

# INTERNAL AUDIT CHARTER



MARCH 1, 2023

## PURPOSE

The Employees Retirement System of Texas (ERS) Internal Audit Division (Internal Audit) is established by the ERS Board of Trustees (Board) in accordance with Texas Government Code 2102. Internal Audit is an independent, objective assurance and consulting activity designed to add value and improve operations. The mission of internal audit is to enhance and protect organizational value by providing risk-based and objective assurance, advice and insight. Internal Audit helps ERS accomplish its objectives by bringing a systematic, disciplined and risk-based approach to evaluate and improve the effectiveness of risk management, control and governance processes.

## AUDIT STANDARDS

Internal Audit will comply with the following legal requirements and professional standards:

- Texas Government Code, Chapter 2102, (Texas Internal Auditing Act)
- International Standards for the Professional Practice of Internal Auditing, Definition of Internal Auditing, Code of Ethics and Core Principles for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors
- Generally Accepted Government Auditing Standards as promulgated by the U.S. Government Accountability Office
- The Director of the Internal Audit Division will report periodically to executive management and the ERS Audit Committee regarding the internal audit division's conformance to the Definition of Auditing, Code of Ethics and the Standards.

## ORGANIZATION

The Director of the Internal Audit Division (IA Director) will report functionally to the Board and administratively to the Executive Director.

The Board will approve all decisions regarding the performance evaluation, appointment, or removal of the IA Director as well as the IA Director's annual compensation.

The IA Director will communicate and interact directly with the Board at Audit Committee meetings and between meetings as appropriate. The IA Director will have unrestricted access to, and communicate and interact directly with the Board, including private meetings without management present.

The Executive Director is responsible for the administrative supervision of Internal Audit and Investment Compliance, including approval of the budget for submission to the Board.

## INDEPENDENCE AND OBJECTIVITY

The IA Director will ensure that internal audit activity remains free from all conditions that threaten the internal auditors in carrying out their responsibilities in an unbiased manner, including matters of audit selection, scope, procedures, frequency, timing, and report content. If the IA Director determines that independence or objectivity may be impaired in fact or appearance, the details of the impairment will be disclosed to appropriate parties.

Internal auditors shall be free from personal or external impairments to independence in order that opinions, conclusions, and recommendations will be impartial and will be viewed as impartial by knowledgeable third parties. Internal auditors shall not use any information obtained in an audit for any personal gain, nor in a manner which would be detrimental to the welfare of ERS or its officers and employees. Internal auditors will maintain an unbiased mental attitude that allows them to perform engagements objectively and in such a manner that they believe in their work product, that no quality compromises are made, and that they do not subordinate their judgement on audit matters to others.

Internal auditors will have no direct operational responsibility or authority over any of the activities audited. Accordingly, internal auditors will not implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that may impair their judgement including:

- assessing specific operations for which they had responsibility within the previous year.
- performing any operational duties for ERS.
- initiating or approving transactions external to the internal audit division.
- directing the activities of any ERS employee not employed by the internal audit division except to the extent those employees have been appropriately assigned to assist internal auditors.

Where the IA Director has, or is expected to have, roles and responsibilities that fall outside of internal auditing, safeguards will be established to limit impairments to independence or objectivity. Internal Auditors will:

- disclose any impairment of independence or objectivity, in fact or appearance, to appropriate parties.
- exhibit professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined.
- make balanced assessments of all available and relevant facts and circumstances.
- take necessary precautions to avoid being unduly influenced by their own interests or by others in forming judgements.

The IA Director confirms the organizational independence of the internal audit activity to the Board each year. The IA Director will disclose to the Board any interference and related implications in determining the scope of internal auditing, performing work, and/or communicating results.

## AUTHORITY

To establish, maintain and assure that ERS' internal audit division has sufficient authority to fulfill its duties the Board authorizes the internal audit division to:

- have full, free and unrestricted access to all functions, records, property, and personnel to carry out any engagement, subject to accountability for confidentiality and safeguarding of records and information.
- allocate resources, set frequencies, select subjects, determine scope of work, apply techniques required to accomplish audit objectives, and issue reports.
- obtain assistance from necessary personnel of ERS as well as other specialized services from within or outside ERS in order to complete the engagement.

To establish, maintain and assure that ERS' investment compliance officer has sufficient authority to fulfill its duties, the Board authorizes the investment compliance officer to have full, free and unrestricted access to all functions, records, property, and personnel to carry out any engagement, subject to accountability.

## SCOPE OF AUDIT WORK

The Internal Audit Section shall provide consulting services, the nature and scope of which are agreed with management, and are intended to add value and improve governance, risk management, and control processes. Examples include counsel, advice, facilitation, and training. Internal Audit shall be responsible for all assurance and consulting services of ERS within the scope of this charter.

The scope of internal audit encompasses, but is not limited to, the objective examinations of evidence for the purpose of providing independent assessments to the Board, management and outside parties and evaluation of the adequacy and effectiveness of ERS' governance, risk management, and control process as well as the quality of performance in carrying out assigned responsibilities to achieve the organization's stated goals and objectives. This includes assurance that:

- risks relating to the achievement of ERS' strategic objectives are appropriately identified and managed.
- actions of ERS officers, directors, employees and contractors are in compliance with ERS policies, procedures, and applicable laws, regulations, and governance standards.
- results of operations or programs are consistent with established goals and objectives.
- operations or programs are being carried out effectively and efficiently.

- established processes and systems enable compliance with policies, procedures, laws and regulations that could significantly impact ERS.
- information and means used to identify, measure, analyze, classify and report such information are reliable and have integrity.
- resources and assets are acquired economically, used efficiently, and protected adequately.

