

STATE
COMPENSATION
INSURANCE
FUND AUDIT COMMITTEE CHARTER

ADOPTED MAY 10, 2007

Statement of Policy

California Insurance Code Part 3, Chapter 4, Article 1, section 11781 "...vests the Board of Directors with the full power and jurisdiction over the State Compensation Insurance Fund....(and) may perform all acts necessary or convenient in the exercise of any power, authority or jurisdiction over the fund, either in the administration thereof or in connection with the insurance business..." The Omnibus Audit Accountability Act of 2006 codifies the creation of an Audit Committee [SB1452, Part 3.5, Government Code Section 13886(a)] by the governing body which oversees an agency which performs internal audits.

The Audit Committee (the "**Committee**") of the Board of Directors (the "**Board**") of State Compensation Insurance Fund of the State of California ("**State Fund**") is appointed by the Board. This charter (the "**Charter**") specifies the scope of authority and responsibility of the Committee.

Purpose and Authority

The purpose of the Committee is to assist the Board in fulfilling its responsibility for oversight of the quality and integrity of the accounting, auditing and financial reporting practices of State Fund, and to perform such other duties as may be directed to the Committee by the Board. The Committee's role includes monitoring and overseeing State Fund's financial reporting, State Fund's management of business and financial risk, monitoring State Fund's internal control system and assuring compliance with significant legal, ethical and regulatory requirements. The Committee is also directly responsible for the appointment, compensation and oversight of the public accounting firm engaged to prepare or issue an audit report on the financial statements of State Fund.

Notwithstanding these duties of the Committee, it is understood that the Committee's responsibilities do not include planning or conducting audits or determining that State Fund's financial statements are accurate, complete and prepared in accordance with generally accepted accounting principles. Such matters are the responsibility of management and State Fund's independent auditors. It is not the duty of the Committee to resolve disagreements between management and the independent auditors or to ensure compliance with applicable laws, regulations and rules promulgated by the State of California or State Fund's Code of Business Conduct and Ethics (the "**Code of Ethics**").

The Committee shall have the authority and responsibility to adopt its own operating rules and procedures including the authority to call for assistance from State Fund operating staff or to request outside assistance when needed.

The Committee's general duties and responsibilities include:

1. Serving as an objective and independent party to monitor State Fund's financial processes and internal control system.

2. Reviewing and appraising the audit, assurance and other attestation efforts of the Board's independent financial statement auditor.
3. Reviewing and appraising the audit and assurance efforts of the internal auditors, and receiving quarterly notices of the consulting activities of the internal auditors.
4. Ensuring that an adequate system of risk evaluation exists in the organization.

Membership and Procedures

Membership and Appointment. The Committee will be comprised of not fewer than three members of the Board. The members of the Committee will be appointed from time to time by the Board based on recommendations from the Nominating and Corporate Governance Committee of the Board or from those members of the Board who meet the definition of independent directors under applicable standards ("**Independent Directors**").

Independence. Each member will be an Independent Director and must satisfy all applicable independence requirements.

Qualifications. Each member of the Committee will be generally knowledgeable in financial and auditing matters and possess an appropriate level of financial sophistication. [The Board will endeavor to appoint at least one member to the Committee who qualifies as an "audit committee financial expert" as defined in Item 401(h) of Regulation S-K under the Securities Act of 1933, as amended.]

Removal of Members. The entire Committee or any individual Committee member may be removed from the Committee with or without cause by the affirmative vote of a majority of the Board. Any Committee member may resign from the Committee effective upon giving oral or written notice to the Chair of the Board, the Secretary or the entire Board (unless the notice specifies a later time for the effectiveness of such resignation). The Board may appoint a qualified successor to take office when such resignation becomes effective.

Chairperson. A chairperson of the Committee (the "**Chairperson**") may be designated by the Board upon the recommendation of the Nominating and Corporate Governance Committee of the Board or the Independent Directors. In the absence of such designation, the members of the Committee may designate the Chairperson by majority vote of the Committee. The Chairperson will determine the agenda, the frequency and the length of meetings and will have unlimited access to management and information. The Chairperson will establish such other rules as he or she from time to time may deem necessary and proper for the conduct of the business of the Committee.

Secretary. The Committee may appoint a Secretary whose duties and responsibilities will be to keep full and complete records of the proceedings of the Committee for the purposes of reporting Committee activities to the Board and to perform all other duties as from time to time may be assigned to him or her by the Committee, or otherwise at the direction of a Committee member. If no Secretary is appointed, any member of the Committee may serve as acting Secretary of a meeting. The Secretary need not be a member of the Committee or the Board. The Committee may assign Secretary duties to State Fund's legal counsel.

Meetings. The Committee will meet as frequently as circumstances dictate but not less frequently than quarterly. Meetings may be held in conjunction with regularly scheduled meetings of the Board or otherwise. Except as otherwise specified herein, the Committee is generally governed by the same rules regarding meetings (including meetings by telephone or similar communications equipment), written action without meetings, notice, waiver of notice, quorum and voting requirements as are applicable to the Board. The Committee is authorized and empowered to adopt its own rules of procedure not inconsistent with any provision of the Charter, any provision of the Bylaws of State Fund, or the laws of the State of California or any other applicable law, rule or regulation. Minutes will be kept of each Committee meeting.

