



Agenda Item 5a

August 14, 2012

ITEM NAME: Annual Audit Plan and Risk Assessment

PROGRAM: Audit Services

ITEM TYPE: Information

EXECUTIVE SUMMARY

On May 15, 2012, the Office of Audit Services presented to the Risk & Audit Committee our proposed audit plan for the Committee's review and recommendation to the Board of Administration. The Risk & Audit Committee requested additional detail regarding the risk assessment approach and audit selection process used to develop the audit plan. The approved audit plan for Fiscal Year 2012-13 and the related risk assessment methodology are appended to this agenda item as Attachment 1 and 2.

BACKGROUND

The Office of Audit Services completed an annual risk assessment for the purpose of developing our annual audit plan, as required by the International Standards for the Professional Practice of Internal Auditing (Standards). The risk assessment is a rigorous, systematic process involving detailed analysis of various sources of data to identify events or conditions that could adversely affect the organization's ability to achieve its objectives. Office of Audit Services recently received an external Quality Assurance Review that confirmed our risk assessment program complied with the Standards and appropriately includes management involvement.

We analyze both internal and external risks and then score and rank each auditable area based on a number of risk factors. We then allocate audit resources to address critical risk areas as well as to perform mandated and recurring audits. Attachment 2 provides a graphical overview of the risk assessment process.

ANALYSIS

The risk assessment process is comprised of two primary components consisting of Contracting Public Agency reviews and internal audits.

Contracting Public Agency Risk Assessment

Contracting public agencies include cities, counties, special purpose districts, schools, district agricultural associations, the California State University system and state agencies. In Contracting Public Agency reviews, we evaluate and validate the integrity and accuracy of membership and payroll data reported to CalPERS by business partners that contract for retirement or health benefits. These reviews focus

primarily on compensation reporting, member enrollment, payroll reporting elements, reporting of unused sick leave for additional service credit, and employment of retired annuitants. We also review the members' health enrollment documentation.

When conducting the risk assessment, we consider the impact of a number of risk factors such as agency size and type, safety coverage, highly paid employees, high levels of special compensation, chartered cities, and whether the agency contracts to provide additional service credit for unused sick leave. Each risk factor is assigned a value and receives a score by totaling the assigned values of each factor. Agencies are then grouped into high, medium or low risk agencies. While the majority of our available resources will be engaged in reviewing high risk agencies, we also will review selected medium and low risk agencies as well as responding to special requests from management and tips received from the public. This year, we also plan to conduct limited scope reviews which focus on targeted areas of concern. In our original audit plan, approved in May of this year, we estimated we would complete a minimum of 47 reviews and 12 limited scope reviews this year. However, we plan to seek new approaches to increase our ability to efficiently target resources on the highest-risk agencies and issues. This is discussed further in Agenda Item 5b.

Internal Audit Risk Assessment

Internal audits evaluate risk exposures relating to the organization's governance, operations, and information systems regarding the reliability and integrity of financial and operational information, effectiveness and efficiency of operations, safeguarding of assets and compliance with laws, regulations, and contracts. Our approach for the internal risk assessment is highly aligned with leading practices in the internal auditing profession and includes reviewing business area objectives, strategic plans, key projects, operations summaries, and other resources. We also leverage existing risk assessment information and analyses prepared by the Enterprise Risk Management Division and map this information to our existing audit universe.

For each audit entity identified, we apply risk factors and score each item. Risk criteria and factors include: assessed adequacy and effectiveness of programmed controls, character and complexity of the business activity and its underlying systems, the application information, dollar size or transaction volume, management interest, results and time since previous audits, and degree of changes in operations or business processes. We then rank all risk scores for each auditable entity to arrive at an overall preliminary risk assessment.

We also consider other factors in developing the audit plan and selecting audits such as management or Board priorities, necessary timing of audit activities to coincide with the auditable activity, the logical sequencing of some audits, maturity of area, any assurance provided by other assurance functions, maintaining a reasonable impact on business areas, and available audit resources. Taking all this into account and applying the professional judgment of experienced auditors, we select the areas to include on our audit plan.

Since one of the goals of the audit function is to not only provide assurance to the Board, but also provide assistance to management, we also apply resources toward responding to special requests and consulting projects.

In addition to our audit plan activities, Office of Audit Services also coordinates contracted external auditor activities including the financial statement audit and real estate and other contracted investment audits.

The Office of Audit Services recognizes that risk assessment is an ongoing activity. In today's ever changing environment, current risks evolve and new risks emerge on a regular basis. To remain flexible and responsive to changing conditions, we continually reassess the auditable entities identified in our risk assessment and refresh our audit plan to accommodate emerging risks and ad hoc requests. Proposed modifications to the audit plan will be presented to the Risk & Audit Committee as needed during the year.

ATTACHMENTS

Attachment 1 - Approved Audit Plan for Fiscal Year 2012-13

Attachment 2 - Overview of the Risk Assessment process

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