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Date: May 4, 2021

**TO: MEMBERS, BOARD OF DIRECTORS**

<b>I. AGENDA ITEM # AND TITLE :</b>	Open Agenda Item 3g – Consent Calendar: Annual Review of Internal Audit Activity Charter and Compliance with International Internal Audit Standards
<b>II. NAME AND PROGRAM:</b>	Margie Lariviere, General Counsel and Corporate Secretary and Chief of Internal Affairs; and Gwilym Martin, Vice President of Internal Audit
<b>III. ACTIVITY:</b>	<input 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 Audit Committee and 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.

**VI. ANALYSIS:**

At the May 2019 Audit Committee meeting, the Committee approved the revised Internal Audit Charter to align with the Institute of Internal Auditors (IIA) Model Internal Audit Activity Charter.

The staff has reviewed the Internal Audit Charter and has a few recommended changes for 2021. The proposed updates include recommendations of CPA consulting firm, Grant Thornton LLP (GT), who recently completed a five year external quality assurance assessment of IAD. In their report, GT recommended that IAD further define our consulting activities in our charter. IAD also cleaned up some language and formatting in the proposed draft.

**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**

[Proposed for review and to be approved ]

Audit Committee: May 18, 2021

Board of Directors: May 20, 2021

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 1.0.

### **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~~ have authorization 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 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 (CAE) 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 CAE ~~Chief Audit Executive~~ will disclose details of impairment to the appropriate parties if he/she determines that independence or objectivity may be impaired in fact or appearance. ~~the details of impairment will be disclosed to the 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 the audit committee will be notified and, 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~~ activities or processes ~~being examined~~ they are examining.
- 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, internal processes, ~~and 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's 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 **the organization employs** resources. ~~are employed.~~
- Evaluating operations or programs to ascertain whether results are consistent with established objectives and goals, and whether the **organization is executing** 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.
- Reviewing and adjusting the internal audit plan, as necessary, in response to changes in State Fund's business, risks, operations, programs, systems, and controls.
- Ensuring **IAD executes** 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.
- Following up on engagement findings and corrective actions, and report periodically to senior management and the Audit Committee any corrective actions not effectively implemented.
- Ensuring **that the organization applies and upholds** the principles of integrity, objectivity, confidentiality. ~~and competency are applied and upheld.~~

- Ensuring the Internal Audit Department collectively possesses or obtains the knowledge, skills, and other competencies needed to meet the requirements of the internal audit charter.
- Ensuring trends and emerging issues that could materially impact State Fund are considered and communicated to senior management and the Audit Committee.
- Ensuring emerging trends and successful practices in internal auditing are considered.
- Establishing and ensure adherence to policies and procedures designed to guide the Internal Audit Department
- Ensuring 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.
- Ensuring conformance of the Internal Audit Department with the Standards, with the following qualifications:
  - ~~If the Internal Audit Department is prohibited by law or regulation from conformance with certain parts of the Standards, the~~ The Chief Audit Executive will ensure appropriate disclosures and will ensure conformance with all other parts of the Standards ~~if a law or regulation prohibits IAD from conformance with parts of the Standards.~~
  - ~~If the Standards are used in conjunction with requirements issued by other authoritative bodies, the~~ The Chief Audit Executive will ensure that the Internal Audit conforms ~~with to~~ the Standards, even if the Internal Audit Department also conforms ~~with to~~ the more restrictive requirements of other authoritative bodies.

The Internal Audit Department (IAD) accomplishes the above referenced responsibilities through 1) Assurance Services and 2) Consulting Engagements. These services are IAD’s primary project types. IAD aligns its definitions for these services with the Institute of Internal Auditors’ (IIA) definitions. IAD defines:

- Assurance Services as risk-based, objective engagements where auditors evaluate management process, operations, systems and/or other subject matters to assess risks and controls.
- Consulting Engagement as advisory service, which IAD performs at the specific requests of State Fund’s business partners, Audit Committee, and/or Chief Audit Executive. However, IAD and business partners generally develop the nature and scope of a consulting engagement based on agreed-upon procedures.

## INTERNAL AUDIT PLAN

At least annually, the Chief Audit Executive will submit ~~to Senior Management and the Board~~ a risk-based Internal Audit Plan ~~to Senior Management and the Board~~ 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 Department will develop its~~ 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.

The Internal Audit Department will communicate any significant deviation from the approved Internal Audit Plan ~~will be communicated~~ to Senior Management and the Board through periodic activity reports.

### **QUALITY ASSURANCE AND 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.