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Date: May 13, 2016

TO: MEMBERS, AUDIT COMMITTEE

I. AGENDA ITEM # AND TITLE :	Open Agenda Item 3b – Consent Calendar: Annual Review of Audit Committee Charter
II. NAME AND PROGRAM:	Judith Sapper, Legal and Hilda Padua, Board Liaison
III. ACTIVITY:	<input type="checkbox"/> Informational <input type="checkbox"/> Request for Direction <input checked="" type="checkbox"/> Action Proposed <input type="checkbox"/> Exploratory
IV. JUSTIFICATION:	<input checked="" type="checkbox"/> Standard/Required Item <input type="checkbox"/> Board Request – New Item <input type="checkbox"/> New Topic from Staff

V. EXECUTIVE SUMMARY:

It is a useful practice to conduct a review of Committee Charters annually for potential changes and to make recommendations to the Audit Committee and Board to be presented and approved at the May Audit Committee and Board Open meetings.

VI. ANALYSIS:

The staff reviewed the Audit Committee Charter in 2013 and 2014 by comparing it to a recent Blue Ribbon Committee on Audit Committee material and considering any industry changes. The staff did not recommend any changes to the Audit Committee Charter during those annual reviews.

This year the staff recommends a change to the Audit Charter for consistency with other Committee charters and conformance with the provisions of State Fund’s By-Laws on appointment of Committee members to specify that Audit Committee member nominations are made by the Board Chair, reviewed and approved by the Governance Committee and ratified by the Board annually and that the Chair of the Audit Committee shall serve until resignation, removal or a successor has been appointed.

VII. RECOMMENDATION:

To approve and adopt the proposed amendments to the Audit Committee Charter as presented.

VIII. APPENDIX:

- Copy of Audit Committee Charter and summary of proposed changes



DISCUSSION DOCUMENT FOR AUDIT COMMITTEE

Annual Review of Audit Committee Charter
Judith Sapper, Legal and Hilda Padua, Board Liaison

**Summary of Proposed Changes to
State Compensation Insurance Fund
Audit Committee Charter**

- 1st Amended by Audit Committee August 15, 2012
Adopted by the Board August 16, 2012
- 2nd Amended by Audit Committee May 20, 2015
Adopted by the Board May 21, 2015
- [Proposed 3rd Amended for review and to be approved:]
Governance Committee: May 26, 2016
Audit Committee: May 25, 2016
Board of Directors: May 26, 2016

The following summarizes the proposed revisions to the Second Amended State Compensation Insurance Fund (“State Fund”) Audit Committee Charter, to be adopted by State Fund’s Board of Directors as the Third Amended Audit Committee Charter. Section and paragraph references are to the provisions in the Audit Committee Charter.

<u>Section</u>	<u>Summary of Proposed Changes</u>
<u>Under Organization</u>	The revision conforms to State Fund’s By-Laws to state that Audit Committee member nominations are made by the Board Chair, reviewed and approved by the Governance Committee and ratified by the Board annually and that the Audit Committee Chair shall serve until resignation, removal or a successor has been appointed.



DISCUSSION DOCUMENT FOR AUDIT COMMITTEE

STATE COMPENSATION INSURANCE FUND AUDIT COMMITTEE CHARTER

1st Amended by Audit Committee August 15, 2012

Adopted by the Board August 16, 2012

2nd Amended by Audit Committee May 20, 2015

Adopted by the Board May 21, 2015

[Proposed 3rd Amended for review and to be approved:]

Governance Committee: May 26, 2016

Audit Committee: May 25, 2016

Board of Directors: May 26, 2016

Purpose

The purpose of the Audit Committee of the Board of Directors of the State Compensation Insurance Fund (the "State Fund") is to assist the Board of Directors (the "Board") in its oversight responsibilities for State Fund's legal, ethical and regulatory compliance obligations by:

1. Overseeing the preparation, presentation and integrity of the State Fund's financial statements and financial reporting processes, policies and practices;
2. Maintaining adequate internal controls and procedures designed to ensure compliance with accounting standards and applicable laws and regulations;
3. Overseeing State Fund's internal accounting systems, enterprise risk management initiatives and financial and operational controls;
4. Assessing the qualifications and independence of the independent auditor;
5. Evaluating and assuring the performance of the Internal Audit function responsible for reviewing and auditing State Fund management's assessment of its controls and procedures;
6. Hiring, evaluating and assuring the performance of the independent auditor responsible for planning and carrying out a proper audit of State Fund's annual financial statements;
7. Monitoring State Fund's compliance with legal, ethical and regulatory requirements, including the National Association of Insurance Commissioners' Model Audit Rule ("MAR").

