

BWC Board of Directors

AUDIT COMMITTEE

Wednesday, July 28, 2010, 1:30 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, Larry Price,
David Caldwell

Counsel Present: None

Scribe: Jill Whitworth

CALL TO ORDER – JULY 28, 2010

Mr. Haffey called the meeting to order at 1:35 PM and the roll call was taken. All committee members were present.

MINUTES OF JUNE 18, 2010

The minutes were approved without changes by 5-0 unanimous roll call vote on a motion by Mr. Smith, seconded by Mr. Lhota.

REVIEW/APPROVE AGENDA

Mr. Haffey noted no changes to the Agenda. The agenda was approved by 5-0 unanimous roll call vote on a motion by Mr. Matesich, seconded by Mr. Smith.

NEW BUSINESS / ACTION ITEMS

1. FY 2010 3rd Quarter Executive Summary

Caren Murdock, Chief of Internal Audit, reviewed the FY2010 3rd Quarter Executive Summary for Internal Audit. Her presentation included reference to the “FY 10 3rd Quarter Executive Summary Report” of July 28, 2010, which is incorporated by reference into the minutes.

Ms. Murdock initially clarified that the report covers the quarter ending March 31, 2010. The Internal Audit Division (IAD) performed three consulting projects and two audits. The consulting projects are as follows:

- Coal Mine Safety Program
The consult was performed to evaluate controls at both BWC and the Ohio Department of Natural Resources (ODNR). No material inappropriate expenditures were found. It should be noted this is not related to the Coal Mine Permitting program for which BWC funding was discussed at a prior meeting.
- Warrant Printing
The consult was performed to review procedures based upon the recent transfer of warrant printing functions to the Department of Administrative Services (DAS). Most of the controls over the revised process appeared reasonable. Two recommendations to improve internal controls were made.
- Outside Investment Manager (OIM) Background Check Process
The consult was performed to review the Investment Division’s fingerprinting and background checks for compliance with statutory and Investment Policy Statement procedures. The exception found was a failure to compile a five-year residency list for OIM personnel, as required by Ohio Revised Code §4123.444(B)(1). The exception has been addressed.

Mr. Haffey noted the warrant process project is an example of IAD’s flexibility to allocate time and personnel when new risks arise or when management requests assistance.

IAD conducted an audit of death benefit claims, which occur at the rate of approximately 200 per year. Internal controls were reasonably designed, but several weaknesses were noted. A “Material Weakness” was found in that 28% of claims had problems with average weekly wage rate calculations, resulting in underpayment or overpayment. Tina Kilmeyer, Chief of Customer Service, discussed the steps taken to resolve this issue. Mandatory rate-setting training

was performed and will be required annually, along with proficiency testing and an improved audit tool. Additionally, subject matter experts will audit all initial wage and benefit calculations for accuracy. Over the long-term, accuracy checks will be built into V3, and a specialized claims team will be created for greater control and consistency. Per a question from Mr. Smith, Ms. Kielmeyer stated this was a new approach. Per a question from Mr. Hummel, Ms. Kielmeyer affirmed that wage calculations are usually performed once at the onset of the claim, unless new wage information is received. Mr. Pitts asked if underpaid claims have been corrected. Ms. Kielmeyer replied in the affirmative, and clarified that the look-back period for such correction is the life of the claim, rather than two years.

IAD also conducted an audit of the Self-Insured Underwriting (SIU) Unit, to assist management in evaluating the unit's operational efficiency. Internal controls were not adequately designed in several areas, as follows:

- There was a "Material Weakness" in the segregation of duties. The SIU Director had the final authority to approve or disapprove applications or require securitization regardless of the financial analyst or supervisor recommendations. This created a risk of a financially unstable employer being granted self-insured status. Management will develop and implement policies to create review criteria and a group decision process.
- There was a significant application backlog. Untimely processing of applications was at a 31% level. Resources are being devoted to correct the problem.
- It was recommended that the SIU Unit develop policies and procedures related to non-renewal of self-insured employers, and failure to submit required forms and financial information in a timely manner.

