



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;
- Minimize 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;
- Identify any insufficiencies in staff knowledge or resources and obtain 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:

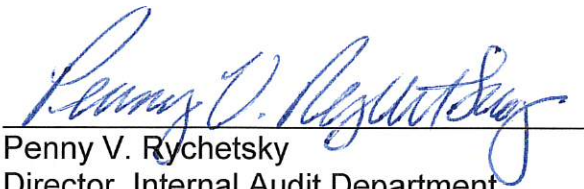
- Approving the Internal Audit Department Charter;
- Providing any input and approving the risk-based Annual Internal Audit Plan;
- Approving the Internal Audit Department budget and resource plan;
- Reviewing status reports/updates regarding internal audit activities;
- Reviewing and accepting internal 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.



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



Bill Magness
President and Chief Executive Officer



Finance and Audit Committee Chair

2-13-2017

Dated