BWC Board of Directors
Audit Committee

FY 10 2nd Quarter Executive Summary Report

March 25, 2010

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To: Audit Committee Members

From: Caren Murdock, Chief of Internal Audit

Date: March 25, 2010

Fiscal Year 2010 2nd Quarter Executive Summary report

Following you will find the Fiscal Year (FY) 2010 2nd Quarter Executive Summary (QES) Report containing:

1. Audit Comment Status
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BWC Internal Audit Division
Consulting Project Activity – 2nd Quarter Activity

Pending available resources, the Internal Audit Division (IAD) performs consulting projects for management when requested. Consulting services do not necessarily seek to attest or provide assurance; rather, they are advisory in nature and the scope is agreed upon with the client. Management assumes the risk for implementing or not implementing the recommendations. Consulting services are intended to add value and improve an organization's governance, risk management and control processes without the internal auditor assuming management responsibility. IAD does not opine on the process controls as a whole.

Drug Utilization Review - January 2010

The BWC IAD conducted a consulting review of the Drug Utilization Review (DUR) process. The BWC pharmacy program recently underwent several internal and external reviews. In the context of the resulting recommendations, management requested that IAD provide guidance for the retrospective DUR function within the pharmacy program. The scope of this review included the retrospective DUR function only, and did not include the prospective or concurrent drug utilization reviews. IAD's review sought to address the following questions:

- Are the purpose, scope, and scale of the DUR program consistent with peer organizations and industry standards?
- Is the DUR process appropriate to accomplish the purpose and goals of the current DUR program?
- Are procedures for the current DUR program adequately designed and operating as intended?

Consistent with management's continuous improvement efforts, IAD provided 10 recommendations to improve programmatic governance, strengthen internal controls and improve the efficiency and effectiveness of the DUR process.

Self Insured Audit Process - February 2010

IAD conducted a consulting review of the Self-Insured Audit (SIA) process. Management requested that IAD review the SIA process for the purpose of evaluating its effectiveness and identifying potential efficiencies. The following objectives were agreed upon:

- Evaluate the SIA audit selection process against best practices;
- Review SIA process governance and reporting;
- Assess if SIA activities adequately address key areas of Self-Insured (SI) Employer compliance and risk to the (BWC) and Injured Workers (IW);
- Evaluate if audits are performed in an efficient manner;
- Determine if SIA supervisory review procedures are conducted in an effective and efficient manner;
- Evaluate controls over the IW complaint resolution process; and

- Determine if current SIA position descriptions include critical job skills.

Consistent with management's continuous improvement efforts, IAD provided 14 recommendations to improve internal controls, compliance, and efficiency and effectiveness of the process.

BWC Internal Audit Division
Audit Comments Issued – 2nd Quarter Activity

Employer Workers' Compensation Insurance System (WCIS) Credit Transactions Audit – January 2010

The BWC IAD conducted an audit of Employer WCIS Credit Transactions, which include various transactions that result in a reduction in amounts owed by employers. The purpose of the audit was to assist management in evaluating Employer WCIS Credit Transactions.

The audit scope consisted of transactions completed between April 1, 2008 and March 31, 2009. The audit included:

- Obtaining an overall understanding of BWC policies, procedures, and statutory requirements for the Employer WCIS credits process; and
- Identifying and documenting both manual and automated control activities in place and determining the adequacy and operating effectiveness of existing controls.

	Recommendation	Disposition
1	Perform an examination of the existing processes for claim cost transfers and develop controls to provide assurance that such transfers only occur when valid and properly authorized. **Rating: Material Weakness**	Management will commence mapping the process for claims cost transfers in January and plans to have new policies and procedures in place by the end of 2010. **Responsible**: **Chief of Customer Services** **Target Resolution Date: December 2010** **Current Resolution Status: In Process**
2	Revise premium audit procedures to require copies of pertinent employer payroll records be obtained and included in audit workpapers. **Rating: Significant Weakness**	Management will identify the resource requirements to support records capture in some premium audit workpapers and will develop policies outlining the criteria for which audits will require supporting documentation. **Responsible**: **Chief of Customer Services** **Target Resolution Date: July 2010** **Current Resolution Status: In Process**
3	Revise premium audit policies and procedures to establish a mechanism for ensuring that all reviews of audits with findings greater than $50,000 take place and require sign-off by the Director of Underwriting & Premium Audit to evidence involvement in the review of audit findings over $250,000. **Rating: Significant Weakness**	Management will update auditing policies and procedures to include review of all audits over $50,000 and require Director sign off on all audits over $250,000. **Responsible**: **Chief of Customer Services** **Target Resolution Date: March 2010** **Current Resolution Status: In Process**

	Recommendation	Disposition
4	Revise premium audit policies to require review of audit findings of less than $200 on a sample basis and reconsider the dollar threshold for the posting of such findings to WCIS. **Rating: Significant Weakness**	Management will revise the audit review process to incorporate a review of a sample of "No Findings Without Classification Changes" and "Insignificant Findings Without Classification Changes" audits. **Responsible**: **Chief of Customer Services** **Target Resolution Date: April 2010** **Current Resolution Status: In Process**
5	Revise the Quality Assurance (QA) process for manually posted premium audits to require the supervisor performing the audit to select the sample rather than the employee processing the transactions. **Rating: Significant Weakness**	Management will modify the review process to require the Underwriting Supervisor to obtain a listing of all audit findings requiring manual keying into WCIS and test a 10% sample of the audits to verify the accuracy of posting to WCIS. **Responsible**: **Chief of Customer Services** **Target Resolution Date: February 2010** **Current Resolution Status: In Process**
6	Revise premium audit policies and procedures to provide guidelines for a consistent estimated audit methodology. **Rating: Significant Weakness**	Management will develop policies and procedures for the estimated audit process. The procedures will include guidance for the documentation of estimated audits and a review process. **Responsible**: **Chief of Customer Services** **Target Resolution Date: June 2010** **Current Resolution Status: In Process**
7	Revise the QA process for the "PA Adjustments" report so that all significant transactions are subject to independent review. Develop a QA review process for the transactions processed by the supervisor performing the weekly review of the report. **Rating: Significant Weakness**	Management will establish achievable goals for review of transactions appearing on the "PA Adjustments" report and will modify policies to ensure proper review and documentation. **Responsible**: **Chief of Customer Services** **Target Resolution Date: April 2010** **Current Resolution Status: In Process**
8	Implement a reporting system and a supervisory QA review process for non-compliance claim credit transactions processed in the Adjudication Unit. **Rating: Significant Weakness**	Each month, the manager will review 10% of the transactions created by Adjudicating Unit employees. Such review will include determining whether written documentation is provided for WCIS or Version 3 (V3) adjustments and the adjustment is justified through claim activity. The report will be kept for two years. The manager will report all non-documented or non-justified adjustments to his supervisor for further review. **Responsible**: **Chief Legal Officer** **Target Resolution Date: March 2010** **Current Resolution Status: In Process**

Recommendation		Disposition
9	Implement control procedures to provide additional assurance that the accounts to be written off are appropriate. **Rating: Significant Weakness**	Management will draft policies and procedures for completing a reconciliation of the file for writing off accounts identified as cancel uncollectible to the file of accounts received from the Attorney General and implement reconciliation procedures. **Responsible**: **Chief of Fiscal and Planning** **Target Resolution Date: April 2010** **Current Resolution Status: In Process**
10	Develop written procedures for Collections and Direct Billing Unit QA reviews and document transactions selected for detailed examination. **Rating: Significant Weakness**	Management will draft and implement formalized policies and procedures for completing QA reviews. **Responsible**: **Chief of Fiscal and Planning** **Target Resolution Date: February 2010** **Current Resolution Status: In Process**
11	Revise the QA process over transactions processed by the Accounts Receivable (AR) Manager to include reporting of transactions processed to the next level of management and a review of such transactions for appropriateness and accuracy. **Rating: Significant Weakness**	Management will draft and implement formalized policies and procedures for completing QA reviews for transactions processed by the AR Manager. **Responsible**: **Chief of Fiscal and Planning** **Target Resolution Date: March 2010** **Current Resolution Status: In Process**
12	Improve controls to provide assurance that only properly authorized safety council rebate and performance bonuses are issued. **Rating: Significant Weakness**	Management will revise the safety council rebate process to include an independent reconciliation between the file from which the audit sample is selected and the file provided to IT and update FY10 rebate program policy to more clearly outline intended policy. **Responsible**: **Chief of Customer Services** **Target Resolution Date: January 2010** **Current Resolution Status: In Process**

Overall, internal controls for employer WCIS credit transactions did not appear to be reasonably designed to help ensure that transactions are processed completely and accurately.

Investment Accounting Audit – February 2010

The BWC Internal Audit Division conducted an audit of the Investment Accounting unit. The purpose of the audit was to assist management in evaluating the design of controls over the Investment Accounting process and verifying these controls were implemented from October 1, 2008 to September 30, 2009. The audit included:

- Determining if current controls over investment accounting are adequately designed and implemented;

- Evaluating the adequacy of quality assurance procedures in place over the processes;
- Assessing the accuracy of portfolio valuations and investment performance as reported to agency stakeholders;
- Verifying investment accounting transactions are recorded accurately, timely and completely; and
- Assessing the timeliness and accuracy of reconciliations for monthly investment values, monthly performance, weekly holdings for Treasurer of State and daily cash reconciliations.

Overall, internal controls for the investment accounting process appear to be reasonably designed and operating as intended to help ensure that investment transactions and events are accounted for appropriately and performance reporting is reasonably stated. The audit identified four minor recommendations to further enhance existing controls. These recommendations include a more detailed review of investment income, further formalizing supervisory reviews of investment accounting control procedures, clarification of quality assurance procedures over the Treasurer of State's confirmed reconciliation, and incorporating the investment consultant's performance results into the monthly performance reconciliation.

Fixed Asset Audit – February 2010

The BWC IAD conducted an audit of Fixed Assets, which include processes for asset additions, transfers and disposals. The audit scope consisted of fixed assets processed between September 1, 2008 and October 31, 2009. The audit included:

- Obtaining an overall understanding of BWC policies, procedures, and statutory requirements for the fixed asset process;
- Interviewing management and staff personnel;
- Developing workflows and/or narratives to document our understanding of the processing activities;
- Identifying and documenting both manual and automated control activities currently in place and determining the adequacy and operating effectiveness of existing controls; and
- Performing detailed testing to assess overall compliance with BWC policy and procedures relating to the fixed asset process.

	Recommendation	Disposition
1	Develop written procedures for the physical inventory process and ensure that it is performed over a shorter timeframe. Develop formal, cross-functional investigative procedures for items not found during the inventory. Modify the reporting process of	Management will create written physical inventory procedures, investigate means of reducing physical inventory time to a minimum, and develop formal investigative procedures for not-found assets. **Responsible**: **Chief Information Officer**

	Recommendation	Disposition
	inventory results to improve transparency. **Rating: Significant Weakness**	**Target Resolution Date: June 2010** **Current Resolution Status: In Process**
2	Improve controls over inventory transfers. Create standard transfer documentation formats, implement a supervisory sign-off requirement for transfers, and formalize asset transfer policies in the BWC employee handbook. **Rating: Significant Weakness**	Management will evaluate options for improving controls over inventory transfers. **Responsible**: **Chief Information Officer** **Target Resolution Date: June 2010** **Current Resolution Status: In Process**
3	Modify the Oracle asset management system to comply with State policy or acquire another more capable application. **Rating: Significant Weakness**	Management will investigate compensating controls and/or look into alternative solutions. **Responsible**: **Chief Information Officer** **Target Resolution Date: June 2010** **Current Resolution Status: In Process**
4	Improve controls over component parts, including inventory records for all portable components over a given cost threshold, establish written policies and procedures, and improve data integrity controls. **Rating: Significant Weakness**	Management will investigate ways to comply, including supplemental records. **Responsible**: **Chief Information Officer** **Target Resolution Date: June 2010** **Current Resolution Status: In Process**
5	Develop written procedures for the QA reviews performed by the Inventory Control Officer that include a requirement to document the items selected for examination and a description of the minimum steps to be performed. **Rating: Significant Weakness**	Management will begin documenting the QA review process and ensure documents are retained for subsequent review. **Responsible**: **Chief Information Officer** **Target Resolution Date: June 2010** **Current Resolution Status: In Process**
6	Restrict access to furniture, equipment and supplies to individuals responsible for them. Take steps to ensure that furniture transfers are properly authorized, documented and tracked. **Rating: Significant Weakness**	Management will restrict warehouse access to those responsible for maintenance and delivery of furniture, equipment and supplies, and a small number of other staff requiring access to the area. Alternatives to securing excess furniture items will be investigated. **Responsible**: **Chief Information Officer** **Target Resolution Date: June 2010** **Current Resolution Status: In Process**
7	Restructure, or otherwise supplement, the Inventory Control Unit to provide for adequate segregation of duties and compliance with State policy. **Rating: Significant Weakness**	Management will investigate potential solutions to improve segregation of duties issues. **Responsible**: **Chief Information Officer** **Target Resolution Date: June 2010** **Current Resolution Status: In Process**

Recommendation		Disposition
8	Design and implement a formal monthly reconciliation process to account for any differences between the assets added to the Oracle system and total purchases reported in the Equipment Payment Reports. **Rating: Significant Weakness**	Management will begin preparing and documenting the reconciliation. **Responsible**: **Chief Information Officer** **Target Resolution Date: April 2010** **Current Resolution Status: In Process**

Our audit identified a number of areas in which controls could be strengthened or procedures improved in order to help ensure the validity and accuracy of fixed asset reporting. While controls over the tagging of fixed assets purchased appear adequately designed, other controls over asset transfers, the performance of the annual physical inventory procedures, and the related research and resolution of items not found, did not appear adequately designed. The audit also identified one minor recommendation for management's consideration.

