

FINANCIAL AUDIT

Commonwealth of Pennsylvania
Department of Labor and Industry
State Workers' Insurance Fund
Harrisburg, Pennsylvania
For the Years Ended December 31,
2014 and December 31, 2013

December 2015



Commonwealth of Pennsylvania
Department of the Auditor General
Eugene A. DePasquale • Auditor General

**DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND
DECEMBER 31, 2014 and 2013**

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**DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND
DECEMBER 31, 2014 and 2013**

BACKGROUND

The State Workers' Insurance Fund (SWIF) is a self-sustaining fund operating within the Department of Labor and Industry for the purpose of providing workers' compensation insurance to employers, including those refused policies by private insurance firms. SWIF is subject to underwriting rules, classifications, and rates promulgated by rating bureaus authorized by the State Insurance Commissioner. A board consisting of the Secretary of Labor and Industry, the State Treasurer, and the Insurance Commissioner oversees operations of the fund.



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EUGENE A. DEPASQUALE
AUDITOR GENERAL

Independent Auditor's Report

The Honorable Tom Wolf
Governor
Commonwealth of Pennsylvania
Harrisburg, PA 17120

Report on the Financial Statements

We have audited the accompanying Statements of Admitted Assets, Liabilities and Surplus-statutory basis of the State Workers' Insurance Fund (SWIF) as of December 31, 2014, and December 31, 2013, and the related Statements of Operations and Changes in Surplus-statutory basis and the Statements of Cash Flows-statutory basis for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with statutory accounting practices as prescribed or permitted by the Insurance Department of Pennsylvania. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities and surplus of SWIF as of December 31, 2014, and December 31, 2013, and the results of its operations and its cash flows for the years then ended in accordance with statutory accounting practices as prescribed or permitted by the Insurance Department of Pennsylvania as described in Note A.

Basis of Accounting

We draw attention to Note A of the financial statements, which describes the basis of accounting. As described in Note A to the financial statements, the financial statements are prepared by SWIF in accordance with statutory accounting practices as prescribed or permitted by the Insurance Department of Pennsylvania, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to meet the requirements of the Insurance Department of Pennsylvania. The effects on the financial statements of the variances between these regulatory accounting practices and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material. Our opinion is not modified with respect to this matter.

Emphasis of Matter

As discussed in Note E, the insurance loss liability of SWIF is based on actuarial analysis of historical experience adjusted to estimate the impact of Act 44 of 1994 and Act 57 of 1996 and changes in claims management practices adopted by SWIF management. Because of the length of time required for the actual insurance loss liability to be determined and the uncertainty regarding whether the adjusted data will be supported by future claim payments, the actual liability may vary significantly from the estimated amount provided for in the Statements of Admitted Assets, Liabilities and Surplus-statutory basis.

Other Matters

Supplementary Information

Our audit was conducted for the purposes of forming an opinion on the statutory financial statements as a whole. The management's discussion and analysis is presented for purposes of additional analysis and is not a required part of the statutory financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the statutory financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Information

The background has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 4, 2015, on our consideration of SWIF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SWIF's internal control over financial reporting and compliance.



Eugene A. DePasquale
Auditor General

December 4, 2015

**DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND
DECEMBER 31, 2014 and 2013**

SWIF MANAGEMENT'S DISCUSSION AND ANALYSIS

Assets and Liabilities

The State Workers' Insurance Fund (SWIF) disclosed total admitted assets of \$1.542 billion as of December 31, 2014. This was an increase of \$20.8 million or 1.4% from 2013. Cash and invested assets increased from \$1.442 billion in 2013 to \$1.459 billion in 2014 or a \$17 million increase. The largest increase came from an increase of \$43 million in bonds offset by a decrease in stocks of \$17.3 million and short term investments of \$8 million. The largest increase from other assets was due to an increase in amounts recoverable from reinsurers of \$4.4 million.

SWIF's total liabilities increased to \$1.718 billion, an increase of \$17.7 million or 1.0% from the prior year. Total unpaid losses increased as of year end 2014 to \$1.366 billion, from \$1.349 billion, an increase of \$17 million or 1.3%. The reserve for loss adjustment expenses decreased to \$227.8 million from \$229 million. This resulted in a net increase in loss and loss adjustment expense reserves of \$16.2 million. All other liabilities increased \$1.5 million mainly due to unearned premium deficiency reserves increasing \$5.8 million to \$7.4 million.

Surplus

Surplus as regards policyholders was (\$176) million, an improvement of \$3.1 million or 1.73% for 2014 as compared to the reported deficit of (\$179.1) million in 2013. SWIF's net income before other changes in surplus for 2014 was \$12.4 million versus a net loss in 2013 of \$331 thousand. The improvement in surplus was largely due to the net income of \$12.4 million offset by a change in unrealized capital losses of (\$9.4) million.

SWIF continues to address its negative surplus and has implemented several initiatives to address this issue, as outlined below in the section titled Future Initiatives.

**DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND
DECEMBER 31, 2014 and 2013**

SWIF MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

Operational Results

SWIF recorded net income before other changes in surplus of \$12.4 million for 2014. This is an improvement of \$12.8 million as compared to the 2013 net loss of (\$331) thousand. Earned premiums continued to increase by \$18.4 million, to \$225.4 million in 2014 from \$207 million in 2013, or 8.9%. This improvement to earned premium was offset by an increase in loss and loss adjustment expenses incurred of \$35.6 million. Losses incurred increased \$52.8 million while loss adjustment expenses incurred decreased \$17.1 million. The majority of the decrease in loss adjustment expenses incurred was from a reduction in salaries and benefits of \$9.1 million and claim adjustment services of \$5.8 million.

Net investment income earned (excluding realized capital gains/losses) decreased to \$36.9 million in 2014 from \$40.9 million in 2013. The increase in overall net investment income was fueled by an increase in net realized gains. SWIF recorded net realized capital gains of \$57.3 million in 2014, an increase of \$33.9 million from the prior year. During 2014 SWIF saw improvement in its investment portfolio performance as total yield improved from (0.58%) to 7.5%. The yield of SWIF's fixed portfolio increased from (3.35%) in 2013 to 7.0% in 2014.

