

**DISTRICT OF COLUMBIA  
WATER AND SEWER AUTHORITY**

**Board of Directors**

*Audit Committee*

*Thursday, December 22, 2011*

9:30 a.m.

1. **Call to Order** ..... Bradford Seamon, Chairperson
  
2. **External Auditor Status**..... Uzma Malik-Dorman  
**Thompson, Cobb, Bazilio & Associates**
  
3. **Summary of Internal Audit Activity/Internal Audit Status**..... Joseph Freiburger
  - A. Grant Operations Report Final
  - B. IT Vendor Management Report Final
  - C. Human Capital Management Report Final
  
4. **Executive Session**..... Bradford Seamon
  
5. **Adjournment**



*Internal Audit Update*  
*Audit Committee Meeting*  
*December 22, 2011*

The following represents a summary of the activities and achievements since the September 22, 2011 meeting.

**I. HIGHLIGHTS:**

Performance of scheduled internal audits – Internal Audit performed audit work in six separate audit areas. Three of the projects were totally completed and the final report issued. The three projects completed were the internal audits of Grant Operations, Human Capital Management, and IT - Vendor and Contractor Management. The one project in Draft Report stage is Risk Management. The two other projects, IT Operations & Business Applications, and Payroll are in the Fieldwork stage. The chart below depicts the planned projects and their status for the fiscal year.

**A. Stage of Audits & Special Projects** - The following represents an indication of the stage of completion for each scheduled audit and requested special project.

PROJECT	PLANNING / SCOPING	FIELDWORK	Draft Report	Final Report
Grant Operations <sup>1</sup>				
IT Business & Operating Applications <sup>1</sup>				
IT Vendor & Contractor Management <sup>1</sup>				
Human Capital Management <sup>1</sup>				
Payroll				
Risk Management				
IT Help Desk and Computer Operations				
IT Governance				
Accounts Payable				
Call Center Operations				
Warehouse Operations				
Biosolids Management				

Maintenance Services (Wastewater)				
Capital Projects				
Permit Operations				

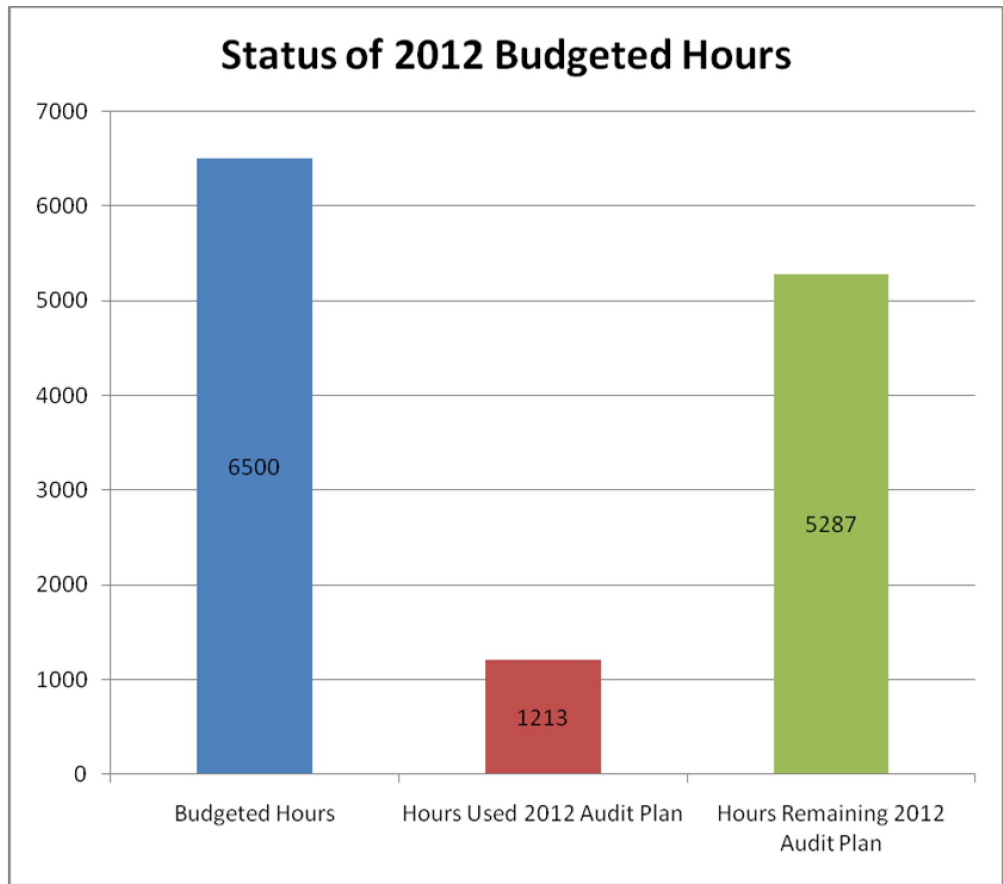
**Note:** <sup>1</sup> indicates carry over from 2011 audit plan.

**B. Analysis of key milestone dates** - The following represents an indication of the date of completion of key project milestones.

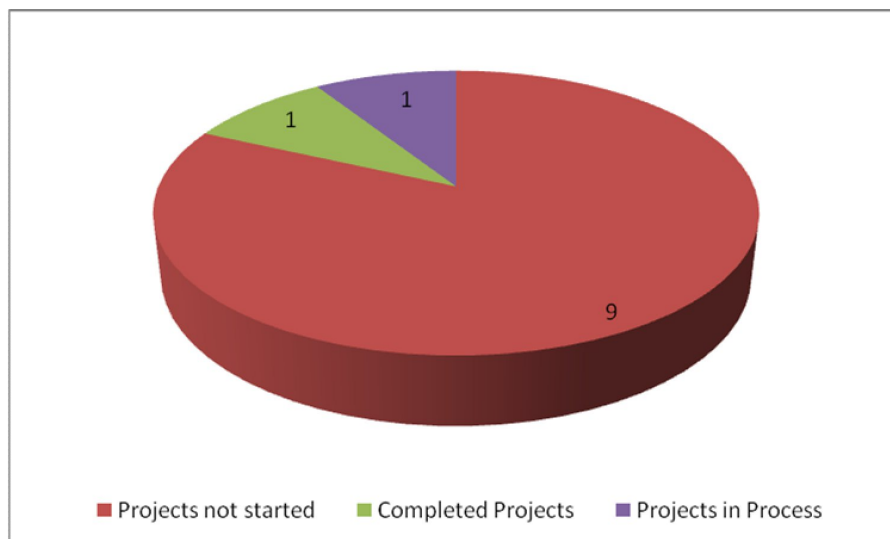
PROJECT	Start Date	FIELDWORK End Date	Draft Report Issuance Date	Final Report
Grant Operations <sup>1</sup>	6/28/2011	9/7/2011	9/12/2011	10/20/2011
IT Business & Operating Applications <sup>1</sup>	9/13/2011	12/7/2011		
IT Vendor & Contractor Management <sup>1</sup>	7/21/2011	9/9/2011	9/12/2011	10/6/2011
Human Capital Management <sup>1</sup>	6/2/2011	9/5/2011	9/7/2011	11/29/2011
Payroll	10/11/2011			
Risk Management	10/10/2011	12/9/2011		
IT Help Desk and Computer Operations				
IT Governance				
Accounts Payable				
Call Center Operations				
Warehouse Operations				
Biosolids Management				
Maintenance Services (Wastewater)				
Capital Projects				
Permit Operations				

