



## **State Fund Responses to Department of Insurance's Operational Review**

### **Executive Summary**

#### Background

State Fund has worked closely with the California Department of Insurance in its top-to-bottom audit of State Fund's operations. This audit followed an internal review conducted by State Fund's Board of Directors that focused on State Fund's administrative fee program and related internal controls. The Board's review disclosed very serious shortcomings in those areas and the need for immediate changes in State Fund's senior management and operations. The findings of the Board's review team also made clear that a much wider review of State Fund's operations was essential.

At the same time, the California Department of Insurance concluded that these findings demonstrated the need for the Department to conduct a thorough independent audit immediately. This audit and the ensuing work of the Board and interim president Lawrence A. Mulryan proceeded on parallel and complementary tracks. During this time the Board and Mr. Mulryan made immediate changes in the most critical management areas. The department's audit of State Fund's operations was broad-based and resulted in extensive findings and recommendations.

There is wide agreement among the Department, State Fund's management and the Board of Directors both as to the nature of shortcomings in State Fund's operations and what needs to be done to remedy them. In fact, the Board and State Fund's new senior management have already made significant progress on many of these issues. The Department's independent auditors provided fresh insights and recommendations that offer a road map for State Fund's management as it implements operational improvements.

#### Summary of Response

In an effort to maximize the benefit from the department's detailed report, State Fund has addressed each of the 110 findings and recommendations. The following summarizes State Fund's responses in each of the areas examined in the report

## Governance and Management Practices

While State Fund's responses to these recommendations may differ in some details, State Fund shares the views expressed by the Department's independent auditors and, in fact, began implementing many of these changes immediately after interim president Mulryan was appointed in late March, 2007. The Board chartered an audit committee and created a direct reporting relationship between our Internal Audit Department and the audit committee. State Fund strongly agrees with the need for new exempt positions and has identified the need for the following positions: Chief Financial Officer, Chief Information Officer, Chief Operating Officer, Chief Risk Officer, General Counsel, and Chief Investment Officer. State Fund has been working on the recommended improvements for our Information Technology and Human Resources Departments. Expanding the staff and responsibilities of the Internal Audit Department also has been a high priority.

## Group Association Program

While group insurance is an area of continuing dialog between State Fund and the department, State Fund agrees with much of the criticism of its former program. The new program is fully transparent and makes clear that the basis for the fees is the performance of services, especially in the area of safety. There are clear performance metrics and audit rights that will be exercised. While State Fund continues to regard this program as essential, the amount of administrative fees in the aggregate will be greatly reduced.

## Information Technology

State Fund has recognized that it needs to strengthen its system controls for Information Technology. The rapid pace of change in this highly technical area presents significant challenges. State Fund has taken decisive steps in the past few months to begin to implement best practices in many operational areas and to strengthen IT's overall authority and control. The use of IT consultants has declined as State Fund focuses on the training and development of its internal resources and training.

## District Office and Claims Adjusting Centers

State Fund's claims operations have experienced a tremendous amount of change in the past few years. The implementations of the Claims Processing Centers (CPC) and the Electronic Claims File (ECF) system have been major undertakings. Improving the bill processing at the CPC's is a top priority and State Fund has already implemented a number of measures to address this issue. We recognize that like most change, the transition to ECF has been difficult for many of our adjusters. Overall, however, ECF provides State Fund with some important tools including: a uniform database, increased ability to manage workload distribution and management reports that will assist State Fund in managing a consistent claims product. State Fund will also review the underwriting policies reviewed in this report to ensure they are consistent and conform to guidelines.

## Business Services

State Fund has taken significant action in many of the areas described in this section of the report. For example, all of our consultant contracts do reflect an estimated value, IT consultant contracts have been reviewed and rewritten in consultation with outside counsel and we have established procedures to ensure payments accurately reflect contracts. We will continue to strengthen these procedures to ensure our contracting and payment process are in alignment with best practices.

## Conclusion

State Fund has never been in a better position to improve its operations and align them with industry best practices. The work of the Board, new management and the Department of Insurance has provided an invaluable road map for the way forward. We have no doubt that our talented and dedicated work force will succeed in this effort.