

Discussion Draft
Funding Policy
Audit Committee Discussion
~~May 28, 2009~~ June 18, 2009

BWC requires a prudent level of net assets (~~otherwise known as “surplus”~~) to protect the fund against financial and operational risks that may threaten the ability to meet future obligations. These financial and operational risks include, but are not limited to, the following:

- Uncertainty in the ultimate amount and timing of future payments on known claims;
- Legislative and court actions that may affect future operations;
- Substantial catastrophic events, either through acts of nature or acts of man;
- Significant market fluctuations resulting in material changes in the valuation of the portfolio; and
- Economic factors impacting BWC’s ability to collect premiums.

In an effort to maintain a solvent and stable state fund, BWC ~~needs to~~ should maintain a sufficient level of net assets to handle these risks.

Business Rationale

- Adoption of a Funding Policy will enable the organization to maintain prudent funded net assets to support the financial strength of the State Insurance Fund and maintain stability in premium costs.
- Adoption of a Funding Policy will enable the organization to fulfill the statutory requirements of maintaining a solvent state fund while keeping premiums as low as possible.
- Adoption of a Funding Policy that establishes ~~an acceptable a~~ range will provide flexibility in decision-making with respect to options such as premium credits or surcharges.

Methodology and Guiding Principles

- Should use methodology supported by customized metrics to calculate key results used in measuring funding adequacy.
 - Funding Ratio is defined as funded assets divided by funded liabilities (funded assets= cash, investments, and current receivables less deposits and current payables, funded liabilities=reserves for

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unpaid claims and funded claim expenses, excluding any risk margin, discounted at a risk free discount rate).

- Net Leverage Ratio is defined as net premiums written plus reserves divided by net assets
- Should incorporate the concept of ~~acceptable~~ ranges to be responsive to changes and to maintain a degree of stability in operating results over time.
- Should incorporate appropriate options for premium credits or surcharges, if metrics indicate excessive or inadequate financial reserves.
- Should enable BWC to make limited peer comparisons.
- Should be tailored to each fund where a material amount of a fund's obligations are funded, as opposed to pay-as-you-go (Pay-as-you-go funds include the DWRF I and II, SIEGF and ACF).
- Should include consideration of risks associated with estimates inherent in financial reporting including, but not limited, to medical inflation, discount rate, and market valuation.
- Sound fiscal principles would dictate the need to maintain sufficient assets to meet current and future obligations. Therefore, as a matter of policy, the minimum ~~target range~~ guidelines should never be below 1.00.

The following steps should be taken when establishing ~~target ranges~~ guidelines for the funding ratio and net leverage ratio:

1. The Administrator, with approval from the BWC Board of Directors, should establish ~~an acceptable guidelines range~~ for a Funding Ratio and a Net Leverage Ratio.
2. The ~~acceptable range guidelines~~ for a Funding Ratio and a Net Leverage Ratio should be monitored as a component of the monthly Enterprise Report (or comparable financial report).
3. The Administrator, in conjunction with senior executives as appropriate, should prepare a recommendation to address variations from the ~~established range~~ guidelines.
4. The Administrator shall present recommendations to the Board of Directors for review and approval.
5. The Board of Directors shall review ~~target ranges guidelines for of~~ the Funding Ratio and Net Leverage Ratio on an annual basis.

Historical State Insurance Fund Information*

FY Ended June 30	Net Assets (in millions)	Funding Ratio	Net Leverage Ratio
2000	\$6,644,827	1.552	2.1555
2001	\$4,643,351	1.373	3.1594
2002	\$1,886,585	1.148	8.3538
2003	\$417,937	1.029	39.8767
2004	\$644,444	1.044	26.4196
2005	\$507,491	1.038	34.4908
2006	\$1,278,845	1.091	13.5202
2007	\$2,080,045	1.144	8.2621
2008	\$2,206,923	1.152	7.9323
Policy Guidelines			
2009			

[*Funding Policy with Guidelines adopted by the Board of Directors in 2009. Data previous to 2009 is for historical purposes only.](#)



Bureau of Workers'
Compensation

Internal Audit Division

**Fiscal Year 2010
Annual Audit Plan**

Promoting a strong control environment through
open communication, professionalism, expertise and trust.

Caren Murdock, Chief
Rich Ridewood, IT Audit Director
Karl Zarins, Director
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FY 2010 Annual Audit Plan

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FY 2010 Annual Audit Plan

Introduction

The BWC Internal Audit Division performed an assessment of the organization's risk environment to develop our audit plan for FY 2010. Development of the assessment was based on various risk factors to the organization, as well as interviews with various members of management, the BWC Board of Directors, and other stakeholders.

