



STATE TEACHERS  
RETIREMENT SYSTEM  
OF OHIO

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RETIREMENT BOARD CHAIR  
ROBERT B. BROWN

RETIREMENT BOARD VICE CHAIR  
CONSTANCE K. RAMSER

EXECUTIVE DIRECTOR  
DAMON F. ASBURY

March 27, 2006

Mr. Aristotle Hutras  
Ohio Retirement Study Council  
88 East Broad Street, Suite 1175  
Columbus, OH 43215

Dear Mr. Hutras:

Pursuant to Senate SB 133, enclosed is a report of the actions of the Audit Committee of the State Teachers Retirement Board for Fiscal 2005.

Please contact me if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read 'Damon Asbury', written over a horizontal line.

Damon Asbury  
Executive Director



## AUDIT COMMITTEE ANNUAL REPORT

*Audit Committee  
Members:*  
Robert Brown, *Chair*  
Geoffrey Meyers, *Vice  
Chair*  
Dennis Leone

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To: Ohio Retirement Study Council (ORSC)  
Subject: STRS Ohio Audit Committee Report – 2005  
Date: March 22, 2006

As required by Section 3307.044 of the Ohio Revised Code, the following report outlines the activities of the STRS Ohio Audit Committee and the STRS Ohio Internal Audit Department for the year ending Dec. 31, 2005. This report outlines the following: audit reviews completed during 2005; STRS Ohio Audit Committee meetings and actions; special reviews completed during 2005; and the 2006 Internal Audit Plan.

### **Audit Reviews Completed During 2005**

The attached Internal Audit Summary lists the audits performed, the scope for each audit, the recommendations to management, management's response, and expected implementation date. The Internal Audit Summaries were mailed to all State Teachers Retirement Board members in March, May, September and December 2005.

### **STRS Ohio Audit Committee Meetings and Actions**

May 19, 2005 – The Audit Committee met to discuss the Internal Audit Quarterly Report of audit findings and recommendations.

Dec. 8, 2005 – The KPMG auditors were present to provide the results of the 2005 STRS Ohio financial examination for year ending June 30, 2005. The KPMG presentation included a review of the STRS Ohio Financial Statements and Supplemental Schedules, and the Independent Auditors' Report. The Audit Committee also reviewed the initial 2006 Internal Audit Plan and Internal Audit Quarterly Report of audit findings and recommendations.

### **Special Reviews**

The Internal Audit Department did not perform a special review during 2005.



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## 2006 Internal Audit Plan

With Board and Audit Committee assistance, the 2006 Internal Audit plan was redesigned to reflect updated methods of assigning risk and audit priorities. The revised plan resulted in an increased focus on risk related to investments and the reclassification of the more numerous non-financial risk audits. Changes were also made to the expected frequency with which audits will rotate through the audit cycle.

The revised 2006 Internal Audit Plan was approved by the State Teachers Retirement Board on March 10, 2006. A copy of the 2006 Plan is enclosed.

