



STATE AUDIT COMMITTEE

**MONDAY, SEPTEMBER 23, 2013, 10:00 A.M.
RHODES STATE OFFICE TOWER
30 EAST BROAD STREET, 35TH FLOOR, JUPITER/SATURN CONFERENCE ROOMS
COLUMBUS, OHIO 43215**

Members Present: Paolo DeMaria
Kai Monahan
John Merchant
Ryan Hecht

Members Absent: Beverly Vitaz

Call to Order

Chairman DeMaria called the meeting to order at 10:01 a.m. He introduced Ryan Hecht, the newest State Audit Committee member, who was sworn in by Joy DeMarco from OBM's legal staff.

Approval of Minutes

Mr. Merchant moved for the minutes of the meeting held June 20, 2013 to be approved with no additions or corrections. Mr. Monahan seconded the motion and all members unanimously approved.

Director of the Office of Budget and Management

Chairman DeMaria introduced Tim Keen, Director of the Ohio Office of Budget and Management. Director Keen mentioned his support of the Office of Internal Audit and the State Audit Committee, having participated in establishing these bodies under Mary Taylor, who was the Auditor of State at that time.

Director Keen reported to the Committee that after a structural imbalance in the State's General Revenue Fund for the past two budget cycles, General Revenue Fund revenues are balanced. The Administration also rebuilt the State's budget stabilization fund to \$1.48 billion as a result of the Governor's policy objectives, tax cuts, offsetting tax changes, increase in sales tax, and stimulation of economic activity. Director Keen believes the General Revenue Fund to be in good condition, based on conservative revenue estimates and economic outlook. The Administration has also been focusing on addressing the loan with the federal government and lowering those balances that were, at one point, over \$1 billion. Director Keen's office continues to monitor important gauges such as personal income and commercial activity tax receipts as well as Medicaid expenditures, all of which were below estimates for the first two months of the fiscal year. Upcoming events in his office include the Capital Appropriations bill, the mid-

biennium budget review, which is based on the Governor's initiative, and ongoing monitoring of the fiscal year 2014/2015 budget that was enacted at the end of June, 2013.

Director Keen also mentioned how his Office expanded the Office of Internal Audit's (OIA) oversight in the most recent budget bill. As a result, OIA has Public Utilities Commission, Lottery Commission, Opportunities for Ohioans with Disabilities, Adjutant General and Medicaid under their purview. He believes the work at Medicaid is especially significant, which could include documenting policies and procedures, overseeing Medicaid revenue flow, and reconciling federal government transactions in a timely manner. The law also included the ability for agencies not under OIA's purview to request assistance from OIA if desired.

Director Keen also mentioned other initiatives his office has pursued such as the audit oversight work group (for state agency management letter comments), working closely with the Auditor of State and shortening time for preparation of financial statements, and assisting state agencies in addressing their single audit comments.

Mr. Monahan asked Director Keen about the criteria used for OBM's estimates. Director Keen spoke about Medicaid and the various formulas, methodologies and comparisons that occur and how OBM works with the state agencies to improve the overall programs.

Mr. Hecht asked if the decrease in the personal income and commercial activity taxes were signs of a downward trend. Director Keen said actual receipts were just a few percentage points below estimates and along with other fluctuations that occur, such as companies paying quarterly, it was too early to determine if this was a concern. Chairman DeMaria mentioned the monthly budget report on OBM's website for the Committee's knowledge and thanked the Director for his presentation.

Office of Budget and Management State Debt Update

Chairman DeMaria introduced Kurt Kauffman, Debt Manager at the Ohio Office of Budget and Management. Mr. Kauffman provided an overview presentation on the state's debt process. He mentioned the State's current indebtedness as \$9.7 billion, considered modest compared to other states. Mr. Kauffman spoke about the constitutional limits on state debt, such as the five percent test; the state constitution prohibits the issuance of new debt obligations if the total debt service would exceed five percent of the estimated current year General Revenue Fund (GRF) revenue plus net State Lottery proceeds. Exceptions to this limitation include Third Frontier Research and Development, Site Development, and Veterans Bonus debt.

Mr. Kauffman discussed a graph included in his printed materials that demonstrated a decline in the GRF debt service as a percentage of GRF revenue in fiscal years 2010-2012. This decline was due to strategies employed as a result of the Great Recession, including the restructuring of the state's debt and not issuing new general obligation debt for four years. In fiscal year 2013, new general obligation debt was issued. Mr. Kauffman also mentioned OBM's other debt responsibilities such as reviewing and approving bond issuances backed by state revenue and providing historic information on the state's debt to financial entities.

