



**State Fund's Response to the Department of Insurance's Operational Review
December 11, 2007**

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.

Governance and Management Practices

1. SCIF Lacks Key Officer Positions

Finding

SCIF lacks key management positions that comparable insurance companies possess.

Recommendation

In order for SCIF to have an effective management structure, new exempt management positions need to be established. SCIF needs at least five additional exempt positions. These positions are Chief Financial Officer, Chief Information Officer, Chief Investment Officer, Chief Operating Officer and General Counsel. Legislation should be enacted to allow SCIF to create these five exempt positions in order for SCIF to compete with other firms to attract the most qualified individuals. It is important that duties for these executives be properly outlined. Other exempt positions may be needed as SCIF reorganizes other functions and enhances controls within the organization.

Response

We agree and after assessing the needs of the State Fund, six critical positions have been identified: Chief Financial Officer, Chief Information Officer, Chief Operating officer, Chief Risk Officer, General Counsel, and Chief Investment Officer. Job descriptions and accountabilities are being finalized to petition the legislature in early December.

2. Use of Consultants

Finding

SCIF has been utilizing two consultants to fulfill the duties of the CFO position. These consultants will not be renewing their contracts with SCIF at year-end. SCIF does not have a plan for the assumption of these duties after year-end.

Recommendation

SCIF should retain a consultant to assume the CFO duties by year-end. The earliest that legislation could be adopted to provide for a permanent CFO position would be in 2008. Additionally, SCIF should appoint someone in the Fiscal and Investment Program to work closely with the selected consultant to ensure that institutional knowledge is retained.

Response

The President, interim President, and acting CFO have been interviewing candidates to assume the CFO position and expect to have the position filled by year end. This position needs to be permanent to be the most effective. The current acting CFO will work with our fiscal services staff to transition our new CFO.

3. General Counsel Role and Reporting Structure Needs Revision

Finding

The General Counsel reporting structure may have allowed the President to have too much influence over the General Counsel and compromise the position's authority and utility.

Recommendation

SCIF should revise the reporting structure and duties of the General Counsel position to report administratively to the President, but functionally to the Board of Directors. The Board should be ultimately responsible for this function. The General Counsel should attend all Board meetings and be permitted to have executive sessions with the Board members. The General Counsel should also help define what authority the Board delegates to committees from a legal perspective. The position should also assist the Board in identifying when outside specialists are needed.

Response

We agree and are requesting an exempt General Counsel position who will report administratively to the President, and functionally to the Board.

Board of Directors

4. Increase the Size of SCIF Board, Review Director Qualifications, Training Curriculum, Compensation and Meeting Frequency

Finding

The SCIF Board has only five members which makes it difficult to form committees, as the same members would sit on all committees due to the Board's limited size.

There are minimal qualification provisions for Board members in the insurance code. This creates difficulties in obtaining a diverse Board. The Board's compensation structure is below other comparable boards for an entity of this size and complexity.

Board member training is conducted informally at the discretion of the Board Chair. SCIF employees typically design training curriculum for Board members at the Board's request.

Recommendation

Significant changes should be made to the Board. The size of the Board should be expanded. Board terms and qualifications should also be reviewed and revised. The Board should ensure that conflicts of interest do not limit members' capacity to function effectively. It is important that the majority of Board members have diverse qualifications with base line insurance knowledge. SCIF should consider having an investment expert represented on the Board as well as a legal expert. The appointment process should assure that only highly qualified individuals, without conflicts, are considered for appointment to the SCIF Board.

SCIF is a unique organization that operates in a specialized market. It is important that SCIF develop a training curriculum for Board members. This training program should be approved by the Board Chair. All Board members should be required to complete this training. Board training should include corporate governance and ethics. Additionally, Board members should participate in educational sessions annually related to trends in the workers' compensation market.

Once the expanded Board is filled, the Board should be divided into committees to conduct business more effectively. Earlier this year, SCIF formed an audit committee. Budget, governance and compensation committees should also be formed to address current issues and provide effective oversight.

In order to attract and retain qualified Board members, SCIF should review the Board members' current compensation structure to bring it in line with comparable organizations.

It is noted that these Board modifications require changes in legislation.

Response

We agree. This recommendation needs Legislative approval for compliance. We recommend expanding the Board from the current five voting and three non-voting member structure to a Board size of 12-14, all with voting status. We also agree that compensation structure for Board members is inadequate and needs to be brought into alignment with the compensation for comparable organizations. The Board needs to be sufficient in number with a diversity of qualifications to effectively run the following committees:

- **Governance/Ethics/Legal**
- **Fiscal/Budget**
- **Audit/Enterprise Risk Assessment (in place)**
- **Investment**
- **Compensation**

An on-boarding curriculum, including continuing education opportunities, is underway and will be presented to the Board at our January meeting. We will work

with the Department of Insurance, the Administration and the Legislature to pursue legislation necessary to implement.

5. Establish Benchmarks for Board Reporting

Finding

Certain Board budget directives were not followed by SCIF executives. SCIF has not developed standard reporting parameters for consistent communication and reporting to the Board.

Recommendation

The Board should develop a mechanism to ensure that pertinent financial information, including budget information and other related matters of importance, is presented and approved by the Board on a regular basis. Set parameters for Board reporting should be approved and followed by SCIF executives. The Board should appoint one executive to be the responsible party for this information. It is recommended that the President or General Counsel assume this role. Additionally, the Board should ensure that information is received from an array of executive officers so that the entire management team's expertise is fully utilized.

Response

We agree with this recommendation and will be taking the following action:

The Management Information and Budget (MIB) program will prepare a quarterly report comparing actual and budgeted expenses to produce a variance report. Variances will be discussed with members of the Executive Committee for reconciliation purposes and for appropriate remediation. The report will be prepared under the direction of the CFO and General Counsel for the President and the Board's review and approval. Quarterly and year end financial information is currently reported to the Board as well as other matters of importance under the President's Report. (Until a CFO and General Counsel are in place the Executive VP managing MIB will oversee this process)

Governance Framework

6. Adopt a Governance Framework

Finding

SCIF has not adopted a formal governance framework. SCIF established a SOX Committee in March 2005 to review internal control processes of key accounts related to executive certification of periodic financial statement accuracy.

Recommendation

SCIF should adopt a framework for corporate governance that outlines a structure for effective internal controls. The NAIC Model Audit Rule or the Sarbanes Oxley Act of 2002 may serve as models for SCIF regarding monitoring and control over financial reporting. SCIF should consider objective standards such as COSO and COBIT. A plan for all internal controls, not just financial reporting controls, needs to be implemented.

This framework should ensure that all risks are monitored. If necessary, SCIF should consider another position for a Compliance Officer who would be responsible for compliance with state regulations. An annual compliance report, certified by SCIF executives, should be considered to make certain that adequate Board and management resources are dedicated to improving and maintaining an effective control environment at SCIF.

Response

We agree with this recommendation and have made significant progress in strengthening our corporate governance. The Board has been working with outside counsel to develop and implement a Code of Ethics for Board members and an incompatibility activities policy for State Fund employees. Outside counsel is also working with State Fund management to incorporate these policies into the corporate code of conduct. The Code of Conduct will meet all NAIC Model Audit Rule requirements and will establish a clear and strong "Tone at the Top" message to the organization.

State Fund has also established an Enterprise Risk Assessment Committee and will be conducting an enterprise-wide risk assessment. The review will include sustainable activities utilizing the COSO framework as a guide to assure appropriate monitoring, information & communication, control activities, risk assessment, and control environment elements are achieved for financial reporting. The risk assessment will include information technology and will address the issue of COBIT standards. While the initial phase of the risk assessment will focus on risks across the organization and financial reporting elements, it is expected recommendations will address how best to sustain focus on risk assessment, internal controls and compliance for the organization.

General Management Practices

7. Enhance Existing Internal Committees

Finding

SCIF executives formed a committee to address risk management issues. However, it was unclear if the SOX Committee would disband and be reconstituted under this new committee.

Recommendation

It is recommended that SCIF retain both committees. The Risk Committee should be reviewing and monitoring potential prospective risks, as well as current risk indicators, while the SOX Committee should continue to focus on internal control enhancements.

Response

The Enterprise Risk Assessment Committee's role has expanded and will include assessment of control activities and internal controls for financial reporting. The project findings are expected to result in recommendations on how best to organize a permanent focus around risk assessment, internal control and compliance activities.

8. Executives Should be Actively Involved in Monitoring Interim Consultants

Finding

Certain members of the Executive Committee were not fully informed on the use of key consultants.

Recommendation

The Board and the President should ensure that executives and staff working with consultants understand the scope of the consultant's engagement. Executives that have primary oversight responsibility for consultant use should have regular communication with the consultant, and apprise the President regularly on the status.

Response

We agree that the Executive Committee needs to be fully informed and responsible for consultant use. In 2006 we initiated a process to begin addressing this need. Today the entire Executive Committee meets monthly with the Project Services Office to review all projects including consultant work and activity. Executives are required to be sponsors for all major projects under the new governance process and are accountable for budgets, deliverables, schedules, as well as documenting and reporting changes in scope.

9. Improve Communication Throughout the Organization

Finding

An improved communication process needs to be implemented throughout the organization.

Recommendation

SCIF management should take an active role in communicating corporate changes, both formally and informally, as it interacts with staff. A formal communication strategy should be developed and approved by the Board.

Response

We agree with this recommendation and improving organizational communication is a top priority. We have retained a consultant to assist in this work and will be developing:

- **Implemented communication protocols and procedures for the organization**
- **Developed a clear and concise "message map" for 2008**
- **Developed short and long communication plans and strategy for the organization**

Human Resources

10. Establish Formal Succession Planning

Finding

SCIF does not engage in a formal succession planning process.

Recommendation

Strategic succession planning is critical for SCIF, as many of its staff near retirement in the next few years. HR should work with the Executive management team to develop a formal succession plan.

Response

State Fund agrees that we have a significant need to do succession planning.

In the past year State Fund has taken the following steps to implement a succession planning process:

- **Created an Employee and Organizational Development unit in Human Resources to specifically to address this and similar issues**
- **Sent HR staff to the Workforce/Succession Planning Workshops**
- **Retained a consultant to assist in designing a succession planning model for State Fund**

11. Accurate Recordkeeping for Vacation Accruals

Finding

There is no formal vacation policy or vacation time reporting structure for program managers and executives. Two significant payouts were made to former employees for unused vacation time.

A vacation balance for one former executive was over 3,300 hours and for another former executive the vacation balance was over 2,100 hours.

Recommendation

SCIF employees must submit a form complete with the dates and hours of vacation requested with the employee's signature and the supervisor's signature. This policy should be followed by all staff in the organization. HR should perform a reconciliation to verify that accruals accurately reflect vacation time used by employees. SCIF should follow the state prescribed vacation and annual leave policies. If exceptions are made permitting employees to go over the designated accrual limit, proper approval and related documentation should be maintained. Significant deviations should be reviewed and documented from both a legal and business perspective.

Response

We acknowledge that keeping our management's vacation hours within the state's prescribed vacation and annual leave policies is a challenge due to business demands. It is State Fund's policy, however, that all employees, including Executives and Program Managers, are to receive approval from their supervisor to take vacation time. All employees are also required to submit a form to their supervisors indicating the date and amount of time taken, so that charges are made to their leave accruals. Failure to properly report leave is grounds for disciplinary action and State Fund has disciplined employees who have failed to report time properly.

Human Resources will provide quarterly reports detailing vacation accruals to make managers aware of balances that exceed guidelines.

12. Procedures Should be Established to Safeguard SCIF Assets and Information

Finding

There is no established procedure to ensure that company issued equipment, SCIF property or records are returned upon an employee's termination or resignation. HR does not regularly communicate directly with the IT Department to provide notification of terminated employees. Program Managers and others notify IT through different means without following specific procedures.

The same practice is followed for employees that are promoted or transferred into different programs. Due to the lack of controls in place within IT, employees may be granted multiple accesses to various software tools or information outside of their current employment and terminated employees may still have access to SCIF systems.

Recommendation

HR should develop a written protocol to safeguard SCIF's assets and proprietary information when an employee is terminated, resigns or transfers to another position within the organization. It should be the Enterprise Security Department's role to ensure that employee access to systems has been terminated or revised timely. SCIF is enhancing procedures in this area.

