



Transmitted via e-mail

December 20, 2011

Ms. Anne Stausboll, Chief Executive Officer  
California Public Employees' Retirement System  
P.O. Box 942701  
Sacramento, CA 94229-2701

Dear Ms. Stausboll:

**Final Report—Quality Assurance Review**

The Department of Finance, Office of State Audits and Evaluations, has completed its Quality Assurance Review of the California Public Employees' Retirement System, Office of Audit Services (OFAS), for the period October 1, 2006 through June 30, 2011.

The enclosed report is for your information and use. OFAS concurs with the findings and its response to the report observations is incorporated into this final report. This report will be placed on our website.

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

Sincerely,

Original signed by:

David Botelho, CPA  
Chief, Office of State Audits and Evaluations

Enclosure

cc: Ms. Margaret Junker, Chief Auditor, California Public Employees' Retirement System  
Mr. Peter Mixon, General Counsel, California Public Employees' Retirement System

# A Quality Assurance Review

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## California Public Employees' Retirement System Office of Audit Services



Source: CalPERS website

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

## **MEMBERS OF THE TEAM**

Jennifer Whitaker  
Manager

Rich Hebert  
Supervisor

**Staff**  
Dennis Solheim, CPA

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

You can contact our office at:

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# B BACKGROUND, S SCOPE, M METHODOLOGY, and D DEFINITIONS

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## **BACKGROUND**

The California Public Employees' Retirement System (CalPERS) is the nation's largest public pension fund, with assets at June 30, 2011 of approximately \$231.4 billion. CalPERS manages retirement benefits for more than 1.6 million California public employees, retirees, and their families.

The Office of Audit Services (OFAS) consists of the Chief Auditor, 6 senior managers, and 37 professional auditors. The current Chief Auditor was appointed to the position in July 2010. OFAS provides audit and consulting services to CalPERS customers and ad hoc assistance to the Board of Administration and Management.<sup>1</sup>

## **SCOPE**

The Department of Finance performed a Quality Assurance Review of the internal audit activity of OFAS to evaluate its conformance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing (Standards)*. We conducted our review in accordance with the Institute of Internal Auditors' *Quality Assessment Manual, Sixth Edition*. Fieldwork was conducted from September 2011 through November 2011.

## **METHODOLOGY**

To assess OFAS' compliance with the *Standards*, we performed the following:

- Reviewed and evaluated the self assessment completed by OFAS, including the list of completed audits.
- Selected a sample of completed assignments and reviewed the audit reports and working papers for compliance with the *Standards* and OFAS' own policies and procedures.
- Reviewed other documents to assess compliance with *Standards*, including the continuing professional education records and risk assessment documentation.
- Surveyed staff and selected clients to evaluate the effectiveness and value added by OFAS to the overall organization.
- Interviewed management, those charged with governance, and a selection of professional audit staff at various levels to assess their understanding of and compliance with relevant quality control policies and procedures.

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<sup>1</sup> Background information was obtained from the CalPERS self assessment.

## DEFINITIONS

In forming an overall opinion of OFAS' compliance with the *Standards*, we utilized the definitions delineated in the *Quality Assessment Manual, Sixth Edition* as defined below:

**Generally Conforms**—The relevant structures, policies, and procedures of the activity, as well as the processes by which they are applied, comply with the requirements of the individual *Standard* or element of the Code of Ethics in all material respects. For the sections and major categories, this means that there is general conformity to a majority of the individual *Standards* or elements of the Code of Ethics, and at least partial conformity to the others, within the section/category. General conformance does not require complete/perfect conformance.

**Partially Conforms**—The activity is making good-faith efforts to comply with the requirements of the individual *Standard* or element of the Code of Ethics, section, or major category, but falls short of achieving some major objectives. These will usually represent significant opportunities for improvement in effectively applying the Standards or Code of Ethics and/or achieving their objectives.

**Does Not Conform**—The activity is not aware of, is not making good-faith efforts to comply with, or is failing to achieve many/all of the objectives of the individual *Standard* or element of the Code of Ethics, section, or major category.



## OPINION

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We completed an independent quality assurance review of the California Public Employees' Retirement System's Office of Audit Services (OFAS), for the period October 1, 2006 through June 30, 2011. In our opinion, OFAS generally conforms with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing (Standards)*.

This opinion means the assessor has concluded that the relevant structures, policies, and procedures of the activity, as well as the processes by which they are applied, comply with the requirements of the individual *Standard* or element of the Code of Ethics in all material respects. For the sections or major categories, this means that there is general conformity to a majority of the individual *Standards* or elements of the Code of Ethics, and at least partial conformity to the others, within the section/category. General conformance does not require complete/perfect conformance.

Specific instances of minor deficiencies with the *Standards* and other observations are described in the *Observations and Recommendations* section of this report. Our recommendations, if implemented, will assist OFAS in improving audit quality and ensuring continued compliance with the *Standards*.

Original signed by:

David Botelho, CPA  
Chief, Office of State Audits and Evaluations

December 20, 2011

# OBSERVATIONS AND RECOMMENDATIONS

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This section contains our observations of the California Public Employees' Retirement System's (CalPERS) Office of Audit Services' (OFAS) compliance with the *International Standards for the Professional Practice of Internal Auditing (Standards)*.

