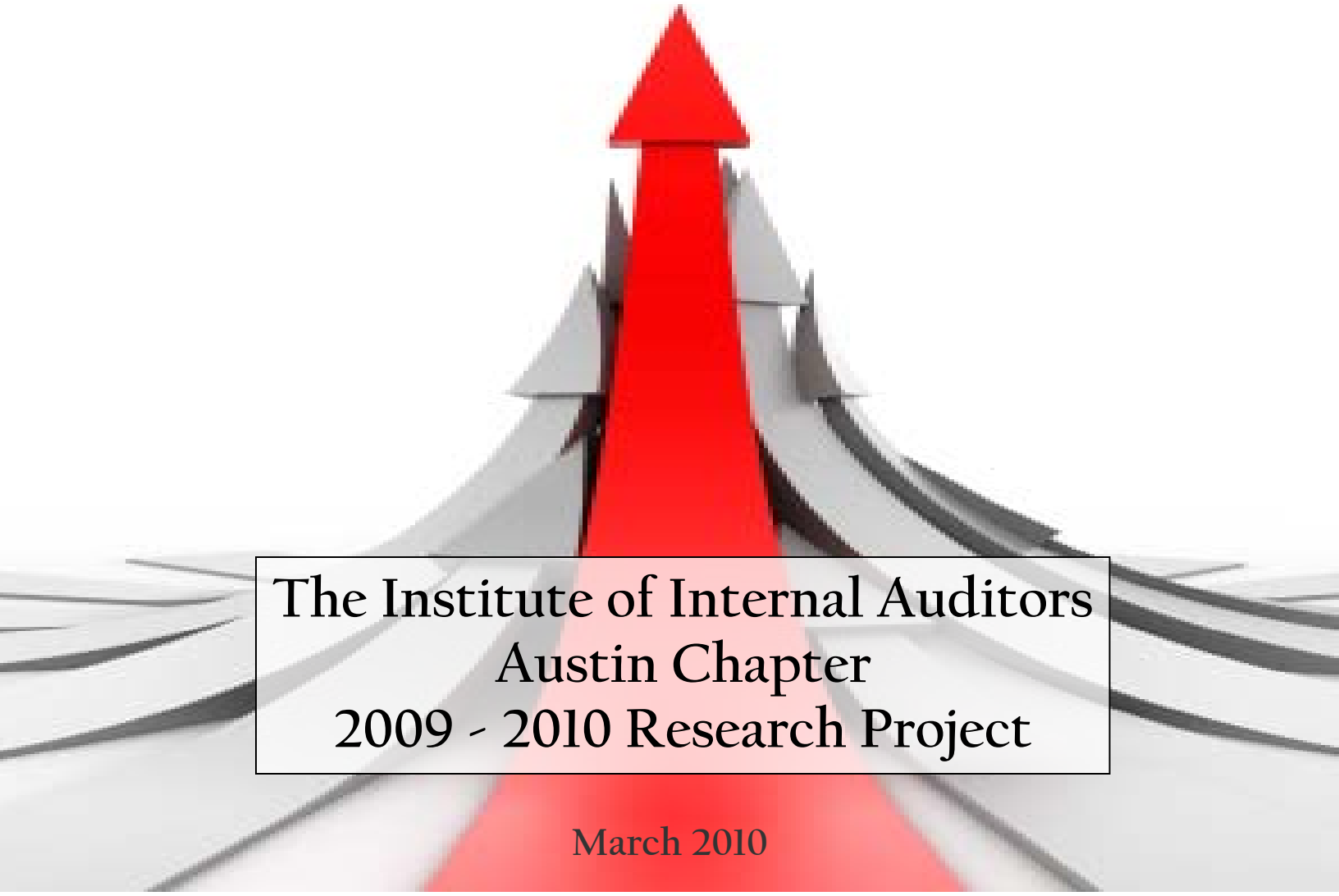
Internal Audit's Role in Promoting a Positive Tone @ the Top



The Institute of Internal Auditors Austin Chapter 2009 - 2010 Research Project

March 2010

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The IIA Research Foundation, Donald J. Ricketts Research Award, March 2010

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Table of Contents

Executive Summary 1

Introduction 2
- Background 2
- IIA Guidance 4
- IIA Chapter Research Reports 6
- Relevance to Profession 6

Research Methodology 6

Respondent Demographics 7
- Country 8
- Leadership Structure 8
- Industry 9
- Annual Revenue – Fiscal Year 2009 9

Survey Results 10
- Internal Audit's Role in Governance 10
- Internal Audit's Role in Performance Management and Accountability 15
- Internal Audit's Role in Consulting 19
- Internal Audit's Role in Coordinating Audit Activities 20
- Internal Audit's Role in Control Self-Assessment/Enterprise Risk Management 22

Case Studies 25
- Texas Adjutant General's Department 25
- Aditya Birla Group, (HQ location) 30

Conclusions 33

Further Study 34

Acknowledgments 34

Selected Bibliography 35

Appendices:
- Appendix A: Other activities relating to organizational ethics and values the Internal Audit Department participates in 38
- Appendix B: How the internal audit department helps ensure accountability and integrity in the organization 40
- Appendix C: Survey Tool 41

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Executive Summary

"Company culture depends on many factors - size, whether it's public or private, how regulated the industry is, whether the company is growing through acquisition or from within. But nothing matters more than the tone set at the top"

-- *Cynthia Cooper – former Vice President of Internal Audit at WorldCom.*

Tone at the top is the ethical climate generated by an organization's leadership. The tone set by management has a significant influence on the employees of the organization. The behavior and actions of the employees will naturally gravitate toward what they witness in their supervisors, line managers, and upper management.

A positive tone promotes honesty, integrity, transparency, fairness, competence, performance, and mission accomplishment throughout the organization. Conversely, a negative tone at the top projects a more narrow focus on the bottom line and meeting selfish personal goals within the organization. If the organization's leadership fails to set a positive tone, employees at all levels will be more inclined to commit wasteful or fraudulent activities, because ethical conduct is not shown to be a concern or priority within the organization.

This research paper explores how Internal Audit uses its role in the organization to influence and promote a more positive tone at the top. As you read through the survey results and analytical comments, the two very diverse organizational case studies, and the resulting conclusions you will better understand what Internal Audit can effectively do to promote a positive tone at the top and throughout the organization.

As evidenced throughout the survey and case studies, Internal Audit's constant, routine, and multiple lines of communication with the organization's top management and the board is the most important element in influencing the organization's tone at the top. Internal Audit can effectively promote a positive tone by upholding clear and unyielding ethical values in our actions, in all of our communications, and in our professional demeanor.

As identified in the report conclusions, Internal Audit can have a significant positive effect on the organization's ethical atmosphere through a variety of activities.

Introduction

The Institute of Internal Auditors (IIA) has provided significant leadership, guidance, and direction in the arena of organizational governance for many years. The concept of corporate governance has clearly evolved and been more fully defined over the past 20 years. A Google Internet search of the term "corporate governance" yields about 16,400,000 results. Governance is defined as "the framework of rules and practices by which the board of directors ensures accountability, fairness, and transparency in the firm's relationship with its stakeholders (financers, customers, management, employees, government, and the community)." [1]

Accountability, integrity, and ethical behavior are appropriate areas of concern and review for internal audit activities. The internal auditor has a unique role in reporting to corporate, nonprofit, and public sector boards. Internal auditors are required by professional standards to consider "big picture" governance, risk management, and control issues and concerns that impact or could impact all stakeholders of our organizations.

Background

Although the original (1978) version of the *Standards for the Professional Practice of Internal Auditing* did not specifically discuss the concept of "governance," it did contain excellent guidance on organizational governance in the delineation of the primary objectives of internal control. General Standard 300 described the scope of work of internal auditors[2] and included the following objectives which remain paramount to internal audit work some 32 years later:

- Reliability and integrity of information;
- Compliance with policies, plans, procedures, laws, and regulations;
- Safeguarding of assets;
- Economical and efficient use of resources; and
- Accomplishment of established objectives and goals for operations or programs.

The IIA's first *Statement on Internal Auditing Standards* (SIAS) provided additional "guidance to internal auditors on the nature of controls and the roles of participants in its establishment, maintenance, and evaluation."[3]

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[1] www.businessdictionary.com

[2] Institute of Internal Auditors, *Standards for the Professional Practice of Internal Auditing* (also then known as "the Brown Book") was issued in August 1978 and republished in the October 1978 issue of *The Internal Auditor*.

[3] Institute of Internal Auditors, *Statement on Internal Auditing Standard No. 1, Control: Concepts and Responsibilities was* issued by the IIA Professional Standards and Responsibilities Committee and republished in the December 1983 issue of *The Internal Auditor*.

A number of other major events that occurred over the past 30-plus years were instrumental in leading to today's renewed focus on accountability, integrity, ethical behavior, and good governance. Among the key events were the following:[4]

- The Foreign Corrupt Practices Act of 1977 detailing transparency requirements and anti-bribery provisions
- The Treadway Commission 1987 report on fraudulent corporate financial reporting
- The Committee of Sponsoring Organizations (COSO) of the Treadway Commission's landmark 1992 work on *Internal Control – Integrated Framework* and 2004 publication of the *Enterprise Risk Management Framework*
- Major business scandals in the early 2000s involving the collapse of corporations such as Enron (2001), WorldCom (2002), Tyco (2002), and Adelphia (2002)
- The Sarbanes-Oxley Act of 2002 including Section 406 requiring a code of ethics for senior financial professionals.
- The New York Stock Exchange and the American Stock Exchange corporate governance rules promulgated in 2003
- The National Association of Securities Dealers' 2003 *Summary of NASDAQ Corporate Governance Proposals*
- PricewaterhouseCoopers White Paper on *Strengthening Internal Audit's Role in Corporate Governance* (2004)
- *COSO Guidance on Monitoring Internal Control Systems (2009)*
- Efforts by leading public, private, and non-profit organizations to educate and inform diverse groups of the components of good governance. These organizations included the Business Round Table, the California Public Employees Retirement System, the Canadian Institute of Chartered Accountants, the Conference Board, the International Capital Markets Group, the National Association of Corporate Directors, and PricewaterhouseCoopers

According to the IIA, a control environment comprises the attitude and actions of the board and management regarding the significance of control within the organization. It provides the discipline and structure for the achievement of the primary objectives of the system of internal control and includes:

- Integrity and ethical values;
- Management's philosophy and operating style;
- Organizational structure;
- Assignment of authority and responsibility;
- Human resource policies and practices; and
- Competence of personnel.

[4] Further information on these and other key events pertaining to governance may be found in the IIA's *Governance Update 2003: Impact of New Initiatives on Audit Committees and Internal Auditors* available through the IIA Bookstore.

The IIA was actively involved in numerous deliberations during this critical period, and IIA representatives provided testimony in various settings. In addition, the IIA Research Foundation (IIARF) provided a considerable number of educational publications and research reports for practitioners, board members, and other interested parties. Among the IIA ethics and governance-related publications developed or supported were the following:

- *Audit Committee Effectiveness – What Works Best* (1993, 2000, and 2005) prepared by PricewaterhouseCoopers and sponsored by the IIARF
- *Effective Fraud Detection and Prevention Techniques* (1993)
- *Competency Framework for Internal Auditing: The Global Landscape (1999)*
- *Corporate Governance and the Board: What Works Best* (2000) prepared by PricewaterhouseCoopers and sponsored by the IIARF
- *Audit Committee Briefing: Understanding the 21st Century Audit Committee and Its Governance Role* (2000)
- *Information Security Governance: What Directors Need to Know* (2001)
- *Governance Update 2003: Impact of New Initiatives on Audit Committees and Internal Auditors* (2003)
- *Internal Audit's Role in Corporate Governance: Sarbanes-Oxley Compliance* (2003)
- *Ethics and the Internal Auditor: 20 Years Later* (2004)
- *Changing Internal Audit Practices in the New Paradigm: The Sarbanes-Oxley Environment* (2004)
- *Factors Affecting Corporate Governance and Audit Committee in Selected Countries* (2005)
- *Role of Auditing in Public Sector Governance* (2006)
- *A Global Summary* of the *Common Body of Knowledge 2006*,(2007)
- *Ethics and Compliance: Challenges for Internal Auditing* (2007)
- *The Role of Internal Auditing in Enterprise Risk Management – Position Paper* (2009)
- *Internal Auditing and Fraud - Practice Guide (2009)*
- *Global Technology Audit Guide (GTAG) 13: Fraud Prevention and Detection in an Automated World* (2009)

IIA Guidance

The IIA's *International Standards for the Professional Practice of Internal Auditing* has also evolved since 1978 with major changes implemented in 2004 and 2009. A key development in 1999 was the IIA's approval of the Guidance Task Force recommendations to approve a new Definition of Internal Auditing and a new Professional Practices Framework.

