

MARCH 2020 AUDIT SERVICES CHARTER

I. PURPOSE

The purpose of this Audit Services Charter is to assist CalSTRS Audit Services personnel in fulfilling their mission and fiduciary responsibilities under the oversight of the Audits and Risk Management Committee. This document includes the following topics:

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II. MISSION

The mission of Audit Services is to provide independent, objective assurance and consulting services designed to add value and improve CalSTRS operations. Audit Services assists CalSTRS in accomplishing its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes. To do so, Audit Services:

- Provides a wide range of quality, independent internal auditing assurance and consulting services for the Audits and Risk Management Committee (ARM Committee) and CalSTRS management.
- Performs independent assessments of the systems of risk management, internal controls, and operating efficiency, guided by professional standards and using innovative approaches.
- Supports CalSTRS efforts to achieve its objectives through independent auditing assurance services and consulting services; and
- Maintains a dynamic, team-oriented environment which encourages personal and professional growth, and challenges and rewards audit staff for reaching their full potential and excelling.

III. OBJECTIVES AND SCOPE

Auditing Objectives:

- To provide independent assurance to the ARM Committee and management that CalSTRS assets are safeguarded, operating efficiency is enhanced, and compliance is maintained with prescribed laws and Board and management policies.
- To provide independent assessment of CalSTRS risk awareness and management, reliability and integrity of CalSTRS data and employee data reported by employers and used by management to compute benefit payments, and achievement of CalSTRS goals and objectives.

Consulting and Advisory Objectives:

- To provide management with assessments and advice for improving processes that will advance the goals and objectives of CalSTRS.
- In particular, to provide the assessment on the front-end of major projects so that risks may be identified, and managed and internal controls may be designed at the beginning of a project.

Scope:

The scope of work of Audit Services is to determine whether CalSTRS network of risk management, internal controls, and governance processes, as designed and represented by management, is adequate and functioning in a manner to ensure:

- Programs are operating within the highest fiduciary standards and are directed under the requirements defined in Teachers' Retirement Law and other applicable laws, and CalSTRS policies and procedures.
- Existing policies and procedures are appropriate, documented, and approved by management.
- Risks within and outside of CalSTRS are appropriately identified and managed.
- Employers (school districts, county offices of education, charter schools, community colleges and other government entities) appropriately enroll employees, accurately report member earnings, and appropriately report other member data to CalSTRS.
- Benefit payments to CalSTRS members and communication regarding benefit payments to members are accurate, reliable, and timely.
- Investment and Pension Administration operations and processes are consistent with established missions, goals, and objectives and are being carried out as planned.
- Financial, managerial, and operating information, including those reported by

employers, third party administrators, and internal management are accurate, reliable, and timely.

- Quality service and continuous improvement are fostered in CalSTRS control processes.
- Resources are acquired economically, used efficiently, and adequately managed and protected.
- Contractors are meeting contract obligations, while in conformance with applicable laws, regulations, policies, procedures, and best practices.
- Coordination with any external auditors, which includes providing access to records and reports, is carried out properly.
- Quality of performance of the external financial statement auditor and any other auditors engaged by CalSTRS is reviewed.
- Specific operations, processes, or programs are reviewed at the request of the ARM Committee.
- Significant legislative or regulatory issues impacting the organization are recognized and addressed appropriately.

Opportunities for improving member service, management of risks, internal control, governance, performance, efficiency, and CalSTRS effectiveness and image may be identified during audits. This information will be communicated to the ARM Committee, the Board, and to appropriate levels of management.

IV. AUTHORITY

Government Code, Section 13886.5. (a) requires "...all state agencies that have their own internal auditors or that conduct internal audits or internal audit activities, shall conduct internal audit activity under the general and specified standards of internal auditing prescribed by the Institute of Internal Auditors..."

The State Leadership and Accountability Act 2015, Government Code Sections 13400-13407, requires each state agency to maintain effective systems of internal control, to evaluate the effectiveness of those controls on an ongoing basis, and to biennially review and prepare a report on the adequacy of the internal control monitoring system to ensure a satisfactory system of internal control is maintained. Management and the designated monitor should work together to determine the scope and frequency of the evaluations necessary for their agency. Separate evaluation may also be performed by internal and external auditors, inspectors, and other external parties.

