



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

*Penny Rychetsky*  
Director of Internal Audit

Finance & Audit Committee Meeting

ERCOT Public  
February 19, 2018

# 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.
- Items more operational in nature have been removed from the charter and more consistent terminology is used. All of the elements required by auditing standards are included, as are ERCOT specific requirements.
- Attached are the proposed revised charter (Attachment A) and the red-lined current charter approved by the Finance and Audit Committee on February 13, 2017 (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. Consulting services are advisory in nature. The audit plan may include assurance activities, consulting engagements and special projects.

### **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 of the Board of Directors.

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 CAE reports administratively to the Chief Executive Officer (CEO) and functionally to the Finance and Audit Committee (Committee). The CAE serves at the pleasure of the CEO and the 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 Committee. The CAE confirms the organizational independence of the department with the Committee on an annual basis.

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 Committee and the authority to conduct audits independently and without interference to accomplish audit objectives.

### **ACCOUNTABILITY**

The Director of Internal Audit is the CAE at ERCOT. The CAE, in the discharge of his/her duties, shall be accountable to the CEO and the Committee 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, and submitting the plan to the Committee for review and approval;
- Implementing the approved annual audit plan including all assurance and consulting projects;
- Effectively communicating the results of audit projects;
- Providing periodic status reports of the audit plan and results to the CEO and the Committee;
- Working with the CEO and Committee to assess the budget and staffing levels of the Department annually;
- Maintaining a professional audit staff with sufficient knowledge, skills, experience, and professional certifications;
- Establishing a quality assurance program by which the CAE assures efficient and effective performance of internal auditing activities; and
- Conducting investigations at the direction of the Chair and the Committee.

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 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  
Chief Audit Executive

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Finance and Audit Committee Chair

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Dated

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Bill Magness  
President and Chief Executive Officer



## 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. Consulting services are advisory in nature. The audit plan may include assurance activities ~~designed to address one or more of the following areas:~~ consulting engagements and special projects.

- ~~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 of the Board of Directors.

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## Attachment B

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.

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### INDEPENDENCE, OBJECTIVITY AND AUTHORITY

To ensure independence of the Internal Audit Department, the ~~Chief Audit Executive~~CAE reports administratively to the Chief Executive Officer (CEO) and functionally to the Finance and Audit Committee ~~of the Board of Directors~~(Committee). The CAE serves at the pleasure of the CEO and ~~Finance and Audit~~the 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.

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.

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### 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 all assurance and consulting projects, ~~including significant issues and recommendations to appropriate management;~~
- Providing periodic status reports of the ~~annual~~ audit plan, ~~audit and~~ 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. Conducting investigations at the direction of the Chair and the Committee.~~
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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;

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**Attachment B**

- 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~~ Finance and Audit ~~Department~~ Committee  
~~Chair~~  
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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