

# OIG GUIDANCE ON IRO INDEPENDENCE AND OBJECTIVITY

## **Introduction**

As a result of the Sarbanes-Oxley Act and an increased focus on issues relating to auditor independence, the OIG issued guidance in 2004 in response to inquiries from individuals and entities subject to Corporate Integrity Agreements (CIAs) regarding circumstances that might affect the independence of an Independent Review Organization (IRO) that performs CIA reviews (e.g., claims reviews, cost report reviews, etc.) for the individual or entity. The Government Accountability Office (GAO) updated its auditing standards in 2007 and the OIG issued updated guidance in 2010 to reflect the updated standards and the additional types of IRO reviews included in CIAs (e.g., arrangements reviews, promotional and product services reviews, etc.). This guidance has again been updated to reflect the 2011 revisions to the GAO auditing standards.

The following is a brief summary of the OIG's views on the relevant principles that should be used to assess the independence and objectivity of an IRO that performs CIA reviews, followed by some examples of situations that likely would and likely would not present independence issues.

## **Summary of OIG's Views on Applicable Independence and Objectivity Standards**

The OIG previously determined that it is appropriate to adopt the standards for auditor independence and objectivity set forth in the GAO *Government Auditing Standards (December 2011 Revision)* (referred to here as the "Yellow Book"). The Yellow Book includes both ethical principles and general standards that apply to all types of IRO reviews performed under CIAs and form the basis of the OIG's requirements relating to the independence and objectivity of the IRO. The Yellow Book principles and standards described below should serve as the basis for determining whether an IRO can provide the required certification as to its objectivity and independence with respect to each CIA review that will be performed by the IRO and whether the IRO has the qualifications necessary to perform the review(s).<sup>1</sup>

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<sup>1</sup> CIAs require that each IRO utilized by the provider must furnish a certification that the IRO has evaluated its professional independence and objectivity with respect to the review being performed for the provider and that the IRO has concluded that it is independent and objective. CIAs also give the OIG discretion to reject a provider's choice of IRO or to require a provider to retain a new IRO if the OIG determines that the IRO is not independent or does not possess the required qualifications.

## Objectivity

With respect to objectivity, the Yellow Book provides that objectivity includes “independence of mind and appearance when providing audits, maintaining an attitude of impartiality, having intellectual honesty, and being free of conflicts of interest.”<sup>2</sup> This principle should form the basis of an IRO’s certification as to its objectivity with respect to a CIA review. As noted in the Yellow Book, the concepts of objectivity are closely related and independence impairments impact objectivity.<sup>3</sup>

## Independence

The Yellow Book standards on auditor independence require that, in all matters relating to the audit work, the audit organization and the individual auditor must be independent.<sup>4</sup> According to the Yellow Book, independence comprises: (1) independence of mind and (2) independence in appearance.<sup>5</sup> IROs must maintain independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial and viewed as impartial by the OIG.<sup>6</sup> IROs should avoid situations that could lead the OIG to conclude that the auditors are not able to maintain independence and thus are not capable of exercising objective and impartial judgment on all issues associated with conducting CIA reviews and reporting on the results of those reviews.<sup>7</sup> In making the certification of its independence required under a CIA, the IRO should apply the framework addressed in the Yellow Book at the audit organization, audit, and individual auditor levels.<sup>8</sup>

The Yellow Book defines threats to independence as circumstances that could impair independence.<sup>9</sup> Whether independence is impaired depends on the nature of the threat, whether the threat is of such significance that it would compromise an auditor’s professional judgement or create the appearance that the auditor’s professional judgement may be compromised, and on the specific safeguards applied to eliminate the threat or reduce it to an acceptable level.<sup>10</sup> The Yellow Book identifies as two of the categories of threats to independence (1) the threat that an auditor or audit organization that has provided nonaudit services will not appropriately evaluate the results of previous judgments made or services performed as part of the nonaudit services when forming a judgment significant to an audit (the “self-review threat”) and (2) the threat that results

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<sup>2</sup> See GAO-12-331G, Government Auditing Standards, paragraph 1.19.

<sup>3</sup> Id.

<sup>4</sup> See Government Auditing Standards, paragraph 3.02.

<sup>5</sup> See Government Auditing Standards, paragraphs 3.03.a and 3.03.b.

<sup>6</sup> See Government Auditing Standards, paragraph 3.04.

<sup>7</sup> Id.

<sup>8</sup> See Government Auditing Standards, paragraph 3.08.

<sup>9</sup> See Government Auditing Standards, paragraph 3.13.

