BWC Board of Directors

Audit Committee

Thursday, May 28, 2009, 4:00 p.m.
William Green Building
30 West Spring St., 2nd Floor (Mezzanine)
Columbus, OH 43215

Members Present: Mr. Kenneth Haffey, Chair
Mr. Robert Smith, Vice Chair
Mr. James Harris
Mr. William Lhota
Mr. James Matesich (arrived at 4:06 PM)

Members Absent: None

Other Directors Present: Mr. Charles Bryan
Ms. Allison Falls
Mr. Thomas Pitts
Mr. Larry Price

CALL TO ORDER

Mr. Haffey called the meeting to order at 4:05 PM and the roll call was taken. All members were present except Mr. Matesich, who arrived at 4:06 PM.

MINUTES OF APRIL 29, 2009

Mr. Haffey opened the floor for discussion of any changes to the minutes of April 29, 2009.

Mr. Lhota sought clarification of the statement at the top of page 8 of "Mr. Haffey added there was a reasonableness test involved in determining whether or not an activity was a capital improvement or maintenance."

Ms. Tracy Valentino, Chief of Fiscal & Planning responded to Mr. Lhota's question. Ms. Valentino began by stating the Bureau records every asset greater than $500. Capital improvements can cost in excess of $100,000, which are expenses beyond normal repair and maintenance of equipment intended to extend the life of an asset. The underlying nature of the purchase determines if an asset is a capital improvement. Ms. Valentino noted assets are depreciated based upon their expected life and cost. Ms. Valentino noted a computer costing $500-$600 would be written off within one year, but a vehicle costing $15,000-$16,000 would be amortized and depreciated over several years. Mr. Smith inquired if a one year depreciation schedule was a tax policy, and Ms. Valentino answered in the negative. Mr. Smith also inquired if there were any assets being tracked valued at $100 or less. Ms. Valentino replied in the negative. Ms. Valentino indicated the statement as noted in the minutes was correct.

Mr. Lhota moved to have the minutes of April 29, 2009 be approved without change. The motion was seconded by Mr. Matesich, and the motion passed with a 5-0 unanimous roll call vote.

REVIEW AND APPROVAL OF AGENDA

Mr. Haffey asked if there were any modifications to the agenda. With no modifications recommended, Mr. Haffey moved to have the agenda approved, and Mr. Lhota seconded the motion. The motion passed with a 5-0 unanimous roll call vote.

NEW BUSINESS

1. **INFORMATION TECHNOLOGY (IT) AUDIT APPROACH**

Mr. Raj Subramanian, Office of Budget and Management (OBM), Chief of Business Process & Information Technology Audit, appeared before the Audit Committee. Mr. Haffey introduced Mr. Subramanian, and stated this discussion would provide a high level overview of IT auditing.

Mr. Subramanian stated the areas of IT audit are: application development and maintenance; business resiliency; project management; enterprise architecture; IT governance; and security and privacy.

Mr. Subramanian discussed the various IT frameworks and standards used when performing audits. Mr. Subramanian then reviewed the FY2010 audit areas for the Bureau, both agency specific and enterprise-wide reviews. From an assurance standpoint, his department will be auditing the Bureau’s data warehouse. The data warehouse generates many reports the Bureau depends upon. Audit areas will focus on: data quality and whether Bureau management could rely upon the data; timeliness and accuracy of the data; and operational effectiveness and efficiency. From a consulting standpoint, his department will focus on the many changes occurring with Bureau rates and payments. Mr. Subramanian indicated his department is meeting with Bureau management to ensure successful completion of the projects in this area.

Enterprise-wide activities will include database vulnerability and mobile data security. Databases used by multiple agencies may not be secured properly. Mr. Subramanian further added the main goal was to identify risks associated with each database, examine how each database is maintained, and bring risk down to a level that is acceptable by management. A database vulnerability assessment is provided to management along with feedback. Given the sensitive issues associated with a database vulnerability assessment, the reports and feedback are not public. Mobile data security deals with tapes, laptops and other devices that store data and are movable. The goals and objectives include identifying all forms of mobile data and mobile devices, examining how these devices are secured, and determining if security policies are effective.

Mr. Haffey inquired how many professionals were in Office of Budget and Management (OBM) Office of Internal Audits IT unit. Mr. Subramanian replied that OBM was in the process of hiring three new auditors, and they expect to have five new senior IT auditors by the end of June. Mr. Subramanian confirmed that two Bureau IT auditors will transfer to OBM on June 22, 2009. Mr. Subramanian noted these auditors have expertise in certain areas, which will help the Bureau. Additionally, however, Mr. Subramanian noted these auditors will also work with other agencies.

