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Date: May 10, 2019

**TO: MEMBERS, AUDIT COMMITTEE**

<b>I. AGENDA ITEM # AND TITLE :</b>	Open Agenda Item 3c – Consent Calendar: Annual Review of Internal Audit Activity Charter and Compliance with International Internal Audit Standards
<b>II. NAME AND PROGRAM:</b>	Dante Robinson, Chief of Internal Affairs
<b>III. ACTIVITY:</b>	<input checked="" type="checkbox"/> Informational <input type="checkbox"/> Request for Direction <input checked="" type="checkbox"/> Action Proposed <input type="checkbox"/> Exploratory
<b>IV. JUSTIFICATION:</b>	<input checked="" type="checkbox"/> Standard/Required Item <input type="checkbox"/> Board Request – New Item <input type="checkbox"/> New Topic from Staff

**V. EXECUTIVE SUMMARY:**

The Audit Committee Chair, Chief Executive Officer, and Vice President of Internal Audit are required to annually review the Internal Audit Activity Charter that is an adjunct to Corporate Policy GOV 1.0. The Board of Directors are required to review and approve any changes to the Internal Audit Activity charter. The Internal Audit Activity Charter sets forth the purpose, authority, and responsibility of the Internal Audit Department (IAD) at State Compensation Insurance Fund.

The Internal Audit Department made updates to the Internal Audit Activity Charter to align with the The Institute of Internal Auditors (IIA) Model Internal Audit Activity Charter that need to be reviewed and approved by the Board of Directors.

**VI. ANALYSIS:**

All proposed changes to the IAD Activity Charter were either recommended in the IIA current Model Internal Audit Activity Charter, or are were required by the updated IIA, International Professional Practices Framework (IPPF). IAD tailored some updated language to be State Fund specific as recommended by the IIA guidance. Updated language, highlighted in the proposed Internal Audit Activity Charter, is included in the following five (5) sections of the proposed Internal Audit Activity Charter.

1. PROFESSIONALISM

On page 2, paragraph 3, IAD added a requirement for the Chief Audit Executive (CAE) to periodically report to Senior Management IAD's conformance to the Code of Ethics and Standards.

2. PURPOSE AND MISSION

On page 2 IAD simplified the Purpose and Mission and added a Mission phrase recommended by the IIA model.

3. **AUTHORITY**

On page 2, bullet 3, IAD added a phrase related to unrestricted access to records and information subject to accountability for confidentiality and safeguarding, and bullet 4, IAD added a phrase related to the CAE and Vice President of Internal Audit having access to the Audit Committee without management presence. The changes are based on the IIA recommended Model Internal Audit Activity Charter.

4. **INDEPENDENCE AND OBJECTIVITY**

On page 3, from paragraph 2 to last paragraph added a whole section related to ensuring IAD activity remains free from conditions impacting its objectivity and independence that will align with IIA's Model Internal Audit Activity Charter authority recommendations.

5. **RESPONSIBILITY**

On page 5, bullet 3, added "regulators" to phrase, and page 5 last 5 bullets and bullets on page 6, added 12 phrases to describe IAD's responsibilities that align with IIA's Model Internal Audit Activity Charter.

6. **INTERNAL AUDIT PLAN**

On page 6, paragraph 2 added "risk-based" to sentence.

IAD removed the Standards of Audit Practice section as content contained in this section was covered in other sections of the proposed Internal Audit Activity Charter.

**VII. RECOMMENDATION:**

To approve the Internal Audit Activity Charter as presented.

**VIII. PRESENTATION EXHIBITS:** None

**IX. APPENDIX:**

- See attached Proposed Internal Audit Activity Charter

# INTERNAL AUDIT ACTIVITY CHARTER

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(Proposed to State Fund Board of Directors May 22, 2019)

This Activity 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 1.0.

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

The Chief Audit Executive (CAE) will report periodically to Senior Management and the Audit Committee regarding the Internal Audit Department's conformance to the Code of Ethics and the Standards.

## PURPOSE & MISSION

The purpose of the Internal Audit Department is to provide independent, objective assurance and advisory services to State Fund through the evaluation of risk, internal control, and governance processes. The mission of the Internal Audit Department is to enhance and protect State Fund by providing risk-based and objective assurance, advice, and insight.

## AUTHORITY

The State Fund Chief of Internal Affairs shall act in the capacity of Chief Audit Executive for the Organization. Under the direction and control of the Chief Audit Executive, the Vice President of Internal Audit and Internal Audit Department staff are authorized to:

- 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, personnel, documents or information of State Fund that the Chief Audit Executive considers necessary for the Internal Audit Department to meet its responsibilities. Unrestricted access is subject to accountability for confidentiality and safeguarding of records and information.
- Have full and free access to the Audit Committee of the State Fund Board of Directors. The CAE and Vice President of Internal Audit will have access to the Audit Committee's members without management's presence.

