

**KPPA Audit Committee
August 24, 2023 at 10:00 a.m. Eastern Time
Live Video Conference/Facebook Live**

AGENDA

- | | | |
|-----|---|--|
| 1. | Call to Order | Bill O'Mara |
| 2. | Opening Video Teleconference Statement | Legal Representative |
| 3. | Roll Call | Sherry Rankin |
| 4. | Public Comment | Sherry Rankin |
| 5. | Approval of July 26, 2023 KPPA Audit Committee Minutes* | Bill O'Mara |
| 6. | Overview of Fiscal Year 2023 External Audit | Adam Gordon, Auditor of
Public Accounts |
| 7. | Financial Statements for Fiscal Year Ended June 30, 2023 (unaudited)
including Contribution Report and Administrative Expenses | Mike Lamb |
| 8. | KPPA Audit Committee Administrative Updates | |
| | a. Internal Audit Budget as of June 30, 2023 | Kristen Coffey |
| | b. Approval of Internal Audit Budget for Upcoming Fiscal Year* | Kristen Coffey |
| | c. Audit Committee Agenda Items* | Kristen Coffey and Mike Lamb |
| | d. Information Disclosure Incidents | Carrie Bass |
| | e. Anonymous Tips | Carrie Bass |
| | f. FY 2024 Auditor Independence Statements | Kristen Coffey |
| | g. Status of Current Internal Audit Projects | Kristen Coffey |
| | h. Update on Self-Assessment Project | Kristen Coffey |
| | i. Charter for the Division of Internal Audit Administration* | Kristen Coffey |
| 9. | Professional Articles | Madeline Evans |
| | a. Institute for Internal Auditors – Tone at the Top, April 2023 –
<i>Adjusting the Risk Appetite for Non-Financial Measures</i> | |
| 10. | Adjourn* | Bill O'Mara |

***Action may be taken by the KPPA Audit Committee**

**MINUTES OF MEETING
KENTUCKY PUBLIC PENSIONS AUTHORITY
SPECIAL CALLED AUDIT COMMITTEE
JULY 26, 2023, 10:00 A.M., E.T.
VIA LIVE VIDEO TELECONFERENCE**

At the June 26, 2023 Special Called Meeting of the Audit Committee of the Kentucky Public Pensions Authority, the following Committee members were present: William O'Mara (Chair), Betty Pendergrass, Lynn Hampton, and William Summers, V. Staff members present were CERS CEO Ed Owens, III, KRS CEO John Chilton, David Eager, Rebecca Adkins, Erin Surratt, Michael Board, Victoria Hale, Leigh Ann Davis, Lori Casey, Steve Willer, Kristen Coffey, Madeline Perry, Melinda Wofford, Ashley Gabbard, Phillip Cook and Sherry Rankin.

Mr. O'Mara called the meeting to order.

Mr. Board read the Opening Statement.

Ms. Rankin called roll.

Mr. O'Mara introduced the agenda item ***Approval of Minutes – June 21, 2023*** (Video 00:07:18 to 00:07:55). Ms. Hampton made a motion to approve the minutes as presented. The motion was seconded by Ms. Pendergrass and passed unanimously.

Mr. O'Mara introduced the agenda item ***Conversion of job description from Division Director of Internal Audit to Chief Auditor*** (Video 00:07:56 to 00:57:54). Mr. Board recapped the progress of the implementation of HB 587 and advised of the remaining action items required to implement the legislation. He announced that the purpose of the Special Called Meeting was to further discuss the conversion of the job description from Division Director of Internal Audit to Chief Auditor as requested by the chair of KPPA. Mr. O'Mara directed the Committee Members to the meeting materials provided. Ms. Coffey reviewed her submitted memorandum with the Members. There was discussion surrounding the intention of HB 587. Ms. Coffey expressed her concerns regarding the volume of administrative tasks assigned to the role.

Mr. O'Mara summarized the discussion. He reiterated Ms. Coffey's concern that the duties and responsibilities detailed in the Chief Auditor position description change the scope of her role. Mr. O'Mara requested that the Committee Members discuss whether the approved Chief Auditor position description is a material change to Ms. Coffey's position. The will of the Committee was to make no material changes to the duties and responsibilities, said Mr. O'Mara. An update to the position description and title were the only modifications desired. Mr. Eager added that the approved changes to the position description simply define the requirements of the legislation. Ms. Hampton expressed concern regarding the high percentage (45%) of Task 1 and its resemblance to other tasks listed.

Mr. O'Mara suggested that a motion be made stating that the intent of the KPPA Audit Committee is that the scope of the Chief Auditor position did not materially change aside from the reporting structure. Further, that the tasks and percentages would be reviewed next year for amendment. Ms. Pendergrass made the above motion. Ms. Hampton seconded the motion and the motion passed unanimously.

There being no further business, Mr. O'Mara requested a *adjourn* the meeting.

Ms. Rankin advised that agenda item **Public Comment** was overlooked. She advised that no public comments were received.

Ms. Pendergrass made a motion to adjourn the meeting. The motion to adjourn was seconded and passed unanimously; therefore, the meeting was adjourned.

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CERTIFICATION

I do certify that I was present at this meeting, and I have recorded above the action of the Committee on the various items considered by it at this meeting. Further, I certify that all requirements of KRS 61.805-61.850 were met in connection with this meeting.

Recording Secretary

I, as Chair of the Audit Committee of the Kentucky Public Pensions Authority, do certify that the Minutes of the meeting held on June 26, 2023, were approved by the Audit Committee on August 24, 2023.

Committee Chair

I have reviewed the Minutes of the Audit Committee Meeting on June 26, 2023, for form, content, and legality.

Executive Director
Office of Legal Services

AUDIT UPDATE

Kentucky Public Pensions Authority

Fiscal Year Ending June 30, 2023

August 24, 2023



Mike Harmon
State Auditor

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PURPOSE

- KRS 61.645 (12) (b) requires the Auditor of Public Accounts to audit KPPA at least once every five years. Our last audit was for fiscal year ending June 30, 2018.
- We follow Generally Accepted Government Auditing Standards (Yellow Book) issued by the Government Accountability Office (GAO).
- KPPA signed an engagement letter with us on April 11, 2023 to audit the Annual Comprehensive Financial Report for fiscal year ended June 30, 2023.



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AUDIT TEAM

- Linda Hinton, Audit Manager
- Adam Gordon, Auditor-in-Charge
- Amy Fisher, IT Audit Manager
- Two Financial Audit Staff and Two IT Audit Staff



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AUDIT PROGRESS

- Planning started in April 2023
- IT Auditors began testing in May 2023
- Staff auditors started working in late June and are currently working on gaining an understanding of each section's processes and controls.
 - Sections include Contributions, Benefits, Investments, and Census Data testing



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AUDIT ITEMS REMAINING

- Census Data Testing is expected to begin later this month.
- Actuary report testing is expected to began when we receive the draft reports in late September
- Financial Statement testing will begin once section work is completed and a draft is available



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AUDIT TENTATIVE TIMELINE

- August 13 - receipt of FY23 Actuary files
- September 2 - Financial Statements draft provided by KPPA
- September 29 - Draft GASB 67 and 74 Actuary Reports provided by KPPA / Actuary
- November 1 – Draft ACFR draft provided by KPPA
- November 17 - All findings (if any) will need to be returned by this date from KPPA
- November 20 – Anticipated Planned End of Fieldwork / All management and legal representation letters must be signed and returned by this date
- November 27 - Draft Audit Report presented to KPPA Audit Committee
- December 7 - Board of Trustees approves final audit report / Audit report is released



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THANK YOU!

- We have currently met with staff from Accounting, Investments, Benefits, IT and Employer Reporting divisions
- All KPPA staff have been willing to assist us
- We greatly appreciate KPPA's cooperation with our audit

QUESTIONS?



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State Auditor

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Combining Statement of Fiduciary Net Position - Pension Funds

As of June 30, 2023, with Comparative Totals as of June 30, 2022 (\$ in Thousands) (Unaudited)

	CERS		KERS		SPRS	KPPA TOTAL		Percentage	
ASSETS	Nonhazardous	Hazardous	Nonhazardous	Hazardous		FY 2023	FY 2022	of Change	Note
CASH AND SHORT-TERM INVESTMENTS									
Cash Deposits	\$662	\$262	\$375	\$141	\$35	\$1,475	\$367	301.45%	1
Short-term Investments	303,178	134,691	648,780	89,143	133,780	1,309,572	1,116,933	17.25%	2
Total Cash and Short-term Investments	303,840	134,954	649,155	89,284	133,815	1,311,047	1,117,301	17.34%	
RECEIVABLES									
Accounts Receivable	78,684	26,182	87,322	4,216	5,340	201,743	255,799	-21.13%	3
Accounts Receivable - Investments	58,587	20,435	31,172	6,728	5,800	122,721	82,031	49.60%	4
Total Receivables	137,271	46,617	118,493	10,944	11,140	324,465	337,830	(3.96)%	
INVESTMENTS, AT FAIR VALUE									
Core Fixed Income	862,405	299,149	708,383	106,016	118,419	2,094,372	2,030,333	3.15%	
Public Equities	4,327,129	1,494,664	1,169,731	389,000	190,147	7,570,671	6,193,224	22.24%	5
Private Equities	689,017	229,764	159,836	63,179	16,596	1,158,393	1,289,932	(10.20)%	6
Specialty Credit	1,762,779	605,820	613,193	183,057	101,064	3,265,913	3,097,828	5.43%	
Derivatives	(2,478)	(862)	(2,045)	(306)	(342)	(6,034)	(2,864)	(110.69)%	7
Real Return	268,971	89,758	72,726	24,325	10,693	466,472	417,815	11.65%	8
Real Estate	500,825	159,479	170,599	46,519	20,166	897,589	882,759	1.68%	
Total Investments, at Fair Value	8,408,648	2,877,772	2,892,423	811,790	456,744	15,447,376	13,909,026	11.06%	
Securities Lending Collateral Invested	176,126	60,803	71,804	18,277	12,028	339,038	391,750	(13.46)%	9
CAPITAL/INTANGIBLE ASSETS									
Capital Assets	1,701	153	929	91	11	2,885	2,885	0.00%	
Intangible Assets	9,961	827	5,920	494	100	17,301	17,301	0.00%	
Accumulated Depreciation	(1,701)	(153)	(929)	(91)	(11)	(2,885)	(2,885)	0.00%	
Accumulated Amortization	(9,961)	(827)	(5,920)	(494)	(100)	(17,301)	(16,977)	1.91%	
Total Capital Assets	-	-	-	-	-	-	324	(100.00)%	
Total Assets	9,025,885	3,120,145	3,731,875	930,295	613,726	17,421,927	15,756,231	10.57%	
LIABILITIES									
Accounts Payable	5,091	816	2,567	599	56	9,128	7,048	29.51%	10
Investment Accounts Payable	76,587	26,600	50,340	8,852	8,816	171,194	109,253	56.70%	11
Securities Lending Collateral	176,126	60,803	71,804	18,277	12,028	339,038	391,750	(13.46)%	12
Total Liabilities	257,804	88,218	124,711	27,727	20,900	519,360	508,051	2.23%	
Total Fiduciary Net Position Restricted for Pension Benefits									
	\$8,768,081	\$3,031,927	\$3,607,165	\$902,568	\$592,826	\$16,902,566	\$15,248,180	10.85%	

NOTE - Variance Explanation **Differences due to rounding**

1) The variance is a result of continuous fluctuation of deposits and transactions that flow through the cash account. As a result of an Internal Audit finding, we continue to evaluate the optimum cash balances at JP Morgan Chase.

2) Short term investments are primarily comprised of cash on hand at the custodial bank, the variance in the balance is a result of the cash flows of each plan.

3) The decrease in Accounts Receivable is primarily due to the 06/30/2022 CERS and CERH pension/insurance split correction.

4) The variance in Investment Accounts Receivable is the result of pending trades.

5) The increase in Public Equities is the result of favorable market conditions resulting in realized and unrealized gains

6) The decrease in Private Equities is the result of more distributions than contributions for the asset class most notable for KERS and SPRS who did not participate from 2011-2021.

7) The variance in Derivatives is a result of hedging and arbitration of risk within the portfolios.

8) Despite the increase shown on the statements for Real Return, the overall asset class has actually declined due to the liquidation of Putnam. However, most of Putnam's assets were held in cash (Short-term Investments) at the end of FY22 which is skewing the data.

9) The variance is a result of the demand of the Securities Lending Program.

10) The variance in Accounts Payable is due to an Increase in the payroll and leave liability accrual as well as an increase in outstanding employer credit invoices.

11) The variance in Investment Accounts Payable is due to pending trades.



