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Correspondence Memorandum

Date: May 17, 2023
To: Audit Committee
From: Kurt Petrie, Auditor
Office of Internal Audit
Subject: Office of Internal Audit Quality Assurance Self-Assessment

This memo is for informational purposes only. No Committee action is required.

The following report is on the quality assurance review performed on the Office of Internal Audit (OIA) in order to express an opinion on Internal Audit's level of conformance with the *Institute of Internal Auditors' (IIA) International Standards for the Professional Practice of Internal Auditing and Code of Ethics* (the *Standards*).

The primary objective of the quality assessment is to evaluate Internal Audit's conformance with the *Standards*. Additional objectives included evaluating Internal Audit's effectiveness, highlighting best practices used, and identifying areas to enhance work processes and procedures. The quality assessment covered the process to complete assurance, consulting, and management assistance engagements performed by the OIA from July 1, 2018, through the fiscal year ending June 30, 2023, as well as planning and monitoring functions. The work performed during the quality assessment included:

- Performance of a self-assessment in preparation for an independent external validation in accordance with the *Standards*.
- Review and evaluation of electronic surveys completed by ETF's executives and management.
- Review of surveys completed by the Internal Audit Director and Internal Audit staff.
- Review and evaluation of audit work papers for a sample of engagements.
- Review of the OIA's policies and procedures, risk assessments, audit plans, and other relevant documents.

Reviewed and approved by Yikchau Sze, Director, Office of Internal Audit
Electronically Signed 06/02/23

Board	Mtg Date	Item #
AUD	06.22.23	4

The quality assessment was performed using the IIA Research Foundation's Quality Assessment Manual for the Internal Audit Activity, 2017 Edition.

The observations and recommendations in the following report are resources for the Internal Audit Director to improve operations and continue to add value to ETF.

This engagement is classified as a self-assessment review because I am a member of ETF's OIA. This report will be validated by an independent, external review team qualified in internal audit quality assessment reviews in order to meet the requirements for such reviews outlined in the *Standards*.

Conclusion

In my opinion, the ETF Office of Internal Audit "Generally Conforms" to the *Standards*, which is the highest of three possible ratings¹. This means there is general conformity to a majority of the individual standards or elements of the Code of Ethics and at least partial conformity to the others within the section/category. General conformance does not require complete or perfect conformance.

Results and Recommendations – Follow up on Prior Review

This assessment began by reviewing the report on the last external assessment conducted. The prior period under review was from July 1, 2013, through the fiscal year ending June 30, 2018. The process was essentially the same and the external assessors provided recommendations on the following areas for improvement:

Standard 1110 – Organizational Independence

Recommendation

Revise ETF policy and the OIA Charter to ensure the OIA functional and administrative reporting relationships are properly defined, and clearly provide the appropriate appearance of organizational independence.

Status – In-Progress

The OIA Charter was updated, and ETF has completed as much as possible. However, without statutory changes to create an independent office of internal audit, which ETF has requested in its last three budgets, this will continue to be in-progress.

Standard 1230 Continuing Professional Development

Recommendation

Strengthen OIA policies and procedures to manage and monitor staff continuing professional development.

¹ There are three Quality Assurance Review opinion options: "Generally Conforms", "Partially Conforms", and "Does Not Conform".

Status – Completed

All OIA members track their professional training hours in a centralized spreadsheet. In addition, the Internal Audit Manual was updated with a specific section on professional development, and position descriptions and performance evaluations also include this information.

Standard 2020 Communication and Approval

Recommendation

Revise the OIA biennial planning process and format to increase information regarding resource requirements, the impact of any resource limitations, and to serve as a basis to monitor significant interim changes.

Status – Completed

The audit plan includes detailed resource estimates at the engagement level to indicate clearly the resources required for proper audit coverage.

Results and Recommendations – Current Review

In the conclusion section, it was stated that the internal audit activity “Generally Conforms” with the *Standards*, Definition of Internal Auditing, and Code of Ethics. It was found that ETF’s internal audit function and procedures “provide reasonable assurance of complying” with applicable professional *Standards*, and with internal policies and procedures.

Conformance gaps with the *Standards*

Three *Standards* were identified where partial conformance occurred. For a detailed list of conformances with the individual *Standards* and the Code of Ethics, please see Appendix A.

Standard 1110 – Organizational Independence

There is an organizational independence concern because the Internal Audit Director (IAD) is hired and terminated by the Secretary. In addition, the position’s pay is determined as part of the state compensation plan. To maintain organizational independence, these items should be completed by the Audit Committee.

Management’s Plan for Action

The IAD will continue to work with the Secretary’s Office and others at ETF to ensure the importance of this issue is discussed and known to the Legislature.

Standard 2010 – Planning

The internal audit plan is a risk-based approach. However, rationale supporting why higher risk items were not selected and why certain IT projects were selected was not fully documented. Furthermore, more Board involvement would be beneficial given their knowledge and background of the agency. Finally, consider completing the audit plan annually, given ETF’s changing environment.

