



October 23, 2009

Mr. David E. Wilson, Chief Executive Officer
Conservation & Liquidation Office
425 Market Street, 23rd Floor
San Francisco, CA 94105

Dear Mr. Wilson:

Final Report—Conservation & Liquidation Office Internal Control Review

The Department of Finance, Office of State Audits and Evaluations, has completed its internal control review of the Conservation & Liquidation Office (CLO) as of March 31, 2009.

The CLO's response has been incorporated into the enclosed report. The CLO generally agreed with our observations and we appreciate its willingness to implement corrective actions. The observations in our report are intended to assist management in improving its operations.

In accordance with Finance's policy of increased transparency, this report will be placed on our website. We appreciate the assistance and cooperation of the CLO. If you have any questions regarding this report, please contact Kimberly Tarvin, Manager, or Rick Cervantes, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

David Botelho, CPA
Chief, Office of State Audits and Evaluations

Enclosure

cc: Mr. Ray Minehan, Chief Financial Officer, Conservation & Liquidation Office
Ms. Regina Alava, Vice President of Finance, Conservation & Liquidation Office
Mr. Ed Hahn, Vice President of Estate Finance Group, Conservation & Liquidation Office
Mr. Keith Nelson, Chief, Ethics and Operational Compliance Office, California Department of Insurance
Mr. Jesse Huff, Chair, Audit Committee, California Department of Insurance

AN INTERNAL CONTROL REVIEW

Conservation & Liquidation Office
As of March 31, 2009

Prepared By:
Office of State Audits and Evaluations
Department of Finance

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EXECUTIVE SUMMARY

The Department of Finance, Office of State Audits and Evaluations (Finance), performed a review of CLO's Combined Internal Control Matrix. The objective of our review was to report on the sufficiency of CLO's internal control and to identify control deficiencies.

While most of the controls reviewed were effective and functioning as intended, several control deficiencies were identified. None of the control deficiencies identified were considered material weaknesses. However, if left uncorrected these control deficiencies increase the risk that misstatements may not be prevented or detected on a timely basis. See Tables 1 and 2 below for a summary of the internal control areas reviewed and the results.

Table 1: Summary of Internal Control Review Results

| Control Areas | Controls Tested | Unable to Test Due to No Transactions* | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness |
|-------------------------------------|-----------------|--|-------------------|-----------------------|-----------------|---------------------|
| Period Closing | 3 | 0 | 3 | 0 | 0 | 0 |
| Accounts Receivable | 4 | 0 | 3 | 1 | 0 | 0 |
| Accounts Payable | 9 | 0 | 7 | 2 | 0 | 0 |
| Cash Management | 10 | 0 | 10 | 0 | 0 | 0 |
| Investment Management | 7 | 0 | 7 | 0 | 0 | 0 |
| Estate Management | 5 | 0 | 4 | 1 | 0 | 0 |
| Taxes | 3 | 0 | 2 | 1 | 0 | 0 |
| Claims/Databases | 9 | 1 | 3 | 4 | 1 | 0 |
| Distributions | 10 | 0 | 10 | 0 | 0 | 0 |
| Estate Closures | 2 | 0 | 1 | 1 | 0 | 0 |
| Reinsurance | 6 | 2 | 3 | 1 | 0 | 0 |
| Compensation | 4 | 0 | 3 | 1 | 0 | 0 |
| Control Environment/Risk Assessment | 3 | 0 | 3 | 0 | 0 | 0 |
| Information and Communications | 1 | 0 | 1 | 0 | 0 | 0 |
| Total | 76 | 3 | 60 | 12 | 1 | 0 |

* There were no transactions related to the control during the review period January 1, 2008 through March 31, 2009.

Table 2: Summary of Prior Finding Resolution Results

| Control Areas | Controls Tested | Resolved? | | | Unable to Test Due to No Transactions* |
|----------------------------------|-----------------|-----------|-----------|----|--|
| | | Yes | Partially | No | |
| Records Retention Access | 1 | 1 | 0 | 0 | 0 |
| Claims | 1 | 0 | 0 | 0 | 1 |
| Estate Management | 1 | 1 | 0 | 0 | 0 |
| Estate Closure | 4 | 4 | 0 | 0 | 0 |
| Distributions | 7 | 5 | 2 | 0 | 0 |
| Reinsurance | 3 | 0 | 2 | 0 | 1 |
| Purchasing & Fixed Asset Tagging | 2 | 2 | 0 | 0 | 0 |
| Period Closing | 1 | 1 | 0 | 0 | 0 |
| Total | 20 | 14 | 4 | 0 | 2 |

*There were no transactions related to the control during the review period January 1, 2008 through March 31, 2009.

BACKGROUND, SCOPE, AND METHODOLOGY

BACKGROUND

The California Department of Insurance (Department) takes a leading role to conserve, rehabilitate, or liquidate licensed California financially distressed and insolvent insurance enterprises under appointment by the Superior Courts. The Department's involvement helps secure consumer interests and provide for a stable, consistent insurance market.

The Conservation & Liquidation Office (CLO), created in 1994 to be the successor of the Conservation & Liquidation Division of the Department, is appointed by the California Insurance Commissioner (Commissioner) to oversee the affairs of financially impaired insurance enterprises domiciled in California. The vast majority of financially impaired insurance enterprises will be liquidated.

For enterprises liquidated, the Commissioner, acting through the CLO, assumes title of the enterprise's assets. The insurance enterprise offices are closed, all outstanding policies are cancelled, and the process of obtaining and liquidating the enterprise's remaining assets begins. The books and records of the enterprise are acquired by the CLO for use during this process. The goal of liquidation is to apply the money acquired from liquidating the enterprise's assets toward the enterprise's debts and outstanding insurance claims. Upon issuance of a liquidation order, the CLO issues a notice to all interested parties, including the enterprise's policyholders, creditors, and shareholders. The notice requests proofs of claim be filed with the CLO in order to participate in a distribution of assets. An enterprise subject to a conservation or liquidation order is referred to as an estate. The costs of the CLO administration are borne by the estate of the insolvent entity. For estates with no assets, the California Insurance Fund supplements the costs. The process of conservation and subsequent liquidation can take several years.

The CLO has oversight responsibilities for 26 open estates and 3 trusts of liquidated insurers. As of December 31, 2008, the 26 open estates and 3 open trusts had combined assets and liabilities of \$1,840,500,569 and \$8,276,375,332, respectively. CLO also has oversight for 17 closed estates with closing balances totaling \$1,646,330 at December 31, 2008. In 2008, the CLO made interim and final distributions totaling \$380 million and closed one estate.

