



Agenda Item 7a

June 19, 2013

ITEM NAME: Internal Audit Annual Plan

PROGRAM: Audit Services

ITEM TYPE: Action

RECOMMENDATION

Approve the proposed Audit Plan for Fiscal Year 2013-14.

EXECUTIVE SUMMARY

Each year, the Office of Audit Services presents to the Risk & Audit Committee a proposed audit plan for the Committee's review and approval. Our proposed audit plan for Fiscal Year 2013-14 is appended to this agenda item as Attachment 1.

STRATEGIC PLAN

This item is not a specific product of the Strategic Plan.

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. This process serves as a key building block that balances stakeholder needs and resources available to ensure internal audit fulfills its mission within the enterprise.

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. To ensure that resources are used in the most efficient and effective way, we also coordinate our risk assessment activity with the Office of Enterprise Risk Management to prevent duplication of work while still achieving our respective objectives. The enterprise benefits from an integrated assurance approach, which ensures that the overall assurance process is adequate and sufficiently robust to validate that the risks of the organization are being appropriately managed. A graphical overview of the risk assessment and audit plan preparation process is presented in Attachment 2.

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

The Office of Audit Services performs membership, payroll, and health enrollment reviews of contracting public agencies including cities, counties, special purpose districts, schools, district agricultural associations, the California State University system and state agencies. Our reviews focus specifically on compensation reporting, member enrollment, payroll reporting elements, reporting unused sick leave for additional service credit, and employment of retired annuitants. We have temporarily suspended our review of health enrollment reviews of public agencies since CalPERS has engaged an independent firm to perform a comprehensive dependent eligibility verification audit.

To identify and prioritize contracting public agencies for reviews, we apply risk assessment factors such as agency size, type, safety coverage, if an agency is super funded, highly paid employees, high levels of special compensation, chartered cities, small agencies, and whether agencies have amended contracts to provide additional service credit for unused sick leave or enhanced retirement formulas. We leveraged information from my|CalPERS to analyze and identify agencies with a majority of these specified risk factors. We then prioritize each entity in low, medium, or high risk categories to determine the best use of staff resources. We also review agencies that may be assessed as medium or low risk in response to special requests from management or tips received, as well as periodic randomly selected agencies. We estimate completing 93 reviews for Fiscal Year 2013-14.

Internal Audit Risk Assessment

Internal audits performs assurance and consulting work, consistent with the International Standards for the Professional Practice of Internal Auditing. The internal audit plan addresses areas including retirement, health, investments, information technology, fiscal, operations support, and other internal areas. 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 collaborated with the Enterprise Risk Management Division to develop a risk assessment survey and conducted a series of interviews with senior management and our external auditors to discuss known and emerging areas of risk.

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 an area, any coverage 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, real estate and other contracted specialty investment audits.

Looking Ahead to Fiscal Year 2014-15

In addition to the detailed 2013-14 Plan presented for approval, the Office of Audit Services also looked to the horizon to develop preliminary plans for Fiscal Year 2014-15. In concert with the mandatory and recurring audits, we anticipate including the following areas in the audit plan for Fiscal Year 2014-15:

- Internal controls over financial reporting – Phase II
- Membership eligibility
- Contract development for Health Maintenance Organizations
- Information technology and security
- Investment internal controls
- Public Employees' Pension Reform Act (PEPRA) - consulting

Given the ever changing environment, risks evolve and new risks may 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. Therefore, proposed modifications to the audit plan will be presented to the Risk & Audit Committee as needed during the year. This ensures the Office of Audit Services' resources remain aligned with key enterprise objectives.

BENEFITS/RISKS

The proposed audit plan will set the direction and priorities of the internal audit activities for the next fiscal year, consistent with the organization's goals. Implementation of this audit plan will result in compliance with the Standards while providing senior management and the Board a higher level of assurance that appropriate controls are in place and working as intended and contracting public agencies comply with Public Employees' Retirement Law (PERL). Not implementing the audit plan would result in non-compliance with Standards, decreased levels of assurance, and reduced ability to detect non-compliance with the PERL.

ATTACHMENTS

Attachment 1 - Proposed Audit Plan for Fiscal Year 2013-14

Attachment 2 - Overview of the Internal Audit Risk Assessment Process

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