

HCCA
Audit & Compliance Committee Conference
October 2007

**Internal Audit &
the Audit Committee**

Glen C. Mueller, CPA, CIA, CISA, CISM
Scripps Health, San Diego, CA
Vice President -Chief Audit, Compliance, &
Information Security Executive

1

Today's Key Objectives



- ❑ Review Audit Committee responsibilities for Internal Audit function oversight.
- ❑ Discuss key expectations and deliverables by Internal Audit to the Audit Committee.
- ❑ Overview of the Internal Audit process and Institute of Internal Audit (IIA) professional standards.

2

Audit Committee Key Responsibilities as It Relates to Internal Audit Function

- I. Chief Audit Executive (CAE) Reporting Relationship/ Independence
- II. Understand Internal Audit Function Capabilities/ Competency
- III. Understand Annual Audit Risk Assessment
- IV. Review and Approval of Internal Audit Annual Work Plan
- V. Review Internal Audit Findings/ Receive Periodic “Follow-up Reports”
- VI. Review Internal Audit Operations with Management and CAE
- VII. Require Internal Audit Compliance with Institute of Internal Auditors’ (IIA) *International Standards for the Professional Practice of Internal Auditing*.
- VIII. Conduct Executive Sessions with CAE.
- IX. Conduct Routine Periodic Communications Between Audit Committee Chair and CAE outside of Committee meetings.

3

Chief Audit Executive (CAE) Reporting Relationship/ Independence

To provide for the [independence of the internal audit function](#) its personnel report to the Chief Audit Executive, who reports administratively to the Chief Executive Officer and functionally to the Audit Committee of the Board of Trustees.

Absent organizational independence, the Audit Committee needs to ensure the effective mitigations are in place such close scrutiny of work plan, executive sessions with CAE, periodic independent discussions between Audit Committee chair and CAE, etc.

Audit Committee Charter should clarify thatThe direct reporting relationship of the Chief Audit Executive to the Audit Committee exists to enhance the independence of the internal audit function. This reporting relationship does not suggest that this Board committee exercise any management type responsibilities other than as explicitly articulated in the Audit Committee Charter.

4

Chief Audit Executive (CAE) Reporting Relationship/ Independence *(continued)*

Audit Committee Charters normally include a section that helps to ensure independence of CAE such as:

- I. Review and concur in the appointment, annual compensation, annual performance review, replacement, reassignment, or dismissal of the Chief Audit Executive (CAE) or outsourced internal audit function.

5

Chief Audit Executive (CAE) Reporting Relationship/ Independence *(continued)*

Internal audit should have a direct reporting relationship with the Audit Committee and an indirect reporting relationship with the CEO.

The CEO is ultimately responsible for the organization's internal controls not the CAE.



6

Understand the Internal Audit Function's Capabilities/ Competency

- II. Review and concur with the independence and authority of Internal Audit reporting obligations, charter, qualifications, staffing levels and experience.

(competency)



“You can't audit something you don't understand”.
Staff competency levels commensurate with organizational size and complexity is critical”

7

Definition of Internal Auditing (IIA)

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of *risk management, control, and governance processes*.

8

Qualifications of Internal Auditors

- ✓ **Certified Auditors:** (Certified Public Accountant, Certified Internal Auditor, and/or Certified Information Systems Auditor)
- ✓ **Knowledge of Healthcare Industry:**
- ✓ **Experience Levels (its not just about # of FTEs):**
- ✓ **Use of Computer Assisted Audit Tools and Technques:**

9

Internal Audit Staffing Levels Need Periodic Review by Audit Committee

- A generally accepted IA staffing benchmark is one internal auditor per every \$125-\$150 million in net patient service revenue.
(\$1 billion in net revenues = 6.6 to 8 auditors)
- Information technology expertise
- Certain niche areas may be better co-sourced such as construction audit, information security, and investments. Is co-sourcing in the IA budget and work plan?
- Coverage of high risk audit areas determined through a risk assessment methodology

10

Annual Audit Risk Assessment is a Major Driver for Internal Audit Annual Work Plan

- III. Inquire of the CAE about significant risks or exposures facing the organization; assess the steps management has taken or proposes to take to minimize such risks to the organization; and periodically review compliance with such steps. **Review Internal Auditor's annual risk assessment and incorporation/ alignment of results into IA annual work plan.**



“Audit Committee needs to have confidence that Internal Audit is spending its time on the right areas/ risks”.

