Survey on Audit Committee Relationships: A Research Project

The Institute of Internal Auditors
Austin Chapter
2006-2007 Research Project

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Austin Chapter Research Committee

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INTRODUCTION

How can chief audit executives (CAEs) more effectively serve their Audit Committee members? What responsibility does the CAE have to the Audit Committee? What are the responsibilities of the Audit Committee members? What key features should be included in the Audit Committee's Charter? What does the Professional Practices Framework require? What are some leading practices to foster effective relationships between the CAE and the Audit Committee members? These are just a few of the questions asked in a recent survey by the Institute of Internal Auditors Austin Chapter Research Committee.

The Chapter Research Committee issued a survey to about 75 CAEs who are members of the IIA Austin Chapter and/or the Texas State Agency Internal Audit Forum to obtain ideas on the CAE relationships with their Audit Committee members in line with the requirements of IIA Performance Standard 2060. Only the CAE (or designee) or the senior auditor within each organization was asked to respond to the survey to ensure that only one response was received from each chapter member organization.

The survey was administered on-line through *SurveyMonkey*, and the web link to the survey was sent via email to the CAE of each member organization. The survey questions were a combination of 31 yes/no, multiple-choice, and open-ended type questions. The open-ended questions were used primarily to gather additional information or clarification pertaining to the other questions. If the respondent answered "No" to Question #5 on the survey, they were instructed to skip to Question #30, since the remaining questions were not applicable. Additionally, the survey summary indicated that not all of the remaining respondents answered every question. Respondents had the option of identifying their organization and themselves on the last two questions; otherwise, the respondents' organization and identity remained unnamed.

The purpose of the survey was to identify information and techniques for developing influential and effective relationships between chief audit executives and their Audit Committee members. The survey consisted of five sections:

- Organizational Demographics
- Audit Committee/CAE Relationship
- Audit Committee Basics
- Audit Committee/CAE Communications
- Suggestions/Leading Practices.

The content of this report is a summary of the information gathered through the survey.

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ORGANIZATIONAL DEMOGRAPHICS

Approximately 75 CAEs within the Austin Chapter and/or the Texas State Agency Internal Audit Forum received the survey. Sixty-four usable responses were received, for an 85% response rate.

The first section of the survey focused on the survey audience by asking the respondents to describe their organization, identify their position within their organization, and identify whether or not their organization has an Audit Committee.

Industry Type

The five industry types consisted of private sector, not-for-profit, city/county government, state government, and federal government. Additionally, Table 1 below includes a separate category for those who identified Higher Education in the "Other" category to describe their organization. Not surprisingly, 53% of survey respondents were from the Texas state government sector.

Table 1
Industry Type

	Response Total	Percent
State Government	**34**	**53%**
Private Sector	10	16%
City/County Government	7	11%
Higher Education	6	9%
Not for Profit	3	5%
Other/Federal Government	4	7%

Size of Organization

Respondents were asked to assess their organization size by number of employees and annual revenue or budget. The results are illustrated in Tables 2 and 3 below.

Table 2
Number of Employees

	Response Total	Percent
Less than 100	2	3%
100 to 500	17	27%
501 to 1,000	8	13%
1,001 to 5,000	17	27%
More than 5,000	**20**	**31%**

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Table 3
Annual Revenue or Budget

	Response Total	Percent
Under $10 million	4	6%
$10 million to $25 million	0	0%
$26 million to $100 million	16	25%
$101 million to $500 million	13	20%
$501 million to $1 billion	10	16%
More than $1 billion	**21**	**33%**

Position within Organization
Respondents were also asked to identify their position within their organization as either the Chief Audit Executive (CAE)/Internal Audit Director, designee by the CAE to answer the survey, or another position. Fifty-four respondents or 86% identified their position as the CAE/Internal Audit Director within their organization, one respondent was designated by the CAE to answer the survey, and the remaining nine respondents indicated their position as being Assistant Director, Audit Manager, or Lead Auditor.

