



California Department of Insurance

State Compensation Insurance Fund

2010 Operational Review Report
October 2010



RSM McGladrey, Inc.

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San Francisco, California
December 16, 2010

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, a follow-up Operational Review was made of the

STATE COMPENSATION INSURANCE FUND

at its home office located at 1275 Market Street, San Francisco, California 94103.

Introduction

The December 2008 Operational Review Report, issued by the California Department of Insurance (CDI), tested both the progress made in the control environment and overall corporate governance at State Compensation Insurance Fund (State Fund) resulting from findings in the 2007 Operational Review Report, as well as a new review of areas not covered in the 2007 operational review. RSM McGladrey was appointed by the CDI to conduct another follow up operational review in 2010 to test the progress made on the 2007 findings that remained either partially or not remediated after the 2008 operational review, as well as to test the progress made on the new findings noted in the 2008 operational review.

Background

RSM McGladrey was appointed by the California Insurance Commissioner to conduct the 2007 operational review of State Fund in May 2007. The 2007 operational review was initiated by the CDI in response to corporate governance and management issues identified in the 2006 statutory financial examination, as well as issues surrounding State Fund's Group Association Program. A report was issued in December 2007 that contained 110 findings and recommendations covering State Fund's operations.

The State Fund Board of Directors (Board) initiated an independent review of State Fund in December 2006 to review the Group Association Program and related internal controls. As a result of that investigation, a referral was made to the California Highway Patrol (CHP), which has jurisdiction over state agencies. In April 2007, the CHP, the CDI and the San Francisco District Attorney's Office formed a task force to investigate allegations of potential misconduct by former State Fund employees. The task force investigation is still ongoing.

RSM McGladrey was appointed to conduct a follow-up 2008 operational review to test the progress made in the control environment and overall corporate governance at State Fund. The scope of our 2008 operational review included reviewing specific programs at State Fund that were not examined in the 2007 operational review

and testing the initial 110 findings to determine if the suggested recommendations from the December 2007 Operational Review Report had been implemented. As a result of the 2008 operational review, of the 110 findings from the 2007 Operational Review Report, 53 findings were deemed remediated by State Fund, while 40 findings remained partially remediated and 17 findings were not remediated. The 2008 Operational Review Report also detailed the 35 new findings resulting from the review of areas not covered in the 2007 operational review.

RSM McGladrey was appointed to conduct a follow-up 2010 operational review to test the progress made towards remediating the 57 findings from the 2007 Operational Review Report that remained partially or not remediated after the 2008 operational review. The 2010 operational review tested progress made towards remediating the 35 new findings contained in the 2008 Operational Review Report.

Scope and Approach

The 2010 operational review of State Fund consisted of several procedures including interviewing the executive management team and key personnel involved in the management of day-to-day operations of the programs under review, updating and/or conducting process walk-throughs of critical systems and functions such as claims, underwriting, invoice processing, and vendor contract procedures; reviewing, analyzing and testing certain internal controls for each respective scope area, and performing limited testing of underwriting and claims processing at select district offices. Our review started in January 2010 and ended on October 1, 2010.

Specifically, the review focused on determining the remediation status of the 57 findings that remained open after the 2008 operational review testing of the following areas from the 2007 Operational Review Report:

- **Governance and Management Practices** includes a review of State Fund's risk management activities which encompasses the governance structure over the management positions as well as an assessment of the internal audit function and human resources function. These areas specifically include Chief Officer Positions, Board of Directors, Governance Framework, General Management Practices, Internal Audit and Human Resources.
- **Group Association Program** includes a general review of the Group Association Program components.
- **Information Technology (IT)** includes a follow-up assessment of the general IT controls identified in the 2007 Operational Review Report. A complete IT general controls review was not conducted in 2008 or 2010.
- **District Offices and Claims Processing Centers (CPC)** includes an operational review of four district offices and analyzing the outstanding findings at the CPCs and District Offices (currently referred to as Regional Offices), which included the late penalty payments.
- **Business Services** includes a review of the Business Services Operations (BSO) and Contracts and Purchasing (C&P) Departments, which are responsible for purchasing and fleet operations.

In addition to the review and update of the 2007 operational findings, the review focused on determining the remediation status of the areas reviewed in the 2008 operational report, which resulted in 35 new findings and recommendations and consisted of the following areas:

- **Corporate Governance** includes an assessment of the Board's meeting practices and approval process, the Legal Department's contract review procedures and State Fund's overall strategic plans.

- **Fiscal and Administrative Programs** includes a review of 2008 findings pertaining to the following fiscal programs: Management Information and Budget (MIB) program, Fiscal Accounts Payable (Fiscal AP), Project Services Office (PSO), and Brokerage, as well as two administrative areas were reviewed: manual spreadsheets and the Electronic Claims File (ECF) System. A general review was performed of the changes and restructuring of the budgeting function, as well as the PSO, which is now the Project Management Office (PMO) that currently resides under the IT Program.
- **Business Services** includes a follow-up review of the information technology vendor contracts, C&P and fleet operations.

State Compensation Insurance Fund History

State Fund is California's leading writer of workers' compensation insurance. State Fund employs approximately 7,400 staff. State Fund serves as California's insurer of last resort for workers' compensation insurance. Established by the California Legislature in 1914 State Fund is a self-supporting enterprise that provides workers' compensation insurance to California employers. State Fund's creation in 1914 occurred concurrently with the enactment of the first compulsory workers' compensation laws in California to assure California employers of the availability of workers' compensation coverage. State Fund's organization and powers are defined by the California Insurance Code.

State Fund's Remediation Efforts to the 2007 Operational Review through October 1, 2010

The 2007 Operational Review Report contained 110 specific findings and recommendations for the following areas: Governance and Management Practices, Human Resources, Internal Audit, Group Association Program, Information Technology, District Offices, CPCs and Business Services. A follow up review was performed on these 110 findings in 2008, which resulted in the issuance of the 2008 Operational Review Report in December 2008. Based upon testing performed as part of the 2008 operational review, 53 of the 110 findings were deemed remediated, leaving 57 findings either partially or not remediated. The State Fund 2010 operational review tested the progress made towards addressing the 57 findings that were partially remediated or not remediated after the 2008 operational review. The table below provides a summary of the progress made on the 57 findings by functional area from the current, 2010 operational review:

Status of Remediation Efforts

Functional Area	Original Findings in 2007 Report	2007 Findings Remaining After 2008 Review	Finding(s) Remediated	Finding(s) Partially Remediated	Findings Not Yet in Remediation Status
Governance & Management Practices	9	8	5	3	0
Human Resources	8	8	5	3	0
Internal Audit	14	8	4	4	0
Group Association Program	14	4	4	0	0
Information Technology	24	9	7	2	0
District Offices	13	5	2	2	1
Claims Processing Centers	8	2	2	0	0
Business Services	20	13	5	8	0
Total	110	57	34	22	1

For a detailed status of finding remediation see *Exhibit 1: State Fund's Remediation Efforts to the 2007 Operational Review*.

The details of the findings and recommendations that remain partially remediated are included in Exhibit 1. Areas of significant improvement are noted below.

Governance and Management Practices

The 2007 Operational Review Report had 24 Governance and Management Practices findings and recommendations either only partially or not remediated at the conclusion of the 2008 operational review. Of the 24 findings, 14 are now deemed fully remediated, while ten remain only partially remediated.

Chief Officer Positions

In 2008, legislation was adopted to enable State Fund to add six key exempt management positions to the organization. All six exempt positions were filled by State Fund, including Chief Investment Officer, which was unfilled at the time of the 2008 report. It is noted that recent resignations and retirements in the latter half of 2010 have created changes in the following Chief Officer positions: Chief Risk Officer, Chief Operating Officer and Chief Financial Officer.

State Fund continues to work on its succession planning process for program managers and key executives.

Board of Directors

Legislation passed, effective January 1, 2009, enabled State Fund to increase its five-member Board to twelve voting members, which are all currently filled. Current Board members have a diverse background with many having insurance knowledge and backgrounds. The Board also now has investment expertise, which was

previously lacking. Training programs were implemented to educate new Board members, train on corporate governance and ethics, and educate Board members on the Bagley-Keene open forum act.

Board meeting agenda packages communicate sufficient information to the Board, with financial and budget related information included routinely.

Governance Framework

State Fund established an Ethics and Compliance Program, which is responsible for overseeing the implementation, training, modification and ongoing focus on ethical standards and compliance with government regulations. The ethics team builds and implements corporate training on ethics and the compliance team focuses on meeting the Model Audit Rule (MAR) and other regulatory requirements. The Ethics and Compliance Program also oversees the Enterprise Risk Model/Assessment process, while utilizing various consultants to assist in the risk assessment process and testing of MAR compliance. A Corporate Ethics Policy was implemented and provided to the Board, though was not yet approved at the conclusion of this operational review.

