

AUDIT COMMITTEE

Thursday, January 21, 2010, 8:00 a.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 (arrived at 8:15 AM)

Members Absent: None

Other Directors Present: James Hummel, Thomas Pitts, Alison Falls, Charles Bryan,
David Caldwell

CALL TO ORDER

Mr. Haffey called the meeting to order at 7:59 AM and the roll call was taken. Mr. Matesich was not present at this time.

MINUTES OF DECEMBER 17, 2009

The minutes were approved without changes by 4-0 unanimous roll call vote on a motion by Mr. Lhota, seconded by Mr. Smith.

REVIEW/APPROVE AGENDA

Mr. Haffey noted no changes to the Agenda. The agenda was approved by 4-0 unanimous roll call vote on a motion by Mr. Smith, seconded by Mr. Lhota.

NEW BUSINESS / ACTION ITEMS

1. Annual Disaster Recovery

Tom Croyle, Chief Information Officer, gave a presentation on the annual disaster recovery update. Mr. Croyle stated that he believes the appropriate balance has been achieved between cost and preparedness, because the expense is necessary when a disaster is declared. Since 2000, there have been 16 declared disasters in Ohio, primarily due to floods and tornados.

The disaster recovery plan addresses both mission critical systems such as V3 and WCIS, and ancillary systems such as e-mail. Systems with the heaviest usage are

spread across several servers. BWC has contracted with IBM for remote storage in New York, as well as use of a local site in Plain City. BWC also works with the state Office of Information and Technology locally to recover ancillary systems. This is riskier in the event that a disaster would affect the greater Columbus area, which is why it is used only for less critical systems. Mr. Croyle reviewed a research study by Gartner, Inc. confirming the BWC disaster recovery plan met industry practices.

Testing is done twice a year offsite to avoid disruption to the William Green Building operations. Recovery teams meet on a monthly basis. Over the past five years, testing has successfully met the 48-hour recovery period. Readiness costs were reduced in 2009, primarily from transferring outsourced printing costs to state government, and reducing travel. Mr. Croyle stated the goal is to be able to perform testing so no travel is involved. There were 21 issues with the fall 2009 test, but these did not affect the successful implementation of recovery within 48 hours.

In general, there were several system outages in 2009 which affected BWC operations. Two of these outages occurred on the final payroll payment dates due to peak usage. Mr. Croyle stated work is being done to correct this prior to the next such payment date in February. External customers are notified of such system issues on the BWC web site "banner" page and requested to return at a later time. Vendor software issues also caused system problems on Thanksgiving Eve.

Ms. Falls inquired about personnel notification procedures. Mr. Croyle noted there is a chain of command notification procedure for critical personnel, which was successfully tested within the last month. Per a question from Mr. Lhota, there is a Halon fire protection system in the server room, which extinguishes a fire by forcing air out of the room. The back-up system is a sprinkler system.

2. External Audit Management Letter Comments - Update

Tracy Valentino, Chief of Fiscal and Planning, addressed the management letter comments, in particular the significant deficiency with respect to MCO SAS70 reporting. This issue remains from FY08 because it had not been completely resolved by the beginning of FY09. For clarification, the SAS70 is an evaluation of internal control review and testing for each MCO. Controls tested include such items as physical access, program access, timeliness of information, payment to providers, and information transfer from the MCO to BWC. Mr. Smith commented that he views the SAS 70 as an indication of reliability. Per a question from Mr. Bryan, Ms. Valentino stated that the SAS70 is required to provide BWC's external auditors with assurance as to the control environment at each MCO and thereby reducing the amount of testing BWC's external auditors would need to complete with respect to MCO activity. BWC's internal auditors perform limited MCO testing and evaluations.

The significant deficiency particularly relates to BWC follow-up to make sure that the testing is sufficient. Mr. Bryan asked, given that the MCO's are vendors, why

BWC can't simply elect not to renew the contracts with those who don't comply. Per a question from Mr. Harris, there are 3 non-compliant MCO's out of 24. Ms. Valentino outlined BWC's response plan, which included meeting with the MCO's, notification by letter, training, and revision to the MCO contract to impose penalties. This will be addressed with the BWC external auditors in an upcoming audit pre-planning meeting.

Mr. Haffey noted that his firm prepares a SAS70 report for an MCO. Mr. Haffey stated he has no involvement with this client. Based on BWC's response to the audit comments, he feels BWC has done a very thorough job at letting the MCO's know what is required. Mr. Haffey noted that since 2005, the detail required in SAS70 reports has increased, and some audit firms simply aren't qualified to prepare such a comprehensive report.

