

5th Annual National Congress on Health Care Compliance

Internal Audits Role in Compliance (and Vice Versa)

Welcome To The New Humana



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Your Questions and Concerns?

- **Who audits who?**
- **Who audits what?**
- **Who is responsible for compliance oversight?**
- **Who reports compliance issues to the board?**
- **How do we reduce duplication of effort?**
- **Is there a best practice organization model?**



Agenda

- *Internal Audit's Role Defined*
- **How Internal Audit Does Its Work**
- **Internal Audit's Role in Compliance**
- **How Internal Audit and Compliance Differ**
- **Defining Roles at Your Organization**



Internal Audit's Role Defined

Audit Committee's Primary Role

Foreign Corrupt Practices Act of 1997 requires companies to devise and maintain a system of internal accounting control sufficient to provide reasonable assurances that:

- transactions are authorized by management;
- transactions are recorded so that statements can be prepared in accordance with generally accepted accounting principles and accountability for assets maintained;
- access to assets is authorized by management;
- and periodic inventory is performed to compare recorded assets with existing assets.



Internal Audit's Role Defined

Audit Committee's Additional Roles

In order to assist a Corporation's Board of Directors in fulfilling its fiduciary responsibilities, Audit Committees are usually chartered to review:

- The financial information provided in the Company's Annual Report on Form 10-K and the quarterly reports on Form 10-Q and other reports as appropriate.
- The Company's systems of internal controls regarding finance, accounting, legal, compliance and ethics that management and the Board have established.
- The Company's auditing, accounting and financial reporting processes.
- The independence and performance of the Company's independent accountants and internal auditing department.



Internal Audit's Role Defined

What is Internal Auditing?

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. (Institute of Internal Auditors)



Internal Audit's Role Defined

Corporate Governance Defined

Elements of Corporate Governance

- **Corporate and Functional Strategy and Planning**
- **Enterprise Risk Management**
- **Tone at the Top - Ethics and Compliance**
- **Measuring and Monitoring Performance**
- **Transformational Transactions - Mergers, Acquisitions, Divestitures**
- **Management Evaluation, Compensation, and Succession Planning**
- **Telling the World: External Communications & Financial Reporting**
- **Board Dynamics**



Summary - Internal Audit's Role Defined

#1 - Support the Audit Committee

#2 - Assurance on Risk Management, Control, and Governance

#3 - Consulting on Risk Management, Control, and Governance



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How Internal Audit Does Its Work

Risk Based Engagement Planning

- **The internal auditor should be alert to significant risks that might affect objectives, operations, or resources.**
- **The internal auditor should consider the probability of significant errors, irregularities, noncompliance, and other exposures when developing the engagement objectives.**



How Internal Audit Does Its Work

Focus of Engagement Risk Assessment

Based on the results of the risk assessment, the internal audit activity should evaluate the adequacy and effectiveness of controls encompassing the organization's governance, operations, and information systems. This should include:

- Reliability of integrity of financial and operational information.
- Effectiveness and efficiency of operations.
- Safeguarding of assets.
- Compliance with laws, regulations, and contracts.



Internal Audits Role in Compliance (and Vice Versa)

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Generic Risk Matrix

Ownership Risks – The risks associated with acquiring, maintaining, and disposing of assets (all except human assets).

External Threats

- Customer demands
- Labor/financial/product markets
- Suppliers
- Competitors
- Government Regulation
- Economic/Political Forces
- Environmental Forces

Custodial Risks

- Obsolescence of products and resources
- Damage in handling/storing assets
- Theft from storage
- Image and reputation
- Financial operations and reporting

Hazards

- Fire
- Natural or man-made disaster
- Accidental loss

Opportunity Costs

- Purchasing wrong asset or at wrong time, wrong price (technology, new companies, partnerships)
- Selling asset too soon/too late
- Disposing of wrong asset

Process Risks – The risks associated with putting assets to work to achieve objectives.

