



AUDIT COMMITTEE *Agenda*

Date: Sept. 28, 2006
Time: 8 a.m.
Location: Dayton Convention Center, Level 3, Rooms 302-304
22 E. Fifth St., Dayton, OH 45402

Audit Committee

Denise M. Farkas, CFA
Senior Vice President,
Spero Smith Investment Advisers
representing investments

Edwin McCausland, CFA
President,
Investment Perspectives, LLC
representing investments

Mary Beth Carroll
Vice President,
FirstEnergy
representing self-insured employers

Opening remarks

Chairman's comments.....Denise Farkas

Old business

Approval of previous meeting minutes.....Denise Farkas

New business

State Street roles and responsibilities:

Investment manager for Ohio Passive Bond Market Index Fund;

Investments..... Bruce Dunn and Mark Brubaker

Management update; Progress on initial phase of external audit

..... Tracy Valentino

Adjourn

AdjournDenise Farkas

The next WCO
Audit Committee meeting is scheduled for:
Date: November 16, 2006
Time: 8 a.m.
Location: William Green Building, Level 2, Room 2

**Workers' Compensation Oversight Commission
Audit Committee
September 28, 2006**

External Audit Schedule:

- **September 11, 2006:** Selection of independent public accountant, Schneider Downs & Co. Inc. (Schneider Downs), approval from Controlling Board received.
- **September 19, 2006:** BWC Internal Audit Division and Schneider Downs pre-audit planning meeting.
- **September 25, 2006:** BWC Finance Division and Schneider Downs pre-audit planning meeting.
- **September 27, 2006:** Schneider Downs commences fieldwork.
- **September 29, 2006:** BWC Finance Division to provide draft financial statements, notes and all required supplementary schedule to Schneider Downs.
- **November 30, 2006:** Schneider Downs to provide all recommendations, revisions, and suggestions for improvement to BWC. **
- **December 10, 2006:** Schneider Downs to deliver a revised report, including draft auditor's report, to BWC. **
- **December 18, 2006:** Review of draft report completed by BWC staff and WCOG Audit Committee no later than one week after delivery of draft.
- **December 22, 2006:** Delivery of final audit report to BWC and Auditor of State.**

**Schneider Downs will notify Auditor of State and BWC by November 30, 2006 of an alternative date if not expected to meet these deliverables.

**WORKERS' COMPENSATION OVERSIGHT COMMISSION
AUDIT COMMITTEE**

**THURSDAY, AUGUST 24, 2006, 8:00 A.M.
WILLIAM GREEN BUILDING
THE NEIL SCHULTZ CONFERENCE CENTER
30 WEST SPRING ST., 2nd FLOOR (MEZZANINE)
COLUMBUS, OHIO 43215**

Members Present: Denise Farkas, Chairman
Thomas Bainbridge, Jr.
Mary Beth Carroll

Members Absent: None

ROLL CALL

Ms. Farkas called the meeting to order and the roll call was taken.

CHAIRMAN'S COMMENTS

Ms. Farkas reviewed the meeting agenda

MINUTES OF JULY 20, 2006

Mr. Bainbridge moved that the minutes of the meeting of July 20, 2006, be approved. Ms. Carroll seconded and the minutes were approved by unanimous voice vote.

INTERNAL AUDIT QUARTERLY REPORT – EXECUTIVE SUMMARY

Joe Bell, Chief Internal Auditor, provided the Fourth Quarter Report for the Internal Audit Division. The first section reviews the audits completed in April, May, and June and provides the audit observations, management dispositions, the BWC chief responsible for resolution, and the target resolution date. The next section covers audits conducted from 2002 to 2005 with prior period outstanding issues. There is also a section on pending audits. Any identified “material weaknesses” are management priorities.

Nancy Barber, MCO Audit, reported that BWC had formed an MCO audit work group to discuss changes to audits of the Managed Care Organizations (MCOs). There will be a change from focus solely on contract compliance, which included setoffs, to a risk-based audit approach.

