



Subcommittee on Audits

# Institute of Internal Auditors' Quality Assessment Report

Item 3a

January 23, 2024

# Item 3a

## IIA Quality Assessment Report



## Subject

Institute of Internal Auditors' Quality Assessment Report

## Purpose

Share results of the Institute of Internal Auditors' External Quality Assessment

## Next Steps

Resolve conformance gaps and capitalize on improvement opportunities

# Conformance Rating Criteria

## Appendix A

- “Generally Conforms” (GC)
- “Partially Conforms” (PC)
- “Does Not Conform” (DNC)

# Metropolitan Water District of Southern California Internal Audit

## Overall Conclusion

**Generally Conforms** to the *International Standards for the Professional Practices of Internal Auditing* and the IIA Code of Ethics.

This level of conformance is the top rating and demonstrates a clear intent and commitment to achieving the Core Principles for the Professional Practice of Internal Auditing and the Definition of Internal Auditing.

# Executive Summary

## Conformance Summary

ATTRIBUTE STANDARDS	RATING
1. Purpose, Authority, & Responsibility	Generally Conforms
2. Independence & Objectivity	Generally Conforms
3. Proficiency & Due Professional Care	Generally Conforms
4. Quality Assurance & Improvement Program	Partially Conforms

# Executive Summary

## Conformance Summary

PERFORMANCE STANDARDS	RATING
1. Managing the Internal Audit Activity	Generally Conforms
2. Nature of Work	Generally Conforms
3. Engagement Planning	Generally Conforms
4. Performing the Engagement	Generally Conforms
5. Communicating Results	Generally Conforms
6. Monitoring Progress	Generally Conforms
7. Communicating the Acceptance of Risks	Generally Conforms
IIA Code of Ethics	Generally Conforms

# Executive Summary

## Overall Opinion

- Metropolitan Water District of Southern California's Internal Audit generally conforms with the Standards and the IIA Code of Ethics.
- An External Quality Assessment (EQA) of an internal audit activity must be conducted at least once every five years by a qualified, independent assessor or an independent assessment team from outside the organization.
- The EQA was conducted virtually between October 20, 2023 and November 15, 2023.
- Conclusions were as of November 15, 2023.

# Executive Summary

## Objectives

Evaluate conformance to the Standards.

## Scope

General Auditor's efficiency and effectiveness in executing its mission, as set forth by its Charter.

## Methodology

- Reviewed information prepared by Internal Audit.
- Conducted interviews with key stakeholders.
- Reviewed a sample of audit projects and associated work papers and reports.
- Reviewed survey data received from Internal Audit's stakeholders and internal audit staff.
- Prepared diagnostic tools.



# Overall Summary

## Successful Practices

The Assessment Team identified five areas where Internal Audit operates in a successful practice manner. These practices relate to:

1. III: Board Interaction
2. 2010: Planning
3. 2120: Risk Management
4. 2400: Communicating Results
5. 2500: Monitoring Progress

# Overall Summary

## Conformance Gaps

Eight gaps in conformance with standards were identified related to:

1. 1010: Recognizing Mandatory Guidance in the Internal Audit Charter
2. 1300: Quality Assurance and Improvement Program, 1310: Requirements of the Quality Assurance and Improvement Program, 1311: Internal Assessments, 1320: Reporting on the Quality Assurance and Improvement Program (QAIP)
3. 1312: External Assessments
4. 2110.AI: Governance
5. 2210.AI: Engagement Objectives
6. 2340: Engagement Supervision
7. 2410.AI: Criteria for Communicating
8. 2420: Quality of Communications