During 2014, SWIF also had \$10.6 million in charged off premium that was included in SWIF's net loss. This premium was ruled uncollectible and charged off through the Pennsylvania Attorney General's Office.

Future Initiatives

SWIF's Compromise and Release Initiative continues to produce savings in future reserves. During 2014, 762 claims were settled that resulted in loss reserve savings of \$61.5 million.

SWIF continued to reduce staffing through attrition. During 2014, SWIF's filled complement was reduced by 19 positions from 2013.

SWIF developed and implemented a Claim Review Program as well as a Claim Handling Guide to improve claims quality and identify training opportunities during 2014.

**DEPARTMENT OF LABOR AND INDUSTRY
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SWIF MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

SWIF contracted with Hoover Rehabilitation Inc. in May 2013 for their Medical Bill Repricing, Preferred Provider Organization (PPO), Pharmacy Benefit Management (PBM), and Durable Medical Equipment (DME). During 2014 SWIF realized net savings below medical bill fee schedule of 11.22% for medical bill payment savings of \$13.1 million. Since inception this program has realized net savings of 12.03% or \$28.6 million.

During 2014, SWIF's Customer Service Unit handled 83,558 of the 99,555 calls received or 84% of all calls. This unit eliminates the need to transfer calls to the Underwriting, Claims, Auditing, and Accounting Divisions. This unit also handled 8,030 first report of injury calls.

SWIF's current computer system went live in 2005. In 2014, SWIF began to develop a request for proposal for a new system, with a planned release in 2015. It is anticipated that the new system will allow for enhanced use of online capability to provide expanded customer service features for SWIF policyholders and claimants.

SWIF along with the Office of Information Technology enhanced the SWIF Information Technology Platform for their PowerComp and OnBase systems through installation of a hardware upgrade in May 2014.

During 2014 SWIF managed its non-admitted premium receivable to \$37 million, a decrease of \$1 million from year end 2013.

During 2014, SWIF renewed its reinsurance treaty, lowered retention by \$5 million, increased coverage for a covered event from \$55 million to \$60 million, and picked up additional coverage for a nuclear, biological, chemical, and radiological exposure (NBCR) terrorism event. Also, SWIF obtained improved coverage while lowering the rate from .7955% to .7500%.

STATE WORKERS' INSURANCE FUND
STATEMENTS OF ADMITTED ASSETS, LIABILITIES AND SURPLUS
STATUTORY BASIS
DECEMBER 31, 2014 and 2013

		<u>(Expressed in Thousands)</u>	
<u>ADMITTED ASSETS</u>		<u>2014</u>	<u>2013</u>
<u>Investments</u>			
Bonds		\$ 1,262,009	\$ 1,218,628
Stocks		126,803	144,122
Short-term investments		66,558	74,520
Total investments - Note B		<u>\$ 1,455,370</u>	<u>\$ 1,437,270</u>
<u>Cash</u>			
On deposit in Treasury Department		<u>\$ 3,864</u>	<u>\$ 4,371</u>
<u>Receivables</u>			
Uncollected premiums in course of collection		\$ 6,687	\$ 5,348
Premiums, agents' balances, and installments booked but deferred and not yet due		62,463	64,974
Reinsurance recoverable on loss payments		4,436	66
Interest due and accrued on investments		9,589	9,592
Funds held by or deposited with reinsurance companies		14	14
Total receivables		<u>\$ 83,189</u>	<u>\$ 79,994</u>
Total Admitted Assets		<u>\$ 1,542,423</u>	<u>\$ 1,521,635</u>
<u>LIABILITIES AND SURPLUS</u>			
<u>Liabilities</u>			
Net unpaid losses – Notes C and E		\$ 1,366,146	\$ 1,348,720
Unpaid loss adjustment expenses		227,800	229,019
Reinsurance payable		38	45
Premium deficiency reserve		7,436	1,658
Ceded reinsurance premiums payable		0	301
Accrued administrative expenses		8,029	7,483
Unearned premiums		84,796	87,093
Policyholders' premium credit balances		13,159	12,957
Restricted account – Commonwealth Self Insurance		2,213	2,216
Policyholder deposits		2,561	2,841
Net payable for securities		2,348	3,002
Other liabilities		3,852	5,387
Total liabilities		<u>\$ 1,718,378</u>	<u>\$ 1,700,722</u>
<u>Surplus</u>			
Unassigned surplus (deficit) – Note F		<u>\$ (175,955)</u>	<u>\$ (179,087)</u>
Total surplus (deficit) as regards policyholders		<u>\$ (175,955)</u>	<u>\$ (179,087)</u>
Total Liabilities and Surplus		<u>\$ 1,542,423</u>	<u>\$ 1,521,635</u>

– The notes to the financial statements are an integral part of these statements. –

STATE WORKERS' INSURANCE FUND
STATEMENTS OF OPERATIONS AND CHANGES IN SURPLUS
STATUTORY BASIS
FOR THE YEARS ENDED DECEMBER 31, 2014 and 2013