Delegation. The Committee may, by resolution passed by a majority of the Committee, designate one or more subcommittees, each subcommittee to consist of one or more members of the Committee. Any such subcommittee, to the extent provided in the resolutions of the Committee, and to the extent not limited by law, will have and may exercise all the powers and authority of the Committee, including authority to approve of audit and non-audit services by the independent auditor. Each subcommittee will have such name as may be determined by resolution adopted by the Committee. Each subcommittee will keep regular minutes of its meetings and report the same to the Committee or the Board at its scheduled meetings.

Authority to Retain and Terminate Advisers. The Committee has authority to retain, at State Fund's expense, outside counsel or other experts or consultants as it deems necessary to carry out its responsibilities, including authority to approve fees, other retention terms and ordinary administrative expenses of the Committee that are necessary or appropriate in carrying out its duties. The Committee is empowered to investigate any matter brought to its attention that is within the Charter, with full power to retain outside counsel or other experts for this purpose. Any communications between the Committee and legal counsel in the course of obtaining legal advice will be considered privileged communications of State Fund, and the Committee will take all necessary steps to preserve the privileged nature of those communications. All independent auditors shall report directly to the Committee.

Annual Performance Evaluation. The Committee will evaluate its performance on an annual basis, either separately or in conjunction with an annual evaluation of the full Board. To the extent the Committee determines, it may make recommendations to the Board for changes or modifications to the Charter.

Duties and Responsibilities

The following will be the regular duties and responsibilities of the Committee in carrying out its oversight functions. These duties and responsibilities are set forth below as a guide to the Committee with the understanding that the Committee may alter or supplement them, as appropriate under the circumstances, to the extent permitted or required by applicable law or regulation.

1. Annually, the Committee will retain State Fund's external auditor, which may be subject to Board ratification as may be required or as the Committee may seek.

The Committee will review responses received to audit firm solicitations. This process occurs every five years under Government Code section 20228, which states that an auditor may not serve two consecutive terms.

The Committee will review and set standards for the independence of the external auditor hired by State Fund. These standards will meet or exceed those required by:

- (1) Federal and State laws and regulations,
- (2) Communications from the Public Accounting Oversight Board, and
- (3) Proposals by professional accounting and auditing organizations.

2. The Committee will pre-approve the provision of all audit services and non-audit services by the external auditor to State Fund and will also approve all audit and non-audit engagement fees and terms with the independent auditor. The Chairperson, or other member of the Committee, will sign an engagement letter with the auditor.

3. The Committee will oversee audit assessments of internal administrative and accounting controls by both the external auditor employed by the Board and by the State Fund internal auditors.

4. The Committee will review the external auditor's proposed audit scope and approach, including coordination of audit effort with internal audit.

5. The Committee will serve as the primary liaison and provide the appropriate forum for handling all matters related to audits, examinations, investigations or inquiries of the State Auditor and other appropriate State or Federal agencies.

6. At least annually, obtain and review a report by the external auditor describing: the firm's internal quality-control procedures; any material issues raised by the most recent internal quality-control review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities within the preceding five years respecting one or more independent audits carried out by the firm, and any steps taken to deal with any such issues; and (to assess the auditor's independence) all relationships between the independent auditor and the company.

7. In connection with the Committee's approval of non-audit services, the Committee will consider, among other things, whether the external auditor's performance of any non-audit services is compatible with the independence of the external auditor.

8. The Committee will obtain and review a report by the external auditor describing all relationships between the external auditor and State Fund, in order to assess the auditor's independence, consistent with Independence Standards Board Standard 1, as amended from time to time, and other applicable standards, and any other documents or disclosures required by such standards. The report shall include a description of all services provided by the external auditors and related fees. The Committee shall discuss and will actively engage in dialogue with the

external auditor with respect to any disclosed relationships or services that may impact the auditor's objectivity and independence and will take, or recommend to the Board to take, appropriate action to oversee the independence of the auditor.

9. The Committee will review any situation where State Fund wishes to hire an employee or former employee of State Fund's external auditors.

10. The Committee will review and discuss with the independent auditor the report by the independent auditor, concerning:

- All critical accounting policies and practices to be used;
- Alternative treatments of financial information within statutory accounting principles (SAP) that have been discussed with management, ramifications of the use of alternative disclosures and treatments, and the treatment preferred by the independent auditor; and
- Any other material written communications between the independent auditor and State Fund's management.

11. The Committee will discuss the annual audited financial statements with the external auditor including State Fund's financial reports filed with the Department of Insurance and California State Controller's Office and the independent auditor's opinion with respect to the financial statements in the Reports.

12. The Committee will discuss quarterly financial statements with management and State Fund's internal finance department.