2. FY 2010 ADMINISTRATIVE BUDGET

Ms. Valentino appeared before the Audit Committee to discuss the fiscal year 2010 (FY2010) Administrative Cost (AC) budget and answer questions arising in the recent Actuarial Committee meeting. Specifically there was a question of why the AC budget was $278.1 million, and the Bureau's budget was $273 million. Ms. Valentino noted the $5 million discrepancy was because a portion of William Green's bond payment was paid for by the Industrial Commission of Ohio (IC). Mr. Lhota asked if the IC were renters or owners. Ms. Valentino replied the IC were tenants under lease with the Bureau. Mr. Lhota clarified the bond payment was the rent paid by the IC, and Ms. Valentino replied in the affirmative. Mr. Lhota inquired who would own William Green when the bonds are paid off. Ms. Valentino indicated the bonds would be paid off in 2014, and at that time, ownership will be with the AC fund.

Ms. Valentino then reviewed various portions of the AC budget. There were three sources of funding: the AC fund, Safety & Hygiene, and ancillary funds (such as coal, marine and the Disabled Workers' Relief Fund). Ms.

Valentino noted the budget was $305.9 million for FY2010, which is $22.2 million below the $328.1 million appropriated. Ms. Valentino noted the budget took into consideration known projects and many reforms being done. The buffer between the budget and the appropriation is in consideration that the Bureau may identify a large project during the reforms and would need to spend extra funds.

Ms. Valentino noted payroll was flat with only a 1.6% increase. The increase was primarily due to actuarial positions and the Superintendent of Safety and Hygiene's salaries being budgeted for a full year. Administrator Ryan inquired if the payroll figures included concessions from the bargaining units or reductions in exempt and unclassified positions. Ms. Valentino replied that these figures did not incorporate those concessions and reductions. Ms. Valentino added the actual payroll is expected to be lower. Mr. Haffey inquired if the payroll figure used was a worst case scenario, and Ms. Valentino replied in the affirmative. Mr. Harris inquired when the differences, through the concessions and reductions, would appear. Ms. Valentino replied every month when the budget and actual spending are compared, the savings would appear. Mr. Haffey inquired if there would be a need to re-budget, and Ms. Valentino indicated in the negative. Ms. Valentino added the Enterprise Report and AC fund summaries will also document the concessions and reductions in line items, with the positive variance accumulating over the course of the year. Mr. Haffey commented that Ms. Valentino was budgeting the payroll as best she could moving forward because of many unknowns. She noted the Bureau's budget was significantly below 2008, and the actual spending could be considerably lower than the budget projections.

Ms. Valentino then reviewed other significant changes in line items. First, Ms. Valentino noted other agency payments will increase by 28.8%; however, this figure was slightly inflated because the change in printing. While the budget increased significantly here, the increase was offset in other parts of the budget. Ms. Valentino noted there was a 200% increase in equipment, but the figure actually only increased from $1 million to $3 million. The increase was for replacement and upgrades in operating equipment. Next, there was a 50% increase in safety grants and long term care loans. Ms. Valentino reported the increase was legislatively mandated, and the entire amount was incorporated into next year's budget. Ms. Valentino then reported there would be an approximate 20% increase in strategic initiatives for such items as rate reform and HPP bill payment upgrades. Ms. Valentino noted there were about eleven to twelve primary projects budgeted, along with some secondary projects. Ms. Valentino finally noted there was a 50% decrease in capital improvements budgeted. Ms. Valentino noted this factor was due to the FY2009 budget incorporating the elevator restoration in William Green. This coming year the primary expenditures are cooling towers and roof repairs. Overall, the budget increased by 4.5% from FY2009 to FY2010.

Ms. Valentino concluded her remarks by noting an appropriation line item was provided to the Audit Committee members also documenting the $305.9 million figure, and this document is required by the Legislature.

Mr. Smith moved that Audit Committee recommend the Bureau of Workers' Compensation Board of Directors approve the Administrator's recommendation for the fiscal year 2010 annual administrative budget, and the motion consents to a fiscal year 2010 budget of $305.9 million dollars for the operation of the Bureau of Workers' Compensation and the Bureau of Workers' Compensation Board of Directors as presented at the Audit Committee. The motion was seconded by Mr. Matesich, and the motion passed by a 5-0 unanimous roll call vote.

During the course of voting, Mr. Harris commented he hopes, over the next year, that the Bureau will not take credit for belt tightening as a result of collective bargaining unit givebacks. Administrator Ryan replied this comment was exactly the reason why the payroll was not adjusted in the budget, and this consideration was being made by all agencies.

Mr. Price commented that the presentation by Ms. Valentino did not get any simpler. He commended Ms. Valentino for a very good job and a nice format. Mr. Haffey agreed with Mr. Price's comments.

3. NET ASSETS

Ms. Valentino introduced Mr. Donald Berno, Liaison for the Board of Directors, to the Audit Committee. Mr. Berno began by noting a lot of work had been done with the net asset policy since last August. Mr. Berno then presented a slide show presentation on developing a Bureau funding policy. Mr. Berno asked the Audit Committee consider two decisions during the presentation: first, what is the policy itself, or the guiding principles; and second, establishing a low and high end target ratio. Mr. Berno said he was presenting this information with an opportunity for the Audit Committee to comment. Next month, he will present revisions to the draft which would include the Audit Committee's assessments and comments. The intention is to have a vote on the net asset policy at the July meeting.