BWC Internal Audit Division
Outstanding Audit Comments as of December 31, 2009

Note: Comments designated as "Implemented" are based on managements' assertions and have not been validated by Internal Audit.

Medical Billing and Adjustments – May 2006

	Recommendation	Disposition
1	Implement a systematic process to ensure all eligible medical adjustments are identified and reviewed by the Employer Rate Adjustment unit to determine if an employer rate adjustment is needed. **Rating: Significant Weakness**	The Actuarial Rate Adjustment unit worked with IT on the design, development and implementation of the Automated Medical Cost Adjustment process in the Rates and Payments System (R&P). An error was identified during the first run. Actuarial is working with IT to further research the programming issues and/or operational scenarios that created issues with the automated adjustment process. A meeting has been scheduled to discuss the issues, at which time a decision will be made to either reinstate the automated process, or adopt an alternative approach to ensure that the Rate Adjustment unit is notified of adjustments impacting an employer's experience. **Responsible**: **Chief Actuarial Officer** **Target Resolution Date: March 2010** **Previous Target Date(s): March 2007, September 2007, March 2008, September 2008, December 2008, April 2009, December 2010** **Current Resolution Status: In Process**
2	To ensure the current interest payment methodology operates in accordance with statutory requirements, management should obtain clarification regarding interest payment calculation and ensure Medical Invoice Information System and Cambridge Systems calculations are consistent. **Rating: Significant Weakness**	The interest payment methodology was implemented December, 2009. Internal Audit is in the process of validating this recommendation with the Medical Services Division. **Responsible**: **Chief of Medical Services and Compliance** **Target Resolution Date: December 2009** **Previous Target Date(s): July 2007, September 2008, December 2008, March 2009** **Current Resolution Status: Implemented**
3	Consider converting all medical payments to the Cambridge system and prioritize the elimination of the MIIS	The Health Partnership Program Systems Vendor request for proposal (RFP) will address this issue as well as the future

Recommendation		Disposition
	system. **Rating: Significant Weakness**	vision for medical bill payment processing. **Responsible**: **Chief of Medical Services, Chief Information Officer** **Target Resolution Date: June 2011** **Previous Target Date(s): December 2007, June 2008** **Current Resolution Status: In Process**

Risk/Employer Operational Review – June 2006

Recommendation		Disposition
1	Partner with other agencies to conduct system cross-checks to identify non-complying and non-covered employers. **Rating: Material Weakness**	Management will staff the third region partially and supplement excess need by deploying investigations to appropriate BWC personnel on a case by case basis. **Responsible**: **Chief of Customer Services** **Target Resolution Date: March 2010** **Previous Target Date(s): December 2006, December 2007, April 2008, August 2008, March 2009, June 2009, October 2009** **Current Status: In Process**
2	Consider increasing either the Premium Security Deposit (PSD) or Minimum premium to compensate for potential losses incurred by BWC. **Rating: Material Weakness**	The Deloitte Study recommended examining the feasibility of raising the minimum premium, conducting further analysis of the characteristics of minimum premium employers, and increasing premium audit functions to address potential underreporting or fraud. Management will further analyze this issue and the problems inherent in the minimum premium employer population. **Responsible**: **Chief Actuarial Officer** **Target Resolution Date: July 2011** **Previous Target Date(s): December 2006, June 2007, December 2007, December 2008** **Current Status: In Process**

Manual Override – December 2006

Recommendation		Disposition
1	Resolve the current rating inequity between group rated and non-group rated employers. Also, adopt standard controls to prevent rate manipulation by	Beginning July 1, 2010, the non-group employer base rates remain at appropriate levels without the effect of group discounts. The credibility table and

	Recommendation	Disposition
	employer groups. **Rating: Material Weakness**	group breakeven factor have been adopted by the Board of Directors (BOD) for policy year July 2010. The rate change indication, the 100% Experience Modifier cap and the possible adjustment of the group breakeven factor will be presented to the BOD in the spring of 2010. Senate Bill 213 threatens the progress discussed above for policy year 2011. **Responsible**: **Chief Actuarial Officer** **Target Resolution Date: July 2011** **Previous Target Date(s): January 2007, June 2007, July 2009** **Current Status: In Process**

IT and Application Controls Risk Assessment – January 2007

	Recommendation	Disposition
1	Implement security violation monitoring by using trending or advanced analysis for violation enforcement. **Rating: Material Weakness**	IT has identified a team to address additional deliverables identified during discussions with the IT auditors. The BWC application risk assessment has been initiated and should be completed in January. **Responsible**: **Chief Information Officer** **Target Resolution Date: April 2010** **Previous Target Date(s): March 2008, June 2008, August 2008, December 2008, March 2009, June 2009, September 2009** **Current Resolution Status: In Process**

Pharmacy Benefit Manager (PBM) Audit – May 2007

	Recommendation	Disposition
1	Develop and implement a plan to strengthen oversight and improve management of the program. **Rating: Significant Weakness**	BWC is utilizing the expertise of our PBM to assist in the review of our clinical program. Recently, the PBM submitted a surveillance report on controlled substance utilization. This report will be used by BWC to target areas for improvement. Also, BWC has obtained several reports on Workers' Compensation pharmacy trends and statistics. BWC will compare the BWC pharmacy program results with some of the key metrics published. BWC is

	Recommendation	Disposition
		evaluating the QA and monitoring plan. One tool currently being implemented is the clinical edits program which will provide monthly reporting of edits implemented. Outcomes from these reports will be trended and compared to data from the PBM's national database. This information will be shared quarterly with the Pharmacy and Therapeutics Committee who will oversee the quality of the clinical edits program. Reports are being developed for on-going QA and monitoring. **Responsible**: **Chief of Medical Services and Compliance** **Target Resolution Date: September 2010** **Previous Target Date(s): September 2007, December 2009** **Current Status: In Process**
2	Periodically test transactions to ensure discounts are passed to BWC. **Rating: Significant Weakness**	BWC is working with the rebate aggregator to validate that rebate monies are passed to BWC. The new contract specifies that data must be presented to BWC to permit validation of discount amounts. The new contract was issued February, 2010. **Responsible**: **Chief of Medical Services and Compliance** **Target Resolution Date: March 2010** **Previous Target Date(s): March 2008, April 2008, August 2008, October 2009** **Current Status: In Process**
3	Leverage the services available by the vendor to enhance the likelihood that the goals and objectives of the PBM program will be achieved. **Rating: Significant Weakness**	BWC transitioned to a new PBM vendor, in November 2009. The PBM has submitted daily reports to BWC on the implementation and processing status. Once the transition is stabilized, the PBM will finalize reports for each of the service level agreements identified in the contract. Additionally, other operational and clinical reports have been identified and will be developed. BWC has access to data warehouse for generating ad hoc reports. **Responsible**: **Chief of Medical Services and Compliance** **Target Resolution Date: April 2010** **Previous Target Date(s): November 2007,**

	Recommendation	Disposition
		March 2008, April 2008, August 2008, October 2009 **Current Status: In Process**

Vocational Rehabilitation Audit – October 2007

	Recommendation	Disposition
1	Implement a monthly process that requires Disability Management Coordinators (DMCs) to review costs associated with a sample of claims to determine reasonableness and appropriateness. DMC responses would be returned to Voc Policy for summarization and determination if further action is warranted (i.e., policy clarification, contact with provider to discuss observations, etc.). **Significance Rating: Material Weakness**	Voc Rehab Policy will again address with Regional managers the feasibility of having DMCs review costs monthly for a sample of claims each month. If agreed upon, training would be required to educate the DMCs on the purpose of the review, expectations and documentation requirements. **Responsible**: **Chief of Medical Services and Compliance** **Target Resolution Date: September 2010** **Previous Target Date(s): April 2008, June 2008, December 2008, April 2009, October 2009, December 2009, June 2010** **Current Resolution Status: In Process**
2	Eliminate the potential conflict of interest created by MCOs that refer vocational rehabilitation cases to their related companies. **Significance Rating: Material Weakness**	A report was submitted to the BOD, to be discussed during the January 2010 board meeting. Dependent upon the pursuant discussion and direction, the target date may be updated. **Responsible**: **Chief of Medical Services and Compliance** **Target Resolution Date: May 2010** **Previous Target Date(s): October 2008, January 2010** **Current Resolution Status: In Process**
3	Implement controls over the coordination agreement with the Rehabilitation Services Commission (RSC) to ensure costs expended under that program are only incurred for eligible injured workers and are reasonable and appropriate. **Significance Rating: Material Weakness**	Voc Policy is prepared to analyze the costs for reasonableness and appropriateness once the data is received from RSC. BWC continues to meet with RSC to further the exchange of data. **Responsible**: **Chief of Medical Services and Compliance** **Target Resolution Date: July 2010** **Previous Target Date(s): June 2008, October 2008, June 2009, January 2010** **Current Resolution Status: In Process**
4	Establish effective quality assurance review procedures to ensure controls and activities performed by DMCs are	Rehab Policy collaborated with the Customer Services division to finalize policies and procedures for the quality

Recommendation		Disposition
	proper, timely, and in accordance with policies and statutes. **Significance Rating: Significant Weakness**	review of DMC performance activities. In February, a 90 day pilot was implemented at three service offices to test this new process. Upon completion of the pilot, feedback will be reviewed and revisions made, if necessary, before statewide roll-out. Thereafter, Rehab Policy will review the outcomes monthly to identify DMC training requirements, potential revision of policy/procedures and to trend significant events. **Responsible**: **Chief of Medical Services and Compliance** **Target Resolution Date: September 2010** **Previous Target Date(s): June 2008, August 2008, April 2009, January 2010** **Current Resolution Status: In Process**

Permanent Total Disability (PTD) Claims Audit – January 2008

Recommendation		Disposition
1	Determine the overall impact and best course of action regarding the incorrect overpayments to ensure the accounts receivable balance and BWC financial statements are accurate. Identify and correct the erroneous Disabled Workers' Relief Fund (DWRF) overpayments. **Significance Rating: Significant Weakness**	Erroneous DWRF overpayments have been reduced to $1.3 million from $16.0 million. **Responsible**: **Chief of Customer Services** **Target Resolution Date: February 2010** **Previous Target Date(s): February 2009, June 2009, August 2009, December 2009** **Current Resolution Status: In Process**

Medical Bill Payment Process Audit – March 2008

Recommendation		Disposition
1	Monitor and track the certification application process to verify all providers are routinely reapplying for certification and providing the Bureau with credentialing information. **Significance Rating: Significant Weakness**	A provider recertification project plan has been developed. There are Provider Enrollment and Certification Housing (PEACH) enhancements required to fully implement this process systematically. This will be presented to the Project Governance Board for approval and prioritization. Provider Relations is addressing those areas of the process that are not dependent upon system resources. **Responsible**: **Chief of Medical Services and Compliance**

