The Role of Internal Auditing in Multilateral Organizations: Opportunities and Challenges from the implementation of the COSO framework

By

SALAZAR MEDINA, Lucia Nathali

THESIS

Submitted to
KDI School of Public Policy and Management
In Partial Fulfillment of the Requirements
For the Degree of
MASTER OF PUBLIC POLICY

2018
The Role of Internal Auditing in Multilateral Organizations: Opportunities and Challenges from the implementation of the COSO framework

By

SALAZAR MEDINA, Lucia Nathali

THESIS

Submitted to
KDI School of Public Policy and Management
In Partial Fulfillment of the Requirements
For the Degree of
MASTER OF PUBLIC POLICY

2018

Professor Tae-Hee CHOI
The Role of Internal Auditing in Multilateral Organizations: Opportunities and Challenges from the implementation of the COSO framework

By

SALAZAR MEDINA, Lucia Nathali

THESIS

Submitted to
KDI School of Public Policy and Management
In Partial Fulfillment of the Requirements
For the Degree of
MASTER OF PUBLIC POLICY

Committee in charge:

Professor Tae-Hee CHOI, Supervisor

Professor Cheol LIU

Professor Jisun BAEK

Approval as of May, 2018
Abstract

This thesis deeply investigates the role of internal auditing in multilateral organizations and the implementation of the COSO Framework in the Green Climate Fund. Through interviews with internal audit staff, this research also aims to support theoretical research to deeply understand the role that internal auditing plays in multilateral organizations. Also, this research aims to understand the opportunities and challenges of implementing the COSO framework in multilateral organizations. We pay close attention to the approaches taken by the Green Climate Fund, a recently established organization established to combat climate change. In addition, through the case study of the Green Climate Fund on its adoption and implementation of the COSO framework, we analyze the approach taken by this sizeable multilateral organization, analyze it, and determine the opportunities and challenges of adopting the framework to evaluate internal controls. Opinions stated in this paper are the author’s and are not necessarily those of the Green Climate Fund or the OIA Unit.
Title: The Role of Internal Auditing in Multilateral Organizations: Opportunities and Challenges on the Implementation of the COSO framework

Author: Lucia Salazar

Supervisors: Professor Choi Tahee
Professor Liu Cheol

Key Words: Chief Audit Executive, Internal Controls, COSO Framework, Internal Auditing, Institute of Internal Auditing, Sarbanes-Oxley Act, Risk Management, Risk Appetite, Enterprise-Risk Management

Thesis Purpose: To contribute to the existent knowledge and further research regarding the role of internal auditing in multilateral organizations and to, based on existing theoretical research and primary data, explore the opportunities and challenges of implementing the COSO framework to evaluate the effectiveness of the internal controls.

Theoretical Perspective: The theoretical perspective is a formation of the relevant findings from the Literature Review (LR) and the Case Studies (CS). These two are the theoretical foundation for this thesis.

Empirical Foundation: The empirical data for this research has been collected through semi-structured interviews with the Chief Audit Executive of the GCF as well as other OIA staff at the Green Climate Fund. In addition, relevant information has also been gathered through unstructured interviews with other multilateral and international organizations on their implementation of the COSO framework.

Conclusions: The body of this research relating the role of internal audit in multilateral organizations and the implementation of the COSO Framework is relevant as these organizations play an essential role in dealing with public issues such as health, peace, climate change, etc. The implementation of the COSO Framework leads to more effective and efficient of internal controls, resulting in better management of risks. The CS showed that the internal audit functions plays an important role in multilateral organizations. The CS also showed the opportunities and challenges facing the Green Climate Fund on its implementation of the COSO Framework.
Acknowledgement

I want to thank my grandfather for always motivating his grandchildren to study and for always reminding us the importance of education. In eighth grade, you gave me a desk so that I could do my school homework and engage in learning adventures, thank you, the desk facilitated my learning during my high-school years.

I also want to thank my father and mother for always supporting me in all my endeavors. No words can describe how thankful I am for everything you have done for me.

To my sister and best friend, Mine, thank you for always believing in me and being there for me when I needed it the most. I have missed you since I left home to pursue my education. You are the best sister anyone can ask for.

To Muslima, my best friend. You made this journey more fun and enjoyable. Thank you for all your support and for, no matter how far, always coming to visit me. Soul sisters.

To Aygul for reviewing the citations of this thesis.

To South Korea for providing me with the opportunity to continue my education.

To myself for not losing hope and keeping the hard work.
# Table of Contents

Abstract iii  
Acknowledgement iv  
Table of Contents v  
Tables and Figures vi  
Abbreviations vii  
1. Introduction 1  
  1.1 Background 1  
  1.2 Problem Description 1  
  1.3 Purpose and Research Questions 3  
  1.4 Outline of Thesis 4  
2. Research Design-Methodology 5  
  2.1 Qualitative Approach 5  
  2.2 Case Study Approach 5  
    2.2.1 Selection of Organizations 6  
    2.2.2 Primary Data 6  
    2.2.3 Secondary Data 6  
  2.4 Qualitative Data Analysis 8  
3. Results of Literature Review 10  
  3.1 Internal Audit 10  
  3.2 Institute of Internal Auditors 10  
  3.3 The Scandals 11  
  3.4 Internal Control 12  
  3.5 The Committee of Sponsoring Organizations 12  
  3.6 Sarbanes-Oxley Act 14  
  3.7 Protecting Investors through Audit Oversight 14  
  3.8 Internal Control and Internal Audit 15  
4. Case Study Results 17  
  4.1 Green Climate Fund 17  
  4.2 Organizational Structure 17  
  4.3 The Role of Internal Audit 18  
  4.4 Creating Value and Trust 19  
  4.5 COSO in the GCF 19  
  4.6 COSO in Comparable Organizations 20  
    4.6.1 UNOPS 28  
    4.6.2 ITU 29  
    4.6.3 IFAD 29  
    4.6.4 WFP 29  
    4.6.5 WIPO 30  
    4.6.6 The World Bank Group 31  
    4.6.7 The Global Fund to Fight AIDS, TB & Malaria 31  
    4.6.8 The European Commission 32  
5. Opportunities and Challenges 34  
  5.1 Opportunities 34  
  5.2 Challenges 34  
6. Conclusion 35  
  6.1 Summary of LR and CS Results 35  
    6.1.1 Literature Review 35  
    6.1.2 Case Study 36
Tables and Figures

Table 2.1 Interview Guide Categories...............................................................07
Table 2.2 Interview Summary and Schedules......................................................08
Table 3.1 Comparison of Internal Control Frameworks Definitions......................12

Figure 1 Bryman, Social Research Methods, 4th Edition (pp. 476) ......................07
Figure 2 The COSO Cube (Committee of Sponsoring Organizations) .................13
Figure 3 The Three Lines of Defense Model......................................................16
Abbreviations

ACCA Association of Chartered Certified Accountants
CAE Chief Audit Executive
CFA Certified Fraud Examiner
CIA Certified Internal Auditor
CICA Canadian Institute of Chartered Accountants
COSO Committee of Sponsoring Organizations
CPA Certified Public Accountant
CS Case Study
DG Director General
EC European Commission
ED Executive Director
ERM Enterprise-risk Management
GCF Green Climate Fund
GGGI Global Green Growth Institute
IA Internal Audit
IIA Inc. Institute of Internal Auditors Incorporated
IAF Internal Audit Function
IIF Institute of Internal Auditors
IFAD International Fund for Agricultural Development
IPPF International Professional Practices Framework
ITU International Telecommunication Union
LR Literature Review
OIA Office of the Internal Auditor
PCAOB Protecting Investors through Audit Oversight
RBM Results-based Management
RMG Risk Management Group
SOX Sarbanes Oxley Act
USA United States of America
UNICEF United Nations International Children's Education Fund
UNFPA United Nations Population Fund
UNOPS United Nations Office for Project Services
WFP World Food Programme
WIPO World Intellectual Property Organization
1. Introduction
1.1 Background

Internal Audit has been thought for many years to be a way to accumulate and analyze financial data to ensure the good representation of the financial statements. Richard Brown (1905), an accounting historian, introduced the beginning of the audit function as presented below:

The origin of auditing goes back to times scarcely less remote than that of accounting. Whenever the advance of civilization brought about the necessity of one man being entrusted to some extent with the property of another, the advisability of some kind of check upon the fidelity of the former would become apparent.

