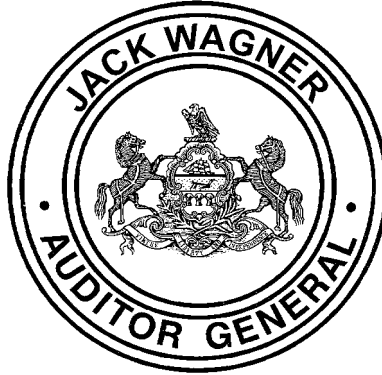


**COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND**

AUDIT REPORT

FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

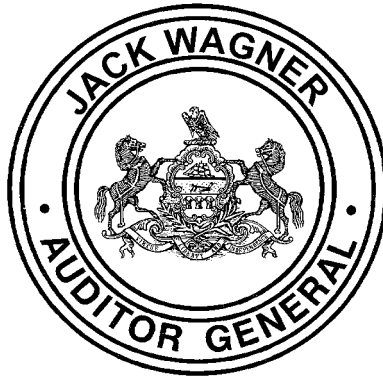


**COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND
SCRANTON, PENNSYLVANIA**

**AUDIT REPORT
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009**

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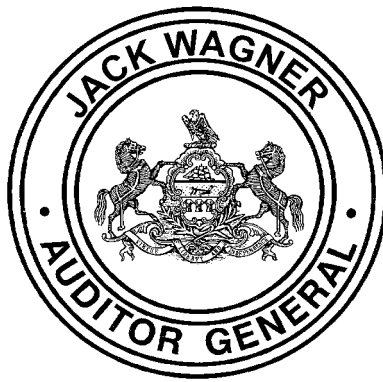
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**DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND
DECEMBER 31, 2010 and 2009**

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 worker's 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.



Independent Auditor's Report

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

We have audited the accompanying Statement of Admitted Assets, Liabilities and Surplus-statutory basis of the State Workers' Insurance Fund (SWIF) as of December 31, 2010 and December 31, 2009, and the related Statement of Operations and Changes in Surplus-statutory basis and the Statement of Cash Flows-statutory basis for the years then ended. These statutory financial statements are the responsibility of SWIF's management. Our responsibility is to express an opinion on these statutory 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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 Statement of Admitted Assets, Liabilities and Surplus-statutory basis.

As described in Note A, these statutory financial statements were prepared in accordance with statutory accounting practices as prescribed or permitted by the Insurance Department of Pennsylvania, which practices differ from accounting principles generally accepted in the United States of America. 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.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the statutory financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of SWIF as of December 31, 2010 and December 31, 2009, or changes in financial position or cash flows thereof for the years then ended.

In our opinion, the statutory financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities and surplus of SWIF as of December 31, 2010 and December 31, 2009, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note A.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 20, 2012, 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 grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

This 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 these specified parties.

January 20, 2012

JACK WAGNER
Auditor General

**DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND
DECEMBER 31, 2010 and 2009**

SWIF MANAGEMENT'S DISCUSSION AND ANALYSIS

Assets and Liabilities

The State Workers' Insurance Fund (SWIF) disclosed total admitted assets of \$1.560 billion as of December 31, 2010. This was a decrease of \$81 million or 4.9% from 2009. Cash and invested assets dropped from \$1.566 billion in 2009 to \$1.497 billion in 2010 or a \$69 million decrease. The value of the bond portfolio decreased \$74 million or 5.4% in addition to a \$4 million decrease in short-term investments.

Total unpaid losses decreased as of year-end 2010 to \$1.305 billion, from \$1.348 billion, a decrease of \$43 million or 3.2%. SWIF's total liabilities decreased to \$1.623 billion, a decrease of \$65 million or 3.9% from the prior year. These declines were the result of continued claim closure rates and fewer new claims caused by lower business activity. The discount rate used to value SWIF's loss reserves stayed the same at 3.25%.

Surplus

Surplus as regards policyholders declined to (\$62) million, a decline of \$14 million or 29.2% for 2010 as compared to a \$17 million decrease or 54.8% last year. SWIF's net loss before other changes in surplus for 2010 was \$32 million versus a net loss in 2009 of \$85 million. The fund had a change in unrealized capital gain of \$10 million from an increase in the market value of SWIF's portfolio. SWIF also had an \$8 million decrease in non-admitted assets, resulting in an addition to surplus.

