

BWC Board of Directors

**Audit Committee**

**Thursday, November 20, 2008, 4:00 p.m.**

**William Green Building**

30 West Spring Street, 2<sup>nd</sup> Floor (Mezzanine)

Columbus, Ohio 43215

---

Members Present: Mr. Kenneth Haffey, Chair  
Mr. Bob Smith  
Mr. Bill Lhota  
Mr. Jim Harris  
Mr. Jim Matesich

Members Absent: None

Other Directors Present: Mr. Thomas Pitts  
Ms. Alison Falls  
Mr. Jim Hummel

**CALL TO ORDER**

Mr. Haffey called the meeting to order at 4:11 PM and the roll call was taken. All members were present except Mr. Matesich, who arrived at 4:21 PM.

**MINUTES OF OCTOBER 28, 2008**

The minutes were approved without further changes by a 4-0 roll call vote on a motion by Mr. Harris, seconded by Mr. Lhota. Mr. Matesich was not present to vote at the time this motion was presented.

**NEW BUSINESS / ACTION ITEMS**

**1. External Audit Update**

Mr. Haffey introduced this new business item by stating Ms. Tracy Valentino, Chief of Fiscal and Planning, had received word the audit findings had been released by the Auditor of State; therefore, it was not necessary to enter Executive Session.

Mr. Joseph J. Patrick, CPA of Schneider Downs was not available to present the audit findings to the Committee. Mr. Roy Lydic, CPA of Schneider Downs presented the audit findings with Mr. Patrick's apologies to the Committee.

Mr. Haffey introduced the audit findings by noting they included a financial statement audit with management disclosure, a management letter, and internal controls findings.

With regard to the financial statements, Mr. Lydic noted a unique disclosure statement. Specifically, due to the decline in financial market valuations, the statements were noted to be accurate as of June 30, 2008 and June 30, 2007, respectively. This disclosure was also noted in the footnotes and management analysis.

With regard to the “yellow book” report, Mr. Lydic noted general compliance with government auditing principles. However, one deficiency noted in the audit revealed some managed care organization reviews by independent auditors had substandard reports. Mr. Lydic noted that Bureau management was responding to this identified deficiency. Mr. Lhota inquired if “substandard” was the worst rating that could be received. Mr. Lydic replied it was the second worst rating. Mr. Haffey noted the MCO reviews were not outright audits, and there were no instances of noncompliance that were otherwise required.

Mr. Lydic then addressed the management letter, which involved execution of the audit findings by Bureau management. In lieu of reading the letter, Mr. Lydic noted the timeliness of internal reviews suggested room for improvement in BWC’s audit trail. There were more suggestions than findings in the management letter.

Mr. Haffey noted he had conversations with Mr. Patrick and Ms. Tracy Valentino, Chief of Fiscal and Planning, and others to insure the Bureau was in lockstep with the external auditing firm.

Mr. Lydic noted the Bureau’s responsibilities with general accounting standards were strongly adhered to, and there was no consultation to his knowledge with any other accounting firm. Mr. Lydic noted all journal entry errors had been corrected and posted to the books, and he believed the final documentation would be signed and sent to Bureau management in the next week or so.

Mr. Haffey concluded this presentation that this audit was a very long and involved process.

## **2. Executive Session -- Semi Annual Meeting with Inspector General**

At 4:21 PM, Mr. Haffey moved for the Audit Committee to go into Executive Session pursuant to Ohio Rev. Code Sec. 121.22(G)(3) for the purpose of discussing personnel matters with the Inspector General. The motion was seconded by Mr. Matesich, and the motion passed by unanimous roll call vote.

At 4:43 PM, Mr. Lhota moved for the Audit Committee to leave Executive Session. The motion was seconded by Mr. Harris, and the motion passed by unanimous roll call vote.

### **3. FY 09 1<sup>st</sup> Quarter Executive Summary**

Ms. Caren Murdock, Chief of Internal Audit, presented a quarterly overview of audit findings that were completed by October, 2008. The following audits findings were discussed: Lump Sum Settlement Audit; Permanent Partial/Scheduled Loss Audit; MCO #5 Audit; and the IT Physical and Environmental Security Audit.

#### *Lump Sum Settlement Audit*

Ms. Murdock presented the findings of the Lump Sum Settlement audit. There were four material, twelve significant and two minor comments resulting from this audit.