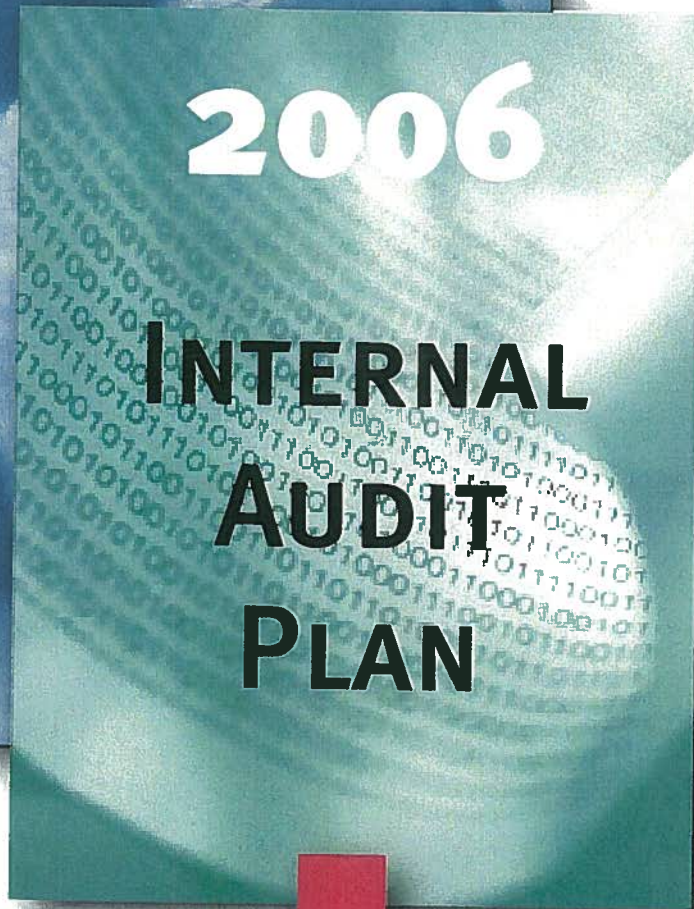
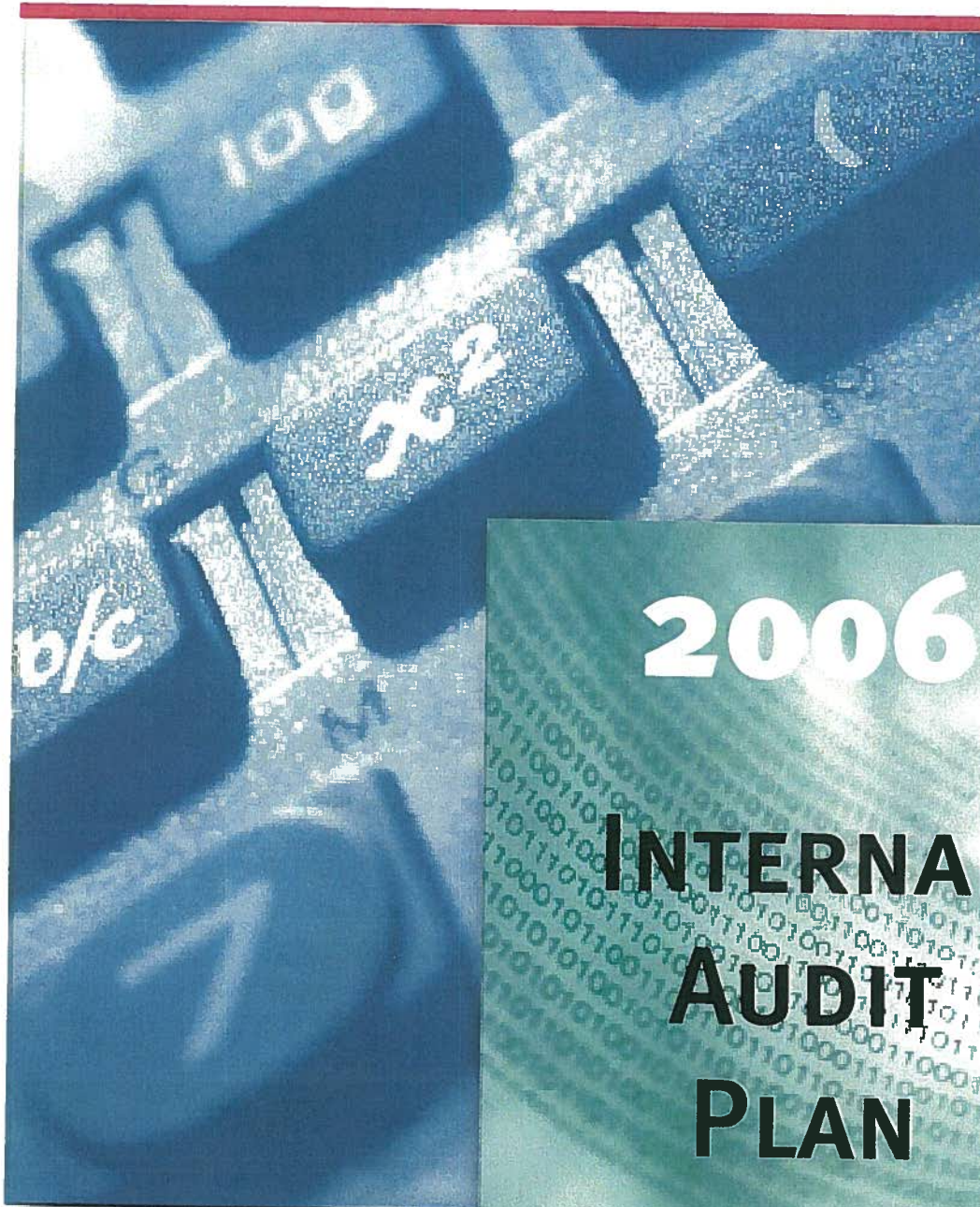
If you have any questions or need further information, please feel free to call me at (614) 227-2821.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'David S. Tackett', with a long horizontal flourish extending to the right.

