FINANCIAL AUDIT

Commonwealth of Pennsylvania

Department of Labor and Industry
State Workers' Insurance Fund

Harrisburg, Pennsylvania
For the Years Ended December 31, 2018
And December 31, 2017

December 2019

Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General

TABLE OF CONTENTS

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.

Commonwealth of Pennsylvania
Department of the Auditor General
Harrisburg, PA 17120-0018
Facebook: Pennsylvania Auditor General
Twitter: @PAAuditorGen
www.PaAuditor.gov

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, 2018, and December 31, 2017, 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, 2018, and December 31, 2017, 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 1993 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 purpose 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 2, 2019, 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.

Restriction on Use

Our report is intended solely for the information and use of the board of directors and management of SWIF, others within the entity, and for filing with the Insurance Department of Pennsylvania, and is not intended to be and should not be used by anyone other than those specified parties.

December 2, 2019

Eugene A. DePasquale
Auditor General

SWIF MANAGEMENT'S DISCUSSION AND ANALYSIS

Assets and Liabilities

The State Workers' Insurance Fund (SWIF) disclosed total admitted assets of $1.43 billion as of December 31, 2018. This was a decrease of $46.6 million or 3.15% from 2017. Total investments decreased from $1.414 billion in 2017 to $1.372 billion in 2018 or a $42 million decrease. This decrease came from a decrease of $40.5 million in stocks. Also contributing to the decline in total assets was a $9.9 million decrease in premiums, agents' balances and installments booked but deferred and not yet due.

SWIF's total liabilities decreased to $1.508 billion, a decrease of $83.1 million or 5.2% from the prior year. Net unpaid losses decreased as of year-end 2018 to $1.190 billion from $1.244 billion in the prior year, a decrease of $54 million or 4.3%. This decrease was due to an actuarial adjustment to SWIF's incurred but not reported and bulk reserves. All other liabilities decreased $29.2 million, mainly due to a decrease of $19.9 million in unpaid loss adjustment expenses and a $5.8 million decrease in unearned premiums.

Surplus

Surplus as regards policyholders was ($74.9) million, a decrease in the deficit of $36.5 million or 32.7% for 2018 as compared to the reported deficit of ($111.4) million in 2017. SWIF's net income before other changes in surplus for 2018 was $66.9 million versus a net income in 2017 of $61.7 million. The improvement to SWIF's deficit was largely due to the net income of $66.9 million offset by the change in unrealized capital loss of ($32) million.

SWIF continues to discount its loss reserves at a discount rate of 2%.

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.

SWIF MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

Operational Results

SWIF recorded net income before other changes in surplus of $66.9 million for 2018. This is an increase of $5.2 million as compared to the 2017 net income of $61.7 million. Earned premiums decreased by $15.9 million or 9%, to $160.3 million in 2018, from $176.2 million in 2017. This decline in earned premium was offset by a decrease in loss and loss adjustment expenses incurred of $26.8 million. Losses incurred decreased $4.1 million and loss adjustment expenses incurred decreased $22.7 million. This led to an underwriting gain of $26.6 million. The decline in losses incurred and loss adjustment expense is the direct result of the decline in exposures as well as open claims.

Net investment income decreased 12.7% or $7.1 million to $49 million. During 2018, SWIF had a decrease in its investment portfolio performance as total yield fell to -0.8% from 6.0% in 2017. The 2018 yield of SWIF's fixed income portfolio was -0.5% and equity yield was -4.5%.

During 2018, SWIF also had a $9.5 million net loss in charged off premium that reduced SWIF's overall net income. 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 2018, 518 claims were settled that resulted in loss reserve savings of $36.6 million.

SWIF continued to reduce staffing through attrition. During 2018, SWIF's filled complement was reduced by 7 positions to 209 as of December 2018.

SWIF contracted with Hoover Rehabilitation Inc. in May 2013 for their Medical Bill Repricing, Preferred Provider Organization, Pharmacy Benefit Management, and Durable Medical Equipment. During 2018, SWIF realized net savings below medical bill fee schedule of 12.23% for medical bill payment savings of $9.7 million. Since inception, this program has realized net savings of $66.9 million.