Audit Committee Presence
Respondents were asked whether their organization has an Audit Committee, or Board Members or Commissioners who function similar to an Audit Committee. Seventy-two percent of those surveyed do have an Audit Committee, 25% do not, and 2% plan to have an Audit Committee. Respondents who do not have an Audit Committee, were instructed to skip to question #30 since questions six through twenty-nine specifically related to the structure and composition of the organization's Audit Committee.

Of the organizations that do not have an Audit Committee, 10 represent state government, 3 represent city/county government, and one each represents federal government, private sector, and the financial sector.

AUDIT COMMITTEE/CAE RELATIONSHIP

The second section of the survey focused on the relationship between the Audit Committee and the CAE. Respondents were asked to whom the CAE/Internal Audit Director reports – both functionally and administratively; who is responsible for hiring the CAE; and who is responsible for evaluating the CAE's performance. Survey responses are illustrated in Tables 4 and 5 below. Please note that multiple answers were possible where indicated.

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Table 4
To Whom Does The CAE/Internal Audit Director Report?

	Functionally	**Administratively***
	Response Percent	**Response Percent**
Board/Audit Committee	**70%**	29%
CEO	26%	**60%**
CFO	4%	17%
VP/Deputy/Chief of Staff	0%	10%
Other	0%	4%

***multiple answers possible**

Table 5
Who is Responsible for:

	Hiring the CAE? *	**Evaluating the CAE's Performance? ***
	Response Percent	**Response Percent**
Board/Audit Committee	**71%**	**69%**
CEO	40%	46%
CFO	15%	19%
Other	10%	13%

*** multiple answers possible**

AUDIT COMMITTEE BASICS

Section three of the survey consisted of eleven questions and focused on the basic composition and key elements of the Audit Committee.

Audit Committee Size

Respondents were asked how many persons serve on their Audit Committee. Forty-three percent of the respondents have less than four persons serving on their Audit Committee, 28% have four or five persons, while 25% have seven or more persons serving on their Audit Committee.

Audit Committee Background

Respondents were asked to identify the background of the Audit Committee members and the replies were as follows:

- 75% Financial
- 43% Administration
- 35% Independent Public Member
- 33% Legal
- 33% Industry
- 13% Citizen/Stockholder/Member
- 8% Higher Education
- 5% Elected Official

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Audit Committee Charter
Questions twelve through fifteen pertained to the Audit Committee Charter. Sixty-seven percent of the organizations surveyed do have an Audit Committee Charter, 26% do not, 3% are planning to develop a Charter, and the remaining 5% indicated that Audit Committee responsibilities are contained in the Board rules or bylaws.

Audit Committee Charter Features
To gain an understanding of each organization's Charter features, respondents were asked to identify various general features and specific features about Internal Audit from a predetermined list.

- 93% Purpose & Responsibilities
- 83% Committee Composition
- 70% Meeting Frequency
- 67% Reporting & Other Activities
- 63% Internal Audit Process
- 60% External Audit Process
- 53% Risk Management & Internal Control System
- 50% Financial Reporting Process
- 43% Compliance Process

Committee Duties and Responsibilities
The specific features about Internal Audit which are included in the Audit Committee Charters are as follows: (multiple answers possible)

- 90% Receive and review internal and external audit reports
- 83% Review and recommend Audit Plans to the Board
- 76% Review Internal Audit Charter, risk assessment, budget, staffing, and/or organizational structure
- 66% Review the overall effectiveness of the Internal Audit Function
- 52% Recommend to the Board CAE appointment, replacement, and/or dismissal
- 48% Evaluate CAE performance
- 21% Recommend to the Board CAE compensation

Audit Charter Review Frequency
Respondents were asked "How often is the Audit Committee Charter reviewed and/or approved?" Forty-four percent of respondents indicated that the Charter is reviewed annually, 4% every two years, and 52% as needed.

The next several questions were asked in an effort to ascertain similarities and differences in Audit Committee practices and procedures.

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Meeting Frequency
How often does your Audit Committee meet?

