



DISCUSSION DOCUMENT FOR GOVERNANCE COMMITTEE

Review of Internal Audit Charter
Dante Robinson, Chief of Internal Affairs

Summary of Proposed Changes to
State Compensation Insurance Fund
Internal Audit Charter, which is adjunct to GOV 1.2 Internal Audit Corporate Policy

[Proposed] Revisions To Be Approved:
Audit Committee: May 15, 2013

The following summarizes the proposed revisions to the Internal Audit Charter, which is an adjunct to the GOV 1.2 Internal Audit Corporate Policy, to be adopted by State Fund's Board of Directors as the revised Internal Audit Charter. Section titles relate to the contents of the existing and revised versions of the Internal Audit Charter.

<u>Paragraph Number</u>	<u>Summary of Proposed Changes</u>	
<u>General Comments</u>	Revisions to the Internal Audit Charter include non substantive and formatting changes Throughout the document, where appropriate, "Senior VP of Internal Affairs/Chief Audit Executive" has been changed to "Chief of Internal Affairs".	

	<u>New Internal Audit Charter (Proposed Changes)</u>	<u>Prior Charter</u>
<u>Table of Contents</u>	<p>The revision includes addition of Table of Contents. Section sequence as follows:</p> <ul style="list-style-type: none"> ▪ INTRODUCTION ▪ ROLE ▪ PROFESSIONALISM ▪ MISSION/PURPOSE ▪ AUTHORITY ▪ INDEPENDENCE AND OBJECTIVITY ▪ RESPONSIBILITY ▪ INTERNAL AUDIT PLAN ▪ REPORTING AND MONITORING ▪ PERIODIC ASSESSMENT 	<p>No Table of Contents in Existing Charter</p> <p>Section sequence as follows:</p> <ul style="list-style-type: none"> ▪ MISSION/PURPOSE ▪ AUTHORITY ▪ RESPONSIBILITIES ▪ INDEPENDENCE ▪ ACCOUNTABILITY ▪ STANDARDS OF AUDIT PRACTICE ▪ REVIEW
<u>Introduction</u>	<p>The revision adds a new section Introduction, <i>“Internal Auditing is an independent and objective assurance and consulting activity that is guided by a philosophy of adding value to improve the operations of State Fund. It assists State Fund in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the organization's risk management, control, and governance processes”.</i></p>	Not in Existing Charter
<u>Role</u>	<p>The revision adds a new section, Role reflecting the Internal Audit Department’s role. <i>“The Internal Audit Department is established by the Board of Directors (hereafter referred to as the Board). The Internal Audit Department’s responsibilities are defined by the Board as part of their oversight role.”</i></p>	Not in Existing Charter
<u>Professionalism</u>	<p>The revision adds a new section, Professionalism. <i>“The Internal Audit Department will govern itself by adherence to The Institute of Internal Auditors' mandatory guidance including the Definition of Internal Auditing, the Code of Ethics, and the International Standards for the Professional Practice of Internal Auditing</i></p>	Not in Existing Charter

	<p><i>(Standards). This mandatory guidance constitutes principles of the fundamental requirements for the professional practice of internal auditing and for evaluating the effectiveness of Internal Audit's activities.</i></p> <p><i>The Institute of Internal Auditors' Practice Advisories, Practice Guides, and Position Papers will also be adhered to as applicable to guide operations. In addition, the Internal Audit Department will adhere to State Fund's relevant policies and procedures and the Internal Audit Procedure Manual."</i></p>	
<p><u>Authority</u></p>	<p>The revision adds <i>"The State Fund Chief of Internal Affairs shall act in the capacity of Chief Audit Executive for the Organization."</i></p>	<p>The Chief Audit Executive and Internal Audit Department staff as determined by and under the direction and control of the Internal Audit Program Manager is authorized to:</p> <ul style="list-style-type: none"> • Manage and conduct the internal audit activity, including determining the risk-based priorities for such activities, consistent with the organization's objectives. • Select audit subjects, determine scopes of work, allocate resources, set frequencies, establish follow-ups on recommendations, and apply the techniques required to accomplish audit, investigation and control objectives. • Exercise full and unrestricted access to all functions, records, property, premises, agents, and personnel, and

