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Transmitted via e-mail

December 14, 2016

Ms. Marcie Frost, Chief Executive Officer
California Public Employees' Retirement System
Lincoln Plaza North
400 Q Street
Sacramento, CA 95811

Dear Ms. Frost:

Final Report—California Public Employees' Retirement System, External Quality Assessment

The Department of Finance, Office of State Audits and Evaluations, has completed its external quality assessment of the California Public Employees' Retirement System, Office of Audit Services (OFAS) for the period July 1, 2011 through June 30, 2016.

The enclosed report is for your information and use. Because there were no recommendations requiring a response, we are issuing the report as final. This report will be placed on our website.

We appreciate the assistance and cooperation of OFAS. If you have any questions regarding this report, please contact Kimberly Tarvin, Manager, or Jennifer Arbis, Supervisor, at (916) 322-2985.

Sincerely,

Jennifer Whitaker, Chief
Office of State Audits and Evaluations

Enclosure

cc: Mr. Matthew G. Jacobs, General Counsel, California Public Employees' Retirement System
Ms. Beliz Chappuie, Chief, Office of Audit Services, California Public Employees' Retirement System

An External Quality Assessment

California Public Employees' Retirement System Office of Audit Services



Source: CalPERS website

Prepared By:
Office of State Audits and Evaluations
Department of Finance

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Final reports are available on our website at <http://www.dof.ca.gov>

You can contact our office at:

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BACKGROUND, SCOPE AND METHODOLOGY

BACKGROUND

The California Public Employees' Retirement System (CalPERS) manages retirement benefits for more than 1.8 million California public employees, retirees, and their families. The Office of Audit Services (OFAS), comprised of 66 positions, assists the Board of Administration and Chief Executive Officer in accomplishing CalPERS objectives through a systematic and disciplined approach to evaluate and improve the effectiveness of the organization's risk management, control, and governance processes. Specifically, OFAS conducts internal audits and consulting engagements, information technology audits, public agency reviews, and real asset and actuarial reviews.

SCOPE

The Department of Finance, Office of State Audits and Evaluations, performed an external quality assessment (Assessment) of OFAS' internal audit operations for the period July 1, 2011 through June 30, 2016. The Assessment objective was to evaluate OFAS' conformance with the Institute of Internal Auditors' (IIA) *International Standards for the Professional Practice of Internal Auditing* (Standards) and *Code of Ethics*, and to provide recommendations for improving the internal audit function.

METHODOLOGY

We conducted our Assessment of OFAS' compliance with the Standards and *Code of Ethics* in accordance with the IIA's *Quality Assessment Manual*. Specifically, we performed the following procedures:

- Reviewed OFAS' self-assessment and Policies and Procedures Manual.
- Surveyed OFAS' staff and CalPERS management.
- Conducted interviews with management, those charged with governance, and audit staff.
- Evaluated OFAS' annual risk assessment process and documentation.
- Reviewed OFAS' continuing professional education records.
- Evaluated a sample of audit reports and working papers for compliance with the Standards, *Code of Ethics*, and OFAS' policies and procedures.

O PINION

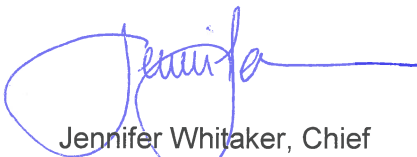
We completed an external quality assessment of the California Public Employees' Retirement System, Office of Audit Services' (OFAS) compliance with the Institute of Internal Auditors' (IIA) *International Standards for the Professional Practice of Internal Auditing* (Standards) and *Code of Ethics* for the period July 1, 2011 through June 30, 2016. We formed our opinion on OFAS' compliance with the Standards and *Code of Ethics* based on the following compliance ratings delineated in IIA's *Quality Assessment Manual*.

Generally Conforms—The internal audit activity has a charter, policies, and processes that are judged to be in conformance with the Standards.

Partially Conforms—Deficiencies in practice are noted that are judged to deviate from the Standards, but these deficiencies did not preclude the internal audit activity from performing its responsibilities in an acceptable manner.

Does Not Conform—Deficiencies in practice are judged to be so significant as to seriously impair or preclude the internal audit activity from performing adequately in all or in significant areas of its responsibilities.

It is our overall opinion that OFAS generally conforms to the Standards and *Code of Ethics*. We did not identify any recommendations for improving OFAS' internal audit function. The Observations section of this report describes some successful practices OFAS has implemented. See Appendix A for a detailed list of conformance with individual Standards and *Code of Ethics*.