- 8% Monthly
- 8% Bi-monthly
- 56% Quarterly
- 5% Semiannually
- 21% As Needed
- 2% Other

Typical Meeting Duration
What is the typical duration of Audit Committee meetings?

- 23% Less than 1 hour
- 33% 1 hour
- 28% 1.5 hours
- 10% 2 hours
- 3% More than 2 hours
- 3% Other

Meeting Agenda Responsibility
Who is responsible for developing the Audit Committee meeting agenda? (multiple answers possible)

- 77% CAE/Internal Audit Director
- 21% CEO
- 39% Audit Committee Chair/Board Members
- 5% Other

Committee Member Participation
Do Audit Committee members actively participate in discussions at meetings?

- 39% Extensively
- 51% Regularly
- 8% Frequently
- 0% Occasionally
- 3% Other

Topics Covered
What topics are typically covered in Audit Committee meetings? (multiple answers possible)

- 90% Internal Audit Reports
- 90% Risk assessment/Audit Plan development and approval
- 82% Status of Audit Plan
- 77% Status of prior audit recommendations
- 74% Risk, control, and governance issues
- 72% External audit reports

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- 67% Internal audit resources
- 56% Fraud prevention and detection
- 54% QAR results
- 51% Information systems security
- 48% IA quality assessment
- 46% Enterprise risk management/control self-assessment
- 44% Financial statement review
- 44% Government requirements
- 44% Accomplishment of IA performance measures
- 36% Sarbanes-Oxley or similar compliance
- 31% Business continuity management
- 31% IIA Standards, Government Auditing Standards, *Tone at the Top* newsletter, etc.
- 18% CAE performance
- 13% CAE compensation
- 10% Summary reports by line managers

AUDIT COMMITTEE/CAE COMMUNICATIONS

Section four of the survey consisted of a series of eight questions to identify methods used by CAEs to communicate with their Audit Committee members. Four of the questions asked for yes/no responses and the remaining five questions were open-ended.

CAE/Audit Committee Chair Communications
How often does the CAE communicate with the Audit Committee Chair?

- 31% Ongoing
- 31% Frequently
- 8% Occasionally
- 26% Usually in conjunction with Audit Committee meetings
- 5% Other

How often does the Audit Committee or Audit Committee Chair hold private meetings with the CAE?

- 21% Not done
- 49% Several times per year
- 10% Once per year
- 8% As needed
- 13% Other

If private meetings are held, what topics are discussed? (multiple answers possible)

- 76% Questions and concerns regarding the organization and management
- 66% Status of Internal Audit projects
- 55% Assessment of the control environment

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- 48% Input for meeting agendas
- 45% Topics requested by the Audit Committee
- 45% Possible impairments to Internal Audit's work
- 21% Compliance with professional standards

Committee's Performance Evaluation

How often does the Audit Committee evaluate its own performance?

- 63% Not done
- 0% Every several years
- 32% Annually
- 5% Planned for the future

Training the Audit Committee Members

How often does the CAE or Internal Audit provide education and training topics to the Audit Committee (e.g. auditing standards, IIA brochures, *Tone at the Top* newsletter, etc.)?

- 18% Frequently
- 44% Occasionally
- 5% Planned
- 18% Not Done
- 15% Other

What are some recent education and training topics?

- New member orientation
- Audit Committee responsibilities
- ERM/control environment
- Financial statement reviews
- Fraud prevention
- Quality assessment review
- Ethics
- Corporate governance
- Audit standards
- Impact of regulatory requirements (SOX, SEC, SAS, FASB, GASB)
- External auditor reports (financial and other audit groups)
- IT systems security
- Risk management
- Corporate compliance
- Presentations by management from various operational areas
- *Tone at the Top* articles
- *CAE Newsletter* articles
- IIA brochures (AC effectiveness, QAR, Standards)

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Management Impairment
Does management cause any impairment (real or perceived) to CAE/Audit Committee communications?

