

Audit Committee Agenda

Feb. 28, 2008

Level 2, Room 3

4 p.m. – 6 p.m.

Call to Order

Kenneth Haffey, Chairman

Roll Call

Jill Whitworth, Scribe

Approve Minutes of Jan. 24, 2008 meeting

Kenneth Haffey

New Business/Action Items

1. Possible Rule Review (only change is from the Workers' Compensation Oversight Commission to the Bureau of Workers' Compensation Board of Directors):

4123-17-03	Employer's classification rates
4123-17-18.1	Early payment discount program
4123-17-26	Minimum annual administrative charge
4123-17-37	Employer contribution to the safety and hygiene fund
4123-17-40	Self-insured buy-out factors
4123-17-45	Initial computation
4123-17-53	Private employer retrospective rating plan minimum premium percentages
4123-17-54	Public employer retrospective rating plan minimum premium percentages

Discussion Items*

2. BWC Surplus Fund
Tracy Valentino, Chief of Fiscal and Planning
3. FY 08 2nd Quarter Executive Summary
Joe Bell, Chief of Internal Audit
4. Office of Budget and Management, Office of Internal Audit Update
Joe Bell, Chief of Internal Audit
5. Open Discussion with Internal Auditor

Adjourn

Ken Haffey

- Not all discussion items have materials included.

Next Meeting: March 27, 2008 4:00 pm – 6:00 pm @ OCOSH, 13430 Yarmouth Drive, Pickerington, Ohio

**BWC Board of Directors
Audit Committee**

Thurs., Jan. 24, 2008, 3:00 P.M.

William Green Building
The Neil Schultz Conference Center
30 West Spring Street, 2nd Floor (Mezzanine)
Columbus, Ohio 43215

Members Present: Kenneth Haffey, Chair
Philip Fulton
William Lhota

Members Absent: None

Other Board Directors in attendance were Charles Bryan, Jim Matesich, James Hummel, Robert Smith, Alison Falls and Larry Price.

Call to Order

Mr. Haffey called the meeting to order at 3:05 PM and the roll call was taken.

Minutes of Dec. 19, 2007

The minutes were approved on a motion by Mr. Lhota, seconded by Mr. Fulton. It was agreed that minutes should reflect all Board members in attendance.

New Business / Action Items

1. Charter

Donald Berno, Board Liaison, noted two small amendments to the Audit Committee Charter. Paragraph 2 is amended to state that the Chair and Vice-Chair are designated by the Board. Paragraph 3 is amended to combine the language therein into a single sentence, that the Board Chair, if not a member of the Committee, is an ex-officio member, and shall not vote if his/her vote will create a tie.

Mr. Lhota moved to approve the Charter as amended, seconded by Mr. Fulton. The motion was approved by unanimous roll call vote. Mr. Fulton will be recommended to the Board to serve as Vice- Chair of the Audit Committee.

2. Rule Review

a. PERRP Rules

Tom Sico, Assistant General Counsel, and Michael Rea, Industrial Safety Administrator, presented a change to Rule 4167-3-04. The rule is amended to incorporate a cross-reference to new OSHA rules regarding personal protective equipment. This change does not require JCARR or public hearing. Mr. Fulton moved to recommend approval of the proposed changes to the Board of Directors, seconded by Mr. Lhota. The motion was approved by unanimous roll call vote.

Personal Information Rules

Mr. Sico next presented the five-year rule review for Rules 4123-16-01 to 4123-16-03, and 4123-16-05 to 4123-16-13. These rules relate to personal information systems maintained by state agencies. There were no items requiring change. A new provision implemented by H.B. 104 may require an additional rule, but does not affect the existing rules. These rules are filed with JCARR for review but do not require public hearing.

Mr. Sico offered the assistance of Ken Cain, Staff Counsel, Leo Genders, Chief Information Officer, and Tom Stevens, Disaster Recovery Manager, for questions from the Committee. Mr. Haffey inquired as to the process for informing the Committee of personal information usage (Rule 4123-16-05) and security precautions (Rule 4123-16-11). Mr. Sico stated there are record retention and destruction schedules for documents containing personal information, such as claim and risk files. Mr. Gender noted the state is establishing an overall policy in this area.

Mr. Fulton asked if consideration was given to rule changes reflecting that injured worker names and addresses are not public records, as revised by S.B. 7. Mr. Sico indicated this was not done. Mr. Fulton then explained there is a public records exception provided for journalists, which is being corrupted by medical professionals and attorneys creating newsletters, and requesting injured worker personal information as a “journalist”. Mr. Fulton also suggested contacting the lobbyist for the newspaper association to assist in taking corrective action. Mr. Sico stated that the claim file information itself, such as medical records and treatment, is not a public record, and expressed concern that injured workers mistakenly believe medical solicitations are somehow condoned by BWC.

Chief Legal Officer and General Counsel James Barnes advised that BWC has requested an opinion from the Attorney General regarding the definition of “journalist”. He will report back to the Committee after the AG opinion is issued.

Mr. Lhota inquired why no changes were needed to reflect general technological advances over the last five years. Mr. Genders explained that BWC has internally done a great deal of work in the last 12 months to tighten system security, encryption, and sensitive data transmission. Mr. Sico noted he had reviewed the underlying statute, R.C. Chapter 1347, and no changes had been made except for the new provision, R.C. § 1347.12, which does not impact these rules.

Mr. Haffey moved to recommend to the Board of Directors that these rules be filed with JCARR for review, seconded by Mr. Lhota. The motion was approved by unanimous roll call vote.

c. Employer Coverage Renewal Rule

Mr. Sico addressed changes to Rule 4123-19-07 brought about by H.B. 100, permitting BWC to lapse coverage of public employers who do not timely pay premiums. The Rule previously only applied to private employers. Mr. Fulton inquired as to how coverage is treated if the employer eventually pays the premium. Mr. Sico explained that if the employer pays within 59 days or less, coverage can be retroactively reinstated by the Adjudicating Committee upon a showing of good cause. This is a statutory provision. Mr. Fulton questioned whether this should also be in the Rule. Mr. Sico offered to provide the appropriate statute reference prior to the conclusion of the meeting.

Mr. Fulton moved to recommend approval of the proposed changes to the Board of Directors, seconded by Mr. Lhota. The motion was approved by unanimous roll call vote.

Discussion Items

1. New Item – Fiduciary Responsibility

Mr. Lhota distributed materials to Committee members from Fiduciary Counsel F. Ronald O'Keefe regarding the Board's responsibilities under the Caremark decision, in conjunction with the oversight duties of the Inspector General. A discussion draft prepared by Mr. O'Keefe has been provided to counsel for the Inspector General for input, who will work with Mr. O'Keefe to finalize. Any recommended changes will be forwarded to the Governance Committee for incorporation within the Board's Governance Guidelines. In addition, the recommendations of fiduciary counsel may also be incorporated in the Audit Committee Charter, and may result in changes to BWC reporting requirements.

At this point it was determined to move Mr. Barnes' quarterly litigation update report to the end of the meeting.

2. External Audit Comments - Update

Barbara Ingram, Director of Accounting, provided a quarterly update regarding the 16 comments from the FY07 external audit. The written comments and resolution actions previously provided to the Committee were reviewed on an individual basis. Eight have been implemented, and all should be resolved within 12 months except for review of reserve for compensation adjustment expenses, for which the target date is 12/31/08.

In addition, the comment regarding segregation of the Surplus Fund within the State Insurance Fund may require legislative correction. A discussion was held clarifying that this stems from an old statute requiring a segregated surplus fund of \$100,000.00. The statute is outdated, and no penalties have ever been enforced for non-compliance. Mr. Barnes stated a legal analysis is

currently being conducted. Administrator Ryan emphasized the need for legislative responsiveness to change the statute

John Pedrick, Chief Actuarial Officer, clarified the process regarding manual overrides. It was suggested that any such instances be presented to the Committee in an annual report.

3. Top 100 Non-Complying Employers

Ms. Ingram reviewed the history and semi-annual process of identifying and contacting non-complying employers who have estimated premiums of \$10,000.00 or more. Since December 2005, these employers have also been posted on the BWC website. The IT Division identifies coverage changes nightly. Through January 18, 2008, 97 of 117 employers remain on the list. Administrator Ryan stated the effectiveness of this program is being evaluated. Mr. Barnes explained there is also a work group involving all units who deal with this program.

4. Internal Audit Update

Joe Bell, Chief Internal Auditor, reported that the Office of Budget and Management (OBM) is reviewing BWC's internal auditing processes. Mr. Bell serves on an OBM advisory committee that is reviewing all state agencies' internal auditing processes. The OBM advisory committee is currently reviewing RFPs from accounting firms to serve as a consultant for this project.

Mr. Bell next discussed the concept of process mapping. A steering committee is reviewing the top three processes: claims, risk and actuarial rating. The long-term goal is to streamline the processes for more efficiency.

Mr. Bell reviewed staffing evaluation and changes in the Internal Audit Division. There are currently 7 vacancies in the 20 overall positions. Administrator Ryan emphasized the importance of quality in filling these vacancies.

Current IT initiatives discussed are the MIRA II project, avoidance of duplication, and self-assessment monitoring.

5. Other Business

Mr. Sico provided the requested clarification that R.C. § 4123.37 applies to both private and public employers with respect to waiver of premium payment default for a period less than 60 days. Therefore, no additional rule changes are needed.

Mr. Lhota moved for recess to executive session, seconded by Mr. Fulton. The motion was approved by unanimous roll call vote. The Committee recessed to executive session at 4:40 for presentation of pending court litigation by Mr. Barnes.

At 5:40, Mr. Lhota moved to conclude the executive session, seconded by Mr. Fulton. The motion was approved by unanimous roll call vote.

Adjournment

The next Audit Committee meeting is February 28, 2008 at 4:00 PM.

Mr. Haffey moved to adjourn the meeting at 5:40 PM, seconded by Mr. Lhota.

Prepared by Jill Whitworth, BWC Staff Counsel
January 25, 2008

Executive Summary

Rules to Change from WCOC to WCB

Legislative History

H.B. 100 abolished the Workers' Compensation Oversight Commission and created the Bureau of Workers' Compensation Board of Directors. Under Section 512.10 of the Act, the Board is the successor to the Oversight Commission, including on rules:

The Board shall supersede the Oversight Commission and its members and succeed to and have and perform all the duties, powers, and obligations pertaining to the duties, powers, and obligations of the Oversight Commission and its members. For the purpose of the institution, conduct, and completion of matters relating to its succession, the Board is deemed to be the continuation of and successor under law to the Oversight Commission and its members. All rules, actions, determinations, commitments, resolutions, decisions, and agreements pertaining to those duties, powers, obligations, functions, and rights in force or in effect on the effective date of this section shall continue in force and effect subject to any further lawful action thereon by the Board. Wherever the Oversight Commission or its members are referred to in any provision of law, or in any agreement or document that pertains to those duties, powers, obligations, functions, and rights, the reference is to the Board.

Rule History

There are various rules that mention the former Workers' Compensation Oversight Commission that now should refer to the Bureau of Workers' Compensation Board of Directors. Most of the rules are rate rules, where the rule requires the advice and consent of the Board of Directors. BWC has presented some of these rules to the Board for revision in the past few months and has incorporated this change in those rules (see: ethics rule, public employer taxing district rate rules, and the marine industry and coal industry rules). BWC will present to the Board more rate rules later this year. The attached rules are those that are not likely to come before the Board for revision soon.

Note that these rules are exempt from the Chapter 119 rule process.

Rule Amendments

In each of the attached rules, the only change is from the Workers' Compensation Oversight Commission to the Bureau of Workers' Compensation Board of Directors.

4123-17-03	Employer's classification rates
4123-17-18.1	Early payment discount program
4123-17-26	Minimum annual administrative charge
4123-17-37	Employer contribution to the safety and hygiene fund
4123-17-40	Self-insured buy-out factors

- 4123-17-45 Initial computation
- 4123-17-53 Private employer retrospective rating plan minimum premium percentages
- 4123-17-54 Public employer retrospective rating plan minimum premium percentages

4123-17-03 Employer's classification rates.

(A) An employer's premium rates shall be the manual basic rates as provided under rules 4123-17-02, 4123-17-06, and 4123-17-34 of the Administrative Code for each of its classifications except as modified by its experience rating, and shall apply for the first two six-month periods beginning on or after the first of July for private employers and shall apply for the calendar year beginning on or after the first of January for public employer taxing districts.

(1) In calculating the manual base rate under this rule, the bureau shall exclude the experience of an employer that is no longer active if the inclusion of the inactive employer's experience would have a significant negative impact upon the remaining active employers in a particular manual classification.

(2) The calculation of the base rate and the experience rate shall be applied to all employers reporting payroll in the manual classification, whether or not the premiums of the individual employers are reduced.

(3) Once the bureau has determined that the loss data of a specific inactive employer shall be removed from the manual classification experience, the bureau shall exclude the data of that employer from all future manual classification rate calculations. If that inactive employer reactivates its account with the Ohio state insurance fund, the bureau shall include the loss data in rate calculations for the manual classification.

(4) As used in this rule, an employer that is "no longer active" or is "inactive" is defined as an employer that satisfies all of the following criteria:

(a) The employer is assigned the policy status "bankrupt cancel," "cancel effective date," "final cancel," "canceled uncollectible," "no coverage due to claim," or "no coverage;"

(b) The employer is not reporting payroll;

(c) The employer is not paying or assessments to the Ohio state insurance fund as of the rate cut off date under either its own identity, the identity of any successor entity, or as a self-insured entity; and

(d) The employer does not employ employees for which Ohio workers' compensation jurisdiction would apply.

(5) As used in this rule, a "significant negative impact" is defined as occurring when the inactive employers in the manual reported forty per cent or more of the payroll in the manual classification in any calendar year in the experience period and when the loss rate and loss/premium ratio of the inactive employers taken as a whole are significantly higher than those of the active employers taken as a whole as measured using the data from the prior policy year's most current four years data. For private employer rates effective July 1, 1997, the bureau shall use the experience period data of the current policy year.

(B) An experience-rated employer's manual classification rate modification (credit or penalty) shall be determined by multiplying its experience modification percentage (EM%) times the basic manual rate for each assigned manual classification. The amount of the modification shall then be subtracted from or added to the respective basic rate to obtain the employer's premium rate for each classification.

(C) The experience modification percentage (EM%) shall be determined on the basis of the employer's experience and applied to the basic rate. The experience modification percentage of the employer's rate is determined in accordance with the following formula:

Subtract the TLL from the TML (TML – TLL), then divide by the TLL; multiply the resulting number by the C%; then add 100 to the resulting number, which will equal the EM%.

TML = Actual losses of the employer for the experience period as reduced in accordance with the maximum value. For individually rated employers, the EM% calculation will use the lower of the total modified losses from either the tabular reserve system or the MIRA reserve system. The TML that will be used in the calculation of the group EM% will be the lower of the TMLs from either the tabular reserve system or the MIRA reserve system, as determined at the individual employer level.

TLL = Total limited losses = TEL x LLR

TEL = Total expected losses as determined by applying the national council of compensation insurance (NCCI) expected loss rate to the NCCI classification payroll of each NCCI classification in the employer's experience period, as provided in appendix A of rule 4123-17-04 of the Administrative Code. The total expected losses are then used to determine the maximum value of a loss, credibility, and CX constant.

LLR = Limited loss ratio = $1 - CX/C\%$. This ratio is calculated for each credibility group within each industry group and is published as Table 1, Part C, in rule 4123-17-05 of the Administrative Code for private employers and rule 4123-17-33 of the Administrative Code for public employer taxing districts.

C% = Credibility given to an employer's own experience. Credibility is assigned by applying the employer's total expected losses to Table 1, Part A, in rule 4123-17-05 of the Administrative Code for private employers and rule 4123-17-33 of the Administrative Code for public employer taxing districts.

CX = Constant for each employer size group (group maximum value pool).

EM% = Credit or penalty applied to the basic rate.

(D) An employer's expected losses shall be the sum of the expected losses for each of its classifications. The expected losses for a classification shall be obtained by applying the expected loss rate of the table of rates to the employer's four-year payroll of the classification.

(E) The “experience period” shall be the oldest four of the latest five calendar years immediately preceding the beginning of the payroll reporting period to which the revised rates are applicable.

(F) Experience modification shall be subject to the following conditions and limitations:

(1) Actual losses include all incurred costs and shall be limited to the amounts stated in the credibility table according to the total expected losses of an employer;

(2) An employer shall not be eligible for experience modification of basic rates unless its expected losses are at least the minimum amount in the credibility table, as periodically established for the applicable rating period by rule adopted by the administrator with the ~~advice~~ advice and consent of the bureau of workers’ compensation oversight commission board of directors and ~~filed with the secretary of state and the legislative services commission;~~

(3) The maximum credit modification will be ninety-five per cent. Commencing with rating years beginning January 1, 1995, and later, shall be no limitation on the penalty modification.

(G) Commencing with the rating year beginning July 1, 1987, and all subsequent rating years, all manual classifications of the state insurance fund are subject to experience rating (i.e., merit rating).

Effective Dates: 8-19-77; 7-2-78; 7-1-79; 7-1-80; 7-1-82; 7-1-83; 7-1-87; 7-1-88; 1-1-92; 7-1-97; 9-8-97; 7-1-02
Rule promulgated under: RC 111.15
Rule authorized by: RC 4121.12, 4121.121, 4121.13
Rule amplifies: RC 4123.29, 4123.34

4123-17-18.1 Early payment discount program.

(A) The administrator of workers’ compensation, with the advice and consent of the bureau of workers’ compensation oversight commission board of directors, has authority to approve contributions made to the state insurance fund by employers pursuant to sections 4121.121, 4123.29, and 4123.34 of the Revised Code. Pursuant to section 4123.29 of the Revised Code, the administrator, with the advice and consent of the bureau of workers’ compensation oversight commission board of directors, may grant a discount as the administrator determines to an employer that makes its semiannual premium payment at least one month prior to the last day on which the payment may be made without penalty.

(B) Employer eligibility for early payment discount.

(1) The early payment discount shall be available to any private state fund employer with active coverage. An employer reporting zero payroll is not eligible for the discount.

(2) The employer may participate in any other alternative rating program offered by the bureau.