SCOPE

The Department of Finance (Finance) performed an internal control review. The objective of this review was to report on the sufficiency of internal controls and to identify control deficiencies in effect as of March 31, 2009. Specifically, we examined the following areas:

- Period closing
- Accounts receivable
- Accounts payable/purchasing
- Cash management
- Investment management

- Estate management
- Taxes
- Claims/databases
- Distributions
- Estate closures
- Reinsurance
- Compensation
- Control environment/risk assessment
- Information and communication

We also reviewed the status of prior audit findings reported in the April 2007 CLO Internal Control Report. However, we did not review information technology controls because these controls are examined by another entity.

METHODOLOGY

To determine whether the controls were functioning as intended, we performed the following:

- Gained an understanding of CLO's critical functions and operations.
- Reviewed the Combined Internal Control Matrix.
- Selected a sample of 76 of the 178 controls listed in the Combined Internal Control Matrix for review.
- Interviewed CLO staff.
- Reviewed documentation from the period January 1, 2008 through March 31, 2009 to evaluate the controls selected for review.

The results in this report are based on fieldwork performed between April 27, 2009 and July 2, 2009. We discussed the results of the review with management throughout our fieldwork. The summary of controls and prior audit findings reviewed are presented in the Results section of this report. We determined:

- Whether the selected controls were:
 - Fully Functioning
 - Partially Functioning
 - Not Functioning
- For controls either partially or not functioning¹, we determined whether the control deficiencies represented a significant deficiency² or material weakness³.
- Whether findings from the 2007 Internal Control Review were:
 - Resolved
 - Partially Resolved
 - Not Resolved

¹ A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

² A significant deficiency is a control deficiency, or combination of control deficiencies, that would adversely affect CLO's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles or other appropriate basis (i.e. liquidation basis) such that there is more than a remote likelihood that a misstatement of the CLO's financial statements that is more than inconsequential will not be prevented or detected by CLO's internal control.

³ A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by CLO's internal control.

The Conservation & Liquidation Office (CLO) management is responsible for establishing and maintaining an effective system of internal control including documenting the system, communicating the system requirements to employees, assuring the system is functioning as designed, and modifying the system as changes in conditions warrant.

Results

Of the 76 controls sampled, 60 controls were functioning as intended, 12 controls were partially functioning, 1 control was not functioning, and we could not evaluate 3 controls because there were no transactions related to the control during the review period of January 1, 2008 through March 31, 2009. Controls that were only partially functioning or not functioning as intended were identified as control deficiencies. None of the control deficiencies identified were considered material weaknesses. However, if left uncorrected, these control deficiencies increase the risk that misstatements may not be prevented or detected on a timely basis. Appendix A presents the detailed results for each control reviewed.

Prior Finding Resolution

Of the 20 findings previously reported in the CLO Internal Control Review as of April 2007, 14 findings were fully resolved and 4 findings were partially resolved. We were unable to verify whether two prior findings were resolved because no related transactions occurred during the review period of January 1, 2008 through March 31, 2009. Appendix B presents the detailed results for each finding reviewed for resolution.

Appendix C provides definitions of acronyms used in this report.

This report is intended for the information and use of the California Department of Insurance and CLO management and is not intended to be and should not be used by anyone other than the specified parties. However, this restriction is not intended to limit the distribution of this report, which is a matter of public record.

APPENDIX A

Internal Control Review Results

| Sample Number | Control Areas | Control Number | Control Activity | NA | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness | Comments |
|---------------|---------------------|----------------|--|----|-------------------|-----------------------|-----------------|---------------------|----------|
| 1 | Period Closing | 1.01.01 | The Sr. Financial Accountant—Cash & Investments publishes a closing schedule about a week before the end of the month listing the key steps and interdependencies in order to close the month. | | X | | | | |
| 2 | Period Closing | 1.01.04 | The ability to create new (object) accounts in the JDE GL system is restricted to the VP of Finance and to the Accounting Supervisor—AP & GL. | | X | | | | |
| 3 | Period Closing | 1.01.05 | The Accounting Technician III prepares the Budget Variance Summary Report that highlights the significant variances from budget. | | X | | | | |
| 4 | Accounts Receivable | 1.02.02 | On a monthly basis, Claims prepares a spreadsheet showing the beginning and ending balances, reductions to the balance such as collections, and increases | | X | | | | |

| Sample Number | Control Areas | Control Number | Control Activity | NA | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness | Comments |
|---------------|---------------------|----------------|--|----|-------------------|-----------------------|-----------------|---------------------|---|
| | | | such as new "first notices." The Estate Financial Analyst reconciles the balances to the general ledger. | | | | | | |
| 5 | Accounts Receivable | 1.02.03 | On a quarterly basis the EFG reviews the fluctuations in the receivable balances. | | X | | | | |
| 6 | Accounts Receivable | 1.02.04 | On a monthly basis, the Accounting Tech III reconciles the Other Receivables spreadsheet with the JDE GL. The reconciliation is reviewed and approved by the VP of Finance. | | | X | | | The Other Receivables spreadsheet (Cost/Benefit) did not foot and did not include two estate balances per the GL (Mission National and Fremont Life). |
| 7 | Accounts Receivable | 2.03.02 (NEW) | The Collections Specialist maintains and updates all premium collection activity and provides accounting with a monthly summary financial report. | | X | | | | |
| 8 | Accounts Payable | 1.03.01 | On a quarterly basis, the AP Accounting Technician II reviews the Audit Log Report and the Accounting Supervisor—AP & GL approves the Audit Log Report when all clarifications and updates have been made. The Accounts Payable group will sign off on the report. | | X | | | | |
| 9 | Accounts Payable | 1.03.04 | The Accounting Supervisor—AP & GL verifies that the payees in | | X | | | | |