11

Annual Audit Risk Assessment *(continued)*

- Consider and incorporate results of key risk assessments into Annual Internal Audit Plan from the following:

Financial Reporting Controls Risk Assessment,
Compliance Risk Assessment,
HIPAA Information Security Risk Assessment,
Enterprise Risk Management Risk Assessment, and
External auditors' reports

12

Annual Audit Risk Assessment *(continued)*

- Anticipate emerging issues likely to impact *internal control environment* in your organization

- Identify potential trouble spots
 - Construction projects
 - Large scale computer system implementations
 - Joint ventures
 - New business models
 - Outsourced third party services

- Identify and consider management's existing measures to mitigate risks, including periodic internal audits.

13

Annual Audit Risk Assessment *(continued)*

- ✓ Consider available relevant risk related information and data such as employee satisfaction survey results, patient satisfaction surveys, patient complaints, amount of Medicare revenue by department, and turnover as potential risk factors/ indicators of problem areas.

- ✓ Actively partner with *Compliance function*, *Information Security function* in this risk assessment and annual planning process. Review results with independent public accountants.

- ✓ CAE must gain senior management and Audit Committee understanding and endorsement of the risk assessment process results.

14

Review and Approval of Internal Audit Annual Work Plan

IV. Review and approve the plan of audit coverage and concur with its scope, breadth, and depth of coverage and receive periodic updates on progress against approved plan.



Audit Committee should inquire of independent public accountants if they have reviewed and concur with the breadth and depth of Internal Audit Annual Work Plan and include response in the minutes of you meeting.

15

Review and Approval of Internal Audit Annual Work Plan *(continued)*

Internal Annual Work Plan Development and implementation should

- ✓ Be risk-based, with participative input
- ✓ Include management input
- ✓ Be prepared/ updated annually, with review and approval by both Management and the Audit Committee
- ✓ Be reassessed on a periodic basis during the year

16

Review and Approval of Internal Audit Annual Work Plan *(continued)*

- ✓ Include Listing of Auditable Entities/ processes/ activities and indicate audit coverage/non-coverage for governance approval (*it is important to understand what risk areas are not being audited and why*)
- ✓ Present “Top N” risk areas to Audit Committee and indicate audit coverage/ non-coverage for approval
- ✓ Identify organization-wide (vs. business/ operating unit specific) audit priorities to be performed across all locations



17

Review and Approval of Internal Audit Annual Work Plan *(continued)*

- ✓ Plan should include sufficient hours budgeted for participation in:
 - Governance activities and key committee participation
 - Investigations and unusual transaction reviews
 - Internal controls communication/ awareness activities
- ✓ Provide “**Total Picture of Audit Coverage**” for Committee by preparing an summary schedule of all audit coverage across disciplines (Internal Audit, External Audit, Compliance, Information Security, etc.)



It is important for the Audit Committee to understand what areas/ risks are not receiving audit coverage in the multi-disciplinary summary schedule.

18

Understand Allocation of Types of Audits in Annual Plan and is Emphasis Appropriately Aligned with Risks

- Operational** - To ensure effectiveness and efficiency of operations, e.g., operational audits of the business office, pharmacy, radiology, physician practices, construction, revenue capture and managed care.
- Financial** - To ensure accuracy and reliability of financial reporting, e.g., review of financial statements or specific balances.
- Compliance** - To ensure compliance with applicable laws and regulations, e.g., physician contracts, Medicare billing and Corporate Policies. Includes coding accuracy and medical record document reviews, Conflicts of Interest reviews, etc.
- IT/ Security** - To determine whether information technology components of operations are functioning as intended, e.g. system implementation reviews, information security audits, application controls reviews, HIPAA Security Risk Assessment annual update.
- Investigations** - To investigate “hotline calls”, financial irregularities, complaints, loss of assets, fraud, etc.

19

Monitoring the Approved Internal Audit Annual Work Plan

- Internal Audit should provide a quarterly or semi annual update to Audit Committee on the status of the annual audit plan
- Senior management and the Audit Committee should approve any significant changes to the plan to maintain independence



Executing at least 80% of planned Annual Work Plan audits, projects, and activities should be a critical success factor for the CAE

20

Review Internal Audit Findings and Receive Periodic Follow-up Reports

- V. Receive and discuss significant findings on internal audits during the year and management's responses thereto. Receive, at least semi-annually, a *follow-up report* from internal audit on management's progress in addressing and mitigating identified internal control deficiencies from issued Internal Audit Reports.

21

Review Internal Audit Findings and Receive Periodic Follow-up Reports *(continued)*

- On at least a semi-annual basis, the *CAE should conduct follow-up on agreed-upon action plans* to ensure action plans are implemented, thereby mitigating weaknesses and strengthening internal controls.
- CAE should have a system/ process to track open items and generate follow-up reminders to responsible management
- Standardize categories and rating criteria (*significance/ severity of issues*) for reporting of outstanding corrective action plans to allow for comparative analysis.
- Request CAE to provide "*Past Due Management Action Plans*" report and with aging to help focus management accountability and governance awareness of risk acceptance during "open items" duration.