**Note:** <sup>1</sup> indicates carry over from 2011 audit plan.

C. **Analysis of Hours** – The chart below indicates the actual hours used through November 30, 2011 toward completion of the internal audit plan, along with an indication of the total hours included in the 2012 plan.



## II. 2012 Audit Plan Status



### A. Completed Projects Since Last Audit Committee Meeting

#### Grant Operations –

Internal Audit established four objectives for its review of grant operations:

- Evaluate the grant application process
- Evaluate the grant project construction and spending process
- Evaluate the grant reimbursement process
- Evaluate the monitoring and control activities related to the relevant processes within the grant operations

We performed a review of the grant application process and documented the process, identified risks and controls within the process, examined for control design weaknesses, control gaps, and process improvement opportunities.

During our review we noted sufficient controls in place within the process to ensure that all grant applications are properly supported and timely submitted, allowing grant awarding agencies to support the District, and in particular DC Water, in carrying out federally mandated projects related to the Safe Drinking Water Act and the Clean Drinking Water Act provisions. During our review of the process, we did not identify any necessary process improvements, and we are therefore, from a design perspective, satisfied with the existing monitoring and control activities within the grant application process.

We also performed a review of the grant project construction and spending process related to the Clean Water Act and the Safe Drinking Water Act grants. We documented the process, identified risks and controls within the process; and reviewed for control gaps, control design weaknesses and process improvement opportunities within the process. We identified sufficient controls in place to ensure compliance with applicable laws and regulations, to ensure proper implementation of grant projects, and we identified proper controls in place to ensure project performance once the project is completed and initiated into operation. Our evaluation of the process did not identify any improvement opportunities within the process, and we conclude the monitoring and control activities within the grant construction and spending process is sufficient.

Finally, we performed a review of the grant reimbursement process, where we documented the process, identified risks and controls within the process, and based on these observations we examined the activities for control design weaknesses, controls gaps, and opportunities to improve the process. During our review we identified sufficient controls in place to ensure existence of all supporting documentation included in the reimbursement requests. We also identified sufficient controls in place to ensure that only paid invoices were submitted for reimbursement, and that grant payments were handled with proper segregation of duties. However, the reimbursement process is currently a highly manual process prone to human error. We therefore see a need to improve the process by automating the manual aspects of the grant reimbursement process.

It is our understanding that DC Water's Finance department is currently working on adding a special grant administration module to Lawson, which may correct the issue noted during this audit. An effective management action plan should therefore be readily available to address the issue noted.

### **Human Capital Management –**

Internal audit established six objectives for its audit of the Human Capital Management (HCM) internal controls:

- Determine whether HCM activities are conducted in accordance with DC Water Policies and employment laws and regulations.
- Determine whether physical personnel files are properly secured and restricted to authorized users.
- Determine whether there are procedures in place to ensure that compensation adjustments in the HCM/Payroll system are authorized; and HCM and payroll functions are segregated within the HCM/Payroll system.
- Determine whether there are procedures in place to ensure the accuracy of the data entered into the HCM/Payroll system.
- Determine whether there are procedures in place to ensure job performance is monitored and documented; performance expectations are communicated to employees.

- Determine whether there are procedures in place to ensure that proper procedures are followed when an employee is terminated and effective measures are performed timely.

Internal Audit evaluated HCM recruiting and hiring activities to determine whether they are conducted in accordance with DC Water Policies. As part of our evaluation we reviewed a sample of new hire files. We noted that the new hire interviews and selection process was properly documented with Interview Scoring Matrices and Notes and the Hiring Manager Selection Memo, as stated in the “*Recruiting Standard Operating Procedures (SOP’s)*”.

However, during the course of our review, we became aware of irregularities in the screening process when internal candidates applied for open positions. During screening activities, resumes and/or applications for open positions are received and reviewed in order to identify qualified applicants. As a result of the irregularities in the screening process, qualified applicants may have not been recommended for a position interview. We also learned that, HCM is updating the Interviewing and Selection Policies and Procedures, including specific guidelines on the proper applicant screening process. Additionally, HCM will offer training on interviewing techniques to Hiring Managers and potential interviewers. Internal Audit will separately review the revised process.

We noted that each of the new hires selected in our sample had a complete background check and a proper Employment Verification Form (Form I-9) included in the personnel file. Although there is no formal process in place to monitor work authorization status for non-U.S. citizen employees, HCM is in the process of implementing one.

Internal Audit evaluated whether there are procedures in place to ensure that physical personnel files are properly secured and restricted to authorized users. We observed the physical location of personnel records and we determined that physical personnel records are stored in a restricted location and secured to prevent damage and/or loss.

Internal Audit evaluated whether there are procedures in place to ensure that compensation adjustments in the HCM/Payroll system are authorized. We evaluated procedures in place to identify unauthorized adjustments. As part of our evaluation, we learned that a validation review of compensation adjustments made in the HCM/Payroll system is performed; however the review is not documented. In the absence of review documentation, we reconciled a sample of compensation adjustments made in the HCM/Payroll system to the supporting documents in the employees’ personnel records. Based on our reconciliation, we noted that adjustments were properly supported with the authorization documents. Although our evaluation did not reveal any unauthorized compensation adjustments, we recommend that all compensation adjustment reviews be documented and signed off by the designated reviewer.

We also evaluated procedures in place to prevent unauthorized adjustments within the HCM/Payroll system. We determined that appropriate segregation of roles between HCM and Payroll does exist within the system and compensation adjustments could be made only by users with the appropriate security roles designated within the system.