Recommendation		Disposition
		Target Resolution Date: September 2010 **Previous Target Date(s): December 2008, June 2009, December 2009** **Current Resolution Status: In Process**
2	Implement a comprehensive bill tracking and reporting process to include MCO timelines to monitor compliance with BWC policies and consider reimbursing providers directly from BWC. **Significance Rating: Significant Weakness**	BWC is working with DAS on an RFP that includes transition to direct provider payment. It is anticipated that the RFP will be issued in May 2010. In the short term, the Medical Services Division has reports which track bill submission and payment timelines. **Responsible**: **Chief of Medical Services and Compliance** **Target Resolution Date: May 2010** **Previous Target Date(s): December 2008, January 2010, February 2010** **Current Resolution Status: In Process**

Subrogation Audit – May 2008

Recommendation		Disposition
1	Collaborate with IT to explore potential system enhancements to better support the subrogation process. **Significance Rating: Significant Weakness**	IT has mapped both the current and future subrogation processes. IT is now conducting a cost analysis of its recommendations for upgrading the current Claims Management (V3) system to include the subrogation requirements. **Responsible**: **Chief Legal Officer** **Target Resolution Date: July 2010** **Previous Target Date(s): December 2009** **Current Resolution Status: In Process**

Lump Sum Settlement Process Audit – October 2008

Recommendation		Disposition
1	Define the mission of the settlement process and clearly describe measurable agency-wide goals and objectives for the program. Additionally, develop a process to identify claims that should be settled and evaluate the impact on actuarial reserves and investments. **Significance Rating: Material Weakness**	A defined mission of the settlement process was created during Phase I of the Settlement Enhancement Team. Phase II includes creating measurable agency-wide goals and objectives for the program. Phase III creates tools to assist with identifing types of claims that should be settled. Some of our agency-wide goals evaluate the impact on actuarial reserves, however analyzing the investment return over future years prior to negotiating a claim willl take several

Recommendation		Disposition
		years. **Responsible**: **Chief of Customer Services** **Target Resolution Date: April 2010** **Previous Target Date(s): February 2009, January 2010** **Current Resolution Status: In Process**
2	Conduct trending and analysis of settled claims to identify whether goals and objectives are being met; expand management reporting to address analysis of performance with identified goals and objectives. **Significance Rating: Significant Weakness**	A private consultant performed benchmarking and analyses to assist BWC in addressing the weaknesses in the Settlement process. Ongoing management reporting will be developed during Phase II and Phase III of the Settlement Enhancement Team. **Responsible**: **Chief of Customer Services** **Target Resolution Date: April 2010** **Previous Target Date(s): June 2009, January 2010** **Current Resolution Status: In Process**
3	Evaluate the Medicare Secondary Payer laws for BWC potential liability and risk exposure and develop a Position (White) Paper to document the position of BWC. **Significance Rating: Significant Weakness**	The Lump Sum Settlement Policy has been updated to include the Medicare Secondary Payer Act language. **Responsible**: **Chief of Customer Services** **Target Resolution Date: January 2010** **Previous Target Date(s): June 2009, December 2009** **Current Resolution Status: Implemented**

Device and Media Control - December 2008

Recommendation		Disposition
1	Create policies and procedures for operational situations regarding device and media controls. **Significance Rating: Significant Weakness**	All IT policies and procedures related to this PARC have been completed and await final review by Human Resources. A schedule for reviewing policies for the Employee Handbook is being developed. **Responsible**: **Chief Human Resource Officer** **Target Resolution Date: June 2010** **Previous Target Date(s): December 2009** **Current Resolution Status: In Process**

Fleet Management Audit - March 2009

Recommendation		Disposition
1	Conduct a vehicle needs analysis to make sure BWC maintains an optimal size fleet.	The purchase order for identified replacement automobiles has been approved. Purchase of several

Recommendation		Disposition
	Significance Rating: Significant Weakness	replacement vans is in process and should be completed in January. Once DAS issues a contract for trucks, the last remaining vehicles to be purchased will be ordered. **Responsible**: **Chief Information Officer** **Target Resolution Date: March 2010** **Previous Target Date(s): July 2009, December 2009** **Current Resolution Status: In Process**

Employer Policy Application Process Audit - March 2009

Recommendation		Disposition
1	Revise procedures to issue prior to coverage (PTC) payroll reports covering the entire period since employers first hired employees and came under obligation to obtain workers' compensation coverage. **Significance Rating: Significant Weakness**	A request was presented to the IT Governance Committee in December 2009 for prioritization and resources as part of new application process (Kaizen). In the interim, all applications with PTC periods are being referred for premium audit. **Responsible**: **Chief of Customer Services** **Target Resolution Date: July 2010** **Current Resolution Status: In Process**
2	Develop an electronic interface to eliminate the manual re-keying of data from online applications into the WCIS system and ensure the capture of all supplemental owner information. **Significance Rating: Significant Weakness**	WCIS access has been modified appropriately. A project request has been submitted that would allow the capture of information entered on line by the employer without the need to re-key the data. A request was presented to the IT Governance Committee in December 2009 for prioritization and resources as part of new application process (Kaizen). In the interim, all applications with PTC periods are being referred for premium audit. **Responsible**: **Chief of Customer Services, Chief of Fiscal and Planning** **Target Resolution Date: January 2011** **Current Resolution Status: In Process**
3	Design a mechanism for detecting policies finalized outside of the Universal Document Service (UDS) system and subject them to formal quality assurance reviews. **Significance Rating: Significant Weakness**	A method of detection will be developed in order to identify policies finalized outside of UDS which may have an incorrect coverage status. Once developed, a quality assurance process will be created and implemented. **Responsible**: **Chief of Customer Services**

Recommendation		Disposition
		Target Resolution Date: April 2010 **Current Resolution Status: In Process**

Auto Adjudication Audit (AA) - April 2009

Recommendation		Disposition
1	Develop policies and procedures for changes to AA rules, allowable International Classification of Diseases (ICD-9) codes, and rule sets that include a review and approval process. **Significance Rating: Material Weakness**	Management has reduced an employee's security level eliminating the segregation of duties concern. Management has not implemented changes to the AA program since its inception in 2006 and does not anticipate any until the advent of ICD-10 codes. Then, the entire AA process will require reengineering. At that point, a governing panel will be incorporated to guide AA through its next phase. Management accepts responsibility for not implementing IAD's recommendations until then. **Responsible**: **Chief of Customer Services** **Target Resolution Date: N/A** **Current Resolution Status: Not Implemented**
2	Establish a project team to evaluate the costs and benefits of converting to ICD-10 coding conventions, monitor the United States Department of Health and Human Services ICD-10 compliance date and guidelines, identify impacted information technology systems, and develop an ICD-10 conversion plan and timeline. **Significance Rating: Significant Weakness**	A subgroup of the agency-wide team is identifying the tasks required for ICD-10 implementation. The sub-group will present their resource needs and implementation recommendations to the Project Governance Board for formal approval in January 2010. **Responsible**: **Chief of Medical Services and Compliance** **Target Resolution Date: October 2013** **Current Resolution Status: In Process**
3	Establish a process and/or decision making body to institute programmatic goals and performance measures. Assess the progress toward achieving those goals or identify issues for further investigation by utilizing existing Data Warehouse reports to support ongoing management and monitoring of manual activities performed in support of looping AA claims. **Significance Rating: Significant Weakness**	Procedures have not been finalized for review. Management anticipates this being completed by June. During this process, management will address the back-end reports and how they will be monitored. **Responsible**: **Chief of Customer Services** **Target Resolution Date: June 2010** **Previous Target Date(s): December 2009** **Current Resolution Status: In Process**
4	Develop and implement procedures to evaluate claims with invalid social	Management has been testing with Centers for Medicare and Medicaid

	Recommendation	Disposition
	security numbers (SSNs) to determine the extent of losses, management's tolerance of risks, and strategies to mitigate risks and their associated costs. **Significance Rating: Significant Weakness**	services (CMS) and is on target to cross-match SSNs as planned. Medicare has delayed reporting requirements to January 2011. While testing continues, implementation of a full SSN cross match may also be extended. **Responsible**: **Chief of Customer Services** **Target Resolution Date: January 2010** **Current Resolution Status: In Process**

Change Management Audit - June 2009

	Recommendation	Disposition
1	Update the policy to include all types of activities that are not required to follow the change management procedures. Enforce the adherence to the change management policy and procedures with all staff. **Rating: Significant Weakness**	Progress has been limited due to delays in completing other high profile initiatives, especially transition of printing and mailing functions to DAS State Printing. Additionally, team membership must be revised due to turnover involving key team members. The team will be re-assembled in January. **Responsible**: **Chief Information Officer** **Target Resolution Date: March 2010** **Previous Target Date(s): September 2009, January 2010** **Current Status: In Process**
2	Convene regular meetings to discuss all changes and assess the impact. Require non-emergency changes go through the normal approval process. **Rating: Significant Weakness**	Progress has been limited due to delays in completing other high profile initiatives, especially transition of printing and mailing functions to DAS State Printing. Additionally, team membership must be revised due to turnover involving key team members. Team will be re-assembled in January. **Responsible**: **Chief Information Officer** **Target Resolution Date: March 2010** **Previous Target Date(s): November 2009** **Current Status: In Process**
3	Better communicate or define an emergency change and require service level agreements with the end-user community. **Rating: Significant Weakness**	Progress has been limited due to delays in completing other high profile initiatives, especially transition of printing and mailing functions to DAS State Printing. Additionally, team membership must be revised due to turnover involving key team members. Team will be re-assembled in January. **Responsible**: **Chief Information Officer**

	Recommendation	Disposition
		Target Resolution Date: March 2010 **Previous Target Date(s): November 2009** **Current Status: In Process**
4	Enforce compliance with the prescribed change management processes, either through tool enhancements or management review of the change requests. **Rating: Significant Weakness**	Progress has been limited due to delays in completing other high profile initiatives, especially transition of printing and mailing functions to DAS State Printing. Additionally, team membership must be revised due to turnover involving key team members. Team will be re-assembled in January. **Responsible**: **Chief Information Officer** **Target Resolution Date: March 2010** **Previous Target Date(s): November 2009** **Current Status: In Process**

Bankrupt Self Insured (BSI) Securitization Process Audit - June 2009

	Recommendation	Disposition
1	Develop and implement all-inclusive policies and procedures for the BSI securitization process. **Rating: Material Weakness**	Self Insured Underwriting (SIU) and Accounts Receivable Direct Billing (ARDB) have completed a joint process mapping project with regard to interactive processes between the two departments. SIU and ARDB have discussed and resolved outstanding issues concerning the transmission of securities from SIU to ARDB. Policies and procedures should be completed in June. **Responsible**: **Chief of Customer Services, Chief of Fiscal and Planning** **Target Resolution Date: June 2010** **Previous Target Date(s): December 2009** **Current Status: In Process**
2	Create a policy and process map that outlines routine collections efforts and certifies amounts past due to the Attorney General's Office, write-off accounts that are settled or uncollectible, and create a centralized system to track and retain documents pertaining to collections efforts. **Rating: Material Weakness**	A new collection policy has been drafted and will be sent to Legal for concurrence. As issues related to collecting from sureties often involve various legal issues and negotiations, BWC Legal will play an important role in collection efforts. Direct Billing still needs to verify accounts that have been settled or declared uncollectible. **Responsible**: **Chief of Fiscal and Planning** **Target Resolution Date: March 2010** **Previous Target Date(s): October 2009, December 2009**