Operational Results

SWIF recorded a net loss before other changes in surplus of \$32 million for 2010. This is a decrease in net loss of \$53 million as compared to the 2009 net loss of \$85 million. Earned premiums declined by \$49 million, to \$173.6 million from \$222.6 million, or 22%. Accompanying this premium decline was a \$36 million, or 14% decline in incurred losses from \$250.2 million in 2009 to \$214.4 million in 2010. The net underwriting loss was \$108.7 million as compared with \$94.9 million in 2009.

Net investment income earned (excluding realized capital gains/losses) decreased from \$57 million in 2009 to \$41 million in 2010. As a result of the improving global market conditions, SWIF recorded net realized capital gains of \$52 million, compared to net losses of \$14 million in 2009. Loss adjustment expenses incurred increased \$15 million or 53.5% from \$28.1 million in

**DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND
DECEMBER 31, 2010 and 2009**

SWIF MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

2009 to \$43.1 million in 2010. The increase was due in a large part to a \$6.9 million increase in salaries and employee relations and a \$5.7 million increase in claim adjustment services from 2009 to 2010 per the Annual Statement.

During 2010, SWIF also had \$17 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

Full implementation of the MedRisk Bill Review and Preferred Provider Organization project took place on September 4, 2009. The full implementation allowed bills to be repriced and processed by MedRisk and interfaced directly in SWIF's PowerComp system for payment. During 2010 MedRisk processed 301,278 medical bills that resulted in net savings of \$8.0 million in medical expense. The Cypress Care prescription program was introduced through the MedRisk program effective April 2010. This network is projected to save 20% below the average wholesale price (AWP) on prescription medications to claimants. The savings will result in lower medical loss expenses.

SWIF's Customer Service Unit handled 98,287 of the 123,591 calls received or 79.5% of all calls. The unit also handled 8,730 first report of injury calls. This unit eliminated the need to transfer calls to the Underwriting, Claims, Auditing, and Accounting Divisions.

During 2010 SWIF settled 1,129 claims through Compromise and Release Agreements resulting in savings of future claim payments of \$79.3 million.

STATE WORKERS' INSURANCE FUND
STATEMENT OF ADMITTED ASSETS, LIABILITIES AND SURPLUS
STATUTORY BASIS
DECEMBER 31, 2010 AND 2009

	(Expressed in Thousands)	
<u>ADMITTED ASSETS</u>	<u>2010</u>	<u>2009</u>
<u>Investments</u>		
Bonds	\$ 1,296,154	\$ 1,370,338
Stocks	107,551	99,871
Short-term investments	85,991	90,344
Total investments - Note B	\$ 1,489,696	\$ 1,560,553
<u>Cash</u>		
On deposit in Treasury Department	\$ 7,076	\$ 5,716
<u>Receivables</u>		
Uncollected Premiums in Course of Collection	\$ 6,403	\$ 8,562
Premiums, Agents' Balances, and Installments Booked But Deferred and Not Yet Due	46,654	54,341
Reinsurance recoverable on loss payments	105	4
Interest due and accrued on investments	10,423	11,144
Funds held by or deposited with reinsurance companies	14	14
Other receivables	0	267
Total receivables	\$ 63,599	\$ 74,332
Total Admitted Assets	\$ 1,560,371	\$ 1,640,601
<u>LIABILITIES AND SURPLUS</u>		
<u>Liabilities</u>		
Net unpaid losses – Notes C and E	\$ 1,304,740	\$ 1,347,701
Unpaid loss adjustment expenses	205,012	206,435
Reinsurance Payable	62	0
Premium Deficiency Reserve	8,411	8,861
Accrued administrative expenses	6,657	13,489
Unearned premiums	65,785	78,008
Policyholders' premium credit balances	11,083	13,500
Restricted account – Commonwealth Self Insurance	2,180	2,061
Policyholder deposits	1,882	2,061
Net Payable for Securities	15,082	12,684
Ceded Reinsurance Premium Payable	0	364
Other liabilities	1,791	3,213
Total liabilities	\$ 1,622,685	\$ 1,688,377
<u>Surplus</u>		
Unassigned surplus (deficit) – Note F	\$ (62,314)	\$ (47,776)
Surplus (deficit) As Regards Policyholders	\$ (62,314)	\$ (47,776)
Total Liabilities and Surplus	\$ 1,560,371	\$ 1,640,601

- The notes to the financial statements are an integral part of this statement. -

STATE WORKERS' INSURANCE FUND
STATEMENT OF OPERATIONS AND CHANGES IN SURPLUS
STATUTORY BASIS
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

