

CONTROL

ENVIRONMENT

QUESTIONNAIRE

Table of Contents

| | |
|--|-----------|
| Integrity and Ethical Values | 1 |
| Commitment to Competence | 7 |
| Board of Directors or Audit Committee | 9 |
| Management’s Philosophy and Operating Style | 16 |
| Organizational Structure | 21 |
| Assignment of Authority and Responsibility | 25 |
| Human Resource Policies and Practices | 28 |

Integrity and Ethical Values

Management must convey the message that integrity and ethical values cannot be compromised, and employees must receive and understand that message. Management must continually demonstrate, through words and actions, a commitment to high ethical standards.

1. Existence and implementation of codes of conduct and other policies regarding acceptable business practice, conflicts of interest, or expected standards of ethical and moral behavior.

| Points to Consider | Description/Comments |
|--|--|
| Codes are comprehensive, addressing conflicts of interest, illegal or other improper payments, anticompetitive guidelines, insider trading. | The company has a comprehensive code of conduct signed by all employees. |
| Codes are periodically acknowledged by all employees. | All employees are required to sign a code of conduct. Discussions with management indicated few instances of obtaining periodic acknowledgment from employees. |
| Employees understand what behavior is acceptable or unacceptable, and know what to do if they encounter improper behavior. | Management feels confident that employees understand the boundaries of acceptable behavior and that it responds appropriately to unacceptable employee behavior. |

Integrity and Ethical Values

| Points to Consider | Description/Comments |
|--|----------------------------------|
| <p>If a written code of conduct does not exist, the management culture emphasizes the importance of integrity and ethical behavior. This may be communicated orally in staff meetings, in one-on-one interface, or by example when dealing with day-to-day activities.</p> | <p>A code of conduct exists.</p> |

2. Establishment of the “tone at the top”--including explicit moral guidance about what is right and wrong--and extent of its communication throughout the organization.

| Points to Consider | Description/Comments |
|---|--|
| <p>Commitment to integrity and ethics is communicated effectively throughout the enterprise, both in words and deeds.</p> | <p>Senior management has been with the company for a long time and appears to be highly respected throughout the organization for their sense of fairness and integrity. No obvious disregard for integrity on the part of management has been observed.</p> |
| <p>Employees feel peer pressure to do the right thing, or cut corners to make a “quick buck.”</p> | <p>Conversations with employees indicate that they do not feel pressure to cut corners or make a “quick buck.”</p> |

Integrity and Ethical Values

| Points to Consider | Description/Comments |
|--|---|
| <p>Management appropriately deals with signs that problems exist, e.g., potential defective products or hazardous wastes, especially when the cost of identifying problems and dealing with the issues could be large.</p> | <p>No serious problems were observed. Also, management appears to have a high degree of integrity. Discussions with management suggest that, when problems have occurred in the past, they are dealt with in a swift and appropriate manner. The company employs in-house legal counsel to assist in dealing with these issues.</p> |

3. Dealings with employees, suppliers, customers, investors, creditors, insurers, competitors, and auditors, etc. (e.g., whether management conducts business on a high ethical plane, and insists that others do so, or pays little attention to ethical issues).

| Points to Consider | Description/Comments |
|---|---|
| <p>Everyday dealings with customers, suppliers, employees and other parties are based on honesty and fairness (e.g., customer's overpayment or a supplier's underbilling are not ignored, no efforts are made to find a way to reject an employee's legitimate claim for benefits, and reports to lenders are complete, accurate and not misleading).</p> | <p>Management appears to treat employees very well. For example, an on-site day care center is provided by the company. No unusual problems with customers or suppliers were observed or noted in conversations with management or employees.</p> |

Integrity and Ethical Values

4. Appropriateness of remedial action taken in response to departures from approved policies and procedures or violations of the code of conduct. Extent to which remedial action is communicated or otherwise becomes known throughout the entity.

| Points to Consider | Description/Comments |
|---|---|
| <p>Management responds to violations of behavioral standards.</p> | <p>No recent violations were noted. However, management indicates that, in the past, it has responded to violations in an appropriate manner.</p> |
| <p>Disciplinary actions taken as a result of violations are widely communicated in the entity. Employees believe that, if caught violating behavioral standards, they'll suffer the consequences.</p> | <p>Because of confidentiality concerns, most actions in recent years have not been widely communicated.</p> |

