



## **Item 4.2 Review and Approval of Internal Audit Department Charter**

*Penny Rychetsky*  
Director of Internal Audit

Finance & Audit Committee Meeting

ERCOT Public  
February 13, 2017

# Review and Approval of Internal Audit Department Charter

- Required periodic review of the Internal Audit Department Charter.
- Internal Audit is recommending changes to the current charter. A red-line version was not provide due to the extensive restructuring and verbiage changes.
- The charter has been rewritten for clarity and conciseness. All of the elements required by auditing standards are included, as are ERCOT specific requirements. One substantive change has been made, the inclusion of executive management responsibilities.
- Attached are the proposed revised charter (Attachment A) and the current charter approved by the Finance and Audit Committee on February 8, 2016 (Attachment B).



## Internal Audit Department Charter

### PURPOSE AND SCOPE

Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve the organization's operations. It helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The Internal Audit Department is an independent function established within the Electric Reliability Council of Texas (ERCOT) to plan, develop and perform internal auditing activities. The Internal Audit Department provides assurance and consulting services. Assurance services are an independent and objective examination of evidence to ensure risk management, control, and governance processes are adequate and functioning in an appropriate manner. The audit plan may include assurance activities designed to address one or more of the following areas:

- Effectiveness and efficiency
- Operational or business process improvements
- Compliance with policies, procedures, protocols, rules, regulations, and applicable state and federal laws
- Internal controls
- Accuracy and reliability of financial, managerial, and operating information

In addition, the Internal Audit Department provides assurance services to external parties when required.

Special projects or consulting engagements may also be conducted at the Finance and Audit Committee or executive management's request. Consulting services are advisory in nature. The scope is agreed upon with the client and is intended to add value and improve the company's governance, risk management and control processes, without the internal auditor assuming management responsibility. Examples include counsel, advice, facilitation and training.

### PROFESSIONAL STANDARDS AND PROCEDURES

Internal Audit Department activities are conducted in accordance with mandatory guidance including the Code of Ethics and the *International Standards for the Professional Practice of Internal Auditing*, promulgated by the Institute of Internal Auditors. In addition, the Internal Audit Department will adhere to ERCOT's policies and procedures and Internal Audit's Department Guide.

The Chief Audit Executive (CAE) will annually assess whether the responsibility and authority, as defined in this charter, continue to be adequate to enable the Internal Audit Department to

accomplish its objectives. The result of this annual assessment will be communicated to executive management and the Finance and Audit Committee.

The Internal Audit Department will be subject to the required external quality assurance review in accordance with professional standards. Additionally, an on-going continuous monitoring assessment program has been established internally to provide assurance of adherence to auditing standards, staff training requirements and job performance expectations. The CAE must communicate the results of the quality assurance and improvement program to senior management and the board.

## **INDEPENDENCE, OBJECTIVITY AND AUTHORITY**

To ensure independence of the Internal Audit Department, the Chief Audit Executive reports administratively to the Chief Executive Officer (CEO) and functionally to the Finance and Audit Committee of the Board of Directors. The CAE serves at the pleasure of the CEO and Finance and Audit Committee. The CAE enhances independence and meets the Institute of Internal Auditors' *Standard* requirement of communication and direct interaction with the board through periodic meetings with the Finance and Audit Committee. The CAE confirms the organizational independence of the department with the Finance and Audit Committee on an annual basis.

Internal auditors must exhibit the highest level of professional objectivity in all aspects of the auditing process and make a balanced assessment of the circumstances, without personal bias or the influence of others.

The Internal Audit Department has no direct authority over the activities under review. Internal auditors should not be assigned duties or engage in any activities they would normally be expected to review since performance of these operational duties might compromise their objectivity. Examples include implementing internal controls, developing procedures, installing systems, preparing records, directing employees not employed by the Internal Audit Department, or engaging in any other activity that would normally be audited. Objectivity is essential to properly fulfilling internal audit responsibilities.

Internal auditors shall be granted unlimited access to all activities, employees, property, and records related to audit activities. Though such access shall be unlimited, the internal auditors shall ensure the safekeeping and confidentiality of all records and information in their possession. The Internal Audit Department also has full and free access to the Finance and Audit Committee and the authority to conduct audits independently and without interference to accomplish audit objectives.

## **ACCOUNTABILITY**

The Director of Internal Audit is the Chief Audit Executive (CAE) at ERCOT. The CAE, in the discharge of his/her duties, shall be accountable to the CEO and the Finance and Audit Committee of the Board of Directors to:

- Periodically provide information on the status and results of audit work, the annual audit plan, and the sufficiency of department resources, and

- Coordinate with executive management in the development of an annual risk assessment, and audit plan that effectively addresses issues of control, risk management, and governance processes.

## **KEY ROLES AND RESPONSIBILITIES**

Key roles and responsibilities of the CAE, Finance and Audit Committee, CEO and executive management are critical to the success of the internal audit function. The CAE will assist the CEO and executive management in the identification and management of company risks.