	<u>(Expressed in Thousands)</u>	
	<u>2010</u>	<u>2009</u>
<u>Underwriting Income</u>		
Premiums earned	\$ 173,571	\$ 222,606
<u>Underwriting Expenses</u>		
Losses incurred	\$ 214,407	\$ 250,183
Loss adjustment expenses	43,082	28,116
Other	25,276	32,224
Change in Premium Deficiency Reserve	(451)	7,014
Total Underwriting Expenses	<u>\$ 282,314</u>	<u>\$ 317,537</u>
Net Underwriting Gain (Loss)	<u>\$ (108,743)</u>	<u>\$ (94,931)</u>
<u>Investment Income</u>		
Investment income earned	\$ 53,944	\$ 61,849
Net realized capital gains (losses)	52,458	(13,907)
Total Investment Income	<u>\$ 106,402</u>	<u>\$ 47,942</u>
<u>Investment Expenses</u>	<u>\$ 12,470</u>	<u>\$ 4,888</u>
Net investment income	<u>\$ 93,932</u>	<u>\$ 43,054</u>
<u>Other Income/Expenses</u>		
Other income/(expenses)	\$ (213)	\$ 851
Net loss from premium balances charged off	(17,307)	(34,333)
Total Other Income/Expenses	<u>\$ (17,520)</u>	<u>\$ (33,482)</u>
<u>Net Income (Loss) Before Other Changes in Surplus</u>	<u>\$ (32,331)</u>	<u>\$ (85,359)</u>
<u>Other Changes in Surplus</u>		
Change in net unrealized capital gain (loss)	\$ 10,055	\$ 48,905
Change in nonadmitted assets	7,738	15,383
Prior period correction	0	4,735
Total Other Changes in Surplus	<u>\$ 17,793</u>	<u>\$ 69,023</u>
Net change in surplus during the year	<u>\$ (14,538)</u>	<u>\$ (16,336)</u>
Surplus (deficit) at beginning of year	<u>\$ (47,776)</u>	<u>\$ (31,440)</u>
Surplus (deficit) at end of year	<u>\$ (62,314)</u>	<u>\$ (47,776)</u>

- The notes to the financial statements are an integral part of this statement. -

STATE WORKERS' INSURANCE FUND
STATEMENT OF CASH FLOWS
STATUTORY BASIS
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(Expressed in Thousands)

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:		
Premiums collected net of reinsurance	\$ 178,980	\$ 235,388
Benefit and loss related payments	(257,406)	(310,803)
Commissions, expenses paid and aggregate write-ins	(75,946)	(70,104)
Investment income (net of investment expenses)	39,240	57,569
Miscellaneous income (uses)	(20,616)	(38,190)
	<hr/>	<hr/>
Net cash from operating activities	\$ (135,748)	\$ (126,140)
Cash flows from investing activities:		
Proceeds from sale of bonds	\$ 1,508,455	\$ 1,162,898
Proceeds from sale of stocks	64,111	140,563
Payments for purchase of bonds	(1,388,252)	(1,091,690)
Payments for purchase of stocks	(58,309)	(76,259)
Miscellaneous applications	(4,992)	0
Cash provided from other sources (net of cash applied)	11,743	11,426
	<hr/>	<hr/>
Net cash from investing activities	\$ 132,756	\$ 146,938
Net change in cash and short-term investments	\$ (2,992)	\$ 20,798
Cash and short-term investments at beginning of year	\$ 96,059	\$ 75,261
	<hr/>	<hr/>
Cash and short-term investments at end of year	\$ 93,067	\$ 96,059
	<hr/>	<hr/>

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 and 2009

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, 2010 and 2009

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

NOTE B - INVESTMENTS

Beginning December 31, 2004, 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, 2010 and 2009

NOTE B – INVESTMENTS (Continued)

Custodial Credit Risk - Custodial credit risk for investments is the risk that, in the event of the failure of the counter-party 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 AGY and UST are government-issued obligations that are assigned such ratings by Mellon Bank since they are not rated by Moody’s. Mellon Bank was given the authority from Moody’s to issue these obligations a rating of “1”, which is higher than a AAA rating. The investments rated NR, NA and WR represent not rated, not available and withdrawn ratings and approximate 1.85% of the fixed income portfolio at December 31, 2010, excluding share balances of \$65.8 million in Treasury’s unrated short-term investment pools, include 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, 2010 and 2009 (amounts in thousands):