5. Management's attitude towards intervention or overriding established controls.

| Points to Consider | Description/Comments |
|--|---|
| <p>Management has provided guidance on the situations and frequency with which intervention may be needed.</p> | <p>No formal guidance exists, and it appears that override could occur without management approval.</p> |

Integrity and Ethical Values

| Points to Consider | Description/Comments |
|--|---|
| Management intervention is documented and explained appropriately. | No interventions by management were observed. |
| Manager override is explicitly prohibited. | Manager override is not explicitly prohibited. Discussions with management indicate that it may occur, but not as a routine matter. |
| Deviations from established policies are investigated and documented. | Discussions with management indicate that there is no formal process for investigating or documenting deviations, and no investigations were noted. |

Integrity and Ethical Values

6. Pressure to meet unrealistic performance targets--particularly for short-term results--and extent to which compensation is based on achieving those performance targets.

| Points to Consider | Description/Comments |
|--|---|
| Conditions such as extreme incentives or temptations exist that can unnecessarily and unfairly test people's adherence to ethical values. | None were observed. Compensation appears to be in line with industry standards. |
| Compensation and promotions are based solely on achievement of short-term performance targets. | Management bonuses are tied to short-term performance, with results tracked against budget and quarterly forecasts. |
| Controls are in place to reduce temptations that might otherwise exist. | The board of directors is active and involved in compensation issues and exercises oversight capacity. |

Commitment to Competence

Management must specify the level of competence needed for particular jobs, and translate the desired levels of competence into requisite knowledge and skills.

1. Formal or informal job descriptions or other means of defining tasks that comprise particular jobs.

| Points to Consider | Description/Comments |
|---|--|
| Management has analyzed, on a formal or informal basis, the tasks comprising particular jobs, considering such factors as the extent to which individuals must exercise judgment and the extent of related supervision. | Management notes that, while it does not review all job descriptions on a formal basis, it attempts to ensure that appropriate supervision exists. |

2. Analyses of the knowledge and skills needed to perform jobs adequately.

| Points to Consider | Description/Comments |
|---|--|
| Management has determined to an adequate extent the knowledge and skills needed to perform particular jobs. | Given the technical nature of the company's business, relevant expertise and knowledge are factored heavily into hiring decisions in all functions. Management believes its staff is highly skilled and competent. |

Commitment to Competence

| Points to Consider | Description/Comments |
|--|--|
| <p>Evidence exists indicating that employees appear to have the requisite knowledge and skills.</p> | <p>The company's success in the marketplace suggests that its employees have the required technical skills and knowledge. Hiring practices for nontechnical jobs also seem to indicate that competent personnel are hired.</p> |

Board of Directors or Audit Committee

An active and effective board, or committees thereof, provides an important oversight function and, because of management's ability to override system controls, the board plays an important role in ensuring effective internal control.

1. Independence from management such that necessary, even if difficult and probing questions are raised.

| Points to Consider | Description/Comments |
|--|---|
| The board constructively challenges management's planned decisions, e.g., strategic initiatives and major transactions, and probes for explanations of past results (e.g., budget variances). | The board consists of seven members and meets approximately five to six times per year. Three are outside members. A review of the minutes of board meetings indicates that strategic initiatives and major transactions are debated and discussed. |
| A board that consists solely of an entity's officers and employees (e.g., a small corporation) questions and scrutinizes activities, presents alternative views and takes appropriate action if necessary. | Not applicable (see above). |

Board of Directors or Audit Committee

2. Use of board committees where warranted by the need for more in-depth or directed attention to particular matters.

| Points to Consider | Description/Comments |
|--|---|
| Board committees exist. | Compensation, audit, and stock option committees exist. |
| They are sufficient, in subject matter and membership, to deal with important issues adequately. | The audit and compensation committees are made up primarily of the outside board members. A review of the minutes of committee meetings suggests that the committees adequately deal with important issues. |