| Sample Number | Control Areas | Control Number | Control Activity | NA | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness | Comments |
|---------------|------------------|---------------------|---|----|-------------------|-----------------------|-----------------|---------------------|--|
| | | | the payment group are the same as the vendors/employees/contract holders and the amounts paid match the amounts invoiced/reimbursed/distributed. | | | | | | |
| 10 | Accounts Payable | 1.03.05 and 1.03.07 | Blank check laser paper stock is stored and locked in an office separate from the check printer. Bank account number and check number is not printed on each blank check paper until the check run process is completed using JDE E1 Systems. (Vendor and Distribution blank check stock) | | | X | | | A portion of the blank check paper was stored in a locked cabinet in the same office as the printer. |
| 11 | Accounts Payable | 1.03.06 | The AP Accounting Tech II maintains an AP check log spreadsheet that shows check numbers used on each check run date. The log is reviewed by the VP of Finance prior to printing the check. | | X | | | | |
| 12 | Accounts Payable | 1.03.08 | The AP Accounting Tech II maintains a Distribution check log spreadsheet that shows check numbers used on each check run date. The log is reviewed by the VP of Finance prior to printing the check. | | X | | | | |
| 13 | Accounts Payable | 1.03.09 | The AP Accounting Tech II scans a copy of each signed check, attaches it | | X | | | | |

| Sample Number | Control Areas | Control Number | Control Activity | NA | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness | Comments |
|---------------|------------------|----------------|---|----|-------------------|-----------------------|-----------------|---------------------|--|
| | | | with invoices and documentation in Image Right. | | | | | | |
| 14 | Accounts Payable | 1.03.11 | The Accounting Supervisor AP & GL reviews vendor vouchers against invoices. The VP of Finance reviews specific invoice images and prints the checks. CFO reviews a listing of all checks over \$20,000. | | X | | | | |
| 15 | Accounts Payable | 1.03.12 | For distribution checks issued through JD Edwards, the VP of Finance reviews the printed checks and verifies them to supporting documents. For non-JD Edwards distribution checks, the EFG verifies the check register to the claims register | | X | | | | |
| 16 | Accounts Payable | C 6.2.2 | The Facilities supervisor is responsible to review the AMEX travel account statement to ensure that the charges are appropriate before authorizing the statement to be paid. | | | X | | | The airline travel on the AMEX statements are not traced to the approved CLO travel forms. |
| 17 | Cash Management | 1.05.02 | The VP of Finance reviews the monthly checklists of accounts and reviews the bank matrix for the estate bank accounts. She signs off signifying her approval. | | X | | | | |
| 18 | Cash Management | 1.05.03 | The VP of Finance reviews the monthly checklists of accounts and reviews the bank matrix for the CLO | | X | | | | |

| Sample Number | Control Areas | Control Number | Control Activity | NA | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness | Comments |
|---------------|-----------------|----------------|---|----|-------------------|-----------------------|-----------------|---------------------|----------|
| | | | bank accounts. She signs off signifying her approval. | | | | | | |
| 19 | Cash Management | 1.05.04 | The Sr. Financial Accountant—Cash & Investments verifies on the payroll bank reconciliation that the payroll ZBA bank activities debits in the General Ledger match the bank account credits | | X | | | | |
| 20 | Cash Management | 1.05.05 | The reconciliation spreadsheet is prepared by the Sr. Financial Accountant, Accounting Tech II, and Accounting Tech III and then printed out, reviewed, and approved by the VP of Finance. | | X | | | | |
| 21 | Cash Management | 1.05.06 | The VP of Finance reviews a manual paycheck log bi-monthly during payroll approval. Sr. Financial Accountant- Cash & Investments verifies on Manual Payroll Bank reconciliation that the amounts for manual checks as entered in the GL, and reported by the Payroll Analyst and as shown on the bank statements agree. | | X | | | | |
| 22 | Cash Management | 1.05.08 | On the following day, the Accounting Technician II downloads the daily account activity for the UBOC accounts, gives the statement to the Accounting | | X | | | | |

| Sample Number | Control Areas | Control Number | Control Activity | NA | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness | Comments |
|---------------|-----------------|----------------|---|----|-------------------|-----------------------|-----------------|---------------------|----------|
| | | | Technician III. The VP of Finance compares cash receipt log and JEs with UBOC account activity to verify that all checks have been accounted for on a monthly basis. | | | | | | |
| 23 | Cash Management | 1.05.09 | Wire transfers are initiated through the use of a Check/Wire Request Form. The Form must be signed by the budget manager, reviewed by the Sr. Financial Accountant, and signed by the VP of Finance. | | X | | | | |
| 24 | Cash Management | 1.05.10 | If the wire transfer request is for \$50,000 or more, the CEO must also sign the Form. | | X | | | | |
| 25 | Cash Management | 1.05.11 | Two Executive Officers must approve the wire information and one of them must release the wire transfer on the UBOC web system, transmitting the funds. | | X | | | | |
| 26 | Cash Management | 1.05.12 | The UBOC wire transfer system requires that the employee who prepares the wire transfer is not the same as the approver of the wire transfer, ensuring segregation of duty. The wire is transferred at the time it is approved. | | X | | | | |

| Sample Number | Control Areas | Control Number | Control Activity | NA | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness | Comments |
|---------------|-----------------------|----------------|---|----|-------------------|-----------------------|-----------------|---------------------|----------|
| 27 | Investment Management | 1.06.01 | The Sr. Financial Accountant—Cash & Investments verifies that the description of securities held (coupon, maturity, CUSIP, quantity, price, etc.) as reported by each investment manager agree with those reported by UBOC. | | X | | | | |
| 28 | Investment Management | 1.06.02 | Relying on reports provided by UBOC and the investment managers, the Sr. Financial Accountant verifies that the parameters calculated for the portfolio are in conformance with CLO's investment policy requirements. | | X | | | | |
| 29 | Investment Management | 1.06.03 | On a weekly basis, the Sr. Financial Accountant informs, via email, the CEO and the CFO of all the transactions made in the investment pool accounts. | | X | | | | |
| 30 | Investment Management | 1.06.04 | The Sr. Financial Accountant—Cash & Investments runs a report which shows the prior month's ending balances in the GL which are verified to the current month's beginning balances of the Investment Pool Spreadsheet and Short Term Investment accounts. | | X | | | | |

| Sample Number | Control Areas | Control Number | Control Activity | NA | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness | Comments |
|---------------|-----------------------|----------------|--|----|-------------------|-----------------------|-----------------|---------------------|----------|
| 31 | Investment Management | 1.06.05 | The Sr. Financial Accountant prepares the journal entries. The VP of Finance reviews and approves the journal entries. | | X | | | | |
| 32 | Investment Management | 1.06.06 | The Sr. Financial Accountant—Cash & Investments runs a second report which shows all the postings to the GL. The GL balances are reconciled to the Investment Pool Spreadsheet. | | X | | | | |
| 33 | Investment Management | 1.06.07 | The VP of Finance signs off on the monthly Investment Pool Spreadsheet journal entry, signifying review and approval. | | X | | | | |
| 34 | Estate Management | 1.08.01 | On a quarterly basis, the Financial Analysts of the Estate Finance group prepare the financial statements for estates under the CLO's conservatorship. The VP of Finance—Estates reviews, approves and publishes the collection of financial statements. | | X | | | | |
| 35 | Estate Management | 1.08.02 | Prior to publishing the estates' financial statements, the VP of Finance—Estates examines the balance sheet and statement of position of each estate, comparing them to those of the prior | | X | | | | |

