program

1. **Organization's Governance Structure** – TYC's seven member board, appointed by the governor with the advice and consent of the senate, is responsible for overseeing the management of the commission, and in so doing, serving the best interests of the commission. The board is required to meet a minimum of four times per year; in fiscal year 2010 they met nine times and are scheduled to meet six times in fiscal year 2011. In accordance with statute, the Executive Director, Director of Internal Audit, and the Inspector General report directly to the board.

2. **Organization's Governance Processes** – TYC has developed an agency philosophy that outlines nine principles for staff to adhere. These include:
   - TYC will create an organization of which all Texans can be proud.
   - TYC will value its employees as the agency's greatest asset.
   - TYC will create an organization where teamwork and collaboration is paramount.
   - TYC will create an organization that will care about the youth in its care and will strive to make a positive impact on their lives.
   - TYC will ensure the public is protected by always maintaining safety, security, and control at its facilities.
   - TYC will create an organization that will be accountable for its actions and that will admit its mistakes.
   - TYC will create a culture of communication and cooperation throughout the organization.
   - TYC will promote sound juvenile correctional techniques, best practices, and research.
   - TYC will protect the fundamental rights of youth.

TYC has developed, and refines as necessary, policies and procedures as part of its governance structure. Policies and procedures are available online and changes are posted on the electronic bulletin board and briefed at staff meetings.

While not all TYC employees have email accounts, they do have access to the electronic bulletin board where information is posted. Some of the sections include:

- Executive Director's Messages – information sharing from the Executive Director to all staff. These messages are sent to provide clarification and keep staff abreast of significant activities.
- Suggestion Box – an opportunity for employees to share their ideas for improvement
- Policy Corner – includes links to policy manuals, recent policy changes, and a way for staff to provide feedback on proposed policy changes
- F.Y.I. – operations team meeting notes and messages from key executive staff
- Agency Responses to Employee Questions & Suggestions – responses to ideas submitted through the suggestion box
- Training Material – reference material for supervisors to provide short training sessions; while currently focused on safety, this is expected to be expanded in the future
- Legislative Updates – outlines Legislative activity during the current session
- Have a Question? – an opportunity for staff to ask questions of the Executive Director and/or her management team
- TYC News Flash – news alerts about the agency
- Policy Review/Announcements – policies currently under review and announcements of recent policy changes

TYC participates in the biannual Survey of Employee Engagement, which is administered by the University of Texas, School of Social Work and measures the agency's culture, to include its communication practices, ethics, values, and other measures. Management takes this survey seriously and in the summer of 2010 deployed members of executive management to each facility to discuss their individual results and obtain recommendations on how to improve the individual facility and the agency as a whole. TYC has also adopted the Council of Juvenile Correctional Administrator's Performance-based Standards (PbS) and Community-based Standards (CBS) at its secure facilities and halfway houses. PbS and CbS are nation-wide improvement systems being used by youth-serving agency managers to improve conditions for both youth and staff. In addition to other data collection methodologies, PbS and CbS include semi-annual climate surveys, of both staff and youth, to obtain information on safety and security as well as on the quality of communication, training, and management of the facilities.

In addition, though in the early stages, TYC has established an IT governance process. Several user groups propose and prioritize IT projects to the Steering Group which makes recommendations to the Executive Management Team for final approval. While in its infancy, this process is proving beneficial in resource management and ensuring the Information Resource Department's activities are aligned with the agency's strategic goals.

III. How is Internal Audit Implementing Standard 2110?

The Internal Audit Charter, approved by the board and signed by the Chairman of the Board, Executive Director and Director of Internal Audit annually identifies the roles of the Internal Audit Department and management. The Director of Internal Audit reports directly to the board and assists the Finance and Audit Committee and board by providing independent and objective analysis, insight, foresight, and recommendations that assist management in making change to improve operations and manage risk.

Promoting Ethics and Values – Internal Audit provides input to ethics and fraud policies and monitors the agency's ethical climate through surveys, administered by the Department as well as by other organizations, and attendance at various meetings. The Director attends the Executive Management Team meetings and meets regularly with individual management staff.

Ensuring Effective Organizational Performance Management and Accountability – The Internal Audit Department conducts a detailed risk assessment each year to develop the annual audit plan and communicate risk to management. Additionally, the survey phase of each audit includes a review of performance measures applicable to the area being audited and agency-wide performance measures are reviewed quarterly with the Executive Management Team with discussion on any that the agency is not meeting and what corrective actions are needed to improve performance.

