

Executive Summary

Audit Committee Meeting, July 12, 2022

Open Audit Observation Management Policy - 802

History

The Open Audit Observation Management Policy is a formal Corporate Policy that informs the organization of the purpose and authority of the Open Audit Observations Policy and clarifies expectations from management throughout the organization.

Audit observations and recommendations require prompt resolution and implementation of corrective action to ensure compliance with statutes, policies, regulations, and best practices. The Open Audit Observation Management Policy addresses the process administered by the Office of the Internal Auditor (OIA) for follow-up, escalation, and resolution of observations and recommendations which may originate from Internal Audit, the Inspector General, the Auditor General, the Office of Insurance Regulation's Market Conduct Unit, or independent audit firms contracted by Citizens.

The Open Audit Observation Management process has been established to ensure that management action plans have been effectively implemented or that management has accepted the risk of not acting on audit results as per the International Standards for the Professional Practice of Internal Auditing Standard 2500

Periodically, the Chief of Internal Audit completes a review of the Policy against industry best practices, Citizens Statute, and the Audit Committee Charter. Following this assessment, the Chief of Internal Audit noted that changes are needed to align the policy with current practice. None of the changes were material and were mainly structural in nature. The revised draft Policy was also provided to Citizens Compliance and Ethics Officer for review.

Recommendation

The Chief of Internal Audit presents, for review and approval, the Open Audit Observation Management Policy.

Approval of the Open Audit Observation Management Policy - 802

ACTION ITEM

New Contract

Contract Amendment

Other _____

CONSENT ITEM

Contract Amendment

Existing Contract Extension

Existing Contract Additional Spend

Previous Board Approval _____

Other _____

Action Items: Items requiring detailed explanation to the Board. When a requested action item is a day-to-day operational item or unanimously passed through committee it may be moved forward to the board on the Consent Index.

Move forward as Consent: This Action item is a day-to-day operational item, unanimously passed through committee or qualifies to be moved forward on the Consent Index.

Consent Items: Items not requiring detailed explanation to the Board of Governors. Consent items are contract extensions, amendments or additional spending authorities for items previously approved by the Board.

Item Description	Office of the Internal Auditor Open Audit Observations Policy
Purpose/Scope	<p>The Audit Committee periodically reviews the adequacy of the Office of the Internal Auditor’s corporate policies.</p> <p>The Open Audit Observation Management process has been established to ensure that management action plans have been effectively implemented or that management has accepted the risk of not acting on audit results as per the International Standards for the Professional Practice of Internal Auditing Standard 2500</p> <p>Periodically, the Chief of Internal Audit completes a review of the Policy against industry best practices, Citizens Statute, and the Audit Committee Charter. Following this assessment, the Chief of Internal Audit noted that changes are needed to align the policy with current practice. None of the changes were material and were mainly structural in nature.</p>
Contract ID	N/A
Committee Recommendation	<p>Staff recommends that the Citizens Audit Committee</p> <ol style="list-style-type: none"> 1. Approve the Office of the Internal Auditor’s Open Audit Observations Policy as presented.
CONTACTS	Joe Martins, Chief of Internal Audit.

Policy Title:	Open Audit Observation Management	Policy Number:	802
Effective Date:	July 12, 2022	Policy Administrator:	Chief of Internal Audit

I. Purpose/Scope

Audit observations and recommendations require prompt resolution and implementation of corrective action to ensure compliance with statutes, policies, regulations, and best practices. The Open Audit Observation Management Corporate Policy and Procedure (Policy) addresses the process administered by the Office of the Internal Auditor (OIA) for follow-up, escalation, and resolution of audit observations and recommendations.

The Open Audit Observation Management process has been established to ensure that management action plans have been effectively implemented or that management has accepted the risk of not acting on audit results as per the International Standards for the Professional Practice of Internal Auditing Standard 2500.

II. Policy

After an audit engagement has been conducted, management must decide upon the appropriate action plan to be taken in response to reported observations and recommendations. Audit observations and recommendations may originate from Internal Audit, the OIG, the Auditor General, the Office of Insurance Regulation's Market Conduct Unit, or independent audit firms contracted by Citizens. Internal Audit shall track the progress of Open Audit Observations and report to the Board and senior staff on the status of management action plans.

Management may decide to assume the risk of not taking corrective action on audit observations due to cost or other considerations. Risk acceptances associated with High or Medium rated audit observations require escalation to the Citizens Risk Steering Committee. When such observations are rated High Impact/Material Weakness or Medium Impact/Significant Deficiency, or when the OIA believes that the level of residual risk is unacceptable to the organization, the following steps shall be taken:

1. The OIA will discuss the observation with senior staff and attempt to reach an agreement on an acceptable level of residual risk.
2. If unable to reach an agreement, Internal Audit will escalate the observation to the President, and if necessary, to the Audit Committee for resolution.

A. Documentation Required to Close Open Audit Observations

Documentation is required to ensure that management action plans have been effectively implemented or that senior management has accepted the risk of not acting. The Chief of Internal Audit shall make the final decision regarding the sufficiency of documentation,

taking into consideration the impact rating of the observation, the audit report, knowledge and history of the audited area, and the current status of the area's operations.