		<p>all documents and information of State Fund that the Chief Audit Executive considers necessary for the Internal Audit Department to meet its responsibilities.</p> <ul style="list-style-type: none"> • Have full and free access to the Audit Committee of the State Fund Board of Directors. • Work with personnel throughout the organization and with external vendors in performing Internal Audit responsibilities. <p>The Chief Audit Executive and Internal Audit Department staff are not authorized to:</p> <ul style="list-style-type: none"> • Perform any operational duties for State Fund. • Initiate or approve accounting transactions external to the Internal Audit Department. <p>Direct the activities of any State Fund employee not employed by the Internal Audit Department, except to the extent such employees have been appropriately assigned to auditing teams or to otherwise assist the internal auditors.</p>
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<p><u>Independence and Objectivity</u></p>	<p>The revision adds, <i>“The Internal Audit Department will remain free from interference by any element in the organization, including matters of audit selection, scope, procedures, frequency, timing, or report content to permit maintenance of a necessary independent and objective mental attitude.</i></p> <p><i>Internal auditors will have no direct operational responsibility or authority over any of the activities audited. Accordingly, they will not implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that may impair internal auditor’s judgment.</i></p> <p><i>Internal auditors must exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors must make a balanced assessment of all the relevant circumstances and not be unduly influenced by their own interests or by others in forming judgments.</i></p> <p><i>The Chief Audit Executive will confirm to the Board, at least annually, the organizational independence of the Internal Audit Department.”</i></p> <p><i>The internal audit activity must be independent of internal influences, and Internal Auditors must be objective in the performance of their work.</i></p>	<p>The internal audit activity must be independent of internal influences, and Internal Auditors must be objective in the performance of their work.</p> <p>To provide for the independence of the Internal Audit Department, its staff will report to the Internal Audit Program Manager, who reports to the Senior VP of Internal Affairs/Chief Audit Executive who reports administratively to the General Counsel and functionally to the Audit Committee. In the event one or more of the individuals in the line of authority is the target of an audit or investigation then the Internal Audit Department staff will not report to those individual(s) and may report if necessary directly to the Audit Chairperson.</p>
<p><u>Responsibility</u></p>	<p>The revision adds language on the scope of internal auditing, <i>“The scope of internal auditing encompasses, but is not limited to, the examination and evaluation of the adequacy and effectiveness of the organization's governance, risk management, and internal process as well as the quality of performance in carrying out assigned responsibilities to achieve the organization’s stated goals and objectives. This includes the following:</i></p> <ul style="list-style-type: none"> • <i>Maintaining a professional audit staff with sufficient knowledge, skills, and experience to meet the requirements of this charter. Retaining independent advisors in the event the Internal Audit staff does not</i> 	<p>The Chief Audit Executive has the responsibility to:</p> <ul style="list-style-type: none"> • Periodically review with the Audit Committee and management the Internal Audit Charter and mission, and recommend changes to support State Fund’s organization, objectives and services. • Develop an Annual Internal Audit Plan