David S. Tackett, CFA, CPA, CIA  
STRS Internal Audit Manager

Enclosures



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# INTRODUCTION

One of the tasks given the Internal Audit Department is to periodically perform an organizationwide risk assessment. The purpose is to identify the need for and to appropriately allocate its resources to the various risks confronting STRS Ohio. Risk assessment is the process of organizing and combining professional judgments about probable adverse conditions or events in auditable areas of an organization. The results are then prioritized in a matrix to develop the audit plan for the subsequent time frame.

The Institute of Internal Auditors' *Statement on Internal Auditing Standards No. 9* defines risk as the probability that an event or action may adversely affect the organization. The effects of risk can involve:

- An erroneous decision from using incorrect, untimely, incomplete or otherwise unreliable information.
- Erroneous record-keeping, inappropriate accounting, fraudulent financial reporting, or financial loss and exposure.
- Failure to adequately safeguard assets.
- Customer dissatisfaction, negative publicity and damage to the organization's reputation.
- Failure to adhere to organizational policies, plans and procedures or not complying with relevant laws and regulations.
- Acquiring resources uneconomically or using them inefficiently or ineffectively.
- Failure to accomplish established objectives and goals for operations or programs.

In 1993, the Internal Audit Department began using a quantitative method to determine which audits to perform in the upcoming calendar year. This method assigns values for six weighted risk factors to determine the relative significance of each auditable area. The risk factors were based on the Institute of Internal Auditors' *Statement on Internal Auditing Standards No. 9*. The Internal Audit Department assigned a risk value to each factor for each entity. A 9-point risk assessment scale, with graduations of risk from 1 = Not Risky to 9 = Extremely Risky, was used. The weighted total was then computed for each entity by totaling the products of value and weight for each factor.

In 2006, as part of a Retirement Board Audit Committee initiative to streamline the Internal Audit Plan focus, the Internal Audit Department developed an additional risk assessment component to focus on different levels of financial risk. "High," "Medium" or "Low" risk designations were assigned to the audit areas to aid in the identification of areas of risk that have a greater potential to significantly impact STRS Ohio operations.

The change resulted in a more focused application of resources in financial and operational reviews.

# INTERNAL AUDIT DEPARTMENT

## **Mission Statement**

To work in partnership with associates to conduct value-added independent appraisals of policies and procedures to contribute to the continuous improvement of STRS Ohio.

## **Vision Statement**

To be recognized as an innovative department that, through independent appraisals and partnered solutions, strives for quality enhancements and the elimination of non-value-added processes.

To create an environment that encourages teamwork, innovation, open communication, empowerment and personal and professional growth.

## **Guiding Principles**

To achieve our mission and vision, we will:

- Prepare a comprehensive, practical, planned program of audit coverage consistent with STRS Ohio's mission, vision and guiding principles.
- Perform audits in compliance with professional standards.
- Verify the adequacy and effectiveness of STRS Ohio's systems of administrative, operating and financial controls.
- Understand the associates' business from their perspective.
- Produce objective, clear, concise, constructive and timely reports.
- Maintain contemporary professional proficiency through continuing education and training.
- Seek to continuously improve our team, tools and processes.
- Develop professional expertise for potential career opportunities within STRS Ohio.

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# 2006 INTERNAL AUDIT SCHEDULE

Audit Area	Description of Audit Area	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
Financial Reporting (STRS Ohio)	Reliability of Information Integrity of Database												
Insurance	Compliance Administration												
Real Estate	Asset Management Income/Expenses Purchases/Sales												
Health Care	Contract Compliance Disbursements Dental and Vision Long-Term Care												
Fixed Income	Broker Commissions Income/Purchases/Sales												
Annual Reporting	Report Processing												
Business Contingency Plan	Compliance Management Support												
Contribution Reporting	Estimated Payroll Foundation Receipts Monthly Deposit Processing												
Equities	Broker Commissions Dividends/Splits Purchases/Sales												
Annual Statements	Accuracy Benefit Estimates												
Accounts Payable	Disbursement Processing Vendor Reviews												
Derivatives	Compliance Reporting												
Defined Contribution Reporting	Quarterly Statement Review Account Additions/Withdrawals												
International Investing	Foreign Tax Reclamations External Managers												
Liquidity Reserves	Income Purchases/Sales												



