
Kentucky Public Pensions Authority

Charter for the Division of Internal Audit Administration

I. Charter

This Charter establishes the authority and responsibility of the Division of Internal Audit Administration (Internal Audit).

II. Mission of Internal Audit

Internal Audit serves the Kentucky Public Pensions Authority (KPPA) as well as the Board of Trustees (Board) of the County Employees Retirement System (CERS) and the Kentucky Retirement Systems (KRS) by enhancing and protecting organizational value with risk-based and objective assurance, advice, and insight.

III. Core Principles of Internal Audit

1. Remain independent, which is objective and free from undue influence.
2. Demonstrate competence and due professional care.
3. Demonstrate integrity.
4. Support the strategies, objectives, and risks of the organization.
5. Remain adequately resourced.
6. Promote quality and continuous organizational improvement by communicating effectively; providing risk-based assurance; and remaining insightful, proactive, and future-focused.

IV. Audit Standards

Internal Audit shall adhere to the *International Standards for the Professional Practice of Internal Auditing* (Standards). Where applicable, Internal Audit will observe standards and statements issued by other accounting and auditing organizations located within the United States of America. Internal Audit is expected to abide by the Institute of Internal Auditors (IIA) Code of Ethics (Exhibit A).

Internal Audit will adhere to the IIA's Mandatory Guidance, which includes the Core Principles for the Professional Practice of Internal Auditing (see section III), the Code of Ethics (see Exhibit A), the *Standards*¹, and the definition of internal auditing (see section VI). The Mandatory Guidance constitutes the fundamental requirements for the professional practice of internal auditing and the principles against which to evaluate the effectiveness of the Internal Audit's performance.

V. Joint Audit Committee

The purpose, authority, composition, and responsibilities of the Joint Audit Committee are outlined in the Charter for the Joint Audit Committee.

¹ <https://na.theiia.org/standards-guidance/Pages/Standards-and-Guidance-IPPF.aspx>

VI. The Internal Audit Function

Definition

As defined by the Institute of Internal Auditors, internal auditing is *an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. The goal of internal auditing is to help the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control, and governance processes.*

Purpose and Objective

Internal Audit was established to assist the KPPA; the CERS and KRS Boards of Trustees; and the Executive Management teams of KPPA, CERS, and KRS in their governance role. Internal Audit also assists in achieving sound managerial control over all financial and operational aspects including, but not limited to, accounting, investments, benefits, legal compliance, asset management, and information management and control systems. The primary objective of Internal Audit is to assist all levels of management in achieving the effective discharge of their assigned responsibilities by providing independent analysis, appraisals, advice, and recommendations concerning the activities reviewed. Internal Audit helps the KPPA and the systems it is tasked with administering and operating, accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control, and governance processes. Accomplishment of the Internal Audit objective may involve:

1. Evaluating the adequacy and effectiveness of the system of internal controls.
2. Evaluating the relevance, reliability, and integrity of management, financial and operating data, and reports.
3. Evaluating the systems established to ensure compliance with those policies, plans, procedures, statutory requirements, and regulations which could have a significant impact on operations.
4. Evaluating the means of safeguarding assets and, as appropriate, verifying the existence of such assets.
5. Evaluating the economy, efficiency, and effectiveness with which resources are employed.
6. Evaluating operations or programs to ascertain whether results are consistent with objectives and goals established by KPPA, CERS, and KRS as well as evaluating whether the operations or programs are being carried out as planned.
7. Assessing the adequacy of established systems and procedures.
8. Conducting special assignments and investigations on behalf of the Joint Audit Committee, KPPA, CERS, or KRS into any matter or activity affecting the probity, interests, and operating efficiency of KPPA, CERS and KRS.

Independence

Internal Audit is an advisory function having independent status within KPPA. The Internal Audit Director:

1. Shall be independent of any other office, division, branch, or section.
2. Shall have direct access, as deemed necessary, to the Joint Audit Committee and/or KPPA, CERS, and KRS Executive Management teams.
3. Shall have no managerial powers, functions, or duties except those relating to the management of the Division of Internal Audit Administration.
4. Shall not be involved in the day-to-day operation of the KPPA, CERS, or KRS.

5. Shall not be responsible for the detailed development and/or implementation of new systems, but should be consulted during the system development process on the control measures to be incorporated in new or amended systems, and be advised of approved variations or new developments.