22

Internal Audit Reporting Must Meet Audit Committee's Needs and Style



- **Internal Audit Reports**
 - Needs to be a decision by Committee as to desired thresholds or topics for which actual reports are provided at each meeting and whether information is communicated in executive summaries, complete reports, or both.

- **Audit Committee Summary Level Reporting**
 - Implement *Internal Control Environment Dashboard*
 - Receive *Annual Internal Audit Report*
 - *Semi-annual follow-up reports* on prior recommendations
 - “Hotline Calls” by month and category
 - *Quarterly Activity Report* showing key findings, reports issued, progress against annual plan.

23

Effective Summary Reports are Key to Keep Focused on Important Issues



Twelve Internal Audit Reports Issued May 31 to September 16, 2008

Report #	Report Title	Report Date	Management's Planned Actions by Risk Rating				Rpt Total
			C	H	M	L	
1	Report of Observations for the Limited Pharmacy Assessment	5/31/08	0	1	4	1	6
2	W-2 and 1099 Processing -Employee Existence Validation for Returned Items for 2007 Tax Reporting Year End	6/30/08	0	0	1	2	3
3	Parking Garage Cash Collections Internal Controls Assessment	7/14/08	1	2	2	1	6
4	Electronic Medical Record Project Risk Assessment/ Go-Live Readiness Review	7/14/08	1	5	0	0	6
5	Investigation of Missing Cash	7/15/08	0	1	3	1	5
6	Follow-Up Audit of Medicare, Level 4 and 5 Established Office Visits	8/12/08	0	4	0	0	4
7	Human Resources - 2008 Employee Referral Bonus Review	8/16/08	0	0	2	4	6
8	Hospitals Audit Expert Coding Software Review	8/22/08	0	2	3	0	5
9	Safeguarding of Donor Personal Financial Information	8/27/08	0	6	0	0	6
10	Health Plan Services - Claims Accuracy Review	9/01/08	0	2	0	1	3
11	Laboratories- Focused Audit for Valid Physician Orders on Medicare Claims	9/09/08	3	2	0	0	5
12	Conflicts of Interest Disclosure Process – Summary Report for FY08	9/16/08	0	1	0	4	5
Totals			5	26	15	14	60

24

Effective *Summary Reports* are Key to Keep Focused on Important Issues (continued)



Exhibit #1
Internal Audit Reports
Issued by Category

Category	# Reports	# Critical Issues
Financial Reporting Controls (FRC)	0	0
Compliance Auditing & Monitoring (CAM)	4	3
Compliance Investigation (CIR)	0	0
Finance and Business Operations (FBO)	6	1
Information Security/ IT Controls (ISR)	2	1
	12	5

Exhibit #2
Internal Audit Reports
Issued by Business Unit

Category	# Reports	# Critical Issues
Hospitals	3	1
Clinics	3	3
System-wide	5	0
Information Technology	1	1
	12	5

25

Review Internal Audit Operations with Management and CAE

- ✓ Discuss **any difficulties internal auditors encountered** in the course of their audits, including any restrictions on the scope of their work or access to required information.
- ✓ Review and concur with **changes required in the scope** of internal audit planned activities.
- ✓ Approve the internal audit **department budget** and staffing.
- ✓ Approve the internal audit **department charter**.

26

Internal Audit Compliance With IIA Professional Standards

Internal Audit compliance with the Institute of Internal Auditors' (IIA) *International Standards for the Professional Practice of Internal Auditing*.

The purpose of the IIA Standards:

- ✓ Delineate basic principles that represent the practice of internal auditing as it should be.
- ✓ Provide a framework for performing and promoting a broad range of value-added internal audit activities.
- ✓ Establish the basis for the evaluation of internal audit performance.
- ✓ Foster improved organizational processes and operations.

27

IIA Professional Standards

Attribute Standards address the characteristics of organizations and parties performing internal audit activities.

Performance Standards describe the nature of internal audit activities and provide quality criteria against which the performance of these services can be evaluated.

Implementation Standards apply to specific types of engagements.

28

Internal Audit *Quality Assurance Review* (QAR) is Required by IIA Standards

- QAR (Peer Review) must have been conducted by December 31, 2006 for any internal audit function in existence 5 or more years in order for internal auditors to use words “*conducted in accordance with the Standards for the Professional Practice of Internal Auditing*”.
- QAR must be conducted at least once every five years.
- CAE should involve Audit Committee in selection of reviewers and report should go directly to the Committee chair.



QAR Answers the question of who audits the auditors ?