The goal of the risk assessment and audit plan is to facilitate a process of continuous improvement in both processes and internal controls throughout the organization with the ultimate goal of improving services to Ohio's workers and employers.

Purpose

The purpose of internal audit is to provide an independent assessment of the adequacy of internal controls throughout the organization. The Institute of Internal Auditors (IIA) provides the following definition of internal auditing:

“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

The role of internal auditing includes some of the following activities:

- Evaluating and improving the adequacy and effectiveness of risk management, control, and governance processes;
- Validating compliance with policies, standards, procedures and applicable laws and regulations;
- Evaluating the management process to determine whether reasonable assurance exists that management objectives and operational goals are achieved; and
- Providing process and managerial consulting to improve risk management, control and governance processes.

FY 2010 Annual Audit Plan – Risk Assessment Process

Risk Assessment Process

In developing the audit plan, we performed a risk analysis for the organization utilizing seven risk factors (see below). The objective of the risk assessment is to optimize the assignment of audit resources through a comprehensive understanding of the audit universe and the risks associated with each universe item.

The IIA defines risk as:

“The uncertainty of an event occurring that could have an impact on the achievement of objectives.”

The risk assessment process included the following activities:

1. Interviewed management and key stakeholders regarding risk/control concerns;
2. Developed audit risk assessment/annual audit planning that defines risk factors applied to a numeric rating scale; and
3. Stratified processes by risk ratings and selected the type of audit planned and projected hours.

Risk Scoring

The seven risk factors utilized for our assessment were developed utilizing IIA guidance and historical knowledge of BWC, as well as best practices in internal auditing. Each risk factor was scored based on likelihood of the risk and significance of the event. The overall goal of the risk scoring approach is to help ensure that we audit high-risk areas each year.

Once the various risk factors were rated, we weighted the various factors in order to arrive at a composite risk score for each area, which was used to determine areas to prioritize for the FY 2010 audit plan.

The specific risk factors are presented in the following table, along with the weighting for each factor.



	Low Risk	Moderate Risk	Neutral Risk	Sensitive Risk	High Risk
Risk Rating A risk rating was assigned to each process across the seven categories. The risk rating contemplated both likelihood and consequence.					
Audit Frequency The audit frequency is directly correlated to the process risk rating.					
Audit Effort The extent of audit effort is typically linked to the level of risk, size and complexity of each process.					
Risk Rating Audit Effort Hours	1 Extra Small <100	2 Small 100-300	3 Medium 301-500	4 Large 501-800	5 Extra Large 801-1200
	The level of audit effort for projects can vary significantly depending on the complexity of the area or process being examined.				

Consideration of External Reviews

To minimize the potential for duplication of effort and to maximize the amount of coverage achieved, we considered other audits or related reviews performed by other divisions within BWC, the external financial auditors, or external consultants. In addition, we also considered areas to be audited by the Office of Internal Audit under the Office of Budget and Management.

To minimize overlap, we leveraged the external reviews for the following areas in achieving audit coverage for FY2010.

Auditable Area	External Audit Coverage
Federal Grants	Annual Program Audit by OSHA
General Accounting and Financial Reports	Annual External Financial Statement Audit By Public Accounting Firm
Information Technology Processes	Annual External Financial Statement Audit and Office of Internal Audit
Payroll	Audited by the Office of Internal Audit in FY 2009
Rate Making	Actuarial Consulting Project Being Performed by an External Firm
Reserves	Annual Actuarial Consultant Review and Annual External Financial Statement Audit

FY 2010 Annual Audit Plan – Listing of Audits/Projects

FY 2010 Audit Plan

Internal Control/Compliance Reviews

- Coal mine safety program
- Coal workers' pneumoconiosis/marine fund claims
- Death benefits
- Disability evaluator panel process
- Drug utilization review process
- Employer compliance
- MCO audits
- Percentage permanent partial disability benefits
- Premium audit
- Safety and Hygiene
- Self insured bankrupt claims
- Temporary total disability benefits

Financial Audits

- Employer rate adjustments
- Fixed assets
- Investments:
 - Investment accounting process
 - Investment compliance monitoring
 - Investment month-end processes - valuation, performance calculation and reconciliations
 - Personal trading policy

Information Technology Audits

- OIA - BWC Specific Audits:
 - Data warehouse
- OIA - Enterprise Wide Audits:
 - Security and Privacy: Database Vulnerability
 - Security and Privacy: HB 648
 - Security and Privacy: Mobile Data Security

Consulting Projects

- Self-Insured Underwriting Process

Other

- Audit validation testing
- External audit assistance
- FY 2011 annual audit plan