| Sample Number | Control Areas | Control Number | Control Activity | NA | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness | Comments |
|---------------|-------------------|----------------|---|----|-------------------|-----------------------|-----------------|---------------------|--|
| | | | quarter. Any material variance is explained and documented. | | | | | | |
| 36 | Estate Management | 1.08.04 | On an annual basis, the VP of Finance—Estates, with the assistance of the Accounting Technician III requests confirmation of statutory deposit balances held by each state department of insurance or its designee. | | X | | | | |
| 37 | Estate Management | 3.04.02 | The ETO performs a quarterly review of financial statements to ensure accuracy. | | X | | | | |
| 38 | Estate Management | 3.04.03 | ETD reviews direct hours on a monthly basis for reasonableness. | | | X | | | No evidence was found of approval for direct hours charged to the closed estates and the estates assigned to one of the ETOs. Other estates were documented as approved. |
| 39 | Taxes | 1.09.02 | The VP of Finance—Estates reviews the tax returns and the CFO signs the returns. | | X | | | | |
| 40 | Taxes | 1.09.04 | The tax consultants prepare and calculate the quarterly estimated taxes and send them to the VP of Finance—Estates for review. | | X | | | | |

| Sample Number | Control Areas | Control Number | Control Activity | NA | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness | Comments |
|---------------|------------------|----------------|--|----|-------------------|-----------------------|-----------------|---------------------|---|
| 41 | Taxes | 1.09.05 | When finalized, the Partnership Tax Return is reviewed by the VP of Finance and signed by the CFO and sent to the IRS. | | | X | | | The VP of Finance does not review the Partnership Tax return prepared by the accounting firm and only verifies the investment spreadsheet as sent to the accounting firm is accurate. |
| 42 | Claims/Databases | 2.01.01 | Any claims in excess of file handler's authority is approved by the Claims Manager and/or the Chief Claims Officer. | | | X | | | Two of fourteen claims tested did not have supporting documentation to validate the POCs were reviewed and approved by Claims Management. |
| 43 | Claims/Databases | 2.01.02 | The Claims Manager reviews all new POC approvals and rejections and documents compliance on the Claims Internal Controls Report. The Claims Review Committee reviews the POC recommendations in excess of \$1 million. | | | X | | | One claim of seven tested did not have supporting documentation to validate the POC was reviewed and approved by Claims Management. A second claim was not properly documented on the Claims Internal Control Report. |
| 44 | Claims/Databases | 2.02.01 | In the interim [until the UDS and the FIQ data are reconciled], the CLO pays to the IGA based on the lower of the FIQ or the UDS data supplied by the IGA. | | | X | | | Three of ten claims tested were not paid with the lesser of FIQ or UDS. |

| Sample Number | Control Areas | Control Number | Control Activity | NA | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness | Comments |
|---------------|------------------|----------------|--|----|-------------------|-----------------------|-----------------|---------------------|---|
| 45 | Claims/Databases | 2.02.02.01 | Prior to an Early Access distribution, ETD ensures execution of Early Access Agreements with IGAs. | | X | | | | |
| 46 | Claims/Databases | 2.02.02.02 | All Early Access distribution agreements include "claw back" clause. | | X | | | | |
| 47 | Claims/Databases | 2.02.07 | On receipt of bad address information Claims codes the claim as "Hold" in the Claims database until a better address is found. | | X | | | | |
| 48 | Claims/Databases | 2.04.01 | The Claims staff member responsible prepares the Reconciliation Report which summarizes the balances required for the Accounting Department to reconcile the TAS database balances to the GL balances. He/she obtains the appropriate sign-offs. | X | | | | | Testing was not performed—no transactions occurred during the review period January 1, 2008 through March 31, 2009. |
| 49 | Claims/Databases | 2.04.02 | Claims Management reviews all POC approvals and rejections beyond claims handler's authority. | | | X | | | Two of seven claims tested did not include supporting documentation to validate review and approval by Claims Management. |
| 50 | Claims/Databases | 2.04.04 (NEW) | Verify check run equals amounts uploaded into POC system. | | | | X | | This is a new control and the responsible claims staff was not aware of the control. |
| 51 | Distributions | 3.07.02 | The Estate Trust Department maintains the early access distribution checklist to ensure relevant procedures have been | | X | | | | |

| Sample Number | Control Areas | Control Number | Control Activity | NA | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness | Comments |
|---------------|---------------|----------------|---|----|-------------------|-----------------------|-----------------|---------------------|----------|
| | | | completed and signed off. | | | | | | |
| 52 | Distributions | 3.07.04 | The ETO and CFO review and approve the Early Access distribution calculation package. | | X | | | | |
| 53 | Distributions | 3.07.08 | The ETO authorizes the Investment Supervisor to prepare a plan to liquidate assets. Responsibility and performance is acknowledged by the ETO, with his/her EAD checklist signature and date. | | X | | | | |
| 54 | Distributions | 3.07.14 | The ETO is required to obtain a court order to proceed with the planned distribution. | | X | | | | |
| 55 | Distributions | 3.08.01 | The Estate Trust Analyst maintains the Interim distribution checklist to ensure relevant procedures have been completed, and signed off. | | X | | | | |
| 56 | Distributions | 3.08.02 | The ETO and CFO review and approve the Interim distribution calculation package. | | X | | | | |
| 57 | Distributions | 3.08.10 | The ETO is required to obtain a court order to proceed with the planned distribution. | | X | | | | |
| 58 | Distributions | 3.09.01 | The Estate Trust Analyst maintains the Final distribution checklist to ensure relevant procedures have been completed, and signed off. | | X | | | | |

