THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Committee Item
INFORMATION

Audit Committee

9/14/2026 Committee Meeting

7a

Subject

Report on Organizational Independence

Executive Summary

Professional internal audit standards require the internal audit function to confirm its organizational independence to its governing board at least annually. Additionally, the internal audit function is required to communicate incidents where independence may have been impaired.

The Office of the General Auditor was organizationally independent for Fiscal Year 2025/26, and there were no incidents where independence may have been impaired.

Applicable Policy

Metropolitan Water District Administrative Code Section 6451(c)(2)

Details and Background

Metropolitan's internal audit function follows the Global Internal Audit Standards (Standards) issued by the Institute of Internal Auditors. The Standards guide the worldwide professional practice of internal auditing and are used to evaluate and elevate the quality of the internal audit function.

Under Domain III: Governing the Internal Audit Function, Principle 7, the Standards require that the board establish and protect the internal audit function's independence, defined as freedom from conditions that could impair the internal audit function's ability to carry out responsibilities in an unbiased manner. The internal audit function can fulfill the Purpose of Internal Auditing only when the chief audit executive (General Auditor) reports directly to the board, is qualified, and is positioned at a level within the organization that enables the internal audit function to discharge its services and responsibilities without interference. Interference can include management delaying or denying access to needed information, people, or facilities, or limiting resources in a way that prevents the internal audit function from operating effectively.

Standard 7.1, Organizational Independence (**Attachment 1**), requires the General Auditor to confirm to the board the organizational independence of the internal audit function at least annually. This includes communicating incidents where independence may have been impaired and the actions or safeguards employed to address the impairment.

Administrative Code Section 6451(c)(2) requires internal auditors to disclose impairments of independence or objectivity, in fact or appearance, to appropriate parties and at least annually.

Attachment 1 – IIA Global Internal Audit Standard 7.1 Organizational Independence

Standard 7.1 Organizational Independence

Requirements

The chief audit executive must confirm to the board the organizational independence of the internal audit function at least annually. This includes communicating incidents where independence may have been impaired and the actions or safeguards employed to address the impairment.

The chief audit executive must document in the internal audit charter the reporting relationships and organizational positioning of the internal audit function, as determined by the board. (See also Standard 6.2 Internal Audit Charter.)

The chief audit executive must discuss with the board and senior management any current or proposed roles and responsibilities that have the potential to impair the internal audit function's independence, either in fact or appearance. The chief audit executive must advise the board and senior management of the types of safeguards to manage actual, potential, or perceived impairments.

When the chief audit executive has one or more ongoing roles beyond internal auditing, the responsibilities, nature of work, and established safeguards must be documented in the internal audit charter. If those areas of responsibility are subject to internal auditing, alternative processes to obtain assurance must be established, such as contracting with an objective, competent external assurance provider that reports independently to the board.

When the chief audit executive's nonaudit responsibilities are temporary, assurance for those areas must be provided by an independent third party during the temporary assignment and for the subsequent 12 months. Also, the chief audit executive must establish a plan to transition those responsibilities to management.

If the governing structure does not support organizational independence, the chief audit executive must document the characteristics of the governing structure limiting independence and any safeguards that may be employed to achieve this principle.

Essential Conditions

Board

- Establish a direct reporting relationship with the chief audit executive and the internal audit function to enable the internal audit function to fulfill its mandate.
- Authorize the appointment and removal of the chief audit executive.
- Provide input to senior management to support the performance evaluation and remuneration of the chief audit executive.
- Provide the chief audit executive with opportunities to discuss significant and sensitive matters with the board, including meetings without senior management present.

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- Require that the chief audit executive be positioned at a level in the organization that enables internal audit services and responsibilities to be performed without interference from management. This positioning provides the organizational authority and status to bring matters directly to senior management and escalate matters to the board when necessary.
- Acknowledge the actual or potential impairments to the internal audit function's independence when approving roles or responsibilities for the chief audit executive that are beyond the scope of internal auditing.
- Engage with senior management and the chief audit executive to establish appropriate safeguards if chief audit executive roles and responsibilities impair or appear to impair the internal audit function's independence.
- Engage with senior management to ensure that the internal audit function is free from interference when determining its scope, performing internal audit engagements, and communicating results.

Senior Management

- Position the internal audit function at a level within the organization that enables it to perform its services and responsibilities without interference, as directed by the board.
- Recognize the chief audit executive's direct reporting relationship with the board.
- Engage with the board and the chief audit executive to understand any potential impairments to the internal audit function's independence caused by nonaudit roles or other circumstances and support the implementation of appropriate safeguards to manage such impairments.
- Provide input to the board on the appointment and removal of the chief audit executive.
- Solicit input from the board on the performance evaluation and remuneration of the chief audit executive.

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Considerations for Implementation

Internal auditing is most effective when the internal audit function is directly accountable to the board (also known as "functionally reporting to the board"), rather than directly accountable to management for the activities over which it provides assurance and advice. A direct reporting relationship between the board and the chief audit executive enables the internal audit function to perform internal audit services and communicate engagement results without interference or undue limitations. Examples of interference include management failing to provide requested information in a timely manner and restricting access to information, personnel, or physical properties. Limiting budgets or resources in a way that interferes with the internal audit function's ability to operate effectively is an example of undue limitation. (See also Standard 11.3 Communicating Results.)