3. Knowledge and experience of directors.

| Points to Consider | Description/Comments |
|---|--|
| Directors have sufficient knowledge, industry experience and time to serve effectively. | Inside members are long-time managers of the company. Outside members also have industry knowledge and experience. Board meets regularly and all members actively participate. |

Board of Directors or Audit Committee

4. *Frequency and timeliness with which meetings are held with chief financial and/or accounting officers, internal auditors and external auditors.*

| Points to Consider | Description/Comments |
|---|--|
| <p>The audit committee meets privately with the chief accounting officer and internal and external auditors to discuss the reasonableness of the financial reporting process, system of internal control, significant comments and recommendations, and management's performance.</p> | <p>The audit committee discusses relevant issues with the chief accounting officer and internal and external auditors on a private basis.</p> |
| <p>The audit committee reviews the scope of activities of the internal and external auditors annually.</p> | <p>Audit committee conducts annual reviews of audit functions and activities. A charter for the committee exists. The committee discusses the scope of the audit with the external auditors.</p> |

5. *Sufficiency and timeliness with which information is provided to board or committee members, to allow monitoring of management's objectives and strategies, the entity's financial position and operating results, and terms of significant agreements.*

| Points to Consider | Description/Comments |
|--|--|
| <p>The board regularly receives key information, such as financial statements, major marketing initiatives, significant contracts or negotiations.</p> | <p>Board receives financial statements and budget updates monthly.</p> |

Board of Directors or Audit Committee

| Points to Consider | Description/Comments |
|---|---|
| <p>Directors believe they receive the proper information.</p> | <p>Discussions with non-management members indicate that they feel they are provided with the proper information to perform their function.</p> |

- 6. Sufficiency and timeliness with which the board or audit committee is apprised of sensitive information, investigations and improper acts (e.g., travel expenses of senior officers, significant litigation, investigations of regulatory agencies, defalcations, embezzlement or misuse of corporate assets, violations of insider trading rules, political payments, illegal payments).**

| Points to Consider | Description/Comments |
|--|--|
| <p>A process exists for informing the board of significant issues.</p> | <p>A review of board minutes indicates that significant issues are thoroughly discussed.</p> |
| <p>Information is communicated in a timely manner.</p> | <p>Minutes indicate that directors receive sufficient information before meetings.</p> |

Board of Directors or Audit Committee

7. Oversight in determining the compensation of executive officers and head of internal audit, and the appointment and termination of those individuals.

| Points to Consider | Description/Comments |
|--|--|
| The compensation committee approves all management incentive plans tied to performance. | The compensation committee gives final approval to all management incentive plans. |
| The compensation committee, in joint consultation with the audit committee, deals with compensation and retention issues regarding the chief internal auditor. | Both the compensation committee and the audit committee are involved in determining both the financial and non-financial compensation of the chief internal auditor. |

8. Role in establishing the appropriate “tone at the top.”

| Points to Consider | Description/Comments |
|---|--|
| The board and audit committee are involved sufficiently in evaluating the effectiveness of the “tone at the top.” | Internal members of the board are active on a day-to-day basis in establishing the “tone at the top,” and outside members play a significant role in major policy decisions. |

Board of Directors or Audit Committee

| Points to Consider | Description/Comments |
|---|---|
| The board takes steps to ensure an appropriate “tone.” | No formal method was observed, but the board appears to be actively involved in establishing an appropriate tone. |
| The board specifically addresses management’s adherence to the code of conduct. | A code exists, but no specific actions related to adherence were observed. |

9. Actions the board or committee takes as a result of its findings, including special investigations as needed.

| Points to Consider | Description/Comments |
|---|----------------------|
| The board has issued directives to management detailing specific actions to be taken. | None were observed. |

Board of Directors or Audit Committee

| Points to Consider | Description/Comments |
|--|-----------------------------|
| The board oversees and follows up as needed. | None observed. |

Management's Philosophy and Operating Style

The philosophy and operating style of management normally have a pervasive effect on an entity. These are, of course, intangibles, but one can look for positive or negative signs.