| Sample Number | Control Areas | Control Number | Control Activity | NA | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness | Comments |
|---------------|-----------------|----------------|---|-----|-------------------|-----------------------|-----------------|---------------------|---|
| 59 | Distributions | 3.09.04 | The ETO and CFO review and approve the Final distribution calculation package. | | X | | | | |
| 60 | Distributions | 3.09.16 | The ETO is required to obtain a court order to proceed with the planned distribution. | | X | | | | |
| 61 | Estate Closures | 3.05.01 | The ETO and VP Estate Finance Group reviews and approves the closing budget received from each department. Final closing budget is approved by the Court. | | X | | | | |
| 62 | Estate Closures | 3.05.03 | The ETO performs periodic review of expense to closing budget prior to the filing of Declaration of Compliance. After this point, the AP controls ensure all expenses are authorized. | | | X | | | CLO has not developed a printed report listing expenses and the variances to the closing budget. |
| 63 | Reinsurance | C 4.1.2a | Reinsurance Specialist and Financial Analyst are responsible for securing the initial data and providing support for the amounts used in the "loading GL." This establishes the beginning balances in the initial GL setup for the estate by CLO. | N/A | | | | | Testing was not performed - no transactions occurred during the review period January 1, 2008 through March 31, 2009. |
| 64 | Reinsurance | C 4.2.2a | Reinsurance Manager reviews, approves, and posts all reinsurance bills and collections. The reinsurance specialist and | | | X | | | Fremont reinsurance bills tested did not include approval or posting by the Reinsurance |

| Sample Number | Control Areas | Control Number | Control Activity | NA | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness | Comments |
|---------------|---------------|----------------|---|-----|-------------------|-----------------------|-----------------|---------------------|---|
| | | | analyst review claims data for potential reinsurance recovery opportunities. | | | | | | Manager. The CLO process for Fremont changed July 1, 2009. Therefore, this area will be tested in the following year's AUP. |
| 65 | Reinsurance | C 4.2.2b | Exit memos are reviewed by Reinsurance management. Sign off on future seizure memos to be archived in ImageRight. Past exit memos and quarterly updates are currently archived on the Reinsurance shared drive. | N/A | | | | | Testing was not performed - no transactions occurred during the review period January 1, 2008 through March 31, 2009. |
| 66 | Reinsurance | C 4.2.8a | Reinsurance accounts sub ledgers maintained by Reinsurance Specialists are reconciled by the Sr. Reinsurance Accountant and the Estate Finance staff at least quarterly. | | X | | | | |
| 67 | Reinsurance | C 4.3.2b | Collateral log maintained by Reinsurance Manager | | X | | | | |
| 68 | Reinsurance | C 4.3.3b | Expiration dates are tracked on the collateral log and monitored quarterly by the Reinsurance Manager. | | X | | | | |
| 69 | Compensation | 5.02.01 | The Executive Officers and SDIC/CEO review and approve the Salary Structure and Ranges. | | | X | | | CLO staff and management indicated that the 2008 Salary Structure and Ranges were discussed and approved. However, |

| Sample Number | Control Areas | Control Number | Control Activity | NA | Fully Functioning | Partially Functioning | Not Functioning | Additional Weakness | Comments |
|---------------|-------------------------------------|----------------|---|----|-------------------|-----------------------|-----------------|---------------------|---|
| | | | | | | | | | there was no written documentation provided to support the reviews and approvals. |
| 70 | Compensation | 5.02.05 | The HR Manager, CFO, and SDIC/CEO review and approve the merit increase. | | X | | | | |
| 71 | Compensation | 5.02.06 | The HR-02 is reviewed, approved, and signed by the HR Manager, Department Officer, and the CFO. | | X | | | | |
| 72 | Compensation | 1.04.03 | The Payroll Analyst personally distributes the paychecks and paystubs to all CLO employees. | | X | | | | |
| 73 | Control Environment/Risk Assessment | 8.01.01 | The CLO will publish a Code of Business Ethics and Behavior, approved by the Oversight Committee. (effective August 15th) | | X | | | | |
| 74 | Control Environment/Risk Assessment | 8.01.08 | Each senior officer of the CLO signs a financial responsibility statement. | | X | | | | |
| 75 | Control Environment/Risk Assessment | 8.02.01 | The individual estate teams provide a written update and present an oral report to the management staff on a quarterly basis. | | X | | | | |
| 76 | Information and Communications | 8.03.01 | An internal report of quarterly financial results is prepared by the VPs of Accounting and reviewed by the CFO. | | X | | | | |

Prior Finding Resolution Results

| Prior Report Sample No. | Control Areas | Finding Description | Resolved? | | | Comments |
|-------------------------|------------------------------------|---|-----------|-----------|----|---|
| | | | Yes | Partially | No | |
| 4 | Records Retention & Access C6.4.1b | Failure to substantiate OPUS system log report reconciliation. | X | | | |
| 9 | 2.02.07 Claims | Insufficient Documentation of Policies and Procedures. Specifically, the CLO does not maintain policies and procedures governing reconciliation process between the Accounting Department's check log and the TAS database. | | | | Testing was not performed—no transactions occurred during the review period January 1, 2008 through March 31, 2009. |
| 20 | Estate Management 3.04.02 | Weakness in updating and monitoring Project Plans. | X | | | |
| 22 & 23 | Estate Closure 3.05.01 & 3.05.02 | Inadequate performance of review and approval for Closing Budgets and Estimated Administrative Budget worksheets. | X | | | |
| 24 & 25 | Estate Closure 3.05.04 & 3.05.05 | Inadequate performance of review of the closing application and declaration of compliance. | X | | | |

| Prior Report Sample No. | Control Areas | Finding Description | Resolved? | | | Comments |
|-------------------------|---------------------------------|--|-----------|-----------|----|--|
| | | | Yes | Partially | No | |
| 26 | Distributions 3.07.01 | Improper Policy over Signing of the EAD Checklist—Several instances were identified where the EAD Checklist was either not signed by the appropriate individual(s) or the required signature(s) was missing. | | X | | The prior audit finding has not been cleared for checklist items 10 and 11. Checklist item 10 was to be signed by the ETO and CFO, but was only signed by the ETO. Checklist item 11 was to be signed by the ETO and the Chief Claims Officer, but was only signed by the ETO. CLO is in the process of implementing new controls. OSAE will test these controls in the subsequent AUP or Internal Control Review. |
| 30 | Distributions 3.07.08 | Inadequate policies and procedures in establishing a plan to liquidate investments. | X | | | |
| 32 | Distributions 3.07.13 | EAD Checklist untimely signed off. | X | | | |
| 36 & 52 | Distributions 3.07.18 & 3.09.14 | Inadequate Separation of Duties. | X | | | |
| 48 | Distributions 3.09.03 | Improper review of receivables prior to final distribution. | X | | | |
| 51 | Distributions 3.09.09 | Untimely Control Procedures—Four instances of final distribution controls were performed after the date of distribution. Specifically, the IT audit report was performed after the date of distribution for all three final distributions tested. Additionally, for S&H, the review of the receivable balances and proposed write-offs was performed after the final distribution. | | X | | The prior audit finding has not been cleared. Specifically, checklist item 70 for Western International and 71 for Paula were completed after the distribution date. Also, checklist items 77 and 78 for the Western International estate were not dated by the ETO to indicate when the items were completed. CLO is in the process of implementing new controls. OSAE will test these controls in the subsequent AUP or Internal Control Review. |