Mr. Berno began the slide show presentation by noting there were three primary goals from this discussion: establishing a funding policy consistent with recommendations outlined in the Deloitte study; define target ranges for key metrics; and correlating strategies to achieve target ranges.

Mr. Berno noted there were several purposes of a funding policy. First, the policy enables the organization to maintain a level of net assets to support the financial strength of the State Insurance Fund and maintain stability of premium costs. Second, the policy also enables the organization to maintain a solvent state fund while keeping premiums as low as possible; Mr. Berno noted this purpose correlates with statutory obligations. Finally, the policy provides guidance in decision-making with respect to options such as premiums credits or surcharges, depending on whether the funding level is above or below the target range desired.

Mr. Berno noted a funding policy should have several components. First, there should be customized metrics to calculate key results used in measuring funding adequacy. He added Deloitte developed a funding ratio, as opposed to the net leverage ratio which is the industry standard. Second, the funding policy should include the concept of acceptable ranges to be responsive to changes and to maintain a degree of stability in operating results over time.

Ms. Falls asked whether the term "target range" should be used, or if a different term, such as "guidelines" would be more appropriate. Ms. Falls believed "guidelines" was a softer term. Furthermore, the term "target range" denoted acceptable behavior of a figure being within the range, and unacceptable behavior if the figure is outside the range. Mr. Berno appreciated Ms. Falls comment, and he would correct the terminology.
In continuing with the funding policy's key components, Mr. Berno noted a funding policy should include options for premium credits or surcharges if the guidelines are above range or below range, respectively. Additionally, the funding policy should allow for changing the guidelines, either widening or narrowing the range. Fourth, the funding policy should enable the Bureau to make limited peer comparisons. Mr. Berno noted Ohio's system was pretty unique given the Bureau's size; if a comparable enterprise of similar size may not be as diverse as the Bureau system. Finally, the funding policy should be tailored to each fund where a material amount of a fund's obligations are funded, as opposed to pay-as-you-go. Mr. Berno noted the pay-as-you-go funds included the Disabled Workers' Relief Fund, the Self Insured Employer Guaranty Fund (SIEGF), and the AC Fund.

Mr. Berno noted the funding ratio is defined by funded assets divided by funded liabilities. A funding ratio of 1.0 means there are enough assets to pay liabilities. The net leverage ratio, which is the industry standard, is defined by the premiums and reserves divided by net assets. If the funding ratio methodology is approved, both figures would be included monthly in the Enterprise Report.

To build a funding policy, Mr. Berno noted several steps are required. First, there must be an acceptable range for a funding ratio and a net leverage ratio. Second, metrics must be monitored as a component of the monthly Enterprise Report, or whatever similar financial report this Board of Directors, or future Board of Directors, develops. Third, recommendations have to be prepared and presented to address variations from the established range. Fourth, the funding policy must be reviewed and approved by the Board of Directors. Finally, the guideline range of the funding ratio and net leverage ratio must be reviewed on an annual basis. Mr. Berno noted this review would most likely be done in November or December because the audit of the fiscal year ending on June 30th would be completed in that time frame.

Mr. Berno provided a detailed chart of net assets, funding ratio, and the net leverage ratio based on the Bureau's available statistical data from 1998-2008. Mr. Haffey inquired if the figures only considered the State Insurance Fund, and Mr. Berno replied in the affirmative. Generally, Mr. Berno noted an inverse relationship between the funding ratio and the net leverage ratio; for example, a higher net funding ratio led to a lower net leverage ratio.

Mr. Berno next indicated several considerations in establishing a guideline range. First, statutory mandates require the Bureau maintain a solvent fund and the lowest possible premiums. Second, net assets can be increased in three ways: expense reduction, investment returns, and premiums. Third, a net asset range should be developed with regard to all underlying risks. These risks include general economic risks, legislation and judicial decisions, and catastrophic events, among others. Mr. Berno used the current economic events as an example where financial market swings have caused the net assets to fluctuate by $500 million in just one month. Finally, the minimal acceptable funding ratio guideline should be 1.00. Mr. Berno noted it may be possible for the funding ratio to go below 1.00, but as a guideline, anything lower than a 1.00 funding ratio would be difficult to justify. Ms. Valentino speculated the fund could be solvent with a funding ratio less than 1.00, but she believed the Bureau had a fiduciary responsibility. She opined, for the Bureau to have sound management in the funding policy, 1.00 is the absolute floor. To set a lower level less than 1.00 consciously, she believed, would simply not be prudent. Ms. Valentino noted this comment was why the lower guideline level was so specifically stated as an item for consideration.

Mr. Berno then proceeded with a peer comparison, which was developed using Ward's industry compilation. The comparison considered the ten largest private workers' compensation carriers and three other state funds in terms of funding ratios and net leverage ratios. In summary, the funding ratio for seven of the ten private companies was between 1.5 and 2.0.

