

STATE AUDIT COMMITTEE

THURSDAY, DECEMBER 18, 2014, 9:00 A.M.
RHODES STATE OFFICE TOWER
30 EAST BROAD STREET, 35TH FLOOR, JUPITER/SATURN CONFERENCE ROOMS
COLUMBUS, OHIO 43215

Members Present: Paolo DeMaria
Ryan Hecht
Wendi Finn
John Merchant
Kai Monahan

Members Absent: None

Call to Order

Chairman DeMaria called the meeting to order at 9:03 a.m.

Approval of Minutes

Mr. Hecht moved for the minutes of the meeting held September 25, 2014 to be approved with no additions or corrections. Wendi Finn seconded the motion and all members unanimously approved.

Chairman DeMaria discussed some agenda changes. The BWC IT Update was postponed until the March meeting. He also stated that, due to Mr. Monahan's schedule, the executive session and subsequent voting on the public reports would be moved up in the agenda to after the External Audit update. After lunch, Joe Bell will provide his chief audit executive update and the rest of the agenda would follow at that point.

Ohio IT Optimization Update

Chairman DeMaria introduced Stu Davis, State Chief Information Officer with the Department of Administrative Services. Mr. Davis provided a handout for the committee and discussed the progress made thus far on IT Optimization.

Mr. Davis mentioned how the IT transformation plan was created in December 2012, and since then they have worked through the plan, learning many things along the way. Through their disaster recovery process, they learned that there were 2,036 total state agency applications, which was initially under-reported by 500 applications. He also pointed out how having over 50,000 email accounts on a single platform has helped reduce costs. Email used to be on 19 different systems.

Mr. Davis also discussed migrating over 19,000 users to the VoIP platform for phone service. Ohio State University is also planning on joining the state's VoIP platform to save costs. Mr. Davis' team is also centrally managing over 12,000 mobile devices and is planning to assess whether this process is saving the state money.

The state still maintains five mainframes, and his group is having discussions with state agencies such as Taxation and Transportation to transfer storage to DAS to save overall costs. Mr. Davis hopes to reduce overall number of servers from 9,000 to 3,500. He talked about how the data center is more like a data center now with the changes that have been made, and they are discussing moving JFS' air data center to the state data center, which can result in a 44% reduction in power for JFS while the state usage in power stays about the same.

Mr. Davis is also encouraged by the lower overall costs as a result of optimization. More federal dollars are able to be used through their centralization process. He spoke about the Ohio One Network is trying to better connect the state's 88 counties. The MARCS go live was moved up from 2016 to April of 2015 and this will increase wireless coverage. His group is also expanding broadband coverage through OARNet.

Ohio IT Security/Cybersecurity Update

Chairman DeMaria introduced David Brown, State Chief Information Security Officer with the Department of Administrative Services' Office of Information Technology (OIT), to provide a security/cybersecurity update for the committee.

Mr. Brown provided some history on the evolution of the State's centralized IT security function. OIT started developing the State's security framework in 2011 since the prior practice of each state agency being responsible for its own security was inefficient and impractical. When OIT developed their framework, it contained three components: 1) centralization of security services and personnel; 2) standardization of tools utilized; 3) development of highly trained security staff.

Centralization of personnel has begun and includes security officers, engineers and architects. The first compliance employee has been hired, and they are in the process of building a vulnerability management team.

OIT currently has five projects for which they have achieved 10 of the 20 critical controls as identified by the Counsel on Cybersecurity. The five projects will give the state agencies the technology and processes to follow in order to achieve those critical controls. In addition, OIT has purchased a multilayered defense software and rolled out to 24 agencies thus far. This is currently covering a little more than 13,000 computers. Data loss prevention software will be rolled out in 2015.

One of OIT's challenges is that state agencies have built workstations and servers based on different standards. OIT is configuring these pieces of equipment to recognize security standards so that once they are on the network, the vulnerabilities are reduced.

OIT has obtained the Center of Internet Security's benchmarks and tools that can assess systems against those benchmarks. This enables OIT to scan the state agency systems so that they can address any concerns with the system administrators promptly. This helps with enterprise visibility and also helps track agency compliance with IRS requirements.