General Management Practices

State Fund created a MAR Steering Committee in February 2009, which oversees the project to document and test controls to ensure compliance with the NAIC's MAR regulation. In July 2009, State Fund created a Risk Committee, which is led by the Chief Risk Officer. In August 2009, the Governance, Risk and Compliance (GRC) Committee was formed as a subcommittee under the Risk Committee, which together oversee the Enterprise Risk Management (ERM) Program.

The Project Review Board (PRB) was disbanded as of January 31, 2008. The Enterprise Governance Committee (EGC) assumed the PRB's responsibilities for handling cross functional projects in February 2009. The EGC has several subcommittees called Functional Steering Committees. Improvements are still needed, as the EGC should monitor usage of consultants and consistently review accurate reports of consultant usage across all of State Fund.

Internal Audit

Internal Audit is responsible for providing independent review designed to improve State Fund's operations. Internal Audit develops an Audit Plan/Schedule each year that is approved by the Board of Directors. Internal Audit develops a Risk Planning Model annually to assess regulatory issues and industry market conditions, which helps determine the Audit Plan for the year and areas in need of an audit.

Internal Audit is adequately monitoring management responses to ensure audit recommendations are being addressed.

The Audit Procedural Manual, updated and implemented as of November 17, 2009, adheres to the Institute of Internal Auditors (IIA) standards. The Audit Procedural Manual includes updated and adequate verbiage for sampling methodology. Testing of audits performed by Internal Audit verified that the updated sampling methodology has been implemented. Audit Template Forms were also created to standardize the audits conducted. Internal Audit staff was trained on the new Audit Procedural Manual and templates. Internal Audit should ensure that the Risk Assessment for every audit is completed and all risks identified as high risk should indicate whether they will be tested in the audit risk analysis.

Internal Audit conducted various training courses to educate the Internal Audit staff. Training of current and new staff was deemed appropriate. Internal Audit staff members are considered cross-functional and there is no separate classification of IT auditors. Out of 39 Internal Audit Staff members, there are two Certified Public Accountants (CPAs), two Certified Fraud Examiners (CFE), and three Certified Internal Auditors (CIA). IT background of Internal Audit Staff should be enhanced

through Certified Information Systems Auditor (CISAs) designations. Internal Audit staff should pursue appropriate designations to demonstrate expertise in their field.

The Audit Committee and the Board of Directors have been more involved with the selection of audits, approval of the Audit Plan and amendments to the Audit Plan and review of summaries of audit recommendations. However, there are a significant number of 2009 and 2010 audits still in progress at the conclusion of this operational review. Six of the outstanding audits are from the 2009 Audit Plan, and twelve of the 25 audits on the 2010 Audit Plan were still in progress as of September 2010. Special requests have been made by the Audit Committee and Board for additional audits during the year, which has contributed to the delays. The Board and Audit Committee have approved these special requests to modify the Audit Plan. State Fund should consider utilizing additional contract audit resources to assist them in reducing the backlog. State Fund may also want to consider adding a key executive position to oversee the Internal Audit function in addition to the current Internal Audit Program Manager. It is strongly encouraged that State Fund fill the key executive position with a candidate that has a strong internal audit or public accounting background.

Human Resources

Human Resources (HR) should continue to strengthen the succession planning process to retain internal knowledge of State Fund processes at the Chief Officer level. The recently opened Chief Officer positions noted above lack internal successors based on the current succession plan in place.

Group Association Program

State Fund has continued to tighten the controls around the contract and monitoring processes for the Group Association Program. Audits of Group Associations are performed, and procedures were updated to ensure that Group Associations must be audited at least once per contract term. State Fund strengthened their group association contract development procedures for Legal Department review of contracts. State Fund has transitioned from the use of external counsel to internal counsel for review and maintenance of group contracts. State Fund Internal Audit completed their audit of the Group Association Program. All findings from the 2007 Operational Review Report have now been remediated.

Information Technology

The 2008 review revealed that nine IT findings remained only partially remediated. Our current review of these nine findings concluded that seven of these findings have been remediated, while two remain only partially remediated.

State Fund is continuing to improve its IT Governance and the control environment. IT policies and procedures have been formally documented, implemented, and appear to be effective as evidenced by the results of our testing. The current IT organization has been consolidated, and IT roles are limited to supporting and enabling the business programs. The Chief Information Officer has six direct reports. Three manage the areas of IT security, operations, and projects, while three support the business programs: legal, claims and policy/billing. The new Chief Information Officer is a member of the Operations Committee, which includes the Chief Operating Officer, Chief Investment Officer and the vice presidents of each business program. The Operations Committee meets twice monthly to review critical projects and issues.

In 2009, the Vacaville Data Center opened providing enhanced network infrastructure, security and system capacity.

A backup facility is in Riverside, CA, but management is considering an alternative site because of the Riverside location's seismic risk. Data backup is primarily handled over the network and virtual backups have reduced tape storage requirements. Prior issues related to tape handling have been addressed. Physical security has been enhanced at all State Fund facilities through the implementation of an integrated card key and video monitoring system. A 2010 initiative to reorganize and centralize the IT Service Desk is scheduled to be completed by the first of the year. This initiative includes the deployment of a new request and incident tracking system. If utilized as intended, these new tracking reports should remediate the prior finding that incidents and requests were not monitored to ensure timely closure.

State Fund should continue remediation efforts in the area of IT. Management has committed to addressing each non-compliant application by the end of October 2010. As noted above, prior issues related to the Service Desk also remain partially remediated.

District Offices and Claims Processing Centers

The 2008 review revealed that five district office findings and two claims processing center findings remained either only partially or not remediated. Our current review of these seven findings concluded that two district office findings remain only partially remediated and one district office finding remains not yet remediated. Two district office findings were remediated, as were both claims processing center findings.

State Fund continued to implement their functional realignment of regional offices through 2009. Changes continue to be made to the organizational structure as office locations are modified and head count decreases. State Fund continues to make an effort to consolidate regional offices to decrease overhead. Several programs were moved to the new Vacaville location, including some claims operations and the Claims Processing Center (CPC) functions from the now closed Fairfield office. The current structure in place consists of a President overseeing Claims and a President overseeing Field Operations, with both reporting to the President and Chief Executive Officer.

Additional functionality related to Management Claims Review (MCR) was added to the Electronic Claims File (ECF) system to document the Assistant Claims Manager (ACM) review of claims. Due to the timing of the implementation, our review could not test the consistent and appropriate use of the improved MCR functionality; however, we did observe the added functionality in ECF. There were instances noted during our testing of claims that showed that there was no evidence of ACM review during the workaround period, prior to the new functionality being added.

ECF has not been enhanced to ensure agreement to Data Base II (DB2), which flows to the financial statements. ECF implementation audits should be completed by Internal Audit once the ECF enhancements are fully implemented.

State Fund's current claims payment procedures continue to allow for the payment of recurring payments, with total payments exceeding adjusters' authority levels. State Fund procedures allow for the establishment of 14 to 52 continuous weeks of payments as long as each individual payment does not exceed the adjuster's authority. State Fund should consider the cumulative total of all recurring payments in accordance with the adjusters' authority limits.

Claims Reference Manual changes and additional training on ECF modules led to improvement in the appropriate establishment of reserves on claims. Identification and prioritization of high-dollar bills also helps to ensure appropriate and timely increases to reserves where applicable.

Total late payment penalties appear to continue to stay at lower levels, as compared to their peak in 2007. While the occasional spike in penalties has occurred, on average from August 2008 to May 2010, monthly late payment penalty payments were under \$600 thousand. From January 2010 to May 2010, monthly penalty payments were approximately \$480 thousand on average.

Business Services

The 2008 review revealed that 13 Business Services findings remained either only partially or not yet remediated. Our current review of these 13 findings concluded that five findings were remediated, while eight remain only partially remediated.

Due to the overlap in areas reviewed in the 2007 and 2008 operational reviews, the summary of changes made and areas still needing improvement is located in the Business Services summary in the 2008 Operational Review section below.

State Fund’s Remediation Efforts to the 2008 Operational Review through October 1, 2010

The 2008 operational review resulted in 35 new findings and recommendations, in addition to the 110 findings and recommendations from the 2007 operational review, covering the following functional areas: Board, Legal, General Management Practices, Management Information and Budget, Fiscal AP, Project Services Office (PSO)*, Brokerage, Manual Spreadsheets, ECF System, Information Technology Vendor Contracting (ITVC), Fleet Operations (Fleet), and Contracts and Purchasing. The table below provides a summary of the progress made on the 35 findings by functional area from the current, 2010 operational review:

Status of Remediation Efforts

Functional Area	2008 Findings	Finding(s) Remediated	Finding(s) Partially Remediated
Corporate Governance	13	12	1
Board	4	4	0
Legal	5	4	1
General Management Practices	4	4	0
Fiscal and Administrative	15	11	4
MIB	3	3	0
Fiscal AP	3	2	1
PSO*	5	3	2
Brokerage	1	1	0
Manual Spreadsheets	2	1	1
ECF System	1	1	0
Business Services	7	4	3
ITVC	2	1	1
Fleet	4	2	2
Contracts and Purchasing	1	1	0
Total 2008 Operational Findings	35	27	8

*The PSO has gone through many changes in 2009 and 2010 and is currently called the Project Management Office. For consistency correlation to prior reports purposes, it is referred to as PSO for tracking in the grids contained within this report.