Three private carriers maintained funding ratios over 2.0, and state funds maintained funding ratios between 1.0 and 1.5. With regard to net leverage ratios, eight of ten private carriers had a net leverage ratio of 4.0 or less, and state funds maintained net leverage ratios between 4.0 and 8.6. For funding ratios, he pointed out the Bureau was at 1.15, the New York State Insurance Fund (NYSIF) was at 1.44, California's workers' compensation fund (SCIF) was at 1.28, and the Washington Department of Labor and Industry (WDLI) was at 1.18. For net leverage ratios, Mr. Berno noted the figures were 7.93 for the Bureau, 4.50 for NYSIF, 3.92 for SCIF, and 8.59 for WDLI.

Ms. Valentino then presented a graphic of the strategy implications; basically, if a funding ratio range is set, data was provided as to how the net leverage ratio, net assets, total funded assets and total funded liabilities appear. Ms. Valentino showed these calculations in comparison to the current funding ratio, based on available data through April, and projected 2009 data, working under the assumption of a 4.5% discount rate. Ms. Valentino noted the graphic shows that once a funding ratio guideline is established, the next issue would be how to fall into, or maintain, the guideline through examining total funded assets. Ms. Valentino noted the funding ratio lines of 1.50 and 2.00 are private sector comparisons.

Ms. Falls asked for an actuarial discussion of these figures. Ms. Falls noted there may be a situation where, in consideration of preliminary reserve analysis, a discount rate of 4.5%, and medical information assumptions, there may be a decrease in net assets by $500 million, and thus no action may be required to achieve a lower funding ratio. While these figures are all still preliminary, Ms. Falls wanted this information for consideration that the Bureau may wish to seek a higher than 1.0 base for the funding ratio.

Mr. Matesich raised the issue of whether the guidelines/ranges for the funding ratio require a trend analysis. For example, if the funding ratio was noted to be going from 1.10 to 1.05 to 1.03, does that mean the Board of Directors needs to act, or is the system under control. Mr. Matesich believed this point was important to consider. He noted there has been documented volatility in the investment arena, and the principles are the same here, especially in consideration of setting premiums. Mr. Matesich wanted to know if there would be a "knee jerk" reaction to raising premiums based on the funding ratio, or if there would be a wait and see approach to see if a trend has shifted through the funding ratio. Mr. Haffey noted Mr. Bryan, Mr. Smith and himself have been discussing that topic. Ms. Valentino commented the funding ratio policy requires monitoring and examination of what factors are impacting the fund ratio. Ms. Valentino stated the fund ratio may require a longer term plan if the ratio were to go below 1.0, for example, due to market volatility. Ms. Valentino noted the discussion focuses on establishing the guidelines, but regular monitoring and regular analysis are required, so the Bureau is prepared over time to make, or not make, changes because of volatility in markets or medical costs. Mr. Smith suggested an analysis of continuing premiums and expenses under a standard deviation likelihood of falling below the 1.0 fund ratio on a regular basis. Mr. Berno remarked there is also an asset liability model (ALM) analysis that is performed every three to five years. Mr. Berno also said there would not be a " knee jerk" change in premiums on a month to month basis through changes in the funding ratio.

Mr. Haffey inquired to Mr. Bryan for any comments he would have on this topic. Mr. Bryan noted no one entity has this issue resolved given the investments have been impacted greatly in the last year. Mr. Bryan noted the Bureau is as far ahead as anyone else at this time. Ms. Falls further remarked short term volatility should be considered from a long term perspective under the guiding principles.

Ms. Falls also wanted to comment on Mr. Smith's standard deviation comments. Clearly, one to two standard deviations correlates to one to two billion dollars in market value. Hence, it might be reasonable to set a lower guideline value for the funding ratio slightly above 1.0, such as 1.03. Ms. Falls also noted increasing equity allocation in the Ohio State Insurance Fund will mean the fund is taking on more volatility.
Mr. Berno continued with the presentation by stating management is recommending that the guidelines for the funding ratio should have a range of 1.00 to 1.35. This range would place Ohio in a comparable position with other state funds, since seven of the ten private carriers were between 1.5 and 2.0. This guideline range for the funding ratio produces a corresponding net leverage ratio of 3.15 to 5.53. This net leverage ratio range places Ohio in a comparable position with other state funds, as eight of ten private carriers were at 4.0 or below.

Mr. Matesich inquired how the Bureau determined the net leverage ratio would be at 3.15 to 5.53 when the chart showed 1.20 corresponded to a 5.53 net leverage ratio. Mr. Matesich noted the 1.0 fund ratio would have a net leverage ratio much higher than 5.53. Ms. Valentino concurred with Mr. Matesich's statement. Mr. Matesich noted the net leverage ratio should be much higher, but not an infinite number. Mr. Haffey agreed with Mr. Matesich's comments, and clearly as the funding ratio goes to 1.0, the corresponding net leverage ratios become rather large numbers. Ms. Falls pointed out that keeping the funding ratio slightly above 1.0, such as 1.03, is something the Bureau needs to seriously consider; however, at the same time, monitoring the net leverage ratio and maintaining it below 5.53 would be triggered well before the funding ratio goes below 1.0.