Authority

The Internal Audit Director will report functionally to the Joint Audit Committee. Functionally meaning the Joint Audit Committee approves items including, but not limited to, the Audit Plan, various Charters, the audit budget, and organizational structure of the internal audit function.

The Internal Audit Director will report administratively to the KPPA Executive Director. Administratively meaning the Internal Audit Director and KPPA Executive Director will work together on day-to-day activities including, but not limited to, leave reporting, training, travel, development of the Audit Plan, and staffing requirements.

It is incumbent that all KPPA, CERS, and KRS employees render assistance to the Internal Audit Director in carrying out his/her audit duties. The KPPA Internal Audit Director shall:

1. Have access, at all reasonable times, to all books, documents, accounts, property, vouchers, records, correspondence, and other data of KPPA, CERS, and KRS necessary for the proper performance of the internal audit function.
2. Have the right, at all reasonable times, to enter any premises of KPPA and to request and promptly receive from any KPPA, CERS, or KRS employee all information and such explanations deemed necessary for the Internal Audit Director to formulate an opinion on the probity of action, adequacy of systems, and/or of controls.

Activities

The Internal Audit Director shall be responsible to the Joint Audit Committee for the functional control of audit activities in relation to:

1. Development, implementation, and oversight of internal audit methods and procedures.
2. Development and control of an efficient Audit Plan.
3. Scope and boundaries of internal audits.
4. Documentation of audit findings.
5. Assistance in the investigation of significant suspected fraudulent activities and promptly notifying the Joint Audit Committee; KPPA; and the KPPA, CERS, and KRS Executive Management teams of the results of any findings and conclusions.
6. Maintenance of certain records such as, but not limited to, records related to internal audits and CERS and KRS Board elections.
7. Considering the scope of work of the external auditors and regulators, as appropriate, for providing optimal audit coverage at a reasonable overall cost.
8. Fulfilling the objectives of the Division of Internal Audit Administration.
9. Utilizing Internal Audit resources to maximize the efficiency and effectiveness of the internal audit function.
10. Adherence to appropriate auditing standards, including, but not limited to, International Standards for the Professional Practice of Internal Auditing, Generally Accepted Government Auditing Standards, and Standards for Internal Controls in the Federal Government (these standards can be applied to state government).

11. Review of the Independent Auditor's Report, Management's Discussion and Analysis, Financial Statements (including footnotes), and other various sections of the Annual Financial Report for both CERS and KRS prior to presentation to the Joint Audit Committee. Internal Audit staff will identify any perceived errors and discrepancies within the Annual Financial Report. However, the KPPA Executive Management team, not Internal Audit, is responsible for the substantive content, accuracy, consistency, and completeness of Management's Discussion and Analysis, Financial Statements (including footnotes), and all other sections of the Annual Report.

Relationship with External Auditors

Upon request, the Internal Audit Director shall make available to the external auditors all internal audit working papers, programs, flowcharts, and reports. The Internal Audit Director shall work with the external auditors to foster a cooperative working relationship, reduce the incidence of duplication of effort, ensure appropriate sharing of information, and ensure coordination of the overall audit effort.

VII. Internal Audit Staff and Responsibilities

Internal Audit was established in July 2003. The following job titles may be utilized by Internal Audit staff:

Division Director

1. Oversees the day-to-day operations of Internal Audit.
2. Ensures policies, programs, and procedures are in place to achieve strategic, risk management, and operational objectives.
3. Performs risk assessment.
4. Develops the Audit Plan to address items noted in the risk assessment and in accordance with specifications from the Joint Audit Committee and the KPPA, CERS, and KRS Executive Management teams.
5. Performs audit, consulting, and assurance services as well as special projects in support of the Audit Plan and in compliance with Internal Audit procedures.
6. Submits results of audit, consulting, and assurance services as well as results of special projects to the Joint Audit Committee and applicable members of the KPPA, CERS, and KRS Executive Management teams. Results of audit, consulting, and assurance services or special projects related to investments will also be submitted to the Investment Committee.