Even in history, there was a need to place controls and limit access. This need for control and access restriction can be traced as far back as 4000 B.C. As responsibilities started to grow, management started to evaluate the business activities as well as the integrity of the workers, and rapid changes demanded the internal audit function to shift from providing assurance to assisting management to improve decision-making.

During the industrial revolution in England, the methods of auditing started to spread and the concept of auditing evolved even further. During this time railroads, streets, industries, were being built and the need for the audit function went far beyond financial information (Whittington & Pany, 1998) and the process of accounting entries being compared to supporting documents (Mautz & Sharaf, 1961). In the early years, the internal audit function was considered an internal function that mainly protected organizations against financial fraud, and the loss of assets and cash, but later it evolved as a function that verified almost every financial transaction. The scope evolved from an audit for management to an audit of management approach (Reeve, cited in Cashin et.al, 1986).
1.2 Problem Description

The internal audit function is a profession that, compared to the past, has become a crucial function in profit and non-profit companies, including multilateral organizations. Internal auditors have a vital role in examining policies and procedures to minimize an organization’s exposure to fraud, risks, and losses. However, public scandals, mistakes and big frauds have raised questions about the role of internal auditing as some of the biggest frauds have occurred despite the presence of the internal audit function. The problem can be noted by Oliverio (2002) in the following way (quoted in Heier, Dugan and Sayers, 2005, pp. 42):

> Recent high-profile business failures and incidents of financial statement fraud have led me to wonder about the adequacy of the internal controls for US corporations. Although reports from the Treadway Commission and certain statutory provisions help provide a basis for a control system that assures proper financial reporting, an important element seems to be absent. There is an implied assumption in the reports and professional literature that someone, somehow, has designed an appropriate system. Yet nowhere is there a straightforward identification of who is – or should be – responsible for this task. In other words, the architect of the system of internal controls is missing.

Frauds such as Enron and WorldCom are not the only scandals that have led many to question the role of internal auditing. In fact, Toshiba, a Japanese adopted an audit committee “more commonly found in Western corporate governance” (Internal Auditor, 2015). The organization followed the example of large global companies and “Toshiba’s internal audit function adopted a rotational model” (Internal Auditor, 2015). However, Toshiba failed to adopt the internal audit function to the structure, values, and culture of the organization. In addition, the internal
audit role relied more on consultancy and advisory work rather than on assurance, leading to the overlook and dismissal of irregularities. These and other scandals and fraud have led many to doubt the role the role that internal auditors play in an organization.

In addition, the environment in which firms operate has dramatically changed in the last century, and it continues to change rapidly, and no internal control can provide absolute assurance against the risk of error or fraud; internal controls can only provide reasonable assurance. Also, in case failures occur, internal controls are ready to come up with actions that to properly control those risks or failures. In this framework, the role of internal auditing is evolving and highly pressured to not only help improve the operations of an organization and provide financial controls but also to add value. As a result, many organizations are trying to improve their internal controls and one way in which they are doing so is through the adoption of the COSO Framework, a model of internal controls to which they assess their control systems and control environments.

However, the debate and research have yet to reach a consensus on how organizations should approach internal controls and whether the implementation of the framework works in practice. The debate is still on an abstract level and lean heavily on the experiences of organizations that have successfully incorporated the COSO framework in their internal controls and risk management system.

Even though there are several practitioner-led audits and reports on the overall implementation of the COSO framework in different multilateral organizations, qualitative studies on the adoption and implementation of the COSO framework as part of the internal controls and risk management of multilateral organizations are scarce. This is even more pronounced in the case of the Green Climate Fund, where the knowledge (theoretical and practical) concerning the implementation of the COSO framework is limited at the moment, owing in part to the fact that despite its adoption by the Board the implementation has not been fully incorporated.
COSO applies to everyone at the Fund, at all levels and in all units. However, understanding of COSO and its implications is limited to the GCF organization so The Fund may not be applying COSO fully or correctly. As a result, there is a risk that its control environment may not be as effective as it should be.

Further research is needed on the role of internal audit in multilateral organizations and the implementation of the COSO Framework. This research could be used in the future as a reference point in subsequent studies in this emerging field. The lack of studies- in addition to the issues described above- has presented numerous obstacles in this research; however, it has, at the same time, provided us a unique opportunity to collect primary data and participate in pioneering efforts that will hopefully result in relevant practical contributions.

1.3 Purpose and Research Questions

The aim of this thesis is to contribute to the existent knowledge and further research regarding the role of internal auditing in multilateral organizations and to, based on existing theoretical research and primary data, explore the success factors, opportunities and challenges of implementing the COSO framework to build an effective internal control environment by analyzing the case of prominent multilateral organizations.

To achieve the purpose of this thesis, the following research questions will be explored:

*One:* What is the current state of academic literature and research concerning the role of internal audit in multilateral organizations?

*Two:* What are the opportunities and challenges that the Green Climate Fund could face when adopting the COSO framework as part of their risk management and internal control systems?

To address the first question, we will provide an overview of the relevant research regarding the role of internal audit in multilateral organizations, from the perspective of academics and practitioners that will be done by conducting a literature review (LR). As a result, we aim to
convey sufficient background knowledge for the following study and to determine information
gaps in the consulted sources.

Secondly, based on the LR and semi-structured interviews with internal audit staff of a
prominent multilateral organization, we will explore different views on the role of the internal
audit. The empirical approach, which involves an element of comparability of the skills of the
audit professionals, specializations, and work assignments of the staff, aims to come as close
as possible to gain a comprehensive view of the audit profession in multilateral organizations.
Lastly, based on a series of unstructured interviews and secondary data, we aim to analyze the
implementation of the COSO framework in multilateral organizations as well as to determine
the success factors, opportunities, and challenges of adopting the COSO Framework.

1.4 Outline of the Thesis

Chapter 1 introduces the outline of the thesis, with the aim to demonstrate the process of
answering the research questions. In Chapter 2 the research design and methodology that have
been chosen for the study is introduced. Furthermore, the qualitative research, the Literature
Review (LR) and the case study (CS) approach are described thoroughly from a theoretical
perspective and the practical implications of the situation observed and discussed in this thesis.
The results of the Literature Review are presented in Chapter 3 to provide a view of the current
literature regarding the role of internal audit in multilateral organizations; therefore, addressing
the first research question. Chapter 4 presents the empirical results of the Case Study and links
them back to the relevant literature. Moreover, we present the results of the primary and
secondary research conducted on the COSO framework implementation in different
international organizations. In Chapter 5, we present the opportunities and challenges of the
COSO implementation in the Green Climate Fund. Finally, the summary of the findings of the
LR and the CS are presented in chapter 6. Furthermore, practical and theoretical contributions
of the thesis are outlined and at the end of the thesis, the limitations and questions for further research this thesis opens are discussed.
2. Research Design – Methodology

This Chapter describes the methodology and research design that enabled a structured collection and analysis of data that allowed us to answer the research questions introduce in Chapter 1.

2.1 Qualitative Approach

This research follows a qualitative approach as this thesis aims to be exploratory and analytical. This approach is suitable for answering the research questions, especially considering that “human organizations are difficult to hold still and isolate since they change constantly” (Greener & Martelli, 2015). The constant change is particularly true for the Green Climate Fund as it is a start-up organization that is rapidly evolving. We also conducted a literature review and used the CS method, which is non-quantitative and textual in nature (Bryman & Bell, 2015).

Furthermore, this approach provides flexibility in the presentation of data as compared to the quantitative data. The validity and relevance of the qualitative research are strengthened by the results of previous studies and do not solely rely on the interpretation derived by the researcher. Since the purpose of this research is to deeply study the role of internal audit in multilateral organizations and to understand the challenges and opportunities of the implementation of the COSO Framework, a qualitative study was determined as the best approach for this thesis.

Although the qualitative approach was determined to be the best method for this thesis, there are some limitation and problems. First, the interpretation is subjective as it relies on the judgment of the researcher, opening the possibility of “a problem to go unnoticed” (Bowen, 20016). Second, the research process is usually understructure, which is difficult if not impossible to replicate. Third, the scope is limited, so it is difficult to generalize.

Therefore, the purpose of this thesis is not to find generalizations but rather to prove the correlation between the theory and the findings. In addition, to mitigate any critique towards
transparency, the data collection and findings of this research have been documented and explained in detail.

