



Audit Committee

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

Thomas H. Bainbridge, Jr.
Partner,
Ward, Kaps, Bainbridge,
Maurer & Melvin
representing injured workers

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



Audit Committee

Agenda
July 20, 2006
William Green Building, Second Floor, Room 2
8 a.m.

Chairman's comments..... Denise Farkas

Old business

Approval of previous meeting minutes Denise Farkas

New business

RFP process for independent auditor (update)
..... Tracy Valentino and Jim Kennedy

Internal Audit's Fiscal Year 07 Audit Plan Joe Bell

Adjourn

Adjourn Denise Farkas

The next WCOC Audit Committee meeting is scheduled for:
8 a.m.
August 24, 2006
William Green Building, Second Floor, Room 2

**WORKERS' COMPENSATION OVERSIGHT COMMISSION
AUDIT COMMITTEE**

**FRIDAY, JUNE 16, 2006, 10:00 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 COMMENTS

Ms. Farkas reviewed the agenda.

MINUTES OF MAY 25, 2006

Ms. Carroll moved that the minutes of the meeting of April 27, 2006, be approved. Mr. Bainbridge seconded and the minutes were approved by unanimous voice vote.

OLD BUSINESS: REQUEST FOR PROPOSAL FOR INDEPENDENT AUDITOR

Tracy Valentino, Chief Financial Officer, and Barb Ingram, Manager, Financial Reporting, reported on the Request for Proposal (RFP) for a new independent auditor. Ms. Ingram reported that the RFP was issued on May 30. The RFP pre-proposal conference was held on June 7 and three firms attended, including Deloitte Touche. Based on the many questions asked during the conference, the response date was changed to July 19 to give the firms an opportunity to complete their risk assessment and review the legal issues.

Ms. Farkas asked if there are no responses will the Auditor of State have sufficient staff to conduct the audit. Robert Hinkle, Chief Deputy Auditor, responded that in that case the Auditor must do the audit.

Bill Sopko, Chairman, Oversight Commission, observed that KPMG had stated it could not do an audit. Mr. Hinkle added that in the event there were no responses to the RFP for an external audit, the Auditor would retain consultants to assist. Ms. Valentino stated that a new firm would not be bound by the problems KPMG would have and could issue an audit with a disclaimer.

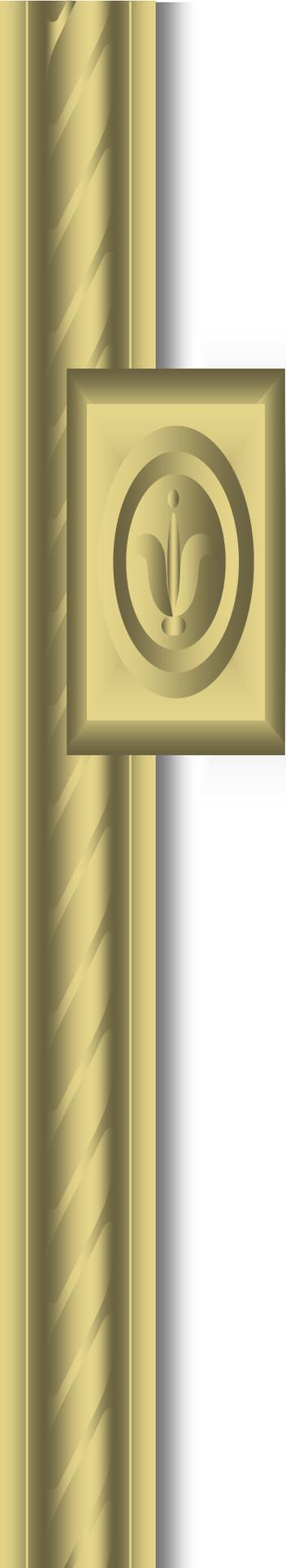
NEW BUSINESS: INTERNAL AUDIT DIVISION/AUDIT PLAN METHODOLOGY

Joe Bell, Chief Internal Auditor, reported on the methodology used to perform the risk assessment by the Internal Audit Division for the audit universe of BWC. He will present the FY2007 Audit Plan at the July meeting.

ADJOURNMENT

There was a motion and second for adjournment and the meeting was adjourned.

Prepared by: Larry Rhodebeck, BWC Attorney
H:\Word\ldr\WCOC Audit 0606.doc
July 6, 2006



BWC

Internal Audit Division

Fiscal Year 2007

Audit Plan

Audit Risk Assessment

Cathy Moseley, Chief of Staff
Joe Bell, Chief of Internal Audit
Nancy Barber, Director of Internal Audit
Fred Booker, Director of Internal Audit
Keith Elliott, Manager of Internal Audit

Focus Areas

Operational Audits (End to End Business Process Flow)

- Payroll reporting and premium collection process
- Indemnity claims and payments process
- Vocational rehabilitation process
- Medical payment process
- Pharmacy payment process
- Employer safety consultations, training and publications process
- Retrospective rating process
- Safety grants process
- Personnel hiring process
- Salary continuation process
- Investment process
- Purchasing process

Internal Control Reviews

- Investment compliance monitoring
- Funded manager contracts
- Employer refunds
- Investment month end procedures
- Payables function

Compliance Audits

- MCO audits
- Special claims unit
- Lump sum advancements
- Compensation audit review
- PTD claims review
- Indemnity claims overpayments

Note:

- Audit schedule will be based on risk rating.
- Based on initial findings, operational audits may be expanded.
- Quarterly progress reports will be provided.

