



BOB TAFT  
GOVERNOR  
STATE OF OHIO

OFFICE OF  
INSPECTOR GENERAL  
2005 NOV -4 AM 10:36

November 1, 2005

Mr. Thomas Charles *OK*  
Inspector General  
30 E. Broad St., 18th Floor  
Columbus, Ohio 43215

Dear Mr. Charles: *can*

In June 2005, I assembled the Management Review Team and charged them with reviewing and assessing the investment division of the Bureau of Workers' Compensation. The team of qualified professionals included Ohio Lottery Commission Director Tom Hayes, Ohio Public Employees Retirement System (OPERS) Director Laurie Fiori Hacking, and James Nichols, Treasurer of The Ohio State University. The MRT members represent decades of financial, management and investment expertise.

The MRT's charge was to complete a systematic review of the BWC investment portfolio, including internal audit and control systems; contracting with independent evaluators to assist with the investment review; assessing BWC investment management and audit staffing; all while consulting with the Workers' Compensation Oversight Commission and cooperating fully with all ongoing investigations and audits. The MRT was given unfettered discretion to carry out this charge.

The MRT, with the help of a nationally recognized management consultant, has completed its mission and has advanced forty recommendations to increase efficiency, oversight and ensure accountability in the BWC Investment Department. Twenty-one recommendations have already been implemented, twelve are in progress and underway and seven are scheduled for future action..

The MRT has joined in my recommendation for an independent investment board and I am pleased that the General Assembly has introduced legislation that will create such a board.

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I am proud and extremely appreciative of Tom, Laurie and Jim's hard work and dedication. In the spirit of true public service, they took time off of their jobs and away from their families to get the Bureau back on track, thus helping Ohio's injured workers and reassuring Ohio's employers that Bureau funds are in good hands.

I have attached a copy of the MRT's report for your review. This report will serve as a blueprint for the new BWC Administrator Bill Mabe as he moves forward with investment reform at the BWC.

Yours truly,

A handwritten signature in black ink, appearing to read "Bob Taft", written over a horizontal line.

Bob Taft  
Governor

OFFICE OF  
INSPECTOR GENERAL  
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Ohio Bureau of Workers' Compensation  
Management Review Team

# Action Report

*October 31, 2005*

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## Background

In response to the inadequate oversight and mismanagement of the investment division of the Ohio Bureau of Workers' Compensation (BWC), Governor Bob Taft has taken a series of steps to safeguard worker compensation funds and ensure that all investments are handled prudently and responsibly:

- Appointed a new management team, including Interim Administrator Tina Kielmeyer, to run the BWC and oversee investments;
- Appointed a Special Liaison to the BWC to keep him informed on day-to-day developments;
- Assigned an executive search committee to find a new Administrator;
- Recommended a new governance structure to separate the investment function from the insurance function at the BWC; and,
- Appointed and empowered a **Management Review Team (MRT)** to review the investment portfolio and investment policy, procedures and controls at the BWC.

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## Management Review Team

- **Tom Hayes, Team Leader** – Hayes has been director of the Ohio Lottery since January 2005 and previously served as director of the Ohio Department of Job and Family Services (ODJFS) from September 2001 through December 2004. Hayes is credited with making substantial management improvements during his tenure at ODJFS. Hayes is also a former Cuyahoga County administrator, holding that post from 1995 to 1997, and again from January 1999 through August 2001. He holds a bachelor's degree and master's degree in public administration from Cleveland State University.
- **Laurie Fiori Hacking** – Since January 2000 Hacking has served as executive director of the Ohio Public Employee Retirement System (OPERS). OPERS manages approximately \$65 billion in retirement assets, making it the tenth largest statewide public retirement system in the country and 16th largest in the world. She previously served as director of the statewide Minnesota Public Employees Retirement System.
- **James Nichols** – Nichols has been treasurer of The Ohio State University (OSU) since 1981. He has also served OSU as interim chief executive officer of University Hospitals and as acting vice president for Business and Administration. Nichols oversees an investment portfolio of the university that exceeds \$2.4 billion and includes endowment, trusts, employee benefit accounts, debt reserves, cash investments and real estate. He has a B.A. in finance from The Ohio State University.