- 3% Yes
- 3% Sometimes
- 95% No

Compliance with IIA Standard 2060 Regarding Reporting to the Board
Does your Internal Audit function generally comply with IIA Standard 2060 regarding reporting to the Board and senior management?

- 90% Yes
- 5% Partially
- 3% No
- 3% Unknown

SUGGESTIONS/LEADING PRACTICES

The CAEs were asked to provide some leading practices to foster effective relationships with Audit Committee members. Below are their responses:

- Audit Committee should be proactive toward internal audit and support IA initiatives
- Monthly meetings and sole reporting to the Audit Committee
- Open communications at Board meetings and informal functions
- Ongoing commitment to effective communications through the sharing of information, personal visits to Audit Committee Chair's business; and request for input on risk assessment and audit planning
- Frequent contact between the CAE and the audit committee outside of normal Audit Committee meetings
- Emphasize the use of "plain English" rather than audit-speak
- Audit liaison with an audit/financial background very valuable.
- Constant and open communication.
- CAEs must be very mindful where their value is – what is it that the Internal Audit function brings to the board?
- As with all relationships, effectiveness is fostered when one understands the needs of the other party.
- Give them a call and take them out to lunch.
- Frequent communication via email and phone calls. Always put brief useful information in the subject line and any date that requires response.
- Write up the minutes from each Audit Committee meeting and send it out for review before approval
- Be patient and respectful in all communications with Audit Committee members.
- Regular communication with the Audit Chairman, written and oral

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- Invite them to professional association meetings
- Stay available, meet on a regular basis, encourage informal meetings, i.e. lunches
- Longevity of members – some members have been on the committee for 10+ years
- Discuss as much as possible with management's knowledge and participation.
- Solicit input on agenda items.
- Be responsive to information requests.
- Guide/direct discussion while reading the audience.
- Discuss status of audit operations, problems and challenges as well as management's operations, problems and challenges.
- Executive summaries.
- Speak in a neutral tone/fact based.
- Get to know them on a personal basis. Talk with them during breaks of meetings.
- Conduct difficult audits and explain the results with them.
- Recognize they are busy, be very candid and frank.
- Include members in Enterprise Risk Management Risk Assessment process.
- Meet at least annually one on one for discussion of areas of concern or opportunity. Provide change in management training for incoming management including specific admin and internal control areas.

CONCLUSIONS

Compliance with the requirements of IIA Standard 2060 on reporting to senior management and the Board is important for effective governance in all organizations today. Also essential are the policies and procedures supporting the Audit Committee's operation and the relationship between the CAE and the Audit Committee members.

Surveys of this nature are useful (1) as a basis for comparison with peers in the internal auditing community, and (2) as a reference for emerging or leading practices. Some Austin Chapter survey results further confirm the findings in the renowned IIA Research Foundation/PricewaterhouseCoopers 2005 study entitled *Audit Committee Effectiveness, 3rd Edition – What Works Best*.

There is much that chief audit executives can do to build and nourish effective relationships with Audit Committee members. There is much we can learn from one another in improving communications with key stakeholders. This research report provides useful guidance that can help CAEs achieve these objectives.

The IIA offers a variety of guidance materials and professional development activities pertaining to Audit Committees and governance issues and concerns. These brochures can be effectively used to educate and inform new and experienced Board members in internal auditing practices, Audit Committee responsibilities, and risk, control and governance issues. Among the excellent IIA informational brochures are the following:

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- *Audit Committee Briefing . . . Internal Audit Standards: Why They Matter*
- *The Audit Committee: Purpose, Process, Professionalism*
- *The Audit Committee: A Holistic View of Risk*

In addition, the *Tone at the Top* newsletter can be used as an educational and advisory tool for audit committees, boards, and executive management. This newsletter regularly provides useful information about governance issues and other relevant concerns.

Further information on IIA products and services pertaining to corporate governance and Audit Committees is available at http://www.theiia.org/guidance.

