

WASHINGTON SUBURBAN SANITARY COMMISSION

EXTERNAL QUALITY ASSESSMENT OF INTERNAL AUDIT ACTIVITY

APRIL 2016



ASSURANCE, TAX & ADVISORY SERVICES

WASHINGTON SUBURBAN SANITARY COMMISSION

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EXECUTIVE SUMMARY

Conformance with the *Standards*

As requested by the Chief Audit Executive (CAE), PBMares, LLP conducted an external quality assessment of the internal audit activity of Washington Suburban Sanitary Commission (WSSC). The principal objectives of the quality assessment were to:

- Assess the internal audit activity's conformance to The Institute of Internal Auditors' (IIA's) *International Standards for the Professional Practice of Internal Auditing (Standards)*;
- Evaluate the internal audit activity's effectiveness in carrying out its mission (as set forth in its charter and expressed in the expectations of WSSC's management); and
- Identify opportunities to enhance its management and work processes, as well as its value to WSSC.

The IIA's *Quality Assessment Manual* suggests a scale of three ratings, "Generally Conforms," "Partially Conforms," and "Does Not Conform."

Generally Conforms means that an internal audit activity has a charter, policies, and processes that are judged to be in conformance with the *Standards*. Partially Conforms means deficiencies in practice are noted that are judged to deviate from the *Standards*, but these deficiencies did not preclude the internal audit activity from performing its responsibilities in an acceptable manner. Does Not Conform means deficiencies in practice are judged to be so significant as to seriously impair or preclude the internal audit activity from performing adequately in all or in significant areas of its responsibilities.

It is our overall observation that the internal audit activity generally conforms with the *Standards* and Code of Ethics. For a detailed list of conformance with individual *Standards*, please see attachment A. The quality assessment team identified opportunities for further improvement, details of which are provided in this report.

Thank you for the opportunity to be of service to WSSC. We will be pleased to respond to further questions concerning this report and furnish any desired information.

PBMares, LLP

PBMares, LLP

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EXECUTIVE SUMMARY (Continued)

Scope and Methodology

As part of the preparation for the quality assessment, the internal audit activity prepared an advanced preparation document with detailed information and sent out surveys to its staff and a representative sample of WSSC executives. A summary of the survey results (without identifying the individual survey respondents) was discussed with the CAE and Audit Manager.

Before commencement of the onsite work by the quality assessment team on March 10, 2016, the team leader conducted a preliminary meeting with WSSC to gather additional background information, select executives for interviews during the onsite fieldwork, and finalize planning and administrative arrangements for the quality assessment. In addition to extensive interviews with WSSC's audit committee chairman, executives (including heads of operating and support divisions), external auditors, internal audit activity staff, and regional managers (some of them by telephone) were also interviewed. The internal audit activity's risk assessment and audit planning processes, audit tools and methodologies, engagement and staff management processes, and a representative sample of the internal audit activity's workpapers and reports were also reviewed.

Findings, Recommendations, and Observations: Summary

The internal audit activity environment where we performed our assessment is well structured and progressive where the *Standards* are understood, and management is endeavoring to provide useful audit tools and implement appropriate practices. Consequently, our comments and recommendations are intended to build on this foundation already in place in the internal audit activity.

Findings, recommendations and observations are divided into three groups:

- Findings that relate to the internal audit activity's structure, staffing, deployment of resources, and similar matters that should be implemented within the internal audit activity, with support from senior management and those charged with governance.
- Recommendations on process improvement opportunities for the internal audit activity to consider in its continuous improvement efforts. These do not indicate a lack of conformance to mandatory guidance of The IIA's International Professional Practices Framework (IPPF). They are offered as suggestions for the continued growth of the internal audit activity's successful internal audit practice.
- Observations that recognize best practices employed by the internal audit activity leading to a level of performance beyond generally conforming to the mandatory guidance of the IPPF.

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FINDINGS, RECOMMENDATIONS, AND OBSERVATIONS: DETAILS

Part I—Findings

These findings, recommendations, and observations originated principally from the comments received from the management survey, interviews with selected executives, and follow-up of these matters. All are of direct importance to adherence to the *Standards* and to enhancing effectiveness and added value of the internal audit activity.

