

**Section 3.0 DUTIES AND RESPONSIBILITIES****3.6.2 Internal Audit Charter**

*Adopted by the Board: November 12, 2013; Revised: November 13, 2018*

**I. PURPOSE**

The purpose of this Charter is to formally define LACERS' internal audit function's purpose, authority, and responsibility. The internal audit charter establishes the internal audit function's position within LACERS including the nature of the Departmental Audit Manager's (or DAM) functional reporting relationship with the Board; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities. This Charter shall be reviewed annually and updated as necessary.

**II. MISSION**

The Mission of the Internal Audit Section is to enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight. Internal Audit helps LACERS accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes.

**III. OBJECTIVES AND SCOPE**

Assurance Objectives: The objectives of the Internal Audit Section's assurance services are to provide independent assurance to the Board, the Audit Committee, and LACERS' Executive Management that LACERS' assets are safeguarded, operating efficiency is enhanced, and compliance is maintained within prescribed laws, Board Rules, and management policies. Assurance objectives include independent assessment of LACERS' governance, risk management, and control processes.

Consulting Objectives: The objectives of the Internal Audit Section's consulting services, the nature and scope of which are agreed with management, are to provide management with assessments and advice for improving LACERS' governance, risk management and control without the Internal Audit Section assuming management responsibility. For example, consulting services may provide assessments and advice on the front-end projects so that risks can be identified, managed, and internal controls can be designed.

Scope: The scope of internal audit activities encompasses, but is not limited to, objective examinations of evidence for the purpose of providing independent assessments to the LACERS' Board, Audit Committee, management, and outside parties on the adequacy and effectiveness of governance, risk management, and control processes for LACERS. Internal audit assessments include evaluating whether:

- Risk relating to the achievement of LACERS' strategic objectives are appropriately identified and managed;
- The actions of LACERS' officers, directors, employees, and contractors are in compliance with Board's policies, procedures, and applicable laws, regulations, and governance standards;

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- The 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 the policies, procedures, laws, and regulations that could significantly impact Plan;
- Information and the 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;

Opportunities for improving member service, management of risks, internal control, governance, and the organization's effectiveness and image may be identified during audits. This information will be communicated to management and the Audit Committee as appropriate.

#### IV. AUTHORITY

The Internal Audit Section reports functionally to the Board through its Audit Committee, and administratively to the General Manager. The Audit Committee advises on the appointment, replacement, or dismissal of the Departmental Audit manager (DAM) in consultation with the General Manager as appointing authority.

The DAM is responsible for managing the Internal Audit Section and preparing an audit plan. The Audit Committee reviews and recommends the approval of the annual audit plan to the Board. The DAM shall periodically inform the Audit Committee regarding the status of the audit plan and changes needed. The DAM is authorized to allocate internal audit resources, set project frequencies, select audit subjects, determine scopes of work, and apply the techniques necessary to accomplish the audit objectives. The DAM is authorized to hire (within budgetary constraints), retain, train, and develop internal audit staff to achieve the internal audit objectives as stated in this Charter.

The DAM and other Internal Audit staff are not authorized to perform operational duties for LACERS and/or its contractors. LACERS Internal Audit staff is not authorized to initiate or approve accounting transactions external to the Internal Audit Section. Internal Audit Section staff is not authorized to direct the activities of any LACERS employee not employed in the Internal Audit Section, except to the extent such employees have been assigned appropriately to auditing teams or to otherwise assist the internal auditors.

#### V. ACCESS

The Departmental Audit Manager and designated audit staff, as appropriate, are granted authority for full, free, and unrestricted access to all of LACERS' functions, records, files and information systems, personnel, contractors, physical properties, and any other item relevant to the function, process or unit under review. All LACERS' contracts with vendors shall contain language enabling the internal auditors, other auditors, and specialists to have access to relevant records and information. All LACERS employees are required to assist the staff of the Internal Audit Section in fulfilling its audit functions and fiduciary duties.

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The DAM shall have free and unrestricted access to the Chairperson of the Audit Committee and Members, the President, Vice President, and Members of the Board of Administration. The DAM shall also have free and unrestricted access to the General Manager, other executive management, and all personnel, contractors and vendors, members, retirees, and beneficiaries of LACERS.

Staff of the Internal Audit Section shall handle documents and information given to them in the same prudent and confidential manner as by those employees normally accountable for them. The DAM shall ensure that the Internal Audit staff is instructed in the handling and safeguarding of confidential information.