Recommendation		Disposition
		Current Status: In Process
3	Determine and document the effective dates for securitization and Self Insured Employers Guaranty Fund (SIEGF) periods, maintain a complete list of all BSI employers including the effective beginning and ending SIEGF and/or securitization dates, fix any incorrect dates in the Rates and Payments system and make the appropriate reimbursements to the Surplus Fund and the SIEGF. **Rating: Material Weakness**	Accounting has identified policies and information needed from Self Insured (SI). Exceptions are being processed as information is received. Accounting has policies and procedures in place for establishing the effective dates for SIEGF charges. We continue to work with SI to obtain information to establish new accounts and make any necessary corrections. **Responsible**: **Chief of Fiscal and Planning** **Target Resolution Date: March 2010** **Previous Target Date(s): August 2009, November 2009** **Current Status: In Process**
4	Implement adequate internal controls to help ensure that all BSI employers are referred to the Self Insured Review Panel (SIRP) and appropriate customer accounts are created. Accurately enter BSI employer information into the Rates and Payments System and the Bond Detail Report (BDR), and bill securities in a timely manner. **Rating: Material Weakness**	SIU and ARDB have completed a joint process mapping project with regard to interactive processes between the two departments. SIU and ARDB have discussed and resolved outstanding issues concerning the transmission of securities from SIU to ARDB. Management is still on target for March. **Responsible**: **Chief of Customer Services, Chief of Fiscal and Planning** **Target Resolution Date: March 2010** **Previous Target Date(s): June 2009, December 2009** **Current Status: In Process**
5	Segregate the duties of requesting the security, receiving and recording the security, and having access to the security. **Rating: Significant Weakness**	Underwriting will finalize a written segregation of duties policy for securities. Any necessary modifications to the UDS workflow will be implemented as well. This item remains pending, but is still on schedule. **Responsible**: **Chief of Customer Services** **Target Resolution Date: January 2010** **Previous Target Date(s): June 2009, August 2009** **Current Status: In Process**
6	Recover securities from the Treasurer of State's Office and store them in a central location; inventory all securities and maintain a complete list; and determine if any securities have been misplaced. **Rating: Significant Weakness**	The securities inventory has been compiled and is being maintained on an ongoing basis. Management is currently performing Quality Assurance procedures to ensure that the listing is accurate and complete. **Responsible**: **Chief of Customer Services**

	Recommendation	Disposition
		Target Resolution Date: March 2011 **Current Status: In Process**
7	Develop and implement record retention policies and procedures to provide evidence that decisions are appropriate, reviewed, and follow established procedures. Determine if any of the bond accounts that are not being billed, but have available balances, could be billed. **Rating: Significant Weakness**	Management will require supporting documentation to evidence decisions are appropriate and all BSI accounts with balances noted as "do not bill" will be researched to identify and document the reason for the notation. Focus has been on getting information to bill new accounts or accounts that were not previously referred to Direct Billing for set-up. **Responsible**: **Chief of Fiscal and Planning** **Target Resolution Date: March 2010** **Previous Target Date(s): September 2009, December 2009** **Current Status: In Process**
8	Develop procedures with sufficient controls to help ensure that all future Data Warehouse queries for initial manual billings of claims are completed accurately and in a timely manner. **Rating: Significant Weakness**	Policies and procedures have been updated to require supervisor or manager approval prior to posting initial manual charges. As procedures are implemented they will be revised to detect and address potential complications. **Responsible**: **Chief of Fiscal and Planning** **Target Resolution Date: March 2010** **Previous Target Date(s): June 2009, September 2009, December 2009** **Current Status: In Process**
9	Request reimbursement from the responsible active SI employer for claims payments that were made by BWC and then charged to securities or the SIEGF. Remove BSI employers' customer accounts from the Rates and Payments System, the BDR and the SIEGF database for employers that are not in default of claims payments and update the V3 status for those that had defaulted. **Rating: Significant Weakness**	This comment identified seven policies whose statuses were not bankrupt per WCIS, but were included on R&P as defaulted. Management has updated all policies except one. WCIS policy status is still final cancel. A SIRP order finds the employer in default. Management has followed up with SI to see if the WCIS status is going to be updated. Procedures have been updated to document how BWC will handle pending defaults and to ensure that all the necessary data has been received. **Responsible**: **Chief of Customer Services, Chief of Fiscal and Planning** **Target Resolution Date: June 2010** **Previous Target Date(s): December 2009** **Current Status: In Process**

Recommendation		Disposition
10	Work with IT to create a new system for tracking securitization balances or implement additional controls specific to the Microsoft Excel format. **Rating: Significant Weakness**	An additional review and approval process has been implemented to improve accuracy of current process for tracking security balances. IT has completed a scope and requirements document for this project. Because this is not a tier 1 strategic project, work is performed as time permits. **Responsible**: **Chief of Fiscal and Planning** **Target Resolution Date: May 2010** **Previous Target Date(s): December 2009** **Current Status: In Process**

Collections Audit - June 2009

Recommendation		Disposition
1	Revise payment processing procedures to help ensure that all payments received and processed by Collections are properly safeguarded from misappropriation. **Rating: Significant Weakness**	Responsibility for processing checks received for collections-related activities has been transferred to the Cash Control Department. Management accepts the risk concerning issues remaining about segregation of duties and controls to assure that all checks are actually deposited to the bank. Accounting has made changes to the extent we feel are necessary. Collections staff do not have the ability to post payments to WCIS so we do not believe there is a segregation of duties issue. **Responsible**: **Chief of Fiscal and Planning** **Target Resolution Date: N/A** **Current Status: Not Implemented**
2	Review and update existing policies and procedures annually for consistency, clarity, and relevance. **Rating: Significant Weakness**	Management will take steps to update the department policies and procedures manual. **Responsible**: **Chief of Fiscal and Planning** **Target Resolution Date: June 2010** **Current Status: In Process**

BWC Internal Audit Division
Audit Report Follow-Up Procedures

The *International Professional Practices Framework* specifically addresses Resolution of Senior Management's Acceptance of Risks in Standard 2600. One of our primary responsibilities as professional auditors is determining that the audit customer takes corrective action on recommendations. This applies in all cases except where "senior management has accepted the risk of not taking action." When senior management accepts the risk of not taking action the comment will be forwarded to the Administrator for review, and the Chief of Internal Audit will report the comment with management's response to the Audit Committee for consideration.

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

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

Casual - This is the most basic form of follow-up and may be satisfied by review of the audit customer's procedures or an informal phone call. Memo correspondence may also be used. This is usually applicable to the less critical findings.

Limited - Limited follow-up typically involves more audit customer interaction. This may include actually verifying procedures or transactions and, in most cases, is not accomplished through memos or phone calls with the audit customer.

Detailed - Detailed follow-up is usually more time-consuming and can include substantial audit customer involvement. Verifying procedures and audit trails, as well as substantiating account balances and computerized records, are examples. The more critical audit findings usually require detailed follow-up.

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

At the end of each quarter, a summary follow-up report is prepared. This report reflects all current period findings with appropriate comments to reflect end of quarter status. Additionally, this report highlights all outstanding findings from prior periods and their status. The intent of this summary report is to track all findings so that they are appropriately resolved.

BWC Internal Audit Division
Audit Comment Rating Criteria

Comment Rating	Description of Factors	Reporting Level
Material Weakness	• Overall control environment does not provide reasonable assurance regarding the safeguarding of assets, reliability of financial records, and compliance with Bureau policies and/or laws and regulations. A significant business risk or exposure to the Bureau that requires immediate attention and remediation efforts. • A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected by employees in the normal course of their work, or that a major operational or compliance objective would not be achieved.	Audit Committee, Senior Management, Department Management
Significant Weakness	• Issue represents a control weakness, which could have or is having some adverse affect on the ability to achieve process objectives. The controls in place need improvement and if not improved could lead to an overall unsatisfactory or unacceptable state of control. Requires near-term management attention. • A control deficiency, or combination of control deficiencies, that results in a remote likelihood that a misstatement of the Bureau's annual or interim financial statements is more than inconsequential will not be prevented or detected by employees in the normal course of their work, or that a major operational or compliance objective would not be achieved.	Senior Management, Department Management, Audit Committee (optional)
Minor Weakness	• Issue represents a process improvement opportunity or a minor control weakness with minimal impact. Observations with this rating should be addressed by line level management. • A control deficiency that would result in less than a remote likelihood that the deficiency could reasonably result in a material misstatement of the financial statements or materially affect the ability to achieve key operational or compliance objectives.	Department Management, Senior Management (optional)

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

BWC Internal Audit Division
FY 2010 Annual Audit Plan

Focus Area	1st Qtr.			2nd Qtr.			3rd Qtr.			4th Qtr.			Audit Effort
	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	
Coal Workers' Pneumoconiosis/Marine Fund Claims													4
SI Audit Consulting Engagement													4
Drug Utilization Review													5
WCIS Credits/Claims Cost Transfer													4
External Audit Assistance													5
Warrant Printing Process													2
Coal Mine Safety Program													2
Investment Accounting & Reconciliation Processes													4
Death Benefits													4
Fixed Assets													3
Self Insured Underwriting													3
Employer Rate Adjustments													
Premium Audit													
Investment Compliance Monitoring													3
Safety & Hygiene													4
DWRF													4
FY 2011 Audit Plan													3
Employer Compliance													5
Temporary Total Disability Benefits													4
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

Original Audit Plan
Revised Audit Plan

BWC Internal Audit Division

QES Acronyms

Acronym	Description
AA	Auto Adjudication
AR	Accounts Receivable
ARDB	Accounts Receivable Direct Billing
BDR	Bond Detail Report
BOD	Board of Directors
BSI	Bankrupt Self Insured
BWC	Bureau of Workers' Compensation
CMS	Centers for Medicare and Medicaid Services
DAS	Department of Administrative Services
DMC	Disability Management Coordinators
DUR	Drug Utilization Review
DWRF	Disabled Workers' Relief Fund
FY	Fiscal Year
IAD	Internal Audit Division
ICD	International Classification of Diseases
IT	Infrastructure and Technology or Information Technology
IW	Injured Worker
MCO	Managed Care Organization
PEACH	Provider Enrollment and Certification Housing
PBM	Pharmacy Benefit Management
PSD	Premium Security Deposit
PTC	Prior to Coverage
PTD	Permanent Total Disability
QA	Quality Assurance
QES	Quarterly Executive Summary
R&P	Rates and Payments System
RFP	Request For Proposal
RSC	Rehabilitation Services Commission
SI	Self Insured
SIA	Self Insured Audit
SIEGF	Self Insured Employers Guaranty Fund
SIRP	Self Insured Review Panel
SIU	Self Insured Underwriting
SSN	Social Security Number

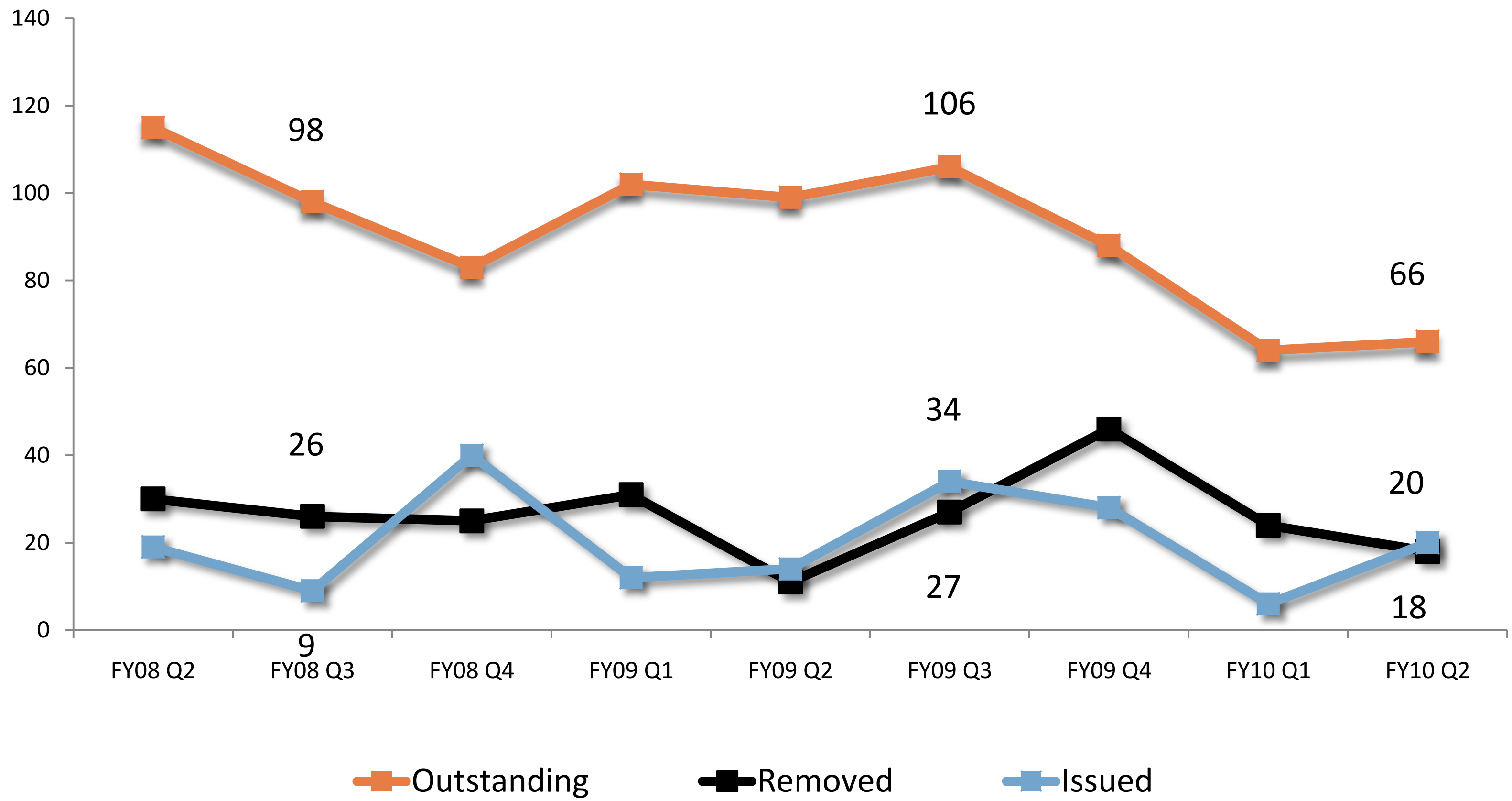
Acronym	Description
UDS	Universal Document Service
V3	Version 3 (BWC’s Claims Management System)
WCIS	Workers’ Compensation Insurance System

