

**KPPA Audit Committee
August 27, 2024 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 May 30, 2024 KPPA Audit Committee Minutes* | Bill O'Mara |
| 6. | External Audit Updates | |
| | a. Internal Audit Self-Assessment with External Validation | Sonja Heath |
| | b. Overview of Fiscal Year 2024 External Audit | Ryan Graham,
Blue and Co. |
| 7. | Financial Statements for Fiscal Year Ended June 30, 2024 (unaudited) | Mike Lamb |
| 8. | Legal Updates | |
| | a. Information Disclosure Incidents | Carrie Bass |
| | b. Anonymous Tips | Stephanie Hold |
| 9. | KPPA Audit Committee Administrative Updates | Kristen Coffey |
| | a. Audit Plan for FY 2025 and proposed for FY 2026 with Risk Assessment* | |
| | b. Staffing Update | |
| | c. Internal Audit Budget as of 6/30/2024 | |
| | d. Status of Current Internal Audit Projects | |
| | e. Issued Reports and/or Memorandums* | |
| | i. Review of Legislative Process (Reissue) | |
| | ii. Review of Interest Added to Member Accounts | |
| | iii. Review of Outstanding Employer Invoices | |
| | iv. Review of ERCE Contributions | |
| | v. Review of Refunds | Will Prince |
| 10. | Professional Article | Will Prince |
| | a. Fundamentals of COSO Framework – Building Blocks for Integrated Internal Controls | |
| | b. Audit Committee Performance Evaluations Guide | |
| 11. | Adjourn | Bill O'Mara |

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

**MINUTES OF MEETING
KENTUCKY PUBLIC PENSIONS AUTHORITY
AUDIT COMMITTEE
MAY 30, 10:00 A.M., E.T.
VIA LIVE VIDEO TELECONFERENCE**

At the May 30, 2024 Meeting of the Audit Committee of the Kentucky Public Pensions Authority, the following Committee members were present: William O'Mara (Chair), George Cheatham, Lynn Hampton, and William Summers, V. Staff members present were CERS CEO Ed Owens, III, KRS CEO John Chilton, David Eager, Erin Surratt, Michael Board, Victoria Hale, Stephanie Hold, Michael Lamb, Connie Davis, Kristen Coffey, Matthew Daugherty, William Prince, Madeline Evans, Elizabeth Smith, Jillian Hall, Dominique McKinley, Ashley Gabbard, Phillip Cook, Sherry Rankin and Katie Park.

Mr. O'Mara called the meeting to order.

Mr. Board read the Opening Statement.

Ms. Rankin called roll.

Ms. Rankin reported that one *Public Comment* was received and read it aloud.

Submitted by Thomas M Wathen

“Why when a person is forced to take Medicare for non Hazardous duty at age 65 is required for their 15 year old son who is also drawing Social Security to pay \$940.00 a month for Insurance for his child. If I was Hazardous Duty I would pay nothing for the Childs Insurance but since I am non Hazardous duty I have to pay \$940.00 a month for insurance beginning December 1, 2024. This is not fair since I paid into the system over \$350,000.00 into the system. The LFUCG put in the same amount. This health insurance system is good only for the Hazardous duty Retirement people. Can you explain the high expense for Non Hazardous duty people forced to go on Medicare.”

Next, Mr. O'Mara introduced the agenda item *Election of Vice Chair* (Video 00:08:34 to

00:09:44). Mr. O'Mara opened the floor for nominations for the office of Vice Chair. Mr. Cheatham nominated Ms. Hampton and was seconded by Mr. Summers. No other nominations were presented, and a motion was made by Mr. Cheatham and seconded by Mr. Summers to elect Ms. Hampton as Vice Chair. The motion passed unanimously.

Next, Mr. O'Mara introduced the agenda item *Approval of February 27, 2024 KPPA Audit Committee Minutes* (Video 00:09:45 to 00:10:44). Ms. Hampton made a motion to approve the minutes as presented. The motion was seconded by Mr. Cheatham and passed unanimously.

Mr. O'Mara introduced the agenda item *Legal Updates* (Video 00:10:45 to 00:14:35). Ms. Jillian Hall presented Potential Information Disclosures/Breaches affecting the KPPA for the third quarter of Fiscal Year 2024. She reported that a total of 14 potential incidences were identified and investigated, of which eight (8) were determined to be disclosures or breaches. She pointed out the steps taken by KPPA staff and outside vendors to remedy the issues.

Next, Ms. Stephanie Hold presented the Anonymous Tips received regarding fraud, waste, and abuse. Since the KPPA Audit Committee met on February 27, 2024, five (5) fraud tips were received. Two (2) of the tips were closed following review and three (3) of these tips are currently open. As of the date of this memo, there were eight (8) cases in open status, reported Ms. Hold.

Mr. O'Mara introduced the agenda item *Update on Emergency Plan* (Video 00:14:36 to 00:39:07). Ms. Rebecca Adkins and Ms. Dominique McKinley provided answers that were previously raised by Committee members regarding the KPPA Emergency Plan. Ms. McKinley reviewed in detail the Disaster Recovery Exercise that is performed on a yearly basis. Ms. Adkins and Ms. McKinley answered questions from the Committee members and provided information related to account security.

Mr. O'Mara introduced the agenda item *KPPA Audit Committee Administrative Updates* (Video 00:39:08 to 01:39:11). Ms. Coffey reviewed the proposed changes made to the Charter for the KPPA Audit Committee, which included updating the name of the Committee from Joint Audit to KPPA Audit and updating Section VI. Scope of Responsibilities, number three (3) under Other to reflect the evaluation is recommended rather than required. She did mention that

there have been some discussion surrounding the composition of the committee to possibly allowing non-KPPA Trustees to be appointed to the KPPA standing committees. If this occurs, Section IV. Composition would need to be updated to reflect the decision of the Board. Ms. Hampton made a motion to approve the proposed changes from requirement of a members' performance evaluation to recommended. Mr. Cheatham seconded the motion and it passed unanimously.

Then, Ms. Coffey presented the Charter for the Division of Internal Audit Administration for the Committee's review. Ms. Coffey indicated that there are no proposed changes at this time and asked the Committee for any recommended changes. There being none provided, Ms. Hampton made a motion to approve the Charter for the KPPA Audit and the Charter for the Division of Internal Audit as presented with noted changes. Mr. Cheatham seconded the motion and it passed unanimously.

Next, Ms. Coffey introduced William Prince who reviewed the Fiscal Year 2025 Auditor Independence Statements. Mr. Prince indicated that the material includes the Annual Independence Statements for all employees of the Division of Internal Audit Administration, except for the Audit Intern who was recently hired. He stated that one can be provided to the Committee should they wish to receive it. These were presented for informational purposes only.

Next, Ms. Coffey introduced Matthew Daugherty who presented the Internal Audit Budget as of March 31, 2024. He reviewed the current budget and the proposed Fiscal Year 2025 Internal Audit Budget. Ms. Coffey answered questions by the committee regarding the personnel and salary line. The Committee asked to be notified of any potential change in salary, including reclassifications, prior to any action is taken. Ms. Coffey agreed and asked the Committee if she can move forward with a search for a supervisory position. She stated that she is currently working with the Human Resource office and the position will go through Personnel. The Committee agreed for her to move forward with the process. Ms. Hampton made a motion to approve the Fiscal Year 2025 Internal Audit Budget as presented. Mr. Cheatham seconded the motion and the motion passed unanimously.

Then, Mr. Daugherty reviewed the Current Status of Audit Projects as of April 30, 2024 report.

With no questions from the Committee, Ms. Coffey reviewed the Update on Open Internal Audit Findings and Recommendations. She reported that as of January 31, 2024, there were 22 open internal audit recommendations that had passed their estimated implementation date. Of those, nine (9) items were closed and remediation was verified by Internal Audit staff; eight (8) items remain open and a new remediation date has been established; four (4) items were closed with no action taken and management accepted the risk of not implementing the suggested recommendation; and one (1) item needs additional input from the KPPA Audit Committee and KPPA Board before the status can be determined.

Ms. Coffey then focused on the one (1) item that needs additional review. She stated that Kentucky Revised Statutes 61.706 references the Kentucky Retirement Systems. However, it is unclear if this is a reference to the former Kentucky Retirement Systems or the Kentucky Retirement Systems as defined by Regular Session 2020 House Bill 484. She indicated that Internal Audit recommended that the KPPA Executive Director of Legal Services review Kentucky Revised Statutes 61.706 and determine if this statute should be updated to reference the Kentucky Public Pensions Authority rather than Kentucky Retirement Systems. Ms. Coffey stated that during this review it was communicated to Internal Audit staff that the Trustees did not desire for KPPA staff to look into this matter. Ms. Coffey requested a motion to close this item if that is the wishes of this Committee. Mr. Board provided some background information as to the stance of KPPA Office of Legal Services regarding this matter. Mr. Lamb also provided information he received from the Office of Financial Management regarding the account which is the subject of this statute. Ms. Hampton made a motion to close this item, Item #9 on the Open Audit Findings. Mr. Cheatham seconded the motion and the motion passed unanimously.

Then, Ms. Coffey provided an update on the Internal Audit Quality Assessment with Validation project.

Ms. Evans then reviewed the Issued Reports and/or Memorandums. The first report, 2024-2 Verifying Final Retirement Calculations (Normal and Early Retirement), resulted in no reportable findings being noted as a part of this audit. She indicated that certain other matters were communicated to the Division of Employer Reporting in a separate letter dated April 30, 2024.

Then, Ms. Evans reviewed the next report, 2024-5 Implementation of New Legislation, which had four (4) findings. Ms. Evans reviewed the findings in detail and discussions were held around these findings.

Mr. Prince reviewed the final report, 2024-8 Disclosures During Correspondence, which had two (2) reportable findings. Mr. Prince reviewed the findings in detail and discussions were held around these findings.

*** Mr. Summers left the meeting ***

Ms. Hampton made a motion to accept the Issued Reports of 2024-2 Verifying Final Retirement Calculations (Normal and Early Retirement) and 2024-8 Disclosures During Correspondence and resubmitting 2024-5 Implementation of New Legislation. Mr. Cheatham seconded the motion and the motion passed unanimously.

Mr. O'Mara introduced the agenda item **Professional Article** (*Video 01:39:12 to 01:42:14*). Mr. Prince presented an overview of the professional article "Root Cause Analysis Explained: Definition, Examples, and Methods".

There being no further business, Mr. O'Mara **adjourned** the meeting.

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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 May 30, 2024, were approved by the Audit Committee on August 27, 2024.

Committee Chair

I have reviewed the Minutes of the Audit Committee Meeting on May 30, 2024, for form, content, and legality.

Executive Director
Office of Legal Services



KPPA
Kentucky Public Pensions Authority

**Quality Assurance and Improvement Plan – Self-Assessment
with Independent External Validation**

As of June 14, 2024

Issued July 22, 2024

Acronyms

The following acronyms will be used throughout the report:

1. Standards - *International Standards for the Professional Practice of Internal Auditing*
2. QAIP – Quality Assurance Improvement Plan
3. KPPA - Kentucky Public Pensions Authority
4. CERS - County Employees Retirement System
5. KRS - Kentucky Retirement System
6. CEO – Chief Executive Officer
7. IIA - Institute for Internal Auditors

Background

The *Standards* require that an external quality assessment of an internal audit activity must be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organization. The qualified assessor or assessment team must demonstrate competence in both the professional practice of internal auditing and the quality assessment process. The quality assessment can be accomplished through a full external assessment or a self-assessment with independent validation.

Opinion

It is our overall opinion that the Division of Internal Audit generally conforms with the *Standards* and generally conforms with the Code of Ethics.

A detailed list of conformance with the individual standards and the Code of Ethics is shown in appendix A.

The Institute of Internal Auditors' *Quality Assessment Manual for the Internal Audit Activity* suggests a scale of three rankings when opining on the internal audit activity: "Generally Conforms," "Partially Conforms," and "Does Not Conform."

1. "Generally Conforms" means that an internal audit activity has a charter, policies, and processes that are judged to be in conformance with the *Standards* and/or the Code of Ethics.
2. "Partially Conforms" means that deficiencies in practice are noted that are judged to deviate from the *Standards* and/or the Code of Ethics; however, these deficiencies did not preclude the internal audit activity from performing its responsibilities in an acceptable manner.
3. "Does Not Conform" means that deficiencies in practice are judged to deviate from the *Standards* and/or the Code of Ethics and are significant enough to seriously impair or preclude the internal audit activity from performing adequately in all or in significant areas of its responsibilities.

Objectives

1. The principle objective of the quality assessment was to assess the Division of Internal Audit's conformance with the *Standards* and the Code of Ethics.
2. The Division of Internal Audit also evaluated its effectiveness in carrying out its mission, as set forth in the internal audit charter; identified successful internal audit practices demonstrated by the Division of Internal Audit; and identified opportunities for continuous improvement to enhance the efficiency and effectiveness of the infrastructure, processes, and the value to their stakeholders.
3. Request an external independent assessor validate the results of the self-assessment. The IIA has a process in place to assist with this request.

Scope

1. The scope of the quality assessment included the Division of Internal Audit, as set forth in the internal audit charter and approved by the KPPA Board, which defines the purpose, authority, and responsibility of the Division of Internal Audit.
2. The independent external validation of the quality assessment was concluded on June 14, 2024, and provides the Audit Committee with information about the Division of Internal Audit as of that date.
3. The *Standards* and the Code of Ethics in place and effective as of June 30, 2024, were the basis for the quality assessment.

Methodology

The Self-Assessment was completed by two internal audit staff members and the review was conducted by the two staff members currently working towards achieving the Certified Internal Auditor license. The results were presented to the Chief Auditor, who provided the management response to the findings. The Division of Internal Audit utilized the Quality Assessment Manual for the Internal Audit Activity published by the IIA to complete the self-assessment. All questionnaires and surveys were designed by the IIA and internal audit staff used these items in their entirety. Information designed by the IIA and completed by internal audit staff included the following items:

1. Complete and detailed planning guides,
2. Survey guides,
3. Testing programs,
4. Evaluation summary which was used to document all conclusions and observations, and
5. Self-assessment report template

The independent external validation team consists of two IIA Louisville Chapter members who are trained to perform self-assessment validations. The QAR team Independent Validation Statement can be found in Appendix B.

Categories of Observations

Observations in the Self-Assessment Results section are divided into three categories:

1. Successful Internal Audit Practices – Areas where the Division of Internal Audit is operating in a particularly effective or efficient manner.
2. Opportunities for Continuous Improvement – Observations of opportunities to enhance the efficiency or effectiveness of the Division of Internal Audit's infrastructure of processes. These items do not indicate a lack of conformance with the *Standards* or the Code of Ethics, but rather offer suggestions on how to better align with criteria defined in the *Standards* or Code of Ethics. They may also be operational ideas based on the experiences obtained while working with other internal audit activities.
3. Gaps to Conformance – Areas identified where the Division of Internal Audit is operating in a manner that falls short of achieving one or more major objectives and attains an opinion of “partially conforms” or “does not conform” with the Standards or the Code of Ethics. These items will include recommendations for actions needed to be “generally in conformance,” and will include a response from the Division of Internal Audit with an action plan to address the gap.

Use of Report

This report is intended solely for use by the KPPA Audit Committee, the CERS and KRS Boards and CEOs, and the Division of Internal Audit. This report is not intended to be, and should not be, used by anyone other than the specified parties. All final reports are subject to Open Records Requests.

Self-Assessment Results

Standards:	1000 and 1010
Overall Rating:	Generally Conforms
Successful Internal Audit Practices:	<ul style="list-style-type: none"> • The internal audit charter is comprehensive and is consistent with the Mission of Internal Audit and the mandatory elements of the <i>Standards</i>. • There is specific language that recognizes the mandatory nature of the Core Principles for the Professional Practice of Internal Auditing, the Definition of Internal Auditing, the Code of Ethics, and the <i>Standards</i>. • The charter is reviewed and approved annually by the Audit Committee and ratified by the Board. As a result, the charter is updated in a timely manner when changes in the IPPF become effective.
Opportunities for Continuous Improvement:	None noted
Gaps to Conformance:	None noted
Internal Audit Response:	Not required

Standards:	1100 to 1130
Overall Rating:	Generally Conforms
Successful Internal Audit Practices:	<ul style="list-style-type: none"> • New reporting structure of the Chief Auditor position ensures independence within the agency. • Division of Internal Audit takes steps to ensure staff that transfer from other agency divisions do not complete audits over their former division for at least one year.
Opportunities for Continuous Improvement:	None noted
Gaps to Conformance:	None noted
Internal Audit Response:	Not required

Standards:	1200 to 1230
Overall Rating:	Generally Conforms
Successful Internal Audit Practices:	<ul style="list-style-type: none"> • The Division of Internal Audit is made of up individuals with different backgrounds and expertise, which provides a wide range of skills and knowledge. • Four of the five staff are currently working towards a professional certification.
Opportunities for Continuous Improvement:	None noted
Gaps to Conformance:	None noted
Internal Audit Response:	Not required

Standards:	1300 to 1322
Overall Rating:	Partially Conforms
Successful Internal Audit Practices:	The Division of Internal Audit acknowledges that this area needs strengthening and has begun taking steps to complete the internal and external assessments.
Opportunities for Continuous Improvement:	<ul style="list-style-type: none"> • Continue working on the development of the QAIP. • Utilize surveys after engagements as a part of the assessment process.
Gaps to Conformance:	An external assessment or internal assessment with validation has not been completed in the past five years; however, the QAR Team notes that our assessment meets this criteria.
Internal Audit Response:	<ol style="list-style-type: none"> 1. We concur with this gap to conformance with the <i>Standards</i>. We will work with KPPA management on the procedures to obtain an internal assessment with validation. We intend to have this completed during fiscal year 2024. 2. We have developed surveys that we will begin sending out with the next completed projects.

Standards:	2000 to 2070
Overall Rating:	Generally Conforms
Successful Internal Audit Practices:	<ul style="list-style-type: none"> • The annual audit plan is risk-based. • Since the internal audit activity does not include an IT expert, review of the IT infrastructure is outsourced to ensure a complete and accurate review is performed. • Internal audit procedures are documented in detail and kept up to date as changes are needed.
Opportunities for Continuous Improvement:	<ul style="list-style-type: none"> • Develop a strategic plan specific to the Division of Internal Audit. • Ensure all relevant stakeholders are consulted when preparing the risk assessment. • Ensure the risk assessment specifically address areas that need to be reviewed for effectiveness and efficiency. • Add the number of internal audit resources needed for engagements identified on the risk assessment.
Gaps to Conformance:	None noted
Internal Audit Response:	<p>We concur with the Opportunities for Continuous Improvement and will take the following action:</p> <ol style="list-style-type: none"> 1. Internal Audit will work with the Audit Committee on a strategic plan. 2. A new process is in place for the risk assessment and feedback will be obtained from all relevant stakeholders. 3. We will update the risk assessment report to ensure it includes areas that need to be reviewed for effectiveness and efficiency. We will also include the number of internal audit resources needed for each engagement.

Standards:	2100 to 2130
Overall Rating:	Generally Conforms
Successful Internal Audit Practices:	The internal audit activity evaluates controls for effectiveness and efficiency and promotes continuous improvement.
Opportunities for Continuous Improvement:	Perform a review of organizational governance.
Gaps to Conformance:	While a stand-alone review of KPPA governance has not been performed, Internal Audit does assess governance as part of each audit performed.

Internal Audit Response:	We concur with the Opportunities for Continuous Improvement. We discussed a governance audit at a recent Audit Committee Meeting (May 2023). We will ensure this item is included on the next risk assessment. We do take steps to look at governance with each audit engagement.
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Standards:	2200 to 2240
Overall Rating:	Generally Conforms
Successful Internal Audit Practices:	<ul style="list-style-type: none"> • Planning procedures are well documented. Templates have been established to ensure consistency. • New audit software allows reviewers to easily connect identified risks, established controls, and testing procedures.
Opportunities for Continuous Improvement:	None noted
Gaps to Conformance:	None noted
Internal Audit Response:	Not required

Standards:	2300 to 2340
Overall Rating:	Generally Conforms
Successful Internal Audit Practices:	<ul style="list-style-type: none"> • Work papers are prepared from templates to help ensure consistency and accuracy. • New audit software makes it easy to see who prepared workpapers, who performed the review, and when the review was performed.
Opportunities for Continuous Improvement:	Establish a formal root-cause analysis.
Gaps to Conformance:	None noted
Internal Audit Response:	We concur with the Opportunities for Continuous Improvement. A formal root-cause analysis will be developed. Procedures to complete this analysis will be added to our Process Documentation SharePoint site.

Standards:	2400 to 2450
Overall Rating:	Generally Conforms
Successful Internal Audit Practices:	Final audit reports include the engagement's objectives, scope, and results. The reports also include a background of the process under review. For complex processes, a detailed background and testing methodology is included as an appendix.
Opportunities for Continuous Improvement:	An overall opinion is tracked in the audit software, but this opinion is not included in the final report. However, the final audit reports contain elements of an overall opinion.
Gaps to Conformance:	None noted
Internal Audit Response:	We concur with the Opportunities for Continuous Improvement. The template of the reports will be updated to pull in the overall audit opinion.

Standards:	2500
Overall Rating:	Generally Conforms
Successful Internal Audit Practices:	<ul style="list-style-type: none"> • A new process has been implemented that makes it easy to track open findings and also allows for reports to be run regarding all issues (open and closed). • A follow-up on open audit findings is completed annually and the results are presented to KPPA management and the Audit Committee.
Opportunities for Continuous Improvement:	None noted
Gaps to Conformance:	None noted
Internal Audit Response:	Not required

Standards:	2600
Overall Rating:	Generally Conforms
Successful Internal Audit Practices:	The Charter for the Audit Committee outlines a process for the Division Director of Internal Audit to bring concerns to the Audit Committee if the Division Director of Internal Audit believes KPPA management has accepted a level of risk that may be unacceptable to the organization.
Opportunities for Continuous Improvement:	None noted
Gaps to Conformance:	None noted
Internal Audit Response:	Not required

Standards:	Code of Ethics
Overall Rating:	Generally Conforms
Successful Internal Audit Practices:	The Division of Internal Auditor follows the Code of Ethics and attest to this annually. This attestation is presented to the Audit Committee on annually.
Opportunities for Continuous Improvement:	None noted
Gaps to Conformance:	None noted
Internal Audit Response:	Not required

Appendix A

Overall Evaluation	Generally Complies	Partially Complies	Does Not Comply
	X		

Code of Ethics	Generally Complies	Partially Complies	Does Not Comply
	X		

Attribute Standards 1000 through 1300		Generally Complies	Partially Complies	Does Not Comply
1000	Purpose, Authority, and Responsibility	X		
1010	Recognizing Mandatory Guidance in the Internal Audit Charter	X		
1100	Independence and Objectivity	X		
1110	Organizational Independence	X		
1111	Direct Interaction with the Board	X		
1112	Chief Audit Executive Roles Beyond Internal Auditing	X		
1120	Individual Objectivity	X		
1130	Impairment to Independence or Objectivity	X		
1200	Proficiency and Due Professional Care	X		
1210	Proficiency	X		
1220	Due Professional Care	X		
1230	Continuing Professional Development	X		
1300	Quality Assurance and Improvement Program		X	
1310	Requirements of the Quality Assurance and Improvement Program		X	
1311	Internal Assessments	X		
1312	External Assessments			X
1320	Reporting on the Quality Assurance and Improvement Program	X		
1321	Use of "Conforms with the International Standards for the Professional Practice of Internal Auditing"	X		
1322	Disclosure of Nonconformance	X		

Performance Standards 2000 through 2600		Generally Complies	Partially Complies	Does Not Comply
2000	Managing the Internal Audit Activity	X		
2010	Planning	X		
2020	Communication and Approval		X	
2030	Resource Management	X		
2040	Policies and Procedures	X		
2050	Coordination and Reliance	X		
2060	Reporting to Senior Management and the Board	X		
2070	External Service Provider and Organizational Responsibility for Internal Auditing		X	
2100	Nature of Work	X		
2110	Governance	X		
2120	Risk Management	X		
2130	Control	X		
2200	Engagement Planning	X		
2201	Planning Considerations	X		
2210	Engagement Objectives	X		
2220	Engagement Scope	X		
2230	Engagement Resource Allocation	X		
2240	Engagement Work Program	X		
2300	Performing the Engagement	X		
2310	Identifying Information	X		
2320	Analysis and Evaluation		X	
2330	Documenting Information	X		
2340	Engagement Supervision	X		
2400	Communicating Results	X		
2410	Criteria for Communicating	X		
2420	Quality of Communications	X		
2421	Errors and Omissions	X		
2430	Use of "Conducted in Conformance with the <i>International Standards for the Professional Practice of Internal Auditing</i> "	X		
2431	Engagement Disclosure of Nonconformance	X		
2440	Disseminating Results	X		
2450	Overall Opinions	X		
2500	Monitoring Progress	X		
2600	Communicating the Acceptance of Risks	X		

Appendix B

Independent Validation Statement

The Louisville Chapter of the Institute of Internal Auditors (IIA) assessment team of Sonja Heath, CIA and Laketa Short (QAR Team) was engaged to conduct an independent validation of Kentucky Public Pension Authority (KPPA) IA self-assessment. The primary objective of the validation was to verify the assertions and conclusions made in the attached self-

assessment report concerning adequate fulfillment of the organization's basic expectations of IA, its conformity to The IIA's *International Standards for the Professional Practice of Internal Auditing*, and successful internal audit practices and opportunities for continuous improvement noted. Other matters that might have been covered in a full external assessment, such as an in-depth analysis of successful practices based on benchmark data, governance activities, consulting services, and use of advanced technology, were excluded from the scope of this independent validation by agreement with the chief audit executive.

In acting as the qualified, independent external assessor from outside the organization, QAR Team is fully independent of KPPA IC and has the necessary skills to undertake this engagement. The validation, concluded on June 14, 2024, consisted primarily of a review and a test of the procedures and results of IA's self-assessment. In addition, interviews were conducted with the president and CEO, CFO, audit committee chair, and other members of senior management.

The QAR Team concurs with IA's conclusions and observations documented in the self-assessment report attached. Implementation of the recommendations contained in the self-assessment report will improve the effectiveness, enhance the value, and support IA's conformity with the *Standards* and the Code of Ethics.

Sonja M. Heath, CIA

 Sonja M. Heath, CIA
 Independent External Assessor Performing the Validation

7/22/2024

Date

Combining Statement of Fiduciary Net Position as of June 30, 2024 (\$ in Thousands)					
ASSETS	Pension		Insurance		Total 2024
	CERS Nonhazardous	CERS Hazardous	CERS Nonhazardous	CERS Hazardous	
CASH AND SHORT-TERM INVESTMENTS					
Cash Deposits	\$276	\$26	\$103	\$22	\$427
Short-term Investments	274,855	146,718	89,412	38,115	549,100
Total Cash and Short-term Investments	275,131	146,744	89,515	38,137	549,527
RECEIVABLES					
Accounts Receivable	96,651	28,809	4,948	2,288	132,696
Accounts Receivable - Investments	43,044	15,644	17,711	7,252	83,651
Total Receivables	139,695	44,453	22,659	9,540	216,347
INVESTMENTS, AT FAIR VALUE					
Core Fixed Income	956,091	336,202	356,789	160,988	1,810,070
Public Equities	4,994,488	1,760,119	1,862,408	897,774	9,514,789
Private Equities	614,731	219,397	246,964	138,211	1,219,303
Specialty Credit	1,923,638	662,597	720,833	331,860	3,638,528
Derivatives	121	49	37	12	219
Real Return	393,377	138,312	130,517	63,385	726,051
Real Estate	507,979	161,767	113,572	100,729	954,047
Total Investments, at Fair Value	9,390,425	3,278,443	3,501,180	1,692,959	17,863,007
Securities Lending Collateral Invested	249,969	88,298	72,492	34,894	445,653
CAPITAL/INTANGIBLE ASSETS					
Capital Assets	1,701	153	-	-	1,854
Intangible Assets	9,961	87	-	-	10,788
Accumulated Depreciation	(1,701)	(153)	-	-	(1,854)
Accumulated Amortization	(9,961)	(87)	-	-	(10,788)
Total Capital Assets	-	-	-	-	-
Total Assets	10,055,220	3,367,938	3,685,846	1,775,530	19,074,534
LIABILITIES					
Accounts Payable	296	1,074	229	5	8,604
Investment Accounts Payable	80,329	28,705	27,231	11,227	147,492
Securities Lending Collateral	249,969	88,298	72,492	34,894	445,653
Total Liabilities	337,594	118,077	99,952	46,126	601,749
Total Fiduciary Net Position Restricted	\$9,717,626	\$3,439,861	\$3,585,894	\$1,729,404	\$18,472,785

See accompanying notes which are an integral part of these combining financial statements.

Note: The displayed fair values include investable assets held by each System and its associated contributions, payables, equipment and intangible assets; unlike those found in the Investment Section, which include only those investable assets held by each System.