Internal Auditor or Auditor

1. Supports the Division Director in completion of daily activities.
2. Focuses primarily on performing non-investment related audit, consulting, and assurance services in compliance with Internal Audit procedures.
3. Completes special projects, upon request, in compliance with Internal Audit procedures.
4. Communicates the results of audit, consulting, and assurance services as well as results of special projects to the Internal Audit Director.
5. As needed, assists in the completion of investment related activities.
6. Serves as first level reviewer on projects performed by less senior staff.

Retirement Investment Specialist

1. Supports the Division Director in completion of daily activities.
2. Focuses primarily on performing investment related audit, consulting, and assurance services in accordance with Internal Audit procedures.
3. Completes special projects, upon request, in accordance with Internal Audit procedures.
4. Communicates the results of audit, consulting, and assurance services as well as results of special projects to the Internal Audit Director.
5. As needed, assists in the completion of non-investment related activities.
6. Serves as first level reviewer on projects performed by less senior staff.

Specific Areas of Expertise

Since Internal Audit has limited resources and specialized requirements are needed to administer a complex public pension system, Internal Audit may request third-party expertise to assist in fulfilling audit goals (e.g. information technology and data security). Outsourced third party audits will be approved by the Joint Audit Committee. The findings, recommendations, and management comments will be presented to the Joint Audit Committee for approval and for subsequent ratification by the CERS Board and KRS Board.

VIII. Internal Audit Practices

Conflicts of Interest

Internal auditors shall be objective and free from undue influence in performing their job. Objectivity requires internal auditors to have an impartial and unbiased attitude, to avoid conflicts of interest, and to perform audits in such a manner that no significant quality compromises occur. To help ensure that internal auditors are not placed in an environment impeding their ability to make objective, professional judgments, Internal Audit will take the following precautionary measures:

1. All Internal Audit staff will be required to complete an annual Independence Statement certifying that auditors have no actual or perceived conflict that would impair their objectivity or independence. This statement will be signed by the auditor's direct supervisor.
2. Staff assignments will be made so that potential and actual conflicts of interest and bias are avoided. If a conflict of interest or bias is present, the auditor(s) will be reassigned.
3. Staff assignments will be rotated periodically, if practicable to do so.
4. Internal Audit staff will not assume operational responsibilities.
5. For a period of no less than one year, Internal Audit staff will refrain from assessing specific operations for which they were previously responsible.

Due Professional Care

Internal auditors shall apply the care and skill expected of a reasonably prudent and competent auditor. Due professional care does not imply infallibility and internal auditors must exercise due professional care, with consideration of the following:

1. Extent of work needed to achieve the engagement's objectives.
2. Relative complexity, materiality, or significance of matters to which assurance procedures are applied.
3. Adequacy and effectiveness of risk management, control, and governance processes.
4. Probability of significant errors, irregularities, or noncompliance.
5. Cost of assurance in relation to potential benefits.
6. Use of various software tools including, but not limited to Excel, Access, Word, Interactive Data Evaluation and Analysis (IDEA), Tableau, and Gravity Software

Proficiency and Continuous Professional Education (CPE)

Internal Audit staff shall collectively possess the knowledge, skills, attributes, and other competencies essential to the practice of internal auditing within the organization. Educational and work experience criteria have been established for the various positions within Internal Audit. In order to maintain their proficiency, all auditors are encouraged to continue their education and will be provided adequate opportunities to do so. Such continuing education ensures that internal auditors remain current on professional techniques and standards. If an auditor holds a certification, continuing education hours necessary to meet certification requirements should be obtained. If no certification requirements are necessary, a minimum of 24 hours of continuing auditor education shall be obtained annually. Continuing education may be obtained through membership and participation in professional societies, attendance at conferences, college courses, and in-house training. KPPA may reimburse an auditor for the cost of obtaining continuing education; however, the employee should obtain approval prior to registering for any course or seminar.

Internal Audit staff are encouraged to obtain professional certification(s). Accreditation is an important indicator of an auditor's technical proficiency. The following certifications are some of those available to auditors (this list is not all inclusive):

1. Certified Internal Auditor,
2. Certified Fraud Examiner,
3. Certified Government Financial Manager,
4. Certified Information Systems Auditor, and
5. Certified Public Accountant.

Performance Evaluations

Performance evaluations for merit employees shall be conducted as outlined in the Commonwealth of Kentucky Personnel Policies and Kentucky Revised Statutes Chapter 18A. The Joint Audit Committee Chair and KPPA Executive Director shall review the performance for non-merit employees.