- 1. Nature of business risks accepted, e.g., whether management often enters into particularly high-risk ventures, or is extremely conservative in accepting risks.***

| Points to Consider | Description/Comments |
|---|--|
| <p>Management moves carefully, proceeding only after carefully analyzing the risks and potential benefits of a venture.</p> | <p>Management appears to be risk-averse in its business practices. Careful consideration of potential risks and benefits of a venture are considered before action is taken. The company keeps an appropriate level of reserves and has a sophisticated hedging program for foreign currency exchange. Conservative revenue recognition policies are followed.</p> |

- 2. Personnel turnover in key functions, e.g., operating, accounting, data processing, internal audit.***

| Points to Consider | Description/Comments |
|--|--|
| <p>There has been excessive turnover of management or supervisory personnel.</p> | <p>While turnover in the current year was not significant, turnover in the two years preceding the current year was significant. The turnover was related to personnel and systems upgrades needed because of a public stock offering and buy out of majority shareholder.</p> |

Management's Philosophy and Operating Style

| Points to Consider | Description/Comments |
|---|---|
| Key personnel have quit unexpectedly or on short notice. | None observed. |
| There is a pattern to turnover (e.g., inability to retain key financial or internal audit executives) that may be an indicator of the emphasis that management places on control. | Turnover was related to the upgrading of personnel and systems, as noted above. |

3. Management's attitude toward the data processing and accounting functions, and concerns about the reliability of financial reporting and safeguarding of assets.

| Points to Consider | Description/Comments |
|---|---|
| The accounting function is viewed as a necessary group of "bean counters," or as a vehicle for exercising control over the entity's various activities. | Discussions with management indicate that accounting is viewed as a "given." It is viewed as an area that is not very complicated and should be done efficiently. |

Management's Philosophy and Operating Style

| Points to Consider | Description/Comments |
|---|---|
| The selection of accounting principles used in financial statements always results in the highest reported income. | No. For example, the company's revenue recognition policies are conservative with respect to their effect on income. |
| If the accounting function is decentralized, operating management "sign off" on reported results. | The accounting function is decentralized. All financial reports are reviewed and approved by the controller, CFO, and CEO before release. |
| Unit accounting personnel also have responsibility to central financial officers. | Unit accounting personnel must report back to central financial officers. |
| Valuable assets are protected from unauthorized access or use. | A control system to protect valuable assets exists. However, a number of examples of failure to adhere to the system or lack of appropriate management oversight were observed. |

Management's Philosophy and Operating Style

4. Frequency of interaction between senior management and operating management, particularly when operating from geographically removed locations.

| Points to Consider | Description/Comments |
|---|---|
| Senior managers frequently visit subsidiary or divisional operations. | Senior management maintains frequent contact with the managers of these operations. |
| Group or divisional management meetings are held frequently. | Several group meetings were held during the year. |

5. Attitudes and actions toward financial reporting, including disputes over application of accounting treatments (e.g., selection of conservative versus liberal accounting policies; whether accounting principles have been misapplied, important financial information not disclosed, or records manipulated or falsified).

| Points to Consider | Description/Comments |
|---|--|
| Management avoids obsessive focus on short-term reported results. | The conservative approach used by management in its accounting policies suggests that there is not an obsessive focus on short-term reported results. Management bonuses, however, are tied to achieving budget targets. |

Management's Philosophy and Operating Style

| Points to Consider | Description/Comments |
|---|---|
| Personnel do not submit inappropriate reports to meet targets (e.g., salespeople submitting orders to meet targets, knowing customers will return goods in the next period). | Management indicates that it does not perceive this to be a problem. |
| Managers do not ignore signs of inappropriate practices. | There were few instances of management investigation of inappropriate practices. |
| Estimates do not stretch facts to the edge of reasonableness and beyond. | Past achievement of budgets and forecasts suggests that estimates are reasonable. |

Organizational Structure

The organizational structure shouldn't be so simple that it cannot adequately monitor the enterprise's activities nor so complex that it inhibits the necessary flow of information. Executives should fully understand their control responsibilities and possess the requisite experience and levels of knowledge commensurate with their positions.