(3) The early payment discount is available only for an employer that reports its payroll and pays its premiums over the internet through electronic submission on the bureau’s website.

(C) Operation of the early payment discount.

(1) An employer participating in the early payment discount program may submit to the bureau the employer's payroll, actual or estimated, with payment, at any time during the current reporting period. The actual discount will depend upon the time of payment as provided in paragraph (D) of this rule.

(2) For the early payment discount, the bureau will accept the employer's payment without the employer's payroll, but will not accept the employer's payroll without the employer's premium payment.

(3) The employer shall report the complete payroll for the payroll reporting period by the normal due date for the premium payment. The employer's coverage will lapse if the employer does not file and pay the full amount due as required by the completed payroll report for the reporting period.

(a) The bureau will not refund an overpayment of early premium payments made by the employer until the employer filed the completed payroll report for the reporting period.

(b) Standard penalties will apply to any net balance due from the employer, i.e., total premium due less discounts, dividends, and early payments made.

(D) Premium discount for the early payment discount.

(1) The bureau will determine the discount rate for each calendar year based on the prior year's actuarial audit's discount rate. The amount of the discount for early payment will be incremental and will decline based upon the date the employer makes the payment to the bureau.

(2) An employer is eligible for the appropriate early payment discount if the employer reports the payroll and pays the complete premium for the payroll reporting period by the first month of the two month grace period for payment; that is, by the end of January for payments due by the end of February, or by the end of July for payments due by the end of August.

(3) The early payment discount shall apply to the total blended premium paid by the employer after all other discounts, dividends, etc.

(4) For an employer participating in retrospective rating, the early payment discount shall be applied only to the minimum premium as defined in rule 4123-17-44 of the Administrative Code.

Effective date: 4-10-01

Rule promulgated under: RC 111.15

Rule authorized by: RC 4121.121

Rule amplifies: RC 4123.29, 4123.34

4123-17-26 Minimum annual administrative charge.

The administrator of workers' compensation, with the advice and consent of the bureau of workers' compensation oversight commission board of directors, has authority to calculate contributions to the administrative cost fund by employers pursuant to sections 4121.121, 4123.341, and 4123.342 of the Revised Code. The administrator hereby establishes that in cases where an employer reports no payroll or calculates total premium due of less than the minimum administrative charge for a payroll reporting period the employer shall pay a minimum annual administrative charge at a rate of fifty dollars each six months or one hundred dollars annually.

Effective Dates: 7/1/62; 2/14/76; 1/1/92; 7/1/96; 7/1/97, 7/1/06
Promulgated Under: 111.15
Statutory Authority: 4121.12, 4121.121
Rule Amplifies: 4123.341, 4123.342

4123-17-37 Employer contribution to the safety and hygiene fund.

The administrator of workers' compensation, with the advice and consent of the bureau of workers' compensation oversight commission board of directors, has authority to approve contributions to the state insurance fund by employers pursuant to sections 4121.121 and 4121.37 of the Revised Code. The administrator hereby establishes the amount of premium to be set aside to fund the division of safety and hygiene to be one per cent of paid premium for public employer taxing districts and public employer state agencies, and one per cent of paid premium for private employers.

Effective dates: 7-1-90; 7-1-93; 7-1-98; 7-1-99
Rule promulgated under: RC 111.15
Rule authorized by: RC 4121.37, 4123.34
Rule amplifies: RC 4121.37, 4123.34

4123-17-40 Self-insured buy-out factors.

The administrator of workers' compensation, with the advice and consent of the bureau of workers' compensation oversight commission board of directors, has authority to establish factors for the purpose of implementing the procedure for self-insurance buy-outs. The administrator hereby adopts factors to establish the liability of a private employer or a public taxing district employer requesting to transfer from state insurance fund coverage to self-insurance with the buy-out calculated upon the pure premium paid by the employer on payroll for a seven calendar year period, as provided in paragraph (M) of rule 4123-19-03 of the Administrative Code. The factors indicated in attached appendix A shall apply to appropriate applications filed on or after July 1, 1998.

Appendix A

Calendar Year – Buyout Percentage: Private Employers – Buyout Percentage: Public Employer Taxing Districts

For all seven years of buy-out calculation – 0.0% – 0.0%

Effective dates: 7-1-90; 7-1-91; 7-1-92; 11-23-92; 2-22-93; 7-1-93; 7-1-94; 7-1-95; 7-1-96; 7-1-97; 7-1-98
Rule promulgated under: RC 111.15
Rule authorized by: RC 4121.12(J)(2)
Rule amplifies: RC 4121.12, 4123.34, 4123.35

4123-17-45 Initial computation.

(A) The hazard group for an employer shall be determined as follows. The employer's experience-rated premium for the policy year shall be allocated to the ten industry groups used in experience rating as provided in appendix B, (table 1, part B), of rule 4123-17-05 of the Administrative Code. The industry group producing the most premium shall be used to determine the hazard group, unless that industry group is group ten; in the latter case, the industry group producing the second highest premium shall be used, unless its premium is less than ten per cent. Industry group ten is the determining industry group only if it has the largest premium and no other industry group has ten per cent of premium. If the determining industry group is two, four, five, or ten, the hazard group shall be A. If the determining industry group is six, seven, or nine, the hazard group shall be B. If the determining industry group is one or three, the hazard group shall be C. If the determining industry group is eight, the hazard group shall be D. For all public employer taxing districts, the hazard group shall be that group specifically developed for such employers and as shall be periodically established by the administrator with the ~~advice~~ advice and consent of the bureau of workers' compensation oversight commission board of directors.

(B) The Ohio bureau of workers' compensation shall notify the employer of the estimated minimum premium percentage based on the limits selected by the employer and the payroll of the employer. The premium rates on the payroll reports received by the employer for the policy year will be calculated using the minimum premium per cent.

Effective dates: 7-1-88; 10-2-90; 7-1-97
Rule promulgated under: RC 111.15
Rule authorized by: RC 4121.12, 4121.121
Rule amplifies: RC 4123.29, 4123.34

4123-17-53 Private employer retrospective rating plan minimum premium percentages.

The administrator of workers' compensation, with the advice and consent of the bureau of workers' compensation oversight commission board of directors, has authority to approve contributions made to the state insurance fund by employers pursuant to sections 4121.121, 4121.13, 4121.30, 4123.29, and 4123.34 of the Revised Code. The administrator hereby sets the private employer retrospective rating plan minimum premium percentages to be effective for the July 1, 2006, policy year, as indicated in the attached Appendixes a, (Tier I, tables A, B, C, and D) and B; (Tier II, tables A, B, C, and D).

APPENDIX A AND B [not attached]

Effective Dates: 7/1/91, 7/1/93, 7/1/94, 7/1/97, 7/1/06
Promulgated Under: 111.15
Statutory Authority: 4121.12, 4121.121
Rule Amplifies: 4123.29, 4123.34

4123-17-54 Public employer retrospective rating plan minimum premium percentages.

The administrator of workers' compensation, with the advice and consent of the bureau of workers' compensation oversight commission board of directors, has authority to approve contributions made to the state insurance fund by employers pursuant to sections 4121.121, 4123.29, and 4123.34 of the Revised Code. The administrator hereby sets the public employer taxing districts retrospective rating plan minimum premium percentages to be effective for the January 1, 2007 policy year, as indicated in the attached appendixes A (Tier I) and B (Tier II).

Appendix A and B [not attached]

Effective Dates: 1/1/92, 1/1/93, 1/1/94, 1/1/98, 1/1/07
Promulgated Under: 111.15
Statutory Authority: 4121.12, 4121.121
Rule Amplifies: 4123.29, 4123.34

Surplus Fund Executive Summary

Background:

The surplus fund is a statutorily defined account within the State Insurance Fund established in accordance with Ohio Revised Code (O.R.C) Section 4123.34(B). This section reads as follows:

(B) Ten per cent of the money paid into the state insurance fund shall be set aside for the creation of a surplus until the surplus amounts to the sum of one hundred thousand dollars, after which time, whenever necessary in the judgment of the administrator to guarantee a solvent state insurance fund, a sum not exceeding five per cent of all the money paid into the state insurance fund shall be credited to the surplus fund. A revision of basic rates shall be made annually on the first day of July.

It should be noted that a 1980 Attorney General Opinion (1980 Ohio Op. Atty. Gen. No. 80-072, (November 12, 1980)) clarifies that the surplus fund is not a separate and distinct fund, but is in fact an account within the State Insurance Fund. However, this opinion also states:

Various statutes, as previously mentioned, expressly provide for the payment of certain expenses from the surplus accounts. See R.C. 4123.343(B); R.C. 4123.35; R.C. 4123.519; R.C. 4123.57(D); R.C. 4123.75. There is no statutory authority to expend funds other than surplus account funds for such purposes. Although surplus account monies may be commingled with other state insurance fund monies for purposes of deposit and investment, a separate and accurate account of all credits to, and disbursements from, the surplus account, as well as an accurate account of the balance in the surplus account, must be maintained.

As such, BWC is required to maintain accounting records specific to the activity that impacts the surplus fund account. As noted above, various sections of the O.R.C. outline specific types of expenses that are to be charged to the surplus fund account. These expenses are charged to the surplus fund account and not charged to an individual employer's experience for rating making purposes. Instead, these costs are spread over all employers in that specific manual classification. The O.R.C. section referenced above limits the amount of funding that may be credited to the surplus fund account. Since the creation of the surplus fund account, the funding levels have not been adjusted. However, since the creation of the surplus fund account, the number and types of expenses required to be charged to the surplus fund account have increased. This has resulted in disbursements exceeding funding and generating the deficit situation that currently exists.

Surplus Fund Executive Summary

Issue:

The recent audit performed by Schneider Downs & Co., Inc. included a management letter comment that read as follows:

In 1913, General Code Section 1465-54-2 was enacted directing that 10% of the money paid into the State Insurance Fund be set aside to create a surplus of \$100,000, after which time, whenever necessary in the judgment of the administrator to guarantee a solvent state insurance fund, a sum not to exceed 5% of the money paid into the state insurance fund shall be credited to the surplus fund. A 1980 Attorney General opinion upheld the concept that the Surplus Fund is an account within the State Insurance Fund. In 1982, \$49,362,000 was transferred from the State Insurance Fund into the Surplus Fund as it had been determined that the balance in the Surplus Fund was not sufficient to cover the required expenditures.

During the audit, we noted that there is no longer \$100,000 in the surplus fund. We encourage management to investigate the accounting for the surplus fund to ensure compliance with the Ohio Revised Code.

Management has reviewed the accounting for the surplus fund and noted it is consistent with the requirements outlined in the statute. In addition, BWC management has engaged in numerous discussions over the past several years regarding the nature and intent of the legislation relative to the surplus fund. The specific question raised was whether the authority to set aside of 10% of premium was limited to the initial funding of the surplus fund account or whether the BWC Administrator has the authority to increase the set aside at any time the surplus fund account is below the \$100,000 specified in the statute. A request for a legal opinion was made to BWC's General Counsel regarding this issue. A follow up question is whether the BWC Administrator has the authority to transfer funding from the State Insurance Fund into the surplus fund account when it is determined that the surplus fund account balance is not sufficient to cover the costs similar to what occurred in 1982.

It should be noted that while the surplus fund account is in a deficit position, there is no risk to the State Insurance Fund. The deficit exists as a result of accounting requirements associated with the surplus fund. Charges to the surplus fund are made from the State Insurance Fund and surplus fund costs are included in the rate making process. The surplus fund account is properly reflected as a reduction in available net assets on the BWC financial statements.

It is management's belief that the BWC Administrator has the authority to establish a set aside of 10% of premium at any time the surplus fund account is below the \$100,000 threshold established by statute. BWC management is also researching the legislative changes that would be helpful to clarify the role of the surplus fund account and the intent of the existing statute.

OHIO BUREAU OF WORKERS' COMPENSATION

FISCAL YEAR 2008
2ND QUARTER
EXECUTIVE SUMMARY

INTERNAL AUDIT DIVISION

JOE BELL, CHIEF OF INTERNAL AUDIT
CAREN MURDOCK, INTERNAL AUDIT DIRECTOR
RICH RIDWOOD, IT AUDIT DIRECTOR
KEITH ELLIOTT, SENIOR MANAGER

MEMORANDUM

TO: Audit Committee Members

FROM: Joe Bell, Chief of Internal Audit

DATE: February 28, 2008

RE: FY 08 2nd Quarter Executive Summary report

Following you will find the Fiscal Year 2008 2nd Quarter Executive Summary report containing:

1. Audit comment status
 - 1a. Comments issued 2nd quarter
 - 1b. Comments outstanding as of December 31, 2007
2. Audit follow-up procedures
3. Audit comment rating criteria
4. Updated FY 08 Audit Plan

BWC INTERNAL AUDIT DIVISION
 COMMENTS ISSUED – 1ST QUARTER ACTIVITY

Manager Selection and Funding Process Audit – January 2008

Business area: Investments

Internal Audit conducted an audit of the Manager Selection and Funding processes used for the selection of new investment managers and the funding process for approved managers. Our specific objectives for the project were as follows:

- To ensure controls over the Request for Proposal (RFP) process minimize risks associated with the hiring of investment managers and help ensure that BWC selects only qualified managers to manage BWC assets;
- To evaluate the adequacy of controls over the RFP and investment funding processes to ensure compliance with applicable rules, regulations and BWC policies, and to ensure that agency assets are appropriately safeguarded; and
- To determine if the funding process includes appropriate controls. This included validation of proper funding request authorization and appropriate segregation of duties.

Conclusion:

Controls appear to be reasonably designed over the RFP and funding processes. The Investment RFP process, including the involvement of an external investment consultant in the drafting of the RFPs and scoring of candidates, appears reasonable to help ensure the hiring of qualified managers. Controls over the funding process, including the segregation of duties, appears reasonable to help ensure that assets are appropriately safeguarded and that only properly approved funding transactions are processed. The tests of key controls identified no exceptions. The audit identified three minor recommendations for management’s consideration.

MCO Audit #2 – January 2008

Business area: Medical Services and Compliance

Activity Reviewed:

- Adequacy of internal control design and assessment if the controls were placed in operation;
- Assessment of compliance with contract requirements and policy established by BWC;
- Areas of focus included:
 - Case management;
 - Provider account controls and accuracy;
 - Bill processing; and
 - Resolution of prior audit recommendations (BWC issues, SAS 70 audit findings, external auditor issues).

	Recommendation	Disposition
1	Take steps to improve the MCO’s financial condition to ensure quality service is not interrupted to injured workers, employers, providers and BWC. Significance Rating: Material Weakness	MCO management has taken steps to resolve the financial difficulties experienced. Target Resolution Date: June 2008

	Recommendation	Disposition
2	Establish controls to prevent and detect unauthorized transfers from the provider account. Significance Rating: Significant Weakness	MCO management clarified BWC ownership of the provider account funds with their bank, which should prevent any further non-provider transfers from the provider account. Current Resolution Status: Implemented
3	Implement an independent quality assurance review process over the provider bill entry process to monitor the accuracy of bills submitted to BWC. Significance Rating: Significant Weakness	Management is working with their provider billing department to maintain above-average data scores and is in the process of developing an independent quality assurance review process for provider bill entry. Target Resolution Date: February 2008
4	Establish controls for all provider checks over \$5,000 to help ensure that the required signatures are obtained and documented by someone independent of the initial data input prior to mailing. Significance Rating: Significant Weakness	Management revised the segregation of duties related to provider bill payments to ensure that the required signatures are obtained for payments greater than \$5,000. Current Resolution Status: Implemented
5	Establish processes to facilitate an annual review and testing of the entire disaster recovery plan and perform any necessary updates each year. Significance Rating: Significant Weakness	MCO management updated the disaster recovery plan and will work with their IT consultant to develop a process to periodically test the plan. Target Resolution Date: June 2008
6	Obtain additional insurance coverage to comply with MCO contract requirements. Significance Rating: Significant Weakness	Insurance coverage limits were increased to the required levels immediately upon notification by the BWC auditors. Current Resolution Status: Implemented
7	Establish processes and controls to help ensure audit findings are resolved within the contract timeframes. Take steps to refund the provider overpayments to BWC. Significance Rating: Significant Weakness	Management is in the process of recovering the provider overpayments and performing the required adjustments. Target Resolution Date: March 2008
8	Lock filing cabinets containing sensitive information each evening in order to minimize the possibility of unauthorized access to such information. Significance Rating: Significant Weakness	Procedures have been changed to require that filing cabinets containing confidential information are locked at the end of each day. Current Resolution Status: Implemented

Auditor Opinion:

Improvement in the financial condition of the MCO is needed to ensure the continued ability to provide quality service to its customers.

Internal controls over much of the operations of the MCO appeared to be adequately designed and placed in operation. Specifically, case management plans appeared to be prepared in a timely manner and responses to requests or motions appeared reasonable. Response requirements for alternative dispute resolution cases were generally met. Resolution of voided checks and segregation of duties for the provider account were also reasonable. In addition, the provider account reconciliations were performed accurately and timely.

However, we identified several areas in which internal controls should be improved, which include:

- Establishing controls to prevent inappropriate transfers from the provider account;
- Ensuring that system access for separated employees is revoked in a timely manner;
- Establishment of independent quality assurance controls for the accuracy of bills submitted to BWC;
- Ensuring that checks exceeding \$5,000 receive the second signature required per the MCO policy; and
- Ensuring resolution of prior findings related to overpayments.

Permanent Total Disability Claims Audit – January 2008

Business area: Customer Services

Internal Audit conducted an audit of the Permanent Total Disability (PTD) Claims process. The objective of the audit was to assist management in evaluating the PTD process by reviewing various key compliance and internal control related components of processing and administering PTD claims.

Activity Reviewed:

- Evaluated if current internal controls were adequately designed for processing and administering PTD claims;
- Determined if claims were processed in accordance with overall BWC policy/procedures and statutory requirements;
- Evaluated whether the PTD process is efficiently and effectively administered; and
- Assessed the adequacy of quality assurance procedures.