Mr. Berno reported that this discussion has presented enough feedback and information that modifications can be made to the proposal. The next steps are to share a revised draft of the funding policy at the June, 2009 Board meeting, approve an established guideline range for a funding ratio and net leverage ratio at the July, 2009 Board meeting, and develop short-term and long-term plan for increasing the level of net assets over the next three to five years. .

Mr. Pitts inquired if the funding ratio is approved, the funding ratio is a tool to evaluate performance and not predict future outcomes. He indicated the funding ratio can be used to create a goal. Ms. Valentino agreed; the funding ratio is a goal, and guidelines will be set as narrow as can be defined under the Bureau's comfort zone. Ms. Valentino noted the range could be as small as 1.04 to 1.05, but this may occur down the road once the Bureau knows how to act in order to achieve that range and maintain it. The funding ratio is a tool in the decision making process, and it's a point of reference in a wide range. Where the Board of Directors wants to be within the guideline range with the funding ratio is a decision the Board of Directors will make. Ms. Valentino's recommendation is to be in the middle of the set guideline range. Ms. Valentino noted the funding ratio needs to be considered with the investment policy of generating better returns for the Ohio State Insurance Fund with lower volatility. In summary, Ms. Valentino reiterated the funding ratio is a tool, but the funding ratio needs to be examined on a short and long term basis as to how the Bureau will reach the middle of the guideline range and maintain being there. Ms. Valentino remarked Deloitte told the Bureau directly the State Insurance Fund did not have enough net assets, and this needed to be considered in determining the range of the funding ratio.

Mr. Pitts indicated the funding ratio is a snapshot over a period of time, not necessarily to increase assets, but more to keep within a guideline range. Once the initial increase in net assets is done, the concern focuses more on maintenance of the funding ratio. In other words, Mr. Pitts commented, in the short term the goal is to develop a plan to increase net assets to obtain a desired funding ratio; long term, the goal shifts to a maintenance of the net assets to maintain the funding ratio. Mr. Smith commented that, at one point in the future, the Bureau will be at the high end of the funding ratio's guideline range. Mr. Smith noted that dividend policy and premium stability policy will flow from the funding policy. Mr. Bryan agreed with Mr. Smith, that there will be a consideration of where the Bureau wants to be in terms of price stability. By forcing the framework of having a funding ratio in a guideline range, the Bureau can decide whether or not dividends are appropriate. Dividends can become a sensitive issue because the dividends also tie into future pricing if net assets have to be increased, and Mr. Bryan was not sure of the reaction that decision would create.

Administrator Ryan commented as to whether or not catastrophic risks are sufficiently being considered in the discussion. Administrator Ryan noted there is a potential need for catastrophic coverage by the Bureau. Mr. Haffey commented the process has begun, but over time, the Board of Directors will become smarter in dealing with the fund ratio/net asset level issue. Mr. Berno commented he would not be surprised if the net asset range significantly narrows over time. Administrator Ryan, while not disagreeing with Mr. Berno, believed the narrowing issue might not be for three to five years or longer.

4. 50/50 PROGRAM

Ms. Valentino also appeared before the Audit Committee to discuss the 50/50 Program. At the onset, Ms. Valentino noted there will be a change in the due date for July/August reporting required by November 1st. Ms. Valentino noted the possibility of changing the due date to December 1st if the rule change as proposed is approved.

Ms. Valentino said a significant number of employers are participating in the 50/50 program, and this trend is expected to continue. The 50/50 Program allows employers to report payroll and pay one-half of premiums by the regular due date applicable to the reporting period. Employers must report and submit payment online. The remaining balance is paid online by participating employers no later than two months following the regular due date (currently June 1st or November 1st).

To illustrate the size of the program, Ms. Valentino noted there are approximately 21,000 employers, representing $353 million in premiums, participating in the 50/50 program. The premium breakdown of the participating employers included 750 employers that made the minimum premium payment of $50 and 2,100 who paid $499 or less in premiums. The range of premiums for participating employers goes up to $2.5 million, with most employers owing less than $20,000 in premiums. With regards to payroll, the highest payroll for a participating employer was $68.5 million, with the lowest payroll reported being none. Most payrolls for participating employers were in the range from $10,000 to $300,000. With regard to manual classifications, 6,000 of the participating employers had one reported manual classification, with the majority reporting payroll under three or fewer manual classifications. In one instance, a participating employer reported 264 manual classifications, and Ms. Valentino did not have an explanation for that one employer’s abnormally high number of manual classifications.