Ms. Murdock next gave a general overview of 63 outstanding internal audit comments. This figure is a major reduction from those in 2007 (127), 2008 (126), and 2009 (106). 89% of outstanding comments are from 2008 to present. Many older comments have been fully resolved, and new comments are addressed in a timelier manner. The bulk of outstanding comments are located in two areas, Customer Service and IT.

Ms. Murdock gave brief overviews of outstanding comments in the following areas:

- Medical Billing and Adjustments
The Request for Proposal to convert all medical payments to the Cambridge system is on hold because a larger, multi-system review is being evaluated.

- Risk / Employer Operational Review
Comment 1 has been implemented regarding cross-checks with other agencies to uncover non-complying and no-coverage employers. Ms. Falls questioned how this would be categorized as the risk of a material misstatement in BWC financials. Ms. Murdock stated this was originally performed in 2006, before she assumed her position, and definitions may have changed over time. Mr. Matesich asked whether there is a specific audit trail created over time to show history. Ms. Murdock responded that workpapers are retained, and a detailed history is also located on Sharepoint.
- Manual Override
Rate reform is ongoing which will address rating inequities. Mr. Matesich questioned why this issue was categorized under this particular topic. Ms. Murdock explained that this problem was identified during the course of the Manual Override audit in 2006 and is the only remaining comment.
- IT Risk Assessment
Monitoring and login software has been validated to correct security violations.
- Pharmacy Benefit Manager
Action on this issue was delayed due to personnel replacement issues. The new pharmacy benefit vendor is assisting in establishing benchmarks.
- Vocational Rehabilitation
Comment 1 a workflow is being revised to address validation of costs. Comment 2 an analysis of MCO referrals to related companies was presented to the Medical Service and Safety Committee in April. Management is performing additional research to identify the best solution. Comment 3 quarterly reviews of the Rehabilitation Services Commission are being conducted.
- Medical Bill Payment
A plan has been developed with respect to provider recertification, but this is not designated as a priority item by the Project Governance Board.
- Subrogation
Funding has been approved for a systems overhaul which will begin in August and take 9-12 months to complete.

Ms. Murdock noted there are no material changes this quarter to the annual audit plan. Mr. Haffey asked how much advance notice is given that an internal audit will be performed. Ms. Murdock stated that all senior team members receive the audit plan. IAD gives 2weeks' notice prior to the entrance conference, and work to coordinate the schedule so it does not create a great deal of interference with normal operations.

2. OBM Office of Internal Audit FY 2011 IT Audit Update

Joe Bell, Office of Budget and Management (OBM) Chief Audit Officer, along with OBM associates Raj Subramanian and Jim Kennedy, presented an update on the IT Audit Plan. There are two identified areas. The Cambridge system is being evaluated internally for incident reporting, and also must be evaluated externally because of outside processing involvement. This has been delayed until the second quarter because of workload issues. IT general controls are also being evaluated and tested. Ms. Murdock is fully informed and these items have been incorporated in to the IAD audit plan. Mr. Bell and Ms. Murdock plan to update the State Audit Committee regarding BWC audit activity, processes and controls.

3. Motion for Board Consideration

A. For First Reading

1. FY 2011 Financial Projections

Tracy Valentino, Chief of Fiscal and Planning, and Ray Mazzotta, Chief Operating Officer, reviewed the FY 2011 Financial Projections. The presentation included reference to the "Executive Summary – Fiscal Year 2011 Financial Projections" of July 28, 2010, which is incorporated by reference into the minutes.

The summary includes a three-page narrative along with projected statements of operations and cash flow. It does not include a balance sheet. The statement of operations includes operating revenues, operating expenses and investment income. Operating revenues are \$232 million less than FY2010, which is consistent with rate decreases. Recommendations in the Deloitte study have been implemented, decreasing the administrative expenses allocated to compensation adjustment from 82% to 68.8%.