| Prior Report Sample No. | Control Areas | Finding Description | Resolved? | | | Comments |
|-------------------------|---------------------|---|-----------|-----------|----|--|
| | | | Yes | Partially | No | |
| 65 | Reinsurance C4.2.2b | Insufficient documentation of Policies and Procedures related to the exit memo. | | | | Testing was not performed—there were no seized insurers with reinsurance during the review period January 1, 2008 through March 31, 2009. |
| 69 | Reinsurance C4.3.2c | Inadequate Documentation of Policies and Procedures—The CLO has not implemented policies and procedures to correct GAPS identified by SOX. Specifically, securing and restricting access to collateral files. | | X | | CLO does not lock the cabinet that contains copies of the letters of credit for reinsurance collateral. However, these forms are maintained electronically. |
| 70 | Reinsurance C4.3.3a | Insufficient Reconciliation of Collateral—An inventory collateral listing is maintained but is not reconciled. | | X | | The amount carried forward to the 12/31/2008 reconciliation was incorrect for one collateral item tested. One of the four quarterly sign-off worksheets for 2008 did not have the appropriate electronic approvals by the Reinsurance Manager and the Reinsurance Officer. |

Audit Findings from 2004 Unresolved Per Finance's CLO Internal Control Review as of April 2007

| Finding No. | Control Areas | Finding Description | Resolved? | | | Comments |
|-------------|--------------------------------------|---|-----------|-----------|----|----------|
| | | | Yes | Partially | No | |
| 7 | 6.2 Purchasing & Fixed Asset Tagging | Inadequate receiving controls over purchases—The CLO has not implemented procedures to document when partial goods are received. | X | | | |
| 11 | 6.2 Purchasing & Fixed Asset Tagging | No periodic review of open purchase orders. | X | | | |
| 14 | Period Closing | Inadequate adherence to policy and procedures. The CLO failed to follow a specific schedule of budgetary deadlines and failed to maintain a file of budgetary documents received from various sources documenting the budget building, review and approval process. | X | | | |

Legend of Acronyms

| Acronym | Description |
|----------------|--|
| AUP | Agreed Upon Procedures |
| AP | Accounts Payable |
| AMEX | American Express |
| CEO | Chief Executive Officer |
| CFO | Chief Financial Officer |
| CUSIP | Committee on Uniform Security Identification Procedures Number |
| EAD | Early Access Distribution |
| ETO | Estate Trust Officer |
| EFG | Estate Finance Group |
| ETD | Estate Trust Department |
| FIQ | Financial Information Questionnaire |
| HR | Human Resources |
| IGA | Insurance Guarantee Association |
| IRS | Internal Revenue Service |
| IT | Information Technology |
| GAPS | Control Weaknesses |
| GL | General Ledger |
| JE | Journal Entry |
| JDE | JD Edwards |
| OPUS | Records Management Database |
| POC | Proofs of Claim |
| SDIC | Special Deputy Insurance Commissioner |
| SOX | Sarbanes-Oxley Act |
| TAS | Trust Administration System |
| UDS | Uniform Data Standards |
| UBOC | Bank |
| VP | Vice President |
| ZBA | Zero Balance Account |

RESPONSES

Our Mission

On behalf of the Insurance Commissioner, the CLO acts to rehabilitate and/or liquidate, under Court supervision, troubled insurance enterprises. The CLO operates as a fiduciary for the benefit of claimants, handling the property of the failed enterprises in a prudent, cost-effective, fair, timely, and expeditious manner.



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August 24, 2009

David Botelho, Chief
DEPARTMENT OF FINANCE
Office of State Audits and Evaluations
300 Capital Mall, Suite 801915 L Street
Sacramento, CA 95814

Subject: Conservation & Liquidation Office Internal Control Review as of March 31, 2009

Dear Mr. Botelho:

The Conservation & Liquidation Office ("CLO") has prepared the following responses to findings contained in the Conservation & Liquidation Office Internal Control Review as of March 31, 2009 performed by the Department of Finance ("DOF") audit staff.

The CLO will take corrective measures in response to your findings as soon as possible and we were pleased to note that, as stated in your report, the findings were not considered material either individually or in total.

Controls Tested with Deficiencies

Accounts Receivable – Sample number 6.

CLO Control tested:

On a monthly basis, the Accounting Tech III reconciles the Other Receivables spreadsheet with the JDE GL. The reconciliation is reviewed and approved by the VP of Finance.

DOF Finding: Partially functioning.

The Other Receivables spreadsheet (Cost/Benefit) did not foot and did not include two estate balances pre the GL (Mission National and Fremont Life).

CLO response:

This is a clerical error. The Other Receivables spreadsheet summary totals have been re-calculated correctly and the Mission National and Fremont Life balances have been incorporated as line items.

Accounts Payable - Sample number 10.

CLO control tested:

Blank check laser paper stock is stored and locked in an office separate from the check printer. Bank account number and check number is not printed on each blank check paper until the check run process is completed using JDE E1 Systems. (Vendor and Distribution blank check stock).

DOF Finding: Partially functioning.

A portion of the blank check paper was stored in a locked cabinet in the same office as the printer.

CLO response:

This finding is due to a small amount of blank check stock that is kept locked in the Vice President - Finance's office to use as needed for out of the ordinary check requests. The rest of the check stock is kept as required under lock and key away from the check printer.

The CLO has mitigating controls which prevent use of the blank check stock to create a fraudulent check including the UBOC positive pay system which system input is performed by an individual who has no access to blank check stock and the JDE system security controls.

The internal control matrix has been modified to remove the specification that check stock must be locked in a separate office.

Accounts payable - Sample number 16.

CLO control tested:

The Facilities supervisor is responsible to review the AMEX travel account statement to ensure that the charges are appropriate before authorizing the statement to be paid.

DOF Finding: Partially functioning.