Errors/Omissions/Delays

- **Poor judgment in plans or operations**
- **Inappropriate or outdated control mechanisms,**
- **Systems malfunctions**
- **Lack of timely,**

Frauds

- Intentional misrepresentation
- Theft (internal and external)
- Bid rigging
- Bribery
- Kick-back schemes
- Customer abuse

Hazards

- Fire
- Natural or man-made disaster
- Accidental loss

Productivity Loss

- Poor process design
- Scheduling conflicts
- Inappropriate work rules
- Lack of monitoring controls
- Under-utilizing assets
- Goal conflicts
- Inefficient processes and controls

Behavioral Risks – The risks associated with acquiring, maintaining, and disposing of human assets.

Workplace Environment

- Gender/racial harassment
- Excessive pressure to meet objectives
- Employee theft and sabotage
- Workplace injuries
- Employee lawsuits
- Workplace violence/safety

Opportunity Costs

- Hiring the wrong people or skills
- Poor compensation system
- Losing the wrong people or skills

Turnover

- Inadequate staff
- Lack of key staff
- Lack of trained staff

Productivity Loss

- Poor management practices
- Poor worker commitment
- Under-utilizing human assets
- Poor leadership
- Favoritism
- Lack of work structure/discipline
- Inconsistent management decisions
- Personal/work goal conflicts
- Lack of training
- Performance-goal misalignment

