



# Audits & Risk Management Committee

## Item Number 8 – Open Session

**Subject:** 2022 Internal Audit Plan

**Presenter(s):** Larry Jensen

**Item Type:** Action

**Date & Time:** November 4, 2021 – 15 minutes

---

**Attachment(s):** Attachment 1 – 2022 Employer Audit Risk Assessment Factors

Attachment 2 – Audit Services’ Audit Plan Calendar Year 2022

**PowerPoint(s):** PowerPoint 1 - 2022 Risk-Based Internal Audit Plan

---

### **PURPOSE**

This item presents the Audit Services proposed 2022 Internal Audit Plan covering the period January 1, 2022 through December 31, 2022 and the risk-ranked methodology to develop the proposed Audit Plan. The 2022 Internal Audit Plan also provides the Audits and Risk Management (ARM) Committee an overview of Audit Services’ mission, scope of work, independence and objectivity, and allocation of resources.

### **DISCUSSION**

#### **IIA Standards and Types of Audit Services**

As required by the *International Standards for the Professional Practice of Internal Auditing* (IIA Standards), Audit Services’ Annual Audit Plan is presented to the ARM Committee. Audit Services conducted risk assessments of CalSTRS’ operations and Employer payroll reporting to identify significant risks to the achievement of strategic objectives. A key requirement of the IIA Standards is that a periodic risk-based plan should be prepared which is sufficiently flexible to reflect the changing risks and priorities of the organization.

Best practices suggest the risk-based plan outline the assignments to be carried out and their respective priorities. Utilizing the audit plan, Audit Services optimizes audit resources to address critical risk coverage. Audit Services also utilizes the planning process to increase the ability to plan around business areas’ peak workload periods, focus on longer-term audit planning and

emerging business risks, and provide greater flexibility to accommodate immediate needs of CalSTRS’ management and the ARM Committee.

Audit Services is independent of management and provides objective assurance and consulting services designed to add value and improve CalSTRS’ operations. IIA Standards defines an assurance engagement as an objective examination of evidence for providing an independent assessment on risk management, control, or governance process for the organization.

Consistent with the IIA Standards and Audit Services Charter, the figure below describes the services included in the audit plan.

<b>AUDIT SERVICES</b>
<b>EMPLOYER AUDITS</b> - Conducts audits of Employer payroll reporting for compliance with Teachers' Retirement Law and the Public Employee's Pension Reform Act regarding eligible membership and creditable compensation reported to CalSTRS.
<b>INTERNAL AUDITS</b> - Conducts Internal audits to assist in the accomplishment of CalSTRS' objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.
<b>CONTRACTED/CO-SOURCED AUDITS</b> – Facilitates contracted audits for the independent financial statement audit and specialized audits (e.g., investment and information technology). Services provided include facilitating the audit and assisting with development of the audit scope and objectives.
<b>CONSULTING / ADVISORY SERVICES</b> - Provides advisory and related client service activities. The nature and scope of services are agreed upon by the client and are intended to add value and improve operations.
<b>OTHER AUDIT ACTIVITIES</b> - Conducts internal projects, such as training, risk assessments, requests for proposals, and quality improvement programs.
<b>MANAGEMENT &amp; ADMINISTRATION</b> - Manages and administers Audit Services including recruitment and staff resource adjustments.

### **Highlights of the Annual Audit Plan**

#### Employer Audits:

Based on available staff resources, Audit Services plans to conduct a total of 120 employer audits comprised of 10 full-scope and 110 limited-scope audits, which will focus on compensation and unused sick leave. The Employers to be audited will be selected based upon their assigned risk score. Audit Services will also continue to consider special requests and referrals.

To determine the Employer’s assigned risk score, Audit Services analyzed, and ranked the employers using 13 predetermined risk factors. For each risk factor, employers received a weighted score up to the maximum value assigned to each risk factor (1 to 5, with five being the highest) based on the potential impact and occurrence. Of the 13 risk factors, three are associated with potential spiking, and three are related to high amounts of reported special compensation. See Attachment 1 for a comprehensive list of risk factors, assigned risk values, and descriptions.

The individual risk factor scores were totaled and applied to each employer. The summation of the risk factor values determines the total risk score of each employer. The employers are then divided into three risk categories (high, medium, and low) based upon total score. For a summary of the risk assessment results, see Table 1.