	<p><i>have the capacity, skills, certifications, experience, or independence necessary for a particular audit.</i></p> <ul style="list-style-type: none"> • <i>Evaluating the reliability and integrity of information and the means used to identify measure, classify, and report such information.</i> • <i>Evaluating the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations that could have a significant impact on the organization.</i> • <i>Evaluating the means of safeguarding assets and, as appropriate, verifying the existence of such assets.</i> • <i>Evaluating the effectiveness and efficiency with which resources are employed.</i> • <i>Evaluating operations or programs to ascertain whether results are consistent with established objectives and goals, and whether the operations or programs are being carried out as planned.</i> • <i>Monitoring and evaluating governance processes.</i> • <i>Monitoring and evaluating the effectiveness of the organization's risk management processes.</i> • <i>Evaluating the quality of performance of external auditors and the degree of coordination with internal audit.</i> • <i>Performing consulting and advisory services related to governance, risk management and control as appropriate for the organization.</i> • <i>Reporting periodically on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan.</i> • <i>Reporting significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by the Board.</i> 	<p>using risk-based methodology for review and approval by the Audit Committee. Material changes to the Annual Internal Audit Plan shall be submitted for review and approval by the Audit Committee.</p> <ul style="list-style-type: none"> • Execute the Annual Internal Audit Plan, as approved and revised. • Complete special projects or activities requested by the Audit Committee or management. • Issue periodic reports to the Audit Committee and management summarizing the results of audit activities. • Maintain a professional audit staff with sufficient knowledge, skills, experience, and professional certifications to meet the requirements of this Charter. Retain independent advisors in the event the Internal Audit staff does not have the capacity, skills, experience or independence necessary for a particular audit. Prior to the retention, obtain approval from the Audit Committee Chairperson to be reported to the Audit Committee at the next Audit Committee meeting. • Consider and coordinate the scope of
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	<ul style="list-style-type: none"> • <i>Evaluating specific operations at the request of the Board or management, as appropriate.</i> • <i>Conducting internal fraud investigations and reporting trends and significant findings on all investigations conducted by either Internal Audit or Human Resources.</i> • <i>Serving as the organization’s contact point for coordination of regulatory audits and compliance issue inquiries, including but not limited to audits from the California Department of Insurance and Bureau of State Audits.</i> <p>Remove references to the following:</p> <ul style="list-style-type: none"> • <i>Prior to the retention, obtain approval from the Audit Committee Chairperson to be reported to the Audit Committee at the next Audit Committee meeting.</i> • <i>Execute the Annual Internal Audit Plan, as approved and revised.</i> • <i>Complete special projects or activities requested by the Audit Committee or management.</i> • <i>Issue periodic reports to the Audit Committee and management summarizing the results of audit activities.</i> 	<p>work of the independent auditors and regulators, as appropriate, for the purpose of providing optimal audit coverage and support for State Fund.</p> <ul style="list-style-type: none"> • Consult with management on matters, beyond Internal Audit's assurance services, such as the design of internal controls, business controls, risk management activities and corporate governance processes. • Conduct internal fraud investigations and report trends and significant findings on all investigations conducted by either Internal Audit or Human Resources. <p>Establish a quality assurance and improvement program for the Internal Audit Department and report findings to Audit Committee semi-annually.</p>
<p><u>Accountability</u></p>	<p>The revision deletes the section since it is addressed in the Reporting and Monitoring sections.</p>	<p>The Chief Audit Executive shall be accountable to the Audit Committee, the General Counsel, and the Executive management of State Fund.</p>
<p><u>Internal Audit Plan</u></p>	<p>The revision adds, “<i>At least annually, the Chief Audit Executive will submit to senior management and the Board an internal audit plan for review and approval. The internal audit plan will consist of a work schedule as well as budget and resource requirements for the next fiscal/calendar year. The Chief Audit Executive will communicate the impact of resource limitations and significant interim changes to senior management and the</i></p>	<p>Not in Existing Charter</p>

	<p><i>Board.</i></p> <p><i>The internal audit plan will be developed based on a prioritization of the audit universe using a risk-based methodology, including input of senior management and the Board. Any significant deviation from the approved internal audit plan will be communicated to senior management and the Board through periodic activity reports.”</i></p>	
<p><u>Reporting and Monitoring</u></p>	<p>The revision adds, “A written report will be prepared and issued by the Chief Audit Executive or designee following the conclusion of each internal audit engagement and will be distributed as appropriate. Internal audit results will also be communicated to the Board.</p> <p><i>The internal audit report may include management’s response and corrective actions taken or to be taken in regard to the specific findings and recommendations. Management’s response, whether included within the original audit report or provided thereafter (i.e. within thirty days) by management of the audited area should include a timetable for anticipated completion of action to be taken and an explanation for any corrective action that will not be implemented.</i></p> <p><i>The internal audit activity will be responsible for appropriate follow-up on engagement findings and recommendations. All significant findings will remain in an open issues file until cleared.”</i></p>	Not in Existing Charter
<p><u>Periodic Assessment</u></p>	<p>The revision adds, “The Chief Audit Executive will periodically report to senior management and the Board on the Internal Audit Department’s purpose, authority, and responsibility, as well as performance relative to its plan. Reporting will also include significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by senior management and the Board.</p> <p><i>In addition, the Chief Audit Executive will communicate to senior management and the Board on the Internal Audit Department’s quality assurance and improvement program, including results</i></p>	Not in Existing Charter

