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# Internal Audit Charter

Effective: 11 November 2024

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# National Energy System Operator (NESO) Internal Audit Charter

## 1 Introduction to the NESO Internal Audit Function

### 1.1 Purpose and Role

The purpose of the internal audit function is to strengthen NESO's ability to create, protect, and sustain value by providing the Audit and Risk Committee and management with independent, risk-based, and objective assurance, advice, insight and foresight.

The internal audit function enhances NESO's:

- Successful achievement of its objectives.
- Governance, risk management, and control processes.
- Decision-making and oversight.
- Reputation and credibility with stakeholders.
- Ability to serve the public interest.

It does this by:

- Providing internal audit and advisory services.
- Assessing whether significant risks are identified, appropriately reported by management to the Audit and Risk Committee and senior management, and that this is done in a timely manner.
- Challenging and influencing senior management to improve the effectiveness of governance, risk management and internal controls, including identifying efficiencies and improvement opportunities.

### 1.2 Scope and Types of Internal Audit Services

The scope of internal audit services covers the entire breadth of the organisation, including all NESO's activities, assets, and personnel. The scope of internal audit activities encompasses but is not limited to objective examinations of evidence to provide independent assurance and advisory services to the board and management on the adequacy and effectiveness of governance, risk management, and control processes for NESO.

The nature and scope of advisory services may be agreed with the party requesting the service, provided the internal audit function does not assume management responsibility. Opportunities for improving the efficiency of governance, risk management, and control processes may be identified during advisory engagements. These opportunities will be communicated to the appropriate level of management.

Internal audit engagements may include evaluating whether:

## Public

- Risks relating to the achievement of NESO's strategic objectives are appropriately identified and managed.
- The actions of NESO's employees, contractors, management, directors and officers comply with NESO's policies, procedures, and applicable laws, regulations, and governance standards.
- The results of operations and programs are consistent with established goals and objectives.
- Operations and 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 NESO.
- The integrity of information and the means used to identify, measure, analyse, classify, and report such information is reliable.
- Resources and assets are acquired economically, used efficiently and sustainably, and protected adequately.

### 1.3 Global Internal Audit Standards and UK and Ireland Internal Audit Code of Practice

NESO's internal audit function will:

- Adhere to the mandatory elements of The Institute of Internal Auditors' International Professional Practices Framework, which are the Global Internal Audit Standards and Topical Requirements. Non-mandatory elements include supplemental global guidance and considerations for implementation.
- Apply the applicable UK and Ireland Internal Audit Code of Practice which builds on the Global Internal Audit Standards and seeks to increase the effectiveness and impact of internal audit by clarifying expectations and requirements within the UK and Ireland.
- Report annually to the board and senior management as to the how the Global Internal Audit Standards and applicable Internal Audit Code of Practice have been applied.

## 2 Authority

- 2.1 NESO's board grants the internal audit function the mandate to provide the board and senior management with objective assurance, advice, insight and foresight. The internal audit function's authority is created by its direct reporting relationship to the board. Such authority allows for unrestricted access to the board.

The board authorises the internal audit function to:

- Have full and unrestricted access to all functions, data, records, information, physical property, and personnel pertinent to carrying out internal audit responsibilities. Internal auditors are accountable for confidentiality and safeguarding records and information.
- Have the right to attend and observe all NESO key decision-making forums where required.
- Allocate resources, set frequencies, select subjects, determine scopes of work, apply techniques, and issue communications to accomplish the function's objectives.

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- Obtain assistance from the necessary personnel of NESO and other specialised services from within or outside NESO to complete internal audit services. All employees are requested to assist the internal audit activity in fulfilling its roles and responsibilities.

### 3 Independence and Reporting Relationships

- 3.1 The Head of Internal Audit reports functionally to the board through the Chair of the Audit and Risk Committee and administratively to the Chief Finance Officer although they also have unrestricted access to NESO's Chief Executive Officer. This positioning provides the organisational authority and status to bring matters directly to senior management and escalate matters to the board, when necessary, and supports the internal audit function's ability to maintain independence and objectivity.
- 3.2 The Head of Internal Audit will communicate, and interact, directly with the Audit and Risk Committee, during and between meetings as appropriate, including without senior management present. The Head of Internal Audit will also interact with any other committees on matters relating to the internal audit of NESO.
- 3.3 The Head of Internal Audit will confirm to the board, at least annually, the organisational independence of the internal audit function. The Head of Internal Audit will disclose to the board any interference internal auditors encounter related to the audit selection, scope, performance including frequency and timing, or communications of any internal audit work and results. This includes disclosing the implications of such interference on the internal audit function's effectiveness and ability to fulfil its mandate.