Quality Assessment and Improvement Program

Internal Audit will maintain a quality assurance and improvement program that covers all aspects of the Internal Audit function. The program will include an evaluation of Internal Audit's conformance with the *International Standards for the Professional Practice of Internal Auditing* and an evaluation of whether internal auditors apply the IIA's Code of Ethics. The program will also assess the efficiency and effectiveness of Internal Audit and identify opportunities for improvement.

Internal Assessments

1. Ongoing Internal Assessments – Ongoing internal assessments for routine internal audit activities are an integral part of the day-to-day supervision, review, and measurement of the internal audit activity. The measurement tools for assessment are engagement supervision, feedback from audit customers, audit plan completion, and analysis of other performance metrics such as recommendations accepted. Conclusions and planned corrective action will be developed and presented to the Joint Audit Committee and KPPA Executive Management team.
2. Periodic Assessments – Periodically, Internal Audit will conduct a Self-Assessment as outlined by the IIA. The Director of Internal Audit will disclose the results of the Self-

Assessment and any needed corrective action to the Joint Audit Committee and KPPA Executive Management team.

External Assessments

Internal Audit should strive to have a qualified, independent assessor (or assessment team) conduct an external assessment at least once every five years. This can be completed as either a Self-Assessment with Independent External Validation or a full external assessment.

Records Retention and Disposition

Internal Audit shall retain a complete file of each audit report and each report of other audit and consulting services made under its authority in accordance with the KPPA records retention policy or policies of the Kentucky Department for Libraries and Archives for a period of seven (7) years. The file shall include audit work papers and other supportive material directly pertaining to the report. After seven (7) years, the work papers and other supportive material directly pertaining to the audit report can be destroyed. An electronic copy of all final reports should be maintained indefinitely. To guard against identity theft and fraud, destruction of business records and materials shall be done in a secured manner such as through use of the on-site Division of Waste Management recycle containers. All CD/DVD materials shall be submitted to the KPPA Information Security Officer.

IX. Internal Audit Services

The scope of Internal Audit shall be sufficiently comprehensive to enable the effective and regular review of all operational, financial, and related activities. Coverage may extend to all areas of KPPA, CERS, and KRS and include financial, accounting, investments, benefits, administrative, computing, and other operational activities. The extent and frequency of internal audits will depend upon varying circumstances such as results of previous audits, relative risk associated with activities, materiality, the adequacy of the system of internal control, and resources available to Internal Audit.

Internal Audit provides independent audit, consulting, and assurance services to assist management in balancing operational efficiency with risk identification, assessment, and control. Internal Audit reports to the Joint Audit Committee and collaborates with the KPPA, CERS, and KRS Executive Management teams to enhance assurance and accountability at all levels of KPPA, CERS, and KRS. In order to meet the responsibilities and objectives as set forth in the Internal Audit Charter, it is necessary for Internal Audit to perform varying types of services depending on the circumstances and requests. Services can be requested by the Joint Audit Committee; KPPA; or any member of the KPPA, CERS, or KRS Executive Management team. Other KPPA employees can also request services. In these instances, the Internal Audit Director will seek approval from the KPPA Executive Director and the Joint Audit Committee before engaging in the service. Internal Audit provides the following types of audit, consulting, and assurance services.

Audits

1. Performance Audits – Most audits conducted by Internal Audit are performance audits. These audits provide an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action. During a Performance Audit, the auditor completes both a Compliance Audit and a Process Review (both explained below). A Policy Review (explained below) may also be included as part of a Performance Audit.