## KEY ROLES AND RESPONSIBILITIES

Certain roles and responsibilities of the IA Director, Board and ERS management are critical to the success of the Internal Audit function.

### Key responsibilities of the IA Director include:

- **Annual Audit Plan** - Annually, submit to the Board and Executive Director a risk-based internal audit plan for review and approval. The internal audit plan will consist of a work schedule, budget and resource requirements for the next fiscal year. The internal audit plan will be developed using a risk-based methodology, including input of the Board and senior management. The IA Director will review and adjust the internal audit plan, as necessary, in response to changes in ERS' business, risks, operations, programs, systems and controls. These adjustments will be communicated to the Board.
- **Reporting** - A written report will be prepared and issued by the IA Director or designee following the conclusion of each audit engagement and will be distributed as appropriate. The report will include audit results, management responses and implementation milestones for management action plans. The report will be issued to the Audit Committee and Board, as well as those external parties required by the Texas Internal Auditing Act. For those reports deemed confidential and sensitive in nature as determined by the Audit Committee Chair and the IA Director, a statement of non-disclosure will be included in the audit report and distributions to required external parties.
- **Audit Engagement** - Internal Audit will notify ERS management of upcoming audit engagement objectives, provide status updates, and conduct an exit conference to discuss final audit results and management action plans. The IA Director will ensure each engagement of the internal audit plan is executed, including the establishment of objectives and scope, the assignment of appropriate and adequately supervised resources, the documentation of the work programs and testing results, and the communication of the engagement results with applicable conclusions and recommendations to the appropriate parties. The IA Director will follow-up on engagement findings and corrective actions, and report periodically to executive management and the Board any corrective actions not effectively implemented.
- **Communication with Board and External Parties** – Internal Audit activities, including presentations to the Board and Audit Subcommittee, shall be in accordance with the laws regarding confidentiality. At the request of the Audit Committee Chair, the IA Director shall meet with the Audit Committee to discuss the status of the audit workload program, exceptions to the accomplishment of the annual plan, the status of management's resolution of audit findings and other significant issues involving Internal Audit. The IA Director will ensure trends and emerging issues are considered and communicated to the Board and executive management. The IA Director will meet periodically with the Audit Committee Chair. Internal Audit shall serve as the primary liaison with external auditors or review groups for any audit or review conducted of ERS.
- **Audit Administration** -The IA Director will ensure the principles of integrity, objectivity confidentiality, and competency are applied and upheld and ensure the internal audit division collectively possesses or obtains the knowledge, skills, and other competencies needed to meet the requirements of the internal audit charter. The IA Director will establish and ensure staff adherence to internal audit and ERS policies and procedures, unless the policies and procedures conflict with the internal audit charter. Any conflicts shall be resolved and communicated to the Board and executive management. The IA Director will also review the internal audit charter on an annual basis to assess the need for changes due to updates in standards or laws as well as updates requested by Board members.

- **Investment Compliance** - The Investment Compliance Officer will report to the IA Director. The position is responsible for ensuring that investment activities comply with applicable statutes, regulations, Board policies and investment guidelines. The IA Director will ensure separation of duties between Investment Compliance and Internal Audit.

**Key responsibilities of ERS management related to Internal Audit activities include:**

- cooperating with audit teams during the performance of internal audits and advisory projects by providing full and unrestricted access to all activities, personnel, property, records, information, and systems requested by auditors, including contractor and subcontractor resources.
- reviewing Internal Audit reports and providing timely, written management responses to address issues and recommendations, including planned actions, responsible manager, and target implementation dates.
- providing status updates to the IA Director regarding management action plans that address outstanding internal and external audit recommendations.
- coordinating with Internal Audit staff to respond to issues and recommendations contained in external audit reports.
- notifying the IA Director of any contacts from external organization auditors, evaluators, and inspectors.

**Key Responsibilities of Investment Compliance Officer**

The Investment Compliance Office, while supervised by the IA Director, is separate and apart from the Internal Audit Division. Certain roles and responsibilities are critical to the success of the Investment Compliance function and include:

- ensuring that investment activities comply with applicable statutes, regulations, Board policies, and investment guidelines.
- providing advice and support for management decision-making related to investment policy compliance.
- assisting in developing and drafting policies and procedures, while reinforcing that such policy and procedures are ultimately the responsibility of management and must receive management's formal approval.

## NON-AUDIT SERVICES

Internal Audit may provide non-audit services, including those related to fraud or other illegal acts. The IA Director will establish and document his understanding with management, or those charged with governance, regarding the objectives of the non-audit service, services to be performed, entity's acceptance of its responsibilities, Internal Audit responsibilities and any known limitations. Based on the level of anticipated work, the deliverable(s) will be at the discretion of the IA Director. The IA Director will advise the requester of the status of the non-audit service while in progress and will forward the results of such project to the requester for review before results are finalized.

## APPROVAL FOR SERVICES

The Audit Committee Chair will approve all requests for audit and non-audit services affecting the approved annual audit plan. If the Audit Committee Chair requests the service, then the Chair of the ERS Board of Trustees will approve the addition and any other necessary revisions.

## QUALITY ASSURANCE AND IMPROVEMENT PROGRAM

The internal audit division will maintain a quality assurance and improvement program that covers all aspects of the internal audit division. The program will include an evaluation of the internal audit division's conformance with the Standards and an evaluation of whether internal auditors apply The IIA's Code of Ethics. The program will also assess the efficiency and effectiveness of the internal audit division and identify opportunities for improvement.

Results will be communicated to executive management and the Board on the internal audit division's quality assurance and improvement program, including the results of internal assessments (both ongoing and periodic) and external assessments conducted at least once every three years by a qualified, independent assessor or assessment team from outside ERS.