## Executive Summary

Governor Taft charged the MRT with completing a systematic review of the BWC investment portfolio, including internal audit and control systems; contracting with independent evaluators to assist with the investment review; assessing BWC investment management and audit staffing; all while consulting with the Workers' Compensation Oversight Commission (WCOC) and cooperating fully with all ongoing investigations and audits.

With help from Ennis Knupp, a nationally recognized management consulting firm, the MRT found that while the BWC's investment portfolio was solvent, true reform was needed in order to ensure the future stability of the BWC investments. And the MRT has taken action to realize this sweeping reform.

Governor Taft gave the MRT the authority to completely dissect the BWC's investment system and the leeway to identify all weaknesses. The MRT took its charge seriously and immediately began to publicly identify problems and work with BWC staff to execute necessary systems changes.

Key recommendations and accomplishments include:

- **Previously**, BWC investment staff reported through various levels of bureaucracy, and not to the Administrator. **Now**, the Investment Department reports directly to the Administrator.
- **Previously**, concerns about the Capital Coin investment voiced by the BWC internal auditor were not acted upon and never provided to the WCOC. **Now**, the Internal Audit Department will be sufficiently staffed and have appropriate independence, submitting reports on any investment directly to the WCOC and the newly created Audit Committee.
- **Previously**, investment staff provided the BWC Investment Consultant rates of return received from Investment Managers, and these rates of return were never independently verified. **Now**, rates of return must be independently verified, computed and reported in accordance with industry best practices.
- **Previously**, all large cap stock transactions were conducted in-house, leading to inefficiencies and increased costs. **Now**, Investment Managers are required to handle all trades, reducing the transaction price per share and assuming the timeliness of trades.
- **Previously**, the BWC had a very large number of external public market managers, increasing costs and making it difficult for investment staff to effectively monitor manager performance. **Now**, poorly performing managers have been terminated and the BWC is reviewing three MRT-suggested options for reducing the large number of managers.
- **Previously**, it was clear that the BWC investment staff was understaffed and not able to handle the responsibility of its large investment portfolio. **Now**, the BWC has a blueprint for properly staffing and managing its investment duties.

The MRT recommended 40 specific reforms (including those listed above) in governance and investment operations, and each of those recommendations and reforms are outlined in the following report. Of the 40 action items recommended by the MRT, 21 have been completed and 19 are in progress or slated for future action. The successful implementation of these recommendations will help safeguard the integrity of the BWC's funds for future generations of Ohioans.

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## Acronyms

Bureau of Workers' Compensation .....	BWC
Workers' Compensation Oversight Commission .....	WCOOC
Management Review Team .....	MRT
Chief Investment Officer/Chief Financial Officer .....	CIO/CFO
Request for Proposal .....	RFP

Completed Action

1

Finding

Powers of attorney were granted to two members of the investment staff giving them complete authority to conduct transactions and to enter into contracts on behalf of BWC.

Recommendation

BWC should immediately rescind all powers of attorney granted to any member of the Investment Department.

Target date

September 2005

BWC action

All powers of attorney were rescinded by order of the Interim Administrator.

2

Finding

Investment staff was required to report through various levels of the administration before reaching the Administrator. This served to stifle staff from raising questions and concerns they may have had about the practices in the Investment Department.

Recommendation

BWC should change the organizational chart so the Investment Department reports directly to the Administrator. MRT has recommended that legislation be drafted to create an independent Investment Board with the CIO and investment staff reporting to that board.

Target date

September 2005

BWC action

The Investment Department now reports directly to the Administrator.

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3

**Finding** The Investment Department did not follow the usual policies and procedures of BWC when entering into contracts.

**Recommendation** The Investment Department should be required to adhere to all BWC policies and procedures for procurement and contracting.

**Target date** September 2005

**BWC action** The Interim Administrator now requires the Investment Department to follow all existing procedures for contracting and procurement including a review by the Law Department. In addition, the Interim Administrator now signs all contracts and will develop long-term financial relationships through a competitive procurement process.