Ms. Falls asked what would occur if there were 3 MCO reporting deficiencies this year. Administrator Marsha Ryan asked Bob Coury, Chief of Medical Services and Compliance, to respond. Mr. Coury stated that the penalties are significant, including denying the MCO the ability to add employers, and withholding administrative payments. The MCO's take this very seriously. If there is further non-compliance, BWC could declare a breach of the contract. Mr. Coury stated he found this audit comment somewhat unfortunate because the plan to address the deficiency was already in place. Mr. Haffey concurred, stating he and Ms. Valentino discussed it with the external auditors, and had no indication this was a continuing problem from the external auditor's perspective. This comment is the external auditor's judgment call.

Mr. Pitts questioned whether such deficiency could impact the MCO's delivery of services to injured workers. Mr. Coury commented that if internal controls are inadequate, services could be impacted. Ms. Valentino noted that untimely transfer of information could affect BWC's financials.

In closing, Mr. Smith and Mr. Haffey stated it is clear BWC took its responsibilities seriously and diligently in addressing the audit comment, but only so much can be done when dealing with vendors.

3. Reinsurance Recommendation

Ray Mazzotta, Chief Operations Officer, and Tracy Valentino, Chief of Fiscal and Planning reviewed the reinsurance recommendation memorandum they prepared dated December 21, 2009, and summarized prior discussion of the types of reinsurance coverage available. Separate types of coverage are available for natural disasters such as an earthquake, and NBCR (nuclear, biological, chemical and radioactive). These would supplement federal TRIA coverage for terrorist activities.

Page 3 of the memorandum discusses the "double trigger" concept, and whether reinsurance could be triggered if the BWC investment portfolio fell below a certain level. This is not an insurable risk, so this option was removed from discussion.

Mr. Mazzotta reviewed a comparison chart of reinsurance procured by other state funds, in particular the “low-end” and “high-end” retention and limits of Hawaii and California respectively.

It was recommended that BWC purchase reinsurance coverage Section A (all natural perils excluding NCBR for an additional \$250 million above retention) and Section C (reinsurance for the 15% required co-pay retention associated with TRIA for NCBR Terrorism). It is anticipated that the effective date of the coverage would be April 1, 2010. The total yearly premium cost would be approximately \$5.5 million. Ms. Valentino stated Deloitte had concurred with this structure.

A discussion ensued concerning whether further Audit Committee and/or Board approval was necessary with respect to the contract terms. Mr. Smith noted that the recently completed comprehensive study recommended we study the possibility of reinsurance, and the consultant (Towers Perrin) hired to assess the situation recommended these coverage levels. Mr. Bryan expressed a concern that the Board should know if something substantial was changed. Per suggestion of Mr. Lhota, it was agreed that the Audit Committee Chair and Board Chair would approve final action.

Motion was made by Mr. Harris, seconded by Mr. Smith, that the Audit Committee recommend to the Board of Directors that it approve the Administrator’s recommendation, per the memorandum dated December 21, 2009 from the Chief Operating Officer and Chief Financial Officer, to obtain reinsurance coverage for the State Insurance Fund for natural disasters and catastrophic industrial accidents at terms favorable to the Bureau and as discussed today, with the approval of the Chair of the Audit Committee and the Chairman of the Board. The motion was approved by unanimous roll call vote.

DISCUSSION ITEMS

1. Open Discussion with Internal Auditor

Caren Murdock, Chief of Internal Audit, noted that S.B. 4 had been passed at the Senate State and Local Government and Veterans Affairs Committee. This would require the Auditor of State to conduct yearly performance audits of BWC and 4 other state agencies. These performance audits are intended to ensure accountability and improve efficiency. The proposed legislation will now go to the full Senate.

Internal Audit staff is currently evaluating all outstanding comments for discussion at the March meeting. There are 3 ongoing audits and 7 other projects, 5 of which will also be discussed at the March meeting. Ms. Murdock also noted that Joe Bell will discuss OBM audit reviews of IT at Executive Session in February. The internal audit charter is being updated to reflect the current Institute of Internal Auditors standards.

No further questions were forthcoming.

2. Committee Calendar

There were no changes to the committee calendar.

3. Quarterly Litigation Update (Executive Session)

Upon motion by Mr. Lhota, seconded by Mr. Smith, and approved by unanimous roll call vote, the Committee adjourned to executive session at 9:27 AM for the quarterly litigation update presented by Legal Counsel Ann Shannon.

Mr. Smith departed the meeting at 9:30 AM.

ADJOURNMENT

Mr. Lhota moved to adjourn the meeting at 9:33 AM, seconded by Mr. Harris and approved by unanimous 4-0 roll call vote.

Prepared by Jill Whitworth, Staff Counsel
January 21, 2010