In carrying out its oversight responsibilities, the Audit Committee does not provide expert or special assurance as to State Fund's financial statements or legal and regulatory compliance or any professional certification as to the work of the independent auditor. As such, it is not the duty or responsibility of the Audit Committee or its members to conduct field work, or other types

of auditing or accounting reviews or procedures, or to set auditor independence standards, and each member of the Audit Committee shall be entitled to rely on:

1. The integrity of those persons and organizations within and outside of State Fund from which it receives information, including State Fund's independent and internal auditors;
2. The accuracy of the financial and other information provided to the Audit Committee by such persons or organizations absent actual knowledge to the contrary (which shall be promptly reported to the Board of Directors);
3. Representations made by management as to any non-audit services provided by the independent auditor. The Internal Audit department and independent auditors report to the Board through the Committee, and shall provide the Committee with periodic reporting on the status of their activities and findings.

In discharging its oversight role, the Audit Committee may investigate any matter brought to its attention with full access to all books, records, facilities and personnel of the State Fund and the authority to engage independent counsel and other advisors as it determines necessary to carry out its duties (including the approval of the fees and other retention terms of such independent counsel and advisers).

Organization

The Committee is a standing committee of the Board and shall be composed of not less than three and not more than five members of the Board. **Member nominations are made by the Board Chair, reviewed and approved by the Governance Committee and ratified by the Board annually.** All members should have general knowledge of financial and auditing matters and the Board shall have, at all times, a member with an auditing background for the purposes of fulfilling the responsibility of the Chair of the Audit Committee pursuant to Insurance Code Section 11770(b)(1) as may be amended. **The Chair of the Audit Committee shall serve until resignation, removal or a successor has been appointed pursuant to the provisions of State Fund's By-Laws.** All members must comply with the minimum requirements of Section 14 of MAR, as may be amended.

Meetings

The Committee will meet at least four times each year with authority to convene additional meetings as required. All meetings shall be held in accordance with the Bagley-Keene Open Meeting Act ("Bagley-Keene"). The Committee may invite members of management, auditors or others to attend meetings and the Committee will hold separate closed sessions where necessary to further the business of the Committee to meet with management, the internal auditors and independent auditors, as in the Committee's judgment is required. Board members who are not members of the Committee may attend the Committee's open session meeting as observers and may attend closed sessions only at the Committee's request. The Committee will regularly report on its actions to the full Board at the next scheduled meeting.

Committee Duties and Responsibilities

The Committee shall have the following duties and responsibilities:

1. *Independent Auditor*

- a. Select and retain, evaluate and terminate when appropriate, the independent auditors, set the independent auditors' compensation and oversee the work of the independent auditors for the purpose of preparing or issuing the State Fund audited financial report or related work.
 - b. Pre-approve all audit services and non-audit services performed by the independent auditor and the related fees and consider whether the provision of any such non-audit services is compatible with the independence of the independent auditor. Review the independent auditors' annual audit plan, including the planning, scope and staffing and approach.
 - c. Review the qualifications, independence and performance of the independent auditors at least once annually, in accordance with the established measures approved by the Committee and including a discussion of the performance of the independent auditors with management.
 - d. Review and confirm the independence of the independent auditors by obtaining statements from the auditors on relationships between the independent auditors and the State Fund, including non-audit services, and discuss any relationships with the independent auditors.
 - e. Monitor and ensure the independent audit partner in charge is rotated as required by law or regulation.
 - f. At least annually, obtain and review a report either in writing or orally by the independent auditors describing the independent auditor's internal quality control procedures; material issues raised by recent internal quality control reviews of the firm, and any investigations by governmental or professional authorities concerning independent audits conducted by the firm for the last five years.
 - g. On a regular basis and in accordance with Bagley-Keene, meet separately with the independent auditors to discuss any matters that the Committee or auditors believe should be discussed privately.
2. *Accounting Principles and Policies, Financial Reporting and Internal Control over Financial Reporting*
- a. Receive periodic reports from the Chief Financial Officer relating to significant accounting developments including emerging issues, the impact of the accounting changes where material, including the effect of regulatory and accounting initiatives.
 - b. Review and discuss reports obtained by the independent auditors in connection with State Fund's audited financial statements that are required by or referred to in SAS 61 (and management's responses thereto) or that describe all significant accounting policies and material permitted practices used, all material alternative treatments within statutory accounting principles that have been discussed with management, the ramifications of the use of the alternative disclosures and treatments, and the treatment preferred by the independent auditors; and any material written communications between the independent auditors and management such as any management letter or schedule of unadjusted differences.