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4

**Finding** The contracts with the Investment Managers did not contain a restriction on campaign contributions as required under ORC 3517.13. Beginning in 2001, RFPs contained the 3517.13 restrictions but they were only incorporated into the contract by reference.

**Recommendation** BWC should include a restriction on campaign contributions (ORC 3517.13) in all contracts with Investment Managers.

**Target date** September 2005

**BWC action** The Interim Administrator has directed staff to include the restrictions of ORC 3517.13 in all contracts regardless of the method of procurement.

# 5

## Finding

The Ancillary Investment Portfolio is currently managed by an investment staff which lacks appropriate supervision and suffers from a lack of well-defined guidelines for the successful management of the assets in this fund.

## Recommendation

BWC should follow the recommendation of Ennis Knupp and contract with an existing BWC fixed income manager to assume responsibility for the management of the \$1.3 billion in assets in the Ancillary Fund. This arrangement should continue until BWC has the opportunity to competitively bid the service.

## Target date

September 2005

## BWC action

The Ancillary Investment Portfolio has been transferred to JPMorgan Chase.

# 6

## Finding

The BWC Internal Audit Department is understaffed and is therefore required to rely on the work product of external Investment Consultants to audit fund manager performance and to audit the criteria and procedures for the selection of fund managers.

## Recommendation

The BWC Internal Audit Department should be sufficiently staffed and include individuals with appropriate investment experience.

## Target date

December 2005

## BWC action

The Interim Administrator has approved a plan to increase the internal audit staff from 7 to 12 persons including one who is trained in investments.



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### Finding

The Internal Audit Department's reports were not shared with WCOC. As early as May 18, 2000, the manager of Internal Audit voiced significant concerns with the operations of the Capital Coin Fund, in a memorandum to the former CFO and CIO. Unfortunately, WCOC never saw this document.

### Recommendation

BWC should increase the staff of the Internal Audit Department and increase its independence by having all reports sent directly to WCOC, Auditor of State and the Administrator. BWC should also create a separate Audit Committee with a charter and built-in independence with a dotted line reporting authority between the Internal Auditor and Audit Committee. The Audit Committee should periodically meet in private session with the internal and external auditors and the Committee should have input into the internal auditor performance evaluation and any related personnel actions. Auditing staff should include staff dedicated and trained in investments. Best practices in the audit area should reflect the basic requirements of the Sarbanes Oxley Act.

### Target date

September 2005

### BWC action

The Interim Administrator has directed that a copy of all internal audit reports be sent to WCOC upon completion.

# 8

## Finding

The BWC Internal Auditor was discouraged from conducting a full audit of Capital Coin Fund. The former CFO and CIO, according to the Internal Auditor, did not want to place an undue burden on the fund manager and therefore would not allow the Internal Auditor direct access to the Capital Coin Fund Investment Manager. As an alternative, the Capital Coin Fund Investment Manager accepted a set of agreed-upon procedures for valuing the assets.

## Recommendation

The Internal Auditor must be given free and unfettered access to all Investment Managers to ensure that all managers are operating in a manner consistent with their contract and Generally Accepted Accounting Principles. The WCOC needs to establish agreed-upon procedures with the Auditor of State external auditor for a deeper analysis of the Investment Department.

## Target date

November 2005

## BWC action

The Interim Administrator now allows the Internal Auditor to report findings to the appropriate parties outside of the BWC and has access to all Investment Managers.

# 9

## Finding

The Internal Auditor was not given direct access to QED, the internal investment data and accounting system, due to the cost of physically running a line between floors. This prevented the Internal Auditor from having access to the tools necessary to perform a thorough, unconstrained review of the actions of the Investment Department.

## Recommendation

The Internal Auditor should be given immediate and direct access to the QED system and the Oracle financial system.

## Target date

September 2005

## BWC action

The Internal Auditor now has direct access to the QED system.

# 10

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**Finding** The Investment Department generated the requests for the transfer of funds and was also the contact with Treasurer of State to have the funds transferred. Failure to have another party outside of the Investment Department act as the contact with the Treasurer of State may present control issues.