	<u>(Expressed in Thousands)</u>	
	<u>2014</u>	<u>2013</u>
<u>Underwriting Income</u>		
Premiums earned	\$ 225,424	\$ 207,039
<u>Underwriting Expenses</u>		
Losses incurred	\$ 233,911	\$ 181,155
Loss adjustment expenses	35,433	52,545
Other	21,692	23,554
Change in premium deficiency reserve	5,779	1,466
Total underwriting expenses	<u>\$ 296,815</u>	<u>\$ 258,720</u>
Net Underwriting Gain (Loss)	<u>\$ (71,391)</u>	<u>\$ (51,681)</u>
<u>Investment Income</u>		
Investment income earned	\$ 40,243	\$ 44,889
Net realized capital gains (losses)	57,288	23,431
Total investment income	<u>\$ 97,531</u>	<u>\$ 68,320</u>
<u>Investment Expenses</u>	<u>\$ 3,319</u>	<u>\$ 3,942</u>
Net Investment Income	<u>\$ 94,212</u>	<u>\$ 64,378</u>
<u>Other Income/Expenses</u>		
Other income/(expenses)	\$ 236	\$ 169
Net loss from premium balances charged off	(10,610)	(13,198)
Total other income/expenses	<u>\$ (10,374)</u>	<u>\$ (13,029)</u>
<u>Net Income (Loss) Before Other Changes in Surplus</u>	<u>\$ 12,447</u>	<u>\$ (331)</u>
<u>Other Changes in Surplus</u>		
Change in net unrealized capital gain (loss)	\$ (9,373)	\$ 15,160
Change in nonadmitted assets	58	8,453
Total other changes in surplus	<u>\$ (9,315)</u>	<u>\$ 23,613</u>
Net change in surplus (deficit) during the year	\$ 3,132	\$ (23,282)
Surplus (deficit) at beginning of year	<u>\$ (179,087)</u>	<u>\$ (202,369)</u>
Surplus (deficit) at end of year	<u>\$ (175,955)</u>	<u>\$ (179,087)</u>

– The notes to the financial statements are an integral part of these statements. –

STATE WORKERS' INSURANCE FUND
STATEMENTS OF CASH FLOWS
STATUTORY BASIS
FOR THE YEARS ENDED DECEMBER 31, 2014 and 2013

	<u>(Expressed in Thousands)</u>	
	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Premiums collected net of reinsurance	\$ 224,903	\$ 218,143
Benefit and loss related payments	(220,863)	(204,851)
Commissions, expenses paid and aggregate write-ins	(63,229)	(63,859)
Investment income (net of investment expenses)	42,909	40,508
Miscellaneous income (uses)	<u>(7,059)</u>	<u>(7,157)</u>
Net cash from operating activities	\$ (23,339)	\$ (17,216)
Cash flows from investing activities:		
Proceeds from sale of bonds	\$ 2,430,662	\$ 764,078
Proceeds from sale of stocks	166,733	118,553
Payments for purchase of bonds	(2,447,543)	(760,504)
Payments for purchase of stocks	(134,328)	(120,160)
Miscellaneous applications	<u>(654)</u>	<u>(294)</u>
Net cash from investing activities	\$ 14,870	\$ 1,673
Net change in cash and short-term investments	\$ (8,469)	\$ (15,543)
Cash and short-term investments at beginning of year	<u>\$ 78,891</u>	<u>\$ 94,434</u>
Cash and short-term investments at end of year	<u>\$ 70,422</u>	<u>\$ 78,891</u>

– The notes to the financial statements are an integral part of these statements. –

**STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The State Workers' Insurance Fund (SWIF) prepares its statutory financial statements in accordance with statutory accounting practices as prescribed or permitted by rules and regulations promulgated by the Insurance Department of Pennsylvania. These statutory practices are primarily designed to demonstrate solvency and differ from generally accepted accounting principles (GAAP) in certain significant areas:

- Certain assets, designated as nonadmitted, are not permitted to be reported in the statutory financial statements and are charged directly to surplus. Major nonadmitted assets include premiums due in excess of statutory limitations (three months); expenses for furniture, fixtures and supplies; and unrealized gains or losses on investments. Under GAAP, these items would be treated as assets net of the related contra accounts of allowance for doubtful accounts, depreciation, and valuation allowances for investments.
- Certain disclosures required under GAAP are not required under SWIF's statutory accounting practices as follows:
 - Securities lending transactions involving the receipt of cash collateral (or securities that may be pledged or sold without default) with an asset and a liability related to the receipt of the collateral reported on SWIF's Balance Sheet.
 - A Statement of Cash Flows which includes a reconciliation of operating income to net cash provided by (used for) operating activities and which excludes short-term investments.
 - Reporting certain investments at fair value in the Balance Sheet with the current year change in fair value recognized as an element of investment income in the Operating Statement.
 - Reporting the annual required contribution, unfunded actuarial liability, and other information regarding postemployment benefits other than pensions.

Investments

Investments are stated on the basis adopted by the National Association of Insurance Commissioners (NAIC) and are recorded based on trade date. The book/adjusted carrying value of bonds is stated at amortized cost. The book/adjusted carrying value of common stock is reported at market value with market value rates taken from the custodian statement. Preferred stock is reported at cost/amortized cost. Realized investment gains or losses are included in the Operating Statement. Unrealized investment gains or losses from revaluation of investments (i.e., stocks) are charged directly to surplus. Short-term investments are recorded at cost which approximates fair value.

**STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Premium and Revenue Recognition

Premiums earned and assessments billed to policyholders are recorded as income. Unearned premiums and assessments are recorded as a liability and earned as the policy term expires. Premiums and assessments are booked as written on the effective date of the policy. Assessments paid are classified as expenses.

Loss and Loss Adjustment Expense Reserves

The liability for unpaid losses is based upon individual case estimates adjusted for incurred but not reported losses based on past experience, a probable loss reserve, and statutory minimum requirements as determined by SWIF's Actuarial Committee and independent review by outside actuaries. Loss reserves ceded by the National Workers' Compensation Reinsurance Pool and the Pennsylvania Workers' Compensation Reinsurance Pool and assumed by SWIF are included in loss reserves. The liability for loss adjustment expense is determined by SWIF's Actuarial Committee as a percentage of loss reserves based on past experience.

Use of Estimates

The preparation of the accompanying Statements of Admitted Assets, Liabilities and Surplus-statutory basis requires management to make estimates and assumptions that affect the reported amounts of admitted assets, liabilities, surplus, and disclosure of contingent liabilities at the date of this statutory financial statement. Actual results could differ from those estimates.

NOTE B - INVESTMENTS

GAAP (per Governmental Accounting Standards Board Statement No. 40) requires certain disclosures regarding policies and practices with respect to investments and the risks associated with them. Although these disclosures are not required for the statutory financial statements of SWIF, similar informative disclosures have been provided as follows:

SWIF categorizes investments according to the level of investment risk assumed by the Commonwealth. SWIF has formally adopted a written investment policy. Provisions of the written investment policy and current management of the investments consider custodial credit risk, concentration of credit risk, credit risk, interest rate risk, and foreign currency risk. The identified risks are discussed in detail below.

**STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013**

NOTE B – INVESTMENTS (Continued)

Custodial Credit Risk - Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, SWIF would not be able to recover the value of investment or collateral securities that are in the possession of an outside party. In accordance with a contractual relationship between SWIF and its custodial agents, substantially all investments, where securities are used as evidence of the investment, are held by the custodians in book entry form in the name of the Commonwealth or the custodian. These investments are defined as insured or registered investments for which the securities are held by SWIF or its agent.

Concentration of Credit Risk - Concentration of credit risk is the risk of loss attributed to the magnitude of the government's investment in a single issuer. SWIF's investment policy does not place a limit on the concentration of investments in any one issuer.

Credit Risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The credit risk of a debt instrument is measured by nationally-recognized statistical rating agencies such as Moody's Investors Services (Moody's). SWIF requires fund assets to be invested in investment grade bonds rated BBB/Baa (or equivalent) or better except that investment managers assigned to a high yield index may invest in non-investment grade bonds. The investments rated NR and WR represent not rated and withdrawn ratings, respectively, and approximate 5.6 percent of the fixed income portfolio at December 31, 2014, excluding share balances of \$45.4 million in Treasury's unrated short-term investment pools, and including US agency securities, mortgage-backed securities, asset-backed securities, and corporate obligations. The following tables disclose aggregate fair value, by major Moody's credit quality rating category at December 31, 2014 and 2013 (amounts in thousands):

December 31, 2014

<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
US Agency	\$ 3,346	A1	0.22%
US Agency	7,529	A2	0.51%
US Agency	1,140	A3	0.08%
US Agency	2,995	AA1	0.20%
US Agency	3,659	AA2	0.25%
US Agency	3,629	AA3	0.24%
US Agency	35,376	AAA	2.37%
US Agency	329	BAA2	0.02%
US Agency	10,786	NR	0.72%
US Agency	552	WR	0.04%
Total US Agency Securities	\$ 69,341		

**STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013**

NOTE B – INVESTMENTS (Continued)

<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
US Government	\$ 263,065	AAA	17.66%
Total US Government Securities	\$ 263,065		
Mortgage-Backed Securities	\$ 1,537	A1	0.10%
Mortgage-Backed Securities	1,453	A2	0.10%
Mortgage-Backed Securities	1,359	A3	0.09%
Mortgage-Backed Securities	1,004	AA1	0.07%
Mortgage-Backed Securities	2,165	AA2	0.15%
Mortgage-Backed Securities	1,465	AA3	0.10%
Mortgage-Backed Securities	258,161	AAA	17.33%
Mortgage-Backed Securities	498	BA2	0.03%
Mortgage-Backed Securities	7	BA3	0.00%
Mortgage-Backed Securities	2,284	BAA1	0.15%
Mortgage-Backed Securities	1,148	BAA2	0.08%
Mortgage-Backed Securities	2,815	BAA3	0.19%
Mortgage-Backed Securities	24	CAA1	0.00%
Mortgage-Backed Securities	74	CAA3	0.00%
Mortgage-Backed Securities	10,127	NR	0.68%
Total Mortgage-Backed Securities	\$ 284,121		
Asset-Backed Securities	\$ 613	AA2	0.04%
Asset-Backed Securities	1,083	AA3	0.07%
Asset-Backed Securities	48,920	AAA	3.28%
Asset-Backed Securities	343	B3	0.02%
Asset-Backed Securities	1,541	BAA1	0.11%
Asset-Backed Securities	1,020	BAA2	0.07%
Asset-Backed Securities	253	BA3	0.02%
Asset-Backed Securities	11,225	NR	0.75%
Total Asset-Backed Securities	\$ 64,998		

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013

NOTE B – INVESTMENTS (Continued)

<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
Corporate Obligations	\$ 66,513	A1	4.47%
Corporate Obligations	69,414	A2	4.66%
Corporate Obligations	90,786	A3	6.09%
Corporate Obligations	7,328	AA1	0.49%
Corporate Obligations	32,482	AA2	2.18%
Corporate Obligations	27,929	AA3	1.88%
Corporate Obligations	6,753	AAA	0.45%
Corporate Obligations	1,474	B1	0.10%
Corporate Obligations	350	B2	0.02%
Corporate Obligations	16,126	BA1	1.08%
Corporate Obligations	8,248	BA2	0.55%
Corporate Obligations	10,336	BA3	0.69%
Corporate Obligations	100,597	BAA1	6.75%
Corporate Obligations	105,118	BAA2	7.06%
Corporate Obligations	51,781	BAA3	3.48%
Corporate Obligations	37,078	NR	2.49%
Corporate Obligations	3,725	WR	0.25%
Total Corporate Obligations	\$ 636,038		
Treasury Investment Program	\$ 45,449	NR	3.05%
Total Fixed Income Securities	\$ 1,363,012		
Equity Securities	\$ 125,369	NR	8.42%
Preferred Securities	\$ 1,474	NR	0.10%
Total Portfolio at December 31, 2014	\$ 1,489,855		100.00%

**STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013**

NOTE B – INVESTMENTS (Continued)

December 31, 2013

<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
US Agency	\$ 11,176	A1	0.77%
US Agency	584	A2	0.04%
US Agency	1,542	A3	0.11%
US Agency	7,648	AA1	0.53%
US Agency	8,812	AA2	0.61%
US Agency	4,139	AA3	0.29%
US Agency	90,461	AAA	6.23%
US Agency	255	BAA2	0.02%
US Agency	13,029	NR	0.90%
US Agency	555	WR	0.04%
Total US Agency Securities	\$ 138,201		
US Government	\$ 430,673	AAA	29.68%
Total US Government Securities	\$ 430,673		
Mortgage-Backed Securities	\$ 778	A1	0.05%
Mortgage-Backed Securities	508	A3	0.03%
Mortgage-Backed Securities	374	AA2	0.02%
Mortgage-Backed Securities	1,994	AA3	0.14%
Mortgage-Backed Securities	139,944	AAA	9.64%
Mortgage-Backed Securities	21	B2	0.00%
Mortgage-Backed Securities	1,137	BAA2	0.08%
Mortgage-Backed Securities	546	BAA3	0.04%
Mortgage-Backed Securities	29	CAA1	0.00%
Mortgage-Backed Securities	74	CAA3	0.00%
Mortgage-Backed Securities	8,393	NR	0.58%
Total Mortgage-Backed Securities	\$ 153,798		