Response

We agree with this recommendation and in July Human Resources implemented a new checklist to be used for all dismissed employees to safeguard our assets. In October, HR implemented the use of a similar checklist to be used for all voluntary separations

Human Resources is working with Information Technology, Business Services, and Real Estate Management to implement organizational procedures that will address the control of State Fund assets.

13. Performance Management Standards Need to Be Enhanced

Finding

Performance evaluations are not conducted consistently throughout the organization on an annual basis. Also, job descriptions are not updated regularly.

Recommendation

HR should enforce the SCIF policy that evaluations be conducted annually. SCIF should conduct training for supervisors on how to prepare an effective performance assessment. Job descriptions need to be updated on a rotational basis to accurately reflect position duties.

Response

We agree with this recommendation and have identified that the appraisal process needed to be strengthened. We have taken significant steps to improve both the quality and regularity of our employee appraisals.

On October 1, 2007, Human Resources sent all programs a reminder notification that appraisals are expected to be completed on all employees on a regular basis. HR also provided programs with the current status of their compliance with our policies and will be tracking the completion of these appraisals and noting reasons any were not completed. Reports will be shared with the assigned Vice President.

HR offers a variety of supervisory workshops on topics related to performance management. Additionally each program is assigned an HR Consultant that is available to assist supervisors in writing appraisals.

14. Improve Human Resources Function at the District Offices

Finding

District office management currently performs typical HR responsibilities. HR confirmed that its involvement with the district offices is limited. The rationale provided for this process is that the district offices are decentralized, and the lack of HR involvement was part of the corporate plan.

Recommendation

HR should oversee all related matters that fall under its supervision, not just those that are at the SCIF home office. HR should visit district offices and participate in oversight. The SCIF Employee Handbook should be reinstated as a tool for employees.

Response

We agree Human Resources needs to oversee all related matters that fall under its supervision and there is no difference in our service levels between our district offices and home office programs. We will clear up any misperceptions that exist within our department. We will also communicate with our district offices and invite feedback if they are not receiving appropriate services.

15. Improve File Retention and Maintenance of Human Resource Files

Finding

Many HR files that were reviewed lacked complete documentation or were missing in their entirety. In certain instances, missing documentation included information on retirements, resignations, terminations, and promotions. The missing and incomplete files are not in compliance with SCIF's HR retention policy. Although SCIF stated that these files/documents were most likely 'checked-out' by other department personnel, there was no evidence to verify this statement, and the missing files were not located.

Recommendation

The HR personnel file maintenance system needs to be updated. A more secure file checkout process could be accomplished electronically with files linked to employee profiles in Oracle, or manually with increased HR employee oversight. Internal audit should also conduct a review of HR files within the next year to verify that file

maintenance has improved. It is recommended that HR files be scanned and backed up electronically.

Response

We agree with this recommendation. Human Resources implemented new procedures in October requiring the Official Personnel Files be locked and have restricted access. HR's Administration staff reviews and logs requests for access, retrieves appropriate file and monitors the file's timely return.

In the future we will consider the cost and feasibility of transitioning to electronic files.

16. Develop Leadership Training

Finding

SCIF offers many training courses that are technical in nature or that are created to satisfy a current initiative such as a change in regulation. There are very few formal leadership training courses available at SCIF that address soft skills for managers.

Recommendation

HR should work with the SCIF Board and executives to develop a comprehensive training program, including leadership training for future managers and additional soft skills training.

Response

The training and development of our supervisors and managers has been identified as a top priority. While Human Resources does provide a number of leadership classes, they are exploring additional curriculum.

In September, HR conducted a training survey of managers to identify necessary technical, soft, and leadership skills to develop additional classes for upper management.

17. Re-Establish Exit Interview Process

Finding

Due to the large number of employees that have been leaving SCIF, HR discontinued the exit interview process.

Recommendation

An exit interview should be conducted for all employees. Exit interviews can be helpful in understanding the morale of employees and also serve as a useful tool in retention and measuring organizational changes. HR should administer all exit interviews, conducting phone interviews as appropriate for employees vacating positions located outside the home office. The exit interview should be maintained within the employee's personnel file with results shared with the respective program manager and the appropriate executive staff.

Response

State Fund agrees with this recommendation and has begun to reintroduce exit interviews.

Internal Audit

18. Enhance Risk Planning Model

Finding

Internal Audit develops its risk planning model primarily from internal assessment surveys and NAIC branded risk classifications. There was no external reference to market conditions reflected in the risk planning model.

Recommendation

Internal Audit should continue to refine its risk planning model. Consideration should be given to regulatory issues and industry market conditions that may not be reflected in the responses collected from management. Internal Audit should conduct an independent assessment of these areas and factor this into the risk planning model. The Board should also assure that Internal Audit resources are adequate to address the risks facing SCIF.

Response

The Institute of Internal Auditors has identified seeking Management input during the risk assessment process as a leading practice. In addition to collecting management responses, Internal Audit adjusts the audit subject risks based upon environmental, process, and/or regulatory changes. Internal Audit will include specific references to these market-related conditions in its future risk planning model.

The Board has and will continue to monitor Internal Audit's staffing levels to ensure resources are adequate.

19. Enhance Internal Auditors' Understanding of IT Standards

Finding

Based upon discussions held with Internal Audit personnel, the IT auditors do not have a strong background in IT.

Recommendation

Although the newly formed unit, Special Projects/External Unit, in Internal Audit allows for the contracting of IT specialists when needed, SCIF should require additional training for existing IT auditors in the area of Information Systems and COBIT standards.

Response

Internal Audit incorporates COBIT standards during IT-related audits. We believe that all audit staff benefit from a basic understanding of information security and technology and provide annual training in IT-related subjects from locally and nationally recognized organizations. Internal Audit has planned additional training for the department in 2008 to promote continued proficiency in COBIT and other

IT subjects. In addition, the Board has given Internal Audit authorization to recruit some IT specialists to enhance the Special Projects/External Unit.

20. Improve Audit Follow-up and Implement Central Repository for Open Findings

Finding

SCIF performs audit follow-ups with the auditee at 90, 180 and 365 days after the audit report date, with management responses due within 10 business days. Although Internal Audit is required to conduct these audit follow-ups, Internal Audit does not maintain a central log of open issues and findings. The auditor in charge tracks the follow-up dates via an MS Outlook calendar or bulletin board posting, as well as on the newly revised Project Review Form (PRF).

Recommendation

The implementation of post-audit follow-up is a useful step for Internal Audit in eliminating repeat findings and ensuring that recommendations are addressed by auditees. Internal Audit should create and maintain a central log of open findings. They should designate a staff member to track these findings for the entire department, and retain the applicable documents from the auditee such as newly created policies or procedures suggested in the audit report. Additionally, the Audit Committee of the Board should receive a copy of these logs to note which audit recommendations are still open or are in progress and to determine which audit issues have not been properly addressed. We also recommend that the Audit Committee adopt a formal policy on how open audit issues should be addressed.

On September 17, 2007, Internal Audit implemented a procedure to maintain a central log of open findings.

Response

We agree with this recommendation and have begun maintaining a centralized tracking tool to manage open findings. Reports of open issues will be published on a periodic basis to Executive and the Audit Committee. Internal Audit will refer audit findings to the Audit Committee if management has not taken corrective action in a timely manner.

21. Improve Workpaper Documentation

Finding

The Internal Audit Manual states that each workpaper should have a heading, the name of the auditor performing the work, the date, workpaper purpose, audit source and a conclusion. In general, the SCIF Internal Audit workpapers lacked headings, purposes, audit dates and conclusions.

Recommendation

The Internal Audit Program Manager should ensure that Internal Audit staff is following standards set forth in the Internal Audit Manual. Specifically, internal audit workpapers should contain a heading, purpose, audit date and conclusion. Audit workpapers should be easy to interpret and provide support for the audit performed.

Response

Internal Audit workpapers are expected to comply with the Institute of Internal Audit’s Professional Practices Framework. We have included workpapers in an internal quality review assessment.

22. Update Project Review Forms

Finding

Internal Audit staff prepare a Project Assignment Order (PAO) in the planning phase of the audit to document the audit plan, which includes the estimated completion date of the project and a Project Review Form (PRF) at the completion of the audit to document the completion date, whether follow up is needed, actual hours incurred and supervisory review of the project. Of the 47 audits reviewed, 19 audits were missing follow-up dates, 13 audits contained large variances between the budget to actual hours with no explanation of the variances, 10 audits had no actual hours populated, and three audits contained large variances between the planned and actual completion dates with no explanation of the variances.

Recommendation

Internal Audit management should ensure that it has adequate data so that internal audits can be completed in a timely manner and within budgeted hours.

Response

Internal Audit will modify the current PRF to ensure that variances are documented and reviewed by management.

23. Strengthen Audit Recommendations and Monitor Management Responses and Repeat Findings

Findings

Report recommendations contain “soft” language such as: “remind” and “encourage.” Soft language does not lend itself to enforceable action plans, accountable individuals and target dates.

Recommendations with “soft” language coupled with poor responses from management lead to unaddressed risks and repeat findings. We also noted several repeat findings in our review of the internal audit reports.

Recommendation

Audit recommendations should use stronger language, such as “implement,” “complete” and “perform” in order to promote better responses with action plans and target dates.

Internal Audit should not accept responses that do not contain solid action plans, indicate target dates and identify responsible parties. Any responses lacking the appropriate language should be sent back to the auditee for revision. Internal Audit should also ensure that management responds to each and every recommendation.

Additionally, Internal Audit should consider incorporating management responses into the report as opposed to maintaining them in a separate document. This information should be reported to the Audit Committee in summary format.

Response

We agree with this recommendation and have initiated use of reporting language which promotes on-point responses, action plans and target dates. Responses that fail to contain solid action plans, indicate target dates and identify responsible parties will be returned to the audit subject. Internal Audit will ensure that management responds to each and every recommendation.

Internal Audit has begun incorporating management responses into Executive Summaries. Unabridged text of management responses are included in the report appendices.

24. Develop Sampling Documentation

Finding

The PAO addresses the need, objective, scope and procedures to be performed in the audit, and is approved by the Internal Audit Program Manager. Under the procedure section, the populations subject to sampling and the method of sampling (i.e., statistical or judgmental) are not addressed. In general, the workpapers lacked detailed descriptions of sampling methods utilized for test work.

Recommendation

Internal Audit should ensure that it is documenting the selection and justification for its samples and that the samples are sufficient to support the conclusions. The Internal Audit Manual should be updated to include documentation of sampling methods.

Response

The Project Assignment Order (PAO) is formulated to obtain and record the Internal Audit Manager's authorization to proceed with the audit.

Audit work papers contain detailed audit process information, including sampling methods and testing techniques. Internal Audit strives to ensure that its samples and testing are sufficient to support audit conclusions. The Internal Audit Manual will be updated to fully reference sampling methodology.

25. Provide Responses to Self-Reviews

Finding

The Internal Audit Manager did not respond to recommendations in self-reviews performed by members of the Internal Audit staff.

Recommendation

Internal Audit management should provide responses to self-reviews to ensure that the department, as well as SCIF as a whole, benefits from the recommendations provided in these self reviews.

The Internal Audit Program Manager indicated that, going forward, she will be providing formal responses to be distributed to the Board of Directors and Executive Committee.

Response

We agree. Internal Audit self- assessments will contain a response and will be forwarded to the Audit Committee.

26. Monitor Corporate Underwriting and District Office Self-Reviews

Finding

Many of the underwriting audits are performed as self-reviews by both the district offices and corporate underwriting personnel. Internal Audit has not monitored these self-reviews.

Recommendation

Internal Audit should monitor these self-reviews to ensure they are being appropriately conducted and documented. In addition, Internal Audit should ensure that action plans and dates that are developed as a result of these self-reviews are strictly followed. Audits of these self-reviews are planned for 2008 and on a rotational basis every five years thereafter. If the audits in 2008 yield poor documentation and follow-up, Internal Audit should consider assigning a resource to follow up on these self-reviews.

Response

We agree and Internal Audit is planning to review and validate the conclusions of these self evaluations in 2008.

27. Implement Consistency in Supervisory Reviews

Finding

The use of coaching/review notes is inconsistent.

Recommendation

Internal Audit should make certain that there is consistency in regards to supervisory workpaper review. Once Internal Audit starts utilizing the TeamMate Audit Management System (electronic workpapers), coaching notes will be directly linked to the workpaper with the exception, and will require a response from the auditor who performed the work, as well as review by the supervisor in order for the comment to be cleared.