**Table 1 – Number of Employers by Risk Categories**

School/Employer	High-Risk	Medium-Risk	Low-Risk	Total
Community Colleges	61	11	1	73
K12 Schools	349	387	197	933
K12 Charter Schools	40	391	267	698
State Agencies	0	8	13	21
Regional Occupational Centers	1	9	6	16
County Superintendents	33	19	2	54
<b>Grand Total</b>	<b>484</b>	<b>825</b>	<b>486</b>	<b>1795</b>

This risk ranking process provides an equitable method of prioritizing each employer for audit coverage. Audit services will select 10 full-scope audits using the following methodology:

- 70 percent of audits will be selected from High Risk = 7 (7/10)
  - 1.44 percent of entities assessed as high risk will be audited (7 audits / 484 employers)
- 20 percent of audits will be selected from Medium Risk = 2 (2/10)
  - 0.24 percent of entities assessed as medium risk will be audited (2/825)
- 10 percent of audits will be selected from Low Risk = 1(1/10)
  - 0.20 percent of entities assessed as low risk will be audited (1/486)

Over the past seven years, Audit Services’ full-scope audits found that employers commonly misreported compensation (67% of employers audited) and unused sick leave (34% of employers audited). Therefore, Audit Services plans to perform 110 limited-scope audits focused on compensation or unused sick leave. Audit Services will utilize data analytics to select employers with a greater likelihood of misreported compensation and unused sick leave.

#### Internal Audits:

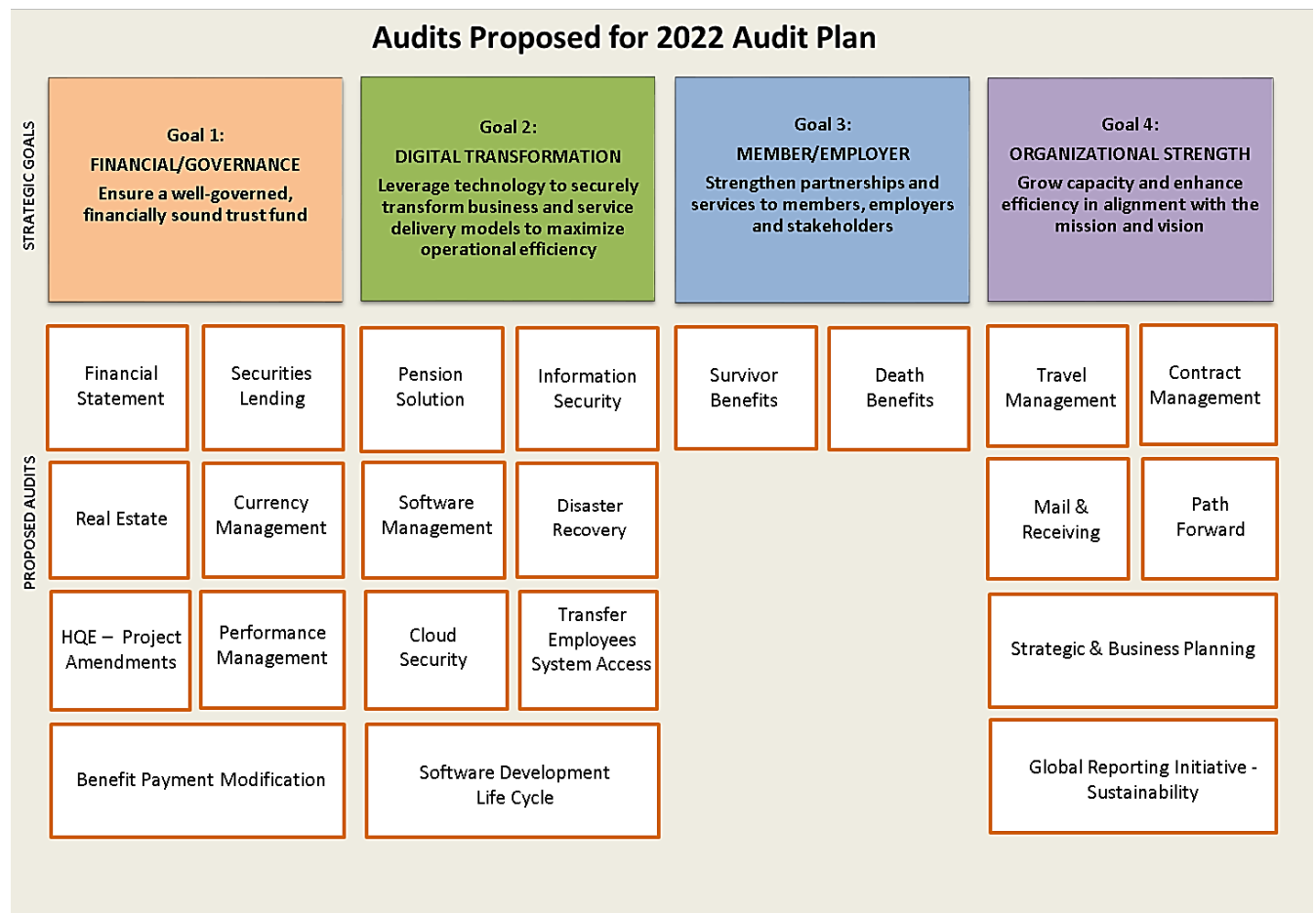
Based on available staff resources, Audit Services proposes to conduct 13 internal audits and facilitate nine external reviews related to the Financial Statements, Investments, and Information Technology from January 1, 2022 through December 31, 2022. To determine the highest ranked auditable activities, Audit Services considered internal and external inputs to update the audit