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013

NOTE B – INVESTMENTS (Continued)

<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
Asset-Backed Securities	\$ 833	A1	0.06%
Asset-Backed Securities	415	A2	0.03%
Asset-Backed Securities	30,613	AAA	2.11%
Asset-Backed Securities	373	BAA1	0.02%
Asset-Backed Securities	213	BAA3	0.01%
Asset-Backed Securities	7,105	NR	0.49%
Total Asset-Backed Securities	\$ 39,552		
Corporate Obligations	\$ 56,766	A1	3.91%
Corporate Obligations	62,509	A2	4.31%
Corporate Obligations	63,889	A3	4.40%
Corporate Obligations	6,872	AA1	0.47%
Corporate Obligations	16,962	AA2	1.17%
Corporate Obligations	26,710	AA3	1.84%
Corporate Obligations	12,545	AAA	0.86%
Corporate Obligations	10,409	B1	0.72%
Corporate Obligations	5,307	B2	0.37%
Corporate Obligations	1,275	B3	0.09%
Corporate Obligations	6,935	BA1	0.48%
Corporate Obligations	8,843	BA2	0.61%
Corporate Obligations	17,937	BA3	1.24%
Corporate Obligations	85,882	BAA1	5.92%
Corporate Obligations	78,046	BAA2	5.38%
Corporate Obligations	18,705	BAA3	1.29%
Corporate Obligations	421	CAA1	0.03%
Corporate Obligations	429	CAA2	0.03%
Corporate Obligations	7,990	NR	0.55%
Corporate Obligations	1,776	WR	0.12%
Total Corporate Obligations	\$ 490,208		
Treasury Investment Program	\$ 54,403	NR	3.75%
Total Fixed Income Securities	\$ 1,306,835		

**STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013**

NOTE B – INVESTMENTS (Continued)

<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
Equity Securities	\$ 144,021	NR	9.93%
Preferred Securities	\$ 101	A3	0.01%
Total Portfolio at December 31, 2013	\$ 1,450,957		100.00%

Interest Rate Risk - Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. SWIF measures interest rate risk using duration. As means for limiting SWIF's exposure to fair value losses arising from rising interest rates, SWIF requires investments to have maturities consistent with SWIF's liabilities. SWIF's long-term asset allocation diversifies its fixed income core segment between intermediate duration and longer duration strategies. Duration is a measure of an investment's sensitivity to changes in interest rates. The higher the duration, the greater the changes in fair value when interest rates change. For reporting purposes, SWIF elects to use option-adjusted duration, which takes into account embedded options affecting cash flows. At December 31, 2014 and 2013, SWIF's fixed income portfolio had the following option-adjusted durations by fixed income sector:

<u>December 31, 2014</u> <u>Investment Type</u>	<u>Amount</u>	<u>Duration (in years)</u>
US Agency Securities	\$ 69,341	6.96
US Government Securities	263,065	9.84
Mortgage-Backed Securities	284,121	2.76
Asset-Backed Securities	64,998	2.25
Corporate Obligations	636,038	7.01
Treasury Investment Program	45,449	N/A
Total Fixed Income Securities	\$ 1,363,012	
Equity Securities	125,369	N/A
Preferred Securities	1,474	N/A
Total Portfolio Securities	\$ 1,489,855	

**STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013**

NOTE B – INVESTMENTS (Continued)

<u>December 31, 2013</u> <u>Investment Type</u>	<u>Amount</u>	<u>Duration</u> <u>(in years)</u>
US Agency Securities	\$ 138,201	7.41
US Government Securities	430,673	10.32
Mortgage-Backed Securities	153,798	3.09
Asset-Backed Securities	39,552	2.22
Corporate Obligations	490,208	5.39
Treasury Investment Program	54,403	N/A
Total Fixed Income Securities	<u>\$ 1,306,835</u>	
Equity Securities	144,021	N/A
Preferred Securities	101	N/A
Total Portfolio Securities	<u>\$ 1,450,957</u>	

N/A – Indicates duration is not applicable to investment.

Foreign Currency Risk - Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. All SWIF investments are denominated in US dollars, issued under US laws and regulations, designed for US investors, and traded in US markets.

Securities Lending Program

The Fiscal Code provides the Treasury Department with numerous custodial responsibilities; the securities lending program (SLP) is an integral part of the custodial function. A contract between the Treasury Department and its custodian, acting as lending agent, provides that the custodian lends securities owned by SWIF to independent brokers, dealers and banks, acting as borrowers.

Lending agreements between the custodian and the borrowers require that the custodian receives collateral from the borrowers in exchange for the securities lent. For collateral received which is not denominated in United States dollars or whose primary trading market is located outside the United States, the fair value of the collateral received must be at least 105 percent of the fair value of the securities lent. The fair value of all other collateral received must be at least 102 percent of the fair value of the securities lent. Securities lent consist of both domestic and foreign equity securities and United States Treasury and foreign debt obligations. Almost all collateral received consists of cash; a very small portion of collateral received consists of letters of credit, United States Treasury, corporate, and/or foreign debt obligations. Collateral is priced

**STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013**

NOTE B – INVESTMENTS (Continued)

to market daily. Additional collateral from borrowers is required if the fair value of the collateral received declines below lending agreement requirements. The lending agent cannot pledge or sell collateral securities received unless the borrower defaults. Accordingly, neither collateral securities received from borrowers nor the related obligations to borrowers are reported.