	Recommendation	Disposition
1	Formalize policies, procedures, and training materials to ensure consistent, efficient, and effective processing of PTD claims. Additionally, create systematic processing procedures and/or training materials for Disabled Workers' Relief Fund (DWRF) claim functions. Significance Rating: Significant Weakness	Management will ensure all policies, procedures, and systematic instructions are current. Responsible Chief: Chief of Customer Services Targeted Resolution Date: May 2008
2	Meet with IT management and evaluate the cost benefit of updating the Version 3 (V3) system to better assist in the process of PTD and DWRF or develop compensating controls. Significance Rating: Significant Weakness	Management is working with IT to evaluate and prioritize the system changes. Responsible Chief: Chief of Customer Services Targeted Resolution Date: December 2008
3	Review other alternatives for processing PTD claims to provide more effective and efficient claim maintenance. Significance Rating: Significant Weakness	Management will conduct a review of the Claims Service Specialists' (CSS) caseloads and recommend a staffing model to senior management. In addition, a system change control was submitted for a PTD CSS profile to exist in V3. Responsible Chief: Chief of Customer Services Targeted Resolution Date: June 2008
4	Conduct the cross match each month and monitor reports to ensure appropriate actions have been taken based on the diary type. Significance Rating: Significant Weakness	Management will work with IT and DAS to ensure the cross match is performed monthly. In addition, a system change control was submitted to IT requesting a clean-up control report as well as a system enhancement to tag the claim. Responsible Chief: Chief of Customer Services Targeted Resolution Date: June 2008
5	Implement controls to ensure that DWRF overpayments are processed and recouped in accordance with statute and BWC policy. Significance Rating: Significant Weakness	Claims policy will utilize the Law Department to ensure policy is in accordance with statute. Furthermore, the field will develop/update procedures to make sure over payments are processed and recouped. Responsible Chief: Chief of Customer Services Targeted Resolution Date: October 2008

	Recommendation	Disposition
6	Establish the essential resources needed to complete the previous clean up project by identifying and reviewing claims that have never been reviewed and correcting those claims with outstanding errors. Significance Rating: Significant Weakness	Management has strengthened the training program for the PTD CSS and plans to have the clean-up project completed by June 2008. Responsible Chief: Chief of Customer Services Targeted Resolution Date: June 2008
7	Create proactive controls and monitoring processes to ensure benefit payments due to injured workers are not inappropriately interrupted. Significance Rating: Significant Weakness	Management has requested a system change control to create diaries for suspended PTD claims and for non-suspended plans due to a date of death (DOD) not entered. Data warehouse queries will be developed as an interim control measure. Responsible Chief: Chief of Customer Services Targeted Resolution Date: December 2008
8	Implement procedures to provide reasonable assurance that V3 notes are entered and all required documents exist in the PTD claim file. Significance Rating: Significant Weakness	Management will review all training materials, workflows, and policy to ensure notes, rate calculation worksheets, wage information, and images are documented in the claim. Responsible Chief: Chief of Customer Services Targeted Resolution Date: March 2008
9	Implement processes and/or controls to monitor claims in which the injured worker has clearly retired (or is eligible for retirement) are calculated and paid appropriately. Significance Rating: Significant Weakness	Management has requested a system change control so the diary will post to the assigned and DWRF CSS when an IW reaches the age 62 and there is no retirement date in V3. Responsible Chief: Chief of Customer Services Targeted Resolution Date: December 2008
10	Determine the overall impact and best course of action regarding the incorrect overpayments to ensure the accounts receivable balance and BWC financial statements are accurate, and identify and correct the erroneous DWRF overpayments. Significance Rating: Significant Weakness	Management will work with Finance and Customer Service Divisions to determine the best solution for incorrect DWRF payments and inappropriate PTD offsets. A system change control was submitted to prevent incorrect DWRF overpayments. Responsible Chief: Chief of Customer Services Targeted Resolution Date: April 2008 (overpayment correction); February 2009 (clean-up project); February 2008 (QA; IT related)
11	Provide additional communication and/or training for the assigned CSS to complete an annual review of the drugs and treatments related to the PTD claims. Significance Rating: Significant Weakness	Management will create a report to identify claims with diaries posted 60 days prior to the IW's date of birth to the assigned CSS during the quarter. This report will be provided to the IMS for a random sample to ensure compliance with policy. Responsible Chief: Chief of Customer Services Targeted Resolution Date: February 2008

Auditor Opinion:

In general, established policies and procedures were insufficient and internal controls were not adequately designed for processing and administering PTD claims. Compliance testing identified some significant non-compliance issues, which confirm controls need improvement for the appropriateness of PTD claims processing. The overall PTD process was not efficiently and effectively administered and quality assurance weaknesses were noted.

Management generally agrees with the recommendations and has committed to an action plan for implementing the changes. Five management comments require IT resources and include a preliminary target completion date since IT resources may be limited to other higher priority strategic initiatives. Based on IT and management updates, Internal Audit will reevaluate how the risk will be mitigated by management.

Employer Payroll Reporting Process Audit – February 2008

Business area: Fiscal and Planning and Customer Services

The BWC Internal Audit Division conducted an audit of the Employer Payroll Reporting Process. Our specific objectives for the project were as follows:

- Obtain a thorough understanding of the policies, procedures and controls over the payroll reporting process;
- Determine if current internal controls are adequately designed;
- Assess the adequacy of quality assurance procedures over the process; and
- Provide recommendations to improve controls and reduce risks.

Our review included performing walkthroughs of the procedures used for each of the various methods of payroll reporting and payment, which include the following:

- Lockbox payments (via checks or credit cards);
- On-line payments (BWC website and Ohio Business Gateway);
- Services office payments (via checks or credit cards);
- BWC Call Center payments received over the phone (ACH or credit cards); and
- Wire transfers (Attorney General's Office (AG) collections).

In addition, the audit also involved an examination of the processes for recording reported payroll and premium payments into the Workers Compensation Insurance System (WCIS) used for employer policies and the posting of financial transactions into the BWC general ledger.

Conclusion:

Controls appear to be reasonably designed over the employer payroll reporting and payment processes to help ensure that reported payroll and premium amounts are processed completely and accurately and that the relevant information is properly posted to the WCIS system and the BWC general ledger. In addition, in most instances, quality assurance review procedures for the above referenced processes appeared reasonable. The audit identified three minor recommendations for management's consideration.

BWC INTERNAL AUDIT DIVISION

OUTSTANDING COMMENTS AS OF DECEMBER 31, 2007

“Death Bed” Settlements – October 2003

	Recommendation	Disposition
1	The current settlement process contains no mechanism to help identify terminal conditions of injured worker (IW) attempting to settle their claims. As a result, we have seen instances in which injured workers die within the 30 day cooling off period or shortly after the settlement as the result of terminal conditions of which we were not aware. As a result, management based the settlements on normal life expectancies and overpaid for the settlements.	Claims Policy is working with Internal Audit and Legal Operations to finalize a policy update on medical documentation obtained for settlement purposes but otherwise not related to the claim. The policy will include requirements for disposition of this data outside of claim files. Responsible Chief: Chief of Customer Services Target Resolution Date: December 2007 Current Resolution Status: In-Process

Non-Complying Employer Audit – August 2004

	Recommendation	Disposition
1	BWC currently does not lapse employers that do not pay all premium amounts owed within a designated time period. While the remaining balances are certified to the Attorney General for collection, the employer continues to have active coverage. This is contrary to industry standard practice.	BWC received the legislative authority to implement this change. BWC management is working with IT and other divisions to determine how best to implement a solution. Responsible Chief: Chief of Fiscal and Planning Targeted Resolution Date: December 2007 (IT related) Current Resolution Status: In-process

MDL and Capital Coin Fund Control Review – June 2005

	Recommendation	Disposition
1	Establish processes to monitor activities of investment managers to ensure compliance with agreements.	Investment Division is in the process of reviewing and rewriting policies and procedures. Outside investment manager scorecard to monitor and grade managers' quarterly performance and adherence to IPS has been developed and is in use. All passive managers have been reviewed for the 2 nd , 3 rd and 4 th quarters of 2007. The next major thrust will be dependant on fully integrating the new Mellon Analytical System (MAS) with its monitoring, compliance and performance measurement features. The hiring of a new BWC Investment Consultant and possible IPS rewrite may also be a large factor. Responsible Chief: Chief Investment Officer Target Resolution Date: June 2008 Current Resolution Status: In-process

	Recommendation	Disposition
2	Establish controls ensuring that the Board of Directors is informed of and approves significant changes in investment strategy by approved managers or funds.	New MAS system offers compliance and portfolio monitoring. Procedures discussed to incorporate interested parties (i.e. Auditing, Financial Reporting, Investment Consultant, Investment Committee) to receive out of compliance notification. A possible revision to the Investment Policy Statement to require approval of outside investment manager strategy changes by the Investment Committee or Board will be targeted for discussion/approval in 1Q 2008. Responsible Chief: Chief Investment Officer Target Resolution Dates: March 2008(IPS); June 2008 (MAS) Current Resolution Status: In-process

Disability Evaluators Panel (DEP) Audit – July 2005

	Recommendation	Disposition
1	During the review, we identified unusual trends in scheduling exams or file reviews with certain administrative agents and/or providers (i.e., high % of exams all scheduled with one provider/Admin Agent). One administrative agent received 32% of all Admin Agent scheduled exams compared with next highest of 9%.	The updates to the exam scheduling items listed have all been implemented for the State Fund process. The Self-Insured portions of exam scheduling are slated to be released in December 2007. Responsible Chief: Chief of Customer Services and Medical Services and Compliance Chief Target Resolution Date: September 2007 (Medical Operations); December 2007 (IT related) Current Resolution Status: In-process

Bankrupt Self-Insured Claims – March 2006

	Recommendation	Disposition
1	Consider a legislative change to permit BWC to offset PTD compensation for an injured worker receiving Social Security Retirement benefits, potentially saving \$60 million annually; “grandfather-in” current PTD recipients receiving both benefits to avoid financial hardship to those individuals.	Management has recently issued a Request For Proposal (RFP) for a study that will evaluate this issue and provide options for BWC consideration. Management has tabled this issue to include this recommendation on a list of potential legislative changes until after the study is complete. Responsible Chief: Chief of Customer Services Target Resolution Date: December 2008 Current Resolution Status: In-process

Medical Billing and Adjustments (MB&A) – May 2006

	Recommendation	Disposition
1	<p>There is a general lack of controls over the identification and processing of medical bill adjustments which result in the need to adjust the employers' claims experience data. Significance Rating: Significant Weakness</p>	<p>IT developed a report (quarterly) to identify/display the medical transactions processed within the given quarter. Using the 3Q 2007 data, MB&A verified that the report is extracting appropriate transactions that reflect adjustments to an original invoice. Actuarial filters the data to reflect only those transactions that adjust medical cost for claims impacting the experience. Actuarial is working with IT to develop a systematic (upload) process that will adjust the medical experience cost without manual intervention. However it was discovered that this process could only be applied to adjusting private employer policies, not public. Currently, the Rate Adjustment Unit is manually processing approx 363 medical transactions (in the 3Q 2007) for public employer policies. The MB&A dept no longer is required to send an adjustment request to the unit. A request for change will be submitted to create the systematic adjustment process for private employers, approx 2,300 transactions for 3Q 2007. The adjustment process will occur on a quarterly basis but will be dependent on the availability of IT and Rate Adjustment resources. Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: September 2008 (IT related) Current Resolution Status: In-process</p>
2	<p>Application system security issues were identified involving inadequate system security profiles to ensure proper segregation of duties was maintained. Individuals possessed access to process medical bills and adjustments that no longer required such access. Segregation of duties issues related to individuals with both the ability to update the provider master file and process payments, which increases the potential for inappropriate or fraudulent payments. Significance Rating: Significant Weakness</p>	<p>IT completed a review of CAM users several months ago and will continue to monitor those users that have not accessed the system in over 180 days on a monthly basis. CAM implemented a monthly script to identify CAM users that have not accessed the system in over 180 days. HPP Systems Support implemented a periodic review of all CAM user profiles to validate whether update capabilities are appropriate for that user. Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: February 2008 (IT related) Current Resolution Status: Implemented</p>
3	<p>To ensure the current interest payment methodology operates in accordance with statutory requirements, obtain clarification regarding the correct interest payment calculation and ensure MIIS and Cambridge Systems calculations are consistent. Significance Rating: Significant Weakness</p>	<p>The changes were implemented into CAM with the December 2007 release as scheduled. However, based on further analysis a new resolution was required. The new resolution requires 1) creation of a new data element, 2) adding a data field to the EDI 837 transaction set to receive new data element, 3) modifying each MCO's billing system for the data element, and 4) modifying BWC's application to store and use the new data element.</p>

	Recommendation	Disposition
		Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: September 2008 (IT related) Current Resolution Status: In-process
4	There are currently two active systems in place for processing medical payments with limited IT and HPP technical support. Maintenance of the two systems is inefficient and results in increased systems maintenance costs. Significance Rating: Significant Weakness	The Provider Master project is the first step in shutting down MIIS. Provider Master is not scheduled to be completed until 2008. Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: June 2008 (IT related) Current Resolution Status: In-process

Risk/Employer Operational Review – June 2006

	Recommendation	Disposition
1	Policy and procedures were not written for most functions and activities. Significance Rating: Significant Weakness	Procedures for 60% of the core functions are completed (6 of 10 completed). The completion of the remaining four core procedures has been delayed due to departmental focus on managing the processing backlogs in Policy Processing (i.e., implementation of the enterprise solution to train field AE2s on policy processing procedures), on-going modifications being made to the existing policies and procedures to improve operational efficiencies and customer service and assignment of resources to the Staffing Allocation Model (SAM) Project. To overcome these obstacles, additional resources have been assigned to assist with drafting procedures. Policy Processing resource availability for this effort will be limited during the first 4 months of 2008 due to managing our peak processing period, providing processing support to the field AE2s and conducting the time study for the SAM Project. Responsible Chief: Chief of Customer Services Target Resolution Date: July 2008 Current Resolution Status: In-process
2	BWC does not ensure all employers under jurisdiction of Ohio workers' compensation laws have obtained workers' compensation coverage. Systematic cross checks should exist with other state agencies. Significance Rating: Material Weakness	An employer compliance project team has been established to document all BWC operations and processes related to employer compliance with workers' compensation laws and policies. Final recommendations are to be completed in April 2008. Responsible Chief: Chief of Customer Services Target Resolution Date: April 2008 Current Resolution Status: In-process
3	Minimum premiums may not be adequate. The recently revised Ohio Administrative Code Section 4123-17-26, (administrative charge rule) has been increased to cover the administrative expense of maintaining the policies that report no payroll.	The Actuarial Division has included this item in the RFP that requires the BWC to hire an external actuary or other consultant to look at policy and procedures such as this as mandated in House Bill 100. The RFP was issued on December 2007.

	Recommendation	Disposition
	However, there is still inherent risk with the policies that have greater exposure due to industry type. Significance Rating: Material Weakness	Proposals are due on January 24, 2008. Designated Chief: Chief Actuarial Officer Target Resolution Date: December 2007 (RFP issuance); December 2008 (consultant report) Current Resolution Status: In-process
4	Current process controls do not adequately identify duplicate employer policies. Employers can avoid higher premiums by acquiring a new policy, while having an existing policy for the same business. Significance Rating: Significant Weakness	The system enhancement to resolve this weakness is scheduled for completion during the 1 st quarter 2008. The implementation date was moved due to IT resource availability (i.e., resources required to address production and cyclical production issues). Responsible Chief: Chief of Customer Services Target Resolution Date: April 2008 (IT related) Current Resolution Status: In-process
5	When payroll reports are received there is no review to determine if estimated Premium Security Deposits are correct. The lack of review could result in lost revenue due to under reported estimates for premium security deposits. Significance Rating: Significant Weakness	Obtained confirmation to proceed with updating the amount of PSD on individual policies. This project has been prioritized by the WCIS Business Management Team but not scheduled. Responsible Chief: Chief of Customer Services Target Resolution Date: June 2008 (IT related) Current Resolution Status: In-process

Time Reporting and Leave Usage – August 2006

	Recommendation	Disposition
1	Management should conduct research to determine the reason for modifications to ending leave balances. Policies and procedures for these modifications should be reviewed to ensure that only properly authorized and valid adjustment entries are posted. Significance Rating: Significant Weakness	Management has completed research on the differences noted during the audit. In addition, management has re-emphasized with account clerks and payroll officers the need to ensure that any payroll adjustments are properly documented. To improve controls, management is working with DAS to determine what controls and/or management reports can be developed to guard against unauthorized payroll adjustments. The implementation of OAKs has impacted the timing for resolving this comment. Responsible Chief: Chief of Fiscal and Planning Target Resolution Date: June 2008 Current Resolution Status: In-process
2	Develop controls to validate that payroll report information is entered accurately and completely into the database system and that the amounts in the payroll disbursement journals agree with the information on the payroll reports. Significance Rating: Significant Weakness	The implementation of OAKs has addressed the issue of key entry errors, as employee time information is now entered electronically and approved by department managers. Once approved the information is downloaded into the payroll system. Adjustments have been completed to correct the errors identified during the audit. Responsible Chief: Chief of Fiscal and Planning Target Resolution Date: October 2007 Current Resolution Status: Implemented

**Average Weekly Wage/Full Weekly Wage Payment Rates –
September 2006**

	Recommendation	Disposition
1	Take steps to resolve the inconsistencies noted between BWC policy and V3 system calculations of AWW/FWW payment rates. Significance Rating: Significant Weakness	Policy updates were completed in January 2007. The System Change Control request has been reviewed and scheduled. Responsible Chief: Chief of Customer Services Target Resolution Date: March 2008 (IT related) Current Resolution Status: In-process

Medical Bill Payment Controls – September 2006

	Recommendation	Disposition
1	System edit checks exist yet inappropriate or fraudulent provider billings still occur within the system. Consider the feasibility of implementing clinical editing software and an Explanation of Benefits process as added controls in guarding against inappropriate or fraudulent provider billing. Significance Rating: Significant Weakness	Legal has completed the contract for the clinical editing software, which will be implemented in April 2008. Edits have been developed to identify unusually high provider billed amounts. HPP Systems Support is monitoring line items identified by these edits and following up with MCOs to confirm accuracy of the data. MCOs should be able to submit override EOBs indicating they have reviewed unusually high line item charges. Compliance and Performance Monitoring has implemented the review of bills over \$10,000 for accuracy. The first request for bills was sent to MCOs during the 2nd quarter of FY08. Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: January 2007 (MCO contract); April 2008 (clinical editing) Current Resolution Status: In-process