2. Compliance Audits – Compliance audits determine whether a division has complied with KPPA, CERS, and/or KRS agency policies and procedures, divisional policies and procedures, [Kentucky Administrative Regulations](#), [Kentucky Revised Statutes](#), and federal law.
3. Operational Audits – Operational audits analyze how effectively and efficiently business units achieve organization and/or division goals. Effectiveness is measured by how successful a business unit is at achieving organization and/or division goals. Efficiency is measured by how well the business unit uses resources in order to achieve organization and/or division goals.
4. Investment Audits – Investment audits may be performed to review movement of funds (e.g. purchases, sales, and income), cash management, manager fees, and other investment related activities. Investment audits may also be performed to ensure compliance with procurement regulations, contracts, internal policies and procedures as well as to ensure proper internal controls exist over the investment function.
5. Investigative Audits – Investigative audits may result from findings during a routine audit or from information received from personnel. These audits are normally requested by a member of the KPPA, CERS, or KRS Executive Management team, the Joint Audit Committee, or the KPPA as a result of information received from an anonymous tips. These audits focus on alleged, irregular conduct. Reasons for investigative audits may include internal theft, misuse of agency property, and/or conflicts of interest. These audits should be conducted immediately in order to collect and preserve as much relevant evidence as possible. It is essential that the records in question be removed from the division/employee under investigation or otherwise safeguarded. Investigative audits will be conducted in accordance with Internal Audit procedures and may include expertise from internal and external experts in fields, such as but not limited to, legal, information technology, human resources, and accounting. A draft investigative audit report will be provided to the Joint Audit Committee. The Joint Audit Committee will determine if further actions are needed. The Joint Audit Committee will control any internal or external report distribution.
6. Information Technology Audits – Audits of information systems and technology may be performed to determine whether existing or new computer applications and hardware function in an accurate and efficient manner and include adequate internal controls. Internal Audit involvement in a new system may include the review of system development methodology and the effectiveness and efficiency of the system being implemented. These audits could include reviews of general controls which affect all computer applications. Examples may include computer security, disaster recovery, business continuity, program change controls, and quality control procedures.
7. Financial Audits – A financial audit is a review intended to serve as a basis for expressing an opinion regarding the fairness, consistency, and conformity of financial information with generally accepted accounting principles (GAAP). Financial audits can be comprehensive or limited in scope depending on the objectives.
 - a. A comprehensive financial audit consists of a review of the financial statements of an entity over a specific duration of time to accurately express an opinion on those statements. Such an audit is conducted in accordance with generally accepted auditing standards (GAAS) as adopted by the American Institute of Certified Public

Accountants (AICPA). For CERS and KRS, an external auditor performs this type of audit annually.

- b. A limited financial audit concentrates on a review of specific financial transactions. The primary concerns include determining accuracy of data and evaluation of controls by reviewing the following items:
 - i. Physical control over assets,
 - ii. System of authorization and approval,
 - iii. Separation of duties between operations and custody of assets.

Process Reviews

A process review is specific to a single business process. These reviews assess the effectiveness of internal controls over the process as well as test the efficiency of the process. These reviews also help ensure the business process is operating the way management intended. These reviews are typically performed in conjunction with a new business process being developed or immediately after a new business process is implemented. These reviews may be performed as needed in response to particular findings identified during the course of performing other types of services within a particular division.

Policy Reviews

During a policy review, Internal Audit analyzes either a new or established policy. Internal audit will ensure the policy complies with applicable [Kentucky Administrative Regulations](#), [Kentucky Revised Statutes](#), and federal laws. Internal Audit will also determine if the policy establishes sufficient internal controls in relation to the related business process. For example, during a review of a policy related to invoice payment, Internal Audit would ensure internal controls have been designed to ensure timely payment, prevent duplicate payment, establish segregation of duties, etc.

Agreed Upon Procedures

An Agreed upon Procedures engagement is performed only upon request. During these engagements, the requestor specifies exactly what the auditor is to do. The auditor then performs only the requested procedures. An opinion is not expressed in these reviews. For example, a request could be made to review all expenditures posted to a particular account(s) during a specific time-frame to determine if any expenditures were improperly coded to the account(s). Internal Audit would review the requested account(s) over the specified time-frame and issue a report indicating how many expenditures were posted incorrectly. These engagements are beneficial if there is an area a division wants to review, but does not have the resources or time to perform the review themselves.

Annual Report Review

Each year, KPPA personnel prepares an Annual Financial Report for the County Employees Retirement System and Kentucky Retirement Systems. Prior to presentation to the CERS Board and KRS Board, Internal Audit will review the Independent Auditor's Report, Management's Discussion and Analysis, and other various sections of the Annual Financial Report – Financial Statements (including footnotes), Actuarial, and Statistical. Internal Audit staff will identify any perceived errors or discrepancies within the Annual Financial Report. However, the KPPA Executive Management team, not Internal Audit, is responsible for the substantive content, accuracy, consistency, and completeness of Management's Discussion and Analysis, Financial Statements (including footnotes), and other sections of the Annual Financial Report.