The OIT-purchased software has the ability to assess the vulnerabilities of a machine and, along with what data is stored on that machine, provides a risk rating. This rating helps determine the prioritization of remediation for certain state agency equipment. For vulnerability management, cabinet agencies have been the priority – six agencies have been analyzed thus far, with nine more to go. The plan is to complete the assessment of all agency IT-related equipment (printers, computers, etc.) by September 2015.

The tool also has the ability to scan web applications as well as code under development before it is in production for any vulnerabilities. This coming year, OIT also plans to provide training to developers on secure coding and have them teach others in their agency. For the state servers, there are over 300 million logons per day. OIT is adding more servers and more visibility. They have also seen a significant number of intrusion attempts that their firewall is preventing. Greater visibility helps reduce the reaction time needed to address the intrusions.

OIT is developing a 24/7 security monitoring team in order to immediately respond to and resolve any problems. Training has been procured for this group, which includes cyber-exercises to measure capabilities to respond. OIT is also working with the FBI, the Highway Patrol, and other investigating agencies to utilize other resources and get their perspective. OIT continually evaluates their processes for effectiveness.

Ms. Finn asked the anti-virus being set to “notify” vs. “block”. Mr. Brown stated that the host intrusion is set to monitor because of different computers and systems being place. There is real time monitoring occurring and after the learning process it will be set to “block”. Ms. Finn also asked about how the 20 critical controls were determined, and Mr. Brown stated that the Council on Cybersecurity evaluates those critical controls every six months based on threats that occur [a later request for list of 20 critical controls will be sent to Ms. Finn].

Ms. Finn asked about training for the system users on changes that are occurring, and Mr. Brown mentioned that SANS securing the human training is being utilized for those state agencies that do not already have a related training in place. Ms. Finn also asked about the 24/7 monitoring team and whether the software was in place. Mr. Brown stated that they are still in the midst of the hiring process, developing the skill sets and providing intrusion training. Mr. Hecht asked about whether OIA should be testing the 20 critical controls. Mr. Bell stated that OIA would test those controls which are critical for the applications we are testing. Mr. Monahan asked whether OIT has had an independent, external assessment. Mr. Brown stated that they had some external assistance in developing their strategy; they consulted with external companies such as Gartner and Forrester; and they have also collaborated with other states such as Colorado, Michigan and Minnesota. They also regularly receive feedback from the National Guard and are subject to audits from the IRS and SSA. Chairman DeMaria thanked Mr. Brown for his presentation and said that he looked forward to having him back to periodically update the Committee.

OBM Financial Reporting Update

Jim Kennedy, OBM Senior Deputy Director for Services & Operations, and Amy Hall, Financial Reporting Manager, provided the financial reporting update.

Mr. Kennedy discussed the timeline, which showed most of the milestones as having been met. The most recent item, the Schedule of Expenditures of Federal Awards – also known as “SEFA” - was submitted on Monday, December 15, which was three days after the target date. The next item, the CAFR audit opinion, is expected to be received next week. Mr. Hecht asked about the reason for the SEFA delay; Mr. Kennedy stated that one of the state agencies revised their federal schedule late in the process.

Mr. Kennedy emphasized that completing the audit of the CAFR within six months is a significant accomplishment, which is the result of a lot of work in a short amount of time. Last year’s audit was the first time in many years that the six month target was successful. He also mentioned to the Committee that the CAFR containing the Auditor of State opinion is released by OBM; approximately 60 days later, the Auditor of State will release the State’s Single Audit report.

Chairman DeMaria asked Mr. Kennedy if there were any new upcoming challenges. Mr. Kennedy stated that one item was the FIN (financial modules) upgrade of the OAKS enterprise software system, which is planned to go live on July 1, 2015. Even though there is a level of risk with any upgrade, he indicated that it will most likely not negatively impact the financial statements.