Mr. Kauffman also discussed the three credit rating agencies and the factors that they consider when preparing the ratings. Ohio's rating is currently at an AA+, which is the second highest rating that only about 12 states have exceeded.

Mr. Kauffman was asked about whether the credit reporting agencies had a role in the pension obligation reporting change and how OBM was reacting to that. Mr. Kauffman stated that the pension obligation reporting was primarily a local government concern as the state is only one employer utilizing the pension fund. He stated that Ohio is a leader in their fund to asset ratio, and also serves as a liaison to rating agencies regarding pension issues.

OBM Financial Reporting Update

Jim Kennedy, Deputy Director of State Accounting and Reporting, Office of Budget and Management (OBM), spoke about the CAFR preparation timeline in that more milestones had been achieved, some even a few days early. All of the state agency GAAP packages were received by September 4, which was significant. There are still more milestones to achieve which will be reported in December's committee meeting.

Mr. Kennedy discussed a handout on the State's direct and material laws. The Statement on Auditing Standards No. 117 requires that a government's management identify all significant and material laws and provide to the auditors for their audit. Mr. Kennedy stated that he updated the information by conducting research and discussing with other state agencies. The list is comprehensive in that it includes many types of legal requirements such as the Ohio Revised Code and significant laws affecting revenue streams and disbursements, including welfare laws and transportation.

Joe Bell explained to the group that Mr. Kennedy's direct and material law identification was a precursor step in continually updating the list over time. Mr. Kennedy mentioned that the Casino Commission activity is not yet large enough to make the list, but he is monitoring. Chairman DeMaria asked that Mr. Kennedy keep the Committee apprised on any significant changes.

Mr. Kennedy also presented a handout on Significant Financial Statement Estimates, which was requested by the Committee in the prior meeting. Mr. Kennedy pointed out two primary estimates, taxes receivable and Medicaid claims liability. He pointed out that staff at the Bureau of Workers' Compensation (BWC) is responsible for BWC's significant estimate, which is complex and involves an actuarial study. He mentioned that the pension liability will affect future financial statements starting in fiscal year 2015. It was also stated that significant estimates do not change much from year to year.

Mr. Hecht asked about the Medicaid payable since the state has an obligation to pay claims for two years after services are performed. Mr. Kennedy stated that the July and August claims (for services prior to July 1) make up a significant portion of the overall claims. Mr. Hecht also asked if the estimated taxes receivable was collectible. Mr. Kennedy affirmed that it was and said that calculation also includes estimated refunds.

External Audit Update

Debbie Liddil, Chief Auditor, State Region, Auditor of State (AOS) and her staff provided the committee with a financial audit update.

Maria Jackson, Assistant Chief Auditor, stated that her team completed fieldwork on their SOC 1 report on OAKS, the state's enterprise financial system, on September 13. The report covers the period April 1, 2012 through March 31, 2013 and is planned for release on September 24, 2013. Ms. Jackson stated that the report contained an unqualified opinion and all control objectives were met. The report will be released one month earlier than the prior year report. Since the end of the reporting period is prior to the state's fiscal year end, her team tested additional IT controls for the last quarter of fiscal year 2013. They will also issue a transmittal letter in the future regarding items for improvement.

Chairman DeMaria gave a brief explanation to the Committee, specifically the new member, on how the Auditor of State conducts a service organization review every year on the FIN and HCM applications and that state agencies are the primary users of the report. Mr. Hecht asked if the prior year delay related to SSAE 116 and Ms. Jackson indicated that it did not directly impact the report release date. Ms. Liddil indicated that the report's change in reporting period occurred in the prior year.

Jim Swonger, IT Senior Audit Manager, discussed the OAKS data file request. Each year the Auditor of State obtains detailed OAKS data files for financial audit testing purposes. In prior years, obtaining accurate and timely data files was a concern. Fiscal Year 2013 was the second year the Auditor of State utilized a quarterly requesting process in obtaining the files, as opposed to an annual process. This process was successful again in fiscal year 2013 and they will continue this method next fiscal year.

Ms. Liddil provided an overall financial audit update for the Committee. She stated the Letter of Arrangement for the state financial audit was previously sent to and signed by OBM. The Committee was recently provided a copy. Audit teams are performing fieldwork on significant transaction cycles and no major issues have been detected as this point. Her staff is closely monitoring their Medicaid Information Technology System (MITS) data request. There has been improved communication this audit cycle, but still more is needed to complete audit fieldwork. In addition, in August her staff sent letters of understanding to independent auditors on which they rely (primarily college and university audits). JobsOhio will be a new entity to include in the state's financial report this year. A few of these letters have not yet been returned.