# Overall Summary

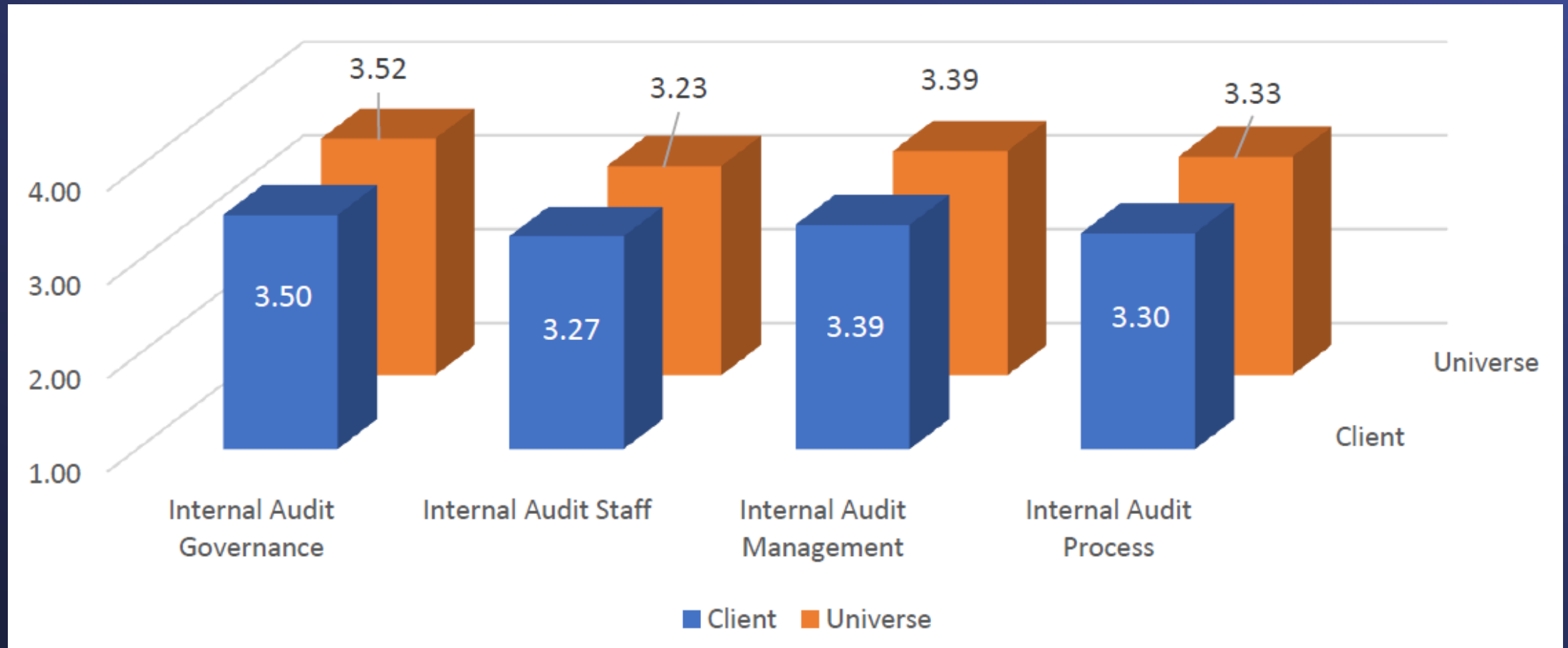
## Improvement Opportunities (not related to Conformance)

Nine opportunities to improve were identified, unrelated to conformance with Management Standards:

1. 1210 Proficiency
2. 1220 Due Professional Care
3. 2000 Managing the Internal Audit Activity
4. 2040 Policies and Procedures - Internal Audit Procedures
5. 2040 Policies and Procedures – Key Performance Indicators
6. 2050 Coordination and Reliance
7. 2060 Reporting to Senior Management and the Board – Audit Charter
8. 2120 Risk
9. 2600 Reporting to Senior Management and the Board – Management’s Acceptance of Risk