Combining Statement of Changes In Fiduciary Net Position					
For the fiscal year ending June 30, 2024 (\$ in Thousands)					
	Pension		Insurance		CERS Total 2024
	CERS Nonhazardous	CERS Hazardous	CERS Nonhazardous	CERS Hazardous	
ADDITIONS					
Member Contributions	\$161,176	\$61,438	\$-	\$-	\$222,614
Employer Contributions	764,747	321,225	2,765	20,556	1,109,293
Pension Spiking Contributions	31	68	-	-	99
Health Insurance Contributions (HB1)	(86)	(59)	20,737	5,038	25,630
Humana Gain Share Payment	-	-	10,445	1,637	12,082
Medicare Drug Reimbursement	-	-	-	-	-
Insurance Premiums	-	-	262	(151)	111
Retired Reemployed Healthcare	-	-	7,378	2,088	9,466
Total Contributions	925,868	382,672	41,582	29,168	1,379,293
INVESTMENT INCOME					
From Investing Activities					
Net Appreciation (Depreciation) in FV of Investments	785,266	277,925	108,813	145,629	1,507,633
Interest/Dividends	296,682	104,715	1,186	53,690	566,984
Total Investing Activities Income (loss)	1,081,948	382,640	410,710	199,319	2,074,617
Less: Investment Expense	61,844	26,340	23,130	11,985	117,899
Less: Performance Fees	18,483	6,211	7,441	4,096	36,234
Net Income (loss) from Investing Activities	1,001,621	350,186	380,139	183,238	1,920,484
From Securities Lending Activities					
Securities Lending Income	11,200	4,000	3,296	1,484	20,244
Less: Securities Lending Borrower Rebates (Income)/Expense	10,174	3,653	2,857	1,286	17,970
Less: Securities Lending Agent Fees	181	65	66	30	342
Net Income from Securities Lending	995	366	373	168	1,932
Net Investment Income (loss)	1,002,646	355,852	380,512	183,406	1,922,416
Total Additions	1,928,514	738,524	422,099	212,574	3,301,711
DEDUCTIONS					
Benefit Payments	940,514	343,583	-	-	1,284,097
Refunds	25,267	8,540	-	-	33,807
Administrative Expenses	26,547	2,338	930	522	30,337
Healthcare Premiums & Subsidies	-	-	122,209	96,053	218,262
Self Funded Healthcare Costs	-	-	2,585	184	2,769
Excise Tax Insurance	-	-	13	-	13
Total Deductions	992,328	354,461	125,737	96,759	1,569,285
Net Increase (Decrease) in Fiduciary Net Position Restricted for Pension Benefits	936,186	384,063	296,362	115,815	1,732,426
Total Fiduciary Net Position Restricted for Pension Benefits					
Beginning of Period	8,781,440	3,055,797	3,289,532	1,613,588	16,740,357
End of Period	\$9,717,626	\$3,439,860	\$3,585,894	\$1,729,403	\$18,472,783
See accompanying notes, which are an integral part of these combining financial statements.					

Combining Statement of Fiduciary Net Position - Pension

As of June 30, 2024 (\$ in Thousands)

	Pension			Insurance			KRS Total 2024
	KERS Nonhazardous	KERS Hazardous	SPRS	KERS	KERS Hazardous	SPRS	
ASSETS							
CASH AND SHORT-TERM INVESTMENTS							
Cash Deposits	\$268	\$27	\$29	\$100	\$23	\$18	\$465
Short-term Investments	254,633	49,952	38,006	68,261	20,702	9,876	441,430
Total Cash and Short-term Investments	254,901	49,979	38,035	68,361	20,725	9,894	441,895
RECEIVABLES							
Accounts Receivable	93,357	4,965	2,498	14,426	462	918	116,626
Accounts Receivable - Investments	30,542	5,671	4,925	10,444	3,303	1,492	56,377
Total Receivables	123,899	10,636	7,423	24,870	3,765	2,410	173,003
INVESTMENTS, AT FAIR VALUE							
Core Fixed Income	1,096,029	115,245	166,303	189,154	75,621	29,762	1,672,118
Public Equities	1,347,282	431,605	205,635	708,372	284,692	114,446	3,092,032
Private Equities	194,862	66,044	31,411	111,418	48,801	21,728	474,267
Specialty Credit	785,092	229,560	123,774	75,074	151,847	61,598	1,726,445
Derivatives	(73)	9	(9)	10	(3)	3	(63)
Real Return	349,425	79,738	56,205	135,303	45,489	18,475	684,912
Real Estate	217,911	58,902	35,155	95,993	42,344	16,169	466,474
Total Investments, at Fair Value	3,990,528	981,103	618,174	1,305,601	648,298	262,181	8,116,185
Securities Lending Collateral Invested	109,246	26,629	16,923	33,811	13,516	5,449	205,574
CAPITAL/INTANGIBLE ASSETS							
Capital Assets	929	91	11	-	-	-	1,031
Intangible Assets	5,920	45	100	-	-	-	6,514
Accumulated Depreciation	(929)	(91)	(11)	-	-	-	(1,031)
Accumulated Amortization	(5,920)	(494)	(100)	-	-	-	(6,514)
Total Capital Assets	-	-	-	-	-	-	-
Total Assets	4,478,544	1,088,347	680,855	1,742,643	686,304	279,934	8,936,657
LIABILITIES							
Accounts Payable	456	988	113	132	2	1	5,692
Investment Accounts Payable	67,562	10,809	10,603	16,606	4,869	2,393	112,582
Securities Lending Collateral	109,246	26,629	16,923	33,811	13,516	5,449	205,574
Total Liabilities	181,004	38,426	27,639	50,549	18,387	7,843	323,848
Total Fiduciary Net Position Restricted for Pension Benefits	\$4,297,570	\$1,029,921	\$653,216	\$1,692,094	\$667,917	\$272,091	\$8,612,809

See accompanying notes which are an integral part of these combining financial statements.

Note: The displayed fair values include investable assets held by each System and its associated contributions, payables, equipment and intangible assets; unlike those found in the Investment Section, which include only those investable assets held by each System.

Combining Statement of Changes In Fiduciary Net Position							
For the fiscal year ending June 30, 2024 (\$ in Thousands)							
	Pension			Insurance			KRS Total 2024
	KERS	KERS	SPRS	KERS	KERS Hazardous	SPRS	
ADDITIONS							
Member Contributions	\$96,615	\$21,568	\$5,703	\$-	\$-	\$-	\$123,886
Employer Contributions	156,007	89,897	61,998	41,362	45	10,158	359,467
Actuarially Accrued Liability Contributions	899,663	-	-	87,782	-	-	987,445
General Fund Appropriations	240,000	-	-	-	-	-	240,000
Pension Spiking Contributions	25	1	-	-	-	-	26
Health Insurance Contributions (HB1)	(18)	(8)	(12)	10,603	2,094	408	13,067
Humana Gain Share Payment	-	-	-	8,440	651	390	9,481
Medicare Drug Reimbursement	-	-	-	4	-	-	4
Insurance Premiums	-	-	-	79	(24)	(13)	42
Retired Reemployed Healthcare	-	-	-	7,114	1,865	5	9,354
Total Contributions	1,392,292	111,458	67,689	155,954	4,631	10,948	1,742,772
INVESTMENT INCOME							
Net Appreciation (Depreciation) in FV of Investments	243,618	76,073	38,386	12,287	51,738	20,310	553,412
Interest/Dividends	137,373	33,477	21,885	55,309	21,974	8,932	278,990
Total Investing Activities Income (loss)	380,991	109,550	60,271	78,636	73,712	29,242	832,402
Less: Investment Expense	19,430	5,801	2,672	9,251	4,577	1,819	43,550
Less: Performance Fees	5,970	1,722	614	2,852	1,763	615	13,534
Net Income (loss) from Investing Activities	355,591	102,029	56,985	166,533	67,372	26,808	775,318
From Securities Lending Activities							-
Securities Lending Income	4,525	1,166	744	1,583	551	242	8,524
Less: Securities Lending Borrower Rebates (Income)/ Expense	(3,733)	1,040	658	1,370	476	209	7,486
Less: Securities Lending Agent Fees		19	13	32	11	5	155
Net Income from Securities Lending	427	110	73	181	64	28	883
Net Investment Income (loss)	356,018	102,139	57,058	166,714	67,436	26,836	776,201
Total Additions	1,748,310	213,597	124,747	322,468	72,067	37,784	2,518,973
DEDUCTIONS							
Benefit Payments	1,032,124	80,528	63,823	-	-	-	1,176,475
Refunds	11,693	4,133	221	-	-	-	16,047
Administrative Expenses	14,128	1,583	314	727	117	71	16,940
Healthcare Premiums Subsidies	-	-	-	93,751	20,260	12,412	126,423
Self Funded Healthcare	-	-	-	1,378	94	7	1,479
Excise Tax	-	-	-	7	-	-	7
Total Deductions	1,057,945	86,244	64,358	95,863	20,471	12,490	1,337,371
Net Increase (Decrease) in Fiduciary Net Position Restricted for Pension Benefits	690,365	127,353	60,389	226,605	51,596	25,294	1,181,602
Total Fiduciary Net Position Restricted for Pension Benefits							
Beginning of Period	\$3,607,205	902,567	592,826	1,465,489	616,321	246,797	7,431,205
End of Period	\$4,297,570	\$1,029,920	\$653,215	\$1,692,094	\$667,917	\$272,091	\$8,612,807
<i>See accompanying notes, which are an integral part of these combining financial statements.</i>							



KENTUCKY PUBLIC PENSIONS AUTHORITY

David L. Eager, Executive Director

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MEMORANDUM

TO: Kristen Coffey, Director of Internal Audit

FROM: Beth Camic, Staff Assistant to Executive Director of Legal Services
 Shelley Dalton, Legal Secretary, Office of Legal Services
 Carrie Bass, Staff Attorney Supervisor, Office of Legal Services

DATE: August 16, 2024

SUBJECT: Potential Information Disclosures/Breaches Affecting the Kentucky Public Pensions Authority (“KPPA”), 4th Quarter Fiscal Year 2024

DATA ON POTENTIAL DISCLOSURES/BREACHES 4th QUARTER FY 2024

Total Disclosures/Breaches Investigated: 10

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

Total Members Affected by Potential Disclosures/Breaches: 23

Total Potential Disclosures/Breaches by Source of Disclosure/Breach

<u>Total Number of Disclosures/Breaches</u>	<u>Source</u>
2	KPPA, KRS, or CERS
3	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>
1	Email
1	Mail
1	Self-Service
0	Phone
0	Fax
1	Other

SYNOPSIS ON POTENTIAL DISCLOSURES/BREACHES 1st QUARTER FY 2024

KPPA, KRS, and CERS Disclosures/Breaches

- **Federal law (HIPAA/HITECH):** There were no potential breaches of protected health information by the KPPA.
- **State law (KRS 61.931, et seq.):** There was one potential “security breach” of “personal information” as defined by state law by the KPPA.
 - **Background:** Member's April & May payment were not received. Investigation revealed unauthorized changes were made to member's banking information via self-service.
 - **Root Cause:** A bad actor used information obtained outside of KPPA to access the member’s self-service account. To make banking changes, the bad actor had knowledge of the member's banking information. KPPA sent out notices per state law disclosure statutes.
 - **Follow Up:** Member was advised to make a police report. KPPA provided documentation regarding changes to assist in report. Member's self-service was locked down and flagged. Account changes are limited to management only.
- **KPPA Internal Data Disclosure Notification Policy:** The following three disclosures occurred under the KPPA’s Data Disclosure Notification Policy.
 - **Background:** KPPA staff member accidentally sent a member's KPPA ID and retirement date to another member.
 - **Root cause:** Human error.
 - **Follow Up:** Affected member was contacted via the phone and in writing. The recipient was sent an affidavit to confirm they had deleted the disclosed information.
 - **Background:** An unidentified party called in regard to receiving a death benefit notice for a member whom they did not know. The caller did not leave any contact information or a last name for follow up.
 - **Root Cause:** Paperwork on file was not recent. Its likely KPPA staff used locator tools to attempt to locate the executor's current address.
 - **Follow Up:** Not enough information to reach to any relevant parties for follow up.
 - **Background:** A member received another member's qualifying event letter.
 - **Root Cause:** It is likely a USPS mail sort error as the correspondence was addressed correctly for the affected member but ended up in the recipient’s mail box.
 - **Follow Up:** Even though not the fault of KPPA, to ensure member was aware of incident sent affected member correspondence and sent recipient an affidavit to ensure the documentation was returned to KPPA.

External Disclosures/Breaches

The KPPA received one notification from a vendor this quarter that a security breach or disclosure occurred. This event occurred in December 2023 and impacted 19 members. Unauthorized third parties were able to use information obtained from sources other than the vendor or KPPA to log on to webpages associated with the vendor. Upon accessing the webpages, the unauthorized third parties were able to view and access limited information about the 19 members. The vendor has notified the affected members and has instituted additional monitoring of the accounts of the affected members.

RECOMMENDATION

This memorandum is provided for informational purposes only.



KENTUCKY PUBLIC PENSIONS AUTHORITY

David L. Eager, Executive Director

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MEMORANDUM

TO: Kristen Coffey, Chief Auditor

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

DATE: August 27, 2024

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 Kentucky Public Pensions Authority Audit Committee (Audit Committee).

OPEN FRAUD TIP CASES

Since the Audit Committee met on May 30, 2024, the KPPA received five (5) fraud tips. Two (2) tips were closed following review and three (3) of the tips are currently open.

As of the date of this memo, the KPPA has eight (8) 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
12/13/2022	Failure of an employer to report all employees in regular fulltime positions	The Office of Legal Services is investigating.
09/26/2023	Prearranged agreement for an employee to retire and return to work for the same employer.	The Office of Legal Services continues to monitor.
11/02/2023	Employer not making the required retirement contributions for employees since January 2021.	The Office of Legal Services is working with ERCE to address the issue.
01/22/2024	Disability retirement fraud.	The Office of Legal Services is investigating.
03/28/2024	Prearranged agreement for an employee to return to work for the same employer and failure to have the required break in service.	The Office of Legal Services is investigating.

Date Reported	Allegation(s)	Current Action
06/12/2024	Employer not making the required retirement contributions for employees.	The Office of Legal Services is working with ERCE and obtaining additional information.
06/16/2024	Prearranged agreement to return to work for the same employer and failure to have the required break in service.	The Office of Legal Services is investigating.
07/12/2024	Prearranged agreement to return to work for the same employer.	The Office of Legal Services is investigating.

(Memo continued on next page.)

FRAUD TIPS CLOSED SINCE LAST MEETING

As of the date of this memo, five (5) cases have been closed since the last meeting of the KPPA Audit Committee. The following case(s) were closed since the last meeting:

Date Reported	Allegation(s)	Disposition
01/22/2024	Member is not working the hours claimed but receiving retirement credit.	The Office of Legal Services investigated this tip and closed as unsubstantiated in June 2024.
02/21/2024	Prearranged agreement for an employee to retire and return to work for the same employer.	The Office of Legal Services investigated this tip and closed as unsubstantiated in June 2024.
02/29/2024	Prearranged agreement for an employee to retire and return to work for the same employer.	The Office of Legal Services investigated this tip and closed as unsubstantiated in August 2024.
06/19/2024	Non-specific fraud allegations.	Contacted tipster and allegations involved potential Social Security fraud. Closed in June 2024
06/27/2024	Non-specific general allegations.	Emailed tipster; however, s/he failed to communicate with any additional information in order to proceed with review. Closed in June 2024.

RECOMMENDATION

This memorandum is provided for informational purposes only.

FY 2025 Audit Plan

Follow-up audit
Suggested as part of a Corporate Governance Audit, to occur after Strategic Plan is officially established

Fiscal Year 2025 Audits/Projects		Hours Available		1,496	1,950	1,625	1,950	1,950	Starting Month
		Total Risk Score	Estimated Hours	Auditor 1 (Currently Vacant)	Auditor 2	Auditor 3 (Currently Vacant)	Auditor 4	Auditor 5	
Internal Audit	Internal Audit Staff Hiring	-	170	0	50	50	50	20	July
Internal Audit	Internal Audit Process Documentation and Updates	-	100	0	0	35	25	40	July
	Non-Board Meetings	-	500	80	80	100	100	140	July
	Board/Committee Meetings	-	300	40	40	40	50	130	July
	Miscellaneous KPPA Group Participation/Projects	-	202	15	15	15	55	102	July
	Training	-	200	40	40	40	40	40	July
	Evaluations	-	120	15	15	15	15	60	July
	Internal Audit Key Performance Indicators	-	24	0	0	0	0	24	July
Board of Trustees	CERS Election	-	100	0	0	0	10	90	July
Retiree Payroll	1099-R Process (Follow-up on 2019-4 1099-R Process issued 3/16/2020)	16	400	0	320	0	0	80	July
Investments	Review of Investment Administrative Fees - this was approved on FY 2024 Plan and needs to be completed	6	500	0	150	0	25	325	July
Investments	Review of Policies Specific to Office of Investments	20	300	0	0	45	240	15	September
Annual Review	Annual Comprehensive Financial Report/Summary Annual Financial Report Review	32	75	0	60	0	0	15	September
	Charter and Policy Updates	-	20	0	0	0	5	15	October
Internal Audit	FY 2026 Risk Assessment and Audit Plan	-	130	5	5	5	15	100	October
ERCE	Employer Reporting Process	48	600	0	400	80	90	30	October
Various	Procurement Card (ProCard) Process (Follow-up to 2018-1 ProCare Expenditures issued 10/2/2018)	8	350	0	0	255	55	40	October
Legal and Disability	Disability Appeal Process	18	400	0	0	60	310	30	Nov/Dec
HR	Hiring Process	24	400	310	0	0	60	30	November
Annual Review	Open Audit Recommendation Review	24	50	0	0	10	0	40	January
Procurement/Office Services	Inventory Process	40	400	0	50	270	60	20	Dec/Jan
Accounting	Accounts Payable Process (Follow-up on 2019-3 AP Invoice Audit issued 6/28/2019)	12	500	80	320	0	75	25	Jan/Feb
Accounting	Travel Process (Follow-up on 2018-1 Travel Expenditures issued 10/2/2018)	8	250	200	10	0	0	40	February
	Other Administration	-	1,000	155	155	155	230	305	
	Holiday/vacation/Sick Leave	-	1,295	176	224	185	439	271	
	Scheduled hours for FY 2025	-	8,386	1,116	1,934	1,360	1,949	2,027	
	Unscheduled Hours - Reserved for contingency	-	585	380	16	265	1	-77	

KPPA Audit Committee Meeting - KPPA Audit Committee Administrative Updates

Fiscal Year 2026 Audits/Projects		Hours Available		1,950	1,950	1,950	1,950	1,950
		Total Risk	Estimated	Auditor 1	Auditor 2	Auditor 3	Auditor 4	Auditor 5
Accounting	Accrual Process	20	500	0	0	400	75	25
ERCE	Employer Training Process	20	500	400	0	0	75	25
Legal	Process for Responding to Open Records	20	400	0	320	0	60	20
Legal	Process to Report Disclosures of PII (Follow-up on 2019-2 HIPPA Compliance issued 5/29/2019)	20	300	0	0	240	45	15
Procurement/Office Services	Process to Prevent Unauthorized Building Access (Follow-up on 2019-1 Building Security issued 1/10/2019)	20	400	0	0	60	320	20
Member Services	Process for Answering Member/Public Calls	16	400	0	0	60	320	20
Accounting	Employer Penalty Waiver Process (Follow-up on 2022-2 Employer Waived Penalties issued 11/19/2021)	12	400	0	320	0	60	20
Procurement/Office Services	Procurement Process (Follow-up on 2020-1 Procurement and Contract Management issued 8/20/2020)	12	500	400	0	0	75	25
Disability	Disability Benefit Approval Process	12	500	400	0	0	75	25
Investments	Capital Call Process	12	400	0	320	0	60	20
IT	System Access Process (Follow-up on 2021-3 System Access issued 8/19/2021)	8	300	0	45	240	0	15
ERCE	Hazardous Duty Classification Process	6	300	0	240	45	0	15
Annual Review	Annual Comprehensive Financial Report/Summary Annual Financial Report Review	32	75	0	60	0	0	15
Annual Review	Open Audit Recommendation Review	24	50	0	0	0	10	40
Board of Trustees	KERS Election	-	100	0	0	0	10	90
Internal Audit	FY 2027 Risk Assessment and Audit Plan	-	130	5	5	5	15	100
Internal Audit	Internal Audit Process Documentation and Updates	-	100	0	0	35	25	40
	Non-Board Meetings	-	500	80	80	100	100	140
	Board/Committee Meetings	-	300	40	40	40	50	130
	Miscellaneous KPPA Group Participation/Projects	-	200	15	15	15	55	100
	Training	-	200	40	40	40	40	40
	Evaluations	-	120	15	15	15	15	60
	Internal Audit Key Performance Indicators	-	24	0	0	0	0	24
	Charter and Policy Updates	-	20	0	0	0	5	15
	Other Administration	-	1,000	155	155	155	230	305
	Holiday/vacation/Sick Leave	-	1,107	214	214	214	214	251
	Scheduled hours for FY 2025	-	8,826	1,764	1,869	1,664	1,934	1,595
	Unscheduled Hours - Reserved for contingency	-	924	186	81	286	16	355

Risks Addressed as a Part of All Audits		
	Establishment of Succession Plan	32
	Review Division Procedures and Internal Controls	24
	Employee Onboarding and On-going Training Processes	24
	Review Division Record Retention	24
	Review Division Process for Reporting Information to Boards/Committees	20
	Review IT Data	18
	Review Use of Electronic Signatures and/or Signature Stamps	16
	Ensure Segregation of Duties	16

Audits Completed Since 2018 (follow-up needed on those at least 2 years old)			
Accounting	Daily Cash Projection Process	12	2022-1 Plan Liquidity issued 2/3/2022.
Various	Process to Update Member's Death Status	20	2022-3 Process for Updating Death Status issued 4/7/2022.
Accounting	Use of Non-custodial Accounts	12	2022-4 Review of Chase Accounts issued 2/20/2023.
Retiree Health Care	Retiree Insurance Process	4	2022-5 Accuracy of Information Sent to Insurance Vendors issued 4/14/2023.
Investments	Review of Investment Manager Fees (did not include administrative or performance fees)	6	2024-1 Investment Manager Fees issued 11/17/2023.
Various	Member Retirement Process	6	2024-2 Verifying Retirement Calculations issued 5/31/2023.
Various	Applying Interest to Member Accounts	8	2024-3 Review of Interest Applied to Member Accounts, audit currently underway.
Accounting	CERS Separation Expenses	8	2024-4 Allocation of Expenses issued 9/22/2023.
Executive	Legislative Implementation Process	4	2024-5 Implementation of New Legislation issued 3/21/2024.
ERCE	Employer Invoicing Process	24	2024-6 Review of Employer Outstanding Invoices, audit currently underway.
ERCE	Employer Contribution Process	16	2024-7 Employer Contributions, audit currently underway.
Various	Member Correspondence Process	10	2024-8 Disclosure During Correspondence issued 5/31/2023.
Various	Member Refund Process	20	2024-9 Review of Refunds, audit currently underway.
Recommended for Review on Future Audit Plan			
Executive	Corporate Governance/Strategic Plan Review	40	
Executive	KPPA, CERS, and KRS Responsibilities and Delegation of Responsibility	36	
Executive	Trend Analysis and Reporting Review	30	
Executive	KPPA, CERS, and KRS Compliance with Kentucky Open Meetings statutes.	20	
Executive	KPPA Policies Pertaining to Use of KPPA Accounts and Equipment	16	
Executive	Process to Replace/Upgrade IT Systems/Equipment/Software	16	
Executive	Process to Ensure Trustees Receive Required Training Hours	4	
Accounting	Process for Providing Information to Actuary	20	
Accounting	Reciprocity Process	16	
Accounting	Accounts Receivable Process	12	
Accounting	Journal Entry Process	12	
Investments	Investment Distribution Process	12	
Investments	Investment Repo Process	12	
HR	Use of EEO, ADA, and FMLA	12	
Legal	Process to Update Administrative Regulations	12	
Various	Process to Secure Member Data	10	
Communications	Process for Updating KPPA Website	10	
Various	Member Benefit Payment Process	8	
Various	Process to Update Member Information	8	
Accounting	Budgetary Process	8	
Accounting	Service Purchases Process	8	
Legal	Retired/Re-employed Process	8	
Accounting	Excise Tax Process	6	
IT	Process to Test IT System Changes	6	
IT	IT Batch Run Process	6	
ERCE	Employer Error Correction Process	6	
Retiree HealthCare	Medicare as a Secondary Payer Process	4	

Risk by COSO Element and Principle

Reported by multiple individuals

COSO Principle	Risk Type	Risk Title	Financial Statement Impact	Reputational Impact	Likelihood	Total Risk Score
Control Environment						
1. Demonstrates commitment to integrity and values	Compliance	Review KPPA, CERS, and KRS policies, bylaws, and procedures related to Board and Committee meetings. Confirm that internal controls have been established to ensure compliance with Kentucky Open Meetings statutes.	2	8	4	20
2. Demonstrates independence and exercises oversight responsibility 3. Establishes structure, authority and responsibility	Compliance	Review KPPA, CERS, and KRS policies and bylaws related to Board responsibilities and delegation of responsibility to ensure compliance with organizational statutes.	4	8	6	36
4. Demonstrates commitment to attracting, developing and retaining competent staff	Operational	Review executive and division procedures and ensure a succession plan has been established.	4	4	8	32
4. Demonstrates commitment to attracting, developing and retaining competent staff	Compliance	Review the hiring process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to review and address KPPA staffing levels and to ensure vacancies are filled timely.	4	2	8	24
4. Demonstrates commitment to attracting, developing and retaining competent staff	Operational	Review the employee onboarding and on-going training processes and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure staff are properly training to perform their job tasks.	4	2	8	24
4. Demonstrates commitment to attracting, developing and retaining competent staff	Compliance	Review CERS and KRS policies, bylaws, and procedures and to ensure Trustees receive the required training hours.	2	2	2	4
5. Enforces accountability	Operational	Review KPPA process for implementing audit findings and ensure compliance with internal policies and confirm internal controls have been established to ensure audit recommendations (internal and external) are thoroughly investigated and implemented within the established time frame.	4	4	6	24
5. Enforces accountability	Operational	Review KPPA policies pertaining to use of KPPA accounts and equipment and ensure policies have been established to address ways to monitor and minimize personal use of KPPA owned accounts and equipment.	2	6	4	16
Risk Assessment						
6. Specifies suitable, specific objectives 7. Identifies and analyzes risks 8. Assesses fraud risk	Operational	Review KPPA Strategic Plan and ensure it has been established and is being followed in accordance with internal policies. Confirm internal controls have been established to review the plan periodically, update it as needed, and ensure compliance.	4	4	10	40
9. Identifies and analyzes significant changes	Financial	Review KPPA's process for performing trend analysis and reporting this information to Executive Management and Trustees. Specifically determine if there is a process to review significant financial changes, unusual financial trends, and a process to investigate if trends in one area do not match trends in another area (for example, investment trends do not match Net Fiduciary Position trends).	6	4	6	30
Control Activities						
10. Selects and develops control activities that help mitigate risks	Compliance	Review the employer reporting process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure employer's properly report all required employees.	6	6	8	48
10. Selects and develops control activities that help mitigate risks	Operational	Review the inventory process and ensure it is in compliance with statutes/regulations/policies and confirm internal controls have been established to ensure inventory is properly tracked and disposed.	4	4	10	40
10. Selects and develops control activities that help mitigate risks	Financial	Review the employer invoicing process and ensure it is in compliance with statutes/regulations/policies and confirm internal controls have been established to ensure invoices are properly prepared and collected timely.	6	6	4	24
10. Selects and develops control activities that help mitigate risks	Compliance	Review process to update a member's death status and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure a member's death is properly verified.	2	8	4	20
10. Selects and develops control activities that help mitigate risks	Operational	Review process related to preventing unauthorized building access and ensure it is in compliance with statutes/regulations/ policies and confirm internal controls have been established to ensure contractors, vendors, visitors, etc. are monitored while on site.	2	8	4	20
10. Selects and develops control activities that help mitigate risks	Compliance	Review member refund process to ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure refunds are properly calculated and approved.	4	6	4	20
10. Selects and develops control activities that help mitigate risks	Financial	Review the accrual process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure accruals are properly supported, reversed, and approved.	8	2	4	20
10. Selects and develops control activities that help mitigate risks	Compliance	Review the process report disclosures of PII and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure disclosures are reported properly and timely.	2	8	4	20
10. Selects and develops control activities that help mitigate risks	Operational	Review the disability appeal process and ensure it is in compliance with statutes/regulations/policies and confirm internal controls have been established to ensure affidavits are prepared properly and appeals are completed timely.	2	4	6	18
10. Selects and develops control activities that help mitigate risks	Compliance	Review the employer contribution balancing process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure employer contributions are accurate and received and balanced timely.	4	4	4	16
10. Selects and develops control activities that help mitigate risks	Compliance	Review 1099-R process to ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure 1099-Rs are prepared accurately and mailed timely.	2	6	4	16
10. Selects and develops control activities that help mitigate risks	Financial	Review the reciprocity process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure reciprocity is properly applied.	4	4	4	16
10. Selects and develops control activities that help mitigate risks	Operational	Review use of non-custodial accounts and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure account access is proper, transfers are accurate, accounts are properly reconciled, and excessive balances are not held in the accounts.	4	2	4	12