FY 2010 Annual Audit Plan - Focus Areas by Quarter

Focus Area	1 st Qtr.			2 nd Qtr.			3 rd Qtr.			4 th Qtr.			Audit Effort
	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	
Investment Accounting Process													3
Coal Workers' Pneumoconiosis/Marine Fund Claims													4
Self Insured Underwriting													2
Temporary Total Disability Benefits													5
External Audit Assistance													5
Coal Mine Safety Program													2
Premium Audit													5
Percentage Permanent Partial Disability Benefits													4
Fixed Assets													3
Valuation, Performance Calculation and Reconciliations													2
Death Benefits													4
Disability Evaluator Panel Process													4
Drug Utilization Review													5
Self Insured Bankrupt Claims													4
Investment Compliance Monitoring													3
Employer Rate Adjustments													4
Safety & Hygiene													5
Employer Compliance													5
FY 2011 Audit Plan													2
Investment Personal Trading Policy													2
Audit Validation Testing													5
MCO Audits													5

(Note: The above does not include IT audits to be performed by OIA.)

Audit Effort Explanations

Number	Level of Audit Effort	Hours
1	Extra Small	< 100 hours
2	Small	100 - 300 hours
3	Medium	301 - 500 hours
4	Large	501 - 800 hours
5	Extra Large	801 - 1200 hours

FY 2010 Annual Audit Plan – Audit Scope Descriptions

Audit Validation Testing – We perform validation testing each quarter to ensure outstanding audit observations are resolved adequately and in a timely manner. As part of this process, management provides Internal Audit with updates each quarter regarding the resolution status of the outstanding observations. For observations which management indicates are completely implemented, we perform testing to validate that action taken is adequate to address the issue identified. In addition, if there are outstanding audit observations that are still in process, but are beyond the timeframes established for resolution of the audit comment, we will meet with management to determine factors delaying resolution. As comments are cleared through this process, they are removed from the list of outstanding comments provided to the Audit Committee.

Coal Workers' Pneumoconiosis/Marine Fund Claims Audit – The Coal Workers' Pneumoconiosis Fund and Marine Fund issue workers compensation benefits to injured workers for employers in the Coal Mining and Marine industries in Ohio. This audit will examine the claims payment process for the funds to evaluate the adequacy of internal controls over these payments. The audit will also include sample testing of claims payments to assess the level of compliance with agency policies and procedures and applicable regulations, as well as the timeliness and accuracy of processing.

Coal Mine Safety Program – BWC funds from the Coal Workers' Pneumoconiosis Fund were distributed to the Ohio Department of Natural Resources (ODNR) during FY 2009. The Coal Mine Safety Program was created and implemented during this time period. This review will assess ODNR and BWC controls over this program, as well as compliance with policies and procedures.

Data Warehouse Audit (OIA – BWC Specific) – The data warehouse contains data from multiple systems utilized within BWC. The data from this warehouse is utilized for key operational and strategic decision making. This review will focus on providing assurance regarding data quality control, effectiveness of security management, economy and efficiency of operations, and overall administration of the data warehouse.

Death Benefits Audit – When injured workers expire as the result of a work related injury, their spouse and dependants are entitled to death benefits. This audit will evaluate the adequacy of internal controls over benefit payments, as well as the level of compliance with agency policies and procedures and applicable regulations.

Disability Evaluator Panel Process Audit – At various stages in the claims management process, injured workers are scheduled for independent medical examinations. This audit will evaluate the adequacy of controls over the scheduling of examinations and the payment of the related invoices.

Drug Utilization Review Process Audit - Utilization review of prescription medications is a medical management strategy performed by BWC, to evaluate the necessity and appropriateness of prescription drug treatment. Drug utilization reviews can identify over-utilization or under-utilization of prescription medications. The Customer Care Team is responsible for identifying and scheduling these reviews. The focus of this project will be on evaluating the efficiency and effectiveness of the procedures and methodologies used to identify, monitor, and track questionable prescription medications. In addition, this audit will examine the related processes for evaluating and issuing determinations on these medications and compliance with policies and procedures and applicable regulations.

Employer Compliance Audit – This operational audit will examine the employer compliance process used to help ensure employers obtain the required workers' compensation coverage. The focus will be on evaluating the efficiency and effectiveness of the procedures and methodologies used to identify, monitor, and track non-complying employers.

Employer Rate Adjustments Audit – While the majority of employer rates are established systemically, there are times when manual rate adjustments are required due to various circumstances. This audit will examine the process for performing these adjustments and evaluate the adequacy of internal controls over this process.