<sup>10</sup> Id.

from an auditor's taking on the role of management or otherwise performing management functions on behalf of the entity undergoing the audit (the "management participation threat").<sup>11</sup>

The Yellow Book includes specific standards that apply when an audit organization agrees to perform nonaudit services for the same client.<sup>12</sup> These standards would apply to IROs that perform CIA reviews and also provide other nonaudit professional services. The standards require the IRO to evaluate whether providing the service would create a threat to independence either by itself or in aggregate with other nonaudit services provided, with respect to any CIA review(s) being performed.<sup>13</sup>

The Yellow Book states that, if an auditor were to assume management responsibilities for an audited entity, the management participation threats created would be so significant that no safeguards could reduce them to an acceptable level.<sup>14</sup> Management responsibilities involve leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, physical, and intangible resources.<sup>15</sup> The Yellow Book also notes that an auditor who previously performed nonaudit services for an entity that is a prospective subject of an audit should evaluate the impact of those nonaudit services on independence before accepting an audit.<sup>16</sup> Nonaudit services provided by auditors can impact independence of mind and in appearance in periods subsequent to the period in which the nonaudit service was provided.<sup>17</sup>

In order to facilitate an IRO's assessment of its independence and objectivity with respect to CIA reviews, the OIG has set forth below some examples of nonaudit services furnished by an IRO to an entity under a CIA that likely would and likely would not present an impairment to the IRO's independence and objectivity with respect to the IRO performing a CIA review for that entity.

**Services That Likely Would Not Impair the IRO's Independence and Objectivity:**

- IRO personnel furnish general compliance training that addresses the requirements of the provider's CIA and introduces employees to the provider's overall compliance program.

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<sup>11</sup> See Government Auditing Standards, paragraphs 3.14.a and 3.14.b.

<sup>12</sup> See Government Auditing Standards, paragraphs 3.33 – 3.58.

<sup>13</sup> See Government Auditing Standards, paragraph 3.34.

<sup>14</sup> See Government Auditing Standards, paragraph 3.35.

<sup>15</sup> Id.

<sup>16</sup> See Government Auditing Standards, paragraph 3.42.

<sup>17</sup> See Government Auditing Standards, paragraph 3.43.

- The IRO performs routine tasks relating to the provider's confidential disclosure program, such as answering the confidential hotline or transcribing the allegations received via the hotline.
- The IRO performs the ineligible persons screening by entering the employee names into the exclusion databases and providing the screening results back to the provider.
- The IRO evaluates the provider's existing compliance program before the provider's CIA is executed, presents its conclusions regarding the strengths and weaknesses of the provider's existing compliance program, and makes recommendations regarding areas for improvement.
- The IRO provides personnel to perform work plan procedures that are developed by the provider's internal audit department and are not related to the subject matter of the CIA reviews.
- The IRO furnishes consulting services to the provider under an engagement that is completed prior to the start of the CIA reviews and the services (1) are not related to the subject matter of the CIA reviews and (2) do not involve the performance of management functions.
- The IRO performs an assessment of the strengths and weaknesses of the provider's internal controls, even if those controls relate to the subject matter of the CIA review, as long as the IRO is not responsible for designing or implementing corrective action based on its internal controls assessment, or otherwise performing management functions.

**Services That Likely Would Impair the IRO's Independence and Objectivity:**

- A provider uses a billing system or coding software that was developed or designed by the IRO and the IRO is being engaged to perform a claims review (the self-review threat).
- IRO personnel furnish specific training that addresses the subject matter of the CIA review (the self-review threat).
- The IRO develops the provider's policies, procedures or internal control systems (the management participation threat and also possibly the self-review threat if the policies and procedures address the risk areas that are the subject of the IRO review).
- The IRO participates in decision making relating to the confidential disclosure program, such as determining which allegations warrant further investigation or the appropriate corrective action to take in response to compliance allegations (the management participation threat).
- The IRO performs an assessment of the strength and weaknesses of the provider's internal controls associated with the specific risk areas that are addressed in the CIA and is engaged by the provider to design or implement new processes or

internal controls that relate to the subject matter of the CIA reviews (the management participation threat).

- The provider outsources its internal audit function to the IRO (the management participation threat).
- The IRO is engaged to provide consulting services to the provider during the term of the CIA on a matter that is related to the subject matter of the CIA reviews (the self-review threat).

### Professional Judgment and Competence

The Yellow Book also provides guidance regarding professional judgment and competence that should be followed when selecting an IRO for purposes of a CIA review.<sup>18</sup> According to the Yellow Book, using professional judgment is important to auditors in carrying out all aspects of their professional responsibilities, including following the independence standards and related conceptual framework, maintaining objectivity and credibility, assigning competent staff to the audit, defining the scope of work, evaluating, documenting, and reporting the results of the work; and maintaining appropriate quality control over the audit process.<sup>19</sup> Further, the staff assigned to perform the CIA reviews must collectively possess adequate professional competence needed to address the review objectives and perform the work.<sup>20</sup> The IRO staff must have the technical knowledge, skills, and experience necessary to be competent to perform the particular type of CIA review for which the IRO is being retained.<sup>21</sup>

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<sup>18</sup> See Government Auditing Standards, paragraphs 3.60 - 3.71.

<sup>19</sup> See Government Auditing Standards, paragraph 3.64.

<sup>20</sup> See Government Auditing Standards, paragraph 3.69.

<sup>21</sup> See Government Auditing Standards, paragraph 3.72.