- 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

## INDEPENDENCE AND OBJECTIVITY

To provide for the independence of the Internal Audit Department, its staff will report to the Vice President of Internal Audit, who reports to the Chief of Internal Affairs/Chief Audit Executive. The Chief of Internal Affairs/Chief Audit Executive reports administratively to the Chief Executive Officer 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, 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 Chief Audit Executive will ensure that the Internal Audit Department remains free from all conditions that threaten the ability of internal auditors to carry out their responsibilities in an unbiased manner, including matters of audit selection, scope, procedures, frequency, timing, and report content. If the Chief Audit Executive determines that independence or objectivity may be impaired in fact or appearance, the details of impairment will be disclosed to appropriate parties.

Internal auditors will maintain an unbiased mental attitude that allows them to perform engagements objectively and in such a manner that they believe in their work product, that no quality compromises are made, and that they do not subordinate their judgment on audit matters to others.

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

- Performing any operational duties for State Fund or its affiliates
- Initiating or approving transactions external to the Internal Audit Department
- Directing the activities of any State Fund employee not employed by the Internal Audit Department except to the extent that such employees have been appropriately assigned to auditing teams or to otherwise assist internal auditors
- Assessing specific operations for which they had responsibility within the previous year.

Where the Chief Audit Executive has or is expected to have roles and/or responsibilities that fall outside of internal auditing, safeguards will be established to limit impairments to independence or objectivity.

Internal auditors will:

- Disclose any impairment of independence or objectivity, in fact or appearance, to appropriate parties.

- Exhibit professional objectivity in gathering, evaluating, and communicating information about the activity or processes being examined.
- Make balanced assessments of all available and relevant facts and circumstances.
- Take necessary precautions to avoid undue influence from their own or others' interest(s) when forming judgments.

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

The Chief Audit Executive will disclose to the Audit Committee any interference and related implications in determining the scope of internal auditing, performing work, and/or communicating results.

## 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 the Internal Audit Activity Charter, mission, and recommended changes with the Audit Committee and Management 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, regulators, 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, including those of third-party vendors, 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 the Internal Audit Department 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.
- Review and adjust the Internal Audit Plan, as necessary, in response to changes in State Fund's business, risks, operations, programs, systems, and controls.
- Ensure each engagement of the Internal Audit Plan is executed, including the establishment of objectives and scope, the assignment of appropriate and adequately supervised resources, the documentation of work programs and testing results, and the communication of engagement results with applicable conclusions and recommendations to appropriate parties.
- Follow up on engagement findings and corrective actions, and report periodically to senior management and the Audit Committee any corrective actions not effectively implemented.
- Ensure the principles of integrity, objectivity, confidentiality, and competency are applied and upheld.
- Ensure the Internal Audit Department collectively possesses or obtains the knowledge, skills, and other competencies needed to meet the requirements of the Internal Audit Charter.

- Ensure trends and emerging issues that could impact State Fund are considered and communicated to senior management and the Audit Committee as appropriate.
- Ensure emerging trends and successful practices in internal auditing are considered.
- Establish and ensure adherence to policies and procedures designed to guide the Internal Audit Department.
- Ensure adherence to State Fund's relevant policies and procedures, unless such policies and procedures conflict with the Internal Audit Charter. Any such conflicts will be resolved or otherwise communicated to senior management and the Audit Committee.
- Ensure conformance of the Internal Audit Department with the IIA IPPF Standards, with the following qualifications:
  1. If the Internal Audit Department is prohibited by law or regulation from conformance with certain parts of the Standards, the Chief Audit Executive will ensure appropriate disclosures and will ensure conformance with all other parts of the Standards.
  2. If the Standards are used in conjunction with requirements issued by other authoritative bodies, the Chief Audit Executive will ensure that the Internal Audit conforms with the Standards, even if the Internal Audit Department also conforms with the more restrictive requirements of other authoritative bodies.

## INTERNAL AUDIT PLAN

At least annually, the Chief Audit Executive will submit to Senior Management and the Board a risk-based 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.

## QUALITY ASSURANCE IMPROVEMENT PROGRAM

The Internal Audit Department will maintain a Quality Assurance and Improvement Program (QAIP) that covers all aspects of the Internal Audit Department. The program will include an evaluation of the Internal Audit Department's conformance with the IIA Standards and an evaluation of whether internal auditors apply The IIA's Code of Ethics. The program will also assess the efficiency and



effectiveness of the Internal Audit Department and identify opportunities for improvement. The Chief Audit Executive will communicate to Senior Management and the Audit Committee on the Internal Audit Department's Quality Assurance and Improvement Program, including results of internal assessments (both ongoing and periodic) and external assessments conducted at least once every five years by a qualified, independent assessor or assessment team from outside State Fund.

## **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 Department engagement and will be distributed as appropriate. The Internal Audit Department will also communicate its results to the Board.

The Internal Audit Department 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.

## **REVIEW**

The Audit Committee, Chief Executive Officer, Chief of Internal Affairs and Vice President of Internal Audit shall review the Internal Audit Activity Charter annually to update the Charter's provisions. Any changes recommended to the Charter are subject to review and approval by the Board of Directors.