This paper will follow a deductive qualitative analysis approach to test the theories against observations.

2.2 Case Study Approach

The Case Study Approach aims to answer the second research question of this thesis. Compared to researches that involve a vast number of “settings to collect…a representative spectrum of perspectives,” case studies allow “in-depth examination” (Saldaña, 2011) and permit researchers “to uncover the unique features of the case” (Bryman & Bell, 2007). Through a case study, researchers can collect data and analyze decisions and processes taking into consideration individual factors of the Green Climate Fund. By collecting data from different international organizations, we provide a foundation for the implementation of the COSO framework in comparable organizations to the GCF. Since these organizations are comparable to the Green Climate Fund, we consider these cases as a single case study. While some scholars consider a single case study as a limiting factor since multiple case studies present superior evidence and achieve stronger results, a single case study allows us to achieve greater in-depth analysis (Yin, 2009) in this thesis. In addition, the second research question does not aim to generalize but rather to provide evidence, according to the results of the single case study, that could be used to facilitate the implementation of the COSO Framework.

In addition, the data collected and analyzed during the semi-structured and unstructured interviews is associated with the literature review and contribute to addressing the research questions of this thesis.

To help answer the first question, we conducted interviews with staff members from a wide range of positions to increase the reliability and credibility of our research. Finally, the reliability and validity of the results, particularly for the second questions, is increased by
enlarging the number of interviewees to gather primary data from internal members of different international organizations (Yin, 2009; Bryman & Bell, 2015).

2.2.1 Selection of Organizations
In addition to having formally adopted the COSO Framework, the case organization should be engaged on the frontier of development, research and implementation of the COSO Framework. Furthermore, the organizations should have the ability to handle the challenges related to a fast-changing environment and should be a multilateral organization (or fund) that leads its area of focus. The final factor to decide the selection of organizations is the possibility of reaching out CAE(s) and staff members in the Internal Audit Department to gaining access to primary data and conducting interviews. The Green Climate Fund (GCF) has been selected as the main case study company since the author had professional and personal connections with the Internal Audit Department that facilitated the access to information and the arrangement of interviews.

2.2.2 Primary Data
The data gathered to help answer the two research questions was collected through interviews with CAEs of two large multilateral organizations as well as with other staff members of the office of the internal auditor. The interviews cover a wide range of positions on the internal audit department to gain a more in-depth insight of the role of internal audit in multilateral organizations as well as to increase the reliability of the findings. In this thesis, semi-structured interviews will be conducted to help answer the first research question, which allows us to ask detailed questions but also to give participants and the researcher a degree of freedom to adapt interview questions to the interviewees’ experiences and knowledge. Moreover, unstructured interviews will be conducted to answer the second research question of this thesis.
Due to lack access to interview members of other international organizations who have relevant knowledge and experience on COSO implementation in their respective organizations, the Chief Audit Executive (CAE) of the Green Climate Fund conducted the interviews and transferred the data collected to the writer of this thesis. To get closer to the ideal type of unstructured interview, the interviewer follows the interview’s narration and is highly responsive to formulate questions spontaneously and smoothly (Patton, 20012). In addition, the interviewer sends the memos and gathered data to the interviewees to receive their verification that the data represents their narration. If changes are to be made, the interviewee promptly informs the interviewer of such changes, and makes the proper amendments. Once the process is finalized, the interviewer transfers the data to the writer of this thesis. The semi-structure interviews follow the structure that Bryman & Bell (2015) present in their Research Methods textbook. Figure 1 below shows the structure of this process. The process starts with identifying the general research area. Second, the research questions need to be determined and allocated into categories. After that, interviews questions are formulated based on the established categories and reviewed. In the next step, novelty issues are identified and interview questions revised to improve the existing questions. The interview guide in this thesis (Annex III), is divided into five categories presented in Table 2.1. The guide has been selected with the objective of covering a broad range of general questions on the role of the internal auditor in multilateral organizations. The final category aims to analyze how the internal audit function can create more value for an organization.

**Table 2.1: Interview Guide Categories**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>General Questions on the professional and personal view of the role of the internal auditor in multilateral organizations</td>
</tr>
<tr>
<td></td>
<td>2. Creating Value and Trust</td>
</tr>
</tbody>
</table>
The interviewees have been contacted via email including a short introduction of the purpose of the research topic. All the interviews were conducted in person as geographical distance facilitated the process. All interviews were conducted in English. The settings of the interviews were decided by the interviewees to increase their comfortability and familiarity.

The interviewer was asking questions to the interviewee and notes were taken to raise immediate follow-up questions or clarifications. In addition, each interview was recorded, for which permission was requested at the beginning of each interviewee. This approach enabled us to listen to the recordings for clarifications and information that might have been missed during the interview. This was a good way to recall relevant information and statements. In addition, permission to publish of their insights was also requested from each interviewee. To retain comparability among the interviews, all interviewees were asked the same questions regardless of their current position, knowledge, and background. Table 2.2 presents a summary of the interviews that were conducted for this research. This table also presents general information of the interviewees: their organization and position.
The interviews included an assistant with under 2 years of relevant experience, an internal audit specialist with over 15 years of relevant experience, an associate professional with over 10 years of relevant experience, a Chief Audit Executive with over 15 years of relevant experience, and a Chief Audit Executive with over 30 years of relevant experience. All participants had internal audit qualifications (e.g., CPA, CIA, ACCA, CFE) or are working toward them (i.e., assistant). As a result of the diverse background and experience in the internal audit field, participants were able to provide us with valuable insights regarding the role of internal audit in multilateral organizations from different expertise levels.

Table 2.2: Interview Summary and Schedules

<table>
<thead>
<tr>
<th>Interviewee No.</th>
<th>Date</th>
<th>Position</th>
<th>Organization</th>
<th>Length</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>20/12/2017</td>
<td>Chief Audit Executive</td>
<td>GCF</td>
<td>20 minutes</td>
</tr>
<tr>
<td>2</td>
<td>20/12/2017</td>
<td>Internal Audit Specialist</td>
<td>GCF</td>
<td>25 minutes</td>
</tr>
<tr>
<td>3</td>
<td>22/12/2017</td>
<td>Associate Professional</td>
<td>GCF</td>
<td>30 minutes</td>
</tr>
<tr>
<td>4</td>
<td>22/12/2017</td>
<td>Assistant</td>
<td>GCF</td>
<td>15 minutes</td>
</tr>
</tbody>
</table>

2.2.3 Secondary Data

The quality of the secondary data gathered from research and internal documents and reports (e.g., papers to the Board) is reviewed in advance to evaluate its suitableness (Stewart & Kamins, 1993). Furthermore, publicly available data, research paper and audit reports on COSO Framework implementation from a number of international organizations were thoroughly examined to achieve a more comprehensive understating about the COSO implementation in comparable organizations to GCF. An advantage of the use of secondary data is that it is easy to reach and does not incur high costs (Glaser, 1962). Moreover, secondary
data complements and strengthens the credibility of the primary data collected during the interviews.

2.3 Qualitative Data Analysis

This analysis has been defined as the “range of processes and procedures whereby we move from the qualitative data that have been collected into some form of explanation, understanding or interpretation of the people and situations we are investigating” (Skinner et.al, 2014) The process that we follow in this research was developed by Seidel (1998), and it involves three interlinked and cyclical steps: Noticing Things, Collecting Things and Thinking about things. The steps that are followed to prepare data for analysis was suggested by Dörnyei, Zoić (2007):

1) Transcribing the data – In this research interviews were recorded and transferred into text.
2) Pre-coding and coding – This step involves “reading and re-reading the transcripts, reflecting on them” (Dörnyei, Zoić 2007) to gain a comprehensive of the studied phenomenon.
3) Growing ideas: memos – in this step, the researcher notes down thoughts in memos as a means of “structure reflection.”
4) Interpreting the data and drawing conclusions – Although data interpretation happens “as early as the initial coding stage,” this stage of the process the “we have to select the overarching theme or themes that the write-up will be centered around” (Dörnyei, Zoić 2007).

Moreover, as mentioned earlier in this thesis, this research follows a deductive approach, and it is explanatory in nature given that its purpose is to address the first and second research questions introduced in the previous chapter.