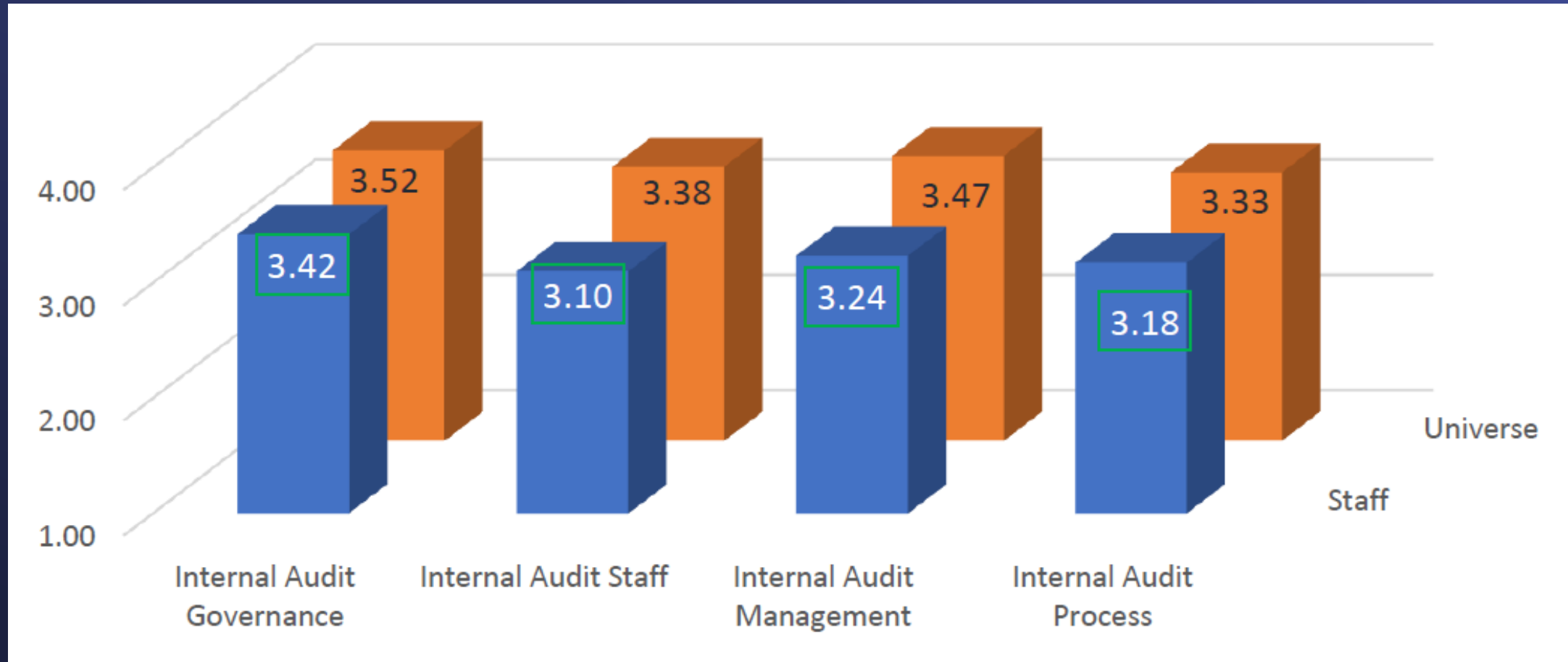
# Survey Results

## Client Survey



# Survey Results

## Staff Survey





Institute of Internal Auditors Quality Assessment Report

**Thank You**

Addendum:  
Detailed  
Observations  
&  
Management  
Responses

- Successful Practices
- Conformance Gaps
- Improvement Opportunities

# Detailed Observations

## Successful Practices

### 1. Board Interaction:

- IA Charter access to the Board
- Board interaction with the General Auditor (GA)
- GA access to the Board chair and the committee chair

### 2. Planning:

- Risk assessment planning process
- Board members' requests for specific audits

### 3. Risk Management:

Risk assessment workshop



# Detailed Observations

## Successful Practices

### 4. Communicating Results:

- New report format
- New recognition section
- Improved summary of scope and objectives as well as exclusions
- Prioritization of individual recommendations

### 5. Monitoring Progress:

Changes to the observation/recommendation monitoring process

# Detailed Observations

## CGI

### Observation

The current charter does not mandate adherence to the Core Principles as required by the Standards.

We recommend internal audit amend the charter to include a mandate to adhere to the Core Principles.

### Management Response

Agree. We will review our charter in 2024, and if the revised Standards continue to require adherence to the Core Principles, we will request an amendment to our charter before December 31, 2024.

# Detailed Observations

## CG2

### Observation

An internal assessment has not been performed since 2021.

We recommend IA :

1. Address all open items identified in the 2021 QAIP report
2. Integrate key performance measures into their ongoing monitoring activities
3. Enhance their QAIP policy and procedures to clarify key activities
4. Carry out periodic self-assessments
5. Re-implement QAIP reporting procedures

### Management Response

Agree. We will implement the seven recommendations in the 2021 QAIP report pertaining to the engagement work program, documenting information, engagement supervision, policies and procedures, the department charter, audit committee charter, and continuing professional education.

# Detailed Observations

## CG3

### Observation

The last external quality assessment (EQA) was an independent validation done in May 2017.

We recommend Internal Audit develop a plan that provides reasonable assurance that EQA requirements will be met in the future. Upon conclusion of this EQA, Internal Audit will be in full conformance with this Standard and no additional action will need to be taken.