While the chief audit executive reports functionally to the board, the administrative reporting relationship is often to a member of management. This enables access to senior management and the authority to challenge management's perspectives. To achieve this authority, it is leading practice for the chief audit executive to report administratively to the chief executive officer or equivalent, although reporting to

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another senior officer may achieve the same objective if appropriate safeguards are implemented. Subsidiary, branch, and divisional heads of the internal audit function should be able to communicate directly with the senior management responsible for those areas.

When evaluating whether independence is impaired, the chief audit executive should consider reporting relationships, roles, and responsibilities to determine whether actual, potential, or perceived impairments exist. Additionally, through discussions with the concerned parties, the chief audit executive may be able to resolve any situations of perceived impairments that do not in fact affect the internal audit function's ability to perform its responsibilities independently.

Situations that may introduce impairments to independence include:

- The chief audit executive lacks direct communication or interaction with the board.
- Management attempts to limit the scope of the internal audit services that were previously approved by the board and documented in the internal audit charter.
- Management attempts to restrict access to the data, records, information, personnel, and physical properties required to perform the internal audit services.
- Management pressures internal auditors to suppress or change internal audit findings.
- The budget for the internal audit function is reduced to a level that leaves the function unable to fulfill its responsibilities as outlined in the internal audit charter.
- An assurance engagement is performed by the internal audit function or supervised by the chief audit executive in a functional area for which the chief audit executive is responsible, has oversight, or is otherwise able to exert significant influence.
- The internal audit function performs, or the chief audit executive supervises, assurance services related to an activity that is managed by a senior executive (non-CEO) to which the chief audit executive reports administratively. For example, the chief audit executive reports to the chief financial officer and is responsible for auditing treasury, a function that also reports to the chief financial officer.

In addition to the responsibilities of managing the internal audit function, the chief audit executive is sometimes asked to take on nonaudit roles that may impair or appear to impair the internal audit function's independence. Examples include situations such as:

- A new regulatory requirement prompts an immediate need to develop controls and other risk management activities to ensure compliance.
- The chief audit executive has the most appropriate expertise to adapt existing risk management activities to a new business segment or geographic market.
- The organization's resources are too constrained or the organization is too small to afford a separate compliance function.

When discussing nonaudit roles and responsibilities with the board and senior management, the chief audit executive should identify appropriate safeguards depending on whether the roles are permanent or temporary and intended to be transferred to management.

When the board agrees that an impairment has occurred, the chief audit executive should suggest to the board and senior management potential safeguards to manage the risks. It is also important to specify a timeline for transitioning temporary nonaudit responsibilities to management.

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The requirement is to have assurance activities overseen by an independent third party for the subsequent 12 months after the chief audit executive completes temporary responsibilities in that area. However, judgment should be used as there may be circumstances whereby the perception of impairment may exist beyond 12 months. The chief audit executive should discuss with the board and senior management whether 12 months is appropriate or not.

To determine the other parties to which disclosure of existing impairments must be made, the chief audit executive should consider the nature of the impairment, the impairment's impact on the reliability of the results of internal audit services, and the expectations of relevant stakeholders. If a potential impairment of the internal audit function's independence is discovered after an engagement has been completed that may affect the reliability or perceived reliability of the engagement findings, recommendations, and/or conclusions, the chief audit executive should discuss the concern with the management of the activity under review, the board, senior management, and/or other affected stakeholders and determine the appropriate actions to resolve the situation. (See also Standards 2.3 Disclosing Impairments to Objectivity and 11.4 Errors and Omissions.)

Before a chief audit executive is hired, the board should be involved in the recruitment and appointment process. For example, the board may discuss the qualifications and competencies necessary to lead the internal audit function and perform any additional roles and responsibilities expected by the organization. Additionally, the board should consider reviewing candidates' résumés and participating in interviews before a candidate is selected.

Examples of Evidence of Conformance

- The internal audit charter, which documents the internal audit function's reporting relationships.
- Meeting minutes or other evidence of the chief audit executive's direct communication with the board and senior management regarding potential impairments to independence and planned safeguards.
- Board meeting minutes or other documentation showing that the chief audit executive confirmed with the board the ongoing independence of the internal audit function or discussed impairments affecting the internal audit function's ability to fulfill its mandate and the safeguards to manage the impairments.
- The internal audit charter documenting board approval of long-term nonaudit roles and responsibilities and corresponding safeguards to independence, including the expected duration of the roles, responsibilities, and safeguards and how the effectiveness of the safeguards will be evaluated periodically.
- Documented methodologies to be followed when an impairment is suspected or identified.
- Formal action plans that outline specific safeguards to address independence concerns.
- Documentation of assurance services to be provided by other internal or external providers as a safeguard to independence.
- Minutes or other documentation evidencing the board's approval of the appointment or removal of the chief audit executive.

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