SWIF MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

During 2018, SWIF's Customer Service Unit handled 63,475 of the 73,889 calls received or 86% of all calls. This unit eliminates the need to transfer calls to the Underwriting, Claims, Auditing, and Accounting Divisions. This unit also handled 4,224 first report of injury calls.

SWIF's current computer system went live in 2005. SWIF is currently under contract negotiations with a selected vendor for a new system, with a planned release in 2021. It is anticipated that the new system will allow for the enhanced use of online capability to provide expanded customer service features for SWIF policyholders and claimants. As part of the project, there will also be a business process reengineering effort to move SWIF's current processes more in line with private industry.

As of April 2018, SWIF's Commercial Loss Cost Multiplier (LCM) remained at 3.187 and Coal LCM at 1.904.

In 2017, SWIF began to transition its investment portfolio to the Office of the State Treasurer, which should lead to savings in SWIF's future investment expense. The equity portion of the portfolio was transitioned in 2018 and the fixed portion will be completed in 2019.

SWIF is the third-party administrator for the Commonwealth's Uninsured Employers Guarantee Fund and the Self-Insurance Guarantee Fund which resulted in annual revenue of $624,598 for 2018.

In May 2018 SWIF raised its minimum premium from $492 to $564.

SWIF introduced the use of credit cards for payment on past due premium. Through December 2018 SWIF collected $508,347 in premium via credit card payments.

STATE WORKERS' INSURANCE FUND
STATEMENTS OF ADMITTED ASSETS, LIABILITIES AND SURPLUS
STATUTORY BASIS
DECEMBER 31, 2018 and 2017

(Expressed in Thousands)

ADMITTED ASSETS	2018	2017
Investments		
Bonds	$ 1,226,817	$ 1,222,976
Stocks	95,541	136,072
Short-term investments	49,768	54,519
Total investments - Note B	$ 1,372,126	$ 1,413,567
Cash		
On deposit in Treasury Department	$ 2,640	$ 3,356
Receivables		
Uncollected premiums in course of collection	$ 5,355	$ 417
Premiums, agents' balances, and installments booked but deferred and not yet due	40,993	50,919
Reinsurance recoverable on loss payments	2,234	1,998
Interest due and accrued on investments	9,722	9,030
Funds held by or deposited with reinsurance companies	14	14
Other amounts receivable under reinsurance contacts	0	265
Accrued retrospective premiums	152	268
Total receivables	$ 58,470	$ 62,911
Total Admitted Assets	$ 1,433,236	$ 1,479,834
LIABILITIES AND SURPLUS		
Liabilities		
Net unpaid losses – Notes C and E	$ 1,190,090	$ 1,243,913
Unpaid loss adjustment expenses	233,618	253,529
Reinsurance payable	22	28
Accrued administrative expenses	9,251	8,138
Unearned premiums	56,303	62,141
Ceded reinsurance premiums payable	3	0
Policyholders' premium credit balances	10,783	11,402
Restricted account – Commonwealth Self Insurance	2,460	2,410
Policyholder deposits	1,910	1,917
Net payable for securities	106	3,045
Other liabilities	3,637	4,726
Total liabilities	$ 1,508,183	$ 1,591,249
Surplus		
Unassigned surplus (deficit) – Note F	$ (74,947)	$ (111,415)
Total surplus (deficit) as regards policyholders	$ (74,947)	$ (111,415)
Total Liabilities and Surplus	$ 1,433,236	$ 1,479,834

– 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, 2018 and 2017

(Expressed in Thousands)