December 31, 2010

<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
US Agency	\$ 23,704	AAA	1.55%
US Agency	120,085	AGY	7.87%
US Agency	2,046	NR	0.13%
US Agency	497	A1	0.03%
US Agency	539	A2	0.04%
US Agency	1,125	A3	0.07%
US Agency	3,111	AA1	0.20%
US Agency	5,750	AA2	0.38%
US Agency	13,373	AA3	0.88%
US Agency	277	UST	0.02%
Total US Agency Securities	\$ 170,507		

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 and 2009

NOTE B – INVESTMENTS (Continued)

December 31, 2010 (Continued)

<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
US Government	\$ 13,457	AGY	0.88%
US Government	462,415	UST	30.30%
Total US Government Securities	\$ 475,872		
Mortgage-Backed Securities	\$ 12,845	AAA	0.84%
Mortgage-Backed Securities	631	AA1	0.04%
Mortgage-Backed Securities	692	AA2	0.05%
Mortgage-Backed Securities	522	AA3	0.03%
Mortgage-Backed Securities	486	BAA3	0.03%
Mortgage-Backed Securities	67	CAA3	0.00%
Mortgage-Backed Securities	66	A3	0.00%
Mortgage-Backed Securities	182,862	AGY	11.98%
Mortgage-Backed Securities	39	B1	0.00%
Mortgage-Backed Securities	278	B2	0.02%
Mortgage-Backed Securities	888	NA	0.06%
Mortgage-Backed Securities	14,011	NR	0.92%
Total Mortgage-Backed Securities	\$ 213,387		
Asset-Backed Securities	\$ 400	A1	0.03%
Asset-Backed Securities	200	A2	0.01%
Asset-Backed Securities	296	A3	0.02%
Asset-Backed Securities	98	AA2	0.01%
Asset-Backed Securities	1,453	AA3	0.10%
Asset-Backed Securities	29,820	AAA	1.95%
Asset-Backed Securities	13,377	AGY	0.88%
Asset-Backed Securities	119	BA1	0.01%
Asset-Backed Securities	72	BAA1	0.00%
Asset-Backed Securities	422	BAA2	0.03%
Asset-Backed Securities	5,059	NR	0.33%
Total Asset-Backed Securities	\$ 51,316		

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 and 2009

NOTE B – INVESTMENTS (Continued)

December 31, 2010 (Continued)

<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
Corporate Obligations	\$ 24,501	AAA	1.61%
Corporate Obligations	8,417	AA1	0.55%
Corporate Obligations	28,899	AA2	1.89%
Corporate Obligations	36,150	AA3	2.37%
Corporate Obligations	51,414	A1	3.37%
Corporate Obligations	75,537	A2	4.95%
Corporate Obligations	55,870	A3	3.66%
Corporate Obligations	6,363	B1	0.42%
Corporate Obligations	3,652	B2	0.24%
Corporate Obligations	3,855	B3	0.25%
Corporate Obligations	6,388	BA1	0.42%
Corporate Obligations	9,132	BA2	0.60%
Corporate Obligations	16,725	BA3	1.10%
Corporate Obligations	39,107	BAA1	2.56%
Corporate Obligations	46,994	BAA2	3.08%
Corporate Obligations	21,929	BAA3	1.44%
Corporate Obligations	243	CAA1	0.02%
Corporate Obligations	187	CAA2	0.01%
Corporate Obligations	5,042	NR	0.33%
Corporate Obligations	1,295	WR	0.08%
Total Corporate Obligations	\$ 441,700		
Treasury Investment Program	\$ 65,833	NR	4.31%
Total Fixed Income Securities	\$ 1,418,615		
Equity Securities	\$ 107,564	NR	7.05%
Total Portfolio at December 31, 2010	\$ 1,526,179		100.00%

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 and 2009

NOTE B – INVESTMENTS (Continued)

December 31, 2009

<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
US Agency	\$ 11,349	AAA	0.71%
US Agency	136,573	AGY	8.59%
US Agency	5,222	NR	0.33%
US Agency	7,259	A1	0.46%
US Agency	595	A2	0.04%
US Agency	37	A3	0.00%
US Agency	332	AA1	0.02%
US Agency	1,532	AA2	0.10%
US Agency	10,412	AA3	0.66%
Total US Agency Securities	\$ 173,311		
US Government	\$ 3,567	AGY	0.22%
US Government	563,264	UST	35.35%
Total US Government Securities	\$ 566,831		
Mortgage-Backed Securities	\$ 8,976	AAA	0.56%
Mortgage-Backed Securities	191	AA3	0.01%
Mortgage-Backed Securities	174	A1	0.01%
Mortgage-Backed Securities	1,010	A2	0.06%
Mortgage-Backed Securities	205,637	AGY	12.94%
Mortgage-Backed Securities	101	BA1	0.01%
Mortgage-Backed Securities	167	BAA3	0.01%
Mortgage-Backed Securities	828	NA	0.05%
Mortgage-Backed Securities	4,851	NR	0.31%
Total Mortgage-Backed Securities	\$ 221,935		
Asset-Backed Securities	\$ 501	A2	0.03%
Asset-Backed Securities	183	A3	0.01%
Asset-Backed Securities	224	AA2	0.01%
Asset-Backed Securities	1,479	AA3	0.09%
Asset-Backed Securities	9,777	AAA	0.62%
Asset-Backed Securities	13,274	AGY	0.84%