Internal Audit did not test the accuracy of the data in the HCM/Payroll system. Instead, we inquired about the process in place to ensure that the data entered in the HCM/Payroll system by the data entry clerk is accurate. Based on our inquiries, we learned that the HCM System Administrator reviews information entered for accuracy and propriety, but the review process is not documented. We recommend that HCM create a data reconciliation binder and document the data entry reviews and reconciliations.

Internal Audit examined procedures in place to monitor compliance with applicable federal employment laws and regulations. We observed various DC Water common areas and identified that Equal Employment Opportunity Act (EEO) notices were posted as required by federal law. We also inquired of HCM personnel about EEO training requirements for supervisors, and learned that supervisors are provided training on EEO topics such as sexual harassment and discrimination. Newly promoted, or hired, supervisors are required to take EEO training upon promotion or hiring. Refresher training is offered every three years thereafter, and it is mandatory for all supervisors to participate. However, we noted that compliance with mandatory EEO training is not being monitored and records pertaining to training are not being maintained. We recommend that a monitoring process be put in place.

In addition, we noted that efforts have been made to update DC Water policies related to employment laws and regulations to reflect current laws and regulations; however, these policies have not been officially approved by the General Manager and distributed to all employees. We recommend that the relevant policies be approved and distributed as soon as possible.

Internal Audit examined a sample of personnel records to determine if performance evaluations were completed and properly documented. We noted most evaluations in our sample were completed and documented. According to the *“DC Water Employees Annual Performance Evaluation Guidelines”* the employee and supervisor must sign the annual performance evaluation form and confirm that the initial annual performance plan and any subsequent adjustments to the plan were discussed and agreed to. However, we noted that a number of performance evaluations examined did not have evidence of the initial annual performance plan discussion between employee and supervisor.

Finally, Internal Audit evaluated the Employee Termination process to make certain that policy is being followed and appropriate measures take place in a timely manner. Under the current termination process, HCM relies on the terminated employee’s department Manager to initiate the termination communication process. The department Manager is required to initiate the termination communication process by completing a Separation Personnel Action Report (SPAR) and submitting it to HCM for approval. However, the department Manager does not always complete and submit the SPAR to HCM. This may result in terminated employees remaining in the HCM/Payroll system with an active status after the effective termination date. In addition, access to the IT network and DC Water facilities may not be promptly terminated. We recommend that HCM collaborate with the Department Heads to identify and designate a point of contact in charge of promptly communicating with HCM and applicable parties when employees are terminated.

Once the designated points of contact have been identified, HCM should reach out to each point of contact regarding the existence of recently terminated employees to make certain the correct procedures are completed.

### **IT – Vendor and Contractor Management**

Internal audit established the following objectives to assess IT vendor contract management:

- Ensure proper due diligence is practiced prior to contract initiation and upon renewal
- Ensure effective procedures are in place to manage IT vendor contracts and monitoring vendor performance

Internal audit interviewed senior management of the Department of Information Technology to gain an understanding of their role in the selection, management and monitoring of IT vendors. It was determined that their role is limited and the key responsibility resides with the primary business owners. IT's role is centered primarily on network monitoring and providing limited support when requested.

Internal audit also conducted a series of interviews with those responsible for managing the Ceridian and Vertex contracts. Their role in the management process was identified.

Internal Audit reviewed the contracts for both vendors along with other relevant documents on file. Internal audit noted records related to due diligence along with specific terms listed in the service level agreements, including penalties for nonperformance. The service level agreements (SLAs) and nonperformance penalties were clearly listed in each contract and provided clarity on what management should be monitoring.

The intent of the interviewing and file review was to address specific topics of interest related to assessing whether:

- There was adequate communication between the vendor and DC Water and the vendor was responsive to the needs of DC Water
- DC Water was receiving reports identifying vendor performance
- Performance reports identified compliance with the contract and the SLAs
- DC Water collected any required reimbursements in the case of nonperformance
- Management evaluated internal control reports pertaining to each vendor
- Any noncompliance with contractual terms was addressed timely

Another area of audit focus was an identification of DC Water's review of reports by independent sources relative to the internal control environment at the outside vendor. It is essential that these vendors provide assurance to DC Water that they have established proper safeguards for their operations. In the two areas under review, both vendors process vital information (Customer Billing Data and Employee payroll data). In the case of IT vendors, the most essential report for assessing their internal control environment is the SSAE 16 (formerly known as SAS 70) report.

Both business process owners received reports for the vendors and they are reviewed as a part of the monitoring process. Internal audit reviewed both SAS 70 reports prepared by independent auditors to determine if there were any significant deficiencies involving internal controls. Both SAS 70s reported that each company had adequate safeguards in place to protect the data of the clients they serve.

Based on the audit procedures noted above, we determined that the vendor relationships are being actively managed. There were two areas in which we determined controls and processes could be improved:

- Policies and procedures should be developed to clearly describe the roles and responsibilities of the individuals relative to IT contract management from the initiation of a contract with a vendor to on-going monitoring and subsequent contract renewal
- The Department of Information Technology should participate in the process to determine whether the outside vendor has demonstrated sufficient IT internal controls

### **Risk Management**

Internal audit established four objectives for its audit of the Risk Management department activities:

- Assess the effectiveness of the risk management process.
- Determine whether outside expertise is obtained to properly identify risk, outline options to mitigate risk, and brokerage firms are providing adequate guidance, documentation and performing within their contractual obligations.
- Determine whether DC Water has obtained sufficient insurance coverage to address insurable risk.
- Assess the adequacy of reporting and review procedures relative to processing liability claims.

As of the distribution date of this status report this project was in the Draft Reporting stage. Specific observations and responses from DC Water Management will be presented at the February committee meeting.

### **B. Audits Currently in Process**

IT Operating & Business Applications – This audit is designed to evaluate and test the effectiveness of processing controls built into and around the application to ensure data integrity is preserved and reporting includes accurate and complete data. We will assess the security, confidentiality, and availability of the application information/data as well as the adequacy and maintenance of related system documentation. This project is currently in the final stage of fieldwork.

Payroll– This audit is designed to evaluate and test the design and effectiveness of controls over payroll processing. This project is currently in the fieldwork stage.

### III. Follow Up

In addition to our work performed relative to the audit projects identified in the 2012 Internal Audit Plan, Internal Audit conducted follow-up activity relative to previously reported audit comments. The table below summarizes the issues by area of responsibility and the current status of the action plan proposed by Management.