Ms. Murdock noted that settlement costs were on the rise, with \$172 million in settlements in fiscal year 2006, \$256 million in fiscal year 2007, and \$321 million in fiscal year 2008. Ms. Murdock provided an overview of what a lump sum settlement was, and how lump sum settlements were initiated and processed. The Bureau's responsibility was insuring the settlement was in the best interest of all parties, with final review of the settlement performed by the Industrial Commission. As a result of the audit findings, a settlement consultant has been retained. While the internal controls were adequately described in some instances, the controls were poorly implemented. In summary, the audit revealed the lump sum settlement process did not describe its purpose or goals, and cross divisional problems were identified. Furthermore, internal controls over the entire process were weak.

Seven key issues were discussed by Ms. Murdock. First, the process lacked mission goals and strategies that impacted the entire agency with regard to claim obligations. This issue was identified as a material weakness. Bureau management has agreed to describe the agency goals and the process of settlements. Additionally, Bureau management has agreed to determine what types of claims should be settled in consideration of investment risk.

Second, Ms. Murdock noted a material weakness in the policies and procedures of the settlement process. While many of the policies and procedures were documented, many were either outdated or undocumented. Bureau management has agreed to develop an end to end lump sum settlement process and complete a process map of the lump sum settlement process.

Third, Ms. Murdock noted a material weakness in the lump sum settlements as many settlements were not being reviewed and approved by the Industrial

Commission. Failing to have this approval subjected the Bureau to potential liability as claims -- previously thought to be settled—could be later challenged and held invalid. Recommendations were made to install a data warehouse query to supplement reporting and timelier quality assurance reviews. Management agreed to address this issue through compensation audits.

Fourth, Ms. Murdock noted a material weakness in quality assurance in the lump sum settlement process. There was no compilation by the Bureau's Legal Division, and there was no indication in any of the reviews to say the settlement was reasonable. In summary, quality assurance needed to be implemented into the process.

Fifth, Ms. Murdock noted a significant weakness in the lump sum settlement process performance results. There was no benchmarking of the results to industry practices. Ms. Murdock, in addition to the benchmarking, recommended trending analysis in the performance measurements and management reporting should include identified goals and objectives maintained by private carriers.

Sixth, Ms. Murdock noted a significant weakness in inconsistency with the "fast track" lump sum settlement process. "Fast track" settlements are those where verbal negotiations occur with settlement of claims of values of less than \$10,000. There were compliance errors in testing the process. Ms. Murdock recommended Bureau management develop and implement procedures for this process.

Finally, Ms. Murdock noted a significant weakness in failing to itemize medical costs in lump sum settlements. The United States Department of Health and Human Services has mandated this cost segregation under secondary payer laws. Failure by the Bureau to segregate these costs may expose the Bureau and the injured worker to subrogation by Medicare. Ms. Murdock has recommended that the Bureau develop a white paper to limit liability and risk exposure in this regard.

At the conclusion of her presentation, Mr. Haffey thanked Ms. Murdock for the detail and time involved in the audit. The audit had significant findings and took hundreds of hours to complete. As a result of the audit, Mr. Haffey noted Ms. Pat Drago has been retained as an outside consultant who has much expertise in this area.

Mr. Pitts inquired as to whether this audit applied to court settlements. Ms. Murdock replied that her audit findings addressed all settlements, including court settlements. Mr. Pitts also inquired as to the current settlement thresholds. Ms. Murdock agreed to provide this information to Mr. Pitts.

*Permanent Partial/Scheduled Loss Audit*

Ms. Murdock reported this was an overall good audit. The audit was to insure the Bureau had effective controls in place to effectively follow statutory and policy requirements. There were two significant and two minor comments resulting from this audit.

The primary significant weakness identified, according to Ms. Murdock, was located in the claim audit tool. The claim audit tool currently in use may be ineffective in identifying and addressing potential scheduled loss awards.

Mr. Pitts inquired if the audit focused only on scheduled loss permanent partial awards or if it included percentage of permanent partial awards. Ms. Murdock stated the audit only focused on scheduled loss permanent partial awards.

#### *MCO #5 Audit*

Ms. Murdock then presented the MCO #5 audit findings. There was one material, seven significant, and two minor comments resulting from this audit.