For a detailed status of finding remediation see *Exhibit 2: State Fund's Remediation Efforts to the 2008 Operational Review*.

The details of the findings and recommendations that remain partially remediated are included in Exhibit 2. Areas of significant improvement are noted below.

Corporate Governance

The 2008 Operational Review Report had 13 Corporate Governance findings and recommendations, of which 12 have been fully remediated and one has only been partially remediated.

Board

The minutes and agendas reviewed from January 2009 through January 2010 reflect that the Board discussed strategic plans, market and industry conditions, and the direction of State Fund, usually in closed sessions. The Board voted on key action items, in addition to approving the committee compositions of the Audit, Investment and Governance Committees. The Board minutes appropriately documented new Board member appointments.

State Fund analyzed its payment authorization levels and decreased the maximum approval limits effective February 2010, as previous approval limits were deemed excessive.

Legal

The Legal Department is responsible for providing legal services, including review of contracts, subrogation cases, court appeals and decisions, civil litigation cases and workers compensation cases. The Legal Department solicits external counsel assistance when needed and utilizes a case management system to manage legal case activity. The Chief Counsel provides legal counsel and guidance to program managers in areas requiring specialized legal expertise and legal representation to policyholders pursuant to insurance contracts.

The Legal Department is going through a transition period of transferring legal case activities to an upgraded case management system. While the 2008 Operational Review Report stated that case management system changes were taking place, those were put on hold and have only recently been revised. Case management system changes are now planned for implementation in the fourth quarter of 2010. A manual process is currently used to track the legal review of contracts, which has led to inconsistencies and tracking errors. The new tracking system should be configured within the case management system to track outstanding contracts that have not been reviewed. The case management system should also be configured to provide an audit trail to show when a supervisory review has been performed on contracts. The case management system should reflect multiple levels of contract review to ensure appropriate contract review.

State Fund improved their selection process for the use of external counsel through the creation and use of a Request for Proposal (RFP) team, consisting of appropriate staff from the Legal Department, Risk Management and Contracts and Purchasing. The Legal Peer Review process has changed from a district audit of open cases by Home Office personnel to a more automated monitoring and review process to ensure that open cases are closed in a timely fashion. A reporting structure appears to be in place to show quarterly and annually accumulated review and case closing activity.

General Management Practices

State Fund developed a strategic plan in a comprehensive format that was communicated to all employees. As described below in Fiscal and Administration, State Fund restructured the Project Management Office (PMO), previously the Project Services Office, within Information Technology (IT) and moved the budgeting function to the Fiscal Program. While the PMO and Fiscal programs are not overseen by the Chief Financial Officer as recommended, State Fund's communication through the various committees appears appropriate.

Fiscal and Administrative

The 2008 Operational Review Report had 15 Fiscal and Administrative findings and recommendations, of which 11 have been remediated and four have been partially remediated.

Management Information and Budget

What was previously referred to as Management Information and Budget (MIB) was responsible for the budgeting process, which included planning and implementing the budgeting process, as well as maintaining the central repository of financial budgeting data utilized to produce management reports. As of June 2009, MIB no longer exists and the budgeting duties now fall under Fiscal and Administrative.

Fiscal and Administrative restructured the budget process to begin with the Board approved strategic plan and filter down to the detailed budget line items. Support for budgeted items has been standardized, and guidance is available for budget preparers.

Through the use of a new Budget Variance Analysis tool, the budget variance monitoring process now contains the necessary metrics and guidelines for providing appropriate budget variance explanations.

Fiscal Accounts Payable

The Fiscal Accounts Payable (AP) function within Fiscal is responsible for processing payments of vendor invoices as well as employee reimbursements.

Fiscal AP has refined its policies concerning vendor invoice payment process, employee reimbursements, advances, and emergency purchases. Documentation of Oracle authorization level changes are now appropriately retained by State Fund.

State Fund had been incurring recurring expenses at regional offices based on contracts created in the late 1990s. State Fund is in the process of re-bidding old contracts and maintaining them in the Oracle system targeted for completion by December 31, 2010.

Project Services Office

The redesigned Project Management Office, formerly the Project Services Office, is responsible for monitoring all State Fund projects. Each month, the PMO provides Executive Status Reports (ESRs) to the Functional Steering Committees, Executive Committee, and the Operations Committee. The ESRs contain budget and project status data. The Committees are charged with project approval and monitoring, to ensure that projects meet business objectives. PMO is responsible for training project

managers in the proper use of the Planview project management tool. Revised PMO procedures have been published on the State Fund's internal web site. However, the effectiveness of the new PMO procedures cannot be tested until the procedures have been adopted by the entire organization and applied to a number of completed projects.

Brokerage

Brokerage procedures were sufficiently updated and/or reviewed in 2010.

Manual Spreadsheets

An inventory of manual spreadsheets is now maintained by State Fund. State Fund has adopted procedures to formalize spreadsheet review and protection including authorized procedures, peer review, password and cell protection. At the time of our review, State Fund procedures lacked the specification that proof of peer review should be retained.

Electronic Claims File System

ECF is the systems application that is used by the State Fund to process claims. This application is capable of electronically storing claim information and documentation. ECF also facilitates the authorization of medical claim payments. The current ECF version is only capable of processing medical payments; indemnity payments continue to be processed utilizing the Wang Interchange System Processor (WISP). WISP is the application that was used to process all claims payments prior to ECF implementation in 2006. State Fund should continue adding the planned programming enhancements to address improvements noted in the 2008 implementation plan and recommended herein.

State Fund has been accounting for late payment penalties in Defense and Cost Containment for statutory reporting purposes. These penalty payments should be accounted for in Adjusting and Other per Statements of Statutory Accounting Principals No. 55.

Business Services

The 2008 Operational Review Report had seven Business Services findings and recommendations, of which four have been remediated and three have been partially remediated.

Business Services

The Business Services Program Manager, who oversees Business Services, reports to the Chief Operating Officer. State Fund continues to work towards scanning claims files. However, completion is not scheduled until year end 2010. An authorized procedure for the destruction and retention of non-claim files should be developed and implemented.

Consistent processing of invoices for vendors has been implemented.

State Fund continues to work to obtain, but has not completed, approval of the Code of Conduct.

Fleet Operations

The Business Services Transportation Unit is responsible for the overall management of State Fund's fleet vehicle operations. State Fund contracted with Automotive Resources International (ARI) on November 1, 2009 to assume responsibility for the fleet car management and vehicle maintenance. With the implementation of the ARI contract, the fleet operations function has been centralized. As of April 2010, the Business Services Transportation Unit was responsible for the management of approximately 2,000 vehicles, of which approximately 1,800 are assigned to State Fund employees. The remaining 200 vehicles are utilized as pool cars for employee business use.

In June 2010, State Fund changed its fleet policies and procedures to only allow fleet vehicles to employees who in a six month period drive at least 5,000 business miles or are required to travel to locations (other than to an assigned office) on at least 60% of the available work days. It is estimated by State Fund that the new qualification requirements will remove around 1,000 vehicles from the fleet. All employees affected by the change in policy were notified in June 2010. Executive management and Program Managers have until December 31, 2010 to turn in vehicles if they do not meet the requirements and all other drivers have until June 30, 2011. The reduction in the fleet is estimated by State Fund to result in an \$8 million annual savings. Based on review, the policies and procedures appear sufficient.

State Fund fleet vehicle drivers are entered into the Fleet Safety Program and the DMV Employer Pull Notice (EPN) program upon receiving a fleet vehicle. The Fleet Safety and EPN programs were moved to Risk Management as of October 2009. The program guidelines have been sufficiently updated and the program is adequately monitored.

Risk Management also oversees the quarterly vehicle inspections by State Fund managers of fleet vehicle drivers. A tracking system should be implemented to ensure all drivers' quarterly vehicle inspections are performed. A review of the Quarterly Vehicle Inspection form should be performed to ensure the signatures and dates of the drivers and inspectors are present.

Personal use of State Fund fleet vehicles is considered a fringe benefit and is taxable. In order to track personal use, State Fund employees with fleet vehicles complete a form each pay period and State Fund makes the appropriate Non-USPS adjustments. Procedures for the Non-USPS adjustment were updated in October 2009 and are sufficient.