# RISK FACTORS

<b>Risk Factor</b>	<b>Risk Factor Description</b>	<b>Weighting</b>
A	Adequacy and Effectiveness of the System of Internal Controls	9
B	Major Changes in Technology, Operations, the Organization or the Economy	8
C	Dates and Results of Previous Audits	7
D	Recent or Relevant Changes in Key Personnel	6
E	Complexity or Volatility of Activities	5
F	Asset Size or Transaction Volume	4

# RISK ASSESSMENT SCALE

The risk assessment scale is a 9-point system with graduations of risk as follows:

<b>Risk Factor Description</b>	<b>Score</b>
Extremely Risky	9
Very Risky	7
Risky	5*
Slightly Risky	3
Not Risky	1

\* If no previous audit was performed, the auditable area was assessed a 5 — Risky.

# ASSIGNMENT OF RISK RATING

Audit Area	Risk Factors*						Total
	A	B	C	D	E	F	
<b>ADMINISTRATION</b>							
Associate Payroll	3	3	4	2	3	3	18
Associate Travel Expenses	4	4	3	3	2	2	18
Attendance Reporting	3	3	3	3	3	3	18
Benefit Check Printing	3	4	3	3	3	3	19
Board Elections	2	2	2	2	2	1	11
Board Expenses	3	3	2	2	2	2	14
Building Maintenance	2	2	2	2	2	2	12
Business Continuity Plan	3	3	3	3	4	3	19
Child Care Center	2	3	2	2	2	2	13
Corporate Credit Cards	2	3	4	2	2	4	17
Educational Assistance Program	2	2	2	2	2	2	12
Fixed Assets — Computer Equipment	4	3	5	3	3	3	21
Flexible Spending Plans	3	3	3	3	2	2	16
Insurance	3	3	3	3	2	2	16
Internet/Intranet	2	3	3	2	3	3	16
Network Security	3	3	3	2	2	2	15
Ohio Ethics Commission Reporting	1	2	2	2	2	1	10
Other Staff Expenses	2	2	5	2	1	1	13
Personal Investment Disclosure	2	2	2	2	2	2	12
Postage	2	2	3	2	2	3	14
Prior Work Experience — Vacation Leave Credit	3	3	3	2	3	2	16
Purchasing Practices	3	3	4	2	2	3	17
Unused Sick and Vacation Leave	2	2	5	2	2	1	14

\*See Page 3 for description of risk factors.

# ASSIGNMENT OF RISK RATING

Audit Area	Risk Factors*						Total
	A	B	C	D	E	F	
<b>FINANCE</b>							
Accounts Payable	2	2	2	2	2	2	12
Actuarial Tape Processing	3	2	2	2	2	2	13
Annual Reporting	2	2	2	2	2	2	12
Annual Statements	2	2	2	2	2	2	12
Contribution Reporting	2	3	3	2	2	3	15
Early Retirement Incentive Credit	2	2	2	2	3	2	13
Employer Audits	3	2	3	2	2	2	14
Financial Reporting (STRS Ohio)	3	4	2	2	4	4	19
Fixed Assets	3	2	3	2	2	2	14
Income Taxes	4	4	2	2	2	4	18
Member Withdrawals	3	4	3	2	2	3	17
Petty Cash	3	2	4	3	1	1	14
Purchasing Service Credit by Payroll Deduction	3	3	3	2	3	2	16

<b>INVESTMENTS</b>							
Alternative Investments	3	4	3	2	3	3	18
Derivatives	3	2	2	4	4	2	17
Equities	3	5	2	2	4	5	21
Fixed Income	2	2	2	2	3	3	14
International Investing	3	3	2	4	4	3	19
Investment Performance	3	2	3	2	3	3	16
Liquidity Reserves	2	2	3	2	2	2	13
Proxy Voting	2	2	2	2	2	1	11
Real Estate	4	3	3	3	3	4	20
Securities Lending	4	3	2	2	4	4	19
Soft Dollars	3	3	3	3	2	2	16

\*See Page 3 for description of risk factors.

