



External Quality Assurance Review of the TRS Internal Audit Department



Stephen R. Hillerman

July 14, 2022



Team Leader

- Stephen R. Hillerman, CIA, CRMA, CIGA
 - Chief Audit Executive
 - New York State Office of the State Comptroller

Team Member

- Carim Cervantes, CIA, CFE, CIGA
 - Internal Audit Supervisor
 - New York State Office of the State Comptroller

- The Institute of Internal Auditors (IIA) International Professional Practices Framework – The “Red” Book
- United States Government Accountability Office (GAO) Government Auditing Standards – The “Yellow” Book
- Texas Internal Auditing Act (Texas Government Code, Chapter 2102)

Requirement - Obtain an External Quality Assurance Review every 3 years

- The Institute of Internal Auditors (IIA) International Professional Practices Framework Standard 1312 – External Assessments
 - A qualified assessor or assessment team demonstrates competence in two areas: the professional practice of internal auditing and the external assessment process. Competence can be demonstrated through a mixture of experience and theoretical learning. Experience gained in organizations of similar size, complexity, sector or industry, and technical issues is more valuable than less relevant experience.

- The New York State Comptroller is the State's chief fiscal officer who ensures that State and local governments use taxpayer money effectively and efficiently to promote the common good. The Comptroller's responsibilities include:
 - Serving as sole trustee of the \$258.1 billion New York State Common Retirement Fund
 - Administering the New York State and Local Retirement System for public employees, with more than one million members, retirees and beneficiaries and more than 3,000 employers
 - Maintaining the State's accounting system and administering the State's \$16.7 billion payroll
 - Reporting on State finances and Managing and issuing State debt
 - Reviewing State contracts and auditing payments
 - Conducting audits of State agencies and public benefit corporations
 - Overseeing the fiscal affairs of local governments, including New York City
 - Overseeing the Justice Court Fund and the Oil Spill Fund
 - Serving as custodian of more than \$17 billion in Unclaimed Funds

- Reviewed, verified, and evaluated the self-assessment prepared by the Internal Audit Department
 - Reviewed and evaluated surveys completed by TRS management
 - Interviewed the Chief Audit Executive, Internal Audit Staff, Executive Director, Senior Managers, Board Chair, and Chair of the Audit, Compliance and Ethics Committee
 - Reviewed Internal Audit's policies and procedures, annual risk assessment, annual audit plan, and other relevant documents
 - Reviewed and evaluated audit working papers
-
- Scope of engagement: June 1, 2019 – May 31, 2022

- IIA Code of Ethics
- Standard 1000 – Purpose, Authority and Responsibility
- Standard 1100 – Independence and Objectivity
- Standard 1200 – Proficiency and Due Professional Care
- Standard 1300 – Quality Assurance and Improvement Program
- Standard 2000 – Managing the Internal Audit Activity
- Standard 2100 – Nature of Work
- Standard 2200 – Engagement Planning
- Standard 2300 – Performing the Engagement
- Standard 2400 – Communicating Results
- Standard 2500 – Monitoring Progress
- Standard 2600 – Communicating the Acceptance of Risks



Results

Results of Quality Assurance Review

- Rating – Pass/Generally Conforms
- Highest of three possible ratings
- Policies, procedures and practices are in place to implement the standards and requirements necessary for ensuring the independence, objectivity, and proficiency of the internal audit function



Internal Audit Department of the
Teacher Retirement System of Texas
receives a rating of

"Pass/Generally Conforms"

In compliance with the Institute of Internal Auditors' International Professional Practices Framework, Government Auditing Standards, and the Texas Internal Auditing Act.

This opinion is based on a quality assessment review conducted during June 2022 in accordance with the methodology developed by the Texas State Agency Internal Audit Forum.

Stephen R Hillerman, CIA, CRMA, CIGA
Chief Audit Executive
NYS Office of the State Comptroller

Carim Cervantes, CIA, CFE, CIGA
Internal Audit Supervisor
NYS Office of the State Comptroller

- Internal Audit has good relationships with management
- Internal Audit has a strong dedicated team of data analysts
- Internal Audit staff members are highly qualified and credentialed
- Internal Audit staff are well trained and leaders in the industry
- Internal Audit staff has a diverse blend of backgrounds
- Excellent system for reporting engagement results
- Excellent system for monitoring the disposition of audit issues
- Excellent Quality Assurance and Improvement Program, which includes a Quality Control Review at key phases of each audit

- The department has faced significant challenges hiring and retaining qualified IT auditors sufficient to provide appropriate audit coverage of the TRS' IT systems.
- As a result, we also noted a limited number of IT audits during the review period. The 2019 QAR report also noted a need for more IT audit coverage and recommended increasing the number of IT audits in future annual audit plans.