	Chief Engineer	AGM Consumer Services	Chief Financial Officer	General Counsel	Chief Information Officer	AGM Support Services	General Manager	Total
New Management Action Plans Since Previous Meeting	-	-	1	-	-	7	-	8
Management Action Plans Implementation Date Not Expired	-	1	-	-	-	7	-	8
Management Action Plans Implementation Date Expired	3	-	-	-	3	3	1	10
Total	3	1	1	-	3	17	1	26

**Listed Below is the Originating Audit of the Management Action Plans With the Expired Implementation Dates**

**Chief Engineer** – Permit Operations

**Chief Information Officer** – Disaster Recovery Plans

**AGM Support Services** – Corporate Policies & Procedures; Succession Planning and Training; Safety

**General Manager** –Legal & Regulatory Compliance Monitoring – Regulatory Compliance Review

OTHER TOPICS:

Internal Audit is collaborating with DC Water's Chief Financial Officer regarding his initiative to develop a Fraud Mitigation plan for the organization.

Internal Audit is also working with DC Water to ensure there is no duplication of work between the Internal Audit plan and the Office of the CFO's Internal Control Assessment Monitoring Program.



**INTERNAL AUDIT OF GRANT OPERATIONS**

**October 20, 2011**

**INTERNAL AUDIT STAFF**

Staff Auditor: Perry Eggers  
Audit Manager: Dennis Fitzgerald  
Audit Principal: Joseph Freiburger

DC Water Internal Audit of Grant Operations

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**TABLE OF CONTENTS**

**I. EXECUTIVE SUMMARY .....3**

- Background
- Scope
- Objectives
- Summary of Work

**II. DETAILED OBSERVATIONS & RECOMMENDATIONS.....6**

DC Water Internal Audit of Grant Operations

## I. EXECUTIVE SUMMARY

### Background

For the fiscal year which ended on September 30, 2010, DC Water received \$8,148,189 in grants for safe drinking water projects. Up to 100 percent of the cost of a safe drinking water project can be reimbursed by grants. The Safe Drinking Water Act was established to protect the quality of drinking water in the U.S. This law focuses on all water actually or potentially designed for drinking use, whether from above ground or underground sources. The Act authorizes the Environmental Protection Agency (EPA) to establish minimum standards to protect tap water and requires all owners or operators of public water systems to comply with primarily health-related standards.

The Clean Water Act established the basic structure for regulating discharges of pollutants into the waters of the United States and regulating quality standards for surface water. The EPA awards grant funding to assist municipalities in creating or expanding sewage treatment plants as needed to comply with the Clean Water Act provisions. As the only water and sewer authority in the District of Columbia, DC Water is highly involved in carrying out all federally mandated projects, ensuring District compliance with the Clean Water Act provisions or ensuring working progress towards District compliance with the Clean Water Act provisions. For the fiscal year which ended on September 30, 2010, DC Water received \$4,908,768 in grants from the EPA to execute numerous clean water projects. Clean Water grants are available to fund 55% of a clean water project. These grant funds are received on a reimbursement basis.

The DC Water Department of Engineering & Technical Services (DETS) identifies and plans both clean water and safe drinking water projects at DC Water. All grant funds that DC Water is awarded are received on a reimbursement basis. Approval by DC Water's Board of Directors of initial funding to carry out clean water and safe drinking water projects is required before a project can be constructed. Due to budget restrictions, DC Water annually creates a project priority listing (PPL), which ranks the different proposed projects according to importance. In order to seek grant funding for clean and safe water projects included in the PPL, DC Water must obtain an approval of these projects from the grant awarding agency prior to executing the projects.

DETS is the department responsible for obtaining project approvals and preparing grant applications, whereas DC Water's Finance department is responsible for preparing the grant reimbursement requests. Clean water project grant applications are reviewed and approved by the District Department of the Environment (DDOE), whereas safe drinking water grant applications are reviewed and approved by the EPA. However, all grant assistance agreements are prepared by the EPA, and the EPA is also the only agency reimbursing the grantees for eligible grant project expenses incurred.

Safe drinking water and clean water projects are carried out by independent contractors, which are contracted through the normal procurement/bidding process at DC Water.



DC Water Internal Audit of Grant Operations

Once invoices, received from the bid-winning contractor working on a grant eligible project, have been processed and paid by DC Water; the Finance department's Grant Manager prepares the grant reimbursement request. The request includes all support for eligible grant project disbursements. All reimbursement requests must be reviewed and approved by a special grant unit under the U.S. Army Corps of Engineers (COE) before the EPA payment center can process the payment for reimbursement. Grant payments are received by DC Water's Treasury department, and all grant balances are maintained by the Finance Grant Manager. A grant project is completed when the COE has inspected and approved the project.

**Scope**

This audit was conducted as part of the approved FY2011 Internal Audit plan. The audit was initiated in July 2011 and completed in August 2011, and included a review of all relevant aspects of grant operations at DC Water.

We reviewed the processes with individuals involved in the daily grant operations to determine the nature of the processes in place at DC Water with regard to keeping grant operations operational and uninterrupted, allowing DC Water to carry out the federally mandated clean water and safe drinking water programs or projects.

We reviewed applicable information and formally documented the relevant processes within the grant operation. We obtained relevant evidence supporting the grant operation processes as described by the individual process owners and, from a design perspective; we performed a design review of the processes identified to evaluate the grant operations and controls in place at DC Water.

**Objectives**

Internal Audit established four objectives for its review of grant operations:

- Evaluate the grant application process
- Evaluate the grant project construction and spending process
- Evaluate the grant reimbursement process
- Evaluate the monitoring and control activities related to the relevant processes within the grant operations

**Summary of Work**

We performed a review of the grant application process and documented the process, identified risks and controls within the process, examined for control design weaknesses, control gaps, and process improvement opportunities.

DC Water Internal Audit of Grant Operations

During our review we noted sufficient controls in place within the process to ensure that all grant applications are properly supported and timely submitted, allowing grant awarding agencies to support the District, and in particular DC Water, in carrying out federally mandated projects related to the Safe Drinking Water Act and the Clean Drinking Water Act provisions. During our review of the process, we did not identify any necessary process improvements, and we are therefore, from a design perspective, satisfied with the existing monitoring and control activities within the grant application process.

