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Date: March 2, 2009

AUDIT COMMITTEE AGENDA ITEM 9

TO: MEMBERS OF THE AUDIT COMMITTEE

- I. SUBJECT: STATE FUND'S AUDIT COMMITTEE CHARTER**
- II. PROGRAM: EXECUTIVE/OFFICE OF THE GENERAL COUNSEL**
- III. RECOMMENDATION: ADOPT THE PROPOSED AUDIT COMMITTEE CHARTER AND RECOMMEND BOARD APPROVAL**

IV. ANALYSIS: The methodology used in the preparation of the Audit Committee Charter began with strategic direction from the Board Chair and the General Counsel. Based on that direction, research was conducted by an attorney within State Fund's Legal Department which included a review of over 25 audit committee charters from various organizations including insurance companies. A copy of State Fund's current audit committee charter was used as a guide and the majority of the terms contained therein were incorporated into the final Audit Charter.

After the review of these documents, five common topics were identified and used as headings. These headings included (1) Mission/Purpose; (2) Organization; (3) Meetings; (4) Duties and Responsibilities; and (5) Powers, all of which appeared in almost all other investment charters. The duties/responsibilities were broken down into four major categories which include (1) Financial Reporting; (2) External Audit; (3) Internal Audit Function; and (4) Ethics and Legal Compliance.

V. RESULTS/COSTS: Compiling material and recommendations for the potential charter fulfills a responsibility of the General Counsel to give support for the Board and its Committees. The development of the Audit Charter was done by in-house counsel with a final review by outside counsel to ensure compliance with laws and regulations.

CAROL NEWMAN, General Counsel

Attachment

AUDIT COMMITTEE MEETING (OPEN)

AGENDA ITEM 9

ATTACHMENT 9-I

PROPOSED AUDIT COMMITTEE CHARTER

PRESENTED BY: Francis Quinlan

March 12, 2009

STATE COMPENSATION INSURANCE FUND
PROPOSED Audit Committee Charter
(Adopted , 2009)

Mission/Purpose

The Audit Committee (the “Committee”) shall assist the Board of Directors (the “Board”) of State Compensation Insurance Fund (“State Fund”) in fulfilling its responsibility for oversight of (1) the quality and integrity of State Fund’s accounting, auditing and financial reporting practices and the management of State Fund’s financial risk; (2); the independent public accounting firm’s qualifications, performance, and independence; (3) the performance of State Fund’s internal audit function; and (4) State Fund’s compliance with legal, ethical and regulatory requirements.

Organization

The Committee is a standing committee of the Board and shall be composed of not less than three (3) members. 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 11770(b)(1) as may be amended.

Meetings

The Committee shall hold regular meetings, in accordance with the provisions of the Bagley-Keene Open Meeting Act (“Bagley-Keene”) and no less than four (4) times a year. The Committee shall hold regular meetings on the same day as, or within one day of, the regular meetings of the Board. At the request of any Committee member, the Committee may hold additional, in compliance with the provisions of Bagley-Keene and State Fund’s By-laws.

- a. The Committee is expected to maintain free and open communications with the independent auditor, internal audit manager, internal finance staff and management in compliance with Bagley-Keene.
- b. The Committee may, at its discretion, invite members of management or other Board members to attend the Committee’s meetings where necessary to further the business of the Committee. Notwithstanding the foregoing, the total number of members of the Board (including committee members) attending the Committee’s meeting at any one time shall not equal or exceed a majority of the number of members of the Board.
- c. The Committee shall create an agenda for each meeting pursuant to the requirements of Bagley-Keene.
- d. Unless the Committee determines otherwise, the Committee shall hold separate closed sessions to meet with management, the internal auditors and independent auditors. Closed sessions of the Committee may be held at any meeting pursuant to the provisions of Bagley-Keene and California Government Code section 11120, et seq., as may be amended.
- e. A majority of the Committee shall constitute a quorum. Each member of the Committee will have one vote and actions at the meeting shall be approved by a majority of the members present.
- f. Minutes shall be prepared at each meeting and shall be filed with the minutes of State Fund’s Board.

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- g. The Committee Chairperson or the Chairperson's designee shall give a full report on the Committee's actions at the earliest scheduled Board meeting.