Combining Statement of Changes In Fiduciary Net Position - Pension Funds

For the twelve month period ending June 30, 2023, with Comparative Totals for the twelve month period ending June 30, 2022 (\$ in Thousands) (Unaudited)

	CERS Nonhazardous	CERS Hazardous	KERS Nonhazardous	KERS Hazardous	SPRS	KPPA Total		Percentage of Change	Note
	FY 2023	FY 2022	FY 2023	FY 2022	FY 2023	FY 2023	FY 2022		
ADDITIONS									
Member Contributions	\$145,491	\$53,246	\$84,563	\$17,459	\$5,250	\$306,008	\$290,471	5.35%	
Employer Pay Credit	\$50,830	\$20,206	\$22,012	\$8,758	\$1,585	\$103,390	\$80,710	28.10%	1
Employer Contributions	635,723	267,703	114,408	64,021	56,536	1,138,391	1,091,160	4.33%	
Actuarially Accrued Liability Contributions (AALC)	-	-	898,546	-	-	898,546	912,705	(1.55)%	
General Fund Appropriation	-	-	240,000	-	-	240,000	215,000	11.63%	2
Pension Spiking Contributions	46	186	16	29	-	276	122	126.38%	3
Health Insurance Contributions (HB1)	(30)	(20)	(12)	(7)	(8)	(78)	(208)	(62.59)%	4
Employer Cessation Contributions	-	-	-	-	-	-	63,113	(100.00)%	5
Total Contributions	832,061	341,320	1,359,532	90,259	63,362	2,686,534	2,653,072	1.26%	
INVESTMENT INCOME									
From Investing Activities									
Net Appreciation (Depreciation) in FV of Investments	637,414	219,241	134,777	56,604	25,422	1,073,457	(1,175,882)	191.29%	6
Interest/Dividends	239,709	83,235	102,220	26,388	17,889	469,440	429,376	9.33%	
Total Investing Activities Income	877,123	302,476	236,996	82,991	43,311	1,542,897	(746,506)		
Less: Investment Expense	52,167	17,540	15,205	4,914	2,227	92,054	75,188	22.43%	7
Less: Performance Fees	10,465	3,295	1,866	910	336	16,871	96,461	(82.51)%	8
Net Income from Investing Activities	814,490	281,641	219,926	77,167	40,748	1,433,972	(918,155)		
From Securities Lending Activities									
Securities Lending Income	8,998	3,143	2,918	867	489	16,414	1,652		
Less: Securities Lending Borrower Rebates (Income)/Expense	7,904	2,760	2,526	756	426	14,371	(506)		
Less: Securities Lending Agent Fees	164	57	59	17	9	306	324		
Net Income from Securities Lending	930	325	333	94	53	1,736	1,834	(5.34)%	
Net Investment Income	815,420	281,966	220,259	77,262	40,801	1,435,708	(916,321)	(256.68)%	
Total Additions	1,647,481	623,286	1,579,791	167,520	104,164	4,122,242	1,736,752	137.35%	
DEDUCTIONS									
Benefit Payments	894,351	319,593	1,023,704	78,636	63,804	2,380,088	2,328,592	2.21%	
Refunds	23,263	6,568	11,847	4,041	166	45,886	42,927	6.89%	
Administrative Expenses	24,131	2,125	13,818	1,513	293	41,881	39,743	5.38%	
Total Deductions	941,746	328,287	1,049,369	84,190	64,263	2,467,855	2,411,263	2.35%	
Net Increase (Decrease) in Fiduciary Net Position Restricted for Pension Benefits	705,735	294,999	530,422	83,330	39,900	1,654,387	(674,511)		
Total Fiduciary Net Position Restricted for Pension Benefits									
Beginning of Period	8,062,346	2,736,928	3,076,743	819,237	552,926	15,248,180	15,922,691	(4.24)%	
End of Period	\$8,768,081	\$3,031,927	\$3,607,165	\$902,568	\$592,826	\$16,902,566	\$15,248,180	10.85%	

NOTE - Variance Explanation

Differences due to rounding.

- 1) The Employer Pay Credit will continue to increase as Tier 3 members increase.
- 2) General Fund Appropriation 4th Quarter FY 2023 (KERS only): HB1 \$135,000,000; HB604 \$105,000,000; Compared to 4th Quarter FY 2022 (SPRS only) \$215,000,000;
- 3) Pension Spiking contributions increased due to an increase in KERS Hazardous and CERS Hazardous.
- 4) Health Insurance Contributions continue to fluctuate in the Pension accounts due to Tier 2 and Tier 3 retiree health insurance system costs as well as corrections being processed to previous fiscal years.
- 5) Employer Cessation payment received from Kentucky Housing Corporation FY2022.

NOTE - Variance Explanation continued on next page.

- 6) *The increase in Net Appreciation in Fair Value of Investments is the result of unrealized gains in public equity.*
- 7) *The increase in Investment Expense is primarily the result of increased partnership expenses for Specialty Credit.*
- 8) *The decrease in performance fees is the result of less than favorable market conditions causing returns to drop, impacting those fees directly related to performance most notably Private Equity, Real Estate and Specialty Credit.*



Combining Statement of Fiduciary Net Position - Insurance Funds

As of June 30, 2023, with Comparative Totals as of June 30, 2022 (\$ in Thousands) (Unaudited)

	CERS	CERS	KERS	KERS	SPRS	KPPA Total		Percentage	
ASSETS	Nonhazardous	Hazardous	Nonhazardous	Hazardous		FY 2023	FY 2022	of Change	Note
CASH AND SHORT-TERM INVESTMENTS									
Cash Deposits	\$259	\$8	\$105	\$9	\$8	\$389	\$255	52.63%	1
Short-term Investments	132,269	31,789	170,092	29,906	10,868	374,923	431,686	(13.15)%	2
Total Cash and Short-term Investments	132,528	31,797	170,196	29,915	10,876	375,312	431,941	(13.11)%	
RECEIVABLES									
Accounts Receivable	12,658	4,082	13,235	334	956	31,265	39,914	(21.67)%	3
Investment Accounts Receivable	22,443	10,253	11,749	4,294	1,762	50,501	37,496	34.68%	4
Total Receivables	35,101	14,335	24,984	4,628	2,719	81,767	77,410	5.63%	
INVESTMENTS, AT FAIR VALUE									
Core Fixed Income	327,065	148,991	171,536	72,740	27,887	748,219	753,514	(0.70)%	
Public Equities	1,633,030	807,897	637,102	268,599	108,362	3,454,991	2,871,630	20.31%	5
Private Equities	268,195	150,750	94,390	53,885	23,922	591,143	625,456	(5.49)%	
Specialty Credit	664,738	330,931	295,825	134,897	53,531	1,479,922	1,401,887	5.57%	
Derivatives	(908)	(412)	(478)	(200)	(78)	(2,076)	(934)	(122.40)%	6
Real Return	82,403	43,561	31,681	17,472	6,563	181,681	164,241	10.62%	7
Real Estate	173,577	95,157	54,522	39,974	15,293	378,523	372,995	1.48%	
Total Investments, at Fair Value	3,148,101	1,576,874	1,284,579	587,368	235,481	6,832,402	6,188,789	10.40%	
Securities Lending Collateral Invested	59,513	29,266	26,420	11,270	4,491	130,959	146,144	(10.39)%	8
Total Assets	3,375,242	1,652,273	1,506,180	633,180	253,566	7,420,440	6,844,284	8.42%	
LIABILITIES									
Accounts Payable	223	22	118	-	1	363	57,501	(99.37)%	9
Investment Accounts Payable	27,873	12,877	14,161	5,588	2,277	62,777	43,999	42.68%	10
Securities Lending Collateral	59,513	29,266	26,420	11,270	4,491	130,959	146,144	(10.39)%	11
Total Liabilities	87,609	42,164	40,699	16,858	6,769	194,100	247,644	(21.62)%	
Total Fiduciary Net Position Restricted for OPEB	\$3,287,633	\$1,610,108	\$1,465,480	\$616,322	\$246,797	\$7,226,340	\$6,596,640	9.55%	

NOTE - Variance Explanation *Differences due to rounding*

- 1) The variance is a result of continuous fluctuation of deposits and transactions that flow through the cash account. As a result of an Internal Audit finding, we continue to evaluate the optimum cash balances at JP Morgan Chase.
- 2) Short term investments are primarily comprised of cash on hand at the custodial bank, the balance decline is the result of cash being invested.
- 3) The decrease in Accounts Receivable is due to a decrease in the member/employer month-end accrual due to the decreased insurance transfer rate.
- 4) The variance in Investment Accounts Receivable is the result of pending trades.
- 5) The increase in Public Equities is the result of favorable market conditions resulting in realized and unrealized gains
- 6) The variance in Derivatives is a result of hedging and arbitration of risk within the portfolios.
- 7) Despite the increase shown on the statements for Real Return, the overall asset class has actually declined due to liquidation of Putnam. However, most of Putnam's assets were held in cash (Short-term Investments) at the end of FY22 due to the liquidation which is skewing the data.
- 8) The variance is a result of the demands of the Securities Lending Program.
- 9) The decrease in Accounts Payable is primarily due to the 06/30/2022 CERS and CERH pension/insurance split correction.
- 10) The variance In Investment Accounts Payable is due to pending trades.
- 11) The variance is a result of the demands of the Securities Lending Program.



Combining Statement of Changes In Fiduciary Net Position - Insurance Funds

For the twelve month period ending June 30, 2023, with Comparative Totals for the twelve month period ending June 30, 2022 (\$ In Thousands) (Unaudited)

	CERS Non-hazardous	CERS Hazardous	KERS Non-hazardous	KERS Hazardous	SPRS	KPPA Total		Percentage of Change	Note
	FY 2023	FY 2022				FY 2023	FY 2022		
ADDITIONS									
Employer Contributions	\$99,501	\$45,605	\$35,542	\$37	\$9,289	\$189,975	\$217,319	(12.58)%	1
Actuarially Accrued Liability Contributions (AALC)	-	-	87,674	-	-	\$87,674	\$101,637	(13.74)%	2
Medicare Drug Reimbursement	-	-	4	-	-	4	3	57.23%	
Insurance Premiums	294	(546)	(27)	(69)	(131)	(479)	364	(231.69)%	3
Humana Gain Share Payment	5,951	914	4,851	368	224	12,308	18,381	(33.04)%	4
Retired Re-employed Healthcare	4,922	1,611	5,885	1,452	-	13,870	12,666	9.50%	
Health Insurance Contributions (HB1)	17,502	3,987	8,368	1,591	356	31,805	27,790	14.45%	5
Employer Cessation Contributions	-	-	-	-	-	-	2,404	(100.00)%	6
Total Contributions	128,170	51,571	142,297	3,380	9,738	335,156	380,566	(11.93)%	
INVESTMENT INCOME									
From Investing Activities									
Net Appreciation (Depreciation) in FV of Investments	240,043	116,609	95,983	39,902	16,099	508,637	(482,475)	205.42%	7
Interest/Dividends	88,629	43,939	42,258	17,802	7,164	199,792	192,803	3.62%	
Total Investing Activities Income	328,673	160,548	138,242	57,704	23,263	708,429	(289,672)		
Less: Investment Expense	19,478	10,174	7,451	3,946	1,559	42,608	34,478	23.58%	8
Less: Performance Fees	3,499	1,782	2,870	819	299	9,270	49,495	(81.27)%	9
Net Income from Investing Activities	305,696	148,591	127,921	52,939	21,404	656,551	(373,645)		
From Securities Lending Activities									
Securities Lending Income	2,775	1,336	1,124	460	196	5,890	679		
Less: Securities Lending Borrower Rebates (Income)/Expense	2,414	1,162	969	399	169	5,113	(198)		
Less: Securities Lending Agent Fees	54	26	23	9	4	116	131		
Net Income from Securities Lending	307	148	132	52	23	661	745	(11.28)%	10
Net Investment Income	306,003	148,739	128,052	52,991	21,427	657,212	(372,900)	(276.24)%	
Total Additions	434,173	200,310	270,350	56,371	31,165	992,368	7,666	12,844.93%	
DEDUCTIONS									
Healthcare Premiums Subsidies	123,587	93,485	103,952	19,748	14,290	355,063	377,015	(5.82)%	
Administrative Expenses	937	522	771	123	74	2,427	2,453	(1.06)%	
Self-Funded Healthcare Costs	3,241	171	1,668	80	18	5,178	5,152	0.51%	
Excise Tax Insurance	-	-	-	-	-	-	19	(100.00)%	11
Total Deductions	127,765	94,178	106,391	19,951	14,382	362,668	384,639	(5.71)%	
Net Increase (Decrease) in Fiduciary Net Position Restricted for OPEB	306,408	106,131	163,959	36,420	16,782	629,700	(376,973)		
Total Fiduciary Net Position Restricted for OPEB									
Beginning of Period	2,981,224	1,503,977	1,301,522	579,902	230,015	6,596,640	6,973,613	(5.41)%	
End of Period	\$3,287,632	\$1,610,108	\$1,465,480	\$616,322	\$246,797	\$7,226,340	\$6,596,640	9.55%	

NOTE - Variance Explanation. Differences due to rounding

1) Employer Contributions decreased due to a decrease in the employer insurance rate.

NOTE - Variance Explanation continued on next page.

- 2) AALC will fluctuate year to year based on the actuarial valuation.
- 3) Health Insurance Premiums decreased primarily due to refunds processed to hazardous retirees for premiums paid for dependents that should have been covered by KPPA.
- 4) The Humana Gain Share payment will fluctuate year to year based on claims paid.
- 5) Health Insurance Contributions will continue to rise as Tier 2 and Tier 3 members increase.
- 6) Employer Cessation payment received from Kentucky Housing Corporation FY2022.
- 7) The increase in Net Appreciation in Fair Value of Investments is the result of unrealized gains in public equity.
- 8) The increase in Investment Expense is primarily the result of increased partnership expenses for Specialty Credit.
- 9) The decrease in performance fees is the result in less than favorable market conditions causing returns to drop, impacting those fees directly related to performance most notably Private Equity, Real Estate and Specialty Credit.
- 10) The variance is a result of the demand of the Securities Lending Program.
- 11) The Excise Tax will fluctuate based on the timing of the posting of the payment.

Pension Funds Contribution Report

For the twelve month period ending June 30, 2023, with Comparative Totals for the twelve month period ending June 30, 2022 (\$ in Millions)

**County Employees Retirement System**

	Nonhazardous		Hazardous	
	FY23	FY22	FY23	FY22
Member Contributions	\$145.5	\$144.4	\$53.3	\$52.7
Employer Pay Credit	\$50.8	\$42.2	\$20.2	\$16.8
Employer Contributions	635.8	606.8	267.9	222.0
Net Investment Income	178.0	136.8	62.7	48.7
Total Inflows	1,010.1	930.2	404.1	340.2
Benefit Payments/Refunds	917.6	878.0	326.2	311.6
Administrative Expenses	24.1	22.7	2.1	2.0
Total Outflows	941.7	900.7	328.3	313.6
NET Contributions	68.4	29.5	75.8	26.6
Realized Gain/(Loss)	3.4	374.0	(0.8)	126.0
Unrealized Gain/(Loss)	633.9	(1,011.8)	220.0	(350.1)
Change in Net Position	705.7	(608.3)	295.0	(197.5)
Beginning of Period	8,062.3	8,670.7	2,736.9	2,934.4
End of Period	\$8,768.0	\$8,062.3	\$3,031.9	\$2,736.9



Differences due to rounding.

