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TIMOTHY L. DEFOOR
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 Joshua D. Shapiro
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, 2023, and December 31, 2022, and the related notes to the financial statements, and have issued our report thereon dated December 20, 2024.

Report on 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) as a basis for designing 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.

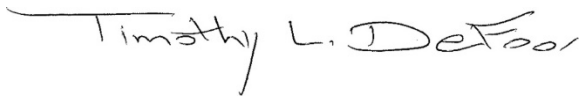
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and responses as finding No. 1 that we consider to be a material weakness.

Report on 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 financial statements. 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 instances of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as finding No. 1.

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.

A handwritten signature in black ink that reads "Timothy L. DeFoor". The signature is written in a cursive, flowing style.

Timothy L. DeFoor
Auditor General
December 20, 2024

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Finding No. 1 – Inadequate Validation of Financial Reporting Capabilities Prior to Implementation of the New Claims Management System Resulted in the Inability to Produce Timely Financial Reporting

Type of Finding: Material Weakness in Internal Control, Noncompliance

Condition: The State Workers' Insurance Fund (SWIF) management decided to "go live" with the new vendor-developed claims management system in May 2023 without designing all of the requirements for user acceptance testing to ensure that the new system would be able to produce monthly financial statements. The new system was unable to produce required statements for a 14-month period from May 2023 to July 2024. Timely recognition of financial information is key to an effective system of internal control because it promotes operational efficiency, timely identification and correction of errors, and allows management to ensure compliance with policies, procedures, laws and regulations. The delay with processing and closing monthly financial activity impacted several areas of SWIF's operations:

- Untimely issuance of the *Annual Statement of the State Workers' Insurance Fund of Scranton in the State of Pennsylvania to the Insurance Department of the State of Pennsylvania for the Year Ended December 31, 2023* which was required to be issued by March 1, 2024 to the Pennsylvania Insurance Department. The report was issued at the end of October 2024.
- Untimely completion of SWIF's financial year-end close. The year-end trial balance and draft financial statements were not available until October 2024 and November 2024, respectively.
- Untimely reconciliation of account balances for key financial statement areas, including investments, receivables, unearned premiums, premiums earned, net investment income, losses incurred claims, loss adjustment expenses, and other underwriting expenses.
- SWIF was unable to timely monitor compliance with its investment policy for statutory equity limitations. SWIF fell out of compliance with limitations during the audit period. SWIF is required to annually develop a plan to rebalance investments if necessary.
- The data provided to SWIF's actuary for the reserve and loss liability calculation was untimely. This only allowed the independent actuary limited time to complete the review of this data and report.
- SWIF relied on the prior year loss adjustment expense (LAE) data when calculating the ratio of paid LAE to paid loss when calculating the current years reserve.
- Overall financial data was not available for oversight and operational decision making.

Criteria: Management Directive 325.12 – *Standards for Enterprise Risk Management in Commonwealth Agencies*, Amended October 1, 2021, establishes policy, responsibilities, and procedures for implementing an Enterprise Risk Management (ERM) Framework within Commonwealth agencies. Section 5d states:

- *Agencies are required to conduct a comprehensive Risk Assessment of operations annually. Agency Risk Assessments must, at a minimum:*
 - (1) *Identify and analyze Risks across the organization.*
 - (2) *Determine how to respond to identified Risks.*
 - (3) *Identify and assess the effectiveness of Internal Controls in place to mitigate identified Risks.*
 - (4) *Develop and implement a monitoring plan for identified Risks.*

Management Directive 325.12 also adopted the internal control framework outlined in the United States Government Accountability Office's *Standards for Internal Control in the Federal Government (Green Book)*.

- Green Book Principle 7 – Identify, Analyze, and Respond to Risks, states in part:
 - 7.02 *Management identifies risks throughout the entity to provide a basis for analyzing risks. Risk assessment is the identification and analysis of risks related to achieving the defined objectives to form*

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a basis for designing risk responses.

