Internal Audit & the Audit Committee

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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.

- Review the Internal Audit process and Institute of Internal Audit (IIA) professional standards.
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.
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.
Chief Audit Executive (CAE) Reporting Relationship/ Independence (continued)

Audit Committee Charters normally include a section that ensures 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.
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 internal controls.
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”
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.
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:**
Internal Audit Staffing Levels

- A general 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

- Medical record and coding expertise

- Coverage of high risk audit areas determined through a risk assessment methodology
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”.
Consider and incorporate results into Annual Internal Audit Plan from ………….  

Financial Reporting Controls Risk Assessment,  
Compliance Risk Assessment,  
HIPAA Information Security Risk Assessment, and  
Enterprise Risk Management processes.
Anticipate emerging issues likely to impact *internal control environment*

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

- **Identify and consider existing measures to mitigate risks**
Annual Audit Risk Assessment (continued)

✓ Consider employee satisfaction survey results, patient satisfaction surveys, patient complaints, and turnover as potential risk factors/indicators of problem areas.

✓ Actively partner with Compliance function and Information Security function in this risk assessment and annual planning process.

✓ CAE must gain senior management and Audit Committee understanding and endorsement of the risk assessment process results.
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 Internal Audit Annual Work Plan.
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 Governance and Management

✓ Be reassessed on a periodic basis during the year
Review and Approval of Internal Audit Annual Work Plan (continued)

✓ Include Listing of Auditable Entities and indicate audit coverage/non-coverage for governance approval

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

✓ Include budgeted annual plan hours for participation in:
  ▪ Governance activities and key committee participation
  ▪ Investigations and unusual transaction reviews
  ▪ Internal controls communication/w awareness activities

✓ Provide “Total Picture of Audit Coverage” for Committee by preparing a 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.
Types of Internal Audits in Annual Work Plan

**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.
Monitoring the Approved Internal Audit Annual Work Plan

- Internal Audit should provide a quarterly update to Audit Committee on the status of the annual audit plan.

- Audit Committee should approve any significant changes to the plan to maintain independence.

Executing at least 80% of planned activities should be a critical success factor for the CAE.
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.
Review Internal Audit Findings and Receive Periodic Follow-up Reports (continued)

- On 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.
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 reports are provided 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.
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.
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.
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.
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 very 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?
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.
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.
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
Summary Comments

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

- Independence
- Communication
- Team Work (internal audit/external audit/compliance/info security)
- Focus on Annual Plans and Charter
- Competency for the Tasks at Hand
- Effective Ongoing Risk Assessment
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/
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- Association of Healthcare Internal Auditors
  http://www.ahia.org/
Further Thoughts and Ideas!!

Please contact me and share......

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