- We recommend that the CAE work with executive management to identify and pursue various options to ensure appropriate and sufficient IT audit resources are available to accomplish the approved audit plan.

- Internal Audit management agrees with the need to increase audit coverage in the IT area, and the need to obtain and maintain sufficient IT audit resources. Internal Audit management has requested an additional IT Auditor position as part of the Fiscal Year 2023 Budget Request.
- We, like most Internal Audit Departments, have experienced acute turnover, especially within the IT Audit team. This was due to the Great Resignation and a very competitive labor market. The CAE will work with executive management to pursue various options in filling the current vacancies.



Questions

Report on the External Quality Assurance Review of the
Teacher Retirement System of Texas
Internal Audit Department
June 2022



Performed by

Stephen R Hillerman, CIA, CRMA, CIGA
Chief Audit Executive
New York State Office of the State Comptroller

Carim Cervantes, CIA, CFE, CIGA
Internal Audit Supervisor
New York State Office of
the State Comptroller

Performed in Accordance with the Texas State Agency Internal Audit
Forum Peer Review Policies and Procedures

Table of Contents

Overall Opinion	1
Acknowledgements.....	1
Background	2
Objectives, Scope, and Methodology	2
Detailed Results.....	3
IIA Code of Ethics	3
Standard 1000: Purpose, Authority, and Responsibility.....	3
Standard 1100: Independence and Objectivity.....	3
Standard 1200: Proficiency and Due Professional Care.....	3
Standard 1300: Quality Assurance and Improvement Program	3
Standard 2000: Managing the Internal Audit Activity	4
Standard 2100: Nature of Work	5
Standard 2200: Engagement Planning.....	5
Standard 2300: Performing the Engagement	5
Standard 2400: Communicating Results	5
Standard 2500: Monitoring Progress	6
Standard 2600: Communicating the Acceptance of Risks.....	6
Best Practices	6
In compliance with the Institute of Internal Auditors' International Professional Practices Framework, Government Auditing Standards, and the Texas Internal Auditing Act.....	8

Overall Opinion

Based on the information received and evaluated during this external quality assurance review, it is our opinion that the Teacher Retirement System of Texas (TRS) Internal Audit Department receives a rating of **"Pass/Generally Conforms"** and is in compliance with the Institute of Internal Auditors (IIA) *International Professional Practices Framework* and Code of Ethics, the United States Government Accountability Office (GAO) *Government Auditing Standards*, and the Texas Internal Auditing Act (Texas Government Code, Chapter 2102). This opinion, which is the highest of the three possible ratings, means that policies, procedures, and practices are in place to implement the standards and requirements necessary for ensuring the independence, objectivity, and proficiency of the internal audit function.

We found that the Internal Audit Department is independent, objective, and able to render impartial and unbiased judgments on the audit work performed. The staff members are qualified, proficient, and knowledgeable in the areas they audit. Individual audit projects are planned using risk assessment techniques; audit conclusions are supported in the working papers; and findings and recommendations are communicated clearly and concisely.

The Internal Audit Department is well managed internally. In addition, the Department has effective relationships with the Board and is well respected and supported by management. Surveys and interviews conducted during the quality assurance review indicate that management considers Internal Audit a useful part of the overall agency operations and finds that the audit process and report recommendations add value and help improve the agency's operations.

The Internal Audit Department has reviewed the results of the peer review team's work and has accepted them to be an accurate representation of the Department's operations.

Acknowledgements

We appreciate the courtesy and cooperation extended to us by the Chief Audit Executive, Internal Audit staff, the Board Chair, the Chair of the Audit, Compliance and Ethics Committee, the Executive Director, and the executive managers who participated in the interview process. We would also like to thank each person who completed surveys for the quality assurance review. The feedback from the surveys and the interviews provided valuable information regarding the operations of the Internal Audit Department and its relationship with management.



Stephen R Hillerman, CIA, CRMA, CIGA
Chief Audit Executive
New York State Office of the State
Comptroller
Peer Review Team Leader



Carim Cervantes, CIA, CFE, CIGA
Internal Audit Supervisor
New York State Office of the State
Comptroller
Peer Review Team Member

Background

The Institute of Internal Auditors (IIA) *International Professional Practices Framework*, U.S. Government Accountability Office (GAO) *Government Auditing Standards*, and the Texas Internal Auditing Act require that internal audit functions obtain external quality assurance reviews to assess compliance with standards and the Act and to appraise the quality of their operations. Government auditing standards require these reviews at least every three years. A periodic external quality assurance review, or peer review, of the internal audit function is an essential part of a comprehensive quality assurance program. This quality assurance review was performed in accordance with Texas State Agency Internal Audit Forum (SAIAF) Peer Review guidelines. No member of the review team had a conflict of interest with the TRS or its Internal Audit Department.