Cathy Moseley, Chief of Staff, reported that the Management Review Team had recommended increasing the audit staff from seven to twelve. The merger of three former units into an independent Internal Audit Division, for a total number of twenty-eight, this satisfies this recommendation.

FISCAL YEARS 2005 AND 2006 EXTERNAL AUDITS

Robert Hinkle, Chief Deputy Auditor, reported that the Auditor of State had conferenced with BWC for the last four Thursdays on the external audits. Today, the Auditor will submit a proposal to the Controlling Board for a no-bid contract for the external audits by Schneider Downs & Co., Inc. The target date for completion of both audits for fiscal year 2005 and fiscal year 2006 is still December 31. Schneider Downs met with BWC on August 10 to gather information and is highly impressed with BWC's "tone at the top." Members of the audit team will include Hemphill and Associates; an actuarial subcontractor to be chosen later; the Auditor of State; and the BWC Internal Audit Division.

Mr. Bainbridge asked if Schneider Downs will be able to use the previous work from KPMG. Mr. Hinkle replied that as a professional courtesy Schneider Downs will be able to look at the papers of the 2004 audit from KPMG as the predecessor auditor; the Auditor of State will be able to share the papers from the 2005 audit, but they cannot be used in the audit.

ADJOURNMENT

There was a motion by Ms. Carroll for adjournment, second by Ms. Farkas, and the meeting was adjourned.

Prepared by: Larry Rhodebeck, BWC Attorney
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September 11, 2006

DATE: September 18, 2006

TO: BWC Investment Committee
Bill Mabe, Administrator/CEO

FROM: Bruce Dunn, Chief Investment Officer

RE: **State Street Compliance and Controls Due Diligence
CIO Recommendation**

An investment manager due diligence meeting involving BWC Investment staff (Bruce Dunn and Doug Walouke), Wilshire Associates (Michael Patalsky), and a number of representatives of State Street Global Advisors (State Street) occurred at the offices of State Street in Boston on September 13, 2006. Among the topics discussed were portfolio management, risk management, compliance, and accounting processes of the Ohio Passive Bond Market Fund (“Ohio Fund”) managed by State Street.

This report will focus on providing observations and comments on risk management and compliance operations in place at Street State to assure separation of duties between portfolio management, accounting, and custody services.

State Street Bank & Trust is one of the largest custodians in the world with \$11 trillion in assets under custody. State Street currently has \$1.5 trillion in total assets under management. The firm has a very strong corporate governance structure with a strict Code of Ethics that all employees must adhere and certify annually. A thorough background check on each prospective employee occurs before a new employee can join the organization.

State Street is staffed with highly experienced Compliance and Risk Management professionals. The Compliance and Risk Management department has an independent reporting structure directly to the CEO and has significant interaction with the Corporate Audit and Enterprise Risk Management departments. The firm develops and maintains a formal, continuous compliance and risk management monitoring and testing system program for regulatory and contractual requirements.

Each portfolio manager at State Street is subjected to a compliance module that is programmed by the Compliance and Risk Management department so as to always satisfy the relevant portfolio guidelines. For example, such guidelines would consist of all of the guidelines imposed by the creator of the targeted benchmark index for passively managed client commingled account structured portfolios and specific client imposed investment guidelines for actively managed separate account structured portfolios. These compliance modules are designed so as to block a portfolio manager and/or trader from executing a trade that would violate an investment guideline.

The Compliance and Risk Management Department also conducts routine periodic reviews of client account activity to ensure compliance with client imposed guidelines as well as adherence to regulatory requirements.

Daily pricing of securities for accuracy from various external pricing sources is carefully monitored and is subjected to a formalized centralized exceptions process with defined tolerances to avoid inaccurate or stale prices. State Street performs a daily reconciliation of both cash and securities for portfolios under management.

Price Waterhouse Coopers (PWC) serves as the outside auditor of State Street and performs a SAS 70 review on control activities and processes. The commingled funds managed by State Street are subject to an annual outside audit performed by PWC. PWC also performs Sarbanes-Oxley reviews on State Street on a regular basis.