We also performed a review of the grant project construction and spending process related to the Clean Water Act and the Safe Drinking Water Act grants. We documented the process, identified risks and controls within the process; and reviewed for control gaps, control design weaknesses and process improvement opportunities within the process. We identified sufficient controls in place to ensure compliance with applicable laws and regulations, to ensure proper implementation of grant projects, and we identified proper controls in place to ensure project performance once the project is completed and initiated into operation. Our evaluation of the process did not identify any improvement opportunities within the process, and we conclude the monitoring and control activities within the grant construction and spending process is sufficient.

Finally, we performed a review of the grant reimbursement process, where we documented the process, identified risks and controls within the process, and based on these observations we examined the activities for control design weaknesses, controls gaps, and opportunities to improve the process. During our review we identified sufficient controls in place to ensure existence of all supporting documentation included in the reimbursement requests. We also identified sufficient controls in place to ensure that only paid invoices were submitted for reimbursement, and that grant payments were handled with proper segregation of duties. However, the reimbursement process is currently a highly manual process prone to human error. We therefore see a need to improve the process by automating the manual aspects of the grant reimbursement process.

It is our understanding that DC Water's Finance department is currently working on adding a special grant administration module to Lawson, which may correct the issue noted during this audit. An effective management action plan should therefore be readily available to address the issue noted.

SC&H Consulting

By: \_\_\_\_\_  
Joe Freiburger, CPA, CIA

## II. DETAILED OBSERVATIONS & RECOMMENDATIONS

The existence of internal control weaknesses increases the likelihood that future errors or inappropriate transactions would not be prevented or detected. In order to mitigate this risk, we have provided recommendations to remediate the control weaknesses via the implementation of additional controls or modification of existing controls.

Observation #1	Internal Audit Recommendations	Management Comments
<p><b>Observations:</b></p> <p>Invoices for grant reimbursement are manually identified in Lawson and ImageNow, and all active grant balances are manually maintained and reconciled in multiple spreadsheets. This highly manual grant reimbursement process is prone to error, which may lead to grant balance inaccuracies or incorrect management decisions.</p>	<p><b>Recommendation(s):</b></p> <p>In order to eliminate the inherent risks in the highly manual reimbursement process, we recommend that DC Water complete the process of implementing the special grant administration Lawson module. With this system in place, there should no longer be a need to manually identify invoices eligible for grant reimbursement.</p> <p>Additionally, the grant administration module would also improve the grant balance reconciliation process, where grant balances automatically would be updated within Lawson once grant reimbursement payments have been received by the Treasury department.</p>	<p><b>Management's Action Plan and Implementation Date:</b></p> <p>Management agrees with the recommendation and plans to have the grants module implemented by September 30, 2012.</p>

Observation #1	Internal Audit Recommendations	Management Comments
	<p>The special grant administration module would also ensure that all grant reimbursement information readily available to other Finance staff members.</p> <p><i>Business Owner(s):</i>                      Olu Adebo                      Chief Financial Officer</p>	



**INTERNAL AUDIT OF IT VENDOR MANAGEMENT**

**October 6, 2011**

**INTERNAL AUDIT STAFF**

Staff Auditor: Carmon Choice  
Audit Manager: Dennis FitzGerald  
Audit Principal: Joseph Freiburger

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**TABLE OF CONTENTS**

**I. EXECUTIVE SUMMARY .....3**

- Background
- Scope
- Objectives
- Summary of Work

**II. DETAILED OBSERVATIONS & RECOMMENDATIONS.....6**

DC Water Internal Audit of IT Vendor Management

## **I. EXECUTIVE SUMMARY**

### **Background**

Internal Audit conducted an audit relative to the management of Information Technology (IT) vendor contracts. The services provided by IT vendors play an important role in the billing, payroll, and human resources functions of DC Water. Our audit focused primarily on the management of two IT vendor contracts: Vertex and Ceridian. Vertex and Ceridian are contracted to perform billing services and payroll services, respectively. These are the primary systems-based vendors for DC Water. Presently, Lauren Preston, Director of Customer Service, plays an active role in monitoring the Vertex contract. Cassandra Redd, Payroll Manager, actively monitors the contractual obligations of Ceridian. The Vertex and Ceridian contracts have been active since June 26, 2000 and September 14, 1999, respectively. The services performed by these vendors are critical to the operational efficiency of DC Water.

Due diligence should be practiced in selecting a vendor, taking into consideration strong internal controls, the cost/benefit of utilizing a particular vendor, and how services provided by the vendor can help DC Water reach operational objectives. As important as it is to perform due diligence prior to entering into a contract, it is also crucial that effective strategies are implemented to monitor vendor contracts.

### **Scope**

This audit was conducted as part of the approved FY2011 internal audit plan. The audit was initiated and completed in August 2011. Internal audit reviewed the existing relevant practices, examined the Vertex and Ceridian contracts; and interviewed IT, customer service, and payroll personnel. In addition, internal audit reviewed vendor performance and SAS 70 (internal control) reports for both Vertex and Ceridian.

### **Objectives**

Internal audit established the following objectives to assess IT vendor contract management:

- Ensure proper due diligence is practiced prior to contract initiation and upon renewal
- Ensure effective procedures are in place to manage IT vendor contracts and monitoring vendor performance

DC Water Internal Audit of IT Vendor Management

### Summary of Work

Internal audit interviewed senior management of the Department of Information Technology to gain an understanding of their role in the selection, management and monitoring of IT vendors. It was determined that their role is limited and the key responsibility resides with the primary business owners. IT's role is centered primarily on network monitoring and providing limited support when requested.

Internal audit also conducted a series of interviews with those responsible for managing the Ceridian and Vertex contracts. Their role in the management process was identified.

Internal Audit reviewed the contracts for both vendors along with other relevant documents on file. Internal audit noted records related to due diligence along with specific terms listed in the service level agreements, including penalties for nonperformance. The service level agreements (SLAs) and nonperformance penalties were clearly listed in each contract and provided clarity on what management should be monitoring.

The intent of the interviewing and file review was to address specific topics of interest related to assessing whether:

- There was adequate communication between the vendor and DC Water and the vendor was responsive to the needs of DC Water
- DC Water was receiving reports identifying vendor performance
- Performance reports identified compliance with the contract and the SLAs
- DC Water collected any required reimbursements in the case of nonperformance
- Management evaluated internal control reports pertaining to each vendor
- Any noncompliance with contractual terms was addressed timely

Another area of audit focus was an identification of DC Water's review of reports by independent sources relative to the internal control environment at the outside vendor. It is essential that these vendors provide assurance to DC Water that they have established proper safeguards for their operations. In the two areas under review, both vendors process vital information (Customer Data and Employee payroll data). In the case of IT vendors, the most essential report for assessing their internal control environment is the SSAE 16 (formerly known as SAS 70) report. Both business process owners received reports for the vendors and they are reviewed as a part of the monitoring process. Internal audit reviewed both SAS 70 reports prepared by independent auditors to determine if there were any significant deficiencies involving internal controls. Both SAS 70s reported that each company had adequate safeguards in place to protect the data of the clients they serve.