Net Contributions*	(\$109.6)	(\$107.3)	\$13.1	(\$22.1)
Cash Flow as % of Assets	(1.25)%	(1.33)%	0.43%	(0.80)%
Net Investment Income	\$178.0	\$136.8	\$62.7	\$48.7
Yield as % of Assets	2.03%	1.70%	2.07%	1.78%

**Net Contributions are less Net Investment Income.*

Pension Funds Contribution Report

For the twelve month period ending June 30, 2023, with Comparative Totals for the twelve month period ending June 30, 2022 (\$ in Millions)

 	Kentucky Employees Retirement System				State Police Retirement System	
	Nonhazardous		Hazardous			
	FY23	FY22	FY23	FY22	FY23	FY22
Member Contributions	\$84.6	\$74.2	\$17.5	\$15.1	\$5.2	\$3.9
Employer Pay Credit	\$22.0	\$15.3	\$8.7	\$5.5	\$1.6	\$0.9
Employer Contributions	114.4	141.1	64.0	59.1	56.5	62.3
Actuarially Accrued Liability Contributions	898.5	912.7	-	-	-	-
Employer Cessation Contributions	-	63.1	-	-	-	-
General Fund Appropriations	240.0	-	-	-	-	215.0
Net Investment Income	85.5	52.7	20.7	15.1	15.4	6.3
Total Inflows	1,445.0	1,259.1	110.9	94.8	78.7	288.4
Benefit Payments/Refund	1,035.6	1,035.5	82.7	82.0	64.0	64.4
Administrative Expenses	13.8	13.3	1.5	1.5	0.3	0.3
Total Outflows	1,049.4	1,048.8	84.2	83.5	64.3	64.7
NET Contributions	395.6	210.2	26.7	11.3	14.4	223.7
Realized Gain/(Loss)	(18.7)	91.4	(1.4)	35.3	(4.1)	11.3
Unrealized Gain/(Loss)	153.5	(310.0)	58.0	(102.3)	29.5	(39.8)
Change in Net Position	530.4	(8.4)	83.3	(55.7)	39.8	195.2
Beginning of Period	3,076.7	3,085.0	819.2	874.9	552.9	357.7
End of Period	\$3,607.1	\$3,076.7	902.5	\$819.2	\$592.7	\$552.9

Differences due to rounding.

Net Contributions*	\$310.1	\$157.5	\$6.0	\$(3.8)	\$(1.0)	\$217.4
Cash Flow as % of Assets	8.60%	5.12%	0.67%	(0.46)%	(0.17)%	39.31%
Net Investment Income	\$85.5	\$52.7	\$20.7	\$15.1	\$15.4	\$6.3
Yield as % of Assets	2.37%	1.71%	2.29%	1.84%	2.59%	1.15%

**Net Contributions are less Net Investment Income.*

Insurance Fund Contribution Report

For the twelve month period ending June 30, 2023, with Comparative Totals for the twelve month period ending June 30, 2022 (\$ in Millions)

**County Employees Retirement System**

	Nonhazardous		Hazardous	
	FY23	FY22	FY23	FY22
Employer Contributions	\$99.5	\$118.6	\$45.6	\$58.4
Insurance Premiums	0.3	0.5	(0.5)	(0.3)
Humana Gain Share	6.0	8.9	0.9	1.3
Retired Reemployed Healthcare	4.9	4.8	1.6	1.5
Health Insurance Contributions	17.5	16.0	4.0	3.8
Net Investment Income	66.0	51.6	32.1	24.8
Total Inflows	194.2	200.4	83.7	89.5
Healthcare Premiums	126.8	137.7	93.7	89.5
Administrative Expenses	0.9	0.9	0.5	0.5
Total Outflows	127.7	138.6	94.2	90.0
NET Contributions	66.5	61.8	(10.5)	(0.5)
Realized Gain/(Loss)	0.6	137.9	2.1	74.1
Unrealized Gain/(Loss)	239.4	(360.3)	114.5	(177.4)
Change in Net Position	306.5	(160.6)	106.1	(103.8)
Beginning of Period	2,981.2	3,141.8	1,504.0	1,607.8
End of Period	\$3,287.7	\$2,981.2	\$1,610.1	\$1,504.0



Differences due to rounding.

Net Contributions*	\$0.5	\$10.2	\$(42.6)	\$(25.3)
Cash Flow as % of Assets	0.02%	0.34%	(2.65)%	(1.68)%
Net Investment Income	\$66.0	\$51.6	\$32.1	\$24.8
Yield as % of Assets	2.01%	1.73%	2.00%	1.65%

**Net Contributions are less Net Investment Income.*

Insurance Fund Contribution Report

For the twelve month period ending June 30, 2023, with Comparative Totals for the twelve month period ending June 30, 2022 (\$ in Millions)

 	Kentucky Employees Retirement System				State Police Retirement System	
	Nonhazardous		Hazardous			
	FY23	FY22	FY23	FY22	FY23	FY22
Employer Contributions	\$35.5	\$31.6	\$-	\$-	\$9.3	\$8.8
Actuarially Accrued Liability Contributions	87.7	101.6	-	-	-	-
Employer Cessation Contributions	-	2.4	-	-	-	-
Insurance Premiums	-	0.2	(0.1)	-	(0.1)	-
Humana Gain Share	4.9	7.3	0.4	0.5	0.2	0.3
Retired Reemployed Healthcare	5.9	5.1	1.5	1.3	-	-
Health Insurance Contributions	8.4	6.6	1.6	1.2	0.4	0.3
Net Investment Income	32.1	20.0	13.1	9.5	5.3	3.6
Total Inflows	174.5	174.8	16.5	12.5	15.1	13.0
Healthcare Premiums	105.6	120.0	19.8	20.5	14.3	14.5
Administrative Expenses	0.8	0.8	0.1	0.1	0.1	0.1
Total Outflows	106.4	120.8	19.9	20.6	14.4	14.6
NET Contributions	68.1	54.0	(3.4)	(8.1)	0.7	(1.6)
Realized Gain/(Loss)	(7.2)	40.9	0.1	26.9	(0.1)	11.3
Unrealized Gain/(Loss)	103.1	(146.5)	39.8	(63.8)	16.2	(25.7)
Change in Net Position	164.0	(51.6)	36.5	(45.0)	16.8	(16.0)
Beginning of Period	1,301.5	1,353.1	579.9	624.9	230.0	246.0
End of Period	\$1,465.5	\$1,301.5	\$616.4	\$579.9	\$246.8	\$230.0

Differences due to rounding.

Net Contributions*	\$36.0	\$34.0	\$(16.5)	\$(17.6)	\$(4.6)	\$(5.2)
Cash Flow as % of Assets	2.46%	2.61%	(2.67)%	(3.02)%	(1.88)%	(2.27)%
Net Investment Income	\$32.1	\$20.0	\$13.1	\$9.5	\$5.3	\$3.6
Yield as % of Assets	2.19%	1.54%	2.12%	1.63%	2.16%	1.58%

**Net Contributions are less Net Investment Income.*

KPPA ADMINISTRATIVE BUDGET FY 2022-2023 BUDGET-TO-ACTUAL ANALYSIS						
FOR THE FISCAL YEAR ENDING JUNE 30, 2023, WITH COMPARATIVE TOTALS FOR THE FISCAL YEAR ENDING JUNE 30, 2022						
Account Name	Budgeted	FY 2023 Expense	Remaining	Percent Remaining	FY 2022 Expense	Percent Difference
PERSONNEL						
Staff						
Salaries/Wages	\$17,000,000	\$16,431,880	\$568,120	3.34%	\$15,628,481	5.14%
Wages (Overtime)	285,000	209,522	75,478	26.48%	174,159	20.31%
Emp Paid FICA	1,270,448	1,210,689	59,759	4.70%	1,113,391	8.74%
Emp Paid Retirement	14,865,100	12,503,955	2,361,145	15.88%	12,421,914	0.66%
Emp Paid Health Ins	2,700,000	2,382,370	317,630	11.76%	2,455,352	(2.97)%
Emp Paid Sick Leave	115,000	213,594	(98,594)	(85.73)%	86,032	148.27%
Adoption Assistance Benefit	8,000	-	8,000	100.00%	7,000	(100.00)%
Workers Compensation	75,000	11,116	63,884	85.18%	75,163	(85.21)%
Unemployment	8,000	8,834	(834)	(10.42)%	-	100.00%
Emp Paid Life Ins	3,000	2,953	47	1.57%	2,905	1.65%
Employee Training	18,000	10,722	7,278	40.43%	9,685	10.71%
Bonds	-	-	-	0.00%	81	(100.00)%
Staff Subtotal	36,347,548	32,985,636	3,361,913	9.25%	31,974,163	3.16%
LEGAL & AUDITING SERVICES						
Legal Hearing Officers	100,000	197,202	(97,202)	(97.20)%	117,998	67.12%
Legal (Stoll, Keenon)	150,000	74,994	75,006	50.00%	88,189	(14.96)%
Frost Brown	80,000	344,263	(264,263)	(330.33)%	40,458	750.91%
Reinhart	25,000	276	24,724	98.90%	-	100.00%
Ice Miller	505,645	239,921	60,079	20.03%	701,266	(65.79)%
Johnson, Bowman, Branco LLC	150,000	108,718	41,283	27.52%	95,428	13.93%
Dentons Bingham & Greenebaum	150,000	42,099	107,901	71.93%	52,661	(20.06)%
Legal Expense	25,000	23	24,977	99.91%	138	(83.33)%
Auditing	200,000	109,510	90,490	45.24%	141,883	(22.82)%
Total Legal & Auditing Services	1,180,000	1,117,005	62,995	5.34%	1,238,020	(9.77)%
CONSULTING SERVICES						
Medical Reviewers	1,800,000	1,413,350	386,650	21.48%	1,593,144	(11.29)%
Escrow for Actuary Fees	-	(32,866)	32,866	0.00%	-	(100.00)%
Total Consulting Services	1,800,000	1,380,484	419,516	23.31%	1,593,144	(13.35)%
CONTRACTUAL SERVICES						
Miscellaneous Contracts	100,000	97,223	2,777	2.78%	20,124	383.12%
Human Resources Consulting	8,000	-	8,000	100.00%	5,794	(100.00)%
Actuarial Services	500,000	523,627	(23,627)	(4.73)%	474,411	10.37%
Facility Security Charges	80,000	33,782	46,218	57.77%	104,067	(67.54)%
Tuition Assistance	8,000	-	8,000	100.00%	-	0.00%
Contractual Subtotal	696,000	654,632	41,368	5.94%	604,396	8.31%
PERSONNEL SUBTOTAL	\$40,023,548	\$36,137,757	\$3,885,791	9.71%	\$35,442,380	1.96%
OPERATIONAL						
Natural Gas	35,000	35,685	(685)	(1.96)%	31,229	14.27%
Electric	125,000	110,404	14,596	11.68%	105,960	4.19%
Rent-Non State Building	56,000	37,982	18,018	32.18%	50,643	(25.00)%
Building Rental - PPW	1,000,000	962,097	37,903	3.79%	962,097	0.00%
Copier Rental	67,000	85,173	(18,173)	(27.12)%	86,605	(1.65)%
Rental Carpool	5,500	4,421	1,079	19.62%	3,881	13.91%
Vehicle/Equip. Maint.	1,000	1,123	(123)	(12.30)%	249	351.00%
Postage	420,000	351,762	68,238	16.25%	376,335	(6.53)%
Freight	200	41	159	79.28%	155	(73.55)%
Printing (State)	12,000	1,045	10,955	91.29%	6,508	(83.94)%
Printing (non-state)	105,000	67,376	37,624	35.83%	71,162	(5.32)%
Insurance	12,000	5,572	6,428	53.57%	5,422	2.77%
Garbage Collection	6,000	6,716	(716)	(11.93)%	4,853	38.39%
Conference Expense	35,000	21,532	13,468	38.48%	24,816	(13.23)%
Conference Exp. Investment	-	64	(64)	0.00%	-	100.00%
Conference Exp. Audit	2,000	794	1,206	60.30%	-	100.00%
MARS Usage	50,000	27,100	22,900	45.80%	27,100	0.00%

KPPA ADMINISTRATIVE BUDGET 2022-23 BUDGET-TO-ACTUAL ANALYSIS						
FOR THE FISCAL YEAR ENDING JUNE 30, 2023, WITH COMPARATIVE TOTALS FOR THE FISCAL YEAR ENDING JUNE 30, 2022						
Account Name	Budgeted	FY 2023 Expense	Remaining	Percent Remaining	FY 2022 Expense	Percent Difference
COVID-19 Expenses	12,000	4,836	7,164	59.70%	12,686	(61.88)%
Office Supplies	75,000	70,638	4,362	5.82%	82,826	(14.72)%
Furniture & Office Equipment	20,000	654	19,346	96.73%	1,825	(64.16)%
Travel (In-State)	15,000	13,905	1,095	7.30%	5,526	151.63%
Travel (In-State) Investment	1,000	412	588	58.80%	39	956.41%
Travel (In-State) Audit	500	-	500	100.00%	-	0.00%
Travel (Out of State)	75,000	49,026	25,974	34.63%	9,148	435.92%
Travel (Out of State) Investment	100,000	21,412	78,588	78.59%	7,393	189.63%
Travel (Out of State) Audit	500	1,077	(577)	(115.40)%	-	100.00%
Dues & Subscriptions	70,000	61,001	8,999	12.86%	52,488	16.22%
Dues & Subscriptions Invest	17,000	13,243	3,757	22.10%	12,228	8.30%
Dues & Subscriptions Audit	1,500	400	1,100	73.33%	738	(45.80)%
Miscellaneous	70,000	56,021	13,979	19.97%	34,336	63.16%
Miscellaneous Investment	-	-	-	0.00%	-	0.00%
Miscellaneous Audit	200	-	200	100.00%	-	0.00%
COT Charges	25,000	26,373	(1,373)	(5.49)%	28,640	(7.92)%
Telephone - Wireless	7,000	7,336	(336)	(4.80)%	5,420	35.35%
Telephone - Other	150,000	100,524	49,476	32.98%	117,806	(14.67)%
Telephone - Video Conference	-	4,836	(4,836)	0.00%	-	100.00%
Computer Equip./Software	3,500,000	2,671,684	828,316	23.67%	2,916,313	100.00%
Comp. Equip./Software Invest	-	-	-	0.00%	-	0.00%
Comp. Equip./Software Audit	3,000	24,407	(21,407)	(713.56)%	-	100.00%
OPERATIONAL SUBTOTAL	\$6,074,400	\$4,846,670	\$1,227,730	20.21%	\$5,039,064	(3.82)%
SUB-TOTAL	\$46,097,948	\$40,984,427	\$5,113,522	11.09%	\$40,481,444	1.24%
Reserve	4,086,552	-	4,086,552	100.00%	-	0.00%
TOTAL	\$50,184,500	\$40,984,427	\$9,200,074	18.33%	\$40,481,445	1.24%
<i>Differences due to rounding</i>						

Plan	Budgeted	FY 2023 Expense	% of Total KPPA FY 2023 Expense
CERS Nonhazardous	\$28,896,235	\$23,598,833	57.58%
CERS Hazardous	2,559,410	2,090,206	5.10%
KERS Nonhazardous	16,543,320	13,510,516	32.965%
KERS Hazardous	1,824,207	1,489,784	3.635%
SPRS	361,328	295,088	0.720%
TOTAL	\$50,184,500	\$40,984,427	