The Chief Auditor reports functionally to the ARM Committee and reports administratively to the Chief Operating Officer. The ARM Committee oversees the appointment and work of the Chief Auditor and oversees the work of Audit Services. The Chief Executive Officer grants authority to the Chief Auditor to direct a broad, comprehensive program of auditing within

CalSTRS. The ARM Committee retains the right to approve the annual audit plan presented by the Chief Auditor. Due to the administrative reporting relationship of the Chief Auditor to the Chief Operating Officer, the Chief Operating Officer can meet separately with the ARM Committee, subject to the open meeting laws, to discuss certain performance matters that specifically pertain to the Chief Auditor or the work of Audit Services.

Education Code Section 22206 authorizes the Board to perform audits of any public agency. By adoption of this charter, Audit Services is designated to conduct audits of the school districts and county offices of education and any employer that has employees who may perform creditable service subject to coverage by the State Teachers' Retirement Plan.

Section 22208 of the Education Code grants the Board the authority to delegate its responsibilities to a committee of two or more of its members to perform any act within the power of the Board itself to perform. The Board may also delegate the authority to the Chief Executive Officer to perform any such act.

The Chief Auditor is delegated the authority to operate Audit Services. The Chief Auditor shall periodically inform the ARM Committee on the status of the audit plan and any changes needed. The Chief Auditor is authorized to allocate resources, set project frequencies, select audit subjects, determine scopes of work, and apply the techniques necessary to accomplish the audit objectives. The Chief Auditor is authorized to manage audit personnel, including hiring, training, developing, promoting, retaining, and terminating audit personnel when necessary and subject to applicable laws.

The Chief Auditor and audit personnel are not authorized to perform the following operational duties for CalSTRS and/or its affiliates and contractors:

- Initiate or approve accounting transactions external to Audit Services Division.
- Direct the work of any CalSTRS employees not employed by Audit Services, except to the extent such employees have been appropriately assigned to audit teams or to otherwise assist the audit personnel.
- Management of enterprise-wide risks, implementing risk responses on management's behalf, setting the risk appetite, or imposing risk management processes.
- Internal Auditors will have no direct operational responsibility or authority over any of the activities audited. Accordingly, they will not implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that may impair auditor's judgment.

This Charter is approved by, and all future amendments to it are to be approved by, the ARM Committee through a majority vote. The Chief Auditor will periodically review the Charter and present amendments to the ARM Committee for approval.

V. ACCESS

In carrying out their duties and responsibilities, the Chief Auditor, and designated members of

audit personnel, as appropriate, will have full, free and unrestricted access to all CalSTRS functions, records, files and information systems, personnel, contractors, physical properties, and any other items relevant to the function, processes of the divisions or branches under review. All contracts with vendors shall contain the standard CalSTRS language enabling Audit Services auditors and specialists to have access to relevant records and information. All CalSTRS employees are required to assist the audit personnel in fulfilling their audit functions and fiduciary duties.

The Chief Auditor shall have free and unrestricted access to the Chairperson and members of the ARM Committee and members of the Board, subject to open meeting laws. As needed, or when the Chief Auditor believes that certain matters should be discussed privately, the Chief Auditor can meet separately with the ARM Committee, subject to open meeting laws.

The Chief Auditor shall also have free and unrestricted access to the Chief Executive Officer; CalSTRS executives, managers, staff, contractors, and vendors; and employers, members, retirees, and beneficiaries of CalSTRS.

Documents and information given to Audit Services shall be handled in the same prudent and confidential manner as by those employees normally accountable for them. The Chief Auditor shall ensure that audit personnel are instructed in the handling and safeguarding of confidential information.