1. Appropriateness of the entity's organizational structure, and its ability to provide the necessary information flow to manage its activities.

| Points to Consider | Description/Comments |
|---|---|
| The organizational structure is appropriately centralized or decentralized, given the nature of the entity's operations. | The organizational structure appears appropriate given the nature of the entity's operations. |
| The structure facilitates the flow of information upstream, downstream and across all business activities. | The structure should facilitate the flow of information. However, discussions with management and employees indicate that there is little follow-up to ensure that written policies are being followed. |

Organizational Structure

2. Adequacy of definition of key managers' responsibilities, and their understanding of these responsibilities.

| Points to Consider | Description/Comments |
|--|--|
| Responsibilities and expectations for the entity's business activities are communicated clearly to the executives in charge of those activities. | Expectations are discussed and made clear through the quarterly budgeting and forecasting processes and through the annual performance review process. |

3. Adequacy of knowledge and experience of key managers in light of responsibilities.

| Points to Consider | Description/Comments |
|--|---|
| The executives in charge have the required knowledge, experience and training to perform their duties. | A major strength of the company appears to be the knowledge and experience of its key managers. |

Organizational Structure

4. *Appropriateness of reporting relationships.*

| Points to Consider | Description/Comments |
|---|--|
| Established reporting relationships--formal or informal, direct or matrix--are effective, and they provide managers information appropriate to their responsibilities and authority. | Written reporting relationships are clear and appropriate. Since no management reviews of the adherence to written procedures were observed, it is not clear that the defined responsibilities are adhered to. |
| The executives of the business activities have access to communication channels to senior operating executives. | Open communication channels were observed. |

5. *Extent to which modifications to the organizational structure are made in light of changed conditions.*

| Points to Consider | Description/Comments |
|---|---|
| Management periodically evaluates the entity's organizational structure in light of changes in the business or industry. | No formal periodic assessment of the organizational structure was observed. |

Organizational Structure

6. Sufficient numbers of employees exist, particularly in management and supervisory capacities.

| Points to Consider | Description/Comments |
|---|---|
| Managers and supervisors have sufficient time to carry out their responsibilities effectively. | Time constraints do not appear to be a significant issue. |
| Managers and supervisors work excessive overtime, and are fulfilling the responsibilities of more than one employee. | Overtime does not appear to be excessive. However, some examples of supervisors fulfilling dual responsibilities were observed. |

Assignment of Authority and Responsibility

The assignment of responsibility, delegation of authority and establishment of related policies provide a basis for accountability and control, and set forth individuals' respective roles.

- 1. Assignment of responsibility and delegation of authority to deal with organizational goals and objectives, operating functions and regulatory requirements, including responsibility for information systems and authorizations for changes.***

| Points to Consider | Description/Comments |
|--|--|
| Authority and responsibility are assigned to employees throughout the entity. | Responsibility and delegation of authority are assigned in a formal, written manner. |
| Responsibility for decisions is related to assignment of authority and responsibility. | Employees are given authority to make decisions based on assigned responsibilities. |
| Proper information is considered in determining the level of authority and scope of responsibility assigned to an individual. | Proper information appears to be considered in developing assigned responsibilities. |

Assignment of Authority and Responsibility

2. Appropriateness of control-related standards and procedures, including employee job descriptions.

| Points to Consider | Description/Comments |
|---|--|
| Job descriptions, for at least management and supervisory personnel, exist. | Written job descriptions and standards exist. |
| They contain specific references to control-related responsibilities. | The written job descriptions include specific references to the employee's control responsibilities. |

3. Appropriate numbers of people, particularly with respect to data processing and accounting functions, with the requisite skill levels relative to the size of the entity and nature and complexity of activities and systems.

| Points to Consider | Description/Comments |
|--|--|
| The entity has an adequate workforce--in numbers and experience--to carry out its mission. | In general, yes. The recent additions to administrative staff appear to have raised staffing to an adequate level in the accounting and finance functions. |

Assignment of Authority and Responsibility

4. *Appropriateness of delegated authority in relation to assigned responsibilities.*

| Points to Consider | Description/Comments |
|--|---|
| There is an appropriate balance between authority needed to “get the job done” and the involvement of senior personnel where needed. | Senior management does not involve itself in decisions related to many day-to-day activities. Responsibility for these activities is delegated to area supervisors. |
| Employees at the “right” level are empowered to correct problems or implement improvements, and empowerment is accompanied by appropriate levels of competence and clear boundaries of authority. | Supervisors have broad levels of authority and senior management does not appear to exercise significant oversight. |

Human Resource Policies and Practices

Human resource policies are central to recruiting and retaining competent people to enable the entity's plans to be carried out so its goals can be achieved.