Plan - Specific Expenses	CERS Nonhazardous	CERS Hazardous	KERS Nonhazardous	KERS Hazardous	SPRS	Total
FY 2023 Expense	\$23,598,833	\$2,090,206	\$13,510,516	\$1,489,784	\$295,088	\$40,984,427
Hybrid Percent Adjustment	(450,865)	(39,900)	(258,106)	(28,461)	(5,637)	(782,969)
Plan Specific Adjustment	102,618	9,093	241,884	26,667	-	380,262
Separation Expense Adjustment	369,927	32,780	-	-	-	402,707
Total Expenses	\$23,620,513	\$2,092,179	\$13,494,294	\$1,487,990	\$289,451	\$40,984,427

JP MORGAN CHASE CREDIT EARNINGS AND FEES FOR THE FISCAL YEAR ENDING JUNE 30, 2023			
	Earnings	Fees	Net Earnings
June-22	\$5,289	\$(5,906)	\$(616)
July-22	8,921	(5,814)	3,107
August-22	17,621	(6,185)	11,436
September-22	17,026	(6,033)	10,993
October-22	24,574	(6,031)	18,543
November-22	59,589	(5,070)	54,519
December-22	10,556	(6,884)	3,673
January-23	10,331	(6,550)	3,781
February-23	1,707	(6,524)	(4,817)
March-23	2,825	(6,510)	(3,685)
April-23	4,006	(6,836)	(2,830)
May-23	6,688	(7,084)	(396)
June-23	2,286	(7,762)	(5,476)
Total	\$171,419	\$(83,187)	\$101,654

JP MORGAN CHASE HARD INTEREST EARNED FOR THE FISCAL YEAR ENDING JUNE 30, 2023				
	Clearing Account	CERS	KERS	Total
February-23	\$20,504	\$5,149	\$3,415	\$29,068
March-23	15,428	6,688	4,505	26,621
April-23	18,436	8,902	11,611	38,949
May-23	20,922	10,733	7,681	39,335
June-23	35,786	5,856	3,775	45,417
Total	\$111,075	\$37,328	\$30,986	\$179,389



Kentucky Public Pensions Authority

Internal Audit Administration



To: Members of the KPPA Audit Committee

From: Kristen N. Coffey, CICA
Division Director, Internal Audit Administration

Date: August 24, 2023

Subject: Fiscal Year 2023 Internal Audit Budget as of June 30, 2023 and Proposed FY 2024 Budget

Account Number	Account Name	FYE 2023 Adjusted Budget	FY 2023 Actual Expenditures	Remaining Budget	Percent Remaining
111	Salaries	\$ 275,872.24	\$ 282,092.59	\$ (6,220.35)	-2.25%
121	Employer Paid FICA	21,104.23	21,126.46	(22.23)	-0.11%
122	Employer Paid Retirement	231,649.92	214,421.11	17,228.81	7.44%
123	Employer Paid Health Insurance	40,000.00	41,353.44	(1,353.44)	-3.38%
124	Employer Paid Life Insurance	55.00	53.00	2.00	3.64%
133T	Employee Training	1,000.00	-	1,000.00	100.00%
259T	Conference Expenses	2,000.00	714.00	1,286.00	64.30%
361T	Travel - In State	500.00	-	500.00	100.00%
362T	Travel - Out State	500.00	1,076.98	(576.98)	-115.40%
381T	Dues & Subscriptions	1,500.00	1,250.00	250.00	16.67%
399T	Miscellaneous	200.00	-	200.00	100.00%
847T	Computer Equipment	35,000.00	35,698.98	(698.98)	-2.00%
	Total	\$ 609,381.39	\$ 597,786.56	\$ 11,594.83	1.90%

Proposed FY 2024 Budget

Account Number	Account Name	FYE 2023 Actual	FYE 2024 Budget	Variance of Budget Compared to Actual Prior Year
111	Salaries ¹	\$ 282,092.59	\$ 339,000.00	\$ 56,907.41
121	Employer Paid FICA ¹	\$ 21,126.46	25,933.50	4,807.04
122	Employer Paid Retirement ¹	\$ 214,421.11	280,879.65	66,458.54
123	Employer Paid Health Insurance	\$ 41,353.44	45,000.00	3,646.56
124	Employer Paid Life Insurance	\$ 53.00	60.00	7.00
133T	Employee Training	\$ -	3,400.00	3,400.00
259T	Conference Expenses	\$ 714.00	3,000.00	2,286.00
361T	Travel - In State	\$ -	1,000.00	1,000.00
362T	Travel - Out State	\$ 1,076.98	3,000.00	1,923.02
381T	Dues & Subscriptions	\$ 1,250.00	1,200.00	(50.00)
399T	Miscellaneous	\$ -	200.00	200.00
847T	Computer Equipment ²	\$ 35,698.98	20,000.00	(15,698.98)
	Total	\$ 597,786.56	\$ 722,673.15	\$ 124,886.59

1. Increase in salary line items reflects the 6% raise approved for all state employees as well as potential reclassifications for some employees.

2. Computer equipment budget amount includes a surcharge paid to the 3rd party vendor that we must work with as a part of the 45A process. Without that surcharge, the cost of the software would be \$10,780.



Kentucky Public Pensions Authority

Internal Audit Administration



Kentucky Public
Pensions Authority

To: Members of the KPPA Audit Committee

From: Kristen N. Coffey, CICA
Division Director, Internal Audit Administration

Date: August 24, 2023

Subject: Proposed Audit Committee Agenda Items

KPPA staff present information to various boards and committees each quarter. In order to reduce the amount of duplicate information being presented at these meetings, staff are requesting that Audit Committee members consider the proposed schedule outlined below.

Indicates possible approval needed

Indicates potential ratification needed

Topic	Audit Committee	CERS Finance Committee	KRS Board	KPPA Board
Overview of Fiscal Year External Audit	X			X
DRAFT Results of fiscal year external audit, including	X	X	X	X
a. Financial Section of the Annual Report				
b. GASB 67 and 74				
DRAFT GASB 68 and GASB 75 Proportionate Share Audits	X	X	X	X
Management Letter Comments	X			X
Auditor Communications with those Charged with Governance	X			X
Fiscal Year Ended Financial Statements (unaudited)	X	X	X	X
Quarterly Financial Statements, including		X	X	X
a. Contribution Report				
b. Admin Expenses				
c. Penalty Waiver Report				
d. Outstanding Invoices Report				
Update on External Audit/ACFR Timetable	X	X	X	X
Memorandum on Submission of ACFR	X	X	X	X
APA Approval Request for External Audit		X	X	X
DRAFT Management Response to GFOA ACFR Letter	X	X	X	X
Request for Infrastructure and Application Security Assessment	X			X
Charter for the Joint Audit Committee	X			X
Charter for the Division of Internal Audit Administration	X			X
Annual Risk Assessment and Audit Plan	X			X

Topic	Audit Committee	CERS Finance Committee	KRS Board	KPPA Board
Approval of Internal Audit Budget for Upcoming Fiscal Year	X			X
Quarterly Internal Audit Budget	X			X
Issued Reports and/or Memorandums	X			X
Follow-up on Open Internal Audit Findings and Recommendations	X			X
Status of Current Internal Audit Projects	X			X
Information Disclosure Incidents	X			X
Anonymous Tips	X			X
Auditor Independence Statements	X			X
Professional Articles	X			X

Requested Action: KPPA staff request that the Audit Committee approve the presented schedule.



KENTUCKY PUBLIC PENSIONS AUTHORITY

David L. Eager, Executive Director
 1260 Louisville Road • Frankfort, Kentucky 40601
 kyret.ky.gov • Phone: 502-696-8800 • Fax: 502-696-8822



MEMORANDUM

TO: Kristen Coffey, Director of Internal Audit

FROM: Carrie Bass, Staff Attorney Supervisor, Office of Legal Services
 Beth Camic, Staff Assistant, Office of Legal Services
 Jennifer Korth, Legal Secretary, Office of Legal Services

DATE: August 17, 2023

SUBJECT: Potential Information Disclosures/Breaches Affecting the Kentucky Public Pensions Authority (“KPPA”), 4th Quarter Fiscal Year 2023

DATA ON POTENTIAL DISCLOSURES/BREACHES 4TH QUARTER FY 2023

Total Disclosures/Breaches Investigated: 4

<u>Total Number Investigated</u>	<u>Type</u>
0	Implicated HIPAA/HITECH
0	Implicated state law
4	Implicated KPPA Data Disclosure Notification Policy
0	Found not to be a disclosure/breach

Total Members Affected by Potential Disclosures/Breaches: 4

Total Potential Disclosures/Breaches by Source of Disclosure/Breach

<u>Total Number of Disclosures/Breaches</u>	<u>Source</u>
4	KPPA, KRS, or CERS
0	External (e.g., vendor, business associate)

Total Potential Disclosures/Breaches by Method of Disclosure/Breach

<u>Total Number of Disclosures/Breaches</u>	<u>Method</u>
0	Email
4	Mail
0	Self-Service
0	Phone
0	Fax
0	Other

SYNOPSIS ON POTENTIAL DISCLOSURES/BREACHES 4TH QUARTER FY 2023

KPPA, KRS, and CERS Disclosures/Breaches

- **Federal law (HIPAA/HITECH):** There were no potential breach of protected health information by the KPPA.
- **State law (KRS 61.931, et seq.):** There were no potential “security breaches” of “personal information” as defined by state law by the KPPA.
- **KPPA Internal Data Disclosure Notification Policy:** The following disclosures occurred under the KPPA’s Data Disclosure Notification Policy.
 - **Background:** A check meant for a KPPA member was returned to KPPA. KPPA sent a change of address form and the resident who now lives at the member's address called KPPA to notify receipt. KPPA is unsure if the form was pre-populated and the resident stated they did not open the letter.
 - **Root Cause:** KPPA doing their due diligence to acquire new address for member.
 - **Follow Up:** Out of an abundance of caution, the current resident was sent a letter and affidavit to sign as well as a return envelope to return the KPPA member's letter and signed affidavit to KPPA.
 - **Background:** A member received an envelope from KPPA that was addressed to them. Attached to the envelope was another envelope addressed to another member for a different address.
 - **Root Cause:** Unknown. The envelope could have been stuck via KPPA mail process or USPS mail process. Not enough information to pinpoint. Considered to be an isolated incident.
 - **Follow Up:** Out of an abundance of caution, the affected member was sent correspondence regarding the incident. The recipient returned the envelope and KPPA destroyed accordingly. The recipient completed an affidavit attesting that the information was not shared.
 - **Background:** Two instances of a member receiving documentation from KPPA and within the contents was a letter addressed to another member. Both letters were a generic health insurance communication. The letter did not contain protected health information. The incidents occurred several weeks apart.
 - **Root Cause:** Unknown, likely happened at automatic mail sorting stage as the correspondence was sent via automatic mailing.
 - **Follow Up:** Recipient returned documentation and KPPA promptly destroyed. Affected member was resent the letter and given a brief description of the incident.

External Disclosures/Breaches

No external disclosures were made by KPPA vendors or business associates this quarter. However, on June 23, 2023, Humana notified the KPPA of a potential disclosure of member information. The KPPA has requested confirmation of whether a disclosure of member information occurred.

RECOMMENDATION

This memorandum is provided for informational purposes only.



KENTUCKY PUBLIC PENSIONS AUTHORITY

David L. Eager, Executive Director
 1260 Louisville Road • Frankfort, Kentucky 40601
 kyret.ky.gov • Phone: 502-696-8800 • Fax: 502-696-8822



MEMORANDUM

TO: Kristen Coffey, Director of Internal Audit

FROM: Carrie Bass, Staff Attorney Supervisor, Office of Legal Services
 Stephanie Hold, Investigator II, Office of Legal Services

DATE: August 17, 2023

SUBJECT: Tips Received Regarding Fraud, Waste, and Abuse

The information contained in this memo concerns tips regarding potential fraud, waste and abuse received by the Kentucky Public Pensions Authority (KPPA), including updates on all open cases and cases closed since the last meeting of the Joint Audit Committee of the Board of Trustees of the Kentucky Retirement System and the Board of Trustees of the County Retirement System (Audit Committee)

OPEN FRAUD TIP CASES

Since the Audit Committee met on May 17, 2023, the KPPA received one (1) fraud tip was received on July 4, 2023, which involved two (2) members, alleging inappropriately earned overtime pay resulting in pension spiking. This tip is currently open and being monitored to ensure current KPPA policies address any pension spiking concerns.

As of the date of this memo, the KPPA has seven (7) cases in open status. The following chart provides current information for all open cases as of the date of this Memorandum:

Date Reported	Allegation(s)	Current Action
10/03/2022 & 10/28/2022	Alleged prearranged agreement for an employee to retire and return to work for the same employer	As of the date of this memo, the member has not submitted reemployment documents to the KPPA. The Office of Legal Services continues to monitor the member's file.
12/13/2022	Alleged failure of an employer to report all employees in regular full-time positions	The Office of Legal Services is investigating.

Date Reported	Allegation(s)	Current Action
12/27/2022	Alleged prearranged agreement for an employee to retire and return to work for the same employer	As of the date of this memo, the member has not submitted reemployment documents to the KPPA. The Office of Legal Services continues to monitor the member's file.
2/11/2023	Alleged prearranged agreement for an employee to retire and return to work for the same employer	The Office of Legal Services is investigating.
2/28/2023	Alleged prearranged agreement for an employee to retire and return to work for the same employer	As of the date of this memo, the member has not submitted reemployment documents to the KPPA. The Office of Legal Services continues to monitor the member's file.
4/25/2023	Alleged prearranged agreement for an employee to retire and return to work for the same employer; alleged failure to observe required break in service between retirement and reemployment	The Office of Legal Services is awaiting additional information.
7/4/2023	Alleged improperly earned overtime pay resulting in pension spiking by two (2) members	The Office of Legal Services continues to monitor the members' files.

(Memo continued on next page.)

FRAUD TIPS CLOSED SINCE LAST MEETING

As of the date of this memo, the (6) six cases have been closed since the last meeting of the Joint Audit Committee of the Board of Trustees of the Kentucky Retirement System and the Board of Trustees of the County Retirement System. The following case(s) were closed since the last meeting:

Date Reported	Allegation(s)	Disposition
5/17/2022	Alleged misreporting of employee in hazardous position	Upon investigation by the Office of Legal Services, the information obtained did not support the allegation.
4/25/2022	Alleged prearranged agreement for an employee to retire and return to work for the same employer	Member has not requested reemployment a year after retiring; therefore, the allegation was unsubstantiated.
2/02/2023	Alleged disability fraud.	Upon investigation, it was learned the subject of the allegation is not a KPPA member.
2/04/2023	Alleged prearranged agreement for an employee to retire and return to work for the same employer	Upon investigation by the Office of Legal Services, the information obtained did not support the allegation.
4/20/2023	Alleged prearranged agreement for an employee to retire and return to work for the same employer	This member did not retire. The member instead accepted a position with another participating agency; therefore, the allegation was unsubstantiated.
3/02/2022	Multiple retired members allegedly continuing to provide the same services to their former employers via contract arrangements	Upon investigation by the Office of Legal Services, the information obtained did not support the allegation.