Management's Plan for Action

The IAD will document why certain higher-risk ranked items were not selected and the selection of the IT plan items going forward. The Board members involvement and input will be pursued further.

Standard 2340 – Engagement Supervision

We reviewed four audit projects within TeamMate+ and found the workpapers and procedures were sufficient, concise, and easy to follow. However, there appeared to be insufficient documentation to reflect evidence of a timely supervisory review. We found audit projects where fieldwork began prior to the approval of the audit work program and workpapers with approval from the IAD after the draft report was provided to management. We know from our own experiences that supervisory review takes place in a timely manner, but the evidence of that review could be enhanced.

Management's Plan for Action

The IAD will change the current practice of signing off on workpapers prior to the audit report being finalized for the Secretary's Office discussion to before the report is issued to business areas for management's response.

Successful Internal Audit Practices

Successful internal audit practices are areas where the OIA is operating in a particularly efficient or effective manner when compared to other internal audit activities.

Successful internal audit practices identified during the self-assessment include:

- Risk and control summary document: Details all the risks and applicable controls in a summarized document that is easy to follow and understand.
- Internal audit procedures: The Internal Audit Manual references specific Standards, which is very helpful for staff when reviewing it. In addition, the Internal Audit Manual is very comprehensive.
- Staff qualifications: Staff members of the OIA have numerous professional certifications and are committed towards continuing professional education.

Opportunities for Continuous Improvement

Opportunities for continuous improvement include observations of opportunities to enhance the efficiency or effectiveness of the OIA'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.

Suggestions identified during the self-assessment, along with the corresponding *Standard* reference include:

- Consulting engagements that are PowerPoint presentations should also contain language that they conform with the International Standards for the Professional Practice of Internal Auditing when applicable. (Standard 2430)

- Consider scheduling regular recurring (i.e., monthly) meetings with the Audit Committee Chair to discuss a variety of topics and activities. In addition, consider annually having an individual meeting with each Board member. (Standard 2010 and 2060)
- Consider completing a follow-up audit process on all recommendations marked as complete by management. (Standard 2500.A1)

Staff will be at the Committee meeting to answer any questions.

Appendix A – Evaluation Summary and Rating Definitions

	GC	PC	DNC
Overall Evaluation	X		

Table 1. Attribute Standards (1000 through 1300)

		GC	PC	DNC
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	NA		
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		

		GC	PC	DNC
1320	Reporting on the Quality Assurance and Improvement Program	X		
1321	Use of “Conforms with the <i>International Standards for the Professional Practice of Internal Auditing</i> ”	X		
1322	Disclosure of Nonconformance	NA		

Table 2. Performance Standards (2000 through 2600)

		GC	PC	DNC
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	NA		
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		

		GC	PC	DNC
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	NA		
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	NA		
2440	Disseminating Results	X		
2450	Overall Opinions	NA		
2500	Monitoring Progress	X		
2600	Communicating the Acceptance of Risks	X		

Table 3. Code of Ethics

		GC	PC	DNC
	Code of Ethics	X		

Rating Definitions

GC – “Generally Conforms” means that the assessor has concluded that the relevant structures, policies, and procedures of the activity, as well as the processes by which they are applied, comply with the requirements of the individual standard or elements of the Code of Ethics in all material respects. For the sections and major categories, this means that there is general conformity to a majority of the individual standard or element of the Code of Ethics and at least partial conformity to the others within the section/category. There may be significant opportunities for improvement, but these should not represent situations where the activity has not implemented the *Standards* or the Code of Ethics and has not applied them effectively or has not achieved their stated objectives. As indicated above, general conformance does not require complete or perfect conformance, the ideal situation, or successful practice, etc.

PC – “Partially Conforms” means that the assessor has concluded that the activity is making good-faith efforts to comply with the requirements of the individual standard or elements of the Code of Ethics, or a section or major category, but falls short of achieving some major objectives. These will usually represent significant opportunities for improvement in effectively applying the *Standards* or the Code of Ethics and/or achieving their objectives. Some deficiencies may be beyond the control of the internal audit activity and may result in recommendations to senior management or the board of the organization.

DNC – “Does Not Conform” means that the assessor has concluded that the internal audit activity is not aware of, is not making good-faith efforts to comply with or is failing to achieve many or all of the objectives of the individual standard or element of the Code of Ethics, or a section or major category. These deficiencies will usually have a significantly negative impact on the internal audit activity’s effectiveness and its potential to add value to the organization. These may also represent significant opportunities for improvement, including actions by senior management or the board.

NA – “Not Applicable” means the assessor has concluded that the individual standard listed did not apply to the internal audit function during the review period. Even though no audit activity occurred where the individual standard was applicable, the internal audit activity is still responsible for the individual standard or elements of the Code of Ethics in all material respects.