Finally, primary and secondary comparisons (Dudovskiy 2016) are conducted to analyze the findings. This approach allows us to compare the interview and other qualitative data collected to the findings of the literature review (Dudovskiy, 2016).
3. Results of the Literature Review

This chapter presents a view of the current research on the role of internal audit in multilateral organizations with the help of a literature review. The literature review will be conducted through research and identification of relevant literature from various sources as described in Chapter 2. First, the development and evolution of the internal audit function in past years and the different definition and implications of internal audit are described. Second, the different definitions of internal control and its role in the organization are introduced. Finally, the COSO Framework, its definition and the implications of its implementation presented in the relevant literature review are compiled and discussed.

3.1 Internal Audit

With many high-profile scandals going public, management and senior executives have become aware of the fact that a lack of internal controls can be costly for an organization both financial and reputational. Organizations are constantly exposed to fraud, which has led global regulations to pressure organizations to implement an effective risk management framework. Now more than ever organizations are pressured to manage fraud risks, which has led managements to count on the internal audit function to keep the organization safe. In fact, according to the Indian Banking Fraud Survey (cited by Deloitte), the most reliable fraud detection mechanisms in the internal audit/legal/compliance function.

The key role that internal auditing plays and its relevance to business can be explained by one of the founders of the IIA, Arthur E. Hald (cited in Flesher 1996):

Necessity created internal auditing and is making it an integral part of modern business. No large business can escape it. If they haven’t got it now, they will have
to have it sooner or later, and, if events keep developing as they do at present, they will have to have it sooner.

This shows that internal auditing is important for every organization operating in modern society and sooner or later, every organization will need to adopt the function. Reasonable assurance and consulting on the organization’s activities improve the way organizations manage their risks, set controls, and govern. As a result, the IAF adds value and helps organizations to achieve their goals and objectives.

3.2 Institute of Internal Auditors

The IIA represents the major authority for the internal audit function and a primary source of education for internal auditors. As defined by the IIA:

The IIA is the internal audit profession’s global voice, recognized authority, acknowledged leader, chief advocate, and principal educator.

The Institute of Internal Auditors has provided such leadership to the profession that many trace the origin of internal auditing back to its creation in 1941.

3.3 The Scandals

As previously mentioned, all organizations are exposed to fraud risks. In fact, there have been several cases in the past when frauds have even led to the downfall of organizations. Two notable instances include Enron in 2001 and WorldCom in 2002.

Enron’s scandal became public in 2001 and led the corporation to bankruptcy. The American energy company hired Arthur Andersen, a well-known auditing firm of the time, as its auditing firm. However, the auditors of Arthur Anderson would only have few meeting to conduct the
audit of Enron, something they were hugely criticized for especially when considering the vast amount of information of such a complex organization as it was Enron. According to Arthur Andersen, auditors of the firm were pressured to overlook Enron’s accounting practices since even though the organization was following the generally accepted accounting principles (GAAP), it was believed that Enron was taking advantage of the gaps that existed in the standards.

It was until 2001 when the SEC started to investigate the organization, particularly the use of its accounting methods and found the internal frauds in Enron, which led the SEC to file Enron for bankruptcy two months later.

After receiving the news, Enron blamed Arthur Andersen for their misleading accounting and financial advice. In 2002, Andersen was convicted of obstruction of justice over the destruction of emails and Enron’s case-related documents. Even though the Supreme Court overturned the conviction of the accounting firm in 2005, the damage was already done. From being a top accounting firms in the United States, Arthur Andersen ended up with only 200 employees. Thousands of employees lost their job, clients left, and Andersen could never restore its reputation.

WorldCom, a telecommunication corporation reported that an internal audit discovered that the company misreported its books from 1999 to 2002. During this time, WorldCom was reporting growth in earning per share even though the firm was financially declining since 1998. This created a lot of pressure for the firm and led WorldCom to understate the expenses and capitalize the costs that should have been expensed. The company also inflated revenues to purposely overstate their assets and was involved in reserves manipulation making WorldCom seem profitable.

Once again, Arthur Andersen was the accounting of WorldCom during this time and accused the Chief Financial Officer, Scott Sullivan, for withholding information. The fraud amounted
3.8 billion dollars, and the company declared bankrupt at 103.9 billion dollars making it one of the largest bankruptcies in U.S. history. These and other frauds that occurred during this time were a turning point in the internal audit profession.

3.4 Internal Control

There are many ways to define internal controls, each definition entails different purposes, goals and objectives, achievements, and values that define an organization. The following table shows a comparison of definitions provided by different frameworks:

<table>
<thead>
<tr>
<th>COSO</th>
<th>CICA</th>
<th>Turnbull</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal control is a process</td>
<td>Control comprises those elements of an organization (including its resources, systems, processes, culture, structure and tasks that, taken together, support people in the achievement of the organization’s objectives. Elements include four categories:</td>
<td>An internal control system encompasses the policies, processes, tasks, behaviors, and other aspects of a company that taken together:</td>
</tr>
<tr>
<td>of directors, management, and other personnel</td>
<td>• Effectiveness and efficiency of operations</td>
<td>• Facilitate its effective and efficient operation;</td>
</tr>
<tr>
<td>designed to provide reasonable assurance regarding the achievement of objectives in the following categories:</td>
<td>• Reliability of financial report; and</td>
<td>• Help ensure the quality of internal and external reporting; and</td>
</tr>
<tr>
<td>• Effectiveness and efficiency of operations</td>
<td></td>
<td>• Help ensure compliance with applicable laws and regulations, and with internal policies with</td>
</tr>
</tbody>
</table>
• Compliance with applicable laws and regulations

<table>
<thead>
<tr>
<th>respect to the conduct of business</th>
</tr>
</thead>
</table>

*Source: SOX 404 for Small, Publicly Held Companies 2009*

Hightower (2008) considers internal control to be “a program of activities established to catch and monitor a potential exposure that could result in significant error, omission, misstatement, or a fraud.” Other authors define internal control as an “instrument and means of risk control, which helps the enterprise to achieve its goals and to perform its tasks” (Lakis and Giriūnas, 2008). However, the most common definition is the one introduced in the above table and presented by the Committee of Sponsoring Organizations of the Treadway Commission.

3.5 The Committee of Sponsoring Organizations

The Committee of Sponsoring Organizations or Treadway Commission, named after the first chairman of the National Commission and established in 1985, was firstly designed to lead management in enterprise risk management and internal control. It later created the Internal Control Integrated Framework.

Following reports and studies, the COSO Integrated Framework of Internal Control (COSO Framework) was released in 1992, and it was updated in 2013 to address new issues such as the impact of new technology. The five components of the COSO integrated framework should be implemented by management to achieve the goals of the organization and assure that the operations are effective and efficient, the reports reliable, the laws and regulations complied with, and the financial statements prevented of misstatement. The COSO framework allows management to define, implement and monitor the internal controls in order to improve processes and help management to have better control of the organization.
The COSO framework was designated to meet the needs of commercial entities; however, it is also relevant to government and non-profit organizations as it is a model of internal controls against which all organizations, including non-profit entities, may assess their controls systems and control environments. As a result, several multilateral organizations have adopted COSO as the basis of their internal control framework including:

(a) Several UN agencies, including UNICEF, UNFPA, and UNOPS;
(b) The World Bank Group
(c) The Global Fund to Fight AIDS, TB, and Malaria
(d) The International Fund for Agricultural Development
(e) World Food Programme
(f) World Intellectual Property Organizations

The COSO cube shows the direct relationship between an organization’s objectives (what it aims to achieve), components (what is needed to achieve the objectives) and structure.
The COSO Framework is a model of internal control against which all organizations (companies and not-for-profit entities) may assess their control systems and, more importantly, their overall “control environments.”

The COSO Framework is not a separate policy or activity for an organization. Rather it is a structure that underlies all activities, including risk management and audit, and provides a way of assessing activities and evaluating their outcomes.

3.6 Sarbanes-Oxley Act

Before these and many other financial scandals, there was a lack of oversight of corporations and their practices. After big scandals such as Enron and WorldCom, the government saw the need of developing ways that could be used to exert more controls over managers and monitor organizations.