In 2004 the *Professional Practices Framework* included Standard 2130 on governance and Practice Advisory 2130-01 on the *Role of the Internal Audit Activity and Internal Auditor in the Culture of the Organization*.

The current *International Professional Practices Framework* (IPPF) includes Standard 2110 providing:

> "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, executive management, and internal auditors, and management."

Standard 2110 also provides mandatory guidance for professional internal auditors in (1) evaluating "the design, implementation, and effectiveness of the organization's ethics-related objectives, programs, and activities"[5] and (2) in assessing "whether the information technology governance of the organization sustains and supports the organization's strategies and objectives."[6]

In recent years, the IIA has also published Practice Guides and Position Papers directly or indirectly relevant to governance, risk management, and control issues and concerns. Some of the more prominent publications were previously detailed on page 4 of this Introduction.

Also of significant value were several IIA brochures designed to assist Audit Committee members with their governance and Internal Audit oversight responsibilities, which include the following:

- *Internal Auditing: Adding Value Across the Board*
- *Internal Auditing: Building Quality Into Practice*
- *The Audit Committee: A Holistic View of Risk*
- *The Audit Committee: Internal Audit Oversight*
- *The Audit Committee: Purpose, Process, Professionalism*

The IIA also initiated the *Tone at the Top* newsletter around 1997. This informative newsletter is published several times per year and is designed to inform and educate board members, chief executive officers, and others charged with governance. Among the recent topics were:

- What's On Your (Corporate) Conscience? (November 2009)
- A New Level of Audit Committee Involvement (August 2009)
- Getting Serious About Board-level Scrutiny (November 2008
- Stakeholder Trust Remains A Hot Topic (May 2008)
- Walking the Walk (August 2006)

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[5] Codified as IIA Standard 2110.A1
[6] Codified as IIA Standard 2110.A2

IIA Chapter Research Reports

The IIARF has encouraged both Chapter-sponsored and Institute-sponsored research for the past 20 years. Prior ethics and governance research reports include a range of topics as noted below:

- “Insider Trading from the Internal Auditor's Perspective” (Dallas Chapter, 2007)
- “Survey on Audit Committee Relationships: A Research Project” (Austin Chapter, 2007)
- “Survey on Ethics and Governance: A Research Project" (Austin Chapter, 2006)
- “Viewing Organizational Trust and Internal Auditing” (Dallas Chapter, 2004)
- "Internal Audit Independence and Corporate Governance" (Chicago Chapter, 2003)
- “The Foreign Corrupt Practices Act: An International Perspective” (IIA Italy, 1998)
- "Corporate Policies & Reporting Requirements: Prohibited & Fraudulent Activities” (Central Illinois Chapter, 1994)
- "What Causes Unethical Behaviors in Business: Breakdowns in the Formal or Informal Systems?" (Calgary Chapter, 1992)

Relevance to the Profession

The results of this research project provide further information and perspective that can be useful to the profession on the generally well-documented topic of auditing accountability and governance.

The Austin Chapter believes the survey results are beneficial from several standpoints:

- Gaining a greater understanding of leading practices among internal audit practitioners in more fully implementing the requirements of Standard 2110;

- Encouraging survey respondents and report readers to engage in further efforts to improve the ethical climate, accountability, and integrity of their respective organizations; and

- Offering another opportunity to implement the IIA’s distinctive motto of “progress through sharing.”

Research Methodology

This study utilized a survey of internal auditors as well as case studies of organizations identified as having best practices and a literature review. The survey was conducted from December 2, 2009 through January 7, 2010 using the Survey Monkey online survey tool.

The survey was sent via the email listserv for the Austin Chapter of the Institute of Internal Auditors. Additionally, the 14 Chapter members who serve on IIA International Committees or governing bodies were requested to forward it for further distribution. International Committees represented were:

- Academic Relations
- Board of Directors
- Board of Regents
- Board of Research and Education Advisors
- Internal Audit Standards Board
- Nominating
- Professional Conferences
- Professional Issues
- Public Sector
- Research Foundation Board of Trustees

The use of the listserv and request to forward the electronic survey means that an exact number of people who received the survey cannot be determined. Of those to whom the survey was sent, 113 persons responded. The survey data was then analyzed using basic statistical techniques.

As part of the survey, respondents were asked about their willingness to participate in a case study. Two organizations that rated their tone at the top as 5 (the highest possible rating) and provided contact information were selected for further study; the case studies were conducted by interviewing the head of each organization's Internal Audit activities.

This research report is organized to provide the perspectives of fellow practitioners regarding several aspects of accountability and governance. Survey questions pertained to the role of the internal audit activity in the following areas:

- Governance
- Performance Management and Accountability
- Consulting
- Coordinating Audit Activities
- Control Self-Assessment/Enterprise Risk Management.

Respondent Demographics

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

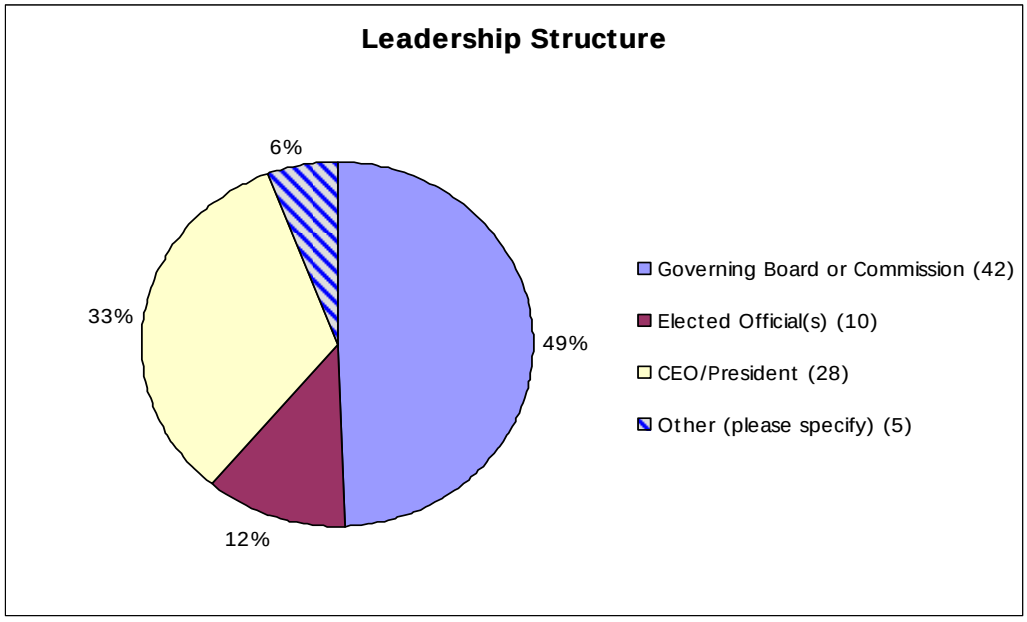
Country

As discussed above, this was a global survey; 51 of the 113 respondents indicated their country of origin. Of those, more than half (55%) were from outside the United States. In addition to the United States, responses came from audit professionals in Canada, India, Japan, Jersey Channel Islands, The Netherlands, South Africa, Uganda, the United Kingdom, and Venezuela.

Country	Response Percent	Response Count
Canada	2.0%	1
India	2.0%	1
Japan	3.9%	2
Jersey Channel Islands	2.0%	1
Netherlands	3.9%	2
South Africa	11.8%	6
Uganda	2.0%	1
United Kingdom	25.5%	13
United States	45.1%	23
Venezuela	2.0%	1

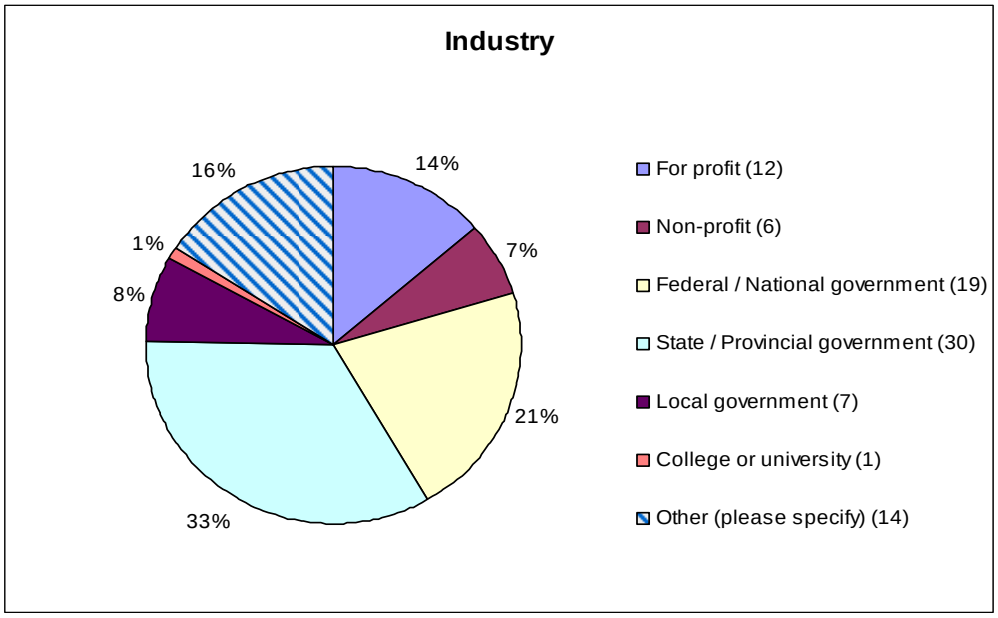
Leadership Structure

To allow for analysis and comparison of different leadership structures, respondents were asked to indicate the structure of their organizations. Of the 85 respondents who answered this question, nearly half of them report under a governing board or Commission-style leadership structure with almost one-third reporting having a CEO or President.



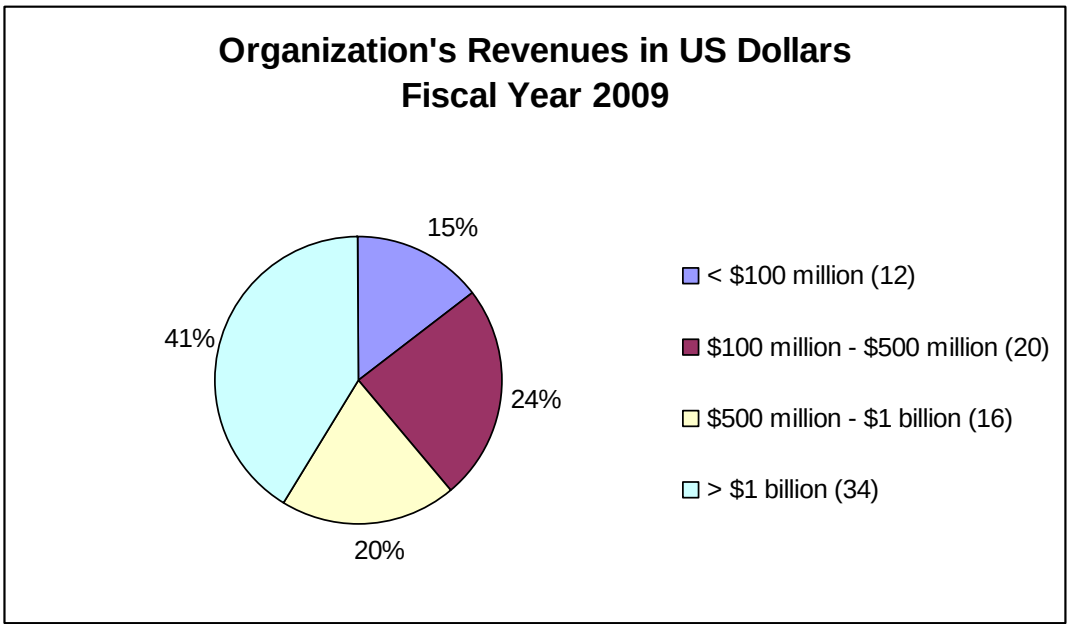
Industry

Of the 89 respondents who answered this question, 56 were employed at some level of government.