Key responsibilities of the Chief Audit Executive include:

- Developing an effective internal auditing program based on a flexible, risk-based annual audit plan that considers risks or control concerns identified by management, and submitting the plan to the Finance and Audit Committee for review and approval;
- Implementing the approved annual audit plan, including any special tasks or projects requested by executive management and the Finance and Audit Committee;
- Effectively communicating the results of audit projects, including significant issues and recommendations to appropriate management;
- Providing periodic status reports of the annual audit plan, audit results and/or internal auditing activities and engagements to the CEO and the Finance and Audit Committee;
- Working with the CEO and Finance and Audit Committee to assess the budget and staffing levels of the Internal Audit Department annually;
- Coordinating with other control and monitoring functions to provide and obtain relevant organizational information;
- Minimizing duplicative work by considering the scope of work of the external auditors and regulators, as appropriate;
- Maintaining a professional audit staff with sufficient knowledge, skills, experience, and professional certifications;
- Identifying any insufficiencies in staff knowledge or resources and obtaining competent advice or assistance to fill any gaps;
- Establishing a quality assurance program by which the CAE assures efficient and effective performance of internal auditing activities; and
- Assisting in the investigation of suspected fraudulent activities within the organization upon request.

Key responsibilities of the Finance and Audit Committee include:

- Approving the Internal Audit Department Charter;
- Providing any input and approving the risk-based Annual Internal Audit Plan;
- Approving the Internal Audit Department budget and resource plan;
- Reviewing status reports/updates regarding internal audit activities;
- Reviewing and accepting internal audit reports;
- Receiving communications from the CAE on the Internal Audit Department's performance relative to its plan and other matters;
- Approving decisions regarding the appointment and removal of the CAE;
- Approving the remuneration of the CAE; and
- Inquiring of management and the CAE to determine whether there are inappropriate scope or resource limitations.

Key responsibilities for the Chief Executive Officer include:

- Initiating the recruitment and hiring of a qualified CAE/Internal Audit Director;
- Ensuring the independence of the internal audit function through establishment of an organizational structure with direct lines of reporting between the CAE and the CEO;
- Assessing the Internal Audit Department's budget and staffing levels in coordination with the CAE for Board approval;
- Performing an annual evaluation of the CAE;
- Reviewing and accepting internal audit reports;
- Contributing to and reviewing the results of the risk assessment prepared to support the annual internal audit plan;
- Reviewing the Internal Audit Charter; and
- Communicating with the CAE regarding issues or concerns pertaining to internal audit activities.

Key responsibilities for executive management include:

- Cooperating with audit teams during the performance of internal audits by granting unlimited access to all activities, employees, property and records requested by the auditors;
- Reviewing internal audit reports and providing written responses to address issues and recommendations; and
- Providing information to auditors regarding the occurrence and status of significant issues, which pertain to the organization and its risks.

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Penny V. Rychetsky  
Director, Internal Audit Department  
Chief Audit Executive

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Bill Magness  
President and Chief Executive Officer

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Finance and Audit Committee Chair

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Dated



## **Internal Audit Department Charter**

### **MISSION AND SCOPE OF WORK**

The mission of the Internal Audit Department is to provide independent, objective assurance and consulting services designed to add value and improve the organization's operations. It helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The scope of work of the Internal Audit Department is to determine whether the organization's network of risk management, control, and governance processes, as designed and represented by management, is adequate and functioning in a manner to ensure:

- Risks are appropriately identified and managed.
- The systems of internal control established to ensure compliance with ERCOT's policies, plans and procedures, laws, and regulations are adequate and functioning as intended.
- Interaction with the various governance groups occurs as needed.
- Significant financial, managerial, and operating information is accurate, reliable, and timely.
- Employee's actions are in compliance with policies, standards, procedures, and applicable laws and regulations.
- Resources are acquired economically, used efficiently, and adequately protected.
- Programs, plans, and objectives are achieved.
- Quality and continuous improvement are fostered in the organization's control process.
- Significant legislative or regulatory issues impacting the organization are recognized and addressed properly.

Opportunities for improving management control, economy, and the organization's image may be identified during audits. They will be communicated to the appropriate level of management.

### **ACCOUNTABILITY**

The Director of Internal Audit is the Chief Audit Executive at ERCOT. The Chief Audit Executive (CAE), in the discharge of his/her duties, shall be accountable to management and the Finance and Audit Committee of the Board of Directors to:



- Provide annually an assessment on the adequacy and effectiveness of the organization's processes for controlling its activities and managing its risks in the areas set forth under the mission and scope of work.
- Report significant issues related to the processes for controlling the activities of the organization and its affiliates, including potential improvements to those processes, and provide information concerning such issues through resolution.
- Provide information periodically on the status and results of the annual audit plan, the sufficiency of department resources, and a regular report on Internal Audit personnel.
- Coordinate with and provide oversight of other control and monitoring functions (risk management, compliance, security, legal, ethics, environmental, external audit).