One of the initial attempts of the regulator to focus on issues of financial transparency was the adoption of Sarbanes-Oxley Act in July 2002 by the US Congress. It took effect in 2005 for US companies with the market capitalization more than USD 75 million. The Act has established new corporate governance rules targeted at the increase of reliability of financial statements of firms. The Act has obliged external auditors to report on managements’ internal control procedures and their efficiency according to section 404 of SOX. As a result of SOX implementation, more than 1000 companies in the US has recognized the necessity to restate their accounts and about 8% of companies affected reported weaknesses in their internal control systems. On the other hand, Michael Oxley, co-author of the Act from the US House of Representatives, acknowledged that the Act “had imposed real costs on firms,” but it is “an investment for the future” (Chorafas, 2006).

In the economic literature, the estimation of effectiveness of SOX is ambiguous. There are specific studies (Li et al., 2006), Jain and Rezaee (2005) suggesting that the Act has improved
the corporate governance practices, reduced the fraudulent corporate activities and increased
the transparency of financial reports. The criticism aims mostly the high compliance costs
imposed by the Act and greater litigation risks for managers. The existing studies on measuring
the stock market reactions around the legislative events prior and after SOX implementation
(Zhang, 2007) suggest that cumulative abnormal returns of US firms are negative, which seems
to be consistent with the compliance costs imposed by SOX. However, all the studies have
limitations with regards to the scope of legislative events concerned and omitted variable biases.
Therefore, it is hard to measure the impact of SOX directly. What is certain is that the Sarbanes-
Oxley Act created more pressure not only for both publicly traded companies and the auditing
and accounting professions.

3.7 Protecting Investors through Audit Oversight
With the aim of protecting investors from fraudulent actions that could be undertaken by
organizations and preventing companies from committing fraud other initiatives (beyond SOX)
were undertaken. In the past, the auditing was a self-regulated profession, but nowadays the
PCAOB inspects the audit profession.

The PCAOB establishes auditing and related professional practice standards for
registered public accounting firms to follow in the preparation and issuance of audit
reports.

The Sarbanes-Oxley Act authorizes the PCAOB to inspect registered firms in order to assess
compliance with laws and regulations and standards associated with the audit function “for
clients that are issuers, and a firm’s audit work for clients that are securities brokers and dealers”
(PCAOB). Among the entities that decide to register but do not do audit work for issuers,
brokers, or dealers, the PCAOB inspects them and give an opinion on the financial statements of issuers by completing audit reports.

3.8 Internal Control and Internal Audit

Both internal control and internal audit work together to improve organizational processes to achieve the goals and objectives of an organization by evaluating the business environment using analytical instruments and auditing tools (Hightower, 2008). Although these concepts share similarities, the main difference can be presented by referring to Manoukian (2016), “Internal Audit is a function, while Internal Control is a system.”

Internal audits are conducted to assess “if the company has a good understanding of the risks that it faces” (Manoukian, 2016) and to determine whether the controls are effective to eliminate risks. In other words, it is not the responsibility of the internal audit function to identify risks or establish controls to mitigate risks; in fact, this is the role of internal control. Internal audit assists the process by providing consulting activities for assessing the processes, controls and solutions developed by internal control.

Another distinction between these two concepts is that from an organizational perspective, internal audit is an independent function that reports to the Board of Directors or the Audit Committee. On the other hand, “internal control is the responsibility of operational management functions” (Manoukian, 2016).

Figure 3 outlined below represent the “Three Lines of Defense Model,” a framework that well outlines the role of internal audit and internal control and that distinguishes the three lines that are responsible for effective risk management.
At the first line, management is responsible to identify and assess risks as well as to secure that the actions and controls are in place to handle deficiencies.

The function at the second line is to implement independent oversight to reasonably assure that “the first line of defense is properly designed” (IIA, 2013). The third line is composed of the IAF. As mentioned earlier in the chapter, this function provides reasonable assurance “based on the highest level of independence and objectivity within the organization” (IIA, 2013).

The external auditors and regulators “reside outside of the organization but they have an important role in the organization’s overall governance and control structure” (IIA, 2013). External bodies such as Arthur Andersen, PCAOB, and the US Sarbanes-Oxley Act, can be significant in strengthening the controls in the organization and perform objective assessments of the first, second and third lines of defense.
4. Case Study Results

This chapter covers the results of the empirical findings. In Chapter 4.1, an introduction of the case company is presented. Later, the empirical findings of the COSO implementation in the Green Climate Fund (information extracted from a Paper to the Board) as well as in other comparable organizations are introduced.

4.1 Green Climate Fund

The Green Climate Fund was established in 2010 by 194 countries of the United Nations Framework Convention on Climate Change to tackle climate change. In addition, the multilateral Fund pursues a country-driven approach in the way it operates. Moreover, the operations of the Green Climate Fund are aligned with the priorities of the countries, particularly developing countries, through the concept of country ownership. In addition, the Fund aims for sustainable development and promotes a fundamental change by supporting developing countries to reduce greenhouse gas emissions and; as a result, working towards a low-emission and climate-resilient development.

The Fund pays particular attention to countries highly exposed to the impacts of climate change, as these are the most vulnerable to the negative effects caused by it. The Green Climate Fund counts with different financial instruments and investments, in the form of grants, loans, equity or guarantees, to tackle the problem and helps countries to engage in climate-resilient and low-emission projects for climate change adaptation and mitigation.

By composing the Board, the governing body of the Fund, with the same number of members from developing and developed country the Green Climate Fund fosters equality in the way it operates. In addition, the Fund is operated by the Secretariat, which is directed by an Executive Director.

---

1 Extracted from the Green Climate Fund Website.
4.2 Organizational Structure (Confidential Information)

4.3 The Role of Internal Audit

This chapter describes interviewees' perception regarding the role of internal audit in multilateral organizations. The following analysis of the empirical results regarding the role of function in multilateral organizations will provide an insight into the perception of internal auditors working at the Green Climate Fund.

The consensus among interviewees is that internal audit is an important line of defense that multilateral organizations should not overlook as it plays a key role in helping organizations to meet their objectives. Also, participants pointed out that a wide range of skills need to be developed in-house or be outsourced to diversify the internal audit function depending on the industry in which they operate. In the case of multilateral organizations, they aim to achieve public good, and it is, therefore, important to have specialists in the industry as part of the team.

Interviewee 1 and 4 explained that the internal audit team is planning to recruit climate change and environment specialists as the GCF is a leading organization addressing climate change and agreed that multilateral organizations should be doing the same. Interviewee 2, who had experience in other multilateral organizations explained the importance of bringing specialists
into the internal audit unit in order to conduct high-quality audits that are relevant and helpful to the organization. Interviewee 2 and 3, indicated that the internal audit function allows multilateral organizations to evaluate and assess the environment in which they operate. They extended by explaining that in the case of the Green Climate Fund, a recently established organization that is rapidly changing, it is critical to have a system that provides management with a good understanding of the risks the organizations are exposed to.

According to the interviewees, the internal audit function provides management with reasonable assurance of the risks and allows the organization to evaluate the controls that are in place to protect the Fund or any other multilateral organization from different types of risk. The perception of the participants regarding the role of internal audit in multilateral organizations aligned with the literature, where authors like Hightower (2008) and Manoukian (2016) point out that internal audit uses “techniques and analytical tools to evaluate the environment” in order to understand the risks that organizations face. Manoukian expands by proclaiming that internal audits are conducted to assess “if the company has a good understanding of the risks that it faces” and to assess the performance of the “controls put in place to mitigate risks.” The results are also in line with the IIA in that internal audit plays a key role at helping organizations achieve their objectives by assessing and upgrading “the effectiveness of risk management, control, and governance processes” (Institute of Internal Auditors).

4.4 Creating Value and Trust

The participants reached a consensus that the incorporation of the internal audit function in multilateral organizations increases quality in the short-term and long-term. The internal audit function does not only assess the risks faced by the organization and assess the effectiveness of controls, but it also plays a vital role at “adding value to the daily operation of multilateral organizations” (Interviewee 3). Considering that start-up multilateral organizations, like the
GCF, face rapid and inevitable changes, internal auditors must be constantly aware of the environment in order to add value to the organization; otherwise, there is considerable risk of recommendations and audits becoming out of date (Interviewee 1).

Executive stakeholders are asking for more value adding services to be performed by their internal auditors to “...add strategic value in addition to raising compliance standards” (KPMG, 2017). Furthermore, they want internal audit to be more involved in organizational matters, “and not just in dealing with questions about processes, controls and compliance” (KPMG, 2017). Roth (2016) claim that internal auditors need to raise stakeholder’s expectations by demonstrating how much value they can add to the organization. Interviewee 1 agrees that internal auditors should exceed expectations and adapt to rapid changes in the way that achieve surprising results. Interviewees 2 and 3 add that apart from testing if the organizations follow the rules, internal auditors can also create more value by understanding the organization’s culture and environment and by having a broad knowledge of the professional practices that could specifically add higher value to multilateral organizations.