External Audit Assistance – Internal Audit provides approximately 1,000 hours of assistance to the external accounting firm during their audit of the BWC financial statements. This assistance reduces audit fees each year by approximately \$75,000 - \$80,000.

Fixed Assets Audit – BWC capitalizes various items as fixed assets on the BWC balance sheet. This audit will include reviewing the process and criteria for capitalization and evaluating the adequacy of internal controls over fixed assets to ensure proper safeguarding and tracking of assets.

FY 2011 Annual Audit Plan – Activities include meeting with management, BWC Board of Directors, and other parties to obtain suggestions for areas to include in the FY 2011 Internal Audit plan. An analysis is performed to map trial balance accounts to key processes to ensure Internal Audit resources are appropriately assigned. In addition, we update the agency risk analysis, which assesses the relative risk for agency processes and assigns a risk score to each of the potential audit areas.

Investment Accounting Process – The goal is to gain assurance that investment accounting transactions are being performed and recorded accurately, timely and completely. The project will include an analysis of controls performed at BWC’s outsourced investment accountant and custodial bank.

Investment Compliance – This on-going project will involve regular assessment/monitoring of compliance with the BWC Investment Policy Statement and/or other applicable rules or regulations. Activities will include receipt and review of daily/monthly compliance reports issued via the compliance rules established within the outsourced investment accounting system. In addition, we will perform periodic testing to assess compliance with sections of the investment policy statement which may not be addressed by the automated compliance rules.

Investment Monthly Process: Valuation, Performance Calculation and Reconciliations – This project will examine the processes for portfolio valuation and performance calculation and the related reconciliation processes, as well as any related controls over these functions. The goal of the project is to provide assurance regarding the accuracy of portfolio valuations and investment performance figures reported to agency stakeholders.

Investment Personal Trading Policy – During the year, BWC implemented a Personal Trading Policy to provide safeguards against BWC staff utilizing non-public information regarding pending investment transactions for personal gain. This audit will evaluate the adequacy of the existing policy and assess the level of compliance with the policy.

MCO Audits – Throughout the year, the MCO Audit Unit within Internal Audit will perform a number of risk-based audits of MCOs to help ensure adequate internal controls are in place to safeguard agency assets and to help ensure MCO compliance with the contract. The activities of this unit work in conjunction with the Medical Services Compliance and Performance Monitoring Unit, which performs various day-to-day monitoring procedures to verify compliance with contractual requirements.

Percentage Permanent Partial Benefits Audit – Percentage permanent partial benefits are compensation awarded for residual impairment resulting from an allowed injury or occupational disease in State Fund or SI claims. The disability is measured in terms of “whole person impairment.” It is not a wage loss payment but a payment for residual damage. This audit will examine the related processes for evaluating and issuing determinations on these types of claims, as well as the actual payment of benefits. The focus of the audit will be on compliance with policies and procedures and applicable regulations.

Premium Audit – The Premium Audit department is responsible for verifying the accuracy of employer payroll reporting. This engagement will examine the premium audit process and related controls. The review will include an examination of the premium audit methodology and rationale for audit selection; determining the adequacy of controls to provide assurance that audits are accurate, timely and properly safeguarded and recorded. The project will also assess the level of compliance with policies and procedures and statutory requirements and evaluate the adequacy of quality assurance procedures.

Safety and Hygiene Audit – To assist in lowering employer premiums, a portion of premiums paid by employers is set aside for safety services performed by the Division of Safety and Hygiene. The Division of Safety and Hygiene provides a variety of safety services including technical support, consultation, publications, training classes, research and video libraries, local safety councils, safety grants and an annual convention/tradeshow. This audit will focus on core functions for the division and related controls.

Security and Privacy: Database Vulnerability (OIA – Multi-Agency Project) – Integrity of information in databases utilized by agencies is critical to ensuring accurate management reporting. This review will identify database vulnerabilities and provide recommendations to resolve any weaknesses identified.

Security and Privacy: House Bill 648 (HB 648) (OIA – Multi-Agency Project) – On a statewide basis, OIA will consult with agencies working to implement HB 648 data privacy related changes to help ensure that design of controls over these changes is appropriate.

Security and Privacy: Mobile Data Security (OIA – Multi-Agency Project) – This audit will assess data security as it relates to mobile devices such as laptops, USB flash drives, and backup tapes/devices. The scope will also include an assessment of compliance with agency policies and procedures, as well as DAS directives.