State Street has represented that their investment clients are permitted to have client auditors visit the appropriate State Street office to conduct internal audit examinations on their particular portfolio(s). State Street has represented to me that appropriate BWC employees are welcome to visit the Boston operations for the purpose of conducting specific audit reviews on the Ohio Fund.

In summary, the BWC Chief Investment Officer is satisfied that proper controls, processes and segregation of duties are in place throughout the State Street organization. It is these well defined internal structures and the culture of compliance being given the highest of priorities that enables passive investment management clients of State Street to be comfortable with the commingled account structure and the State Street role serving as custodian.

It is recommended that the commingled account trust structure for the Ohio Fund be maintained with State Street.



To: **The Ohio Bureau of Workers' Compensation Investment Committee**
Cc: Bruce Dunn
From: Mark E. Brubaker, CFA
Phone: (412) 434-1580
Date: September 21, 2006
Subject: ***Common Trust Fund***

Background:

On September 7, 2005, the Ohio Bureau of Workers' Compensation ("OBWC") executed an Agreement of Trust with State Street Bank and Trust Company that authorized them to "hold, manage and invest" assets of the OBWC. On January 13, 2006, a Fund Declaration was executed by State Street Bank and Trust Company establishing the Ohio Passive Bond Market Index Securities Lending Common Trust Fund ("OBWC Fund"). Unlike typical common trust funds, this fund consists entirely of assets of the OBWC. No other client assets are commingled with OBWC assets.

The OBWC Investment Committee has requested that Wilshire provide an assessment of the primary differences between common trust fund investment vehicles and separate accounts.

Wilshire Assessment:

Many Wilshire clients invest in common trust funds and other forms of commingled funds. While common trust funds are most frequently associated with smaller institutional funds, they are also widely utilized by large institutional investors, particularly in the area of passive management.

Wilshire generally recommends that our clients obtain the most cost-effective form of exposure to any particular investment mandate. Depending on the circumstances, this could lead to either a common trust fund or a separate account. Highlighted below are what Wilshire believes to be the primary issues for investors to consider when evaluating the differences between common trust funds and separate accounts:

Fees:

Due to economies of scale, common trust funds often provide lower total management expenses for investors. This is a primary advantage of common trust



funds over separate account investments. Given the size of the assets of the OBWC Fund and the fact that it is not commingled with any other investor assets, the economies of scale benefit versus a separate account is limited.

Security of Assets:

Wilshire believes that assets held in a common trust fund are as secure as assets held in a separate account in the event of the bankruptcy of the trustee/custodian. In both cases, these assets are held in trust and are not able to be accessed by the creditors of the trustee/custodian for any reason.

Custom guidelines:

Separate accounts allow clients to give managers specific portfolio guidelines, while common trust funds are governed by the manager's standard Fund Declaration and/or Declaration of Trust. Clients must review these documents carefully to ensure that they are consistent with the client's risk profile and objectives.

Access to funds:

The OBWC Fund is valued daily and provides the required liquidity for the OBWC's operating needs. In the event of a large withdrawal request, 15 days notice may be required and State Street may, depending on the circumstances at the time the request is made, elect to distribute either cash or securities in kind.

Corporate actions:

Common trust funds will typically vote corporate actions and proxies in the best interest of fund investors. Because the OBWC Fund consists only of OBWC assets, the OBWC could maintain proxy voting authority if so desired; however, this responsibility was specifically signed over to State Street as part of the Agreement of Trust

Securities lending:

The OBWC Fund specifically allows for securities lending, with State Street named as securities lending agent. Common trust fund investments limit investors' ability to select third party securities lending agents.

Wilshire believes that investing with SSgA via a common trust fund was a prudent decision given the situation at OBWC at the time it was implemented. As the OBWC moves forward with the implementation of the new asset allocation policy, Wilshire and staff will assess the appropriate investment vehicle for each individual mandate.

Please feel free to call me on (412) 434-1580 should you have any questions.