Annual Revenue – Fiscal Year 2009

Of the 113 respondents, 82 reported their fiscal year 2009 revenues, which follow:



Survey Results

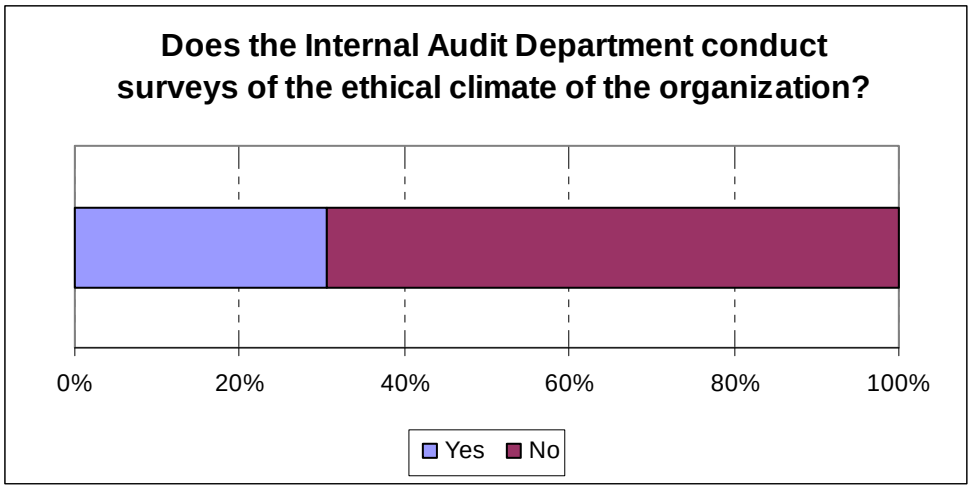
In addition to understanding the demographics of the respondents, it was important to understand the interaction the Internal Audit Department has with the organization in areas that impact governance. The last question of each section asked the respondent to rate Internal Audit's effectiveness in the specific area. Additionally, the final question of the survey asked respondents to rate the organization in key areas and activities related to governance and tone at the top.

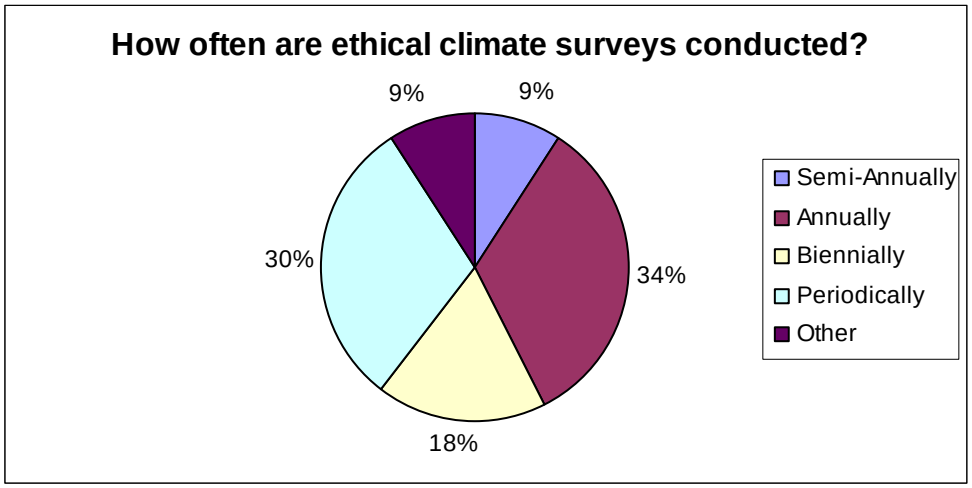
Internal Audit's Role in Governance

The first group of questions discussed ethics and fraud as well as Internal Audit's involvement in developing related training and providing input and guidance to the organization. Performance Standard 2110.A1 requires the Internal Audit activity to "evaluate the design, implementation and effectiveness of the organization's ethics-related objectives, programs, and activities."

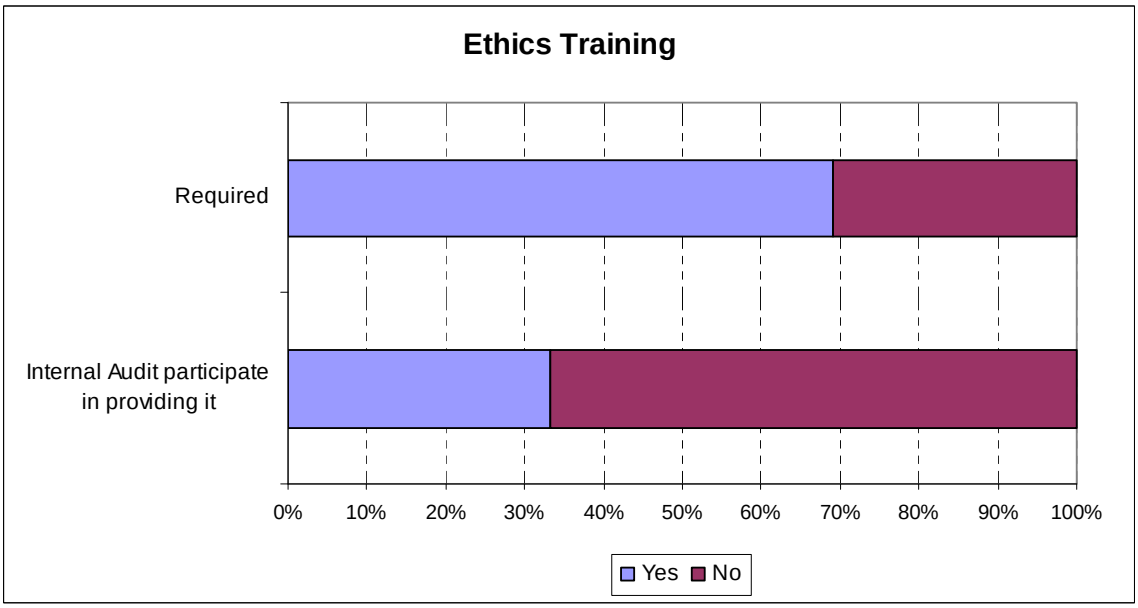
To understand how the respondents meet this requirement, the survey asked about various activities of the Internal Audit activity including surveys of ethical climate, involvement in ethics and fraud training, provision of input to the ethics policy, advice or guidance, and other activities.

Respondents were asked whether the Internal Audit Department conducts surveys of the ethical climate of the organization, and if so how often and to whom the results are reported. Of the 111 respondents who answered the question, just under one-third (34) answered "yes" with a variety of responses as to their frequency. Those who responded "other" noted that the survey has only been conducted once; the frequency is dependent on the risk analysis; and multi-year (which could also be interpreted as periodically). Most of the respondents indicated multiple levels of reporting the results including the board, audit committee, executive management, external auditors, agency-wide, and others.



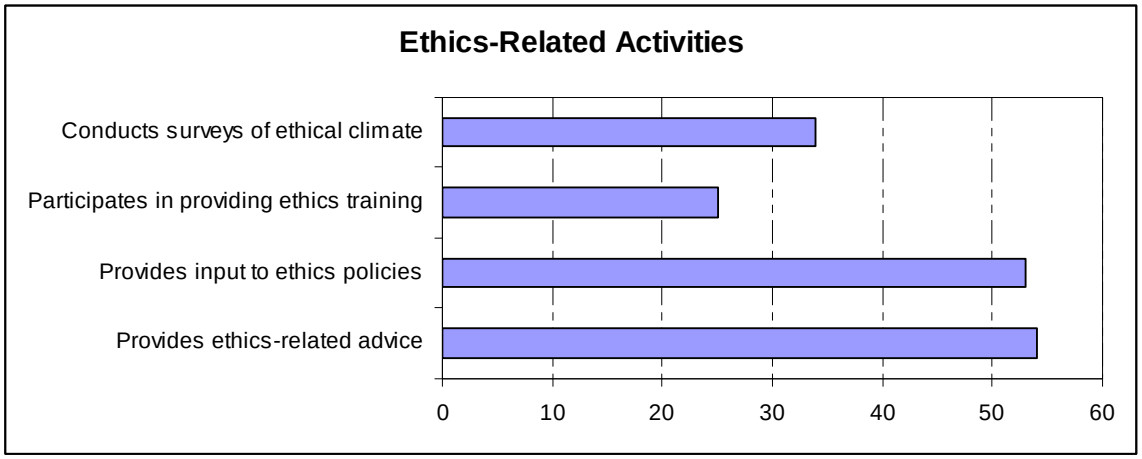


While it has long been debated whether ethics can be taught, ethics training is often required as a process of communicating the organization's expectations of ethical conduct. To understand the organization's requirements and Internal Audit's involvement, we asked whether training is required and, if so, whether Internal Audit participates in providing such training. Of the 110 respondents who answered the question, 76 responded "yes" to whether ethics training was required and, of those, 25 responded "yes" that Internal Audit participated in providing the training.

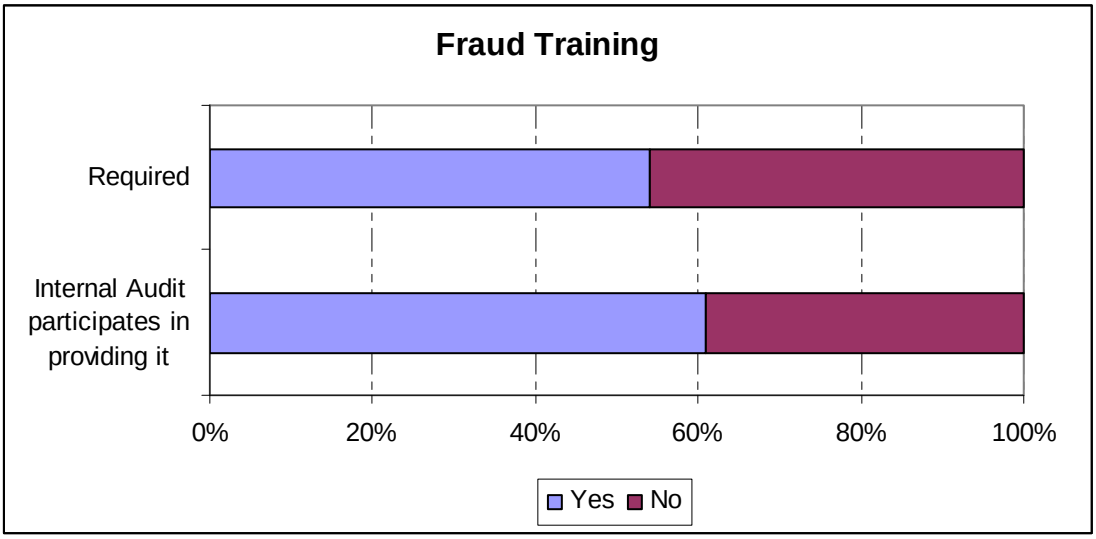


While most respondents do not participate in providing ethics training, questions about providing input to ethics policies and other ethics or values-related advice supported significant activity in this area. Of the 105 respondents who answered the question, 53

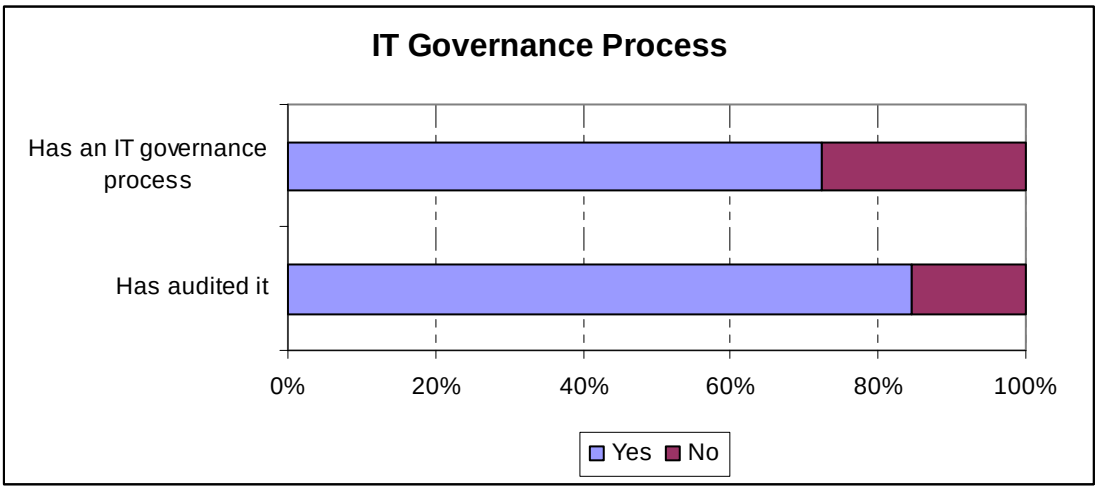
indicated that they provide input to the organization's ethics policies, and 54 said that they provide ethics/value related advice or guidance to the organization.



