

**STATE COMPENSATION INSURANCE FUND
AUDIT COMMITTEE**

MINUTES OF OPEN SESSION MEETING

MAY 12, 2011

The Audit Committee met on May 12, 2011 in the Omni San Francisco Hotel, Russian Hill Room, 500 California Street, San Francisco, California.

AGENDA ITEM 1: ROLL CALL

The meeting was called to order at 8:05 a.m. and the following Members were present:

Francis (Frank) E. Quinlan, Chair; Steven L. Rank; William M. Zachry; and Sheryl A. Chalupa (Alternate).

There was a quorum.

Also present: President and CEO Thomas E. Rowe; Chief Financial Officer Dan Sevilla; Chief Risk Officer Ken Van Laar; Internal Audit Program Manager Marie W. Wardell; General Counsel and Corporate Secretary Carol R. Newman; Assistant Chief Counsel and Assistant Corporate Secretary Vera C. De Martini; and KPMG Engagement Partner Leigh Wilson and KPMG Manager Julie Rhodes-Urrea.

Mr. Quinlan welcomed new alternate committee member Sheryl A. Chalupa.

AGENDA ITEM 2: APPROVAL OF MARCH 17, 2011 OPEN MEETING MINUTES

MOTION: Mr. Rank

Second: Mr. Zachry

To approve the minutes of the March 17, 2011 Open Meeting Minutes of the Audit Committee as presented.

YES: 3

NO: 0

Motion carried.

AGENDA ITEM 3: COMPLETED CLOSED AUDITS

Mr. Quinlan invited Marie W. Wardell, Internal Audit Manager, to report on closed audits.

PAO 603 – Project Management Audit

Ms. Wardell explained that Internal Audit evaluated both active and closed projects overseen by the Project Management Office (PMO) as of May 2010 to verify that

proper internal controls were in place to effectively manage projects over their lifecycles. The audit examined the project manager's role, the effectiveness and timeliness of project monitoring and reporting, and the project closing process. The audit found that improvements were achieved over the past two years and an appropriate project management framework is in place. The audit identified the need for continued improvement concerning project definition, management methodology and ability to meet project objectives, budgeting, cost tracking and evaluating project return on investment (ROI) and methodology for project closing. The PMO has developed and implemented a remediation plan with full and final remediation implementation targeted for June 30, 2011.

There was discussion about the PMO's reorganization and the continuing need for improvements. Some of the identified needed changes include engaging the PMO where the project involves more than two functional areas and where proposed projects are above specific dollar value thresholds. Internal Audit's contributions to in-place improvements were acknowledged.

PAO 605 – Loss Control Operational Review

Ms. Wardell reported that Internal Audit evaluated the Loss Control Operational Review (LCOR) control self-assessment developed by Safety & Health Services (SHS) to assess whether it added value to the loss control functions and would deliver on objectives identified by SHS. The audit identified LCOR elements which require strengthening in order to improve the timeliness of LCOR implementation; eliminate redundancies in process reviews and action planning; and enhance tracking LCOR recommendations. SHS is making LCOR program modifications to achieve efficiencies in the implementation process; to de-duplicate redundancies; and to create an issue log and tracking procedure, and it targets complete implementation of its remediation plans by October 2011.

There was discussion concerning whether a self assessment process could focus on qualitative measures (rather than quantitative criteria) in order to reflect the value of State Fund's investment in safety services through the reduction in frequency and severity of workplace injuries. It was noted that qualitative rather than quantitative evaluation is needed to deliver effective safety services which will support State Fund's goals of underwriting and pricing accounts in line with account experience and risk. It was concluded that further review and evaluation of the Loss Control functions are required.

AGENDA ITEM 4: AUDIT COMMITTEE CHARTER

Mr. Quinlan noted that the Audit Committee Charter was first developed last year and at the Committee's request it has been reviewed and updated. Mr. Quinlan asked Mr. Zachry to report on recommended changes to the Audit Committee Charter.