How Internal Audit Does Its Work



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Audit Approach

Collaborative
& Enabling

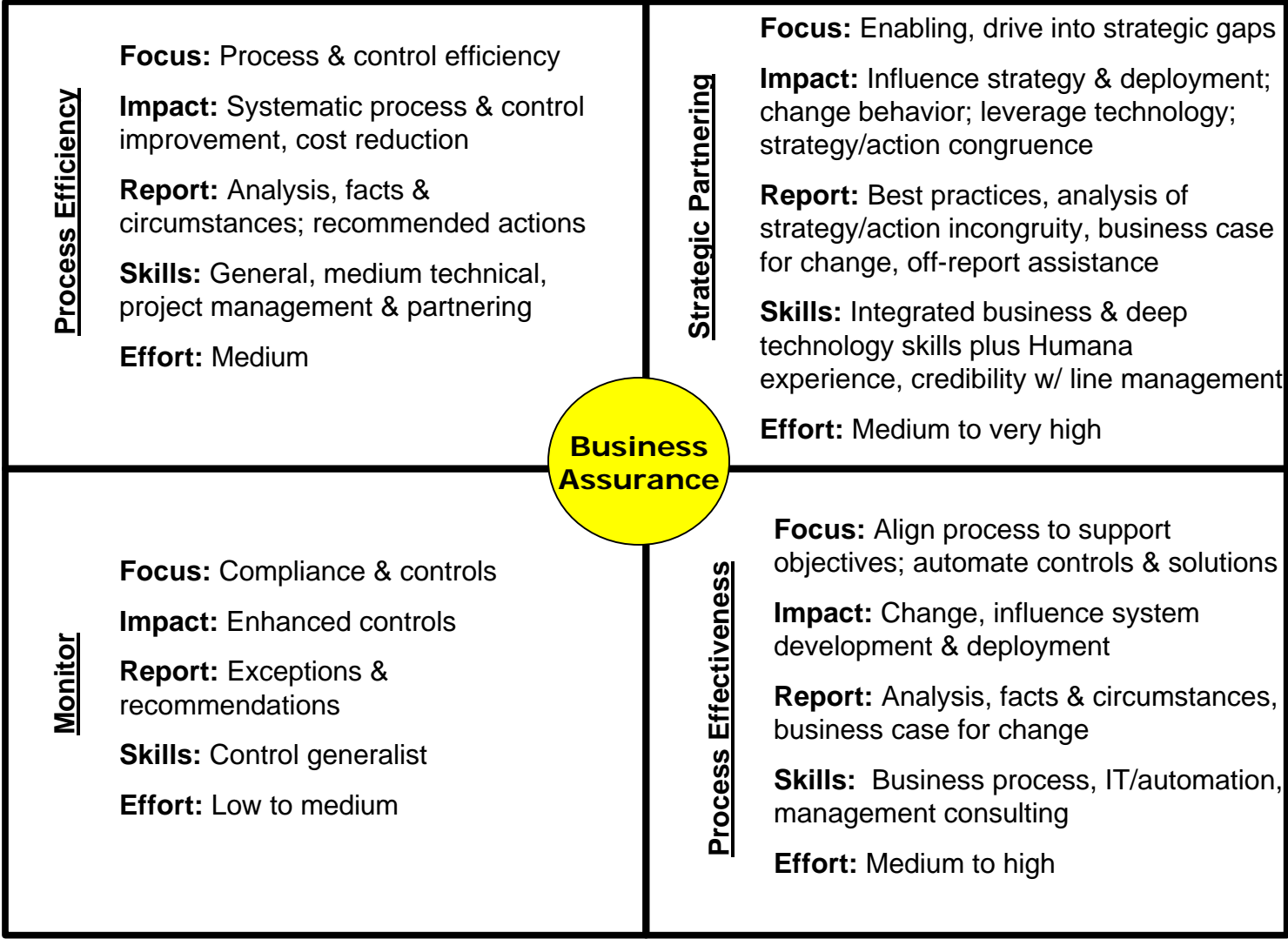


Consultative

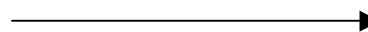


Controls &
Compliance

Value Proposition



Risk Management



Strategy Achievement



A Range of HIPAA Value Propositions





Summary - How Internal Audit Does Its Work

5 Year Outlook - Assurance & Consulting Services Groups

- Enterprise Wide Risk Management
- Majority of Effort on Consulting & Facilitating
- Less Than 50% of Effort on Traditional Audits
- Shift to Assurance on Risk Management Culture
- Manager of Outsourced Experts
- Strategic Role



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Internal Audits Role In Compliance

Practice Advisory 2100-5: Legal Considerations in Evaluating Regulatory Compliance Programs

Internal auditors should evaluate an organization's regulatory compliance programs in light of the following suggested steps for effective compliance programs.

- The organization should establish compliance standards and procedures to be followed by employees and agents.
- Specific high-level individual(s) should be assigned overall responsibility to oversee regulatory compliance.
- The organization should use due care not to delegate substantial discretionary authority to individuals the organization knows, or should know through the exercise of due diligence, have a propensity to engage in illegal activities.
- The organization should take steps to communicate effectively its standards and procedures.
- The organization should take reasonable steps to achieve compliance with its standards.
- The standards should be consistently enforced through appropriate disciplinary mechanisms, including, as appropriate, discipline of individuals responsible for the failure to detect an offense.
- After an offense has been detected, the organization should take all reasonable steps to respond appropriately to the offense and to prevent further similar offenses.



Internal Audits Role In Compliance

Practice Advisory 2130-1: Role of the Internal Audit Activity and Internal Auditor in the Ethical Culture of an Organization

At a minimum, the internal audit activity should periodically assess the state of the ethical climate of the organization and the effectiveness of its strategies, tactics, communications, and other processes in achieving the desired level of legal and ethical compliance. Internal auditors should evaluate the effectiveness of the following features of an enhanced, highly effective ethical culture.

- Formal code of conduct.
- Frequent communication of expected ethical attitudes and behavior by the influential leaders of the organization.
- Explicit strategies to support and enhance the ethical culture with regular programs.
- Several, easily accessible ways for people to confidentially report alleged violations of ethics code.
- Regular declarations by employees, vendors that they are aware of requirements for ethical behavior.
- Clear delegation of responsibilities for investigation and resolution of case findings.
- Easy access to learning opportunities regarding ethics.
- Regular reviews of formal and informal processes within the organization.
- Regular reference and background checks.



Internal Audits Role In Compliance

Practice Advisory 2130-1: Role of the Internal Audit Activity and Internal Auditor in the Ethical Culture of an Organization

The internal audit activity may assume one of several different roles as an ethics advocate.

Those roles include chief ethics officer (ombudsman, compliance officer, management ethics counselor, or ethics expert), member of an internal ethics council, or assessor of the organization's ethical climate.