The plan is for her staff to begin fieldwork on the State financial audit in late September or early October and to issue their financial opinion on December 16, 2013 and single audit opinion on February 18, 2014, barring any unforeseen circumstances. Ms. Liddil also stated that she provided information to the Office of Internal Audit regarding the clarity standards. These revised standards will not cause significant changes but will affect some Auditor processes such as how the Auditor documents their work, formats their reports, and to whom they send subsequent event inquiries. She does not anticipate any concerns with the implementation of the clarity standards. Mr. Hecht asked about how the group audit requirement will affect their audit and Ms. Liddil stated that the Auditor of State can still rely on the work of other auditors but the main changes are the subsequent event inquiries and how the reference to other auditors is documented in their report.

CAE Update

Joe Bell, Chief Audit Executive for OIA, updated the Committee on the progress on the OIA annual plan for the first quarter of fiscal year 2013.

One engagement change occurred for the Department of Medicaid's Integrated Eligibility System. That system will solely be reviewed at the Department of Administrative Services for this cycle and not at Medicaid. OIA may be involved with a mainframe assurance audit at the State's computer center (SOCC). Other state agencies may be able to leverage this work.

Mr. Bell mentioned that the Highway Patrol engagement was changed to a consulting engagement, as was the Department of Rehabilitation and Correction engagement on contract monitoring.

Mr. Bell stated that there are three public reports for the Committee to approve for the first quarter. Even though this does not seem like that many – we would like to be at 25% of the plan as opposed to 18% - this is similar to last year's first quarter reporting. Mr. Bell said that there have been some shortages in OIA resources due to staff medical leave, and Mr. Monahan asked if outside audit contractors are needed. Mr. Bell stated that he has considered it, but has not pursued at this time. Mr. Monahan stated that OIA has a lot left in the plan to accomplish.

Mr. Bell stated that OIA was able to remediate 13 observations from previous public reports. He believes that short term progress is being made on the outstanding issues. OIA has granted agency management some extensions on the deadline dates. Mr. Bell also stated that he is providing the Committee a status on any outstanding high risk issues even if they are not yet due. Mr. Monahan asked about the revised deadline date for Development Services Agency's (DSA) Various Tax Credits comment and Mr. Bell agrees with extension due to the complexity of the issue. Mr. Merchant asked about the DSA tax credit issue and Mr. Bell mentioned that it was a self-reporting situation with a lack of validation. OIA recommended that monitoring procedures be established to increase accuracy. Mr. Bell also stated that OBM's high risk issue is making progress. Chairman DeMaria asked if there was a similar tracking sheet for security issues. Mr. Bell said he would speak to the security remediation issues during Executive Session.

With Macro Statistics on the agenda, Mr. Bell stated that he is willing to discuss this issue in more detail either during this meeting or at another time. Chairman DeMaria asked Mr. Bell to send information to members between meetings and obtain Mr. Monahan's input for the next meeting.

Mr. Monahan mentioned his concern about some agencies going beyond their revised due dates in remediating issues. This is exposing the agencies to more risk due to later implementation. Mr. Bell mentioned that DSA has implemented controls but it is too early for OIA to attempt to validate.

Cindy Klatt, Chief of Quality Assurance in OIA, gave a brief update on client survey results and quality assurance activities. Survey results from client agencies were distributed to the

Committee and were positive overall. Ms. Klatt stated that she had no major concerns at this point regarding the quality reviews and that the chiefs would be working on consistency issues.

Mr. Bell talked to the Committee about the Lottery Commission, now under OIA's purview. Lottery has a separate audit committee and plan. Mr. Bell asked the Committee what communication they would like to have regarding the Lottery. Chairman DeMaria asked what is communicated regarding the Bureau of Workers' Compensation (BWC). Mr. Bell stated that OIA communicates the IT audit results to BWC's audit committee on a quarterly basis. OIA also communicates these results to the State Audit Committee. Mr. Bell also mentioned that Ms. Klatt will be performing an assurance review on BWC's internal audit function for OIA's reliance, as was performed in 2012, and will document results in a memorandum. She will also perform an assurance review for Lottery's internal audit function. Upon Mr. Monahan's inquiry as to whether those two reviews were included on the annual plan status listing, the Committee requested that both be added. The format of the memorandum was discussed and may include more information. Mr. Bell also mentioned his concern on Lottery Commission's Internal Audit group staffing as one of the long-time staff recently retired. Mr. Bell will keep the Committee apprised.

The Committee paused their meeting for lunch at 11:38 a.m. and reconvened at 11:50 a.m.