Ms. Valentino noted the 50/50 program requires employers to file payroll reports online for both halves of the reporting period. Ms. Valentino did not have the most recent results for the Audit Committee as the current deadline was on June 1st. Ms. Valentino noted the 50/50 Program was showing participation by employers in every segment of the population.

Ms. Valentino noted her presentation of the rule change came before the Audit Committee at this meeting because the Bureau was currently printing new payroll reports. Given the date change from November 1st to December 1st proposed in the rule, the Bureau has to instruct the vendor accordingly of any due date change that is approved.

Mr. Lhota inquired why the rule has dates spelled out instead of using a calendar notation. Mr. James Barnes, Chief Legal Officer, responded he would research the issue and provide a response to Mr. Lhota the next day.

Mr. Lhota then moved that the Audit Committee recommend that the Bureau of Workers' Compensation Board of Directors approve the Administrator's recommendations to amend rule 4123-17-14.2 of the Administrative Code, Bureau 50/50 Program, and the motion consented to the Administrator amending the rule as presented at the meeting. Mr. Harris seconded the motion, and the motion passed by a 5-0 unanimous roll call vote.

Mr. Haffey inquired to Ms. Valentino if the Bureau was seeing a lot of activity in the 50/50 Program near the upcoming deadline. Ms. Valentino could not provide an answer, but she would research the issue and respond back to Mr. Haffey.

DISCUSSION ITEMS

1. FY 2009 3rd QUARTER EXECUTIVE SUMMARY

Ms. Caren Murdock, Chief of Internal Audit, appeared before the Audit Committee to provide her Quarterly Executive Summary (QES) for the third quarter. She told the Audit Committee her staff was always developing ways to improve the document, and this quarter a table of contents and a list of acronyms was added.

Ms. Murdock began her discussion of audit findings by her department with the Fleet Management Audit. There were eight significant comments resulting from this audit.

Ms. Murdock first reported one significant weakness comment was the State of Ohio requires vehicles to be salvaged at 90,000 miles. The audit revealed 125 out of 336 vehicles used by the Bureau exceeded this mileage requirement. The recommendation was a vehicle needs analysis should be performed, with consideration of purchasing new vehicles as opposed to repairing older vehicles. Another significant weakness comment was that Ohio law prohibited reimbursement to state employees of any mileage incurred above the break-even amount, which is 7,514 miles for FY2009. Ms. Murdock noted there were many underutilized vehicles not exceeding break even miles assigned to various employees. The audit recommended reallocation of vehicles. Third, the Fleet Management Audit revealed twelve of thirty monthly vehicle reports reviewed were not completed accurately. Ms. Murdock said there was no supervisor review required, and this finding decreased Internal Audit's confidence that the reports are accurate. The recommendation made was that management must provide controls to ensure the reports are completed accurately.

Mr. Matesich inquired about the insurability audit comment. This comment noted state law required all drivers maintain liability insurance; however, the Bureau does not verify this information. Mr. Matesich believed this audit finding was critical, that the Bureau should verify drivers of its vehicles have liability insurance. Ms. Murdock replied her department's findings and Mr. Matesich's statement are on the same lines; however, management believes the risk is not high, but she would follow-up with regard to Mr. Matesich's comments.

The next audit discussed by Ms. Murdock was the results from the Employer Policy Applications Process (EPAP) Audit. Ms. Murdock noted 30,000 employer applications are processed each year, with about half online and half through lock boxes. The audit revealed eleven significant and five minor comments. Ms. Murdock noted controls could be strengthened to reduce processing times, prevent duplication of policies, and increase revenues.

Ms. Murdock presented four of the comments from the EPAP Audit to the Audit Committee. First she noted policy for Prior to Coverage payroll reports appeared limited in view of Ohio law, and the policy may result in lost revenue for the agency. This comment was identified as a significant weakness. Ms. Murdock reported the Bureau may recover premiums for the entire period an employer misrepresented payroll or the entire period an employer failed to report payroll. The recommendation was to modify the policy to allow Prior to Coverage payroll reports back to the initial date the employer was under obligation to obtain workers' compensation coverage, and not limit the policy to a two year look back. The second comment was also a significant weakness. Ms. Murdock reported the EPAP Audit revealed employer policy applications were being submitted online; however, the data needs to be manually rekeyed into the Workers' Compensation Information System (WCIS) even though the data was already received electronically. Furthermore, there was no requirement in the online application that the user provide a valid email address. Ms. Murdock recommended a database interface be developed to avoid rekeying data and maintaining data accuracy, as well as requiring a valid email address in the online application process.