External Audit Assistance

Assistance may be provided to the External Auditor during the annual audit of the KPPA financial statements or other audit engagements. The Internal Audit Director will work with the external

auditors to foster a cooperative working relationship, reduce the incidence of duplication of effort, ensure appropriate sharing of information, and ensure coordination of the overall audit effort. Upon request, the Internal Audit Director will make available to the external auditors all internal audit working papers, programs, flowcharts, and reports. The Internal Audit Director will review the resulting audit findings and management letter comments to determine any impact upon the Audit Plan.

Referencing

During the course of various types of audit, consulting, and assurance services, the Internal Audit Director may identify continuing patterns of conduct or reoccurring “themes” (e.g. the same type of problem is noted in multiple divisions). For example, findings for two divisions within an office, which identify a broader office finding (e.g. lack of controls, need for increased communication, absence of performance criteria, insufficient data processing policy, etc.). When developing the Audit Plan, Internal Audit always considers these themes when scheduling audits for the next period, particularly when these items impact the KPPA mission.

Board of Trustee Elections

Internal Audit assists in both CERS and KRS Board elections. Detailed Internal Audit procedures related to the Board elections can be found on the [KPPA Process Documentation SharePoint](#) site.

Other Services

Internal Audit staff may conduct other services as deemed necessary to meet the responsibilities and objectives as set forth in the Charter for Internal Audit Administration. Internal Audit staff may participate on the KPPA Information Technology Governance team, the Continuity of Operations team, and other similar KPPA, CERS, or KRS teams.

X. Audit Process

Methodology

For all audit projects, the person responsible for the activity under review shall be advised and given the opportunity to discuss the following:

1. Objectives and scope of the audit to be conducted, prior to the commencement of such audit.
2. Findings and proposed recommendations upon the completion of an audit, including providing an official response to the findings.

Audit Reports

A comprehensive written report will be prepared and issued by Internal Audit at the conclusion of each audit and will be distributed as considered appropriate. A copy of each report is to be made available on a timely basis to the Joint Audit Committee and applicable members of the KPPA, CERS, and KRS Executive Management teams. Audit reports will normally explain the scope and objectives of the audit, present findings and conclusions in an objective manner relevant to the specific user's needs, and make recommendations where appropriate.

XI. Internal Control System

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued the *Internal Control – Integrated Framework* to provide guidance to entities on setting up an effective internal control system. Internal Audit helps KPPA; the CERS and KRS Boards of Trustees; and the Executive Management teams of KPPA, CERS, and KRS ensure the established internal control system meets COSO requirements,

Internal controls serve as the first line of defense in safeguarding assets. An internal control system includes the plans, methods, policies, and procedures implemented so that the organization can meet its objectives. Most objectives and related risks can be broken down into three categories

1. Operations – This relates to the effectiveness and efficiency of business operations.
2. Reporting – This relates to the reliability of reporting for internal and external use.
3. Compliance – This relates to compliance with applicable laws and regulations.

Roles in the Internal Control System

Internal controls are the responsibility of management; however, all members of an organization play a role in the system.

1. The KPPA, CERS Board, KRS Board, CERS CEO, and KRS CEO make up the oversight body. The responsibilities include overseeing the strategic direction and obligations related to accountability. The oversight body should oversee management's design, implementation, and operation of the internal control system.
2. KPPA Executive Management serves in the management role. Management is directly responsible for all activities of an entity, including the design, implementation, and operating effectiveness of the internal control system.
3. Other KPPA staff make up the personnel role. Personnel help management design, implement, and operate the internal control system. Personnel is responsible for reporting issues noted in the entity's operations, reporting, and compliance.

Components of COSO

There are five components to the COSO guidance. An organization must ensure these components are effectively designed, implemented, and operated in order for an internal control system to be sufficient.

1. Control Environment
2. Risk Assessment
3. Control Activities
4. Information and Communication
5. Monitoring

Each component consists of different principles that are needed to effectively design, implement, and operate an internal control system. Internal Audit utilizes the *Standards for Internal Control in the Federal Government* to perform reviews and assessments that help ensure these principles are established and working as intended.