## VI. INDEPENDENCE

Organizational Placement: To provide for the independence for the Internal Audit Section, its personnel report to the Departmental Audit Manager, who in turn reports functionally to the Board and administratively to the General Manager. By reporting functionally to the Board, the DAM is able to maintain independence and objectivity in planning and executing internal audit activities. The Board supports internal audit's role by maintaining internal audit's independence, and by recognizing and promoting internal audit as a value-added activity.

Professional Standards Independence: The Audit Committee recognizes that professional independence requires that the auditors have knowledge of operations and appropriate expertise in the subject matter that is being audited. Therefore, the DAM will include as part of the reports to the Audit Committee, a regular report regarding internal audit personnel, including their qualifications, certifications, and development. The DAM shall periodically discuss standards of professional audit independence with the Audit Committee. The standards of independence used as benchmarks shall be those indicated in the Professional Standards section of this document.

Potential Impairment of Independence: The DAM should discuss any potential issues regarding impairment of independence and/or conflicts of interest and their mitigation(s) with the Audit Committee, as necessary. If objectivity is impaired in fact or in appearance, the details of the impairment should be disclosed to the General Manager and the Audit Committee. The nature of the disclosure will depend on the impairment. Each Internal Audit Section staff member (including the DAM) shall be required to annually certify to the Audit Committee that he/she has no actual or perceived conflicts of interest that would impair their objectivity or independence. The form for such certification is attached to this charter, and may be revised by the DAM with approval of the Audit Committee as needed.

## VII. RESPONSIBILITIES AND ACCOUNTABILITY

The Departmental Audit Manager is responsible for the following in order to meet the mission, objectives, and scope of this Charter and the Internal Audit Section:

1. Select, train, develop, and retain a competent Internal Audit staff who collectively have the abilities, knowledge, skills, experience, expertise, and professional certifications necessary to accomplish the mission, objectives, and scope of this Charter, subject to the General Manager's approval and budgetary considerations. Provide opportunity and

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- support for staff obtaining professional training, professional examinations, and professional certifications.
2. Establish policies for conducting and directing internal audit activities, and technical and administrative functions according to LACERS' policies and direction provided by the Audit Committee and the Board, and professional standards described in Section VIII.
  3. Perform an annual operational risk assessment. Develop and implement a flexible annual audit plan (audit plan) using an appropriate risk-based methodology, including any risks or concerns identified by management, and submit the audit plan to the Audit Committee for review and approval. The audit plan will include some unassigned hours in order to provide flexibility for changing conditions. Performance of the audit plan will be periodically reviewed and reported to the Audit Committee. The audit plan may be updated, if necessary.
  4. Perform independent analyses of significant operations to evaluate the adequacy and effectiveness of existing systems of internal control and the quality of performance (economy, efficiency, and effectiveness) in carrying out LACERS' business objectives.
  5. Coordinate with audit clients to finalize recommendations for improvement and identify implementation timelines. Internal Audit staff shall consider costs and benefits while formulating and discussing its recommendations.
  6. Establish and maintain a follow-up system to monitor the disposition of results communicated to management and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.
  7. Issue periodic reports to management and the Audit Committee and management summarizing results of assurance and consulting services. Any management letters issued should also be reported to the Audit Committee.
  8. At least every three years, assess whether the purpose, authority, and responsibility, as defined in this Charter, continue to be adequate to enable the Internal Audit Section to accomplish its mission, objectives, and scope. The result of this assessment should be communicated to the Audit Committee.
  9. Implement a quality assurance and improvement program. Obtain an external assessment no less frequently than every five years as required by the International Standards for the Professional Practice of Internal Auditing. Conduct periodic internal quality assurance and ongoing quality procedures. Results of the quality assurance and improvement program should be reported to the Audit Committee.
  10. Lead the process for selecting the external audit firms. Coordinate/manage the contract(s) with any external audit firms and evaluate their performance. Report to the Audit Committee on all activities and associated cost of work performed by the external audit firms.
  11. Consider the scope of work of the external auditors and regulators, as appropriate, for the purpose of providing optimal audit coverage to LACERS at a reasonable overall cost