Response

Internal Audit acknowledges that coaching notes vary by subject and auditor experience and will work with its supervisors to improve the consistency and documentation level of notes.

28. Standardize Audit Reports

Finding

The format and content of the Internal Audit reports varied greatly between units.

Recommendation

In order to ensure reports contain complete information and are easy to follow, Internal Audit should require that auditors follow a standard format for reports.

Response

Our audit report format and contents do vary by subject. Audit reports are constructed for the auditee's review as well as for the Audit Committee. For customer service reasons, report formatting is sometimes revised at the request of stakeholders.

All reports contain engagement, scope and objectives, conclusions, recommendations and follow-up plans.

29. Include Explanations for Items Excluded from Audit Scope

Finding

Some internal audit reports outlined items that were not included in the scope of the audit, but there was no explanation as to why the excluded items were not covered.

Recommendation

If audit reports exclude certain items, an explanation should be provided.

Response

Internal Audit agrees and will include explanations of items excluded from the audit scope in the audit report.

30. Implement Grading Within Reports

Finding

Internal Audit reports do not use a grading or rating scale to measure the results of audits.

Recommendation

Internal Audit should utilize a grading or rating scale in order to track audit areas of greatest concern. These ratings could be a useful tool in developing future audit plans as this would direct the auditors to those areas that have had problems in the past.

Response

Internal Audit believes it is important to objectively evaluate risks identified in audits rather than subjectively grading that would put us at odds with management. Reports identify areas of critical risks and summarize the most critical findings in Executive Summaries. Planned follow-ups at 90, 180 and 365-days are used to review and assure management has initiated or completed corrective action.

31. **Maintain the Integrity of the Audit Plan**

Finding

Audits of Group Administrative Fees and Group Insurance were started in 2005, but were not completed. It was explained by the Internal Audit Program Manager that the person performing these audits was pulled off of the audits to assist with higher priority special projects.

Recommendation

Deviations from the audit plan should be approved by the Board or the Audit Committee.

Response

We agree. The integrity and transparency of the audit plan must be maintained by the Audit Committee which is now in place to ensure that Internal Audit is free from improper influences and that internal audit resources are managed by independent directors. While State Fund's internal investigation revealed that audit resources were inappropriately diverted from review of the Group Administrative and Group Insurance program, the individuals responsible for this action have been removed from management by the Board of Directors and structural changes are in place to ensure the independence of the audit function.

Group Association Programs

32. **Group Administrative Fees – Directors**

Finding

From 1997 to June 2007, SCIF paid close to \$140 million in group administrative fees to Western Insurance Administrators. This association was controlled by an individual who also served as a Board member for SCIF from 2003 to 2006. For the same period, SCIF paid approximately \$125 million to associations related to Golden State Builders Exchange. Similarly, this association was controlled by an individual who served as a SCIF Board member from 2004 to 2006. Both of these board members resigned in 2006. The Board minutes indicated that there was no conflict of interest. Effective October 1, 2007 the groups administered by Western Insurance Administrators were not renewed by SCIF. The CDI is referring these findings to the joint task force.

Recommendation

It is recommended that the Board take action to ensure that its members do not personally benefit, either directly or indirectly, as a result of decisions made by the Board.

SCIF indicated that corrective actions to be implemented by the Board include the development of a code of ethics policy for board members, officers and employees. This code of ethics will include, among other provisions, articles related to financial conflicts of interest and procedures for investigations of directors and officers concerning ethics complaints. SCIF also indicated that it is in the process of preparing an Employee Incompatibility Activities policy. The Board is scheduled to review and adopt this policy in the later part of 2007.

Response

State Fund's Board is committed to the highest level of independence and integrity in its governance of our organization. Current Board members have actively embraced changes in board structure and operation that will encourage transparency, independence and accountability. At a minimum, it is clear that Board members must not benefit personally as a result of any decision made by the Board. This policy will be enforced through adoption of a code of ethics and implementation of a code of conduct written by independent outside legal counsel. This code of conduct will be completed in the first quarter of 2008 and the Board will commit to its full and immediate implementation.

33. Excessive Administrative Fees Paid for Minimal Services

Finding

Based upon interviews with group administrators, some group associations were paid millions of dollars for merely sending members quarterly newsletters and providing few other safety services. In many instances SCIF wrote most of the content for the newsletters. The SCIF group contracts were poorly written, which allowed associations to provide minimal services and still be in compliance with their contract.

Recommendation

SCIF should develop contracts that require specific services to be performed commensurate with the administrative fees paid. In 2007 SCIF developed contracts that require specific performance of administrative and/or safety services.

Response

Group insurance has been a fundamental part of State Fund's business plan for decades.

Depending on the group, the administrators provide a wide variety of services. In State Fund's new program, administrators are required to provide safety services among other tasks. There is a wide variety of groups and the kinds of services that are needed both for the members and for State Fund. If there were not outside group administrators, State Fund would need to provide these services

These groups provide a service to State Fund that is not susceptible to a straight service payment. State Fund also receives the groups' endorsement of State Fund and a promise not to promote competing carriers. This is unquestionably a benefit that has great value and it would not be given to State Fund without compensation. We recognize serious shortcomings in the way State Fund managed group insurance in the past. In fact, through the Board, State Fund performed a rigorous review of the program and self-reported all of the problems that were discovered. The review's findings led to far-reaching changes in the program and much more widely within State Fund including the replacement of those who were responsible for the way the former program was run.

The new program contains explicit safety requirements, safety performance metrics and auditing requirements. This program now is a transparent, high profile, flagship program for State Fund, receiving appropriate management attention.

34. Contract Expense Review Provision Not Exercised

Finding

The group contract provision that permitted SCIF to review group association expenses was not exercised.

Recommendation

SCIF should enforce the contract provision that allows for a review of group expenditures. Additionally, a new contract should be developed for the groups that allow SCIF to periodically audit the group associations for contract compliance.

Response

We agree that we did not previously exercise the contract provision permitting us to review group association expenses. The lack of review was based in part on the fact that we viewed administrative fees paid to associations as more than fees for service and direct reimbursements. We view administrative fees as paid for a variety of purposes, including endorsement, licensing, exclusivity, and safety. The new association administrative fee program includes specific and verifiable safety requirements. We are committed to auditing all participating associations to monitor compliance.

35. No Internal Audits Completed on Group Association Program

Finding

No internal audit reviews were completed for the group association program despite the fact that it represented a significant portion of SCIF's business. The 2005 audit was never completed as SCIF allocated Internal Audit resources to other reviews that SCIF management indicated were higher priorities.

Recommendation

SCIF should regularly include a review of the group programs in the Internal Audit Plan. A review should be completed at least once every three years, prioritized according to the program's significance.

Response

We agree and Internal Audit will continue to include the group programs in its annual risk assessment. We will conduct audits whenever the results of Internal Audit's analysis indicate the risks warrant one. This may occur more or less frequently than every three years.

36. Multiple Contracts in Force for Group

Finding

There was one group association that had both a multi-year and one year contract signed. The group claimed that the multi-year contract was in-force.

Recommendation

SCIF should have the Legal Department retain copies of all contracts. A procedure should be developed to ensure that only one contract is in-force for each group to avoid litigation issues.

Response

State Fund's Underwriting Department is in charge of the new association contracts and is completing procedures to prevent multiple contracts from occurring again. Underwriting will track all contract versions going forward, will monitor, contract payments and compliance and will confirm that there is no overlap between contracts. Underwriting will work with the Legal Department on contract-related matters.

37. Group Association Payment Approval Based on Incomplete Support

Finding

Clarence & Dyer provides SCIF management reports on the groups based on interviews performed. This information is utilized by SCIF as a basis for determining whether to resume payments to the individual group associations.

As of September 5, 2007, we obtained a listing of groups that had been reviewed by the SCIF Board and Executives with decisions regarding whether they would be approved for payment or not (as prepared by a SCIF Workers' Compensation Insurance Technician).

According to the schedule, three groups (one main group) were approved for payment on August, 30, 2007. However, Clarence & Dyer conducted a follow up interview with these groups on September 4, 2007 in order to gather more information. This follow up interview focused primarily on specific safety-related services provided by the groups.

Recommendation

SCIF should not approve groups for payment until all applicable information is obtained from the groups and analyzed.

Response

State Fund agrees payments should be made only after all applicable information from the group has been analyzed and supports payment. This incident occurred early on in payment process. The fact that a re-interview was scheduled was not noted in the file and payment was made. Subsequently the re-interview confirmed that payment was appropriate. All parties have increased their diligence to ensure files are accurate and up to date.

State Fund has implemented controls into the Oracle system that resolve the risk described in the finding. A cancelled requisition can not be processed without going through the approval process.

38. Lack of Verification of Group Membership at District Office

Finding

Generally, there is no policyholder verification performed by the district office when a new member of an existing group association requests a new policy to be written. This

process is a breach of SCIF's underwriting standards. If a policyholder's class code indicates that eligibility for a group discount exists, the underwriter usually asks/tells the broker and assigns the policyholder to the group without question or confirmation of actual association membership. This could result in SCIF receiving fewer premiums (due to group discount) and paying higher broker commissions and group association fees.

Recommendation

An underwriting policy should be put in place that requires verification with the group administrator if the policyholder is a member of the group before or shortly after the discount is applied. The verification of the discount should take place within 60 days after the quote is provided by SCIF. On September 12, 2007, SCIF management informed us that they are reviewing broad aspects of the group program for improvements.

Response

The State Fund agrees with this recommendation and will require verification of group membership for new policies that receive a group discount. We will also review the logistical challenges and possible solutions for policyholders who do not complete the membership process.

39. Underwriting Guidelines for Groups Need Enhancement

Finding

While there are rules regarding eligibility requirements for policyholders' entry into a group, an exception was noted of inappropriate involvement on the part of a group association in the underwriting decision making process.

Recommendation

Underwriting guidelines need to be clear regarding the eligibility of policyholders for groups. Guidelines should be strengthened regarding the placement of ineligible members into group policies.

Response

State Fund's Underwriting Department will review and revise any group procedures relating to group eligibility and will develop training for district and group personnel on the exception process.

40. Group Estimated Contract Premium (ECP) and Administrative Fees – Lack of Adherence to Controls and Contract Requirements

Finding

SCIF had inadequate controls over the ECP which allowed for the payment of group administrative fees to groups that did not meet the minimum premium requirement, and payments which deviated from amounts owed under the contract.

Recommendation

Policies and procedures should be developed and followed for all contracts. Any exceptions made to newly established policies and procedures should be documented and approved by the SCIF President and the Board. The Legal Department should be actively involved in the contract review process and should approve any changes made to the

standard contract. Any old contracts, should be terminated before any new contracts are issued with individual groups, to guarantee there are no overlapping contracts.

Response

State Fund is establishing policies and procedures for the administration of our new association contracts and will arrange for Legal Department involvement with contract review or modification. There will be no overlap between the old and new contracts. Any substantial exceptions made to newly established policies and procedures will be documented and approved by the President and the Board.

41. Lack of Contract Review Procedures

Finding

A lack of established procedures and guidelines allowed for the signing of group administrative contracts without proper oversight by the SCIF Marketing Managers or review by the legal staff. As a result of the 271 group contracts reviewed, the following items were noted:

- 26 contracts had no evidence of SCIF Marketing Manager signature
- 35 contracts were not provided for review
- 68 contracts had unidentified signatures instead of SCIF Marketing Manager signature
- 139 contracts were signed by the 'Acting Marketing Manager'. Of these contracts, only 13 were signed on days in which the SCIF Marketing Manager was noted as out of the office for vacation or sick time
- 4 contracts were signed by SCIF Marketing Managers

We confirmed with SCIF HR and with other SCIF Departments, that there was not an 'Acting Marketing Manager' policy to allow contracts to be signed when the SCIF Marketing Manager was out. This was a policy that only existed informally in the SCIF Marketing Department.

Recommendation

Procedures should be established that clearly define the group association contract review process. The Legal Department should be actively involved to monitor compliance. SCIF executives are currently making changes to the contract review process with assistance from outside counsel. As the procedures evolve, all departments should be informed of the new policies and these procedures should be strictly enforced.

The Vice President of Groups indicated on September 11, 2007 that the current process for the signing of new contracts has changed. He stated that he will be signing the initial contracts. He added that the President or any SCIF employee in a higher position (i.e., Executive Committee) may sign the contracts in his absence as well.