To the extent collateral received consists of cash, the lending agent may use or invest the cash in accordance with reinvestment guidelines approved by the Treasury Department. Either the participant or the borrower may terminate lending agreements on demand. Lending agreements are typically of very short duration – usually overnight. Therefore, the duration of lending agreements does not generally match the maturities of the investments made with cash collateral. The resulting interest rate risk is mitigated by the lending agent's ability to reallocate lending agreements among SLP participants.

The SLP requires that the lending agent indemnify the Treasury Department for all claims, liabilities and costs resulting from the lending agent's negligence or intentional misconduct. During the fiscal year ended December 31, 2014, there were no failures by any borrower to return securities lent or pay distributions thereon. Also, there were no losses resulting from a lending agent or borrower default, and there were no Treasury Department restrictions on the amount of the loans that could be made.

At December 31, 2014 and 2013 there was no credit risk to the borrowers because the fair value of collateral received was greater than the fair value of the securities lent, consistent with the lending agreements outstanding. The carrying amount and fair value (in thousands) of the securities lent was \$114,205 and \$80,177, respectively.

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013

NOTE B – INVESTMENTS (Continued)

SWIF's investment securities owned at December 31, 2014 and 2013, were as follows (amounts in thousands):

<u>December 31, 2014</u>		
	<u>Book/Adjusted</u> <u>Carrying Value</u>	<u>Market Value</u>
<u>Bonds</u>		
Government	\$ 332,486	\$ 341,154
States, Territories and Possessions	17,699	19,517
Political Subdivisions of States, Territories, and Possessions	8,042	8,970
Revenue & Special Obligations	39,955	41,618
Residential Mortgage-Backed Securities	193,624	197,122
Industrial & Miscellaneous	670,203	688,073
<u>Total Bonds</u>	<u>\$ 1,262,009</u>	<u>\$ 1,296,454</u>
<u>Common Stocks</u>	<u>\$ 125,369</u>	<u>\$ 125,369</u>
<u>Preferred Stocks</u>	<u>\$ 1,434</u>	<u>\$ 1,474</u>
<u>Short-Term Investments</u>	<u>\$ 66,558</u>	<u>\$ 66,558</u>
<u>December 31, 2013</u>		
	<u>Book/Adjusted</u> <u>Carrying Value</u>	<u>Market Value</u>
<u>Bonds</u>		
Government	\$ 504,919	\$ 503,735
States, Territories and Possessions	18,247	18,693
Political Subdivisions of States, Territories, and Possessions	15,933	15,884
Revenue & Special Obligations	56,986	57,591
Residential Mortgage-Backed Securities	98,100	97,375
Industrial & Miscellaneous	524,443	539,037
<u>Total Bonds</u>	<u>\$ 1,218,628</u>	<u>\$ 1,232,315</u>
<u>Common Stocks</u>	<u>\$ 144,021</u>	<u>\$ 144,021</u>
<u>Preferred Stocks</u>	<u>\$ 101</u>	<u>\$ 101</u>
<u>Short-Term Investments</u>	<u>\$ 74,520</u>	<u>\$ 74,520</u>

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013

NOTE B – INVESTMENTS (Continued)

In accordance with the Fiscal Code, cash balances of most Commonwealth funds, including SWIF, are pooled by the Treasury Department. SWIF's short-term investments were also pooled for the calendar years ended December 31, 2014 and 2013. Pertaining to marketable equity securities, both December 31, 2014 and December 31, 2013 showed net unrealized capital gains (in thousands) of \$21,168 and \$30,541, respectively.

NOTE C - COMPOSITION OF LOSS RESERVES AND INCURRED BUT NOT REPORTED (IBNR) LOSSES

	December 31, 2014		
	(Amounts in Thousands)		
	<u>Coal</u>	<u>Commercial</u>	<u>Total</u>
<u>Loss Reserves</u>			
Indemnity	\$ 23,431	\$ 451,616	\$ 475,047
Medical	4,361	148,550	152,911
Bulk	15,010	944,051	959,061
Total Loss Reserves	<u>\$ 42,802</u>	<u>\$ 1,544,217</u>	<u>\$ 1,587,019</u>
<u>IBNR Loss Reserves</u>	<u>\$ 1,088</u>	<u>\$ 83,429</u>	<u>\$ 84,517</u>
<u>Net Losses</u>			<u>\$ 1,671,536</u>
Add:			
Assumed Outstanding Loss Reserves (Including IBNR)			1,830
Less:			
Discount of Reserves			(305,045)
Recoverable Reinsurance (Including IBNR)			<u>(2,175)</u>
<u>Net Unpaid Losses</u>			<u>\$ 1,366,146</u>

**STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013**

NOTE C - COMPOSITION OF LOSS RESERVES AND INCURRED BUT NOT REPORTED (IBNR) LOSSES (Continued)

	December 31, 2013 (Amounts in Thousands)		
	<u>Coal</u>	<u>Commercial</u>	<u>Total</u>
<u>Loss Reserves</u>			
Indemnity	\$ 24,292	\$ 493,620	\$ 517,912
Medical	4,200	141,210	145,410
Bulk	14,257	900,092	914,349
Total Loss Reserves	<u>\$ 42,749</u>	<u>\$ 1,534,922</u>	<u>\$ 1,577,671</u>
<u>IBNR Loss Reserves</u>	<u>\$ 1,257</u>	<u>\$ 79,904</u>	<u>\$ 81,161</u>
<u>Net Losses</u>			\$ 1,658,832
Add:			
Assumed Outstanding Loss Reserves (Including IBNR)			2,055
Less:			
Discount of Reserves			(306,163)
Recoverable Reinsurance (Including IBNR)			<u>(6,004)</u>
<u>Net Unpaid Losses</u>			<u>\$ 1,348,720</u>

NOTE D - PENSION AND OTHER POSTEMPLOYMENT BENEFITS

Plan Description: To provide pension benefits for employees of state government and certain other organizations, the State Employees' Retirement System (SERS) administers a cost-sharing multiple-employer defined benefit retirement plan. The plan, covering substantially all Commonwealth employees, is a contributory defined benefit pension plan as established by Commonwealth laws.