Due to the change in fleet policies, State Fund employees will be utilizing personal cars more frequently and obtaining mileage reimbursement for business trips. Currently, State Fund does not maintain a centralized list of employees who have been authorized to use personal vehicles for business use. Personal Vehicle Mileage Reimbursements should be maintained in a centralized location. Also, a separate General Ledger account should be utilized to track Personal Vehicle Mileage Reimbursements payments instead of pooled with all employee reimbursements.

Information Technology Vendor Contracting and Contracts & Purchasing

Contracts and Purchasing is responsible for the purchasing of capital equipment, contracting for services, contract management/administration and is ultimately overseen by the Chief Operating Officer. Within Contracts and Purchasing, there is an IT sourcing division and a corporate sourcing division, which handles all non-IT, related sourcing. The prior Chief Information Officer created a vendor management organization during her tenure. State Fund discovered that the CIO's vendor management organization had become involved in contracts, which had allowed the CIO to enter into contracts outside of Contracts and Purchasing guidelines and procedures. The CIO's vendor management organization was disbanded and control over IT sourcing and contracting was moved to Contracts and Purchasing in November 2009. Information Technology Vendor Contracting (ITVC) contracts are now overseen by the IT sourcing division of Contracts and Purchasing and contracts, based on State Fund Policy, which may be required to be reviewed by the Legal Department.

State Fund has updated and improved procedures for the general contracting process, including bid requirements, sourcing processes and review and approval thresholds, contract negotiations, reviews by the Legal Department, amendments/renewals, as well as supplier identification, qualification and risk analysis. State Fund updated the purchasing authority guidelines and strengthened the process to ensure vendor payments are in accordance with contract terms. State Fund is in the process of procuring a Contract Life Cycle Management System. The system is expected to allow for complete documentation of contract bids, reviews, including legal reviews when required, approval and amendments from inception to completion. The system will also interface with State Fund's payment system to ensure that no payments will be allowed against a project or contract until documentation and approvals are complete. Implementation is targeted for year-end 2010.

State Fund updated procedures related to the review of certain contracts by the Legal Department. State Fund should consistently follow the updated procedures to ensure all contracts requiring legal review are appropriately reviewed. Contracts and Purchasing has strengthened the process around contracting and selecting contractors. Contracts and Purchasing should ensure they are appropriately forwarding contracts requiring legal review to the Legal Department in accordance with the updated procedures.

State Fund established a policy requiring its vendors to perform background checks of personnel fulfilling State Fund contracts. Although the certification process has begun, completion of the verification process will not be complete until the fourth quarter of 2010. State Fund should ensure adequate documentation is maintained to demonstrate vendor compliance with this State Fund policy.

Overall Summary

Since the last operational review conducted in 2008, State Fund has continued to make improvements that have strengthened corporate governance, internal controls and financial/business planning throughout the organization. During this time, State Fund remediated 34 of the remaining 57 findings from the 2007 Operational Review Report, partially remediated an additional 22 findings and has indicated it will continue to address the remaining one outstanding finding.

State Fund fully remediated 27 of the 35 new findings from the 2008 Operational Review Report and partially remediated the remaining eight findings.

Exhibits:

The following exhibits are included in this report:

- Exhibit 1 – State Fund's remediation efforts regarding the remaining 57 findings from the 2007 Operational Review Report that remained outstanding since the last operational review conducted in 2008.
- Exhibit 2 – State Fund's remediation efforts regarding the 35 new findings from the 2008 Operational Review Report.

Exhibit 1: State Fund’s Remediation Efforts to 2007 Operational Review

The State Fund 2010 operational review included a review of the progress made towards addressing the 57 findings and recommendations that remained from the Operational Review Report issued in December 2007, after the performance of the follow up 2008 Operational Review. The 2007 Operational Review Report contained findings and recommendations for the following areas: Governance and Management Practices; Human Resources; Internal Audit; Group Association Program; Information Technology; District Offices; Claims Processing Centers; and Business Services. Note that the numbering of the findings corresponds to the numbers used in the 2007 Operational Review Report, which originally contained 110 findings, of which only 57 findings remained either partially or not yet remediated after the 2008 operational review.

See the matrix below for the Company and examiners’ 2010 response to 2007 Findings.

Functional Area	Summary of Finding	2008 Report Conclusion	2010 Report Conclusion	State Fund Response
07-001 Chief Officer Position	State Fund Lacks Key Officer Positions	<i>This finding has been partially remediated.</i> Senate Bill 1145 was signed on September 30, 2008 for the addition of six exempt positions. Positions with the exception of the Chief Investment Officer were filled as of September 30, 2008.	<i>This finding has been partially remediated.</i> While all six exempt positions, including Chief Investment Officer were filled, recent resignations and retirements have led to open positions at the Chief level. Prior to year end 2010, the Chief Risk Officer, Chief Financial Officer and Chief Operating Officer will be vacant.	<p>The Board immediately appointed an Interim President and CEO who served until the appointment of the new President on August 2, 2010. The former Acting President then resumed his duties as the Chief Risk Officer through December 31, 2010.</p> <p>A new Chief Operating Officer was appointed effective December 2, 2010 following the retirement of the incumbent.</p> <p>Following the resignation of the Chief Financial Officer, an Acting Chief Financial Officer was immediately appointed on October 4, 2010 and the two were able to work together to ensure a smooth transition.</p> <p>The Executive search for a permanent Chief Financial Officer and Chief Risk Officer are proceeding in a timely fashion.</p>
07-007	Enhance Existing	<i>This finding has not yet been</i>	<i>This finding has been partially</i>	The Board Governance Committee

Functional Area	Summary of Finding	2008 Report Conclusion	2010 Report Conclusion	State Fund Response
General Management Practices	Internal Committees	<p><i>remediated.</i> As minutes of the ERA Committee meetings are not maintained, an assessment of the committee's activities could not be determined. The ERA Committee should be significantly involved in developing the Model Audit Rule compliance plan of action and for providing status updates to the Board.</p>	<p><i>remediated.</i> There was neither discussion of Model Audit Rule updates nor appointment of PwC to assist with Model Audit Rule compliance evidenced in the open/closed Board meeting minutes or the open Audit Committee meeting minutes.</p> <p>The Operations Committee was established in February 2010 and no charter has yet been created.</p> <p>State Fund should update the comprehensive listing of internal committees quarterly to identify the committee members, chairman and committee objectives. Committee charters should be established following the first committee meeting to ensure that committee objectives and responsibilities are clearly outlined. Committee creations (formal or informal) should be approved by a State Fund Executive Member or Program Manager.</p>	<p>received an extensive report on the State Fund Enterprise Risk Model plan in July 2010. The Governance Committee received further specific updates in November 2010.</p> <p>The Board Audit Committee received an extensive report from State Fund leadership and the external auditors in September 2010.</p> <p>Subsequent to the close of the external review, the Operations Committee Charter was completed. All State Fund committees now have an operating charter; a comprehensive list of committees is available.</p>
07-008 General Management Practices	Executives Should be Actively Involved in Monitoring Interim Consultants	<p><i>This finding has been partially remediated.</i> Reports are prepared for the PRB detailing the number of consultants utilized per project. Although an executive sponsors each project, discussions surrounding consultant use were not evidenced in the PRB minutes. Use of consultants should be consistently challenged by executives to ensure that all available resources are utilized effectively.</p>	<p><i>This finding is partially remediated.</i> While State Fund has an Enterprise Governance Committee (EGC), no discussions were noted in the 2009/2010 EGC meeting minutes regarding the usage of consultants. Furthermore, the consultant usage reports created monthly are not an accurate account of total consultants used at State Fund.</p>	<p>The Organizational Development Information Analysis and Compliance unit (OD-IAC) manually compiles consultant head count information based on information submitted. The OD-IAC is working with IT on a plan to produce a concurrent report in Oracle. Estimated implementation of the completed new solution is expected by second quarter 2011.</p>
07-010	Establish Formal	<p><i>This finding has been partially</i></p>	<p><i>This finding has been partially</i></p>	<p>State Fund's succession planning includes</p>