**Recommendation** BWC should consider improving segregation of duties for the process of requesting fund transfers for investments. This would help ensure that all such requests are properly approved and that any related subscription agreements receive the proper review and approval from the Administrator, the CIO and any other appropriate members of BWC management.

**Target date** September 2005

**BWC action** Two parties must now approve any transfer of funds. One of the parties must be the Administrator.

# 11

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**Finding** The current funding process does not require more than one signature on requests for funding of investments. Currently, the CFO, CIO, and/or one of the Senior Investment Officers can execute these requests with no additional authorization. Permitting transfers of funds based on the signature of only one individual increases the potential for inappropriate activity.

**Recommendation** BWC should modify internal procedures for funding Investment Managers to require two signatures on the requests for funding, one from the Administrator and one from the CIO.

**Target date** October 2005

**BWC action** The Administrator and the CIO will now sign off on all requests for funding.

# 12

## Findings

The Quarterly Investment Reports did not include detailed reporting to WCOC and other members of BWC management regarding all Investment Managers, the nature of their respective investments, the cumulative amounts funded, current market values and cumulative performance for each manager. Instead, only summary information was presented by asset classification or type of investment. Failure to present the cumulative funding of the various managers, current market values, and total gains and losses for the individual Investment Managers decreased the ability to readily identify Investment Managers with significant losses.

## Recommendation

The Quarterly Investment Reporting process should be modified to conform to current investment industry standards and should include a comprehensive listing of all investments, including: the nature of the investment, the primary investment manager, the cumulative amounts funded, current market values and the performance net of fees since inception of the manager. Quarterly performance reports should be the responsibility of the independent Investment Consultant and should be reported directly to the WCOC Investment Board.

## Target date

October 2005

## BWC action

The RFP for a new Investment Consultant required appropriate standards for the Quarterly Investment Reports.

# 13

**Finding** BWC's custodial bank, JPMorgan Chase, also currently serves as an Investment Manager for BWC, running a mid cap domestic equity portfolio. One of the functions of the custodial bank is to participate in the valuation of the assets of BWC and therefore could place the custodial bank in the unusual position of evaluating its own performance.

**Recommendation** WCOC should amend its investment policies to either restrict the custodial bank from also serving as an investment manager or develop an alternative, independent method of evaluating its performance.

**Target date** November 2005

**BWC action** Ennis Knupp completed an historic review of the investment performance for the last 10 years. The new Investment Consultant will be required to report on investment performance on a quarterly basis.

# 14

**Finding** Investment staff provided the rates of return they received from the individual Investment Managers to Callan & Associates. Callan & Associates did not perform any independent verification of returns, making it impossible to provide an independent and unbiased evaluation as required by the Investment Policy.

**Recommendation** BWC should not renew the contract with Callan & Associates and should seek proposals for a new Investment Consultant.

**Target date** October 2005

**BWC action** The Interim Administrator has decided not to extend the contract of Callan & Associates as the BWC Investment Consultant. A new investment consulting firm will be selected through an RFP process and will report to WCOC. The contract for the new Investment Consultant will specify how returns are to be computed and reported in accordance with industry best practices.

# 15

## Finding

At the direction of the BWC Investment Department, Callan & Associates was required to conduct an asset liability study using the total return method only and not a liability-driven approach that would match asset allocation with future liabilities. The result of this action would provide BWC with an incomplete view of its future obligations and could result in an asset allocation plan that is inappropriate to meet the future liability needs of BWC.

## Recommendation

Once BWC and WCOC have completed their RFP and selected a new Investment Consultant, that consultant should review the work completed by Callan & Associates and either confirm its recommendations or conduct a new study. After the asset liability study is completed, WCOC, with the help of its outside consultant, should review and amend its investment policies and include a clear delineation of investment roles and responsibilities of key parties.

## Target date

October 2005

## BWC action

Callan & Associates was requested to include the liability-driven approach when preparing their asset allocation study. The new Investment Consultant will review Callan's asset liability study.

# 16

## Finding

Callan & Associates was restricted in its ability to fully evaluate the investment portfolio because the scope of its engagement was limited to the top 30-45 Investment Managers.