KPPA Audit Committee Meeting - KPPA Audit Committee Administrative Updates

	COSO Principle	Risk Type	Risk Title	Financial Statement Impact	Reputational Impact	Likelihood	Total Risk Score
24	10. Selects and develops control activities that help mitigate risks	Operational	Review the accounts payable process and ensure it is in compliance with statutes/regulations/policies and confirm internal controls have been established to ensure expenses are properly paid, supported, tracked, coded, and allocated. Also ensure the payment process is working effectively and efficiently.	4	2	4	12
25	10. Selects and develops control activities that help mitigate risks	Operational	Review the accounts receivable process and ensure it is in compliance with statutes/regulations/policies and confirm internal controls have been established to ensure receivables are properly tracked, recorded, coded, allocated, and reconciled. Also ensure the receivable process is working effectively and efficiently.	4	2	4	12
26	10. Selects and develops control activities that help mitigate risks	Compliance	Review the procurement process and ensure it is in compliance with statutes/regulations/policies and confirm internal controls have been established to ensure contracts are properly monitored and are the best value for the agency.	2	4	4	12
27	10. Selects and develops control activities that help mitigate risks	Compliance	Review the disability benefit approval process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure disability benefits are properly calculated and approved. Also confirm internal controls have been established to ensure medical review vendor contract is cost beneficial to KPPA.	2	4	4	12
28	10. Selects and develops control activities that help mitigate risks	Financial	Review the journal entry process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure journal entries accurate, supported, approved, and timely.	4	2	4	12
29	10. Selects and develops control activities that help mitigate risks	Financial	Review daily cash projection process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure the daily cash projection is accurate and communicated timely.	4	2	4	12
30	10. Selects and develops control activities that help mitigate risks	Compliance	Review the capital call process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure capital calls are accurate, approved, properly allocated, and timely.	4	2	4	12
31	10. Selects and develops control activities that help mitigate risks	Compliance	Review the investment distribution process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure distributions are accurate, approved, properly allocated, and timely.	4	2	4	12
32	10. Selects and develops control activities that help mitigate risks	Compliance	Review the investment repo process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure repos are accurate, approved, properly allocated, and timely.	4	2	4	12
33	10. Selects and develops control activities that help mitigate risks	Compliance	Review the employer penalty waiver process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure waivers are properly applied and approved.	4	2	4	12
34	10. Selects and develops control activities that help mitigate risks	Compliance	Review the process to secure member data and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure member information is not released without proper authorization.	2	8	2	10
35	10. Selects and develops control activities that help mitigate risks	Operational	Review the member benefit payment process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure payments are made timely and accurately.	4	4	2	8
36	10. Selects and develops control activities that help mitigate risks	Financial	Review process to apply interest to member accounts and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure interest is applied accurately and timely and the proper interest amount is reflected on the financial statements.	4	4	2	8
37	10. Selects and develops control activities that help mitigate risks	Compliance	Review the process for updating member information and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to prevent unauthorized changes to member accounts.	2	6	2	8
38	10. Selects and develops control activities that help mitigate risks	Compliance	Review the CERS separation expenses process and ensure it is in compliance with statutes/regulations/policies and confirm internal controls have been established to ensure separation expenses are properly approved, tracked, allocated, and reconciled.	4	4	2	8
39	10. Selects and develops control activities that help mitigate risks	Financial	Review the budgetary process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure the budget is properly prepared, approved, and monitored.	4	4	2	8
40	10. Selects and develops control activities that help mitigate risks	Compliance	Review the procurement card (ProCard) process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure ProCard use is allowable and approved and that expenses are supported.	4	4	2	8
41	10. Selects and develops control activities that help mitigate risks	Compliance	Review the travel process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure travel is properly approved, supported, and reimbursed.	4	4	2	8
42	10. Selects and develops control activities that help mitigate risks	Compliance	Review the service purchases process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure service purchase are properly calculated, paid, and applied to member accounts.	4	4	2	8
43	10. Selects and develops control activities that help mitigate risks	Compliance	Review the retired/re-employed process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure retired/re-employed requests are properly reviewed and approved.	2	6	2	8
44	10. Selects and develops control activities that help mitigate risks	Financial	Review the excise tax process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure the excise tax is properly calculated and paid.	4	2	2	6
45	10. Selects and develops control activities that help mitigate risks	Operational	Review the member retirement process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure retirement calculations are accurate and the process is efficient.	2	4	2	6
46	10. Selects and develops control activities that help mitigate risks	Compliance	Review the hazardous duty classification process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure hazardous duty classification is properly reviewed and approved.	2	4	2	6
47	10. Selects and develops control activities that help mitigate risks	Operational	Review the legislative implementation process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure potential legislation is properly approved, relevant legislation is tracked, and enacted legislation is implemented timely.	2	2	2	4
48	10. Selects and develops control activities that help mitigate risks	Compliance	Review the retiree insurance process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure insurance files are accurate, premiums are paid properly, members qualify for their plan, and changes are made timely.	2	2	2	4
49	10. Selects and develops control activities that help mitigate risks	Compliance	Review the Medicare as a secondary payer process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to review the process and ensure compliance.	2	2	2	4

KPPA Audit Committee Meeting - KPPA Audit Committee Administrative Updates

COSO Principle	Risk Type	Risk Title	Financial Statement Impact	Reputational Impact	Likelihood	Total Risk Score	
50	11. Selects and develops general controls over technology	Operational	Review IT data available to divisions and ensure it is accurate and reliable for internal analysis.	4	2	6	18
51	11. Selects and develops general controls over technology	Operational	Review process to replace/upgrade IT systems/equipment/software. Confirm internal controls have been established to ensure operations continue in the event of a system/equipment/software failure.	4	4	4	16
52	11. Selects and develops general controls over technology	Compliance	Review the system access process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure employees have only the minimal system access required to complete their job tasks.	4	4	2	8
53	11. Selects and develops general controls over technology	Operational	Review the process to test IT system changes. Confirm internal controls have been established to ensure changes are tested and errors are corrected prior to changes being put into production.	4	2	2	6
54	11. Selects and develops general controls over technology	Operational	Review IT batch run process. Confirm internal controls have been established to ensure batches run timely and accurately and that system generated data cannot be altered.	4	2	2	6
55	12. Bases controls on thorough policies and procedures	Operational	Review division procedures and ensure guidance on how to perform business processes is documented and confirm internal controls have been established to ensure established procedures are followed.	4	8	4	24
56	12. Bases controls on thorough policies and procedures	Compliance	Review division record retention and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure staff are aware of the record retention policy and to monitor for compliance.	2	4	8	24
57	12. Bases controls on thorough policies and procedures	Compliance	Review the disclosure reporting process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure disclosures are reported appropriately and timely.	2	8	4	20
58	12. Bases controls on thorough policies and procedures	Compliance	Review the use of electronic signatures and/or signature stamps and ensure compliance with statutes/regulations and ensure internal controls have been established to ensure electronic/stamped signatures are kept secure and only used if properly authorized.	4	4	4	16
59	12. Bases controls on thorough policies and procedures	Compliance	Review use of EEO, ADA, and FMLA and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure staff are properly trained on procedures related to EEO, ADA, and FMLA.	4	8	2	12
Information and Communication							
60	13. Uses relevant, high-quality information 14. Communicates internally to support controls	Operational	Review divisions' process for reporting information to KPPA, CERS, and KRS Boards. Confirm internal controls have been established to ensure all required information is reported timely.	4	6	4	20
61	15. Communicates externally	Financial	Review the process for generating financial statements and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to review financial statements to ensure they are accurate and prepared timely.	10	6	4	32
62	15. Communicates externally	Compliance	Review the process for responding to Open Records and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure responses are completed accurately and timely.	2	8	4	20
63	15. Communicates externally	Operational	Review the process for training employers and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure new employers receive training, ongoing training is provided when processes change, and follow-up is conducted with employers with continual reporting errors.	4	6	4	20
64	15. Communicates externally	Financial	Review the process for providing information to the actuary and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure information is provided accurately and timely.	6	4	4	20
65	15. Communicates externally	Reputational	Review the process for answering calls received from members ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure calls are answered timely and issues are properly resolved or escalated.	2	6	4	16
66	15. Communicates externally	Operational	Review member correspondence process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure member correspondence is properly disseminated.	2	8	2	10
67	15. Communicates externally	Reputational	Review the process for updating the KPPA website. Confirm internal controls have been established to ensure the website reflects accurate information.	2	8	2	10
Monitoring							
68	16. Conducts ongoing and/or separate evaluations	Compliance	Review Office of Investments policies and ensure they have been documented, approved, and properly followed. Confirm internal controls have been established to monitor compliance with policies and report issues of non-compliance to Executive Management and Trustees.	6	4	4	20
69	16. Conducts ongoing and/or separate evaluations	Operational	Review divisions' procedures for ensuring segregation of duties of tasks. Confirm that internal controls have been established to prevent one individual from completing all aspects of a task.	4	4	4	16
70	17. Evaluates and communicates deficiencies	Compliance	Review the process to update administrative regulations and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure administrative regulations are not expired.	4	2	4	12
71	17. Evaluates and communicates deficiencies	Operational	Review the process for monitoring investment fees (administrative, manager, and performance) and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure fees are accurate, paid timely, and properly reported.	4	2	2	6
72	17. Evaluates and communicates deficiencies	Operational	Review the employer error correction process and ensure compliance with statutes/regulations/policies and confirm internal controls have been established to ensure errors are corrected properly and timely.	4	2	2	6



Kentucky Public Pensions Authority

Division of Internal Audit



Kentucky Public Pensions Authority

To: Members of the KPPA Audit Committee

From: Kristen N. Coffey, CICA
Chief Auditor

Date: August 27, 2024

Subject: Fiscal Year 2024 Internal Audit Budget as of June 30, 2024

Account Number	Account Name	FYE 2024 Budget	FY 2024 Actual Expenditures	Remaining Budget	Percent Remaining
111	Salaries	\$ 339,000.00	\$ 310,332.80	\$ 28,667.20	8.46%
121	Employer Paid FICA	25,933.50	23,249.87	2,683.63	10.35%
122	Employer Paid Retirement	221,338.65	205,218.65	16,120.00	7.28%
123	Employer Paid Health Insurance	45,000.00	45,728.34	(728.34)	-1.62%
124	Employer Paid Life Insurance	60.00	57.00	3.00	5.00%
133T	Employee Training	3,400.00	-	3,400.00	100.00%
259T	Conference Expenses	3,000.00	290.00	2,710.00	90.33%
361T	Travel - In State	1,000.00	-	1,000.00	100.00%
362T	Travel - Out State	3,000.00	-	3,000.00	100.00%
381T	Dues & Subscriptions	1,200.00	380.00	820.00	68.33%
399T	Miscellaneous	200.00	-	200.00	100.00%
847T	Computer Equipment	20,000.00	23,753.25	(3,753.25)	-18.77%
	Total	\$ 663,132.15	\$ 609,009.91	\$ 54,122.24	8.16%

259T Conference Expenses

1. 2nd Quarter - \$90 AGA Conference (Madeline, Matt, Will; Kristen and Melinda attended for free because they organized the event)
2. 3rd Quarter - \$200 AGA Conference (Kristen)

381T Dues and Subscriptions

3rd Quarter - \$380 IIA membership (Madeline and Matthew)

847T Computer Equipment

- 2nd Quarter - \$9,354.94 Audit Software licenses (all staff)
 4th Quarter - \$14,398.31 FY 2025 Audit Software Renewal (2nd quarter was FY 2024 renewal)

KPPA Audit Committee Meeting - KPPA Audit Committee Administrative Updates

Project Code	Project Name	Phase	Scheduled Start	Actual Start	Scheduled End	Actual End	Quarter 1 Hours	Quarter 2 Hours	Quarter 3 Hours	Quarter 4 Hours	Total FY 2024 Hours to Date	Estimated Hours	Estimated Hours Variance
2024-1	Review of Investment Manager Fees	Closed	7/10/2023	5/1/2023	10/13/2023	11/17/2023	379.75	121.00	0.00	0.00	500.75	600.00	95.75
2024-2	Review of Member Information Utilized for Retirement	Closed	9/5/2023	10/5/2023	3/29/2024	4/30/2024	19.25	211.25	255.75	32.00	518.25	600.00	(30.75)
2024-3	Review of Interest Applied to Member Accounts	Fieldwork	7/3/2023	5/25/2023	6/14/2024	1/0/1900	95.25	29.00	67.75	277.75	469.75	600.00	(23.25)
2024-4	Review of Expense Allocation	Closed	7/3/2023	5/18/2023	9/15/2023	9/22/2023	291.50	0.00	0.00	0.00	291.50	450.00	25.00
2024-5	Implementation of New Legislation	Closed	10/2/2023	10/2/2023	2/16/2024	3/21/2024	0.00	174.50	207.25	0.00	381.75	300.00	81.75
2024-6	Review of Employer Outstanding Invoices	Fieldwork	3/18/2024	3/13/2024	7/15/2024	1/0/1900	0.00	0.00	11.50	357.50	369.00	600.00	(231.00)
2024-7	Review of Employer Contributions	Planning	10/9/2023	10/6/2023	6/28/2024	1/0/1900	18.75	240.75	199.00	155.00	613.50	600.00	14.25
2024-8	Review of Disclosures During Correspondence	Closed	9/25/2023	10/3/2023	3/29/2024	4/30/2024	0.00	378.25	605.50	17.75	1,001.50	600.00	401.50
2024-9	Review of Refunds	Fieldwork	3/21/2024	3/21/2024	7/3/2024	1/0/1900	0.00	0.00	5.00	393.25	398.25	600.00	(201.75)
2024-10	Review of Administrative Fees	Not Started	1/0/1900	1/0/1900	1/0/1900	1/0/1900	0.00	0.00	0.00	31.25	31.25	600.00	(568.75)
2024-Other-1	FY 2024 Board and Committee Meetings	Fieldwork	7/1/2023	7/1/2023	6/30/2024	1/0/1900	112.00	80.25	62.25	87.75	342.25	425.00	(82.75)
2024-Other-2	FY 2024 Process Documentation	Closed	7/1/2023	7/5/2023	6/30/2024	5/31/2024	8.50	0.00	0.00	0.00	8.50	300.00	(291.50)
2024-Other-3	FY 2024 Miscellaneous KPPA Projects/Work Groups	Fieldwork	7/1/2023	7/5/2023	6/30/2024	1/0/1900	52.00	125.25	130.25	15.75	323.25	400.00	(76.75)
2024-Other-4	FY 2025 Audit Charter Updates	Review	7/5/2023	10/20/2023	6/28/2024	1/0/1900	0.75	0.75	1.75	0.00	3.25	20.00	(16.75)
2024-Other-5	Trustee Election RFP	Closed	12/1/2022	1/26/2023	3/1/2024	5/3/2024	4.50	22.50	10.00	5.00	42.00	125.00	(76.00)
2024-Other-6	Self-Assessment for Peer Review	Completion	7/5/2023	7/11/2023	10/20/2023	10/19/2023	315.00	1.75	1.00	3.75	321.50	500.00	(171.75)
2024-Other-7	FY 2025 Board Election Policy Updates	Fieldwork	9/5/2023	8/10/2023	6/10/2024	1/0/1900	4.75	0.00	1.00	2.50	8.25	20.00	(11.75)
2024-Other-8	FY 2024 ACFR and SAFR Review	Closed	9/1/2023	9/11/2023	1/12/2024	1/11/2024	13.00	62.50	2.00	0.00	77.50	150.00	(70.50)
2024-Other-9	FY 2025 Risk Assessment and Audit Plan	Fieldwork	7/1/2023	7/17/2023	8/27/2024	1/0/1900	29.25	24.50	66.50	64.25	184.50	300.00	(115.50)
2024-Other-10	Internal Audit Meetings	Fieldwork	7/1/2023	7/3/2023	6/30/2024	1/0/1900	175.00	64.25	132.00	96.75	468.00	500.00	(32.00)
2024-Other-11	Other KPPA Meetings	Fieldwork	7/1/2023	7/3/2023	6/30/2024	1/0/1900	40.25	16.50	49.00	49.50	155.25	260.00	(104.75)
2024-Other-12	Evaluations	Closed	7/1/2023	7/3/2023	6/30/2024	5/31/2024	35.50	1.50	39.00	3.50	79.50	70.00	9.50
2024-Other-13	Training	Fieldwork	7/1/2023	7/3/2023	6/30/2024	1/0/1900	206.00	110.50	92.50	65.50	474.50	400.00	74.50
2024-Other-14	Miscellaneous Internal Audit Projects	Closed	2/1/2024	1/11/2024	3/15/2024	1/0/1900	87.25	82.75	56.00	149.25	375.25	235.00	140.25
2024-Other-15	2024 Follow-Up on Open Items	Fieldwork	7/1/2023	7/10/2023	6/30/2024	3/26/2024	0.00	0.00	31.50	0.00	31.50	100.00	(68.50)
2025-1	1099-R Process (Follow-up to 2019-4)	Open	Planning	7/1/2024	6/17/2024	9/13/2024	0.00	0.00	0.00	2.00	2.00	-	-
2025-30	CERS Trustee Election	Open	Planning	7/1/2024	6/10/2024	4/30/2025	0.00	0.00	0.00	4.75	4.75	-	-
2025-31	Internal Audit Staff Hiring	Open	Planning	7/1/2024	6/10/2024	6/30/2025	0.00	0.00	0.00	2.75	2.75	-	-
	Administrative Hours	Fieldwork	7/1/2023	7/1/2023	6/30/2024	1/0/1900	461.50	151.00	167.25	179.25	959.00	882.00	77.00
	Non-Working Hours	Fieldwork	7/1/2023	7/1/2023	6/30/2024	1/0/1900	273.75	331.25	174.50	136.25	915.75	650.00	265.75
	Holidays	Fieldwork	2/1/2024	1/11/2024	6/30/2024	1/0/1900	82.50	225.00	93.75	67.50	468.75	465.00	3.75
							2,706.00	2,455.00	2,462.00	2,200.50	9,823.50	11,352.00	

Overage Explanation

2024-1: First time process has been reviewed.
2024-4: This was the auditor's first solo project. A little additional time is not unexpected.
2024-5: First time process has been reviewed, there were some delays in getting information.
2024-8: Scope was expanded based on a concern brought to Internal Audit during the review. Additionally, the first level reviewer took on an assistant/oversight role to help guide the lead auditor.
2024-Other-12: Additional evaluation added for Chief Auditor
2024-Other-13: An employee attended the Governmental Management Training Program, which increased training hours.
2024-Other-14: Unplanned projects were requested

Available Hours FY 2024 (including holidays)	9,667.50
Available Hours Remaining in FY 2024 (including holidays)	0.00
Overtime Worked for FY 2024	156.00
Average Overtime Worked in FY 2024, per employee	34.67
FY 2024 Project Hours Charged	7,480.00
FY 2024 Administrative Hours	959.00
FY 2024 Holidays and Time Off	1,384.50
Actual Hours Charged for FY 2024	9,823.50



Kentucky Public Pensions Authority

Division of Internal Audit



Re-Issue Date

May 30, 2024

Original Issue Date

March 20, 2024

Overall Opinion

Process complies with relevant statutes, regulations, policies, and procedures. Internal controls have not been established.

Summary of Findings

The following reportable findings were noted during our review. Additional details related to the findings, including the corresponding recommendations can be found in Appendix A.

1. Back-up Not Established for Legislative Tracking
2. Trustees May not Have the Opportunity to Provide Input on Legislative Changes
3. Procedures Related to the Legislative Implementation Process have not been Developed
4. Review Access to Document Used to Track Suggested Legislative Changes

Commendations

The KPPA Deputy Executive Director, Executive Director-Office of Benefits, staff from the Office of Legal Services and various division directors were prompt to respond to questions and the legislative questionnaire. Specifically, the Communications Division Director and Retiree Health Care Division Director provided especially thorough responses which was greatly appreciated.

Report Contents

[Acronyms2](#)

[Objectives.....2](#)

[Recommendations for Future Audits.....2](#)

[Appendix A – Audit Results.....3](#)

[Appendix B – Risks and Testing Methodology.....8](#)

[Appendix C – Background11](#)

Acronyms

The following acronyms will be used throughout the report:

1. KPPA - Kentucky Public Pensions Authority
2. CERS - County Employees Retirement System
3. KRS - Kentucky Retirement Systems
4. CEO - Chief Executive Officer
5. CFO - Chief Financial Officer
6. KPPA Executive Management Team - KPPA Executive Director, KPPA Deputy Executive Director, KPPA Executive Director – Office of Benefits, KPPA Executive Director – Office of Legal Services, and KPPA CFO
7. Communications – KPPA Division of Communications
8. DETS – KPPA Division of Enterprise and Technology Services

Objectives

The objectives of the Implementation of New Legislation audit were to ensure internal controls have been designed and are operating effectively and efficiently. We also ensured compliance with applicable state and federal statutes and regulations as well as policies established by the KPPA, CERS, and KRS Boards and procedures developed by KPPA staff.

The Implementation of New Legislation audit was conducted from October 2, 2023 to January 30, 2024. The scope of the audit was fiscal years 2021 to 2023 with the exclusion of House Bill 8 from the 2021 regular session due to litigation and House Bill 587 in the 2023 regular session due to its impact on the Division of Internal Audit. The report was issued on March 20, 2024.

Recommendations for Future Audits

Based on work conducted during this audit, the following items have been recommended for review during future audits:

1. The process for updating regulations before the Legislative Review Committee expiration date.
2. KPPA Governance audit.

Use of Report

This report is intended solely for use by the KPPA Audit Committee; the KPPA, CERS, and KRS Boards; the CERS CEO; the KRS CEO; and the KPPA Executive Management Team. This report is not intended to be, and should not be, used by anyone other than the specified parties. All final reports are subject to Open Records Requests.

Appendix A – Audit Results

1. Back-up Not Established for Legislative Tracking

Responsible Area(s):	KPPA Executive Management Team
Condition:	The Communications Director is the only KPPA staff member who tracks legislation in detail and a back-up has not been established for this task.
Criteria:	200 KAR 38:070 states, “Each fiscal officer shall develop and document internal controls to both prevent and detect abuse, unintentional errors, and the fraudulent disbursement of funds or use of state assets...An internal control plan shall include...Detailed procedures to be followed in the performance of job duties and functions to emphasize duties that comprise the overall framework of accountability and internal controls, and to help ensure the continuation of agency operations in the event of staffing changes...”
Cause:	Prior to 2017 the agency had a Director of Government Relations and Strategic Planning. Two of the primary tasks of this role were serving as the legislative liaison and tracking legislation that could potentially impact the agency. In 2017, the individual who served in that role was asked to move into the Communications Director position. When this move was made, the Director of Government Relations and Strategic Planning role was eliminated, and the responsibilities of that role were placed under Communications Director, in addition to the responsibilities already assigned to that role. Subsequently, some tasks have been moved to other KPPA staff. However, the request to include a position focused on government relations and research have not yet been approved by the KPPA Executive Director.
Effect:	Several preventative measures are dependent on the legislative tracking process. If this task is not performed, the KPPA Executive Management Team may not become aware of bills that could have a negative impact on the agency. KPPA staff may not have sufficient time to work with legislators on bills that impact the agency and/or may not have sufficient time to prepare for implementing bills.
Recommendations:	<ol style="list-style-type: none"> 1. The KPPA Executive Director should work with the Communications Director to determine who should be trained as the back-up for the legislative tracking process. 2. Alternatively, the KPPA Executive Director could consider establishing a position within the Division of Communications dedicated to being an active presence in the General Assembly. Another option would be to have this role set up outside of the Division of Communications and report directly to the KPPA Executive Director. Responsibilities of this role could include assisting the Executive Director with the following tasks: <ol style="list-style-type: none"> a. Maintaining a working relationship with the General Assembly. b. Attending legislative sessions and committee hearings with the Executive Directors or the CEOs of the CERS and KRS board. c. Working with the KPPA Executive Management Team, and CERS and KRS Boards and CEOs to determine legislative priorities and strategies for each session as well as long-term goals. d. Educating legislators about KPPA issues throughout the year. e. Engaging in constructive conversations with stakeholder groups throughout the year. f. Preparing correspondence for members about legislative updates. g. Addressing any inquiries from the Legislative Research Committee. h. Training staff to understand the legislative process and how KPPA can use it to promote the interest of the Boards and membership.
Recurring Issue:	No
Management Response:	<ol style="list-style-type: none"> 1. The KPPA Executive Management Team agrees with recommendation #1 to establish a back-up. The KPPA Executive Director will work with the Communications Director to establish a back-up to complete the various tracking documents currently completed by the Communications Director. The anticipated implementation date for this is June 30, 2024. 2. The KPPA Executive Management Team agreed with recommendation #1, therefore, this alternative recommendation is not needed.
Implementation Date:	June 30, 2024

Auditor Response:	Establishing a back-up for the Division of Communications is a good start at reducing the risk that legislative tasks are not addressed. The alternative suggestion of establishing a separate position was made because a government relations role requires a specialized skill set. Just as it likely would not be beneficial to have information technology professionals handle investments responsibilities or to have human resource professionals handle accounting tasks, asking someone without government relations expertise to complete government relations tasks may not be beneficial to the agency. While it is possible that a current employee could perform the job, it does not mean they are the best person to serve in the role. We also understand there may be other constraints related to hiring a full-time position. As such, we request that management consider the possibility of hiring a part-time or interim employee to take on these tasks during the legislative sessions.
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2. Trustees May not Have the Opportunity to Provide Input on Legislative Changes

Responsible Area(s):	KPPA Executive Management Team
Condition:	Trustees may not be given the opportunity to provide input on and approve the Housekeeping Bill or other legislative changes suggested by KPPA staff.
Criteria:	<p>As approved on May 28, 2024: The [CERS] Board will review and recommend statutory changes to the General Assembly related to the administration of benefits and compliance with federal law and determine which changes are in the best interests of the CERS plans. The CERS bylaws Section 1.2(l) states, "The [CERS] Board will review and recommended statutory changes to the General Assembly related to the administration of benefits and compliance with federal law and determine which changes are in the best interest of the CERS plans. The Board will also review legislation proposed by the General Assembly that is likely to have significant impact on the funded status, existing member benefits, or system administration for any of the CERS plans." Additionally, Section 1.3(j) states, "The CERS CEO shall recommend legislative or regulatory changes and propose draft language. These recommendations shall be presented to the CERS board for review and approval."</p> <p>KRS bylaws have no such requirement for the KRS Board to review legislation. Section 1.3(i) of the KRS bylaws states, "The CEO shall recommend legislative or regulatory changes and propose draft language."</p>
Cause:	There are no statutory, regulatory, or Board policies that require Trustees to approve legislative suggestions from KPPA staff before being sent to a bill sponsor.
Effect:	If Trustees are not given the opportunity to provide input and/or approval of legislation prior to it being sent to a bill sponsor, a policy could be changed in a manner that conflicts with the view of the oversight body.
Recommendations:	The KPPA Executive Management Team should seek input from the CERS and KRS Trustees as well as the KPPA Board to determine if Board approval is required prior to suggested legislative changes being submitted to a bill sponsor. If approval is needed, the CERS, KRS, and KPPA bylaws may need to be updated to reflect this requirement.
Recurring Issue:	No
Management Response:	<p>The KPPA Executive Management Team believes part of this recommendation is already in place. The CERS and KRS CEOs are involved in the approval process and the Trustees know what the process is. The current Bylaws speak to the role of the Board(s) and CEO(s) in the legislative process. The Boards of Trustees do not need the KPPA Executive Management Team to spur them into action to amend their respective Bylaws if they want the process to change. The CERS and KRS Trustees have complete control of the contents of their respective Bylaws.</p> <p>Involving the CERS, KRS, and KPPA Boards in an approval process is untenable due to the time constraints of dealing with proposed legislation. Additionally, the KPPA Board, through its Executive Director, direct the actions of KPPA staff. If the KPPA Board wishes to impose this requirement on its staff, only the KPPA Bylaws need to change.</p>
Implementation Date:	June 30, 2024

Auditor Response:	While the CERS and KRS Bylaws do include some guidance related to legislative actions, we recommend the KPPA Executive Director seek input from all CERS and KRS Trustees as well as the KPPA Board concerning the extent of approval needed from Trustees before suggested legislative changes are submitted to a bill sponsor. Additionally, we did not recommend that the KPPA Executive Management Team "spur the Trustees into action" regarding updating Bylaws. We only noted that the Bylaws may need to be updated if the Trustees determine their approval is needed prior to legislative changes being submitted to a bill sponsor.
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3. Procedures Related to the Legislative Implementation Process have not been Developed

Responsible Area(s):	KPPA Executive Management Team
Condition:	<p>KPPA staff have not officially developed procedures related to the process for implementing legislation that impacts the agency. The following items were noted during the audit:</p> <ul style="list-style-type: none"> • Written procedures do not exist pertaining to the development of the list of legislative changes sent to a bill sponsor. <ul style="list-style-type: none"> ○ For fiscal years 2021 to 2023, 46 legislative changes that were sent to a bill sponsor were not on the "KPPA Wishlist." ○ For fiscal years 2021 to 2023, 22 legislative changes included on the "KPPA Wishlist" did not make it to a bill sponsor. • Communications between KPPA staff and the bill sponsor regarding the reasonableness of implementation dates is handled verbally so testing could not be performed. • Documentation does not exist in a tangible format to confirm that the Legislative Research Committee draft was reviewed by KPPA staff so testing could not be performed.
Criteria:	200 KAR 38:070 states, "Each fiscal officer shall develop and document internal controls to both prevent and detect abuse, unintentional errors, and the fraudulent disbursement of funds or use of state assets...An internal control plan shall include...Detailed procedures to be followed in the performance of job duties and functions to emphasize duties that comprise the overall framework of accountability and internal controls, and to help ensure the continuation of agency operations in the event of staffing changes...."
Cause:	The exact process for implementing each legislative change is different so a standard process has not been documented.
Effect:	New legislation that impacts the agency may not be adequately implemented by the required deadline.
Recommendations:	<p>The KPPA Executive Management Team should develop written procedures related to the implementation of legislation process.</p> <ol style="list-style-type: none"> 1. Develop procedures related to how KPPA develops suggested legislative changes that are submitted to a bill sponsor. Procedures should include the following elements: <ol style="list-style-type: none"> a. Directions pertaining to how KPPA staff make suggestions for legislative changes. This guidance should be shared with staff that are allowed to make recommendations. b. Information on how KPPA staff suggestions will be tracked (see recommendation #2 of this issue). c. When it is not feasible for all suggestions to be sent to a bill sponsor, guidance on how suggestions will be prioritized. d. Reference to the need to work with the bill sponsor to ensure the implementation date of a proposed bill is reasonable. e. Reference to the need to work with the Legislative Research Committee after a bill has been drafted to ensure the original intent has not been lost or altered. 2. Consider taking the following actions pertaining to tracking KPPA staff suggestions for legislative changes. If necessary, these actions should be documented in the related procedures (see recommendation #1 of this issue): <ol style="list-style-type: none"> a. The <u>spreadsheet used to track the items on the fiscal year 2024</u> Housekeeping Bill list for fiscal year 2024 could be used as a base to start a centralized location for all ideas submitted by KPPA staff. b. The KPPA Executive Management Team should work with the Office of Legal Services to determine if it would be beneficial to keep this list on SharePoint so that access and edits can be monitored and restricted as appropriate. c. The KPPA Executive Management Team should consider adding <u>the</u> following elements to the tracking document. These additions would allow the KPPA Executive Management Team to easily see ideas that have not yet been <u>proposed and added</u>

	<p>to a Housekeeping Bill that may need to be considered for a future bill. Additionally, users would be able to quickly determine why an item was not considered for a Housekeeping Bill (or another separate legislative bill).</p> <ul style="list-style-type: none"> • A column to show in which fiscal year ideas are submitted. • A column showing the resolution of the suggestion – item sent to bill sponsor, held over for future year, legislative change not needed, etc. <p>3. Update written procedures related to the process for implementing legislation. Procedures should include the following elements:</p> <ol style="list-style-type: none"> a. Guidance on documenting how the change will be implemented and documenting the timeline of how the change will be implemented either by manual workaround or LOB programing by the due date. b. Information on how KPPA staff will track the status of implementing legislative changes, including legislation with an emergency clause. <p>4. Consider taking the following actions to ensure KPPA meets required deadlines for implementing changes. These actions should be documented in the procedures developed pertaining to the legislative implementation process (see recommendation #3 of this issue):</p> <ol style="list-style-type: none"> a. Document legislative implementation due dates on the log of legislative changes to be implemented. b. Work with DETS to ensure the log of legislative changes to be implemented includes the specific actions taken and the date the actions were taken. c. Present the status of the implementation process to the CERS, KRS, and KPPA Boards (as applicable) on a quarterly basis.
Recurring Issue:	No
Management Response:	<ol style="list-style-type: none"> 1. The KPPA Executive Management Team agrees with this recommendation. The KPPA Executive Management Team has established written procedures. These procedures are fluid and timelines are guided by the bill sponsor/Kentucky General Assembly process. 2. Each Executive Director should establish a process for collecting legislative items for consideration. Executive Directors should work with upper management in their respective Office to determine items that will go to the Executive Team for review. 3. The KPPA Executive Management Team agrees with this recommendation. Written procedures will be updated and include the considerations noted in a. and b. The anticipated date for completion will be June 30, 2024. 4. The KPPA Executive Management Team agrees with this recommendation. These actions will be taken into consideration when updating the written procedures in 3. The anticipated date for completion will be June 30, 2024.
Implementation Date:	<ol style="list-style-type: none"> 1. December 31, 2024 2. December 31, 2024 3. June 30, 2024 4. June 30, 2024
Auditor Response:	<ol style="list-style-type: none"> 1. Once the procedures referenced in management responses 1, 3, and 4 are completed, please provide them to the Division of Internal Audit for review. 2. Once the process referenced in management response 2 is developed and procedures are documented, please provide them to the Division of Internal Audit for review.

