



Annual Internal Audit Independence Assessment

August 23, 2023

From the Director

ERS Internal Audit is independent in accordance with Charter provisions. The internal audit activity is free from interference by any element in the organization, including matters of audit selection, scope, procedures, frequency, timing or report content.

Internal Audit staff have affirmed they are free from personal or external impairments that would impact auditor opinions, conclusions and recommendations.

Internal Audit has established proper safeguards for non-audit services that might impair independence. Additional information has been included describing safeguards in place.

Sincerely,

Anthony Chavez, CIA, CGAP, CRMA

Director, Internal Audit Division

ERS Internal Audit Division

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Background

In accordance with the approved Employees Retirement System of Texas (ERS) Internal Audit Charter (Charter), the Director of Internal Audit (Director) will confirm to the Board annually on the independence of the internal audit function.

Texas Government Code (2102.011) requires Internal Audit to follow both the Standards for the Professional Practice of Internal Auditing and Generally Accepted Government Auditing Standards (GAGAS). Although each set of standards has its respective approach, both standards require independence to be assessed by each individual, by organization and by activities performed including non-audit services. In assessing independence the GAGAS Conceptual Framework for Independence was utilized which instructs the following:

- a. Identify threats to independence
- b. Evaluate the significance of the threats identified, both individually and in the aggregate
- c. Apply safeguards as necessary to eliminate the threats or reduce them to an acceptable level

Threats to Independence

- a. Self-interest threat
- b. Self-review threat
- c. Bias threat
- d. Familiarity threat
- e. Undue influence threat
- f. Management participation threat
- g. Structural threat

Independence—The freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner.

(Source: The Institute of Internal Auditors)

Conclusion

The ERS internal audit function and staff remain independent.

- 1) Internal Audit staff have affirmed they are free from personal or external impairments that would impact auditor opinions, conclusions and recommendations.
- 2) The audit function is free from interference in determining the scope of work, the performance of work, and communication of results.
- 3) Safeguards are in place to prevent non-audit services from impacting independence.

Audit Independence Assessment

Procedures were performed to assess audit independence. Our analysis is as follows:

Auditor Independence (Individual) - All staff formally affirmed in writing they were free from impairments to independence. Due to an internal hire from the Finance Division (June 2022), a new impairment was identified. To ensure independence, that auditor will not work on any Finance Division audits for a period of two years.

Organizational Independence - Per the approved ERS Internal Audit Charter the Director reports functionally to the Board. This helps to ensure the audit function is free from interference in determining the scope of work, the performance of work and communication of results. The Director observed no instances of undue influence over audit work performed or results communicated.

Audit Activities - Internal Audit provides multiple types of services including audits, agreed-upon procedures and consulting services (formal and informal). All projects and activities performed by Internal Audit are documented in the annual audit plan which is presented to, and approved by, the Audit Committee each year.

Certain non-audit services were identified for further evaluation. Based on safeguards in place, threats to independence were either eliminated or reduced to acceptable levels.

| Non-Audit Service | Safeguard |
|--|--|
| Consulting in areas where assurance will not be provided in the same period | Responses to recommendations are written and implemented by management. No management decisions are made by Internal Audit. |
| Investment Compliance | Internal Audit Charter has been approved by the Board to reflect Director's and compliance staff roles and responsibilities. No audit engagements were performed based on investment compliance results. |
| Participation in various ERS committees | IA participation is in a nonvoting capacity. |
| Informal review and input into new policies or design of internal controls | Management responses are not required and implementation decisions are made by management, not Internal Audit. |
| Collection of benchmarking information and industry best practices requested by management | Management responses are not required and implementation decisions are made by management, not Internal Audit. |
| Flowcharting key business processes | Flowcharting involves documenting current business practices. Management responses are not required and implementation decisions are made by management, not Internal Audit. |
| Coordination with external auditors | Activity does not involve management decisions or recommendations by Internal Audit. |
| Coordination of fraud hotline and related procedures | Internal Audit is involved in a non-voting capacity. Decisions and actions taken are made by management, not Internal Audit. |