

## Is Your Organization Equipped for Compliance Auditing?

By Joseph Keen and Clifford W. Therrien

### Executive Summary

Is your audit plan comprehensive enough to assess your organization's compliance performance in today's regulatory environment? What about five years from now... twenty years? Nearly all organization leaders, regardless of industry, have adopted some form of internal monitoring or auditing to assess various components of their business. For those of us working for publicly listed companies, we have been dealing with internal control and risk assessments in order to comply with the U.S. Sarbanes Oxley Act since 2002.

Regardless of whether your organization is publicly listed or privately held, the new millennium has brought about a heightened focus on compliance, monitoring, and auditing. Terms such as enterprise risk management, internal controls, performance auditing, risk stratification, compliance program have become everyday jargon. While these terms are easily defined, what do they really mean for your organization?

### What is a compliance program?

The story of formal compliance programs dates back to 1984 with the passage of the Sentencing Reform Act and the creation of the U.S. Sentencing Commission. The Commission was created to formalize and coordinate the ambiguous sentencing standards being used by trial judges.

This formalization process was accomplished with the creation of the Federal Sentencing Guidelines in 1987. In 1991, provisions were added to include civil penalties and compliance with specific internal controls for private companies. These controls are referred to as the Seven Core Elements of an Effective Compliance Program and include:

- Implementing written standards and procedures
- Designating a compliance officer who reports directly to the Board of Directors, CEO or other high-level officer of the company
- Conducting effective training and education for employees at all levels of the compliance program
- Developing effective lines of communication for employees to report

suspected violations of the law without fear of reprisal

- Conducting appropriate internal monitoring and auditing to detect inappropriate conduct
- Enforcing standards through clear disciplinary guidelines
- Responding promptly to detected offenses, taking corrective action, and implementing additional preventative measures<sup>1</sup>

In November 2004, the Federal Sentencing Guidelines were again amended to include two additional key provisions: (1) the need for directors and executives to take an active role in the management of their organizations' compliance and ethics programs and (2) the importance of promoting a corporate culture of compliance.

### What is appropriate internal monitoring and auditing?

While each of the seven elements is critically important, appropriate

<sup>1</sup> US Sentencing Commission. Changes to section 8C2.5(f) April 2010

monitoring and auditing is where prevention, detection, and correction begin for any effective compliance program. Done effectively, monitoring and auditing are the "source of truth" on operational and compliance performance. They also present the biggest challenge for management.

Many organizations use the terms *monitoring* and *auditing* interchangeably, when in fact, they are very different. From the compliance perspective, monitoring is considered real-time and issues can be addressed by a supervisor (i.e. examining a claim for errors prior to submitting it for payment). An effective monitoring program should measure operational performance to ensure standards are met in a wide array of areas, including compliance with internal control standards and compliance with external regulatory standards.

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Of course for any internal monitoring program to be effective it must contain avenues for communication and escalation. Risk associated with operational monitoring must be escalated to senior management, and senior management must drive and own formal risk remediation efforts to achieve optimum results.

Auditing, on the other hand, is very different. Auditing efforts typically

provide independent validation of the effectiveness of risk control mechanisms. They are most often considered after-the-fact or retroactive. Audits can be used by the compliance staff to document trends and careful consideration of sampling size becomes important.

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Organizational audit plans are typically focused on operational risks that are of the greatest concern to executive management, board members, and/or audit committees. Many organizational audit plans are not reaching maximum effectiveness because the audit selection process is often in the hands of management personnel who may not have an appropriate line of sight to the current and future risks of the organization.

The U.S. Sentencing Commission got it right when it linked monitoring and auditing as elements of an effective compliance program. One without the other is a recipe for habitual noncompliance. But how does an organization ensure that its monitoring program and/or auditing program is geared to detect inappropriate conduct or noncompliance with state and/or federal regulations?