4. Review Access to Document Used to Track Suggested Legislative Changes

Responsible Area(s):	KPPA Executive Management Team
Condition:	The Office of Legal Services maintains a document where certain KPPA staff can make suggestions for legislative changes. The following items were noted pertaining to the access to this spreadsheet: <ul style="list-style-type: none"> No employees from the Office of Investments or Division of Human Resources have access to this list. The Division of Internal Audit did not have access to this list until it was requested as a part of this audit. 16 of 19 (84%) individuals sampled did not know they had access to this document. Division directors do not have access to the document.
Criteria:	KPPA Access Control Policy Section 5 #1 states, "All data shall be classified in accordance with the Data Classification Policy, its access determined by the business owner, and access granted based on the Principle of Least Privilege."
Cause:	This folder was sent up as an idea in November 2022 after the 2023 Housekeeping Bill was finalized. Since this bill did not pass during the 2023 session, it was recycled for the 2024 session. There has not been an opportunity to collect additional ideas from staff. Additionally, guidance has not been provided pertaining to who should have access to this document.
Effect:	The list used to track KPPA staff's suggested legislative changes is not a useful tool in developing the proposed legislation <u>Housekeeping Bill or other recommended bills</u> if staff who have access are not aware of the existence of the document or if all necessary staff do not have access to the document.
Recommendations:	The KPPA Executive Management Team should decide who at KPPA needs access to the suggested legislative changes spreadsheet. After that decision is made, the following steps should be taken: <ol style="list-style-type: none"> Work with DETS to ensure the determined individuals have access. Communicate to staff who are granted access to let them know they have access and to explain how this spreadsheet is utilized.
Recurring Issue:	No
Management Response:	The KPPA Executive Management Team agrees with the recommendations. The KPPA Executive Management Team has directed Office of Legal Services - Non-Advocacy Staff Attorney Supervisor to take these steps immediately.
Implementation Date:	December 31, 2024

Appendix B – Risks and Testing Methodology

Proportional statistical sampling was used to select sample that best represented the testable population. The testable population was considered by first reviewing everything tracked by the Division of Communications. That population was then split into changes that required a programming change, did not require a programming change, or were not directly related to KPPA. These groups were then split into house and senate bills for each year in scope. A proportionate sample with 99% confidence and 0.05% margin of error was then randomly selected within each category for each legislative session.

Risk:	Lack of Back-ups in Key Areas of KPPA
Control:	Back-up is established.
COSO Element:	Control Environment
COSO Principle:	Oversight body and management establish an organizational structure, assign responsibility, and delegate authority to achieve the entity’s objectives.
Testing Methodology:	Auditor spoke to staff involved in the legislative process to ensure a back-up had been established for the key activities.
Test Result:	Back-ups have been established for activities handled by the Office of Legal Services and DETS. A back-up has not been established for the Communications Director. Please see finding #1.

Risk:	Board of Trustees May Not Receive Proper Information Timely
Controls:	<ol style="list-style-type: none"> 1. CEO of CERS and KRS are consulted. 2. All trustees are notified of KPPA proposed legislation.
COSO Element:	Information and Communication
COSO Principle:	Management communicates necessary information internally.
Risk	Proposed Legislation is not Approved Appropriately
Control:	No control established. There are no specific statutory, regulatory or bylaw requirements that specify proposed legislation should be presented or approved by CERS, KRS or KPPA boards.
Testing Methodology:	<ol style="list-style-type: none"> 1. Auditor emailed CERS CEO and KRS CEO to determine if they were consulted during the creation of the housekeeping bills for fiscal years 2021 to 2023. 2. Auditor spoke with Office of Legal Services staff to determine if all trustees were notified of and have the chance to approve KPPA proposed legislation.
Test Result:	<ol style="list-style-type: none"> 1. Both CEOs were notified and given the opportunity to comment on housekeeping bills for all three fiscal years before they were sent to the bill sponsor. 2. The Office of Legal Services indicated there are no statutory, regulatory, or board policies that require all trustees to be notified of purposed legislation or that require any of the three boards (CERS, KRS, and KPPA) to approve anything before a list or idea is sent to the bill sponsor. Please see finding #2.

Risk:	Policies and Procedures not Accurate
Control:	Division Director ensures procedures are up-to-date and available to all relevant staff.
COSO Element:	Control Activity
COSO Principle:	Management implements controls through policies.
Testing Methodology:	Auditor reviewed division procedures to ensure they were up-to-date, reflected current practices, and were available to staff.
Test Result:	Various procedures had not been documented for the legislative process. Please see finding #3.

Risk:	Housekeeping Bill Sent to Sponsor is not Complete
Control:	Members of the KPPA Executive Management Team develop the Housekeeping Bill based on multiple criteria - review ideas from staff, unintended consequences of bills passed in prior sessions, changes to federal law requiring state law to be changed, court orders, and audit recommendations.
COSO Element:	Control Activity
COSO Principle:	Management designs control activities to achieve objectives and respond to risks.
Testing Methodology:	Auditor compared the wish lists for each fiscal year against the final version of the housekeeping bill that was sent to a bill sponsor.

Test Result:	There were items on the wish list that were not sent to the bill sponsor. When auditor asked about the reasoning for these items not being included, members of the KPPA Executive Management team stated there is no process to document the reasoning for ideas not making it to the final list. Please see finding #3.
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Risk:	Housekeeping Bill not Filed by the Due Date
Control:	Bill sponsor sets due dates and KPPA staff monitor these dates to ensure they are met.
Risk:	Draft of Bill Does not Meet Original Intent
Control:	KPPA staff review the draft of the bill and communicate any concerns to bill sponsor.
Risk:	Effective Date of New Legislation is Unreasonable
Control:	KPPA staff communicate concerns with due dates to bill sponsor.
COSO Element:	Information and Communication
COSO Principle:	Management communicates necessary information externally.
Testing Methodology:	Information pertaining to these steps of the process are typically communicated verbally or the emails are not retained so there was no tangible evidence to test.
Test Result:	Please see finding #3 for recommendations related to this item.

Risk:	Violation of Record Retention Policy
Control:	Prior versions of the housekeeping bill wish list are maintained.
COSO Element:	Control Activity
COSO Principle:	Management implements controls through policies.
Testing Methodology:	Auditor confirmed that each fiscal year in scope had a rough draft of issues for executive consideration to include in the final list that goes to the bill sponsor.
Test Result:	No exceptions noted. However, prior to fiscal year 2024 there was no centralized list of issues noted by staff outside of the Office of Legal Services. See finding #3 for a recommendation pertaining to a centralized storage file.

Risk:	State law is not Compliant with Federal Law
Control:	KPPA staff compare federal law updates to current state law.
COSO Element:	Monitoring
COSO Principle:	Management establishes and operates monitoring activities to monitor the internal control system and evaluate the results.
Testing Methodology:	Auditor reviewed notifications about updates to federal law and ensure necessary updates were suggested to state laws.
Test Result:	No exceptions noted. However, please see finding #3 for recommendations to improve the documentation of this process.

Risk:	Access to Housekeeping Wish List Folder is Inappropriate
Control:	Control not established. There is no official process to monitor and maintain an appropriate list of users with access to this folder.
COSO Element:	Monitoring
COSO Principle:	Management establishes and operates monitoring activities to monitor the internal control system and evaluate the results.
Testing Methodology:	Auditor reviewed the list of users with access to folder. Auditor then asked a sample of users with access if they were aware they had access and knew how to use the folder.
Test Result:	Please see finding #4.

Risk:	State Regulations not Updated to Match New Legislation
Control:	Office of Legal Services staff update state regulations.
COSO Element:	Monitoring
COSO Principle:	Management establishes and operates monitoring activities to monitor the internal control system and evaluate the results.

Testing Methodology:	Auditor confirmed regulations were updated when required based on new legislation for fiscal years 2021 to 2023.
Test Result:	No exceptions were noted.

Risk:	Retirement and Other Related Bills are not Tracked
Control:	Updates on all "Acts Related to Retirement" are provided daily
COSO Element:	Information and Communication
COSO Principle:	Management communicates necessary information internally and externally.
Testing Methodology:	Confirmed all relevant bills for fiscal years 2021 to 2023 were tracked.
Test Result:	No exceptions noted.

Risk:	Legislative Changes not Implemented by the Due Date
Control:	Legislative implementation is prioritized
COSO Element:	Control Activity
COSO Principle:	Management designs control activities to achieve objectives and respond to risks.
Testing Methodology:	Auditor confirmed legislation was implemented or a manual work around was established prior to the due date of the new legislation.
Test Result:	No exceptions were noted.

Risk:	Manual Workarounds May be Required Until Legislation is Fully Implemented
Control:	Division directors work with DETS business analyst to determine how to process work until new legislation is implemented.
COSO Element:	Control Activity
COSO Principle:	Management designs control activities to achieve objectives and respond to risks.
Testing Methodology:	Auditor sent a legislative questionnaire to divisions impacted by legislation during fiscal years 2021 to 2023 to determine if manual workarounds were needed and, if so, to determine how long the workarounds were utilized before the new legislation was fully implemented.
Test Result:	No exceptions were noted.

Risk:	Staff not Properly Trained to Perform Job Duties
Control:	Employees are briefed on the changes resulting from new legislation.
COSO Element:	Information and Communication
COSO Principle:	Management communicates necessary information internally.
Testing Methodology:	Auditor sent a legislative questionnaire to divisions impacted by legislation during fiscal years 2021 to 2023 to determine if staff were trained on new legislation.
Test Result:	No exceptions were noted.

Risk:	Public not Made Aware of Impactful Changes
Control:	Impactful legislation is disclosed in the Annual Comprehensive Financial Report.
COSO Element:	Information and Communication
COSO Principle:	Management communicates necessary information externally.
Testing Methodology:	Auditor confirmed that sampled bills directly related to KPPA were listed in the Annual Comprehensive Financial Report, if required.
Test Result:	No exceptions were noted.

Appendix C – Background

Creation of the Housekeeping Bill

Starting in 2020, the Staff Attorney Supervisor began keeping a list of housekeeping items. This is now maintained by Policy Specialist (beginning in 2022). The items on this list are court decisions that require statutory changes or ideas that provided by staff if they notice that statutes do not match or are contradictory. Ideas to make statutes more efficient are also added to this list. For ideas to be added to the list, staff reach out to the Staff Attorney Supervisor or Policy Specialist

Around June or July, KPPA’s Executive Director begins working with legislators to find a sponsor for the KPPA Housekeeping Bill, while the list of what should be in the bill is being developed. Executive Directors work with their division directors to determine if there are items that need to be added to the list of housekeeping items. The KPPA Executive Management Team then reviews the final list of items to determine which items will be requested in the Housekeeping Bill provided to the bill sponsor. The CEOs of CERS and KRS as well as external stakeholders are consulted on potential changes. Changes required to clean up unintended consequences of bills passed in prior sessions, court decisions, federal law, and items that effect a large percentage of membership must also be considered.

The bill sponsor reviews the complete list of items in order to ensure they are appropriate for a housekeeping bill. Items that are not deemed housekeeping items are recommended for a separate bill. The information is then filed with the Legislative Research Committee to be drafted.

During the drafting process Legislative Research Committee staff communicate with KPPA staff and the bill sponsor to ensure the original intent has not been lost. Legislative Research Committee staff will also inquire as to whether any specific legal language should be used. The drafted version is provided to the bill sponsor for approval. The bill sponsor then presents the bill to the Public Pension Oversight Board for approval.

Tracking Legislation

According to section 36 of the Kentucky constitution, legislative sessions convene on the first Tuesday after the first Monday in January and each chamber, the Senate and the House, will set the rules for the session. The Legislative Research Commission posts all introduced bills with a title and summary of its contents to their website. The Communications Division Director reads through the summaries of all introduced bills. All titles that state “an act related to retirement” are tracked. Other titles that may impact operations such as “an act related to personnel” are also considered for tracking. The bills are separated based on those that impact retirement rules or funding and those that impact operational functions. The movement of bills through the legislative process is tracked and conveyed to KPPA staff, Trustees, and other interested parties on a daily basis.

The daily email from the Communications Division Director is used by DETS, the Office of Benefits, and the Deputy Executive Director so they can be proactive in responding to bills and to potentially get a head start on implementing a change if it is anticipated to be a difficult procedural change or require many hours of reprogramming.

DETS assigns business analysts and developers to read through the tracked legislation so they are prepared to work with affected divisions should bills pass.

Implementation

Members of the KPPA Executive Management Team work to educate legislators on the estimated time needed to implement a change to assist legislators in setting reasonable effective dates. Inconsistences with federal retirement law are pointed out in the educational process as well. If a law is inconsistent with federal retirement law, KPPA will only implement parts of state law that do not contradict federal law since federal law takes precedence.

After the session is completed, the divisions impacted by the change will create a work group to determine how best to implement new laws. The following groups are included in the work group when needed:

1. DETS will be included if the change requires a programing change. Each division in the Office of Benefits and the Office of Operations has a designated business analyst that meets with the division workgroup in design sessions to discuss how Line of Business will operate to meet the new change. DETS also keeps track of the status of implementation through a spreadsheet that is shared with the workgroup.

2. Executives and Legal will be brought in if there is a question or disagreement with how to interpret the new law within the workgroup or if the intent is unclear.

After everyone in the workgroup and other groups involved agree on how the new law should be applied, the workgroup will log a Web Helpdesk ticket that will launch a work item so DETS programmers can complete the changes in time for the scheduled release. If several laws are passed at the same time, then implementation is completed according to business needs such as but not limited to, how soon a change needs to be implemented and how many members are affected. Manual workarounds will be developed by division directors if a programing change cannot be launched in time to meet the effective date.

Regulation Changes

The Staff Attorney Supervisor and the Policy Specialist work with the impacted division to update corresponding regulations to match the new law when needed. The appropriate board (CERS, KRS, KPPA) will then approve the updated regulation before it is submitted to the regulation compiler at the Legislative Research Committee.

Communication of Changes

The Executive Director-Office of Benefits creates a summary of all passed laws and brief Office of Benefits employees on how to implement the new change in their daily tasks and how to communicate the changes to members should they ask during calls or appointments.

Members and other stakeholders are informed about the changes through the following steps taken by the Division of Communications:

1. The last daily legislative update for each session includes a summary of the key retirement-related bills that passed. This is sent as an email to all KPPA staff, Trustees, and other stakeholders who have specifically asked to receive the daily emails. An edited version of that email is posted to the Legislative Update page of the KPPA website, where it remains until the next Session begins.
2. The spring edition of Pension Insights, member/retiree e-newsletter, features the major legislation from the just-completed Session. The newsletter contains highlights of certain bills and sometimes includes separate articles about individual bills to further explain their impact on members. The newsletter also includes a hyperlink to a more detailed summary of major bills that is written and placed in one document. The Division of Communications also emails the newsletter to everyone who has provided a valid email address (approximately 207,000 addresses at last count) and posts the newsletter on the KPPA website. Previous newsletters are also archived on the website.
3. The Division of Communications produces a newsletter for Kentucky Government Officials several times each year: the April/May edition always contains a summary of major legislation. This is emailed to all 138 legislators, cabinet officials, and various staff members in state government. This newsletter is also posted to the KPPA website.
4. The Director of Communications is invited to several Kentucky Public Retirees chapter meetings throughout the state in spring/summer to speak to their members about recent legislative happenings. These meetings help to spread awareness among our retirees.
5. For the last few years Communications has written Note N – Pension Legislation for the ACFR.
6. The Director of Communications provides background information and status reports of various bills and resolutions to the executive team for use in board meetings that occur during legislative Sessions.
7. Communications regularly uses KPPA social media outlets and website to draw attention to legislative happenings. Website data shows that these pages are among the most frequently visited.
8. Communications updates webpages and publications to reflect legislative changes and develop materials that explain legislative changes.



Kentucky Public Pensions Authority

Division of Internal Audit



Re-Issue Date

May 30, 2024

Original Issue Date

March 20, 2024

Overall Opinion

Process complies with relevant statutes, regulations, policies, and procedures. Internal controls have not been established.

Summary of Findings

The following reportable findings were noted during our review. Additional details related to the findings, including the corresponding recommendations can be found in Appendix A.

1. Back-up Not Established for Legislative Tracking
2. Trustees May not Have the Opportunity to Provide Input on Legislative Changes
3. Procedures Related to the Legislative Implementation Process have not been Developed
4. Review Access to Document Used to Track Suggested Legislative Changes

Commendations

The KPPA Deputy Executive Director, Executive Director-Office of Benefits, staff from the Office of Legal Services and various division directors were prompt to respond to questions and the legislative questionnaire. Specifically, the Communications Division Director and Retiree Health Care Division Director provided especially thorough responses which was greatly appreciated.

Report Contents

Acronyms2

Objectives.....2

Recommendations for Future Audits.....2

Appendix A – Audit Results.....3

Appendix B – Risks and Testing Methodology.....8

Appendix C – Background11

Acronyms

The following acronyms will be used throughout the report:

1. KPPA - Kentucky Public Pensions Authority
2. CERS - County Employees Retirement System
3. KRS - Kentucky Retirement Systems
4. CEO - Chief Executive Officer
5. CFO - Chief Financial Officer
6. KPPA Executive Management Team - KPPA Executive Director, KPPA Deputy Executive Director, KPPA Executive Director – Office of Benefits, KPPA Executive Director – Office of Legal Services, and KPPA CFO
7. Communications – KPPA Division of Communications
8. DETS – KPPA Division of Enterprise and Technology Services

Objectives

The objectives of the Implementation of New Legislation audit were to ensure internal controls have been designed and are operating effectively and efficiently. We also ensured compliance with applicable state and federal statutes and regulations as well as policies established by the KPPA, CERS, and KRS Boards and procedures developed by KPPA staff.

The Implementation of New Legislation audit was conducted from October 2, 2023 to January 30, 2024. The scope of the audit was fiscal years 2021 to 2023 with the exclusion of House Bill 8 from the 2021 regular session due to litigation and House Bill 587 in the 2023 regular session due to its impact on the Division of Internal Audit. The report was issued on March 20, 2024.

Recommendations for Future Audits

Based on work conducted during this audit, the following items have been recommended for review during future audits:

1. The process for updating regulations before the Legislative Review Committee expiration date.
2. KPPA Governance audit.

Use of Report

This report is intended solely for use by the KPPA Audit Committee; the KPPA, CERS, and KRS Boards; the CERS CEO; the KRS CEO; and the KPPA Executive Management Team. This report is not intended to be, and should not be, used by anyone other than the specified parties. All final reports are subject to Open Records Requests.

Appendix A – Audit Results

1. Back-up Not Established for Legislative Tracking

Responsible Area(s):	KPPA Executive Management Team
Condition:	The Communications Director is the only KPPA staff member who tracks legislation in detail and a back-up has not been established for this task.
Criteria:	200 KAR 38:070 states, “Each fiscal officer shall develop and document internal controls to both prevent and detect abuse, unintentional errors, and the fraudulent disbursement of funds or use of state assets...An internal control plan shall include...Detailed procedures to be followed in the performance of job duties and functions to emphasize duties that comprise the overall framework of accountability and internal controls, and to help ensure the continuation of agency operations in the event of staffing changes...”
Cause:	Prior to 2017 the agency had a Director of Government Relations and Strategic Planning. Two of the primary tasks of this role were serving as the legislative liaison and tracking legislation that could potentially impact the agency. In 2017, the individual who served in that role was asked to move into the Communications Director position. When this move was made, the Director of Government Relations and Strategic Planning role was eliminated, and the responsibilities of that role were placed under Communications Director, in addition to the responsibilities already assigned to that role. Subsequently, some tasks have been moved to other KPPA staff. However, the request to include a position focused on government relations and research have not yet been approved by the KPPA Executive Director.
Effect:	Several preventative measures are dependent on the legislative tracking process. If this task is not performed, the KPPA Executive Management Team may not become aware of bills that could have a negative impact on the agency. KPPA staff may not have sufficient time to work with legislators on bills that impact the agency and/or may not have sufficient time to prepare for implementing bills.
Recommendations:	<ol style="list-style-type: none"> 1. The KPPA Executive Director should work with the Communications Director to determine who should be trained as the back-up for the legislative tracking process. 2. Alternatively, the KPPA Executive Director could consider establishing a position within the Division of Communications dedicated to being an active presence in the General Assembly. Another option would be to have this role set up outside of the Division of Communications and report directly to the KPPA Executive Director. Responsibilities of this role could include assisting the Executive Director with the following tasks: <ol style="list-style-type: none"> a. Maintaining a working relationship with the General Assembly. b. Attending legislative sessions and committee hearings with the Executive Directors or the CEOs of the CERS and KRS board. c. Working with the KPPA Executive Management Team, and CERS and KRS Boards and CEOs to determine legislative priorities and strategies for each session as well as long-term goals. d. Educating legislators about KPPA issues throughout the year. e. Engaging in constructive conversations with stakeholder groups throughout the year. f. Preparing correspondence for members about legislative updates. g. Addressing any inquiries from the Legislative Research Committee. h. Training staff to understand the legislative process and how KPPA can use it to promote the interest of the Boards and membership.
Recurring Issue:	No
Management Response:	<ol style="list-style-type: none"> 1. The KPPA Executive Management Team agrees with recommendation #1 to establish a back-up. The KPPA Executive Director will work with the Communications Director to establish a back-up to complete the various tracking documents currently completed by the Communications Director. The anticipated implementation date for this is June 30, 2024. 2. The KPPA Executive Management Team agreed with recommendation #1, therefore, this alternative recommendation is not needed.
Implementation Date:	June 30, 2024

Auditor Response:	Establishing a back-up for the Division of Communications is a good start at reducing the risk that legislative tasks are not addressed. The alternative suggestion of establishing a separate position was made because a government relations role requires a specialized skill set. Just as it likely would not be beneficial to have information technology professionals handle investments responsibilities or to have human resource professionals handle accounting tasks, asking someone without government relations expertise to complete government relations tasks may not be beneficial to the agency. While it is possible that a current employee could perform the job, it does not mean they are the best person to serve in the role. We also understand there may be other constraints related to hiring a full-time position. As such, we request that management consider the possibility of hiring a part-time or interim employee to take on these tasks during the legislative sessions.
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2. Trustees May not Have the Opportunity to Provide Input on Legislative Changes

Responsible Area(s):	KPPA Executive Management Team
Condition:	Trustees may not be given the opportunity to provide input on and approve the Housekeeping Bill or other legislative changes suggested by KPPA staff.
Criteria:	As approved on May 28, 2024: The [CERS] Board will review and recommend statutory changes to the General Assembly related to the administration of benefits and compliance with federal law and determine which changes are in the best interests of the CERS plans. KRS bylaws have no such requirement for the KRS Board to review legislation. Section 1.3(i) of the KRS bylaws states, “The CEO shall recommend legislative or regulatory changes and propose draft language.”
Cause:	There are no statutory, regulatory, or Board policies that require Trustees to approve legislative suggestions from KPPA staff before being sent to a bill sponsor.
Effect:	If Trustees are not given the opportunity to provide input and/or approval of legislation prior to it being sent to a bill sponsor, a policy could be changed in a manner that conflicts with the view of the oversight body.
Recommendations:	The KPPA Executive Management Team should seek input from the CERS and KRS Trustees as well as the KPPA Board to determine if Board approval is required prior to suggested legislative changes being submitted to a bill sponsor. If approval is needed, the CERS, KRS, and KPPA bylaws may need to be updated to reflect this requirement.
Recurring Issue:	No
Management Response:	The KPPA Executive Management Team believes part of this recommendation is already in place. The CERS and KRS CEOs are involved in the approval process and the Trustees know what the process is. The current Bylaws speak to the role of the Board(s) and CEO(s) in the legislative process. The Boards of Trustees do not need the KPPA Executive Management Team to spur them into action to amend their respective Bylaws if they want the process to change. The CERS and KRS Trustees have complete control of the contents of their respective Bylaws. Involving the CERS, KRS, and KPPA Boards in an approval process is untenable due to the time constraints of dealing with proposed legislation. Additionally, the KPPA Board, through its Executive Director, direct the actions of KPPA staff. If the KPPA Board wishes to impose this requirement on its staff, only the KPPA Bylaws need to change.
Implementation Date:	June 30, 2024
Auditor Response:	While the CERS and KRS Bylaws do include some guidance related to legislative actions, we recommend the KPPA Executive Director seek input from all CERS and KRS Trustees as well as the KPPA Board concerning the extent of approval needed from Trustees before suggested legislative changes are submitted to a bill sponsor. Additionally, we did not recommend that the KPPA Executive Management Team "spur the Trustees into action" regarding updating Bylaws. We only noted that the Bylaws may need to be updated if the Trustees determine their approval is needed prior to legislative changes being submitted to a bill sponsor.

3. Procedures Related to the Legislative Implementation Process have not been Developed

Responsible Area(s):	KPPA Executive Management Team
Condition:	<p>KPPA staff have not officially developed procedures related to the process for implementing legislation that impacts the agency. The following items were noted during the audit:</p> <ul style="list-style-type: none"> • Written procedures do not exist pertaining to the development of the list of legislative changes sent to a bill sponsor. <ul style="list-style-type: none"> ○ For fiscal years 2021 to 2023, 46 legislative changes that were sent to a bill sponsor were not on the "KPPA Wishlist." ○ For fiscal years 2021 to 2023, 22 legislative changes included on the "KPPA Wishlist" did not make it to a bill sponsor. • Communications between KPPA staff and the bill sponsor regarding the reasonableness of implementation dates is handled verbally so testing could not be performed. • Documentation does not exist in a tangible format to confirm that the Legislative Research Committee draft was reviewed by KPPA staff so testing could not be performed.
Criteria:	200 KAR 38:070 states, "Each fiscal officer shall develop and document internal controls to both prevent and detect abuse, unintentional errors, and the fraudulent disbursement of funds or use of state assets...An internal control plan shall include...Detailed procedures to be followed in the performance of job duties and functions to emphasize duties that comprise the overall framework of accountability and internal controls, and to help ensure the continuation of agency operations in the event of staffing changes...."
Cause:	The exact process for implementing each legislative change is different so a standard process has not been documented.
Effect:	New legislation that impacts the agency may not be adequately implemented by the required deadline.
Recommendations:	<p>The KPPA Executive Management Team should develop written procedures related to the implementation of legislation process.</p> <ol style="list-style-type: none"> 1. Develop procedures related to how KPPA develops suggested legislative changes that are submitted to a bill sponsor. Procedures should include the following elements: <ol style="list-style-type: none"> a. Directions pertaining to how KPPA staff make suggestions for legislative changes. This guidance should be shared with staff that are allowed to make recommendations. b. Information on how KPPA staff suggestions will be tracked (see recommendation #2 of this issue). c. When it is not feasible for all suggestions to be sent to a bill sponsor, guidance on how suggestions will be prioritized. d. Reference to the need to work with the bill sponsor to ensure the implementation date of a proposed bill is reasonable. e. Reference to the need to work with the Legislative Research Committee after a bill has been drafted to ensure the original intent has not been lost or altered. 2. Consider taking the following actions pertaining to tracking KPPA staff suggestions for legislative changes. If necessary, these actions should be documented in the related procedures (see recommendation #1 of this issue): <ol style="list-style-type: none"> a. The spreadsheet used to track the items on the fiscal year 2024 Housekeeping Bill could be used as a base to start a centralized location for all ideas submitted by KPPA staff. b. The KPPA Executive Management Team should work with the Office of Legal Services to determine if it would be beneficial to keep this list on SharePoint so that access and edits can be monitored and restricted as appropriate. c. The KPPA Executive Management Team should consider adding the following elements to the tracking document. These additions would allow the KPPA Executive Management Team to easily see ideas that have not yet been proposed and may need to be considered for a future bill. Additionally, users would be able to quickly determine why an item was not considered for a legislative bill. <ul style="list-style-type: none"> • A column to show in which fiscal year ideas are submitted. • A column showing the resolution of the suggestion – item sent to bill sponsor, held over for future year, legislative change not needed, etc.