	<i>of ongoing internal assessments and external assessments conducted at least every five years.”</i>	
Standards of Audit Practice	The revision removes this section that is now addressed under <u>Professionalism</u> , <i>“The Chief Audit Executive and staff of the Internal Audit Department shall comply with the Institute of Internal Auditors International (IIA) Professional Code of Ethics and follow IIA’s standards. “</i>	The Chief Audit Executive and staff of the Internal Audit Department shall comply with the Institute of Internal Auditors International (IIA) Professional Code of Ethics and follow IIA’s standards.
Review	The revision removes this section that is now addressed under the first bullet of <u>Responsibility</u> , <i>“This Charter shall periodically be reviewed with the Audit Committee, the General Counsel and the Chief Audit Executive for the purpose of updating the provisions of the Charter. Any suggested changes to the Charter are subject to review by the Audit Committee.”</i>	This Charter shall periodically be reviewed with the Audit Committee, the General Counsel and the Chief Audit Executive for the purpose of updating the provisions of the Charter. Any suggested changes to the Charter are subject to review by the Audit Committee.

STATE COMPENSATION INSURANCE FUND INTERNAL AUDIT ACTIVITY CHARTER

(To Be Approved by the Audit Committee May 15, 2013)

This charter sets forth the purpose, authority, and responsibilities of the Internal Audit Department at State Compensation Insurance Fund (State Fund). It provides the framework for the activities of the Internal Audit Department. The Charter is an adjunct to Corporate Policy GOV 1.2.

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INTRODUCTION

Internal Auditing is an independent and objective assurance and consulting activity that is guided by a philosophy of adding value to improve the operations of State Fund. It assists State Fund in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the organization's risk management, control, and governance processes.

ROLE

The Internal Audit Department is established by the Board of Directors (hereafter referred to as the Board). The Internal Audit Department's responsibilities are defined by the Board as part of their oversight role.

PROFESSIONALISM

The Internal Audit Department will govern itself by adherence to The Institute of Internal Auditors' mandatory guidance including the Definition of Internal Auditing, the Code of Ethics, and the *International Standards for the Professional Practice of Internal Auditing (Standards)*. This mandatory guidance constitutes principles of the fundamental requirements for the professional practice of internal auditing and for evaluating the effectiveness of internal audit's activities.

The Institute of Internal Auditors' Practice Advisories, Practice Guides, and Position Papers will also be adhered to as applicable to guide operations. In addition, the Internal Audit Department will adhere to State Fund's relevant policies and procedures and the Internal Audit Procedure Manual.

MISSION/PURPOSE

The mission of the Internal Audit Department is to provide independent, objective assurance and consulting services designed to add value and improve State Fund's operations. Internal Audit will help State Fund accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, compliance and governance processes. By accomplishing its mission, the Internal Audit Department will assist the Board and Executive management in fulfilling its oversight responsibilities.

AUTHORITY

The State Fund Chief of Internal Affairs shall act in the capacity of Chief Audit Executive for the Organization. The Chief Audit Executive and Internal Audit Department staff as determined by and under the direction and control of the Internal Audit Program Manager is authorized to:

State Compensation Insurance Fund
Audit Committee – May 15, 2013

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- Manage and conduct the internal audit activity, including determining the risk-based priorities for such activities, consistent with the organization's objectives.
- Select audit subjects, determine scopes of work, allocate resources, set frequencies, establish follow-ups on recommendations, and apply the techniques required to accomplish audit, investigation and control objectives.
- Exercise full and unrestricted access to all functions, records, property, premises, agents, and personnel, and all documents and information of State Fund that the Chief Audit Executive considers necessary for the Internal Audit Department to meet its responsibilities.
- Have full and free access to the Audit Committee of the State Fund Board of Directors.
- Work with personnel throughout the organization and with external vendors in performing Internal Audit responsibilities. All employees of State Fund are required to assist and support the Internal Audit Department in fulfilling its roles and responsibilities

The Chief Audit Executive and Internal Audit Department staff is not authorized to:

- Perform any operational duties for State Fund.
- Initiate or approve accounting transactions external to the Internal Audit Department.
- Direct the activities of any State Fund employee not employed by the Internal Audit Department, except to the extent such employees have been appropriately assigned to auditing teams or to otherwise assist the internal auditors.

INDEPENDENCE AND OBJECTIVITY

To provide for the independence of the Internal Audit Department, its staff will report to the Internal Audit Program Manager, who reports to the Chief of Internal Affairs/Chief Audit Executive, who reports administratively to the General Counsel and functionally to the Audit Committee. In the event one or more of the individuals in the line of authority is the target of an audit or investigation, then the Internal Audit Department staff will not report to those individual(s) and may report if necessary directly to the Board's Audit Committee Chairperson.