The most recent quality assurance review for the TRS Internal Audit Department was performed in June 2019.

Although an internal audit department might receive a "pass/generally conforms" rating, it is expected that the review team will offer recommendations based on best practices or supplemental (non-mandatory) guidance. Such recommendations, in the form of opportunities for improvement, do not necessarily indicate a deficiency in operation of the Internal Audit Department, but are suggestions to enhance a properly functioning activity.

Objectives, Scope, and Methodology

The primary objective of the quality assurance review was to evaluate the TRS Internal Audit Department's compliance with auditing standards and the Texas Internal Auditing Act.

Additional objectives included identifying best practices as well as areas where improvement may be needed. The review covered all completed audit and management assistance projects performed by the TRS Internal Audit Department from June 1, 2019 through May 31, 2022.

The work performed during the review included:

- Review, verification, and evaluation of the self-assessment prepared by the Internal Audit Department according to SAIAF guidelines.
- Review and evaluation of 48 survey responses completed by management.
- Interviews with the Chief Audit Executive, Internal Audit Department staff, the Executive Director, seven senior managers, the Board Chair and Chair of the Audit, Compliance and Ethics Committee.
- Review and evaluation of audit working papers.
- Review of Internal Audit's policies and procedures, annual risk assessment, annual audit plan, and other relevant documents.

Detailed Results

The results of the quality assurance review for the TRS Internal Audit Department are presented in the order of the IIA *International Professional Practices Framework*. No significant weaknesses were identified during the review that would prevent the Department from fulfilling its responsibilities. The detailed results include identification of best practices as well as some opportunities for improvement that the Internal Audit Department may wish to consider.

IIA Code of Ethics

Internal Audit demonstrates its commitment to the IIA *Code of Ethics* by including it in the *Internal Audit Charter*, attending periodic ethics training classes, and practicing ethical behavior in the course of daily work. In addition, the agency's *Ethics Policy* and Ethics and Fraud Hotline are indications of an organization-wide commitment to accountability and integrity.

Standard 1000: Purpose, Authority, and Responsibility

The purpose, authority, and responsibility of Internal Audit have been defined in a charter that is consistent with auditing standards. The current charter was revised and adopted on September 17, 2020. It defines the nature of audit and consulting services and grants the Internal Audit Department unrestricted access to agency records, property, and personnel.

Standard 1100: Independence and Objectivity

The Internal Audit Department is independent both in terms of the agency's organizational structure and the Department's practices. The Chief Audit Executive reports functionally to the Board, which provides sufficient authority to promote independence and to ensure adequate consideration of audit reports and appropriate action on audit issues and recommendations. Per the TRS Bylaws, the Audit, Compliance and Ethics Committee recommends to the Board, in consultation with the executive director, the appointment, replacement, dismissal, and compensation of the Chief Audit Executive.

The Charter helps ensure continued independence by specifying that internal auditors must remain free of operational and management responsibilities that could impair their ability to make independent reviews of all areas of the agency's operations. None of the internal auditors has had prior responsibility within the last year for any areas that the Department audits. In addition, auditors are required to sign independence statements for each audit they perform.

Standard 1200: Proficiency and Due Professional Care

The TRS internal auditors individually and collectively possess the knowledge, skills, and abilities to perform their responsibilities. A majority of the auditors have at least one relevant professional certification, and several have advanced degrees. TRS internal auditors are required by the Department's policies and procedures to enhance their knowledge, skills, and abilities by obtaining continuing professional education each year. Accordingly, staff attends local and national conferences each year. As also required by the *Standards*, the Department hires contractors to assist in areas for which its expertise or resources have not been sufficient to satisfy the audit objectives.

Standard 1300: Quality Assurance and Improvement Program

The CAE has implemented a quality assurance and improvement program to help ensure that Internal Audit adds value and improves the agency's operations, and to provide assurance that the Department complies with *Standards* and the IIA Code of Ethics. As required, the program includes both internal assessments and external assessments. Internal assessments include, among other elements, auditor performance evaluations, work paper reviews and annual self-

assessments. External assessments are conducted once every three years by qualified, independent assessors, and are communicated to the Board and made available on the agency's Internet site.