	<ol style="list-style-type: none"> 3. Update written procedures related to the process for implementing legislation. Procedures should include the following elements: <ol style="list-style-type: none"> a. Guidance on documenting how the change will be implemented and documenting the timeline of how the change will be implemented either by manual workaround or LOB programing by the due date. b. Information on how KPPA staff will track the status of implementing legislative changes, including legislation with an emergency clause. 4. Consider taking the following actions to ensure KPPA meets required deadlines for implementing changes. These actions should be documented in the procedures developed pertaining to the legislative implementation process (see recommendation #3 of this issue): <ol style="list-style-type: none"> a. Document legislative implementation due dates on the log of legislative changes to be implemented. b. Work with DETS to ensure the log of legislative changes to be implemented includes the specific actions taken and the date the actions were taken. c. Present the status of the implementation process to the CERS, KRS, and KPPA Boards (as applicable) on a quarterly basis.
Recurring Issue:	No
Management Response:	<ol style="list-style-type: none"> 1. The KPPA Executive Management Team agrees with this recommendation. The KPPA Executive Management Team has established written procedures. These procedures are fluid and timelines are guided by the bill sponsor/Kentucky General Assembly process. 2. Each Executive Director should establish a process for collecting legislative items for consideration. Executive Directors should work with upper management in their respective Office to determine items that will go to the Executive Team for review. 3. The KPPA Executive Management Team agrees with this recommendation. Written procedures will be updated and include the considerations noted in a. and b. The anticipated date for completion will be June 30, 2024. 4. The KPPA Executive Management Team agrees with this recommendation. These actions will be taken into consideration when updating the written procedures in 3. The anticipated date for completion will be June 30, 2024.
Implementation Date:	<ol style="list-style-type: none"> 1. December 31, 2024 2. December 31, 2024 3. June 30, 2024 4. June 30, 2024
Auditor Response:	<ol style="list-style-type: none"> 1. Once the procedures referenced in management responses 1, 3, and 4 are completed, please provide them to the Division of Internal Audit for review. 2. Once the process referenced in management response 2 is developed and procedures are documented, please provide them to the Division of Internal Audit for review.

4. Review Access to Document Used to Track Suggested Legislative Changes

Responsible Area(s):	KPPA Executive Management Team
Condition:	<p>The Office of Legal Services maintains a document where certain KPPA staff can make suggestions for legislative changes. The following items were noted pertaining to the access to this spreadsheet:</p> <ul style="list-style-type: none"> • No employees from the Office of Investments or Division of Human Resources have access to this list. The Division of Internal Audit did not have access to this list until it was requested as a part of this audit. • 16 of 19 (84%) individuals sampled did not know they had access to this document. • Division directors do not have access to the document.
Criteria:	KPPA Access Control Policy Section 5 #1 states, “All data shall be classified in accordance with the Data Classification Policy, its access determined by the business owner, and access granted based on the Principle of Least Privilege.”

Cause:	This folder was sent up as an idea in November 2022 after the 2023 Housekeeping Bill was finalized. Since this bill did not pass during the 2023 session, it was recycled for the 2024 session. There has not been an opportunity to collect additional ideas from staff. Additionally, guidance has not been provided pertaining to who should have access to this document.
Effect:	The list used to track KPPA staff's suggested legislative changes is not a useful tool in developing proposed legislation if staff who have access are not aware of the existence of the document or if all necessary staff do not have access to the document.
Recommendations:	The KPPA Executive Management Team should decide who at KPPA needs access to the suggested legislative changes spreadsheet. After that decision is made, the following steps should be taken: <ol style="list-style-type: none"> 1. Work with DETS to ensure the determined individuals have access. 2. Communicate to staff who are granted access to let them know they have access and to explain how this spreadsheet is utilized.
Recurring Issue:	No
Management Response:	The KPPA Executive Management Team agrees with the recommendations. The KPPA Executive Management Team has directed Office of Legal Services - Non-Advocacy Staff Attorney Supervisor to take these steps immediately.
Implementation Date:	December 31, 2024

Appendix B – Risks and Testing Methodology

Proportional statistical sampling was used to select sample that best represented the testable population. The testable population was considered by first reviewing everything tracked by the Division of Communications. That population was then split into changes that required a programming change, did not require a programming change, or were not directly related to KPPA. These groups were then split into house and senate bills for each year in scope. A proportionate sample with 99% confidence and 0.05% margin of error was then randomly selected within each category for each legislative session.

Risk:	Lack of Back-ups in Key Areas of KPPA
Control:	Back-up is established.
COSO Element:	Control Environment
COSO Principle:	Oversight body and management establish an organizational structure, assign responsibility, and delegate authority to achieve the entity’s objectives.
Testing Methodology:	Auditor spoke to staff involved in the legislative process to ensure a back-up had been established for the key activities.
Test Result:	Back-ups have been established for activities handled by the Office of Legal Services and DETS. A back-up has not been established for the Communications Director. Please see finding #1.

Risk:	Board of Trustees May Not Receive Proper Information Timely
Controls:	<ol style="list-style-type: none"> 1. CEO of CERS and KRS are consulted. 2. All trustees are notified of KPPA proposed legislation.
COSO Element:	Information and Communication
COSO Principle:	Management communicates necessary information internally.
Risk:	Proposed Legislation is not Approved Appropriately
Control:	No control established. There are no specific statutory, regulatory or bylaw requirements that specify proposed legislation should be presented or approved by CERS, KRS or KPPA boards.
Testing Methodology:	<ol style="list-style-type: none"> 1. Auditor emailed CERS CEO and KRS CEO to determine if they were consulted during the creation of the housekeeping bills for fiscal years 2021 to 2023. 2. Auditor spoke with Office of Legal Services staff to determine if all trustees were notified of and have the chance to approve KPPA proposed legislation.
Test Result:	<ol style="list-style-type: none"> 1. Both CEOs were notified and given the opportunity to comment on housekeeping bills for all three fiscal years before they were sent to the bill sponsor. 2. The Office of Legal Services indicated there are no statutory, regulatory, or board policies that require all trustees to be notified of purposed legislation or that require any of the three boards (CERS, KRS, and KPPA) to approve anything before a list or idea is sent to the bill sponsor. Please see finding #2.

Risk:	Policies and Procedures not Accurate
Control:	Division Director ensures procedures are up-to-date and available to all relevant staff.
COSO Element:	Control Activity
COSO Principle:	Management implements controls through policies.
Testing Methodology:	Auditor reviewed division procedures to ensure they were up-to-date, reflected current practices, and were available to staff.
Test Result:	Various procedures had not been documented for the legislative process. Please see finding #3.

Risk:	Housekeeping Bill Sent to Sponsor is not Complete
Control:	Members of the KPPA Executive Management Team develop the Housekeeping Bill based on multiple criteria - review ideas from staff, unintended consequences of bills passed in prior sessions, changes to federal law requiring state law to be changed, court orders, and audit recommendations.
COSO Element:	Control Activity
COSO Principle:	Management designs control activities to achieve objectives and respond to risks.
Testing Methodology:	Auditor compared the wish lists for each fiscal year against the final version of the housekeeping bill that was sent to a bill sponsor.

Test Result:	There were items on the wish list that were not sent to the bill sponsor. When auditor asked about the reasoning for these items not being included, members of the KPPA Executive Management team stated there is no process to document the reasoning for ideas not making it to the final list. Please see finding #3.
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Risk:	Housekeeping Bill not Filed by the Due Date
Control:	Bill sponsor sets due dates and KPPA staff monitor these dates to ensure they are met.
Risk:	Draft of Bill Does not Meet Original Intent
Control:	KPPA staff review the draft of the bill and communicate any concerns to bill sponsor.
Risk:	Effective Date of New Legislation is Unreasonable
Control:	KPPA staff communicate concerns with due dates to bill sponsor.
COSO Element:	Information and Communication
COSO Principle:	Management communicates necessary information externally.
Testing Methodology:	Information pertaining to these steps of the process are typically communicated verbally or the emails are not retained so there was no tangible evidence to test.
Test Result:	Please see finding #3 for recommendations related to this item.

Risk:	Violation of Record Retention Policy
Control:	Prior versions of the housekeeping bill wish list are maintained.
COSO Element:	Control Activity
COSO Principle:	Management implements controls through policies.
Testing Methodology:	Auditor confirmed that each fiscal year in scope had a rough draft of issues for executive consideration to include in the final list that goes to the bill sponsor.
Test Result:	No exceptions noted. However, prior to fiscal year 2024 there was no centralized list of issues noted by staff outside of the Office of Legal Services. See finding #3 for a recommendation pertaining to a centralized storage file.

Risk:	State law is not Compliant with Federal Law
Control:	KPPA staff compare federal law updates to current state law.
COSO Element:	Monitoring
COSO Principle:	Management establishes and operates monitoring activities to monitor the internal control system and evaluate the results.
Testing Methodology:	Auditor reviewed notifications about updates to federal law and ensure necessary updates were suggested to state laws.
Test Result:	No exceptions noted. However, please see finding #3 for recommendations to improve the documentation of this process.

Risk:	Access to Housekeeping Wish List Folder is Inappropriate
Control:	Control not established. There is no official process to monitor and maintain an appropriate list of users with access to this folder.
COSO Element:	Monitoring
COSO Principle:	Management establishes and operates monitoring activities to monitor the internal control system and evaluate the results.
Testing Methodology:	Auditor reviewed the list of users with access to folder. Auditor then asked a sample of users with access if they were aware they had access and knew how to use the folder.
Test Result:	Please see finding #4.

Risk:	State Regulations not Updated to Match New Legislation
Control:	Office of Legal Services staff update state regulations.
COSO Element:	Monitoring
COSO Principle:	Management establishes and operates monitoring activities to monitor the internal control system and evaluate the results.

Testing Methodology:	Auditor confirmed regulations were updated when required based on new legislation for fiscal years 2021 to 2023.
Test Result:	No exceptions were noted.

Risk:	Retirement and Other Related Bills are not Tracked
Control:	Updates on all "Acts Related to Retirement" are provided daily
COSO Element:	Information and Communication
COSO Principle:	Management communicates necessary information internally and externally.
Testing Methodology:	Confirmed all relevant bills for fiscal years 2021 to 2023 were tracked.
Test Result:	No exceptions noted.

Risk:	Legislative Changes not Implemented by the Due Date
Control:	Legislative implementation is prioritized
COSO Element:	Control Activity
COSO Principle:	Management designs control activities to achieve objectives and respond to risks.
Testing Methodology:	Auditor confirmed legislation was implemented or a manual work around was established prior to the due date of the new legislation.
Test Result:	No exceptions were noted.

Risk:	Manual Workarounds May be Required Until Legislation is Fully Implemented
Control:	Division directors work with DETS business analyst to determine how to process work until new legislation is implemented.
COSO Element:	Control Activity
COSO Principle:	Management designs control activities to achieve objectives and respond to risks.
Testing Methodology:	Auditor sent a legislative questionnaire to divisions impacted by legislation during fiscal years 2021 to 2023 to determine if manual workarounds were needed and, if so, to determine how long the workarounds were utilized before the new legislation was fully implemented.
Test Result:	No exceptions were noted.

Risk:	Staff not Properly Trained to Perform Job Duties
Control:	Employees are briefed on the changes resulting from new legislation.
COSO Element:	Information and Communication
COSO Principle:	Management communicates necessary information internally.
Testing Methodology:	Auditor sent a legislative questionnaire to divisions impacted by legislation during fiscal years 2021 to 2023 to determine if staff were trained on new legislation.
Test Result:	No exceptions were noted.

Risk:	Public not Made Aware of Impactful Changes
Control:	Impactful legislation is disclosed in the Annual Comprehensive Financial Report.
COSO Element:	Information and Communication
COSO Principle:	Management communicates necessary information externally.
Testing Methodology:	Auditor confirmed that sampled bills directly related to KPPA were listed in the Annual Comprehensive Financial Report, if required.
Test Result:	No exceptions were noted.

Appendix C – Background

Creation of the Housekeeping Bill

Starting in 2020, the Staff Attorney Supervisor began keeping a list of housekeeping items. This is now maintained by Policy Specialist (beginning in 2022). The items on this list are court decisions that require statutory changes or ideas that provided by staff if they notice that statutes do not match or are contradictory. Ideas to make statutes more efficient are also added to this list. For ideas to be added to the list, staff reach out to the Staff Attorney Supervisor or Policy Specialist

Around June or July, KPPA’s Executive Director begins working with legislators to find a sponsor for the KPPA Housekeeping Bill, while the list of what should be in the bill is being developed. Executive Directors work with their division directors to determine if there are items that need to be added to the list of housekeeping items. The KPPA Executive Management Team then reviews the final list of items to determine which items will be requested in the Housekeeping Bill provided to the bill sponsor. The CEOs of CERS and KRS as well as external stakeholders are consulted on potential changes. Changes required to clean up unintended consequences of bills passed in prior sessions, court decisions, federal law, and items that effect a large percentage of membership must also be considered.

The bill sponsor reviews the complete list of items in order to ensure they are appropriate for a housekeeping bill. Items that are not deemed housekeeping items are recommended for a separate bill. The information is then filed with the Legislative Research Committee to be drafted.

During the drafting process Legislative Research Committee staff communicate with KPPA staff and the bill sponsor to ensure the original intent has not been lost. Legislative Research Committee staff will also inquire as to whether any specific legal language should be used. The drafted version is provided to the bill sponsor for approval. The bill sponsor then presents the bill to the Public Pension Oversight Board for approval.

Tracking Legislation

According to section 36 of the Kentucky constitution, legislative sessions convene on the first Tuesday after the first Monday in January and each chamber, the Senate and the House, will set the rules for the session. The Legislative Research Commission posts all introduced bills with a title and summary of its contents to their website. The Communications Division Director reads through the summaries of all introduced bills. All titles that state “an act related to retirement” are tracked. Other titles that may impact operations such as “an act related to personnel” are also considered for tracking. The bills are separated based on those that impact retirement rules or funding and those that impact operational functions. The movement of bills through the legislative process is tracked and conveyed to KPPA staff, Trustees, and other interested parties on a daily basis.

The daily email from the Communications Division Director is used by DETS, the Office of Benefits, and the Deputy Executive Director so they can be proactive in responding to bills and to potentially get a head start on implementing a change if it is anticipated to be a difficult procedural change or require many hours of reprogramming.

DETS assigns business analysts and developers to read through the tracked legislation so they are prepared to work with affected divisions should bills pass.

Implementation

Members of the KPPA Executive Management Team work to educate legislators on the estimated time needed to implement a change to assist legislators in setting reasonable effective dates. Inconsistencies with federal retirement law are pointed out in the educational process as well. If a law is inconsistent with federal retirement law, KPPA will only implement parts of state law that do not contradict federal law since federal law takes precedence.

After the session is completed, the divisions impacted by the change will create a work group to determine how best to implement new laws. The following groups are included in the work group when needed:

1. DETS will be included if the change requires a programming change. Each division in the Office of Benefits and the Office of Operations has a designated business analyst that meets with the division workgroup in design sessions to discuss how Line of Business will operate to meet the new change. DETS also keeps track of the status of implementation through a spreadsheet that is shared with the workgroup.

2. Executives and Legal will be brought in if there is a question or disagreement with how to interpret the new law within the workgroup or if the intent is unclear.

After everyone in the workgroup and other groups involved agree on how the new law should be applied, the workgroup will log a Web Helpdesk ticket that will launch a work item so DETS programmers can complete the changes in time for the scheduled release. If several laws are passed at the same time, then implementation is completed according to business needs such as but not limited to, how soon a change needs to be implemented and how many members are affected. Manual workarounds will be developed by division directors if a programming change cannot be launched in time to meet the effective date.

Regulation Changes

The Staff Attorney Supervisor and the Policy Specialist work with the impacted division to update corresponding regulations to match the new law when needed. The appropriate board (CERS, KRS, KPPA) will then approve the updated regulation before it is submitted to the regulation compiler at the Legislative Research Committee.

Communication of Changes

The Executive Director-Office of Benefits creates a summary of all passed laws and brief Office of Benefits employees on how to implement the new change in their daily tasks and how to communicate the changes to members should they ask during calls or appointments.

Members and other stakeholders are informed about the changes through the following steps taken by the Division of Communications:

1. The last daily legislative update for each session includes a summary of the key retirement-related bills that passed. This is sent as an email to all KPPA staff, Trustees, and other stakeholders who have specifically asked to receive the daily emails. An edited version of that email is posted to the Legislative Update page of the KPPA website, where it remains until the next Session begins.
2. The spring edition of Pension Insights, member/retiree e-newsletter, features the major legislation from the just-completed Session. The newsletter contains highlights of certain bills and sometimes includes separate articles about individual bills to further explain their impact on members. The newsletter also includes a hyperlink to a more detailed summary of major bills that is written and placed in one document. The Division of Communications also emails the newsletter to everyone who has provided a valid email address (approximately 207,000 addresses at last count) and posts the newsletter on the KPPA website. Previous newsletters are also archived on the website.
3. The Division of Communications produces a newsletter for Kentucky Government Officials several times each year: the April/May edition always contains a summary of major legislation. This is emailed to all 138 legislators, cabinet officials, and various staff members in state government. This newsletter is also posted to the KPPA website.
4. The Director of Communications is invited to several Kentucky Public Retirees chapter meetings throughout the state in spring/summer to speak to their members about recent legislative happenings. These meetings help to spread awareness among our retirees.
5. For the last few years Communications has written Note N – Pension Legislation for the ACFR.
6. The Director of Communications provides background information and status reports of various bills and resolutions to the executive team for use in board meetings that occur during legislative Sessions.
7. Communications regularly uses KPPA social media outlets and website to draw attention to legislative happenings. Website data shows that these pages are among the most frequently visited.
8. Communications updates webpages and publications to reflect legislative changes and develop materials that explain legislative changes.



Kentucky Public Pensions Authority

Division of Internal Audit



Issue Date

July 22, 2024

Overall Opinion

Process generally complies with relevant statutes, regulations, policies, and procedures. Internal controls are established but steps could be taken to strengthen controls or make the process more effective and/or efficient.

Summary of Findings

The following reportable finding was noted during our review. Additional details related to the finding, including the corresponding recommendations can be found in Appendix A.

1. Inconsistency when rounding interest rates.

We noted certain other matters that we communicated to the CEOs of CERS and KRS and to the Divisions of Accounting and Enterprise and Technology Services in separate management letters dated July 22, 2024.

Commendations

Throughout the entire audit, DETS provided a tremendous amount of help developing reports needed for identifying potential issues and to help us confirm the validity of journal entries. With their help, and insights provided by Accounting staff in researching issues identified, we were able to better understand the intricacies of LOB.

Beginning in fiscal year 2024, the Office of Investments will be utilizing Solovis (investment management software), which will allow Investments staff to independently verify performance of the investment portfolio as well as the GANIR amount.

Report Contents

Acronyms	2
Objectives	2
Recommendations for Future Audits	2
Appendix A – Audit Results	3
Appendix B – Risks and Testing Methodology	4
Appendix C – Background	6

Acronyms

The following acronyms will be used throughout the report:

1. KPPA - Kentucky Public Pensions Authority
2. CERS - County Employees Retirement System
3. KERS - Kentucky Employees Retirement System
4. SPRS - State Police Retirement System
5. KRS - Kentucky Retirement Systems
6. CEO - Chief Executive Officer
7. CFO - Chief Financial Officer
8. KPPA Executive Management Team - KPPA Executive Director, KPPA Deputy Executive Director, KPPA Executive Director – Office of Benefits, KPPA Executive Director of Legal Services, and KPPA CFO
9. Investments – KPPA Office of Investments
10. Accounting – KPPA Division of Accounting
11. DETS – KPPA Division of Enterprise and Technology Services
12. LOB – Line of Business
13. GANIR - Geometric Average Net Investment Return

Objectives

The Review of Interest Applied to Member Accounts audit was conducted from May 25, 2023 to June 14, 2024. The scope of the audit was interest applied to member accounts at the end of fiscal year 2023.

The objectives of the Review of Interest Applied to Member Accounts audit were to ensure internal controls have been designed and are operating effectively and efficiently. We also ensured compliance with applicable state statutes and regulations as well as procedures developed by KPPA staff.

Recommendations for Future Audits

Based on work conducted during this audit, the following items have been recommended for review during future audits:

1. Ensure interest is correctly removed from member accounts, if applicable.
2. Review Office of Investments Reasonability Check process (new process put in place in fiscal year 2024).
3. Ensure member account balance is zero after retiring or receiving a refund (retirements reviewed in audit 2024-2 and refunds being reviewed as a part of 2024-9).
4. Determine if custodial bank expenses are coded to the proper tax code.
5. Determine if custodial bank follows KPPA allocation instructions, including use of any non-standard allocation rates.
6. Confirm business rules in Line of Business are operating as intended.

Use of Report

This report is intended solely for use by the KPPA Audit Committee; the KPPA, CERS, and KRS Boards; the CERS CEO; the KRS CEO; the KPPA Executive Management Team; and the KPPA Divisions of Accounting and Enterprise and Technology Services. This report is not intended to be, and should not be, used by anyone other than the specified parties. All final reports are subject to Open Records Requests.

Appendix A – Audit Results

1. Inconsistency when rounding interest rates

Responsible Area(s):	Accounting and DETS
Condition:	<p>The related statutes do not provide guidance on rounding in relation to the hybrid cash balance plan. Inconsistencies were noted during the review.</p> <ol style="list-style-type: none"> 1. The approved GANIR is stored in LOB rounded to five decimal places, which is three decimal places as a percentage. 2. LOB calculates the upside sharing interest rate rounded to six decimal places, which is four decimal places as a percentage. 3. When applying interest to member accounts, the interest rate is rounded to four decimal places, which is two decimal places as a percentage. 4. The design document provided to DETS staff when the rounding rule was initially created showed the approved GANIR rounded to three decimal places (one decimal place as a percentage) and the upside sharing rate rounded to five decimal places (three decimal places as a percentage).
Criteria:	<ol style="list-style-type: none"> 1. Per KRS 16.583, 61.597, 78.5512, and 78.5516: 4(b) If the member contributed to the hybrid cash balance plan or the [Statute Specific Retirement System] during the fiscal year, the interest credit added to the member's account for that fiscal year shall be determined by multiplying the member's accumulated account balance on June 30 of the preceding fiscal year by a percentage increase equal to 1. Four percent (4%); plus 2. Seventy-five percent (75%) of the system's geometric average investment return in excess of the four percent (4%) rate of return. 2. DETS staff indicated that the business rule states the GANIR should be stored to two decimal places and when the Upside Sharing Rate is calculated rounding should go to four decimal places.
Cause:	<ol style="list-style-type: none"> 1. An administrative regulation or other official policy has not been developed to provide guidance on the rounding to be utilized in relation to the hybrid cash balance plan. 2. There is unclear internal guidance on rounding to be stored in and utilized by LOB.
Effect:	<p>The difference in calculating interest based on rounding to four decimal places (as stored in LOB) versus two decimal places (as utilized when applying interest) extends back to the inception of Tier 3. If interest had been awarded based on rounding to four decimal places, for fiscal year 2023, members of the SPRS and KERS Nonhazardous Cash Balance plans would have been awarded less interest totaling \$232 and \$4,644, respectively. There is a potential that members could be awarded additional interest in past or future years if interest is applied rounding to four decimal places, rather than two. The audit scope was not expanded to determine the total impact of this issue.</p>
Recommendation #1:	<p>The KPPA Executive Management Team should review statutes and clarify the rounding method to be used in relation to the hybrid cash balance plan. Additionally, the KPPA Executive Management Team should work with the CEOs of both CERS and KRS to determine if input is needed from the respective Board of Trustees.</p>
Recommendation #2:	<p>After clarification is received on the rounding method to be utilized, DETS should update business rules in LOB pertaining to the application of the interest rate applied to member accounts.</p>
Management Response:	<p>KPPA executive management concurs with this finding and recommendations. We believe that both the Geometric Average Net Investment Return (GANIR) and the Upside Sharing Rate (UPS) have been calculated and applied in accordance with Kentucky Revised Statutes since the inception of the hybrid cash balance plan; however, we do need to formalize the rounding method used in the calculation. In doing so we will review the statutes, the current business rules, and discuss with CEOs and others as needed. Upon concluding this review, we will have DETS update the business rules as appropriate.</p>
Recurring Issue:	No
Implementation Date:	August 31, 2024

Appendix B – Risks and Testing Methodology

Risk:	Interest used to determine the amount of journal entries is different from member account.
Control:	System calculates the journal entries and member account interest using the approved interest rates.
COSO Element:	Control Activity
COSO Principle:	Management designs the entity’s information system and control activities.
Testing Methodology:	Auditor recalculated interest for the previous fiscal year and ensured the recalculated amount agreed to the amount posted to the member account as well as to the journal entry used to generate the amount of interest reported in the financial statements.
Test Result:	See finding #1. The related statutes do not provide guidance on rounding in relation to the hybrid cash balance plan. There is unclear internal guidance on rounding to be stored in and utilized by LOB.

Risk:	Incorrect/unapproved interest rates in LOB.
Control:	The interest calculation batch fails if a second individual does not approve the GANIR rates.
COSO Element:	Control Activity
COSO Principle:	Management designs the entity’s information system and control activities.
Testing Methodology:	Auditor observed the Accounting Assistant Director – Cash Management enter and approve the interest rates.
Test Result:	See Accounting Management Letter. Accounting Assistant Director - Cash Management was able to both enter and approve the interest rate in LOB.

Risk:	Incorrect interest journal entries in Great Plains.
Control:	Staff compares total interest awarded in START to the journal entry posted in Great Plains.
COSO Element:	Control Activity
COSO Principle:	Management designs the entity’s information system and control activities.
Testing Methodology:	Auditor compared data from journal entries to the report detailing awarded interest for fiscal year 2023.
Test Result:	See Accounting Management Letter. Initially, auditor was unable to recalculate the journal entries for the interest awarded to member accounts because a detailed report outlining this information was not maintained by either Accounting or DETS staff. During the audit, DETS staff was able to create a report that allowed auditor to perform testing and validate the journal entries.

Risk:	Trustees do not receive complete information in a timely manner.
Control:	Tier 3 GANIR rates are included in the Annual Comprehensive Financial Report.
COSO Element:	Information and Communication
COSO Principle:	Management communicates necessary information internally.
Testing Methodology:	Auditor reviewed the annual report for the approved GANIR rate.
Test Result:	See CEO Management Letter. Neither the CERS nor KRS Board of Trustees has reviewed the interest rate applied to members who began participating before September 1, 2008 since the rate was initially set at 2.5% in 2004.

Risk:	Interest applied incorrectly to members participating in multiple plans.
Control:	Interest calculation batch automatically calculates and applies interest based on the member's balance for each participating plan
COSO Element:	Control Activity
COSO Principle:	Management designs the entity’s information system and control activities.
Testing Methodology:	Auditor recalculated interest applied to member accounts.
Test Result:	No exceptions noted.

Risk:	Retired/refunded members do not receive interest for their last year of employment.
Control:	System automatically applies interest to member accounts with a balance as of June 30 of the prior fiscal year.
COSO Element:	Control Activity
COSO Principle:	Management designs control activities to achieve objectives and respond to risks.
Testing Methodology:	Auditor reviewed members who refunded or retired during fiscal year 2023 to see if they received interest for

	the last year of their employment. Since the interest batch is not run until August, members who refunded or retired between the start of the new year and the date the interest batch was run were reviewed to ensure their accounts were awarded interest, if applicable.
Test Result:	No exceptions noted.

Risk:	Interest application processes not performed timely.
Control:	System automatically runs batches as needed.
COSO Element:	Control Activity
COSO Principle:	Management designs the entity's information system and control activities.
Testing Methodology:	Auditor confirmed the date interest batch was run.
Test Result:	No exceptions noted.

Risk:	Insurance contributions inaccurately factored into applied interest.
Control:	The interest posting batch does not include health insurance amounts.
COSO Element:	Control Activity
COSO Principle:	Management designs the entity's information system and control activities.
Testing Methodology:	Auditor verified that only contributions are added to member insurance account balances.
Test Result:	No exceptions noted.

Risk:	Incorrect interest applied to member accounts.
Control #1:	Base interest rates for all three tiers are set and approved independently of the GANIR.
Control #2:	Staff review the interest amount calculated by the system.
COSO Element:	Control Activity
COSO Principle:	Management designs the entity's information system and control activities.
Testing Methodology:	The auditor reviewed the Interest Rates reported by START for each system and plan. Auditor recalculated interest applied to member accounts
Test Result:	No exceptions noted.

Risk:	Interest to member accounts not updated timely.
Control:	LOB back dates interest to member accounts to June 30 of the most recent fiscal year.
COSO Element:	Control Activity
COSO Principle:	Management designs the entity's information system and control activities.
Testing Methodology:	Auditor verified the date the interest was applied to the member account.
Test Result:	No exceptions noted.

Risk:	Quadratic return rate calculated incorrectly.
Control:	Investment returns are calculated and reported based on instructions and industry standards.
COSO Element:	Control Activity
COSO Principle:	Management designs the entity's information system and control activities.
Testing Methodology:	Auditor compared the values entered in LOB, the approval email, and the KPPA Monthly Performance Reports for fiscal year 2023 to ensure the values agreed.
Test Result:	No exceptions noted.

Risk:	Policies and procedures not accurate.
Control:	Division director ensures procedures are up-to-date and available to staff.
COSO Element:	Control Activity
COSO Principle:	Management implements control activities through policies.
Testing Methodology:	Auditor evaluated division procedures and ensured they were accurate, complete, up-do-date, and available to staff.
Test Result:	No exceptions noted.

Appendix C – Background

Kentucky Revised Statutes 16.56, 61.575, and 78.640 establish a statutory minimum interest rate to be applied to Tier 1 member accounts and the statutorily required interest rate for Tier 2 members. In 2004, the governing body at the time established an interest rate of 2.5% to be applied to Tier 1 member accounts. With the establishment of Tier 2 in 2008, this rate applies to their accounts as well. The currently established rate does satisfy the criteria set for both membership tiers.