BWC Internal Audit Division

	FY09 3rd Qtr	FY09 4th Qtr	FY10 1st Qtr	FY10 2nd Qtr
Prior Total: Comments Outstanding	99	106	82	64
Plus: New Comments Issued	34	22	6	20
Minus: Comments Removed	-27	-46	-24	-18
New Total: Comments Outstanding	**106**	**82**	**64**	**66**
Material Weakness	20	17	14	14
Significant Weakness	85	65	50	52
New Total: Comments Outstanding	**105**	**82**	**64**	**66**

Data as of 12/31/2009

BWC Internal Audit Division

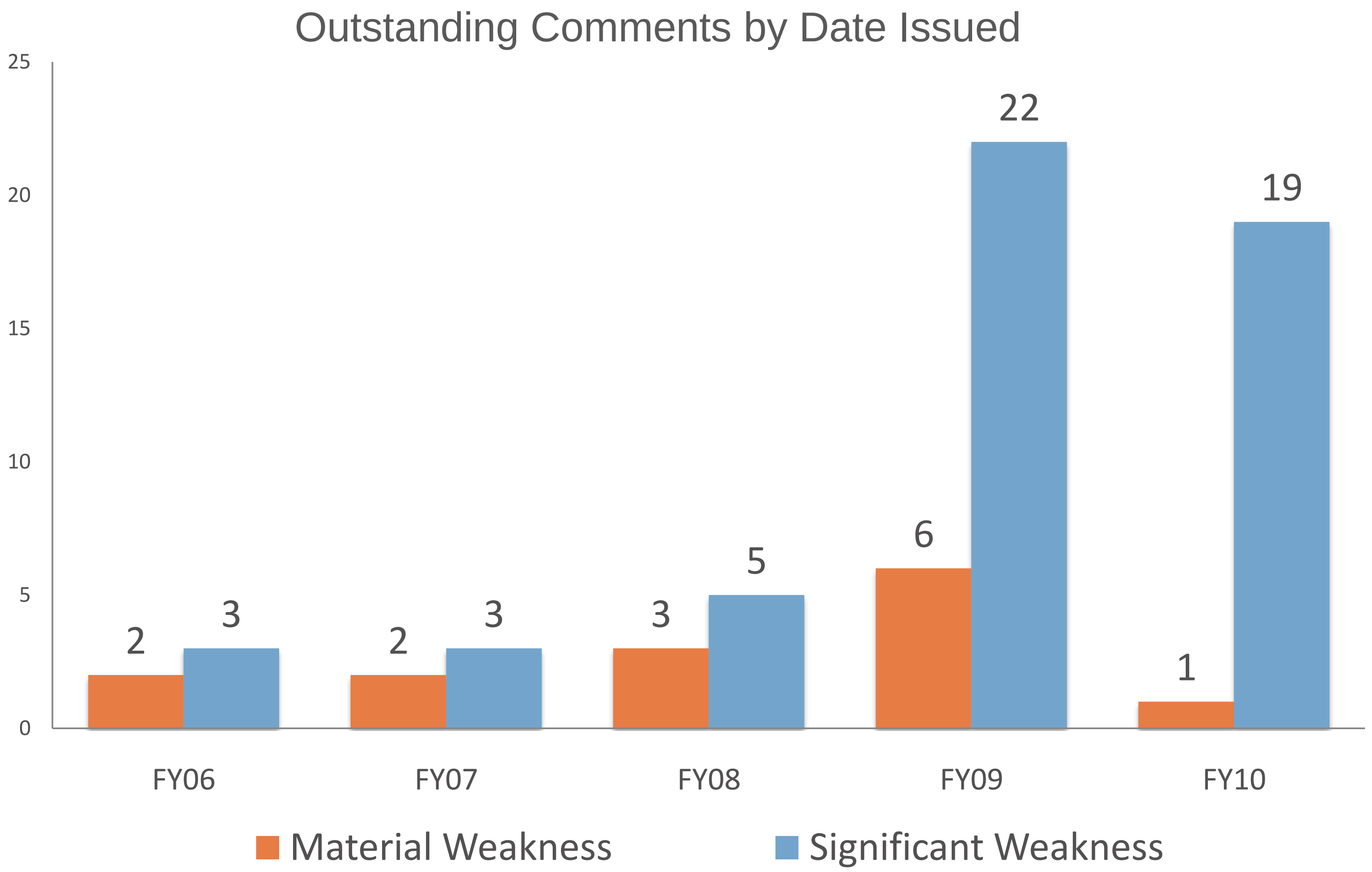


Note: Chart excludes 24 consulting recommendations issued this quarter.

Ohio | Bureau of Workers' Compensation

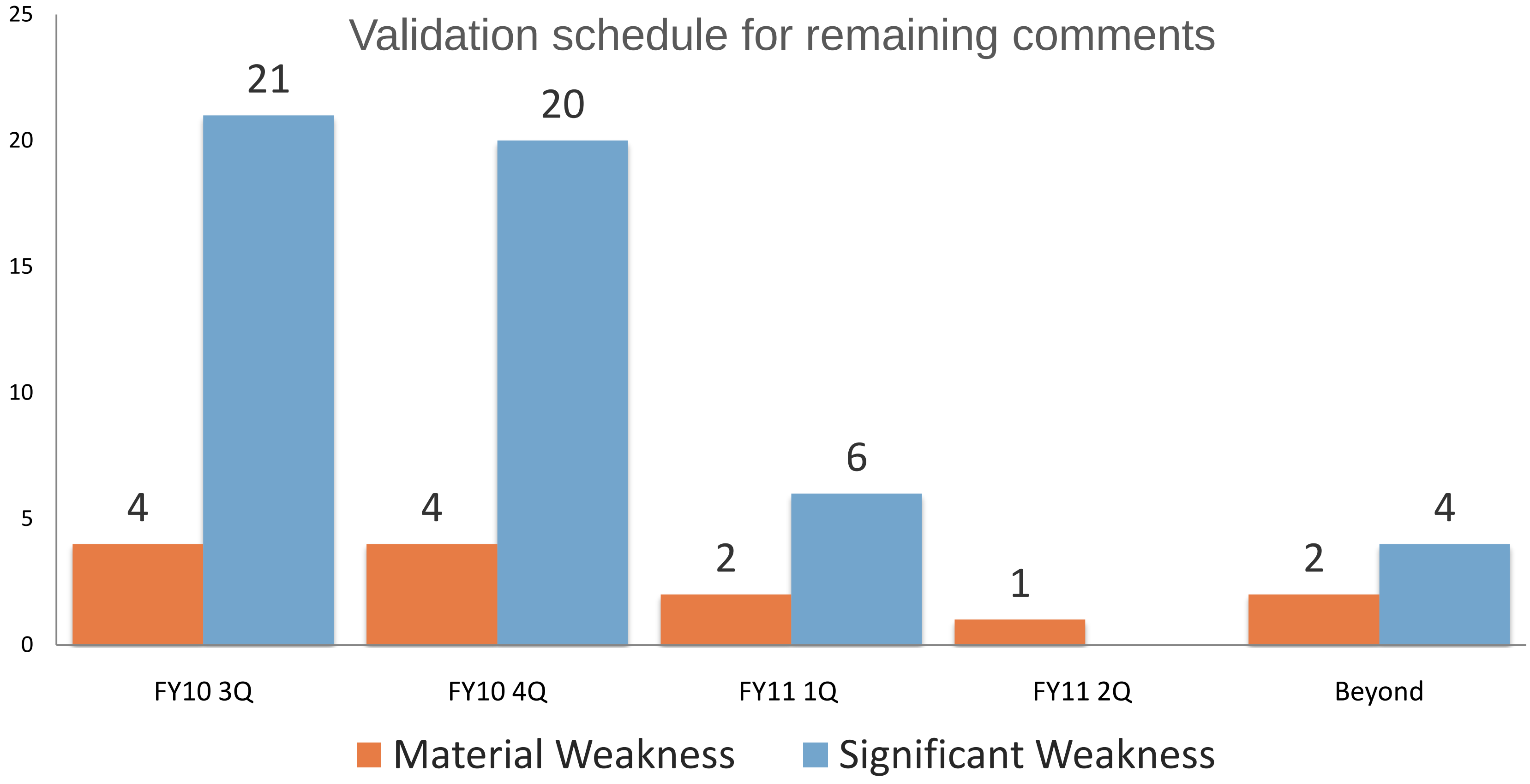
Data as of 12/31/2009

BWC Internal Audit Division



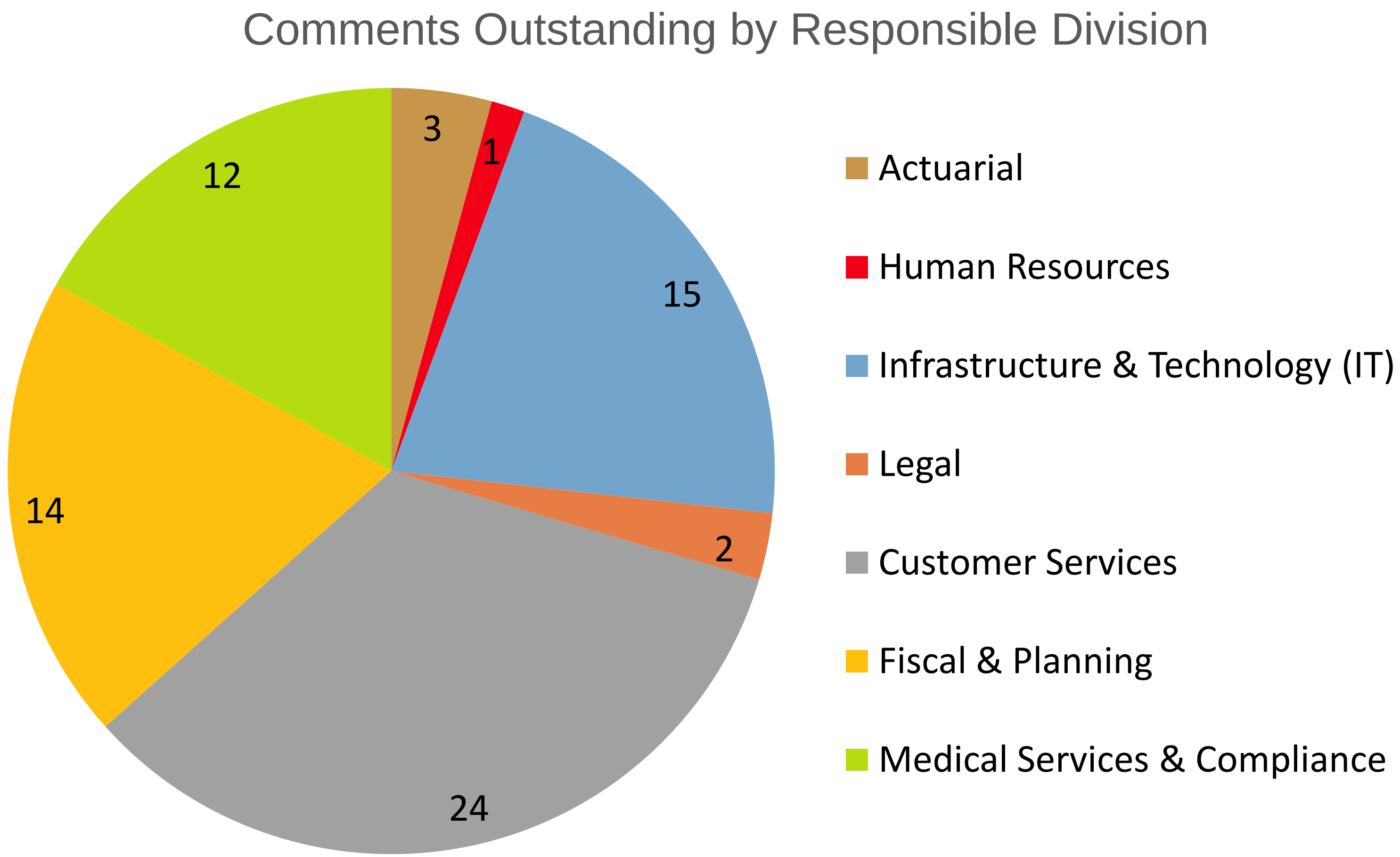
Data as of 12/31/2009

BWC Internal Audit Division



Note: Chart excludes two comments for which Management accepts the risk.