RECOMMENDATION

This memorandum is provided for informational purposes only.



Kentucky Public Pensions Authority

Division of Internal Audit



Independence Statement– Fiscal Year 2024

The International Professional Practices Framework (excerpted):

- 1100** The internal audit activity must be independent and internal auditors must be objective in performing their work.
- 1110** The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.
 - 1110.A1** The internal audit activity must be free from interference in determining the scope of internal auditing, performing work, and communicating results. The chief audit executive must disclose such interference to the board and discuss the implications.
- 1111** The chief audit executive must communicate and interact directly with the board.
- 1112** Where the chief audit executive has or is expected to have roles and/or responsibilities that fall outside of internal auditing, safeguards must be in place to limit impairments to independence or objectivity.
- 1120** Internal auditors must have an impartial, unbiased attitude and avoid any conflict of interest.
- 1130** If independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to appropriate parties. The nature of the disclosure will depend upon the impairment.
 - 1130.A1** Internal auditors must refrain from assessing specific operations for which they were previously responsible. Objectivity is presumed to be impaired if an internal auditor provides assurance services for an activity which the internal auditor had responsibility within the previous year.
 - 1130.A2** Assurance engagements for functions over which the chief audit executive has responsibility must be overseen by a party outside the internal audit activity.
 - 1130.A3** The internal audit activity may provide assurance services where it had previously performed consulting services, provided the nature of the consulting did not

impair objectivity and provided individual objectivity is managed when assigning resources to the engagement.

1130.C1 Internal auditors may provide consulting services relating to operations for which they had previous responsibilities.

1130.C2 If internal auditors have potential impairments to independence or objectivity relating to proposed consulting services, disclosure must be made to the engagement client prior to accepting the engagement.

Impairments to independence and objectivity must be reported. Please answer all the following questions. Any "Yes" responses should be explained in detail in third column. Impairments are not limited to the examples below; therefore, any other situation that meets the definition of an impairment should be listed on page three.

KPPA – Kentucky Public Pensions Authority

CERS – County Employees Retirement System

KRS – Kentucky Retirement Systems

Question	Yes or No	Explanation for Yes Response
1. Have you or any of the following had any financial interest, direct or indirect, in any transaction with KPPA, CERS, and/or KRS?	No	
a. Any member of your immediate family (defined as your spouse, children, siblings, parents, and parents of spouses).	No	
b. Any person, firm, etc. in which you have a substantial economic interest.	No	
c. Any firm or corporation of which you are an officer, director, trustee, partner, or employee.	No	
d. Any person for whom you hope, expect, or are negotiating to work.	No	
e. Any person with whom you have any contact or who owes you money and is, therefore, able to affect your economic interests.	No	
2. Have you accepted or solicited anything of value in return for promises of favorable action on any matter that might be the subject of an audit?	No	

3. Are any members of your immediate family currently employed by KPPA, CERS, and/or KRS or have been in the previous three years?	No	
4. Do you have any official, professional, personal, or financial relationships that might cause you to limit the extent of any inquiry, to limit disclosure, or to weaken or slant audit findings in any way?	No	
5. Do you have any preconceived ideas towards individuals, groups, organizations, or objectives of a particular program that could bias an audit?	No	
6. Are you currently or have you previously maintained the official accounting records of a fund, agency, or program of KPPA, CERS, or KRS?	No	
7. Did you have any previous responsibilities for decision-making on a program or process team that would influence the current operations of KPPA, CERS, and/or KRS?	No	
8. Did you have any previous authority at KPPA, CERS, and/or KRS to approve the payment of direct payment requisitions, payrolls, claims, or any other expenditures?	Yes	I approve payments to our election vendor and the vendor for our audit software. These vendors do not have any other business with KPPA, CERS, or KRS and I am not involved in auditing payments to these vendors.

In relation to my responsibilities as an employee of the Kentucky Public Pensions Authority – Division of Internal Audit, there are no impairments (unless indicated on pages 2-3 or listed below) to my professional independence as defined by the International Professional Practices Framework with respect to the responsibilities of the Division of Internal Audit, my public employment, and, specifically, units of state and local government and quasi-public corporations.

Also, I acknowledge receipt of a copy and affirm adherence to the Institute of Internal Auditor's Code of Ethics (page 5). I have also reviewed and understand the information set forth in Charter of the Division of Internal Audit.

Please list any personal impairment not discussed on page 2 or answer "None":

None

Kristen N. Coffey

Employee Name (Please Print)



May 18, 2023

Employee Signature

Date

Please note: This independence statement is only intended to list individual threats to independence during the period of the professional engagement, which begin with the initial engagement letter or other agreement to perform an audit or begin to perform an audit, whichever is earlier. Documentation of non-audit services, if any, will be included in the corresponding audit documentation. In addition, if the individual auditor encounters a threat to independence, the individual auditor is required to report the threat to his or her immediate supervisor for timely implementation of safeguards to eliminate or reduce the threat to an acceptable level.

{ 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



Kentucky Public Pensions Authority

Division of Internal Audit



Independence Statement– Fiscal Year 2024

The International Professional Practices Framework (excerpted):

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impair objectivity and provided individual objectivity is managed when assigning resources to the engagement.

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Impairments to independence and objectivity must be reported. Please answer all the following questions. Any "Yes" responses should be explained in detail in third column. Impairments are not limited to the examples below; therefore, any other situation that meets the definition of an impairment should be listed on page three.

KPPA – Kentucky Public Pensions Authority

CERS – County Employees Retirement System

KRS – Kentucky Retirement Systems

Question	Yes or No	Explanation for Yes Response
1. Have you or any of the following had any financial interest, direct or indirect, in any transaction with KPPA, CERS, and/or KRS?	No	
a. Any member of your immediate family (defined as your spouse, children, siblings, parents, and parents of spouses).	No	
b. Any person, firm, etc. in which you have a substantial economic interest.	No	
c. Any firm or corporation of which you are an officer, director, trustee, partner, or employee.	No	
d. Any person for whom you hope, expect, or are negotiating to work.	No	
e. Any person with whom you have any contact or who owes you money and is, therefore, able to affect your economic interests.	No	
2. Have you accepted or solicited anything of value in return for promises of favorable action on any matter that might be the subject of an audit?	No	

3. Are any members of your immediate family currently employed by KPPA, CERS, and/or KRS or have been in the previous three years?	No	
4. Do you have any official, professional, personal, or financial relationships that might cause you to limit the extent of any inquiry, to limit disclosure, or to weaken or slant audit findings in any way?	No	
5. Do you have any preconceived ideas towards individuals, groups, organizations, or objectives of a particular program that could bias an audit?	No	
6. Are you currently or have you previously maintained the official accounting records of a fund, agency, or program of KPPA, CERS, or KRS?	No	
7. Did you have any previous responsibilities for decision-making on a program or process team that would influence the current operations of KPPA, CERS, and/or KRS?	No	
8. Did you have any previous authority at KPPA, CERS, and/or KRS to approve the payment of direct payment requisitions, payrolls, claims, or any other expenditures?	No	

In relation to my responsibilities as an employee of the Kentucky Public Pensions Authority – Division of Internal Audit, there are no impairments (unless indicated on pages 2-3 or listed below) to my professional independence as defined by the International Professional Practices Framework with respect to the responsibilities of the Division of Internal Audit, my public employment, and, specifically, units of state and local government and quasi-public corporations.

Also, I acknowledge receipt of a copy and affirm adherence to the Institute of Internal Auditor's Code of Ethics (page 5). I have also reviewed and understand the information set forth in Charter of the Division of Internal Audit.

Please list any personal impairment not discussed on page 2 or answer "None":

I have previously worked for ERCE and will not complete any audit work related to that
Division until I have been in my current position for one year.

Melinda Wofford

Employee Name (Please Print)

\s\ Melinda Wofford

05/18/2023

Employee Signature

Date

Please note: This independence statement is only intended to list individual threats to independence during the period of the professional engagement, which begin with the initial engagement letter or other agreement to perform an audit or begin to perform an audit, whichever is earlier. Documentation of non-audit services, if any, will be included in the corresponding audit documentation. In addition, if the individual auditor encounters a threat to independence, the individual auditor is required to report the threat to his or her immediate supervisor for timely implementation of safeguards to eliminate or reduce the threat to an acceptable level.

{ CODE of ETHICS... }

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

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- 2.3. Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.

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Internal Auditors:

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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



Kentucky Public Pensions Authority

Division of Internal Audit



Independence Statement– Fiscal Year 2024

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1130.C2 If internal auditors have potential impairments to independence or objectivity relating to proposed consulting services, disclosure must be made to the engagement client prior to accepting the engagement.

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CERS – County Employees Retirement System

KRS – Kentucky Retirement Systems

Question	Yes or No	Explanation for Yes Response
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a. Any member of your immediate family (defined as your spouse, children, siblings, parents, and parents of spouses).	No	
b. Any person, firm, etc. in which you have a substantial economic interest.	No	
c. Any firm or corporation of which you are an officer, director, trustee, partner, or employee.	No	
d. Any person for whom you hope, expect, or are negotiating to work.	No	
e. Any person with whom you have any contact or who owes you money and is, therefore, able to affect your economic interests.	No	
2. Have you accepted or solicited anything of value in return for promises of favorable action on any matter that might be the subject of an audit?	No	

3. Are any members of your immediate family currently employed by KPPA, CERS, and/or KRS or have been in the previous three years?	No	
4. Do you have any official, professional, personal, or financial relationships that might cause you to limit the extent of any inquiry, to limit disclosure, or to weaken or slant audit findings in any way?	No	
5. Do you have any preconceived ideas towards individuals, groups, organizations, or objectives of a particular program that could bias an audit?	No	
6. Are you currently or have you previously maintained the official accounting records of a fund, agency, or program of KPPA, CERS, or KRS?	No	
7. Did you have any previous responsibilities for decision-making on a program or process team that would influence the current operations of KPPA, CERS, and/or KRS?	Yes	
8. Did you have any previous authority at KPPA, CERS, and/or KRS to approve the payment of direct payment requisitions, payrolls, claims, or any other expenditures?	No	

In relation to my responsibilities as an employee of the Kentucky Public Pensions Authority – Division of Internal Audit, there are no impairments (unless indicated on pages 2-3 or listed below) to my professional independence as defined by the International Professional Practices Framework with respect to the responsibilities of the Division of Internal Audit, my public employment, and, specifically, units of state and local government and quasi-public corporations.

Also, I acknowledge receipt of a copy and affirm adherence to the Institute of Internal Auditor's Code of Ethics (page 5). I have also reviewed and understand the information set forth in Charter of the Division of Internal Audit.

Please list any personal impairment not discussed on page 2 or answer "None":

None.

Madeline Perry

Employee Name (Please Print)

/S/ Madeline Perry

5/18/2023

Employee Signature

Date

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{ CODE of ETHICS... }

// PRINCIPLES

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- **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



Kentucky Public Pensions Authority

Division of Internal Audit



Independence Statement– Fiscal Year 2024

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 - 1110.A1** The internal audit activity must be free from interference in determining the scope of internal auditing, performing work, and communicating results. The chief audit executive must disclose such interference to the board and discuss the implications.
- 1111** The chief audit executive must communicate and interact directly with the board.
- 1112** Where the chief audit executive has or is expected to have roles and/or responsibilities that fall outside of internal auditing, safeguards must be in place to limit impairments to independence or objectivity.
- 1120** Internal auditors must have an impartial, unbiased attitude and avoid any conflict of interest.
- 1130** If independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to appropriate parties. The nature of the disclosure will depend upon the impairment.
 - 1130.A1** Internal auditors must refrain from assessing specific operations for which they were previously responsible. Objectivity is presumed to be impaired if an internal auditor provides assurance services for an activity which the internal auditor had responsibility within the previous year.
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 - 1130.A3** The internal audit activity may provide assurance services where it had previously performed consulting services, provided the nature of the consulting did not

impair objectivity and provided individual objectivity is managed when assigning resources to the engagement.

1130.C1 Internal auditors may provide consulting services relating to operations for which they had previous responsibilities.

1130.C2 If internal auditors have potential impairments to independence or objectivity relating to proposed consulting services, disclosure must be made to the engagement client prior to accepting the engagement.

Impairments to independence and objectivity must be reported. Please answer all the following questions. Any "Yes" responses should be explained in detail in third column. Impairments are not limited to the examples below; therefore, any other situation that meets the definition of an impairment should be listed on page three.

KPPA – Kentucky Public Pensions Authority

CERS – County Employees Retirement System

KRS – Kentucky Retirement Systems

Question	Yes or No	Explanation for Yes Response
1. Have you or any of the following had any financial interest, direct or indirect, in any transaction with KPPA, CERS, and/or KRS?	No	
a. Any member of your immediate family (defined as your spouse, children, siblings, parents, and parents of spouses).	No	
b. Any person, firm, etc. in which you have a substantial economic interest.	No	
c. Any firm or corporation of which you are an officer, director, trustee, partner, or employee.	No	
d. Any person for whom you hope, expect, or are negotiating to work.	No	
e. Any person with whom you have any contact or who owes you money and is, therefore, able to affect your economic interests.	No	
2. Have you accepted or solicited anything of value in return for promises of favorable action on any matter that might be the subject of an audit?	No	

3. Are any members of your immediate family currently employed by KPPA, CERS, and/or KRS or have been in the previous three years?	No	
4. Do you have any official, professional, personal, or financial relationships that might cause you to limit the extent of any inquiry, to limit disclosure, or to weaken or slant audit findings in any way?	No	
5. Do you have any preconceived ideas towards individuals, groups, organizations, or objectives of a particular program that could bias an audit?	No	
6. Are you currently or have you previously maintained the official accounting records of a fund, agency, or program of KPPA, CERS, or KRS?	No	
7. Did you have any previous responsibilities for decision-making on a program or process team that would influence the current operations of KPPA, CERS, and/or KRS?	No	
8. Did you have any previous authority at KPPA, CERS, and/or KRS to approve the payment of direct payment requisitions, payrolls, claims, or any other expenditures?	No	

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Also, I acknowledge receipt of a copy and affirm adherence to the Institute of Internal Auditor's Code of Ethics (page 5). I have also reviewed and understand the information set forth in Charter of the Division of Internal Audit.

