

**STATE COMPENSATION INSURANCE FUND  
AUDIT COMMITTEE**

**MINUTES OF OPEN SESSION MEETING**

**July 14, 2011**

The Audit Committee met on July 14, 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 8:00 a.m. and the following Members were present:

Francis (Frank) E. Quinlan, Chair and Sheryl A. Chalupa (Alternate). Steven L. Rank and William M. Zachry were absent by prior arrangement.

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.

**AGENDA ITEM 2: APPROVAL OF MAY 12, 2011 OPEN MEETING MINUTES**

MOTION: Mr. Quinlan

Second: Ms. Chalupa

To approve the minutes of the May 12, 2011 Open Meeting Minutes of the Audit Committee as presented.

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

YES: 2

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 593 – Data Integrity Audit**

Ms. Wardell explained that Internal Audit evaluated State Contract claims transactions involving payments, journal voucher and ECF subrogation entries, manual cash receipts and claim file transfers between October 2009 through February 2010 to assess the process controls to determine if they are adequate to ensure data accuracy. Areas of needed improvement included reconciliation of manual entries between databases, procedures for key-data operators, and identification of process flow / data migration defects in the Electronic Claims File (ECF) and System Assisted Litigation (SAL) databases. The business unit stakeholders' remediation action plans target completion by Qtr 3 2011, which Internal Audit will verify.

### **California Department of Insurance (CDI) Statutory Financial Examination of the State Compensation Insurance Fund as of December 31, 2009**

Ms. Wardell reported that the CDI review of State Fund's business operations and financial statements from January 1, 2007 through December 31, 2009 was completed and its audit report filed on June 15, 2011. Ms. Wardell provided copies of the filed report for members' review and reported that the CDI determined that loss and loss adjustment expense reserves as reported by State Fund are reasonable, although trends will be monitored.

### **AGENDA ITEM 4: MODEL AUDIT RULE (MAR) AND USL&H AUDIT REQUIREMENT**

Mr. Quinlan invited Dan Sevilla, Chief Financial Officer, to report on the status of State Fund's Model Audit Rule compliance and the USL&H Audit Requirement.

Mr. Sevilla noted that the 2010 MAR work is complete. Management issued its report regarding internal controls in May 2011 and filed it with the CDI, together with the 2010 audited financial statements, in May 2011. The report findings are consistent with his prior report to the Audit Committee that internal control of statutory financial reporting is effective and there are no unremediated material weaknesses. Mr. Sevilla also noted that State Fund held its 2011 kick-off meeting and expressed his confidence with respect to State Fund's understanding of MAR requirements and its ability to execute appropriately.

Mr. Sevilla further reported that State Fund is required to file an annual report with the Department of Labor (DOL) concerning the number of cases and compensation and medical payments made under the Longshore and Harbor Workers' Compensation Act (USL&H), and effective beginning 2010 the DOL suspended its previous requirement that carriers' annual filings be audited by independent auditors.

### **AGENDA ITEM 5: DESKTOP VIRTUALIZATION AND CLOUD COMPUTING SYSTEMS SECURITY**

Mr. Quinlan invited Shaun Coyne, Chief Information Officer, to report on the new IT Cloud Computing initiative. Mr. Coyne reported that the geographic transition gave

IT opportunities to realize efficiencies, improve system resiliency, security and disaster recovery redundancies while simultaneously reducing cost, increasing information delivery speed and protecting server capacity by replacing traditional laptop/desktop and telephone equipment by augmenting State Fund's networked systems with cloud computing capability and Voice-Over-Internet-Protocol (VOIP) phone service. These IT enhancements, which will be rolled out over the next several years, will bring State Fund's IT capabilities into the 21<sup>st</sup> century with significantly improved data encryption and security. These initiatives will roll out first in the Vacaville based Data Center, then to Claims Processing and Customer Service Centers, with State Fund wide roll anticipated to be complete by Q4 2012.

**AGENDA ITEM 6: PUBLIC COMMENTS ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 9 THROUGH 15**

Mr. Quinlan requested public comment on the appropriateness of Closed Session Agenda Items 9-15, of which there was none.

**AGENDA ITEM 7: PUBLIC COMMENT**

Mr. Quinlan requested public comment of which there was none. The Audit Committee immediately convened into Closed Session at 8:25 a.m.

**AGENDA ITEM 16: CALL TO ORDER AND ROLL CALL**

The meeting reconvened at 9:57 a.m. following the conclusion of the Closed Session and the following Members were present: Francis (Frank) E. Quinlan, and Sheryl A. Chalupa. Steven L. Rank and William M. Zachry were absent by prior arrangement.

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 17: REPORT OF EXTERNAL AUDITOR**

Leigh Wilson of KPMG, State Fund's independent External Auditor, informed the Audit Committee that it issued its report on the 2010 statutory financial statements May 27, 2011 and reminded the Committee that the required auditor communications were presented in draft form and discussed at the May 12 meeting. Those written communications were finalized without significant changes and distributed in final form to Audit Committee members. In response to a question, Ms. Wilson clarified that under American Institute of Certified Public Accountant (AICPA) Professional Standards, the auditor's opinion on general distribution statutory financial statements must also comment as to whether those financial statements are in conformity with Generally Accepted Accounting Principles in the United States (U.S. GAAP). Since the statutory financial statements are not in conformance with GAAP, and they are

not intended to be, there is a paragraph in the auditor's opinion stating this. This paragraph's standing wording, used in statutory financial statement opinions, is meant to inform the user that these financial statements are not intended to be in conformance with U.S. GAAP.

KPMG also reported that it performed a review of the 2010 WCIRB filing and issued a report June 8, 2011, and with respect to that report there were no matters requiring communication to the Audit Committee.

#### **AGENDA ITEM 18: 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 SEPTEMBER 14, 2011 AGENDA**

Mr. Quinlan noted the September 14, 2011 Standing Agenda Items and requested proposals and suggestions for the September 2011 agenda. It was suggested that Chief Financial Officer Dan Sevilla assist the Audit Committee in tracking and informing it of proposed plans and/or changes to State Fund's potential share of state Pension and Other Post Employment Benefit (OPEB) claims, as well as any changes proposed by the GAAP standards Board of Directors at its October 2011 hearing on whether the Pension and OPEB values need to be reported on agency balance sheets. Mr. Rowe pointed out that proper allocation of the Pension and OPEB costs should be reflected in State Fund's pricing. Mr. Quinlan requested public comment of which there was none.

The next Audit Committee meeting is scheduled for September 14, 2011 at 2:00 p.m. in Napa, California.

#### **ADJOURNMENT**

There being no further business before the Audit Committee, the meeting adjourned at 10:00 a.m.

Respectfully submitted,

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Vera C. De Martini  
Assistant Corporate Secretary