Response

State Fund has established policies and procedures that clearly define the group association contract review process. All affected departments have been informed of these new policies and the procedures will be strictly enforced. The Vice President of Groups has been signing the initial contracts and ongoing contracts will either be signed by him or someone in an equal or higher position.

42. Communication of Advertising Responsibility to Groups Inconsistent

Finding

SCIF did not consistently communicate information regarding the group associations' responsibility for advertising.

Recommendation

SCIF Group Program communication regarding advertising should be consistent. Advertising requirements should also be listed and adhered to in the group contracts. A formal memo should be created by the Marketing Department and then be sent to all groups communicating any change in the allowance of advertising of the SCIF group insurance program.

Response

We agree and outreach obligations of the group associations are now listed in the new contracts. State Fund's Marketing Department will issue a formal memo to all group associations if there is any change in the advertising provisions.

43. Eliminate Conflicts of Interest for Group Association Administration

Finding

In addition to Board members being affiliated with the group associations, there were also former SCIF employees administering some group associations.

Recommendation

SCIF must develop policies to address the administration of associations by former SCIF employees in order to avoid potential conflicts of interest. Conflict of interest statements should be reviewed by the Legal Department to ensure that all potential conflicts are addressed. The state appointment process should assure that conflict of interests do not exist for future Board appointments.

Response

We agree and State Fund will review the issue of former employees administering group associations with the intention of setting a reasonable post-employment time limit restricting former employees from group administration, consistent with applicable law.

44. Group Administrative Fees Paid to Individuals

Finding

There are some administrative fee checks paid to the individuals who administer the groups instead of to the group associations. While it appears this was the exception, rather than the rule, this is not a proper business practice.

Recommendation

All checks to group associations should be made out to the group association, not to the administrator of the group association.

Response

State Fund agrees and has amended its procedures to ensure that administrative fee checks are paid to the entities with which it contracts.

Information Technology (IT) General Computer Controls

45. Group Administrative Fees Classified Incorrectly

Finding

Group administrative fees paid to associations were classified incorrectly as legal and auditing fees in the SCIF financial statements. This classification was misleading to users of the financial statements. Certain Board members stated that they were not aware of this material misclassification.

Recommendation

SCIF should develop guidelines for the correct classification of group administrative fee payments. We recommend that these fees be classified in total as a write in for miscellaneous expense on the NAIC Annual Statement. This will promote transparency.

Response

We will separately identify and report these expenses as miscellaneous write-ins in our annual Underwriting and Investment Expense Exhibit beginning with the year-end 2007 statement. This change will provide appropriate transparency to users of State Fund's financial statements going forward.

46. Lack of Permanent IT Program Manager

Finding

There has been turnover in the oversight of the IT Department. There is not a permanent IT Program Manager. The IT Program Manager transferred to another position as of October 2007. Another IT staff member assumed the role of interim IT Program Manager.

Recommendation

SCIF should engage an outside consultant to assist with the oversight of the IT Department until a permanent Chief Information Officer position is established. As there are significant IT matters to address prospectively, SCIF should look for more effective leadership in this department.

Response

We are engaging a consulting group to complete a current assessment of IT. The project lead will assist in providing oversight. We are petitioning legislative approval for an exempt CIO as part of our critical needs

47. Prior Report Findings Remain Open

Finding

There have been IT control reports, with findings, issued by third parties and SCIF's internal audit team that have remained open for more than a year. SCIF's management responses to these exceptions were not fully documented and detailed workpapers were not presented.

Recommendation

Internal and external audit IT exceptions should be prioritized by management in a timely manner to address remediation issues. These action steps should be memorialized in the IT files for reference.

Response

We agree with this recommendation and Information Technology has established an ongoing Audit Compliance Oversight Team that is responsible for prioritizing and following up on the remediation of internal and external audit IT exceptions. The Audit Response Team was formed in October of 2007 and will work directly with each section of IT to review the progress of this work to resolve audit findings.

48. IT Procedures Not Formalized or Approved

Finding

IT policies and procedures are fragmented and many of the key policies have not been formalized or approved by management. This includes network policy, access control, applications security, data center policy, etc. The absence of formal implemented policies limits the effectiveness of the IT governance at SCIF.

Recommendation

All IT related policies and procedures should be updated and submitted for senior management approval. Once approved, these procedures should be implemented and monitored. Additionally, communication policies between the district and home office should be formalized so that all parties are aware of the protocol. COBIT control objectives should be used by SCIF to assure that policies and procedures adequately identify and address the risks.

Response

Information Technology's Corporate Guidelines and Security Policies have been updated and include suggestions received from CDI. The package has been reviewed by key departments and is currently going through the final stages of review.

The Enterprise Security Operations unit in IT monitors and reports to management on policy compliance. Each Program Manager is responsible for enforcing the policy throughout their department. The Information Technology groups enforce the policy using technical controls wherever feasible.

Once these corporate guidelines and security policies are approved, Business Services will disseminate to all Program Managers for distribution to their respective departments and publish them on State Fund's intranet site. In addition,

Enterprise Security will communicate the policies through its security awareness program.

49. Vacaville Project Budget Incomplete

Finding

SCIF has not developed a detailed plan for the Vacaville migration project. SCIF management stated that the details of the project will be included in the 2008 IT budget.

Recommendation

The contracts and expense budgets for the Vacaville Data Center should be reviewed by the Board and/or financial experts to assess the accuracy of assumptions in the budget for each phase. The budgets for the data center migration costs should be documented in more detail to ensure that expense calculations like project supervision, decommissioning of old data centers and engagement of consultants can be analyzed.

Response

All contracts and expenses for the Vacaville Data Center are scheduled to be presented to the Board at their next meeting.

50. Enterprise Security Group Lacks Authority

Finding

The Enterprise Security Group is not formally empowered to enforce use of IT resources with other programs that are part of the organization. This lack of empowerment results in critical events or actions relating to the security of the systems being executed without proper supervision and assessment by the Enterprise Security Group (i.e., user access modifications or user permissions modifications).

Recommendation

The role of SCIF's Enterprise Security Group should be evaluated in order to permit the Security Group to act as an enforcer of SCIF's IT policies. Security best practices should also be integrated into the IT policies on an enterprise-wide basis.

Response

We agree with this recommendation and in order to strengthen Enterprise Security's authority, the unit will be splitting off into a stand alone IT business unit as part of the proposed budget for 2008. Included in this proposed budget for 2008 is a recommendation that all District Systems Administrators report directly to Information Technology increasing Enterprise Securities' ability to enforce its policies.

51. Segregation of Duties Issues

Finding

Several users across different departments of SCIF are authorized as 'super users' over the General Ledger and other modules of the Oracle Financials application. This type of function (module super users) allows the execution of critical commands and queries on

modules and should be centralized and not shared. These IT segregation of duty issues could lead to possible data integrity issues, failure to allocate resources effectively, unauthorized access to financial data and confidential information that could result in possible fraud or misstatement.

A formal separation between production system changes control and security monitoring functions does not exist at the Orange County District Office, as these responsibilities are performed by the same individual.

Oracle monitoring reports are not being reviewed on a consistent basis.

Recommendation

SCIF should make enhancements to the Oracle system. The Oracle segregation of duties should be reviewed and revised. User criteria in Oracle, including the functions of preparing, approving and receiving should be assigned separately to provide for segregation of duties. The Oracle software has extensive exception reports available to SCIF. These reports should be enabled. Oracle audit trails from critical systems must be reviewed on a periodic basis with exceptions followed up by the Enterprise Security staff.

Response

We agree with this finding. A comprehensive review of all Oracle Financial responsibilities was recently completed by Fiscal & Investment Services and the Oracle Financials/Human Resources Tech Support Team. Modifications were made to a number of responsibilities. Users have been re-assigned the modified responsibilities effective 11/16/07 to ensure they have appropriate access and that segregation of duties is maintained.

As a direct response to CDI's preliminary audit findings super-user responsibilities are no longer in use.

On 9/01/07 Internet Procurement preparing, approving and receiving duties were segregated per the recommendations of CDI.

All SCIF Active Oracle Financials/HR Users Report are reviewed on a monthly basis by the key user departments. This report lists the active users and their responsibilities. Any changes necessary to user access are completed immediately.

Key departments have met to discuss the additional business areas for which the Audit Trail feature needs to be enabled and audit reports developed.

52. Business Recovery Plans Outdated

Finding

Business Continuity and Disaster Recovery plans were not current or standardized. In addition, several data centers were not properly protected from the elements, and access to computer rooms was not appropriately restricted.

Recommendation

SCIF should perform a review of its computer operations functions to ensure that Business Continuity and Disaster Recovery plans are updated, tested and standardized throughout the organization. Data center physical and logical security in all offices should be enhanced to protect equipment from damage and to safeguard the center from unauthorized access.

Response

We agree with the findings and have plans underway to standardize, update and consolidate the different disaster recovery plans after the relocation and consolidation to Vacaville. Current disaster recovery plans in the data center are tested on a monthly basis. All data center locations are protected with pre-action sprinkler systems, non-water based fire suppression system, in addition to UPS and back up power generators. Physical security is monitored by an electronic card key security access protection system that is verified annually.

53. Standardize Change Management and Formalize Procedures

Finding

Change management documentation is not standardized. This has been an open external audit report issue since 2005.

The Enterprise Security Group does not have a sufficient active role in the review and approval of critical systems changes.

Recommendation

The Change Management documentation process should be standardized. Instead of utilizing a paper form for certain changes, the automated tool (People Soft Change Management module) should be used for all types of changes.

The Enterprise Security Group should have a more active role in the supervision and approval of critical systems changes as the inherent risks of the Change Management/System Development Life Cycle (SDLC) process are closely related to this discipline.

Response

We agree there should be a standard change management process utilized in the Information Technology Department. Currently there are sections of IT using the PeopleSoft change management module for a consistent process. IT plans to migrate all change management functionality to an upgraded PeopleSoft application and utilize this process for all approvals and product releases.

54. User Administration Procedures Not Formalized

Finding

The SCIF Logon and Application User ID/Password methodology and procedures are not formalized. There is not a designated entity or person in charge of ensuring that all departments regularly review the users' access to their systems.

SCIF's process for setting up users is informal. There is little correspondence between HR and IT to set up the users.

There is also no set coordination and communication between HR and IT for the termination of users' access rights. SCIF does not have a standard process to terminate user access.

Recommendation

Policies and procedures related to user account management should be documented to describe in detail a standard authorization and set up process for the SCIF systems. A standardized user access report should be produced for all the critical systems. The report should be reviewed and approved by the data and systems owners on a regular periodic basis.

Policies and procedures related to user account creation should be documented to describe in detail a standard authorization and set-up process on the systems. IT and HR should both play a role in this process.

User termination on the SCIF systems should follow established procedures. The termination process should be consistent throughout the organization, including the district offices. This process would commonly be initiated by HR communicating to the Enterprise Security Group regarding the employee termination. Enterprise Security would then be responsible for terminating all user system access rights.

Response

We agree with this recommendation. In August 2007 Enterprise Security developed a user administration procedures manual to document user account management and user account creation. In addition, Enterprise Security is in the process of developing a standardized format for all district offices/departments to use in maintaining their user access. The user access reports will be reviewed by Enterprise Security on a periodic basis based on access information that will be provided by the data and systems owners. Enterprise Security is developing, in conjunction with Human Resources, a separation checklist that should be used by all districts offices/departments whenever a State Fund employee or consultant leaves State Fund. This will ensure that the termination of user access privileges is performed on a timely basis and for all user system access rights.

55. Non-Authorized Software and Applications on Workstations

Finding

Non-authorized applications are installed on most of the desktops in the Bay Area and Fairfield District Offices, as well as the Burbank Claims Processing Center. In addition, there are network packet capture tools, referred to as "sniffing tools", on several computers in the Bay Area and Fairfield offices. These tools can be utilized to monitor all ingoing and outgoing network information and data, through computer surveillance technology, as well as all e-mail activity for the offices.

Recommendation

A strict policy should be enforced over non-authorized software and application installation by employees. The policy should consider the monitoring of installed

software and the removal process. Also, sanctions for the violation of this policy should be communicated to employees. All staff should acknowledge their awareness of the policy.

In September 2007, SCIF executives began implementing a policy to address this issue. The new policy and corresponding controls should be tested once implementation is deemed final.