While many organizations have enterprise-wide internal audit programs that typically assess the internal control environment, it is not uncommon to see programs failing to measure operational performance against specific regulatory guidance. When these organizations received sanctions from a regulatory agency, often it was unforeseen because audit controls were focused on operational internal controls and financial risk rather than compliance risk.

### **What is effective compliance monitoring & auditing?**

How can an organization know if its compliance efforts are working if there is no mechanism in place to measure effectiveness? Whether it is through implementation of formal compliance

programs or various compliance awareness campaigns, organizations need to change their culture to one of compliance. But without effective compliance monitoring and auditing, the best an organization can hope for is improving compliance awareness.

Many organizations have been successful in improving compliance awareness, but few have invested in and implemented monitoring and auditing controls in order to measure the effectiveness of these compliance-related initiatives.

Where to begin? This is often the most difficult question facing organization leaders today when implementing tighter compliance controls. There is no roadmap on how to implement effective compliance programs for your organization. The seven elements lay out fundamental principles, but only management have the insight to know what compliance controls and measures are the best fit for their company.

One thing is certain. Your organizational compliance effort must be measurable in order to be effective. Otherwise, there is no way to determine if organizational compliance efforts and the associated costs are driving better compliance outcomes.

It is critically important here that monitoring and auditing align with the scope and maturity of the overriding compliance initiative/program. As the scope and maturity of the organizational compliance efforts increase, the monitoring and auditing efforts need to be enhanced to gauge effectiveness.

### **Strengthen compliance control**

Below are the fundamental principles and recommendations that should be considered when implementing stronger compliance controls through structured compliance monitoring and auditing.

1. *Clarification of compliance ownership*  
It is critical that an organization understands that compliance is not owned by compliance staff, but by operational staff and leadership. Once compliance ownership is embedded within organizational operations, better compliance outcomes will become more likely. This ownership can be documented in the compliance program's policies and procedures.
2. *Operational compliance monitoring*  
It is incumbent upon operational management to build compliance monitoring mechanisms that allow

for routine reporting and feedback on operational compliance performance. The operational compliance monitoring program should be formally written. It should contain a clear purpose and objective which includes routine assessment as to how operational performance aligns with applicable regulatory guidance. The monitoring should be based on data and metric reporting, and results should be communicated to those responsible for operational performance.

At the end of the day, true effectiveness is measured by monitoring key compliance indicators in formal audit plans and organizational remediation/process improvement efforts. The monitoring mechanisms should also include management action plans resulting from monitoring feedback. If you only monitor with no repercussions for a department with a 56% coding error rate, the monitoring component is of negligible value.

### 3. *Compliance auditing*

Unlike compliance monitoring, compliance auditing is an independent and disciplined function where certain standardization is necessary to assess compliance program effectiveness. The following are guiding principles to consider when developing and executing a compliance audit plan that best fits your organization:

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- a. *Audit mission and structure*  
The primary objective of auditing within a compliance program is to support the program and help drive better compliance outcomes through independent and disciplined audit protocols. How the compliance audit program and staff is structured is largely dependent upon the organization itself. It can be a stand-alone audit function or it can be integrated with existing

audit functions. Regardless of structure, it is essential that the audit-related activity assesses operational compliance performance and assesses/validates overall compliance effectiveness.

- b. Audit life cycles and selection  
Audit selection is critical to the success of any compliance audit program, and this is where many organizational leaders find their biggest hurdle. Appropriate audit selection begins with the identification of key compliance risk indicators. Effective compliance auditing includes not only auditing known or high risk, but also cycling through key organizational processes validating compliance where no (or minimal) risk is identified.

At the end of a compliance audit “cycle,” management will want to demonstrate that the audit plan(s) assessed comprehensive operational performance and identified risk which was remediated through formal compliance audit and compliance program processes.

For a compliance audit plan to be successful, the auditor needs to know the organization and the compliance program, including its strengths and vulnerabilities. The audit plan should be created to allow the compliance program and organization to be able to grow and mature while maintaining the ability to be effectively audited.