DC Water Internal Audit of IT Vendor Management

Based on the audit procedures noted above, we determined that the vendor relationships are being actively managed. There were two areas in which we determined controls and processes could be improved:

- Policies and procedures should be developed to clearly describe the roles and responsibilities of the individuals relative to IT contract management from the initiation of a contract with a vendor to on-going monitoring and subsequent contract renewal
- The Department of Information Technology should participate in the process to determine whether the outside vendor has demonstrated sufficient IT internal controls

The following pages describe the relevant Observations and Recommendations for Internal Audit, along with Management's Action plans.

SC&H Consulting

By: \_\_\_\_\_  
Joe Freiburger, CPA, CIA

## II. DETAILED OBSERVATIONS & RECOMMENDATIONS

The existence of internal control gaps could increase the likelihood that future errors or inappropriate transactions would not be prevented or detected. In order to mitigate this risk, we have provided recommendations to remediate the control gaps via the implementation of additional controls or modification of existing controls.

Observation #1	Internal Audit Recommendations	Management Comments
<p><b>Observations:</b></p> <p>Currently, no policies and procedures exist to provide basic guidance on contract monitoring following entry into a contract with an IT Vendor. Without such policies, vendor accountability may not be properly enforced and the overall risk of loss from mismanagement of contracts is increased.</p> <p>Currently, the IT department is not actively involved in IT vendor contract monitoring. Specifically, the IT department does not participate in the review of the internal controls of the outsourced IT vendors. By not having members of the IT department involved in the review of vendor SSAE 16 reports, there is an increased risk that improperly designed and/or ineffective IT controls go undetected. In addition, current IT control gaps existing within the Client Controls Considerations section of the report (outlining those controls in which the user rather than the service organization is responsible for) may also go undetected.</p>	<p><b>Recommendation(s):</b></p> <p>Internal audit suggests that general procurement manual procedures be updated to adequately reflect the role of IT in the evaluation of potential IT vendors. During the evaluation of potential IT vendors, procedures should be reflective of IT involvement in evaluating:</p> <ul style="list-style-type: none"> <li>• The service provider’s standards, policies, procedures relating to internal controls, security, privacy protections, maintenance of records, contingency planning, and systems development and maintenance.</li> <li>• The SSAE 16 reports of IT vendors in order to help identify the existence of any inadequate or failed IT internal controls.</li> <li>• Whether the service provider provides sufficient security precautions, including, when appropriate, firewalls, encryption, and customer identity authentication,</li> </ul>	<p><b>Management’s Action Plan and Implementation Date:</b></p> <p>The Procurement Manual will be updated to reflect the current procedure that any IT-related purchases will be approved by the CIO/designee. A draft of the revised section(s) of the manual will be presented to the AGM Support Services and Procurement Director by the end of October 2011.</p> <p>Policies and procedures for IT-related procurements will be drafted, detailing:</p> <p>(1) Vendor selection: IT’s involvement in IT-related vendor evaluation and selection in relation to applicable internal controls, security, privacy protections, maintenance of records, contingency planning, and systems development and maintenance; and</p>

Observation #1	Internal Audit Recommendations	Management Comments
	<p>to protect institution resources as well as detect and respond to intrusions.</p> <p>Internal audit suggests that the general tasks of the Contracting Officer's Technical Representative (COTR) be updated to reflect that the COTR should seek IT department assistance in reviewing the annual SSAE 16 reports of IT vendors in order to help identify the existence of any inadequate or failed IT internal controls. During the review, the IT department should also verify that all IT controls outlined within the Client Controls Consideration section are in place and operating effectively within DC Water's environment. In addition, procedures should reflect the COTR responsibility to consult with IT on matters relating to security, privacy protections, maintenance of records, contingency planning, and systems development and maintenance.</p> <p><b>Business Owner(s):</b> AGM Support Services</p>	<p>(2) Contract monitoring: COTRs will consult with IT on IT-related contract matters such as security, privacy protections, maintenance of records, contingency planning, and systems development/maintenance.</p> <p>A draft of the policies and procedures will be presented to the AGM Support Services and Director of Procurement by the end of the first quarter of 2012.</p> <p>The COTR authority letter will be updated with a section to add key deliverables, reporting, and/or other requirements. Key deliverables for IT-related contracts, including reviewing SSAE 16 reports, will be developed with IT. A draft of the revised letter will be presented to the AGM Support Services and Director of Procurement in mid-October 2011.</p> <p>Full implementation of all changes will be in place by March 31, 2012.</p>



**INTERNAL AUDIT OF HUMAN CAPITAL MANAGEMENT**

**November 29, 2011**

**INTERNAL AUDIT STAFF**

Senior Auditor: Jexter Rivera  
Audit Manager: Dennis Fitzgerald  
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**TABLE OF CONTENTS**

**I. EXECUTIVE SUMMARY .....3**

- Background
- Scope
- Objectives
- Summary of Work

**II. DETAILED OBSERVATIONS & RECOMMENDATIONS .....7**

## **I. EXECUTIVE SUMMARY**

### **Background**

The Human Capital Management Department (HCM) is responsible for attracting, recruiting and retaining employees for DC Water. The mission of the Department is to deliver high quality, innovative, valued and timely human resource services that are responsive to the needs of employees and the departments of the Authority and enable them to reach their individual and organizational goals. The Department is comprised of 5 divisions with a staff of 23 HCM professionals that provide services to more than one thousand employees. The following are examples of services provided by the HCM Department and its divisions:

- Recruitment and Hiring – Employment Division
- Performance Management – Compensation Division
- Americans with Disabilities Act (ADA) Compliance – Benefits Division
- EEO Complaint Investigation & Responses – Labor Relations Division
- Training – Training Division

### **Scope**

This audit was conducted as part of the approved FY2011 internal audit plan. This audit was initiated in June 2011 and completed in August 2011.

Internal audit conducted audit procedures to evaluate HCM activities in place during FY2011. Audit procedures included discussions with responsible parties, sample selection and testing, observation and inquiries of key personnel.