Response

We agree with this finding. Information Technology is now performing software scans of all personal computers once per quarter rather than upon request. Information Technology is comparing the inventory of installed software at each location with our catalogue of authorized software. If non-catalogue software is identified in this review Information Technology will instruct the Program to complete the “Workstation Software Request” for IT approval or the software will be removed from the system.

If violations of State Fund Information Technology security policy are identified the information will be referred to the Human Resources department for appropriate follow up and possible disciplinary action.

56. Oracle Procurement System Approval Limits Not Reviewed

Finding

No documentation exists to support how user limits are established. The Oracle system is set up to allow for up to a \$100 million entry without further approval.

Recommendation

Approval limits should be reviewed and criteria for limits should be defined.

In September 2007, SCIF Executives stated that new range limits were implemented for each functional position. However, user access criteria and appropriate range limit criteria were still in development.

Response

State Fund has reviewed the limits and criteria or purchase authority and has made the following changes effective September 1, 2007:

Maximum IProcurement Authority:

\$250 – for Supervisors

\$500 – for 1st level Assistant Program Managers (Manager I or equivalent and AICs)

\$1,000 – for 2nd level Assistant Program Managers (Manager II or equivalent and Assistant Chief Counsels)

\$50,000 – for Program Managers (Requisitions over \$50,000 will require Executive Approval)

Additionally no “Approver” has “Preparer” rights to both prepare and approve a Web requisition. These requisitions now require at least two people to request and approve.

No “Approver” has “Receiver” rights to both approve and confirm receipt of purchases.

57. Procurement Settings Not Reviewed

Finding

No email or communication message is sent to the preparer/approver when a requisition is cancelled. Unless the preparer/approver runs a report of cancelled requisitions, no warning of a cancelled requisition is received by the preparer/approver.

A cancelled requisition can be copied to a new requisition and moved to the shopping cart interface for processing without any additional approval requirements as long as the requisition does not exceed the preparer/approver’s purchasing authority.

Subsequent to our testwork, SCIF implemented compensating controls that address the segregation of the preparer and approver rights and functions. These changes have not been tested.

Recommendation

A review should be performed of the settings and configuration of the Procurement system. Formalized requisition procedures should be established to include:

- An audit trail of preparer/approver
- Monetary restrictions
- Preventative controls to eliminate the re-use of cancelled requisitions

Response

State Fund has implemented controls into the Oracle system that resolve the risk described in the finding. A cancelled requisition can not be processed without going through the approval process.

58. Oracle Audit Logs Not Consistently Reviewed

Finding

Oracle monitoring reports are not reviewed on a consistent basis. The Oracle software has extensive exception reports that would be valuable to the IT environment at SCIF.

Recommendation

Audit trails from critical systems should be reviewed on a periodic basis. Furthermore, identified exceptions should be documented and followed up by the Enterprise Security Group.

Response

We agree with this recommendation. Business users will be supplied audit logs on a periodic basis to review for exceptions, provide documentation and report to Enterprise Security for follow up.

59. Password Settings Not Standardized

Finding

The password settings vary through the different applications deployed at SCIF. Some of the inconsistencies identified on the password settings are:

- Passwords do not expire
- Password expiration time frames vary
- Password complexity is not required on all applications
- Password length is not in accordance with established policies
- Shared passwords

Also, the Oracle database default profile password settings are set to unlimited. These types of settings are not recommended as they increase the risk of security violations in the Oracle environment.

Recommendation

All password settings for critical applications and systems should be reviewed and established in a way that complies with the recommended security settings established by best practices.

Response

Enterprise Security's Compliance Review Team is reviewing all password settings of applications and systems as part of their compliance review to ensure adherence with our corporate guidelines and security policies including our password policy. Network password requirements have recently been set to increase complexity in line with best practices.

60. User Recertification Process Deficient

Finding

The annual audit in the Bakersfield District Office called the "Enterprise Security Annual IDs Audit" that compares the SCIF LAN ID with the application did not include a review of the system privileges assigned to users.

Recommendation

A user access review and approval recertification process should be performed at least every six months. Data owners should be required to sign a user access review document, which should detail the name of the staff and the authorized functions for each employee based on a "least privilege" criteria.

Response

We agree with this recommendation. Enterprise Security will be performing a user access recertification with the data owners every six months. A user access report, which reflects the user name and the authorized job function with the user access privileges, will be provided to the data owners so they can review the information and sign off on the report.

61. Internet Access Monitoring Not Performed

Finding

Internet access monitoring functions in the Burbank District Office are not being performed uniformly for WEB access to unauthorized sites. Virus alerts and detection is being performed by McAfee software. The Bindview security application software is no longer utilized for WEB security monitoring; security monitoring is only performed upon the notification of a security issue with an individual from HR to the Burbank IT.

Recommendation

Formalized internet monitoring should be enabled to track unauthorized access attempts.

Response

Enterprise Security and Human Resources are examining the feasibility of a formalized internet monitoring process. Currently internet monitoring occurs on a regular basis whenever there is suspicion that an employee is misusing internet/email and regularly results in formal disciplinary action. All employees are governed by our System User Information Notice which states in part that our systems belong to State Fund and misuse will not be tolerated.

62. Security Management Access Not Restricted

Finding

British Telecomm (BT) Global Workstation security and access administration software for the entire PC desktop data and applications should be restricted in all offices. Access to this application has been granted to 15 Home Office individuals, in addition to the Los Angeles District Office staff of 32 people.

Also, user security and access procedures and reconciliation reports are not being consistently performed. The Active Directory contains 276 User IDs and the security profile data base log contains 138 entries.

Recommendation

User access procedures should be created to ensure authorized access is restricted for the following:

- BT Global Workstation Administration security
- PC Desktop Data
- Applications

Active directory user access procedures should be established to make certain that current IDs belong to active employees and any unauthorized access is revoked in a timely manner.

Response

Information Technology will ensure authorized systems access is restricted. There are procedures in place to match current Id's with active employees and make sure that we are disabling accounts in a timely manner. IT will initiate a review of all applications to ensure access is appropriately restricted.

63. SCIF Anti-Virus Policy Not Formally Approved

Finding

The Anti-Virus policy is not formally approved. A report generated on September 7, 2007 determined that although 11,400 units are protected, over 2000 desktops are not protected. Currently, the nature of these unprotected workstations is unclear. An investigation was initiated by the Network Security Group.

Recommendation

SCIF should prepare, approve and implement a written anti-virus policy to ensure that all workstations on the SCIF network are protected from viruses.

Response

One of Information Technology's proposed Security Policies is to install Anti-Malware, which includes anti-virus. This, along with other corporate guidelines and security policies, has been reviewed by key departments and is currently in the final stages of review.

In addition, a new procedure has been implemented requiring laptop users to connect to the network every 30 days. This ensures our equipment receives critical security patches to better protect from viruses.

64. Data Tape Encryption Not Performed

Finding

Data that resides on the backup tapes is not encrypted. According to the Data Center Manager, there is a corporate initiative to encrypt all data tapes within the next year.

Recommendation

The initiative to encrypt all data tapes should be completed within a set timeline.

Response

We agree with this recommendation and have developed a comprehensive action plan to install hardware based encryption to all data tapes. This initiative is in combination with new hardware proposed for State Fund's state of the art data center under construction in Vacaville.

65. Performance and Capacity Monitoring Not Performed

Finding

According to the Data Center Manager, the nature of the monitoring strategy of the data center is reactive rather than proactive. Besides a report of uptime for equipment and services, there does not appear to be robust reporting of performance and capacity monitoring that is communicated to upper management. Without this information, decision makers will be challenged to properly assess budgets and capacity planning.

Recommendation

SCIF should assess upper management reporting needs. Per the Data Center Manager, there is a corporate initiative to utilize a more robust monitoring for performance and

capacity, to be installed with the new data center. This initiative should be completed within a set timeline.

Response

Centralizing and standardizing systems and services in Vacaville will provide clearer data on performance and capacity. HP Openview redesign, SAN software, VMWare Virtual Infrastructure 3, CISCO utilities, and MSX would provide up to the minute performance and capacity data as well as historical information. Reporting requirements need to be determined.

66. Data Center Physical Access Activity Not Reviewed

Finding

There is no periodic review of the physical access activity to the SCIF Home Office Data Center.

Recommendation

Physical and logical access restrictions should be enhanced to include logging and monitoring of access, and prevention of unauthorized access.

Response

We agree. Physical access log data is collected by the card key access system that is managed by Real Estate Management. This information is not currently provided to data center management to review access and unauthorized attempts. We will work with Real Estate Management and/or Enterprise Security and/or Human Resources to provide information in a useable format. Once implemented, access will be tracked and reported to the Data Center Manager monthly.

67. Data Center Physical Security Not Monitored

Finding

There are no cameras for surveillance in the Fresno Claims Processing Center data center. Also, two access cards were identified for contractors without an appropriate deactivation time limitation (badges expire 2010). The IT system servers sit on the first floor (bottom level). There is no water detection controls and the floor is not raised.

In addition, there is no formal recertification of access to the data center or other sensitive areas such as the check printing room. There is no formal review of activity access to either data center or the printing room.

Recommendation

SCIF should strengthen the physical security at the data center. The Data Center Manager should sign a user access review document which should detail the name of the staff and the authorized functions for each employee based on a "least privilege" criteria. Access cards should be reviewed regularly to determine if the deactivation date is appropriate.

Response

When Fresno Claims Processing Center tenant improvements were planned and constructed, the MDF room was intended as a server room for CPC needs only. Since it was built, the use was expanded to add servers for corporate enterprise purposes. Real Estate Management will meet with IT to discuss the most appropriate placement of a surveillance camera in the Fresno data center. We will also meet with Human Resources to discuss notice to the Union as this is adding surveillance to work areas which they have objected to in the past.

REM has a policy of a maximum 1 year activation period for all contractor/ vendor access cards. We will review the access period for all contractors and vendors with access to the Fresno data center to verify whether continued access is required and if so, limit the access to not more than 1 year.

68. Home Office Help Desk and Support Not Monitored

Finding

A review of help desk tickets indicated that many tickets were not yet closed, some from January 2007.

Recommendation

Help desk tickets should be monitored and closed in a timely fashion. The help desk ticket monitoring should be performed centrally where problems occurring throughout SCIF can be identified and addressed.

Response

We agree with the finding that at times Help Desk tickets are not closed in a timely manner. We have recently implemented an incident handling process in which all open tickets are reviewed and either closed or escalated to senior level staff or management.

69. Physical Security Access Cards Not Reviewed

Finding

The card access list for the SCIF home office with the users and access types is not accurate.

Recommendation

SCIF should review and update the access cards on a periodic basis.

Response

We agree and REM is drafting a corporate guideline for physical security access to establish consistent policy and procedures for all locations, as well as periodic review and updates.

District Offices and Claims Processing Centers

All District Offices

70. Lack of Formalized Claim Review

Finding

A lack of evidence existed in a portion of the claims testing regarding the proper review and approval of case reserves. A formal claim evaluation process has not been established.

Recommendation

Management should sign-off on the case reserve balances to indicate that the reviews, performed at least annually, and the case reserves were properly recorded. Establishment of a quality review function would enhance SCIF's ability to evaluate individual performance, identify training opportunities, and establish and monitor metrics across the organization. Additionally, procedures should be developed to ensure that all known medical costs are considered when case reserves are established and that actuaries are made aware of medical bill processing delays when determining reserves.

Response

See 71.

71. Claim Reserve Revisions

Finding

Case reserves estimated by the claim adjustor are often modified as medical bills are received instead of establishing case reserves based on the adjustor's best estimation of cost. A report is generated detailing claims in which medical bills paid exceed the reserve. These claims are the focus of routine reserve revisions. Due to the processing delay of medical bills received at the claims processing centers, there seems to be a consistent delay before case reserves are revised in response to the medical bill. This practice may result in understated case reserves for known medical costs.

Recommendation

Consistent methods should be followed to monitor timely completion of case reserve estimates.

Response for 70/71

The Electronic Claims File (ECF) does allow adjusters to review unpaid medical bills and adjusters are expected to consider all medical costs as well as doctor reports when determining case reserves. We do have a review process and there is a method available in ECF for management to sign off on the case reserves exceeding adjuster's authority level. Claims managers and assistant managers are responsible for ensuring adjusters are reserving cases timely and accurately. It is our expectation that managers are performing this quality review.