The following table clarifies the process applied to close an Open Audit Observation based on its Risk Rating:

Risk Rating	Required Documentation
High Impact or Material Weakness	The listed audit observation owner provides an updated status in the Audit Observations Tracking System, including supporting documentation indicating completion of the corrective action. Internal Audit reviews material received and could schedule a process walkthrough to verify the implementation of the stated resolution.
Medium Impact or Significant Deficiency	The listed audit observation owner provides an updated status in the Audit Observations Tracking System, including supporting documentation indicating completion of the corrective action. Internal Audit reviews material received to verify the implementation of the stated resolution.
Low Impact or Control Deficiency	The listed audit observation owner indicates completion of the corrective action.

To ensure timely resolution, observations originating from audits by external entities that are not rated according to the scale mentioned above will be monitored under the same criteria established for Medium/Significant Deficiency ratings unless otherwise agreed upon by senior staff and Internal Audit.

B. Non-reportable Audit Observations

During the audit process, some observations may be deemed non-reportable, such as process improvement recommendations (not related to risk or control observations) or audit observations of an immaterial nature. The auditor may determine there is value in verbally communicating the observation; however, such observations shall not be tracked in the Open Audit Observations Management process.

C. Target Date Extensions

If circumstances prevent or delay adherence to the target completion date of an open observation, management may request an extension. The length of the extension shall depend on the reason for the extension (e.g., operational reorganization, control environment changes, or system conversions) and the estimated timeframe needed to complete the corrective action.

On observations with high impact ratings, management is required to pursue and implement short-term remediation efforts to mitigate Citizens' exposure to the risk. Such interim measures must be reported to the Chief of Internal Audit.

The approval level required to request an extension is provided below:

Risk Rating	Required Approval
High or Material Weakness	The Chief Officer of the business area and the Chief of Internal Audit
Medium or Significant Deficiency	A member of senior staff of the business area and the Chief of Internal Audit are required for the first request. The second request for an extension requires approval from the Chief Officer of the business area.

D. Escalation of Past Due Audit Observations

Past due high/medium impact open audit observations will be highlighted as such in the Chief of Internal Audit's quarterly report to the Audit Committee and placed on the next Risk Steering Committee agenda for management comment.

III. Procedure

A. Open Audit Observations Resolution Process

1. Upon completion of an audit engagement, the OIA shall enter all reported observations, recommendations/agreed management action plans, contact names, and target due dates into the Open Audit Observations Database.
2. Management shall prepare and implement action plans to address their audit observations by the target due dates.
3. In the event agreed corrective action has not been completed by the established target date, an extension may be granted as per Section II, C, of this Policy. Management shall report any short-term remediation efforts to Internal Audit.
4. Management shall submit the required documentation specified in Section II, A, of this Policy, to close an open audit observation.
5. The OIA shall close items deemed to have met the required documentation and verification standards.

B. Progress Reporting

1. At the end of each month, the OIA shall distribute an Open Audit Observations Report to management.
2. Management shall report the status of action plans related to open audit observations.
3. At the end of each quarter, the Chief of Internal Audit will present a final report to management. A summary of open audit observations will be included in the quarterly

Audit Committee communications with a focus on high impact and past due observations.

IV. **Definitions**

For this Policy, the following definitions apply:

- A. Chief Officer - a member of the Executive Leadership Team, including the Inspector General.
- B. Chief of Internal Audit – the position responsible for all Internal Audit activities who report directly to the Board of Governors (Audit Committee).
- C. Control Environment - the attitude and actions of the Board and management regarding the significance of control within the organization. The control environment provides the discipline and structure for the achievement of the primary objectives of the system of internal control. The control environment includes the following elements:
 - 1. Integrity and ethical values
 - 2. Management's philosophy and operating style
 - 3. Organizational structure
 - 4. Assignment of authority and responsibility
 - 5. Human Resource policies and practices
 - 6. Competence of personnel
- D. Control Deficiency – a lack of internal control procedures that occurs when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect mistakes, misstatements, or other irregularities.
- E. High Impact – when internal control processes are not functioning to control risk. Any existing or potential breakdown of these processes may have direct exposure to assets and could have a serious impact on operations, legal and/or statutory compliance, or financial results.
- F. Low Impact – when internal control processes are functioning to control risk. Any existing or potential breakdown of these processes may have minimal exposure to assets and an insignificant impact on operations, legal and/or statutory compliance, or financial results.
- G. Material Weakness – a lack of internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.
- H. Medium-Impact - when internal control processes are controlling risk, but the opportunity to improve control(s) exists. Any existing or potential breakdown of these processes may have direct or indirect exposure to assets and could have a significant impact on operations, legal and/or statutory compliance, or financial results.
- I. President – the President/CEO and Executive Director of Citizens Property Insurance

Corporation.

- J. Risk – the possibility of an event occurring that will have an impact on the achievement of company objectives. Risk is measured in terms of impact and likelihood.
- K. Senior Staff - positions at or above the level of Assistant Director, including Chief Officers.
- L. Significant Deficiency - a lack of internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the company's financial reporting.

V. Authority

Citizens Plan of Operation, Section 7(I)(6)
 Section 627.351(6)(i), Florida Statutes
 Audit Committee Charter
 Office of Internal Audit Charter

VI. History

<u>Action</u>	<u>Date</u>
Created	June 30, 2008
Revised	April 13, 2011
Revised	March 26, 2019
Revised	July 12, 2022

VII. Resources

For information regarding this Policy, contact the Office of the Internal Auditor, at Internal.Audit@citizensfla.com.

VIII. Approval

Policy Title	Open Audit Observations Management
Approved by	Citizens' Audit Committee at its meeting on July 12, 2022