With respect to the projected statement of cash flows, projected income and historical payment trends are used in the calculations. Cash used for capital is declining because it is based upon the William Green Building bond payment. There is a net decrease of \$290 million, with a projected year-end cash balance of \$144 million. Per a question from Mr. Matesich, Ms. Valentino clarified that the "net cash provided by investment activity" figure is comprised of dividend and investment income offset against sales and purchases. Mr. Matesich inquired about whether the use of two reporting cycles over a one-year period can really be deemed a "trend" for the purpose of projecting premium income. Ms.

Valentino stated that payroll receipts had been holding steady until the last two reporting periods, and then declined. While this may not be a “trend”, more weight was placed on recent activity given the uncertainties surrounding payroll figures. Mr. Haffey and Ms. Valentino agreed that there will not be a great deal of modification to these figures from the audit adjustments.

Mr. Mazzotta reviewed the projected insurance ratios. Most of the ratios are healthy and well within designated ranges. The operating ratio is slightly higher, but reasonable. However, the net loss ratio and combined ratio are not within designated guidelines. The plan is to work with Deloitte over the next six months to examine accuracy of the guidelines. Ms. Falls commented that such review is entirely appropriate, rather than artificially altering the guidelines to fit the budget. She continued that it may be necessary to have a higher funding ratio, but then we would have to lower the net leverage ratio.

2. FY 2012/2013 Biennial Budget

Ms. Valentino reviewed the FY 2012/2013 Biennial Budget. The presentation included reference to the “Executive Summary – Fiscal Year 2012-2013 Biennial Budget” of July 15, 2010, which is incorporated by reference into the minutes.

The budget reflects proposed funding for the Administrative Cost Fund, Safety & Hygiene Fund, Disabled Workers’ Relief Fund, Marine Industry Fund, and Coal Workers’ Pneumoconiosis Fund. This will be submitted to OBM and the General Assembly in February 2011.

Under the recently released OBM budget submission guidelines, the FY 2012-13 budget request cannot exceed 100% of the current appropriation level. BWC is proposing a total budget of \$300 million for each year. These figures reflect a \$28 million (9%) decrease from current appropriation. However, it is 6% higher than the budget approved by the Board, due to the elimination of Cost Savings Days and the return of step increases in pay for employees.

Mr. Lhota asked about a \$5 million decrease in payroll in FY 2013. Ms. Valentino explained that the FY 2012 figure reflects a one-time payout to restore 32 hours employee personal leave. Mr. Hummel inquired about increases for safety grants and long term care loans. This is the effect of changes to these programs which occurred in 2010. Mr. Matesich asked if there had been any discussion of moving funds previously allocated to the building bond payment to a capital improvement fund. Ms. Valentino stated this has been discussed in a general sense, but not the use of a separate fund. Work on the elevators should be finished in FY 2011.

DISCUSSION ITEMS

1. Open Discussion with Internal Auditor

Ms. Murdock reported that IAD has begun validating the 4th Quarter Executive Summary. Management reported twenty-one comments are implemented and ready for validation. Ten comments have missed the target resolution dates and have not been reported as implemented by management. A meeting was held with external auditors Schneider Downs on July 15, in preparation for further auditing beginning August 9. Eleven projects are in process – 3 in planning, 4 in field work and 4 in final phase. Staff resources continue to be adequate for project coverage.

Mr. Haffey commented that the meeting with Joe Patrick of Schneider Downs was productive and all parties are on the same page.

2. Committee Calendar

There were no changes to the calendar.

3. Quarterly Litigation Update

Mr. Lhota moved to adjourn to executive session for a quarterly litigation update by James Barnes, General Counsel. The motion was seconded by Mr. Smith and approved by 5-0 unanimous roll call vote at 3:17 PM.

ADJOURNMENT

At 3:50 PM, the Committee returned from Executive session. Mr. Lhota moved to adjourn the meeting. The motion was seconded by Mr. Matesich and approved by 5-0 unanimous roll call vote.