1. Impairment of Independence

Standard 1130 *Impairment to Independence or Objectivity* states “Impairment to organizational independence and individual objectivity may include, but is not limited to, personal conflict of interest, scope limitations, restrictions on access to records, personnel, and properties, and resource limitations, such as funding.”

As a result of resolution #2015-2077 to the Audit Committee Charter, a scope limitation has been imposed on the internal audit activity. As noted above, restrictions to access Commission personnel and other records impairs the independence and objectivity of the internal audit activity.

Recommendations

PBMares, LLP recommends that the Internal Audit Charter be amended in order to remove restrictions on access to records in order for the committee to appear independent and objective in fact and appearance. In addition, as a best practice measure, all records pertaining to personnel should be housed in a central location within Human Resources.

Audit Committee Response

WSSC is governed by a Board of Commissioners comprised of six members (independent of management) appointed by the County Executives of Prince George’s and Montgomery Counties. The Commission Board provides leadership, guidance and oversight of WSSC which includes (but is not limited to) setting the strategic direction for the agency, establishing general policy and guidelines for the operation of the agency and supervising and managing 3 direct reports – the General Manager, Corporate Secretary and Internal Audit Director – which the Commission has delegated certain of its authority to each, to accomplish matters falling within the Commission’s original jurisdiction. The three direct reports are contractual at-will employees reporting directly to and serving at the pleasure of the Commission body. The Commission Office/Board of Commissioners is a separate business unit that operates independent of Operations (with authority for managing the agency’s day-to-day Operations (outside of the Corporate Secretary and Internal Audit Director Offices)

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FINDINGS, RECOMMENDATIONS, AND OBSERVATIONS: DETAILS

Part I—Findings (Continued)

having been delegated by the Commission to the General Manager). As such, the confidential personnel records and files for the Commission Office's three direct reports are kept separately in the Commission Office's files. Additionally, the authority and responsibilities that have been delegated by the Commission to the Internal Audit Director (and Internal Audit Office) extend only to the business functions that fall under management and operations and in no way covers or extends to the supervisory office from which the Internal Audit Director's authority is derived. Oversight of Commission Office personnel matters and files falls under the responsibility of the Personnel and Governance Committee of the Commission.

The Audit Committee disagrees with PBMares' finding and recommendation relating to Impairment of Independence for the reasons stated above.

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FINDINGS, RECOMMENDATIONS, AND OBSERVATIONS: DETAILS

Part II—Recommendations for the Internal Audit Activity

1. Audit Reporting

Standard 1321 *Use of “Conforms with the International Standards for the Professional Practice of Internal Auditing”* states “the CAE may state that the internal audit activity conforms with the International Standards for the Professional Practice of Internal Auditing only if the results of the quality assurance and improvement program support this.”

The internal audit activity conforms with the Standards when it achieves the outcomes described in the Definition of Internal Auditing, Code of Ethics, and Standards. The results of the quality assurance and improvement program (QAIP) include the results of both internal and external assessments.

Recommendation

Based on PBMares, LLP’s observations WSSC’s internal audit activity confirms with the *International Standards for the Professional Practice of Internal Auditing*, and should reference conformity within issued reports. Also, consider documenting in the Internal Audit Policies and Procedures Manual the requirements for performing external assessments at least once every five years as required by Standard 1312 and reporting the results of the QAIP, including both internal and external assessments, to senior management and the board.

Internal Audit Response

We concur with the observations and are pleased to comply with the recommendations in the following manner:

- Commencing May 1, 2016, the internal audit activity will include the following statement in its audit reports “the internal audit activity conforms with the *International Standards for the Professional Practice of Internal Auditing*.”
- Effective May 30, 2016, the Internal Audit Policies and Procedures Manual will be modified to reflect the requirement for performing external assessments at least once every five years and reporting the results of internal and external assessments of the QAIP to senior management and the Board of Commissioners.

