



SAIF CORPORATION

BOARD OF DIRECTORS AUDIT COMMITTEE

**Wednesday
December 10, 2008
8:30 a.m.**

**SAIF Corporation
400 High Street SE
Salem, Oregon**

After determining a quorum was present, the meeting was called to order at 8:49 a.m.

Roll Call:

John Endicott
Catherine Travis

SAIF Corporation Personnel Present:

Brenda JP Rocklin, President and CEO
Cathy Pollino, Chief Internal Auditor
Casey Baumert, Corporate Internal Auditor
Chris Davie, Vice President of Corporate Policy and External Affairs
Jerry Dykes, Chief Financial Officer
Michelle Graham, Vice President of Claims
Michael Hartman, Vice President of Underwriting Services
Pamela Jordan, Vice President of Administrative Services
Gina Manley, Financial Reporting Manager
Theresa McHugh, Vice President of Financial Services
Mike Mueller, Senior Vice President of Claims and Legal Services
Garry Robinson, Vice President of Information Services
Colleen Sealock, Vice President of Operations and Human Resources
Steve Snyder, Vice President of Fraud and Investigations
Shawn Wright, Chief Actuarial Officer
Stephanie Robinson, Assistant Pro Tem to the Board

Others Present:

Andrea Dooley, KPMG
Geoff Hill, Secretary of State, Audits Division
Juli Kennedy, Secretary of State, Audits Division
Karen Saunders, KPMG
Elisa Stilwell, KPMG

Approval of Audit Committee Minutes

Motion Ms. Travis, second Mr. Endicott to approve the minutes of the September 10, 2008 meeting. The vote was unanimous, and the motion was carried.

Secretary of State Financial Audit

Karen Saunders of KPMG reviewed the roles and responsibilities SAIF management and KPMG had during the audit period.

Elisa Stilwell addressed the changes to the initial 2007 audit plan. Deficiencies related to the information system general controls were encountered. As a result of those deficiencies, KPMG was not able to rely on system-generated reports from either the WCIS or Legacy systems. KPMG modified its approach in the areas that were affected by those systems - premiums and losses.

One audit adjustment was noted relating to reinsurance recoverables. There were no unrecorded audit adjustments. In the GAAP financial statements, two omitted disclosures under GASB 40 were noted – one related to disclosure of investments that are sensitive to interest rate changes, and the other related to a disclosure for the credit quality ratings of debt securities by type of investment. KPMG and SAIF management have agreed that these omitted disclosures were not significant or material to the financial statements taken as a whole.

Ms. Saunders advised that KPMG identified four significant deficiencies during the course of the audit. None of the areas identified was considered to be a material weakness.

The four significant deficiencies in internal controls related to:

- Reinsurance recoverable
- IT – administrator and superuser access
- IT – administrator access and user provisioning
- IT – review of user access

Reinsurance Recoverable:

- Reinsurance recoverable on unpaid losses was overstated by \$1.3 million as a result of an error in the spreadsheet that calculates the amount recorded. KPMG recommended that SAIF put a review process in place to ensure the accuracy of the spreadsheet for reporting into the financial statements.
- SAIF management agreed with the recommendation. The spreadsheet has been reviewed and a column added to cap the expected recovery for each reinsurance treaty. The SAIF actuaries will review the data and calculations in the spreadsheet on a quarterly basis. Reinsurance contracts will be reviewed separately by SAIF actuaries to ensure that the spreadsheet properly reflects the language of each contract.

IT – Administrator and Superuser Access:

- KPMG identified a generic user within the WCIS system. KPMG determined that the password to this account was not controlled, and increased the risk of unauthorized or inappropriate access to programs and data. KPMG recommended that a detailed review of all system accounts be performed.

- SAIF management agreed with the recommendation. In this instance, the generic user identified was an unused account that has since been deleted. SAIF Information Systems has completed a detailed review of all administrator accounts and confirmed that all are assigned to authorized individual users.

IT – Administrator Access and User Provisioning

- KPMG noted that, for both the WCIS and Legacy environments, administrators with developer rights have access to modify code and promote their own changes to the production environment. Changes to the production environment were found to be lacking proper evidence of testing and approval. KPMG recommended that SAIF either limit the level of access the developers have or implement a control that would provide assurance to the integrity of the change management process.
- SAIF management agreed with the recommendation. Controls are now in place that prevent developers from promoting their own code. KPMG's finding identified an exception where two individuals, due to staffing efficiencies, were responsible for administration duties as well as for code development. In this specific circumstance, a detective control will be put in place to assure the integrity of the change management process.

IT – Review of User Access

- KPMG found that SAIF did not conduct a user review for WCIS or Oracle users in 2007. KPMG recommended that a periodic review be undertaken for user access to all financially relevant applications, databases, and operating systems.
- Management agreed with the recommendation. SAIF completed a manual review of WCIS and Oracle users in September 2008. An automated process is under development.

One new and significant accounting policy change was identified. SAIF adopted GASB Statement No. 45. There were no other significant or unusual transactions, or controversial areas.

There were several financial reporting risks and issues that were tested during this review:

- *RISK: SAIF's investment portfolio is inappropriately valued.* KPMG reviewed the impairment analysis prepared by SAIF, and found it to be appropriate. KPMG independently valued the assets in the portfolio by using KPMG's pricing service and reviewing third party financial statements for the alternative investments that SAIF holds. There was one investment that was backed by sub-prime mortgages, which was properly disclosed in the financial statements.
- *RISK: A high degree of judgment and actuarial analysis/estimation exists in determining the reserves for losses and loss adjustment expenses.* KPMG performed test work to verify the accuracy of the statistical loss data included in the actuarial study used to estimate reserves. KPMG actuaries reviewed SAIF's in-house actuarial study, as well as the study of board-appointed actuary Rick Sherman, and determined that reserves were reasonable.