- *7.04 Management considers all significant interactions within the entity and with external parties, changes within the entity's internal and external environment, and other internal and external factors to identify risks throughout the entity. Internal risk factors may include... the use of new technology in its operational processes....*
- Green Book Principle 11 – Design Activities for the Information System, states in part:
 - *11.09 Management designs control activities over the information technology infrastructure to support the completeness, accuracy, and validity of information processing by information technology. ... Management evaluates the objectives of the entity and related risks in designing control activities for the information technology infrastructure.*
 - *11.15 Management designs control activities over the acquisition, development, and maintenance of information technology. Management may use a systems development life cycle (SDLC) framework in designing control activities. An SDLC provides a structure for a new information technology design by outlining specific phases and documenting requirements, approvals, and checkpoints within control activities over the acquisition, development, and maintenance of technology.*
- Green Book Principle 13 – Use Quality Information, states in part:
 - *13.04 Management obtains relevant data from reliable internal and external sources in a timely manner based on the identified information requirements. Relevant data have a logical connection with, or bearing upon, the identified information requirements. Reliable internal and external sources provide data that are reasonably free from error and bias and faithfully represent what they purport to represent. Management evaluates both internal and external sources of data for reliability. Sources of data can be operational, financial, or compliance related. Management obtains data on a timely basis so that they can be used for effective monitoring.*
 - *13.05 Management processes the obtained data into quality information that supports the internal control system. This involves processing data into information and then evaluating the processed information so that it is quality information. Quality information meets the identified information requirements when relevant data from reliable sources are used. Quality information is appropriate, current, complete, accurate, accessible, and provided on a timely basis. Management considers these characteristics as well as the information processing objectives in evaluating processed information and makes revisions when necessary so that the information is quality information. Management uses the quality information to make informed decisions and evaluate the entity's performance in achieving key objectives and addressing risks.*
- Green Book Principle 14 – Communicate Internally, states in part:
 - *14.05 The oversight body receives quality information that flows up the reporting lines from management and personnel. Information relating to internal control communicated to the oversight body includes significant matters about adherence to, changes in, or issues arising from the internal control system. This upward communication is necessary for the effective oversight of internal control.*

The Office of Administration – Office for Information Technology (OA-OIT) Information Technology Policy ITP-SFT000 – Software Development Life Cycle (SDLC) Policy, Section 5 states in part:

- Testing & Validation - processes and procedures associated with test planning, test design, test

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execution, validations, defect management, and approvals, based on SADM [Software Application Development Methodologies] and in relation to unit, systems integration, user acceptance, and security vulnerability testing requirements. These processes and procedures should also include integrated quality control and assurance mechanisms to ensure solution meets all business, systems, security, policy, product quality, and/or other relevant compliance/certification requirements.

- *Application quality is fundamental to delivering expected business outcomes and agreed upon service level. The quality of testing is the overall contributor to the quality of the application. The effectiveness of the testing effort can be maximized by selection of a testing strategy which includes thorough unit, integration, system, regression, performance, stress testing, good management of the testing process....*
- *Implementation - processes and procedures regarding production ready solution adoption, delivery, and deployment; including business and technical operational readiness assessments with integrated go-live decision and roll-back mechanisms....*
- *Release Management – The objective of release management is to ensure that standardized methods and procedures are used for defining executable solution deployment strategies and implementation playbooks to ensure efficient and successful delivery of all software releases with minimal impact the integrity of existing services and/or business operations.*

Further, OA-OIT ITP ITP-INF000 – Enterprise Data and Information Management Policy, requires that Agencies should, in part:

- *Conduct and assess business and systems operational readiness assessments in order to make recommendations and determinations for final approval and sign-off.*

Pennsylvania Statutes Title 72. Taxation and Fiscal Affairs Chapter 1. The Fiscal Code Article XVII-A. Special Funds Subarticle D. Investments Section 1731-A State Workers' Insurance Board, states in part:

- Notwithstanding any inconsistent provisions of section 1512 of the act of June 2, 1915 (P.L. 736, No. 338), known as the Workers' Compensation Act, section 504 of the act of November 30, 1965 (P.L. 847, No. 356), known as the Banking Code of 1965, and any other law of this Commonwealth, the power of the State Workers' Insurance Board to invest money shall include the power to hold, purchase, sell, assign, transfer and dispose of securities, including common stock with the following restrictions:
 - (1) Investments in equities may not exceed the lesser of:
 - (i) 15% of the State Workers' Insurance Fund's assets; or
 - (ii) The State Workers' Insurance Fund's statutory surplus after discount, except that, notwithstanding the statutory surplus, the State Workers' Insurance Fund is authorized to invest up to 7 ½ % of the book value of its assets in equities.
 - (1.1) Investments in equities shall be made subject to the prudent investor rule as provided for under 20 Pa.C.S. § 7203 (relating to prudent investor rule).
 - (2) The State Workers' Insurance Board shall establish a policy for investments and shall meet at least annually to develop a schedule for rebalancing its investments in securities to meet the restriction of paragraph (1).

Insurance Company Law of 1921 – Omnibus Amendments Act of Mar. 22, 2010, P.L. 147, No. 14 Session of 2010 No. 2010-14, states in part:

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

- Section 1. Section 320 of the act of May 17, 1921 (P.L. 682, No. 284), known as The Insurance Company Law of 1921, amended December 18, 1992 (P.L.1519, No.178) and February 17, 1994 (P.L.92, No.9), is amended to read:

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Section 320. Annual and Other Reports; Penalties.—(a) (1) Every stock and mutual insurance company, association, and exchange, doing business in this Commonwealth, shall annually, on or before the first day of March, file in the office of the Insurance Commissioner and with the National Association of Insurance Commissioners a statement which shall exhibit its financial condition on the thirty-first day of December of the previous year, and its business of that year...

Cause: Personnel from the Employment Banking and Revenue (EBR) Delivery Center in the Office of Administration, Office for Information Technology (OA-OIT) provided evidence that SWIF management had signed off that all user acceptance testing was performed prior to “go-live.” EBR Delivery Center personnel were aware, however, that SWIF management had deferred development of business requirements for required financial reports until the next phase of the project.

Although users had not completed all requirements for testing of financial reports by the May 2023 system implementation date, SWIF management proceeded with the “go live” decision. SWIF management failed to fully assess the operational risk created by the new system’s inability to generate timely, reliable financial reporting.

Effect: The lack of fully functional claims management reporting prevented management from producing monthly financial statements from May 2023 through July 2024, which was 14 months after the implementation of the new system and increased the risk of generating incomplete and/or inaccurate financial information. As a result, SWIF encountered several operational deficiencies and delays with key deliverables as noted above in the condition.

Recommendation: SWIF management should work with their system implementation vendor to ensure:

- Transactions are promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from its initiation and authorization through its final classification in summary records;
- Timely and accurate completion of the monthly closing process which would allow SWIF to maintain normal and timely operations, such as, monitoring investment policy and issuing the Annual Statement by the March 1 deadline;
- Current and future monthly financial reports are accurate and complete to support SWIF’s financial position;
- Adequate financial reporting is fully developed and tested in future system upgrades prior to authorizing system “go-live”; and
- Operational risks are identified and reported in accordance with Management Directive 325.12.

Management Response: SWIF acknowledges management proceeded with the "go-live" decision without designing all the requirements for user acceptance testing to ensure the new system would be able to produce monthly financial statements. SWIF agrees EBR Delivery Center personnel were aware SWIF management had deferred development of business requirements for required financial reports until the next phase of the project. SWIF management’s decision to go-live was based on the following considerations: the operational readiness of the system on the go-live date, the cost of further delay in going live, and the understanding that delaying development of business requirements for required financial reports until the next phase of the project would not have significant downstream implications.

Auditors’ Conclusion: The SWIF management response acknowledged the finding. No new information was provided which would mitigate the finding. The finding remains as stated. We will evaluate any corrective action in the subsequent audit.