The primary policies and procedures reviewed in this audit were well designed but a material weakness was noted in the reconciliation of provider accounts. Ms. Murdock believed this material weakness needed to be addressed immediately as this finding had been made in prior audits. It was imperative that reconciliation of accounts with zero balancing occur, and this was not occurring.

Additionally, Ms. Murdock noted a significant weakness in the use of backup devices with confidential claims information. Ms. Murdock recommended that the MCO require encryption before releasing confidential data to an outside vendor.

Ms. Falls asked what internal controls are in place if nothing is done with Ms. Murdock's recommendations. Administrator Ryan indicated she speaks with department heads regarding the recommendations. If the recommendations are not being followed, she examines the failure to adhere to the recommendation from a risk standpoint.

#### *IT Physical and Environmental Security Audit*

Ms. Murdock then presented the audit findings of the IT Physical and Environmental Security Audit. There was one material, four significant and five minor comments resulting from this audit.

Ms. Murdock noted the internal controls reviewed during this audit were adequate. Fire, temperature and humidity risks to the data center were adequately protected, as was direct exposure from outside sources.

Ms. Murdock noted a material weakness existed where written policies or procedures were uncovered through the audit, but no evidence these policies

and procedures were actually being followed. Furthermore, there appeared to be an ad hoc implementation of policies and procedures with IT staff relying on more experienced staff to address issues as they arose. Ms. Murdock recommended the IT division implement policy and procedures and provide training on the policy and procedures.

Finally, Ms. Murdock noted a significant weakness in penetration, or “hacking.” Ms. Murdock recommended a policy on penetration testing be designed and implemented.

After presentation of these audit findings, Ms. Murdock inquired to the Committee, if the detail provided was sufficient for the Committee. Mr. Haffey asked if all of these audits were completed in October, 2008, and Ms. Murdock replied they were. Mr. Haffey noted the findings provided to the Committee had a great amount of detail, and he was satisfied with the detail given.

Ms. Murdock then noted she was obligated to notify the Board of Directors if she made a recommendation, and Bureau management refused to implement her recommendation. This obligation notifies the Board of Directors that Bureau management has assumed a risk she has identified for corrective action. At the present time, Ms. Murdock notified the Committee there were two partial implementations of recommendations by Bureau management. One of the partial recommendations concerned the noncomplying employer audit, and the other concerned audit findings of a managed care organization.

*Partial Implementation Notification of Noncomplying Employer Audit Recommendation*

Ms. Murdock reported to the Committee that Bureau management had accepted a risk in partial implementation of a recommendation concerning when an employer goes into lapsed status. The audit recommendation was if an employer had not paid their full amount of premium when due, the employer would go into lapsed status immediately. This recommendation was consistent with industry standards. Bureau management partially implemented this recommendation by allowing employers to pay at least 65% of premiums by the due date without going into lapsed status.

Mr. Harris inquired if industry standards were other state fund programs or private insurance companies. Ms. Murdock replied the standard was based upon other state funds.

Mr. Lhota asked what Ms. Murdock was asking the Committee to do. Ms. Murdock replied if an audit recommendation was not fully implemented by management, the issue is presented to the Administrator. If the Administrator accepts the risk undertaken by management, her position required her to present

the risk undertaken by the Administrator to the Board to determine if the Board also accepts the risk.

Mr. Lhota asked Administrator Ryan for a rationale for undertaking the risk in this instance. Ms. Ryan noted implementing the no coverage on a certain date may end up disenfranchising too many employers. Ms. Ryan also noted the Attorney General's office does obtain certification for lapsed premiums. Ms. Ryan was of the opinion, at this time, the Bureau and Ohio employers would not be well served by trying to reach a much higher standard. Ms. Ryan also noted she was meeting tomorrow to discuss new methods of ensuring compliance, and there is a balance between being a public enterprise enforcing collections and finding those employers who are truly abusing the system.