Control Environment

Control Environment is the foundation for an internal control system. This provides the discipline and structure to help an entity achieve its objectives. Control Environment consists of five principles:

1. The oversight body and management should demonstrate a commitment to integrity and ethical values.
2. The oversight body should oversee the entity's internal control system.
3. Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives.
4. Management should demonstrate a commitment to recruit, develop, and retain competent individuals.
5. Management should evaluate performance and hold individuals accountable for their internal control responsibilities.

Risk Assessment

A Risk Assessment is used to determine the risks an entity faces when trying to meet its objectives. As a part of the assessment, a risk response should also be developed. Risk assessment consists of four principles:

1. Management should define objectives clearly to enable the identification of risks and define risk tolerances.
2. Management should identify, analyze, and respond to risks related to achieving the defined objectives.
3. Management should consider the potential for fraud when identifying, analyzing, and responding to risks.
4. Management should identify, analyze, and respond to significant changes that could impact the internal control system.

Control Activities

Control Activities are the actions taken by management to establish policies and procedures that help the entity achieve its objectives and respond to risks. Control activities consists of three principles:

1. Management should design control activities to achieve objectives and respond to risks.
2. Management should design the entity's information system and related control activities to achieve objectives and respond to risks.
3. Management should implement control activities through policies.

Information and Communication

Management should provide information needed to support the internal control system to all personnel. Information and Communication consists of three principles:

1. Management should use quality information to achieve the entity's objectives.
2. Management should internally communicate the necessary quality information to achieve the entity's objective.
3. Management should externally communicate the necessary quality information to achieve the entity's objectives.

Monitoring

Monitoring includes the activities established by management to assess the quality of performance over time as well as the activities established to resolve findings from audits and other reviews. Monitoring consists of two principles:

1. Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.
2. Management should remediate identified internal control deficiencies on a timely basis.

XII. Risk Assessment and Audit Plan

Consistent with the long-term strategic plan, the Internal Audit Director shall prepare an Audit Plan providing for the review of significant operations of KPPA, CERS, and KRS based on an assessment of risks pertaining to the achievement of objectives. The Audit Plan shall be presented to the Joint Audit Committee for deliberation and finalization. Upon approval by the Joint Audit Committee, the Audit Plan will be presented to both the CERS Board and the KRS Board for ratification.

Risk Assessment

The Audit Plan is based on a risk assessment methodology, as well as requests from management. Internal Audit assesses KPPA, CERS, and KRS by seeking input from the Joint Audit Committee; key members of KPPA, CERS, and KRS management; and other personnel. Internal Audit also reviews the results of past internal and external audits. Internal Audit then considers organizational risks, such as the COSO components, existing internal controls, staffing, system changes, regulatory and legal changes, and impact to the financial statements. Based on the information gathered, an Audit Plan is developed weighting each risk according to the significance to the overall mission and objective of KPPA, CERS, and KRS.

The Risk Assessment methodology is based upon the following five-part process:

1. Identifying KPPA, CERS, and KRS activities/processes (these become the “audit universe”).
2. Scoring the organizational risks for each process identified in the audit universe.
3. Ranking the processes by overall risk.
4. Developing the Audit Plan.
5. Submitting the Audit Plan to the Joint Audit Committee for review and approval.

Organizational risks are scored using a point value with one (1) representing the lowest level of risk and five (5) the highest. The individual factor scores are then multiplied by the risk weight factor. The weighted risk factor elements are collectively totaled to obtain the respective aggregate risk rating for each auditable area. The overall risk scores for all KPPA activities are then ranked highest to lowest. After ranking, an Audit Plan is developed.

Audit Plan

Based upon the results of the Risk Assessment, Internal Audit develops the Audit Plan through a prioritization process that includes scheduling audits for the highest risk areas as well as areas that have not been reviewed in recent years. The Audit Plan represents potential audits to be completed during the upcoming fiscal year. Internal Audit also identifies other potential audit segments such as business processes, expense contracts, and functional areas that may cross over operational units.

The Risk Assessment and Audit Plan are presented to the KPPA, CERS, and KRS Executive Management teams in order to obtain suggestions, concerns, and priorities. After approval of the Audit Plan is obtained from the KPPA Executive Director, the Audit Plan is submitted to the Joint Audit Committee for approval. The Audit Plan is periodically reviewed, evaluated, and modified (e.g. objectives, goals, and strategies) according to the specific risk factors related to KPPA, CERS, and KRS operations, internal controls, and estimated liability exposure to the Commonwealth of Kentucky. Staff is assigned to audits based upon that auditor’s background and experience.