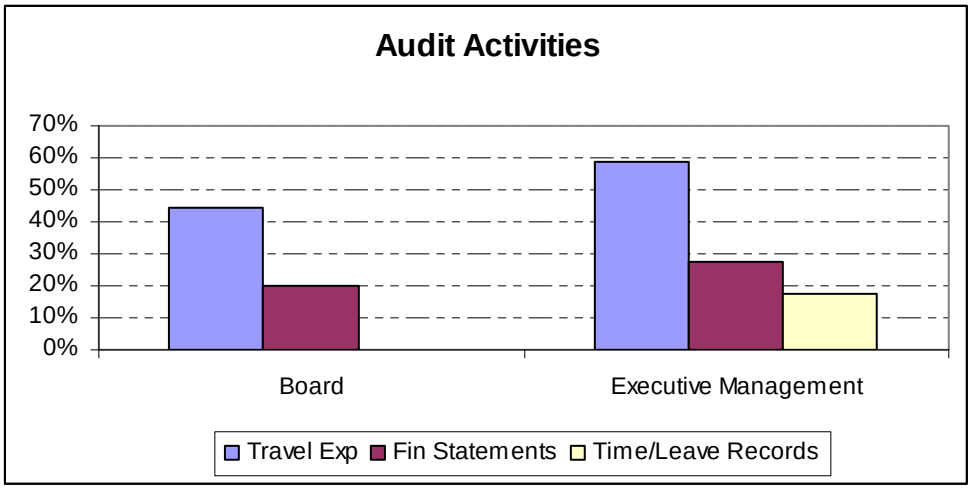
More of the respondents' organizations require ethics training than fraud training, but Internal Audit was more likely to be involved in training for fraud prevention than ethics. When asked whether the organization required fraud training, and if so, whether Internal Audit participated in providing it, 59 of the 109 respondents who answered the question answered "yes" that it was required, and of those, 35 responded "yes" that Internal Audit participates in providing the training. This higher level of involvement by Internal Audit is likely a reflection of the expertise auditors have related to fraud, whereas often organizations rely on the General Counsel to provide guidance on ethics.



A major topic in seminars and conferences over recent years and one that continues to receive widespread interest is Information Technology (IT) governance. Almost 85 percent of the 103 who answer the question responded that their organization has an IT governance process, and 60 of those that responded to the follow-up question indicated that Internal Audit had reviewed the process.

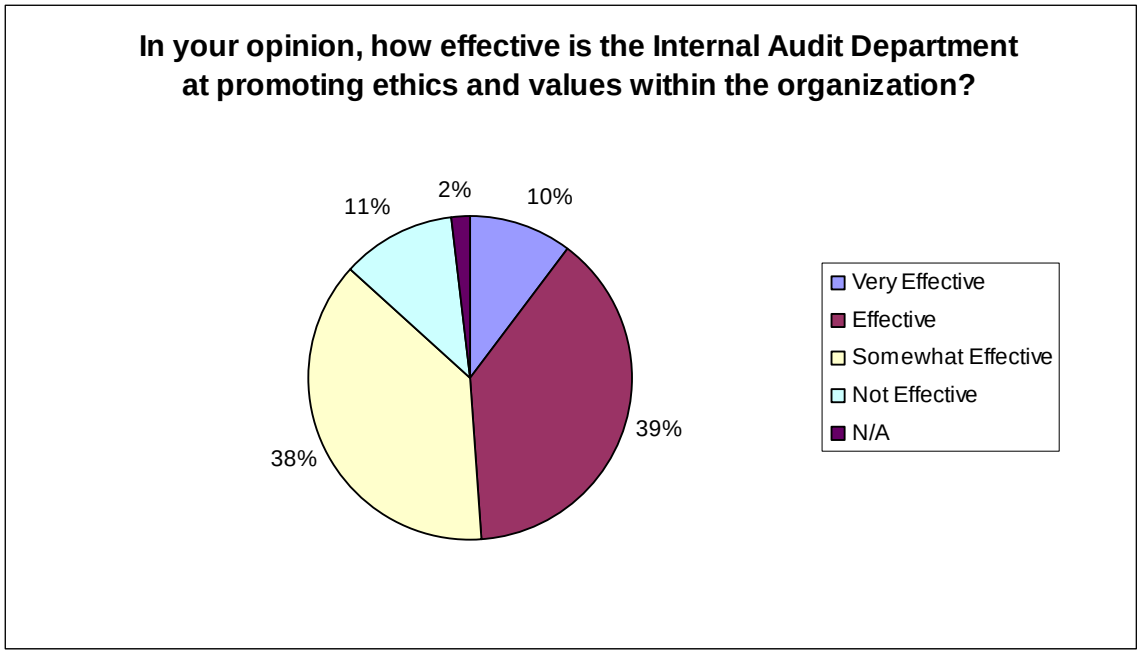


To determine what type of audit activities are conducted specific to board members and executive management, we asked whether Internal Audit had audited travel expenses and financial statements for these individuals. Response to these questions identified that departments were more likely to have audited executive management than board members. While these responses appear low, it is not known how or whether this has changed since the frauds committed in recent history or as a result of the economic conditions over the past couple of years.



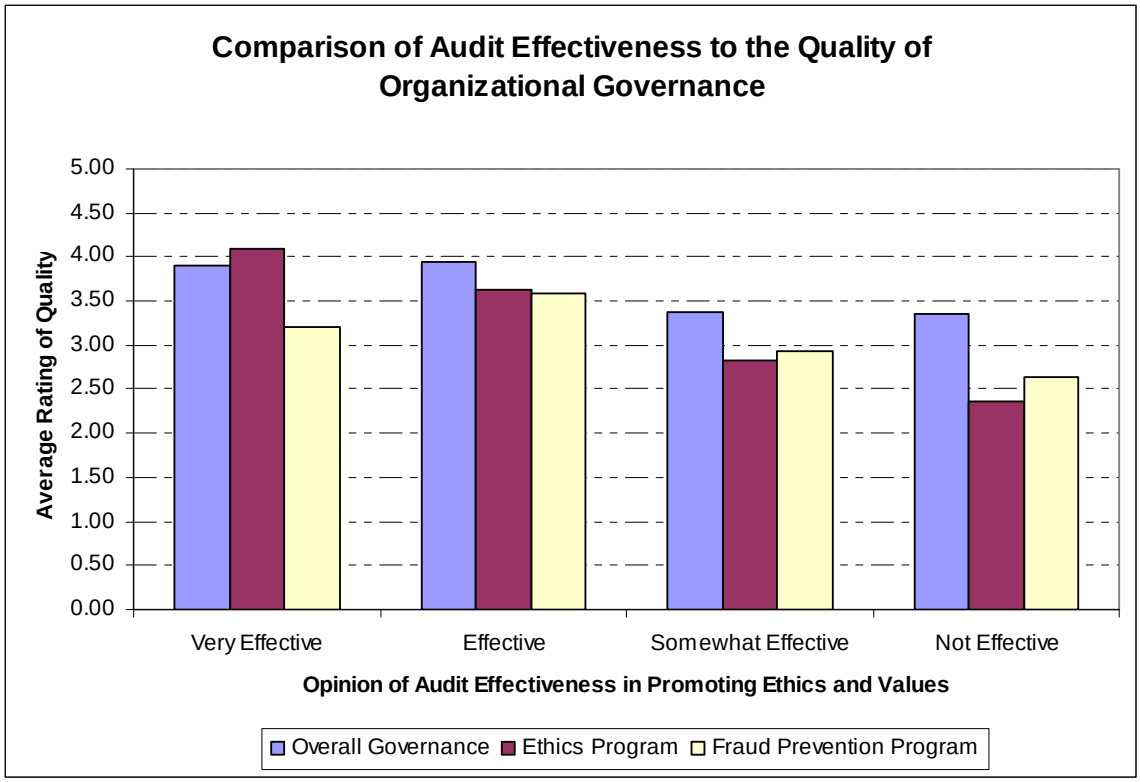
In addition to the areas specifically questioned, respondents indicated that they perform other ethics/values-related activities in their organizations. Some of these include reviewing potential conflicts of interest; writing and promoting anti-fraud and whistle-blowing policies; and conducting annual governance reviews. A full list of the activities reported can be found in Appendix A on pages 38-39.

Respondents were asked their opinion of how effective the Internal Audit Department is at promoting ethics and values within the organization. Of the 98 who answered this question, almost half of respondents rated their effectiveness as either "very effective" or "effective."



Comparison of the previous questions to the respondents' opinions of the Internal Audit Department's effectiveness in this area identified that those that selected "very effective" were more likely to be involved in providing both ethics and fraud training, and all of them indicated that they provide input to ethics policies as well as ethics or value-related advice not specifically asked about in the survey. Similarly, those who selected "not effective" were less likely to be involved in providing either ethics or fraud training or to provide input to ethics policies and ethics or value related advice not specifically asked about in the survey.

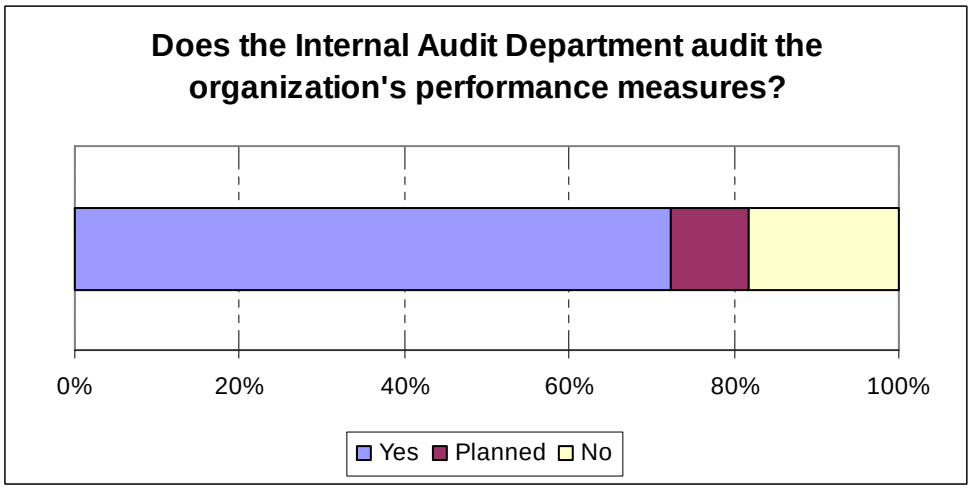
Another analysis determined whether Internal Audit's perceived effectiveness in promoting ethics and values in the organization correlated with their ratings of the organization's quality in select areas. The higher the respondents' opinion of Internal Audit's effectiveness in this area, the higher they rated the quality of the ethics program. Ratings varied from an average of 4.1 (on a scale of 1 to 5) for those who selected "very effective" to 2.4 by those who selected "not effective." The respondents believe that Internal Audit's effectiveness is directly tied to the quality of these areas.



Internal Audit's Role in Performance Management and Accountability

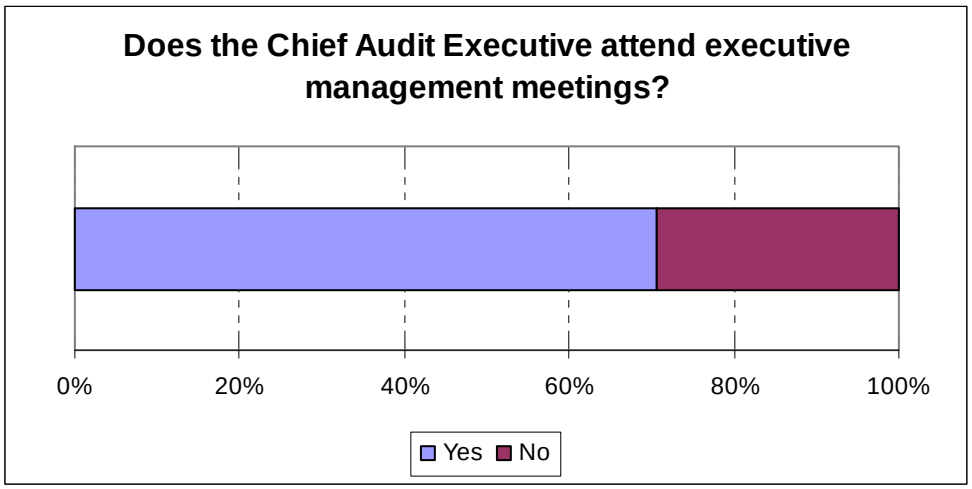
The survey also included several questions to gain an understanding of the Internal Audit Department's involvement in performance management and accountability.

The survey asked whether the Internal Audit Department audits the organization's performance measures. Of the 94 respondents who answered this question, 68 replied "yes" and 9 others indicated that such an audit was planned.