Mr. Lhota then inquired as to the definition of lapsed coverage. Ms. Valentino noted employers can achieve lapsed status in a number of ways. First, failing to report premiums by the due date will place an employer in lapsed status, and the next due date is February 28<sup>th</sup>. Second, if an employer accumulates a \$1,000 debt that is certified to the Attorney General's Office, the employer is in lapsed status by virtue of statute. Third, an employer will also be lapsed under the current 65% rule discussed by Ms. Murdock. Ms. Valentino noted the 65% threshold currently in place is being examined by the Bureau from a financial impact perspective of increasing the threshold to 85%. Valentino added the effect of being in lapsed status means an employer will be liable for any claim allowed during the lapsed status on a dollar for dollar basis.

Mr. Harris inquired if the threshold for lapsed coverage was discretionary. Ms. Valentino noted the lapsing process is done systematically, and reiterated the Bureau was examining the financial impact of raising the threshold higher.

Mr. Harris inquired if this threshold was impacting any particular group of employers, such as small employers, differently. Ms. Valentino said smaller employers pay fewer premiums, and Ms. Ryan indicated the 65% policy was directed at both public and private employers. Ms. Valentino also noted lapsed status is in effect for an employer until their balance due is paid in full, and these employers cannot participate in various premium discount programs the Bureau offers.

Mr. Haffey said it sounded like the Bureau was headed in the right direction, and Mr. Harris said he had no present objections to the Bureau's current policy on this matter.

#### *Partial Implementation Notification of MCO Audit Recommendation*

Ms. Murdock reported to the Committee the second assumption of risk by the Bureau involved a managed care organization with a Columbus office which used a vendor located in Cleveland. The issue involved the fact that both the

Columbus office and the Cleveland vendor were not date stamping documents. The Cleveland vendor was using the date on the imaged documents as the received date, which could have some impact on incentive payments. The Bureau and the MCO have agreed the Columbus office will date stamp invoices as they are received, but the vendor will continue with their normal process. No concerns were raised by the Committee with this compromise.

### **Overview of Annual Audit Plan**

Ms. Murdock then presented an overview of the annual audit plan to the Committee. She indicated all audits scheduled for completion in the coming year were on schedule with no proposed changes at this time. Ms. Murdock meets with the Administrator and management periodically to discuss the upcoming audits, and no concerns or questions were identified that would effect the current audit plan.

At the beginning of the last quarter, there were 83 outstanding comments. In the past quarter, 31 new comments were added, and 12 were validated, which left 102 outstanding comments at the conclusion of this past quarter. Of the 102 outstanding comments: 2 were rather old and not presently rated; 22 were material; and 78 were significant. However, there was a 19% decrease in outstanding comments on a year over year comparison. Ms. Murdock specifically noted management had partially implemented the employer non-compliance comment. Furthermore, according to the management quarterly responses, the bankrupt self insured comment is to be implemented in March, 2009 and the medical adjustment and billing audit comments were projected for implementation in December, 2008.

Many of the comments were expected to be validated in the coming year, but the scheduled implementation of 9 of the comments extended out to the first quarter, 2010. Those 9 comments involved IT benchmarking, which required long-term transition.

Ms. Murdock inquired if this portion of the presentation was sufficient in detail for the Committee's needs. Mr. Haffey noted there was a very nice story in the presentation, and overall the presentation was good.

Mr. Pitts inquired how the bankrupt self insured comments would be implemented by March, 2009 when it was noted that legislative change was required. Subordinate to that question, he inquired whether this position or policy is something that the Board should be advocating. Ms. Ryan stated she has had some discussions regarding this issue. She is waiting for the Deloitte study before seeing if the Bureau would actively pursue a legislative change.

Mr. Pitts then inquired regarding the Lump Sum Settlement audit. At present, the pre-PTD settlements appeared to be on hold. Mr. Pitts wanted to know if all

other settlements were being processed. Ms. Ryan replied the settlement process required a top to bottom review and the Bureau has retained Ms. Pat Drago, a consultant with experience in the settlement process. Several recommendations have been shared by the Bureau and Ms. Drago. Ms. Ryan said settlements are taking place, but enough work needs to be done regarding documentation and controls that some lump sum settlements require a second look.

Mr. Pitts finally asked about the status of permanent total disability vocational assessments with respect to the settlement process. Ms. Tina Kielmeyer, Chief of Customer Services, responded to Mr. Pitts. Ms. Kielmeyer replied that Ms. Drago is looking at elements and components of these evaluations. Mr. Pitts asked if there is only one person presently doing the evaluations at BWC, and whether or not this was causing a significant delay in the processing of pre-PTD settlement applications. Ms. Kielmeyer confirmed there was only one person at present doing these evaluations; however, the Bureau is evaluating whether or not a network of vocational evaluators could provide independent vocational evaluations. With regard to pre-PTD settlements, there was a backlog; however, the backlog did not impact the processing of the PTD application itself.