29

Conduct Executive Sessions with CAE

The Audit Committee should Conduct executive sessions with the chief audit executive as part of Audit Committee meetings

(independence)

This is a good opportunity to ask questions or be asked questions by CAE without members of management or independent auditors present.

30

Conduct Routine Periodic Communications Between Audit Committee Chair and CAE Outside of Committee meetings

Establish and maintain level of communications on major internal control or internal audit function issues during interval between Audit Committee meetings.



At a minimum there should be a pre-Committee meeting call or in-person meeting to review all materials mailed to Committee for meeting.

31

Audit Committee Assistance by CAE

Internal Audit assists Audit Committee in on-going activities:

- Prepare advance materials, prepare meeting minutes
- Ensure annual agenda covers all the responsibilities required by the Audit Committee Charter
- Provide Audit Committee a self-assessment tool to evaluate committee effectiveness
- Provide Audit Committee Education

32

Summary Comments

Audit Committee Oversight of the Internal Audit Function is a Key Responsibility to ensure

- Independence
- Communication
- Team Work (internal audit/external audit/compliance/ info security)
- Proper Focus on Risks, Annual Plans and Charter
- Adequate Competency of staff and outsourced partners for the Tasks at Hand
- Effective Ongoing Risk Assessment

33

Resources

- AICPA Audit Committee Effectiveness Center

<http://www.aicpa.org/audcommctr/homepage.htm>

- Institute of Internal Auditors

<http://www.theiia.org/>

- Association of Healthcare Internal Auditors

<http://www.ahia.org/>

34

Address <http://www.aicpa.org/audcommctr/homepage.htm>

October 10, 2008 [Login](#) | [Volunteer](#) | [Membership Info](#) | [My Account](#) | [Jobs at the AICPA](#) | [AICPA Store](#)

Search

[Search Options](#)

- About the AICPA
- Professional Resources
- Conferences, Publications, CPE & the AICPA Library
- Magazines and Newsletters
- Becoming a CPA/Academic Resources
- Career Development and Workplace Issues
- Consumer Information
- Media Center and Video Library
- Legislative Activities and State Licensing Issues

[Home](#) > [Professional Resources](#) > [Business, Industry, and Government](#) > [Audit Committee Effectiveness Center](#)

Audit Committee Effectiveness Center

A key element in the corporate governance process of any organization is its audit committee. The battle for financial statement integrity and reliability depends on balancing the pressures of multiple stakeholders, including management, regulators, investors and the public interest. We present the guidance and tools to make audit committee best practices actionable.

in cooperation with **CNA**

If after reviewing the website you have further questions or need of assistance, please e-mail us at ACMS@aicpa.org and we will respond within 24 hours.

AICPA Audit Committee Toolkits

The audit committee toolkits are designed to make audit committee best practices actionable for audit committees of public companies, not-for-profit organizations, and

Spotlight Area

New [Fair Value Accounting Explained](#). Access FAQs and resources on fair value accounting.

35

AICPA Toolkit: Not-for-Profit Organizations

To purchase a copy of the Toolkit, [click here](#)

[Download](#) a zipped file of all the tools listed below. The individual documents are formatted in Word

- [Audit Committee Charter Matrix](#)
- [Financial Expertise](#)
- [Sample RFP for CPA Services](#)
- [Independence and Related Issues](#)
- [Peer Review of CPA Firms](#)
- [Fraud and the Audit Committee](#)
- [Hiring the Chief Audit Executive](#)
- [Hiring External Experts](#)
- [Internal Control](#)
- [Evaluation of the Auditors Engagement Letter](#)
- [Tracking Report \(Whistleblowers\)](#)
- [Conducting an Exec. Session](#)
- [Issues Report from Management](#)
- [Discussions with Indp. Auditors](#)
- [Evaluating Indp. Auditors](#)
- [Evaluating Internal Audit Team](#)
- [Audit Committee Self Evaluation](#)
- [Single Audit Act Issues](#)
- [Resources for Audit Committees](#)
- [Unique Transactions and Fin. Relationships](#)

Acknowledgements

[Not-for-Profit Organizations](#)

[Directors \(NACD\)](#)

[Center for Audit Quality](#)

[Governmental Audit Quality Center](#)

[Employee Benefit Plan Audit Quality Center](#)

[The Institute of Internal Auditors](#)

[A Strategic Player: Hiring and Inspiring a Chief Audit Executive](#)

36



Thank you for your Service to Your Organizations...

Further Thoughts and Ideas!!

Please contact me and share.....

Glen C. Mueller, Scripps Health
VP, Chief Audit & Compliance Executive
mueller.glen@scrippshealth.org
Tel 858-678-7203 Fax 858-678-7209

37