Moreover, the internal audit function could potentially prevent risks, both tangible and intangible, and serve to avoid scandals (e.g., GGGI) from happening in other multilateral organizations (Interviewee 1 and 4); thus, increasing public trust. Considering the critical role multilateral organizations play in solving public and social problems, public trust can be increased by assurance of the work performed in multilateral organizations by the internal auditors (Interviewee 3).

Interviewee 3 and 4, expand on the fact that multilateral organizations play important roles in solving public problems and that creating public trust can be achieved by making public audit reports and internal information that the public values. Being transparent about the way an organization operates is critical to achieve public trust; however, the organizational culture is the one that determines whether certain information goes public or not (Interviewee 3).
Interviewee 3 adds that creating public trust can be a double edge-sword: while it is an ethical choice for auditors to provide information that is critical to improve the organization’s operations, there have been many instances when auditors’ reputation and career have been stopped when making the ethical choice of releasing information. In this sense, the creation of a body that protects whistle-blowers needs to be in place to protect those who expose critical information.

4.5 COSO in the Green Climate Fund (Confidential Information)

GCF wants to improve its internal control culture and build an effective control environment. It seeks to adopt guidelines and best practices that are internationally accepted and have demonstrated a successful track-record. Therefore, GCF adopted the COSO framework (COSO) as the internal control framework.

The GCF Secretariat is following the COSO principles in the development of the Green Climate Fund’s risk management framework and compliance management and the design, and performance of internal audits. However, this adoption has mostly been on an ad-hoc, case-by-case basis and there has not been an explicit reference to COSO in reports submitted to the Board or used within the Secretariat.

The Secretariat organized a training course on COSO on May 2017; the total cost was approximately USD 28k. The course was presented by the Institute of Internal Auditors under the official COSO Internal Control Certificate program; participants were invited to sit an online exam in the following few months in order to be certified under that program. Twenty people participated, mainly from audit, risk management, and finance; nineteen took and passed the exam.

The course was extremely well received. Attendance was high throughout the course and all the feedback from the participants was very positive. The presenter, a senior member of the Institute of Internal Auditors, was impressed by the level of participation and by the number of
participants as he was used to getting only 2-5% of an organization to join the training. It was clear from the training that:

(a) All 17 principles of internal control (see Annex I) apply to the Green Climate Fund.

(b) COSO applies to the work of everyone at the Green Climate Fund, in all functions and at all levels. All staff, therefore, would benefit from the knowledge of how to use COSO to help manage the Green Climate Fund’s risks.

At the end of the course, an informal poll was taken, assessing how the Green Climate Fund was performing against the COSO framework. The results showed that the Green Climate Fund demonstrates commitment to integrity and ethical values.

4.6 COSO in Comparable Organizations

4.6.1 United Nations Office for Project Services

UNOPS has gone beyond the Internal Control Framework to create a tailored (ERM) system. Under this system:

(a) UNOPS management defines its major organizational risks as a basis for setting annual management work plans.

(b) Risk tolerance is occasionally defined under the mandate of the ED

(c) The UNOPS Strategic Risk Management Planning Framework provides strategic direction to the risk management system.

The activities that must be performed regardless of the level at which risks are being managed are the categories, the ownership and the process of managing risk. The three interrelated dimensions that comprise the risk management system in UNOPS is depicted in the diagram below (the similarity to the COSO Cube does not seem accidental).
4.6.2 International Telecommunication Union

The COSO framework is an integral part of the audits conducted at ITU. Each audit has an opinion on the relevant control environment, risk assessment, and control activities. These enable the Internal Audit Unit to reach an overall opinion each year on the control environment, risk assessment and control activities of the ITU.²

4.6.3 International Fund for Agricultural Development

IFAD has adopted COSO as a basis of its control framework and uses it to guide ERM activities. The main elements of IFAD’s ERM framework are:

(a) ERM Policy and Framework / ERM Committee (high level Committee chaired by the IFAD VP)

(b) Corporate risk register – Risk owners and key risk indicators

(c) Decentralized risk management (strategic, operational, financial)

(d) Direct link to corporate strategy and Medium-Term Plan and divisional plans with risks associated with results/outputs

² Based on the Interview with ITU conducted by the Chief Audit Executive of GCF.
(e) COSO based Internal Control Frameworks – Financial Reporting - ICFR (subject to external audit) and investments

IFAD does not have a full-time position devoted to risk management; although, it does have a financial risk management position. The Controller’s division has direct responsibility for the ICFR process with internal audit supporting in the annual testing.³

4.6.4 World Food Programme

WFP adopted its ERM Policy, which involves: identification of current and emerging risks, response to risks based on the organization’s risk appetite, escalation of risks as required, and communication of risks and mitigation actions to stakeholders.

Enterprise Risk Management (ERM) in WFP has been designed as an Executive Board-approved framework which outlines risk management philosophy, risk appetite, and risk tolerance. According to the Internal Audit of the Operationalization of the organization’s Enterprise Risk Management (2013), ERM overarches and informs internal control and risk response choices to assist best the beneficiaries and stakeholders WFP serves: managing and not merely avoiding or transferring risks. As of 2017, the Internal Audit of the Operationalization of WFP’s Enterprise Risk Management, established the following observations:

(a) Roles and responsibilities should be clear and should be assigned without consideration for required seniority.

(b) Incentive systems for the use of ERM tools and processes should be adequate.

(c) Investment in training and staff time for ERM Communication culture and protocols should be sufficient.

(d) ERM policy should be clear on escalation/de-escalation guidelines.

---

³ Based on the Interview with ITU conducted by the Chief Audit Executive of GCF.
(e) Communication protocols for risk-related information to both internal and external parties should be open and transparent.

4.6.5 World Intellectual Property Organization

Based on COSO, this organization’s internal control framework identifies the same main components of an internal control framework and can be linked to the existing elements of the internal control system in WIPO. Annex III provides the figure of the COSO internal control components as applied to WIPO.

WIPO’s formal efforts in Enterprise Risk Management (ERM) was presented to the Program and Budget Committee in 2010 in the organization’s Strategic Realignment Program (SRP). Following the SRP initiative, a Risk Management and Internal Controls Board was established in 2012, which was then replaced by the Risk Management Group established in 2014. WIPO’s efforts to establish an effective ERM process in 2014 translates into the rapid progress that has been made in establishing the formal elements of the ERM system. Specifically, (and according to WIPO’s ERM):

(a) The WIPO Accountability Framework (comprising a pillar on Risk Management and Internal Controls) was endorsed by the Member States in September 2014;

(b) Risk Management Policy and Risk and Internal Control Management Manual were issued in 2014;

(c) A Risk Management Group (RMG) was established in 2014 to promote a culture of responsible and effective financial and risk management in WIPO. The RMG reviews and monitors WIPO’s financial situation and the key risks to help the organization to achieve the goals of the organization. The RMG is chaired by the Director-General and meets quarterly;

(d) A Risk Appetite Statement was prepared by the WIPO Secretariat and taken note of by the Member States in 2014;
(e) A risk management platform (Acuity STREAM) to record and monitor the identified and assessed risks. This effort includes training end-users in the use of the system and providing support when required; and

(f) The reporting of Risk Management information has been incorporated into the Business Intelligence dashboards and provides for a simplified and easy access to risk management information for program managers and their alternates.

Moreover, WIPO’s risk assessment process is driven by its Results-based Management (RBM) framework. Risks are identified and assessed concerning the Expected Results thereby linking risk management with the RBM framework (World Intellectual Property Organization, 2016). When assessing the effectiveness of enterprise governance and risk management, WIPO relies on the Three Lines of Defense model to provide reasonable assurance that risk management and internal control functions are coordinated and complementary across the organization.