		2018		2017
Underwriting Income				
Premiums earned	$	160,309	$	176,183
Underwriting Expenses				
Losses incurred	$	100,695	$	104,839
Loss adjustment expenses		14,058		36,749
Other		18,945		21,130
Total underwriting expenses	$	133,698	$	162,718
Net Underwriting Gain (Loss)	$	26,611	$	13,465
Investment Income				
Investment income earned	$	46,437	$	42,805
Net realized capital gains (losses)		5,150		17,215
Total investment income	$	51,587	$	60,020
Investment Expenses	$	2,439	$	3,738
Net Investment Income	$	49,148	$	56,282
Other Income/Expenses				
Other income/(expenses)	$	630	$	642
Net loss from premium balances charged off		(9,483)		(8,690)
Total other income/expenses	$	(8,853)	$	(8,048)
Net Income (Loss) Before Other Changes in Surplus	$	66,906	$	61,699
Other Changes in Surplus				
Change in net unrealized capital gain (loss)	$	(32,261)	$	7,000
Change in nonadmitted assets		1,823		(2,106)
Total other changes in surplus	$	(30,438)	$	4,894
Net change in surplus (deficit) during the year	$	36,468	$	66,593
Surplus (deficit) at beginning of year	$	(111,415)	$	(178,008)
Surplus (deficit) at end of year	$	(74,947)	$	(111,415)

– 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, 2018 and 2017

	(Expressed in Thousands)	
	2018	**2017**
Cash flows from operating activities:		
Premiums collected net of reinsurance	$ 161,485	$ 172,659
Benefit and loss related payments	(154,494)	(165,331)
Commissions, expenses paid and aggregate write-ins	(51,037)	(58,601)
Investment income (net of investment expenses)	42,722	41,296
Miscellaneous income (uses)	(8,853)	(8,048)
Net cash from operating activities	$ (10,177)	$ (18,025)
Cash flows from investing activities:		
Proceeds from sale of bonds	$ 925,721	$ 853,912
Proceeds from sale of stocks	140,960	133,378
Payments for purchase of bonds	(949,960)	(856,717)
Payments for purchase of stocks	(107,323)	(111,387)
Miscellaneous proceeds (applications)	(2,939)	(7,101)
Net cash from investing activities	$ 6,459	$ 12,085
Cash flows from miscellaneous sources:		
Other cash provided (applied)	$ (1,749)	$ 144
Net change in cash and short-term investments	$ (5,467)	$ (5,796)
Cash and short-term investments at beginning of year	$ 57,875	$ 63,671
Cash and short-term investments at end of year	$ 52,408	$ 57,875

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

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 net pension liability and related deferred outflows of resources and deferred inflows of resources.

  - Reporting the net other postemployment benefits liability and related deferred outflows of resources and deferred inflows of resources.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 Statement of Operations and Changes in Surplus. 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.

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.

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 may invest up to 10 percent of the total fixed income portfolio in non-investment grade bonds. The investments rated NR (Not Rated) and WR (Withdrawn Rating) are approximately 4 percent of the fixed income portfolio at December 31, 2018. This excludes share balances of $42.6 million in Treasury's unrated short-term investment pools.

NOTE B – INVESTMENTS (Continued)

The following tables disclose aggregate fair value, by major Moody's credit quality rating category at December 31, 2018 and 2017 (amounts in thousands):

December 31, 2018

Investment Type	Amount	Moody's Rating	% Portfolio
US Agency	$ 8,470	A1	0.63%
US Agency	2,728	A2	0.20%
US Agency	3,427	Aa1	0.25%
US Agency	3,811	Aa2	0.28%
US Agency	3,878	Aa3	0.29%
US Agency	29,588	Aaa	2.19%
US Agency	286	Baa2	0.02%
US Agency	174	Baa3	0.01%
US Agency	9,184	NR	0.68%
Total US Agency Securities	**$ 61,546**		
US Government Securities	$ 227,623	Aaa	16.85%
Total US Government Securities	**$ 227,623**		
Mortgage-Backed Securities	$ 339	A1	0.03%
Mortgage-Backed Securities	128	A3	0.01%
Mortgage-Backed Securities	100	Aa3	0.01%
Mortgage-Backed Securities	196,317	Aaa	14.53%
Mortgage-Backed Securities	266	Ba1	0.02%
Mortgage-Backed Securities	251	Ba2	0.02%
Mortgage-Backed Securities	71	Ba3	0.01%
Mortgage-Backed Securities	306	Baa1	0.02%
Mortgage-Backed Securities	841	Baa3	0.06%
Mortgage-Backed Securities	608	WR	0.04%
Mortgage-Backed Securities	8,235	NR	0.61%
Total Mortgage-Backed Securities	**$ 207,462**		