Following each complete month, the custodial bank, Bank of New York Mellon sends a Performance Report to Investments, the Accounting Investment Operations branch, the Chief Auditor, the Accounting Division Director, and the KPPA Executive Director. The receipt period can vary based upon how quickly the custodial receives and compiles data from investment managers and other sources; this is usually mid-way through or late in the following month. When the final performance reports are received, Investments staff review the reports to determine the reasonability of performance calculated against set parameters and anticipated performance based on market conditions. This review is intended to identify significant deviations in the returns calculated by the custodial bank within a reasonable degree of tolerance.

The June performance report follows the same process. However, in late July of the following fiscal year, the Accounting Assistant Director – Investment Operations sends Investments staff a reminder regarding the deadline of when the GANIR rates must be approved. The final June Performance Reports are reviewed following the same monthly performance review procedures. This review, combined with the prior months' reviews, provides assurance to the reasonability of the annual performance as of June 30 of a given year. If the values provided by the custodial bank for June's performance fall within the reasonable range, Investments staff provide their approval for the Annualized Five-Year Performance Net of Fees and Expenses calculated by the custodial bank, also referred to as the GANIR. Investments staff then communicates to Investment Operations the GANIR for each of the pension plans for the most recently ended fiscal year. The Accounting Assistant Director – Investment Operations then forwards the email containing the approved GANIR rates to the Accounting Assistant Director – Cash Management.

After the Accounting Assistant Director – Cash Management receives the email containing the GANIR rate for each plan, either Accounting Assistant Director can enter each plan's rate in LOB. For a given year, five lines will need created, one for each plan. When all the lines have been completed, the Accounting Assistant Director who entered the GANIR into LOB sends an email to the other Accounting Assistant Director and copy the Deputy Executive Director, Chief Financial Officer, and Accounting Division Director stating that the rates have been entered in LOB and are ready for approval. The Accounting Assistant Director who receives the email verifies that the correct GANIR has been entered for each plan. If everything is correct, the entry is approved in LOB. The Accounting Assistant Director – Cash submits a Web Help Desk ticket to schedule the batch that applies member interest.

The batch runs over the weekend. DETS sends a list to the Accounting Assistant Director – Cash Management identifying individuals whose interest amounts should be independently recalculated and verified as being correct to confirm that the batch ran correctly. If the values are correct, the Accounting Assistant Director – Cash Management approves the entries in LOB.



Kentucky Public Pensions Authority

Division of Internal Audit



Issue Date

July 22, 2024

The Review of Interest Applied to Member Accounts audit was conducted from May 25, 2023 to June 14, 2024. The scope of the audit was interest applied to member accounts at the end of fiscal year 2023. In addition to the recommendations included in that report, we noted two recommendations that we wanted to communicate to Accounting and DETS management. These items will be reviewed during follow-up engagements and/or during a review of open recommendations.

The objectives of the Review of Interest Applied to Member Accounts audit were to ensure internal controls have been designed and are operating effectively and efficiently. We also ensured compliance with applicable state statutes and regulations as well as procedures developed by KPPA staff.

Acronyms

The following acronyms will be used throughout the report:

1. KPPA - Kentucky Public Pensions Authority
2. CERS - County Employees Retirement System
3. KRS - Kentucky Retirement Systems
4. CEO - Chief Executive Officer
5. CFO - Chief Financial Officer
6. KPPA Executive Management Team - KPPA Executive Director, KPPA Deputy Executive Director, KPPA Executive Director – Office of Benefits, and KPPA CFO
7. Accounting – KPPA Division of Accounting
8. DETS – KPPA Division of Enterprise and Technology Services
9. LOB – Line of Business
10. GANIR - Geometric Average Net Investment Return

Additional Recommendations

1. Accounting and DETS staff should work together to review the control in LOB to ensure it prevents the same individual from entering and approving interest rates in a single entry.

Accounting Assistant Director - Cash Management was able to both enter and approve the interest rate in LOB. There is a control in LOB that prevents an individual from entering the interest rate and then approving that rate in a separate entry. However, that control does not prevent an individual from both entering and approving the interest rate in the same entry.

200 KAR 38:070 Section 2 states, “Each fiscal officer shall develop and document internal controls to both prevent and detect abuse, unintentional errors, and the fraudulent disbursement of funds or use of state assets. In addition, the fiscal officer shall work with agency personnel to implement the internal controls and monitor their effectiveness. (3) An internal control plan shall include the following: (a) Organizational structure and alignment of job duties that provide the appropriate segregation of duties for the proper safeguarding of agency assets to prevent one (1) individual from controlling or processing a transaction from beginning to end...”

Management Response: Accounting submitted a Web Help Desk ticket to disable the user who enters the GANIR rates from approving them at the time of entry. The ticket was assigned to a developer in October 2023 and tested by Accounting staff. The issue was pushed to Production in the November build (11/29/2023). The user who enters the GANIR rates can no longer approve them.

Auditor Response: Auditor will test this corrective action in August 2024.

2. As a part of the year end process, the CFO should designate a staff member to validate the summary journal entry (related to applying interest to member accounts) by utilizing the detailed report created by DETS.

Initially, auditor was unable to recalculate the journal entries for the interest awarded to member accounts because a detailed report outlining this information was not maintained by either Accounting or DETS staff. During the audit, DETS staff was able to create a report that provides detailed support for the journal entries related to applying interest to member accounts. Auditor was able to utilize this report for testing. The review previously performed by Accounting staff was considered to be sufficient for validating the values of the automatically created journal entries. However, financial statements could reflect the incorrect member interest amounts if the related journal entries are inaccurate.

200 KAR 38:070 Section 2 states, “(2) Each fiscal officer shall develop and document internal controls to both prevent and detect abuse, unintentional errors, and the fraudulent disbursement of funds or use of state assets...(3) An internal control plan shall include the following: 1. Authenticity of transactions or documents....”

Management Response: CFO and Accounting staff agree that having the detail entries to back up the summary report used to balance journal entries for interest in LOB is beneficial. This will be implemented with the 2024 fiscal year end process.

This report is intended solely for use by the KPPA Audit Committee; the KPPA, CERS, and KRS Boards; the CERS CEO; the KRS CEO; the KPPA Executive Management Team; the Division of Accounting; and the Division of Enterprise and Technology Services. This report is not intended to be, and should not be, used by anyone other than the specified parties. All final reports and management letters are subject to Open Records Requests.



Kentucky Public Pensions Authority

Division of Internal Audit



Issue Date

July 22, 2024

The Review of Interest Applied to Member Accounts audit was conducted from May 25, 2023 to June 14, 2024. The scope of the audit was interest applied to member accounts at the end of fiscal year 2023. In addition to the recommendations included in that report, we noted one recommendation that we wanted to communicate to the CERS and KRS CEOs. This item will be reviewed during follow-up engagements and/or during a review of open recommendations.

The objectives of the Review of Interest Applied to Member Accounts audit were to ensure internal controls have been designed and are operating effectively and efficiently. We also ensured compliance with applicable state statutes and regulations as well as procedures developed by KPPA staff.

Acronyms

The following acronyms will be used throughout the report:

1. KPPA - Kentucky Public Pensions Authority
2. CERS - County Employees Retirement System
3. KRS - Kentucky Retirement Systems
4. CEO - Chief Executive Officer
5. CFO - Chief Financial Officer
6. KPPA Executive Management Team - KPPA Executive Director, KPPA Deputy Executive Director, KPPA Executive Director – Office of Benefits, and KPPA CFO

Additional Recommendations

1. The interest rate for Tier 1 members should be brought to the CERS and KRS Boards on an annual basis for review/confirmation.

The Board of Trustees has not reviewed the interest rate applied to members who began participating before September 1, 2008 since the rate was initially set at 2.5% in 2004. Internal Audit staff communicated with the CERS and KRS CEOs to determine how to address this item. The recommendation made is based on the result of that communication.

Since the rate set in 2004 for Tier 1 members matches the rate statutorily set for Tier 2 members, the Board of Trustees has not been asked by staff, nor has the Board of Trustees requested, to review the interest rate applied to members who began participating before September 1, 2008. However, it is possible the Board of Trustees was unaware that reviewing/confirming this information was within their purview.

Kentucky Revised Statutes 16.560 (3)(b) states, “For a member who begins participating before September 1, 2008, interest shall be credited to his or her individual account at a rate determined by the board but not less than two and one-half percent (2.5%) per annum on the accumulated account balance of the member on June 30 of the preceding fiscal year.” Kentucky Revised Statutes 61.575 (3)(b) and 78.640 (3)(b) state, “For a member who begins participating before September 1, 2008, interest shall be credited to his or her individual account at a rate determined by the board but not less than two percent (2%) per annum on the accumulated account balance of the member on June 30 of the preceding fiscal year.”

This report is intended solely for use by the KPPA Audit Committee; the KPPA, CERS, and KRS Boards; the CERS CEO; the KRS CEO; and the KPPA Executive Management Team. This report is not intended to be, and should not be, used by anyone other than the specified parties. All final reports and management letters are subject to Open Records Requests.



Kentucky Public Pensions Authority

Division of Internal Audit



Overall Opinion

Process generally complies with relevant statutes, regulations, policies, and procedures. Internal controls are established but steps could be taken to strengthen the controls or make the process more effective and/or efficient.

Issue Date

August 7, 2024

Summary of Findings

The following reportable findings were noted during our review. Additional details related to the findings, including the corresponding recommendations can be found in Appendix A.

1. Interest and penalty not charged on delinquent invoices
2. Additional research needed by staff

We noted certain other matters that we communicated to the Divisions of Accounting; Employer Reporting, Compliance, and Education; and Enterprise and Technology Services in a separate management letter dated August 7, 2024.

Commendations

ERCE provided thorough answers in a timely manner which helped significantly in keeping the project on schedule. They were able to provide this high-quality information despite working through a regression testing period in LOB and dealing with monthly reporting tasks.

Report Contents

Acronyms	2
Objectives.....	2
Recommendations for Future Audits.....	2
Appendix A – Audit Results.....	3
Appendix B – Risks and Testing Methodology.....	7
Appendix C – Background	10

Acronyms

The following acronyms will be used throughout the report:

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5. CFO - Chief Financial Officer
6. KPPA Executive Management Team - KPPA Executive Director, KPPA Deputy Executive Director, KPPA Executive Director – Office of Benefits, and KPPA CFO
7. Accounting – KPPA Division of Accounting
8. ERCE – KPPA Division of Employer Reporting, Compliance, and Education
9. DETS – KPPA Division of Enterprise and Technology Services
10. Legal Services – KPPA Office of Legal Services
11. LOB – Line of Business
12. KHRIS – Kentucky Human Resource Information System

Objectives

The Review of Employer Outstanding Invoices audit was conducted from March 13, 2024 to July 23, 2024. The scope of the audit was fiscal year 2023.

The objectives of the Review of Employer Outstanding Invoices audit were to ensure internal controls have been designed and are operating effectively and efficiently. We also ensured compliance with applicable state and federal statutes and regulations as well as policies established by the KPPA, CERS, and KRS Boards and procedures developed by KPPA staff.

Recommendations for Future Audits

Based on work conducted during this audit, the following items have been recommended for review during future audits:

1. Follow-up on Employer Invoice Penalty Waivers.
2. Review of member invoices.
3. Review of service averaging.
4. Review of recording cash flows in Great Plains.

Use of Report

This report is intended solely for use by the KPPA Audit Committee; the KPPA, CERS, and KRS Boards; the CERS CEO; the KRS CEO; the KPPA Executive Management Team; and Accounting, ERCE, and DETS. This report is not intended to be, and should not be, used by anyone other than the specified parties. All final reports are subject to Open Records Requests.

Appendix A – Audit Results

1. Current delinquent invoice review process is not feasible

Responsible Area(s):	ERCE
Recurring Issue:	No
Condition:	<ol style="list-style-type: none"> 1. Invoices are not being escalated to Legal Services once they are outstanding for 120 days. As of March 24, 2024, there were 3,519 outstanding invoices with an average age of 846 days. The oldest invoices have been outstanding since 2011. 2. There are no procedures for how disputed invoices will be reviewed and resolved timely.
Criteria:	<ol style="list-style-type: none"> 1. ERCE procedures titled "Delinquent Invoice Collection Process" state, "At 120 days, the counselor will review if delinquent invoices still remain from the original spreadsheet. If delinquencies remain, the counselor will provide an updated spreadsheet to his/her manager and the director. If good faith is being shown, the director will contact the employer and possibly allow additional time to pay delinquencies before turning over to legal for collections. If the agency has been unwilling to pay the delinquencies, the director will provide the spreadsheet and further documentation to our legal department for assistance in the collection of the delinquent invoices." 2. 200 Kentucky Administrative Regulation 38:070 states, "Each fiscal officer shall develop and document internal controls to both prevent and detect abuse, unintentional errors, and the fraudulent disbursement of funds or use of state assets...An internal control plan shall include...Detailed procedures to be followed in the performance of job duties and functions to emphasize duties that comprise the overall framework of accountability and internal controls, and to help ensure the continuation of agency operations in the event of staffing changes..."
Cause:	<p>Each ERCE branch (School Board, File/Web and KHRIS) has their own way of collecting invoices and each branch has a unique set of problems. Given the factors outlined below, the current process of escalating invoices after 120 days does not seem feasible.</p> <ol style="list-style-type: none"> 1. School board specific issues: <ul style="list-style-type: none"> • Credit invoices often are not claimed by employers due to the process involved. For example, member A is a sub at school A. This member does not average over the prior fiscal year so employer and member contributions must be refunded in the form of a credit invoice. Member A is now working at school B. School A can process a refund through its payroll by temporarily making the employee active and issuing the refund credit due. MUNIS has provided specific instructions to school board for this process. This is a MUNIS process document and is not owned by KPPA. Another option is for the agency to use a "penny payroll" to process the credit. • Overall, KPPA owes contributions back to school board employers. • All but one School Board employer use MUNIS which is a payroll system used by the Board of Education. This system is set up to keep track of funds in different pools such as grant money. Credit invoices can be claimed by an employer through its payroll by making the employee active and issuing the refund credit due. MUNIS has provided specific instructions to School Board employers, which is available in ERCE's process documentation. However, they are hesitant to take this option because they are audited and these methods may not pass inspection.

	<ol style="list-style-type: none"> File/Web team specific issues: As of March 2024, this team is responsible for 1,096 active employers spread among only 8 employees not including the Branch Manager (there is currently one vacant position). Based on conversation with staff, the File/Web team is too understaffed to monitor invoices in the way that the written procedures prescribe. KHRIS team specific issues: There are only three employees on this team. While two are senior counselors, one counselor is still learning all processes, which makes researching invoices an arduous task.
Effect:	As of March 2024, outstanding and disputed invoices totaled \$9,651,529 and is expected to grow if this process continues unchanged. Note, approximately five million of this total is currently with Legal Services or involved in current litigation.
Recommendations:	<ol style="list-style-type: none"> ERCE Division Director and staff should work together to determine a more feasible escalation timeline given current workloads and staffing levels. The "Delinquent Invoice Collection Process" should be updated to reflect the new timeline. The KPPA Executive Management Team and ERCE should determine the benefit of having an individual, or team of individuals dedicated to reviewing outstanding invoices and working with employers to settle outstanding credits and debits.
Management Response:	<ol style="list-style-type: none"> KPPA management agrees with the recommendation that the Delinquent Invoice Collection Process needs to be adjusted based on staffing. ERCE management has started initial discussion on how to better streamline the Invoice Collection process. KPPA management agrees with the recommendation of having a single individual/team of individuals dedicated to reviewing outstanding invoices and working with employers to satisfy the invoices. In the past, ERCE had an individual who was responsible for invoice collection on the File/Web team; however, due to different pieces of legislation causing additional workload we had to utilize the counselor for more pressing job tasks. In addition, the File/Web team currently has one vacant position. Once ERCE is able to fill the vacant position they will have additional resources in order to utilize one counselor to be dedicated strictly to invoice collection.
Implementation Date:	<ol style="list-style-type: none"> December 31, 2024 June 30, 2025

2. Additional research needed by staff

Responsible Area(s):	ERCE and DETS
Recurring Issue:	No
Condition:	<p>Multiple areas were noted as needing further research by staff:</p> <ol style="list-style-type: none"> ERCE staff may have the ability to update invoices. They may also be able to mark invoices as paid, cancelled, or written-off without needing Accounting staff involvement. One of 184 invoices reviewed is assigned to an employer that was merged into another employer; however, the invoices assigned to the merged employer cannot be seen or paid by the new employer. When LOB was created in 2011, a module (ECE Delinquent Employer Invoice) was created which was intended to allow ERCE staff to escalate invoices to Legal Services through a LOB workflow. However, this module has not worked since inception.
Criteria:	<ol style="list-style-type: none"> KPPA Access Control Policy Section 5 #1 states, "All data shall be classified in accordance with the Data Classification Policy, its access determined by the business owner, and access granted based on the Principle of Least Privilege." 200 Kentucky Administrative Regulation 38:070 states, "Each fiscal officer shall develop and document internal controls

	to both prevent and detect abuse, unintentional errors, and the fraudulent disbursement of funds or use of state assets...An internal control plan shall include...Detailed procedures to be followed in the performance of job duties and functions to emphasize duties that comprise the overall framework of accountability and internal controls, and to help ensure the continuation of agency operations in the event of staffing changes...”
Cause:	<ol style="list-style-type: none"> 1. A review process has not been established regarding which staff can update invoices or mark invoices as paid, cancelled, or written-off. 2. Since a Web Help Desk ticket has not been logged, DETS was not aware of the issue that prevents absorbed, merged, or consolidated employers from being able to see invoices belonging to the prior employers. 3. Since a Web Help Desk ticket has not been logged, DETS was not aware that the workflow to escalate outstanding invoices to Legal Services was not working as intended.
Effect:	<ol style="list-style-type: none"> 1. Staff could improperly mark the invoices paid, cancelled, or written-off which could result in KPPA not collecting amounts due to the agency. 2. Merged, consolidated, or absorbed employers are unable to pay the outstanding invoices they now owe. The total of invoices outstanding for employers that are merged or consolidated is \$12,994 as of March 2024. 3. ERCE staff have to manually escalate outstanding invoices to Legal Services. Since staffing resources are limited and the employer outstanding invoice process is time-consuming, invoices are not being escalated to Legal Services timely and outstanding invoices are not being collected. The total of outstanding invoices aged 120 days or older is \$7,952,301 as of March 2024.
Recommendations:	<ol style="list-style-type: none"> 1. ERCE Division Director should review invoice permissions of ERCE staff and determine if permissions are appropriate. If updates to permissions are needed, Division Director should follow established KPPA processes to update the permissions. The permissions related to invoices should be periodically reviewed. 2. ERCE, Legal Services, and DETS should work together to determine if the ECE Delinquent Employer Invoice Workflow is working as intended. <ul style="list-style-type: none"> • If not, DETS should correct the module and ERCE staff should develop procedures detailing how to use the corrected module. • If the module is working properly, ERCE staff should begin using the module to escalate outstanding invoices to Legal Services and should develop procedures detailing how to use the module. 3. ERCE and DETS staff should work together to correct Employer Self-Service so that merged, consolidated, and absorbed employers can see and pay invoices assigned to them.
Management Response - ERCE:	<ol style="list-style-type: none"> 1. KPPA management disagrees with this finding. Invoices cannot be deleted from LOB. ERCE director has reviewed permissions and confirmed staff only has the ability to make comment on the invoice inquiry screen, however staff does not have permissions to update, cancel, mark as paid, or write off invoices. 2. KPPA management partially agrees with this finding. The ECE Delinquent Employer Invoice Workflow is controlled by the Invoice Aging and Monitoring batch which is currently not turned on. The decision to turn on the batch has been re-evaluated at various intervals, and still declined in order to give staff time to follow up on employer's invoice questions and disputes that were then at a backlog. In 2017, the batch was modified to allow it to be run by employer classification (US 15621) in preparation to turn on the batch and run it for each team as they caught up on the backlog. However, the decision to turn on the batch has still not been made as a thorough testing effort will be needed before it is turned on in Production to ensure it still fits our current/desired model for delinquent follow up. For the workflow itself, there has

	<p>been additional discussion around creating a manual trigger, but this had not yet been done as ERCE knew we had a future Invoice Upgrade design project in the works, and this could possibly be done during this upgrade.</p> <p>Due to the timing of when we needed to have the invoice collection process in place and the testing effort it would take to turn the batch/or create a new trigger through a build, when ERCE was meeting with Legal Servies regarding the employer collection process, a business decision was made to email the employer collection matter to Legal Services. In an upcoming Invoice Design meeting, this will be discussed further with our Business Analyst and a user story will be created to either turn on the batch or create a manual trigger which would allow this process to work in the future.</p> <p>3. KPPA management agrees with this finding. ERCE is currently reviewing this issue further and will create to query all the instances in which this has occurred. In addition, ERCE will create a user story defect in order to allow employers to be able to view these invoices when merging/consolidating.</p>
Management Response - DETS:	Business users should determine whether development changes are needed and request and prioritize according to KPPA's established build process.
Implementation Date:	December 31, 2024
Auditor Response:	Regarding ERCE Management Response #1 - During the Exit Conference on July 23, 2024, management stated agreement with this finding and recommendation. Neither the finding nor recommendation indicates that staff can delete invoices. Periodically reviewing access levels is a standard practice within KPPA.

Appendix B – Risks and Testing Methodology

Risk:	Disputed invoices not resolved timely.
Control:	Control not established
Testing Methodology:	Testing could not be completed as there is not a process in place to investigate disputed invoices.
Test Result:	See finding #1 - According to staff, there is a project that will be launched to investigate disputed invoices. A workflow will be created for ERCE staff to review but this may not be in place in the near future.

Risk:	Employer good faith effort is not applied consistently.
Control:	ERCE Division Director reviews actions taken by employer.
COSO Element:	Information and Communication
COSO Principle:	Management uses quality information to achieve the organization’s objectives.
Testing Methodology:	Auditor selected a sample of invoices and read through journal comments to see communication attempts made by that employers related to their plan to pay invoices.
Test Result:	See finding #1 – Auditor sampled 184 invoices, of which 24 had been open for more than 120 days. There was no documentation that these employers attempted to contact KPPA in relation to the payment of these invoices, so they should have been escalated to Legal Services. However, staffing levels in ERCE can cause it to take longer than 120 days to investigate invoices.

Risk:	Policies/procedures/internal controls not established, documented, effective or efficient.
Control:	Procedures reviewed and updated periodically. Division director ensures procedures are on SharePoint.
COSO Element:	Control Activity Information and Communication
COSO Principle:	Management implements control activities through policies. Management communicates necessary information internally.
Testing Methodology:	Auditor reviewed division procedures to ensure they were up-to-date, reflected current practices, and were available to staff.
Test Result:	See finding #1 - Procedures are up-to-date but are lacking details about informal procedures such as what is considered "good will effort" and reasoning for extending the time for agencies to pay invoices. Additionally, staff indicated that the written procedures are not currently being followed by staff.

Risk:	Employers receive invoice after being removed from active status.
Control:	Merged and consolidated invoices are assigned to new employers.
COSO Element:	Control Environment
COSO Principle:	Oversight body and management establish an organizational structure, assigns responsibility, and delegates authority to achieve the entity's objectives.
Testing Methodology:	For invoices assigned to employers that are not active (merged, consolidated, inactive or dissolved), auditor confirmed that outstanding invoice was related to items that occurred prior to the employer not being active.
Test Result:	See finding #2 – Invoices assigned to a merged employer cannot be seen or paid by the new employer.

Risk:	Lack of support for invoices marked as cancelled, written-off, or disputed.
Control:	Accounting requires a comment from ERCE.
COSO Element:	Control Activity
COSO Principle:	Management designs the entity's information system and control activities.
Testing Methodology:	For each sampled invoice in "write off", "canceled" or "disputed" status, auditor reviewed the invoice details to determine if the reasoning for the status was documented.
Test Result:	See Management Letter - Seven invoices did not have a comment documenting the reasoning of why the invoice was marked disputed, cancelled or written off.

Risk:	Penalty not applied to late invoices.
Control:	Control not yet established. A work group of executives is investigating.
Testing Methodology:	Testing could not be completed as this process has not yet been established.
Test Result:	See Management Letter.

Risk:	Invalid employer invoice.
Control:	Invoices are automatically generated by LOB.
COSO Element:	Control Activity
COSO Principle:	Management implements control activities through policies.
Testing Methodology:	Auditor compared invoice details to LOB for each member listed on the invoice.
Test Result:	No exceptions noted. All sampled invoices had proper documentation.

Risk:	Outstanding invoices not recorded in general ledger.
Control:	Invoices are recorded automatically in Great Plains.
COSO Element:	Control Activity
COSO Principle:	Management designs the entity's information system and control activities.
Testing Methodology:	For sampled invoices, auditor confirmed the invoice was recorded in the General Ledger account report generated from LOB.
Test Result:	No exceptions noted. All sampled invoices were posted to the general ledger.

Risk:	Invoices marked as paid are not actually paid.
Control:	Payments are automatically logged in Great Plains by LOB.
COSO Element:	Control Activity
COSO Principle:	Management designs the entity's information system and control activities.
Testing Methodology:	Auditor generated the General Ledger Transaction Detail Report. Report was filtered by agency code so auditor could ensure invoices marked as paid were properly recorded.
Test Result:	No exceptions noted. All payments were recorded in the general ledger.

Risk:	Trustees do not receive complete information in a timely manner.
Control:	Outstanding employer invoices are presented quarterly to CERS and KRS Board of Trustees.
COSO Element:	Monitoring
COSO Principle:	Management establishes and operates monitoring activities to monitor the internal control system and evaluate the results.

Testing Methodology:	For the scope of the audit, the auditor reviewed CERS Finance and KRS Board meeting materials and confirmed that outstanding invoices were presented. Additionally, auditor confirmed that the amount presented was accurate.
Test Result:	No exceptions noted. Outstanding invoices were presented as required. The values shown in the charts matched the corresponding employer invoice aging report for the reporting time frame.

Risk:	Non-compliance with employer involuntary cessation statutes.
Control:	Board approval required to cease participation.
COSO Element:	Control Environment
COSO Principle:	Oversight body and management oversees entity's internal control system.
Test Result:	According to staff interviewed, this option has never been exercised.

Appendix C – Background

ERCE Delinquent Invoice Collection Process

At various times, employer invoices may be generated for additional amounts owed by the employer or amounts due to the employer. There are a variety of situations which result in the creation of these invoice, including, but not limited to: adjustments on member accounts, adjustments made during the monthly reporting process, and service purchases.

In relation to pension spiking invoices, Kentucky Revised Statutes 61.598(5)(d) states, “For any additional actuarial costs charged to the employer under this subsection, the systems shall allow the employer to pay the costs without interest over a period of one (1) year from the date of receipt of the employer's final invoice.” All other invoices created must be paid within 30 days of issuance. After the 30-day mark, ERCE begins the invoice collection process. ERCE has three different teams based on employer type: KHRIS, School Board and File/Web.

- The KHRIS team is responsible for employers who report through the Personnel Cabinet's payroll system called KHRIS. This includes most KERS participating agencies and some sheriff's offices and County Clerk offices.
- The School Board teams is responsible for all Boards of Education.
- The File/Web team is responsible for all other employers.

While each group has their own way of collecting delinquent outstanding employer invoices (see below), they all use a report generated out of LOB called “Employer Invoice Aging Report” and Form 7521 (Invoice Collection).

- Employer Invoice Aging Report - This report can be generated for any time period by specifying the beginning and ending dates. Employer codes can also be specified when generating the report. The report shows each invoice per employer, the invoice number, date of issuance, and invoice age as of end date requested.
- Form 7521 - Employer information (code, invoice count, and invoice sum) are filled in by ERCE staff. The employer responds to the following items:
 - Reason for invoice delinquency.
 - Agency agreement or disagreement with outstanding invoice(s).
 - Need for training on how to pay invoices through Employer Self-Service.
 - Expected date of payment of outstanding invoices.

KHRIS Team

At least monthly, the Branch Manager requires staff to review outstanding invoices for their assigned employers. KHRIS team generates the Employer Invoice Aging Report for each of their assigned employers. Delinquent invoices are researched to determine if the invoiced items actually need to be invoiced. If an invoice is needed, the following items are emailed to the employer after the invoice has been outstanding for 30 days:

- Invoice,
- Details about which members are included on the invoice, and
- Form 7521 Invoice Collection.

The email is uploaded to the employer's Library Manager and the attempt to contact the employer is logged in the employer's journal comment section of LOB. The same process is followed after the invoice has been delinquent for 60 days and again after 90 days. Once an invoice has been outstanding for 120 days, it is escalated to the ERCE Assistant Director and the ERCE Division Director.

Any communication with employers during the collection process is documented by KHRIS staff in journal comments in LOB.

- If an employer indicates invoices will be paid by a specific date, but the payment is not received by that time, KHRIS staff may follow up with the employer on a weekly basis to pursue payment.
- If KHRIS staff are having a hard time getting any response from employers, the Branch Manager will assist.
- If neither KHRIS staff nor the Branch Manager can get a response, the ERCE Assistant Director and Division Director will assist in contacting the agency.

School Board Team

The School Board Team staff reach out to their assigned agencies on a monthly basis during the process of correcting monthly reporting errors. The Employer Invoice Aging Spreadsheet is prepared for each employer with the following items highlighted:

- Omitted Sick Leave Service and Health Insurance Reimbursements past the 30-day mark (highlighted red).
- Invoices over one year old (highlighted blue).
- Invoices over two years old (highlighted orange).
- Invoices eligible for write-off - \$5 or less (highlighted yellow).
- Invoices with amounts related to a KPPA issue (highlighted green).

Employers are asked about their plan to pay all the listed invoices. School Board staff follow up on a monthly basis for six months. If the agency has highlighted items (excluding eligible write off items), the assigned ERCE representative will make a separate journal comment, using the “INVOICES” category listing the specific invoice numbers provided to the employer. The assigned ERCE representative updates the comment with any details/responses the employer provides. If the employer does not respond within six months or shows no signs of following a previously established payment plan, the School Board Branch Manager creates a reconciliation worksheet of all the invoices due and emails it, along with Form 7521 to the employer's reporting official and financial officer. The Branch Manager generally gives the employer two weeks to respond before taking additional action. When invoices have been outstanding for 90 days, all emails, spreadsheets, and forms are sent to the Division Director. After the invoices have been outstanding for 120 days, the invoice is escalated to Legal Services – Division of Advocacy.