Current efforts seek to document key business processes and identify internal controls within those processes. “As part of this effort, internal controls that are identified within business processes are also recorded in the risk management system. The objective is to eventually be able to link identified and assessed risks to the identified internal controls (World Intellectual Property Organization, 2016). According to the Audit of Enterprise Management conducted by the internal oversight division at WIPO (2016), further improvements to the ERM process can be made by:

- Clear categorization and focus on strategic risks facing the Organization;
- Constantly improving the linkage between annual work plan activities and the identification and assessment of risks;
- Using incident management records to identify any potential unmitigated risks; and
- Reviewing inventory of controls within business processes to identifying opportunities for optimization of internal controls.
4.6.6 The World Bank Group

The approach of introducing the framework in the financial units of the World Bank and subsequently rolling it to the operational side, allowed a better adoption of the framework and facilitated staff members to familiarize themselves with it. According to Choudhury & Mitchel (2000), in order to gain assurance that the controls in place are adequate, management sign a statement provided by the auditor to confirm that controls are adequate and to expose any risk in the controls.

Despite the approach followed by the organization, the World Bank faced challenges in implementing the COSO framework due to a lack of soft-related skills of the staff members where the framework was first introduced. However, according to Choudhury & Mitchel (2000), a benefit from the COSO implementation in the World Bank is that it reduced “control aversion” among staff members. Also, the introduction of an internal control framework “helped the controller play a more proactive and corporate-wide role in the Bank.”

4.6.7 The Global Fund to Fight AIDS, TB & Malaria

In 2014, the Board adopted COSO as the internal control framework. The Global Fund spent 2014-15 in building its understanding of COSO. Since then, the Global Fund’s Risk Department has taken a more proactive role to develop the Global Fund’s alignment with COSO by leading Key Business Process Reviews in partnership with Process Owners.

- In 2015 the Global Fund identified a number of business processes, mapped them and prioritized 20 of them as Key Processes; its criteria included representation in corporate/operational KPIs, process type, volume, materiality, and frequency.

---

4 Based on the Interview with Global Fund conducted by the Chief Audit Executive of GCF.
- The Fund is reviewing these 20 Key Processes in detail, evaluating their alignment is being assessed with COSO.5

- These processes include some (e.g., Grant, and Local Fund Agent (LFA) management) that are acted on regularly and that had already been mapped and documented.

- Other processes (e.g. Ethics and integrity management) are low-volume, emerging and had not been formally mapped.

For each process the Risk Department works with process Owners to develop a Risk and Control Matrix, a one-page summary identifying

1. Key risks and inherent risk level,
2. Controls and other mitigating actions in place,
3. Residual level,
4. Target risk level, and
5. Additional actions needed.

A self-assessment questionnaire to assess that the 5 components and 17 principles of the COSO Framework are present and effective. Once these 20 Key Processes have been reviewed, the Risk Department plans to review emerging priority processes. (A recent exercise has identified 80 processes, including a number of emerging processes and initiatives.)

The monitoring and testing of key controls will, in the future, be performed by the Global Fund’s compliance function, which is currently under development.6

4.6.8 The European Commission

The internal control framework of the European Commission aims to join the Commission standards to the international ones set by the COSO framework. In this sense, the international

5 As of 15 September 2017, the Global Fund had reviewed 12 Key Processes; the remaining eight were planned to be completed by the end of the current year.

6 Based on the Interview with Global Fund conducted by the Chief Audit Executive of GCF.
standards of the COSO Framework supplement other regulations “both financial and non-financial” (COSO, 2004). Particularly, the internal control framework of the EC was designed to provide reasonable assurance that the objectives of the Financial Regulation are being met. According to the Revision of the Internal Control Framework through a communication to the Commission from Commissioner Oettinger (2017), these objectives are:

(a) Effectiveness, efficiency and economy of operations;
(b) Reliability of reporting;
(c) Safeguarding of assets and information;
(d) Prevention, detection, correction, and follow-up of fraud and irregularities, and
(e) Adequate management of the risks relating to the legality and regularity of the underlying transactions.

According to the European Commission (2017), the assessment of whether the internal control system reduces the risk of not achieving the organizational goals to an acceptable level should follow these logical steps, leading to the identification of internal control deficiencies:

- Establishment of a baseline for each principle;
- Assessment at principle and at component level, and
- Overall assessment.

Before assessing its internal control system, each Directorate-General (DG) in the European Commission must set the baseline for each internal control principle as best adapted to its specific risks. The benchmarks should be expressed considering relevant and pertinent indicators. Where possible, these indicators should be quantitative; these benchmarks are a starting point for effective internal control. From these benchmarks, regular monitoring and specific assessments can be undertaken.
5. Opportunities and Challenges

This chapter answers presents the opportunities and challenges that the Green Climate Fund face on the Implementation of the COSO Framework, answering the second research question.

5.1 Opportunities

Once an organization has established its goals and objectives and set its strategy to achieve them, the COSO Framework could provide a system of internal control that allows management to focus on the achievement of those goals while managing any problems as they arise and adapting to a changing operating environment.

In this scenario, the opportunities of implementing COSO as the internal controls and risk management framework include but are not limited to:

(a) Improving processes by implementing and monitoring the control structure;

(b) Fostering accountability within the Fund;

(c) Promoting teamwork;

(d) Gaining the attention of management and the Board on overarching control issues;

(e) Changing the perception of internal control; and

(f) Maintaining the Fund up-to-date with internal controls

5.2 Challenges

For an organization to efficiently implement the COSO ERM Framework, it needs to educate staff members, management and the Board (American Society for Health Risk Management, 2006). Even though this Framework is widely accepted, only few organizations have systematically and robustly implemented it.
This framework aligns the organization’s risk appetite and strategy for managing risk (Dornberger, Oberlehner, Zadrazil, 2014). Based on the risk appetite, the Green Climate Fund is able to either avoid, reduce, share or accept the risk. However, up to today, there has not been formal direction from the Board as to whether the risk assessment and risk appetite approved is for each unit of the Fund or for the projects approved. As a result, there is no guidance as to the chosen techniques to measure risk, the frequency of risk assessment, and the time frame of reporting (COSO, 2004). Without appropriate direction, monitoring the internal and external environment arises as one of the significant challenges for the Green Climate Fund.

The lack of commitment can be reflected on the below average rating against principles 2, 5, 7, 9, 11, 16 and 17 (Refer to Annex I), which also represents a challenge for the well implementation of the COSO Framework as part of the internal controls systems and risk management framework. The Green Climate Fund needs to ensure that these principles are fully adopted and well understood by the organization as they are key concepts of the adopted framework.

Moreover, the recent establishment of the Green Climate Fund exposes the organization to a fast-changing internal and external environment, challenges that the Green Climate Fund need to appropriately address for the well implementation of the COSO Framework. In this sphere, the attitude of staff members towards control is critical. For an organization that is highly exposed to changes (both internal and external), a clear understanding of the importance and implications of the adoption of the COSO Framework is critical.

Finally, the projection for the Green Climate Fund is to double the number of staff in the short-term and keep increasing it in the long-term. Approximately twenty staff participated in the previous COSO training session, a number that even though higher than expected remains low. Ensuring that current and upcoming staff members are knowledgeable enough to incorporate
the COSO Framework in their daily operations and have a positive attitude towards internal control remains as one of the biggest challenges on the incorporation of this Framework in the Green Climate Fund.

6. Conclusion
6.1 Summary of LR and CS Results

6.1.1 Literature Review

Practitioners and scholars have recognized the importance of the internal audit function. Organizations, now more than ever, are realizing the important role that the internal audit function plays. After several organizations have faced problems in their internal operations and have been exposed to a number of frauds, the role of internal audit becomes a critical tool to protect an organization from facing scandals that can lead them to bankruptcy. Similar to private organizations, public and multilateral organization can also benefit from the internal audit function and reduce their exposure to the many risks that exist in the environment in which they operate. For this reason, many organizations are trying to improve their internal controls and one way in which they are doing so is through the adoption of the COSO Framework, a model of internal controls to which they assess their control systems and control environments.

However, the debate and research have yet to reach a consensus on how organizations should approach internal controls and whether the implementation of the framework works in practice. The debate still on an abstract level and lean heavily on the experiences of organizations that have successfully incorporated the COSO framework in their internal controls and risk management system. The full implementation of this framework in the Green Climate Fund is still a few years away. However, this does not make the topic less important.

The benefits of a successful implementation of the COSO Framework can potentially lead to increases in the effectiveness, efficiently, and internal controls of the entire organization.
COSO applies to the work of everyone at the Green Climate Fund, in all functions and at all levels. All staff, therefore, would benefit from the knowledge on how to use COSO to help manage the Green Climate Fund’s risks. However, determining the risk appetite is critical to conduct a risks assessment that allows the organization to manage risks appropriately.