### Management Response

Agree. Our recently released quarterly dashboard report to the Board and management has an element reporting compliance with the Standards requirement for EQA. This will provide visibility to the EQA requirement and ensure the next independent validation occurs in 2028.

# Detailed Observations

## CG4

### Observation

No evaluation of the design, implementation, and effectiveness of the organization's ethics-related objectives, programs, and activities has been conducted.

We recommend Internal Audit include an assessment of the design, implementation, and effectiveness of the organization's ethics-related objectives, programs, and activities in their audit plan.

### Management Response

Agree. We will add an evaluation of Metropolitan's control environment, e.g., COSO Principle 1 – Demonstrate Commitment to Integrity and Ethical Values, to our business plan by fiscal year 2024/25.

# Detailed Observations

## CG5

### Observation

Engagement level risk assessments have not consistently been used to narrow audit objectives to the most significant risks.

We recommend Internal Audit implement engagement procedures to assure that risk assessment results are used to narrow audit objectives to the most significant risks identified.

### Management Response

Agree. Identification of the highest risk areas in the risk and control matrix (engagement risk assessment) is already occurring. We have modified engagement procedures to ensure audit objectives are narrowed and focus on the most significant risks identified.

# Detailed Observations

## CG6

### Observation

Work papers reviewed for this EQA lacked evidence of timely supervision, including review and approval of engagement work programs and other significant work papers.

We recommend Internal Audit assure that supervision is provided in a timely manner.

### Management Response

Agree. The expected hiring of a senior audit manager will significantly contribute to the effort for the timely provision of engagement supervision and work paper review.

# Detailed Observations

## CG7

### Observation

Final engagement communications did not consistently include the engagements' objectives and scopes. Additionally, communications did not include management responses and action plans.

We recommend Internal Audit include in engagement communications the engagements' objectives and scopes as well as management responses and action plans.

### Management Response

Agree. The newly implemented audit report format includes a provision for the engagement scope and objectives, as well as a section for the management response and action plan.



# Detailed Observations

## CG8

### Observation

Recommendations communicated to management did not consistently focus on the cause of the conditions identified. Additionally, numerous engagements have not been reported to management and the board in a timely manner.

We recommend Internal Audit identify and address the causes of the conditions identified and address those causes in their recommendations.

### Management Response

Agree. The recent upgrade of our project management system includes a provision for documenting the cause of an audit observation. This will ensure our recommendations address an observation's cause and the condition. Implementing corrective action for CG5 (reducing an engagement's objectives and scope) and hiring a senior audit manager will accelerate the turnaround of engagement reporting to the Board and management.

# Detailed Observations

## IOI

### Observation

1. Talent Management. IA has high-level job descriptions but could benefit from doing an analysis that ties in with the IIA competency framework.

We recommend Internal Audit:

- A. Use an “internal audit competency framework” to conduct an annual gap and opportunity assessment.
- B. Make talent management part of the detailed Internal Audit strategic plan.

# Detailed Observations

## IOI (con't)

2. IT Related Credentials. IA has indicated that due to skill set limitations, there are items with the audit universe that have been excluded from the audit plan related to cyber. Conversations with the board indicate that a position to close the skill gap has been approved and is in the administrative execution phase.

We recommend Internal Audit continue to evaluate if the resources being used today are adequate for the future.

### Management Response

Agree. We will conduct a gap assessment using the internal audit competency framework, which will conclude if current resources are adequate for the future. Additionally, talent management will be added to our strategic plan, and we will collaborate with the Human Resources Group to align job descriptions with IIA guidance.

# Detailed Observations

## IO2

### Observation

While Internal Audit acquired a data analytics tool in 2022, the overall use of data analytics (DA) remains immature. A more robust use of data analytics would allow the expanding of capabilities related to data extraction and analysis, fraud prevention/detection, and executive and departmental reporting using technology and Computer Assisted Audit Techniques (CAATs).

### Management Response

Agree. Once we achieve consistent adherence to essential operational procedures, we will explore advancing our use of data analytics and take advantage of the aforementioned opportunities.

# Detailed Observations

## IO3

### Observation

IA Strategic Plan: The current strategic plan is part of the annual business plan. However, it is very high level and does not include detailed timelines with specific measurable targets. Accordingly, the plan could be strengthened by creating a 3-5 year rolling plan that is updated annually.