- Black Lung and Marine Fund claims

Information Technology Audits

- Computer operations (general and key application controls; outsourced)
 - Web/Intranet/Internet maintenance and safeguards
 - Business continuity plan and backup facilities
 - Change management (testing of program changes or upgrades)

Consulting

- Investments
 - Alternative investments - Private Equity Assets
 - Alternative investments - Rare Coin LLP
 - Manager selection and funding
 - Investment value reconciliation
- Fixed asset/inventory tagging and inventory procedures
- Auto adjudication process
- Settlement process

External Financial Audit Assistance

Focus Area	1st Qtr.			2nd Qtr.			3rd Qtr.			4th Qtr.		
	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June
	Settlement process											
Indemnity claims overpay-ments												
Manager selection and funding												
Salary continuation process												
Alternative investments - Private Equity Assets												
Fixed asset/inventory tag-ging and inventory proce-dures												
Purchasing process												
Payroll reporting and pre-mium collection process												
Indemnity claims and pay-ments process												
Compensation audit review												
External audit assistance												
Investment process												
Retrospective rating proc-ess												
Lump sum advancements												
Computer operations (general and key application controls; outsourced)												
Special claims unit												
Pharmacy payment process												
Investment compliance monitoring												
Personnel hiring process												
Safety grants process												
Investment month end pro-cedures												
Black Lung and Marine Fund Claims												
Employer refunds												
Medical payment process												
Vocational rehabilitation process												
Employer safety consulta-tions, training and publica-tions process												
Investment value reconcilia-tion												
Payables function												
PTD claims review												
Funded manager contracts												
Auto adjudication process												
MCO Audits												
Alternative investments - Rare Coin LLP												

FY 2007 Internal Audit Division Risk Assessment Methodology

1. Mapped trial balance accounts to key processes (Sarbanes-Oxley Guidelines).
2. Identified audit process population by division.
3. Interviewed management regarding risk/control concerns.
4. Developed audit risk assessment/annual audit planning (IIA Model) that defines risk factors applied to a numeric rating scale.
5. Stratified processes by risk ratings and selected the type of audit planned and projected hours.

Ongoing

1. Actively defining each engagement scope and objectives.
2. Scheduling audits for FY 2007.

Audit Risk Assessment/Annual Audit Planning

The objective of the risk model is to optimize the assignment of audit resources through a comprehensive understanding of the audit universe and the risks associated with each universe item.

Starting with the Fiscal Year 2007 audit plan, an audit risk model will be used to quantify the risk rating of each process. Audits will be scheduled by priority and will guide the use of personnel. The audit universe will first start with the trial balance statements. The trial balance statements are mapped to core business processes and weighted by financial risk (Sarbanes-Oxley Guidelines). Process flows often cross multiple functional lines of the business; however, for presentation purposes we subdivided significant processes and focus areas by the division with primary responsibility for process oversight. The risk assessment process described below will then be applied.

The new risk model is based on seven factors or elements of risk. They are:

1. Financial exposure (Sarbanes-Oxley),
2. Changes in operations/personnel,
3. Confidence in management,
4. Size of department,
5. Complexity of operations,
6. Liquidity of assets, and
7. Operational opportunity.

Each item in the audit universe will be rated on these seven factors using a numeric rating of 1 to 4. The ratings are:

1. Low risk (highly unlikely a problem)
2. Moderate risk (probably not a problem)
3. Sensitive risk (possibly a problem)
4. High risk (probably a problem)

NOTE: In FY 2008, the risk model will incorporate prior audit findings as an element of risk. Also, future risk ratings will be multiplied by an audit aging factor.

Ratings are sorted into 4 strata by risk rating and desired audit coverage is as follows:

- High risk = Top 10% stratum → Audit 100%
- Sensitive risk = Next 30% stratum → Audit 40%

- Moderate risk = Next 40% stratum → Audit 25%
- Low risk = Lowest 20% stratum → Audit 10%

The lower risk groups are sampled to see if the rating process is working and confirm that the levels of risk are appropriately stacked. Furthermore, nearly 10% of total budgeted audit hours will be reserved for unplanned activities to allow for real-time feedback to management on sensitive or critical issues.

While the risk model still requires judgment, the individual ratings are documented and subject to critical review and challenge. The model also promotes uniform definition of the Bureau's audit universe.

Defining the audit universe is the first prerequisite to risk ranking. The audit universe to which this risk assessment will be applied will be determined by the Audit Directors and the Chief of Internal Audit. Determination of the audit universe will be based on their knowledge of the BWC strategic plan and operations, discussions with responsible management personnel, and a review of organization charts, functions, and areas of responsibility.