Communicating Risk and Control Information to the Appropriate Areas of the Organization – The results of the annual risk assessment are communicated to Executive Management, through the Management Audit Committee (MAC), and the board when the annual audit plan is proposed for approval – management's ability to mitigate risks is factored into the final risk score. Additionally, the MAC meets monthly to receive status updates on audit work during which more detailed risk assessments and review of controls are discussed. MAC members are knowledgeable of the audit process and provide input throughout the projects.

Coordinating the Activities of and Communicating Information Among the Board, External and Internal Auditors, and Management – The Internal Audit Department considers recently completed external audit activities, known

upcoming activities, and management monitoring activities in the development of the annual audit plan. The Department is the primary contact for audits conducted by the Texas State Auditor's Office and has developed a relationship with management to ensure it is kept apprised and involved as needed with other audit and evaluation entities. The Department is provided a copy of final reports and track and reports the implementation status of recommendations to executive management and the board on a quarterly basis. Finally, the Director of Internal Audit discusses audit activity with the Finance and Audit Committee each board meeting and with the Chairman of the Board and other members on an individual basis as needed.

IV. Closing

The recent reform and significant management turnover the TYC has experienced has provided opportunity for the Internal Audit Department to provide the assurance and guidance identified in Standard 2110 as well as helped institutionalize positive practices. The Internal Audit Department continues to identify ways to increase its value by providing insight and foresight to management and the board.

Case 3 – State of Ohio

I. Mission and Background

Vision and Mission

The mission of the Ohio Office of Internal Audit (OIA) is to provide independent, objective assurance and consulting activities designed to improve management practices, identify operational improvement, and reduce agency risk exposure.

Background

Recap of Fiscal Year 2010:

- OIA issued 21 public reports that are available on the OIA webpage; 15 of these reports related to ARRA monies which was a significant focus in fiscal year 2010
- These program audits covered 4.5 of the 6.5 billion dollars of ARRA monies in our oversight
- In addition, we devoted significant time to assist several agencies with ARRA system documentation requirements. This will be helpful for future external audits by the Auditor of State or federal oversight agencies.
- Our IT group performed a mobile data audit of all 21 state agencies as well as other "security record" audits which are not public reports.
- OIA developed an annual audit plan in June 2009 and was able to complete 85 % of the projects scheduled for fiscal year 2010.

Current Audit Plan Highlights:

- OIA will expand audit procedures from 12 agencies last fiscal year to all 21 state agencies in its oversight for fiscal year 2011.
- We plan to perform IT general control computer audits at 15 agencies. Several of these agencies have never had an external audit done of their IT departments.
- The Ohio Auditor of State plans to leverage our work at three agencies (Transportation, Commerce, and Health) to reduce their procedures and expedite the completion of the 2010 State Single Audit.
- The financial group plans to focus on large state systems including Bureau of Motor Vehicles at Public Safety; Unemployment Insurance at JFS; Unclaimed Funds at Commerce; and Income Tax Refunds at Taxation.

Opportunities for the Future:

- Leverage risk information on major processes to serve as an advisor for agency reductions, consolidations, or privatization.
- After development at Bureau of Workers' Compensation, expand the ERM model to other cabinet level agencies.
- Become part of the senior cabinet level management team which would allow us to focus on the high risk value-added opportunities.

- Begin continuous monitoring utilizing OAKS data (Ohio's general ledger) generated by the Business Intelligence group.

II. Key Elements of the Organization's Governance Program

1. **Organization's Governance Structure –** OIA has 26 employees with all staff housed in the same location. Our 21 audit clients are walking distance from our downtown location or within 10 miles. The proximity of our staff allow for frequent communication on policies and guidelines. The OIA Policy and Procedures Manual is updated annually and we conduct "all hands" staff meetings each quarter. Additionally, Ohio has a five member, independent State Audit Committee that meets quarterly in public session with OIA and the external auditors (Ohio Auditor of State).

2. **Organization's Governance Processes** – OIA uses a series of metrics to monitor results. Each staff member has an assigned chargeable percentage based on their position within the organization and these results are shared monthly. OIA maintains a monthly status of agency billing and measures our progress toward meeting the audit hours necessary to complete our annual plan. The status of our annual plan is reviewed with the State Audit Committee on a quarterly basis.