File/Web Team

The File/Web team Branch Manager periodically generates the Employer Invoice Aging Report for her staff. Each month, File/Web staff are required to reach out to ten employers who have outstanding invoices. The File/Web team sends Form 7521 to each employer they contact during the month. Additionally, each File/Web team member keeps a spreadsheet of attempts made and documents the attempt in the employer's journal comments in LOB.

Legal Services – Division of Advocacy

Invoices have not been escalated to Legal Services in several years. When an invoice is escalated, the ERCE Division Director emails the staff attorney with the invoice, supporting documentation, and details on attempts to contact the employer’s reporting official. Once all the relevant information has been collected, Legal Services staff may send a letter to the employer explaining that the invoice has been turned over to Legal Services for collection.

- Kentucky Revised Statutes 61.675 (KERS and SPRS) and 78.625 (CERS) require employers to supply information to KPPA, if requested. These statutes also set out the consequences for delinquent payments and the various steps that KPPA may take in an attempt to collect the invoice.
- 105 Kentucky Administrative Regulation 1:140 describes how invoices can be offset by an amount KPPA owes the employer.

If an employer continues to refuse to pay the amount owed, Legal Services staff may present the matter to the appropriate Board of Trustees and request permission to take more significant action against the employer, such as filing a court action. If Legal Services staff is able to collect the invoice amount, payments may be processed through the monthly employer reporting process or may be collected via other methods such as transfers from the Finance and Administration Cabinet or via check.



Kentucky Public Pensions Authority

Division of Internal Audit



Issue Date

August 7, 2024

Scope and Objectives

The Review of Employer Outstanding Invoices audit was conducted from March 13, 2024 to July 23, 2024. The scope of the audit was Fiscal Year 2023. In addition to the recommendations included that report, we noted three recommendations that we wanted to communicate to management. These items will be reviewed during follow-up engagements and/or during a review of open recommendations.

The objectives of the Review of Employer Outstanding Invoices audit were to ensure internal controls have been designed and are operating effectively and efficiently. We also ensured compliance with applicable state and federal statutes and regulations as well as policies established by the KPPA, CERS, and KRS Boards and procedures developed by KPPA staff.

Acronyms

The following acronyms will be used throughout the report:

1. KPPA - Kentucky Public Pensions Authority
2. CERS - County Employees Retirement System
3. KRS - Kentucky Retirement Systems
4. CEO - Chief Executive Officer
5. CFO - Chief Financial Officer
6. KPPA Executive Management Team - KPPA Executive Director, KPPA Deputy Executive Director, KPPA Executive Director – Office of Benefits, and KPPA CFO
7. ERCE – KPPA Division of Employer Reporting, Compliance, and Education
8. Accounting – KPPA Division of Accounting
9. DETS – KPPA Division of Enterprise and Technology Services
10. Legal Services – KPPA Office of Legal Services
11. LOB – Line of Business

Additional Recommendations

1. ERCE and Accounting management should consider requiring staff to include a comment when the status of an invoice is changed to cancelled, disputed, or written-off, similar to how a comment is required when employer penalty invoices are waived. If necessary, a request for this updated should be submitted to DETS according to KPPA's established build process.
2. DETS, ERCE, and Accounting staff should work together to determine the benefit of LOB applying an automatic journal comment for invoices automatically written off by LOB. If this avenue is pursued, either ERCE or Accounting will need to log a Web Help Desk ticket so the work progress and hours can be appropriately tracked.

Seven of 184 invoices did not include a comment documenting the reason an invoice was marked as disputed, cancelled or written off. Note, these invoices were all from 2012. The invoices showed a counselor saved a comment; however, the comment was no longer showing in the system. Invoices can be marked write off, cancelled or disputed by Accounting or other staff with access to employer invoice without appropriate oversight by ERCE.

Accounting procedures titled "Invoices" states, "Cancellation of Invoices – When an invoice needs to be cancelled, ERCE will email Accounting and request an invoice cancellation for various reasons (must be noted by ERCE in the comments as a “cancel” comment before it’s requested)." ERCE procedures do not state that comments should be on invoices explaining why an invoice should be marked disputed, paid, cancelled or written off. Additionally, LOB does not require a comment to be left when changing the status of an invoice.

Management Response: ERCE and Accounting discussed this recommendation and agree for canceled and disputed invoices a journal entry should be added in the employer file stating the invoice was canceled/disputed and the reasoning for the cancellation/dispute. For invoices that will be written-off ERCE will be adding an "Internal" comment on the Invoice Inquiry screen providing the reason for the write-off. ERCE will be updating our process documentation to state that a disputed/canceled invoice must have a comment put on the invoice inquiry screen in LOB. In addition, ERCE will meet with Accounting to make a determination on pursuing an automatic comment for invoices that are written off and will create a user story to have this implemented if determined to be beneficial.

DETS - The LOB Maintain Invoice module does require a comment on the invoice to cancel or mark an invoice disputed; however, it does not require a comment to write off or mark an invoice paid. No journal comment is created in the employer's journal for any of these actions. Business users should determine whether comments should be added to the employer's journal or the invoice inquiry screen and request and prioritize according to KPPA's established build process.

3. KPPA staff should continue researching whether penalty and interest can be charged on all employer invoices.

Penalties and interest are not being charged for all outstanding invoices. Currently, penalties are only incurred for invoices generated as a result of late monthly reporting and interest is only charged on outstanding employer pension spiking invoices, after one year has lapsed since the invoice was created.

The Auditor of Public Accounts recommended in 2019 that Kentucky Revised Statutes 61.675 and 78.625 be amended to provide a graduated scale of penalties to encourage quicker payments from employers. KPPA Executive Management and Legal Services have been reviewing the legal aspect of charging interest.

Management Response: KPPA staff agrees with this recommendation as this issue is currently being researched. Executives, Legal Services, Accounting and ERCE have met several times regarding this subject and have reviewed Kentucky Revised Statutes and Kentucky Administrative Regulations to determine what authority KPPA has to charge penalties and/or interest on different types of invoices. In addition, data has been pulled and reviewed to determine what impact charging interest on specific invoices would have to the Systems.

This report is intended solely for use by the KPPA Audit Committee; the KPPA, CERS, and KRS Boards; the CERS CEO; the KRS CEO; the KPPA Executive Management Team; and ERCE, Accounting, and DETS. This report is not intended to be, and should not be, used by anyone other than the specified parties. All final reports and management letters are subject to Open Records Requests.



Kentucky Public Pensions Authority

Division of Internal Audit



Overall Opinion

Process generally complies with relevant statutes, regulations, policies, and procedures. Internal controls are established and working effectively and efficiently.

Issue Date

August 19, 2024

Summary of Findings

No reportable findings were noted as a part of this audit. We noted certain other matters that we communicated to the Division of Employer Reporting, Compliance, and Education in a separate management letter dated August 19, 2024.

Commendations

ERCE was helpful throughout the audit and responded to questions timely. DETS staff was thorough in their explanation of the batches involved in this process.

Report Contents

Acronyms	2
Objectives	2
Recommendations for Future Audits.....	2
Appendix A – Risks and Testing Methodology	3
Appendix B – Background	5

Acronyms

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7. ERCE – KPPA Division of Employer Reporting, Compliance, and Education
8. DETS – KPPA Division of Enterprise and Technology Services
9. KHRIS – Kentucky Human Resource Information System
10. START – Strategic Technology Advancements for the Retirement of Tomorrow
11. LOB – Line of Business

Objectives

The Review of Employer Contributions audit was conducted from October 6, 2023 to August 8, 2024. The scope of the audit was Monthly Employer Reports received in fiscal year 2023.

The objectives of the Review of Employer Contributions audit were to ensure internal controls have been designed and are operating effectively and efficiently. We also ensured compliance with applicable state and federal statutes and regulations as well as policies established by the KPPA, CERS, and KRS Boards and procedures developed by KPPA staff.

Recommendations for Future Audits

Based on work conducted during this audit, the following items have been recommended for review during future audits:

1. Review employer error correction process. Specifically, ensure items in warning status cannot be overridden by the user.
2. Review the Installment Payment of Service Purchase process.
3. Review accuracy of Hazardous Duty classification.
4. Review County Clerks and Sheriff Offices for counties that have reached the statutorily required population threshold to ensure they are not reporting via KHRIS.

Use of Report

This report is intended solely for use by the KPPA Audit Committee; the KPPA, CERS, and KRS Boards; the CERS CEO; the KRS CEO; the KPPA Executive Management Team; and the KPPA Division of Employer Reporting, Compliance, and Education. This report is not intended to be, and should not be, used by anyone other than the specified parties. All final reports are subject to Open Records Requests.

Appendix A – Risks and Testing Methodology

Multiple samples from various populations were taken during this audit:

1. For testing the records submitted by employers monthly, the auditor selected a sample of employers based on the way they report and the retirement plan code using a 95% Confidence Interval and a 5% Sampling Error. A sample was taken of members for each group (Report Type + Retirement Plan Code).
2. For testing the timeliness of employer fund qualification, the entirety of fiscal year 2023’s receipts were tested initially. To validate claims made about funds which were identified as qualified late, a sample of the 10 most recent items was reviewed.
3. For testing the Balancing and Write Off processes, the auditor used the previously selected employers from the reporting testing to test the process for KERS and CERS Hazardous and Non-Hazardous employers. Agencies reported by Personnel Cabinet were not tested, as that report is always balanced by an invoice.
 - a. For the KERS Hazardous and Non-Hazardous reporting entities, the difference between the Reported values and Posted Values was used to determine if the transaction was Balanced or Unbalanced. Unbalanced months made up the population to be tested. A judgmental sample size of 10 of some of the largest differences was selected.
 - b. For the CERS Hazardous and Non-Hazardous employers, the Posted Contributions for a given month were sorted and the percentage change from month to month was calculated. Minimizing selecting from employers more than once, with exceptions for large changes between months, the auditor selected a sample of 15 of some of the largest changes in Posted Contributions.
4. All record adjustments for fiscal year 2023 were reviewed to determine if they adjustments went through the quality control process. Additional analysis was performed on records that did not go through the quality control process.

Risk:	Record adjustments may be created erroneously.
Control:	All record adjustments require review by a Quality Control individual.
COSO Element:	Control Activity
COSO Principle:	Management designs the entity’s information system and control activities.
Testing Methodology:	Auditor pulled monthly employer reports for June 2022 through July 2024. The difference between old and new salary, employer contribution, and insurance contribution was calculated. For the selected sample, a record passed testing if there was no difference or if the difference went through the quality control process. Additionally, auditor ensured that the employers’ records reported matched the records in LOB.
Test Result:	No exceptions to the quality control process were found. However, three items were found to not have supporting documentation in LOB. See Management Letter.

Risk:	Employer contributions, details, and/or summaries not received timely.
Control:	Penalty invoice automatically generated if information received late.
COSO Element:	Control Activity
COSO Principle:	Management designs the entity’s information system and control activities.
Testing Methodology:	Auditor pulled Employer Payroll Status Detail Reports for all fiscal year 2023. Auditor calculated the number of net working days between the 25th and the 10th. Since there is leeway given due to weekends and holidays, the auditor strove to have the late date be after 12 business days. Auditor determined the number of days late by subtracting the "End Date" for a given report from the Receipt date. For late items, a sample was tested to ensure an invoice was generated.
Test Result:	No exceptions noted.

Risk:	Contributions do not equal statutorily required amounts.
Control:	Employer reporting batch process compares contribution details to employer's contribution group.

COSO Element:	Control Activity
COSO Principle:	Management designs the entity’s information system and control activities.
Testing Methodology:	Auditor recalculated statutorily required items and compared them to the records reported by the employer.
Test Result:	No exceptions noted. Any contributions over/under the statutory requirements were detected and rejected by the batches and the contributions were corrected.

Risk:	Monthly reports balanced improperly.
Control:	<ol style="list-style-type: none"> 1. System automatically writes-off variances of \$25 or less. 2. System automatically balances invoices within 2%. 3. KHRIS employers manually balanced with invoice.
COSO Element:	Control Activity
COSO Principle:	<ol style="list-style-type: none"> 1. Management designs the entity’s information system and control activities. 2. Management designs control activities to achieve objectives and respond to risks.
Testing Methodology:	Controls related to employer invoices were tested in a separate audit – Review of Outstanding Employer Invoices, issued August 7, 2024. For the third control, as a part of this audit, the auditor did confirm that these invoices were created for the scope of the audit.

Risk:	Contributions not balanced timely.
Control:	Management monitors the Balance Employer Report module
COSO Element:	Control Activity
COSO Principle:	Management designs control activities to achieve objectives and respond to risks.
Testing Methodology:	Auditor reviewed the total number of workdays that passed between the date contributions were received and date contributions were qualified. For items not qualified timely, a sample was selected, and auditor reviewed the individual items in LOB to determine if something occurred to justify the late qualification date.
Test Result:	No exceptions noted. For items sampled that initially appeared to be qualified late, justification was on file for the delayed qualification.

Risk:	Contributions posted to improper member account.
Control:	Employer representatives review the Contribution Template each month to ensure information is correct.
COSO Element:	Control Activity
COSO Principle:	Management designs control activities to achieve objectives and respond to risks.
Testing Methodology:	For selected sample, auditor compared member information in LOB to information reported by the employer. Additionally, auditor performed a count for reported social security numbers to ensure employees were not improperly reported multiple times.
Test Result:	No exceptions noted.

Risk:	Policies and procedures not accurate.
Control:	Division director ensures procedures are up-to-date and posted on SharePoint.
COSO Element:	Control Activity
COSO Principle:	Management implements control activities through policies.
Testing Methodology:	Auditor reviewed division procedures to ensure they were up-to-date, reflected current practices, and were available to staff.
Test Result:	No exceptions noted.

Appendix B – Background

Employer Templates

On the 25th of each month, or the next business day if the 25th falls on a holiday or weekend, the batch runs that generates the Monthly Employer Reporting templates and related invoices. The templates and invoices are sent to the primary reporting official for all active employers except for those who report in KHRIS. For those employers, the template is created in START to allow the new reports to be uploaded via the monthly KHRIS File Process submitted by Personnel Cabinet, and employers who have a delinquent report for the prior month. From the 26th through the 10th of the following month, adjusted to account for holidays and weekends, employers will utilize the template to submit the required employee detail information, a summary of that information, and payment. Multiple batches are run nightly to review the reports and payments received.

Detail and Summary Reports Batch

The first phase of the batch is the LOAD phase. During this phase, information in the employer submitted file report is reviewed. If the file fails for any reason, it is rejected, and the employer is alerted to this fact with an explanation of why the rejection occurred. The rejected file is moved to the Rejected folder. If the file is validated by the batch, the file is moved to the Processed folder. Once a file has been approved by this phase of the batch, individual records are moved to the EDIT phase of the batch process.

The EDIT phase of the batch process reviews the records marked with an EDIT status, meticulously checking member contribution, demographic, and employer information against what is in LOB. Any issues identified in the EDIT batch, are assigned a severity level of Error, Warning, or Information. If no issues are noted with a record, it is placed in PASS status.

Once the EDIT phase has completed, the batch that captures electronic payments is run. This batch matches payments received to the employer reports and applies the appropriate credits.

The BALANCE phase determines if the values in the summary report equal the amounts in the detail report that were placed in the PASS, ERROR, or WARNING status. After this review, the records are marked as Balanced, Unbalanced But Within Tolerance, or Unbalanced. For summaries given a status of Unbalanced But Within Tolerance, a difference between summary and detail of 2% or less, LOB creates invoice entries during the nightly batch process. This results in the application of the Balanced status. For KHRIS reporting employers, the phase will only evaluate the Total Detail Amounts when all expected employers are present. If they are not present, ERCE will notify the Personnel Cabinet concerning any missing employers in the KHRIS Monthly file. To balance the report by invoice, the employer must have submitted enough funds to cover the employee contributions portion of the employer report. Without the funds required to cover that portion, invoice entries cannot be created because the invoices can only cover the employer contributions. To resolve this ERCE will notify the employer concerning the report shortage and request the employer pay by check for the difference. For employers who pay by check, the Division of Accounting manually allocates the funds to the employer's report and then ERCE staff continue the balancing process.

Balancing

As payments, reports, and summaries are received and processed by the phases discussed above, the individuals responsible for balancing Unbalanced reports can review the list of outstanding, unbalanced employers. Not all employers have complete packets submitted at the same time.

- File/Web and School Board: ERCE staff investigate the causes of unbalanced items for their assigned employers. Each staff member has their own approach to investigating and resolving the causes of variances. If the causes are resolved, resulting in a \$0.00 variance, the counselor moves the item to the Balanced status.

If staff is unable to determine the cause of the issue or the information needed is not received timely, an invoice is generated for the unbalance amount so that the item can be moved to the Balanced status. In these instances, a comment is left to explain how the item was balanced.

- KHRIS: Employers reporting through KHRIS arrive in one file. This file is formatted by DETS to the START format along with summary reports. When both halves of the payment are received and acknowledged as such by LOB, staff balance the sum of the payments and reports. If these were to be equal, staff move the item to the Balanced status. Due to monthly variations, these items rarely have a \$0.00 balance. A large amount of data is included in the KHRIS file, as a result variances in terms of money received compared to money expected are not investigated. Instead, the variances are balanced with an invoice. New monthly record rejections are reviewed by ERCE and communicated to Personnel Cabinet. After the BALANCE phase is completed, a member of KHRIS staff will request that the three independent aspects of the batch process be run. This automatically fixes errors that fall within specified parameters. If one of the record's fields is still in Error status, it must be resolved manually before the record can be posted in LOB. Items in the Warning status must also be resolved before the record posts.

For all three branches, the balancing must be accompanied by a comment explaining the cause of the variance, the employer representative contacted, and the final total variance amount. If the payment received varies from what the Balance phase of the batch believes is correct by \$25.00 or less, the amount is automatically written off and the money received is posted. If the difference in money received and money expected is equal to 2% or less, the system automatically issues an invoice to the employer and posts the payment. If the payment received is less than \$200,000, the counselors have five days from receipt to get it balanced and posted. If the amount received is equal to or greater than \$200,000, it must be balanced the same day it is received, per ERCE process documentation.

Once an employer report has the Balanced status, the report will be processed by the POST phase of the batch process. This phase posts all Employer Contribution Detail information that has been marked as PASS, applying any new or revised contributions or service to the member's account. If a member record is marked with either the ERROR or WARNING status, they are not posted to the member's account. ERROR, INFORMATION, and WARNING statuses are corrected in the Error Correction process.

Error Correction

Please note this process will be reviewed in a separate audit.



Kentucky Public Pensions Authority

Division of Internal Audit



Issue Date

August 19, 2024

Scope and Objectives

The Review of Employer Contributions audit was conducted from October 6, 2023 to August 12, 2024. The scope of the audit was Monthly Employer Reports received in fiscal year 2023. We did not note any reportable findings during the audit, but we did note one recommendation that we wanted to communicate to management. This item will be reviewed during follow-up engagements and/or during a review of open recommendations.

The objectives of the Review of Employer Contributions audit were to ensure internal controls have been designed and are operating effectively and efficiently. We also ensured compliance with applicable state and federal statutes and regulations as well as policies established by the KPPA, CERS, and KRS Boards and procedures developed by KPPA staff.

Acronyms

The following acronyms will be used throughout the report:

1. KPPA - Kentucky Public Pensions Authority
2. CERS - County Employees Retirement System
3. KRS - Kentucky Retirement Systems
4. CEO - Chief Executive Officer
5. CFO - Chief Financial Officer
6. KPPA Executive Management Team - KPPA Executive Director, KPPA Deputy Executive Director, KPPA Executive Director – Office of Benefits, and KPPA CFO
7. ERCE – KPPA Division of Employer Reporting, Compliance, and Education

Additional Recommendations

1. **When ERCE Division Director sends out the next reminder to ERCE staff outlining the importance of following processes, the reminder should specifically highlight the importance of communicating errors to employers timely and uploading supporting documentation to LOB for any changes made to an employee's account.**

Within the scope of the audit, three transactions were split by ERCE staff. Two of the splits did not have supporting documentation uploaded in LOB. Since testing, documentation has been uploaded to LOB for both items. However, in one instance, the employer was not consulted on the change until June 10, 2024, more than a year after the change was made. ERCE's Error Correction Process states, "...STEP 5 - CONTACT: The ERCE error processor should reach out to the Primary Reporting Official either by phone or by secure email to review the issue on the record. If the ERCE error processor contacts the Reporting Official by phone, they need to write down the information provided during the call and send an email back to the employer requesting verification of

the information received...STEP 8 - COMPLETE: Once all error records are corrected for the employer on the report month, image the employer verification document into the employer's Library Manger as a Form 7242 – Error Correction Information Request." Salary splits are excluded from quality control if there is no monetary contribution difference in the total salary reported by the employer. In these cases, there was no change in monetary contributions; therefore, the cases would not have gone to the quality control step process for a second review.

While there is not a monetary impact to the agency, there is a concern that proper procedures are not being followed. If procedures are not being followed in relation to this process, this could indicate proper procedures are not being followed for other processes.

Management Response: KPPA management partially agrees with this finding. ERCE agrees that staff did not upload the documentation timely in the file for two occasions; however, this is a deviation from our standard practice. The ERCE Division Director sends frequent reminders to staff on the importance of uploading documentation to the file. In addition, ERCE management ensures process documentation is up to date and provides all the steps staff needs to take during the error correction process.

This report is intended solely for use by the KPPA Audit Committee; the KPPA, CERS, and KRS Boards; the CERS CEO; the KRS CEO; the KPPA Executive Management Team; and the KPPA Division of Employer Reporting, Compliance, and Education. This report is not intended to be, and should not be, used by anyone other than the specified parties. All final reports and management letters are subject to Open Records Requests.



Kentucky Public Pensions Authority

Division of Internal Audit



Overall Opinion

Process generally complies with relevant statutes, regulations, policies, and procedures. Internal controls are established and working effectively and efficiently.

Issue Date

August 19, 2024

Summary of Findings

No reportable findings were noted as a part of this audit.

Commendations

We worked with various divisions throughout this audit – Divisions of Membership Support, Member Services, Retiree Payroll, and Disability and Survivor Benefits. All staff we worked with were helpful and responded quickly to our requests. No significant issues were noted during the audit. An initial issue was noted, but the auditor found that compensating controls were established that addressed the situation. Please see Appendix A for additional details on the testing results.

Report Contents

Acronyms	2
Objectives	2
Recommendations for Future Audits	2
Appendix A – Risks and Testing Methodology	3
Appendix B – Background	6

Acronyms

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1. KPPA - Kentucky Public Pensions Authority
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4. CEO - Chief Executive Officer
5. CFO - Chief Financial Officer
6. KPPA Executive Management Team - KPPA Executive Director, KPPA Deputy Executive Director, KPPA Executive Director – Office of Benefits, and KPPA CFO
7. MSUP – KPPA Division of Membership Support
8. MSVC – KPPA Division of Member Services
9. DSB – KPPA Division of Disability and Survivor Benefits
10. Retiree Payroll – KPPA Division of Retiree Payroll
11. LOB – Line of Business
12. QDRO – Qualified Domestic Relations Order

Objectives

The Review of Refunds audit was conducted from March 21, 2024 to August 6, 2024. The scope of the audit was fiscal year 2024.

The objectives of the Review of Refunds audit were to ensure internal controls have been designed and are operating effectively and efficiently. We also ensured compliance with applicable state and federal statutes and regulations as well as policies established by the KPPA, CERS, and KRS Boards and procedures developed by KPPA staff.

Recommendations for Future Audits

Based on work conducted during this audit, no additional items were noted for future audits.

Use of Report

This report is intended solely for use by the KPPA Audit Committee; the KPPA, CERS, and KRS Boards; the CERS CEO; the KRS CEO; the KPPA Executive Management Team; and the KPPA Divisions of Membership Support, Member Services, Retiree Payroll, and Disability and Survivor Benefits. This report is not intended to be, and should not be, used by anyone other than the specified parties. All final reports are subject to Open Records Requests.

Appendix A – Risks and Testing Methodology

Auditor generated a report showing all standard refunds between July 1, 2023 and May 2, 2024. During that timeframe, there were 4,506 refunds. Using suggested audit sampling methodologies, a sample size of 62 items was selected. Once testing began, an additional six overpayments were found. These items were added to the sample, for a total sample size of 68 items. Additionally, auditor discovered 39 refunds related to retiree deaths and three refunds related to a Qualified Domestic Relations Order. These items are considered non-standard refunds. Auditor tested 100% of these items.

Risk:	Refund processed inaccurately.
Control:	<ol style="list-style-type: none"> 1. System pulls in information for standard refunds. 2. Refund is prepared and checked by different people. 3. Counselor verifies non-standard refunds. 4. Counselor verifies member is qualified for a refund.
COSO Element:	Control Activity
COSO Principle:	<ol style="list-style-type: none"> 1. Management designs the entity’s information system and control activities. 2. Management designs control activities to achieve objectives and respond to risks.
Testing Methodology:	Auditor totaled the contribution and interest in the member’s profile and compared that to the refund paid to verify the accuracy of the refund paid to the member. Auditor reviewed LOB and ensured the refund was prepared and reviewed by different individuals. Auditor recalculated non-standard refunds and applied the selected split option to the total refund and compared that to the refund split paid to the member and the alternate payee to verify the accuracy of the non-standard refund. Auditor matched the amount in LOB to the amount paid to the estate to verify the accuracy of retired death refunds. For each standard refund, auditor confirmed that the member’s termination date was prior to application date, member was not rehired, member was not eligible for normal or early retirement, and application was completed correctly.
Test Result:	No exceptions noted related to the first three controls. However, for the fourth control, seven members were deemed not eligible for the refund because the member re-employed in the same system simultaneously to the prior service being refunded. In each instance, the overpayment was caught by KPPA staff and invoices were issued to recover the overpayment. Since compensating controls worked appropriately in all instances, no exceptions were noted for the audit.

Risk:	Member refunded incorrect amount.
Control:	System pulls in information for supplemental payroll.
COSO Element:	Control Activity
COSO Principle:	Management designs the entity’s information system and control activities.
Testing Methodology:	For all payroll periods in scope, the auditor compared the supplemental payroll register to the supplemental payroll balance and ensured the total for each plan matched.
Test Result:	No exceptions noted.

Risk:	Refund with multiple payees split incorrectly.
Control:	<ol style="list-style-type: none"> 1. QDRO refund amounts are hand checked. 2. Active death refund split for multiple payees is set by member.
COSO Element:	Control Activity
COSO Principle:	Management implements control activities through policies.

Testing Methodology:	Auditor recalculated QDRO refunds and applied the selected split option to the total refund and compared that to the refund split paid to the member and the alternate payee to verify the accuracy of the QDRO refund. Auditor examined all active death refunds within scope of the audit; none had multiple payees.
Test Result:	No exceptions noted. Since no exceptions were noted with other testing related to active deaths or with other refunds that required splitting across multiple payees, auditor does not have concerns related to the process of splitting active death refunds across multiple payees.

Risk:	Improper refund of contributions.
Control:	Separation of service is verified.
COSO Element:	Control Activity
COSO Principle:	Management implements control activities through policies.
Testing Methodology:	Auditor verified termination date was before application date.
Test Result:	No exceptions noted.

Risk:	Additional contributions received after refund are not paid to member/beneficiary.
Control:	Secondary sweep of refunded accounts checks for additional contributions.
COSO Element:	Control Activity
COSO Principle:	Management designs the entity's information system and control activities.
Testing Methodology:	Auditor verified that all refunded accounts in sample have a contribution and interest balance of zero in LOB.
Test Result:	No exceptions noted.

Risk:	Refund canceled, but still issued.
Control:	Counselor verifies refund status.
COSO Element:	Control Activity
COSO Principle:	Management implements control activities through policies.
Testing Methodology:	Auditor verified members who received a refund did not request a cancelation of their refund.
Test Result:	No exceptions noted.

Risk:	Refund overpayments are not recovered.
Control:	Members are invoiced for overpayments.
COSO Element:	Control Activity
COSO Principle:	Management implements control activities through policies.
Testing Methodology:	For the seven individuals in the sample that were overpaid, auditor verified that the member was invoiced by KPPA.
Test Result:	No exceptions noted.

Risk:	Address change not verified before refund is issued.
Control:	Payroll staff verifies addresses after changes.
COSO Element:	Control Activity
COSO Principle:	Management implements control activities through policies.
Testing Methodology:	Auditor verified that the address on the Refund Application or Certification of Beneficiary matched the member's address at the time the refund was processed by comparing the address on the application to the address in member's profile.
Test Result:	No exceptions noted.

Risk:	Policies/procedures/internal controls not established, documented, effective, and/or efficient.
Control:	1. Procedures reviewed and updated periodically. 2. Division director ensures procedures are on SharePoint.
COSO Element:	Control Activity Information and Communication
COSO Principle:	Management implements control activities through policies. Management communicates necessary information internally.
Testing Methodology:	Auditor reviewed division procedures to ensure they were up to date, reflected current practices, and were available to staff. Throughout other testing, auditor ensured internal controls were established and working effectively and efficiently.
Test Result:	No exceptions noted.

Appendix B – Background

Standard Refund Process

A refund is initiated by members. Upon completion of the appropriate form, a refund request is generated and indexed in LOB. The MSUP Retirement Benefit Consultant distributes the refunds among the MSUP counselors and their data support staff. All counselors, unless they are new, take part in the processing of refunds. The counselor reviews the refund to make sure the application is valid, and a termination date is on file. If changes are noted to the member's physical address or email address, the counselor updates the member's information. Counselors verify the refund amount that is pulled in automatically and make a note of the amount in a journal comment. The Retirement Benefit Consultant assigns all the completed refund requests to Quality Control staff. MSUP staff escalate refunds that should be part of a different refund process, such as a Qualified Domestic Relations Order refund or members that need to have their address verified. Once refunds have completed the quality control process, they are sent to Retiree Payroll for processing through the supplemental payroll batch.