portfolio which is validated and prioritized to complete the draft audit plan. Internal input was obtained in collaboration with Audit Services’ assurance partners – Enterprise Compliance Services and Enterprise Risk Management. Audit Services sorted the risk portfolio in descending order based on its aggregate score and identified the top auditable areas. Audit Services then evaluated the top auditable activities, to determine which should be included in the 2022 Proposed Audit Plan.

Audit Services contracts with external audit firms to conduct investment and information technology audits because of the specialized knowledge and expertise required. Audits of investment asset classes are performed on a rotating cycle and investment programs are risk ranked.

Internal audits are designed to assist the organization in the achievement of its strategic goals and objectives. For a summary of the internal audit risk assessment results and the alignment to CalSTRS’ strategic plan goals, see Diagram 1.

**Diagram 1: Proposed Audits Alignment with Strategic Plan Goals**



The proposed 2022 Internal Audit Plan will set the direction and priorities of the internal audit activities in the calendar year, consistent with the organization’s goals. Implementation of this Audit Plan will result in compliance with the IIA Standards while providing executive

management and the ARM committee objective and independent assurance that appropriate controls are in place and working as intended, and employer payroll reporting complies with the Teachers' Retirement Law. Given the uncertainty surrounding the COVID-19 pandemic and rapidly changing environment, we may reprioritize our activities to address emerging risks.

**RECOMMENDATION**

Staff recommends the ARM Committee approve the 2022 Internal Audit Plan (Attachment 2).

<b>2022 Employer Audit Risk Assessment Factors</b>			
	<b>Risk Factors</b>	<b>Risk Scoring Range*</b>	<b>Description</b>
<b>1</b>	Retirees with increased Annual Compensation Earnable (ACE) while active	0 to 4	Employers with members who retired during the last two years and received over 10 percent increase in compensation during fiscal year 2019-20 or 2020-21. Minimum threshold for earnings of \$65,000.
<b>2</b>	Retirees with high ACE	0 to 5	Employers with retirees who retired during fiscal year 2019-20 or 2020-21 who have annual compensation earnable greater than \$120,000 (while active).
<b>3</b>	Special compensation	0 to 4	Employers reported members' special compensation of \$2,500 or more during fiscal year 2019-20 or 2020-21.
<b>4</b>	Active members with ACE increases	0 to 3	Employers reported active members with increases greater than 20 percent in annual compensation earnable during fiscal year 2019-20 or 2020-21.
<b>5</b>	One-Time Payments	0 to 5	Employers with high level of one-time payments over \$1,200, concentrated in one month, during the 2019-20 or 2020-21 fiscal year.
<b>6</b>	Retirees reported with excess sick leave days	0 to 3	Employers with members who retired during fiscal year 2019-20 or 2020-21 with excess sick leave.
<b>7</b>	Prior audits	0 to 1	Employers not audited, or only audited on a limited basis, during the last five years
<b>8</b>	Active members eligible to retire with ACE increases	0 to 4	Employers reported active members with birthdays prior to January 1, 1966, that had increases greater than 10 percent during fiscal year 2019-20 or 2020-21.
<b>9</b>	Retirees with high unused sick leave days reported	0 to 3	Employers who reported retirees total unused sick leave days greater than basic service credit multiplied by 10 that retired during fiscal year 2019-20 or 2020-21.
<b>10</b>	PEPRA members with high special compensation	0 to 3	Employers with PEPRA members with reported special compensation of \$1,200 or more in fiscal year 2019-20 or 2020-21.
<b>11</b>	Number of active members reported to CalSTRS	0 to 3	Employers with active members of 750 or more during fiscal year 2020-21.
<b>12</b>	New Employer	2	New employer as of July 1, 2016.
<b>13</b>	Employer within a County that has a high occurrence of systemic findings.	0-2	Employers reporting to a County Office of Education that has a high rate of probable systemic findings. County must have at least 2 employers audited in last 5 years to score.