Executive Session -- At 11:50 a.m., Chairman DeMaria moved for a motion to move the meeting into executive session for the purpose of discussing confidential matters exempted from public disclosure under Ohio Revised Code Sections 126.48 and 149.433. Mr. Merchant seconded the motion and a roll call vote was taken and, there being 4 yeas and 0 nays, the motion was approved.

The Committee moved out of Executive Session at 12:43 p.m.

The Committee determined the following three reports to be final public reports in accordance with Revised Code Section 126.48:

1. Department of Natural Resources – Soil and Water Subsidies
2. Board of Regents – Ohio College Opportunities Grant Audit
3. Department of Youth Services – Gift Card Process Audit

Chairman DeMaria presented a motion to approve the three public reports and Mr. Monahan seconded. A roll call approval was made with four yeas and the reports were approved. John Merchant then left the meeting.

Open Discussion

Audit Committee Charter

The Committee discussed OBM Legal Division's suggested wording changes on meetings and communications in the State Audit Committee Charter. Mr. Hecht asked about the Committee's responsibilities regarding BWC and Lottery Commission and how those two entities report

issues to the State Audit Committee. Mr. Hecht inquired about whether the State Audit Committee should be communicating with BWC or Lottery's audit committee. Mr. Bell stated that BWC's Internal Audit charter recognizes OIA's responsibilities for overseeing internal audit activities.

The Committee requested a two page memorandum on what the law requires of the Committee for the work performed by BWC and Lottery Commission's internal auditors. The Committee felt that there should be more interaction with BWC for updates and reporting. Either the OIA charter or State Audit Committee charter should recognize internal audit functions in other state agencies under OIA purview. Mr. Hecht said the memorandum should address whether the flow of risk extends to the State Audit Committee, and if so, how the flow of communication should occur. If the Committee does not bear the risk, communication is not relevant.

Chairman DeMaria requested a motion to adopt the changes as set forth in OBM Legal Division's amendment to the State Audit Committee charter. Mr. Monahan motioned and Mr. Hecht second; motion was approved.

CAE/OIA Assessment

Chairman DeMaria spoke about the edits to the assessment document. Mr. Monahan asked Mr. Bell if OIA utilized a scorecard, upon which Mr. Bell mentioned the audit plan status form. Mr. Monahan suggested an attachment for the scorecard that would include timelines for completing the plan. Chairman DeMaria agreed that a separate communication would be valuable. Mr. Hecht asked about the two strategic goals that have not yet been achieved and Mr. Bell said he would provide information to the Committee on the two goals not yet achieved.

Assessment of Committee meeting (checklist)

Committee members will provide feedback on the meeting assessment (attached) to Mr. Bell. Mr. Bell will follow up with Mr. Monahan on his suggested macro statistics. Mr. Bell also stated that he would forward the Auditor of State Letter of Arrangement to the Committee members who have not received it. He will also forward the assurance memo for the BWC review from last year to the members and will include the two assurance reviews (BWC and Lottery) on the audit plan status report.

Mr. Hecht mentioned that the list of material laws provided earlier was a comprehensive list, but he had concerns about what the Committee's responsibility is regarding the list. Mr. Hecht also requested the policy in place for monitoring the list of material laws and the process for keeping the current, such as who monitors new legislation to determine how it impacts the list. Mr. Bell will follow up on this item.

Set CY 14 Committee Meeting Dates

Suggested dates for 2014 meetings – March 13, June 26, September 25, December 11. Members will check calendars and follow up with OIA.
The meeting was adjourned at 1:28 p.m.

Open Items for December, 2013 meeting

1. Advise availability for future meetings.

Responsible Party: Members

2. Confirm meeting dates for 2014

Responsible Party: Joe Bell/Members

3. Schedule Janet Conkey, OBM Senior Deputy Director to December 2013 meeting to discuss OBM's Audit Oversight Work Group.

Responsible Party: Joe Bell

4. Schedule periodic IT Optimization updates with State Chief Information Officer Stu Davis (December)

Responsible Party: Joe Bell

5. Develop macro statistics for previously issued audit issues

Responsible Party: Joe Bell

6. Provide feedback on Committee meeting assessment

Responsible Party: Joe Bell/Members

7. Policies and procedures in place for maintaining list of material laws

Responsible Party: Joe Bell

8. Send Auditor of State Letter of Arrangement to other Committee members and send FY 2013 Assurance Review Memo for BWC to all Committee members

Responsible Party: Joe Bell

9. Add BWC and Lottery assurance reviews to audit plan status report

Responsible Party: Joe Bell