Claims Operational Review – September 2006

	Recommendation	Disposition
1	Discontinue performing functions that are the primary responsibility of the MCOs. Significance Rating: Significant Weakness	Customer Services is aiding Medical Services' effort to define the tasks being performed by MCOs and to identify efforts in the service offices. This investigation will be done by June 2008. Based on that investigation, revisions in policies and procedures to eliminate duplication of effort will be scheduled at that time.. Responsible Chief: Chief of Customer Services Target Resolution Date: June 2008 Current Resolution Status: In-process

Recommendation		Disposition
2	<p>Systematically assign new injury claims filed with no return to work date and an ICD-9 code to the lost time service offices.</p> <p>Significance Rating: Significant Weakness</p>	<p>The Triage team has completed their recommendations. Implementation of those recommendations is dependent on agency enterprise projects in 2008.</p> <p>Responsible Chief: Chief of Customer Services Target Resolution Date: June 2008 (IT related) Current Resolution Status: In-process</p>
3	<p>Enhance current V3 system to link an injured worker with multiple claims to the same case manager or team.</p> <p>Significance Rating: Significant Weakness</p>	<p>Management is conducting a work allocation study to address this recommendation.</p> <p>Responsible Chief: Chief of Customer Services Target Resolution Date: June 2008 Current Resolution Status: In-process</p>
4	<p>Research, benchmark, and devote the resources necessary to create, train, and implement the use of pertinent, financially focused performance and outcome measurements to support the staffing process.</p> <p>Significance Rating: Significant Weakness</p>	<p>The staffing policy has been revised. The committee on staffing submitted recommendations to management. Those recommendations are on hold pending the results of allocation studies and manpower cost reviews.</p> <p>Responsible Chief: Chief of Customer Services Target Resolution Date: June 2008 Current Resolution Status: In-process</p>

Manual Override – October 2006

Recommendation		Disposition
1	<p>Resolve the current rating inequity between group rated and non-group rated employers. Management should also adopt standard controls to prevent rate manipulation by employer groups. Possible corrective actions could include restoring credibility factors assigned to employer groups to levels consistent with sound actuarial standards and prohibiting groups from utilizing claims experience as an eligibility criterion for group participation.</p> <p>Significance Rating: Material Weakness</p>	<p>The Board of Directors has adopted a reduction of the maximum credibility percent from a maximum of 90% for the rating year beginning 7-1-2007 to a maximum of 85% for the rating year beginning 7-1-2008. The Actuarial Committee of the Board has requested that the BWC provide a written report and presentation to the Board no later than the June 2008 meeting. The report is to address the ideal solution to the premium inequities, the plan or road map to achieve the ideal solution and an action item to take the first step. A work group has been formed. The project consists of 3 phases. The first phase will provide an overview of the NCCI rate making methodology. Phase 2 will provide the employer and group impacts as a result of the change to an NCCI methodology. Phase 3 will address the group rating program rules, specifically, the monitoring of compliance to the group rating program rules. In December 2007, a class action lawsuit was filed in the Cuyahoga Court system alleging that the group rating program violates Section 35, Article II of the Ohio Constitution; and implementation of the plan violated the mandate under O.R.C. 4123.29.</p> <p>Responsible Chief: Chief Actuarial Officer Target Resolution Date: December 2006 (actuarial study); July 2009 (implementation plan) Current Resolution Status: In-process</p>

Indemnity Claims Overpayment Audit – October 2006

Recommendation	Disposition
<p>1 Implement quality assurance reviews to provide assurance that overpayments are properly documented and are adjusted accurately and completely. Significance Rating: Significant Weakness</p>	<p>Management has implemented an overpayment checklist and modified the compensation audit tool to include questions regarding overpayments. In addition, Field Operations has submitted a System Change Control and enhancements are scheduled to be released in June 2007. General overpayment data has been linked to Data Warehouse and reports are being created to ensure overpayments are being addressed. Responsible Chief: Chief of Customer Services Target Resolution Date: October 2007 (Field Operations): December 2007 (IT related) Current Resolution Status: Implemented</p>
<p>2 Implement processes to provide reasonable assurance that absorption rates temporarily set to 0% or 100% are subsequently changed to the appropriate rates. Significance Rating: Significant Weakness</p>	<p>A System Change Control request was implemented in June 2007 allowing reviews of accuracy of absorption rates. Management is creating reports to identify claims with overpayments as well as developing a quality assurance process for overpayments. Responsible Chief: Chief of Customer Services Target Resolution Date: December 2007 (IT related) Current Resolution Status: Implemented</p>
<p>3 In order to ensure the required employer experience adjustments are performed, develop a process to ensure all claims that meet the criteria requiring a referral to the Employer Rate Adjustment (ERA) Unit are identified and forwarded to the ERA Unit. Significance Rating: Significant Weakness</p>	<p>Customer Services is working with the Actuarial department to define the criteria for referral of claims to the ERA. Responsible Chief: Chief of Customer Services Target Resolution Date: February 2008 Current Resolution Status: In-process</p>
<p>4 Implement a process to proactively identify claims that may contain potential overpayments. Significance Rating: Significant Weakness</p>	<p>Internal Audit recommended that three reports be created to identify claims that could potentially result in an overpayment. These reports are: 1) Claims when a warrant was cashed after a date of death for non-death claims, 2) Compensation paid after a return to work date and 3) Claims receiving concurrent periods of compensation. “Warrants Cashed After a Date of Death” is created and being run by SIU. Current V3 automated processes set an overpayment amount for injured workers who have returned to work or who have non-eligible concurrent payments. This results in the claims being included the Monthly Overpayment Report. That report is used by the IMS to confirm the overpayment policy was followed. Therefore, the “Compensation Paid After a Return to Work Date” and the “Concurrent Periods of Compensation,” reports are not needed. Responsible Chief: Chief of Customer Services Target Resolution Date: December 2007 Current Resolution Status: In-process</p>

Recommendation		Disposition
5	Implement procedures requiring supervisory review and approval of requests for the removal or adjustment of overpayment amounts. Significance Rating: Significant Weakness	Policy updates will be made pending verification of IMS review process. Updates were not completed in November because we were unable to verify process implementation.. Responsible Chief: Chief of Customer Services Target Resolution Date: February 2008 (policy) Current Resolution Status: In-process
6	To effectively collect injured worker overpayments, determine best practices for injured worker overpayment collection and request legislative changes allowing the BWC to adopt the best practices identified. Significance Rating: Significant Weakness	Management will benchmark with other jurisdictions' policies and procedures for addressing injured worker overpayments and develop a plan for implementing necessary changes. Responsible Chief: Chief of Fiscal and Planning Target Resolution Date: January 2008 Current Resolution Status: In-process

**Electronic Funds Transfer and Electronic Benefits Transfer
Account Processing – October 2006**

Recommendation		Disposition
1	Terminate EFT system access rights for separated individuals or positions no longer requiring such access. Significance Rating: Significant Weakness	Business leads now review and refine access requirements as they change with each individual's assignments. Also, yearly review of access needs for all personnel is being performed. Service offices are the first to be reviewed and nine have been completed to date. In addition, IT is contemplating a process change to terminate an employee's system access completely upon either separation or promotion. For employees transferring between positions within BWC, the hiring supervisor would be required to submit a form requesting all access required by the employee in their new position or role. Responsible Chief: Chief Information Officer Target Resolution Date: April 2008 Current Resolution Status: In-Process

Lump Sum Advancements Audit – March 2007

Recommendation		Disposition
1	Improve controls and implement monitoring reports to ensure the rate of payment is reset to the original rate once the advancement has been repaid. Significance Rating: Significant Weakness	Policy updates were made that require the CSS to review the LSA payment plan at the conclusion of the paid out award and to ensure the rate adjustment has been made to reflect the original rate. It was determined that Data Warehouse would not be available to provide the information needed. Field Operations will work with IT to create a management report. Responsible Chief: Chief of Customer Services Target Resolution Date: Field Operations (QA; IT Related) – December 2007; Claims Policy – July 2007 Current Resolution Status: Implemented

2	<p>Implement a preventative systemic control which prohibits the CSS from paying more than two concurrent LSAs in a claim. Additionally, update policy to clarify that the type of compensation is not a factor when determining the total number of LSAs running concurrently in a claim. Significance Rating: Significant Weakness</p>	<p>The System Change Control has been submitted and been approved. Actual Scheduling of IT changes will be dependent upon IT resource allocation and project prioritization. Responsible Chief: Chief of Customer Services Target Resolution Date: Field Operations (QA; IT Related) – September 2008; Claims Policy – July 2007 Current Resolution Status: In-process</p>
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Compensation Audit Review – March 2007

	Recommendation	Disposition
1	<p>Implement controls on Compensation Audits completed by the IMSs/SOMs to provide reasonable assurance that audits are completed accurately and consistently. Also, take appropriate steps to ensure IMSs are properly utilizing the Compensation Audit Tool and apply a consistent audit methodology to each question. Significance Rating: Significant Weakness</p>	<p>The Claim Audit Tool questions are currently being revised based on feedback from users of the tool. These question changes will be provided to IT and part of the next Claim Audit Tool IT Production release. Communication will take place at that time clarifying the appropriate audit approach to each question. Responsible Chief: Chief of Customer Services Target Resolution Date: Field Operations – April 2007; Field Operations (QA Related) – February 2008 Current Resolution Status: In-process</p>
2	<p>Take appropriate steps to provide reasonable assurance the IMSs comply with current policy regarding the appropriate number and type of payments to review each day. Significance Rating: Significant Weakness</p>	<p>Field Operations has identified 4 reports that would be useful from the Claim Audit Tool and made these report recommendations to IT. IT has approved these reports and will prioritize them with other IT requests. Also, since the Claim Audit Tool is a statewide database, a new version of the database will be sent to the Field during a normally scheduled IT production release. Responsible Chief: Chief of Customer Services Target Resolution Date: Field Operations (IT Related) – February 2008 Current Resolution Status: In-process</p>
3	<p>Add or update questions for various compensation types to address policy and statutory requirements. Significance Rating: Significant Weakness</p>	<p>Users of the Claim Audit Tool have provided feedback with regards to new questions and eliminating questions not needed. These question changes will be provided to IT and part of the next Claim Audit Tool IT Production release. Responsible Chief: Chief of Customer Services Target Resolution Date: Field Operations – February 2008 Current Resolution Status: In-process</p>

	Recommendation	Disposition
4	<p>Perform benchmarking to determine how similar organizations are performing quality assurance procedures over claims management activities in order to determine what might be considered best practice.</p> <p>Significance Rating: Significant Weakness</p>	<p>Field Operations has reviewed claims QA procedures with 3 private and 2 public organizations. No clear, “best Practice,” was found. Two more large private insurers will be poled for adjuster audit best practices. Based on the overall findings a summary memorandum will be provided to Customer Services management by year end. Recommendations on changes, if any, to BWC operations will be included in that memo.</p> <p>Responsible Chief: Chief of Customer Services Target Resolution Date: Field Operations – December 2007 Current Resolution Status: In-process</p>

Salary Continuation Program – March 2007

	Recommendation	Disposition
1	<p>Develop management reporting to ensure initial contacts and all ongoing contacts are being made in Salary Continuation (SC) claims. Enforce existing policy and implement the necessary incentives and penalties as a control to ensure that participating employers are meeting all reporting requirements. Conduct a data and status cleanup project on the SC claims in an “unknown” status. Amend the SC policy to clarify expectations, roles, and responsibilities of BWC as well as MCO staff.</p> <p>Significance Rating: Significant Weakness</p>	<p>The salary continuation policy has been reviewed and immediate changes are pending administrative approval. Recognizing that these will likely require significant programmatic considerations as a result of implementation of MIRA2 and the comprehensive actuarial analysis mandated by HB100, further changes to present salary continuation policies (including administrative rules) will not be considered at this time. Field Operations is creating reports based on the current policy to ensure that Salary Continuation claims are being handled in accordance with policy today. These reports will continue to be run to monitor SC claims until the policy is updated.</p> <p>Responsible Chief: Chief of Customer Services Target Resolution Date: December 2007; April 2008 (“unknown claim” project clean up) Current Resolution Status: In-process</p>
2	<p>Establish controls for monitoring and reporting wage submissions.</p> <p>Significance Rating: Significant Weakness</p>	<p>The salary continuation policy has been reviewed and immediate changes are pending administrative approval. Recognizing that these will likely require significant programmatic considerations as a result of implementation of MIRA2 and the comprehensive actuarial analysis mandated by HB100, further changes to present salary continuation policies (including administrative rules) will not be considered at this time. Field Operations is creating reports based on the current policy to ensure that Salary Continuation claims are being handled in accordance with policy. These reports will continue to be run to monitored SC claims until the policy is updated.</p> <p>Responsible Chief: Chief of Customer Services Target Resolution Date: December 2007 Current Resolution Status: In-process</p>

	Recommendation	Disposition
3	<p>Enforce existing policy and implement the necessary incentives and penalties as a control to ensure that participating employers are meeting all reporting requirements.</p> <p>Significance Rating: Material Weakness</p>	<p>The salary continuation policy has been reviewed and immediate changes are pending administrative approval. Salary continuation program enhancements continue to be explored. Recognizing that these will likely require significant programmatic considerations as a result of implementation of MIRA2 and the comprehensive actuarial analysis mandated by HB100, further changes to present salary continuation policies (including administrative rules) will not be considered at this time. Field Operations is creating reports based on the current policy to ensure that Salary Continuation claims are being handled in accordance with policy today. These reports once created will continue to be run to monitored SC claims until the policy is updated.</p> <p>Responsible Chief: Chief of Customer Services Target Resolution Date: December 2007 Current Resolution Status: In-process</p>
4	<p>Ensure that injured workers receive sufficient information to make informed decisions concerning salary continuation.</p> <p>Significance Rating: Significant Weakness</p>	<p>The salary continuation policy has been reviewed and immediate changes are pending administrative approval. System Change Controls to V3 will be submitted once policy is finalized.</p> <p>Responsible Chief: Chief of Customer Services Target Resolution Date: April 2008 Current Resolution Status: In-process</p>
5	<p>Regarding lost time changeovers, BWC should ensure return to work dates, salary continuation, and lost time changeovers are re-assigned to the proper service offices. Reserve these claims properly and apply the corrected dollar impacts to the premiums and to the state fund. Develop management reporting to keep future claims from being overlooked, and to eliminate adverse impacts to the state fund.</p> <p>Significance Rating: Material Weakness</p>	<p>Regarding changeovers and reassignment; analysis continues and the project is on target for 4/08 completion. Regarding reserving, salary continuation will be addressed as part of MIRA2 implementation</p> <p>Responsible Chief: Chief of Customer Services Target Resolution Date: Staffing - February 2007; Procedure Updates - September 2007; Quality Control-Implement - December 2007; Unknown claim project clean up - April 2008 Current Resolution Status: In-process</p>
6	<p>Revise the existing policy to contain clear and concise language for utilization of Independent Medical Exams and other claims management tools to avoid confusion and multiple interpretations. Ensure all IMEs are completed correctly and timely in accordance with BWC Policy.</p> <p>Significance Rating: Significant Weakness</p>	<p>The salary continuation policy has been reviewed and immediate changes are pending administrative approval. Salary continuation program enhancements continue to be explored. Recognizing that these will likely require significant programmatic considerations as a result of implementation of MIRA2 and the comprehensive actuarial analysis mandated by HB100, further changes to present salary continuation policies (including administrative rules) will not be considered at this time. Field Operations is creating reports based on the current policy to ensure that Salary Continuation claims are being handled in accordance with policy today. These reports once created will continue to be run to monitored SC claims until the policy is updated.</p> <p>Responsible Chief: Chief of Customer Services Target Resolution Date: December 2007 Current Resolution Status: In-process</p>

	Recommendation	Disposition
7	<p>Develop a standard referral system to identify, contact, educate, and track all employers who are not in compliance with the Salary Continuation Policy. Communicate to all of Field Operations that the Policy Department role is defining the policy, not enforcing the policy. Promulgate a formal rule to support program enforcement.</p> <p>Significance Rating: Material Weakness</p>	<p>The salary continuation policy has been reviewed and immediate changes are pending administrative approval. Salary continuation program enhancements continue to be explored. Recognizing that these will likely require significant programmatic considerations as a result of implementation of MIRA2 and the comprehensive actuarial analysis mandated by HB100, further changes to present salary continuation policies (including administrative rules) will not be considered at this time. Field Operations is creating reports based on the current policy to ensure that Salary Continuation claims are being handled in accordance with policy today. These reports once created will continue to be run to monitored SC claims until the policy is updated.</p> <p>Responsible Chief: Chief of Customer Services Target Resolution Date: December 2007 Current Resolution Status: In-process</p>

Information Technology General and Application Controls Risk Assessment – January 2007

NOTE: The Internal Audit Division worked together with the IT Division to voluntarily contract with an external auditing firm to perform a baseline review of the internal general and applications controls of BWC's IT Division.