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FINDINGS, RECOMMENDATIONS, AND OBSERVATIONS: DETAILS

Part II—Recommendations for the Internal Audit Activity (Continued)

2. Project Planning

The internal audit activity does an excellent job of following-up on and ensuring audit recommendations are implemented by the respective departments, however does not complete until a project until all recommendations have been implemented. Often, it takes time for a department to implement audit recommendations and for the internal audit activity to adequately follow-up on the applicable recommendations, which may delay the overall reporting and completion of a project.

Recommendation

Consider ways to compartmentalize projects into phases that can be closed out within an established time period. For example, the completion of the procedures and findings could be considered one phase, while follow-up and remediation of audit recommendations could be a second phase. Using a phase approach may allow the audit function to better manage the status and completion of audit projects.

Internal Audit Response

We concur with the observation and will take the necessary steps to break down audit project phases into more manageable time frames. This action will commence with the start of the Fiscal Year 2017 (FY '17) Risk-Based Audit Plan. The FY' 17 Risk-Based Audit Plan is scheduled to be presented for approval to the Board of Commissioners at the July 20, 2017 Commission Meeting.

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FINDINGS, RECOMMENDATIONS, AND OBSERVATIONS: DETAILS

Part III—Observations of Best Practices

1. Audit Workpapers

Workpapers reviewed during this quality assessment were of beyond expectations. Workpapers were clear, concise and adequately document their purpose and conclusions reached. The internal audit activity has worked extremely hard to in order to streamline their software in a manner that allows for automation of various workpapers and templates in order to gain efficiencies throughout the projects.

2. Use of Key Performance Indicators and Monitoring Process

The use of key performance indicators allows the internal audit activity to document both qualitative and quantitative factors in order to evaluate and monitor how efficiently and effectively the activity is performing and achieving key strategic objectives.

3. Audit Monitoring and Value

The internal audit activity constantly seeks feedback and evaluations both from its own staff as well as others within WSSC to monitor quality and overall effectiveness. The activity appropriately monitors and follows up on recommendations to departments, and the activities value can measured qualitatively in the number of findings and recommendations that are implemented, and quantitatively by the significant cost savings to the Commission.

4. Internal Audit Activity Objectives

The internal audit activity's strategies and goals are adequately and clearly defined within the vision and mission statements. These statements have been skillfully developed in order to ensure the activity is assisting WSSC meet its objectives in a fiscally and ethically responsible manner, by striving to provide independent and objective appraisals of WSSC's internal controls, risk management system, and compliance with laws, regulations, policies, and procedures.

5. Employee Training

Auditors are encouraged to actively seek opportunities to stay well-informed informed of current developments in their field of work and are required to participate in a minimum number of these trainings annually to ensure their skills and knowledge base is appropriate in order to adequately perform their required tasks. In addition, the auditors are encouraged to acquire various certifications in order to enhance the value they add to each engagement.

ATTACHMENT A

WSCC Internal Audit - Quality Assessment Evaluation Summary

RATING DEFINITIONS

“Generally Conforms” means the assessor has concluded the following:

- For individual standards, that the internal audit activity conforms to the requirements of the standard (e.g., 1000, 1010, 2000, 2010, etc.) or elements of the Code of Ethics (both Principles and Rules of Conduct) in all material respects.
- For the sections (Attribute and Performance) and major categories (e.g., 1000, 1100, 2000, 2100, etc.), the internal audit activity achieves general conformity to a majority of the individual standards and/or elements of the Code of Ethics, and at least partial conformity to others, within the section/category.
- For the internal audit activity overall, there may be opportunities for improvement, but these should not represent situations where the internal audit activity has not implemented the *Standards* or the Code of Ethics, has not applied them effectively, or has not achieved their stated objectives.

“Partially Conforms” means the assessor has concluded the following:

- For individual standards, the internal audit activity is making good faith efforts to conform to the requirements of the standard (e.g., 1000, 1010, 2000, 2010, etc.) or element of the Code of Ethics (both Principles and Rules of Conduct) but falls short of achieving some major objectives.
- For the sections (Attribute and Performance) and major categories (e.g., 1000, 1100, 2000, 2100, etc.), the internal audit activity partially achieves conformance with a majority of the individual standards within the section/category and/or elements of the Code of Ethics.
- For the internal audit activity overall, there will be significant opportunities for improvement in effectively applying the *Standards* or Code of Ethics and/or achieving their objectives. Some deficiencies may be beyond the control of the internal audit activity and may result in recommendations to senior management or the board of the organization.