The airline travel on the AMEX statements are not traced to the approved CLO travel forms.

CLO response:

The CLO has eliminated the travel request requirement due to the reduced size of the CLO staff and the fact that it was overly burdensome to complete. The new procedure is that the Facilities supervisor allocates the charges to the appropriate estate and then forwards the AMEX billing form to the CFO who reviews and approves the allocations.

Estate Management - Sample number 37.

CLO control tested:
ETD reviews direct hours on a monthly basis for reasonableness.

DOF Finding: Partially functioning.
No evidence was found of approval for direct hours charged to the closed estates and the estates assigned to one of the ETOs. Other estates were documented as approved.

CLO response:
There are two parts to this finding. The CLO had not identified anyone to sign off on the closed estates since they are for the most part inactive except for document destruction costs which are managed by the VP-Finance. Control procedures are being modified to require review of the closed estates by the VP-Finance.

CLO procedures have always required Estate Trust Officers to review the direct hours reports which are and have been published monthly on the CLO intranet. Recently the CLO added a requirement that evidence of the review be documented on a review annotation document which is included in an ImageRight folder. ETOs have been reminded to place evidence of their review on these documents.

Taxes - Sample number 41.

CLO control tested:
When finalized, the Partnership Tax Return is reviewed by the VP of Finance and signed by the CFO and sent to the IRS.

DOF Finding: Partially functioning.
The VP of Finance does not review the Partnership Tax return prepared by the accounting firm and only verifies the investment spreadsheet as sent to the accounting firm is accurate.

CLO response:
The partnership tax return is the return prepared for the results of the investment pool. Each estate then receives a K-1 partnership return. The VP-Finance prepares and submits the data required to prepare the partnership tax return to PricewaterhouseCoopers who prepares the return and the K-1s. PricewaterhouseCoopers delivers the return to the CFO who reviews and signs it. Control documentation and policy and procedure manual will be changed to reflect this procedure.

Claims/Databases - Sample number 42.

CLO control tested:
Any claims in excess of file handler's authority is approved by the Claims Manager and/or the Chief Claims Officer.

DOF Finding: Partially functioning.

Two of fourteen claims tested did not have supporting documentation to validate the POCs were reviewed and approved by Claims Management.

CLO response:

This finding is correct in that the claim files did not have the appropriate signatures; however, other documentation in file confirmed that the claims were properly approved. The finding is duly noted and the CLO will ensure that each file is properly documented in the future.

Claims/Databases - Sample number 43.

CLO control tested:

The Claims Manager reviews all new POC approvals and rejections and documents compliance on the Claims Internal Controls Report. The Claims Review Committee reviews the POC recommendations in excess of \$1 million.

DOF Finding: Partially functioning.

One claim of seven tested did not have supporting documentation to validate the POC was reviewed and approved by Claims Management. A second claim was not properly documented on the Claims Internal Control Report.

CLO response:

There are two parts to this finding. The finding is partially due to a deficiency in the CLO's internal control documentation. The Claims Manager is only required to approve claims in excess of the examiner's authority. We will correct the controls documentation.

Secondly, there was a file that should have been reviewed that was not reviewed. This was an oversight that should have not occurred.

Claims/Databases - Sample number 44.

CLO control tested:

In the interim [until the UDS and the FIQ data are reconciled], the CLO pays to the IGA based on the lower of the FIQ or the UDS data supplied by the IGA.

DOF Finding: Partially functioning.

Three of ten claims tested were not paid with the lesser of FIQ or UDS.

CLO response:

The finding is correct and relates to early access distributions to guaranty associations with whom we have a claw back provision. The CLO is establishing a formal verification and documentation procedure between the Estate Trust person who oversees the entirety of the distribution and the UDS coordinator who is able to provide most recent UDS totals

Claims/Databases – Sample number 49.

CLO control tested:

Claims Management reviews all POC approvals and rejections beyond claims handler's authority.

DOF Finding: Partially functioning.

Two of seven claims tested did not include supporting documentation to validate review and approval by Claims Management.

CLO response:

This finding is correct in that the claim files did not have the appropriate signatures; however, other documentation in file confirmed that the claims were properly approved. The finding is duly noted and the CLO will ensure that each file is properly documented in the future.

Claims/Databases – Sample number 50.

CLO control tested:

Verify check run equals amounts uploaded into POC system.

DOF Finding: Not functioning.

This is a new control and the responsible claims staff was not aware of the control.

CLO response:

The CLO disagrees with the finding. This control was implemented in 2009 and is not tested. The when asked about the control, the individual questioned, who is also the individual who prepares the internal control matrix for the claims department, stated that she knew about the control but, since it had not yet been used, was unsure as to how it would function.

Estate Closures – Sample number 62.

CLO control tested:

The ETO performs periodic review of expense to closing budget prior to the filing of Declaration of Compliance. After this point, the AP controls ensure all expenses are authorized.

DOF Finding: Partially functioning.

CLO has not developed a printed report listing expenses and the variances to the closing budget.

CLO response:

The CLO will modify the control to require that the cash retained after an estates final distribution is by definition the closing budget. Expenditures are reviewed by the estate trust officer vs. the estates budget each month until the filing of a declaration of

compliance. After which the accounts payable procedures ensure all expenses are authorized.

Reinsurance - Sample number 64.

CLO control tested:

Reinsurance Manager reviews, approves, and posts all reinsurance bills and collections. The reinsurance specialist and analyst review claims data for potential reinsurance recovery opportunities.

DOF Finding: Partially functioning.

Fremont reinsurance bills tested did not include approval or posting by the Reinsurance Manager. The CLO process for Fremont changed July 1, 2009. Therefore, this area will be tested in the following year's AUP.

CLO response:

The CLO control matrix did not properly describe the approval system for Fremont billings that were reviewed and approved by Reinsurance Management in Los Angeles. Approval and posting in JDE were done by Accounting Management at the CLO.

On July 1, 2009, the Los Angeles Fremont office was closed and all work transferred to San Francisco. This will result in compliance with the documented approval process in the future.

Compensation - Sample number 69.

CLO control tested:

The Executive Officers and SDIC/CEO review and approve the Salary Structure and Ranges.

DOF Finding: Partially functioning.

CLO staff and management indicated that the 2008 Salary Structure and Ranges were discussed and approved. However, there was no written documentation provided to support the reviews and approvals.

CLO response:

The CLO questions whether this matter should be a finding. The DOF was shown compensation recommendation sheets prepared by management each of which included the SDIC/CEO approval. While the recommendation sheets did not have management signatures other than the SDIC/CEO the CLO believes this is adequate documentation.