Qualified Domestic Relations Order Refund Process

If a refund request has a Qualified Domestic Relations Order it is sent to the MSVC Assistant Director who reviews the refund to ensure the application is valid and a termination date is on file. The Assistant Director also updates the member's information if changes are noted to the member's physical address or email address. The Assistant Director reviews the option the member and alternate payee have selected - A: a set amount, B: a proportion determined by taking the proportion of total service time spent married to alternate payee divided by 2, or C: a set proportion. The Assistant Director checks a box in LOB to identify that there are legal documents contained in the refund. The Assistant Director determines the amount due to the member and the alternate payee and includes those amounts in a journal comment. The alternate payee is sent forms to verify their address. The refund then goes through the quality control process, which includes verifying that the refund is split appropriately. After the quality control process is completed, the refund is sent to Retiree Payroll for processing.

Death Refund Process

When a member is reported as deceased, a work item is launched for a DSB counselor. A DSB counselor will then pull that work item and audit the file to make sure everything is correct in LOB. They then identify the beneficiary and mail a sympathy letter to that beneficiary or estate. The DSB counselor also requests that the necessary documents be provided - a copy of the death certificate and a form 6810 (Certification of Beneficiary). Once DSB receives the necessary documents an additional letter is sent to the beneficiary that explains the benefits. If it is a retired case, the letter will explain the payment option the member chose, how that option works, and what benefits are remaining for the beneficiary. If it is an active case, the letter will include the refund amount, which is the balance of contributions and interest in the account. A tax form is also included with the letter as well as a form 6025 for an individual beneficiary and a form 6016 for an estate. Once DSB receives the forms back, the refund is launched through LOB. The counselor will launch the request and resolve any errors. The counselor updates the tax information and saves and submits the refund. If the refund is related to a retired member, the counselor verifies the payment option and amount provided by LOB. If changes are made, the counselor will update LOB. In these cases, the automatically generated refund is not always accurate so the counselor manually calculates the refund amount and compares that amount to what is shown in LOB. Once the refund is processed by LOB, it is sent to quality control for review. After the quality control process is completed, the refund is sent to Retiree Payroll.

Payroll Process

Refunds are included in the supplemental payroll that runs every two weeks. By running a "Create" step for supplemental payroll, all accepted refunds from non-retired members from the last two weeks are pulled in automatically. Supplemental payroll is a manual process different from normal payroll process. Retiree Payroll will manually approve the supplemental payroll. Only the Retiree Payroll Division Director and Retirement Programs Manager can approve supplemental payroll. Retiree Payroll reviews all the refunds and removes any that may need to be removed. Retiree Payroll pulls the supplemental pay register and supplemental payroll balance reports and compares the totals to ensure the refunds, taxes, and system breakdown match. If it does match, the supplemental payroll is approved. If issues are noted, Retiree Payroll contacts the Division of Enterprise and Technology Services. The most common issue is an address that is too long and being truncated by the system. If refunds are underpaid, the difference is paid in the next supplemental payroll, after the discrepancy is caught by a post-retirement audit. Additionally, a second sweep of the account is performed to see if additional contributions were reported after the refund was paid. If refunds are overpaid, Retiree Payroll sends an invoice requesting repayment of the excess refund. If the overpayment is not received, Retiree Payroll sends the issue to the Office of Legal Services.

Processes Pertaining to Under/Overpayments and Vesting

When processing active termination refunds, overpayments are associated with in-service distributions, which occur when a member is employed by an agency in the same system as the one in which the member is receiving a refund. The most common scenario is that a member terminates employment with a participating agency, but then begins a new employment with another agency in the same system prior to the disbursement of the refund. Nearly all in-service distributions are uncovered when the member's new employer begins reporting the employee to KPPA. Overpayment invoices for active termination refunds that have been deemed in-service distributions are created by Retiree Payroll upon the request of MSUP management.

Refunds represent a complete disbursement of the contributions credited to the member's account. If contributions are received after the refund has been processed, then the system will detect a non-zero balance in the refunded member account and automatically disburse these funds in the following supplemental payroll. Any initial "underpayment" would be detected by the system. The process for returning vested contributions only pertains to Tier 3 members. Refunds for Tier 1 and Tier 2 members only contain employee contributions and associated interest, regardless if the member is vested. For Tier 3 members, the refund module is programmed to only disburse employee contributions, Employee Base Interest and Employee Upside Sharing Interest if the member has not reached vesting. Additionally, each refund is checked by both the preparer and the quality control process to ensure that the correct amount(s) are pulling in for disbursement.

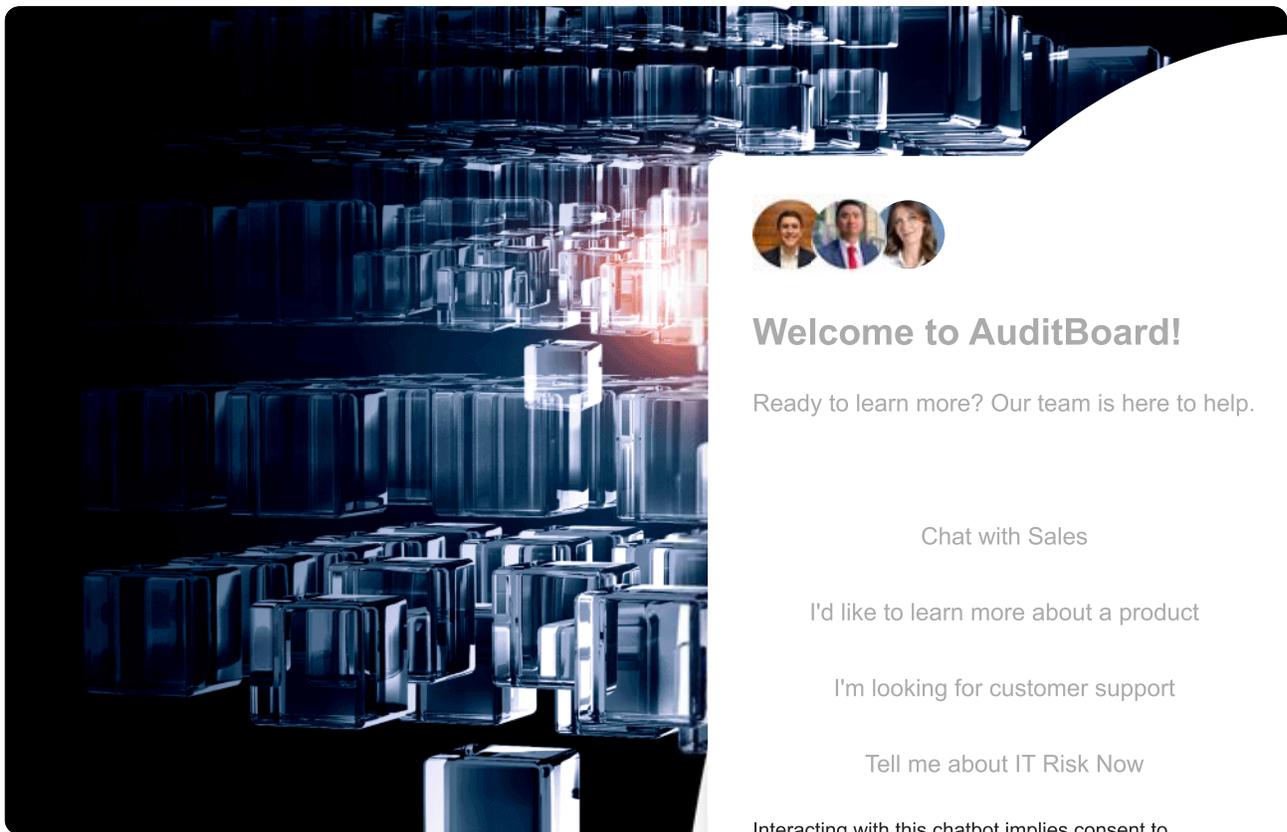
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Fundamentals of the COSO Framework: Building Blocks for Integrated Internal Controls



Arden Leland

May 24, 2023



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— Public Accountants (AICPA), Institute of Management Accountants (IMA), American Accounting Association (AAA), Institute of Internal Auditors (IIA), and Financial Executives International (FEI). COSO formed to investigate the fraud scandals of the 1970s and 1980s, releasing an [internal controls framework](#) in 1992.

This COSO Internal Control – Integrated Framework (ICIF) — also somewhat confusingly known simply as COSO or the COSO framework — provided guidance for how organizations can implement controls to prevent, detect, and manage [fraud risk](#) related to external financial reporting. This article will break down the five pillars and seventeen principles of the COSO framework as well as how implement and use it as a foundation for modern internal controls and fraud deterrence.

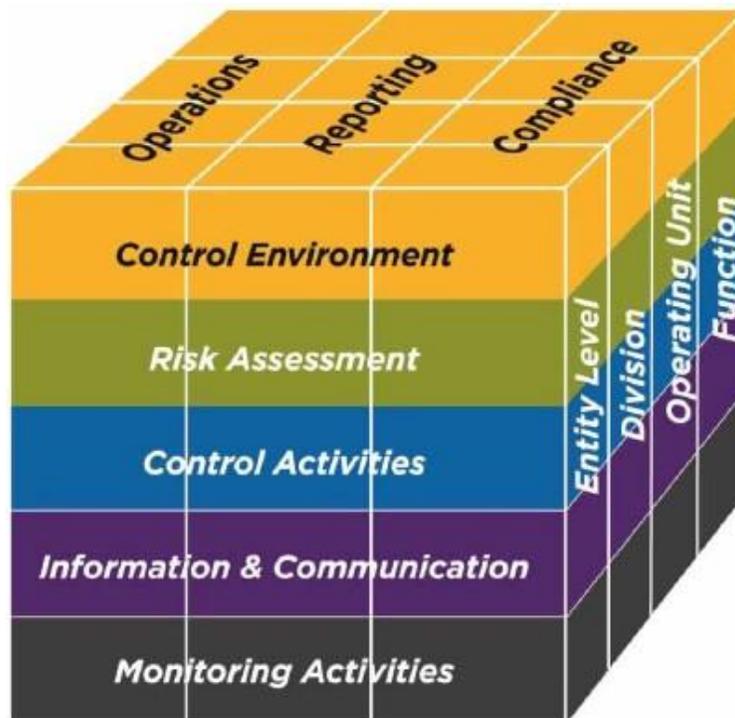
Overview of the COSO Framework

Although the original aim of COSO (the organization) was to investigate and address fraud in the 1970s and 1980s, the COSO framework (the framework) gained increased importance due to the fraud cases of the 1990s and 2000s (Enron, WorldCom, Sunbeam, Tyco) and the subsequent passing of the Sarbanes-Oxley Act (SOX). [SOX](#) requires public companies to implement and maintain effective internal controls across the organization related to financial statements. Companies subject to SOX regulations adopted COSO as one of the primary frameworks to satisfy these requirements. The COSO Internal Control – Integrated Framework (ICIF), was revised and reissued in 2013 with updated guidance, and periodic updates are issued by the Committee. COSO also provides guidance for establishing an [Enterprise Risk Management](#) (ERM) program, which often times works hand in hand with a Company's control environment.



As scrutiny increases around corporate sustainability, more regulations have come into play requiring reliable, trusted reporting around environmental, social, and governance (ESG) matters. COSO and other professional organizations are adapting, and this new guidance around ICSR to give companies a vetted avenue for reporting around sustainability. Though sustainability matters are considered “non-financial”, COSO has supported stakeholder demand to adapt COSO’s ICIF for [ESG reporting](#).

The COSO “cube” visual below summarizes the pillars and components of the COSO framework. On the first face of the cube are five foundations of internal controls. On the top face of the cube are the control objectives categories — that is, the organization’s operational, compliance, and reporting objectives in relation to internal controls. On the last face of the cube are the levels at which controls need to be implemented, from the Entity level to the functional level.



What Are the Five Pillars of the COSO Framework?



support internal controls objectives around operations, reporting, and compliance by providing some guidance on how to implement effective controls. These pillars are further broken down into [17 principles](#).

Control Environment

The Control Environment of an organization refers to the overall culture of internal controls and is established from the top down.’ As demonstrated by Enron and other, more recent fraud cases, poor “tone at the top” can lead to fraudulent activity with devastating consequences. Establishing a Control Environment in accordance with the COSO frameworks involves demonstrating the following principles:

- 1. The company commits to integrity and ethical values.
- 2. The Board of Directors maintains independence from management and oversees internal controls programs.
- 3. Management defines organizational structure, authority, reporting lines, and responsibilities to execute on the company’s operational, reporting, compliance, and business objectives.
- 4. The company prioritizes the recruitment, development, and retention of capable, competent individuals aligned to internal controls objectives.
- 5. The company establishes accountability for control responsibilities.

Achieving these principles can be done through documentation of policies, mission and vision statements, strategic planning documents, meeting notes, and periodic evaluation of the company’s internal controls program, either through an [internal audit](#) or external [compliance audit](#).



Risk Assessment

The next pillar of the COSO framework stipulates the need for periodic or ongoing risk assessments based on the organization's internal controls system. These risk assessments can be performed by internal personnel, such as an internal [audit team](#), or third parties, such as a consulting or CPA firm. COSO specifies four core principles for risk assessment and risk treatment, listed below:

- 6. The company establishes objectives with enough specificity to enable the identification and assessment of risks to the objectives.
- 7. The company identifies risks to objectives and scrutinizes identified risks to develop an action plan for risk treatment.
- 8. When evaluating risks, fraud is explicitly considered as part of the assessment.
- 9. The organization anticipates and assesses any changes that may affect internal controls.

Risks should be logged in a risk register or risk inventory that describe the risk, the likelihood that the risk will be realized (Likelihood/Probability), the impact if the risk is realized (Impact), the plan for mitigating the risk, the timeline for mitigating the risk, and the person(s) responsible for that risk. Risk assessments should occur at least annually, and the risk register should be updated as risks are discovered or mitigated. Consideration of these risk assessments and risk registers should be incorporated into the organization's decision-making process, and align with the organization's risk tolerance.

Control Activities



environment, and performed or initiated a risk assessment, the COSO framework dives another level deeper. Control activities are those processes, activities, actions, and communications performed to mitigate risks and maintain strong internal controls. Three COSO principles fall into this pillar:

- 10. Control activities address and mitigate risks to the company’s objectives.
- 11. The company establishes control activities over technology in line with the company’s objectives.
- 12. Policies and procedures define the control activities that should be taking place at the company as part of the internal controls program.

An example of a control activity might be that code changes need to be 1) reviewed by an appropriate person, 2) who is not the code developer, and 3) approved by that person in the ticketing system. Another control activity might be the termination of an employee account within 24 hours of their last day.

Information and Communication

This may seem obvious, but another crucial aspect of a successful compliance and internal controls program is appropriate, consistent, and timely information distribution and communications to relevant stakeholders. That’s a mouthful — breaking that down further, the COSO framework requires companies to communicate and share information based on these principles:

- 13. The company uses quality data and information to support control objectives.
- 14. The company communicates relevant information, objectives, assignments, accountability, and responsibilities for internal control activities.



More and more companies, especially B2B organizations, include clauses in their contracts that require the disclosure of data breaches, incidents, cyber attacks, and other internal controls matters to external entities. HIPAA directives require the reporting of data breaches to affected parties. A well-orchestrated communication plan can take much of the pain out of building out a COSO program.

Monitoring Activities

The fifth and final pillar of the COSO framework involves monitoring, measuring, and reporting on the company's internal controls system and includes the following principles:

- 16. Regular or ongoing evaluations occur to determine if the internal controls program is operating effectively.
- 17. Any [internal control deficiencies](#) are reported timely to the accountable parties, including the Board of Directors and upper management when necessary.



Pillar	Principle
Control Environment	1. The organization demonstrates a commitment to integrity and ethical values.
	2. The board of directors 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 authorities and responsibilities in the pursuit of objectives.
	4. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
	5. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.
Risk Assessment	6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
	7. The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.
	8. The organization considers the potential for fraud in assessing risks to the achievement of objectives.
	9. The organization identifies and assesses changes that could significantly affect the system of internal control.
Control Activities	10. The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
	11. The organization selects and develops general control activities over technology to support the achievement of objectives.



Information and Communication	13. The organization obtains or generates and uses relevant, quality information to support the functioning of internal control.
	14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.
	15. The organization communicates with external parties regarding matters affecting the functioning of internal control.
Monitoring Activities	16. The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning
	17. The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.

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What Are the Steps to Implement and Use the COSO Framework?

To build and integrate an effective COSO program, an organization can follow these general steps. For more in-depth details on [how to improve organizational performance and governance with COSO guidance](#), refer to this document from COSO.

Planning

In order to get the most out of the COSO framework, organizations need to do some legwork upfront. Organizations should understand why they are leveraging this



the whole organization, it is crucial to develop a meticulous and thorough plan for setting up and maintaining an internal controls system based on COSO. Investing in [compliance management software](#) to coordinate COSO control activities facilitates both planning and execution.

Evaluation and Documentation

Following planning, it is important to understand the maturity of the organization's internal controls program and what documentation exists to support objectives and pillars. In this phase, the responsible team should collect the available documentation around the organization's internal controls, and take into account whether there are common processes, formal [Enterprise Risk Management \(ERM\)](#), and/or appropriate control activities in place. If the documentation available is insufficient to support the organization's objectives and the requirements of COSO, these should be tracked for remediation as gaps.

Remediation

As internal control assessments reveal gaps in an organization's internal controls program, the parties responsible for those control activities or areas undertake remediation or risk mitigation activities. If an internal control gap is found, the responsible team(s) plan the remediation or risk mitigation steps, timeline, and responsibilities, then execute that plan.

Testing and Reporting

Once a company has completed the preceding steps and has comfort that the company is compliant with the COSO framework, testing and reporting occur. Testing involves



involve inspecting the log of incidents for a certain period and determining if the proper documentation was completed for a select subset of those incidents.

Management should receive regular reporting around the internal controls program and the results of testing.

What Are the Pros and Cons of the COSO Framework?

The COSO framework is a foundation of modern internal controls and fraud deterrence. This framework has been used to guide and help develop other existing compliance frameworks. The visualization of the COSO cube emphasizes the need for the integration of operational and control activities. There are plenty of resources available to organizations seeking to build a COSO program. And, perhaps most importantly, applying the COSO framework as an organization subject to SOX is a great way to meet internal control requirements.

However, the COSO framework's greatest strength and limitation is its broadness. Designed to apply to a wide range of industries and companies, the COSO framework does not provide specific methods for implementing effective control activities, but rather provides overarching principles for how internal controls should be structured. Despite this broadness, COSO's other limitation is its stringency. Smaller organizations may find themselves challenged when implementing COSO requirements because of coordination and, plainly, the extent of work that must be completed to establish a successful, COSO-based, effective system of internal controls. [AuditBoard simplifies the path to a strong internal controls program](#) by unifying risks, controls, policies, frameworks, issues, and stakeholder communications to meet the ever-increasing compliance needs of modern businesses.



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Audit committee performance evaluation

The following questionnaire is based on leading practices to assist an audit committee in performing a self-assessment of its performance. This sample tool may not contain all of the criteria applicable to each committee, nor does it suggest all of the criteria should apply to each committee.¹ Each company should consider the items that are most relevant to it and/or its audit committee.²

For each of the following statements, select a number between 1 and 5, with 1 indicating that you strongly disagree and 5 indicating that you strongly agree. Leave blank if the statement is not applicable or you do not have enough information to rank the audit committee on that particular item.

Composition and quality	Strongly disagree				Strongly agree
1. Qualified audit committee members are identified by sources independent of management (e.g., independent board members assisted by an outside search firm).	1	2	3	4	5
2. Audit committee members have the appropriate qualifications to meet the objectives of the audit committee charter, including appropriate financial literacy.	1	2	3	4	5
3. The audit committee demonstrates integrity, credibility, trustworthiness, active participation, an ability to handle conflict constructively, strong interpersonal skills, and the willingness to address issues proactively.	1	2	3	4	5
4. The audit committee demonstrates appropriate industry knowledge and includes a diversity of experiences and backgrounds.	1	2	3	4	5
5. Members of the audit committee meet all applicable independence requirements.	1	2	3	4	5
6. The audit committee participates in a continuing education program to enhance its members' understanding of relevant accounting, reporting, regulatory, auditing, and industry issues.	1	2	3	4	5
7. The audit committee monitors compliance with corporate governance regulations and guidelines.	1	2	3	4	5
8. The audit committee reviews its charter annually to determine whether its responsibilities are described adequately and recommends changes to the board for approval.	1	2	3	4	5
9. New audit committee members participate in an orientation program to educate them on the company, their responsibilities, and the company's financial reporting and accounting practices.	1	2	3	4	5
10. The audit committee chair is an effective leader (e.g., runs committee meetings efficiently and effectively, stays coordinated with the board and other committees, keeps open lines of communication with management, internal audit, and independent auditor, etc.).	1	2	3	4	5
11. The audit committee, in conjunction with the nominating committee (or its equivalent), creates a succession and rotation plan for audit committee members, including the audit committee chair.	1	2	3	4	5

- The information presented can and will change; we are under no obligation to update such information. Deloitte LLP makes no representations as to the sufficiency of these tools for your purposes and, by providing them, we are not rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This tool should not be viewed as a substitute for such professional advice or services, nor should it be used as a basis for any decision that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional adviser. Deloitte LLP does not assume any obligations as a result of your access to or use of this tool.
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Audit committee performance evaluation



Composition and quality	Strongly disagree	←————→			Strongly agree
10. The audit committee chair is an effective leader (e.g., runs committee meetings efficiently and effectively, stays coordinated with the board and other committees, keeps open lines of communication with management, internal audit, and independent auditor, etc.).	1	2	3	4	5
11. The audit committee, in conjunction with the nominating committee (or its equivalent), creates a succession and rotation plan for audit committee members, including the audit committee chair.	1	2	3	4	5
Average					

Understanding the business, including risks	Strongly disagree	←————→			Strongly agree
12. The audit committee considers significant risks that may directly or indirectly affect financial reporting, even in instances where such risks are overseen by the full board or other committees. Examples include: – Regulatory and legal requirements – Concentrations (e.g., suppliers and customers) – Market and competitive trends – Financing and liquidity needs – Financial exposures – Business continuity – Cybersecurity – Company reputation – Financial strategy execution – Financial management’s capabilities – Management override – Fraud control – Company pressures, including “tone at the top”	1	2	3	4	5
13. The audit committee considers, understands, and approves the process implemented by management to effectively identify, assess, and respond to the organization’s risks.	1	2	3	4	5
14. The audit committee understands and approves management’s fraud risk assessment and has an understanding of identified fraud risks.	1	2	3	4	5
15. The audit committee considers the company’s performance versus that of its peers in a manner that enhances comprehensive risk oversight by using reports provided directly by management to the audit committee or at the full board meeting. These may include benchmarking information comparing the company’s financial performance and ratios with industry competitors and peers, industry trends, analyst estimates, and budget analysis with explanations for areas where significant differences are apparent.	1	2	3	4	5
Average					

Audit committee performance evaluation



Process and procedures	Strongly disagree ← → Strongly agree				
16. The audit committee reports its proceedings and recommendations to the board after each committee meeting.	1	2	3	4	5
17. The audit committee develops a calendar that dedicates the appropriate time and resources needed to execute its responsibilities.	1	2	3	4	5
18. Audit committee meetings are conducted effectively, with sufficient time spent on significant or emerging issues.	1	2	3	4	5
19. The level of communication between the audit committee and relevant parties is appropriate; the audit committee chair encourages input on meeting agendas from committee and board members, management, the internal auditors, and the independent auditor.	1	2	3	4	5
20. The audit committee sets clear expectations and provides feedback to the full board concerning the competency of the organization's CFO and senior financial management.	1	2	3	4	5
21. The audit committee has input into the succession planning process for the CFO.	1	2	3	4	5
22. The agenda and related information (e.g., prior meeting minutes, press releases, financial statements) are circulated in advance of meetings to allow audit committee members sufficient time to study and understand the information.	1	2	3	4	5
23. Written materials provided to audit committee members are relevant and concise.	1	2	3	4	5
24. Meetings are held with enough frequency to fulfill the audit committee's duties and at least quarterly, which should include periodic visits to company locations with members of management.	1	2	3	4	5
25. Regularly, audit committee meetings include separate private sessions with management and the internal and independent auditors.	1	2	3	4	5
26. The audit committee maintains adequate minutes of each meeting.	1	2	3	4	5
27. The audit committee and the compensation committee regularly review management incentive plans to consider whether the incentive process is appropriate.	1	2	3	4	5
28. The audit committee meets periodically with the committee responsible for reviewing the company's disclosure procedures.	1	2	3	4	5
29. The audit committee respects the line between oversight and management of the financial reporting process.	1	2	3	4	5
30. Audit committee members come to meetings well prepared.	1	2	3	4	5
Average					

Additional Notes:

Audit committee performance evaluation

Oversight of the financial reporting process, including internal controls	Strongly disagree ← → Strongly agree				
31. The audit committee considers the quality and appropriateness of financial accounting and reporting, including the transparency of disclosures.	1	2	3	4	5
32. The audit committee reviews the company's significant accounting policies.	1	2	3	4	5
33. The audit committee understands and approves the process used by management to identify and disclose related-party transactions.	1	2	3	4	5
34. The audit committee has a process for reviewing quarterly and annual earnings releases, including pro forma or non-GAAP information and other significant financial information or earnings guidance, with management and the independent auditor.	1	2	3	4	5
35. The audit committee oversees the organization's external financial reporting and internal control over financial reporting. This oversight includes a process for reviewing Forms 10-Q and 10-K (including management's discussion and analysis), proxies, and other filings before they are issued and providing comments to management and the independent auditor when applicable.	1	2	3	4	5
36. The audit committee reviews the processes related to financial statement certifications made by the CEO and the CFO.	1	2	3	4	5
37. The audit committee receives sufficient information to assess and understand management's process for evaluating the organization's system of internal controls (e.g., financial reporting and disclosure controls, operation controls, compliance controls) and also believes that management's scope of internal control testing adequately supports its internal control assessment.	1	2	3	4	5
38. The audit committee understands and gives appropriate consideration to the internal control testing conducted by management, the internal auditors, and the independent auditor to assess the process for detecting internal control issues or fraud. Any significant deficiencies or material weaknesses that are identified are addressed, reviewed, and monitored by the audit committee.	1	2	3	4	5
39. The audit committee makes inquiries of the independent auditor, internal auditors, and management on the depth of experience and sufficiency of the company's accounting and finance staff.	1	2	3	4	5
40. The audit committee reviews the management recommendation letters written by the independent and internal auditors and monitors the process to determine that all significant matters are addressed.	1	2	3	4	5
41. The audit committee oversees that management takes action to achieve resolution when there are repeat comments from auditors, particularly those related to internal controls.	1	2	3	4	5
42. Adjustments to the financial statements that resulted from the audit are reviewed by the audit committee, regardless of whether they were recorded by management.	1	2	3	4	5
43. The audit committee is consulted when management is seeking a second opinion on an accounting or auditing matter.	1	2	3	4	5
Average					

Additional Notes:

Audit committee performance evaluation



Oversight of audit functions	Strongly disagree ← → Strongly agree				
44. The audit committee understands the coordination of work between the independent and internal auditors and clearly articulates its expectations of each.	1	2	3	4	5
45. The audit committee regularly reviews the adequacy of the internal audit function (e.g., the charter; audit plan; budget; compliance; and number, quality, and continuity of staff).	1	2	3	4	5
46. The audit committee oversees the role of the internal audit director from selection to termination (e.g., appointment, evaluation, compensation, and retention) and provides feedback at least annually.	1	2	3	4	5
47. The internal audit reporting lines established with the audit committee promote an atmosphere where significant issues that might involve management will be brought to the attention of the audit committee.	1	2	3	4	5
48. The audit committee appropriately considers internal audit reports, management's responses, and steps toward improvement.	1	2	3	4	5
49. The audit committee oversees the role of the independent auditor from selection to termination and has an effective process to evaluate the independent auditor's qualifications and performance.	1	2	3	4	5
50. The audit committee considers the independent audit plan and provides recommendations.	1	2	3	4	5
51. The audit committee reviews the audit fees paid to the independent auditors.	1	2	3	4	5
52. The audit committee comprehensively reviews management's representation letters to the independent auditor, including making inquiries about any difficulties in obtaining the representations.	1	2	3	4	5
53. The audit committee preapproves all audit and non-audit services provided by the independent auditor and considers the scope of the non-audit services provided.	1	2	3	4	5
54. The audit committee reviews other professional services that relate to financial reporting (e.g., consulting, legal, and tax strategy services) provided by outside consultants.	1	2	3	4	5
55. The audit committee monitors the process to determine that the independent auditor's partners are rotated in accordance with applicable rules.	1	2	3	4	5
56. The audit committee has private sessions with management and the internal and independent auditors that result in candid discussion of pertinent issues.	1	2	3	4	5
Average					

Additional Notes:

Audit committee performance evaluation

Ethics and compliance	Strongly disagree				Strongly agree
57. Audit committee members oversee the process and are notified of communications received from governmental or regulatory agencies related to alleged violations or areas of noncompliance.	1	2	3	4	5
58. The audit committee oversees management’s procedures for enforcing the company’s code of conduct.	1	2	3	4	5
59. The audit committee determines that there is a senior-level person designated to understand relevant legal and regulatory requirements.	1	2	3	4	5
60. The audit committee oversees the organization’s hotline or whistleblower process, reviews the log of incoming calls that relate to possible fraudulent activity, and understands the procedures to prohibit retaliation against whistleblowers.	1	2	3	4	5
Average					

Monitoring activities	Strongly disagree				Strongly agree
61. An annual performance evaluation of the audit committee is conducted, and any matters that require follow-up are resolved and presented to the full board.	1	2	3	4	5
62. The company provides the audit committee with sufficient funding to fulfill its objectives and engage external parties for matters requiring external expertise.	1	2	3	4	5
Average					
Average of all sections					

Additional Notes:



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