Retirement Benefits: Under the plan, for most employees hired prior to January 1, 2011, retirement benefits vest after 5 years of credited service. Generally, employees who retire at age 60 or, if under age 60, with 35 years of service are entitled to a normal (unreduced) annual retirement benefit. The general annual benefit is 2 percent of a Class A member's highest three-year average salary multiplied by years of service. This annual benefit is 2.5 percent for Class AA members.

**STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013**

NOTE D - PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

Act 2010-120 (Act 120), which preserved all benefits in place for members, mandated a number of benefit reductions for new members effective January 1, 2011. The benefit reduction included a new class of membership that accrues benefits at 2 percent of their final average salary instead of the previous 2.5 percent. The new vesting period changed from five to ten years of credited service, and the option to withdraw lump sum accumulated employee contributions was eliminated. The new normal retirement age is 65 for most employees. Act 120 created a new A-3 class of service and an optional A-4 class for most employees that entered SERS membership for the first time on or after January 1, 2011. The general annual benefit for Class A-3 members is 2 percent of the member's highest three-year average salary times years of service while the Class A-4 benefit accrual rate is 2.5 percent.

Summary of Significant Accounting Policies: The SERS financial statements are prepared on the accrual basis of accounting, whereby expenses are recorded when the liability is incurred, revenues are recorded in the accounting period in which they are earned and become measurable, and investment purchases and sales are recorded as of the related trade date. Member and employer contributions are recognized in the period in which employee salaries are reported. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

SERS issues stand-alone financial statements which are available at www.sers.state.pa.us. Written requests for financial statements should be directed to the following address:

State Employees' Retirement System
30 North Third Street, Suite 150
Harrisburg, PA 17101-1716

Funding Policy: All member contribution rates are determined by Commonwealth law. The active plan member contribution rate is 6.25 percent of covered payroll for employees in Class AA; for Class A members, the contribution rate is 5 percent. The general membership contribution rate under Act 120 for A-3 and A-4 members is 6.25 percent and 9.3 percent of salary, respectively. The SERS Board has the authority to establish or amend periodic employer contributions at actuarially determined rates, expressed as a percentage of annual covered payroll.

**STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013**

NOTE D - PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

During each of the three years ended December 31, the annual required employer contribution and the related percentage of that amount actually contributed are as follows:

<u>Year Ended December 31</u>	<u>Annual Required Contribution (ARC) (in thousands)</u>	<u>Percentage of ARC Contributed</u>
2014	\$1,407,361	76.9%
2013	\$1,314,925	60.2%
2012	\$1,044,632	53.9%

The SWIF's contributions (in thousands) for the fiscal years ended December 31, 2014 and 2013 were \$2,631 and \$1,937, respectively.

Additional pertinent information regarding SERS, outside the scope of SWIF reporting, is published each year as part of the Commonwealth of Pennsylvania's Basic Financial Statements included in the Comprehensive Annual Financial Report.

Postemployment Health Care Benefits: The Commonwealth established and sponsors a Retired Employees Health Program (REHP) plan which provides postemployment benefits other than pensions (OPEB). This plan is administered by the Pennsylvania Employee Benefits Trust Fund (PEBTF), which acts as a third-party administrator and administers the REHP under an administrative agreement with the Commonwealth. The plan is a single employer defined benefit OPEB plan. The SWIF participates in the REHP, which provides a variety of healthcare benefits to eligible retirees. The OPEB plan and benefit provisions therein have been established under pertinent statutory authority. The OPEB plan does not issue a stand-alone financial report, nor is it included in the financial statements of a public employee retirement system.

REHP contribution requirements are established by the Office of Administration and the Governor's Budget Office. During the period January 1, 2014 to June 30, 2014, SWIF contributed \$305 for each active employee paid and reported as part of biweekly payroll expenses for its employees. During the period July 1, 2014 to December 31, 2014, SWIF contributed \$334 for each active employee paid and reported as part of biweekly payroll expenses for its employees. SWIF recognizes the cost of providing these benefits, which for the fiscal years ended December 31, 2014 and 2013 totaled \$2,629 and \$2,467, respectively, as paid (in thousands).

Additional pertinent information on the REHP, outside the scope of SWIF reporting, including overall actuarial liabilities and assumptions related to the Commonwealth as a whole, is published each year as part of the Commonwealth of Pennsylvania's Basic Financial Statements included in the Comprehensive Annual Financial Report.

**STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014 and 2013**

NOTE E - INSURANCE LOSS LIABILITY

The reported insurance loss liability is primarily based on historical claims experience. One of the assumptions used to determine the reported liability amount includes using a discount rate of 2.00 percent at December 31, 2014 and December 31, 2013. There is uncertainty as to whether the reported liability will be supported by future claim experience, including payments; this uncertainty must be considered when evaluating the reported insurance loss liability. Like other private insurance carriers authorized to transact and provide workers' compensation insurance in the Commonwealth, SWIF is required to pay assessments into the Pennsylvania Workers' Compensation Security Fund, a separate special revenue fund established by the Pennsylvania Department of Insurance to authorize and account for the payment of workers' compensation claims to individuals who are insured by insurance carriers that become insolvent.

For the two calendar years ended December 31, 2014 and 2013, the following summary provides information on prior year reported insurance loss liability, incurred claims and payments, and current year reported insurance loss liability (amounts in thousands):

Year Ended December 31	Prior Year Liability	Incurred Claims		Payments		Current Year Liability
		Current	Prior	Current	Prior	
2014	\$1,577,783	\$224,392	\$44,946	\$43,414	\$209,723	\$1,593,984
2013	\$1,587,276	\$225,901	\$7,793	\$43,931	\$199,256	\$1,577,783

NOTE F – SURPLUS AS REGARDS POLICYHOLDERS

By statute, the State Workers' Insurance Board (board) is required to set aside a percentage of premiums to sufficiently maintain the surplus to cover the catastrophe hazard of all the subscribers in the fund and to guarantee the solvency of the fund. The statute also provides that the board shall have the power to reinsure any risk which they may deem necessary. Accordingly, with the assistance of JLT Re Inc., SWIF entered into contracts with several reinsurers to provide catastrophe coverage to its policyholders. The reinsurance is intended to protect and enhance SWIF's capital base.