Please list any personal impairment not discussed on page 2 or answer "None":

None

Matthew Daugherty

Employee Name (Please Print)

/s/Matthew Daugherty

5/18/2023

Employee Signature

Date

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{ CODE of ETHICS... }

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• **Competency**

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4. **Competency**

Internal Auditors:

- 4.1. Shall engage only in those services for which they have the necessary knowledge, skills, and experience.
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The Institute of Internal Auditors



Kentucky Public Pensions Authority

Division of Internal Audit



Independence Statement– Fiscal Year 2024

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Question	Yes or No	Explanation for Yes Response
1. Have you or any of the following had any financial interest, direct or indirect, in any transaction with KPPA, CERS, and/or KRS?	No	
a. Any member of your immediate family (defined as your spouse, children, siblings, parents, and parents of spouses).	No	
b. Any person, firm, etc. in which you have a substantial economic interest.	No	
c. Any firm or corporation of which you are an officer, director, trustee, partner, or employee.	No	
d. Any person for whom you hope, expect, or are negotiating to work.	No	
e. Any person with whom you have any contact or who owes you money and is, therefore, able to affect your economic interests.	No	
2. Have you accepted or solicited anything of value in return for promises of favorable action on any matter that might be the subject of an audit?	No	

3. Are any members of your immediate family currently employed by KPPA, CERS, and/or KRS or have been in the previous three years?	No	
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Please list any personal impairment not discussed on page 2 or answer "None":

None

William Prince

Employee Name (Please Print)

/s/William Prince

Employee Signature

05/18/2023

Date

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The Institute of Internal Auditors



Kentucky Public Pensions Authority

Division of Internal Audit



Independence Statement– Fiscal Year 2024

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b. Any person, firm, etc. in which you have a substantial economic interest.	No	
c. Any firm or corporation of which you are an officer, director, trustee, partner, or employee.	No	
d. Any person for whom you hope, expect, or are negotiating to work.	No	
e. Any person with whom you have any contact or who owes you money and is, therefore, able to affect your economic interests.	No	
2. Have you accepted or solicited anything of value in return for promises of favorable action on any matter that might be the subject of an audit?	No	

3. Are any members of your immediate family currently employed by KPPA, CERS, and/or KRS or have been in the previous three years?	No	
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Please list any personal impairment not discussed on page 2 or answer "None":

None

Riley Morris

Employee Name (Please Print)/s/ Riley Morris05/18/2023

Employee Signature

Date

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The Institute of Internal Auditors

KPPA Audit Committee Meeting - KPPA Audit Committee Administrative Updates

Project Code	Project Name	State	Phase	Scheduled Start	Actual Start	Scheduled End	Actual End	Total FY 2024 Audit Plan Hours	FY 2023 Hours	FY 2024 Hours	Estimated Hours	Estimated Hours Variance
2024-1	Review of Investment Manager Fees	Open	Planning	7/10/2023	5/1/2023	10/13/2023		274.75	195.00	79.75	600.00	(325.25)
2024-2	Review of Member Information Utilized for Retirement	Open	Planning	8/7/2023	5/13/2023	12/8/2023		51.50	51.00	0.50	600.00	(548.50)
2024-3	Review of Interest Applied to Member Accounts	Open	Planning	7/3/2023	5/25/2023	10/19/2023		135.25	107.00	28.25	600.00	(464.75)
2024-4	Review of Expense Allocation	Open	Planning	7/3/2023	5/18/2023	9/15/2023		260.00	183.50	76.50	450.00	(190.00)
2024-5	Implementation of New Legislation	Open	Not Started					0.00	0.00	0.00	300.00	(300.00)
2024-6	Review of Employer Outstanding Invoices	Open	Not Started					0.00	0.00	0.00	600.00	(600.00)
2024-7	Review of Employer Contributions	Open	Not Started					0.75	0.75	0.00	600.00	(599.25)
2024-8	Review of Disclosures During Correspondence	Open	Not Started					0.00	0.00	0.00	600.00	(600.00)
2024-9	Review of Administrative Fees	Open	Not Started					0.00	0.00	0.00	600.00	(600.00)
2024-10	Review of Refunds	Open	Not Started					0.00	0.00	0.00	600.00	(600.00)
2024-Other-1	FY 2024 Board and Committee Meetings	Open	Fieldwork	7/1/2023	7/1/2023	6/30/2024		14.00	0.00	14.00	425.00	(411.00)
2024-Other-2	FY 2024 Process Documentation	Open	Planning	7/1/2023	7/5/2023	6/30/2024		4.25	0.00	4.25	300.00	(295.75)
2024-Other-3	FY 2024 Miscellaneous KPPA Projects/Work Groups	Open	Fieldwork	7/1/2023	7/5/2023	6/30/2024		29.50	0.00	29.50	400.00	(370.50)
2024-Other-4	FY 2025 Audit Charter Updates	Open	Not Started					0.00	0.00	0.00	20.00	(20.00)
2024-Other-5	Trustee Election RFP	Open	Fieldwork	12/1/2022	1/26/2023	12/29/2023		7.00	7.00	0.00	125.00	(118.00)
2024-Other-6	Self-Assessment for Peer Review	Open	Planning	7/5/2023	7/11/2023	9/29/2023		68.50	6.75	61.75	500.00	(431.50)
2024-Other-7	FY 2025 Board Election Policy Updates	Open	Not Started					0.00	0.00	0.00	20.00	(20.00)
2024-Other-8	FY 2024 ACFR and SAFR Review	Open	Not Started					2.00	2.00	0.00	150.00	(148.00)
2024-Other-9	FY 2025 Risk Assessment and Audit Plan	Open	Not Started					15.50	0.00	15.50	300.00	(284.50)
	Administrative Hours	Open	Fieldwork	7/1/2023	7/1/2023	6/30/2024		415.50	0.00	415.50	2,271.00	(1,855.50)
	Non-Working Hours	Open	Fieldwork	7/1/2023	7/1/2023	6/30/2024		172.25	0.00	172.25	650.00	(477.75)
	Holidays	Open	Fieldwork	7/1/2023	7/1/2023	6/30/2024		45.00	0.00	45.00	465.00	(420.00)
								1,495.75	553.00	942.75	11,176.00	

Available Hours FY 2024 (including holidays) 9,975.00
Available Hours Remaining in FY 2024 (including holidays) 9,037.50

FY 2024 Project Hours Charged 310.00
FY 2024 Administrative Hours 415.50
FY 2024 Holidays and Time Off 217.25
Actual Hours Charged for FY 2024 942.75



Kentucky Public Pensions Authority

Internal Audit Administration



To: Members of the KPPA Audit Committee

From: Kristen N. Coffey, CICA
Division Director, Internal Audit Administration

Date: August 24, 2023

Subject: Update on Self-Assessment Project

The Charter for the Division of Internal Audit states that the Division of Internal Audit shall adhere to the *International Standards for the Professional Practice of Internal Auditing* (Standards) issued by the Institute of Internal Auditors (IIA).

- Standard 1300 states, "The chief audit executive must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity."
- Standard 1311 states, "Internal assessments must include: Periodic self-assessments or assessments by other persons within the organization with sufficient knowledge of internal audit practices."
- Standard 1312 states, "External assessments must be conducted at least once every five years..."

In order to comply with the Standards, the Division of Internal Audit recently began the Self-Assessment project. This project was approved on May 25, 2023, as a part of the fiscal year 2024 audit plan. The IIA has developed a Quality Assessment Process Guide for agencies to use when completing the Self-Assessment, including survey/interview questions that must be sent to specific members of agency management and as well as the Audit Committee Chair and Vice Chair.

These surveys were sent to the required individuals on July 14, 2023. The answers we receive will allow us to improve our processes and the services we provide to the agency. Internal Audit staff are also available to perform an in-person (or virtual) interview if an individual would prefer that instead of responding to the survey. We appreciate everyone's help with this process and look forward to receiving your feedback.

Kentucky Public Pensions Authority

Charter for the Division of Internal Audit

Throughout this Charter, the Kentucky Public Pensions Authority Board will be referred to as the Authority. When referring to the Kentucky Public Pensions Authority as an administrative organization, the acronym KPPA will be used. However, in reference to the Audit Committee, “KPPA Audit Committee” will be used. In that instance, KPPA will refer to the Kentucky Public Pensions Authority Board.

I. Charter

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

II. Mission of Internal Audit

Internal Audit helps the Authority as well as the Board of Trustees (Board) of the County Employees Retirement System (CERS) and the Kentucky Retirement Systems (KRS) meet their fiduciary duties by enhancing and protecting organizational value by providing risk-based and objective assurance, advice, and insight.

III. Core Principles of Internal Audit

1. Demonstrate integrity.
2. Demonstrate competence and due professional care.
3. Remain independent, which is defined as objective and free from undue influence.
4. Support the strategies, objectives, and risks of the organization.
5. Remain appropriately positioned and adequately resourced.
6. Demonstrate quality and continuous improvement.
7. Communicate effectively.
8. Provide risk-based assurance.
9. Remain insightful, proactive, and future focused.
10. Promote organizational improvement.

IV. Audit Standards

Internal Audit shall adhere to the *International Standards for the Professional Practice of Internal Auditing* (Standards) issued by the Institute of Internal Auditors (IIA). 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 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.

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

V. ~~Joint~~KPPA Audit Committee

The purpose, statutory authorization, composition, and responsibilities of the ~~Joint~~KPPA Audit Committee are outlined in the Charter for the Audit Committee².

VI. The Internal Audit Function

Definition

As defined by the IIA, internal auditing is “an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

Purpose and Objective

Internal Audit was originally established in July 2003. Internal Audit's purpose is to assist the Authority, the CERS and KRS Boards of Trustees, the Chief Executive Officer (CEO) of both CERS and KRS, and the KPPA Executive Director in fulfilling their governance role.

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 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.

Internal Audit helps the Authority and the systems it is tasked with administering and operating, accomplish their 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. Participating in working groups established to review known or suspected fraud, waste, or abuse in any area of KPPA, CERS, or KRS.
3. Evaluating the relevance, reliability, and integrity of management, financial and operating data, and reports.
4. Evaluating the systems established to ensure compliance with statutory requirements, regulations, policies, plans, and procedures that could have a significant impact on operations.
5. Evaluating the means of safeguarding assets and, as appropriate, verifying the existence of such assets.
6. Evaluating the economy, efficiency, and effectiveness with which resources are employed.
7. Evaluating operations or programs to ascertain whether results are consistent with objectives and goals established by the Authority, CERS, and KRS as well as evaluating whether the operations or programs are being carried out as planned.
8. Assessing the adequacy of established systems and procedures.
9. Conducting special assignments and investigations on behalf of the Authority, CERS, or KRS into any matter or activity affecting the probity, interests, and operating efficiency of KPPA, CERS and KRS.

² https://kyret.ky.gov/About/Meet_the_Administration/Pages/Board-Policies.aspx

Independence

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

1. The Chief Auditor and Internal Audit staff shall be independent of any other office, division, branch, or section.
2. The Chief Auditor and Internal Audit staff shall have direct access, as deemed necessary, to the Authority and/or KPPA, CERS, and KRS staff.
3. The Chief Auditor and Internal Audit staff shall not be involved in the day-to-day operation of the KPPA, CERS, or KRS.
4. The Chief Auditor and Internal Audit staff 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.
5. The Chief Auditor shall have no managerial powers, functions, or duties except those relating to the management of the Division of Internal Audit.

Authority

As described in Kentucky Revised Statutes 61.505, the Chief Auditor shall report directly to the Authority in the performance of all internal audit functions. The Authority has delegated some of this statutory authority to the KPPA Audit Committee. This delegation is described in the Charter for the Audit Committee.

The **[DECISION NEEDED]** will be responsible for approving the Chief Auditor's weekly timesheet, leave requests, work schedule, and training/educational opportunity requests.

It is incumbent that all KPPA, CERS, and KRS staff render assistance to the Chief Auditor and Internal Audit staff in carrying out their audit duties.

1. The Chief Auditor and Internal Audit staff shall 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. This includes having read-only access to internal systems, drives, and websites that are used to store documents, procedures, policies, etc.
2. The Chief Auditor and Internal Audit staff shall have access to generate reports from internal and external systems as deemed necessary for the proper performance of the internal audit function. If there are any disagreements related to access, the disagreements will be addressed by the KPPA Audit Committee in accordance with the Charter for the Audit Committee.
3. The Chief Auditor and Internal Audit staff shall 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 staff all information and such explanations deemed necessary for the Chief Auditor and Internal Audit staff to formulate an opinion on the probity of action, adequacy of systems, and/or of controls.

Activities

The Chief Auditor shall be responsible to the Authority for the functional control of internal 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.

Commented [CK(1): Note to KPPA Board: A decision is needed on who will handle these tasks. These responsibilities can be performed by the Chair of the Audit Committee, the KPPA Chair, or delegated to a KPPA staff member.

The following information was provided in relation to how these tasks are handled for the KPPA Executive Director:

1. HR approves the Executive Director's weekly KHRIS timesheet.
2. The Executive Director notifies his direct reports and the Executive team when he will be out of the office.
3. The Executive Director's work from home schedule was documented in an email but was not officially approved.
4. The Executive Director's flexible work schedule is documented on the KPPA Flexible Work Schedule form and the form was signed by the HR Division Director.

The KPPA Board Chair would approve the Executive Director's requests to attend educational conferences.

5. Assistance in the investigation of significant suspected fraudulent activities and promptly notifying the ~~Joint~~KPPA Audit Committee, the Authority, the CEOs of CERS and KRS, and the appropriate level of KPPA management 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.
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 issued by the Auditing Standards Board (e.g., Statements on Auditing Standards, Statements on Standards for Attestation Engagements, and Statements on Quality Control Standards).
11. Review of the Annual Comprehensive Financial Report(s) and Summary Annual Financial Report(s).

Commented [CK(2)]: These are the AICPA standards discussed at the June 21 Audit Committee meeting.

Relationship with External Auditors

Assistance may be provided to the external auditor during the annual audit of the CERS and KRS financial statements or other audit engagements. The Chief Auditor 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. Upon request, the Chief Auditor shall make available to the external auditors all internal audit working papers, programs, flowcharts, and reports.