Ms. Falls inquired as to whether or not management found the recommendation not cost justifiable. Ms. Falls found it difficult to comprehend why management would resist this change. Ms. Murdock replied management is analyzing the costs benefits of implementing corrective action, and prioritizing their projects according to available resources. Tina Kielmeyer, Chief of Customer Service, believed there was a great benefit in the recommendations in this audit finding; however, from an IT perspective, the Bureau is required to use the same resources that are addressing rating issues. For this reason, the Bureau has pushed back the implementation date on this comment until January, 2011. Ms. Kielmeyer said the Bureau was excited about the idea, but needed to prioritize the issue. Ms. Falls asked if the delay was an IT resources constraint, and Ms. Kielmeyer responded in the affirmative. Mr. Raymond Mazzotta, Chief Operating Officer, added the WCIS policy system was really old, and there is a ongoing debate to determine if the system should be scrapped or used as a building platform.

The next significant weakness discussed by Ms. Murdock from the EPAP Audit concerned posting of funds received from the service offices. Ms. Murdock reported about $90 million in premiums are received in the local service offices, and there is no formal reconciliation or other controls in place to ensure payments received in the service offices are deposited to the Bureau's bank account and posted to WCIS. The recommendation required the service offices periodically trace a sample of payments received at their offices to the WCIS payment history screen. The last comment Ms. Murdock discussed with the Audit Committee concerned an identified significant weakness in policy processing. The audit revealed there was no requirement that applications be processed in a first-in-first-out (FIFO) manner, and account examiners had ability to select which individual applications they wanted to process first. This assignment method led to account examiners processing less complicated applications first, and more complicated applications not being processed timely. As a result, 23% of all applications took longer than sixty days to process. Ms. Murdock recommended management develop controls, so applications are processed in the order received, either by supervisor assignment of work to account examiners, or other system controls that require account examiners to process the next oldest applications.

Mr. Mazzotta commented the agency processes 30,000 employer policy applications per year, and for most of them, this encounter is their first experience with the Bureau. He indicated it was unacceptable to have, in some cases, up to 90 days to process an application. Mr. Mazzotta reported this comment's recommendation may be the next Kaizen event. Mr. Haffey agreed this recommendation would be a good fit for Kaizen, and Mr. Mazzotta noted he has received favorable feedback from the State. Ms. Murdock added one of her internal auditors would participate on the Kaizen project.

The next audit discussed by Ms. Murdock was of a managed care organization (MCO). The first significant weakness identified in the audit was that case managers for the MCO were not consistently maintaining timely contacts with employers, injured workers and employers. The recommendation from the audit was that MCO management institute a case manager training program to provide assurance of timely communication among these groups. The second significant weakness discussed by Ms. Murdock concerning this audit was that the audit identified an improper level of login and password security for prevention of unauthorized access to MCO systems. The recommendation from this comment was to revise password security and log in controls to prohibit reuse of prior passwords and increase password length to eight characters, including the use of numbers and special characters.

Ms. Murdock then presented the findings from the Auto Adjudication (AA) Audit. Ms. Murdock noted AA is an automated process with rule sets to evaluate claim data. AA is designed to identify claims with low medical costs and low rates of appeal. AA allows Medical Claims and Customer Service Specialists to devote more time to difficult claims. Ms. Murdock noted AA does not deny a claim; it either passes it or not. If AA does not pass a claim, the claim goes to a Medical Claims or Customer Service Specialist for further determination.

Ms. Murdock said, overall, AA functions as intended, but there are insufficient controls in place. Ms. Murdock discussed three comments from the audit. The first comment, a material weakness, Is that AA has no formal oversight to ensure rule set changes are approved and implemented properly due to the "hands free" nature of AA; however, there is a need for a formal approval process. The audit revealed management was not consistently reviewing AA reporting. Ms. Murdock reported AA allows almost 30% of all claims, and if rule sets were changed, a major effort would be required to correct the error. The recommendation from this audit finding was to develop a review and approval process for changes to AA rules. Ms. Murdock specifically noted management disagreed with the rating of this comment.
The next two comments were identified as significant weaknesses. The first comment recognized AA was not prepared to handle ICD-10 codes. Ms.

Murdock noted this comment actually was a Bureau-wide problem, not singled out to AA. The recommendation from the comment was that a project team be established to monitor compliance data for ICD-10 conversion. The final comment discussed by Ms. Murdock noted the audit revealed that the claims processing system does not sufficiently verify the validity of Social Security Numbers (SSNs). Ms. Murdock reported invalid SSNs provide a higher risk for fraud, and the SSNs are used to identify duplicate claims. Furthermore, valid SSNs are required for new Medicare reporting requirements, and the Bureau could be subject to penalties for inaccurate Medicare reporting. The recommendation for this comment was for the Bureau to improve strategies to reduce the risks identified.

At this time, Mr. Matesich inquired for clarification, using comment #3 on page 10 of the third quarter QES as an example. In the disposition section of this comment, it states "management mostly concurs." Mr. Matesich wanted to know what happened, as in the case here to an extent, if management and internal audit agree to disagree. Follow-up to the comments will document what action is being taken by management. The follow-up is important to the Board of Directors because Ms. Murdock brings issues to the Board of Directors that management needs to address either by taking corrective action or by accepting risk. Ms. Murdock also stated Administrator Ryan pays close attention to the comments and follows up with them at senior staff meetings to ensure the comments are being addressed by management. Ms. Murdock indicated her staff follows up on all outstanding comments each quarter, and there are instances where management has agreed to accept risk. If management accepts the risk, the comment is presented to Administrator Ryan and then to the Board of Directors.