Functional Area	Summary of Finding	2008 Report Conclusion	2010 Report Conclusion	State Fund Response
Human Resources	Succession Planning	<i>remediated.</i> State Fund has created a high-level succession planning policy. This policy identifies 149 positions in which succession plans should be developed. However, as of October 2008, no formal succession plans have been implemented nor have detailed plans been documented for any of the 149 key employees identified in the planning policy. State Fund should create a schedule that prioritizes, includes deadlines and detailed action steps for the timely completion of the succession planning policy implementation for all the 149 key employees identified in the initial overview. State Fund anticipates that this finding will be completely remediated in mid 2009.	<i>remediated.</i> Six executive positions' short term succession plan is to hire externally. Three of the executive positions without internal successors, the Chief Risk Officer, Chief Operating Officer and Chief Financial Officer, have resigned in 2010 or will retire by year end. While the prior years of not performing succession planning have led to the need to hire externally, internal development must remain a focus to ensure institutional knowledge of State Fund is not lost at the executive level.	ongoing assessment to address the changing needs of our organization and identifying leadership to fulfill our strategic goals and business needs. We continue to develop the leadership skills of State Fund managers and supervisors and have filled our Chief Operations Officer position with an internal candidate. That being said, utilizing external candidates is a valid part of succession planning. External candidates can often bring an organization new viewpoints and perspectives that continue to energize the organization and keep us current in practices and programs.
07-011 Human Resources	Accurate Recordkeeping for Vacation Accruals	<i>This finding has been partially remediated.</i> While State Fund has taken steps to reduce the number of employees with accrued vacation balances in excess of limits by establishing individual plans to reduce accrued hours, there are still many employees over the established limit. Testing revealed that several retiring employees were paid out for accrued balances in excess of limits.	<i>This finding has been partially remediated.</i> While State Fund is monitoring the balances, furloughs adversely affected progress towards lowering accrual balances. It is noted that State Fund is relatively limited in what they can do to address this finding.	State Fund's Department heads and designees have worked with employees to produce individual plans in reducing accrual balances for those over 640 vacation/annual hours. State Fund's target was to reduce 10% of the over 640 hours from December 31, 2009. By the end of November after completion of the external review, State Fund exceeded this goal and reduced over 10%.
07-015 Human Resources	Improve File Retention and Maintenance of Human Resource Files	<i>This finding has been partially remediated.</i> While all personnel files requested were provided for testing, State Fund should ensure that files checked out by State Fund personnel are returned to HR within the 14-day requirement, and	<i>This finding has been partially remediated.</i> State Fund should ensure that files checked out by State Fund personnel are returned to HR within the 14 day requirement. State Fund plans to update their policy and process around	Human Resources has reevaluated the 14 day return timeframe and found it insufficient in some situations and is revising the procedure accordingly to allow for alternative time periods to check out an Official Personnel File.

Functional Area	Summary of Finding	2008 Report Conclusion	2010 Report Conclusion	State Fund Response
		<p>that the personnel file request log accurately reflects dates files were returned. As some personnel files were still missing some required forms, it is recommended that State Fund continue their quality assurance project of reviewing personnel files to ensure required forms are included. Additionally, as of October 2008, key card access to the personnel file room has not yet been installed. As of October 2008, Internal Audit had begun a four-part review of HR; however, the audit was not yet complete.</p>	<p>the file checkout process in 4th quarter 2010.</p>	
07-018 Internal Audit	Enhance Risk Planning Model	<p><i>This finding has been partially remediated.</i> The 2008 Risk Planning Model includes assessments of regulatory issues and industry market conditions. However, as the 2009 Risk Planning Model was in process at the time of our review, it is difficult to assess the effectiveness of recent revisions.</p> <p>The package for the Audit Committee contains the Board survey, proposed weight factors, procedures for use, and summary of factors which may affect business in 2009. The State Fund Risk Planning Model should continue to be evaluated as industry and market conditions continue to change, and additional risks are identified.</p>	<p><i>This finding has been partially remediated.</i> The Risk Planning Model is currently in development. State Fund should evaluate if Internal Audit resources are adequate to address State Fund's needs.</p>	<p>Internal Audit is starting its second year with a Risk Planning Model which considers and incorporates the enterprise Risk Based Assessment.</p> <p>Additional resources are being engaged to address the recently implemented risk based auditing method.</p>
07-019 Internal Audit	Enhance Internal Auditor's Understanding of IT Standards	<p><i>This finding has been partially remediated.</i> The IT Internal Audit staff appears to have been provided appropriate training when additional</p>	<p><i>This finding has been partially remediated.</i> Out of 39 Internal Audit Staff members, there are two Certified Public Accountants (CPAs), two</p>	<p>A number of the internal auditors have received designations and IT training. CISA certifications would be of benefit and will be encouraged.</p>

Functional Area	Summary of Finding	2008 Report Conclusion	2010 Report Conclusion	State Fund Response
		<p>expertise was needed. However, Internal Audit staff overall do not have appropriate designations for their field.</p> <p>Fourteen of the 37 Internal Audit staff possesses certifications; however, only six of the 14 hold CFE, CIA, or CISA designations. Currently, no Internal Audit staff holds the CPA designation.</p>	<p>Certified Fraud Examiners (CFEs), and three Certified Internal Auditors (CIAs). IT Training has been provided to auditors; however, IT designations such as a CISA would be beneficial to the Internal Audit Program.</p>	
07-021 Internal Audit	Improve Workpaper Documentation	<p><i>This finding has been partially remediated.</i> Improvement was noted in workpaper documentation; however, some workpapers for the audits reviewed lacked headings, purposes, audit dates and conclusions.</p> <p>Specifically, four out of 14 audits reviewed in 2008 did not contain sources, purposes and conclusions on workpapers and one audit contained a significant number of review notes in the form of post its. It should be noted that one of the audits had not received a final review.</p>	<p><i>This finding has been partially remediated.</i> State Fund should ensure that all audit documentation is complete and accurate. For high and medium risks identified in the Internal Control Assessment, which were deemed not necessary to test, State Fund should provide reasoning why the risk is not tested.</p>	<p>As found, workpaper documentation now includes headings, purpose, audit dates, conclusions and a final review. The entire audit process has been revamped and incorporated into a revised Audit Manual.</p> <p>It is appropriate to include documentation as to why a control for a medium or high risk is not tested and the Team Leaders will ensure that the documentation is included.</p>
07-031 Internal Audit	Maintain the Integrity of the Audit Plan	<p><i>This finding has been partially remediated.</i> The 2008 Audit Plan was presented at the January 2008 Audit Committee meeting and revisions were discussed at the May 2008 Audit Committee meeting; however, no reference to the approval of the Audit Plan or subsequent revisions is contained in the minutes. The 2009 Audit Plan was approved by the Board in November 2008.</p>	<p><i>This finding has been partially remediated.</i> The Audit Committee and the Board of Directors have been more involved with the selection of audits and approval of the Audit Plan. However, eight of the 15 audits listed on the 2010 Audit Plan were still outstanding from the approved 2009 Plan. A significant number of 2009 Audits remain in progress. 15 of the 25 audits on the 2010 Audit Plan are still in progress as of June 2010. State Fund estimates that all 2009 audits will be completed in 2010.</p>	<p>Internal Audit agrees that the annual Audit Plan should be completed in the year time frame and future planning will take into account intervening factors.</p>

Functional Area	Summary of Finding	2008 Report Conclusion	2010 Report Conclusion	State Fund Response
07-059 Information Technology	Password Settings Not Standardized	<i>This finding has been partially remediated.</i> State Fund has formalized a Password Policy that has been approved by the IT Vice President. However, the Executive Committee needs to sign off on the policies before they become effective. The Audit Compliance Team is currently reviewing password settings for critical applications and systems. State Fund indicated that the planned remediation date is December 31, 2008.	<i>This finding has been partially remediated.</i> While password standards are established and the majority of applications are compliant, several critical applications are not compliant.	From the CDI list of critical applications that were tested for password compliance, the only ones that are not password compliant are four.
07-068 Information Technology	Home Office Help Desk and Support Not Monitored	<i>This finding has been partially remediated.</i> State Fund has implemented a help desk incident management ticket monitoring procedure to ensure that tickets are cleared in a reasonable timeframe.	<i>This finding has been partially remediated.</i> State Fund has not implemented effective controls to ensure that help desk tickets are properly addressed in a timely manner. Recent reports show an excessive number of open tickets. While the current reorganization of Field Support to create a central Service Desk should address this issue, it will not be fully operational until year end 2010.	Starting October 1, 2010, the IT Service Desk implemented a newly improved process in which the IT Service Desk contacts the original requestors (business users) on all completed work in order to ensure that their infra tickets were resolved in accordance with their request. In addition, on a monthly basis, a dedicated team from the IT Service Desk will review all outstanding infra tickets greater than 90 days. The Team will evaluate and contact the business users for resolution. This finding will be fully remediated by the end of the year 2010.
07-070 District Offices	Lack of Formalized Claim Review	<i>This finding has been partially remediated.</i> Claims testing performed in the district office visits revealed that, in general, case reserves are reviewed by a supervisor or manager at least once every six months. However, ECF lacks the functionality to provide evidence that a review has been performed unless the reviewer makes a change to a reserve or a reserve requires supervisory approval.	<i>This finding has been partially remediated.</i> While functionality was added to ECF to document the Assistant Claims Manager review of claims effective June 1, 2010, there were instances noted during our testing of claims that showed that there was no evidence of ACM review during the workaround period.	In early 2009, Claims and IT began work on developing system enhancements that would require annual estimate reviews by a supervisor. Pending this systems solution, on February 3, 2009, Claims implemented a manual procedure for identifying claims requiring annual estimate review by the supervisor. Instruction was provided and monthly lists were distributed to claims offices.