	Finding	Disposition
1	<p>There is no documentation for personnel assigned access control over powerful utilities that may alter data or programs.</p> <p>Significance Rating: Material Weakness</p>	<p>Management will formally document the approval process including who keeps documentation of approvals and periodic reviews of who has access. Management will determine if other such utilities exist so that they can be addressed. Management is making progress to formally document the approval process and develop a formal policy on Super Claim use.</p> <p>Responsible Chief: Chief Information Officer Target Resolution Date: December 2007 Current Resolution Status: In-process</p>
2	<p>Security violation and monitoring is not in effect for all computer environments or applications. Trending or advanced analysis for security violations is therefore, not performed.</p> <p>Significance Rating: Material Weakness</p>	<p>Management will inventory platforms with powerful system IDs, work with Legal to establish retention periods for archived system logs, evaluate risks/costs where performance impacts may exist and implement system logging where feasible. Management will develop exception based reporting on high risk platforms and will develop periodic review processes to accelerate investigation of exception reports for powerful system IDs.</p> <p>Responsible Chief: Chief Information Officer Target Resolution Date: March 2008 Current Resolution Status: In-process</p>
3	<p>There is no periodic process to evaluate changes in architecture and security impacts to the asset base. In addition, there is no consistent process in place to</p>	<p>Management has verified that security is properly included in the application development methodology. Management is assessing remaining</p>

	Finding	Disposition
	aid in mitigating vulnerabilities. Significance Rating: Material Weakness	processes, and will develop a plan for incorporation of disaster recovery in the change management process. Responsible Chief: Chief Information Officer Target Resolution Date: March 2008 Current Resolution Status: In-process
4	Individuals within the IT department are sometimes responsible for performing end-user data processing activities via items such as Super Claim and SPUFIs. Many individuals in IT have read-only access to production data. Significance Rating: Material Weakness	Control over production data access will be reviewed to determine if more controls, restrictions and/or policies need to be in place. Test environments using production data will be reviewed for policies or changes that are needed. Responsible Chief: Chief Information Officer Target Resolution Date: May 2008 Current Resolution Status: In-process
5	All requests for end-user access to LAN/WAN/Application/Database resources are not documented or maintained. Revocation of terminated employees does not consistently occur at the application/application role level. It is possible for terminated user accounts to remain in the system. There is no regular review of user/role definitions at the business process level. Passwords syntax controls within the Windows environment is not functioning as initially expected (per security policies). Significance Rating: Material Weakness	Management will create a single electronic site and template for storage of access provision procedures. These procedures would be approved through a logged process. A periodic assessment of the separation procedures will be done to confirm that they are being followed. An assessment of who currently has access, documented justification for continued access, and restriction of access for those without justification will be completed. Management is reviewing the feasibility of enabling the security features that would force LAN passwords to be complex. Currently the system will temporarily revoke an ID after five invalid attempts and will not permit re-use of the six most recent passwords. Responsible Chief: Chief Information Officer Target Resolution Date: July 2008 Current Resolution Status: In-process
6	Powerful IDs are neither logged nor monitored. Therefore, activities performed using a powerful ID (e.g., default database, system, or network administrator account) or powerful utility are neither captured nor reviewed. Significance Rating: Material Weakness	The Administrator Account Policy stipulates that all Administrators must re-justify their access. The required Administrator Logon form requires Administrator signature, IT Director, and the Network Director's Signature. Management has audited Super Claim and removed several members from these groups. A purchase order for additional logging tools for the LAN has been approved. Responsible Chief: Chief Information Officer Target Resolution Date: March 2008 Current Resolution Status: In-process
7	The documented criteria for approvals required for a change via the CMT process is sparse. It basically indicates that four director approvals are required for production changes, plus anyone the requestor thinks that would need to be "aware" of the change. There is no governance to ensure affected parties are on the approval. Changes are sometimes made without all approvers having approved the change. There is no tracking or escalation of such incidents. Some changes upgrades are done without a CMT. No business process/IT cross reference maps are	Report of changes implemented without all of the approvals has been developed and is being generated as part of the weekly change meeting. Process to distribute a monthly version of report to Directors for review was implemented in January 2008. A recommended approach to the automated identification of required approvals for CMTs has been developed and will be presented to Directors for approval by the end of January 2008. The CMT approval process is being cleaned up and will be complete by the end of March 2008. Training for the

	Finding	Disposition
	<p>documented. There is no (or very limited) business process documentation.</p> <p>There are no formal sign offs for the SDLC deliverables except for the CMT process (which allows for electronic signoff).</p> <p>Significance Rating: Material Weakness</p>	<p>updated change management process is scheduled to be completed by 3/31/08.</p> <p>Responsible Chief: Chief Information Officer Target Resolution Date: March 2008 Current Resolution Status: In-process</p>
8	<p>There is an inconsistency in approval of hardware modifications. Formal processes do not exist to determine if system software needs to be modified (e.g. patches/upgrades), including required documentation and approvals required. Asset management is not used pervasively across IT to track critical elements of all relevant IT assets.</p> <p>Significance Rating: Material Weakness</p>	<p>Management is working on a new change management policy, documentation, and training program. The revised policy will incorporate all of the updates underway for the change management process and will be included as part of the training currently planned to be completed by the end of March.</p> <p>Responsible Chief: Chief Information Officer Target Resolution Date: March 2008 Current Resolution Status: In-process</p>
9	<p>The process by which projects tailor the common methodology has no oversight or enforcement for a basic set of required project activities. There are no formal criteria for tailoring based on project size. As such, project activities, deliverables, and levels of formal documentation and/or approvals vary greatly and are not predictable. Data warehousing has limited structure regarding a documented SDLC.</p> <p>Significance Rating: Material Weakness</p>	<p>The Applications Department will add a clear definition to the methodology on small/large projects by March 2008.</p> <p>Responsible Chief: Chief Information Officer Target Resolution Date: March 2008 Current Resolution Status: In-process</p>
10	<p>There is no business continuity in the DRP. The disaster recovery plan (DRP) has only been tested for legacy applications and databases; exposure exists for e-generation, Oracle Financials, QED and some client/server systems. The current DR plan does not appear to be sufficiently robust to ensure effective IT support in the event of a significant system outage. IT governance is weak regarding established KPI's/Metrics. While some formal reporting exists (director status reporting, PMO stoplight reporting), there is little in the way of KPI-based (metric-based) reporting or accountability. There is no internal process (self-audit, internal IT audit, or otherwise) to continually evaluate and/or monitor the adequacy and effectiveness of the IT controls environment. No formal procedures have been established or documented to classify application and underlying data from a privacy perspective. While information privacy is monitored by Legal and IT is informed by Legal of the ramifications, the process is informal and goes unmonitored. Processes and procedures have not been established to ensure adherence to federal, state, and local regulations.</p> <p>Significance Rating: Material Weakness</p>	<p>Management will address the IT Business Continuity by determining ownership of business continuity plan. Management will emphasize people portion of IT plan during review after next test and establish periodic walk through of logistical & people aspects of plan. Management will address the encryption issue by: implementing encryption of off site Data Recovery (DR) tapes for IBM mainframe, implementing encryption of off site DR tapes for open systems, and implementing encryption of laptop and tablet disks.</p> <p>Responsible Chief: Chief Information Officer Target Resolution Date: June 2008 Current Resolution Status: In-process</p>
11	<p>For each of the mission critical applications, databases, and operating systems, the functions, transactions, menus, screens, etc. that update mission</p>	<p>Since last update, IT has initially loaded all Appsets and .NET web services into the Aqualogic Enterprise Repository (ALER). User training has been</p>

	Finding	Disposition
	critical financial data have not been identified/documented. Security design documents are not reviewed, updated, nor approved. Significance Rating: Material Weakness	completed. Configuration and Registrar training has been completed. An asset entry process diagram has been developed. In addition, all application and database components will be documented, including all other system components of value. Responsible Chief: Chief Information Officer Target Resolution Date: July 2008 Current Resolution Status: In-process
12	The definition of unscheduled (emergency) changes is widely inconsistent across groups or in some cases not defined or documented. Not all maintenance/development items are recorded because small maintenance items may not be recorded. Reporting/metrics are compromised with the inconsistent and incomplete categorization and tracking. There are no established metrics to track emergency changes (e.g. when it occurs in relation to changes, what modules / application). Significance Rating: Material Weakness	Management is working on a new Change Management policy, documentation and training program. IT managers will assess their compliance with the new program and make changes as needed. The change management program will incorporate ITIL precepts and will address unscheduled and urgent changes as well. Responsible Chief: Chief Information Officer Target Resolution Date: March 2008 Current Resolution Status: In-process
13	The processes used to identify security vulnerabilities for each technology asset are inconsistent. Security design documents are not reviewed, updated, nor approved. There are inadequate mechanisms in place to ensure that security policies are being followed by users. Significance Rating: Significant Weakness	Security design documents have been reviewed, updated, and approved. The mechanisms to monitor whether security policies are being followed by users is in progress. Responsible Chief: Chief Information Officer Target Resolution Date: December 2007 Current Resolution Status: In-process
14	Business impact analysis for changes is performed inconsistently prior to initiation of development or acquisition. Although some deliverables in the project life cycle allow for business impact analysis, this activity is frequently not performed or, in some cases, is performed without documented results. As a result, many projects or maintenance activities have no business impact analysis, cost benefit analysis, or business benefit assessment upon which to formally base decisions. Significance Rating: Significant Weakness	IT will work with the lines of business to document process to include business impacts and will adopt the ITIL practice, which includes business impacts as part of the methodology. The issue of software impact analysis is being addressed with the current efforts to implement the Enterprise Repository. Responsible Chief: Chief Information Officer Target Resolution Date: June 2008 Current Resolution Status: In-process
15	No consistent project post evaluation conducted to determine project performance. Lessons learned are infrequently captured and/or used in future projects. User documentation is typically provided for most applications; however, changes to user documentation as a result of system changes are not always reflected. System documentation is not present for most applications and is not consistent. Significance Rating: Significant Weakness	Management will examine after-action review process for customer satisfaction, lessons learned and harvesting the benefits (benefit realization). Responsible Chief: Chief Information Officer Target Resolution Date: June 2008 Current Resolution Status: In-process
16	The DRP is not updated as part of the overall change management process. There are pockets of asset management, but there is no universal or consistent asset management tool or process currently being utilized. Significance Rating: Significant Weakness	Much of this will be accomplished with the Enterprise Repository (AKA Flashline) efforts currently underway. All software assets and their dependencies will be documented in this repository. BWC currently uses Oracle Financials to track all physical assets over \$300, per OBM requirements. Currently the flow of assets, from receipt to

	Finding	Disposition
		retirement (including any/all movement) is being reviewed for consistency, accuracy, and policy compliance. Long term – the Oracle Fixed Asset (OAKS) tool needs to be reviewed to determine if that is the appropriate tool to be used, as well as owners, users, maintenance, and disaster recovery plans need to be identified. Responsible Chief: Chief Information Officer Target Resolution Date: June 2008 Current Resolution Status: In-process
17	Security testing is not consistently or always performed for emergency changes. Significance Rating: Significant Weakness	Definition of emergency changes will be included in the revised change management policy and discussed as part of the overall training that is currently planned to be completed by the end of March. Management will review existing security testing processes for emergency changes and identify necessary improvements. Responsible Chief: Chief Information Officer Target Resolution Date: March 2008 Current Resolution Status: In-process
18	Security testing is not consistently or always performed after system software modifications and/or version upgrade/patch to ensure key security functions have not been adversely impacted at the operating system layer, at the application security layer, and at the application functionality layer. Significance Rating: Significant Weakness	Management will review existing security testing processes for system software and identify necessary improvements. Responsible Chief: Chief Information Officer Target Resolution Date: March 2008 Current Resolution Status: In-process
19	There is inconsistency in testing standards for hardware. There is inconsistency in security procedures for the testing of new hardware. Significance Rating: Significant Weakness	Management will review existing security testing processes for system hardware and identify necessary improvements. Responsible Chief: Chief Information Officer Target Resolution Date: March 2008 Current Resolution Status: In-process
20	The organization does not have consistent, documented policies and procedures concerning data transmission to external sources. Significance Rating: Significant Weakness	A draft of a policy regarding data transmission has been completed. Once the policy is complete, it will be reviewed again with appropriate business functions and finalized and communicated to appropriate employees. Responsible Chief: Chief Information Officer Target Resolution Date: December 2007 Current Resolution Status: In-process
21	Background checks are not conducted for contract employees. Significance Rating: Significant Weakness	Based on areas of risk, this process will be considered in the requirement for a contractor to work at BWC. Responsible Chief: Chief Information Officer Target Resolution Date: March 2008 Current Resolution Status: In-process
22	There is an inconsistent adherence to corporate policies and standards for contract employees within the Network Group. Significance Rating: Significant Weakness	Beginning November 2006 all contractors, existing and new, must sign a contractor agreement, stating that they will abide by all BWC policies, specifically citing internet usage and ethics, among others. The document is retained with the vendor file located in the IT Business Management and Planning department. Any contractors who refuse to sign or

	Finding	Disposition
		abide by BWC policies are terminated. Also, all SOW's include the scope of work and deliverables. Responsible Chief: Chief Information Officer Target Resolution Date: March 2008 Current Resolution Status: In-process
23	No monitoring or periodic review of outsourced services to ensure that contractual expectations/obligations are met. Contract service agreements for the Network Group are inconsistent compared to other groups regarding scope, reporting responsibilities, restrictions, and compliance to corporate policies and standards. Significance Rating: Significant Weakness	Supervisors will be made aware of their responsibility to directly monitor performance of outsourced services. Management will review possibility of a form for supervisors to sign. Responsible Chief: Chief Information Officer Target Resolution Date: March 2008 Current Resolution Status: In-process
24	There is a concern over existing data retention requirements and how this impacts the data backup policies. Significance Rating: Significant Weakness	Management is seeking the means of resolving this finding through DAS policy. Backups are considered records by definition and are specifically included as a component of the records retention policy and are included in the scope of the initiative. Records Retention Schedules for all identified BWC records will be submitted to DAS for approval by April 30, 2008. Responsible Chief: Chief Information Officer Target Resolution Date: December 2007 Current Resolution Status: In-process

Pharmacy Benefit Manager Audit – May 2007

	Recommendation	Disposition
1	Reconcile the bank balance to the financial records monthly and submit to BWC. Significance Rating: Material Weakness	Recommended reconciliations are now being performed for the New Provider Account and submitted to BWC. Compliance and Performance Monitoring (CPMU) continues to work with the vendor to finalize the old provider account. The vendor returned some refunds to BWC on 1/29/08. The vendor is working on the final reconciliation of the old provider account. Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: March 2008 Current Resolution Status: In-process
2	Ensure the responsibility for resolving overpayments is specified and oversight is improved. Significance Rating: Significant Weakness	Vendor has initiated payment to BWC for these outstanding checks. BWC will monitor to ensure all money is returned. Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: October 2007 Current Resolution Status: Implemented

	Recommendation	Disposition
3	Strengthen internal controls to ensure payments are mailed timely. Significance Rating: Significant Weakness	Compliance and Performance Monitoring confirmed that improved controls have been implemented by vendor; however, the provider checks are printed and securely stored until funding is received from BWC one week later. Vendor has stated that it is not possible to print the checks after receipt of BWC's payment file, as recommended. BWC has received a written explanation from the vendor on this issue. BWC will modify the language in the next contract to better address the timely payment requirement. Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: December 2007 Current Resolution Status: Implemented
4	Develop payment structure that does not reimburse for drugs not dispensed. Significance Rating: Significant Weakness	BWC has identified defects in the test results requiring further development and testing by the vendor to address this issue. Communication to pharmacies will need to take place before implementation. Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: July 2008 Current Resolution Status: In-process
5	Enhance current system to adequately reflect reasons for denials. Significance Rating: Significant Weakness	Vendor has changed their reporting system to capture the required codes for denials. Responsible Chief: Chief of Medical Policies and Compliance Current Resolution Status: Implemented
6	Require vendor to resume imaging of bills and increase oversight. Significance Rating: Significant Weakness	Vendor has resumed imaging. BWC is now receiving a monthly report from the vendor that acknowledges vendor's oversight of this process. BWC will validate through sample testing that the bills were imaged. Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: April 2008 Current Resolution Status: In-process
7	Develop retrospective Drug Utilization Review (DUR) criteria to enhance utilization of the services of the vendor. Significance Rating: Significant Weakness	This plan will be developed once vendor's audit of their DUR process is complete to ensure that appropriate criteria are developed that make the best use of the DUR process. Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: July 2008 Current Resolution Status: In-process

	Recommendation	Disposition
8	Evaluate program resources, review contract, and require the vendor to submit an attestation letter stating that rebates and discounts have not been received. Significance Rating: Significant Weakness	Attestation letter was received from vendor in May 2007. Rebate process will be analyzed by the pharmacy consultant who will be selected through the competitive bid process. Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: April 2008 (Consultant report); August 2008 (PBM contract RFP development) Current Resolution Status: In-process
9	Consider utilizing vendor's technology. Significance Rating: Significant Weakness	Additional therapeutic drug classes will be added to the relatedness editing effective January 2008. Changes to preferred drug list and other drug limitations will be effective January 2008. Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: March 2008 Current Resolution Status: In-process
10	Develop action plan to strengthen oversight and improve management of the program. Significance Rating: Significant Weakness	A comprehensive plan was developed and submitted to the Medical Services and Compliance Chief. The components of this plan will be prioritized to determine what can be implemented given staffing constraints. In addition, a PBM group has been formed which is responsible to ensure that PBM issues are resolved in a timely fashion. This group meets on a weekly basis. Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: September 2007 Current Resolution Status: Implemented
11	Periodically test transactions to ensure discounts are passed-through to BWC. Significance Rating: Significant Weakness	RFP for pharmacy expert is scheduled to be released by the end of November 2007. Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: April 2008 Current Resolution Status: In-process
12	Conduct sufficient review and analysis to identify opportunities. Significance Rating: Significant Weakness	RFP for pharmacy expert is scheduled to be released by the end of November 2007. Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: April 2008 Current Resolution Status: In-process

Retrospective Rating Program Audit – June 2007

	Recommendation	Disposition
1	<p>Evaluate additional alternatives to augment, compliment, or replace financial statement audit requirements.</p> <p>Significance Rating: Significant Weakness</p>	<p>BWC continues to explore alternatives to current financial statement audits and requirements. No additional program changes are currently being contemplated pending results of the comprehensive actuarial study of employer programs.</p> <p>Responsible Chief: Chief of Customer Services Target Resolution Date: December 2007 (Recommendations to senior staff); July 2008 (implementation for private employers) and January 2009 (public entities) Current Resolution Status: In-process</p>
2	<p>Enforce provisions set forth in Ohio Administrative Code Section 4123-17-42 by establishing and implementing an effective procedure for the management review process.</p> <p>Significance Rating: Material Weakness</p>	<p>A revised management review process was used for the 7/1/2007 Retrospective Rating Program period. An individual from another department with financial expertise was used in the decision making. The EM Policy Department is currently drafting a formal written policy to memorialize this approach that has a scheduled completion date of 12/31/2007.</p> <p>Responsible Chief: Chief of Customer Services Target Resolution Date: December 2007 Current Resolution Status: In-process</p>
3	<p>Evaluate requirements and objectives of the program to ensure support exists for all goals and outcomes. Consider eliminating the allowance of any employer who is financially unstable, including employers who are in a part pay status from the program.</p> <p>Significance Rating: Material Weakness</p>	<p>HB100 requires all BWC programs and rating plans to have actuarial reviews conducted within a two year period. This review will include the Retrospective Rating Program. Therefore, because all Retro components have been determined to be appropriate and in support of program financial and safety goals and objectives, no substantial changes are suggested to be made to the program until recommendations are received from the external actuarial company.</p> <p>Responsible Chief: Chief of Customer Services Target Resolution Date: December 2008 Current Resolution Status: In-process</p>
4	<p>Consider drafting a rule to eliminate employers from participating in the program that are unable to manage retrospectively rated claims for their ten-year enrollment period.</p> <p>Significance Rating: Significant Weakness</p>	<p>Management feels eliminating the Tier 2 is not an option at this time and will not be implementing the recommendations. Management believes there is no financial risk to BWC.</p> <p>Responsible Chief: Chief of Customer Services Current Resolution Status: Not Implemented – Management assumes risk</p>
5	<p>Develop ongoing reporting and conduct detailed trending and analysis of pertinent program management data.</p> <p>Significance Rating: Significant Weakness</p>	<p>Contact was made with BWC's Actuarial Department to determine if BWC's actuarial vendor is capable of assisting with identifying reporting and trending analysis data that would be obtainable and beneficial. Follow up will occur and a meeting will be scheduled with a target date of the first quarter 2008.</p> <p>Responsible Chief: Chief of Customer Services Target Resolution Date: April 2008 Current Resolution Status: In-process</p>