## Recommendation

A new Investment Consultant should be retained to replace Callan & Associates. The new Investment Consultant should operate in a manner consistent with investment industry best practices and the investment policies of WCOC and offer an independent and unbiased evaluation of all the Investment Managers in the portfolio. The Investment Consultant should answer only to WCOC or an Investment Board or Committee as required.

## Target date

October 2005

## BWC action

BWC has included this function as a component of the RFP for a new Investment Consultant.

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# 17

**Finding** BWC staff did not have access to a fiduciary counsel to assist them in establishing appropriate investment policies, in making investment decisions and in helping them deal with Private Equity Investment Managers.

**Recommendation** BWC should retain the services of an experienced fiduciary counsel.

**Target date** September 2005

**BWC action** BWC retained the services of Ian Lanoff of the Groom Law Group to advise BWC on all fiduciary and investment matters.

# 18

**Finding** The BWC Statement of Investment Policy and Guidelines requires that all large cap stock transactions requested by Investment Managers be conducted through the BWC Trading Desk. This process is inefficient and could result in increased costs for brokerage fees and an opportunity cost for delaying a transaction and therefore not securing the best execution in trading.

**Recommendation** BWC should require all Investment Managers to be responsible for their own trading on all classes of equities. The Investment Managers should be required to obtain best execution cost and strongly encouraged to conduct these transactions electronically whenever possible which will significantly reduce the transaction price per share.

**Target date** September 2005

**BWC action** Acting on a recommendation from the MRT and the Interim Administrator, WCOC terminated the BWC trading operation at the August meeting. Trades are being conducted through Investment Managers.

# 19

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Finding	The BWC Investment Department receives soft dollars in the form of rebates and other incentives from brokers (\$780,000 in 2004) to purchase unbudgeted goods and services. This is not an industry best practice. It blurs accountability for costs and could result in a competitive advantage for a broker who participates in the rebate scheme.
Recommendation	BWC should terminate the practice of accepting soft dollars from vendors doing business with the Investment Department to purchase goods and services. The operating expenses of the Investment Department should be transparent and reflect all costs of operating the investment function.
Target date	September 2005
BWC action	The BWC Interim CIO and CFO terminated this practice and now require all expenditures for goods and services be done using properly established purchasing procedures.

# 20

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Finding	BWC has invested in 68 private equity partnerships. The large number of private equity investments makes it difficult for the limited investment staff to monitor and perform proper due diligence on these complex arrangements.
Recommendation	BWC should engage an independent Investment Consultant to evaluate the private partnerships and advise BWC whether to continue or restructure those partnerships.
Target date	October 2005
BWC action	BWC has engaged Ennis Knupp to evaluate the private equity partnerships.

# 21

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**Finding** Once a decision was made to terminate an Investment Manager, there was no appropriate place to temporarily place money until the appropriate investment decision could be made.

**Recommendation** BWC should contract with a passive investment fund manager to invest all proceeds recovered from any terminated investment manager.

**Target date** September 2005

**BWC action** At the August WCOC meeting, the Interim Administrator received authority to contract with Barclay's Global Investors or State Street Global Advisors to serve as passive index fund managers for BWC. A contract is being prepared to secure the services of State Street Global Advisors.

Pending Action

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# 22

## Finding

As it is currently constructed WCOC is not able to provide sufficient oversight to the Investment Staff.

## Recommendation

Create a new, separate and independent Investment Board composed of seven members — five investment experts (two appointed by the Treasurer of State, one by the Governor and two by the General Assembly, one each appointed by the majority and minority leaderships) and two from WCOC. In the interim, WCOC should create an Investment Committee composed of the additional investment experts and one member of WCOC. The Recommendation Investment Committee should develop investment objectives and risk targets.

## Target date

January 2006

## BWC action

The Administration has advocated enactment of legislation to create a separate BWC Investment Board and a bill to do so has been introduced in the Ohio General Assembly. As an intermediate step, WCOC created an Investment Committee in September 2005.

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# 23

## Finding

The Investment Consultant, Callan & Associates, reported to the BWC Investment Department, not to WCOC, on investment performance and evaluation of managers. As a result, WCOC was denied independent advice and verification of investment performance.