### 4 Responsibilities

- 4.1 Board Oversight – Essential Conditions
  - 4.1.1 To establish, maintain, and ensure that NESO's internal audit function has sufficient authority to fulfil its duties, the board will:
    - Participate in discussions with the Head of Internal Audit and senior management about the "essential conditions" described in the Global Internal Audit Standards and contained within this document, which establish the foundation that enables an effective internal audit function.
    - Ensure that the Head of Internal Audit has unrestricted access to and communicates and interacts directly with the board, including private meetings without senior management present.
    - Discuss with the Head of Internal Audit and senior management the appropriate authority, roles, responsibilities, scope, and services (assurance and/or advisory) of the internal audit function.
    - Make appropriate inquiries of management and the Head of Internal Audit to determine whether scope or resource limitations are inappropriate.
    - Approve the internal audit function's charter, which includes the internal audit mandate and the scope and types of internal audit services, annually.

## Public

- Review the internal audit charter to consider changes affecting the organisation, such as the employment of a new Head of Internal Audit or changes in the type, severity, and interdependencies of risks to the organisation.
- Discuss with the Head of Internal Audit and senior management other topics that should be included in the internal audit charter.
- Collaborate with senior management to determine the qualifications and competencies the organisation expects in its Head of Internal Audit, as described in the Global Internal Audit Standards.
- Authorise the appointment and removal of the Head of Internal Audit.
- Approve the remuneration of the Head of Internal Audit.
- Review the Head of Internal Audit's performance.
- Approve the risk-based internal audit plan.
- Approve the internal audit function's human resources administration and budgets in line with the usual budgeting process.
- Approve the internal audit function's expenses.
- Receive communications from the Head of Internal Audit about the internal audit function including its performance relative to the plan.
- Ensure a quality assurance and improvement program has been established.
- Review the results of the quality assurance and improvement plan annually.

### 4.2 Head of Internal Audit

#### 4.2.1 Ethics and Professionalism

The Head of Internal Audit will ensure that internal auditors:

- Conform with the Global Internal Audit Standards, including the principles of Ethics and Professionalism: integrity, objectivity, competency, due professional care, and confidentiality.
- Understand, respect, meet, and contribute to the ethical expectations of the organisation and be able to recognise conduct that is contrary to those expectations.
- Encourage and promote an ethics-based culture in the organisation.
- Report organisational behaviour that is inconsistent with the organisation's ethical expectations, as described in applicable policies and procedures.

#### 4.2.2 Objectivity

The Head of Internal Audit will ensure that the internal audit function remains free from all conditions that threaten the ability of internal auditors to carry out their responsibilities in an unbiased manner, including matters of engagement selection, scope, procedures, frequency, timing, and communication. If the Head of Internal Audit determines that objectivity may be impaired in fact or appearance, the details of the impairment will be disclosed to appropriate parties.

Internal auditors will maintain an unbiased mental attitude that allows them to perform engagements objectively such that they believe in their work product, do not compromise

## Public

quality, and do not subordinate their judgment on audit matters to others, either in fact or appearance.

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

- Assessing specific operations for which they had responsibility within the previous year.
- Performing operational duties for NESO or its affiliates.
- Initiating or approving transactions external to the internal audit function.
- Directing the activities of any NESO employee that is not employed by the internal audit function, except to the extent that such employees have been appropriately assigned to internal audit teams or to assist internal auditors.

Internal auditors will:

- Disclose impairments of independence or objectivity, in fact or appearance, to appropriate parties, such as the Head of Internal Audit, board, management, or others, at least annually.
- Exhibit professional objectivity in gathering, evaluating, and communicating information.
- Make balanced assessments of all available and relevant facts and circumstances.
- Take necessary precautions to avoid conflicts of interest, bias, and undue influence.