Guidelines for the risk ranking criteria are as follows:

- 1 **Financial Exposure** – This represents an assessment of the potential financial liability associated with the unit being rated. Using Sarbanes-Oxley Guidelines, business process flows are assigned a weighted risk score based on its impact on the trial balance accounts. It is an assessment of the amount of Bureau assets associated with the unit. It could be risk connected with loss or impairment of assets, risk connected with undetected error, risk connected with liability not recognized or not accurately quantified, or risk of adverse publicity, legal liability.
- 2 **Changes in Operations/Personnel** – Corporate history indicates changes impact internal controls and financial reporting. Change usually occurs to effect long term improvement, but often has short-term offsets that require increased audit coverage. Changes include reorganizations, business cycle swings, rapid growth, new systems, new regulations or laws and personnel turnover.
- 3 **Confidence in Management** – This criterion reflects confidence that audit management places in management directly responsible for the audit unit and management's commitment to internal control. Comfort is characterized by factors such as past audit interaction, experience of management in the work environment, preliminary survey interviews, and the quality and level of staffing.

- 4 **Size of Department** – The relative size of a department or process was included as a risk factor, as larger departments or processes in many instances comprise critical areas of responsibility. If operations in larger departments or processes are not functioning efficiently, effectively and with appropriate internal controls, significant negative impact to the agency may result.
- 5 **Complexity of Operations** – This risk factor reflects the potential for errors or misappropriation to go undetected because of a complicated environment. Complexity depends on many factors such as extent of automation, complex calculations, interrelated and interdependent activities, number of products or services, the time spans of estimates, dependency on third parties, customer demands, processing times, applicable laws and regulations and many other factors.
- 6 **Liquidity of Assets-** This risk factor reviews the inherent risks related to misappropriation of highly liquid assets. Such assets can be in the form of cash, the issuance or processing of checks, or other assets that could easily be misappropriated.
- 7 **Operational Opportunity** – In creating the risk analysis, we included a factor for the perceived opportunity for operational improvements. The ranks for this factor considered prior experience with the area and the perceived potential to improve department processes or operations.

The refinement of the risk rating model will remain an ongoing priority of the Internal Audit Division. We expect the Audit Committee's level of involvement will coincide with their defined roles in the Audit Committee Charter. Our objective will be to assign audit resources in the optimum manner to audits with the greatest risk, savings, or recoveries.

Audit Risk Assessment/Annual Audit Planning Form

Note: Refer to  Internal Audit Manual
- Guidelines for  Risk Rating

Key:

- 1= Low risk (highly unlikely a problem)
- 2= Moderate risk (probably not a problem)
- 3= Sensitive risk (possibly a problem)
- 4= High risk (probably a problem)

Types of Audits

The Internal Audit Division is responsible for the process by which the Bureau reviews and assesses the economy, effectiveness and efficiency of its management control and practices.

Operational Audits (End to End Business Process Flow)

Process/ Division/ Focus Area	Finan- cial ex- posure	Changes in opera- tions/ per- sonnel	Confidence in manage- ment	Size of depart- ment	Complex- ity of opera- tions	Li- quidity of as- sets	Opera- tional oppor- tunity	Total	Com- ments
								0	
								0	
								0	

This category reviews the principal operational functions of the Bureau. Operational audits are undertaken for the purposes of assessment of compliance, efficiency, economy and effectiveness of management practices and controls associated with these operational functions. They have a strategic focus and are primarily concerned with the achievement of the Bureau's strategic objectives and goals.

Internal Control Reviews

Examining and evaluating the effectiveness of the Bureau's system of internal control and the quality of performance in carrying out assigned responsibilities. The primary objectives of the internal control systems are to ensure: the reliability and integrity of information; compliance with policies, plans, procedures, laws, and regulations; safeguarding of assets; economical and efficient use of resources; and accomplishment of established objectives and goals for operations and programs.

Financial Audits



Review of all ancillary functions such as budgeting, financial statements, accounting systems, revenue collection procedures, purchasing operations, payroll, and staff development. As the procedures covering most of the activities in this category are regulated by laws, external principles or management directive, the purposes of the audit generally relate to the integrity of data or compliance. Audits may also be undertaken for the purpose of assessing the

efficiency or effectiveness of these activities or the systems or procedures in use.

Compliance Audits

Compliance audits determine the degree of adherence to policies and procedures set out in the Bureau's Policies and Operating Procedures. It is also concerned with compliance with all relevant external legislative requirements.

Information Technology Audits

Auditing computer systems can be conducted as an integral part of the audit of financial and administrative systems. However, the increasing importance of the computer as a management support tool has seen the need for specialist audits in this field.

Consulting

Consulting services are advisory in nature, and are generally performed at the specific request of an engagement client. The nature and scope of the consulting engagement are subject to agreement with the engagement client. Consulting services generally involve two parties: (1) the person or group offering the advice – the internal auditor, and (2) the person or group seeking and receiving the advice – the engagement client.

Special Investigations

Some internal audit activity takes the form of a special investigation. The object of these investigations is to diagnose specific problem areas, establish whether some further action or investigation is warranted and perhaps prepare the way for subsequent audits or reviews.