Mr. Pitts inquired regarding the comment in the AA Audit concerning ICD-9 conversion to ICD-10. Mr. Pitts believed this comment was a very significant issue, but also a large project involving significant funds, time and effort. Ms. Murdock replied management immediately began to address the comment.

The next audit findings discussed by Ms. Murdock were the results from the Resource Access Control Facility (RACF) Audit. RACF protects the Bureau's key applications and related databases. There were four significant weakness comments and two minor weakness comments resulting from this audit. The significant weakness noted by Ms. Murdock revealed the Bureau's masking algorithm has not been updated since installation in 1992. Passwords not properly encrypted lead to more susceptibility to discovery. The recommendation from this comment was that management does a cost benefit analysis to determine if upgrading to Data Encryption Standard (DES) algorithm is feasible.

Mr. Haffey noted the RACF Audit was led by the Bureau's IT internal auditors who, in two to three weeks, will be performing these types of audits for OBM. Ms. Murdock concurred that, on June 22nd, the Bureau's IT internal auditors will be reporting to OBM. OBM will be performing these audits in the future, and her staff will work closely with OBM.

Mr. Lhota noted many acronyms regarding rating were being used, and he inquired to the definition of "significant" or "material." Ms. Murdock referred him to the definitions on p.31 of the third quarter QES.

Ms. Murdock then briefly touched on the outstanding comments. Ms. Murdock noted 27% of comments outstanding were over two years old, and 73% were less than two years old. She referred the Audit Committee to pages 13-29 of the third quarter QES for updates on all outstanding comments as well as two charts provided to the Audit Committee updating the validation progress of outstanding comments.

Mr. Haffey appreciated Ms. Murdock's presentation, and he noted there were five significant sized audits completed in the past quarter with 34 comments. Mr. Haffey stated there were regular, and even weekly, conversations to clear the outstanding comments, and the chart demonstrates a tightening down. Furthermore, Mr. Haffey reported the QES reports provided to the Audit Committee are a summary of the audit findings. Mr. Haffey stated he receives an even more detailed report than the QES. Mr. Harris recommended, in the future, Ms. Murdock be allowed to present first on the agenda. Mr. Haffey agreed with Mr. Harris.

Ms. Murdock stated she needed to discuss one more subject with the Audit Committee. She referred the Audit Committee to the first paragraph of page 30 of the third quarter QES. Ms. Murdock noted her department and management have a good process in place to discuss outstanding comments. At this time, Ms. Murdock needed to report on six outstanding comments wherein management has agreed to accept the risk. Ms. Murdock noted if she had any concerns about management accepting risk on an outstanding comment, she would present her concerns and opinion; however, with all six comments presented today, she was comfortable with management's explanation for accepting the risk. The risks were accepted by management: in three instances, due to required legislative changes needed; in two instances, due to the need for a program review; and in one instance, due to a budget constraint.
The six outstanding comments where the risks were accepted by management, with the basis for acceptance, are as follows, with page numbers corresponding to the third quarter QES:

Page 5, EPAP Audit, Comment #2, which recommended revising the minimum premium security deposit. The current minimum was in compliance with the law, and management planned no further action. (Legislative change.)

Page 13, Bankrupt Self Insured Audit, Comment #1, which related to offsetting Permanent Total Disability compensation for an injured worker receiving Social Security retirement. (Legislative change.)

Page 15, Claims Operational Review Audit Comment #2, which recommended enhancing the Version 3 (V-3) computer system to link an injured worker with multiple claims to the same case manger or team. This recommendation required a large IT change. (Budget constraint.)

Page 17, Salary Continuation Program Audit, Comment #7, which recommended developing a referral system to track employers not in compliance with salary continuation policy. The program was under review and was inclusive of the Deloitte recommendations. (Program review.)

Page 20, Retrospective Rating Audit, Comment #1, which recommended evaluation of objectives and requirements of the program, including consideration of eliminating the allowance of any employer who was financially unstable. The program was under review and was inclusive of the Deloitte recommendations. (Program review.)

Page 24, Lump Sum Settlement Audit, Comment #14, which recommended review of other state statutes for compensation of injured worker attorneys to determine best practices. (Legislative change.)

2. **COMMITTEE CALENDAR**

Mr. Haffey briefly discussed the Audit Committee's calendar. Through working with several people, the calendars now have a level of detail which the Audit Committee never had before. Mr. Haffey noted draft agendas have been developed through December, 2009.

ADJOURNMENT

Mr. Haffey moved to adjourn the meeting at 6:06 PM, seconded by Mr. Smith. The meeting adjourned with a 5-0 unanimous roll call vote.

Prepared by Michael J. Sourek, Staff Counsel
June 2, 2009