Functional Area	Summary of Finding	2008 Report Conclusion	2010 Report Conclusion	State Fund Response
		<p>ECF should be configured to capture reserve estimate reviews performed even if no changes to the estimates are made or the approval is not required.</p> <p>In addition, we noted a trend of adjusters' first reserve estimates occurring over 20 days past the expected reserve establishment date.</p>		<p>In May 2010, system enhancements were complete, automating this process. Instruction was given on May 12, 2010 and functionality was promoted to production on June 26, 2010. The automated process includes automatic escalation to the supervisor any time an estimate is approaching one year old and has not had a management review of the estimate. The system enhancement ensures that an ACM review and approval of a case estimate is done at least annually, and it was implemented in the adjusting locations on June 26, 2010.</p> <p>To further strengthen control over case reserves and to fully remediate this finding, Claims is currently working with IT to develop monthly reports which will allow management to verify that ACMs are completing the estimate reviews when they receive the notification that a review is due. These compliance reports are expected to be available for management review beginning the first quarter of 2011.</p>
07-072 District Offices	Budget Cuts Not Aligned with Strategic Business Plans for Training and Development	<p><i>This finding has not yet been remediated.</i> State Fund personnel have had an additional year of ECF exposure. Therefore, the necessity for significant training on ECF has been minimized.</p> <p>Many of the dates found in the claim reserve histories do not reconcile from DB2 to ECF. These dates ranged from</p>	<p><i>This finding has been partially remediated.</i> The ECF implementation audits have not yet been completed by Internal Audit as the ECF implementations are not complete by IT. Additional enhancements have been made to the supporting controls; however, differences in reserve dates and amounts between ECF and DB2 were</p>	<p>State Fund continues to work on systems enhancements to ensure the accuracy of the information in our databases which will fully remediate this control. We will continue to work on systems enhancements throughout 2011. Throughout this process, Internal Audit will conduct reviews of our systems at appropriate intervals.</p>

Functional Area	Summary of Finding	2008 Report Conclusion	2010 Report Conclusion	State Fund Response
		<p>differing by one day to exceeding 30 days. Examiners also noted instances where the reserve estimate amount in DB2 did not reconcile to the amount reported in ECF. DB2 should be timely interfacing with ECF to contain the most current information contained in ECF. Once DB2 and ECF interface, a reconciliation report should highlight any differences noted in the two systems.</p> <p>ECF is in need of additional functionality. Specifically, ECF should be regularly interfacing with DB2. ECF should also have the capability to process types of payments (i.e. compensation and medical) and the capability to capture fields necessary for payment processing. State Fund appears to be aware of these additional necessities. Given the strain on State Fund IT resources, the additional functionalities have not been implemented. State Fund should devote adequate IT resources to the development and implementation of additional functionality to ECF in order to maximize the business objectives and streamline claims processing. As of November 1, 2008 ownership of ECF is maintained by the IT Department.</p>	<p>still noted during testing at regional offices.</p>	<p>As part of our continuing efforts to enhance systems, new functionality was promoted in January 2009 to synchronize the posting of standard estimates in our databases, and in June 2010 the system was further enhanced to ensure that "paid costs" are consistently reflected across all of our systems when a claim is reopened. In October 2010, we also began developing enhancements to ensure that standard estimate amounts are consistent across systems.</p> <p>While additional system solutions have been in development, two Job Aids were released in March 2009 to assist the adjusting locations in resolving errors that occur during the daily transmission of information from one database to the other. In addition, during the first quarter of 2010, State Fund began generating quarterly reports to identify discrepancies between our databases. An additional Job Aid for resolving these discrepancies was developed and released in April 2010.</p>
07-081 District Offices	Stricter Controls Needed for Recurring Payments	<i>This finding has not yet been remediated.</i> Testing completed during the district office visits did not reveal any changes implemented to address this finding.	<i>This finding has not been remediated.</i> Based upon testing performed as part of the site visits conducted in June 2010 and status received on changes to ECF, no real progress has been made towards remediating this finding.	To mitigate this issue pending a systems solution, Claims sent formal direction on December 30, 2008 outlining adjusters' payment authority levels. The instructions established limits and required adjusters to clearly document

Functional Area	Summary of Finding	2008 Report Conclusion	2010 Report Conclusion	State Fund Response
				<p>the claims file with reason for any extension of definite payment beyond their definite payment authority level. The policy was reiterated again on August 31, 2009 and was reinforced with the Claims Reference Manual update on October 15, 2009.</p> <p>To ensure management oversight over definite payments and to fully remediate this finding, Claims has submitted a project proposal in September 2010 to promote new functionality which will generate an automatic escalation to the ACM when an adjuster's authority level has been reached. This escalation will require the ACM to review and approve an extension of definite payments when the adjuster's authority level has been reached. The proposal has been submitted for IT review and costing. Pending review and resource availability, IT will begin work on this functionality with an expected deliverable date of 2011.</p>
07-091 Business Services	Internal Audit of Fleet Management Needed	<i>This finding has been partially remediated.</i> State Fund did decrease the size of its fleet car inventory by approximately 200 vehicles. However, the removal of these vehicles was based on age, mileage and condition of the vehicle as opposed to the associated employee's business purpose for being awarded a fleet vehicle. An audit of the fleet management has not been performed by the State Fund Internal	<i>This finding has been partially remediated.</i> An audit of Fleet Management was performed and reviewed. State Fund was able to provide the updated procedures, effective August 1, 2010, for retaining the ARI monthly report reviews, but due to the majority of the processes/procedures being implemented in July, August or September 2010, this did not provide sufficient time to test the entire period.	<p>An audit of Fleet management was completed in 2010 and reviewed with the Board of Directors Audit Committee. Internal Audit is working with Business Services on completion of all needed remediation.</p> <p>In the meantime, State Fund leadership continues to review our Fleet practices and expects to announce shortly new policies that will further reduce the size</p>

Functional Area	Summary of Finding	2008 Report Conclusion	2010 Report Conclusion	State Fund Response
		<p>Audit since 2003. However, Internal Audit has included an audit of fleet management in its 2009 Audit Plan.</p> <p>Additionally, updated policies and procedures pertaining to Business Services Operations are yet to be complete or implemented. The estimated adoption date for updated policies and procedures is January 2009.</p>		<p>of the Fleet by July 2011 and assign vehicles to only a limited number of drivers who work full-time in field assignments outside of a State Fund office.</p>
07-092 Business Services	Reasonableness Tests to Compare Miles Versus Expenses Not Performed	<p><i>This finding has not yet been remediated.</i> State Fund has developed a spreadsheet to monitor the monthly mileage activity and gasoline expenses, and to verify vehicle maintenance. This spreadsheet will serve as a tool to facilitate the internal monitoring of mileage, gasoline expenses incurred and required maintenance. However, a monthly audit of the reasonableness of the miles traveled and corresponding gasoline expenses will not be performed until January 2009.</p> <p>Additionally, the process of completing these audits has not been documented or implemented as the updated policies and procedures for Business Services Operations remain incomplete. The State Fund estimated adoption date for updated policies and procedures is January 2009.</p>	<p><i>This finding has been partially remediated.</i> Employees are now required to enter mileage monthly in the ARI driver's website and the monthly travel logs are no longer required. ARI generates reminder emails to fleet drivers a few days before the mileage entry due date and the sixth day of the month if mileage has not been entered. ARI monthly sends Transportation Unit Administrators a listing of drivers who have not reported mileage timely. If mileage reporting is not completed within 30 days, Transportation Unit Administrators notify the drivers. If mileage reporting is not completed within 60 days, Transportation unit administrators notify driver's Program Managers. State Fund reviews monthly reports from ARI, but due to the majority of the processes/procedures being implemented in July, August or September 2010, this did not provide the examiner sufficient time to test the entire period. Also, quarterly vehicle inspections are lacking evidence of</p>	<p>This is a matter covered by our Internal Audit remediation plan with Business Services and full remediation is expected by year-end 2010.</p>