## Recommendation

A new Investment Consultant should be retained to replace Callan & Associates and should provide independent and unbiased reports directly to WCOC.

## Target date

November 2005

## BWC action

WCOC will direct the hiring of a new Investment Consultant who will report directly to the Commission providing it with better checks and balances on the performance of managers and the total portfolio.

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# 24

**Finding** The current staff of the BWC Investment Department is both understaffed and undertrained to carry out the mission of the Department.

**Recommendation** BWC should immediately hire experienced and credentialed investment professionals to assist in the management of the portfolio.

**Target date** December 2005

**BWC action** BWC has reorganized the Investment Department and will hire additional investment experts.

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# 25

**Finding** Through a RFP process, Treasurer of State selects one of the six Ohio banks to serve as the custodial bank for BWC. Although input is sought by the Treasurer of State, BWC has no role in evaluating the RFPs or selecting the custodial bank.

**Recommendation** BWC should be permitted to participate in the selection process for its custodial bank and granted right of refusal to prevent any bank that was terminated as an Investment Manager during the previous four years from serving as the BWC custodial bank.

**Target date** June 2006

**BWC action** BWC is holding a series of meetings with Treasurer of State to determine protocol.

26

Finding

The current investment policy requires WCOC approval of Investment Managers, but not of all investment funds. Since MDL Active Duration was a new fund with an existing manager, the existing control did not appear to require such approval based solely on the creation of the second fund.

Recommendation

The BWC Investment Policy should be modified to require WCOC (or Investment Board) review and approval of all investment funds, in addition to Fund Managers. This approval documentation should accompany all initial funding requests to provide evidence of proper approval. The Internal Auditor should be charged with responsibility for auditing compliance with this policy.

Target date

November 2005

BWC action

The WCOC Investment Committee is incorporating these recommendations into the new investment policy.

27

Finding

Returns on investments for BWC are not calculated by netting out the management fees. This gross-of-fee calculation method overstates rates of return, runs the risk of inattention to fee levels and does not conform to best practices and industry standards.

Recommendation

BWC should require the new Investment Consultant to calculate rates of return both gross of management fees and net of management fees and present them directly to WCOC or Investment Board once per quarter.

Target date

November 2005

BWC action

BWC and WCOC are currently hiring a full-service consultant and will require calculation of fees in accordance with recommendations.

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# 28

**Finding** BWC investment staff was responsible for cash management and made investments without any standards, policies or supervision.

**Recommendation** The BWC should transfer the cash management function to their custodial bank and establish a new policy to govern cash management.

**Target date** November 2005

**BWC action** Cash management function was moved to the BWC custodial bank and a new policy is being established.

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# 29

**Finding** The BWC Investment Department invested in hedge funds before it was authorized to do so by WCOC.

**Recommendation** BWC should liquidate all hedge funds in the portfolio.

**Target date** November 2005

**BWC action** By order of the Interim Administrator all hedge funds are being liquidated and contracts terminated.

# 30

## Finding

BWC failed to use best practices in the calculation of the rate of return on the investment portfolio.

## Recommendation

30 (a.) Rates of return should be calculated by BWC's custodial bank and/or by an Independent Consultant.

30 (b.) Rates of return should be calculated by all parties using generally accepted performance measurement methods.

30 (c.) Rates of return should be calculated and reported using both gross of management fees and net of management fees so that expenses are not hidden.

30 (d.) Records should be maintained by BWC that provide support for each rate of return calculation.

30 (e.) Rates of return among sources should be reconciled periodically.

## Target date

November 2005

## BWC action

BWC will require the new Investment Consultant to perform a rate of return calculation for each investment manager on a quarterly basis and will require the full-service Investment Consultant to implement all additional rates of return recommendations including responsibility of Custodial Bank.

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# 31

**Finding** The BWC Investment Department does not have the necessary support systems to operate a modern, successful investment operation.

**Recommendation** Working with its Investment Consultant, the Investment Board should ensure that adequate staff, IT, accounting, custody, control systems and auditing structures are in place to support the Investment Department and allow proper oversight and accounting of assets.