Additionally, Internal Audit conducts a formalized quality review of our claims adjusting operations. Their reports are reviewed on an ongoing basis and continuing education training for adjusters is provided in response.

In 2008 managers will have additional claims outcome management tools to assist in consistently evaluating performance in this area.

Actuaries who report to the Executive Committee are regularly informed of the medical bill processing delays

72. Budget Cuts Not Aligned with Strategic Business Plans for Training and Development

Finding

It appears that implementation of the Electronic Claims File (ECF) software was not as effective as SCIF had planned, due, at least in part, to budget cuts. It is important that budget cuts align with strategic business plans developed for training and development. In addition, the ECF system does not retain an accurate historical listing of case reserve detail. Therefore, dates of case reserve changes could not be relied upon utilizing ECF. Internal Audit was aware of this system deficiency in a previous review; however, no action was taken to address this matter.

Recommendation

Additional training should be provided so that new or reassigned claims personnel are proficient with the ECF software and enter consistent and accurate claims data. Also, Internal Audit should conduct reviews of the district offices' implementation of this software on a rotational basis.

Response

We recognize that the transition to ECF has been difficult for many of our adjusters. However, we do have resources in all of our adjusting operations who have been extensively trained on ECF and who are designated trainers for their offices. Those employees are responsible to train all new and existing personnel on ECF.

As new ECF functionality is implemented, Claims/Rehab reviews the level of complexity and determines training needs for that functionality. Claims/Rehab has also developed a comprehensive job aide that is posted on our intranet.

Internal Audit does conducted review of ECF's implementation.

While ECF does in fact retain an accurate historical list of case reserve detail –we did experience a problem with some details on those claims that were transferred from our legacy system (WISP) to ECF. For those claims, Claim/Rehab provided our adjusting operations a remedy to fix that problem. With additional information on which offices were unable to provide an accurate historical listing of case reserve detail, we can provide additional training.

73. Notification of Quotes for Review Needed

Finding

PowerComp does not automatically advise supervisors of a quote to review; rather this is communicated outside of the system by email notification.

Recommendation

PowerComp should be automated to provide supervisors with notification of pending quotes requiring review.

Response

At this time, PowerComp does not have an email feature. There is a “task” created for the supervisor approval. The supervisor is required to check their tasks periodically. The task functionality allows more monitoring of activity and sorting capability than the prior quote system and allows the supervisor to open and approve from one screen. Home Office Underwriting will research the costs and benefits of adding an automated email or alert capability within the PowerComp system, and based on the results, recommend any further development that may be required.

Bay Area District Office

74. Inappropriate Authority to Approve Claims and Process Medical Bills

Finding

The district offices assisted with the processing of payments to help avoid late payment penalties; however, this practice raises concerns about the segregation of duties.

Recommendation

Medical bill payment capability should be limited to the claims processing centers.

Response

We agree. We have used district employees as a stop gap measure to deal with the volume of backlogged medical bills. Their participation has been limited, however, to key data entry and we have taken the following precautions to maintain appropriate checks and balances:

- **Authorization for payment remained with the claims adjuster or was subject to applicable State Fund business rules for payment issuance.**
- **District resources were assigned data entry only for bills of adjusting locations other than their own.**
- **All bills remained subject to automatic bill review system edits and review by trained CPC bill reviewers.**

San Diego District Office

75. Inadequate Staffing in Claims Area

Finding

Many aspects of the claims area seem to be out of compliance with SCIF protocol. Inadequate staffing is one factor that has led to the inability to migrate to ECF timely.

Recommendation

We recommend that SCIF assess the staffing level in the claims area and take appropriate action.

Response

We have reviewed the staffing level for the San Diego District Office's claims department as well as their ECF rollout performance. Their current staffing levels are in alignment with corporate staffing models. The San Diego District met all target deadlines for ECF rollout. A separate implementation for bill document management/mail delivery to CPC was delayed due to San Diego's inventory of medical bills.

76. Need for Accurate Record Keeping Process

Finding

The scanning function at central processing locations occasionally scanned policy information into the wrong policy year. Isolated instances were noted where quotes included wrong brokerage commissions and other documentation deficiencies. Claims correspondence that is not routed to the proper e-mail station for follow-up may be lost. There is no system control to route this information to an appropriate e-mail suspense account. All applications/quote inquiries are received via one of three methods: fax, mail, or e-mail to a generic email address. There is no centralized system in place to track all of these methods of receipt.

Applications are submitted by either the employer or broker. All quotes are required to be issued within 10 business days of a completed/valid submission (application). However, there is no tracking system used to verify compliance with this 10 business day rule.

Recommendation

A protocol should be established to ensure a consistent record keeping process. Additionally, a suspense account for undelivered e-mail should be established and monitored to determine that no claim correspondence is lost.

Response

During 2008 State Fund will review the email concerns expressed in the finding and examine each of the impacted email systems to identify issues and possible solutions. Part of this work will include a cost analysis and return on investment analysis of any solutions.

77. Need for Consistent Processes for Policy Renewals

Finding

Certain policies that were renewed by the Customer Service Center did not follow the same renewal procedures as are followed by the district office (i.e., the inclusion of certain forms and notations of approval for merit ratings).

Recommendation

A consistent process for policy renewals should be established and followed.

Response

Both the Customer Service Center and the Districts use the same quote system (PowerComp) to prepare renewals and determine Merit Rating. A review of the Customer Service Center (CSC) renewal processing will commence in the first quarter of 2008. The review will include an analysis of the renewal processing in

both the districts and the CSC. The review will verify that the procedures are followed. Recommendations and a remediation plan will be developed and implemented based on the results of the review.

78. Lack of Segregation of Duties for Posting of Credits and Custody of Cash

Finding

All payment plan payments pertaining to policies handled by the San Diego district office are received at the San Diego office as opposed to the normal procedure where premium payments are received at the home office. Once a payment is received in the local office, the office mails the checks to the home office for processing. The payment is not entered into any system locally, however, they are noted on tracking sheets of the credit analysts assigned to the account.

Recommendation

All payment plan payments should be sent to a customer service center to strengthen segregation of duties. This will ensure that payments are not being received by the same personnel who are responsible for issuing credit.

Response

Some districts have elected to have the scheduled payments for payment plans sent to them in order to closely monitor and do outreach to the policyholder as needed.

When the payments are received in the district, the same approved protocols are followed that are in place for other payment received in the district. They are logged and sent to Credit and Collections (C&C) for deposit and crediting to the policy.

The Remittance Analysis Unit in C&C also monitors the payment plan for posting per the payment schedule.

Orange County District Office

79. Incomplete Documentation in State Fund Online (SFO) System

Finding

There were several instances where new and/or renewal packages were not imaged. These documents provide the most detailed support for the data in the SCIF Online (SFO) system and because the districts are moving to a more paperless environment, oversight of the archiving of scanned documents is critical.

In addition, there were two instances where the broker commission shown in the SFO system did not agree to the home office calculation and actual payment of the broker commission. These instances raise doubt about the integrity of the data in the SFO system.

Recommendation

Within the existing underwriting procedure, a process should be established that ensures all underwriting documents are scanned and archived.

Additionally, a process should be implemented to verify that the payment of commission agrees to the actual calculation provided by home office.

Response

We have experienced server problems that created some time between archiving and access in SFO. New Servers have been ordered.

There are two areas in SFO where commission information can be located, the Policy History Screen and the Commission Information System (CIS) Screen. Policy History information is updated daily, while the CIS system is updated monthly. Commission information may differ between the two applications until the information is updated in WCIS.

We do have a process in place to verify that commission payment agrees with actual calculation.

80. Standardized Tracking and Monitoring Method Needed for Case Documents

Finding

As the means of tracking support documents are not consistent from adjuster to adjuster, the detection of errors or untimely decisions would be difficult for management or quality review teams to accomplish.

Recommendation

A process should be implemented that provides a consistent methodology in tracking and monitoring case documents to allow management or quality review teams to effectively detect errors or detect untimely decisions.

Response

State Fund has a process in place to track and monitor case activity on a claim and documents such as liens and bill that require adjuster action. Management also has access to reports built on data that is extracted from ECF to assist in monitoring adjuster performance. These reports include issues related to adjuster caseload, bill pending, incomplete finalizations, utilization review referrals, paid exceeds, return to work performance, etc.

81. Stricter Controls Needed for Recurring Payments

Finding

There is a possibility for any adjuster to set up recurring payments for periods up to 52 weeks in the Wang Interchange Source Processor (WISP) system. The WISP system will authorize the first payment based on the adjusters authority limit code, but does not consider the total amount of all recurring payments.

An adjuster is able to establish a stream of recurring payments for an amount other than the calculated benefit amount without detection. The control to identify these types of

errors is performance of a balancing process every two to four weeks; however, the adjuster performs the balancing on their own accounts and would be responsible for identifying their error.

Recommendation

The reconciliation between the recurring payments schedule and the adjuster's accounts should be reviewed by the adjuster's supervisor to guarantee that there are no inaccurate payments. The WISP system should consider the cumulative total of all recurring payments in accordance with the adjusters authority limits.

Response

Recurring payments are an efficient method for adjusters to handle timely benefit delivery to our injured workers. We do have procedures in place that mitigate the risk of over payment.

- **State Fund policy requires adjuster to balance a claim prior to programming a recurring payment.**
- **Adjusters are required to transmit estimates at periodic intervals and ECF requires management approval if these estimates exceed authorities.**
- **The system generates a paid exceed alert that is escalated to management if the estimate is not revised within five days from notification.**
- **Cases that require recurring payments are usually more complex and receive additional supervisory oversight before finalization.**
- **Internal Audit also reviews cases to ensure benefits are provided timely and accurately.**

Bakersfield District Office

82. Review of District Office Procedures Needed to Conform With Established Protocol

Finding

The Bakersfield District Office establishes and maintains its own unique claims processing procedures without review by the Claims Rehabilitation Program Manager.

Recommendation

The Claims Rehabilitation Manager should independently evaluate the district office claims processing procedures to ensure they are consistent with the SCIF Home Office claims manuals and guidelines.

Response

Although it is not clear what the "unique" claims processing and procedures in Bakersfield are, the Claims/ Rehabilitation Department will review them. Internal Audit does a biennial operational audit to ensure that all districts follow corporate claims guidelines and procedures. There is some flexibility at the local level for offices to develop and maintain processes as long as they do not conflict with corporate policy and procedures or impact the integrity of State Fund's claims product.

All Claims Processing Centers

83. Late Payment Penalties Increase

Finding

Since the transition of bill payments to claims processing centers, medical and indemnity bill penalties paid for all district offices have increased significantly to \$19.5 million in penalties from January 2007 through July 2007, with \$4.7 million occurring in July alone. Budget cuts that were made to these centers did not follow the recommendation of the SCIF Board Chair or the Vice President who assumed management of these facilities.

Recommendation

SCIF should ensure that the problems at the claims processing centers resulting in significant late payment penalties are addressed. In August, SCIF hired a consultant to assist with this matter and hired temporary staff to address the processing backlog.

Response

We agree with this recommendation and correcting the late payment situation is a top priority for State Fund.

In response to increased late payment penalties, State Fund has already implemented a number of measures to address this issue including:

- **Hiring additional staff**
- **Invoking mandatory overtime for CPC bill review staff**
- **Recruiting and training additional resources internal to State Fund to provide remote assistance to the CPCs**
- **Employing assistance from temporary employees**
- **Modifying internal business rules for payment processing to increase bill throughput**
- **Implementing systems changes to increase bill throughput**
- **Implementing a “high cost bill search” to expedite processing for those bills with the highest penalty potential**

In addition, in October 2007, State Fund reevaluated its bill processing business model to ensure the greatest efficiency in operations possible. Recommendations made include the increased use of business rules-based auto adjudication, increased utilization of electronic billing, as well as other systems enhancements. All of these measures are aimed at increasing bill throughput, reducing payment turnaround times, and reducing penalties.

84. Need for Proper Establishment of Reserves for Known Claims

Finding

A significant portion of the random sample of claims payments reviewed appeared to have insufficient case reserves. In many instances, case reserves were not increased until the large bills were paid, which was subsequent to year end 2006, yet the bills were received by SCIF prior to December 31, 2006.

Recommendation

A process should be established to ensure all known medical payments, at a minimum, are considered when case reserves are established.

Response

Our expectation of management is to oversee and manage proper case reserving practices. Our reserving policies and procedures are designed to ensure that total medical costs are considered in establishing case reserves.