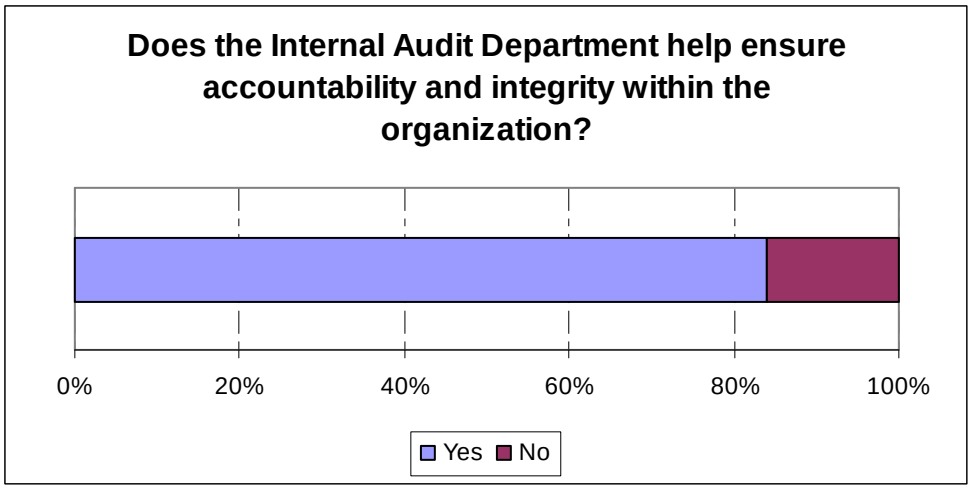
Auditing an organization's performance measures not only provides management and the board the assurance that controls are in place to ensure accurate portrayals of their performance but also permits an objective review of whether the performance measures being tracked are providing a true indication of the organization's performance.

In response to whether the Chief Audit Executive attends executive management meetings, 67 of the 95 who answered the question responded "yes." Having Internal Audit at the table promotes valuable communication, ethical priorities, and additional cultural and operational transparency as well as bringing the unique perspectives internal audit offers.



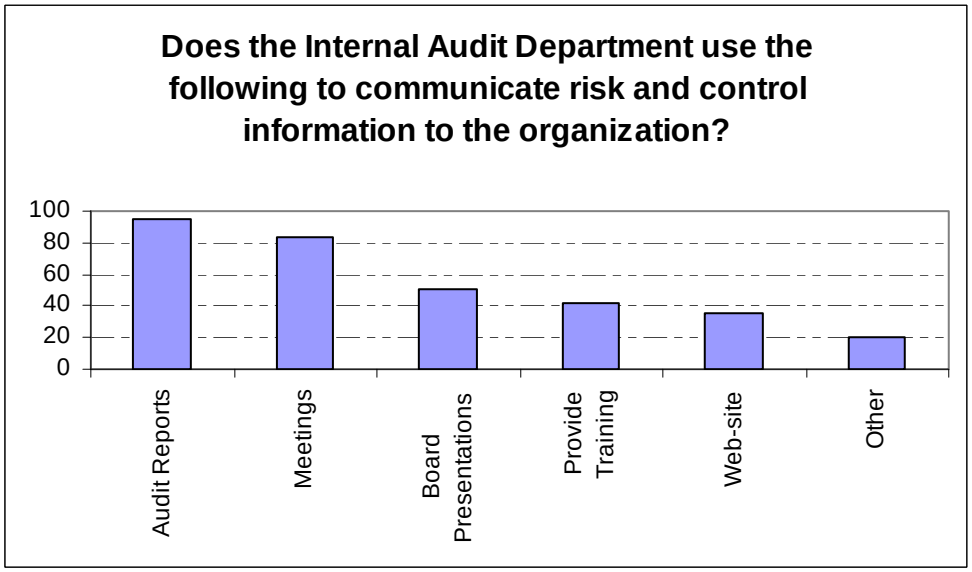
The survey asked whether the Internal Audit Department helps ensure accountability and integrity within the organization. Of the 93 respondents who answered the question, 78 selected "yes" for this question – a relatively low number considering that the definition of internal auditing includes the phrase "… helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes." Further, definitions of corporate governance often include accountability and a discussion of ethics as key elements.

A variety of responses were provided for the follow-up to this question that asked how Internal Audit helps ensure accountability. While many of the respondents identified audit work of varying types, others identified attending meetings, providing training, and consulting services. A full list of the responses to this question can be found in Appendix B on page 40.

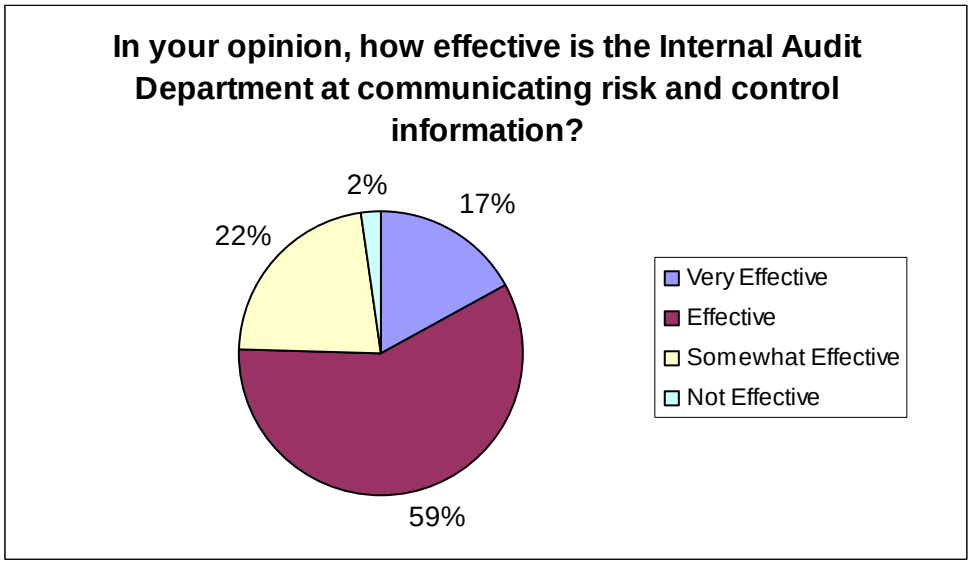


To understand how risk and control information is communicated by Internal Audit Departments, the survey listed six options that included "other" and space to describe activities not provided as a choice. Not surprisingly, all 95 that responded to this question identified audit reports as one of their communication tools, with 84 respondents also selecting meetings as a key means of communication.

Those who selected "other" included a variety of activities used to communicate risk and control information, some of which include facilitated risk workshops, staff newsletters, and risk management gap analyses. The multitude of activities respondents included reflects the flexibility of internal audit professionals and their ability to adjust their practices to meet the needs of their organizations.

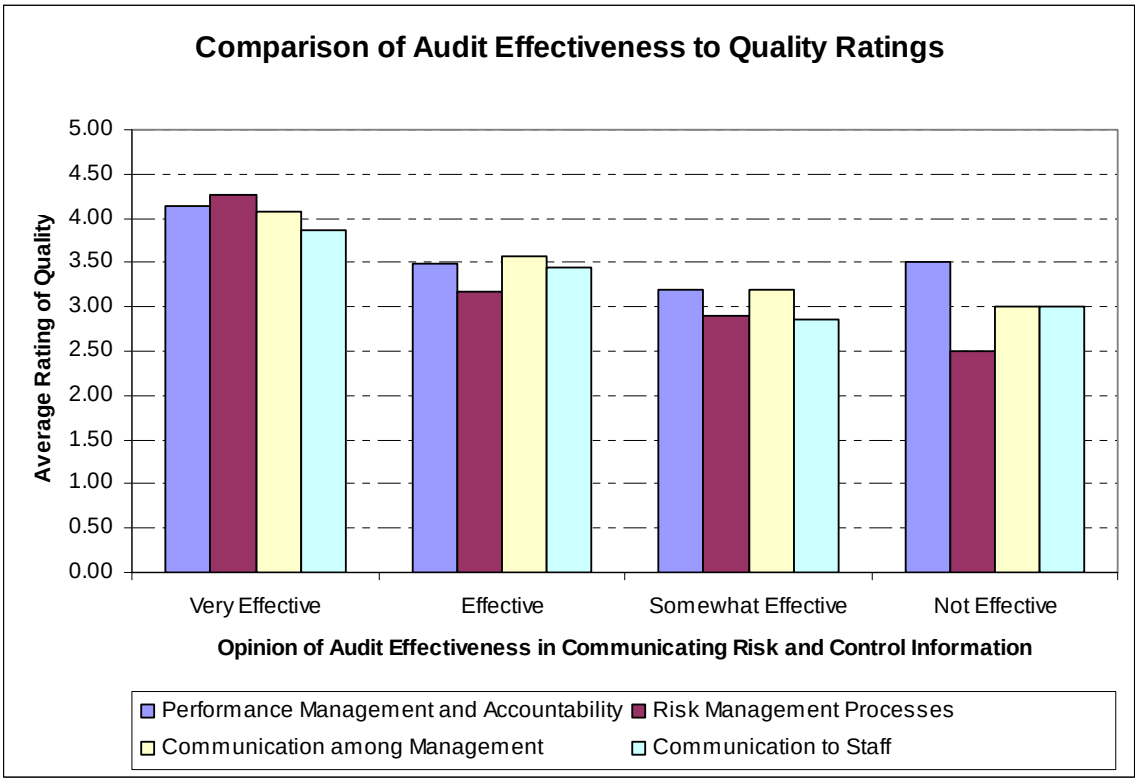


Respondents were asked their opinion of the Internal Audit Department's effectiveness in communicating risk and control information. Of the 94 who answered this question, more than 75 percent selected "very effective" or "effective." The higher rating in this area compared with the ratings for governance could be a reflection of Internal Audit's more traditional and comfortable role as well as recent shifts in focus to include governance.



We compared the responses in this section to the respondents' opinions on the Internal Audit Department's effectiveness. Those respondents that selected "very effective" were more likely to have a seat in executive management meetings and help ensure accountability and integrity within the organization than those who selected lesser levels of effectiveness.

We also analyzed respondents' opinions of the Internal Audit Department's effectiveness at communicating risk and control information and a comparison to the quality ratings pertaining to performance management and accountability, risk management processes, and communication. Generally, those who rated the Internal Audit Department's effectiveness in this area as "very effective" or "effective" rated the quality of the organization's performance management and accountability, risk management processes, and communications higher than those who consider themselves less effective.

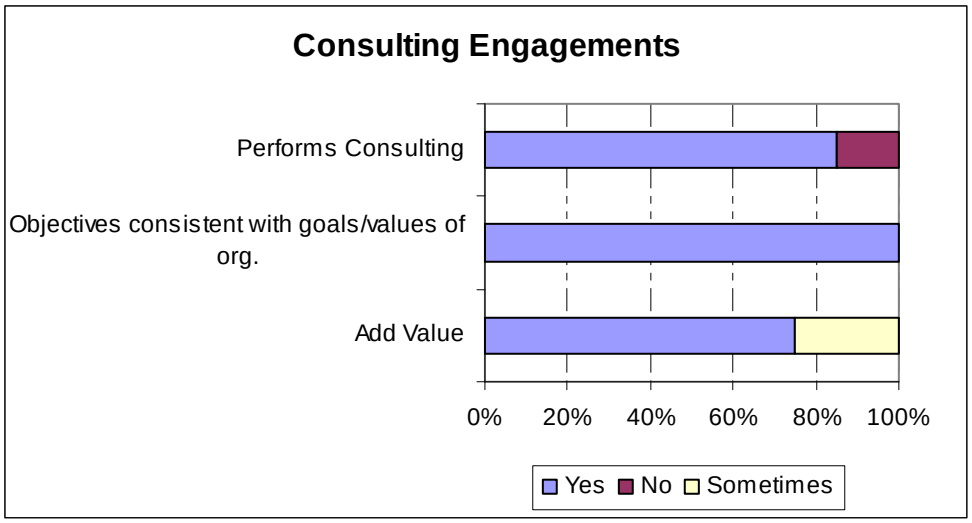


Internal Audit's Role in Other Various Activities

In addition to governance and performance management and accountability, the survey included questions about various other activities that related to the type of relationship internal audit has with the organization.