NOTE B – INVESTMENTS (Continued)

Investment Type	Amount	Moody's Rating	% Portfolio
Asset Backed Securities	$ 678	A1	0.05%
Asset Backed Securities	1,133	A2	0.08%
Asset Backed Securities	3,992	A3	0.30%
Asset Backed Securities	484	Aa1	0.04%
Asset Backed Securities	841	Aa2	0.06%
Asset Backed Securities	2,966	Aa3	0.22%
Asset Backed Securities	31,821	Aaa	2.35%
Asset Backed Securities	1,314	Baa1	0.10%
Asset Backed Securities	998	Baa2	0.07%
Asset Backed Securities	16,682	NR	1.23%
Total Asset Backed Securities	**$ 60,909**		
Corporate Obligations	$ 68,167	A1	5.04%
Corporate Obligations	79,013	A2	5.85%
Corporate Obligations	115,631	A3	8.56%
Corporate Obligations	8,582	Aa1	0.64%
Corporate Obligations	26,168	Aa2	1.94%
Corporate Obligations	23,985	Aa3	1.77%
Corporate Obligations	12,962	Aaa	0.96%
Corporate Obligations	868	B1	0.06%
Corporate Obligations	347	B2	0.03%
Corporate Obligations	20,855	Ba1	1.54%
Corporate Obligations	4,653	Ba2	0.34%
Corporate Obligations	5,419	Ba3	0.40%
Corporate Obligations	119,596	Baa1	8.85%
Corporate Obligations	88,860	Baa2	6.58%
Corporate Obligations	64,510	Baa3	4.77%
Corporate Obligations	14,898	NR	1.10%
Corporate Obligations	1,040	WR	0.08%
Total Corporate Obligations	**$ 655,554**		

NOTE B – INVESTMENTS (Continued)

Investment Type	Amount	Moody's Rating	% Portfolio
Treasury Investment Program	**$ 42,647**	NR	3.16%
Total Fixed Income Securities	**$ 1,255,741**		
Equity Securities	**$ 95,291**	NR	7.05%
Preferred Securities	**$ 249**	NR	0.02%
Total Portfolio at December 31, 2018	**$ 1,351,281**		100.00%

NOTE B – INVESTMENTS (Continued)

December 31, 2017

Investment Type	Amount	Moody's Rating	% Portfolio
US Agency	$ 9,855	A1	0.69%
US Agency	3,111	A2	0.22%
US Agency	4,216	Aa1	0.30%
US Agency	3,088	Aa2	0.22%
US Agency	3,937	Aa3	0.28%
US Agency	35,839	Aaa	2.52%
US Agency	314	Baa2	0.02%
US Agency	11,843	NR	0.83%
Total US Agency Securities	**$ 72,203**		
US Government Securities	$ 284,238	Aaa	19.97%
Total US Government Securities	**$ 284,238**		
Mortgage-Backed Securities	$ 377	A1	0.03%
Mortgage-Backed Securities	277	A2	0.02%
Mortgage-Backed Securities	268	Aa2	0.02%
Mortgage-Backed Securities	259	Aa3	0.02%
Mortgage-Backed Securities	194,266	Aaa	13.65%
Mortgage-Backed Securities	1,036	Ba1	0.07%
Mortgage-Backed Securities	269	Ba2	0.02%
Mortgage-Backed Securities	27	Baa1	0.00%
Mortgage-Backed Securities	409	Baa2	0.03%
Mortgage-Backed Securities	238	Baa3	0.02%
Mortgage-Backed Securities	8,726	NR	0.61%
Mortgage-Backed Securities	186	WR	0.01%
Total Mortgage-Backed Securities	**$ 206,338**		

NOTE B – INVESTMENTS (Continued)