Medical Bill Payment Controls Memorandum – June 2007

	Recommendation	Disposition
1	<p>The BWC Medical Services Division should implement preventive and detective controls to include caps or limits on the amounts reimbursable for hospital bill charges. Preventive controls, coupled with monitoring by management, will help guard against intentional or unintentional keying errors of billed amounts by either the hospitals or Managed Care Organizations (MCO).</p> <p>Significance Rating: Significant Weakness</p>	<p>External vendor has been selected and the software will be implemented in April 2008. Edits have been developed to identify unusually high provider billed amounts. Line items identified will be reviewed with MCOs to confirm accuracy of the data. MCOs should be able to submit override EOBs indicating they have reviewed unusually high line item charges. Compliance and Performance Monitoring has implemented the review of bills over \$10,000 for accuracy. The first request for bills was sent to MCOs during the 2nd quarter of FY08.</p> <p>Responsible Chief: Medical Services and Compliance Chief Target Resolution Date: August 2007 (Cambridge solutions, RFP results, budget decision); April 2008 (implement and train on clinical editing software) Current Resolution Status: In-process</p>

Personal Trading Policy Consulting Project – October 2007

	Recommendation	Disposition
1	<p>Establish a Personal Trading Compliance Committee to develop a personal trading policy and ongoing monitoring procedures for BWC.</p> <p>Significance Rating: Significant Weakness</p>	<p>Personal trading policy committee has been established. The initial meeting was held on February 6, 2008 to review the legal opinion quantifying the minimum legal requirements and to begin drafting policy.</p> <p>Responsible Chief: Chief Ethics Officer (consultation by Chief Investment Officer) Target Resolution Date: Committee formation – Implemented; Policy implementation – To be determined by committee Current Resolution Status – In-process</p>

Investment Reconciliation Consulting Project – October 2007

	Recommendation	Disposition
1	<p>Enhance month-end reporting standards placed on external investment managers and require them to report detailed holdings data. Reconcile returns calculated by the BWC's performance provider to those calculated by the external investment managers on a monthly basis.</p> <p>Significance Rating: Significant Weakness</p>	<p>As of December 2007 BNY Mellon began providing investment accounting and performance measurement services for the BWC. Included in the service level agreement are reconciliation processes and standards. Currently these processes are under review and require more time to ensure effectiveness.</p> <p>Responsible Chief: Chief of Fiscal and Planning Target Resolution Date: April 2008 Current Resolution Status – In-process</p>

Vocational Rehabilitation Audit– October 2007

	Recommendation	Disposition
1	<p>Implement processes to review the actual vocational rehabilitation costs billed in claims for reasonableness and appropriateness. Significance Rating: Material Weakness</p>	<p>Management will establish controls to monitor the appropriateness of costs billed for vocational rehabilitation services. Responsible Chief: Chief of Medical Services and Compliance Target Resolution Date: April 2008 Current Resolution Status: In-process</p>
2	<p>Take steps to eliminate the potential conflict of interest created by Managed Care Organizations (MCOs) that refer vocational rehabilitation cases to their related companies. Significance Rating: Material Weakness</p>	<p>Discussions on the adoption of the rehab redesign proposal are continuing with stakeholder groups. Implementation team has been identified and planning is underway. Responsible Chief: Chief of Medical Services and Compliance Target Resolution Date: October 2008 Current Resolution Status: In-process</p>
3	<p>Formalize policy regarding the authority of the Disability Management Coordinators (DMCs) to challenge MCO feasibility determinations. Significance Rating: Material Weakness</p>	<p>Management is implementing a process requiring written authorization by the DMC of the feasibility and service provider recommendations. When the rehab redesign project is fully adopted this rule and policy will be written and formalized. Responsible Chief: Chief of Medical Services and Compliance Target Resolution Date: October 2008 Current Resolution Status: In-process</p>
4	<p>Implement controls over the coordination agreement with the Rehabilitation Services Commission (RSC) to ensure costs expended under that program are only incurred for eligible injured workers and are reasonable and appropriate. Significance Rating: Material Weakness</p>	<p>Target date for RSC to begin requesting eligibility status from individual DMCs is March 15, 2008. BWC is providing assistance in the training of RSC counselors in the new process. BWC and RSC IT staff are working together now to get detailed data transferred to BWC systems for ongoing analysis. Responsible Chief: Chief of Medical Services and Compliance Target Resolution Date: June 2008 Current Resolution Status: In-process</p>
5	<p>Establish effective quality assurance review procedures to ensure various controls and activities performed by DMCs are proper, timely, and in accordance with policies and statutes. Significance Rating: Significant Weakness</p>	<p>DMCs are evaluating individual performance measures that will actually reflect the highest level of professional service they offered in a day's time. In February 2008 these ideas will be discussed by a Rehab Redesign workgroup. Responsible Chief: Chief of Medical Services and Compliance Target Resolution Date: June 2008 Current Resolution Status: In-process</p>
6	<p>Implement written procedures for establishing reimbursement rates for vocational rehabilitation services and for periodically reviewing and updating such rates. Significance Rating: Significant Weakness</p>	<p>This process is drafted and is in review. New rule making processes for fee changes will be included. Responsible Chief: Chief of Medical Services and Compliance Target Resolution Date: March 2008 Current Resolution Status: In-process</p>

	Recommendation	Disposition
7	Review credentialing and position requirements for DMC positions and ensure individuals possess the qualifications to manage the vocational rehabilitation process. Establish a process to monitor DMC certifications to ensure the required credentials are maintained. Significance Rating: Significant Weakness	Voc Rehab Policy is preparing the position description and DMC credentialing requirements for sign-off by the Chief of Medical Services. Responsible Chief: Chief of Medical Services and Compliance Target Resolution Date: March 2008 Current Resolution Status: In-process

MCO Audit #1 – October 2007

	Recommendation	Disposition
1	Revise computer back-up procedures to ensure proper policies, procedures, and safeguards are in place to minimize the potential for loss or theft of confidential information. Significance Rating: Material Weakness	MCO continues to work with BWC Legal and the MCO Business Unit toward finalizing the agreement and getting external vendor process in place. Target Resolution Date: January 2008 Current Resolution Status: In-process

Note: Comments designated as “Implemented” are based on managements’ assertions and have not yet been validated by Internal Audit.

BWC Internal Audit Division Audit Report Follow-up Procedures

The *International Standards for the Professional Practice of Internal Auditing* specifically addresses follow-up in Standard 2500. One of our primary responsibilities as professional auditors is determining that the audit customer takes corrective action on recommendations. This applies in all cases except where "senior management has accepted the risk of not taking action." When senior management accepts the risk of not taking action, the Chief of Internal Audit will report the comment with management's response to the Audit Committee for consideration.

Being an integral part of the internal audit process, follow-up should be scheduled along with the other steps necessary to perform the audit. However, specific follow-up activity depends on the results of the audit and can be carried out at the time the report draft is reviewed with management personnel or after the issuance of the report. Typically, audit follow up should occur within 90 days of the issuance of the final report.

Follow-up activities may generally be broken down into three areas:

- Casual - This is the most basic form of follow-up and may be satisfied by review of the audit customer's procedures or an informal phone call. Memo correspondence may also be used. This is usually applicable to the less critical findings.
- Limited - Limited follow-up typically involves more audit customer interaction. This may include actually verifying procedures or transactions and, in most cases, is not accomplished through memos or phone calls with the audit customer.
- Detailed - Detailed follow-up is usually more time-consuming and can include substantial audit customer involvement. Verifying procedures and audit trails, as well as substantiating account balances and computerized records, are examples. The more critical audit findings usually require detailed follow-up.

Follow-up scheduling can begin when corrective action is confirmed by acceptance of an audit recommendation or when management elects to accept the risk of not implementing the recommendation. Based on the risk and exposure involved, as well as the degree of difficulty in achieving the recommended action, follow-up activity should be scheduled to monitor the situation or confirm completion of the changes that were planned. These same factors establish whether a simple phone call would suffice or whether further audit procedures would be required.

At the end of each quarter, a summary follow-up report is prepared. This report reflects all current period findings with appropriate comments to reflect end-of-quarter status.

Additionally, this report highlights all outstanding findings from prior periods and their status. The intent of this summary report is to track all findings so that they are appropriately resolved.

**BWC Internal Audit Division
Audit Comment Rating Criteria**

Comment Rating	Description of Factors	Reporting Level
Material Weakness	<ul style="list-style-type: none"> Overall control environment does not provide reasonable assurance regarding the safeguarding of assets, reliability of financial records, and compliance with Bureau policies and/or laws and regulations. A significant business risk or exposure to the Bureau that requires immediate attention and remediation efforts. A significant deficiency, or combination of significant deficiencies, that results in <u>more than a remote likelihood</u> that a material misstatement of the annual or interim financial statements will not be prevented or detected by employees in the normal course of their work, or that a major operational or compliance objective would not be achieved. 	Audit Committee, Senior Management, Department Management
Significant Weakness	<ul style="list-style-type: none"> Issue represents a control weakness, which could have or is having some adverse affect on the ability to achieve process objectives. The controls in place need improvement and if not improved could lead to an overall unsatisfactory or unacceptable state of control. Requires near-term management attention. A control deficiency, or combination of control deficiencies, that results in a <u>remote</u> likelihood that a misstatement of the Bureau's annual or interim financial statements is more than inconsequential will not be prevented or detected by employees in the normal course of their work, or that a major operational or compliance objective would not be achieved. 	Senior Management, Department Management, Audit Committee (optional)
Minor Weakness	<ul style="list-style-type: none"> Issue represents a process improvement opportunity or a minor control weakness with minimal impact. Observations with this rating should be addressed by line level management. A control deficiency that would result in <u>less than a remote</u> likelihood that the deficiency could reasonably result in a material misstatement of the financial statements or materially affect the ability to achieve key operational or compliance objectives. 	Department Management, Senior Management (optional)

NOTE: When management's action plans for Significant Weakness comments are materially delayed from the intended implementation date the comment will elevate to a Material Weakness (pending circumstances).

Internal Audit Division

FY 08 Annual Audit Plan – 2nd Quarter Update

Focus Area	1st Qtr.			2nd Qtr.			3rd Qtr.			4th Qtr.		
	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June
	External Audit Assistance											
Long Term Care Program												
Employer Payroll Reporting Process												
Medical Bill Payments Process												
PTD Claims												
Investment Accounting System												
Investment Manager Selection and Funding Process												
Transitional Work Grants												
Subrogation Process												
Forthwith/Miscellaneous Special Payments												
Employer Compliance and Premium Audit												
Investment Fee Payment Process												
Adjudication Committee												
Settlements Process												
FY 2009 Annual Audit Plan												
Safety Grants Program												
Stakeholder Relations												
MCO Administrative and Incentive Payments												
Investment Manager Continuance Program												
Audit Validation Testing												
MCO Audits												
SOX - Investment Certification Control Testing												

THE ROLE OF AUDITING IN PUBLIC SECTOR GOVERNANCE



PROFESSIONAL GUIDANCE
Setting the Standard

The Role of Auditing in Public Sector Governance

This practice guide presents information on the importance of the public sector audit activity to effective governance and defines the key elements needed to maximize the value the public sector audit activity provides to all levels of government. The practice guide is intended to point to the roles of audit (without differentiating between external and internal), methods by which those roles can be fulfilled, and the essential ingredients necessary to support an effective audit function. As such, it may not be fully applicable in every jurisdiction, particularly where government audit roles and responsibilities are specifically defined to exclude certain functions or assign them to other entities.

November 2006

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This paper presents our position on the importance of the public sector audit activity to effective governance and defines the key elements needed to maximize the value the public sector audit activity provides to all levels of government. The principles we discuss are relevant to national, regional (i.e., state or provincial), and local (i.e., county, city, or village) governments, as well as quasi-governmental and international government organizations. They also may apply to other publicly funded entities.

This guide is addressed primarily to elected and appointed government officials, as well as advocates of good government everywhere. Its purpose is to encourage readers to reflect on the government audit activities that now serve their jurisdictions and evaluate how those audit activities can be supported to most effectively fulfill their highest role in the governance of public sector institutions. In those jurisdictions where a government audit activity is needed, this paper can provide the initial guidance for decision-makers on the outcomes and services they should expect and the elements that are needed to establish an effective audit activity.

Detailed guidance on the standards, model legislation, and other tools for creating and improving government audit services are available from any of the endorsing organizations.

INTERNAL AND EXTERNAL AUDITING IN A GOVERNMENT CONTEXT

This paper addresses the role of government auditing, including both internal and external government auditing. A myriad of government audit activities and reporting relationships exist among different jurisdictions and in different forms of government. The key point, however, is that government audit activities must be configured appropriately to enable governments and government entities to fulfill their duty to be accountable to the citizens, while achieving their objectives effectively, efficiently, and ethically.

PUBLIC SECTOR GOVERNANCE

Public sector governance encompasses the policies and procedures used to direct an organization's activities to provide reasonable assurance that objectives are met and that operations are carried out in an ethical and accountable manner. In the public sector, governance relates to the means by which goals are established and accomplished. It also includes activities that ensure a government's credibility, establish equitable provision of services, and assure appropriate behavior of government officials — reducing the risk of public corruption.

THE ROLE OF GOVERNMENT AUDITING

Government auditing is a cornerstone of good public sector governance. By providing unbiased, objective assessments of whether public resources are responsibly and effectively managed to achieve intended results, auditors help government organizations achieve accountability and integrity, improve operations, and instill confidence among citizens and stakeholders. The government auditor's role supports the governance responsibilities of oversight, insight, and foresight. *Oversight* addresses whether government entities are doing what they are supposed to do and serves to detect and deter public corruption. *Insight* assists decision-makers by providing an independent assessment of government programs, policies, operations, and results. *Foresight* identifies trends and emerging challenges. Auditors use tools such as financial audits, performance audits, and investigation and advisory services to fulfill each of these roles.

KEY ELEMENTS OF AN EFFECTIVE PUBLIC SECTOR AUDIT ACTIVITY

An effective public sector audit activity strengthens governance by materially increasing citizens' ability to hold their government accountable. Auditors perform an especially important function in those aspects of governance that are crucial in the public sector for promoting credibility, equity, and appropriate behavior of government officials, while reducing the risk of public corruption. Therefore, it is crucial that government audit activities are configured appropriately and have a broad mandate to achieve these objectives. The audit activity must be empowered to act with integrity and produce reliable services, although the specific means by which auditors achieve these goals vary. At a minimum, government audit activities need:

- **Organizational independence.** Organizational independence allows the audit activity to conduct work without interference by the entity under audit. The audit activity should have sufficient independence from those it is required to audit so that it can both conduct its work without interference and be seen to be able to do so. Coupled with objectivity, organizational independence contributes to accuracy of the auditors' work and the ability to rely on the results and report. Given the variety of forms of government auditing, it is difficult here to specify one reporting line. Greater guidance is provided in professional standards.
- **A formal mandate.** The audit activity's powers and duties should be established by the government's constitution, charter, or other basic legal document. Among other topics, this document would address procedures and requirements of reporting, the obligation of the audited entity to collaborate with the auditor.
- **Unrestricted access.** Audits should be conducted with complete and unrestricted access to employees, property, and records.
- **Sufficient funding.** The audit activity must have sufficient funding relative to the size of its audit responsibilities. This important element should not be left under the control of the organization under audit because the budget impacts the audit activity's capacity to carry out its duties.
- **Competent leadership.** The head of the audit activity must be able to effectively recruit, retain, and manage highly skilled staff. Moreover, the chief audit executive should be an articulate public spokesperson for the audit activity.
- **Competent staff.** The audit activity needs a professional staff that collectively has the necessary qualifications and competence to conduct the full range of audits required by its mandate. Auditors must comply with minimum continuing education requirements established by their relevant professional organizations and standards.
- **Stakeholder support.** The legitimacy of the audit activity and its mission should be understood and supported by a broad range of elected and appointed government officials, as well as the media and involved citizens.
- **Professional audit standards.** Professional audit standards support the implementation of the previous elements and provide a framework to promote quality audit work that is systematic, objective, and based on evidence. Just as many governments have adopted internal control standards — either as requirements or guidance for public sector managers — audit activities should conduct their work in accordance with recognized standards.

The discussion on the following pages details key public sector governance principles and describes the services and contributions that governments can derive from their audit activities. We invite readers to consider these elements in evaluating current or planned audit activities, to determine if they are positioned to achieve their objectives of public accountability and service improvement.

KEY POINTS**RECOMMENDATIONS**

To protect the public interest, every government requires independent audit activities providing a range of assurance and advisory services — from financial attestation to performance and operational efficiency — whether through the use of internal or external audit services, or a combination of the two. The public sector audit activity's mandate should be as broad as possible to enable it to respond to the full scope of the government's activities.