3. **Other areas used to enhance and improve the governance program** – To improve OIA's consistency with audit programs and supervision, Teammate was implemented in July 2010. Standard practice aids and review processes are used to improve working paper and audit report consistency.

III. How Internal Audit is Implementing Standard 2110

The OIA Audit Policy and Procedure Manual is currently being updated to accommodate the *Standards* changes.

Promoting Ethics and Values – The state of Ohio has a structured ethics process. All state management employees (including OIA management and the State Audit Committee members) are required to attend three hours of annual ethics training. The State has an Ohio Ethics Commission to resolve ethics issues in state government. In addition, each state agency maintains a chief ethics officer (often the agency chief legal counsel) to promote ethics, address questions, or involve the Ohio Ethics Commission as appropriate. OIA has not completed any assurance engagements to date on ethics as the communication and information processes appear well controlled.

Ensuring Effective Organizational Performance Management and Accountability –The OIA Annual Plan is a risk-based approach to plan audit engagements. The OIA receives input from agency management on stakeholder concerns, new processes or programs, and reporting risks to formulate the plan.

OIA will focus audit engagements on the higher risk processes and consider audit efforts of the Ohio Auditor of State to minimize duplication of audit effort.

Communicating Risk and Control Information to the Appropriate Areas of the Organization – The OIA will stay in continuous communication with the audit client and ensure our understanding is correct with audit issues identified. An exit conference is held with agency senior management prior to the completion of the engagement.

Coordinating the Activities of and Communicating Information among the Board, External and Internal Auditors, and Management – The OIA audit reports are presented to the State Audit Committee in a closed executive session. After comment by the State Audit Committee, the audit reports are public record on the OIA website. Those engagements which involve security or Department of Taxation information are except from public disclosure.

Evaluating the Design, Implementation, and Effectiveness of the Organization's Ethics-Related Objectives, Programs, and Activities – As discussed above, the state of Ohio has a structured ethics process. OIA has not completed any assurance engagements to date on ethics as the communication and information processes appear well controlled.

Assessing Whether the Information Technology Governance of the Organization Supports the Organization's Strategies and Objectives – The OIA is performing IT General Controls at 15 separate state agencies this fiscal year. Each of these engagements includes an audit objective on IT governance.

IV. General Information

In fiscal year 2010, OIA performed a governance-related engagement on the State's central reporting of federal ARRA disbursements. This engagement was completed as the reporting process was being designed and provided timely feedback to the State's management. This engagement was also later relied upon by the external auditor (Ohio Auditor of State) performing the fiscal year 2010 State Single Audit.

Conclusions

The survey results include an evaluation of the performance success of internal audit in assessing and improving their organization's governance process as required by Standard 2110.

- Promoting appropriate ethics and values - Overall 85% of the respondents indicated some level of success at implementing this objective with 51% from successful to very successful and another 34% as somewhat successful.
- Promoting organizational performance management and accountability - Overall 87% of the respondents indicated some level of success at implementing this objective with 56% from successful to very successful and another 31% as somewhat successful.
- Communicating risk and control information – Overall 96% indicated they had some level of success at implementing this objective with 74% from successful to very successful and another 22% as somewhat successful.
- Coordinating and communicating activities – Overall 89% indicated they had some level of success at implementing this objective with 76% from successful to very successful and another 13% as somewhat successful.

The results of the case studies support the survey results but also identified specific actions implemented by internal audit to promote the governance process.

- Promoting appropriate ethics and values through participating in designing and delivering the required ethics and fraud training and evaluating the ethical climate through surveys and monitoring of the hotline.
- Promoting organizational performance management and accountability through performing the annual risk assessment using the organizational structure, budget, and strategic plan, performance measures, and input from management; and obtaining information on stakeholder concerns, new processes or programs, and reporting risks from management when preparing the audit plan.
- Communicating risk and control information through providing information on risk and control in all audit reports and verbal presentations; and maintaining continuous communication with the audit client during an engagement to ensure understanding of audit issues.
- Coordinating and communicating activities through providing a board level perspective to the organization; and serving as the primary contact when overall evaluations are conducted on the organization.

These results help internal audit practitioners to gain a greater understanding of leading practices among internal audit practitioners; encourage engagement of further efforts to improve the organizational governance process and associated ethical climate, accountability, and integrity; continue to promote "progress through sharing;" and emphasize and support the IIA's position on the importance of the control environment.