13. In connection with its review of State Fund's financial statements, the Committee will review and discuss with management, the internal finance staff and the external auditor the matters relating to the conduct of the audit required to be discussed by Statements on Auditing Standards Nos. 61 and 90 (Communications with Audit Committees), as they may be modified or supplemented, including the auditor's judgment about the quality of State Fund's accounting principles as applied in its financial reporting.

14. The Committee will review with the external auditor any audit problems or difficulties and management's handling of such matters.

15. Based on its review and discussions with management, the internal finance staff and the external auditor, the Committee will recommend to the Board whether State Fund's financial statements should be included in the Report and any other report it may be required to file.

16. The Committee is expected to maintain free and open communication with the independent auditor, the internal audit manager, internal finance staff and management. Periodically, the Committee will meet separately with members of management, the finance staff, internal auditors and the external auditors.

17. The Committee will review with management and the internal audit manager the charter, activities, staffing and organizational structure of the internal audit function. It will have final authority to review and recommend approval of the annual audit plan, all major changes to the plan and the annual update of the biennial plan.

18. Ensure there are no unjustified restrictions or limitations to the Internal Audit function.

19. The Committee will provide advice and recommendations to the Chief Executive Officer of State Fund, including the assessment criteria to be utilized in the engagement of the manager of the Internal Audit Department or in any disengagement relative to this position.

20. The Committee will review all internal audit reports and recommend appropriate action to the Board and State Fund management.

21. On a quarterly basis, meet separately with the Internal Audit Manager to discuss any matters that the committee or internal audit believes should be discussed privately.

22. The Committee will receive quarterly notices of the consulting activities performed by State Fund's internal auditors.

23. The Committee will oversee all contracted reviews, assessments, assurance reviews and examinations required by the Board or requested by the Committee. Assurance reviews include, but are not limited to, auditing compliance with laws, rules, regulations, Board policies, internal controls, management operating procedures, and industry best practices.

24. The Committee will assign the Internal Audit Department responsibility for the management of the external financial statement auditor contract and designate the department as the liaison for audits and examinations by the Bureau of State Audits and any other State or Federal auditors.

25. The Committee will review all other periodic reports and presentations from State Fund staff or as specified by management letters.

26. The Committee will, on a quarterly basis, review State Fund's efforts to assess its Enterprise Risk Management process.

27. Quarterly, the Committee will review with management, the finance staff and the external auditor the adequacy and effectiveness of State Fund's systems and controls for monitoring and managing legal and regulatory compliance, including State Fund's disclosure controls and procedures and State Fund's internal control over financial reporting.

28. The Committee will establish procedures for:

- The receipt, retention and treatment of complaints received from the California State Auditor regarding improper governmental activity, theft, conflicts of interest, gross misconduct, inefficiencies or incompetence by its employees, accounting, internal accounting controls or auditing matters;

- The confidential, anonymous submission by State Fund's employees of concerns as legislatively mandated or as mandated by the Board;
- The receipt, retention and treatment of reports of investigation and audits conducted of State Fund by the California State Auditor; and
- Receipt of management assurance of implementation of the Auditor's recommendations.

29. The Committee will formulate and recommend to the Board any changes to the Code of Ethics or Code of Conduct adopted by the Board for directors, officers and employees of State Fund. The Committee will obtain reports from management concerning compliance with the Code of Ethics, Code of Conduct and State Fund's other compliance policies and guidelines, and will advise the Board with respect to such compliance. The Committee from time to time will recommend to the Board any other compliance policies and guidelines that the Committee deems appropriate or to ensure compliance with applicable laws or regulations.

30. The Committee will communicate to the Board any issues and recommendations for action with respect to the quality or integrity of State Fund's financial statements, State Fund's compliance with the Codes of Ethics and Conduct, with legal or regulatory requirements, the performance and independence of State Fund's external auditors and the performance of the external audit function.

31. The Committee will review with the Chief Executive Officer of State Fund the scope and plan of the work to be done by the internal audit function and the results of such work.

32. The Committee will conduct an appropriate review of all related-party transactions on an on-going basis and all such transactions shall be approved by the Committee or another independent body of the Board.

Enterprise Compliance Authority and Responsibility

The Committee shall have the following Enterprise Compliance authority and responsibility:

1. Ensure enterprise compliance functions are performed with independence and in accordance with professional standards.
2. Approve the annual enterprise compliance plan.
3. Review the status of the annual enterprise compliance plan and approve changes as needed.
4. Provide a forum which promotes independence of the enterprise compliance process.

Reliance on Information Provided

In adopting the Charter, the Board acknowledges that the Committee members are not legal experts, are not themselves compiling State Fund's financial data or performing the audit function, and are not providing any expert or special assurance as to State Fund's legal, financial or regulatory compliance. Each member of the Committee will be entitled to rely on the integrity of those persons and organizations within and outside State Fund that provide information to the Committee and the accuracy and completeness of the information provided to the Committee by such persons or organizations absent actual knowledge to the contrary.

Amendment

The Charter, and any provision contained herein, may be amended or repealed by the Board.



Audit Committee Chair

7.5.07

Dated