Functional Area	Summary of Finding	2008 Report Conclusion	2010 Report Conclusion	State Fund Response
			review and are not performed consistently.	
07-093 Business Services	Vehicle Mileage Audit Not Completed Periodically	<p><i>This finding has not yet been remediated.</i> A monthly audit of the reasonableness of the miles traveled was not performed by the close of the review.</p> <p>Subsequent to the close of the review, State Fund did perform its first audit for the reasonableness of miles traveled in November 2008.</p>	<p><i>This finding has been partially remediated.</i> State Fund has updated the policies and procedures for Fleet Management, but due to the majority of the processes/procedures being implemented in July, August or September 2010, this did not provide the examiner sufficient time to test the entire period.</p>	The policy and procedures have now been updated.
07-094 Business Services	Some Inequalities Exist Among Employee Benefits Regarding Fleet Vehicles	<p><i>This finding has not yet been remediated.</i> The current fleet management policy does briefly discuss the use of private vehicles. However, State Fund does not have a robust process for tracking personal vehicle use or encouraging personal vehicle use. Additionally, no audit of fleet management has been performed to assess compliance with the 50% travel requirement for fleet vehicle usage contained in State Fund policies.</p> <p>An audit of fleet operations to assess compliance with the 50% travel requirement is to be performed by June 2009. The policies and procedures pertaining to Business Services Operations are expected by State Fund to be finalized in January 2009.</p>	<p><i>This finding has been partially remediated.</i> The policy on utilizing personal vehicles for business travel reimbursement has been updated. We recommend State Fund maintain a centralized list of employees who have been authorized to use personal vehicles for business use or track the reimbursement. With the implementation of the new fleet policies, the job description requirement is no longer applicable. However, due to the job description testing performed in April 2010, it was identified that job descriptions need to be updated. Two of the 25 job descriptions could not be located and seven of the 25 job descriptions were outdated and date back to 2001 or 2002.</p>	<p>07-094, 08-31, 08-33 address similar issues. As part of the annual performance review process, supervisors are instructed to review the job description with the employee and revise if the job has changed substantially.</p> <p>To address the finding related to outdated job descriptions Executives, managers and supervisors are to review all job descriptions during the annual performance review process, whenever a vacant position is to be re-filled, or there is a substantive change in position duties. Human Resources will in turn monitor for such events and work with the Executives, managers and supervisors to update job descriptions as needed.</p> <p>As of May 2010, State Fund implemented and began using a new general ledger account for employee mileage reimbursements. The establishment of this ledger account allows for precise tracking of personal</p>

Functional Area	Summary of Finding	2008 Report Conclusion	2010 Report Conclusion	State Fund Response
				vehicle use.
07-095 Business Services	Large Backlog of Claims Files Not Filmed	<i>This finding has not yet been remediated.</i> State Fund engaged a consultant group to compile a Closed Claim Study detailing the options for file retention and storage. The results and recommendations from the Closed Claim Study were submitted to the Executive Committee for review on July 31, 2008. However, no decision has been made and no actions have been implemented to address this finding.	<i>This finding has been partially remediated.</i> As of August 27, 2010, 23,280 files have been scanned into the State Fund system out of the 51,240 files that have been prepared for scanning. The current anticipated completion date for scanning is December 2010.	As of August 27, 2010 there were 23,280 Closed Claims files waiting to be filmed. The current, anticipated completion date for this project is December 2010.
07-103 Business Services	Record Retention Policy Lacking	<i>This finding has not yet been remediated.</i> State Fund has taken steps to establish a new program solely dedicated to the records management function. However, the full implementation and operation of the new program is expected by State Fund to take 18-24 months. No changes to policies and/or procedures have taken place in the interim to address this finding.	<i>This finding has been partially remediated.</i> State Fund has taken steps to improve its record retention policies. Business Services has created retention schedules and these schedules have been submitted to the Records Management Department to maintain a central repository. An authorized policy has been established for the destruction, retention and scanning of claims files. State Fund should establish an authorized procedure for the destruction and retention of non-claim files.	An authorized procedure for the destruction and retention of non-claim files has been drafted and is currently under approval review.
07-107 Business Services	Lack of Adequate Vendor Background Check	<i>This finding has not yet been remediated.</i> State Fund has drafted new Supplier Identification and Qualification Guidelines. However, the new guidelines have not been finalized or implemented. The State Fund estimated adoption date for the guidelines is December 10, 2008. Contract testing revealed that background	<i>This finding has been partially remediated.</i> State Fund revised its procedures to now require background checks for vendors. State Fund is currently in the process of sending out required forms to vendors.	Procedures are in place to now require background checks for vendors. The timing of the audit did not provide sufficient time for testing.

Functional Area	Summary of Finding	2008 Report Conclusion	2010 Report Conclusion	State Fund Response
		checks are not being performed on vendors as recommended by examiners.		
07-110 Business Services	Circumvention of State Fund Procurement/ Budget Process	<p><i>The finding has been partially remediated.</i> State Fund has refined its Code of Conduct and related Unethical and Incompatible Activities Guidelines. The Code of Conduct will provide for reporting of unethical and incompatible activities through the Integrity in Action and Whistleblower Programs. However, the updated Code of Conduct has not been implemented. The State Fund estimated implementation date is January 2009.</p> <p>A review of the filed Statements of Economic Interest revealed that a number of high-level State Fund personnel are not required to file the Statements of Economic Interest.</p>	<p><i>This finding has been partially remediated.</i> State Fund estimates the completion of the new Code of Conduct by the 4th quarter of 2010 and the implementation of the new filings and certificates in 2011.</p>	The revised Code of Conduct has been submitted to the Policy Advisory Group prior to Executive review.

Exhibit 2: State Fund’s Remediation Efforts to 2008 Operational Review

The State Fund 2010 operational review included a review of the progress made towards addressing the 35 findings and recommendations included in the Operational Review Report issued in December 2008. The 2008 Operational Review Report contained findings and recommendations for the following areas: Board, Legal, General Management Practices, Management Information and Budget, Fiscal AP, Project Services Office, Brokerage, Manual Spreadsheets, ECF System, Information Technology Vendor Contracting (ITVC), Fleet Operations (Fleet), and Contracts and Purchasing. The table below provides a summary of the findings identified during our review by functional area and subsection: As of the October 1, 2010, the original 35 findings still have some outstanding work that needs to be completed.

See the matrix below for the Company and examiners’ 2010 response to 2008 Findings.

Functional Area	Summary of Finding	2008 Recommendation	2010 Report Conclusion	State Fund Response
08-07 Legal	No Procedure Established for Supervisory Reviews of Contracts	The new case management system should be configured to ensure that supervisor review and sign-off is enabled. This will provide evidence that the contracts were reviewed and demonstrate proper controls are in place.	<p><i>This finding has been partially remediated.</i> Enhancement of TeamConnect, the new case management system, was cancelled by the previous Chief Information Officer and is only now being considered in 2010. As such, there is no procedure established in Team Connect for a formal sign-off by supervisory legal staff, nor has it been configured to track supervisory review of contracts. While mitigating controls were in place, testing revealed that controls were not operating effectively, as no legal advice memos could be traced to the supervisory review support provided by State Fund Legal.</p> <p>State Fund Legal Program should maintain accurate spreadsheets that track the legal review process until Legal is able to configure Team Connect to track supervisory review of legal advice. In addition, State Fund Legal Program should provide the Contract and Purchasing Program a copy of the email</p>	<p>We are in the final phase of purchasing a contract management system. We anticipate this system will be installed in March 2011.</p> <p>In the interim the State Fund Legal Program has maintained an accurate spreadsheet that documents the dates of review by two levels of supervisors. In addition, the email(s) reflecting approval of the contract review by the two levels of supervisors is/are now uploaded into the Team Connect folder created for each contract review.</p> <p>State Fund Legal Program will begin the practice of advising the Contract Specialists that the requisite supervisory review of the contract legal advice has occurred.</p> <p>Effective December 1, 2010 Legal assumed responsibility for Contracts; and a unit of Contract Specialists from Contracts and Purchasing transferred to Home Office Legal’s Corporate Advice</p>

Functional Area	Summary of Finding	2008 Recommendation	2010 Report Conclusion	State Fund Response
			<p>from the lead attorney documenting that a supervisory review of the legal advice has occurred.</p> <p>State Fund did implement some manual controls for tracking supervisory review, but there were exceptions to this process during testing.</p>	<p>and Transactions Department. These Contract Specialists will assist in the management of contracts. We are in the process of developing “perfect forms” templates that will allow us to manage the intake of contract requests and track contract requests. These forms will be used until State Fund purchases a contract management system.</p>
08-19 Fiscal AP	Recurring Expenses at the District Offices are based on Obsolete Contracts	Old contracts should be amended to meet the prevailing needs of the district office. Also, such new contracts should be maintained in Oracle. The Business Services Program Manager needs to ensure that district offices are utilizing current contracts as the contract process is controlled by Business Services.	<i>This finding has been partially remediated.</i> State Fund is in the process of re-bidding old contracts and maintaining contracts in the Oracle system. The target completion date per State Fund is December 31, 2010.	State Fund expects completion by December 31, 2010.
08-21 PSO	Lack of Cost Comparisons, Monitoring of Completed Projects and Explanations for Cancellation of Projects	<p>The PSO should ensure that each project presents several alternative options with different price points. This would help to ensure that the most reasonable cost alternative is selected for the project.</p> <p>Savings identified for projects should have adequate support such as Return on Investment (ROI) and/or other related relevant documentation.</p> <p>The PSO should continue to monitor projects after completion to determine whether time and costs savings estimates were achieved. This could be a useful tool for monitoring the success of completed projects in quantitative terms.</p> <p>The PSO should define and require</p>	<i>This finding has been partially remediated.</i> Review of 2009 and 2010 Project Portfolios indicates that budgets are monitored over the course of each project. However, due to organizational changes in 2009 and early 2010, the PMO process is too new to evaluate at this time.	<p>(1) Project proposals may have alternative options when appropriate. In addition, Enterprise Architecture (EA) reviews all proposals to avoid redundancy in applications thus preventing unnecessary cost.</p> <p>(2) Project proposals that are not regulatory require Return On Investment (ROI)</p> <p>(3) There is a plan to create a follow up process after a project has closed. This process is under discussion and IT is planning to implement this process in the 3rd quarter of 2011.</p> <p>(4) This was implemented in March 2010.</p>