BWC Internal Audit Division



Note: Five comments assigned to multiple divisions are reflected in both division counts.

Common Sense Business Regulation (BWC Rules)

(Note: The below criteria apply to existing and newly developed rules)

Rules Chapter 4123-17-02

Rule Review

1. ☒ The rule is needed to implement an underlying statute.

   Citation: 4123.32 (C)

2. ☒ The rule achieves an Ohio specific public policy goal.

   What goal(s): The proposed rule would protect BWC from efforts to structure purchase transactions to avoid legitimate liability.

3. ☒ Existing federal regulation alone does not adequately regulate the subject matter. Yes federal regulation does not address liability and experience transfers regarding Workers' Compensation.

4. ☒ The rule is effective, consistent and efficient.

5. ☒ The rule is not duplicative of rules already in existence.

6. ☒ The rule is consistent with other state regulations, flexible, and reasonably balances the regulatory objectives and burden.

7. ☒ The rule has been reviewed for unintended negative consequences.

8. ☒ Stakeholders, and those affected by the rule were provided opportunity for input as appropriate.

   Explain: January 29, 2010 BWC emailed the proposed changes to the Executive President of the Service Association of Ohio, President of the Workers' Compensation Forum and the Chair of the Workers' Compensation Committee of the Ohio State Bar Association.

   The President of the Workers' Compensation Forum sent back six comments. Their concerns:

   - The impact on rating programs, especially group rating, when a retroactive recalculation of the employer's policy takes place.
   - BWC is trying to circumvent the Supreme Court's decision on "Valley Roofing".
   - They would like to see rules around protecting an employer, who acquires only the assets of the former employer.
   - Go back to the way BWC previously allowed the successor employer to retain the former employer's policy.

9. ☒ The rule was reviewed for clarity and for easy comprehension.

10. ☒ The rule promotes transparency and predictability of regulatory activity.

11. ☒ The rule is based on the best scientific and technical information, and is designed so it can be applied consistently.

12. ☒ The rule is not unnecessarily burdensome or costly to those affected by rule.

If so, how does the need for the rule outweigh burden and cost? This rule change is necessary to safeguard the fund from efforts to structure purchase transactions to avoid legitimate liability.

13. ☒ The Chief Legal Officer, or his designee, has reviewed the rule for clarity and compliance with the Governor's Executive Order.

4123-17-02 Rule change
Executive Summary

<u>Overview</u>

Ohio Revised Code Section 4123.32 provides that the Administrator, with the advice and consent of the Board of Directors, shall adopt rules to protect the state insurance fund, including:

(C) Such special rules as the administrator considers necessary to safeguard the fund and that are just in the circumstances, covering the rates to be applied where one employer takes over the occupation or industry of another or where an employer first makes application for state insurance, and the administrator may require that if any employer transfers a business in whole or in part or otherwise reorganizes the business, the successor in interest shall assume, in proportion to the extent of the transfer, as determined by the administrator, the employer's account and shall continue the payment of all contributions due under this chapter.

BWC has adopted Ohio Administrative Code 4123-17-02 under the authority of this statute. BWC amended Ohio Administrative Code 4123-17-02 effective July 27, 2006, for all successions taking place on or after September 1, 2006. The rule states that where the employer wholly succeeds another employer in the operations of a business, BWC will transfer the financial rights and obligations of the former employer to the successor employer. Ohio Administrative Code 4123-17-02 addresses transfers between a succeeding employer and its predecessor. When BWC receives information that a legal entity wholly succeeded one or more legal entities, the predecessor's policy will be combined into the successor's policy. This combination will transfer the predecessor's rights and obligations to the successor along with the predecessor's experience. Moreover, this same practice is followed by the Ohio Department of Jobs and Family Services under Ohio Revised Code 4141.24.

Background Law

On June 16, 2009, the Supreme Court of Ohio decided *State ex rel. Valley Roofing, L.L.C. v. Ohio Bur. of Workers' Comp.,* 122 Ohio St.3d 275, 2009-Ohio-2684. The court held that, when a business operation is purchased from an intermediary bank and the transfer of the employer's business to this third party was involuntary, the purchaser is not the successor in interest. This case interpreted the BWC statute and rule on successorships. BWC is concerned that employers may use the *Valley Roofing* case to avoid liability for transfers of ownership where there should be successor liability. The proposed rule would protect the BWC from efforts to structure purchase transactions to avoid legitimate liability. It will not overrule the Supreme Court's determination in *Valley Roofing,* but will give direction and bring consistency to those scenarios reviewed at BWC which arise pursuant to transfers under Ohio Administrative Code 4123-17-02.

Amendments to rule 4123-17-02

The amendment to rule 4123-17-02 would find successor liability where:

(a) The purchaser expressly or impliedly agrees to assume such obligations;
(b) The succession transaction amounts to a *de facto* consolidation or merger;
(c) The successor is a continuation of the predecessor; or
(d) The transaction is entered into for the purpose of escaping workers' compensation obligations.

4123-17-02 Basic or manual rate.

(A) The "basic or manual rate" is hereby expressed as the unit of premium per one hundred dollars of payroll for accident and disease coverage.

(B) Succeeding employers -- experience.

(1) Where one legal entity, not having coverage in the most recent experience period, wholly succeeds another legal entity in the operation of a business, his or its rate shall be based on the predecessor's experience within the most recent experience period.

(2) Where a legal entity having an established coverage or having had experience in the most recent experience period wholly succeeds one or more legal entities having established coverage or having had experience in the most recent experience period and at least one of the entities involved has a merit rating experience, the experience of all the involved entities shall be combined to establish the rate of the successor.

(3) Where a legal entity succeeds in the operation of a portion of a business of one or more legal entities having an established coverage or having had experience in the most recent experience period, the successor's rate shall be based on the predecessor's experience within the most recent experience period, pertaining to the portion of the business acquired by the successor.

Pursuant to this rule, the bureau shall provide to the parties to the transfer of experience the necessary forms and instructions to complete the transfer of the appropriate payrolls and claims. Each party to the transfer of experience shall sign the completed forms. The bureau shall review the completed forms and if any questions arise, the bureau may conduct a premium audit on each party's risk account.

(4) When any combination or transfer of experience is indicated under any of the provisions of this rule, the effective date of such combination or transfer shall be the beginning date of the next following payroll reporting period. In cases where an entity not having coverage wholly succeeds another entity or in cases where the date of succession is determined to be January first or July first, the experience of the predecessor shall be transferred to the successor-employer effective as of the actual date of succession.

(5) For an out of state employer purchasing an existing Ohio operation, the bureau may use the out of state experience of the employer as a factor in determining the employer's experience.

<u>(6) Whenever one employer succeeds another employer in the operation of a business under paragraphs (B)(1) to (B)(5) of this rule, the bureau shall transfer</u>

the predecessor's experience under the workers' compensation law to the successor if one of the following critieria is met:

(a) the successor expressly or impliedly agrees to assume such obligations;

(b) the succession transaction amounts to a *de facto* consolidation or merger;

(c) the successor is merely a continuation of the predecessor; or.

(d) the succession transaction is entered into ~~fraudulently~~ for the purpose of escaping obligations under the workers' compensation law.

If one or more of the criteria set forth in this paragraph is met, the bureau shall transfer the predecessor's experience under the workers' compensation law, regardless of whether the predecessor's transfer to the successor was voluntary or through an intermediary bank or receivership.

(C) Succeeding employers -- risk coverage transfer.

(1) Whenever one employer succeeds another employer in the operation of a business in whole or in part, the successor shall notify the bureau of the succession. Where one employer wholly succeeds another in the operation of a business, the bureau shall transfer the predecessor's rights and obligations under the workers' compensation law to the successor if one of the following critieria is met:

(a) the successor expressly or impliedly agrees to assume such obligations;

(b) the succession transaction amounts to a *de facto* consolidation or merger;

(c) the successor is merely a continuation of the predecessor; or.

(d) the succession transaction is entered into ~~fraudulently~~ for the purpose of escaping obligations under the workers' compensation law.

If one or more of the criteria set forth in this paragraph is met, the bureau shall transfer the predecessor's rights and obligations under the workers' compensation law, regardless of whether the predecessor's transfer to the successor was voluntary or through an intermediary bank or receivership.

(2) The successor shall be credited with any credits of the predecessor, including the advance premium security deposit of the predecessor. This paragraph shall apply where an employer wholly succeeds another employer in the operation of a business on or after September 1, 2006.

~~(2)~~(3) Transfer of risk coverage may be retroactive to the date of succession.

~~(3)~~(4) The successor must preserve the predecessor's payroll records for the five years preceding the date of succession.

~~(4)~~(5) A legal entity may be assigned only one risk. Where a legal entity succeeds one or more risks, he or it shall be assigned a single risk designation.

To: BWC Board of Directors
Fm: Donald C. Berno, Board Liaison
Re: Reserve Discount Rate and Financial Metrics
Date: March 17, 2010

This month, we begin the annual review of the reserve discount rate and the net asset policy (financial metrics such as the funding ratio and the net leverage ratio).

I would like to highlight the documentation which follows this memo.

RESERVE DISCOUNT RATE

The first document is "Process to develop the reserve discount rate". It explains the methodology and guiding principles as approved by the Board, the steps the Administrator completes to make her recommendation and a history of the reserve discount rate since 1991.

The second document is the "reserve discount rate recommendation". It answers the questions posed in the process document, and contains additional historical information.

The third document contains comments from the Chief Investment Officer

Finally, there is a memo from Mercer supporting the Administrator's recommendation.

NET ASSET POLICY

This section begins with the "Net Asset Policy" and includes the business rationale, the guiding principles and the steps to be followed.

The second document "Financial Performance Metrics" follows the guiding principles and steps contained in the Net Asset Policy. This document also contains staff recommendations concerning additional standard insurance ratios such as the net loss ratio, expense ratio, the combined ratio and operating ratio.

The Audit Committee will have the first read of these recommendations this month, and forward a recommendation to the Board at the April meeting. The new financial metrics will be included in the April financial statements (which you review at the May meeting). The impact of the discount rate change will appear in the May financial statements (which you review at the June meeting).

Process for Development of the Reserve Discount Rate

Workers' compensation claims are generally paid over a period of several years. A reserve for compensation is set based on the total of all estimated amounts that will be paid in future years on reported claims and claims incurred but not reported. BWC's practice is to discount the reserve to reflect the time value of money (one dollar of future claims liability can be paid by setting aside less than one dollar today due to expected investment earnings).