Jennifer Whitaker, Chief
Office of State Audits and Evaluations

December 9, 2016

OBSERVATIONS

The California Public Employees' Retirement System (CalPERS), Office of Audit Services (OFAS) is well structured and employs many successful practices, which are critical to maintaining their visibility, relevance, and credibility within CalPERS. Additionally, these practices ensure OFAS' compliance with the Institute of Internal Auditors' (IIA) *International Standards for the Professional Practice of Internal Auditing* and *Code of Ethics*. Some examples include the following:

- *Organizational Independence*—OFAS reports directly to the General Counsel Office and quarterly to the Board of Administration.
- *Unrestricted Access to Information*—The Audit Charter, along with management support, provides unrestricted access to records and staff necessary to conduct audits.
- *Risk Assessment*—OFAS performs an extensive risk assessment process and submits the resulting audit plan to the Risk and Audit Committee for adoption.
- *Quality Assurance and Improvement Program*—OFAS performed five self-assessments and reported the results, action plans, and successful implementations to the CalPERS Board, Chief Counsel, and executive management. This practice ensures on-going quality of the internal audit activity.
- *Professional Development of Staff*—Upon employment in OFAS, staff are automatically enrolled as a member of IIA. OFAS supports staff participation in professional organizations and achievement of professional certifications. As of June 30, 2016, approximately 32 percent of the auditors achieved at least one professional license or certification. Further, OFAS encourages staff to obtain 40 hours of continuing professional education per year.
- *Quality Work Products*—OFAS ensures that engagements are properly supervised. As a result, OFAS' work products achieved the engagement objectives and conclusions were based on appropriate analyses with sufficient documentation. Additionally, executive leadership and operating management acknowledged OFAS' professionalism and quality of the internal audit staff work.

APPENDIX A

Quality Assessment Evaluation Summary¹

Quality Assessment Evaluation Summary— Overall Evaluation		GC	PC	DNC
OVERALL EVALUATION		√		

Quality Assessment Evaluation Summary— Major/Supporting Standards		GC	PC	DNC
1000	Purpose, Authority, and Responsibility	√		
1010	Recognition of the Definition of Internal Auditing, the Code of Ethics, and the <i>Standards</i> in the Internal Audit Charter	√		
1100	Independence and Objectivity	√		
1110	Organizational Independence	√		
1111	Direct Interaction with the Board	√		
1120	Individual Objectivity	√		
1130	Impairment to Independence or Objectivity	√		
1200	Proficiency and Due Professional Care	√		
1210	Proficiency	√		
1220	Due Professional Care	√		
1230	Continuing Professional Development	√		
1300	Quality Assurance and Improvement Program	√		
1310	Requirements of the Quality Assurance and Improvement Program	√		
1311	Internal Assessments	√		

¹ See page 6 for Rating Definitions.

Quality Assessment Evaluation Summary— Major/Supporting Standards		GC	PC	DNC
1312	External Assessments	√		
1320	Reporting on the Quality Assurance and Improvement Program	√		
1321	Use of “Conforms with the <i>International Standards for the Professional Practice of Internal Auditing</i> ”	√		
1322	Disclosure of Nonconformance	√		
2000	Managing the Internal Audit Activity	√		
2010	Planning	√		
2020	Communication and Approval	√		
2030	Resource Management	√		
2040	Policies and Procedures	√		
2050	Coordination	√		
2060	Reporting to Senior Management and the Board	√		
2070	External Service Provider and Organizational Responsibility for Internal Auditing	N/A		
2100	Nature of Work	√		
2110	Governance	√		
2120	Risk Management	√		
2130	Control	√		
2200	Engagement Planning	√		
2201	Planning Considerations	√		
2210	Engagement Objectives	√		
2220	Engagement Scope	√		
2230	Engagement Resource Allocation	√		
2240	Engagement Work Program	√		
2300	Performing the Engagement	√		

Quality Assessment Evaluation Summary— Major/Supporting Standards		GC	PC	DNC
2310	Identifying Information	√		
2320	Analysis and Evaluation	√		
2330	Documenting Information	√		
2340	Engagement Supervision	√		
2400	Communicating Results	√		
2410	Criteria for Communicating	√		
2420	Quality of Communications	√		
2421	Errors and Omissions	N/A		
2430	Use of “Conducted in Conformance with the <i>International Standards for the Professional Practice of Internal Auditing</i> ”	√		
2431	Engagement Disclosure of Nonconformance	√		
2440	Disseminating Results	√		
2450	Overall Opinions	√		
2500	Monitoring Progress	√		
2600	Communicating the Acceptance of Risks	√		
	The IIA’s Code of Ethics	√		

Rating Definitions

GC = Generally Conforms

PC = Partially Conforms

DNC = Does Not Conform

N/A = Not Applicable