In some circumstances, the role of chief ethics officer may conflict with the independence attribute of the internal audit activity.



Summary - Internal Audits Role in Compliance

- **Internal Audit Independently and Objectively Reviews Organizations Compliance and Ethics Policies and Processes**
- **The Internal Audit Function May Assume Various Roles Including That of Ethics or Compliance Officer**



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How Internal Audit and Compliance Differ

Independence Requirement - IIA Standards

Independence and Objectivity: The internal audit activity should be independent, and internal auditors should be objective in performing their work.

Assurance engagements for functions over which the chief audit executive has responsibility should be overseen by a party outside the internal audit activity.

How would these standards be applied if the Internal Audit Function was responsible for establishing and overseeing the compliance & ethics functions?



How Internal Audit and Compliance Differ

Reporting Requirement - IIA Standard

The chief audit executive is responsible for communicating the final results of engagements to individuals who can ensure that the results are given due consideration.

The chief audit executive should establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.



How Internal Audit and Compliance Differ

Management's Acceptance of Risks - IIA Standard

When the chief audit executive believes that senior management has accepted a level of residual risk that is unacceptable to the organization, the chief audit executive should discuss the matter with senior management. If the decision regarding residual risk is not resolved, the chief audit executive and senior management should report the matter to the board for resolution.



How Internal Audit and Compliance Differ

Summary - How Internal Audit & Compliance Differ

- **Independence Requirement**
- **Explicit and Expected Regular Reporting Role to the Audit Committee**
- **Chief Audit Executive Reports and Is Accountable to the Audit Committee**
- **Compliance Functions May Not Have an Independent or Objective Means for Assessing or Regularly Reporting How Well They Achieve Compliance**
- **Compliance Functions Generally Have A Responsibility for Implementing Compliance Processes**



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Defining Roles at Your Organization

Internal Audit - Different Approaches

Activities Other Than Traditional Audit

- GE - Controllershship, Corporate Initiatives, and Management Development
- GM - Enterprise Risk Management, Crisis Management, Continuity Planning
- Disney, DuPont, Caterpillar - Enterprise Risk Management
- Citicorp - Rating Awareness & Management of Risks

Healthcare Audit Functions Exploring Different Approaches

- Aetna - Business Analysis of Risk Sessions
- United Healthcare - Compliance, Enterprise Risk Management
- BCBS Florida, Lucent - IT Security
- Scripps Health, BCBS Alabama - Compliance
- United Healthcare & Caremark - Chief Risk Officers (Business Risk)

- Examples From Your Experiences



Defining Roles at Your Organization

Coordination - IIA Standard

The chief audit executive should share information and coordinate activities with other internal and external providers of relevant assurance and consulting services to ensure proper coverage and minimize duplication of efforts.

How do you coordinate compliance and Internal Audit activity?

What information does compliance provide to internal audit at your organization?



Defining Roles at Your Organization

Action Items for Role Clarification

- **How are expectations for regulatory compliance and ethical conduct identified and communicated at your organization?**
- **Who is responsible for implementing compliance and ethics programs, including continuous improvement and monitoring of those programs as the “process owner”?**
- **Who is responsible for independent and objective assessment of the effectiveness of your compliance and ethics programs?**
- **Who has the independence, authority, and responsibility for reporting to senior management and the Board on the effectiveness of your compliance and ethics programs?**
- **How do internal audit and compliance coordinate risk assessment, work plans, reviews, follow-up and reporting at your organization?**



Summary - Defining Roles at Your Organization

The Value Proposition

Internal Audit

- **Powerful Voice**
- **Clear Responsibilities for Bringing Matters to the Attention of Senior Management and the Board**
- **Clear Access To Board and Responsibility to Follow-up on Issues**
- **Assurance & Consulting Focus on Risk Management, Controls, and Governance**

Compliance

- **Powerful Insight and Understanding of Compliance Issues and Activities**
- **Champion of Compliance Activities**
- **Key Quality Assurance Function**
- **Consultant to Management on Compliance Issues**

Thank You!

For more information on the Institute of Internal Auditors:
www.theiia.org

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