BWC has been discounting reserves for at least 30 years. Since 1997, BWC has established a practice to review and evaluate the current discount rate on an annual basis using a documented approach. The approach relies on GASB 10. Prior to FY 2006, BWC performed this evaluation at the time of the actuarial audit. In FY 2006, BWC began its current practice of performing the evaluation in conjunction with the rate making process for private employers. This results in better matching of the ratemaking and reserving processes. The discount rate is utilized for rate making purposes effective July 1. The discount rate is utilized for auditing the reserve for compensation and compensation adjustment expense effective June 30.

Under Ohio Revised Code 4121.121(B)(1) the Administrator has the responsibility to establish a discount rate. Every March, the Administrator presents the discount rate decision to the Board for review, discussion and concurrence.

The business rationale and methodology and guiding principles for the establishment of the discount rate are:

<u>Business Rationale</u>

- The discount rate recognizes the economic benefit of the time value of money. It is an appropriate accounting treatment that recognizes that benefit. However, the discount rate does not create income.
- The discount rate enables the organization to present a prudent picture of its liabilities that is consistent with economic forces and BWC's mission to provide benefits for injured workers at the lowest possible cost while maintaining a solvent state insurance fund.

<u>Methodology and Guiding Principles</u>

- Should use a methodology supported by accounting and actuarial literature, especially the provisions of Governmental Accounting Standards Board (GASB) Statement No. 10 ("Accounting and Financial Reporting for Risk Financing and Related Insurance Issues") and Actuarial Standard of

Practice No. 20 ("Discounting of Property and Casualty Loss and Loss Adjustment Expense Reserves") as approved by the Actuarial Standards Board.

- GASB 10 requires an examination of past portfolio performance, historical payment patterns and settlement rates
- Actuarial Standard of Practice #20 requires that explicit provisions for risk accompany reserve discounting and suggests the uncertainty in the timing and amounts of future payments be considered along with historical payment patterns
- Both standards recommend consideration of a risk-free investment yield

- Should be established with a long term view to reduce volatility in BWC's balance sheet and premiums
- Should not exceed highly probable investment returns over long periods of time
- Should enable management to focus on business enterprise goals
- Should be reviewed annually

The Administrator completes the following steps to establish the discount rate:

1. Meets with the Chief Actuarial Officer, Chief Investment Officer, Chief Fiscal and Planning Officer and other senior executives as appropriate to review reserves, investment returns, and cash flow needs
2. Follows the Actuarial Standard of Practice #20 concerning discounting
3. Follows the Government Accounting Standards Board Statement 10
4. Considers the following questions:
   - Is it consistent with BWC's practice of establishing a conservative discount rate?
   - Is it consistent with industry standards?
   - Is there a decreasing or increasing return on BWC's investment portfolio?
   - Are there changes in BWC's investment strategy?
   - What are the trends of risk free investment yields?
   - Do we anticipate changes in the financial markets?

5. Administrator presents a recommendation and rationale to the Board for review, discussion and concurrence

Discount Rate Assumptions used in actuarial audits and rate indications

Evaluation Date	Discount Rate
12/1991-12/1996	7.00%
12/1997	6.75%
6/1998	6.50%
6/1999	6.25%
6/2000 – 6/2001	6.00%
6/2002	5.80%
6/2003 – 6/2004	5.50%
6/2005 – 6/2006	5.25%
6/2007	5.00%
6/2008	5.00%
6/2009	4.50%

Approved by BWC Board of Directors
February 20, 2009
April 30, 2009

Reserve Discount Rate Recommendation

The Reserve Discount Rate Policy approved by the Board in February 2009 contained a series of steps, listed below, for the Administrator to complete as she considers her recommendation/conclusion. The Administrator recommends a reduction from a 4.5% to a 4% discount rate to be adopted for fiscal year end 2010.

Policy Documentation

The Administrator met with senior executives on March 2, 2010, and followed the Actuarial Standard of Practice #20 and the Government Accounting Standards Board (GASB) Statement 10.

Following BWC Board policy, the Administrator considered the following questions.

- *Is the proposed discount rate consistent with BWC's practice of establishing a conservative discount rate?*

Yes. Table 1 shows a slow yet steady decline in our discount rate that reflects the slow yet steady decline in the yields of "risk free" investments.

TABLE 1

Fiscal Year	Discount Rate (FY)		Fiscal Year	Discount Rate (FY)
1996	7.0		2005	5.50
1997	6.75		2006	5.25
1998	7.00/6.75		2007	5.25
1999	6.50		2008	5.00
2000	6.25		2009	4.50
2001	6.00			
2002	6.00		**Avg.**	
2003	5.80		2005-2009 (5 years)	5.1
2004	5.50		2000 -2009 (10 years)	5.5

- *Is the proposed discount rate consistent with industry standards?*

Yes. Mercer has informed us that many entities select their discount rate based on the yields of a 10 year Treasury and the 10 year "AA" corporate bond.

In their August, 2008 presentation to the Board, Deloitte discussed a 4% "risk-free" discount rate. They compared Ohio's 5% discount rate to discount rates used by West Virginia (3.8%), New York (5%), Canada's monopoly fund (3.3%) and Australia's monopoly fund (6.5%). For FY 2009, the state of Washington used a discount rate of 2.5% for their accident and medical aid fund, and 6.5% for their pension fund.

- *Is there a decreasing or increasing return on BWC's investment portfolio?*

Table 2 indicates State Insurance Fund (SIF) annual returns over a ten year period. While there are year-over-year fluctuations, the five year investment average return is slightly higher than average Treasury yields. BWC returns for the five and ten year period are below corporate bond yields. (See Summary Table). Investment returns should exceed the discount rate. SIF investment returns exceeded the discount rate in just seven of the past ten years.

TABLE 2

Calendar Year	BWC SIF Investment Returns
2000	5.8%
2001	-3.1%
2002	-4.7%
2003	14.4%
2004	7.3%
2005	6.3%
2006	6.3%
2007	6.6%
2008	-2.3%
2009	8.7%
Avg.	
2005-2009	5.12% (5 yr. avg.)
2000-2009	4.53% (10 yr. avg.)

- *Are there changes in BWC's investment strategy?*

The SIF targeted asset class mandate weightings per BWC's Investment Policy Statement were achieved in December 2009. Also please review the attached March 3, 2010 memo from Bruce Dunn.

- *What are the trends of risk free investment yields?*

While the GASB and the Actuarial Standards don't specifically define "risk free" yields, many practitioners in the field use the "AA" corporate bond yield or the 10 year Treasury yield. The trends in these yields are shown below. The five year average yields are consistently lower than the ten year average yields. See Table 3.

TABLE 3

Calendar Year	"AA" Corporate Bonds		Treasuries	
	10-15 years	15+ years	10 year	20 year
2000	7.53	7.83	6.03	6.23
2001	6.47	7.04	5.02	5.63
2002	5.93	6.73	4.61	5.43
2003	4.97	5.84	4.02	4.96
2004	5.15	5.87	4.27	5.05
2005	5.16	5.69	4.29	4.65
2006	5.82	6.07	4.79	4.99
2007	5.89	6.23	4.63	4.91
2008	6.27	6.79	3.67	4.36
2009	6.32	6.33	3.29	4.12
Avg.				
1/05 To 12/09	5.89	6.22	4.13	4.60
1/00 To 12/09	5.95	6.44	4.46	5.03

Bond yields provided are month-end averages for each calendar year.

- *Do we anticipate changes in the financial markets?*

  The following is an excerpt of the March 3, 2010 CIO report to the Administrator.

"Based on the most recently published Mercer Consulting Capital Market Outlook report dated January, 2010, an exercise of calculating expected future rates of return can be made on both the current SIF fixed income portfolio and the current SIF total portfolio with respect to targeted asset mandate weightings per the current investment policy targets for SIF. These asset class mandate weightings were achieved by the BWC investment staff in December 2009 with the completion of certain portfolio transition activities. This asset allocation weighting is broadly a 70% fixed income and 30% equity mix. These calculations reflect the current expected future **twenty-year** rate of return (ROR) assumptions of each asset class Mercer provides in this referenced Capital Market Outlook report relevant to the SIF portfolio. The Mercer twenty-year SIF fixed income portfolio expected average annual future rate of return based simply on the target weights of the current SIF fixed income portfolio asset classes is **5.22%** comprised as follows: 28% long credit bonds @ 6.0% ROR; 17% TIPS @ 4.6% ROR; 15% U.S. Aggregate index bonds @ 4.9% ROR; 9% long U.S. government bonds @ 4.7% ROR and 1% cash @ 3.4% ROR. When the 30% weighted allocation for public equities @ 8.3% ROR are included and added (alternative asset classes ignored for this calculation), the total SIF portfolio expected average annual return increases to **6.15%**. Although these projected theoretical rates of returns are certainly not risk-free, the premise can be made that they can be considered as reasonable expected annual returns over a long period of ten years or more for the current asset allocation targets of the SIF portfolio."

Summary Table

Calendar Year	"AA" Corporate Bonds		Treasuries		BWC SIF* Investment Returns	Discount Rate (applied FY)
	10-15 years	15 + years	10 yr.	20 yr.		
1996	6.93	7.66	6.44	6.82	8.8	7.00
1997**	7.05	7.51	6.35	6.68	19.4	7.00/6.75
1998**	6.39	6.84	5.26	5.72	12.8	6.75/6.50
1999**	7.00	7.27	5.64	6.19	9.9	6.50
2000**	7.53	7.83	6.03	6.23	5.8	6.25
2001**	6.47	7.04	5.02	5.63	-3.1	6.00
2002**	5.93	6.73	4.61	5.43	-4.7	6.00
2003**	4.97	5.84	4.02	4.96	14.4	5.80
2004**	5.15	5.87	4.27	5.05	7.3	5.50
2005**	5.16	5.69	4.29	4.65	6.3	5.50
2006	5.82	6.07	4.79	4.99	6.3	5.25
2007	5.89	6.23	4.63	4.91	6.6	5.25
2008	6.27	6.79	3.67	4.36	-2.3	5.00
2009	6.32	6.33	3.29	4.12	8.7	4.50
Avg.						
1/05 To 12/09	5.89	6.22	4.13	4.60	5.12 (5 yr. avg.)	5.1
1/00 To 12/09	5.95	6.44	4.46	5.03	4.53 (10 yr. avg.)	5.5

* Calendar Year returns for State Insurance Fund only. Specialty Funds not included.
** Dividends rebates paid from SIF to employers

DATE: March 3, 2010

TO: Marsha Ryan, Administrator

FROM: Bruce Dunn, CFA, Chief Investment Officer

SUBJECT: **CIO Discount Rate Setting Comments**
State Insurance Fund
Fiscal Year 2011

[**Introductory Note:** Historical State Insurance Fund portfolio performance and selected bond yield averages over each of the past ten years were recently provided to the Fiscal & Planning Division for the purposes of producing summary information useful for discount rate setting discussions and determination.]

The State Insurance Fund (SIF) portfolio has earned an average per annum total return of **4.53%** over the past ten calendar year period 2000-2009 and **5.12%** over the past five calendar year period 2005-2009. It is interesting to note that the ten-year average annual yield for 10-year maturity Treasuries over the ten-year calendar period 2000-2009 is 4.46% or almost identical to the 4.53% SIF average annual portfolio return over this same most recent ten-year calendar year period. The five-year average annual return of 10-year maturity Treasuries over calendar years 2005-2009 is 4.13% versus the 5.12% SIF average annual portfolio return over this same period. Given this historical information and performance results, the argument can be made to lower the SIF discount rate by ½% to 4.0%. Deloitte Consulting has previously suggested focusing on a 10-year U.S. Treasury yield as the risk-free yield. As a matter of information, the yield of the current market 10-year Treasury note at the time of this writing was 3.62%. Only if one adopts a long-term time frame of ten years can an investor essentially be assured of earning the yield currently available from a 10-year maturity Treasury. If yield levels on 10-year Treasuries at current levels move up even modestly higher (30-40 basis points per year) for several years, then 10-year Treasuries could produce a negative return over that time period. Some investors consider a 3-month Treasury bill to be a true risk-free yield and that instrument is currently yielding an extremely low 0.13% at this time.