## **OBSERVATIONS AND POSITIVE ATTRIBUTES**

The activity on which we performed our review is well-structured, the *Standards* are understood, and management endeavors to implement appropriate practices. Some successful practices observed were:

- Use of a formal risk assessment program developed with management involvement.
- Visibility within the organization, a good reputation, and value added to the organization.
- Instituted an ethics hotline.

## **OBSERVATIONS AND RECOMMENDATIONS**

For the recommendations listed below, we state our observation, the relevant *Standard* and our recommended action:

### **Observation 1**

The last update to the OFAS audit charter was in 2004. An update to the audit charter was presented to the Finance Committee in June 2011, with an approval expected in November 2011.

*Standard 1000 states:*

*"The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Definition of Internal Auditing, the Code of Ethics, and the Standards. The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval."*

### **Recommendation 1**

OFAS should continue its efforts to obtain an approved and updated audit charter. In addition, OFAS should periodically review the audit charter and present it to senior management and the Finance Committee for approval.

## **Observation 2**

OFAS performs ongoing monitoring of the performance of the audit unit through the use of client surveys and management review of the audit activity. However, periodic self-assessments are not performed or reported to senior management.

*Standard 1311 states:*

*"Internal assessments must include:*

- *Ongoing monitoring of the performance of the internal audit activity, and*
- *Periodic reviews performed through self-assessment or by other persons within the organization with sufficient knowledge of internal audit practices."*

## **Recommendation 2**

OFAS should conduct periodic self-assessments of the quality assurance and improvement program to ensure complete compliance with the *Standards*. The Chief Auditor should report the results of internal assessments, necessary action plans, and successful implementation to senior management and the Finance Committee.

## **Observation 3**

OFAS training records are updated only when staff submit their CPE certificates to the Staff Services Analyst. Without adequate management control over the process, OFAS cannot effectively monitor the status of its continuing professional education program. OFAS meets the requirement of *Standard 1230*; however, control over the record keeping process could be improved.

*Standard 1230 states:*

*"Internal Auditors must enhance their knowledge, skills, and other competencies through continuing professional development."*

## **Recommendation 3**

Control over continuing professional education tracking should be improved by coordinating the collection of training documentation with staff time reporting, or use of other techniques to ensure training efforts are accurately recorded.





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December 9, 2011

File Number: I11-015

Mr. David Botelho, CPA  
Department of Finance  
Office of State Audits and Evaluations  
300 Capitol Mall, Suite 801  
Sacramento, CA 95814

Dear Mr. Botelho:

Thank you for your report on Office of Audit Services Quality Assurance Review. We concur with all observations and have already implemented corrective action. Corrective action for each observation is presented below:

### **Observation 1**

#### Recommendation:

OFAS should continue its efforts to obtain an approved and updated audit charter. In addition, OFAS should periodically review the audit charter and present it to senior management and the Finance Committee for approval.

#### OFAS Response:

Concur. OFAS recently revised its Charter to ensure consistency with the International Standards for the Professional Practice of Internal Auditing. The revised charter was approved by the CalPERS Finance Committee in November 2011. OFAS plans to continue its efforts to annually review and if necessary update the charter. If changes are required, OFAS will present the revised OFAS Charter to senior management and the Board for approval, in accordance with Standard 1000.

### **Observation 2**

#### Recommendation:

OFAS should conduct periodic self-assessments of the quality assurance and improvement program to ensure complete compliance with the *Standards*. The Chief Auditor should report the results of internal assessments, necessary action plans, and successful implementation to senior management and the Finance Committee.

David Botelho  
December 9, 2011  
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OFAS Response:

Concur. OFAS has been performing elements of a quality assurance and improvement program, but need to formalize and annually summarize and report to the Board. In March 2011, OFAS performed a self-assessment of the internal audit activity. OFAS identified three areas that required improvement to ensure compliance with the Standards, and corrective action was taken to fully address each area of improvement. OFAS intends to continue to conduct annual self-assessments as part of its quality assurance and improvement program. OFAS will document the results and corrective action on improvements for each assessment and will present results annually to senior management and the Board, in accordance with Standard 1311.

**Observation 3**

Recommendation:

Control over continuing professional education tracking should be improved by coordinating the collection of training documentation with staff time reporting, or use of other techniques to ensure training efforts are accurately recorded.

OFAS Response:

Concur. OFAS recently designated a manager to oversee the training tracking process and the OFAS training coordinator. We revised our training procedures and implemented an enhanced process to assist the training coordinator in tracking staff training. The training coordinator will provide training reports to managers and staff on a regular basis for review to ensure training efforts are accurately recorded and to confirm full compliance with Standard 1230.

We appreciate your work on our Quality Assurance Review and the professionalism of the review team. Please contact me at (916) 795-2454 if you have any questions regarding our response, or if you would like any further information.

Sincerely,

Original signed by Margaret Junker

MARGARET JUNKER, Chief  
Office of Audit Services