VII. Internal Control System

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued the Internal Control – Integrated Framework³ to provide guidance to entities on setting up an effective internal control system. The Government Finance Officers Association recommends governments adopt COSO as the conceptual basis for designing, implementing, operating, and evaluating internal control so as to provide reasonable assurance that they are achieving their operational, reporting, and compliance objectives.⁴

Internal Audit utilizes guidance outlined in the COSO Internal Control Integrated Framework as well as the Standards for Internal Control in the Federal Government⁵ to perform reviews and assessments that help ensure these principles are established and working as intended.

Roles in the Internal Control System

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

1. Oversight Body – This includes the Authority, CERS Board, KRS Board, CERS CEO, and KRS CEO. 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. Management Role – This includes the KPPA Executive Director, Deputy Executive Director, Chief Investment Officer, Executive Director-Office of Operations, Executive Director-Office of

³ [COSO Internal Control - Integrated Framework Principles](#)

⁴ [GFOA Internal Control Framework](#)

⁵ [GAO Standards for Internal Control in the Federal Government](#)

Benefits, Executive Director-Office of Legal Services, and Chief Financial Officer. Management is directly responsible for all activities of an entity, including the design, implementation, and operating effectiveness of the internal control system.

3. Personnel Role – this includes all other KPPA staff. 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 of COSO. Each component consists of different principles that are needed to effectively design, implement, and operate an internal control system. An entity must establish a comprehensive framework for internal control that includes all five essential components identified by the COSO. The entity must also ensure that each component of internal control is functioning in a manner consistent with all relevant principles. Below is a summary of the components and principles. A complete discussion is provided by the COSO Internal Control Integrated Framework (see footnote 3) and the Standards for Internal Control in the Federal Government (see footnote 5).

Commented [CK(3)]: I have provided two options for presenting this data.

Option 1

To determine if an internal control system is effective, auditee management assesses the design, implementation, and operating effectiveness of the five components and 17 principles. If a principle or component is not effective, or the components are not operating together in an integrated manner, then an internal control system cannot be effective.

Summary of Green Book and COSO Components and Principles of Internal Control

Components of Internal Control	Principles
Control Environment	1. Demonstrate Commitment to Integrity and Ethical Values 2. Exercise Oversight Responsibility 3. Establish Structure, Responsibility, and Authority 4. Demonstrate Commitment to Competence 5. Enforce Accountability
Risk Assessment	6. Define Objectives and Risk Tolerances 7. Identify, Analyze, and Respond to Risks 8. Assess Fraud Risk 9. Identify, Analyze, and Respond to Change
Control Activities	10. Design Control Activities 11. Design Activities for the Information System 12. Implement Control Activities
Information and Communication	13. Use Quality Information 14. Communicate Internally 15. Communicate Externally
Monitoring	16. Perform Monitoring Activities 17. Evaluate Issues and Remediate Deficiencies

Option 2

A. 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 organization demonstrates a commitment to integrity and ethical values.

2. The oversight body demonstrates independence from management and exercises oversight of the development and performance of internal control.
3. Management establishes, with board oversight, structures, reporting lines, and appropriate responsibility to achieve the entity's objectives.
4. Management demonstrates a commitment to recruit, develop, and retain competent individuals.
5. Management evaluates performance and holds individuals accountable for their internal control responsibilities.

B. 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:

6. Management defines objectives clearly to enable the identification and assessment of risks and defines risk tolerances.
7. Management identifies, analyzes, and responds to risks related to achieving the defined objectives.
8. Management considers the potential for fraud when identifying, analyzing, and responding to risks.
9. Management identifies, analyzes, and responds to significant changes that could impact the internal control system.

C. 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:

10. Management designs control activities to achieve objectives and mitigate risks.
11. Management designs the entity's information system and related control activities to achieve objectives and mitigate to risks.
12. Management implements control activities through policies and procedures.

D. Information and Communication

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

13. Management uses relevant, quality information to support the functioning of internal controls.
14. Management internally communicates the necessary objectives and responsibilities for internal control.
15. Management externally communicates matters affecting the functioning of internal controls.

E. 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:

16. Management selects, develops, and performs evaluations to ensure internal controls are present and functioning.
17. Management evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action.

VIII. Scope of Responsibilities

In order fulfill the Internal Audit mission, staff will be responsible for the following activities:

Internal Audit Function

1. In coordination with KPPA Division of Human Resources, Chief Auditor will appoint all employees deemed necessary to fulfill the mission of Internal Audit.
2. Chief Auditor will oversee the day-to-day operations of Internal Audit.
3. Chief Auditor will work cooperatively with the CEOs of the CERS and KRS as well as KPPA management.

Internal Controls and Compliance

1. Work with the KPPA Audit Committee, the CEOs for the CERS and KRS, and the KPPA Executive Director and other appropriate KPPA staff in the performance of an annual risk assessment.
2. Develop an audit plan to address items noted in the risk assessment.
3. Review and evaluate effectiveness of policies and procedures that are in place to determine if they achieve strategic, risk management and operational objectives.
4. Perform audit, consulting, and assurance services as well as special projects in support of the Audit Plan and in compliance with Internal Audit procedures.

Board and Committee Meetings

1. Prepare agenda and meeting materials (to be presented by Internal Audit) for KPPA Audit Committee meetings.
2. Strive to provide meeting materials (to be presented by Internal Audit) to trustees at least one week prior to the meeting date.
3. Present results of audit, consulting, and assurance services as well as results of special projects to the KPPA Audit Committee and the Authority. If requested, present results to the CERS and/or KRS Boards of Trustees or any committee of those Boards.

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~~KPPA Audit Committee. The findings, recommendations, and management comments will be presented to the ~~Joint~~KPPA Audit Committee for approval and for subsequent ratification by the Authority.

IX. 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.

2. Internal Audit 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. Internal Audit 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 non-compliance.
5. Cost of assurance in relation to potential benefits.
6. Use of various software tools including, but not limited to TeamMate, Excel, Access, Word, Tableau, and Gravity.

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. 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 must 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 **[DECISION NEEDED]** shall review the performance for the Chief Auditor.

Records Retention and Disposition

As required by the Kentucky Department for Libraries and Archives, Internal Audit shall retain a complete file of each audit and consulting service made under its authority for a period of eight (8) years and an

Commented [CK(4)]: Note to the KPPA Board: A decision is needed on who will perform the evaluation of the Chief Auditor and how this will be documented.

electronic copy of all final reports shall be retained by Internal Audit indefinitely. To guard against identity theft and fraud, destruction of business records and materials shall be done in a secured manner such as using the on-site Division of Waste Management recycle containers. All CD/DVD materials shall be submitted to the KPPA Information Security Officer.

X. 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 Chief Auditor will provide the results, including planned corrective action, of the internal and external assessments to the KPPA Audit Committee.

Internal Assessments

1. Ongoing ~~Internal Assessments~~Monitoring – Ongoing ~~internal assessments~~monitoring 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-ongoing monitoring~~ are engagement supervision; feedback from auditees, KPPA management, and the KPPA Audit Committee; Audit Plan completion; and identification and analysis of other performance metrics such as recommendations accepted.
2. Periodic Assessments – Internal Audit will conduct a Self-Assessment as outlined by the IIA. Internal Audit will strive to complete a Self-Assessment every three years.

Commented [CK(5)]: Changed from Ongoing Internal Assessment to Ongoing Monitoring to reflect the language used in the Standards.

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. The Chief Auditor will disclose the results and any needed corrective action to the KPPA Audit Committee.

XI. 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 Authority and collaborates with trustees and KPPA, CERS, and KRS staff to enhance assurance and accountability at all levels of KPPA, CERS, and KRS. 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 KPPA Audit Committee; the Authority; the CERS and KRS Boards; or any member of KPPA, CERS, or KRS staff. If a request is

made by someone outside of the [KPPA](#) Audit Committee, the Chief Auditor will seek approval from the Chair of the [KPPA](#) Audit Committee before engaging in the service. Internal Audit provides the following types of audits, consulting, and assurance services.

Audits

1. Internal Control Audits – Internal Control audits serve as a systematic evaluation of the effectiveness and efficiency of internal controls in mitigating risks and ensuring the reliability of financial reporting. An Internal Control audit aims to assess the design, implementation, and operating effectiveness of controls across various business processes and functions. This comprehensive examination involves evaluating the adequacy of policies, procedures, segregation of duties, access controls, and monitoring mechanisms. An Internal Control audit can identify weaknesses, gaps, and potential vulnerabilities within systems, which enables KPPA to implement corrective measures and strengthen their control environment. Ultimately, these audits contribute to the overall governance, risk management, and compliance framework of KPPA, promoting transparency, accountability, and the achievement of strategic objectives.
2. Compliance Audits – Compliance audits determine whether an organizational area has complied with federal law, [Kentucky Revised Statutes](#), [Kentucky Administrative Regulations](#), agency policies and procedures, and division specific procedures,
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 goals. Efficiency is measured by how well the business unit uses resources to achieve the 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 sources outside of Internal Audit. These audits are normally requested by a trustee or staff of the KPPA, CERS, or KRS as a result of information received from a tip. These audits focus on alleged, irregular conduct. Reasons for investigative audits may include internal theft, misuse of agency property, and/or conflicts of interest. [The Chief Auditor will refer this information](#) to the [KPPA](#) Audit Committee Chair and Executive Director, Office of Legal Services. The Executive Director, Office of Legal Services will take immediate action 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. [The KPPA Audit Committee, in coordination with](#) the Executive Director, Office of Legal Services and appropriate KPPA management will determine if an investigative audit needs to be conducted by Internal Audit, in accordance with Internal Audit procedures. These audits 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~~[KPPA](#) Audit Committee. The ~~Joint~~[KPPA](#) Audit Committee will determine if further actions are needed. The ~~Joint~~[KPPA](#) 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 may be involved in the evaluation/implementation of a new system to review the system development methodology and the effectiveness and efficiency of the internal controls 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. At least every five years, the Auditor of Public Accounts performs the annual financial audit.
 - b. A limited financial audit concentrates on a review of specific financial transactions. The primary concerns include determining the 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.

An engagement may involve more than one type of audit. For example, most audits performed are a combination of an internal controls, compliance, and operational audit.

Assurance Services – Assurance services help the organization improve their operations and financial performance.

1. 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 findings identified while performing other types of services within a particular division.
2. 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 Revised Statutes](#), [Kentucky Administrative Regulations](#), 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.

Consulting Services – Consulting services help organizations improve their efficiency and effectiveness.

1. Internal Audit staff may participate in the preparation of the Strategic Plan.
2. Internal Audit staff may participate on various work groups including, but not limited to, the KPPA Information Technology Governance team, the Continuity of Operations team, and other similar

KPPA, CERS, or KRS working groups in order to provide an unbiased review of any policies and procedures created from these teams.

Other Services

1. 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 timeframe to determine if any expenditures were improperly coded to the account(s). Internal Audit would review the requested account(s) over the specified timeframe 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.
2. Annual Report Review – Each year, KPPA personnel prepares an Annual Comprehensive Financial Report for the County Employees Retirement System and Kentucky Retirement Systems. Prior to presentation to the Authority, the CERS Board, and KRS Board, Internal Audit will perform a review the Annual Comprehensive Financial Report and identify any perceived errors or discrepancies. However, the KPPA staff, not Internal Audit, is responsible for the substantive content, accuracy, consistency, and completeness of the Annual Comprehensive Financial Report.
3. Summary Annual Financial Report Review – Each year, KPPA personnel prepares a Summary Annual Financial Report for the County Employees Retirement System and Kentucky Retirement Systems. Internal Audit will review the Summary Annual Financial Report and identify any perceived errors or discrepancies. However, the KPPA staff, not Internal Audit, is responsible for the substantive content, accuracy, consistency, and completeness of the Summary Annual Financial Report.
4. Referencing – During the course of various types of audit, consulting, and assurance services, the Chief Auditor 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.
5. 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](#).

XII. 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. Prior to the audit: Objectives and scope of the audit to be conducted.
2. During the audit:
 - a. Preliminary findings and recommendations. These will be provided to staff in charge of the area under review and may also be provided to the Executive Director over the area under review, if requested.

- b. Documentation of audit processes, including information that will be used to develop the background of the audit report and/or included as an exhibit in the audit report. This information will be provided to staff in charge of the area under review and may also be provided to the Executive Director over the area under review, if requested.
 - c. Final findings and recommendations. These will be released to management over the area under review so a response can be provided.
 - d. Draft audit report, without management's responses. This will be released to Executive Director over the area under review and the KPPA Executive Director.
3. Upon completion of the audit: Completed audit report that includes final findings and recommendations with management's response to the findings and any additional auditor responses.

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 KPPA Audit Committee, the Authority, the CEOs of the CERS and KRS, and applicable members of KPPA staff. 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.

XIII. Annual Risk Assessment and Audit Plan

Consistent with the long-term strategic plan, the Chief Auditor shall prepare an annual Risk Assessment and Audit Plan providing for the review of significant operations of KPPA, CERS, and KRS pertaining to the achievement of objectives.

The Risk Assessment and Audit Plan shall be presented to the KPPA Audit Committee for deliberation and approval. Upon approval by the KPPA Audit Committee, the Risk Assessment and Audit Plan will be submitted to the Authority for ratification. After ratification by the Authority, the Risk Assessment and Audit Plan may be presented to the CERS Board and KRS Board for informational purposes.

Risk Assessment

Internal Audit assesses risks of KPPA, CERS, and KRS by seeking input from the trustees of the Authority, CERS, and KRS as well as key personnel of KPPA, CERS, and KRS. 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, impact to the financial statements and organization reputation.

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.

Internal Audit staff utilize audit software to determine the overall risk of each item in the audit universe. The inherent risk and inherent likelihood of each item are scored using a point value with zero (0) representing the lowest level and ten (10) representing the highest level of inherent risk/likelihood. The risk and likelihood individual scores are combined to generate the overall risk to the KPPA, CERS, and KRS. The overall risk scores for all items are then ranked highest to lowest.

Audit Plan

Based upon the results of the Risk Assessment as well as requests from trustees and/or KPPA, CERS, and KRS management, Internal Audit develops the Audit Plan. The Audit Plan is created 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.

Throughout the fiscal year, the Audit Plan may be reviewed, evaluated, and modified according to the specific risk factors related to KPPA, CERS, and KRS operations and internal controls. If an adjustment is needed to the Audit Plan based on the periodic evaluation or if Internal Audit receives a request to complete an audit not previously identified on the Audit Plan, the requested modification(s) shall be forwarded to the Chair of the KPPA Audit Committee for approval.

