

BWC Board of Directors

AUDIT COMMITTEE

Wednesday, December 16, 2009, 2:30 p.m.

William Green Building

30 West Spring Street, 2nd Floor (Mezzanine)

Columbus, Ohio 43215

Members Present: Kenneth Haffey, Chair
Robert Smith, Vice Chair
William Lhota
James Harris
James Matesich

Members Absent: None

Other Directors Present: James Hummel, Thomas Pitts, Alison Falls, Charles Bryan,
Larry Price

CALL TO ORDER

Mr. Haffey called the meeting to order at 2:28 PM and the roll call was taken.

REVIEW/APPROVE AGENDA

Mr. Haffey noted a change to the Agenda under "Discussion Items" to include an updated discussion of reinsurance. The agenda as amended was approved by unanimous roll call vote on a motion by Mr. Haffey, seconded by Mr. Matesich.

MINUTES OF NOVEMBER 19, 2009

The minutes were approved without changes by unanimous roll call vote on a motion by Mr. Smith, seconded by Mr. Matesich.

NEW BUSINESS / ACTION ITEMS

1. FY 2010 1st Quarter Executive Summary

Caren Murdock, Chief of Internal Audit, reviewed the 1st Quarter Executive Summary. The Internal Audit Division performed two consulting projects at the request of management: one involving the Adjudicating process, the other involving the Black Lung and Marine Funds.

Mr. Haffey inquired what type of follow-up is performed on consulting engagements. Ms. Murdock explained that there is no follow-up because the

comments given are merely suggested methods of improvement. However, the comments are considered during the annual risk assessment process. In response to a question from Mr. Price, Administrator Marsha Ryan explained that the Adjudicating project was a follow-up to the 2008 Kaizen project to make certain nothing critical was omitted. Chief Legal Counsel James Barnes added that there is now both an internal committee to monitor the process and an ongoing audit component, including the 32 policies which have been created to provide consistency across business units and address the most common Adjudicating issues.

Ms. Murdock then reviewed the eighth MCO audit, noting that while internal controls are good, there was one material weakness found where a program change caused errors. It was advised that such changes need to be tested and approved. Per a question from Ms. Falls as to why target resolution dates of October 2009 are included in the report, Ms. Murdock advised that this report shows activity as of September 30, 2009. Mr. Haffey asked if the MCO's address comments in a timely fashion. Ms. Murdock replied that comments are usually addressed within one quarter, and the internal audit department does validate the implementation.

There are six (6) new audit comments and sixty-four (64) outstanding comments. This is the lowest number of outstanding comments since 2007. 83% of current outstanding comments were issued between FY 08 to current.

Ms. Murdock noted that unless management asked for an extension, 75% of the outstanding comments (including 71% of the material comments) would be addressed and implemented over the next six months.

75% of overall comments have been implemented, while management has accepted the risk on 7% of comments issued since FY 2006.

Per a question from Mr. Pitts regarding BWC's position on Medicare Secondary Payer laws, Mr. Barnes stated that a position paper has been prepared which is subject to the attorney-client privilege.

Ms. Murdock concluded by reviewing changes to the audit plan, including a shift in the audit focus of the Self-Insured Division from bankrupt employers to underwriting.

2. Continuous Investment Monitoring

Ms. Murdock, Karl Zarins, Internal Audit Director, and Mike Overmyer, Investment Compliance Program Manager gave a presentation concerning the continuous monitoring process to ensure management is in compliance with statutory requirements and the Investment Policy Statement (IPS). Staff is in the early stages of developing this process. The proposed continuous investment monitoring process consists of the following five (5) steps:

- Identifying the compliance requirements (IPS, statutory and internal policy);
- Understanding the process and controls used by the Investment Division to ensure compliance with requirements;
- Evaluating compliance risk;
- Developing periodic control testing; and
- Reporting results.

An excerpt from the document Internal Audit is designing to list the key Ohio Revised and IPS compliance requirements was reviewed. One of the examples is the requirement that prohibits an Outside Investment Manager's employees to have never been convicted or pled guilty to a financial or investment crime. Ms. Falls asked how this can be determined when working with a large investment firm. It was explained the provision is limited to those working on the BWC account. Ms. Murdock noted this requirement is included in the BWC IPS.