The Internal Audit Department will remain free from interference by any element in the organization, including matters of audit selection, scope, procedures, frequency, timing, or report content to permit maintenance of a necessary independent and objective mental attitude.

Internal auditors will have no direct operational responsibility or authority over any of the activities audited. Accordingly, they will not implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that may impair internal auditor's judgment.

Internal auditors must exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors must make a balanced assessment of all the relevant circumstances and not be unduly influenced by their own interests or by others in forming judgments.

The Chief Audit Executive will confirm to the board, at least annually, the organizational independence of the Internal Audit Department.

The internal audit activity must be independent of internal influences, and Internal Auditors must be objective in the performance of their work.

RESPONSIBILITY

The scope of internal auditing encompasses, but is not limited to, the examination and evaluation of the adequacy and effectiveness of the organization's governance, risk management, and internal process as well as the quality of performance in carrying out assigned responsibilities to achieve the organization's stated goals and objectives. This includes the following:

- Periodically reviewing with the Audit Committee and Management the Internal Audit Charter and mission, and recommend changes to support State Fund's organization, objectives, and services.
- Maintaining a professional audit staff with sufficient knowledge, skills, and experience to meet the requirements of this charter. Retaining independent advisors in the event the Internal Audit staff does not have the capacity, skills, certifications, experience, or independence necessary for a particular audit.
- Evaluating the reliability and integrity of information and the means used to identify measure, classify, and report such information.
- Evaluating the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations that could have a significant impact on the organization.
- Evaluating the means of safeguarding assets and, as appropriate, verifying the existence of such assets.
- Evaluating the effectiveness and efficiency with which resources are employed.

- Evaluating operations or programs to ascertain whether results are consistent with established objectives and goals, and whether the operations or programs are being carried out as planned.
- Monitoring and evaluating governance processes.
- Monitoring and evaluating the effectiveness of the organization's risk management processes.
- Evaluating the quality of performance of external auditors and the degree of coordination with internal audit.
- Performing consulting and advisory services related to governance, risk management and control as appropriate for the organization.
- Reporting periodically on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan.
- Reporting significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by the Board.
- Evaluating specific operations at the request of the Board or management, as appropriate.
- Conducting internal fraud investigations and reporting trends and significant findings on all investigations conducted by either Internal Audit or Human Resources.
- Serving as the organization's contact point for coordination of regulatory audits and compliance issue inquiries, including but not limited to audits from the California Department of Insurance and Bureau of State Audits.

INTERNAL AUDIT PLAN

At least annually, the Chief Audit Executive will submit to senior management and the Board an internal audit plan for review and approval. The internal audit plan will consist of a work schedule as well as budget and resource requirements for the next fiscal/calendar year. The Chief Audit Executive will communicate the impact of resource limitations and significant interim changes to senior management and the Board.

The internal audit plan will be developed based on a prioritization of the audit universe using a risk-based methodology, including input of senior management and the board. Any significant deviation from the approved internal audit plan will be communicated to senior management and the Board through periodic activity reports.

REPORTING AND MONITORING

A written report will be prepared and issued by the Chief Audit Executive or designee following the conclusion of each internal audit engagement and will be distributed as appropriate. Internal audit results will also be communicated to the Board.

The internal audit report may include management's response and corrective actions taken or to be taken in regard to the specific findings and recommendations. Management's response, whether included within the original audit report or provided thereafter (i.e. within thirty days) by management of the audited area should include a timetable for anticipated completion of action to be taken and an explanation for any corrective action that will not be implemented.

The internal audit activity will be responsible for appropriate follow-up on engagement findings and recommendations. All significant findings will remain in an open issues file until cleared.

PERIODIC ASSESSMENT

The Chief Audit Executive will periodically report to senior management and the Board on the Internal Audit Department's purpose, authority, and responsibility, as well as performance relative to its plan. Reporting will also include significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by senior management and the Board.

In addition, the Chief Audit Executive will communicate to senior management and the Board on the Internal Audit Department's quality assurance and improvement program, including results of ongoing internal assessments and external assessments conducted at least every five years.

INTERNAL AUDIT ACTIVITY CHARTER APPROVALS

Approved this _____ day of _____, _____.