6.1.2 Case Study

The case study resulted in credible empirical data collected at the Green Climate Fund, a large multilateral organization leading the climate change sector. Semi-structured interviews with different staff members of the OIA have been conducted, with the aim of gaining perceptions and insights of the role of internal audit in multilateral organizations. All staff members had different years of experience, but despite those differences, a consensus was reached regarding several topics. Accordingly, the interviewees agree on the importance of having an internal audit function in multilateral organizations to protect organizations from both tangible and intangible risks (e.g., reputational).

Furthermore, the interviewees also commented on the role of internal audit in adding value and creating trust. The results here showed that the rapid changes that organizations face could be a challenge for internal auditors to add value to organizations as many of the emerging audit issues become obsolete at the time they are presented to senior management and the client units. Nevertheless, internal auditors highlight the importance of communication and timely receipt of information, which could result in more valuable participation by the auditors.

In addition, unstructured interviews were conducted to gain deep insight into the implementation of the COSO Framework in comparable organizations. Results showed that the implementation of COSO Framework is beneficial to multilateral organizations and its adoption improves efficiency, effectiveness, and internal control in an organization. Furthermore, results show that the experience of comparable organizations could be beneficial
for the implementation of this framework in the Green Climate Fund and other multilateral organizations.

6.2 Theoretical and Practical Contributions

This thesis adds to the existing knowledge in the research of internal auditing and in the role of the internal audit function. In addition, this research closes the gap in existing literature since there are, to our knowledge, no academic papers that directly address the role of internal audit in multilateral organizations and links it to the implementation of the COSO Framework. Research on these two topics is mostly corporate and focuses on the private sector.

The Literature Review provides an overview of the current state of literature and research from the academic, regulative, and practical perspective. The relevant information on the research topic is gathered and analyzed to present a logical and consistent summary. Also, the empirical data that was collected through interviews is analyzed to relate it to the findings of the literature reviews.

In addition, this research is relevant from a practical perspective as well. The empirical research provides a deep insight in the role of the internal audit in multilateral organizations and the role it plays on the implementation of the COSO Framework, particularly in the Green Climate Fund, the largest organization that is addressing climate change, a public problem that affects everyone around the globe. In this perspective, the effective implementation of this Framework can be a critical factor for the organization and its ability to achieve a paradigm shift and combat climate change.

This thesis provides a list of opportunities and challenges that the Green Climate Fund can face during their implementation of the COSO Framework. From a practical perspective, this thesis can be a roadmap for GCF and other multilateral organizations in their future implementation of the COSO Framework; especially for those that are on an early stage of implementation. Looking forward, multilateral organizations who are planning to implement the COSO
Framework as part of their internal controls and risk management will have an opportunity to determine the opportunities and challenges that comparable organizations face when implementing this framework, to identify gaps in our research, and to extend this research by adding their experience.

6.3 Limitations and Further Research
6.3.1 Limitations

This research has several limitations relating to both theoretical and empirical parts of the study. Firstly, we have endeavored to relate the concepts of internal audit and COSO Framework, something that has not been extensively studied in an academic setting, to the best of our knowledge. For this reason, it is possible that the study suffers gaps and inconsistencies in the process of collecting and analyzing data. Secondly, despite our best efforts, the literature review can never be fully comprehensive, especially considering that some of the papers we have used were internal documents that remain entirely confidential in the Green Climate Fund. The empirical part of this study presents a limitation concerning the choice of interviewees and the actual empirical data that was collected. Firstly, due to a lack of accessibility, the interviews conducted on the implementation of the COSO Framework in similar organizations was conducted by a third party; thereby, hindering the judgment of the writers of this thesis to raise follow up questions during the interview. Although the interviewer aimed to get closer to the ideal type of unstructured interview by following the interview’s narration and being highly responsive to formulate questions spontaneously and smoothly (Patton, 20012), this still represents a slight limitation from the writer’s point of view. Even though this was not emphasized by the interviewer, there may be relevant aspects that were missed that could have potentially contributed to a better understanding of the research question. This last statement also applies to the interviews that were conducted by the writer of this thesis and are summarized in Table 2.2. Finally, the responses provided by the interviewees are subjective to
their understanding and experience on the profession; therefore, not reflecting the actual role of internal audit.

6.3.2 Future Research
This research was able to identify several gaps in the existing literature and research as discussed in previous chapters. All these gaps represent opportunities for further studies, with the COSO ERM Implementation, the role of internal audit in multilateral organizations apart from those that deal with climate change, the risk management, and the overall results of the COSO Implementation as part of the internal controls and risk management of multilateral organizations.

Moreover, the perspectives for future research in this field consist in the unification of the concepts covered in this thesis and applying them to a more extensive scope of multilateral institutions. Also, an essential part of research to be performed consists in the analysis of the implementation of the COSO Framework once it is at a mature stage of implementation.
References


IIA see The Institute of Internal Auditors.


KPMG (2017, March). Enhancing the Strategic Value of Internal Audit. A report. Available at kpmg.com


<table>
<thead>
<tr>
<th>Annex I</th>
<th>Component</th>
<th>Principle</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Control environment</strong>: the set of standards, processes and structures that sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing the discipline and structure they need to operate effectively.</td>
<td>1. The organization demonstrates a <strong>commitment to integrity and ethical values</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2. The board of directors demonstrates independence from management and <strong>exercises oversight</strong> of the development and performance of internal control.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>3. Management, with board oversight, <strong>establishes structures, reporting lines, and appropriate authorities and responsibilities</strong> in the pursuit of objectives.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>4. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>5. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.</td>
<td></td>
</tr>
<tr>
<td><strong>Risk assessment</strong> is the process for identifying and assessing relevant risks to the achievement of objectives. This assessment is a prerequisite for determining how the risks should be managed.</td>
<td>6. The organization <strong>specifies suitable objectives</strong> with sufficient clarity to enable the identification and assessment of risks relating to objectives.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>7. The organization <strong>identifies risks</strong> to the achievement of its objectives across the entity and <strong>analyzes risks</strong> as a basis for determining how the risks should be managed.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>8. The organization <strong>considers the potential for fraud</strong> in assessing risks to the achievement of objectives.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>9. The organization <strong>identifies and assesses changes</strong> that could significantly impact the system of internal control.</td>
<td></td>
</tr>
<tr>
<td><strong>Control activities</strong> are the actions established by policies and procedures to help ensure that management’s directives to mitigate risks to the achievement of objectives are carried out. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.</td>
<td>10. The organization <strong>selects and develops control activities</strong> that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>11. The organization <strong>selects and develops general control activities over technology</strong> to support the achievement of objectives.</td>
<td></td>
</tr>
</tbody>
</table>
| | 12. **The organizations deploys through policies and procedures** – The organization deploys control
activities through policies that establish what is expected and in procedures that put policies into action.

**Information and Communication** – Information plays a key role in internal control as management uses it to manage and control the organization. Communication is the continual, iterative process of providing, sharing, and obtaining the necessary information to control the organization. Internal communication is the means by which information is disseminated throughout the organization. External communication is twofold—it enables inbound communication of relevant external information and provides information to external parties in response to requirements and expectations.

13. The organization obtains or generates and uses relevant, quality information to support the functioning of internal control.

14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.

15. The organization communicates with external parties regarding matters affecting the functioning of internal control.

**Monitoring activities** – Internal control systems need to be monitored, to assess the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, built into operating processes, and/or separate evaluations, conducted periodically. Findings are evaluated against criteria established by regulators, standard setting bodies, or management and the board of directors, and deficiencies are communicated to management and the board of directors as appropriate. Corrective actions should then be taken to ensure continuous improvement of the system.

16. The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.

17. The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.

*Source: 2013, COSO Internal Control Integrated Framework (Committee of Sponsoring Organizations)*
Annex II

Source: Audit of Enterprise Risk Management, WIPO (2016)

Annex III

Interview Guide

Role of Internal Audit in Multilateral Organizations

1. In your opinion, what is the main role of internal audit in multilateral organizations?

Creating Value and Trust

1. In your opinion, how can the internal audit function create value in the organization?

2. In your opinion, how could the internal audit function affect public trust towards multilateral organizations?