\* Risk Scoring Range is weighted based on the number of occurrences at each employer and earnings amount where applicable.

# Audit Services’ Audit Plan

## Calendar Year 2022

### **Professional Standards**

As required by Audit Services’ Charter (Charter) and the *International Standards for the Professional Practice of Internal Auditing* (IIA Standards), Audit Services presents the 2022 *Audit Plan* to the Audits and Risk Management (ARM) Committee for approval.

### **Audit Services Mission**

The mission of Audit Services is to provide independent, objective assurance and consulting services designed to add value and improve CalSTRS operations. Audit Services assists CalSTRS in accomplishing its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. To do so, Audit Services:

- Provides a wide range of quality, independent internal auditing services for the ARM Committee and executive management and provides consulting services for management;
- Performs independent assessment of the systems of risk management, internal controls, and operating efficiency guided by professional standards and using innovative approaches;
- Supports CalSTRS efforts to achieve its objectives through independent auditing services and consulting services; and
- Maintains a dynamic, team-oriented environment which encourages personal and professional growth, and challenges and rewards audit staff for reaching their full potential and excelling.

### **Audit Organization and Charter**

Audit Services is independent of management and provides objective assurance and consulting services designed to add value towards achieving CalSTRS’ strategic goals and enhance the efficiency and effectiveness of operations. To maintain independence and objectivity, the Chief Auditor reports functionality to the ARM Committee and administratively to the Chief Operating Officer.

The Internal Audit Charter authorizes Audit Services to perform auditing and consulting services of CalSTRS' governance, risk, and controls. Additionally, Audit Services conducts reviews of school districts, county offices of education, and any employer that has employees who may perform creditable service subject to coverage by CalSTRS. The Charter also defines reporting relationships, objective and scope of audit work, and roles and responsibilities of the Chief Auditor.

Enterprise Compliance Services (ECS) is integrated with Audit Services. The *Institute of Internal Auditors* (IIA) provides guidance to ensure the IIA Standards for independence and objectivity are not compromised in situations where an internal audit may be responsible for second line of defense functions such as compliance or risk management. To preserve independence and objectivity, it is essential to implement safeguards to limit potential impairments to the internal audit activity and to routinely validate the safeguards are operating effectively. Standards 1112 emphasizes the importance of safeguards such as oversight activities, the Chief Auditor's organizational position and reporting relationship, and documenting roles and responsibilities. To that end, Audit Services has implemented the following safe guards:

