



Agenda Item 6a

June 17, 2014

ITEM NAME: 2014-16 Audit Plan – Office of Audit Services

PROGRAM: Audit Services

ITEM TYPE: Action

RECOMMENDATION

Approve the proposed Audit Plan for Fiscal Year 2014-15 and 2015-16.

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 detail audit plan for Fiscal Year 2014-15 is appended to this agenda item as Attachment 1. We also include preliminary project plans for Fiscal Year 2015-16.

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 and payroll 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 dependent eligibility verification audit.

To identify and prioritize contracting public agencies for reviews, we apply and score risk factors. These factors include agency demographics such as size, type, employee classifications, contract dates, and amendments. In addition, we include risk factors for agencies that have highly paid employees or employees receiving high levels of special compensation and recently contracted agencies. We also consider the time since any previous audit. We leveraged information from the Business Intelligence Unit to analyze agencies based on these specified risk factors. We then prioritize risk scores as low, medium, or high for each contracting agency to determine the best use of staff resources. We primarily focus on high risk agencies but also select agencies in the low and medium risk categories to ensure all agencies have a chance to be selected. In Fiscal Year 2014-15, we estimate completing approximately 90 reviews with a focus on agencies that have never been reviewed by our Office and are considered high risk during this risk assessment cycle. We will also select agencies to review based on random selection, in response to special requests from management, and tips received.

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 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 2015-16

In addition to the detailed 2014-15 Plan presented for approval, the Office of Audit Services also looked to the horizon to develop preliminary plans for Fiscal Year 2015-16. In concert with the mandatory and recurring audits, we anticipate including the following areas in the audit plan for Fiscal Year 2015-16:

- Pharmacy benefit manager contract compliance
- Health's process for managing and monitoring the premiums received from health plans
- Cash management
- Financial Integrity and State Manager's Accountability (FISMA)
- Information technology and security
- Compliance with CCR 559, Disclosure of Placement Agent Fees, Gifts, and Campaign Contributions

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 2014-15
- Attachment 2 - Overview of the Internal Audit Risk Assessment Process

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