### 4.2.3 Managing the Internal Audit Function

The Head of Internal Audit has the responsibility to:

- At least annually, develop a risk-based internal audit plan that considers the input of the board and senior management. Discuss the plan with the board and senior management and submit the plan to the board for review and approval.
- Communicate the impact of resource limitations on the internal audit plan to the board and senior management.
- Review and adjust the internal audit plan, as necessary, in response to changes in NESO's business, risks, operations, programs, systems, and controls.
- Communicate with the board and senior management if there are significant interim changes to the internal audit plan.
- Establish and ensure adherence to methodologies designed to guide the internal audit function.
- Ensure internal audit engagements are performed, documented, and communicated in accordance with the Global Internal Audit Standards.
- Communicate the results of internal audit services to the board and senior management for each engagement as appropriate.
- Follow up on engagement findings to confirm the implementation of remediation plans as agreed by management. Management is responsible for ensuring appropriate corrective action is taken on deficiencies identified, and any corrective action not taken by the due date will be reported to the board and senior management as overdue.
- Ensure the internal audit function collectively possesses or obtains the knowledge, skills, and other competencies needed to meet the requirements of the Global Internal Audit Standards and fulfill the internal audit mandate.

## Public

- Identify and consider trends and emerging issues that could impact NESO and communicate in a timely manner to the board and senior management as appropriate.
- Consider emerging trends and successful practices in internal auditing.
- Ensure adherence to NESO's relevant policies and procedures unless such policies and procedures conflict with the internal audit charter or the Global Internal Audit Standards. Any such conflicts will be resolved or documented and communicated to the board and senior management.
- Coordinate activities and consider relying upon the work of other internal and external providers of assurance and advisory services, in particular collaborating with NESO's second line Risk and Compliance functions.
- Where the internal audit activity is co-sourced with an external provider, the work will be subject to the same quality assurance and improvement program oversight at the in-house function.

### 4.2.4 Communication with the Board and Senior Management

The Head of Internal Audit will report periodically to the board and senior management regarding:

- The internal audit function's mandate.
- The internal audit plan and performance relative to its plan.
- Internal audit budget.
- Significant revisions to the internal audit plan and budget.
- Potential impairments to independence, including relevant disclosures as applicable.
- Results from the quality assurance and improvement program, which include the internal audit function's conformance with the Global Internal Audit Standards and remediation plans to address the internal audit function's deficiencies and opportunities for improvement.
- Significant risk exposures and control issues, including fraud risks, governance issues, and other areas of focus for the board.
- Results of assurance and advisory services.
- Resource requirements.
- Management's responses to risk that the internal audit function determines may be unacceptable or acceptance of a risk that is beyond NESO's risk appetite.
- The adequacy and effectiveness of NESO's governance, risk and internal control framework, together with an analysis of themes and trends emerging from internal audit work and their impact on the NESO's risk profile.

### 4.2.5 Quality Assurance and Improvement Program

The Head of Internal Audit will develop, implement, and maintain a quality assurance and improvement program that covers all aspects of the internal audit function. The program will include external and internal assessments of the internal audit function's conformance with the Global Internal Audit Standards, as well as performance measurement to assess the internal audit function's progress toward the achievement of its objectives and promotion of continuous improvement. The program will also assess, if applicable, compliance with laws and/or regulations relevant to internal auditing. Also, if applicable, the assessment will include remediation plans to address the internal audit function's deficiencies and opportunities for improvement.

## Public

Annually, the Head of Internal Audit will communicate with the board and senior management about the internal audit function's quality assurance and improvement program, including the results of internal assessments (ongoing monitoring and periodic self-assessments) and external assessments. External assessments will be conducted at least once every five years by a qualified, independent assessor or assessment team from outside NESO; qualifications must include at least one assessor holding an active Certified Internal Auditor credential.

## 5 Changes to the Internal Audit Charter

Certain circumstances may result in a need to update or change the internal audit charter outside of normal process. Any of these circumstances arising should result in a discussion between the Head of Internal Audit, board, and senior management on the content of the internal audit charter and whether it may need to be updated.

Such circumstances may include but are not limited to:

- A significant change in the Global Internal Audit Standards.
- A significant acquisition or reorganisation within the organisation.
- Significant changes in the Head of Internal Audit, board, and/or senior management.
- Significant changes to the organisation's strategies, objectives, risk profile, or the environment in which the organisation operates.
- New laws or regulations that may affect the nature and/or scope of internal audit services.

**This Internal Audit Charter was approved by the Audit and Risk Committee at its meeting on 11 November 2024**