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12. Act as the primary point of contact for handling all matters related to audits, examinations, investigations, or inquiries by other City entities, State or Federal agencies. Keep the Audit Committee and/or the General Manager informed as appropriate.
13. Evaluate annually the quality of the annual financial report and suggest improvements in the presentation and disclosure.
14. Consult with LACERS management, as appropriate, regarding potential policy and procedural changes.
15. As appropriate, provide consulting services to management that add value and improve the organization's governance, risk management, and control processes without assuming management responsibility.
16. Participate in professional audit organizations by attending meetings, joining the governing boards, presenting speeches and papers, and networking with other professionals. Network with internal audit staff of other public pension systems to learn and exchange best practices information. Participate in other professional organizations related to LACERS' mission. These may include, but are not limited to, organizations involved with benefits, investments, and accounting.
17. Periodically review LACERS' fraud and ethics policies.
18. Assist in the investigation of significant suspected fraudulent activities within LACERS and notify the General Manager, the Audit Committee, and other executives, as appropriate, of the results.
19. Inform the Audit Committee of significant risk exposures and control issues including fraud risks, governance issues, and other significant matters.
20. Inform the Audit Committee of emerging trends and successful practices in internal auditing.
21. Attend all Audit Committee meetings and ensure the attendance of additional audit staff and attendance by auditees as appropriate.

**VIII. PROFESSIONAL STANDARDS**

The Internal Audit Section will govern itself by adherence to the mandatory elements of The Institute of Internal Auditors' International Professional Practices Framework, including the Core Principles for the Professional Practice of Internal Auditing, the Code of Ethics, the International Standards for the Professional Practice of Internal Auditing, and the Definition of Internal Auditing. Internal Audit Section shall also obtain guidance from professional standards of other relevant professional organizations including, but not limited to, the following:

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- Information Systems Auditing Standards, Guidelines, and Procedures, and the Code of Professional Ethics of the Information Systems Audit and Control Association (ISACA);
- Public Company Accounting Oversight Board (PCAOB) auditing standards, as applicable;
- American Institute of Certified Public Accountants (AICPA) Professional Standards and Code of Ethics, as applicable;
- Generally Accepted Government Auditing Standards (GAGAS) from the United States General Accounting Office, as applicable; and
- Other professional standards, such as those of the Institute of Management Accountants (IMA) and the Association of Certified Fraud Examiners (ACFE), as applicable.

#### **IX. RELATIONSHIP TO THE RISK MANAGEMENT AND INTERNAL CONTROLS PROGRAMS**

The Board has overall responsibility for ensuring that risks are managed. In practice, the Board delegates to management the operation and implementation of the risk management system. The Internal Audit Section's role is to provide an independent and objective assurance on the effectiveness of the risk management system.

Management is responsible for implementing the system of internal control. The Internal Audit Section is responsible to provide an independent and objective assurance that the internal control system is operating effectively.

#### **X. PROCUREMENT**

The Departmental Audit Manager occasionally may need to obtain expertise of persons outside of the Internal Audit Section. This expertise may be obtained within LACERS through appropriate arrangements with management. When obtaining this expertise, care must be taken to avoid conflicts of interest within LACERS that could damage the quality of the audit work performed and/or conclusions obtained.

Expertise may also be obtained from outside LACERS through contracts. In such cases, the DAM needs to obtain sufficient information regarding the scope of work of the external service provider to ensure the scope of work is adequate for the purposes of the internal audit activity. The DAM must document the scope of work, professional standards to be used, deliverables, deadlines, and other matters in an engagement letter or contract. The Audit Committee should be informed of the use of an external service provider.

#### **XI. RELATIONSHIP TO PREVENTION, DETECTION, AND CORRECTION ACTIVITIES**

Because LACERS recognizes that it is more expensive to detect and correct problems after the fact than it is to prevent them in the initial stages of a project, the Internal Audit Section will strive to participate in the initial stages of major projects so that risks can be managed appropriately and internal controls instituted in the design phase in order to prevent problems and minimize costs.

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**Auditor Annual Independence Certification**

**DIRECTIONS:** Each auditor must complete this Evaluation form in its entirety. The purpose of this form is for individual auditor and LACERS Internal Audit management to consider all circumstances relative to internal audit projects, in order to identify and address any potential threats to independence by applying appropriate safeguards or controls.

In all matters relating to audit work, LACERS Internal Audit (IAS), and individual auditors must be independent, in compliance with Sections 1100, 1120 and 1130 of the International Standards for the Professional Practice of Internal Auditing (ISPPA). Auditors should avoid situations that could lead reasonable and informed third parties to conclude that the auditors are not independent and thus are not capable of exercising objective and impartial judgment on all issues associated with conducting the audit and reporting on audit work. Auditors should evaluate these considerations during the course of their audits and immediately report any potential or actual threats.