Additionally, Internal Audit does conduct quality audits to evaluate the performance of our adjusting operations.

85. Identify and Prioritize High-Dollar Bills

Finding

Claims Processing Center Managers were not aware of a way to identify all high-dollar bills to move them up in the bill review queue.

Recommendation

An aging report for management should be developed to identify all old and high dollar-value unpaid and un-reviewed bills so they can be processed in a timely manner. Subsequent to testing, SCIF added a document type, such as hospital, doctor, etc., to the index of scanned medical bills. This allows SCIF the ability to sort by document type and potentially identify high dollar bills. The high dollar medical bills can then be manually assigned to a bill reviewer for processing.

Additionally, a report currently exists to identify unpaid bills under review of over \$5,000 and 45 days or more from receipt (“BDM Management Report – Unpaid Bills over \$5,000, 45 or more from receipt”). At a minimum, management should leverage this query to age and monitor unpaid bills currently under review that are nearing the 45 day mark.

Response

For bills that are submitted on standard forms, the equipment in our CPC’s is able to optically read all the necessary data and our management is able to run aging reports that identify high dollar amounts and move them up in the queue.

The problem is that approximately 80% of the bills submitted to us are on standard forms and the optical technology is unable to extract the data necessary to create the management reports needed. We are currently adding three additional data elements that can be queried by the management report system to mitigate this situation.

Fairfield Claims Processing Center

86. Call Center Training Needed

Finding

The Fairfield Claims Processing Center does not have its own call center. They have no trained call center staff and no system to handle the incoming calls questioning the bills that are handled in Automated Bill Review (ABR).

Recommendation

Appropriate district office staff and the manager should be provided training to handle ABR related calls.

Response

While we don't have a call center for our CPC's, we do have a telephone system and trained employees in place to assist callers with questions regarding bill processing. As part of our business model evaluation, we will be evaluating whether a call center would more effectively manage these calls.

87. Limited Understanding of the Functions of the CPC

Finding

Certain Claims Managers have very limited knowledge of the claims processing functions.

Recommendation

The CPC Claims Managers should receive additional training on the functions of the Claims Processing Center. Certain CPC Claims Managers should be paired with a mentor in another CPC location and be encouraged to ask questions and participate in open discussions with this mentor.

Response

The CPC's Program Manager has more than four years of CPC experience and is knowledgeable in both the functionality and business processes used. Additionally there are three claims managers who are responsible for the local management of our CPC locations in Burbank, Fresno and Fairfield. The managers in the Fresno and Burbank locations have multiple years of experience in the CPC and are well versed on the functionality and business process used. The Fairfield Claims Processing Center Manager is new to CPC, having started in mid-April 2007. This manager, however, came to the position with 15 years of claims management experience. At the time of this review, though, she had only two months of on-the-job experience in CPC. Considering the extensive technical and business process-related knowledge required to manage a CPC effectively, it is not surprising that her understanding would be limited at that point. She is very knowledgeable on general management principles and State Fund's guidelines and procedures.

Fresno Claims Processing Center

88. Quality Assurance Reviews Should be Re-established

Finding

Quality assurance reviews by the ABR supervisors were suspended in early April 2007 in an effort to reduce the backlog of unpaid medical bills.

Recommendation

The reviews performed by the ABR supervisors should be reinstated in order to ensure issues are identified on a timely basis.

Response

While we have temporarily suspended these quality assurance reviews to provide increased time to process medical bills and reduce the review backlog, many bills remain subject to a second level review via programmed business rules to ensure quality and provide an opportunity for error correction. When quality concerns are noted, this information is elevated to a supervisor for further action.

89. Automated Control over the E-fax System

Finding

During some unknown period of time, the e-fax system that receives faxes from providers and enters them into ECF experienced some problems. In March 2007, a large quantity of bills that had not been previously received was transferred into ECF. Some had been paid with a subsequent or duplicate bill while others had not. The CPC had to review all of the invoices and determine the payment status of each bill.

Recommendation

The e-fax system problem needs to be resolved in order to avoid a similar large number of bills being recorded into the ECF system and to make certain duplicate payments are not made. Management should be provided with the status of the resolution and review of any duplicate payments.

Response

The problem noted represented a one-time incident that has since been resolved through programming changes.

Burbank Claims Processing Center

90. Ensure Access Controls to Archive Room is Restricted

Finding

The archive room was not locked and entry to the room was not monitored. Consequently, unauthorized access to insured's medical information and documents could occur, resulting in potential violation of HIPPA privacy rules.

Recommendation

Access to the archive room should be restricted to authorized employees only.

Response

The Burbank CPC will install a locking mechanism on the document storage area as recommended.

Although workers' compensation medical documents are specifically exempt from HIPAA Privacy requirements, the CPC's are very concerned with the need to protect the confidentiality of the claims and legal documents it handles. As such, all CPC staff is trained on document confidentiality and secured document destruction. Scanned documents are not "archived." Instead, they are stored temporarily after scanning, and are routinely destroyed pursuant to State Fund's secured document destruction policy.

Business Services

91. Internal Audit of Fleet Management Needed

Finding

There are more than 2,000 fleet vehicles for a total of 8,000 employees. In spite of the significant cost of acquisition and maintenance of this vehicle fleet, SCIF has not performed an audit of fleet management since 2003. The 2008 approved internal audit plan does not include a review of fleet management.

Recommendation

An internal audit of the fleet car pool should be performed as fleet management is an area where a large amount of funds are expended. An analysis of the need for fleet vehicles should be considered to determine whether all of the vehicles owned or leased by SCIF are necessary. On a periodic basis, the fleet manager should also perform an audit of the SCIF Monthly Travel Logs for compliance with SCIF policy.

Response

See 97.

92. Reasonableness Tests to Compare Miles Versus Expenses Not Performed

Finding

Each pool vehicle has an assigned gasoline card. A reasonableness test of miles driven to fuel charges is not performed by management.

Recommendation

Reasonableness tests of gasoline expense on a random sample of fleet vehicles should be performed by Business Services on a periodic basis to ensure cards are not used for unauthorized purchases.

Response

See 97.

93. Vehicle Mileage Audit Not Completed Periodically

Finding

Procedures have not been established to perform audits/reviews comparing fleet vehicle mileage to that reported on the SCIF Monthly Travel Log. Instances of inaccurate

odometer readings were noted in our review of the travel log. Additionally, there is no tracking mechanism to verify that maintenance is being performed every 5,000 miles as required by SCIF policy and no individual is specifically held accountable for the pool vehicles' maintenance. Instances were noted in which employees would not travel off-site unless they receive approval to take their own vehicle due to the condition of the pool vehicle assigned.

Recommendation

On a periodic basis, the fleet manager should perform an audit of the SCIF Monthly Travel Logs for compliance with SCIF policy. Testing should include verification of the recorded mileage and any miles not related to SCIF business should be identified. In addition, substantiation of required maintenance should be performed.

Response

See 97.

94. Some Inequalities Exist Among Employee Benefits Regarding Fleet Vehicles

Finding

Supervisors at a level II category in district offices qualify for a SCIF vehicle and gas card benefit, but that same category of supervisors in the Customer Service Center (CSC) environment are not offered the same benefit. CSC job descriptions have been rewritten to increase time spent in the field in order to obtain cars; however, the time spent in the field is not accurate. We also noted that there are no special controls in place to review job description changes for fleet car status qualification.

Recommendation

For all employees with assigned vehicles, an audit of the time spent in the field versus time spent at their job site should be performed. For all employees not meeting the 50% requirement, the assignment of a SCIF owned vehicle should be discontinued. Consideration should also be given to allow employees the option of using their own vehicles for the occasional off-site travel requirements.

Response for 94, 95, 96, 97

The Executive Committee will review fleet policy and management as well as options/alternatives including the areas identified in this report.

95. Large Backlog of Claims Files Not Filmed

Finding

Currently, there is a backlog of several years for the filming of closed paper claims files. These files are being microfilmed by two units with a total of 20 employees.

Recommendation

Given the magnitude of backlog (over 100,000 files) and the newer scanning and indexing processes available, consideration should be given to scanning/indexing these old claim files in lieu of microfilming.

Response

While not impacting our current business, Business Services is reviewing options available for storing closed claims files including different media storage formats.

96. Significant Contracts Signed by Inappropriate Personnel

Finding

The December 2000 SCIF approved policy for purchasing standards indicates the Business Services Manager was authorized to act as the sole agent for all purchases. During the review of contracts with IT vendors, we noted that most contracts were signed by a Business Services Representative not a Business Services Manager. Additionally, one contract was signed by the Business Applications Manager, who was also responsible for accounts payable function and another contract was signed by a Data Processing Manager II, in the IT Department.

Recommendation

To maintain the proper level of internal controls, a manager who is also responsible for the accounts payable function should not perform the purchasing function, even on a limited basis. Also, SCIF's policy states that no other department should be permitted to agree to any agreement or contract, for other than real property.

Response

We agree with this recommendation and Business Services has made sure that purchasing guidelines clarify signature authority for both purchases and contract approval.

In the specific situation mentioned, the Business Applications Manager was delegated signing authority as the "Acting Program Manager". As the Applications Manager now reports to Fiscal & Investment Services, this circumstance no longer exists.

97. Contracts Entered into with Zero Cost

Finding

Prior to June 2007, contracts with IT vendors, for labor only, did not have a value based on the estimated hours and the hourly rate negotiated in the contract and were given a \$0 cost value on the Statement of Work. However, at the end of the contract terms these contracts could have paid amounts in excess of \$1 million.

Recommendation

SCIF stated that beginning in June 2007, the zero cost contract practice was discontinued and all contracts are now given a dollar value based on estimated hours and the contracted hourly rates. However, our testing samples did not reflect the new procedures implemented in June so we cannot verify this change.

Management should continue the practice of requiring a valid estimated cost be included on all Statements of Work and in all contracts. By doing so, the contracts will be signed and approved by an individual with the appropriate authority levels.

Response

As of June 2007, all IT Consultant contracts reflect an estimated value determined by all of the actual terms of the contract including the estimated hours of work and the contracted hourly rate of the consultant(s).

Business Service will continue to specify the estimated value for all of these contracts.

98. Accounts Payable Supervisor has Inappropriate Access within Oracle

Finding

The Accounts Payable Manager, who is responsible for all bill payments at SCIF through the Oracle system, has the highest level of authority in the system and has been identified as an Oracle “super user”. An Oracle “super-user” is someone who is able to make any changes, additions or deletions to Oracle. Additionally, two supervisors reporting to the Accounts Payable Manager also have high levels of authority in the system similar to the Accounts Payable Manager. Changes are logged within the Oracle system. However, the reports detailing changes are not reviewed.

Recommendation

Authority levels for all Oracle users should be reviewed to determine whether the permissions given are appropriate. Please see IT Findings for further details on user permission recommendations.

Response

An exhaustive review of all Oracle Financials responsibilities was recently completed. Users have been assigned revised responsibilities effective 11/16/07 to ensure access is appropriate and in alignment with their job functions and that segregation of duties is maintained.

99. Improperly Prepared Reconciliations of Funds Received

Finding

Two departments receiving funds for the PACE program incorrectly completed the reconciliation subsequent to the event. After we identified the error, a new reconciliation was provided that properly accounted for the PACE program expenditures and the reimbursement to SCIF.

Recommendation

All reconciliations and reimbursements for the PACE program should be thoroughly reviewed for accuracy before processing payments to SCIF employees.

Response

We agree with this recommendation and a new verification control has been added to identify, report and correct any discrepancy encountered on the Program Managers’ PACE expense reconciliation. The PACE Employee Recognition Program procedure was enhanced to include an independent review and validation by a second analyst.

100. Invoices Paid With No Purchase Order or Contract

Finding

In the sample of 30 payments charged to the Marketing Department, a total of nine payments were made without a purchase order or signed contract. Five of these payments related to vendors that are listed on the Master 594 form; however, a signed contract with these vendors still would be appropriate.

Recommendation

All payments should be evidenced by an approved purchase order or a fully executed contract.

Response

We agree and the situations such as those charged to the Marketing Department have been addressed. New procedures and controls have been established and are now being enforced by Business Services and Fiscal and Investment Services.

Although purchase orders and/or contract agreements will exist for most material transactions, there will always be utility bills, property tax assessments, postage, and emergency purchases. While these transactions will not have a purchase order and/or contract agreement on file prior to the expense, they will be reviewed, approved and submitted for payment in alignment with the new approval limits.