Standard 2000: Managing the Internal Audit Activity

The CAE conducts an annual risk assessment that forms the basis for the Annual Audit Plan, which is approved by the Board. Each internal audit report addresses risk and control issues within the agency. The CAE has developed policies and procedures to guide the internal audit activity. The CAE reports the Department's performance relative to the annual plan via quarterly reports to the Board of Trustees' Audit, Compliance and Ethics Committee and an annual report to the agency's Executive Director and Audit, Compliance and Ethics Committee, and Oversight agencies (Governor's Office, Legislative Budget Board, and the State Auditor's Office). The annual report is also placed on the TRS Internet site.

Opportunity for Improvement:

- Standard 2030, Resource Management, states that the chief audit executive must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan. The Implementation Guide for this Standard states "appropriate refers to the mix of knowledge, skills, and other competencies needed to perform the plan. Sufficient refers to the quantity of resources needed to accomplish the plan. Resources are effectively deployed when they are used in a way that optimizes the achievement of the approved plan." Also, the Texas Internal Auditing Act specifies that agencies shall conduct a program of internal auditing that includes periodic audits of the agency's major systems and controls, including Information Technology (IT) systems and controls.

Our review team noted that the department has faced significant challenges hiring and retaining qualified IT auditors sufficient to provide appropriate audit coverage of the TRS' IT systems. Currently, the Internal Audit department has an IT Audit Manager with prior experience who began employment with TRS in November 2021, and two vacant IT auditor positions. As a result, we also noted a limited number of IT audits during the review period. The 2019 QAR report also noted a need for more IT audit coverage and recommended increasing the number of IT audits in future annual audit plans.

When allocating specific resources to the engagements identified in the approved internal audit plan, the CAE may consider how the available resources correspond with the specific skills and timing required to perform the engagements. During this process, the CAE typically works to fill any gaps that may have been identified. If the quantity of resources is insufficient to cover the planned engagements efficiently and effectively, the CAE may hire additional staff, co-source or outsource engagements, use one or more guest auditors, or develop a rotational auditing program.

We recommend that the CAE work with executive management to identify and pursue various options to ensure appropriate and sufficient IT audit resources are available to accomplish the approved audit plan.

IA Management Response

Internal Audit management agrees with the need to increase audit coverage in the IT area, and

the need to obtain and maintain sufficient IT audit resources. Internal Audit management has requested an additional IT Auditor position as part of the Fiscal Year 2023 Budget Request.

We, like most Internal Audit Departments, have experienced acute turnover, especially within the IT Audit team. This was due to the Great Resignation and a very competitive labor market. The CAE will work with executive management to pursue various options in filling the current vacancies.

Standard 2100: Nature of Work

Internal Audit evaluates risks related to financial and operating information as well as the effectiveness and efficiency of operations, safeguarding of assets, and compliance with laws and regulations. The Department also evaluates the extent to which operating, and program objectives have been achieved.

To comply with the IIA *Standards* requirement that Internal Audit contribute to the organization's risk management and governance processes, the Department provides information and assistance to Executive Management and the Board through various advisory engagements and on-going data analysis and testing.

Standard 2200: Engagement Planning

During planning, internal auditors consider the objectives of the activity being reviewed and the related risks and controls. Resources needed for each audit are adequately considered during planning. Risk assessments are used to develop the objectives of each audit. Surveys and interviews conducted during this quality assurance review indicated that the objectives of audits are clearly communicated to the audit clients. An Audit Plan and an Audit Program are documented and approved for each audit. The scope of audits is adequately planned and documented in planning documents and audit reports.

Standard 2300: Performing the Engagement

The TRS internal auditors identify and document sufficient, reliable, relevant, and useful information to achieve their audit objectives. Their results and conclusions are based on appropriate analysis and evaluation.

Audits are properly supervised by the CAE. The Auditor-in-Charge for each project monitors the progress of the individual audits. The CAE attends planning meetings, approves all control documents, and reviews working papers to ensure sufficiency of evidence and compliance with *Standards*.

Standard 2400: Communicating Results

Audit results are communicated in a timely manner. Potential findings are communicated throughout the audits, which provide management the opportunity to provide additional information and/or to start taking corrective action. Audit results are presented to management before they are finalized in a report, which helps ensure there is agreement about the areas for improvement and the recommended solutions.

Audit reports contain the audit objectives, results, conclusions, recommendations, and management's responses and action plans. The results of our surveys and interviews with management indicated that internal audit reports are accurate, objective, clear, concise, and complete. The CAE distributes internal audit reports to the Board, to Executive Management, and to management of the activity being audited. In addition, internal audit reports are placed on the agency's Internet site and hard copies are available.