Investment Type	Amount	Moody's Rating	% Portfolio
Asset Backed Securities	$ 503	A1	0.04%
Asset Backed Securities	2,146	A2	0.15%
Asset Backed Securities	3,319	A3	0.23%
Asset Backed Securities	1,698	Aa2	0.12%
Asset Backed Securities	2,490	Aa3	0.17%
Asset Backed Securities	34,999	Aaa	2.46%
Asset Backed Securities	259	Ba1	0.02%
Asset Backed Securities	1,686	Baa1	0.12%
Asset Backed Securities	788	Baa2	0.06%
Asset Backed Securities	13,354	NR	0.94%
Total Asset Backed Securities	**$ 61,242**		
Corporate Obligations	$ 60,002	A1	4.22%
Corporate Obligations	71,621	A2	5.03%
Corporate Obligations	149,781	A3	10.53%
Corporate Obligations	7,122	Aa1	0.50%
Corporate Obligations	25,540	Aa2	1.79%
Corporate Obligations	22,219	Aa3	1.56%
Corporate Obligations	12,200	Aaa	0.86%
Corporate Obligations	1,618	B1	0.10%
Corporate Obligations	364	B2	0.03%
Corporate Obligations	17,150	Ba1	1.21%
Corporate Obligations	5,801	Ba2	0.41%
Corporate Obligations	5,020	Ba3	0.34%
Corporate Obligations	104,904	Baa1	7.37%
Corporate Obligations	68,300	Baa2	4.80%
Corporate Obligations	60,014	Baa3	4.22%
Corporate Obligations	111	Caa1	0.01%
Corporate Obligations	14,888	NR	1.05%
Corporate Obligations	784	WR	0.06%
Total Corporate Obligations	**$ 627,439**		

NOTE B – INVESTMENTS (Continued)

Investment Type	Amount	Moody's Rating	% Portfolio
Treasury Investment Program	**$ 35,436**	NR	2.49%
Total Fixed Income Securities	**$ 1,286,896**		
Equity Securities	**$ 135,822**	NR	9.54%
Preferred Securities	**$ 265**	NR	0.02%
Total Portfolio at December 31, 2017	**$ 1,422,983**		100.00%

NOTE B – INVESTMENTS (Continued)

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, 2018 and 2017, SWIF's fixed income portfolio had the following option-adjusted durations by fixed income sector:

December 31, 2018 Investment Type	Amount	Duration (in years)
US Agency Securities	$ 61,546	5.35
US Government Securities	227,623	9.08
Mortgage Backed Securities	207,462	3.72
Asset Backed Securities	60,909	2.78
Corporate Obligations	655,554	6.51
Treasury Investment Program	42,647	N/A
Total Fixed Income Securities	**$ 1,255,741**	
Equity Securities	95,291	N/A
Preferred Securities	249	N/A
Total Portfolio Securities	**$ 1,351,281**	

NOTE B – INVESTMENTS (Continued)

December 31, 2017 Investment Type	Amount	Duration (in years)
US Agency Securities	$ 72,203	5.32
US Government Securities	284,238	9.54
Mortgage Backed Securities	206,338	3.69
Asset Backed Securities	61,242	2.81
Corporate Obligations	627,439	6.88
Treasury Investment Program	35,436	N/A
Total Fixed Income Securities	**$ 1,286,896**	
Equity Securities	135,822	N/A
Preferred Securities	265	N/A
Total Portfolio Securities	**$ 1,422,983**	

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.

NOTE B – INVESTMENTS (Continued)

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 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, 2018, 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, 2018 and 2017 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 $22,957 and $88,836, respectively.

NOTE B – INVESTMENTS (Continued)

SWIF's investment securities owned at December 31, 2018 and 2017, were as follows (amounts in thousands):

December 31, 2018

	Book/Adjusted Carrying Value	Market Value
Bonds		
Government	$ 296,082	$ 292,187
States, Territories, and Possessions	17,963	18,076
Political Subdivisions of States, Territories, and Possessions	7,555	8,292
Revenue and Special Obligations	29,193	29,342
Residential Mortgage Backed Securities	145,022	141,496
Commercial Mortgage Backed Securities	12,668	12,668
Industrial and Miscellaneous	718,334	703,912
Total Bonds	$ 1,226,817	$ 1,205,973
Common Stocks	$ 95,291	$ 95,291
Preferred Stocks	$ 250	$ 249
Short-Term Investments	$ 49,768	$ 49,768