Mr. Zachry thanked those who participated in the review process, which resulted in a revised draft Audit Committee Charter addressing the Committee's purpose, organization, meetings and its duties and responsibilities with respect to the independent auditor; accounting principles and policies, financial reporting and internal controls over financial reporting; Internal Audit; ethics and legal compliance; enterprise risk management; and evaluation of the Committee and Charter. Revisions to the Charter include authorizing the Audit Committee, in accordance with Bagley-Keene (Open Meeting Act), to meet separately with the independent auditors. There was discussion whether the Charter should also allow the Committee to meet separately with both the State Fund and independent actuary,, listing of all potential auditors and regulators, and outlining a centralized audit reporting process. Ms. Newman noted that all audits performed by State Fund's Internal Audit Program or external entities are reported to the Audit Committee, and the Senior Vice President of Internal Affairs, once the vacant position is filled, will continue to report such audit activity to the Committee. Ms. Newman also noted that anti-fraud activity reporting by the Special Investigation Unit will be added to the Audit Committee's standing agenda items. The Committee recommended allowing separate meetings with the internal and external actuary and retaining enterprise risk management provisions in both the Audit and Governance Committee Charters because the Governance Committee oversees enterprise risk management with respect to identifying and evaluating the materiality of exposure and the Audit Committee evaluates controls and mitigations in place. The final proposed recommendation was for the Charter to be reviewed at least annually. Mr. Quinlan requested a motion to adopt the Audit Committee Charter with amendments as discussed.

MOTION: Mr. Zachry

Second: Mr. Rankin

To recommend that the Audit Committee adopt the revised Audit Committee Charter as modified.

Mr. Quinlan requested public comment of which there was none, and called for the vote.

YES: 3

NO: 0

Motion carried

AGENDA ITEM 5: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 8 THROUGH 13

Mr. Quinlan requested public comment on the appropriateness of Closed Session Agenda Items 8-13. Ms. Kathleen B. Collins, Vice President of Bargaining, SEIU Local 1000, observed that Agenda Item 8-Independent Auditor's Preliminary Report 2010; Agenda Item 9-Update on 2010 Outstanding Audits and Investigations; Agenda Item 10-Premium Audit Review; Agenda Item 11-Anti-Fraud Audit Review and Strategy; and Agenda Item 12-Document Protection, Retention and Destruction Policy; and Agenda Item 14-Audit Considerations Related to the Strategic Plan, all contained some information that should be public since each item appeared to contain at least some portions that would not be strategic.

Mr. Randall F. Cheek, Legislative Advocate, SEIU Local 1000, observed that placing items in closed session limited public access to materials that would help educate the public.

Mr. Quinlan noted that State Fund was rigorous in determining whether items were for Open or Closed Sessions. Mr. Rowe observed that public comments were taken seriously and, in the spirit of openness, State Fund assessed whether more matter could move to Open Session even as it exercised strict discipline to protect what was inappropriate to disclose in Open Session. General Counsel noted that the Agendas went through two levels of legal review, and where the subject was of a mixed nature, functional matters were placed in Open Session and strategic matters in Closed Session.

Ms. Maggie Blevins, Investigator with the Special Investigations Unit and SEIU member, commented that Agenda Item 11-Anti-Fraud Audit Review and Strategy should be in Open Session. She asked that the Llorente Study be released and discussed publically since it is not a personnel matter, and asked for an explanation of why the report would not be released since management had met with SIU members to discuss the results.

Mr. Quinlan noted that the Audit Committee had not yet seen the report, and he acknowledged that State Fund employees are key players in combating fraud but, State Fund will not publicly disclose its anti-fraud procedures.

AGENDA ITEM 6: PUBLIC COMMENT

Mr. Quinlan requested public comment of which there was none. The Audit Committee immediately convened into Closed Session at 8:45 a.m.

AGENDA ITEM 15: CALL TO ORDER AND ROLL CALL

The meeting reconvened at 10:05 a.m. following the conclusion of the Closed Session and the following Members were present: Francis (Frank) E. Quinlan, Steven L. Rank, William M. Zachry and Sheryl A. Chalupa.

Also present: President and Chief Executive Officer Tom Rowe; Internal Audit Manager Marie W. Wardell; Chief Risk Officer Ken Van Laar; Chief Financial Officer Dan Sevilla; General Counsel and Corporate Secretary Carol R. Newman; and Assistant Chief Counsel and Assistant Corporate Secretary Vera C. De Martini.

There was a quorum.

AGENDA ITEM 16: COMMITTEE MEMBER PRESENTATIONS

Mr. Quinlan asked if there were any Committee Member presentations of which there were none.

AGENDA ITEM 17: PROPOSALS AND SUGGESTIONS FOR MAY 12, 2011
AGENDA

Mr. Quinlan noted the July 14, 2011 Standing Agenda Items and requested proposals and suggestions for the July 2011 agenda. It was suggested that the Committee receive a presentation from Chief Information Officer Shaun Coyne on Desktop Virtualization and Cloud Computing System Security. Mr. Quinlan requested public comment of which there was none.

The next Audit Committee meeting is scheduled for July 14, 2011 at 8:00 a.m. in San Francisco, California.

ADJOURNMENT

There being no further business before the Audit Committee, the meeting adjourned at 10:10 a.m.

Respectfully submitted,

Vera C. De Martini
Assistant Corporate Secretary