If Internal Audit receives a request to complete an audit not previously identified on the Audit Plan, the request shall be forwarded to the Chair of the Joint Audit Committee for approval. The Chair of the Joint Audit Committee will determine if a special called meeting of the Joint Audit Committee is

necessary to discuss the requested audit. If the Chair of the Joint Audit Committee determines that a special called meeting is not warranted, then the requested audit will be added to the Audit Plan and reported to the Joint Audit Committee on the "Status of Current Projects" at the next regularly scheduled Joint Audit Committee meeting.

Tracking Projects

Internal Audit staff continually track audits and other projects using the Audit Status Tracker spreadsheet, which includes dates for significant milestones. If Internal Audit is requested to complete projects not foreseen during risk-assessment/planning, these are also tracked on the Audit Status Tracker spreadsheet. The status of current projects is presented to the Joint Audit Committee at each quarterly meeting. All findings and recommendations, including status and implementation date, are thoroughly tracked and documented using appropriate methodologies.

XIII. Quality Assurance and Improvement Plan

Internal Audit will maintain a quality assurance and improvement program that covers all aspects of the internal audit function. The program will include an evaluation of Internal Audit's conformance with the Standards and an evaluation of whether internal auditors apply the IIA's Code of Ethics (see Exhibit A). The program will also assess the efficiency and effectiveness of Internal Audit and identify opportunities for improvement.

Internal Audit will conduct both ongoing and periodic internal assessments. Internal Audit should strive to have a qualified, independent assessor (or assessment team) conduct an external assessment at least once every five (5) years. The Internal Audit Director will provide the results of the quality assurance and improvement program, including results of internal and external assessments, to the Joint Audit Committee and KPPA Executive Management team.

XIV. Internal Audit Procedures

Detailed Internal Audit procedures can be found on the [KPPA Process Documentation SharePoint](#) site.

XV. Approvals

We, the undersigned of the Joint Audit Committee, CERS Board of Trustees, KRS Board of Trustees, and KPPA do certify that this Charter was approved on 16th day of June, 2022.

William Omana 7-18-2022
Joint Audit Committee Chair Date

Betty A. Pendergrass 08/17/2022
Board Chair Date
County Employees Retirement System

Jim Hays 7-25-2022
Board Chair Date
Kentucky Retirement Systems

David Engel 6/23/22
Executive Director Date
Kentucky Public Pensions Authority

Kristen D. Coffey June 20, 2022
Division Director Date
KPPA Division of Internal Audit Administration

History: Approval Date: September 15, 2021
Amended: June 16, 2022

EXHIBIT A

{ CODE of ETHICS... }

// PRINCIPLES

Internal auditors are expected to apply and uphold the following principles:

- **Integrity**

The integrity of internal auditors establishes trust and thus provides the basis for reliance on their judgment.

- **Objectivity**

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

- **Confidentiality**

Internal auditors respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.

- **Competency**

Internal auditors apply the knowledge, skills, and experience needed in the performance of internal audit services.

// RULES OF CONDUCT

1. **Integrity**

Internal Auditors:

- 1.1. Shall perform their work with honesty, diligence, and responsibility.
- 1.2. Shall observe the law and make disclosures expected by the law and the profession.
- 1.3. Shall not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organization.
- 1.4. Shall respect and contribute to the legitimate and ethical objectives of the organization.

2. **Objectivity**

Internal Auditors:

- 2.1. Shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organization.
- 2.2. Shall not accept anything that may impair or be presumed to impair their professional judgment.
- 2.3. Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.

3. **Confidentiality**

Internal Auditors:

- 3.1. Shall be prudent in the use and protection of information acquired in the course of their duties.
- 3.2. Shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.

4. **Competency**

Internal Auditors:

- 4.1. Shall engage only in those services for which they have the necessary knowledge, skills, and experience.
- 4.2. Shall perform internal audit services in accordance with the *International Standards for the Professional Practice of Internal Auditing*.
- 4.3. Shall continually improve their proficiency and the effectiveness and quality of their services.



The Institute of Internal Auditors