Internal Audit's Role in Consulting

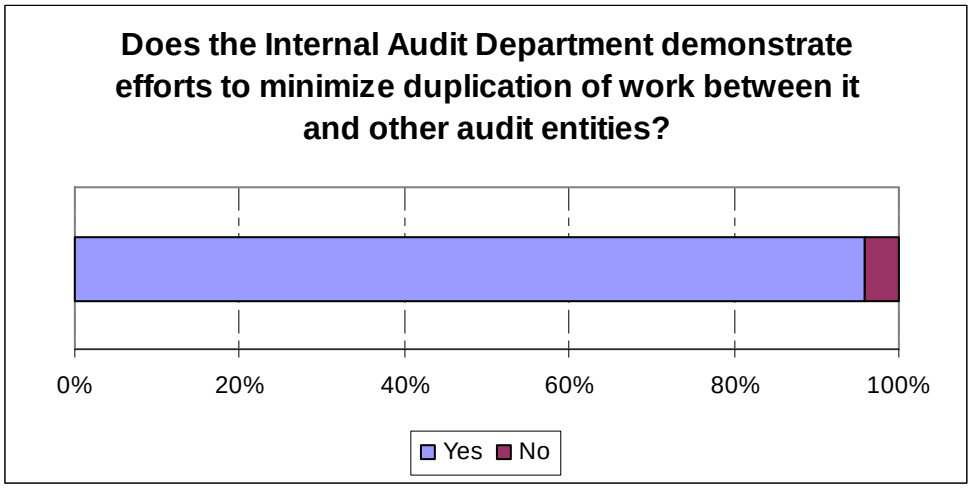
Respondents were asked whether the Internal Audit Department performs consulting engagements and, if so, whether the objectives of their consulting work were consistent with the objectives of the organization and added value to the organization. Of the 94 respondents who answered the question, 80 indicated that the Internal Audit Department performs consulting engagements. While all of them responded that the objectives were consistent with those of the organization, 60 responded that the results added value while the other 20 noted that the work sometimes added value.



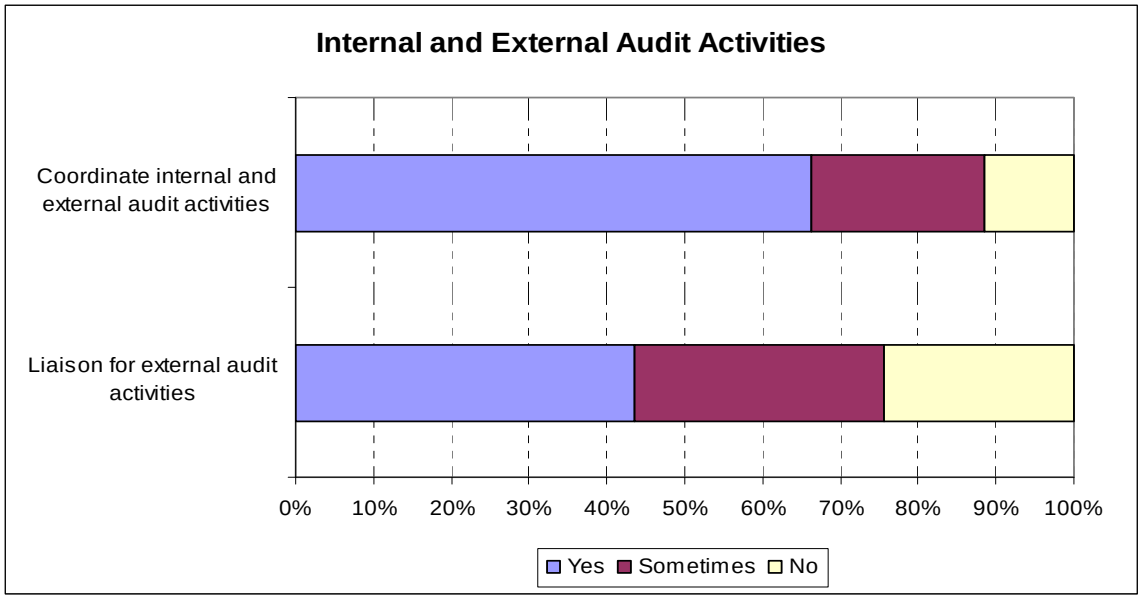
Internal Audit's Role in Coordinating Audit Activities

Performance Standard 2050 – Coordination establishes the requirement that the "chief audit executive share information and coordinate with other internal and external providers of assurance and consulting services to ensure proper coverage and minimize duplication." In January 2009, the IIA issued a practice advisory to provide additional guidance regarding coordination. It released another practice advisory in July 2009, that provides guidance on assurance maps to assist in considering internal monitoring efforts conducted throughout the organization.

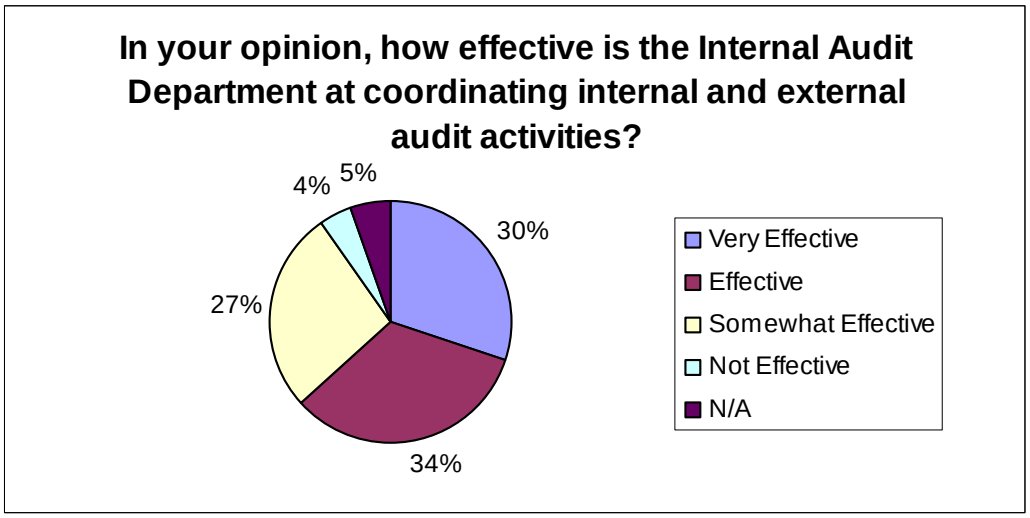
Response to the question of whether the Internal Audit Department demonstrates efforts to minimize duplication of work between it and other audit entities was quite positive. Of the 95 respondents to the question, 91 answered "yes". Additionally, when asked whether monitoring activities were considered during development of the audit plan, 88 of the 94 who responded said "yes."



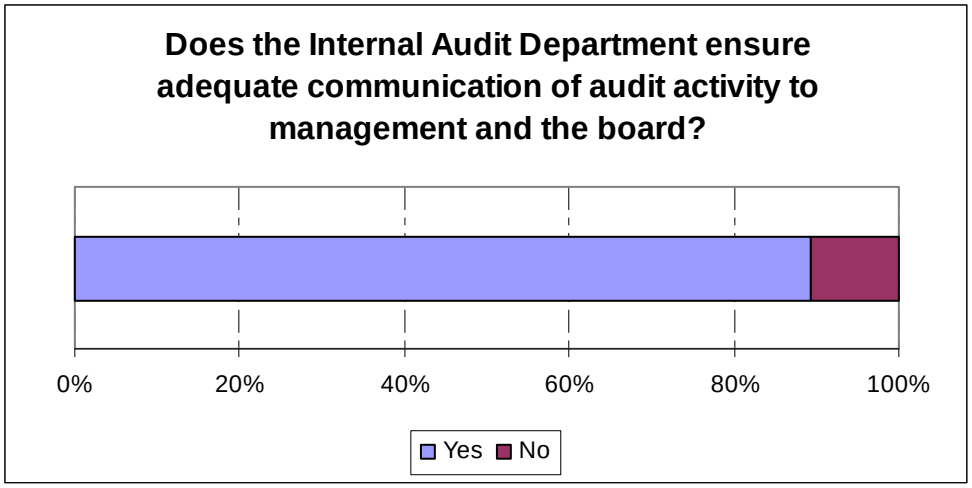
Another activity often undertaken by Internal Audit Departments is coordinating the activities of external auditors. Of the 95 respondents who answered the question of whether they coordinated the organizations internal and external audit activities, 63 responded "yes" and 21 others indicated "sometimes." When asked whether Internal Audit acted as the liaison for external audit activities, 41 of 94 respondents said "yes" with another 30 selecting "sometimes."



Respondents were asked their opinion of how effective the Internal Audit Department is at coordinating internal and external audit activities. Of the 93 who answered this question, just under two-thirds rated their effectiveness as "very effective" or "effective." While one may expect this to be higher, challenges of the Internal Audit Department always being informed of other auditing activities and other organizational practices could be limiting factors in excelling in this area.

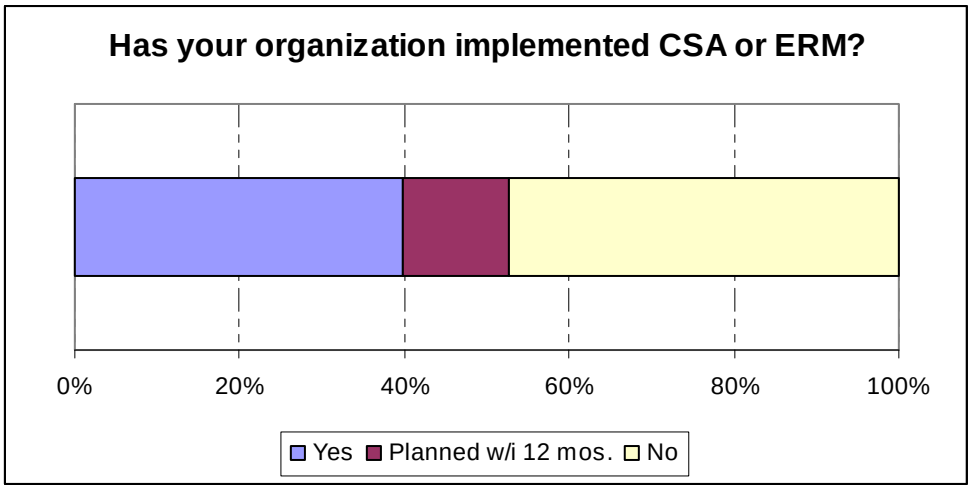


Those organizations that responded seem to understand the importance of Internal Audit's communication with both management and the board in improving the Tone at the Top.

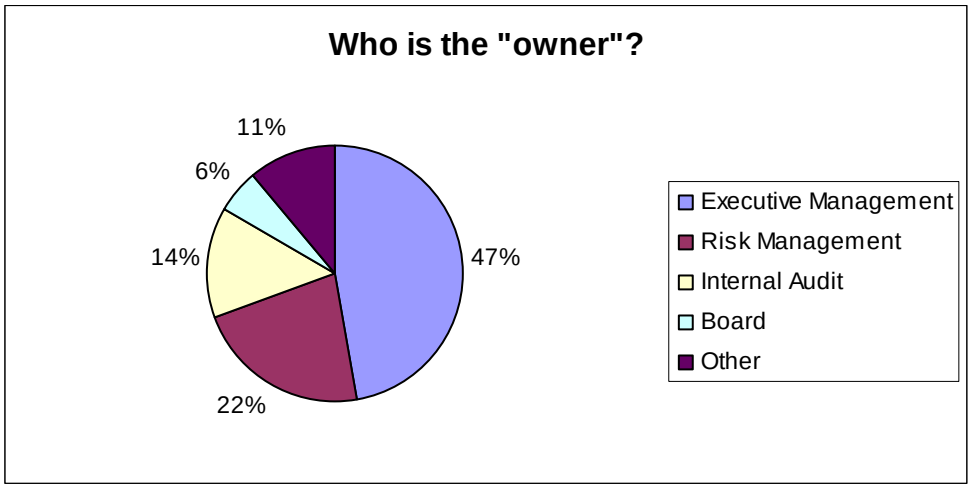


Internal Audit's Role in Control Self-Assessment/Enterprise Risk Management

Internal auditors play an important role in evaluating the Enterprise Risk Management (ERM) processes of an organization and advocating their continued improvement. Internal auditors' core role in the ERM process is to provide objective assurance to the board that the organization's risk management activities are effective and assist with ensuring key business risks are being managed appropriately and that internal control is operating effectively. Over half (53%) of the respondents who answered the question have either implemented or plan to implement a Control Self-Assessment (CSA)/ERM process within their organization. This helps to illustrate an effective cultural shift in management's taking a more visible and documented responsibility for the organization's process of governance, risk, and internal controls.