“Does Not Conform” means the assessor has concluded the following:

- For individual standards, the internal audit activity is not aware of, is not making good faith efforts to conform to, or is failing to achieve many/all of the objectives of the standard (e.g., 1000, 1010, 2000, 2010, etc.) and/or elements of the Code of Ethics (both Principles and Rules of Conduct).
- For the sections (Attribute and Performance) and major categories (e.g., 1000, 1100, 2000, 2100, etc.), the internal audit activity does not achieve conformance with a majority of the individual standards within the section/category and/or elements of the Code of Ethics.
- For the internal audit activity overall, there will be deficiencies that will usually have a significant negative impact on the internal audit activity’s effectiveness and its potential to add value to the organization. These may also represent significant opportunities for improvement, including actions by senior management or the board.

(GC = Generally Conforms, PC = Partially Conforms, DNC = Does Not Conform)

Quality Assessment Evaluation Summary—Overall Evaluation	GC	PC	DNC
OVERALL EVALUATION	X		

Quality Assessment Evaluation Summary—Major/Supporting Standards		GC	PC	DNC
1000	Purpose, Authority, and Responsibility			
1010	Recognition of the Definition of Internal Auditing, the Code of Ethics, and the <i>Standards</i> in the Internal Audit Charter	X		
1100	Independence and Objectivity			
1110	Organizational Independence	X		
1111	Direct Interaction with the Board	X		

Quality Assessment Evaluation Summary—Major/Supporting Standards		GC	PC	DNC
1120	Individual Objectivity	X		
1130	Impairment to Independence or Objectivity		X	
1200	Proficiency and Due Professional Care			
1210	Proficiency	X		
1220	Due Professional Care	X		
1230	Continuing Professional Development	X		
1300	Quality Assurance and Improvement Program			
1310	Requirements of the Quality Assurance and Improvement Program	X		
1311	Internal Assessments	X		
1312	External Assessments	X		
1320	Reporting on the Quality Assurance and Improvement Program	X		
1321	Use of "Conforms with the <i>International Standards for the Professional Practice of Internal Auditing</i> "		X	
1322	Disclosure of Nonconformance	X		
2000	Managing the Internal Audit Activity			
2010	Planning	X		
2020	Communication and Approval	X		
2030	Resource Management	X		
2040	Policies and Procedures	X		
2050	Coordination	X		
2060	Reporting to Senior Management and the Board	X		
2070	External Service Provider and Organizational Responsibility for Internal Auditing	X		

Quality Assessment Evaluation Summary—Major/Supporting Standards		GC	PC	DNC
2100	Nature of Work			
2110	Governance	X		
2120	Risk Management	X		
2130	Control	X		
2200	Engagement Planning			
2201	Planning Considerations	X		
2210	Engagement Objectives	X		
2220	Engagement Scope	X		
2230	Engagement Resource Allocation	X		
2240	Engagement Work Program	X		
2300	Performing the Engagement			
2310	Identifying Information	X		
2320	Analysis and Evaluation	X		
2330	Documenting Information	X		
2340	Engagement Supervision	X		
2400	Communicating Results			
2410	Criteria for Communicating	X		
2420	Quality of Communications	X		
2421	Errors and Omissions	X		
2430	Use of "Conducted in Conformance with the <i>International Standards for the Professional Practice of Internal Auditing</i> "		X	
2431	Engagement Disclosure of Nonconformance	X		

Quality Assessment Evaluation Summary—Major/Supporting Standards		GC	PC	DNC
2440	Disseminating Results	X		
2450	Overall Opinions	X		
2500	Monitoring Progress	X		
2600	Communicating the Acceptance of Risks	X		
	The IIA's Code of Ethics	X		