The results of the Austin Chapter survey were shared during a presentation at the IIA's *General Audit Management Conference* in Kissimmee, Florida in March 2007. The results will also be provided at future meetings of both the IIA Austin Chapter and the Texas State Agency Internal Audit Forum. This research paper will be posted on the Austin Chapter website.

The questionnaire survey is included in the Appendix to this report on pages 14-19. Additionally, the report will be available on the IIA Austin Chapter website.

THANK YOU

The Chapter Research Committee members would like to thank the chief audit executives of the following organizations who responded to our survey and shared their thoughts and ideas:

1. ArthroCare
2. Capital Metro
3. CHAN
4. City National Bank
5. Department of Aging & Disability Services
6. Department of Aviation, City of Austin
7. Department of Family & Protective Services
8. Employees Retirement System of Texas
9. Extraco Corporation
10. General Land Office
11. Health & Human Services Commission
12. Kilgore College
13. Linebarger Goggan Blair & Sampson, LLP
14. Lower Colorado River Authority
15. McLane Company, Inc.
16. Midwestern State University
17. New Braunfels Utilities
18. Office of Court Administration
19. Office of the Governor
20. Teacher Retirement System of Texas
21. Texas A&M University System
22. Texas Adjutant General's Department

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23. Texas Department of Assistive & Rehabilitative Services
24. Texas Department of Housing & Community Affairs
25. Texas Department of Insurance
26. Texas Department of State Health Services
27. Texas Department of Transportation
28. Texas Education Agency
29. Texas Lottery Commission
30. Texas Mutual Insurance Company
31. Texas Mutual Insurance Company
32. Texas State University System
33. Texas Water Development Board
34. Texas Workforce Commission
35. Texas Youth Commission
36. University Federal Credit Union
37. US Army, III Corps & Fort Hood
38. UT Austin
39. UT Dallas
40. UT El Paso
41. UT M.D. Anderson Cancer Center
42. UT Permian Basin
43. UT System
44. Whole Foods Market
45. Williamson County, Texas

Thank you also to 19 other internal audit organizations who responded to the survey but did not identify themselves.

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Appendix

IIA Austin Chapter Audit Committee Relationship Survey

1. ORGANIZATIONAL DEMOGRAPHICS

1. What best describes your organization?

   Private Sector
   Not for Profit
   City/County Government
   State Government
   Federal Government
   Other (please specify)

2. How many people are employed by your organization?

   Less than 100
   100 to 500
   501 to 1,000
   1,001 to 5,000
   More than 5,000

3. What is your organization's annual revenue or budget?

   Under $10 million
   $10 million to $25 million
   $26 million to $100 million
   $101 million to $500 million
   $501 million to $1 billion
   More than $1 billion

4. What is your position within your organization?

   Chief Audit Executive (CAE)/Internal Audit Director
   Designated by CAE to answer the survey
   Other (please explain)

5. Does your organization have an Audit Committee or Board Members or Commissioners who function similar to an Audit Committee?

   Yes
   No (If No, skip to question #30)
   Planned
   Other (please explain)

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2. AUDIT COMMITTEE / CAE RELATIONSHIP

6. To whom does the CAE/Internal Audit Director functionally report?

   Board/Audit Committee
   CEO
   CFO
   Other (please explain)

7. To whom does the CAE/Internal Audit Director administratively report? (multiple answers possible)

   Board/Audit Committee
   CEO
   CFO
   Other (please explain)

8. Who is responsible for hiring the CAE? (multiple answers possible)

   Board/Audit Committee
   CEO
   CFO
   Other (please explain)

9. Who is responsible for evaluating the CAE's performance? (multiple answers possible)

   Board/Audit Committee
   CEO
   CFO
   Other (please explain)

3. AUDIT COMMITTEE BASICS

10. How many persons serve on your Audit Committee?

    2
    3
    4
    5
    Other (please specify)

11. What is the background of your Audit Committee members? (multiple answers possible)

    Financial
    Legal
    Administration

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Industry
Citizen/Stockholder/Member
Independent Public Member
Elected Official
Other (please explain)