101. Need for Consistent Invoice Processing Forms

Finding

In the sample of 30 payments charged to the Marketing Department cost center, two payments were submitted for payment with an Invoice Substitution form rather than an original vendor invoice. However, the two vendors were not included on the Master 594 listing as vendors not obligated to provide SCIF with invoices prior to payment.

Recommendation

Internal controls should be designed and implemented to ensure that expenditures are properly supported by an original invoice and approved prior to the release of funds. SCIF should consider additional testing in this area.

Response

We agree and the majority of expenditures made by State Fund are properly supported by original invoices and approved prior to payment.

On an exception basis where no invoice is available (such as witness fees paid for court appearances, or replenishment of U.S. Postal Services meters housed at State Fund's facilities), an "Invoice Substitution" form will support the transaction. In all instances, one of the Accounts Payable Supervisors or the Accounts Payable Manager will review and approve the use of the "Invoice Substitution" form.

A log is being developed by the Accounts Payable Unit which will identify all payment types where invoices are not available and an "Invoice Substitution" form is required.

102. Employee Reimbursements Not Processed in Compliance with SCIF Policy

Finding

In the sample of 30 employee payments, three invoices from two different executives were submitted as ‘rush’ transactions and were given priority processing. None of these reimbursements were subject to the audit or approval process. Currently, there is no policy regarding the timely reporting of expense reports. Expense reimbursements can be submitted at any time with no restrictions applied. Per discussion with the Accounts Payable Manager, expense reimbursements designated as ‘rush’ are not common. Situations that would warrant such treatment include expenses that created a financial burden for the employee or if the employee was owed a significant amount of money.

Recommendation

A formal policy covering employee expense reimbursements should be established and followed at all times. These transactions should also be subjected to the audit and approval process in all instances.

Response

We agree with this recommendation. There are situations where a ‘RUSH’ payment is needed and appropriate, but they will always be subject to the same audit and approval process as all other payments, in all instances.

The ‘RUSH’ priority level will be used to handle special situations (financial burden, large out-of-pocket items, overdue claims) affecting State Fund employees.

A policy is being developed for employee expense reimbursements that will be incorporated in our operating procedures and will be formally communicated to all employees.

103. Record Retention Policy Lacking

Finding

The Records Retention policy states that it is the responsibility of Business Services Managers to “develop and maintain record retention schedules for SCIF’s Programs” as well as “store and preserve records in an efficient, effective and secure manner.” Each business area retains its own record retention schedule, and the schedules are not retained centrally by the Business Services Department per the SCIF policy. The policy also fails to address the length of time records should be stored, the off-site storage facilities utilized by SCIF, procedures for sending items offsite, and the tracking of destruction dates.

Recommendation

The Business Services Department should make certain that retention schedules are developed and maintained for each business area, as well as maintain a central repository with all SCIF record retention schedules. The Records and Information Management policy should be updated to include the retention schedules for all business areas, as well as the length of time records should be stored, procedures for sending records offsite, off-

site storage facilities utilized by SCIF, procedures for sending items offsite, and the tracking of destruction dates.

Response

There are guidelines in place that Business Services will review to determine if additional procedures are needed. An oversight group is in the process of being established to determine industry-specific best practices and to assist in the creation, augmentation and maintenance of retention schedules and related procedures. This group will solicit input and assistance from department managers as needed and a recommendation for implementation will be presented to the Executive Committee.

104. IT Vendor Contract Guidelines Vague

Finding

IT vendor contract guidelines are general in nature and do not address key control procedures, nor do they outline IT, Business Services, HR, or the Legal Departments' roles in the vendor contract process.

Recommendation

IT vendor contract guidelines should be updated to provide specific policies and procedures for the following areas: 1) review and approval of IT vendor contract service, 2) preparation and approval of IT vendor service requisitions, 3) solicitation and evaluation of quotations such as price, vendor reliability and vendor quality, 4) review and approval of contracts by managers in the IT and Legal Department, 5) preparation and approval of purchase orders, 6) required procedures for a vendor background check, and 7) accounting for IT vendor services such as capitalization and expenditures. Additionally, retention of contracts should be centralized at SCIF to ensure that original contracts, amendments and any other pertinent information are available. SCIF is working with outside counsel to enhance the IT vendor contract process.

Response

We agree with this recommendation. IT contracting has been revised in consultation with outside counsel. Additionally, Business Services will initiate a whole new process for all IT vendor contracting including vendor contract service, requisition purchase order preparation and processing, vendor solicitation and evaluation and vendor background checks.

105. Methods for IT Contracting Should Be Realigned

Finding

Contracts for IT consultants used for operational purposes have been extended years beyond the original contract term. The consultants have been used to augment the existing IT operational staff on a long-term basis, and not necessarily to fill temporary needs. The use of IT consultants to fill long-term operational needs circumvents the HR hiring process and may not be cost beneficial. Additionally, this practice distorts the true IT departmental staffing needs in the budgetary process, and may increase security issues.

IT consultants that perform project development work are contracted over six month periods, and are not contracted by project. Using the IT consultants in this method

circumvents both the HR hiring process and the vendor bid and selection process. By not requesting project bids, SCIF may not be receiving the best rates possible.

Recommendation

The method in which IT consultants are employed should follow SCIF prescribed policies and procedures. IT consultants used for operational purposes should be utilized for short-term needs only. For long term needs, IT needs to work with the HR Department to develop an annual budget for utilization requirements. IT consultants used for project development purposes should be contracted by project through the use of a fixed fee bidding process that requires key objectives and deliverables be met by the vendor.

Response

The use of consultants and the hiring process is currently being reviewed and will result in new guidelines and procedures. State Fund has begun to initiate a plan to continue migrating work from consultants to employees as is evidenced by a 32% reduction in our consultant count since January of 2007.

IT has developed a formalized transition plan to move other long term work from consultants to employees. New employees with the requisite technical skills needed to replace consultants will be hired.

In 2007 all IT consultant contracts were shortened to six month terms and revised to require consultants provide knowledge transfer through on the job training and mentoring.

106. IT Vendor Guidelines Should Address the Legal Department's Review

Finding

The purchasing agent decides whether the contract modification needs legal review and there is no guideline prepared by the Legal Department defining what requires legal review. Legal review is required only if outside vendor contracts are used or if purchasing agents make modifications to the standard model contract that they believe warrants legal review.

Recommendation

The SCIF Legal Department should establish written guidelines outlining the process for legal review of IT vendor contracts. These guidelines should include a definition of what modifications require legal oversight and define the criteria to be considered by the purchasing agents. Additionally, supervisory control should be established over the purchasing agents. This review should be conducted by a supervising Program Manager.

Response

Business Services will initiate a review of the entire IT vendor contract process to include roles and responsibilities of not only Business Services but also, Information Technology, Human Resources and Fiscal & Investment Services with appropriate and substantial Legal Department review. This will include vendor contract service, requisition purchase order preparation and processing, vendor solicitation and evaluation and vendor background checks.

Supervisory control does exist for all purchasing agents and is exercised by the Purchasing Supervisor. The Purchasing Manager and Business Service Program Manager will review the Purchasing Supervisor's responsibilities and will incorporate changes by revised job description and closer monitoring of performance.

IT and Business Services will work with the Legal Department to establish written guidelines for the process of Legal's review of the IT vendor contracts.

107. Lack of Adequate Vendor Background Check

Finding

The SCIF IT contract states that vendors are responsible for performing background checks on their employees. Background checks on IT vendors are not adequately performed to ensure legitimacy of the vendor. We performed background research on certain SCIF vendors, which revealed that one vendor, while working as an insurance lobbyist, was convicted of a felony in 1993. In addition, we have not received copies of the signed contract, amendments or requisitions for that particular vendor. As a result, we were not able to conclude on the legitimacy of the vendor and the employee who initiated the request.

Recommendation

SCIF should refine background checks for vendors and implement controls in Business Services to ensure compliance with all contract provisions.

Response

At present, only D&B reports are available to the Purchasing Department. However, Business Services will evaluate both the need and the method by which vendor background checks could be made and will consult with our Legal Department on the implementation of any procedure to address this.

108. IT Vendor Contract Documentation Not Available for Review

Finding

Complete information was received on only eight of the 20 IT vendors selected for review.

Recommendation

Retention of contracts should be centralized at SCIF to ensure that original contracts, amendments and any other pertinent information are available for review.

As a result of the Internal Audit IT Consultant Contract Review recommendation, dated November 8, 2006, Business Services now retains all original contracts and is the custodian of such contracts. However, contract information prior to November 2006 may not have been retained by Business Services. As a follow up, we provided the IT Department with a list of the missing vendor information to determine whether the IT Department retained any of the missing documentation. We have received documentation from the IT Department subsequent to September 11, 2007 and have not yet reviewed the completeness of the information.

Response

In line with Internal Audit recommendations made November 8, 2006, Purchasing has been scanning all documents pertaining to all contracts and purchase orders. Copies of all purchase orders and contracts are copied to the requesting programs for their records. Business Services will continue to maintain all records pertaining to all contracts and purchase orders in the Oracle system. Additional storage space will be obtained to maintain all of the “original” documents as stated in the recommendations.

109. Vendor Payment History Did Not Conform to Contract

Finding

Payments made to certain IT vendors were not in compliance with contract terms. In one instance, payments made to a vendor and its affiliates totaled approximately \$100 million from 1996 to 2006. Even though the term of the contract expired in 1997 the vendor continued to provide services and SCIF continued to make payments through 2006. No additional amendments or contractual agreements were received to support the vendor payment history. In September 2007 SCIF filed suit related to these vendor contracts

Recommendation

If payments deviate from contract terms, SCIF should keep a record of the reasons for payment inconsistencies in the files. Additionally, all contract revisions should be on file and kept with the master vendor contract. These contracts should be filed with the Legal Department.

Response

In the specific instance described, there were executed amendments to agreements prior to 2006, as well as the transition agreement executed in 2005 in order to resolve problems with this vendor. We do agree with this recommendation, however, and have established new procedures for purchase orders and contracts that have amounts or dates that differ from the agreed terms. All contract revisions are kept in file now and will be referenced to the master vendor contract whenever possible.

In addition, Business Services will coordinate with Legal to determine how best to store and retrieve contract information so as to facilitate contract work between the two programs.

110. Circumvention of SCIF Procurement/Budget Process

Finding

Internal investigators, through interviews of certain vendors and review of SCIF’s email system, identified that SCIF engaged in inappropriate business practices that permitted unused encumbrances to be transferred to other budget accounts, allowing additional expenditures to be made in which there was no approved budget. This enabled funds to be used in subsequent budget years without going through the proper budget process. This practice also allowed SCIF to misclassify actual goods or services purchased. For example, one vendor that specializes in advertising and marketing billed SCIF for

services not yet performed. The arrangement between the vendor and former SCIF executives was that the vendor would pre-bill SCIF for a specific amount and then use these funds to obtain goods and services from third parties as directed by former SCIF executives. The funds that SCIF paid to this vendor were used for items such as sponsorships, donations, golf tournaments and gifts. The CDI has referred these transactions to the joint task force.

The Board stated it was not made aware of this practice by former SCIF executives. A sample of invoices and follow-up interviews with SCIF executives revealed that this encumbrance practice also occurred under previous SCIF administrations.

Recommendation

All employees should receive ethics training including information regarding how to report unethical practices. The practice of using encumbrances has been part of the corporate culture at SCIF for some time. Employees require proper training on accruals versus encumbrances in addition to training on proper budget techniques. The Board of Directors and SCIF executives should set the proper tone regarding corporate ethics and take the necessary steps to make certain the organization is in compliance with its ethic policies. Additionally, consideration should be given to requiring retroactive conflict of interest statements or disclosures for all procurement personnel and vendors.

Response

We agree with this recommendation and the business practice that allowed unused encumbrances to be transferred to other budget accounts, allowing additional expenditures to be made in which there was no approved budget, has been eliminated.

The Accounts Payable function has been transferred to Fiscal & Investment Services and additional controls have been implemented. All Accounts Payable staff members have been provided instructions on how to report and escalate exception requests or other discrepancies from established procedures and guidelines. Additionally, all State Fund employees will be covered by a new Code of Conduct and must acknowledge annually their understanding of the Code of Conduct and avenues for reporting any concerns through the Whistleblower program or the Integrity in Action program.