December 31, 2017

	Book/Adjusted Carrying Value	Market Value
Bonds		
Government	$ 349,145	$ 348,949
States, Territories, and Possessions	19,632	20,909
Political Subdivisions of States, Territories, and Possessions	7,690	8,677
Revenue and Special Obligations	22,739	23,342
Residential Mortgage Backed Securities	165,070	156,400
Industrial and Miscellaneous	658,700	674,100
Total Bonds	$ 1,222,976	$ 1,232,377
Common Stocks	$ 135,822	$ 135,822
Preferred Stocks	$ 250	$ 265
Short-Term Investments	$ 54,519	$ 54,519

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, 2018 and 2017. Pertaining to marketable equity securities, December 31, 2018 showed a net unrealized capital loss of ($10,991) (in thousands) and December 31, 2017 showed a net unrealized capital gain of $21,270 (in thousands).

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

	December 31, 2018 (Amounts in Thousands)		
	Coal	**Commercial**	**Total**
Loss Reserves			
Indemnity	$ 14,874	$ 283,293	$ 298,167
Medical	3,505	125,901	129,406
Bulk	13,054	939,133	952,187
Total Loss Reserves	$ 31,433	$ 1,348,327	$ 1,379,760
IBNR Loss Reserves	$ 573	$ 68,891	$ 69,464
Net Losses			$ 1,449,224
Add:			
Assumed Outstanding Loss Reserves (Including IBNR)			975
Less:			
Discount of Reserves			(253,799)
Recoverable Reinsurance (Including IBNR)			(6,310)
Net Unpaid Losses			$ 1,190,090

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

	December 31, 2017 (Amounts in Thousands)		
	Coal	**Commercial**	**Total**
Loss Reserves			
Indemnity	$ 15,669	$ 316,247	$ 331,916
Medical	2,734	101,721	104,455
Bulk	14,150	997,578	1,011,728
Total Loss Reserves	$ 32,553	$ 1,415,546	$ 1,448,099
IBNR Loss Reserves	$ 742	$ 67,904	$ 68,646
Net Losses			$ 1,516,745
Add:			
Assumed Outstanding Loss Reserves (Including IBNR)			1,124
Less:			
Discount of Reserves			(273,906)
Recoverable Reinsurance (Including IBNR)			(50)
Net Unpaid Losses			$ 1,243,913

NOTE D – PENSION AND OTHER POSTEMPLOYMENT BENEFITS

Pension

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.

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 with three years of service, or with 35 years of service if under the age of 60 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.

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.

Contribution Requirements: 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.

Act 120 imposed annual rate increase collars on employer contributions until no longer needed. The fiscal year ended June 30, 2018, marked the first year the actuarially required employer contribution increase was lower than the collar established for the year of 4.5 percent. As a result, the rate caps are no longer in effect.

NOTE D - PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

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 contributions are due, and the employer has a legal requirement to provide contributions. 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.pa.gov. 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

The SWIF's contributions (in thousands) for the fiscal years ended December 31, 2018 and 2017 in relation to the contractually required contributions are as follows:

Year Ended December 31	Contractually Required Contributions	Actual Contributions
2018	$4,300	$4,300
2017	$4,323	$4,323

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.

NOTE D - PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

Other Postemployment Benefits

Plan Description: 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 REHP is provided as part of collective bargaining agreements with most Commonwealth labor unions. All policy decisions and types and levels of benefits for the REHP fall under the purview of the Commonwealth's Executive Board and Secretary of Administration. REHP does not have a governing board. The REHP plan does not issue a stand-alone financial report, nor is it included in the financial statements of a public employee retirement system.