Mr. Kennedy also mentioned GASB 68, Accounting and Reporting for Pensions, will be implemented in the upcoming financial statements. The State will have to show its portion of the liability for both employee retirement systems (Public Employees Retirement System, or PERS, and the State Highway Patrol Retirement System, or SHPRS) and a small piece for the State Teachers Retirement System. Chairman DeMaria asked about the reliance on others’ systems for pension reporting. Mr. Kennedy said that PERS has been aggressive in implementing the guidance and communicating to governmental entities, which includes not just the state, but other governments such as cities and counties, and SHPRS is part of the State’s reporting entity. Chairman DeMaria also mentioned to the Committee that Mr. Kennedy’s duties at OBM have changed. Mr. Kennedy acknowledged this and stated that this will not affect the financial reporting process as he will continue to oversee that, as well as the Office of Internal Audit and other functions.

Mr. Kennedy also provided the Committee the highlights of the unaudited FY 14 financial statements. One highlight was the change in general fund cash balance as of 6/30/14, which encompasses a large number of individual funds. He mentioned the cash balance experienced moderate growth in FY 14 as opposed to the more marked growth in FY 13. Chairman DeMaria asked about the balance of the “rainy day fund” (budget stabilization fund), and Mr. Kennedy said it was approximately \$1.5 billion.

The next item Mr. Kennedy discussed was the change in the unrestricted portion of the State’s primary government net assets (or “net position”). He pointed out that there are three

components of net assets - which totaled \$30 billion for both governmental and business-type activities in fiscal year 2014 – investment in capital assets (\$22 billion), restricted (\$14 billion) [includes constitutional restrictions, federal funds, workers compensation, etc.], and unrestricted (negative \$6.4 billion). Mr. Kennedy stated that the negative amount was fairly consistent from FY 2013 to FY 2014 and that the negative amount had decreased over the years. He also mentioned that a large portion of the negative unrestricted balance (approx. \$ 8.3 billion) was created when other parties, such as universities or schools, hold and record an asset (such as a building) when the state carries the debt on that asset.

Mr. Kennedy also discussed the amount owed to the federal government for the unemployment insurance fund. In 2011, the state borrowed \$2.3 billion for unemployment payments to citizens. That balance continues to experience a steady decrease. The ARRA funding has also decreased to \$.51 billion in FY 2014. There are still a few active ARRA programs, but activity continues to decrease every year.

External Audit Update

Debbie Liddil, Chief Auditor, and Maria Jackson, Assistant Chief Auditor from the Auditor of State's office provided an update.

Ms. Jackson stated that her team is starting to plan the FY 15 SOC 1 audit and that they are still working on state audit. She thanked Mr. Bell for assisting her with training at the National State Auditors Association conference and communicating what is going on with the State of Ohio and the State Audit Committee. Mr. Bell indicated that he spoke about the benefits of having committee members from outside of state government with different skills sets, which helps address audit issues and create more visibility into the internal audit process.

Chairman DeMaria asked about the timing of the SOC 1 audit. Ms. Jackson stated that fieldwork typically begins in February or March, with a report delivered in September. Ms. Liddil mentioned that switching to a March 31 year end for the SOC engagement has helped their audit process. Mr. Bell stated that the earlier process also helps other financial reporting entities and their auditors. Ms. Finn asked if it was an annual report and Ms. Jackson said yes.

Mr. Hecht asked whether Ms. Jackson's group audited any other state systems. Ms. Jackson said they did audit other systems for different purposes such as eligibility testing. Ms. Finn asked whether the SOC 1 scope would evolve beyond where it is now. Ms. Jackson asked to defer that conversation to March. She stated that if multiple agencies would rely on a particular system, that would be a reason for testing that system within a SOC 1 audit.

Ms. Liddil continued the Auditor of State update by stating that audit staff moved onsite at OBM in October to work on the financial statement roll-up process. She mentioned that cash basis testing is performed at the individual state agencies. Ms. Liddil said that her team had not experienced any significant delays and were completing their work on time, with testing at the state agencies being substantially complete. She stated that they had most of the information from the independent auditors except for subsequent events for five of the entities. This information is needed before they can issue their audit opinion. Regarding the financial

statement audit, they are wrapping up final reviews and provided the management representation letter shell to Jim Kennedy for the Governor's signature.