- The Internal Audit Charter clearly states internal audit roles and responsibilities.
- Audit Services will maintain appropriate segregation of duties between the internal audit assurance function and compliance activities.
- The Chief Auditor will continue to report to a level within the organization that allows the internal audit activity to fulfill its responsibilities.
- The Director of ECS has access to the ARM Committee and provides reports on the status of the Compliance program.
- The ARM Committee oversees development of the annual audit plan and reviews any potential for impairment to objectivity with the Chief Auditor.
- Standard 1130 requires the Chief Auditor to disclose the details of any impairment to independence of objectivity, whether in fact or appearance.
- Standard 1130.A2 requires a party outside the internal audit activity to oversee assurance engagements for functions over which the Chief Auditor has responsibility.
  - If the Chief Auditor has responsibilities in areas outside the internal audit activity that are subject to internal auditing, the provision of assurance would be outsourced to an objective, competent assurance provider who reports independently to the ARM Committee, rather than the Chief Auditor.
- Standard 1312 – External Assessments must include a review of the Chief Auditor's independence and objectivity.
- Management, not internal audit, is responsible for managing and mitigating compliance risks. Internal audit will avoid setting the risk appetite, owning or managing risks, and making risk response decisions on management's behalf.



## **Audit Plan Scope and Development**

This Internal Audit Plan covers the period from January 1, 2022 through December 31, 2022. The Audit Plan is designed to provide coverage of key risks, given the existing staff and approved budget. Audit Services completed a risk assessment for the purpose of developing this Audit Plan of CalSTRS' operations and for employers, as required by the IIA Standards. The Audit Plan aligns with the CalSTRS Strategic Plan and incorporates management input, risk assessment results, and the enterprise risk management report. Proposed audits and audit objectives are designed to provide assurance that management has identified key risks, and that management is sufficiently mitigating those risks to an acceptable level.

## **Acceptable Level of Risk**

Although this Internal Audit Plan contemplates a wide-ranging scope of activities, it does not provide coverage for all of CalSTRS operations of systems. Audit Services has tried to maximize the limited resources to provide reasonable coverage to the activities believed to require the most attention based on the risk assessment results. Management is responsible for determining an acceptable level of risk. If the Chief Auditor determines that management has accepted a level of risk that may be unacceptable to the organization, the Chief Auditor must discuss the matter with senior management. If the decision regarding the matter has not been resolved, the Chief Auditor must communicate the matter to the ARM Committee.

## **Quality Assurance**

Audit Services is required to comply with the IIA Standards, Code of Ethics, and Definition of Internal Auditing. The IIA Standards require an external quality assurance review every five years. The last external quality assurance review of Audit Services was performed in 2021. The Internal Audit Plan provides a provision for conducting an annual internal quality assessment review.

## **Plan Progress**

Interim changes to the Internal Audit Plan will occur from time to time due to changes in business risks, timing of CalSTRS' initiatives, and staff availability. Audit Services will report the audit plan and progress against the plan as changes to executive management and to the ARM Committee. Amendments to the approved Internal Audit Plan deemed to be significant (based on discussions with the executive staff and Committee chair) will be submitted to the ARM Committee for approval in advance.

## **Follow-Up**

The IIA Standards require follow-up as part of each audit. The Internal Audit Plan includes time necessary to determine the status of resolving previous audit findings.

## **Professional Organizations**

Audit Services staff are members of several professional auditing and accounting organizations. These groups are excellent sources for obtaining information on auditing, accounting, business management, and other professional issues and concerns. The Internal Audit Plan anticipates staff training provided by the following organizations:

- Association of Public Pension Fund Auditors (APPFA)
- Institute of Internal Auditors (IIA)
- American Institute of Certified Public Accountants (AICPA)
- Association of Government Accountants (AGA)
- Information Systems Audit and Control Association (ISACA)

## **Certifications**

Audit Services staff have multiple certifications and/or licenses issued by sponsoring professional organizations. Audit Services staff are required to obtain Continuing Professional Education (CPE) each year to maintain their certifications and/or licenses. The CPE hours provide the Audit Services staff with new and/or updated skills for performing audits. The Internal Audit Plan anticipates staff obtaining required CPE and training.

## **Calendar Year 2022 Audit Plan**

Summarized below are the types of audit services, name of each audit activity and preliminary objectives to be performed. The scope of work and objectives will be finalized as part of the formal planning phase for each activity.

### **EMPLOYER AUDITS**

#### **Full-Scope Audits – 10**

Evaluate employer payroll reporting for compliance with Teachers' Retirement Law regarding eligible membership, unused sick leave, post-retirement earnings, pay rates and creditable compensation reported to CalSTRS.

#### **Limited Scope Audits – 110**

Utilize Data Analytics to select employers that have a high likelihood of misreported compensation and unused sick leave.