- c. Audit planning  
When the audit selection is finalized, each compliance audit initiative takes a considerable amount of planning. This level of planning includes collection of information related to the operational area and/or issue in order to appropriately assess compliance risk and /or validate compliance controls. The results of this information gathering will drive the audit approach, scope, and objectives.
- d. Audit process  
Process standardization is generally critical in the execution of internal audit work. However, compliance auditing

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often warrants a certain level of flexibility in the process. If the audit planning drives an approach whereby you are validating the effectiveness of a corrective action plan, the audit process might be very different than if you were auditing the compliance internal control environment. The point here is to avoid such strict process standardization that it is limiting to the effectiveness of the outcome of the audit objective.

- e. Audit report  
The audit report should reflect the type of audit being conducted, and clearly articulate the objective and results of the audit initiative.

To the extent this can be captured in a common format, standardization can be useful. However, the primary objective of the audit report is to communicate the results of an

audit to management and related stakeholders. The report should include recommendations to reduce or eliminate the identified risks including management’s response to do so. Your reporting should include updates to the Board on the compliance audits in order to close the compliance oversight loop.

- f. Monitoring progress  
Monitoring corrective actions progress resulting from internal audit activity is critical. However, in true compliance auditing, the compliance program itself should dictate when, where, and how the monitoring process should be monitored. In certain compliance functions, it may be very logical for the audit department to own the monitoring piece. In other compliance departments where robust monitoring processes occur outside the audit function, it could make sense that the monitoring



responsibility lies with a dedicated monitoring team.

Since the compliance auditing function should be part of a larger compliance program, it should be the program that dictates accountabilities for the monitoring process of corrective actions.

### Conclusion

Are your organization's compliance initiatives and audit programs strong enough to meet the needs and

expectations of executive management, for-profit investors, regulators, and customers? This is the common question Chief Executives and Corporate Compliance officers ask themselves.

Today, particularly in the healthcare industry, organizations are looking for answers to this question as if they were seeking the Holy Grail. While much guidance has been provided in the healthcare industry regarding the need for better compliance, regulators are hesitant to provide a "one size fits all" answer to effective compliance.

Effective compliance is based on an organization's reaction to its critical compliance needs. It begins by instilling an organizational culture of compliance leading to operational compliance ownership. This accountability must be shared by executive leadership and driven from the top down. The compliance outcomes must be measured through effective compliance monitoring and auditing. Once an organization has accomplished these objectives, it can begin the journey to the summit of effective compliance. **NP**

## Authors

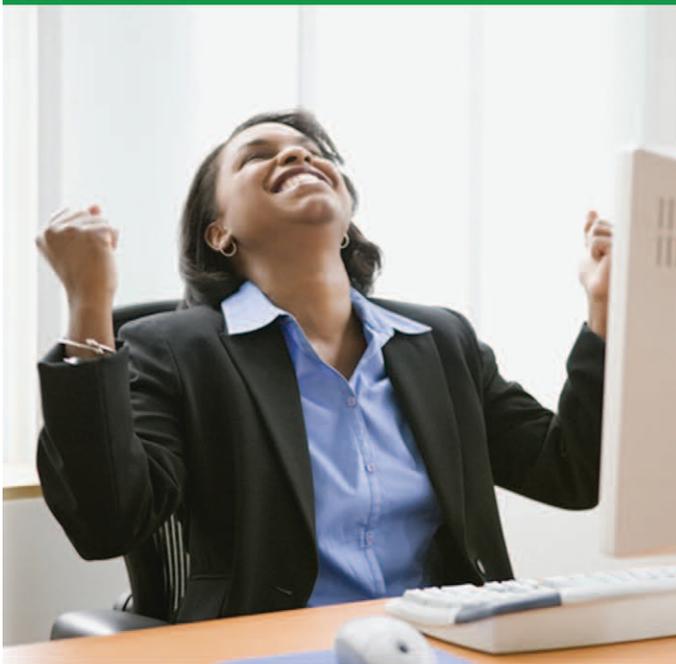


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