VI. CODE OF ETHICS

The Chief Auditor shall ensure that the International Standards for the Professional Practice of Internal Auditing (IIA Standards) and associated Code of Ethics are adhered to by audit personnel. Accordingly, the following Principles will be upheld, and the following conduct will be expected of all audit personnel:

Integrity

Auditors shall perform their work with honesty, diligence, and responsibility, observing applicable laws, and making expected disclosures. Additionally, auditors shall not knowingly be a party to any illegal activity or engage in acts that are discreditable to the profession of auditing or to CalSTRS. Auditors shall respect and contribute to the legitimate and ethical objectives of CalSTRS.

Objectivity

Auditors shall demonstrate the highest level of professional objectivity in gathering, evaluating, and communicating information specific to the activity or process being audited; exhibit balanced assessments of all relevant circumstances; and will not unduly be influenced by personal interests or by others in forming judgments. Auditors shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. Disclose any impairment of independence or objectivity, in fact or appearance, to appropriate parties. Auditors shall not accept anything that may impair or be presumed to impair their professional judgment. Auditors will disclose all material facts known to them that, if not disclosed, may distort the reporting of

activities under review.

Confidentiality

Auditors shall be prudent in the use and protection of information acquired in the course of their duties. Auditors shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of CalSTRS.

Competency

Auditors shall perform audit services in accordance with IIA Standards, or other professional audit standards as necessary, and shall engage only in those services for which they have the necessary knowledge, skills, and experience. Auditors will continually improve their proficiency and the effectiveness and quality of their services.

VII. INDEPENDENCE

Organizational Placement:

To provide for the independence of Audit Services, audit personnel report to the Chief Auditor. The Chief Auditor reports functionally to the ARM Committee and administratively to the Chief Operating Officer. The Chief Auditor may occasionally report to the Teachers' Retirement Board or the Chief Executive Officer, as circumstances require the Chief Auditor to fulfill the duties of reporting and disclosure. The Chief Auditor shall freely discuss audit polices, audit findings and recommendations, audit follow-up, guidance issues and other matters as necessary with appropriate CalSTRS staff, management, ARM Committee members, Board and others who have the need to know.

Professional Standards of Independence:

Professional standards require that the auditors have knowledge of operations and appropriate expertise in the subject matter that is being audited. Therefore, the Chief Auditor will regularly report to the ARM Committee information on audit personnel, including their qualifications, certifications, and professional development. The Chief Auditor shall periodically discuss audit independence with the ARM Committee. The standards of independence used as benchmarks will be those of the professional organizations mentioned in Section XIII. The reporting relationships of the Chief Auditor should be reviewed periodically by the ARM Committee.

Potential Impairment of Independence:

Where the Chief Auditor has or is expected to have roles and/or responsibilities that fall outside of internal auditing, safeguards will be established to limit impairments to independence or objectivity.

The Chief Auditor should discuss any potential issues regarding impairment of independence and/or conflicts of interest and their mitigations with the ARM Committee as necessary.

VIII. QUALITY ASSURANCE AND IMPROVEMENT PROGRAM

The Quality Assurance and Improvement Program (Program) is designed to provide an evaluation of Audit Services' audit activities conformance with the Definition of Internal Auditing and IIA Standards, and an evaluation of whether auditors apply the Code of Ethics. The Program also assesses the efficiency and effectiveness of audit activities and identifies opportunities for improvement.

The Chief Auditor will ensure an internal quality assurance review is incorporated in the annual audit plan, completed, and reported consistent with the ARM Committee work plan. The Chief Auditor will also ensure an external quality assurance review is conducted at least once every five years by a qualified, independent reviewer or review team from outside CalSTRS, or more frequently as determined in consultation with the ARM Committee or as required by applicable professional standards.

The Chief Auditor will communicate to the ARM Committee and CalSTRS executives the results of the Program. Follow-up on opportunities for improvement (or implementation) identified in the quality assurance reviews shall also be reported to the ARM Committee at least annually, or until resolution of the results.

IX. RESPONSIBILITIES AND ACCOUNTABILITY

The Chief Auditor is responsible for the completion of the following activities to meet the mission, objectives, and scope of this Charter and Audit Services.