12. Does your organization have an Audit Committee Charter?

    Yes
    No
    Planned
    Other (please explain)

13. What general features are included in the Audit Committee Charter? (multiple answers possible)

    Composition
    Meeting Frequency
    Purpose/Responsibilities
    Financial Reporting Process
    Risk Management & Internal Control System
    Internal Audit Process
    External Audit Process
    Compliance Process
    Reporting & Other Activities
    Other (please explain)

14. What specific features about Internal Audit are included in the Audit Committee Charter? (multiple answers possible)

    Review Internal Audit Charter, risk assessment, budget, staffing, and/or organizational structure
    Review and recommend Audit Plans to the Board
    Receive and review internal and external audit reports
    Recommend to the Board CAE appointment, replacement, and/or dismissal
    Recommend to the Board CAE compensation
    Evaluate CAE performance
    Review the overall effectiveness of the Internal Audit function
    Other (please explain)

15. Has often is the Audit Committee Charter reviewed and/or approved?

    Quarterly
    Semiannually
    Annually
    Every two years

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As needed
Other (please explain)

16. How often does your Audit Committee meet?

Monthly
Quarterly
Semiannually
Annually
As needed
Other (please explain)

17. What is the typical duration of Audit Committee meetings?

Less than 1 hour
1 hour
1.5 hours
2 hours
More than 2 hours
Other (please explain)

18. Who is responsible for developing the Audit Committee meeting agenda? (multiple answers possible)

CAE/Internal Audit Director
CEO
Audit Committee Chair/Members
External Auditor
Other (please explain)

19. Do Audit Committee members actively participate in discussions at meetings?

Extensively
Regularly
Frequently
Occasionally
Other (please explain)

20. What topics are typically covered in Audit Committee meetings? (multiple answers possible)

Risk control, and governance issues
Internal Audit reports
External audit reports
Risk assessment/Audit Plan development and approval
Status of Audit Plan
Accomplishment of IA performance measures

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Status of prior audit recommendations
QAR results
CAE performance
CAE compensation
Internal Audit resources
Fraud prevention and detection
Financial statement review
Enterprise risk management/control self-assessment
Information systems security
Business continuity management
Sarbanes-Oxley or similar compliance
Government requirements
IIA Standards, Government Auditing Standards, Tone at the Top newsletter, etc.
IA quality assessment
Summary reports by line mangers
Other (please explain)

4. AUDIT COMMITTEE/CAE COMMUNICATIONS

21. How often does the CAE communicate with the Audit Committee Chair?

Ongoing
Frequently
Occasionally
Usually in conjunction with Audit Committee meetings
Other (please explain)

22. How often does the Audit Committee or Audit Committee Chair hold private meetings with the CAE?

Not done
Several times per year
Once per year
Other (please explain)

23. If private meetings are held, what topics are discussed? (multiple answers possible)

Possible impairments to Internal Audit's work
Compliance with professional standards
Status of Internal Audit projects
Questions and concerns regarding the organization and management
Assessment of the control environment
Input for meeting agendas
Topics requested by the Audit Committee
Other (please explain)

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24. How often does the Audit Committee evaluate its own performance?

    Not done
    Every several years
    Annually
    Planned for the future
    Other (please explain)

25. How often does the CAE or Internal Audit provide education and training topics to the Audit Committee (e.g. Auditing standards, IIA brochures, Tone at the Top newsletter, etc.)?

    Frequently
    Occasionally
    Planned
    Not done
    Other (please explain)

26. What are some recent education and training topics?

27. Does management cause any impairment (real or perceived) to CAE/Audit Committee communications?

    Yes
    Sometimes
    No
    Other (please explain)

28. Does your Internal Audit function generally comply with IIA Standard 2060 regarding reporting to the Board and senior management?

    Yes
    Partially
    No
    Unknown
    Other (please explain)

5. SUGGESTIONS/LEADING PRACTICES

29. Please provide ideas and practices used to foster effective relationships with Audit Committee members:

30. Name of Organization:

31. Name of Contact Person:

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