Although the means to accomplish them will vary, all government audit activities require:

- *Organizational independence.*
- *A formal mandate.*
- *Unrestricted access.*
- *Sufficient funding.*
- *Competent leadership.*
- *Competent staff.*
- *Stakeholder support.*
- *Professional audit standards.*

Governments must establish protections to ensure that audit activities are empowered to report significant issues to appropriate oversight authorities. One means of accomplishing this protection is through creation of an independent audit committee.

To preserve their independence, government auditors advisory/assistance services should never assume a management role. Moreover, auditors must maintain independence and objectivity for any subsequent audits conducted where advisory/assistance services have been provided previously.

PUBLIC SECTOR GOVERNANCE

Government auditors play an important role in effective public sector governance. The term *governance* refers to how an organization makes and implements decisions — “the processes by which organizations are directed, controlled, and held to account.”

Because governments throughout the world are structured differently — with different and possibly overlapping mandates and jurisdictions — no single governance model applies to public sector organizations. Nevertheless, certain governance principles are common across the public sector. Common principles of corporate governance encompass the policies, processes, and structures used by an organization to direct and control its activities, to achieve its objectives, and to protect the interests of its diverse stakeholder groups in an ethical manner.

“Broadly speaking, corporate governance generally refers to the processes by which organizations are directed, controlled, and held to account.”

— Australian National Audit Office, *Corporate Governance in Commonwealth Authorities and Companies*, 1999.

PRINCIPLES OF GOVERNANCE

The following elements of governance principles are relevant in both private and public sector organizations, although they are described in terms applicable to government.

Setting direction. Good governance establishes policies to guide an organization’s actions.

In government, policy may be directed through broad national goals, strategic plans, performance goals, legislative guidance, designated oversight organizations, or legislative oversight committees. A government’s policies — or at least its priorities — can generally be found in its budget, which allocates limited resources to specific activities.

Instilling ethics and integrity. Good governance includes clearly articulated ethical values, objectives, and strategies; proper tone at the top; and internal control. It should align policies and procedures to encourage behavior that is consistent with the government organization’s ethics and integrity values.

An important element necessary to achieve behavior that is consistent with good ethics and integrity is setting and enforcing clear lines of accountability that hold people responsible for doing the right thing.

“In virtually all jurisdictions, the public sector plays a major role in society, and effective governance in the public sector can encourage the efficient use of resources, strengthen accountability for the stewardship of those resources, improve management and service delivery, and thereby contribute to improving peoples’ lives. Effective governance is also essential for building confidence in public sector entities — which is in itself necessary if public sector entities are to be effective in meeting their objectives.”

— International Federation of Accountants (IFAC) *Corporate Governance in the Public Sector: A Governing Body Perspective*, 2001.

Overseeing results. Good governance requires continuing oversight to ensure that policy is implemented as intended, strategies are met, and the overall performance of the government meets expectations and needs within policy, laws, and regulations.

Accountability reporting. Because government organizations act as “agents” to use resources and authority to accomplish established goals, governments must account for how they used the resources and what they accomplished. Accordingly, good governance requires regular financial and performance reporting that is validated for accuracy by an independent auditor. Accountability also implies imposing penalties or sanctions against those who have misapplied the resources for purposes other than intended.

Correcting course. When the organization has not achieved its financial or operational performance goals, or when problems are detected in operations or the use of funds, a good governance system will identify the cause of the problems, determine the corrective actions needed, and follow up to determine whether those actions were implemented effectively. Auditors’ findings and recommendations represent critical inputs to good governance that can lead organizations to take prompt and appropriate corrective actions to remedy identified weaknesses and deficiencies.

GOVERNANCE PRINCIPLES CRITICAL TO THE PUBLIC SECTOR

Unique governance principles arise from the unique nature of government and are especially important in government. For example, unique to the public sector is the importance of political forces, the not-for-profit nature, and the ultimate objective of public service for many governmental activities. Simultaneously, governments hold coercive (police, taxation, and regulatory) powers over citizens and economic enterprises, and thus they must enact protections to ensure accountability in the use of those powers and in the delivery of the expected services. These protections are fundamental in political systems in which citizens endow the government with its powers. In general, any form of government can benefit from accountability measures that ensure that officials use resources and authority to meet the aims of the ruling body, lending authorities, and alliances. Moreover, good public governance requires fair and impartially enforced legal frameworks. The absence of good governance structures and lack of adherence to basic governance principles increases the risk of public corruption, which is defined as the misuse of entrusted power for private gain. Therefore, in addition to the basic governance principles described in the previous section, the principles of accountability, transparency, probity, and equity are essential in the public sector.

“The principles of good governance — transparency and accountability; fairness and equity; efficiency and effectiveness; respect for the rule of law; and high standards of ethical behavior — represent the basis upon which to build open government.”

— Organisation for Economic Co-operation and Development (OECD) Policy Brief, “Public Sector Modernisation: Open Government,” 2005.

Accountability. *“Accountability is the process whereby public sector entities, and the individuals within them, are responsible for their decisions and actions, including their stewardship of public funds and all aspects of performance, and submit themselves to appropriate external scrutiny. It is achieved by all parties having a clear understanding of those responsibilities, and having clearly defined roles through a robust structure. In effect, accountability is the obligation to answer for responsibility conferred.”* (Source: IFAC, Governance in the Public Sector: A Governing Body Perspective, 2001).

Transparency. The principle of transparency relates to the openness of government to its citizens. Good governance includes appropriate disclosure of key information to stakeholders so that they have the necessary facts about the government's performance and operations. Accordingly, the government's decisions, actions, and transactions are conducted in the open. Many governments require public documents to be disseminated or made available upon request, or mandate that meetings of elected officials be publicized, with information on the decisions to be made. Although the public's interest is sometimes served by protecting information from disclosure — such as instances where national security, criminal investigations, or the proprietary information of a private company would be compromised — the transparency of government actions and information plays a significant role in public oversight.

“The chief aim of the Lima Declaration is to call for independent government auditing ... this independence is also required to be anchored in the legislation. For this, however, well-functioning institutions of legal security must exist, and these are only to be found in a democracy based on the rule of law.

Rule of law and democracy are, therefore, essential premises of really independent government auditing and are the pillars on which the Declaration of Lima is founded.”

— Dr. Franz Fiedler, Secretary General of the International Organisation of Supreme Audit Institutions (INTOSAI), 1998.

Auditors can provide a direct link between transparency and the credibility of the government. Lawmakers and the public look to audits for assurance that government actions are ethical and legal, and that financial and performance reporting accurately reflects the true measure of operations.

Probity. The principle of probity calls for public officials to act with integrity and honesty. The erosion of public trust if public information and actions are not reliable undermines a government's legitimacy and ability to govern. The political, social, economic, and environmental costs to society can be extensive. The principle of probity also applies when information is disseminated to lending authorities or other principals who have an interest other than an ownership share. The consequences of violating the expectation for probity can be swift and shattering when the people's trust in the government, its institutions, and leadership is undermined.

Equity. The principle of equity relates to how fairly government officials exercise the power entrusted to them. Citizens grant their agents — government officials — both money and power to carry out their responsibilities. However, citizens are concerned with the misuse of government power, waste of government resources, and any other issues involving corruption or poor management that could negatively impact the government's obligations and service delivery to its citizens.

Governmental equity can be measured and evaluated across four dimensions: service costs, service delivery, police power, and the exchange of information. Service costs are paid using taxes and fees charged by the government and borrowed funds that will be paid from future taxes. Service costs may also include indirect or future costs resulting from current government action or inaction. Service delivery includes direct services such as transportation infrastructure, public

education, and health, as well as indirect services such as financial stewardship and human capital management. Police power concerns the government's use of its coercive powers: arrest, property seizure, eminent domain, and regulatory processes such as granting liquor licenses or building permits. Exchange of information relates to transparent decision-making, including access to government officials and the ability to be heard.

PUBLIC SECTOR AUDITING

DEFINITIONS AND ORIGINS OF AUDITING

“The need for financial accountability has existed ever since it became necessary for one individual to entrust the care of his possessions or business to another.” — Committee to Review the Functioning of Financial Institutions (“Wilson Committee”), 1980.

The public sector represents a principal-agent relationship. The officials — acting as the principal’s agent — must periodically account to the principal for their use and stewardship of resources and the extent to which the public’s objectives have been accomplished. An effective audit activity reduces the risks inherent in a principal-agent relationship. The principal relies upon the auditor to provide an independent, objective evaluation of the accuracy of the agent’s accounting and to report on whether the agent uses the resources in accordance with the principal’s wishes.

The need for a third party to attest to the believability (credibility) of the financial reporting, performance results, compliance, and other measures arises from several factors inherent in the relationship between the principal and its agent:

1. Moral hazards — conflicts of interest:

Agents may use their resources and authority to benefit their own interests, rather than the principal’s interests.

2. Remoteness: Operations may be physically removed from the principal’s direct oversight.

3. Complexity: The principal may not possess the technical expertise needed to oversee the activity.

4. Consequence of error: Errors may be costly when agents are stewards of large amounts of resources and are responsible for programs affecting citizens’ lives and health.

Some current definitions of auditing illustrate the variability in the roles of auditors, while underscoring the fundamental elements of the profession. For example:

“Audit serves an accountability relationship. It is the independent, objective assessment of the fairness of management’s representations on performance or the assessment of management’s systems and practices, against criteria, reported to a governing body or others with similar responsibilities.”

— Canadian Comprehensive Audit Foundation, 1991.

“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization

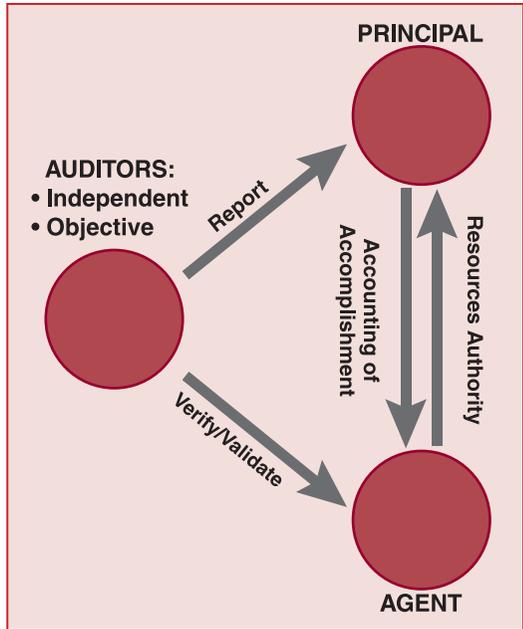


Figure 1 — 3- Party Relationship

accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

—The Institute of Internal Auditors, 1999.

Although public sector auditing has broadened focus from individual transactions to control systems and program operations, government auditing should retain the defining characteristics that are the basis of its credibility — the value it provides to the governance process — including:

- Unbiased orientation toward the subject under audit.
- Use of systematic processes to collect and analyze information.
- Comparison to criteria for formulating conclusions. Examples of criteria include standards, goals/targets, benchmarks, and laws.
- Use of widely accepted professional audit standards.

The credibility of the audit activity strengthens public governance by providing for accountability and protecting the core values of government, which it does by assessing whether managers and officials conduct the public’s business transparently, fairly, honestly, and in accordance with laws and regulations.

AUDIT ROLES

As an essential element of a strong public sector governance structure, government auditing supports the governance roles of oversight, insight, and foresight. Because government’s success is measured primarily by its ability to deliver services successfully and carry out programs in an equitable and appropriate manner, government audit activities should have the authority and the competency to evaluate financial and program integrity, effectiveness, and efficiency. Moreover, auditors must also protect the core values of the government, as it serves all citizens.

“Auditing has evolved as systems, transactions, and operations have become more complex. In its earliest origins (evidence points to audits conducted in Babylonia and Mesopotamia as early as 3,000 B.C.), auditing verified the existence of assets. Over time, auditing shifted from a detailed focus on confirming or validating individual transactions to evaluating the effectiveness of the systems that control transactions. In the 20th century, public sector auditors also moved well beyond evaluating economic and financial transactions and conditions. Since the introduction of social programs, some government auditors have been called upon to validate the effectiveness of the government services themselves. Or, they may be required to determine whether the organization has established mechanisms to measure and report on its effectiveness.”

— Colleen G. Waring, CIA, CGAP
Performance Auditing Training
Course manual, 2002.

“The Baek-Du-Dae-Gan (BDDG) mountain range crosses Korea, and is the main source of most water resources in the Korean Peninsula. The Board of Audit and Inspection of the Republic of Korea inspected development projects that might result in long-lasting damage to the ecosystem, and evaluated the effectiveness of various conservation programs. The audit found that of 72 roads built across the Trans-Korea Backbone, 30 have inflicted damage on the ecosystem. An additional 80 roads not crossing the ridge have been built without due consideration to the ecosystem. This imprudent construction has contributed to frequent landslides and floods. Following the audit, the Ministry of Environment has begun devising management and conservation principles for the areas of the BDDG.”

— Audit of Conservation and Management of the Baek-Du-Dae-Gan, May 2002, by The Board of Audit and Inspection of the Republic of Korea.

Oversight. Auditors assist decision-makers in exercising oversight by evaluating whether government entities are doing what they are supposed to do, spending funds for the intended purpose, and complying with laws and regulations. Audits focusing on oversight answer the questions, “Has the policy been implemented as intended?” and “Are managers implementing effective controls to minimize risks?” Auditing supports the governance structure by verifying agencies’ and programs’ reports of financial and programmatic performance and by testing their adherence to the organization’s rules and aims. Moreover, oversight audits contribute to public accountability by providing access to this performance information to relevant principals within and outside of the organization under audit. Both elected officials and managers are responsible for setting direction and defining organizational objectives. In addition, managers have the duty to assess risks and establish effective controls to achieve objectives and avert risks. In their oversight role, government auditors assess and report on the success of these efforts.

Oversight also describes the role many government auditors have to detect and deter public corruption, including fraud, inappropriate or abusive acts, and other misuses of the power and resources entrusted to government officials. Auditors monitor the effectiveness of management’s internal control structure to identify and reduce the conditions that breed corruption. In many areas of the world, public sector auditors also are responsible for responding to allegations of corruption in the government organizations they serve through detection and deterrence.

Detection. Detection is intended to identify improper, inefficient, illegal, fraudulent, or abusive acts that have already transpired and to collect evidence to support decisions regarding criminal prosecutions, disciplinary actions, or other remedies. Detection efforts can take many forms:

- Audits or investigations based on suspicious circumstances or complaints that include specific procedures and tests to identify fraudulent, wasteful, or abusive activity. Alternatively, red flags that appear during the course of an audit initiated for unrelated reasons may result in added procedures to specifically identify acts of fraud, waste, or abuse.
- Cyclical audits, such as payroll, accounts payable, or information systems security audits, that test an organization’s disbursements and/or related internal controls.
- Audits requested by law enforcement officials that analyze and interpret complex financial statements and transactions for use in investigating and building evidentiary cases against perpetrators.
- Reviews of potential conflicts of interest during the development and implementation of laws, rules, and procedures.

Deterrence. Deterrence is intended to identify and reduce the conditions that allow corruption.

“Formal requirements for government auditing usually do not explicitly include provisions to stimulate learning behavior on the part of the public bodies audited. However, in practice, many auditors would agree that the ultimate goal of auditing is to contribute to better performance of auditees. A government audit office can be considered as part of the institutionalised learning abilities of government (Van der Meer et al, 2000). In the traditional policy cycle of preparing policies, implementing them, evaluating them, and feeding back the results to adjust policies, the audit function is clearly positioned in the evaluative part of the cycle.”

— Gerard Bukkems and Hans de Groot, Netherlands Court of Audit, paper for the 5th biennial conference of the European Evaluation Society, Sevilla, Spain, October 2002.

Auditors seek to deter fraud, abuse, and other breaches of public trust by:

- Assessing controls for existing or proposed functions.
- Assessing organizational or audit-specific risks.
- Reviewing proposed changes to existing laws, rules, and implementation procedures.
- Reviewing contracts for potential conflicts of interest.

Successful detection efforts may also have a deterrent effect.

Insight. Auditors provide insight to assist decision-makers by assessing which programs and policies are working and which are not, sharing best practices and benchmarking information, and looking horizontally across government organizations and vertically between the levels of government to find opportunities to borrow, adapt, or re-engineer management practices. The audit activity helps institutionalize organizational learning by providing ongoing feedback to adjust policies. Auditors conduct their work systematically and objectively to develop a detailed understanding of operations and draw conclusions based on evidence. Therefore, audits can provide a fair description of problems, resources, roles, and responsibilities that, combined with useful recommendations, can encourage stakeholders to rethink problems and programs. Not only can the performance of the specific program under audit be improved, but working through the issues brought to light by a particular audit can enhance the capacity of government and the public to deal with similar problems. Audits focusing on insight contribute importantly to answering the broader question, “Has the policy brought about the intended results?” Concurrently with the accountability function, audits contribute to improving the operations of government.

Foresight. Auditors also help their organizations look forward by identifying trends and bringing attention to emerging challenges before they become crises. The audit activity can highlight challenges to come — such as from demographic trends, economic conditions, or changing security threats — and identify risks and opportunities arising from rapidly evolving science and technology, the complexities of modern society, and changes in the nature of the economy. These issues often represent long-term risks that may far exceed the terms of office for most elected officials, and can sometimes receive low priority for attention where scarce resources drive more short-term focus on urgent concerns. Additionally, a common audit approach — risk-based auditing — focuses the audit on the organization’s overall risk management

“Auditors should engage in oversight, insight, and foresight work. With regard to foresight, the United States’ long-range fiscal imbalance has been the subject of several reports by its supreme auditor, the Government Accountability Office (GAO). As the country’s lead accountability agency, the GAO has undertaken the task of informing the Congress and the citizens of the United States about the serious financial challenges we face. To aid ordinary citizens in understanding the nature of the problem, the information is displayed in context more relevant to individuals. For example, the federal government’s fiscal exposure of US \$46 trillion is presented in context of the total US \$51 trillion net worth of all Americans. In another example, the burden for every citizen is calculated at US \$156,000 or US \$375,000 for every full-time worker. The GAO has stated that initial steps to address this challenge include the need for a top-to-bottom review of existing federal programs, tax policies, and operational priorities.”

— “Saving our Future Requires Tough Choices Today,” Atlanta Rotary Club address by the Honorable David M. Walker, comptroller general of the United States, June 12, 2006.

framework, which can help identify and deter unacceptable risks. Through risk-based auditing, the audit activity provides useful and relevant information to the organization for managing its risks.