# ASSIGNMENT OF RISK RATING

Audit Area	Risk Factors*						Total
	A	B	C	D	E	F	
<b>MEMBER BENEFITS</b>							
Call Center	3	3	3	3	3	2	17
Defined Contribution Plan	2	2	2	2	2	2	12
Disability Benefits	3	3	3	2	2	2	15
Health Care	2	3	2	2	4	4	17
Post-Retirement Benefits	3	2	3	4	2	2	16
Purchasing Service Credit	3	3	2	2	3	3	16
Records Management	3	3	5	3	2	3	19
Reemployed Retirees	3	3	3	3	2	2	16
Service Retirement Benefits	2	3	2	3	4	4	18
Supplemental Benefit Checks (13th Check)	3	2	3	2	3	2	15
Survivor Benefits	2	2	2	3	2	2	13

\*See Page 3 for description of risk factors.

# RISK FACTORS WEIGHTED

Audit Area	Risk Factors*						Total
	A	B	C	D	E	F	
<b>ADMINISTRATION</b>							
Associate Payroll	27	24	28	12	15	12	118
Associate Travel Expenses	36	32	21	18	10	8	125
Attendance Reporting	27	24	21	18	15	12	117
Benefit Check Printing	27	32	21	18	15	12	125
Board Elections	18	16	14	12	10	4	74
Board Expenses	27	24	14	12	10	8	95
Building Maintenance	18	16	14	12	10	8	78
Business Continuity Plan	27	24	21	18	20	12	122
Child Care Center	18	24	14	12	10	8	86
Corporate Credit Cards	18	24	28	12	10	16	108
Educational Assistance Program	18	16	14	12	10	8	78
Fixed Assets — Computer Equipment	36	24	35	18	15	12	140
Flexible Spending Plans	27	24	21	18	10	8	108
Insurance	27	24	21	18	10	8	108
Internet/Intranet	18	24	21	12	15	12	102
Network Security	27	24	21	12	10	8	102
Ohio Ethics Commission Reporting	9	16	14	12	10	4	65
Other Staff Expenses	18	16	35	12	5	4	90
Personal Investment Disclosure	18	16	14	12	10	8	78
Postage	18	16	21	12	10	12	89
Prior Work Experience —							
Vacation Leave Credit	27	24	21	12	15	8	107
Purchasing Practices	27	24	28	12	10	12	113
Unused Sick and Vacation Leave	18	16	35	12	10	4	95

\*See Page 3 for description of risk factors.

# RISK FACTORS WEIGHTED

Audit Area	Risk Factors*						Total
	A	B	C	D	E	F	
<b>FINANCE</b>							
Accounts Payable	18	16	14	12	10	8	78
Actuarial Tape Processing	27	16	14	12	10	8	87
Annual Reporting	18	16	14	12	10	8	78
Annual Statements	18	16	14	12	10	8	78
Contribution Reporting	18	24	21	12	10	12	97
Early Retirement Incentive Credit	18	16	14	12	15	8	83
Employer Audits	27	16	21	12	10	8	94
Financial Reporting (STRS Ohio)	27	32	14	12	20	16	121
Fixed Assets	27	16	21	12	10	8	94
Income Taxes	36	32	14	12	10	16	120
Member Withdrawals	27	32	21	12	10	12	114
Petty Cash	27	16	28	18	5	4	98
Purchasing Service Credit by Payroll Deduction	27	24	21	12	15	8	107

<b>INVESTMENTS</b>							
Alternative Investments	27	32	21	12	15	12	119
Derivatives	27	16	14	24	20	8	109
Equities	27	40	14	12	20	20	133
Fixed Income	18	16	14	12	15	12	87
International Investing	27	24	14	24	20	16	125
Investment Performance	27	16	21	12	15	12	103
Liquidity Reserves	18	16	21	12	10	8	85
Proxy Voting	18	16	14	12	10	4	74
Real Estate	36	24	21	18	15	16	130
Securities Lending	36	24	14	12	20	16	122
Soft Dollars	27	24	21	18	10	8	108

\*See Page 3 for description of risk factors.

# RISK FACTORS WEIGHTED

Audit Area	Risk Factors*						Total
	A	B	C	D	E	F	
<b>MEMBER BENEFITS</b>							
Call Center	27	24	21	18	15	8	113
Defined Contribution Plan	18	16	14	12	10	8	78
Disability Benefits	27	24	21	12	10	8	102
Health Care	18	24	14	12	20	16	104
Post-Retirement Benefits	27	16	21	24	10	8	106
Purchasing Service Credit	27	24	14	12	15	12	104
Records Management	27	24	35	18	10	12	126
Reemployed Retirees	27	24	21	18	10	8	108
Service Retirement Benefits	18	24	14	18	20	16	110
Supplemental Benefit Checks (13th Check)	27	16	21	12	15	8	99
Survivor Benefits	18	16	14	18	10	8	84

\*See Page 3 for description of risk factors.