Functional Area	Summary of Finding	2008 Recommendation	2010 Report Conclusion	State Fund Response
		<p>management approval for project cancellation given the high costs associated with projects. The documentation should include a section outlining the reasons the project was cancelled. Additionally, the steering committee minutes should review the detailed reasons behind the cancellation.</p>		
08-23 PSO	Lack of Supporting Documentation Provided to Steering Committees	<p>The PSO should require that detailed support be provided along with return on investment calculations so that the steering committees can assess whether the calculation is reasonable.</p> <p>The PSO office should develop quality assurance practices and measurable benchmarks to ensure that data in the project proposals and status reports is verified for completeness and accuracy before submitting to the steering committees.</p>	<p><i>This finding has been partially remediated.</i> The current PMO project management process has changed several times over the past two years and has only recently been documented. The establishment of Functional Steering committees, Executive Status Reports (ESRs) and the use of an ROI calculator may result in transparency of project budgets, but the effectiveness of the new process cannot be tested at this time. In addition, the Planview tool has not been fully deployed, so there is no single repository of project documentation.</p>	<p>(1) ROI information is provided on proposal documentation.</p> <p>(2) There are currently quality assurance practices and measurable benchmarks in place. For project proposals, the business and IT sponsors discuss, create, and review a proposal before submission to the Project Management Office (PMO). PMO reviews and concurrently sends the proposal to Fiscal, EA, Security & Information Management (SIM), and Contracts & Purchasing for their reviews before submission to Functional Steering committees (FSCs) for their review and vote.</p> <p>For an ESR, the project manager is responsible for quality assurance and the PMO coordinator reviews it.</p> <p>ESRs are monitored using measurable benchmarks to ensure they are being completed timely. There is also a process in place to notify managers, sponsors, and FSC members if ESRs are not completed timely.</p>
08-26	Lack of	Actuarial personnel should maintain a	<i>This finding has been partially</i>	

Functional Area	Summary of Finding	2008 Recommendation	2010 Report Conclusion	State Fund Response
Manual Spreadsheets	Formalized Spreadsheet Review and Protection	<p>copy of the reviewed spreadsheets including the signature of the peer reviewer, the date the review was performed and appropriate documentation to illustrate the specific cells and amounts that were reconciled to source documents. This documentation will serve to demonstrate a more robust review of the key actuarial spreadsheets.</p> <p>Actuarial personnel should add cell protection to key spreadsheets and workbooks they maintain. Cell protection will prevent inappropriate changes or deletions to formulas contained on a cell by cell basis. Additionally, actuarial personnel should password protect key spreadsheets and workbooks to prevent unauthorized access to this information. As the actuarial data can have a material impact on the financial statements and reserve methodology, it is important to implement safeguards when using spreadsheets of this nature.</p> <p>Procedures detailing the maintenance and updating of the key actuarial spreadsheets and workbooks should be formally documented. Formal documentation of these procedures will ensure that the process is standardized in the event that different actuarial personnel must perform these duties.</p>	<p>remediated. State Fund has adopted procedures to formalize spreadsheet review and protection including authorized procedures, peer review, password and cell protection. However, several of the worksheets tested showed no proof of peer review. State Fund confirms that their written procedures fail to specify that the reviewer should initial and date the worksheet. State Fund should revise their procedures to include the peer review sign-off.</p>	<p>The procedure has been updated with this revision and shared with all Actuarial staff. However, this procedure was completed subsequent to the operational review and was not tested during the review.</p> <p>The spreadsheet review for 3rd quarter end of 2010 has already incorporated this updated procedure. The reviewer now initials and dates on every worksheet he/she reviews.</p>
08-30 ITVC	Contract Documentation Needs	Documents that comprise a contract package should contain a common contract reference number to support	<p>This finding has been partially remediated. Current templates are being used and contract terms are in</p>	State Fund's Legal Program maintains an accurate spreadsheet that documents the dates of review by two levels of

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	Enhancement	<p>future contract dispute resolution.</p> <p>To support future dispute resolutions, State Fund should maintain contract records evidencing the vendor's signature and date signed to document agreement of contracting terms.</p> <p>The contract package documents should include language that identifies the prevailing contract document. Contract package documents should have the same contract terms. Future dispute resolution should be minimized if the prevailing contract document and all supporting documents have like terms.</p>	<p>compliance with current guidelines. Evidence of appropriate review by Legal was not always evident in the contracts tested.</p>	<p>supervisors. In addition, the email(s) reflecting approval of the contract review is/are now uploaded into the Team Connect folder created for each contract review.</p> <p>The Legal Program will begin the practice of advising the Contract Specialists that the requisite supervisory review of the contract legal advice has occurred.</p> <p>The contract management system is in the final phase of selection and purchase. It is anticipated that this system will be installed in March 2011. Once the system is in place, it will document the requisite legal supervisory reviews of contracts.</p>
08-31 Fleet	Fleet Management Corporate Guidelines Not Consistently Reviewed or Defined	<p>Fleet Guidelines should be reviewed periodically and updated as needed to support State Fund's strategic plans and the current operating environment. In addition, a review of guidelines should be documented to evidence the assessment process. Internal Audit should regularly examine this unit.</p> <p>Positions that qualify for vehicles should be reviewed by the appropriate State Fund personnel to determine if their travel requirements or need basis satisfies the guidelines. The guideline and the job descriptions on file with HR should be updated to reflect the need basis criteria or the travel percentage required. In addition, both the guideline and job</p>	<p><i>This finding has been partially remediated.</i> Fleet guidelines were updated and put into effect July 1, 2010 and September 1, 2010.</p> <p>Procedures have been changed to include wording for assigning vehicles only based on "substantial business need" which includes; driving at least 5,000 business miles in a six month period or being required to travel to locations other than the employee's assigned office location on at least 60% of the available work days in a six month period.</p> <p>Executive management and Program Managers have until December 31, 2010 to turn in vehicles if they do not meet the</p>	<p>State Fund has reevaluated and updated our fleet policy to more clearly identify those positions that have a substantial business need for a car. State Fund has plans to further restrict assigned cars to those staff that do not have an assigned desk and are in the field meeting with clients the majority of their work day. Other business use will be handled via pool cars and/or personal miles reimbursement.</p>

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		<p>descriptions should be updated periodically to reflect changes in State Fund's operations. Other positions that are allowed vehicle assignment should be reviewed by State Fund management and HR to determine proper expense classification.</p> <p>Fleet management operations should be centralized under the Business Services/ Transportation Unit. The centralization will allow for better controls over the following functions: monitoring of the assignment of vehicles, redistribution of vehicles, vehicle maintenance/usage reporting and pool car utilization.</p>	<p>requirements and all other drivers have until June 30, 2011.</p> <p>With the implementation of the new fleet policies, the job description requirement is no longer applicable. However, due to the job description testing performed in April 2010, it was identified that job descriptions need to be updated. Two of the 25 job descriptions could not be located and seven of the 25 job descriptions are outdated and date back to 2001 or 2002.</p>	
08-33 Fleet	Job Descriptions Not Reviewed or Updated Timely Regarding Fleet Car Assignment	Job responsibilities should be reviewed and updated timely to ensure any changes in responsibilities are appropriately reflected in the job descriptions maintained by HR. Job responsibility changes may have an effect on the employee's eligibility for a fleet car.	<i>This finding has been partially remediated.</i> With the implementation of the new fleet policies, the job description requirement is no longer applicable. However, due to the job description testing performed in April 2010, it was identified that job descriptions need to be updated. Two of the 25 job descriptions could not be located and seven of the 25 job descriptions are outdated and date back to 2001 or 2002.	07-094, 08-31, 08-33 address similar issues. As part of the annual performance review process, supervisors are instructed to review the job description with the employee and revise if the job has changed substantially. <p>To address the finding related to outdated job descriptions Executives, managers and supervisors are to review all job descriptions during the annual performance review process, whenever a vacant position is to be re-filled, or there is a substantive change in position duties. Human Resources will in turn monitor for such events and work with the Executives, managers and supervisors to update job descriptions as needed.</p>