- c. Review with management and the independent auditors all matters required to be communicated to the Committee under generally accepted auditing standards and any significant findings prepared by the independent auditors and internal audit together with management's responses.
- d. Review and discuss with management and the independent auditor, State Fund's annual audited financial statements and quarterly financial statements and discuss State Fund's financial reports filed with the Department of Insurance and the California State Controller's Office and solicit the independent auditor's opinion with respect to the financial statements in the reports.
- e. Review with management and the independent auditor significant issues regarding accounting principles and financial statement presentation, including any significant changes in the selection or application of accounting principles; any significant deficiencies or material weaknesses in State Fund's internal controls and State Fund's remediation plans regarding these issues; and any special audit steps adopted in light of material control deficiencies.
- f. Review with management and the independent auditors the results of the audit, including any difficulties encountered, and State Fund's accounting practices, policies and compliance with accounting standards.
- g. Review with management, independent and internal auditors, the integrity of State Fund's financial reporting processes and controls, any significant financial risk exposures, and State Fund's policies, guidelines and steps management has taken to monitor, control and report such risk exposures.
- h. Review and assess all significant matters related to audits, examinations, investigations or inquiries regarding State Fund by the California State Auditor and other appropriate State and Federal agencies.
- i. Review and discuss reports from the General Counsel on legal matters determined by the General Counsel to warrant the Audit Committee's attention, including legal, compliance or regulatory matters that may have a material impact on State Fund's business, financial statements or compliance policies and any material reports or inquiries received from regulators and government agencies.

3. *Internal Audit*

- a. Review with management and the Chief Audit Executive and Internal Audit manager the charter, budget, activities, staffing and organizational structure of the Internal Audit function, Internal Audit's compliance with applicable standards and guidelines, and any recommendations with respect to the quality, timeliness, performance or strengthening of that function.
- b. Review and recommend approval of the annual audit plan, all major changes to the plan and the annual update of the biennial plan.

- c. Review and evaluate the performance of the Internal Audit function including a review of the performance of the Chief Audit Executive and, if appropriate, recommend the selection of a new Chief Audit Executive.
- d. Review with the internal auditor any difficulties including restriction on scope of work, access to required information, and any other issues the Committee deems appropriate.
- e. On a regular basis and in accordance with the Bagley-Keene Open Meeting Act, meet separately with the internal auditor to discuss any matters that the Committee or auditors believe should be discussed privately.

4. *Ethics and Legal Compliance*

- a. Review with management, the internal auditors and independent auditors, as applicable, on at least a quarterly basis, the adequacy and effectiveness of State Fund's systems and controls for monitoring and managing legal and regulatory compliance, including State Fund's disclosure procedures and controls.
- b. Establish procedures for the receipt, retention and treatment of complaints received by State Fund regarding State Fund's employees, accounting, internal controls or auditing matters, including complaints received by the California State Auditor regarding State Fund, and for the confidential, anonymous submission of complaints and tips by State Fund's employees regarding questionable accounting or auditing matters as mandated by the Board or by law.
- c. Establish procedures for the receipt, retention, and treatment of reports of investigations and audits conducted of State Fund by the California State Auditor.
- d. Review and recommend to the Board any changes to the Code of Conduct and related policies and/or other compliance policies and guidelines that relate to financial reporting, and receive reports regarding compliance with the Code.
- e. Recommend to the Board, as appropriate, any other compliance policies and guidelines that the Committee deems appropriate to ensure compliance with applicable laws and regulations.
- f. Review and approve State Fund's compliance plan on a regular basis, recommend and approve changes as needed.
- g. Obtain regular updates from State Fund's management and State Fund's legal counsel regarding compliance matters and assurances that compliance functions are performed with independence and in accordance with professional standards. Discuss annually with the General Counsel the effectiveness of State Fund's compliance program in detecting and preventing violations of law, the State Fund Code of Conduct and Business Ethics Policy.
- h. Review with management State Fund's policies and procedures with respect to officers and key employees' expense accounts and perquisites, including excess benefit transactions, and review the results of any audit of these areas by the internal or independent auditors.

5. *Enterprise Risk Management*

- a. Review and discuss with management State Fund's major financial risk exposures and the steps management has taken to monitor and control such exposures and policies with respect to risk assessment and risk management.
- b. Review with State Fund's Chief Risk Officer and Risk Committee the testing of processes and controls in place to mitigate certain risks identified by the Board that could have a material impact on State Fund.
- c. Review with management the effectiveness of State Fund's Enterprise Risk Management system including the design and function of the processes; effectiveness and efficiency of risk responses and control activities; and completeness and accuracy of risk management reporting.
- d. Review with management the effectiveness of State Fund's management of the risk of fraud.

6. *Evaluation of Committee and Charter*

- a. Conduct and report to the Board the results of an annual self evaluation of its performance in accordance with the requirements of this Charter.
- b. Review this Charter at least annually and recommend any changes to the Board.

Powers

The Audit Committee shall have the following powers:

- a. To obtain advice and assistance from internal or external legal, accounting or other advisors and to have direct access to advisors without the presence of any officer of State Fund and to initiate, direct and conduct investigations using outside experts of any kind at the direct cost of the State Fund.
- b. To interview and meet with any employee of State Fund without the presence of any officer of State Fund.
- c. To form and delegate authority to subcommittees, with Board approval.
- d. To recommend to the Board amendments to any provisions of this Charter as appropriate due to new laws, regulations or needs of State Fund or the Board.
- e. Such other powers as may be necessary and appropriate to fulfill the Committee's purposes and responsibilities under this Charter.

To perform such other functions as assigned by State Fund's Charter, By-Laws, or the Board.