### **Objectives**

Internal audit established six objectives for its audit of the Human Capital Management internal controls:

- Determine whether HCM activities are conducted in accordance to DC Water Policies and employment laws and regulations.
- Determine whether physical personnel files are properly secured and restricted to authorized users.
- Determine whether there are procedures in place to ensure that compensation adjustments in the HCM/Payroll system are authorized; and HCM and payroll functions are segregated within the HCM/Payroll system.
- Determine whether there are procedures in place to ensure the accuracy of the data entered into the HCM/Payroll system.

DC Water Internal Audit of Human Capital Management

- Determine whether there are procedures in place to ensure job performance is monitored and documented; performance expectations are communicated to employees.
- Determine whether there are procedures in place to ensure that proper procedures are followed when an employee is terminated and effective measures are performed timely.

### Summary of Work

Internal Audit evaluated HCM recruiting and hiring activities to determine whether they are conducted in accordance with DC Water Policies. As part of our evaluation we reviewed a sample of new hire files. We noted that the new hire interviews and selection process was properly documented with Interview Scoring Matrices and Notes and the Hiring Manager Selection Memo, as stated in the “*Recruiting Standard Operating Procedures (SOP’s)*”.

However, during the course of our review, we became aware of irregularities in the screening process when internal candidates applied for open positions. During screening activities, resumes and/or applications for open positions are received and reviewed in order to identify qualified applicants. As a result of the irregularities in the screening process, qualified applicants may have not been recommended for a position interview. We also learned that, HCM is updating the Interviewing and Selection Policies and Procedures, including specific guidelines on the proper applicant screening process. Additionally, HCM will offer training on interviewing techniques to Hiring Managers and potential interviewers. Internal Audit will separately review the revised process.

We noted that each of the new hires selected in our sample had a complete background check and a proper Employment Verification Form (Form I-9) included in the personnel file. Although there is no formal process in place to monitor work authorization status for non-U.S. citizen employees, HCM is in the process of implementing one.

Internal Audit evaluated whether there are procedures in place to ensure that physical personnel files are properly secured and restricted to authorized users. We observed the physical location of personnel records and we determined that physical personnel records are stored in a restricted location and secured to prevent damage and/or loss.

Internal Audit evaluated whether there are procedures in place to ensure that compensation adjustments in the HCM/Payroll system are authorized. We evaluated procedures in place to identify unauthorized adjustments. As part of our evaluation, we learned that a validation review of compensation adjustments made in the HCM/Payroll system is performed; however the review is not documented. In the absence of review documentation, we reconciled a sample of compensation adjustments made in the HCM/Payroll system to the supporting documents in the employees’ personnel records. Based on our reconciliation, we noted that adjustments were properly supported with the authorization documents. Although our evaluation did not reveal any unauthorized compensation adjustments, we recommend that all compensation adjustment reviews be documented and signed off by the designated reviewer.

DC Water Internal Audit of Human Capital Management

We also evaluated procedures in place to prevent unauthorized adjustments within the HCM/Payroll system. We determined that appropriate segregation of roles between HCM and Payroll does exist within the system and compensation adjustments could be made only by users with the appropriate security roles designated within the system.

Internal Audit did not test the accuracy of the data in the HCM/Payroll system. Instead, we inquired about the process in place to ensure that the data entered in the HCM/Payroll system by the data entry clerk is accurate. Based on our inquiries, we learned that the HCM System Administrator reviews information entered for accuracy and propriety, but the review process is not documented. We recommend that HCM create a data reconciliation binder and document the data entry reviews and reconciliations.

Internal Audit examined procedures in place to monitor compliance with applicable federal employment laws and regulations. We observed various DC Water common areas and identified that Equal Employment Opportunity Act (EEO) notices were posted as required by federal law. We also inquired of HCM personnel about EEO training requirements for supervisors, and learned that supervisors are provided training on EEO topics such as sexual harassment and discrimination. Newly promoted, or hired, supervisors are required to take EEO training upon promotion or hiring. Refresher training is offered every three years thereafter, and it is mandatory for all supervisors to participate. However, we noted that compliance with mandatory EEO training is not being monitored and records pertaining to training are not being maintained. We recommend that a monitoring process be put in place.

In addition, we noted that efforts have been made to update DC Water policies related to employment laws and regulations to reflect current laws and regulations; however, these policies have not been officially approved by the General Manager and distributed to all employees. We recommend that the relevant policies be approved and distributed as soon as possible.

Internal Audit examined a sample of personnel records to determine if performance evaluations were completed and properly documented. We noted most evaluations in our sample were completed and documented. According to the "*DC Water Employees Annual Performance Evaluation Guidelines*" the employee and supervisor must sign the annual performance evaluation form and confirm that the initial annual performance plan and any subsequent adjustments to the plan were discussed and agreed to. However, we noted that a number of performance evaluations examined did not have evidence of the initial annual performance plan discussion between employee and supervisor.

Finally, Internal Audit evaluated the Employee Termination process to make certain that policy is being followed and appropriate measures take place in a timely manner. Under the current termination process, HCM relies on the terminated employee's department Manager to initiate the termination communication process. The department Manager is required to initiate the termination communication process by completing a Separation Personnel Action Report (SPAR) and submitting it to HCM for approval.



DC Water Internal Audit of Human Capital Management

However, the department Manager does not always complete and submit the SPAR to HCM. This may result in terminated employees remaining in the HCM/Payroll system with an active status after the effective termination date. In addition, access to the IT network and DC Water facilities may not be promptly terminated. We recommend that HCM collaborate with the Department Heads to identify and designate a point of contact in charge of promptly communicating with HCM and applicable parties when employees are terminated. Once the designated points of contact have been identified, HCM should reach out to each point of contact regarding the existence of recently terminated employees to make certain the correct procedures are completed.

SC&H Consulting

By: \_\_\_\_\_  
Joe Freiburger, CPA, CIA

## II. DETAILED OBSERVATIONS & RECOMMENDATIONS

The existence of internal control gaps could increase the likelihood that future errors or inappropriate transactions would not be prevented or detected. In order to mitigate this risk, we have provided recommendations to remediate the control gaps via the implementation of additional controls or modification of existing controls.