Ms. Liddil discussed the changes encountered in the FY 2014 audit, including the new line item "deferred inflows and outflows" that needed to be tested. There were no significant changes to the reporting entity, so they did not need to change their approach. They anticipate having a couple of comments in their "yellow book" letter to be finalized next Monday.

Regarding the Single Audit, Ms. Liddil stated that they are wrapping up testing on major programs with a targeted opinion date of February 20, 2015. Mr. Monahan asked if the six month time frame for completion of the financial statement audit was consistent with other states. Ms. Liddil said that six months is generally the goal; some states may issue it sooner but they are not the size of Ohio. She said that issuing audited corporate financial statements is much faster, primarily because they are already reporting on a GAAP basis. She also mentioned that with the new FIN process, they are hopeful that they can perform more interim testing, but State's compilation process and the inclusion of various agencies complicates the timeframe.

Mr. Hecht asked about whether there were any material weaknesses in the single audit. Ms. Liddil said that their single audit opinion was not final yet so that information would be forthcoming. Chairman DeMaria stated that he has asked Joe Bell to provide a summary to the State Audit Committee soon after the single audit is issued in February so that they can review prior to the March meeting. Mr. Hecht asked Mr. Bell whether any single audit weaknesses could cause OIA's audit plan to be adjusted. Mr. Bell stated that these issues are considered and his group reviews the single audit report comments and the required corrective action plans. OBM also reviews management letter comments and follows up with the agencies. It may take some time, especially with IT-related comments, for those comments to be addressed. Mr. Bell asked Chairman DeMaria if the Committee would be interested in reviewing the Management's Discussion and Analysis (MD&A) from the financial report. The Chairman indicated that it would be helpful to see that, so Mr. Bell will send that to the Committee.

Ms. Liddil also mentioned that the next audit will involve the implementation of GASB 68 and that GASB 67 is in place this year for the retirement systems. The Auditor of State's office is working with the retirement system auditors to test system data for this implementation and it seems to be going well.

Executive Session -- At 10:39 a.m., Chairman DeMaria stated 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 five yeas and zero nays, the motion was approved. The Committee moved out of Executive Session at 11:48 a.m.

Chairman DeMaria made a motion to approve the nine public reports. Mr. Monahan seconded the motion, and all approved without objection. The Committee determined the following nine reports to be final public reports in accordance with Revised Code Section 126.48:

1. Department of Administrative Services – Payroll Data Analysis
2. Office of Budget and Management – Payment Card Administration
3. Department of Commerce – Division of Financial Institutions
4. Development Services Agency – Motion Picture Tax Credits
5. Environmental Protection Agency – Recycling Program
6. Environmental Protection Agency – Diesel School Bus Program
7. Department of Health – Maternal Child Health Block Grant Audit
8. Board of Regents – OETC Conference Revenue
9. Department of Rehabilitation and Correction – Local Funds

CAE Update (Part 1)

Mr. Bell stated that for the second quarter, consulting projects were 20% of overall activity compared to the first quarter where it was 49%. OIA had a level of 20 staff in the second quarter, which is under what is needed. Two additional auditors have been requested in the OBM budget for expanded work at agencies. Mr. Monahan asked if OIA had the flexibility to obtain outside resources. Mr. Bell stated that he needs to talk with Mr. Kennedy about options for intermittent employees or possibly co-sourcing with other state agency personnel.

Mr. Monahan stated that cybersecurity and maintaining confidential data are ~~the~~ biggest significant risks; and that Internal Audit needs to be there focused on these risks. Chairman DeMaria stated that if OIA does not have experience available, the Committee could play a role in obtaining outside resources. Mr. Monahan asked if the audit plan was developed for 23 staff and if so, his advice would be to have a target completion of plan of 100 percent instead of 80 percent. If the audit plan cannot be achieved, outside support is needed to get to 100 percent. Chairman DeMaria mentioned the annual plan status report and that there have been new projects added and some that have been dropped and that the completion percentage is calculated using the number of total projects, including those that have been dropped. Mr. Monahan stated that if a project is added to the plan, something needs to be dropped from the plan, and there the expectation is has to be agreement that the project being added is more critical than the project being dropped. Mr. Monahan left the meeting at this point, and Chairman DeMaria asked Joe to continue his update.