1. Select, train, develop, and retain competent audit personnel that collectively has the abilities, knowledge, skills, experience, expertise, and professional certifications necessary to accomplish the mission, objectives, and scope of this Charter. Provide opportunities and support for audit personnel obtaining professional training, professional examinations, and professional certifications.
2. Establish and ensure adherence to policies and procedures for conducting Audit Services activities and directing technical and administrative functions according to CalSTRS policies and direction provided by the ARM Committee and professional standards described in Section XIII.
3. Conduct an annual risk assessment and produce a flexible audit plan that will accomplish the mission, objectives, and scope of this Charter. The audit plan will include some unassigned hours to provide flexibility for changing conditions. The plan shall, in part, be based upon risks and control concerns identified by management. Update the plan as needed.
4. Document within the planning of every audit, consideration of the possibilities that significant errors, fraud, noncompliance, and other exposures exist, occur, or go undetected within the area under audit.
5. Prepare a budget that is complementary to the implementation of the audit plan. The Chief Auditor shall also communicate the impact of resource limitations.

6. Implement the annual audit plan, as approved, including, as appropriate, any plan amendments, special tasks, or projects requested by the ARM Committee and management.
7. Ensure each engagement of the audit plan is executed, including establishment of objectives and scope, the assignment of appropriate and adequately supervised resources, the documentation of work program and testing results, and the communication of engagement results with applicable conclusions and recommendations to appropriate parties.
8. Coordinate with audit clients to finalize recommendations for improvement and identify implementation timelines. Audit staff shall consider costs and benefits while formulating and discussing their recommendations.
9. Establish and maintain a follow-up system to monitor the disposition of results communicated to management and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.
10. When the Chief Auditor concludes that management has accepted a level of risk that may be unacceptable to CalSTRS, the Chief Auditor must discuss the matter with senior management. If the Chief Auditor determines that the matter has not been resolved, the Chief Auditor must communicate the matter to the ARM Committee.
11. Perform a periodic comprehensive evaluation of risk management and internal controls established and monitored by management (see Section X) per the State Leadership Accountability Act 2015, Government Code Sections 13400-13407.
12. Evaluate and assess significant merging/consolidating functions and new or changing services, processes, operations, and control processes coincident with their development, implementation, and/or expansion.
13. Transmit copies of all audit and assurance reports prepared by Audit Services to management. Transmit copies of all audit, attest and assurance reports and management letters by external auditors to the ARM Committee.
14. Issue periodic reports to the ARM Committee and management summarizing results of audit activities.
15. Select performance measures for implementation of the audit plan and activities outlined in this Charter as approved by the ARM Committee.
16. Periodically assess whether the purpose, authority, and responsibility, as defined in this Charter, continue to be adequate to enable Audit Services to accomplish its mission, objectives, and scope. Communicate the result of the assessment to the ARM Committee the Chief Executive Officer, and the Chief Operating Officer.
17. Attend all ARM Committee meetings and ensure attendance of external

- auditors, consultants, internal audit staff and CalSTRS management as appropriate.
18. Maintain a Quality Assurance and Improvement Program, in accordance with the IIA Standards, and obtain an external assurance review no less frequently than every five (5) years, or as determined in consultation with the ARM Committee or as required by professional standards.
 19. Inform the ARM Committee of emerging trends and successful practices in internal auditing.
 20. Assist in the investigation of significant suspected fraudulent activities within CalSTRS. Notify the ARM Committee, the Chief Executive Officer, the Chief Operating Officer, General Counsel, Chief Financial Officer, and other executives, as appropriate, of the results.
 21. Consider the scope of work of the external auditors and regulators, as appropriate, for the purpose of providing optimal audit coverage to CalSTRS at a reasonable overall cost.
 22. Lead in the process for selecting the external financial statement auditor. Assess the independence of the candidate firms by communicating with those firms, with management, by searching the literature, and by obtaining copies of all contracts that the candidate firms have with CalSTRS.
 23. Manage and coordinate the contract with the external financial statement auditors and evaluate their performance. Obtain copies of and evaluate any review of the audit firm by the Public Accounting Oversight Board or by other entities (for example, a peer review).
 24. Report to the ARM Committee on all activities and associated costs of work performed by the external financial statement auditor.
 25. Consult with CalSTRS management, as requested, on potential policy and procedure changes.
 26. Participate, in an advisory capacity, in the planning, design, development, implementation, and modification phases of major information systems to determine one or more of the following:
 - a) best practices are in place for project management.
 - b) adequate controls are incorporated in the systems.
 - c) thorough systems testing is performed at appropriate stages.
 - d) systems documentation is complete and accurate; and
 - e) the new system, or upgraded existing system, will meet the objectives and purposes.
 27. Conduct periodic audits of existing applications systems and make post-implementation evaluations of new data processing systems to determine whether these systems meet their intended purposes and objectives, and