Based on the most recently published Mercer Consulting <u>Capital</u> <u>Market</u> <u>Outlook</u> report dated January, 2010, an exercise of calculating expected future rates of return can be made on both the current SIF fixed income portfolio and the current SIF total portfolio with respect to targeted asset mandate weightings per the current investment policy targets for SIF. These asset class mandate weightings were achieved by the BWC investment staff in December 2009 with the completion of certain portfolio transition activities. This asset allocation weighting is broadly a 70% fixed income and 30% equity mix. These calculations reflect the current expected future **twenty-year** rate of return (ROR) assumptions of each asset class Mercer provides in this referenced Capital Market Outlook report relevant to the SIF portfolio. The Mercer twenty-year SIF fixed income portfolio expected average annual future rate of return based simply on the target weights of the current SIF fixed income portfolio asset classes is **5.22%** comprised as follows: 28% long credit bonds @ 6.0% ROR; 17% TIPS @ 4.6% ROR; 15% U.S. Aggregate index bonds @ 4.9% ROR; 9% long U.S. government bonds @ 4.7% ROR and 1% cash at 3.4% ROR. When the 30% weighted allocation for public equities @ 8.3% ROR are included and added (alternative asset classes ignored for this calculation), the total SIF portfolio expected average annual return increases to **6.15%**. Although these projected theoretical rates of returns are certainly not risk-free, the premise can be made that they can be considered as reasonable expected annual returns over a long period of ten years or more for the current asset allocation targets of the SIF portfolio.

Given all of the above historical, current and projected information on yields and portfolio returns, the CIO would support a discount rate reduction to 4.0% from 4.5% for fiscal year 2011. Such a discount rate reduction would be both reflective of the downward trend of the risk-free interest income returns (however defined) available in the U.S. financial markets in recent years as well as the general relatively low yield environment for high quality U.S. government and credit fixed income securities.

Net Asset Policy
Ohio Bureau of Workers' Compensation
Board of Directors

BWC requires a prudent level of net assets 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 investment portfolio; and
- Economic factors impacting BWC's ability to collect premiums.

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

Business Rationale

- Adoption of a net asset 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 net asset 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 net asset policy with guidelines provides flexibility in decision-making with respect to options such as premium credits or surcharges.

Methodology

- 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 unpaid claims and funded claim expenses, excluding any risk margin, discounted at a rate as approved by the Board of Directors).

- Net Leverage Ratio is premium income plus reserves for compensation and compensation adjustment expense divided by net assets.

Guiding Principles

- 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 guideline for a funding ratio should never be below 1.00.
- Should reflect the unique characteristics of the Ohio system. We have less stress on premiums and have more flexibility on the level of liabilities than a private carrier. The guidelines also reflect the statutory obligation to maintain a solvent fund with the lowest possible premiums.

The Net Asset policy

- Should incorporate the concept of 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 portfolio market valuation.

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

1. The Administrator, with approval from the BWC Board of Directors, should establish guidelines for a Funding Ratio and a Net Leverage Ratio.
2. The 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. Deviations from the established guidelines shall be reported monthly and evaluated at least annually. At least annually, the Administrator, in conjunction with the appropriate senior executives, should prepare a recommendation to address variations from the guidelines.
4. The Administrator shall present these recommendations to the Board of Directors for review and approval.
5. The Board of Directors shall review guidelines for the Funding Ratio and Net Leverage Ratio on an annual basis.

Policy Guidelines

Review Date	Funding Ratio Guideline	Net Leverage Ratio Guideline
July 31, 2009	1.02 to 1.35	3.0:1 to 8.0:1

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
2009	$2,456,xxx	1.14	8.22
Policy Guidelines			
2010		1.02 to 1.35	3.0:1 to 8.0:1

*Net asset policy with Guidelines adopted by the Board of Directors in July 2009. Data previous to 2009 is for historical purposes only.

Audit Committee: Reviewed and approved July 30, 2009, Ken Haffey, Chair
Board of Directors: Reviewed and approved July 31, 2009, Bill Lhota, Chair

Ohio Bureau of Workers' Compensation
Financial Performance Metrics

Introduction

The Monthly Board Financial Reporting Package presents financial results for the current period, projected results, and prior year results. In addition to looking at the raw numbers, ratios are calculated and used to analyze BWC's profitability. These ratios are presented for the current fiscal year to date, projected fiscal year to date, prior fiscal year to date, fiscal year-end forecast, and the last five fiscal year ends.

The ratios enable BWC to benchmark against our peers in the workers' compensation industry. BWC's insurance profitability ratios have been calculated using information contained in BWC's audited financial statements prepared in accordance with generally accepted accounting principles (GAAP). Most private insurance carriers and some state insurance funds prepare financial statements on a statutory accounting basis (SAP). Comparisons of BWC's ratios to industry performance will not be a true apples-to-apples comparison. Major differences will be caused by the following:

- BWC discounts all reserves for compensation and compensation adjustment expenses while most insurance carriers either do not discount their reserves or discount on a very limited basis.
- BWC's investments are reported at fair value, with the change in fair value reported as an unrealized gain or loss in the Statement of Operations. Under SAP bonds are normally reported at amortized cost in the balance sheet, while stocks are reported at values published by the National Association of Insurance Commissioners (NAIC), which are generally fair values, with unrealized gains and losses recognized through a charge to statutory surplus in the balance sheet.
- BWC's exclusive state fund status provides BWC an advantage in that there are no commission, brokerage, or income tax expenses.
- BWC establishes rates at the lowest level possible in order to maintain a solvent State Insurance Fund. This is in contrast to private insurance carriers who must maintain surplus above levels established by state insurance regulators.
- Unlike private insurance carriers, BWC has a separate assessment for administrative costs. The administrative cost assessment is calculated on a pay-as-you-go basis, while liabilities are recognized as incurred. Consequently, the incurred compensation adjustment expenses are not fully funded.

BWC has obtained data from A.M. Best, a widely recognized rating agency dedicated to the insurance industry, from Ward Group, a widely recognized provider of insurance industry benchmarking, best practices and research studies, and from state fund financial statements. BWC utilized data from the state funds in California, New York and Washington, the A.M. Best Composite which consists of groups and companies for which more than 50% of their business is in the workers' compensation line, and six of the largest private workers' compensation carriers.

Ohio Bureau of Workers' Compensation
Financial Performance Metrics

Funding Ratio

Definition: Provides an indication of financial strength and security by evaluating a company's funded assets in relation to its funded liabilities.

For consideration and discussion:

- The funding ratio for four of the six private companies is between 1.5 and 2.0; and
- Two private carriers maintain funding ratios over 2.0 and state funds maintain ratios from 1.0 to 1.5.

Recommendation: Through prudent investments, lowest possible premiums and careful expense management, **the target funding ratio should have a range of 1.15 and 1.40**. This would place Ohio in a comparable position with other state funds (Washington 1.18; California 1.32 and New York 1.44).

Net Leverage Ratio

Definition: Measures a company's exposure to pricing errors and errors in estimating its liabilities in relation to net assets. Premium income and reserves for compensation and compensation adjustment expenses are compared to net assets.

For consideration and discussion:

- Four of the six private carriers had a net leverage ratio of 4.0 or less; and
- State funds maintain net leverage ratios between 4.0 and 8.4.

Recommendation: The target funding ratio range above will produce a net leverage ratio range of 2.97 to 7.93. This assumes the necessary increases in total net assets and total funded assets to achieve the indicated funding ratio and what impact those increases would have on the net leverage ratio if liabilities and premiums remain constant. It should be noted that this ratio is significantly impacted by changes in the market value of the portfolio. **As such, the target net leverage ratio should have a range of 3.0 to 7.0**. This would place Ohio in a comparable position with other state funds (Washington 8.59; California 3.30 and New York 4.50).

Net Loss Ratio

Definition: Net loss ratio measures a company's underlying profitability, or loss experience on its total book of business. Losses and loss adjustment expenses (LAE) are compared to premiums and assessments.

For consideration and discussion:

Ohio (5 year average)[1]	95.8%
Washington (5 year average)	155.1%

[1] BWC's 5 year average excludes the $1.9 billion impact of the 2007 adjustment to income related to a statutory change in accounting for the Disabled Workers' Relief Fund.

California (5 year average)	86.1%
Workers' Comp Composite (5 year average)	79.2%

Recommendation: BWC's five year average noted above reflects an average loss ratio of 78.6% and an average LAE ratio of 17.2%. The net loss ratio was the highest in Fiscal Year 2005. Continued declines have occurred as BWC has stabilized the reserving methodology and reduced the discount rate. This is expected to continue as management reviews the current reserve methodology associated with claims costs and the loss adjustment expenses, as well as the continued decline in the discount rate. **Based on this, management is recommending a target net loss ratio of 102.5%.**

Expense Ratio

Definition: The expense ratio measures a company's operational efficiency in underwriting its book of business. Expenses are compared to premiums and assessments.

For consideration and discussion:

Ohio (5 year average)	3.6%
Washington (5 year average)	9.6%
California (5 year average)	18.9%
Workers' Comp Composite (5 year average)	22.9%

Recommendation: The five year average noted above is reflective of BWC's allocation of administrative costs between loss adjustment expenses and other expenses. Evaluation of this allocation in the current fiscal year will result in a lower percentage of costs allocated to LAE and, as a result, an increase in the expense ratio. **Based on this, management is recommending a target expense ratio of 7.5%.**

Combined Ratio after Policy Holder Dividends

Definition: The combined ratio after policyholder dividends measures a company's overall underwriting profitability.

For consideration and discussion:

Ohio (5 year average)	101.4%
Washington (5 year average)	164.6%
California (5 year average)	105.0%
Workers' Comp Composite (5 year average)	105.9%

Recommendation: This ratio is a compilation of the net loss ratio and the expense ratio. **Based on the recommendations noted above, the target combined ratio would be 110%.**

Operating Ratio

Definition: The operating ratio measures a company's overall operational profitability from underwriting and investment activities (excluding realized and unrealized investment gains and losses). Total expenses, net of the impact of investment income, are compared to premiums and assessment income.

For consideration and discussion:

Ohio (5 year average)	73.5%
Washington (5 year average)	118.5%
California (5 year average)	85.1%
Workers' Comp Composite (5 year average)	88.2%

Recommendation: The operating ratio is a function of both operating results and investment results. The five-year average investment income ratio at the end of FY 2009 is 27.9%. In the past five years, the investment income ratio has been as high as 38.6% to a low of 18.53%. Two years ago, the five-year average investment income ratio was 16%. BWC has currently completed a transition of the investment portfolio to a new asset allocation. In order to remain conservative in our approach, it is anticipated that the investment income ratio will be approximately 20%. **Based on this, management is recommending a target operating ratio of 90%.**

12-Month Audit Committee Calendar

Date	March 2010
3/25/2010	1. Internal Audit QES Review
	2. Survivorship Rule 4123-17-02 (2nd Reading)
	3. Discount Rate and Financial Metrics (1st Reading)
	4. Inspector General Annual Report (Executive Session)
Date	**April 2010**
4/29/2010	1. Discussion of External Audit
	2. Discount Rate and Financial Metrics (2nd Reading)
	3. FY 2011 Administrative Budget (1st Reading)
	4. Quarterly Litigation Update (Executive Session)
	May 2010
5/27/2010	1. FY 2011 Administrative Budget (2nd Reading)
	2. Internal Audit Charter
	3. Metrics Review
	June 2010
6/17/2010	1. Internal Audit QES Review
	2. FY 2011 Audit Plan and Budget
	3. FY 2011 Financial Projections (1st Reading)
	4. External Audit Update
	July 2010
7/28/2010	1. FY 2011 Financial Projections (2nd Reading)
	2. FY 2012/13 Biennial Budget (1st Reading)
	3. Quarterly Litigation Update (Executive Session)
	August 2010
8/26/2010	1. BWC Code of Ethics Review
	2. FY 2012/13 Biennial Budget (2nd Reading)
	3. External Audit Update
	September 2010
9/23/2010	1. Internal Audit QES Review
	2. Inspector General Semi-Annual Report (Executive Session)
Date	**October 2010**
10/21/2010	1. Audit Committee Charter Review (1st Reading)
	2. Quarterly Litigation Update (Executive Session)
Date	**November 2010**
11/18/2010	1. External Audit Update
Date	**December 2010**
12/15/2010	1. Internal Audit QES Review
	2. Office of Budget and Management Update – BWC Staff Transfer

12-Month Audit Committee Calendar

	Calendar 2011
Date	**January 2011**
TBD	1. Annual Disaster Recovery/Business Continuity Plan
	2. External Audit Comments - Update
	3. Quarterly Litigation Update (Executive Session)
Date	**February 2011**
TBD	