Resolution of Prior Internal Control Findings

All Audit Findings from 2004 Unresolved per Finance's CLO Internal Control Review as of April 2007 have been resolved.

The following audit four findings from the 2006 Internal Control Review listed below were found by the DOF to be only partially resolved.

Prior Report Sample Number 26 - Partially resolved - Distributions

Improper Policy over Signing of the EAD Checklist—Several instances were identified where the EAD Checklist was either not signed by the appropriate individual(s) or the required signature(s) was missing.

DOF Comments:

The prior audit finding has not been cleared for checklist items 10 and 11. Checklist item 10 was to be signed by the ETO and CFO, but was only signed by the ETO. Checklist 11 was to be signed by the ETO and the Chief Claims Officer, but was only signed by the ETO. CLO is in the process of implementing new controls. OSAE will test these controls in the subsequent AUP or Internal Control Review.

CLO Response:

The CLO agrees with the finding and new procedures are being implemented to ensure this matter is corrected in the future.

Prior Report Sample Number 51 - Distributions. Partially resolved:

Untimely Control Procedures—Four instances of final distribution controls were performed after the date of distribution. Specifically, the IT audit report was performed after the date of distribution for all three final distributions tested. Additionally, for S&H, the review of the receivable balances and proposed write-offs was performed after the final distribution.

DOF Comments:

The prior audit finding has not been cleared. Specifically, checklist item 70 for Western International and 71 for Paula were completed after the distribution date. Also, checklist items 77 and 78 for the Western International estate were not dated by the ETO to indicate when the items were completed. CLO is in the process of implementing new controls. OSAE will test these controls in the subsequent AUP or Internal Control Review.

CLO Comment:

The CLO has implemented a revised distribution process which should prevent a recurrence of these findings. The DOF will test the new process in connection with their next audit.

Prior Report Sample Number 69 - Reinsurance. Partially Resolved:

Inadequate Documentation of Policies and Procedures—The CLO has not implemented policies and procedures to correct GAPS identified by SOX. Specifically, securing and restricting access to collateral files.

DOF Finding:

CLO does not lock the cabinet that contains copies of the letters of credit for reinsurance collateral. However, these forms are maintained electronically.

CLO Response:

Letters of credit (LOC) are not negotiable instruments, are replaceable by the issuing banks on request, and as noted, maintained electronically. Draws are done by sight draft and original letters of credit are not required. Restricted access is not required and the policy and procedures will be revised.

Prior Report Sample Number 70 - Reinsurance.

Partially Resolved:

Insufficient Reconciliation of Collateral—An inventory collateral listing is maintained but is not reconciled.

DOF Finding:

The amount carried forward to the 12/31/2008 reconciliation was incorrect for one collateral item tested. One of the four quarterly sign-off worksheets for 2008 did not have the appropriate electronic approvals by the Reinsurance Manager and the Reinsurance Officer.

CLO Response:

The findings are the result of an immaterial posting error and an oversight on securing electronic signatures. There was no financial impact or risk to collateral. The December 31, 2008 collateral ending balances were correctly stated.

Thank you and your staff for your diligence in completing this audit and for the findings contained therein.

Sincerely,

Original signed by:

Raymond J. Minahan
Chief Financial Officer

Our Mission

On behalf of the Insurance Commissioner, the CLO acts to rehabilitate and/or liquidate, under Court supervision, troubled insurance enterprises. The CLO operates as a fiduciary for the benefit of claimants, handling the property of the failed enterprises in a prudent, cost-effective, fair, timely, and expeditious manner.



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October 20, 2009

David Botelho, Chief
DEPARTMENT OF FINANCE
Office of State Audits and Evaluations
300 Capital Mall, Suite 801915 L Street
Sacramento, CA 95814

Subject: Conservation & Liquidation Office Internal Control Review as of March 31, 2009 - Revised Sample Number 69 response

Dear Mr. Botelho:

The Conservation & Liquidation Office ("CLO") has revised its responses to finding related to Sample 69 contained in the Conservation & Liquidation Office Internal Control Review as of March 31, 2009 performed by the Department of Finance ("DOF") audit staff.

Compensation - Sample number 69.

CLO control tested:

The Executive Officers and SDIC/CEO review and approve the Salary Structure and Ranges.

DOF Finding: Partially functioning.

CLO staff and management indicated that the 2008 Salary Structure and Ranges were discussed and approved. However, there was no written documentation provided to support the reviews and approvals.

CLO response:

The CLO staff and management use the Salary Structure and Ranges prepared by our outside consultant extensively in establishing individual salaries and to ensure that all employees compensation falls within the ranges contained in this document. In the future the CEO will sign and approve the use of the document and the CLO will maintain a copy of the approved document in the HR department.

Sincerely,

Original signed by:
Raymond J. Mjitehan
Chief Financial Officer

EVALUATION OF RESPONSES

We reviewed the Conservation & Liquidation Office's (CLO) responses, dated August 24, 2009 and October 20, 2009, to the draft report on the CLO's internal control. We acknowledge the CLO's willingness to implement corrective actions for the issues identified in our report. The implementation of the corrective actions identified will strengthen the CLO's internal control and reduce the risk that errors or irregularities affecting the financial statements could occur and remain undetected.

The CLO provided responses to the 17 issues noted in our report. Our comments on the CLO's responses follow:

- **Accounts Payable—Sample Number 16**
The CLO's new procedures should include a review of the travel charges by the CFO prior to payment of the AMEX travel account to ensure the charges are appropriate and to reduce the risk of fraud.
- **Estate Management—Sample Number 37**
The Correct Sample Number reference is 38.
- **Claims/Databases—Sample Number 50**
During the interview process, the responsible claims staff stated she was not aware of the control or that she was the process owner as indicated on the CLO's Internal Control Matrix. Therefore, the observation remains as originally stated in the draft report. We will perform testing of this control in our subsequent AUP engagement and distribution audits.
- **Reinsurance—Sample Number 64**
The new procedures for Fremont reinsurance will be tested in the subsequent AUP engagement.
- **Compensation—Sample Number 69**
The CLO initially disagreed with the finding (see page 30). Additional information was provided to the CLO and it agreed to take corrective action (see page 33).

Prior Audits Internal Control Findings

- **Prior Report—Sample Number 69**
We agree with the CLO's comments. However, the CLO should revise its Control Matrix (Control C4.3.2c) to reflect the current control objectives and control activity.