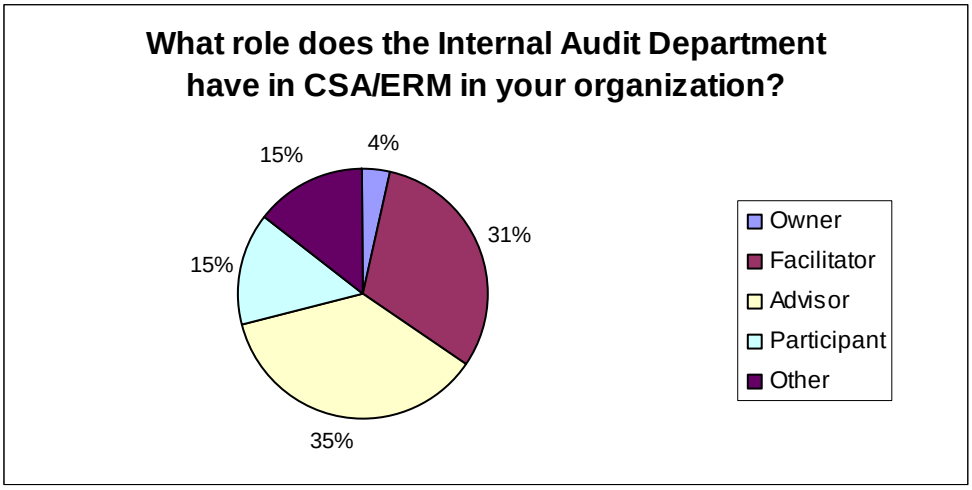


However, to preserve Internal Audit's independence and objectivity, professional standards indicate the function should not take any direct responsibility for making risk management decisions for the enterprise or managing the risk management function. Almost half (47%) of the respondents who indicated a CSA/ERM process had been implemented reported that executive management "owns" the process; another 22 percent noted risk management as the owner and 17 percent selected the board or other. The fact that 14 percent of the respondents reported that Internal Audit was the owner reflects the need for continued emphasis and education on management's versus Internal Audit's responsibilities in areas such as risk, controls, and governance.



Internal audit's expertise in considering risks, understanding the connections between risks and governance and in facilitation make it well qualified to occupy the role of managing or championing the CSA/ERM process. While Internal Audit cannot give objective assurance on any part of the process that it is responsible for, it can and should provide advice and support to management's decision making.

Whereas management has the primary responsibility for identifying and managing risk, it is the responsibility of everyone in the organization to ensure an effective risk management process. Of the 55 that responded to the question, almost two-thirds reported that Internal Audit acts as either the facilitator or advisor for their organization's CSA/ERM process.



Case Studies

Case 1 – Texas Adjutant General's Department

I. Mission and Background of the Texas Adjutant General's Department

Vision and Mission - The vision of the Texas Adjutant General's Department and the Texas Military Forces is to become a fully deployable, diverse and professional Total Force capable of Full Spectrum Operations and responsive to State and Nation. Our mission is to provide the Governor and the President with ready and trained forces in support of the citizens of Texas and State and Federal civil / military authorities at home and abroad.

Background - The Adjutant General's Department (department) is a state agency (state military department) and the central command over the Texas Military Forces and federal and state employees of the department. This central command is referred to as the department's Command Group and consists of the Adjutant General, the Assistant Adjutant General for the Army Guard, the Assistant Adjutant General for the Air Guard, the Chief of the Joint Staff, the Vice Chief of the Joint Staff, the Command Group Executive Officer, and the Command Sergeant Major. The Governor is the Commander in Chief and the Adjutant General is the Commanding General of the Texas Military Forces. The Texas Military Forces consist of military personnel in the Texas Army National Guard; the Texas Air National Guard; and the Texas State Guard and full time federal and state employees. The Texas Military Forces is to the Governor, what the Department of Defense is to the President. The Adjutant General's Department is the official State of Texas agency name for the Texas Military Forces, but in the context of the agency's day-to-day operations is the part of the organization that interfaces officially with other Texas State Government entities.

The Texas Military Forces day-to-day operations are predominantly funded by the Federal Government; Army and Air Force funding funnels through the National Guard Bureau (NGB) in Washington DC to the United States Property and Fiscal Office (USPFO) for Texas in Austin. The USPFO for Texas provides oversight for execution and fiscal accounting as well as oversight of accounting for federally owned property and equipment. The department performs the same function, only limited to accounting for state (general revenue and other funds appropriated by the Texas Legislature) and federal funds (received from USPFO through Cooperative Agreements and appropriated by the Texas Legislature) allotted and authorized by the Texas State government.

II. Key Elements of the Organization's Ethics and Governance Program (EGP)

1. **Higher Expectations for Top Management** – The department has expectations of top management that exceed those of the other employees of the organization. These expectations are in the following areas:

a. responsibilities – within the last few years the department has brought additional direct command responsibilities and critical department operational responsibilities directly under the department's Command Group;
b. time and leave - the Generals and other top department management must work significantly more hours than other state employees before they are able to earn any type of compensatory leave;
c. accountability – the General Officer Management Office was developed and became operational in September 2008 to review, track, and better ensure compliance for all General Officer time and travel; and
d. performance – the operational tempo of the Texas Military Forces continues to increase in intensity. This intensity is the result of activity and value provided as both state and federal missions increase (over 4,000 Texas Military Forces troops deployed in Iraq and Afghanistan and increased state missions to prepare for and complete missions involving natural disasters, the border, and counterdrug activities).

2. **Annual Organizational Internal/External Quality Reviews –** The department performs an internal quality review using Baldrige criteria. The department develops a report based on this review and submits it to the Army Community of Excellence (ACOE) national competition. The department's submission competes against the state military department of the other fifty three states and territories that submit an ACOE report. The department's submission for the past few years has been among the top three and therefore an external review has been completed by the judges of the department's operations as they relate to the criteria. In 2009, the department won third place and this year (2010) the department submission was again selected for an external review.

3. **Annual Internal Control Assurance Statements** - Each year the department's top management completes Internal Control Assurance Statements for both army and air guard operations. These Statements are based on Internal Control Reviews conducted throughout the organization and then summarized, evaluated, and reported on by the department's top management.

4. **Internal Audit's Major Controls Reviews –** The department's Internal Audit Office (Internal Audit) conducts an Annual Major Controls Review of the department. Internal Audit reviews and includes information from all external audits; all internal audits and other operational reviews; the department's Internal Control Assurance Statements; the department's ACOE submission; and other compliance and management system reviews conducted by control system personnel throughout the department.

5. **Human Resources Required Training –** All department personnel must periodically complete ethics related training.

6. **Information Technology Required Training** – All department personnel must complete information technology ethical awareness type trainings periodically to be able to maintain access to the department's network.

7. **Management Accountability –** In addition to continuous review by a separate General Officer Management Office, Internal Audit also conducts annual audits on time accountability and leave summaries that always includes members of the department's top management.

III. Implementation of the Ethics and Governance Program

Although the department's Ethics and Governance Program has been evolving for the past three years, it grew significantly and with profound intensity beginning September 2008 and then again in March and April 2009. In September 2008 the department confronted and immediately addressed significant policy and control issues related to top management. In March and April 2009 external reviews of the department and the change in the Adjutant General and all top management positions in the department further intensified both the ethical and governance lessons learned by the department and resulted in significant additional control processes implemented both internally by the department and externally by the state legislature. The adversity and outside scrutiny of the department helped to narrow the focus and intensified the implementation of specific actions that significantly improved and communicated the department's tone at the top and the related ethics and governance operational and control systems and processes.

IV. General Information

1. The Adjutant General is the executive sponsor for the department's Ethics and Governance Program. The Adjutant General is a federally recognized Major General and in addition to extensive military experience also has extensive state agency experience which has prepared him to be uniquely qualified to not only be the executive head of the department but also to sponsor a crosscutting ethics and governance program that extends throughout the department.

2. Internal Audit's role in the department's Ethics and Governance Program is to provide information on risks related to governance and ethics; promote ethical conduct, compliance, and accountability through conducting audits, reviews, meeting presentations; and through conducting and reporting on the annual Major Controls Review.

3. The department continually conducts ethical type surveys through its internal website. The climate survey has over fifty questions with a number of the questions directly related to ethics and governance. There were 507 responses to the 2009 survey and these responses are graphed and reported in the department's Army Community of Excellence (ACOE) submission.

4. Internal Audit conducts audits on Time and Leave that always includes a review of department top management; conducts an annual Major Control Review that examines all the department operations and risks; conducts annual risk assessments; promotes ethics and good governance practices in all activities and audits conducted; conducts investigations as assigned by the Adjutant General to determine the validity and merit of ethical and/or compliance allegations; and reviews and develops a report on all hotline complaints received and forward to the department by the State Auditor's Office .

5. Although all internal audit activities relate somewhat to the department's ethics and governance program, those projects that are specifically related and have been conducted in the past year include an Internal Audit of the General Officer Management Office; an Internal Audit on Time and Attendance; an extensive review of members of top management's time, leave, and travel payments; a department-wide major controls review; hotline complaint reviews, reports, and recommended assignments of further investigation; and an annual risk assessment.

6. Internal Audit devotes about 30% of its annual audit plan to activities that directly relate to the department's ethics and governance program.

7. Internal Audit is marketed by top management within the department through attendance at weekly management meetings; quarterly Internal Audit Steering Committee meetings; and through coordination with top management on sensitive issues. Internal Audit is also marketed through participation and involvement with several professional organizations.

8. Internal Audit meets privately with the department's Internal Audit Steering Committee quarterly. Internal Audit sets the agenda for these meetings, which is reviewed and discussed with a member of the Command Group and discussed and edited prior to the meeting. Discussions at these meetings include all Internal Audits, Internal Audit Activities, and Internal Audit Performance Measures as they relate to the Annual Internal Audit Plan that was approved by the Adjutant General.

9. The three internal audit activities that most contribute to a strong tone at the top are as follows.

a. Provide weekly update reports and hold monthly meetings with the Chair of the Audit Committee/Head of the Organization or their designee for this specific purpose.
b. Provide a secure section on Internal Audit's Intranet Website that only top management and the department's General Counsel have access. Include a weekly and monthly summary of all internal audit activities on that secure portion of the website with links to draft reports, completed reports, high risk information, investigation activities, weekly and monthly internal audit activity reports, etc.
c. Coordinate internal investigations with an external regulatory organization if permitted by the organization.

10. Three suggestions to those organizations that are just starting an Ethics and Governance Program are as follows.

a. Ensure that multiple types of training on organizational expectations, ethics, and operations are provided. These types of training include training presentations; online training; a training segment at routine operational and management meetings; etc.
b. Ensure and maintain top management approval, participation, and support.
c. Ensure that there are performance criteria, expectations, and accountability built in to every portion of the program.

Case 2 – Aditya Birla Group

I. Mission of the Aditya Birla Group

The Aditya Birla Group is a 30 BUSD conglomerate consisting of many different businesses with different practices. The company is the largest producer of aluminum rolled products in the world and is the fifth largest global producer of carbon black. It is also a market leader in viscose staple fiber and cement. In addition, it has a significant presence in copper, ready-made garments, textiles, business process outsourcing, financial services, insurance, retail, and telecommunications.

II. Key Elements of the Organization's Ethics and Governance Program

1. **Role and Position of Internal Audit -** Despite the many businesses that are part of Aditya Birla, the role of Internal Audit is the same across the group and is managed centrally. One individual, the President of Corporate Audit, manages Internal Audit for the Aditya Birla Group. He is a Chartered Accountant from India as well as a CIA and a CISA. He is responsible for internal audit in major group companies/ business and has a Chief Audit Executive (CAE) who reports to him for each business. The CAEs give support for the strategy he sets.

   The CAEs report to the President of Corporate Audit, and he in turn reports to the group chairman. There are 12 or 13 audit committees among the group. He has 8 internal audit team leaders for his staff of about 65 employees who provide an international presence. His job is at the strategic level. He makes sure the business is run consistently and he is also expected to share good practices across units, to be an agent of change, and to influence good governance practices, imparting a risk and a control culture.

2. **Internal Audit's Independence** – The President of Corporate Audit and his team are in the payroll of an apex body rather than from any of the business units he audits, which enhances their independence. His superior will inquire how the business managers are performing, and he is sufficiently independent to provide that kind of information in an objective manner. All Internal Audit reports are published to all the companies through email, which is an indicator that management takes audit issues seriously.

3. **Belief in the Tone at the Top -** The Aditya Birla Group has a shared belief that if the tone at the top, or the ethical climate, is weak, the company may fail. The company believes in hiring good people and making sure controls are in place internally. The President of Corporate Audit maintains that "trickle down" is critical. Within his team, he has individuals sign off on a certification statement that includes topics such as adhering to the code of conduct, IIA Ethics and standards, Group policies and statements and also disclosures of relatives working in the group and any conflict of interest as well an agreement to disclose any potential issues.

4. **Values Framework -** The Group has implemented a values framework that includes the five values of integrity, commitment, passion, seamlessness, and speed. To create awareness on values and understanding value dilemmas, the company made a values booklet and put information about it on the Intranet. It partnered with a consulting firm to develop values workshops for senior management. The information was then distributed to all levels of the organization. The workshops were performed to engage in a discussion, draw from experiences, and identify the expected behaviors. For instance, integrity includes honesty but also respect for others. The workshops also illustrated what behaviors are not tolerated.