**Target date** January 2006

**BWC action** BWC and WCOC are in the process of hiring a full-service Investment Consultant who will make recommendations regarding Investment Department internal staffing and systems.

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# 32

**Finding** Because the WCOC lacks a specialized committee structure, it is inefficient and ineffective. The current structure prohibits an in-depth review of the many complex issues confronting WCOC.

**Recommendation** WCOC, with or without the aid of a consultant, should set up a committee structure to include an Investment Committee, an Audit Committee and an Actuary Committee. Each committee should have free and unfettered access to any staff and consultants employed by BWC in their respective areas.

**Target date** January 2006

**BWC action** WCOC has established an Investment Committee and plans to establish Audit and Actuary Committees.

# 33

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## Finding

BWC has 70 external public market managers. The large number of managers makes it difficult for investment staff to effectively monitor manager performance and creates a more costly fee structure.

## Recommendation

BWC should significantly reduce the number of public market managers and index a sizable portion of those assets. MRT provided three options for reducing the number of managers. At a minimum, poorly performing managers need to be evaluated promptly.

## Target date

Depends upon option selected.

## BWC action

BWC has already taken action to terminate five poorly performing managers and will be reviewing the three options offered by MRT in the near future.

# Future Action

# 34

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**Finding** In the case of Capital Coin Fund, a lack of audited financial statements reduced BWC's ability to identify and correct internal control, and other issues, in a timely manner.

**Recommendation** BWC should require all private equity funds and other similar investments to provide annual audited financial statements, prepared in accordance with U.S. Generally Accepted Accounting Principles. In addition, based on discussions with the BWC CIO, BWC may also want to consider requiring SAS 70 reports for these funds.

**Target date** January 2006

**BWC action** The WCOC Investment Committee will review and implement private equity reporting requirements.

# 35

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**Finding** The manager for MDL did not have any experience managing a hedge fund, despite investment policy requirements that managers have such experience. Existing controls were not effective in ensuring that before the investment was funded someone outside of investments validated that the manager met all eligibility requirements.

**Recommendation** When a new manager is approved for funding, documentation substantiating that the manager meets all required eligibility and experience requirements should be prepared.

**Target date** January 2006

**BWC action** BWC and WCOC Investment Committee will update investment policies to include verification of manager qualifications.

# 36

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**Finding** In both the MDL and Capital Coin Fund scenarios, BWC's investment represented 99%-100% of the total investment managed by the respective fund. The lack of other investors in investment funds increased risk to the agency.

**Recommendation** BWC should consider establishing limits on the percentage BWC's investments can constitute of the total investment in a private equity or joint venture fund (e.g., 5%, 10% of the total investment). Having other investors involved will serve as an indirect mitigating control.

**Target date** November 2005

**BWC action** WCOG and Investment Committee will incorporate private equity recommendations into the new investment policy.

# 37

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**Finding** Policies and procedures governing WCOG operations are out of date and need to be revised and expanded.

**Recommendation** WCOG should rewrite all of their policies and procedures to reflect the recent changes at BWC and to include a code of conduct and ethics policy.

**Target date** March 2006

**BWC action** WCOG will update all policies including incorporating fiduciary training.

# 38

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Finding	BWC does not conduct periodic reviews of its investment operations.
Recommendation	BWC should commission a fiduciary performance audit within three years of completing the governance restructuring and at least every five years thereafter.
Target date	January 2006
BWC action	WCOC and BWC will require periodic fiduciary performance audits.

# 39

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Finding	BWC and WCOC do not conduct joint briefings with WCOC, the Actuary and Investment Consultant.
Recommendation	BWC's Actuary should regularly report to the WCOC Investment Committee regarding the nature of BWC's liabilities and adequacy of its financial reserves. The Actuary should be involved in periodic asset liability studies.
Target date	January 2006
BWC action	WCOC will form an Actuary Committee to report regularly to the Investment Committee.

40

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Finding	WCOC never required direct reports from the Auditor of State.
Recommendation	The Auditor of State should report regularly to WCOC on investment-related audit activities and financial statements.
Target date	January 2006
BWC action	WCOC intends to form an Audit Committee to allow direct reporting.