Standard 2500: Monitoring Progress

The agency has a system for monitoring the disposition of audit issues and the results are made accessible to all levels of management. Further, the status of all prior audit recommendations are reported to the Audit, Compliance and Ethics Committee at its quarterly meetings.

Standard 2600: Communicating the Acceptance of Risks

During the quality assurance review, no instances were identified of management accepting an inappropriate level of risk that would require the Internal Audit Director to notify the Board.

Best Practices

Internal Audit is a progressive department that is dedicated to continuous improvement. During the quality assurance review, we observed a number of practices that demonstrate outstanding commitment and professionalism. These leading practices include the following:

- IA has relationships with executive and division management based on mutual respect and commitment to improving controls within the agency. The CAE and staff work in concert with executive management on diverse audit assurance and consulting projects.
- The Department has established a dedicated team of data analysts to significantly increase the level and sophistication of its data analytics efforts. Data analytics is a powerful audit tool that can greatly enhance the efficiency and effectiveness of the internal audit function. This process has been clearly recognized by Executive management as an area where Internal Audit adds significant value.
- The internal auditors are professional and proficient. Numerous certifications are held by staff including, Certified Internal Auditor, Certified Public Accountant, Certified Information Systems Auditor, and Certified Fraud Examiner. In addition, one staff member holds the Chartered Financial Analyst designation, three have Certifications in Risk Management Assurance, and seven have advanced degrees. Overall, there is a level of expertise beyond what is normally found in an internal audit Department.
- All IA staff members obtain the requisite level of continuing professional education as provided by local professional auditing organizations including the State Auditor's Office (SAO), the Texas Society of Certified Public Accountants (TSCPA), the Institute of Internal Auditors (IIA), the Information Systems Audit and Control Association (ISACA), the Association of Certified Fraud Examiners (ACFE), and the Association of Public Pension Fund Auditors (APPFA). They are also active and well respected in these professional groups and have served and continue to serve in leadership positions in these groups. Agency managers stated in interviews that the internal auditors are competent professionals and are committed to public service.
- Members of the IA staff possess a diverse blend of backgrounds. The audit staff

includes individuals with experience at other agencies, in public accounting, and some with operating experience in other business units at TRS. This provides varying perspectives and leads to better decision making on matters involving auditor judgement.

- There is an excellent system for reporting engagement results. In addition to a written report, the Department presents a color-coded summary that includes key points pertaining to business objectives, business risks, management controls, controls tested, results (positive and negative), recommended actions, and management's response.

This summary captures the essence of the engagement on one page, which enables the reader to quickly assimilate the information.

- The Department has an excellent system for monitoring the disposition of audit issues. The status of management's progress in implementing recommendations is reported quarterly, and the results are made accessible to all levels of management. Additionally, the Department verifies recommendations that have been implemented and assesses their effectiveness during the survey phase of audits and as time permits during the year.
- Internal Audit performs a Quality Control Review performed at the end of Planning, Fieldwork and Communication phases, which should be acknowledged as a best practice. These Reviews look for elements of conformance to standards further increasing the likelihood of compliance with standards.

Overall IA Management Response

IA management is grateful to the peer review team for agreeing to perform this External Quality Assurance Review. We appreciate the comprehensive nature of the review and agree with the recommendations. As discussed above, the CAE will work with executive management to increase and maintain IT Audit resources to help increase IT audit coverage.

REPORT DISTRIBUTION LIST

Jarvis V. Hollingsworth, Chairman of the Board

Christopher Moss, Chairman of the Audit, Compliance and Ethics Committee

Brian Guthrie, Executive Director

Amanda Jenami, Chief Audit Executive

Confidential



Internal Audit Department of the
Teacher Retirement System of Texas
receives a rating of

"Pass/Generally Conforms"

In compliance with the Institute of Internal Auditors' International Professional Practices Framework, Government Auditing Standards, and the Texas Internal Auditing Act.

This opinion is based on a quality assessment review conducted during June 2022 in accordance with the methodology developed by the Texas State Agency Internal Audit Forum.

A handwritten signature in black ink, appearing to read "Stephen R. Hillerman".

Stephen R Hillerman, CIA, CRMA, CIGA
Chief Audit Executive
NYS Office of the State Comptroller

A handwritten signature in black ink, appearing to read "Carim Cervantes".

Carim Cervantes, CIA, CFE, CIGA
Internal Audit Supervisor
NYS Office of the State Comptroller

Confidential