## INDEPENDENCE

To provide for the independence of the Internal Audit Department, its personnel report to the CAE, who reports administratively to the Chief Executive Officer and functionally to the Finance and Audit Committee of the Board of Directors. The Finance and Audit Committee demonstrates this functional reporting relationship by:

- Approving the Internal Audit Department Charter;
- Approving the risk-based, Annual Internal Audit Plan;
- Approving the Internal Audit Department's budget and resource plan;
- Receiving communications from the CAE on the Internal Audit Department's performance relative to its plan and other matters;
- Approving decisions regarding the appointment and removal of the CAE;
- Approving the remuneration of the CAE; and
- Making appropriate inquiries of management and the CAE to determine whether there are inappropriate scope or resource limitations.

The CAE enhances independence and meets the Institute of Internal Auditors' *Standard* requirement of communication and direct interaction with the Board through periodic meetings with the Finance and Audit Committee, including private sessions. In addition, the CAE confirms with the Finance and Audit Committee the organizational independence of the Internal Audit Department on an annual basis.

## RESPONSIBILITY

The CAE and staff of the Internal Audit Department have responsibility to:

- Develop a flexible annual audit plan using appropriate risk-based methodology, including any risks or control concerns identified by management, and submit that plan to the Finance and Audit Committee for review and approval.
- Implement the annual audit plan, as approved, including, and as appropriate, any special tasks or projects requested by management and the Finance and Audit Committee.
- Maintain a professional audit staff with sufficient knowledge, skills, experience, and professional certifications to meet the requirements of this Charter.



- Establish a quality assurance program by which the CAE assures the operation of internal auditing activities.
- Perform consulting services, beyond Internal Audit's assurance services, to assist management in meeting its objectives. Examples may include facilitation, process design, training, and advisory services. When performing these consulting services, the Internal Audit Department will maintain and monitor its independence and objectivity.
- 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.
- Issue periodic reports to the Finance and Audit Committee and management summarizing results of audit activities.
- Keep the Finance and Audit Committee informed of emerging trends and successful practices in internal auditing.
- Provide a list of significant measurement goals and results to the Finance and Audit Committee.
- Assist in the investigation of significant suspected fraudulent activities within the organization and notify management and the Finance and Audit Committee of the results.
- Consider the scope of work of the external auditors and regulators, as appropriate, for the purpose of providing optimal audit coverage to the organization at a reasonable overall cost.

## **AUTHORITY**

The CAE and staff of the Internal Audit Department are authorized to:

- Have unrestricted access to all functions, records, property, and personnel.
- Have full and free access to the Finance and Audit Committee.
- Allocate resources, set frequencies, select subjects, determine scopes of work, and apply the techniques required to accomplish audit objectives.
- Obtain the necessary assistance of personnel in units of the organization where they perform audits, as well as other specialized services from within or outside the organization.
- Provide assurance services to external parties (e.g., the PUCT per Protocol 1.4.3.1.(2)).

The CAE and staff of the Internal Audit Department are not authorized to:

- Perform any operational duties for the organization or its affiliates.
- Initiate or approve accounting transactions external to the Internal Audit Department.
- Direct the activities of any organization employee not employed by the Internal Audit Department, except to the extent such employees have been appropriately assigned to auditing teams or to otherwise assist the internal auditors.
- Implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that would normally be audited.

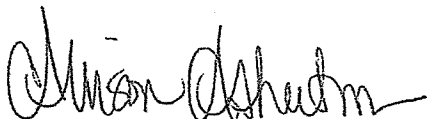
**STANDARDS OF AUDIT PRACTICE**

The Internal Audit Department will govern itself by adherence to the Institute of Internal Auditors' mandatory guidance including the definition of Internal Auditing, the Code of Ethics, and the *International Standards for the Professional Practice of Internal Auditing*. This mandatory guidance constitutes statements of the fundamental requirements for the professional practice of internal auditing and for evaluating the effectiveness of the Internal Audit Department's performance and constitute an addendum to this charter.

The Institute of Internal Auditors' Practice Advisories, Practice Guides, and Position Papers will also be adhered to as applicable to guide operations. In addition, the Internal Audit Department will adhere to ERCOT's policies and procedures and Internal Audit's procedures guide.

**PERIODIC ASSESSMENT**

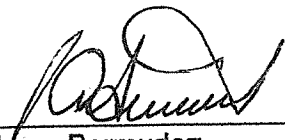
The Chief Audit Executive should at least annually assess whether the mission, responsibility, and authority, as defined in this charter, continue to be adequate to enable the Internal Audit Department to accomplish its objectives. The result of this annual assessment should be communicated to senior management and the Finance and Audit Committee.



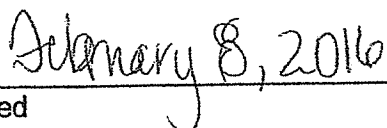
Allison Atherton  
Director, Internal Audit Department (Interim)  
Chief Audit Executive



Bill Magness  
President and Chief Executive Officer



Jorge Bermudez  
Finance and Audit Committee Chair



Dated