Benefits Provided: Benefit provisions included in the REHP plans are established and may be amended by the establishing sponsor. The REHP plan provides postemployment healthcare benefits to eligible employees. Employees who retire from the Commonwealth and meet one of the following eligibility criteria are eligible to receive REHP benefits:

- 25 or more years of service;
- 20 or more years of service and superannuation age – age 50 for Park Rangers, Capitol Police, and certain enforcement officers, or age 60 for all other employees (age 55 or 65 for employees subject to Act 120 of 2010);
- Disability retirement – requires five years of service (no service requirements for enforcement officers).

Contribution Requirements: REHP contribution requirements are contractually required and established by the Commonwealth's Office of Administration and the Office of the Budget. The contribution rates are established as a set amount per current active REHP eligible employee per biweekly pay in order to fund the REHP plan. During the period January 1, 2018 to June 30, 2018, SWIF contributed $188 for each active employee paid and reported as part of biweekly payroll expenses for its employees. During the period July 1, 2018 to December 31, 2018, SWIF contributed $300 for each active employee paid and reported as part of biweekly payroll expenses for its employees.

NOTE D - PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

The SWIF's contributions (in thousands) for the fiscal years ended December 31, 2018 and 2017 in relation to the contractually required contributions are as follows:

Year Ended December 31	Contractually Required Contributions	Actual Contributions
2018	$1,578	$1,578
2017	$2,292	$2,292

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

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, 2018 and December 31, 2017. 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, 2018 and 2017, 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	Prior Year	Incurred Claims		Payments		Current Year
December 31	Liability	Current	Prior	Current	Prior	Liability
2018	$1,497,470	$191,500	(76,754)	$35,579	$152,907	$1,423,730
2017	$1,562,897	$183,256	(41,676)	$34,832	$172,175	$1,497,470

NOTE F – SURPLUS AS REGARDS POLICYHOLDERS

By statute, the State Workers' Insurance 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.

NOTE G – SUBSEQUENT EVENTS

Adjustment to written premiums on 2018 policies due to Pennsylvania Compensation Rating Bureau (PCRB) Filings C-372 and C-375:

In January 2019, the State Workers' Insurance Board (SWIB), the governing board of the State Workers' Insurance Fund, approved a notational ballot to retroactively revise and correct the loss cost values used in developing premiums charged to policyholders during the period of April 1, 2018 to December 31, 2018. Prior to the approval, the PCRB submitted Filing C-372, "Interim Loss Cost Filing" and Filing C-375, "January 1, 2019 Informational Loss Cost Filing" in which the PCRB provided revised workers' compensation loss costs to replace the loss costs submitted in Filing C-370. The effect of Filing C-372 was an overall average decrease to rates of approximately 10.02 percent.

This decision by the SWIB will change the premiums charged to policyholders during this period, with the vast majority of policyholders receiving a decrease in premium. Policies affected by the change in loss costs were rerated in January 2019. The overall effect of this action will cause a decrease in written premiums for these policies of approximately $10.1 million. Changes in premium will be recorded as adjustments to written premium in 2019, with the resulting effects on written and earned premium reflected in the results of 2019.

Decrease in premium rates on 2019 and future policies due to PCRB Filings C-372 and C-373:

In the 4th quarter of 2018, the PCRB submitted Filings C-372 and C-373 to adjust loss costs used in calculating premiums on workers' compensation policies. Filing C-372, "Interim Loss Cost Filing", was submitted to correct loss costs due to incorrect data used in loss cost development for Filing C-370. Filing C-372 will affect policies written on or after January 1, 2019, with an average decrease to loss costs of 10.02 percent. Filing C-373, "Protz Adjustment Filing", was submitted to adjust loss costs for policies written on or after January 1, 2019 due to Pennsylvania Act 111 of 2018 being signed into law. Filing C-373 will affect policies written on or after January 1, 2019, with an average decrease to loss costs of 5.24 percent. Due to the effect that this may have on future policies written, we cannot provide a meaningful estimate on the amount of premiums written in the future.

Effective April 1, 2019, the PCRB submitted Filing C-374, to adjust loss costs used in calculating premiums on workers' compensation policies. The average change in overall workers' compensation rates was a decrease of 12.95 percent.