Mr. Bell stated that 25 engagements were completed in the second quarter; nine of these were public reports, five were security records, five were Business-IT Alignment projects, and six were consulting engagements. Projects were replaced for three agencies (Casino Control Commission, OBM and Medicaid), three projects were moved from third to second quarter, and there are two new projects for the Department of Education. BWC's CORE consulting project is on hold and may be deleted from the plan due to BWC's delay in implementation.

Mr. Hecht inquired about the personal services spent being at 45 percent. Mr. Bell responded that OIA experienced cost savings since there were fewer personnel working this quarter. Mr. Hecht asked if OIA was behind in completing the plan and mentioned that perhaps 34,000 hours is too big of a budget to manage. Mr. Bell stated that more work was scheduled than resources since some projects will be deleted. Mr. Hecht said that risk he sees is completing large audits. Mr. Bell assured him that OIA was on task to complete the large audits.

The Committee paused their meeting for lunch at 12:05 p.m. and reconvened at 12:28 p.m.

Executive Session -- At 12:28 p.m., Chairman DeMaria stated 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. A roll call vote was taken and, there being four yeas and 0 nays, the motion was approved. The Committee moved out of Executive Session at 12:50 p.m.

CAE Update (Part 2)

Mr. Bell discussed the financial remediation dashboard and stated that all issues were closed in a timely manner with no outstanding high risk comments.

Mr. Bell summarized the assurance review performed at BWC for OIA reliance on their internal audit function. He stated that OIA has comfort for reliance by observing BWC Internal Audit's elements of practice and auditing approach in relation to IIA standards. There is still some room for improvement in their work paper preparation. Both BWC and Lottery have agreed to be included in OIA external peer review.

Mr. Bell then talked about OIA's strategic initiative to document data analytic considerations in each audit in order to help OIA conduct audits in a more effective and efficient manner. This is still in the planning phase, and OIA is looking at skill sets and training needs. Different options are being explored (ACL and other software), along with possible approaches, such as having a dedicated database at the SOCC to minimize the need for continually requesting data from the agencies. This process will take time to implement. Possible considerations for analysis would be: payment card usage, travel expenses, compliance, accounts payable.

Mr. Bell confirmed for the Committee that OIA continues to be organizationally independent with no undue scope limitations.

Open Discussion

OIA Charter

Mr. Bell stated that the few changes suggested for the OIA charter were made to conform to Ohio Revised Code changes as well as making minor wording enhancements. He also mentioned that a reference to the federal internal control standards ("green book") was added, since the State intends to adopt that framework.

Chairman DeMaria moved that the revised OIA Charter be approved; Mr. Merchant seconded the motion. There were no objections, and Mr. Hecht agreed to the approval [Ms. Finn left the meeting at 1:00 p.m.]

Chairman DeMaria stated that dates for calendar year 2015 will be sent to the members. He also asked the members to send their meeting feedback to Joe in the next few days.

The meeting was adjourned at 1:30 p.m.

Open Items for March, 2015 meeting

1. Finalize dates for calendar year 2015 meetings

Responsible Party: Chief Audit Executive/Members

2. Provide feedback on Committee meeting assessment (each meeting)

Responsible Party: Chief Audit Executive/Members

3. Schedule periodic IT Optimization updates with State Chief Information Officer Stu Davis and State Chief Information Security Officer David Brown

Responsible Party: Chief Audit Executive

4. Auditor of State technical update (as needed)

Responsible Party: Debbie Liddil

5. Develop timeframe to implementing Green Book standards/COSO

Responsible Party: Jim Kennedy/Chief Audit Executive

6. Schedule BWC CIO to provide update to Committee

Responsible Party: Chief Audit Executive