Mr. Pitts then inquired to Ms. Ryan whether the comments resulting from the lump sum settlement audit inferred a rather broad based reform was needed. Ms. Ryan responded the statement could be interpreted in that way from a perspective of needed document controls and internal attention of how settlements are affecting reserves and the activities of the Bureau. Mr. Pitts asked where the Bureau was going in this process. Ms. Ryan replied the settlement process needed to insure timeliness, with all parties being heard, as well as fulfilling requirements and potentially initiating methodologies used by other carriers and state funds to achieve settlements.

Mr. Pitts finally inquired regarding the Bureau's policies on settling pre-PTD claims. Some states had up to three times the number of PTD recipients, but peer states proactively settled PTD claims, which in turn reduced the number of PTD recipients on the books. Ms. Ryan replied this was an issue that was being discussed at the present time.

Mr. Harris made a statement that he wanted it clear he opposed offsets of Social Security from PTD. This topic was an issue of previous discussions with the Board, and he was opposed to it then, and he was opposed to it now. Mr. Pitts cited agreement with Mr. Harris' statement.

Ms. Murdock concluded her presentation to the Committee by noting there was a tentative start date for the Investment Auditor on December 12<sup>th</sup>. The new Investment Auditor has over twenty years experience in the field. Furthermore, Ms. Murdock reported there are six vacant auditor positions, but only three would be filled. Interviews were being conducted for one position, and one candidate

has been extended an offer. The two remaining positions will be posted in December, which requires a proficiency test be passed before conducting interviews.

#### **4. Audit Committee Charter Review**

Mr. Lhota reported the Governance Committee of the Board of Directors had reviewed the Audit Committee's Charter. Three recommendations were made by the Governance Committee for consideration by the Audit Committee. First, wording in the membership provisions was clarified so that non-members of the Board of Directors could serve on the Audit Committee. Second, the Governance Committee recommended a redundant clause regarding open meetings be removed. Third, the Governance Committee would be overtaking general rule review provisions, and thus, the Audit Committee's charter needed to reflect its rule review authority will be limited only to audit based rules.

After brief discussion, Mr. Lhota moved that the Audit Committee refer the Audit Committee Charter, as amended through incorporating the Governance Committee's recommendations in their entirety, to the Board of Directors for review and approval. The motion was seconded by Mr. Smith, and the motion passed by a unanimous roll call vote.

#### **5. Rule Review – First Reading – Interstate Jurisdiction 4123-17-14, 4123-17-17, and 4123-17-23**

Mr. Michael Glass, Director of Underwriting and Premium Audit, and Ms. Kilmeyer presented the first reading of proposed rules 4123-17-14, 4123-17-17, and 4123-17-23 to the Committee.

Mr. Glass noted prior to implementation of recent legislative changes, Ohio employers were at a competitive disadvantage. Specifically Ohio employers were required to report all payroll for all of their employees, regardless of whether work was to be done in other states. Furthermore, those employers subject to the Longshore Harbor Workers' Compensation Act (LHWCA) also had to report their longshoremen payroll to the Bureau even though the exclusive remedy was under that federal act.

Ms. Kilmeyer noted there was frequently confusion with injured workers as to which state they were to file for benefits. Ultimately this situation often led to a denial or a delay in benefits while jurisdictional issues were being sorted out. Ms. Kilmeyer also noted there was an issue of dual recovery of benefits from multiple jurisdictions, leading to various states trying to recover benefits and allegations of fraud. These proposed rules hopefully help clarify the jurisdictional requirements that have now been implemented through legislation.

Ms. Kielmeyer reported 95 employers currently subject to the LHWCA will benefit under the current legislation and rule proposal. With regard to interstate employers, the figure was more difficult to ascertain, but the figure could be as high as 40,000. Clearly the rule proposals will also benefit injured workers as the rules help clarify who will assert jurisdiction for their claims.