## 2006 INTERNAL AUDIT WORK PLAN

<b>Audit Area</b>	<b>Priority</b>	<b>Dept.</b>	<b>Risk Score</b>	<b>Estimated Audit Date</b>	<b>Risk Codes</b>
Equities	High	I	133	Jul-06	F, I, C, O
Real Estate	High	I	130	Mar-06	F, I, C, O
International Investing	High	I	125	Oct-06	F, I, C, O
Alternative Investments	High	I	119		F, I, C, O
Derivatives	High	I	109	Sep-06	F, I, C, O
Fixed Income	High	I	87	May-06	F, I, C, O
Liquidity Reserves	High	I	85	Dec-06	F, I, C, O
Business Contingency Plan	Med.	A	122	Jun-06	F, I, C, O
Financial Reporting (STRS Ohio)	Med.	F	121	Jan-06	I, C, O
Insurance	Med.	A	108	Jan-06	F, I, C, O
Health Care	Med.	MB	104	Mar-06	I, C, O
Contribution Reporting	Med.	F	97	Jun-06	I, C, O
Accounts Payable	Med.	F	78	Sep-06	I, C, O
Annual Reporting	Med.	F	78	May-06	I, C, O
Annual Statements	Med.	F	78	Aug-06	I, C, O
Defined Contribution Plan	Med.	MB	78	Oct-06	I, C, O
Fixed Assets-Computer Equip.	Low	A	140		I, C, O
Records Management	Low	MB	126		C, O
Benefit Check Production Process	Low	A	125		I, C, O
Associate Travel Expenses	Low	A	125		I, C, O, PS
Securities Lending	Low	I	122		I, C, O
Income Taxes	Low	F	120		I, C, O
Associate Payroll	Low	A	118		I, C, O
Attendance Reporting	Low	A	117		I, C, O
Member Withdrawals	Low	F	114		I, C, O
Purchasing Practices	Low	A	113		I, C, O, PS
Call Center	Low	MB	113		C, O
Service Retirement Benefits	Low	MB	110		I, C, O
Reemployed Retirees	Low	MB	108		I, C, O
Corporate Credit Cards	Low	A	108		I, C, O, PS
Flexible Spending Programs	Low	A	108		I, C, O

## 2006 INTERNAL AUDIT WORK PLAN

Audit Area	Priority	Risk Dept.	Score	Estimated Audit Date	Risk Codes
Soft Dollars	Low	I	108		I, C, O
Prior Work Experience-Vacation Leave Credit	Low	A	107		I, C, O
Purchasing Service Credit by Payroll Deduction	Low	F	107		I, C, O
Post-Retirement Benefits	Low	MB	106		I, C, O
Purchasing Service Credit	Low	MB	104		I, C, O
Investment Performance	Low	I	103		I, C, O
Network Security	Low	A	102		I, C, O
Internet/Intranet	Low	A	102		I, C, O
Disability Benefits	Low	MB	102		I, C, O
Petty Cash	Low	F	98		I, C, O, PS
Board Expenses	Low	A	95		I, C, O, PS
Unused Sick and Vacation Leave	Low	A	95		I, C, O
Employer Audits	Low	F	94		I, C, O
Fixed Assets	Low	F	94		I, C, O
Other Staff Expenses	Low	A	90		I, C, O, PS
Postage	Low	A	89		I, C, O
Actuarial Tape Processing	Low	F	87		I, C, O
Child Care Center	Low	A	86		I, C, O
Survivor Benefits	Low	MB	84		I, C, O
Early Retirement Incentive Credit	Low	F	83		I, C, O
Building Maintenance	Low	A	78		I, C, O
Educational Assistance Program	Low	A	78		I, C, O
Personal Investment Disclosure	Low	A	78		I, C
Board Elections	Low	A	74		I, C
Proxy Voting	Low	I	74		I, C
Ohio Ethics Commission Rep.	Low	A	65		I, C, O, PS

**Risk Codes:**

- F: Financial = Risk related to financial impact
- I: Integrity = Risk related to accuracy of data or asset managed/presented
- C: Compliance = Risk related to non-compliance with laws/regulations/internal policies
- O: Operational = Risk related to operational efficiencies/inefficiencies
- PS: Public Sensitivity = No material financial impact but high public sensitivity