The first report on this continuous monitoring process is scheduled for June 2010. Mr. Lhota asked if there is a written procedure manual for compliance monitoring. Ms. Murdock responded that one will be created. Per a question from Mr. Haffey, Ms. Murdock stated that due to personnel and budgetary constraints, there is no planned expansion of compliance monitoring at this time.

3. FY2009 Comprehensive Annual Report

Statute requires BWC and the Industrial Commission to prepare an annual report. The report includes information on the performance of each investment class, the HPP Program, the annual financial statement, the Safety and Hygiene Division report, and the Industrial Commission report. No further comments were forthcoming.

Mr. Matesich moved that the Audit Committee of the Workers' Compensation Board of Directors accept the recommendation of the Administrator to approve the BWC Annual Report and refer it to the Board of Directors for review, approval and release. The motion was seconded by Mr. Smith and approved by unanimous roll call vote.

4. Reinsurance Discussion

Ray Mazzotta, Chief Operations Officer, and Tracy Valentino, Chief of Fiscal and Planning followed up on last month's presentation by Towers Perrin on the role of reinsurance for BWC. Separate types of coverage are available for natural disasters such as an earthquake, and NCBR (nuclear, chemical, biological and radioactive). These would supplement federal Terrorism Reinsurance Act (TRIA) coverage for terrorist activities. The 5-10 reinsurers who would participate are all rated at A- or above.

Mr. Mazzotta is satisfied with the design and pricing (\$4.8 Million) of the natural disaster coverage. The NCBR coverage is about the same price. He clarified that an accident at a nuclear plant would be covered as a natural occurrence, while a

“dirty bomb” would fall under NCBR. If BWC purchases all available coverage, the approximate cost is \$11 million or .003% of the net assets and less than 0.1% of premiums for the State Insurance Fund. The premium expense would be classified as a reduction in revenue for accounting purposes.

A discussion ensued among the directors concerning several topics, including whether other private insurers or state funds utilize such coverage, methods of evaluation, the reasonableness of the expenditure, possible use of a “double trigger” and potential media reaction. Administrator Ryan commented that Deloitte recommended BWC evaluate reinsurance, and whatever decisions the Board makes need to be documented. She noted that if we decide to purchase coverage, it doesn’t mean we think bad things are going to happen. Mr. Matesich noted from a business perspective, it makes sense to prepare for the unknown. Reinsurance would protect the assets of employers and employees.

Per a question from Mr. Bryan, Mr. Mazzotta stated that the overall price is comparable to what Towers Perrin estimated, but there is a good deal of divergence in pricing on the NCBR coverage.

John Pedrick, Chief Actuarial Officer, and Bruce Dunn, Chief Investment Officer, both emphasized that it is imperative to avoid a cash flow dilemma which would result in assets being sold under duress or panic due to a catastrophic event. Reinsurance is a risk reduction mechanism.

Mr. Lhota opined that reinsurance could be a prudent decision. He asked about the applicability, if any, of reinsurance to self-insuring employers. Mr. Mazzotta replied that it would not be applicable because there is no insurable BWC interest before the act occurs. Administrator Ryan noted that SI employers investigated reinsurance about six (6) years ago on their own and rejected it, but the topic can be raised with them.

The Committee and other Directors agreed that this ongoing evaluation and decision process should not be rushed, and the various coverage components should be carefully considered. Further input from Deloitte was requested, as well as research on what other entities have determined about the value of reinsurance. Mr. Mazzotta clarified that the broker is receiving a flat fee irrespective of what or how much coverage is purchased.

DISCUSSION ITEMS

1. Open Discussion with Internal Auditor

No questions were presented to Ms. Murdock, and Director Haffey acknowledged all issues were covered in earlier presentations.

2. Committee Calendar

Mr. Haffey commented that a disaster recovery update, the quarterly litigation update and review of external audit management letter comments will occur at the January meeting. Joe Bell will report on IT audits at the February meeting.

ADJOURNMENT

Mr. Smith moved to adjourn the meeting at 4:05 PM, seconded by Mr. Matesich and approved by unanimous roll call vote.

Prepared by Jill Whitworth, Staff Counsel
December 17, 2009