Mr. Glass noted reciprocity was the most advantageous portion of the new legislation. Ohio can agree with other states to enter into reciprocal agreements to waive the other states coverage requirements if the other state will waive our coverage requirements as well. The concept, while it makes perfect sense, unfortunately is difficult to enforce. Most other states cannot waive under their respective laws; however, currently West Virginia is fully favorable at the present time. They have a thirty day waiver currently in place, and thus they will have reciprocity with Ohio.

Mr. Glass then presented an overview of the changes encompassed by these new rules through a slide show presentation. Mr. Glass noted that proposed rule 4123-17-14 changed a requirement of all payroll had to be reported to Ohio, no matter where the work was performed. Additionally, in addition to having to disclose coverage and insurer on a separate form, a copy of the policy would also be required.

Mr. Pitts noted one correction was needed in proposed rule 4123-17-17(C) regarding changing a “the” to “an out of state.” Ms. Kielmeyer appreciated the suggestion which will be changed. She encouraged any other suggested changes be submitted to her attention before the next reading.

## **6. Rule Review – First Reading – Ambulatory Surgery Center (ASC) Fee Schedule**

Mr. Freddie L. Johnson, Director of Managed Care Services, and Ms. Anne Casto, a private reimbursement and coding consultant retained by the Bureau, addressed the Committee regarding this proposed rule. This was the first reading of the rule, with the second reading expected at the December, 2008 meeting, and if approved, the fee schedule will be put into effect on April 1, 2009. Mr. Johnson was of the belief the proposed rule will provide injured workers better access to a higher quality of medical care.

Mr. Johnson provided a financial overview of the impact of the fee schedule of ASCs and the objectives of the underlying recommendations in the rule changes. Mr. Johnson noted appropriate revision of the Bureau’s ASC billing processes was needed due to inefficiencies and ineffectiveness of the rule as it was currently worded.

Ms. Casto discussed the ASC reimbursement changes and impacts under the current proposal. Ms. Casto noted the Medicare Modernization Act, first passed

in 1982, has undergone several changes over the years, most recently in 2003. One of the driving forces of the changes in 2003 was the increasing disparity between payments to ASCs and hospital outpatient settings. Medicare has evaluated this disparity again as recently as January of this year, and currently ASCs are reimbursed under that system at outpatient hospital rates with adjustment factors considering the lower cost setting. The proposed fee schedule will impact 700 procedures under the scope of service added by Medicare, and the Bureau will add approximately 400 procedures, depending on Bureau needs. The rule will also enhance billing and practice efficiencies with ASCs, and this proposal also is more in line with HIPAA and the Medicare Claims Procedure Manual. One of the biggest complaints from the ASCs has been they dislike the inefficiencies in dealing with the Bureau because of custom data required by the agency. Ms. Casto stated, while some procedures will increase and some decrease in reimbursement, the fee schedule as proposed will provide ultimately increased ease of access and lower costs to the Bureau.

Ms. Casto noted there were about 200 ASCs in the State of Ohio, and the Bureau has approximately a 90% penetration rate at present. The ASCs were providing outpatient services in a very cost efficient environment. Mr. Haffey inquired as to how the Bureau will see a cost benefit. Ms. Casto replied third party payers who pay less than Medicare rates is a bad situation, and this places access of the services at risk. By failing to provide competitive rates, outpatient hospital settings would replace ASCs, and the migration of injured workers from ASCs to the outpatient hospital setting would ultimately lead to higher costs.

Mr. Matesich inquired how an injured worker is to gain education about ASC facilities. Ms. Casto responded primary care physicians help by guiding the injured workers to appropriate facilities to obtain treatment. The condition of the injured worker, required services and other factors determine whether or not an ASC facility would be appropriate, or if the procedure should be done on an outpatient basis at a hospital.

Mr. Pitts noted familiarity with one ASC, Crystal Clinic of Akron, and that particular ASC has been a tremendous benefit to injured workers in the surrounding area. Ms. Casto noted that facility was the number two ASC provider of services in the BWC system. Mr. Pitts asked who the number one provider was, and Ms. Casto stated it was the Northeast Surgical Center.

## **ADJOURNMENT**

Mr. Harris moved to adjourn the meeting at 6:10 PM, seconded by Mr. Smith. The meeting adjourned with a unanimous roll call vote.

Prepared by Michael J. Sourek, Staff Counsel November 25, 2008