As a result of this reinsurance program, SWIF's catastrophe reserve is not required as a set aside of the fund's unassigned surplus.



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EUGENE A. DePASQUALE
AUDITOR GENERAL

**Report on Internal Control Over Financial Reporting and on Compliance and Other
Matters Based on an Audit of Financial Statements Performed in Accordance With
*Government Auditing Standards***

Independent Auditor's Report

The Honorable Tom Wolf
Governor
Commonwealth of Pennsylvania
Harrisburg, PA 17120

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Statements of Admitted Assets, Liabilities and Surplus-statutory basis of the State Workers' Insurance Fund (SWIF), the related Statements of Operations and Changes in Surplus-statutory basis and the Statements of Cash Flows-statutory basis as of and for the years ended December 31, 2014, and December 31, 2013, and the related notes to the financial statements and have issued our report thereon dated December 4, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered SWIF's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of SWIF's internal control. Accordingly, we do not express an opinion on the effectiveness of SWIF's internal control.

A deficiency in internal control 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 and correct, misstatements on a timely basis. *A material weakness* is a

deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a certain deficiency in internal control, described in the accompanying Finding Section as Finding No. 1, that we consider to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether SWIF's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

SWIF's Response to the Finding

SWIF's response to the finding identified in our audit is described in the accompanying Finding Section. SWIF's response was not subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of SWIF's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SWIF's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Eugene A. DePasquale
Auditor General

December 4, 2015

**STATE WORKERS' INSURANCE FUND
FINDING
DECEMBER 31, 2014 and 2013**

Finding No. 1 – General Computer Controls in SWIF Need Improvement (A Similar Condition Was Noted in Prior Year Finding No. 1)

Condition: Our review of general computer controls at SWIF for the calendar year ended December 31, 2014, disclosed the following internal control deficiencies that need to be addressed by SWIF management:

1. There is no formally documented system development life cycle (SDLC) policy as required by Commonwealth Information Technology Policy (ITP) – APP012, “Systems Development Life Cycle Policy”, to outline requirements for planning, designing, developing, testing, approving, and implementing new applications and upgrades to existing applications, including vendor-developed software.

Agency Response: Finding is acknowledged. The Office of Information Technology (OIT) is still in the process of documenting an enterprise SDLC.

2. There are no formal reconciliation policies in place to ensure that data migrates successfully and accurately when new or upgraded software applications are implemented.

Agency Response: Finding is acknowledged. OIT has drafted a data migration validation template which can be used by application development projects. See the attached. Additionally, a Request for Proposal (RFP) is currently being drafted to modernize the SWIF systems. The modernization of the SWIF systems will include a data migration, which will include formal reconciliation processes as requirements of the RFP and associated project.

3. Administrators log in to an OnBase (document management system) service account with a shared password to access a production server.

Agency Response: Finding is acknowledged. Addressing the current deficiencies of the SWIF imaging solution (OnBase) will be part of the pending SWIF Modernization RFP. This includes, but is not limited to, user authentication/authorization and data encryption. Also, there is the potential for the OnBase product to be upgraded during the first half of 2016. OIT will evaluate the updated version of OnBase to see if it can meet all requirements.

4. Password requirements for PowerComp (workers compensation policy and claim software), Freedom Financial (general ledger and financial reporting software) and Iworks (investment portfolio software) did not fully comply with one or more of the requirements of the Information Technology Policy (ITP) – SEC007, “Minimum Standards for User IDs and Passwords,” specifically regarding inadequate settings for minimum length, password complexity, password expiration, and user lockout after multiple failed login attempts.

**STATE WORKERS' INSURANCE FUND
FINDING
DECEMBER 31, 2014 and 2013**

Agency Response: Finding is acknowledged. While the PowerComp system uses the userID as its password, the user must first log onto the workstation with their CWOPA ID and password. The system requires the userID entered to match the ID that was used to log onto the workstation. As part of the RFP to modernize the SWIF systems the PowerComp application will be replaced with a system that meets all requirements. A Commonwealth of Pennsylvania Policy and Procurement Action Request (COPPAR) waiver (2015ITBW0648) has been submitted for review by the Office of Administration related to OA IT Policy SEC-007 (Minimum Standards for User ID and Passwords).

5. As a result of software limitations, PowerComp users log on to the application using their CWOPA user ID, which is also their password.

Agency Response: Finding is acknowledged. While the PowerComp system uses the userID as its password, the user must first log onto the workstation with their CWOPA ID and password. The system requires the userID entered to match the ID that was used to log onto the workstation. As part of the RFP to modernize the SWIF systems the PowerComp application will be replaced with a system that meets all requirements. A COPPAR waiver (2015ITBW0648) has been submitted for review by the Office of Administration (OA) related to OA IT Policy SEC-007 (Minimum Standards for User ID and Passwords).

Criteria: A well-designed system of internal controls dictates that sound general computer controls be established and functioning to best ensure that overall SWIF operations are conducted as closely as possible in accordance with management's intent.

Cause: Weaknesses related to user IDs and passwords have not been corrected due to limitations in vendor-provided software. Further, SWIF management continues to wait for several years for guidance on policies for system development life cycle and data migration from the Department of Labor and Industry.

Effect: If general computer control areas are not improved, computer and other agency operations may not be conducted in accordance with SWIF management's intent.

Collectively, we consider the above exceptions to be a significant deficiency under generally accepted auditing standards. The auditing standards define a significant deficiency as a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Recommendation: We recommend that SWIF management review the general computer control deficiencies noted above and take the necessary actions to resolve them.

**STATE WORKERS' INSURANCE FUND
FINDING
DECEMBER 31, 2014 and 2013**

Auditors' Conclusion

Based on the agency's response, the finding and recommendation remain as previously stated. We will review any corrective action in the subsequent audit.

**COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND DISTRIBUTION LIST
DECEMBER 31, 2014 and 2013**

This report was initially distributed to the following:

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