   To further the learning process, the company also developed a pack of cards with 52 values statements on them that pertain to the 5 values. It encourages employees to understand the values better and helps in addressing values dilemmas.

   Every business has a values committee and clear processes for handling violations. There is a process for escalating issues upward. New hires sign a document indicating they are aware of, and will abide by, the core values and the Code of Conduct. Although the organization has not done surveys of the ethical environment, the message has been made clear that each value has the same weight, and compromising on any of the stated values is not tolerated.

5. **Internal Audit's Role in Governance** – Internal Audit is seen as a change agent to move management to a new way of thinking. Internal Audit examines governance at different levels. The team has incorporated information from the IIA's paper on "Internal Audit's Role in Governance." The President of Corporate Audit pointed out that effectiveness does not have to be aggressive – Internal Audit has to be fearless in its reporting standards and yet objective.

6. **Risk Assessment and Audit Services -** Risk is assessed business-wide**.** Internal Audit is now doing a formal assessment of the entity-wide control environment. The President of Corporate Audit offered a caveat that when managing such a large business, it is difficult to put the same effort into each component. The degree of risk assessment his team conducts varies by business. The risks have been mapped out reasonably well. Audits are generally based on the risk assessment process, which considers many factors. In one business, Internal Audit is adopting the consideration of residual risk. The nature of the business drives the degree of assessment and what is reviewed. Internal Audit has developed standardized audit processes and reports to help ensure the quality and consistency of its audit services.

7. **Advisory Services** – The President of Corporate Audit encourages the businesses to ask for internal audit services. When he started the information technology (IT) audit division, he marketed its services using a brochure with a list of available services. Additional marketing could encourage business units to request services from Internal Audit.

8. **Enterprise Risk Management (ERM) –** Internal Audit has performed facilitated risk assessments for five of the smaller companies so far. In preparing to launch ERM, the President of Corporate Audit and his staff went through the IIA's document on "Internal Audit's Role in ERM" and the "fan." They raise the question of whether Internal Audit is looking at emerging risks and how to do so, as well as how to control future risks.

9. **Lead by Example –** The President of Corporate Audit emphasized the importance of internal auditors always demonstrating the highest standards since they are always being watched closely by those they audit.

Conclusions

This research has identified a variety of activities conducted by Internal Audit Departments and evaluated the impact they are perceived to have on Tone at the Top. To have the most influence in promoting a positive Tone at the Top, the Chief Audit Executive must:

- Tailor the Internal Audit Department's activities to meet the organization's needs.
- Have open and honest communication with management and the board.
- Be available to provide input and guidance into ethics and fraud prevention training and policies.
- Be at the table in executive management meetings.
- Serve as a trusted advisor for ethics/values-related issues.
- Lead efforts at coordinating ethical climate surveys within the organization.
- Provide more effective consulting services.
- Share information with internal and external providers of assurance and consulting services.
- Establish or enhance the Internal Audit role in CSA/ERM.

As stated in the Introduction, The Austin Chapter believes the survey results are beneficial to practitioners from several standpoints that include:

- Gaining a greater understanding of leading practices among internal audit practitioners in more fully implementing the requirements of Standard 2110;
- Encouraging survey respondents and report readers to engage in further efforts to improve the ethical climate, accountability, and integrity of their respective organizations;
- Offering another opportunity to implement the IIA's distinctive motto of "progress through sharing;" and
- Emphasizing and supporting the IIA's position on the control environment.

Further Study

While this project identified what respondents are currently doing to support and strengthen corporate governance and the Tone and the Top, it did not evaluate how long these practices have been occurring, how adding them to the auditor's repertoire impacted the organization, or what other activities are considered necessary.

A study of such information from a variety of organizations could further document the progress that has been made as a result of the many changes in the governance environment over the past 30 years. Additional studies could also provide suggestions for consideration and implementation by other Internal Audit Departments in the spirit of "progress through sharing."

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:

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Texas Commission on Environmental Quality
Texas General Land Office
Texas Youth Commission.

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Appendix A

Other activities relating to organizational ethics and values involving the Internal Audit Department (responses from survey participants)/

Please see report pages 12-13 for related discussion.

- Giving advice to improve ERM processes.
- Conflicts of interest
- Writes and promotes the organization's anti-fraud and whistle-blowing policies.
- Anti-fraud policy, whistle-blowing policy, ethical guidelines for Internal Audit
- Personal Integrity Management Program involves detailed independent background checks to ensure suitability of employees
- Audits that comment directly or indirectly on cultural and behavioral matters.
- Annual governance review
- Enterprise wide risk assessment based on interviews with senior executives and audit committee members
- Assessing and providing assurance that values have been taken into account when objectives have been set
- Audits of the integrity management system
- Establish whether code of conduct and ethics exists but we don't audit the policies.
- Provision of frequent ad hoc advice covering the full range of our organization's activities
- All Internal Audit activity is delivered strongly in accordance with the 5 defined values of the organization and the 7 principals of public life.
- Recording and following up on any reported unethical incidents.
- Audits of provision and acceptance of gifts and hospitality
- Usually consulted in any amendment of guidance. Would look into any allegations of wrong-doing. Conduct a Corporate Governance audit yearly. Most of all though, it permeates all audit activity.
- Providing advisories ; Developing policies, such as Whistleblower policy etc
- Ethics as part of governance; Gifts and hospitality
- Internal Audit is responsible for responding to all complaints filed with the SAO regarding TWDB. IA is involved in any allegations of fraud or ethics violations.
- Performs most of the investigations into suspected non-compliance with ethics policy. Is a member of the ethics committee.
- Internal Audit has a slot of 45 minutes with induction training of new appointees
- Private work, gift declaration, financial interest declaration
- Verify the training is completed
- Monitoring; Internal Control Reviews and associated reports; Major Control Reviews; provide input into Baldrige type quality applications and associated interviews; provide Internal Audit's Vision, Mission, Values, and goals on an internal website
- Was on committee which revised agency ethics policy.
- Training and guidance

- Survey of Organizational Excellence - provides input as to additional agency specific questions.
- ERM discussions; agency policy changes; through audits and advisory services
- Share Fraud and Ethics internal website; provide joint training to all agency offices.
- fraud investigations as needed
- IA is a member of the IT Governance Committee.
- The CAE serves on the Ethics Committee.
- Monitor ethics/fraud hotline

Appendix B

How the audit department helps ensure accountability and integrity in the organization (responses from survey participants)

Please see report pages 15-16 for related discussion.

- Provide pervasive assurance by performing and reporting on SOX test of design and effectiveness testing.
- Advising on and auditing compliance with the code of conduct.
- Auditing for 404 compliance and ensuring that strong internal control exists.
- Ex officio on several committees: Budget & Accountability; Extended Cabinet; Risk Council (Vice-Chair)
- Governance reviews
- Articles in the company newsletter
- Reporting to management
- Standing Orders; Rules; Financial Regulations
- Providing independent reports on the governance of the organization to independent non-executive audit committee members
- Commenting on display of corporate behaviors
- Risk-based audit plan
- Formulating PKIs
- Sharing and discussing the risk assessment process
- Provide information related to ARRA
- Provide a constant source of guidance to all managers and executive management.
- Serves as a non-voting member of many agency committees
- Structured follow-up program for all audit recommendations.
- Investigate and report on allegations of fraud, waste, and abuse.
- Chief Auditor has immediate open door to board and executive management when needed.
- Actively participates with Senior Management and will express opinions on any topic.

Appendix C

Survey Tool

Internal Audit's Role in Governance

1. Does the Internal Audit Department conduct surveys of the ethical climate of the organization? ☐ Yes ☐ No
   If yes, how often are they conducted?
   - o Semi-annually
   - o Annually
   - o Biennial
   - o Periodically
   - o Other (please explain)

   Who are the results reported to?
   - o Board
   - o Audit Committee
   - o Executive Management
   - o Other (please explain)

2. Does your organization require ethics training? ☐ Yes ☐ No
   If yes, does the Internal Audit Department participate in providing it? ☐ Yes ☐ No

3. Does your organization require fraud prevention training? ☐ Yes ☐ No
   If yes, does the Internal Audit Department participate in providing it? ☐ Yes ☐ No

4. Does the Internal Audit Department provide input to the organization's ethics policy?
   - o Yes
   - o No
   - o There is no ethics policy

5. Does the Internal Audit Department provide other ethics/values related advice or guidance to the organization? ☐ Yes ☐ No
   If other, please describe:

6. Does your organization have an IT governance process? ☐ Yes ☐ No
   If yes, has the Internal Audit Department audited it? ☐ Yes ☐ No

7. Has the Internal Audit Department reviewed the board members':
   a. Travel Expenses ☐ Yes ☐ No
   b. Financial Statements ☐ Yes ☐ No
   c. Other ☐ Yes ☐ No, please describe_____

8. Has the Internal Audit Department reviewed Executive Management's:
    a. Travel Expenses ☐ Yes ☐ No
    b. Financial Statements ☐ Yes ☐ No
    c. Time/Leave Records ☐ Yes ☐ No
    d. Other ☐ Yes ☐ No, please describe_____

9. What other activities relating to organizational ethics and values does the Internal Audit Department participate in?

_____

10. In your opinion, how effective is the Internal Audit Department at promoting ethics and values within the organization?
    - Very Effective
    - Effective
    - Somewhat Effective
    - Not Effective
    - N/A

Internal Audit's Role in Performance Management and Accountability

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

12. Does the Chief Audit Executive attend executive management meetings? ☐ Yes ☐ No

13. Does the Internal Audit Department help ensure accountability and integrity within the organization? ☐ Yes ☐ No
    If yes, how is this done?

14. Does the Internal Audit Department use the following to communicate risk and control information to the organization: (select all that apply)
    a. Audit Reports
    b. Provide training
    c. Meetings
    d. Board Presentations
    e. Web-site
    f. Other (please describe)

15. What other activities does the Internal Audit Department do to promote performance management and accountability?

16. In your opinion, how effective is the Internal Audit Department at communicating risk and control information?
    - Very Effective
    - Effective

- Somewhat Effective
- Not Effective
- N/A

Internal Audit's Role in Consulting

17. Does the Internal Audit Department perform consulting engagements? ☐ Yes ☐ No
    If yes, are the objectives consistent with the values and goals of the organization? ☐ Yes ☐ No

18. Do consulting engagements provide value-added information?
    - Yes
    - Sometimes
    - No

Internal Audit's Role in Coordinating Audit Activities

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

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

21. Does the Internal Audit Department consider monitoring activities during the development of the Audit Plan? ☐ Yes ☐ No

22. Does the Internal Audit Department demonstrate efforts to minimize duplication of work between it and other audit entities? ☐ Yes ☐ No

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

24. In your opinion, how effective is the Internal Audit Department at coordinating internal and external audit activities?
    - Very Effective
    - Effective
    - Somewhat Effective
    - Not Effective
    - N/A

Internal Audit's Involvement in Control Self-Assessment/Enterprise Risk Management (CSA/ERM)

25. Has your organization implemented CSA or ERM?
    - o Yes
    - o No
    - o Planned within the next 12 months

    If yes, who is the "owner"?
    - o Executive Management
    - o Risk Management function
    - o Internal Audit
    - o Board
    - o Other (please explain) _____

    What role does the Internal Audit Department have in CSA/ERM in your organization?
    - o Owner
    - o Facilitator
    - o Advisor
    - o Participant
    - o Other (please explain) _____

Summary

26. What other activities does the Internal Audit Department engage in that impact the culture and tone at the top of the organization? (please describe)

27. How would you rate the quality of the following in your organization: (1 – low to 5 – high)
    a. Overall governance processes
    b. Ethics program
    c. Fraud prevention program
    d. Performance management and accountability
    e. Risk management processes
    f. Communication among management
    g. Communication to staff
    h. "Tone at the top"

Demographics'

28. How many staff members are in the Internal Audit Department?
    - o 1 – 5
    - o 6 – 20
    - o 21 – 50
    - o > 50

29. Has the Internal Audit Department received an External Quality Assurance Review?
☐ Yes ☐ No
If yes, what year was the most recent review completed? _____

30. What is your industry?
    a. For profit
    b. Non-profit
    c. Federal government
    d. State government
    e. Local government
    f. College or university
    g. Other (please explain) _____

31. What is your leadership structure?
    a. Governing Board or Commission
    b. Elected Official(s)
    c. CEO/President
    d. Other (please explain) _____

32. What were your organization's revenues for fiscal year 2009?
    - <$100 million
    - $100 million - $500 million
    - $500 million - $1 billion
    - > $1 billion

33. Organization Name: _____

34. If selected, would you agree to permit the research team to complete a case study on your organization?
    - Yes
    - No

35. Contact information(optional but needed if selected for case study)
    - Name: _____
    - Phone: _____
    - Email: _____