- *RISK: An accurate estimation of the earned but unbilled portion of premiums earned involves judgment and complex analysis.* Test work was done on earned premium that was being calculated by the WCIS and Legacy systems. KPMG actuaries reviewed SAIF's calculations of the earned but unbilled estimate, as well as the retrospective rating plan accrual estimates, and determined them to be reasonable.
- *RISK: Recoverability of reinsurance receivables on paid and unpaid losses.* KPMG evaluated the credit ratings of the reinsurers and reviewed SAIF's historical experience with the reinsurers. No issues were noted.
- *RISK: Non-GAAP and non-statutory accounting policies.* Based on KPMG's test work and discussions with management, there was nothing significant identified.

Ms. Saunders reported that there were no specific fraud risks identified. There were no other findings, issues, or other matters noted during the review.

Mr. Hill advised that the Secretary of State Audits Division will be issuing the state's Comprehensive Annual Financial Report at the end of March 2009, in which the four deficiencies identified by KPMG will be included, together with the response of SAIF's management.

There was a discussion regarding the contract process for appointing the audit firm and the timing of the 2007 audit which was performed during this year. It was noted that the Office of the Secretary of State is responsible for contracting with the audit firm. The contract with KPMG is for a two-year period; therefore, KPMG will be conducting the 2008 audit as well. It is expected that the 2008 audit will follow a more normal schedule.

DCBS Financial Exam

Ms. McHugh advised that DCBS is very close to completing its examination. The actuarial report should be done within the next week. SAIF management expects to get a draft of the DCBS report by the end of this year, or in early 2009.

Management of Retrospective Rating Plans Audit

The purpose of this audit was to review aspects of SAIF's retrospective rating plans, including timing of plan closures, selection of loss picks, and the accuracy of the factors used in determining retro plan premiums.

Ms. Pollino reported that in reviewing 34 retro policies that were closed before the fifth evaluation period, five were found to have been prematurely closed. For three of those five, the loss development had exceeded the buyout charge. On the remaining two policies, not enough time has passed to accurately predict whether enough premium was collected to cover the ultimate cost of the open claims.

Ms. Pollino also reported that some minor errors were found in the spreadsheet used to determine the maximum premium values and cost containment factors. Only one error had a potential to impact a policyholder, and that was identified prior to the release of the quote. Internal Audit is recommending that some additional controls be placed on the spreadsheet.

While it is not possible to predict an insured's future losses with absolute accuracy, Internal Audit found that most of the loss picks appeared to be appropriate.

Collection Activities Audit

The purpose of this audit was to determine whether collection activities on cancelled policies were accurate and timely.

Ms. Pollino reported that collection activity was not always timely. At the time of the audit there were numerous staffing and job duty changes occurring that may have impacted the results of the audit. Ms. Pollino advised that benchmarks have been established starting at policy cancellation, continuing throughout the collection process. Internal Audit recommends that consideration be given to automating additional parts of the collection process or, in the alternative, determining whether exception reports can be enhanced so that collection activities can be better monitored. Ms. Pollino reported that, in general, collection activities were handled appropriately. Ms. Pollino also reported that the billing and collection system was not always in sync with the legal collections system, and resulted in some invoices being sent where no money was owed.

Ms. Travis stated that, in her opinion, the timelines for collection activities need improvement.

Leave Time Review Audit

The purpose of this audit was to review employee leave time tracked by the automated time system to ensure that employees were not being charged for leave time hours over holidays and weekends, or for too many hours.

Ms. Pollino reported that some leave time was not being charged against leave balances properly. Employees request leave time through the automated system (Workforce Central). Some instances were found where employees were manually entering their leave time and, subsequently, the supervisor was approving that leave time through the automated system, which resulted in a double entry. In other instances, leave requests that crossed over holidays or weekends resulted in leave time being charged for those days not normally worked. Workforce Central is not currently set up to distinguish between working and non-working days. Internal Audit recommends exploring whether there is a feature available on Workforce Central that would alert employees and supervisors when inappropriate entries occur. Internal Audit also recommended that more training be provided to employees and supervisors on how to record unique leave situations and to ensure that all leave reports are reviewed and approved/disapproved in a timely and accurate manner.

Ms. Pollino reported that the hours identified in this audit have been credited back to employees' leave accounts or transferred to the correct leave type.

2008 Audit Update

Ms. Pollino provided the Audit Committee with a draft of the report of SAIF's audit activity for 2008. With input from the Audit Committee, the finalized report will be provided to the full Board of Directors at its meeting in February 2009. The report includes the proposed 2009 Internal Audit Plan.

Motion Ms. Travis, second Mr. Endicott to approve the 2009 Internal Audit Plan. The vote was unanimous, and the motion was carried.

Ms. Pollino also provided the committee with a copy of last year's risk assessment and informed the committee that many of the same risks are being evaluated as part of the Model Audit Rule work. As a result, Internal Audit plans to postpone a complete update of the risk assessment until the Model Audit work is complete to avoid duplicate effort.

Model Audit Update

Deloitte and Touche are on site, and the contract work is currently on schedule. The entity level control and payroll portions are near completion, and Deloitte and Touche is currently working on financial reporting, expenditures, investments, and premiums. In January, they will begin working on claims, general controls in IS, and real estate and property.

Future Meetings

The Audit Committee members agreed to continue quarterly Audit Committee meetings in 2009.

Other Business

The Audit Committee members met with the Internal Audit staff without other staff present.

There being no further business, the meeting adjourned at 10:02 a.m.

Stephanie Robinson, Assistant Pro Tem to the Board