Duties and Responsibilities

In discharging its duties and responsibilities, the Committee shall:

1. Financial Reporting

- a. Review with management and the external auditor, State Fund's financial statements on a semi-annual basis and discuss State Fund's financial reports filed with the Department of Insurance and the California State Controller's Office and solicit the external auditor's opinion with respect to the financial statement in the reports.
- b. Review with management and the external auditor any significant changes or other issues regarding accounting principles, judgments and the quality of financial reporting.
- c. Review with management and the external auditor the accounting practices, policies and compliance with accounting standards.
- d. Review with management, external 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.
- e. Review significant findings prepared by the independent auditors and the internal auditing department together with management's responses.
- f. Review and assess all matters related to audits, examinations, investigations or inquiries of the State Auditor and other appropriate State and Federal agencies.
- g. Review the report issued by the external auditor and discuss with the external auditor all accounting policies and practices to be used and 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, the treatment preferred by the external auditor, and any other material written communications between the external auditor and State Fund's management.

2. External Audit

- a. Have responsibility for the appointment, retention, compensation, termination and oversight of the independent, external auditors' work, scope and terms including the coordination of the audit effort with internal audit. The Committee will recommend to the Board approval of all audit engagement fees. The Chairperson of the Committee or a Committee member will sign the engagement letter with the auditor. The external auditor reports directly to the Committee, and. The standards for selections of the independent auditors will comply with all State and Federal laws and regulations.
- b. Discuss with the external auditor any disclosed relationships or services that may impact the auditor's objectivity and independence.

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- c. Review and confirm the independence of the external auditors by obtaining statements from the auditors of relationships between the auditors and State Fund including non-audit services.
- d. At least annually, the Committee will obtain and review a report by the external auditors describing the external auditor's internal quality control procedures; material issued 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.
- e. Monitor and ensure the external audit partner in charge is rotated as required by law or regulation.
- f. Review the scope and results of the audit and any disagreements the external audit partner may have had with management and any problems encountered by the external audit partner in performing the audit(s).
- g. Review any questions, comments or suggestions the auditor may have relative to the internal controls and accounting practices and procedures of State Fund.

3. Internal Audit Function

- a. Review with management and the internal audit manager the charter, budget, activities, staffing and organizational structure of the internal audit function and any recommendations with respect to the 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 with the manager of internal audit and management the adequacy and effectiveness of State Fund's internal controls, the reliability of its financial reporting as well as the external auditor's assessment of the adequacy of such controls and systems and management's response to any material weakness in State Fund's internal controls.
- d. Review and evaluate the performance of the internal audit function including a review of the performance of the manager of internal auditing and, if appropriate, recommend the selection of a new manager.
- e. 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.

4. Ethics and Legal Compliance

- a. Review with management, the finance staff, the external and internal auditors, 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 from the California State Auditor regarding improper governmental activity, theft, conflict of interest, gross misconduct, inefficiencies or incompetence of State Fund's employees, accounting, internal accounting controls or auditing matters.

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- c. Establish procedures for the confidential, anonymous submission of complaints and tips by State Fund's employees as mandated by the Board or by law.
- d. Establish procedures for the receipt, retention, and treatment of reports of investigations and audits conducted of State Fund by the California State Auditor.
- e. Formulate and recommend to the Board any changes to the Code of Ethics or Code of Conduct and/or other compliance policies and guidelines that relate to financial reporting, and monitor compliance with these Codes.
- f. 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.
- g. Conduct a review of all related-party transactions, as necessary, and recommend to the Board, as appropriate, whether to approve such transactions.
- h. Approve State Fund's compliance plan, make and approve changes as needed and ensure that compliance functions are performed with independence and in accordance with professional standards.
- i. Obtain regular updates from State Fund's management and State Fund's legal counsel regarding compliance matters.

Powers

The Committee shall have the following powers:

- a. To form and delegate authority to subcommittees.
- b. To hire appropriate experts as it deems necessary to carry out its responsibilities and have other responsibilities and authority as designated from time to time by resolution of the Board.
- c. To amend or repeal the Charter or any provisions of the Charter as appropriate.
- d. To have unrestricted access to management, State Fund personnel, and the external auditors as is appropriate for the proper performance of its function.
- e. To oversee all contracted reviews, assessments and examinations required by the Board or requested by the Committee including, but not limited to, compliance with audit-related laws, rules, regulations, Board policies, internal controls, management operating procedures, and industry best practices.
- f. Such other powers as may be necessary and appropriate to fulfill the Committee's purposes.
- g. The Committee will evaluate its performance on an annual basis, either separately or in conjunction with an annual evaluation of the full Board.