Observation #1	Internal Audit Recommendations	Management Comments
<p><b>Observations:</b></p> <p>Internal Audit evaluated whether there are procedures in place to ensure that compensation adjustments made in the HCM/Payroll system are authorized. As part of our evaluation, we learned that a validation review of compensation adjustments made in the HCM/Payroll system is performed; however the review results are not documented.</p>	<p><b>Recommendation(s):</b></p> <p>We recommend that all compensation adjustment reviews be documented and signed off by the designated reviewer. Documenting the reviews will provide a mechanism to track any findings, actions and resolutions. The documentation should include information such as review date, data reviewed, results and signature of the authorized reviewer.</p> <p><b>Business Owner(s):</b></p> <p>Director, Human Capital Management</p>	<p><b>Management's Action Plan and Implementation Date:</b></p> <p>Recommendations Accepted:</p> <p>Manager, HCM Systems has established a binder documenting review of all compensation adjustments. Reviewed documents will contain date; data reviewed; results of the findings, and the reviewer's signature.</p> <p>This recommendation was implemented on September 30, 2011.</p>

Observation #2	Internal Audit Recommendations	Management Comments
<p><b>Observations:</b></p> <p>The Manager, HCM Systems reviews the accuracy of personnel data entered into the HCM/Payroll system by the data entry clerk. However the review results are not documented.</p>	<p><b>Recommendation(s):</b></p> <p>We recommend that the Manager, HCM Systems create a data reconciliation binder and document the results of the data entry reviews and reconciliations. The documentation should include information such as review date, data reviewed, results and signature of the authorized reviewer. Also, we recommend that the written guideline on entering personnel data into the HCM/Payroll system be updated to include guidance of proper data review and reconciliation. The guidance should also specify who is responsible for the reviewing and reconciling the data.</p> <p><b>Business Owner(s):</b></p> <p>Manager, HCM Systems</p>	<p><b>Management's Action Plan and Implementation Date:</b></p> <p>Recommendations Accepted:</p> <p>Manager, HCM Systems has established a binder documenting review of all compensation adjustments. Reviewed documents will contain: date data reviewed, results of the findings, and reviewer's signature.</p> <p>The current Guidelines will be updated to add this new review and reconciliation process. The updated guidelines should be completed by November 30, 2011.</p>

Observation #3	Internal Audit Recommendations	Management Comments
<p><b>Observations:</b></p> <p>The DC Water policies related to employment laws and regulations have been revised to reflect current laws and regulations; however, these updated policies have not been officially approved by the General Manager and made available to all to DC Water employees.</p>	<p><b>Recommendation(s):</b></p> <p>We recommend that Human Capital Management establish a time frame to get the revised employment laws and regulations policies officially approved and distributed to employees.</p> <p><b>Business Owner(s):</b></p> <p>Director, Human Capital Management</p>	<p><b>Management's Action Plan and Implementation Date:</b></p> <p>All DC Water Personnel Policies and Regulations have been updated. Efforts have been underway to have the General Manager sign the updated policies and regulations. As soon as they are signed, the new policies and regulations will be published. It is anticipated that this will be completed by March 31, 2012.</p>

Observation #4	Internal Audit Recommendations	Management Comments
<p><b>Observations:</b></p> <p>According to policy, all Managers are required to participate in mandatory refresher training relative to Equal Employment Opportunities (EEO) requirements. However, there is no process in place to monitor compliance with this training requirement.</p>	<p><b>Recommendation(s):</b></p> <p>We recommend that HCM put in place a monitoring process to identify supervisors that are not in compliance with mandatory training requirements. Once a non-compliance supervisor is identified, HCM should send a training non-compliance notification to the supervisor and a copy to his/her Department Head.</p> <p><b>Business Owner(s):</b></p> <p>Director, Human Capital Management</p>	<p><b>Management's Action Plan and Implementation Date:</b></p> <p>The Manager, HCM Systems will identify a system that has the capability to monitor, identify and notify non compliant Managers and their Department Heads. The system should be identified and implemented by September 30, 2012.</p>

Observation #5	Internal Audit Recommendations	Management Comments
<p><b>Observations:</b></p> <p>In accordance with the “<i>DC Water Employees Annual Performance Evaluation Guidelines</i>”, the employee and supervisor must sign the annual performance evaluation form and confirm that the initial annual performance plan and any subsequent adjustments to the plan were discussed and agreed to. However, in the course of our examination of personnel records we noted that a number of performance evaluations examined did not have evidence of the initial annual performance plan discussion between employee and supervisor.</p>	<p><b>Recommendation(s):</b></p> <p>We recommend that Human Capital Management follow up on identified incomplete or overdue annual plans and evaluations. For any identified missing initial annual plan or evaluation Human Capital Management should document any action taken. Periodically HCM should remind all supervisors of the importance of discussing expectations and their periodic evaluations with staff members.</p> <p><b>Business Owner(s):</b></p> <p>Director, Human Capital Management</p>	<p><b>Management’s Action Plan and Implementation Date:</b></p> <p>Regularly, staff within HCM follows up on all incomplete and overdue initial plans, interim and year-end evaluation documents.</p> <p>We will enhance this effort by providing monthly follow-up with departmental contacts and department heads to ensure that all completed and signed documentation is received within 30 days of the announced deadline of each performance management form.</p>

Observation #6	Internal Audit Recommendations	Management Comments
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<b>Observations:</b>		
<p><b>Observations:</b></p> <p>Internal Audit evaluated the Employee Termination process and determined that proper procedures are not being followed when an employee is terminated. HCM relies on the terminated employee's department Manager to initiate the termination process. The department initiates the termination process by completing the Separation Personnel Action Report (SPAR) and submitting it to Human Capital Management for approval. However, the departments do not always complete and submit the SPAR to HCM. This means that former employees may still have access to DC Water facilities and systems, and may be receiving pay amounts improperly.</p>	<p><b>Recommendation(s):</b></p> <p>We recommend that Human Capital Management work with the Department Heads to identify and designate a point of contact in charge of monitoring terminated employees for each department/division. Once the designated points of contact have been identified, HCM should reach out to each point of contact at the end of each week to inquire about terminated employees. Although any method of communication between HCM and the points of contact could be effective, Internal Audit recommends e-mails for tracking purposes. In the e-mail, HCM should request the points of contact to reply and indicate whether or not there have been any terminations to report during the prior week. A copy of the e-mail should be sent to the Department Heads to keep them aware of HCM initiative of improving the termination process. HCM should also create a spreadsheet to keep track of responses as well as actions taken.</p> <p><b>Business Owner(s):</b></p> <p>Director, Human Capital Management</p>	<p><b>Management's Action Plan and Implementation Date:</b></p> <p>An HCM project team is being established to review the existing termination process and recommend a new termination policy and procedures. This project will begin in FY 2012 and is scheduled to be completed by June 30, 2012.</p>