We recommend Internal Audit :

1. Create a strategic plan that focuses on critical success factors
2. Clear the backlog of audit reports
3. Track and clear management action items
4. Create a plan to update department policies and guidelines
5. Create a plan to reinstitute the QAIP process and to update the related procedures

# Detailed Observations

## IO3 (con't)

### Management Response

Agree. After creating a vision statement and updating our mission statement, the next phase in our strategic plan is to perform a formal gap analysis regarding talent, processes, and technology. We have begun clearing the backlog (carry-over) of audit reports, which we expect to complete this fiscal year. A follow-up process has also been established to review the status of the 61 recommendations and associated management action plans. The update of our audit manual is discussed below in IO4, and we will resume the internal QAIP process in FY 2024/25.

# Detailed Observations

## IO4

### Observation

The current manual covers most of the topics that are typically covered in a small IA department audit manual. However, we did see opportunities to enhance the guidance in several procedures.

We discussed the gaps and enhancements with audit management. We recognize that, individually, that process is being updated under new IA leadership. While the gaps are not significant, collectively they indicate the need to refresh the manual and strengthen conformance with the Standards. We encourage Internal Audit to:

1. Develop a plan with realistic target dates to update their IA manual
2. Use IA staff “monthly staff meeting” to cover the new Global Internal Audit Standards (GIAS)

### Management Response

Agree. We will prioritize updating our audit manual once we have hired a new senior audit manager. Currently, we include Standards coverage at our monthly team meetings and will continue to do so after the release of the new GIAS.

# Detailed Observations

## 105

### Observation

No Key Performance Indicators (KPIs) are used in the monthly General Auditor report prepared for the board. No KPIs are generated within Internal Audit for use in monitoring department progress. The use of KPIs could strengthen the management of Internal Audit and help the board to better understand progress via a visual aid.

We recommend Internal Audit develop Key Performance Indicators (KPIs) and track progress via an Internal Audit dashboard.

### Management Response

Agree. We expect to develop KPIs as part of our strategic plan for 2024 and will include them in future quarterly status reports to the Board and management.



# Detailed Observations

## IO6

### Observation

The approved internal audit charter calls for the internal audit activity to:

1. “Assist in the investigation of significant suspected fraudulent activities within the organization.
2. Assure reporting to the Finance, Audit, Insurance and Real Property Committee on the results, as appropriate.”

However, clarification is needed to identify who internal audit is to assist and what internal audit’s role is in these investigations. We recommend Internal Audit work with management to obtain and document clarity regarding their role in investigations of suspected fraudulent activities.

### Management Response

Agree. As part of the corrective action for CGI above, we will collaborate with the Board to clarify our role in investigating complaints of suspected fraudulent activities.

# Detailed Observations

## I07

### Observation

IA Charter has not been updated in several years.

We recommend the charter be reviewed annually and presented to the Audit Subcommittee (and the Board) annually, even without changes.

### Management Response

Agree. We have established an annual planning calendar for recurring items that includes our charter. A review of our charter, in accordance with Administrative Code Section 6451, will be conducted with the Board in 2024.

# Detailed Observations

## IO8

### Observation

1. There is no defined consistent risk framework used across the company.
2. Accordingly, there is an opportunity for IA to provide training and advisory services (COSO, How to prepare for an audit, etc.) to close this educational gap.
3. Assurance coordination with other departments is minimal.

We recommend Internal Audit explore these opportunities to add additional value to Metropolitan.

### Management Response

Agree. As staffing resources become available, we will look for ways to facilitate establishing an enterprise risk management function, formalizing a combined assurance model, and developing an organizational assurance map.

# Detailed Observations

## IO9

### Observation

While the CAE has a direct reporting relationship with the board and weekly communication with the board chair, there is no formal risk protocol in place. While there is a defined procedure in place for the GA to elevate concerns about management's response to specific audit findings, there is not a defined process in place for risk identified outside of the audit reporting process.

We recommend the GA initiate conversations with senior management and the board regarding what types of other risks could be identified by the CAE and how these would be escalated if necessary.

# Detailed Observations

## IO9 (con't)

### Management Response

Agree. Risks may be identified outside of the audit process through consulting projects, informal discussions with Metropolitan employees, or from board committee meetings. Further discussion of the risk would start with applicable group managers and then escalate to the assistant general manager level, chief of staff, the general manager, and finally, the Board through the Subcommittee on Audits or board chair. This process will be included in a future update of our audit manual.