Self Insured Bankrupt Claims Audit – When a self-insured employer defaults on their claim obligations, the Self-Insured Bankruptcy Claims unit assumes administration and medical management of the employer's claims. The unit performs an audit of the employer's claim files to identify all outstanding compensation owed to the injured workers, as well as any unpaid medical bills or requests for treatment. This audit will ensure the adequacy and effectiveness of internal controls within the department and to evaluate the level of compliance with department policies and procedures and applicable laws and regulations. The project will also include an evaluation of the accuracy, completeness, and timeliness of claims processing.

Self Insured Underwriting Unit Audit – The Self-Insured Underwriting unit is responsible for eligibility determinations and processing for employer applications to be self-insured for the workers’ compensation benefits for their Ohio employees or renewals of existing self-insured employers. This consulting project will involve assisting the Self-Insured Underwriting area as they perform a self-assessment of the work processes for granting self-insurance to Ohio employers.

Temporary Total Disability Benefits Audit - BWC pays temporary total disability benefits for lost wages when an injured worker is expected to recover and return to work. It is the largest compensation type paid by the BWC. This audit will examine the related processes for evaluating and issuing determinations on these types of claims, as well as the actual payment of benefits. The focus of the audit will be on compliance with policies and procedures and applicable regulations.

FY 2010 Annual Audit Plan - Types of Audits

The Internal Audit Division is responsible for the process by which the Bureau reviews and assesses the effectiveness and efficiency of its management control and practices. There are generally six types of projects or reviews that we perform. The following is a listing of the types of projects and a brief description of each type of engagement.

Operational Audits (Beginning-to-End Business Process Flow)

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

Internal Control Reviews/Compliance Audits

Examining and evaluating the effectiveness of the Bureau's system of internal control and the quality of performance in carrying out assigned responsibilities. The primary objectives of the internal control systems are to ensure: the reliability and integrity of information; compliance with policies, plans, procedures, laws, and regulations; safeguarding of assets; economical and efficient use of resources; and accomplishment of established objectives and goals for operations and programs. Compliance audits determine the degree of adherence to policies and procedures. It is also concerned with compliance with all relevant external legislative requirements.

Financial Audits

Review of all ancillary functions such as budgeting, financial statements, accounting systems, revenue collection procedures, purchasing operations and payroll. As the procedures covering most of the activities in this category are regulated by laws, external principles or management directive, the purposes of the audit generally relate to the accuracy and integrity of data or compliance with policy. Audits may also be undertaken to assess the efficiency or effectiveness of these activities or the systems or procedures in use.

Information Technology Audits

IT audits examine the controls surrounding an organization's information systems, practices and/or operations to determine if systems are safeguarding agency assets, maintaining data integrity, and operating effectively and efficiently to achieve agency goals and objectives. IT auditing can be conducted as an integral part of the audit of financial and administrative systems. With the creation of the Office of Internal Audit (OIA) under the Office of Budget and Management, all BWC IT audits will be performed by OIA. BWC IT auditors will transition to OIA on June 22, 2009.

Consulting

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

Special Investigations

Some internal audit activity takes the form of a special investigation. The object of these investigations is to diagnose specific problem areas and establish whether further action or review is necessary.

12-Month Audit Committee Calendar

Date	June 2009	Notes
6/18/2009	1. FY2010 Audit Plan	
	2. FY2010 Financial Projections - (1st reading)	
	3. FY2010 Admin Budget (2 nd reading)	
	4. Enterprise Report Review	
	5. Office of Internal Audit Update	
Date	July 2009	
7/30/2009	1. External Audit Update	
	2. FY2010 Financial Projections (2nd reading)	
	3. Enterprise Report Review	
	4. Quarterly Litigation Update	
Date	August 2009	
8/27/2009	1. Enterprise Report Review	
Date	September 2009	
9/24/2009	1. External Audit Update	
	2. Internal Audit QES Review	
	2. IG Semi-Annual Update	
	3. Enterprise Report Review	
Date	October 2009	
10/29/2009	1. Operation Review Report	
	2. Charter Review	
	3. Enterprise Report Review	
	4. Quarterly Litigation Update	
Date	November 2009	
11/19/2009	1. External Auditor Retention Letter	
	2. Annual Financials MD&A Review	
	3. Comprehensive Report	
	4. Approve Committee Charter Changes	
	5. Enterprise Report Review	
Date	December 2009	
12/16/2009	1. Enterprise Report Review	
	2. Internal Audit QES Review	
Date	January 2010	
1/28/2010	1. Enterprise Report Review	
Date	February 2010	
2/25/2010	1. Internal Audit QES Review	

12-Month Audit Committee Calendar

Date	March 2010	Notes
3/25/2010		
Date	April 2010	
4/29/2010		
	May 2010	
5/27/2010		