### **INTERNAL AUDITS**

#### **Strategic & Business Planning**

Assess the adequacy and effectiveness of strategic and business planning.

#### **Pension Solution – Project Management**

Assess the adequacy and effectiveness of the project management related to the project revisions.

Path Forward

Assess the adequacy and effectiveness of the path forward processes.

Contract Management

Evaluate the adequacy and effectiveness of the contract management process.

Headquarter Expansion – 2021 Project Amendments

Assess HQE project amendments to schedule and budget.

Travel Management

Assess the adequacy and effectiveness of the travel management process.

Software Management

Assess the adequacy and effectiveness of the software management process.

Transfer Employee System Access

Assess the adequacy and timely change of access for employees who transfer within the organization.

Mail & Receiving

Assess the adequacy and effectiveness of the mail and receiving processes.

Benefit Payment Modification

Evaluate the adequacy and effectiveness of the accounts receivable process related to the modifications resulting in benefit payment decreases.

Survivor Benefits

Evaluate the adequacy and effectiveness of the survivor benefits process.

Death Benefits

Evaluate the adequacy and effectiveness of the death benefits process.

Global Reporting Initiative – Sustainability

Independent verification of value and statements in CalSTRS Sustainability Report.

**EMPLOYER AUDITS CONSULTING AND ADVISORY SERVICES**

Appeals

Prepare material for administrative hearings and act as subject matter witness in audit appeals.

Pension Solution

Participate in the Pension Solutions work group as Subject Matter Experts.

Special Projects and Management Requests

Direct Reporting audit requests, process improvements, assist Compensation Review Unit and other requests. Data mining/analytics. Employer Reporting to Final Benefit quality assurance workstream groups.

## **INTERNAL AUDITS CONSULTING AND ADVISORY SERVICES**

### ARM Committee and Management Requests

Respond to ARM Committee and management requests for Audit Services.

### Internal Audit and External Contracted Audit Follow Up

Follow up on internal audit and external contract audit recommendations.

### External Financial Statement Audit Follow Up

Follow up on CalSTRS progress on the External Financial Audit 6-30-21 Management Letter corrective action plans.

### CalSTRS Project Monitoring

Audit Services participates on various project committees.

## **CONTRACTED AUDITS**

### Financial Statement

Annual audit of CalSTRS financial statements, including GASB 67 workload for the year ended June 30, 2022.

### Information Security

Assess the adequacy and effectiveness of controls over CalSTRS information security.

### Disaster Recovery

Assess the adequacy and completeness of the disaster recovery plan.

### Cloud Security

Evaluate the adequacy and effectiveness of internal controls over cloud security.

### Software Development Life Cycle

Assess adequacy and adherence to the software development life cycle.

### Securities Lending

Evaluate whether adequate controls are in place over the securities lending process.

### Currency Management

Evaluate the adequacy and effectiveness of internal controls over the currency management process.

### Real Estate

Assess the adequacy and effectiveness of internal controls over the real estate portfolio.

### Performance Management

Evaluate the adequacy and effectiveness of controls over the performance management system transition.

## **OTHER AUDIT ACTIVITIES**

### Legislative Analysis & Review

Participate on CalSTRS' legislation team and provide consultation and analysis on pending legislation.

### Quality Assurance Improvement Program

Continue to conduct a Quality Improvement Program to ensure conformity with IIA Standards.

### Risk Assessment & Audit Plan

Annual risk assessment for developing the annual audit plan.

### Board Document Development

Analytics, design, and review of Board agenda items.

### Audit Manual Update & TeamMate Champion

Audit Manual updates. Subject matter expert for TeamMate updates and issues.

### Continuing Professional Education & Training

Obtain 40 required hours of continuing professional education per year.

## **AUDIT SERVICES AND ADMINISTRATION**

### Management & Supervision

Management and supervision of internal and employer audit functions and personnel.

### Workpaper/Audit Report Review

First and second level quality assurance review of audits and improvement program.

### Appeals

Prepare and review administrative hearing documents and act as subject matter witness in audit process.

### Administrative Support

Provide administrative support services (budget, contracts, personnel, Board documentation, reporting distribution, etc.)

### Audit Staff Recruitment

Staff recruitment and on the job training.