**Threat Consideration:** To be completed by all audit staff **annually**:

<b>Threat Categories:</b> Complete the following, considering the threat as a broad category that could potentially influence your independence.	<b>Yes</b>	<b>No</b>
<b>Self-interest threat</b> – Do you have a direct or indirect financial or other interest that will inappropriately influence your judgment or behavior?		
<b>Self-review threat</b> – Will any of the anticipated audit work put you in a position to audit the work, services, or judgments you previously performed during a non-auditing (consulting) service?		
<b>Familiarity threat</b> – Do you have any relationship with LACERS management or personnel, or personnel of LACERS contractors/consultants which may impact your ability to be objective as LACERS Internal Audit staff?		
<b>Undue influence threat</b> – Are you experiencing pressure from management, LACERS Staff or external parties, which will impact your ability or make independent and objective judgments on internal audit projects?		
<b>Management participation threat</b> – Have you taken on a management or any other role which has or will result in performing management functions for any unit within LACERS? If so, please list the unit(s) _____		
<b>Relationship</b> – Do you have any official, professional, financial, or personal relationship with anyone that might limit the extent of inquiry or disclosure, or weaken audit findings in any way?		
<b>Accounting</b> – During the past year, have you approved invoices, payrolls, claims, or other proposed payments for any unit within LACERS? During the past year, did you maintain any part of the official accounting records for LACERS?		
<b>Conflict of Interest or Secondary Employment</b> – Are you or have you been in a conflict of interest position or engaged in any secondary employment activities which may impact your ability, in any way, to perform internal audit projects?		
<b>Other Threat:</b> Is there any other relevant potential threat which may impact your independence or perception regarding any audit? (If so, disclose here. If you are not sure, discuss it with the Departmental Audit Manager.)		

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**Safeguard Consideration:** If “yes” is marked in any boxes above, please complete the following section:

Potential Threat	Recommended Safeguard to mitigate Threat (and is risk reduced to an acceptable level?)	Departmental Audit Manager only: Does the safeguard eliminate or reduce the threat to an acceptable level?
<i>Ex. Accounting – I previously worked in the Fiscal Section, but I only handled the accounts payable.</i>	<i>I don't believe this is an unacceptable risk, as I don't manage or work in investment accounting or other areas within Fiscal Section, and I left about six months ago.</i>	<i>No. To avoid the perception of impairment, auditor is not approved to participate in audit projects relating to the Fiscal Section.</i>

**Acknowledgement:** (initial after each statement)

**Comply with ISPPIA:** I understand that I have a duty and obligation to ensure audit work is performed in full accordance with ISPPIA. In conducting my work, I have the obligation to immediately report any conditions or situations which may compromise compliance with any ISPPIA to the Departmental Audit Manager (DAM). \_\_\_\_\_

**Remain Independent:** I have been advised that during the course of any audit, if any personal, external, or organizational impairments or potential threats arise that may affect my ability to do the work and report findings impartially, I will notify the DAM promptly. Further, I will assess ongoing threats, identify potential safeguards, and engage the DAM in remedying any situations which may give rise to even the perception of bias or conditions which may impact the integrity of any audit work. \_\_\_\_\_

**Policies and Procedures:** I have been informed and am familiar with the policies and procedures of IAS, regarding independence and objectivity. I am also familiar with the requirements of the 2012 ISPPIA. \_\_\_\_\_

**Obligation to Report:** I understand that I have an obligation to report any instance or information regarding an actual or potential impairment by any auditor in IAS to the DAM. \_\_\_\_\_

**Direct Access to Audit Committee Chair:** If for any reason I am uncomfortable discussing any of the foregoing matters with the DAM, I understand that I am expected to discuss the matter with the Audit Committee Chairperson. \_\_\_\_\_

I certify that all the included information is complete and accurate and reflects my best ability to provide clear, detailed information regarding any activity or condition which may impair or to be perceived to impair independence and/or objectivity.

Signature: \_\_\_\_\_ Date: \_\_\_\_\_

Name (print): \_\_\_\_\_

**Departmental Audit Manager Review and Approval:**

Overall Assessment: \_\_\_\_\_

Restrictions: \_\_\_\_\_

Signature: \_\_\_\_\_ Date: \_\_\_\_\_