Acknowledgements

The Austin Chapter Research Committee members express our appreciation to the Chief Audit Executives and representatives of all of the organizations who responded to our survey and shared their thoughts and ideas, with special thanks to:

Capital Metropolitan Transportation Authority
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Texas Adjutant General's Department
Texas Education Agency
Texas Commission on Environmental Quality
Texas Department of Public Safety
Texas Youth Commission

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Appendix A

Survey Tool

1. Does your organization require ethics training? ☐ Yes ☐ No

2. If yes, does the Internal Audit Department participate in providing the training?
   ☐ Yes ☐ No

3. Does your organization require fraud awareness training? ☐ Yes ☐ No

4. If yes, does the Internal Audit Department participate in providing the training?
   ☐ Yes ☐ No

5. Does the Internal Audit Department provide input to the organization's ethics policy? ☐ Yes ☐ No

6. Does the Internal Audit Department provide other ethics/values related advice or guidance to the organization? ☐ Yes ☐No
   Please describe:

7. Does the Internal Audit Department conduct surveys of the ethical climate of the organization? ☐ Yes ☐ No

8. If yes, at what level are the surveys conducted? (Choose all that apply)
   - ☐ Senior management
   - ☐ Line management
   - ☐ All staff
   - ☐ Other (please describe)

9. Does your organization have a secured website or hotline to report suspected fraud, waste, and abuse anonymously? ☐Yes ☐ No

10. Does the Internal Audit Department audit the organization's performance measures? ☐ Yes ☐ No

11. Does the Internal Audit Department communicate risk and control information to appropriate management?
    - ☐ Yes, orally
    - ☐ Yes, written
    - ☐ Yes, both orally and written
    - ☐ No

12. Does the Internal Audit Department communicate risk and control information to the governing board?
    - ☐ Yes, orally
    - ☐ Yes, written
    - ☐ Yes, both orally and written
    - ☐ No
    - ☐ There is no governing board

13. Does the Internal Audit Department coordinate internal and external audit activities being conducted within the organization?
    - ☐ Yes
    - ☐ Sometimes
    - ☐ No

14. Does the Internal Audit Department serve as the liaison for external audit activities?
    - ☐ Yes
    - ☐ Sometimes
    - ☐ No

15. Does the Internal Audit Department ensure adequate communication of audit activity to management and the board? ☐ Yes ☐ No
    If yes, how is this done?

16. Standard 2110 states: The internal audit activity must assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives:
    - Promoting appropriate ethics and values within the organization;
    - Ensuring effective organizational performance management and accountability;
    - Communicating risk and control information to appropriate areas of the organization; and
    - Coordinating the activities of and communicating information among the board, external and internal auditors, and management.

    What has your audit function done to comply with this standard?

17. In your opinion, how successful have you been at implementing specific areas of Standard 2110 within your organization?

    Promoting ethics and values.
    - ☐ Not Implemented
    - ☐ Not Successful
    - ☐ Somewhat Successful
    - ☐ Very Successful (fully implemented)

Promoting organizational performance management and accountability.

- ☐ Not Implemented
- ☐ Not Successful
- ☐ Somewhat Successful
- ☐ Very Successful (fully implemented)

Communicating risk and control information to the appropriate areas of your organization.

- ☐ Not Implemented
- ☐ Not Successful
- ☐ Somewhat Successful
- ☐ Very Successful (fully implemented)

Coordinating and communicating activities and information among the board, external auditors, and management.

- ☐ Not Implemented
- ☐ Not Successful
- ☐ Somewhat Successful
- ☐ Very Successful (fully implemented)

18. How many staff members are in the Internal Audit Department?
    - ☐ 1 – 5
    - ☐ 6 – 20
    - ☐ > 20

19. What is your industry?
    - ☐ For profit
    - ☐ Non-profit
    - ☐ Federal government
    - ☐ State government
    - ☐ Local government
    - ☐ College or university
    - ☐ Other (please explain)

20. What is your leadership structure?
    - ☐ Governing Board or Commission
    - ☐ Elected Official(s)
    - ☐ CEO/President
    - ☐ Other (please explain)

21. Organization Name: _____

22. If selected, would you agree to discuss your activities further with a member of the research team? ☐Yes ☐ No

23. Contact information (optional but needed if selected for further inquiry)
Name: _____
Phone: _____
Email: _____