Audits focusing on foresight help answer the question, “What policy revisions or implementation would meet a future need or risk?” When government auditors focus on trends and look forward, they help to support decision making. Government auditors also play a key role in helping managers understand and initiate risk assessments. Additionally, auditing’s own risk assessment assures that audit resources are used effectively to address the areas of greatest exposure.

Through these roles, auditors protect core government values. By providing oversight, insight, and foresight services, government auditors help ensure that managers and officials conduct the public’s business transparently, fairly, and honestly, with equity and probity, while conducting their own work using the highest standards of integrity. Auditors should not only assess the potential abuse of power, but also should be cognizant of their own power within an organization.

- Auditors can serve as a check on abuse of power. Government auditors — whether appointed by the legislature or the executive, or elected by the voters — must be prepared to recognize and report corruption, abuse of authority, or failure to provide equity or due process in the exercise of a governmental police or regulatory activity. Because such reporting may challenge powerful or entrenched interests, auditors require some measure of job protection to be able to report independently.
- Auditors must not abuse their own power. The auditor’s unique role in government confers power that could be susceptible to abuse. Therefore, the auditor’s own work must reflect the same principles of transparency, equity, and probity that are expected of governments. This means auditing issues that matter to people, writing accurate and balanced reports, and making government audit reports available for public examination. Some government auditors may even find themselves presenting their audit findings in televised hearings or committee meetings. And certainly, government auditors must conduct their work with integrity and in full compliance with laws and regulations.

REPORTING LINE OF GOVERNMENT AUDITORS

Organizational reporting relationships affect the audit activity’s independence and scope of work. Reporting line refers to the organizational structure under which the chief audit executive is appointed and controlled relative to the activities subject to audit. Auditors can be located any

“School bus safety in the U.S. state of Missouri relies on driver screening. The state auditor found significant weaknesses in this area. Background checks for bus drivers did not include criminal history information outside of Missouri or information from closed state records. Auditors identified 60 bus drivers who had convictions or charges for offenses that are not allowable. In addition, auditors determined that the state agency responsible for licensing bus drivers did not run applicants through the child abuse and neglect database used to screen child-care workers. A review of 21,000 bus drivers found 330 had obtained licenses in spite of substantiated abuse and neglect cases. An additional 14 bus drivers had permits revoked based on information auditors obtained from Kansas City police officials. City police records in these cases had not been included in state records.”

— Press Release, Report No. 2003-35, Office of the State Auditor of Missouri, April 15, 2003.

place within a government organization. However, auditors should only audit activities that are outside their own reporting line to preserve the independence of the audit activity.

Public sector organizations around the globe are complex and diverse. A single governance model for support and oversight of the government audit activity will not serve all government organizations. Many structures rely on some combination of external and internal audit activities, based on needs and circumstances. Regardless of the governmental structure, the organizational placement of the audit activity should provide sufficient safeguards to prevent the audited entity from interfering with audit's ability to perform its work and report the results objectively.

Globally, governments at all levels have created internal audit activities to serve organizations through their focused, real-time presence within the organization. Although the internal audit activity can add significant value to the organization because of its detailed familiarity and understanding of operational conditions, it may be hampered in upholding the public trust if protections to its independence are not established and cannot be maintained. Governments must establish protections to ensure that internal audit activities are empowered to report significant issues to appropriate oversight authorities. Safeguarding auditor independence is particularly needed when the internal audit activity reports to officials who may also be held accountable for any significant problems. Examples of such protections include statutory requirements that:

- Prevent the audited organization from interfering with the conduct of audit work, staffing of the audit activity, and publication of the audit report.
- Ensure the head of the audit activity reports to the highest executive level in the government organization and that report distribution requirements ensure the transparency of the audit results.
- Require notification to an external oversight entity in the event of plans to dismiss the chief audit executive.

The reporting line of the auditor is tied to the function's independence, which is the most fundamental element of an effective and credible government audit activity. Because the government auditor's role is to provide unbiased and accurate information on the use and results of public resources, auditors must be able to conduct and report on their work without interference or the appearance of interference. Independence is achieved when the audit activity reports outside the hierarchy of the organization and activities under audit and when auditors are free to conduct their work without interference, restrictions, or pressures from the organization being audited. Such interference can occur if the audited entity limits access to records or employees, controls budget or staffing for engagements, or has authority to overrule or modify audit reports. Individual auditors also need to have independence, which means that the auditors are free from conflicts of interest or biases that could affect their impartiality, the appearance of impartiality, or how the auditor conducts the work or reports results.

TYPES OF AUDITS AND OTHER SERVICES

Government auditors conduct audits with different types of objectives. Financial reporting requirements and performance indicators for government functions vary between jurisdictions and types of activity (e.g., public health, law enforcement, national security, and environmental protection) and results may take years to materialize. Consequently, the means to assess government financial regularity and performance vary widely. Accordingly, individual

government auditors demonstrate different types of skills, competencies, and specializations. For instance, government auditors need to understand: accounting standards and systems to examine financial accountability; program operations and performance measurements to assess the success or progress of government activities; as well as standards and good practices for corporate governance, management, and internal control. In some cases, auditors can assess the reliability of existing indicators, but they must also be able to measure performance to independently evaluate achievements of a variety of public programs. Moreover, to make useful recommendations on how to improve operations, they must be able to apply standards and good practices specific to managing the type of operation being examined.

Selection of the type of audit or service to be performed is based upon the audit activity's authority and purpose, as well as the needs and issues to be addressed. The audit activity's scope of work depends on the authority granted to it by its enabling legislation and the needs or risks the organization faces. A broader focus allows the audit activity flexibility to use a risk-based approach to auditing, focusing on the areas of greatest concern or risk, while contributing value across the entire organization. The broadest audit focus also considers the organization's governance activities, which can help the organization achieve its objectives and priority goals and improve its governance framework, including its ethical code. The narrowest audit focus involves testing individual transactions for errors or for compliance with contract terms, policies, regulations, or laws. The auditors' scope of work can vary between these extremes, and include activities such as reviewing internal controls, processes, and systems to identify systemic weaknesses and propose operational improvements. Usually, both types of focus are necessary to varying extents in order to achieve the most effective impact from a government audit activity.

Risk management systems and controls. Auditors assess the adequacy of corporate governance and the control environment; the effectiveness of processes to identify, assess, and manage risks; the assurance provided by control policies, procedures, and activities; the completeness and accuracy of information and communication systems and practices; and the effectiveness of management's monitoring and evaluation activities. Many jurisdictions have developed what is referred to as a "systems" audit, which is designed to assess the full scope of the organization's financial and performance control systems and to identify deficiencies and recommend corrective actions.

EXAMPLES OF WIDELY ACCEPTED PROFESSIONAL AUDIT STANDARDS IN USE BY GOVERNMENT AUDITORS

International Standards for the Professional Practice of Internal Auditing issued by The Institute of Internal Auditors (IIA).

Auditing Standards issued by the International Organization of Supreme Audit Institutions (INTOSAI).

Generally Accepted Government Auditing Standards issued by the U.S. Government Accountability Office (GAO).

Government Internal Audit Standards issued by Her Majesty's Treasury, United Kingdom.

International Standards on Auditing issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants

Guidelines on Internal Auditing issued by the East and Southern African Association of Accountants General (ESAAG).

Performance. Auditors systematically gather evidence to assess aspects of program performance beyond financial reporting. Because the types of government services are broad, the types of objectives appropriate for performance auditing will vary. Also, depending on the jurisdiction, the range and focus of performance auditing will vary. In its broadest context, performance audit objectives might assess:

- **Effectiveness** – evaluates program accomplishments. Has a program achieved its objectives? What are the program’s outcomes or results, both intended and unintended?
- **Efficiency** – examines productivity, unit cost, or indicators such as utilization rates, backlogs, or service wait times. Do operations maximize outputs in relation to costs and other resource inputs (e.g., number of license renewals per staff hour)?
- **Economy** – examines the extent to which a government operation has minimized its use of inputs (e.g., money, staff resources, equipment, or facilities) consistent with the quality needs of the program. For example, an economy audit may evaluate the validity of a competitive procurement process to ensure that costs were controlled.
- **Compliance** – tests the organization’s conformity with objective requirements, standards, or criteria. These types of audits typically assess compliance with laws and regulations, contract requirements, grant requirements, and organizational policies and procedures. A relatively new service, environmental auditing, helps to examine compliance with environmental regulations.
- **Data reliability** – assesses internal controls and reporting for non-financial matters, such as performance measures.
- **Policy and other prospective (forward-looking) evaluation** – assesses program or policy alternatives, forecasts potential program outcomes under various assumptions, or evaluates the advantages or disadvantages of various legislative proposals. Auditors may also compile benchmarking or best practice information to assist in evaluating program design or management practices.
- **Risk Assessment** – identifies risks that may affect achievement of an organization’s strategic and financial goals and objectives and assesses management’s response to those risks. In government, risks go beyond normal financial and operational risks, and can include political and societal risks. For instance, some government risks involve the political and economic consequences of the public’s perception of fairness and equitable treatment of citizens. Auditors also conduct risk assessments to select and plan audits.

Financial/Regularity. Auditors express an opinion on the presentation of the financial statements in accordance with established or accepted accounting principles (regularity). Often performed by external auditors — either commercial auditors or auditors from another branch of government — this type of audit focuses on properly accounting for assets and expenditures as reported by the government. In addition to the financial statement opinion, financial audits can also examine the reliability of specific financial information, compliance with relevant procedures and rules, or the safeguarding of assets.

Advisory, assistance, or investigative services. Auditors may provide objective, expert advice in a range of areas in which they possess expertise. Based on their knowledge and expertise, they may provide technical advice on issues related to good governance, accountability, ethical practices, and anti-corruption programs; effective risk assessment and management; internal controls; sound business processes; information technology (IT) systems development and

operations; project management; program evaluation; and other areas affecting the effectiveness, efficiency, and economy of operations. In addition, government auditors may provide such services as control and risk assessment workshops and training in areas such as fraud awareness, performance measurement, and control design. They may also provide advice on implementing audit recommendations.

In providing advisory/assistance services, auditors should remain independent. Although the auditors may, in an advisory role, provide technical advice and make recommendations to management, they may not make management decisions or assume a management role. Moreover, they must remain cognizant of the need to maintain independence and objectivity for any subsequent audits conducted in any program that has received significant levels of advice or assistance in its formative stages. In other words, auditors should guard against the risk of auditing their own work.

Because government auditing is key to good public governance, it is crucial to maintain an appropriate configuration with an appropriately broad mandate to achieve the organization's governance objectives. The government audit activity's mandate should be as broad as possible to enable it to respond to the full scope of the government's or governmental unit's activities. Although auditors may be able to add value to any segment of the organization for which they can provide independent, objective assurance, our position is that, at a minimum, every government requires some form of independent audit activity that has authority to evaluate the full range of the government's activities.

Full audit coverage is frequently provided by complementary external and internal audit entities. However, in some smaller governments or sub-governmental units, one audit entity alone, or an entity combining a hybrid of internal and external audit characteristics, may be appropriate.

Ultimately, government auditing strengthens public governance by providing for accountability and protecting the core values of government — ensuring managers and officials conduct the public's business transparently, fairly, and honestly, and with equity and probity. We encourage elected and appointed officials at all levels of government to support effective audit activities by establishing independent audit functions that meet all of the key elements.

A significant recent corporate governance development in the private sector has been the use of audit committees to provide strengthened oversight of the financial and ethical integrity of publicly-held companies. Because this oversight role is essential to effective governance, public sector entities may also look to the audit committee to provide a similar role in the government. Moreover, depending on the specific circumstances of these entities, audit committees operate within a variety of governance arrangements. Notwithstanding, it should be noted that many governments have found alternative means to fulfill the role played by private sector audit committees.

THE AUDIT COMMITTEE'S ROLE

The audit committee can greatly strengthen the independence, integrity, and effectiveness of government audit activities by providing independent oversight of the internal and external audit work plans and results, assessing audit resource needs, and mediating the auditors' relationship with the organization. Audit committees also ensure that audit results are aired and any recommended improvements or corrective actions are addressed or resolved.

Every government/public sector organization should evaluate its governance structure to determine whether an audit committee is appropriate for its particular situation.

In some governments, audit committees are formed as subcommittees of the legislative branch or board of directors. Other governments may form audit committees of members of the public who are selected by the legislative branch and/or the executive branch. Some government entities have formed audit committees composed of ministers or managers of outside oversight agencies, members of the management hierarchy under audit, or a combination. As an example of the former approach, central harmonization units within the Finance Directorates of certain European Union countries oversee the audit activities within other agencies, and may form an audit committee to which other agencies' internal auditors provide reports.

The need for, and composition of, the audit committee will depend on individual circumstances, the nature of the audit activity, and the decision of the legislative or governing body.

“State and local government retirement plans, participants, and beneficiaries have a direct interest in sound corporate governance, since they are major investors in securities markets. State and local retirement plans collectively invest over \$2 trillion dollars in the public markets. The quality and integrity of corporate governance directly affects the ability of retirement plans to meet their investment goals, and by extension, the ability to meet their long-term obligations to current and future retirees.

“The Government Finance Officers’ Association (GFOA) supports corporate governance reforms that enhance transparency and align management and the board of directors with the interests of long-term shareholders. These reforms include, but are not limited to ... the appointment of a majority of independent board members, as well as audit and compensation committees comprised entirely of independent board members...”

— Government Finance Officers’ Association, Executive Board, March 2005.

AUDIT COMMITTEE BEST PRACTICES

Where an audit committee is established, depending on the characteristics of the jurisdiction, it should strive to:

1. Operate under a formal mandate, preferably legislation, with sufficient authority to complete its mandate.
2. Include independent members who collectively possess sufficient knowledge of audit, finance, risk, and control.
3. Be chaired by a member who is not the individual to whom a head of audit reports administratively.
4. Assess the effectiveness of the organization's governance, risk management, and control frameworks and legislative and regulatory compliance.
5. Provide oversight to the organization's internal and/or external audit activity, including ensuring adequate coverage and resources, approving internal audit plans, and approving the appointment or termination of internal and/or external auditors.
6. Oversee the organization's financial reporting and accounting standards.
7. Provide a direct link and regular reporting to the organization's governing board, council, or other governing authority.

ENDORISING ORGANIZATIONS

THE INSTITUTE OF INTERNAL AUDITORS

As the only international professional organization dedicated to the practice of internal auditing, The Institute of Internal Auditors (IIA) is the acknowledged authority on the internal audit profession. Headquartered in Altamonte Springs, near Orlando, Fla., The IIA represents internal auditors in business, industry, government, and education in more than 160 countries.

The Institute of Internal Auditors (IIA) is the acknowledged leader, recognized authority, and chief educator for the profession worldwide. Established in 1941, The IIA has 246 affiliates around the world and serves more than 115,000 members in internal auditing, risk management, governance, internal control, IT audit, education, and security in 160 countries. The world's leader in certification, education, research, and technical guidance for the profession, The Institute sets the International Standards for the Professional Practice of Internal Auditing and provides leading-edge guidance.

NATIONAL ASSOCIATION OF STATE AUDITORS, COMPTROLLERS, AND TREASURERS

The National Association of State Auditors, Comptrollers, and Treasurers (NASACT), a U.S.-based organization, plans and executes training and technical assistance programs and handles requests for information from state auditors, comptrollers, treasurers, and other government officials, as well as the private sector. The association also monitors information regarding federal legislation and agency developments that have an impact on state government and acts as a liaison with Congressional committees on issues of interest to members. NASACT uses its expertise to provide responses to technical standards-setting bodies, helping to ensure the highest standards of government transparency, accountability, and integrity. Within NASACT, two “secretariats” — the National Association of State Auditors and the National Association of State Comptrollers — serve members with a specialized focus. For more information about NASACT, see www.nasact.org.

ASSOCIATION OF LOCAL GOVERNMENT AUDITORS

The Association of Local Government Auditors (ALGA) is a professional organization that supports local government auditing as an important component to maintaining trust in government. ALGA's goal is to be the organization of choice for local government auditors and for standards-setting bodies and professional boards seeking input on issues affecting local government auditing, accounting, and operations. The Association provides a reputable quality assurance (peer review) program, an annual conference, and regional training events to local government auditors to enhance their ability to provide high-quality audit services. ALGA also actively advocates for local government auditing among citizens, politicians, and local government managers. Contact ALGA through www.governmentauditors.org.

CANADIAN COMPREHENSIVE AUDITING FOUNDATION — LA FONDATION CANADIENNE POUR LA VÉRIFICATION INTÉGRÉE

CCAF-FCVI seeks to achieve excellence in public sector governance, management, and accountability. To do this, CCAF-FCVI provides thought leadership and builds knowledge and capacity for effective governance and meaningful accountability, management, and audit. The focus for, and beneficiary of, our work is the public sector. Our work, which is funded through public-private partnership with Canadian government organizations, includes research, training and

development, and other capacity building programs. CCAF-FCVI can be contacted through www.ccaf-fcvi.com.

GOVERNMENT INTERNAL AUDIT COUNCIL OF CANADA

Members of the GIACC are comprised of the chief internal auditor of each Canadian province and territory, a representative from the Federal Treasury Board, and the CCAF-FCVI (formerly known as the Canadian Comprehensive Auditing Foundation). GIACC is dedicated to the ongoing strengthening of internal auditing in the provincial and territorial governments of Canada and the strengthening of linkages between provincial/territorial and federal audit organizations. The GIACC can be contacted by telephone: +1-613-957-2400; fax: +1-613-998-9071.

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IN COLLABORATION WITH:

U.S. Comptroller General's Domestic Working Group

David M. Walker, Comptroller General of the United States, convened the Domestic Working Group in March 2001 to facilitate the interaction of federal, state, and local government auditors. The group of 18 top audit officials interacts on an informal basis to address topics of mutual concern. One topic of great interest to the group is the presence of effective governance structures within federal, state, local,

ENDORISING ORGANIZATIONS

and quasi-public jurisdictions. Because auditing is a vital component of effective governance, the group embraced the opportunity to participate in the development of this paper. For more information on the U.S. Comptroller General's Domestic Working Group, visit www.gao.gov.

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