Commonwealth of Pennsylvania
Department of the Auditor General
Harrisburg, PA 17120-0018
Facebook: Pennsylvania Auditor General
Twitter: @PAAuditorGen
www.PaAuditor.gov

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*

<u>Independent Auditor's Report</u>

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, 2018, and December 31, 2017, and the related notes to the financial statements, and have issued our report thereon dated December 2, 2019.

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 have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. 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.*

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.

December 2, 2019

Eugene A. DePasquale
Auditor General

Finding No. 1 – Controls to Remove Terminated Users from SWIF Computer Applications Need Improvement

Condition: Controls to remove terminated users from SWIF applications have been established. However, during current year testing of information technology general controls we identified one user with privileged access who had retained access rights to SWIF computer applications for 30 months after his separation from employment.

Criteria: Management Directive 325.12, *Standards for Internal Control for Commonwealth Agencies*, adopted the internal control framework outlined in the United States Government Accountability Office's *Standards for Internal Control in the Federal Government (Green Book)*, published in September 2014.

- Green Book Principle 11 – Design Activities for the Information System, states in part:

  - *11.14 Management designs control activities to limit user access to information technology through authorization control activities such as providing a unique user identification or token to authorized users. These control activities may restrict authorized users to the applications or functions commensurate with their assigned responsibilities, supporting an appropriate segregation of duties. Management designs other control activities to promptly update access rights when employees change job functions or leave the entity.*

Cause: The procedures required to remove the user's access in January 2017 were not thoroughly completed at that time, so access to certain SWIF applications was not revoked when access to the Commonwealth domain (CWOPA) was removed. Further, system administrators in the Office of Administration, Employment, Banking, and Revenue (OA EBR) Delivery Center have not performed periodic reviews of users with privileged access to SWIF applications, which would have identified the improper access prior to audit.

Effect: Untimely deletion of a separated employee's access to applications could lead to inappropriate access. While some of the risk was mitigated by the removal of the former employee's CWOPA account, the existence of an improper and potentially unmonitored privileged account increases the risk of unauthorized configuration changes and/or inappropriate transactions. The significance of this weakness was increased by the presence of other, less severe, weaknesses that have been included in a confidential communication to management.

Recommendation: We recommend that the OA EBR Delivery Center perform the following:

- review the applications to ensure the user credentials were not improperly accessed after the employee's separation from Commonwealth service;
- reinforce and communicate its existing formal procedures for removing users' access to all applications upon termination or when such access is no longer needed; and
- institute procedures to perform periodic access reviews of privileged users to ensure all application user accounts are appropriate and current.

Agency Response: Office of Administration, Office for Information Technology, accepts the finding along with the EBR Delivery Center and the Department of Labor and Industry.

Auditors' Conclusion: Based on the agency response, the finding and recommendation remain as stated. We will evaluate the corrective action in the subsequent audit period.

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND DISTRIBUTION LIST
DECEMBER 31, 2018 and 2017

This report was initially distributed to the following:

Commonwealth of Pennsylvania

The Honorable Tom Wolf
Governor

The Honorable Joseph Torsella
State Treasurer

The Honorable Jen Swails
Secretary of the Budget

The Honorable Bruce Beemer
Inspector General

The Honorable Jessica Altman
Insurance Commissioner

The Honorable W. Gerard Oleksiak
Secretary
Department of Labor and Industry

Mr. Scott Weiant
Deputy Secretary for Compensation and Insurance
Department of Labor and Industry

Mr. Andrew Thomas
Director
State Workers' Insurance Fund

Mr. Joseph Dorbad
Assistant Director
State Workers' Insurance Fund

Office of Comptroller Operations

Mr. Brian Lyman
Chief Accounting Officer

Mr. Michael Burns
Director of the Bureau of Accounting and Financial Management

Mr. William Canfield
Director of the Bureau of Audits

Ms. Mary Spila
Collections/Cataloging
State Library of Pennsylvania

This report is a matter of public record and is available online at www.PaAuditor.gov. Media questions about the report can be directed to the Pennsylvania Department of the Auditor General, Office of Communications, 229 Finance Building, Harrisburg, PA 17120; via email to: News@PaAuditor.gov.