1. The Chair of the KPPA Audit Committee can approve the requested modification(s) without seeking input from the rest of the KPPA Audit Committee. In these instances, the requested modification(s) will be added to the Audit Plan and reported to the KPPA Audit Committee as a part of the update on the "Status of Current Projects" at the next regularly scheduled KPPA Audit Committee meeting.
2. The KPPA Audit Committee Chair can call a special meeting to discuss the requested modification(s). In these instances, the KPPA Audit Committee will vote on whether to make the requested modifications to the Audit Plan.

Tracking Projects

Internal Audit staff continually track audits and other projects with electronic audit software. If a request is made to complete projects not foreseen during the development of the audit plan, these additional projects are also tracked through the audit software. The status of current projects is presented to the KPPA Audit Committee at each quarterly meeting. All findings and recommendations, including status and implementation dates, are thoroughly tracked, and documented using appropriate methodologies.

XIV. Internal Audit Procedures

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

XV. Approvals

We, the undersigned, do certify that this Charter was approved on 28th day of September 2023.

| KPPA Audit Committee Chair

Date

Board Chair
Kentucky Public Pensions Authority

Date

Chief Auditor

Date

History: Approval Date: September 28, 2023
 Amended:

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**

TONE — at the — TOP®

Providing senior management, boards of directors, and audit committees with concise information on governance-related topics.

Issue 116 | April 2023

Adjusting the Risk Appetite for Non-Financial Measures

Risk appetite — the level of risk that an organization is prepared to accept in pursuit of its objectives — is fundamental to effective governance in all organizations, and boards play a critical role in setting that appetite. But are credit and market risks and other financial factors the only issues that should be considered? Despite their name, non-financial risks can also have a significant financial impact on an organization. As companies focus on governance, risk, and compliance concerns, they should consider how non-financial risk is impacting the success of their enterprise risk management (ERM) efforts and overall risk appetite.

The sheer number of risks that fall into the non-financial category raises the chances that some may be overlooked. They may include operational, compliance, cybersecurity, reputational, environmental, employee conduct, ethical and corporate culture, public health, social justice, diversity, equity and inclusion, human rights, strategic, third-party, geopolitical, natural resources, human resources, and data integrity risk—among others. This partial list shows just how significant non-financial risks can be and makes the case for incorporating them into any discussion on risk appetite. Indeed, “non-financial risks now pose a potentially costlier threat than financial exposures,” according to PwC.¹

“Non-financial risks now pose a potentially costlier threat than financial exposures.” PwC

Expecting the Unexpected

Organizations should be aware that this is an evolving area where new and unfamiliar risks should be expected to emerge. Five years ago, for example, few companies had protocols in place to deal with a potential global health crisis that would interrupt worldwide economic activity, upend supply chains, and bring some industries to a virtual halt, but the COVID-19 pandemic highlighted the need to expect the unexpected.

Even when organizations believe they have their arms around potential non-financial risks, they may not anticipate all the issues that can arise. Privacy risk, for example, seems like a well-known consideration, but it can become a problem in unexpected ways. One well-known retailer experienced reputational damage when

it was reported that a parking system app used by its landlord was tracking customers’ browser usage. In the uproar that ensued, the retailer argued that it was not in charge of the app, but the reputational damage was done.

The board has an important role in this effort. Regarding environmental, social and governance (ESG) issues, which encompass many common types of non-financial risk, “boards need to continuously examine and question information provided by management and recognize that ESG is an enterprise-level risk that should be viewed through the lens of strategy and operations,” according to a National Association of Corporate Directors report.²

An Alphabet Soup

Identifying and measuring non-financial risk is an important concern, but there is little consistency in guidance on how this should be done. There is currently an alphabet soup of frameworks and standards that organizations can choose to use but no actual comprehensive requirements at the federal level in the United States and no globally embraced standards. For the moment, the available guidance covers a number of different areas, as demonstrated by the 23 non-financial measurement and reporting standards and frameworks in a list compiled by the Center for Sustainable Organizations.³ They are categorized based on considerations such as primary constituency of interest (shareholder versus stakeholder), performance constructs of interest (risk, value creation/impact valuation, sustainability), triple bottom line considerations, and primary form of measurement (incrementalist versus context based). Organizations can choose to follow one set of guidelines, to mix and match rules from more than one, or to opt out of this type of reporting altogether. However, the latter may not be a truly viable option going forward. Internal audit can provide insights to help organizations make sense of measurement and reporting options at a time when there is increasing pressure on organizations from a wide range of stakeholders who want more information and transparency on non-financial issues, including ESG. For some of the world's largest institutional investors, "ESG has become a proxy for good risk management and long-termism, two primary concerns today," according to management consulting firm Russell Reynolds Associates.⁴

ISSB REPORTING STANDARDS

In November 2021, the IFRS Foundation trustees announced the creation of a new standard-setting board—the International Sustainability Standards Board (ISSB)—to help meet demands for high-quality, transparent, reliable, and comparable reporting by companies on climate and other environmental, social and governance (ESG) matters.

The ISSB was tasked with developing a comprehensive global baseline of sustainability-related disclosure standards that provide investors and other capital market participants with information about companies' sustainability-related risks and opportunities to help them make informed decisions.

The new ISSB reporting standards addressing climate and sustainability reporting are expected to be published by the end of the second quarter of 2023.

An Evolving Regulatory Landscape

The number of disclosure regulations involving non-financial risk is growing rapidly worldwide, with European Union regulators leading the way. In the U.S., reporting regulations in two non-financial areas are on the imminent horizon. Last year, the U.S. Securities and Exchange Commission (SEC) proposed to require registrants to include specified climate-related and cybersecurity disclosures in their registration statements and periodic reports. For climate concerns, disclosures would include details on risks that could have a material impact on the

business, results of operations, or financial condition, along with some climate-related financial statement metrics and disclosures on greenhouse gas emissions.⁵ Regarding cybersecurity, there would be amendments to the commission's rules to enhance and standardize disclosures regarding cybersecurity risk management, strategy, governance, and incident reporting by public companies.⁶ Although the proposals are aimed at listed companies, private company stakeholders may also press for similar disclosures.

Gathering Non-Financial Risk Data

Many organizations may have some well-established procedures in place related to specific non-financial information, so it's important to understand what data is already available, especially if reporting and disclosure becomes mandatory in some areas. Companies likely have collected a great deal of data for compliance with rules set by regulatory bodies. In the U.S., examples include the Environmental Protection Agency, Occupational Safety and

Health Administration, Department of Labor, Department of Commerce, and others. Risk management procedures related to COSO's internal control framework and ISO management systems may also be capturing information on non-financial issues. Internal audit can help companies assess the data on hand to identify information gaps and to avoid duplication of efforts.

About The IIA

The Institute of Internal Auditors (IIA) is a nonprofit international professional association that serves more than 230,000 global members and has awarded more than 185,000 Certified Internal Auditor (CIA) certifications worldwide. Established in 1941, The IIA is recognized throughout the world as the internal audit profession's leader in standards, certifications, education, research, and technical guidance. For more information, [visit theiia.org](https://theiia.org).

The IIA

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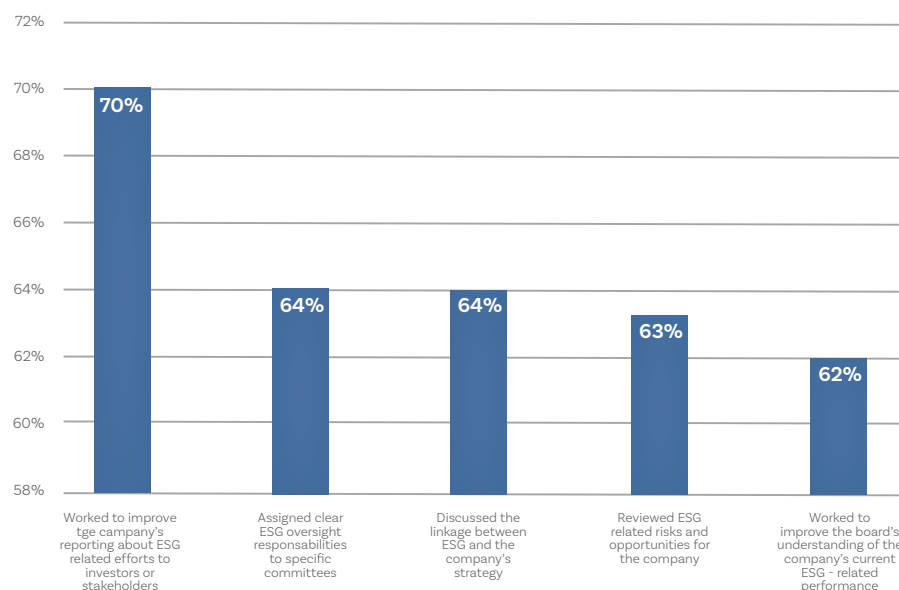
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However, even though companies may already have information, it's important to be aware that, because of the lack of consistent reporting requirements for non-financial risks and lack of familiarity with this area, the processes and procedures around them may be inadequate. Controls and risk assessment procedures may be less developed in some functions than in others, or insufficient for current needs. The information may be coming from a range of areas—such as human resources, procurement, ESG, or sales—making it challenging to identify and gather. Regarding ESG, “fraud risk in this area should be top of mind for audit committees and a focal point in fraud risk assessments overseen by the audit committee,” according to a Deloitte report, which noted that this risk is not governed by the same types of controls present in financial reporting processes. As a result, it may be easier to manipulate voluntarily reported data on carbon emissions or other key non-financial measures.⁷

Private companies may find their controls are lacking. There's clearly room for boards to make a difference on this front. Fourteen percent of private companies told the NACD that their boards had not focused on ESG issues over the past 12 months, compared to only 3% at public companies, which face more demands for data in this area. Only 39% of private companies said their board has reviewed ESG-related risks and opportunities for the company.⁸ (See figure 1.)

Figure 1 - Which ESG Oversight Practices Have Boards Performed in the Last 12 Months?



Source: 2022 NACD Board Practices and Oversight Survey—ESG: Compare and Contrast Among Public and Private Companies

Involving Internal Audit

To help leadership understand and tackle non-financial risks, internal audit leaders can use their holistic understanding of the entity's many facets—and threats—to identify risk considerations and provide advice on how best to deal with them.

Internal audit teams build their audit plans on a number of factors, among them the organization's overall risk appetite. Auditors consider the organization's financial risk limits and appetite statements, as well as considerations such as laws and regulations, organizational policies and standards, and the

expectations of stakeholders—such as the board, investors, analysts, customers, employees, and business partners—as well as industry standards.

One step for boards is to see that internal audit has a chance to play a critical role in ensuring the completeness and accuracy of non-financial data. Unfortunately, many organizations are not making full use of the contribution that internal audit can make. The chief audit executive (CAE) reports to the board on ESG issues at only 11% of public companies surveyed and 8% of private companies, according to the NACD survey.

Internal audit can provide assurance and advice that can help mitigate and identify risks that include:

- **Impact on the business model.** Companies may find themselves facing unexpected pressure to adopt new practices that address unexpected non-financial risks.
- **Loss of competitive edge.** Non-financial risks have the potential to damage a company's market share and reputation.
- **Difficulty accessing capital or higher borrowing costs.** Investors or lenders may require greater transparency on non-financial risks than the company can offer.
- **Labor disadvantages.** A tight hiring market or lack of employee engagement could be damaging, particularly if a company appears as an unappealing place to work.
- **Social and geopolitical implications.** Companies may fail to anticipate localized social or civil unrest.

A Deep Understanding

"Risk management cannot be seen as a collection of static practices but must evolve to keep pace with rapidly changing business models," according to a McKinsey report.⁹ As companies monitor and maintain risk approaches for non-financial data, internal audit can provide a deep understanding of the organization and ongoing insights in a changing and uncertain risk landscape.

QUESTIONS FOR BOARD MEMBERS

- » Are non-financial risks incorporated into our organization's risk appetite?
- » How does our organization monitor non-financial risk?
- » What controls are in place to identify, prevent or mitigate non-financial risks?
- » Are these controls regularly evaluated and updated?
- » Is the board receiving independent assurance from internal audit on non-financial risk measurement and oversight?



Quick Poll Question



Are non-financial risks incorporated into your organization's risk appetite?

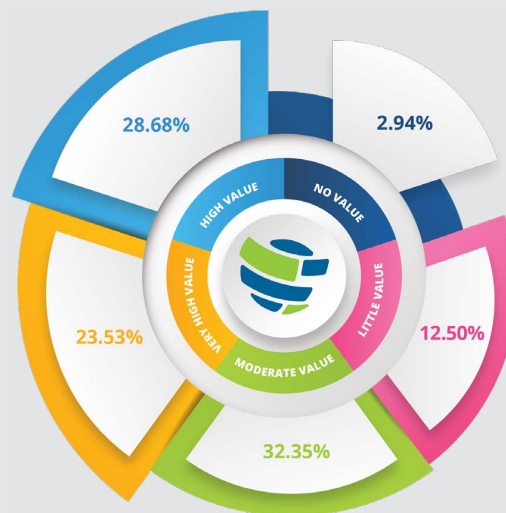
- ☐ Yes
- ☐ No
- ☐ Don't Know

Visit theiia.org/Tone to answer the question and learn how others are responding.

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QUICK POLL RESULTS

Overall, how would you rate the value that has been created from internal audit's use of data analytics or automation at your organization?



Source: Tone at the Top December 2022 Quick Poll Survey.

¹["Taking Control: How to Get on Top of Non-Financial Risk," Christopher Eaton and David O'Brien, PwC, March 9, 2021.](#)

²2022 NACD Board Practices and Oversight Survey—ESG: Compare and Contrast Among Public and Private Companies, NACD, 2022.

³<https://www.sustainableorganizations.org/Non-Financial-Frameworks.pdf>

⁴["ESG and Stakeholder Capitalism," Andrew Droste, Russell Reynolds Associates, published by Bloomberg Law, April 2020.](#)

⁵["SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors," US Securities and Exchange Commission press release, March 21, 2022.](#)

⁶"SEC Proposes Rules on Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure by Public Companies," SEC press release, March 9, 2022.

⁷["Emerging Fraud Risks to Consider: ESG: On the Audit Committee's Agenda," Deloitte, July 2022.](#)

⁸2022 NACD Board Practices and Oversight Survey—ESG: Compare and Contrast Among Public and Private Companies, NACD, 2022.

⁹["Financial Institutions and Nonfinancial Risk: How Corporates Build Resilience," Bjorn Nilsson, Thomas Poppensieker, Sebastian Schneider, and Michael Thun, McKinsey, February 28, 2022.](#)