- management is tracking costs and following up appropriately.
28. Participate in professional audit organizations by attending meetings, joining the governing boards, presenting speeches and papers, and networking with other professionals. Network with audit personnel of other public pension systems and professional audit organizations to learn and exchange best practices information. Participate in other professional organizations related to the mission of CalSTRS.
 29. Act as the primary point of contact for handling all matters related to audits, examinations, investigations, or inquiries of the California State Auditor, the Joint Legislative Audit Committee, and other appropriate State or Federal Auditors.
 30. Review and audit CalSTRS fraud and ethics related policies and procedures periodically.
 31. Participate in CalSTRS cross-functional committees/teams as appropriate.
 32. Conduct special reviews at the request of management, the ARM Committee, or the Board.

X. RELATIONSHIP TO CALSTRS RISK MANAGEMENT AND INTERNAL CONTROL PROGRAMS

Management is responsible for implementing the system of risk management. Audit Services will aid management by evaluating risk management during each audit and through consulting activities. Audit Services will annually conduct an enterprise risk assessment with the goal of formulating an audit plan. Information gathered during the enterprise risk assessment may be shared with management.

Management is responsible for implementing the system of internal control. Audit Services will aid management by evaluating internal controls during each audit and by periodically evaluating the overall system of internal controls.

XI. PROCUREMENT OF EXPERTISE OUTSIDE OF AUDIT SERVICES

Audit Services may occasionally need to obtain expert services in fulfilling its audit plan. When obtaining this expertise, care must be taken to avoid conflicts of interest within the organization that could damage the quality of the audit work performed and/or conclusions obtained. Expertise may also be obtained from outside CalSTRS through contracts. In such cases, the contracts should contain appropriate provisions regarding the nature of the services provided and professional standards to be applied. The ARM Committee should be informed about the use of external consultants.

XII. PARTICIPATION IN MAJOR PROJECTS AND INTERNAL CONTROL

Audit Services strives to participate in the initial stages of major projects so that risks can be appropriately identified and managed, and internal controls instituted in the design phase to limit control weaknesses and minimize the costs to remedy the control weaknesses at a later

stage. It is recognized that to detect and correct problems is more expensive than to prevent them in the initial stages of a project.

XIII. PROFESSIONAL STANDARDS

Audit Services shall follow the International Standards for the Professional Practice of Internal Auditing (IIA Standards) including the Definition of Internal Auditing and the Code of Ethics. There may be circumstances when Audit Services perform certain audits that require compliance with other professional standards. These standards and their relevant professional organizations include, but are not limited to the following:

- Information System Auditing Standards, Guidelines and Procedures, and the Code of Professional Ethics of the Information Systems Audit and Control Association (ISACA). The Control Objectives for Information Technology (CoBIT) and National Institute of Standards Technology (NIST) will be used as a reference.
- Public Company Accounting Oversight Board (PCAOB) auditing standards, as applicable.
- American Institute of Certified Public Accountants (AICPA) Professional Standards and Code of Ethics, as applicable.
- Generally Accepted Government Auditing Standards (GAGAS) from the United States General Accounting Office (GAO), as applicable.
- Other professional standards, such as those of the Institute of Management Accountants (IMA) and the Association of Certified Fraud Examiners (ACFE), as applicable.

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