1. Extent to which policies and procedures for hiring, training, promoting and compensating employees are in place.

| Points to Consider | Description/Comments |
|--|--|
| Existing personnel policies and procedures result in recruiting or developing competent and trustworthy people necessary to support an effective internal control system. | There are clearly elaborated hiring and promotion policies. Management believes the policies are adequate, but there has been little formal assessment of their effectiveness. |
| The level of attention given to recruiting and training the right people is appropriate. | A top priority of the company is to recruit and retain highly qualified individuals. |
| When formal documentation of policies and practices does not exist, management communicates expectations about the type of people to be hired or participates directly in the hiring process. | Senior management only participates in the hiring process for top executives. |

Human Resource Policies and Practices

2. Extent to which people are made aware of their responsibilities and expectations of them.

| Points to Consider | Description/Comments |
|--|--|
| <p>New employees are made aware of their responsibilities and management’s expectations of them.</p> | <p>New employees are provided with formal, written descriptions of their responsibilities and are asked to sign a code of conduct.</p> |
| <p>Supervisory personnel meet periodically with employees to review job performance and suggestions for improvement.</p> | <p>Performance evaluations are conducted at least annually.</p> |

3. Appropriateness of remedial action taken in response to departures from approved policies and procedures.

| Points to Consider | Description/Comments |
|---|---|
| <p>Management’s response to failures to carry out assigned responsibilities is appropriate.</p> | <p>Authority for identifying departures from fulfilling responsibilities rests in the hands of area supervisors. No senior management oversight was observed.</p> |

Human Resource Policies and Practices

| Points to Consider | Description/Comments |
|---|--|
| <p>Appropriate corrective action is taken as a result of non-adherence to established policies.</p> | <p>Discussions with supervisors indicate that non-adherence to established policies will result in poor performance reviews or, in extreme cases, termination.</p> |
| <p>Employees understand that ineffective performance will result in remedial consequences.</p> | <p>Discussions with employees indicate that they are aware of the consequences of failing to fulfill their responsibilities.</p> |

4. Extent to which personnel policies address adherence to appropriate ethical and moral standards.

| Points to Consider | Description/Comments |
|---|--|
| <p>Integrity and ethical values is a criterion in performance appraisals.</p> | <p>A code of conduct exists and is used as a factor in performance evaluation.</p> |

Human Resource Policies and Practices

5. Adequacy of employee candidate background checks, particularly with regard to prior actions or activities considered to be unacceptable by the entity.

| Points to Consider | Description/Comments |
|--|---|
| Candidates with frequent job changes or gaps in employment history are subjected to particularly close scrutiny. | Discussions with the human resource function indicate that attempts are made to investigate prior employment history. However, time constraints often prevent detailed follow-up or careful scrutiny. |
| Hiring policies require investigation for a criminal record. | Potential employees that indicate a criminal record are scrutinized closely. The individual's background is checked thoroughly. |

6. Adequacy of employee retention and promotion criteria and information-gathering techniques (e.g., performance evaluations) and relation to the code of conduct or other behavioral guidelines.

| Points to Consider | Description/Comments |
|--|---|
| Promotion and salary increase criteria are detailed clearly so that individuals know what management expects prior to promotions or advancement. | Promotion and salary criteria are clearly detailed in the performance review process. |

Human Resource Policies and Practices

| Points to Consider | Description/Comments |
|--|---|
| <p>Criteria reflect adherence to behavioral standards.</p> | <p>The documentation for the performance review process clearly indicates that adherence to behavioral criteria is considered in the promotion process.</p> |