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 and 2009

NOTE B – INVESTMENTS (Continued)

December 31, 2009 (Continued)

<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
Asset-Backed Securities	\$ 113	BA1	0.01%
Asset-Backed Securities	518	BAA2	0.03%
Asset-Backed Securities	3,286	NR	0.21%
Total Asset-Backed Securities	\$ 29,355		
<u>Investment Type</u>			
Corporate Obligations	\$ 26,814	AAA	1.69%
Corporate Obligations	10,620	AA1	0.67%
Corporate Obligations	20,959	AA2	1.32%
Corporate Obligations	23,144	AA3	1.46%
Corporate Obligations	52,240	A1	3.29%
Corporate Obligations	83,885	A2	5.28%
Corporate Obligations	43,634	A3	2.75%
Corporate Obligations	4,091	B1	0.26%
Corporate Obligations	2,481	B2	0.16%
Corporate Obligations	3,816	B3	0.24%
Corporate Obligations	5,862	BA1	0.37%
Corporate Obligations	11,095	BA2	0.70%
Corporate Obligations	15,855	BA3	1.00%
Corporate Obligations	37,522	BAA1	2.36%
Corporate Obligations	37,936	BAA2	2.39%
Corporate Obligations	21,092	BAA3	1.33%
Corporate Obligations	576	CAA1	0.04%
Corporate Obligations	166	CAA2	0.01%
Corporate Obligations	249	CAA3	0.02%
Corporate Obligations	11,028	NR	0.69%
Corporate Obligations	732	WR	0.05%
Total Corporate Obligations	\$ 413,797		

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 and 2009

NOTE B – INVESTMENTS (Continued)

December 31, 2009 (Continued)

Investment Type

Treasury Investment Program	\$ 85,696	NR	5.39%
Total Fixed Income Securities	\$ 1,490,925		
Equity Securities	\$ 99,871	NR	6.28%
Total Portfolio at December 31, 2009	\$ 1,590,796		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, 2010 and 2009, SWIF's fixed income portfolio had the following option-adjusted durations by fixed income sector:

<u>December 31, 2010</u>		Duration
<u>Investment Type</u>	<u>Amount</u>	<u>(in years)</u>
US Agency Securities	\$ 170,507	6.48
US Government Securities	475,872	9.61
Mortgage-Backed Securities	213,387	2.61
Asset-Backed Securities	51,316	0.95
Corporate Obligations	441,700	5.69
Treasury Investment Program	65,833	N/A
Total Fixed Income Securities	\$ 1,418,615	
Equity Securities	\$ 107,564	N/A
Total Portfolio Securities	\$ 1,526,179	

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 and 2009

NOTE B – INVESTMENTS (Continued)

<u>December 31, 2009</u>		<u>Duration</u>
<u>Investment Type</u>	<u>Amount</u>	<u>(in years)</u>
US Agency Securities	\$ 173,311	6.55
US Government Securities	566,831	8.45
Mortgage-Backed Securities	221,935	3.03
Asset-Backed Securities	29,355	3.61
Corporate Obligations	413,797	5.61
Treasury Investment Program	85,696	N/A
Total Fixed Income Securities	<u>\$ 1,490,925</u>	
Equity Securities	\$ 99,871	N/A
Total Portfolio Securities	<u>\$ 1,590,796</u>	

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 receive 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.

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 and 2009

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 and 2009

NOTE B – INVESTMENTS (Continued)

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, 2010, 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, 2010 and 2009 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 \$190,163 and \$161,123, respectively.

SWIF's investment securities owned at December 31, 2010 and 2009, were as follows (amounts in thousands):

	<u>December 31, 2010</u>	
	<u>Book/Adjusted</u>	<u>Market Value</u>
	<u>Carrying Value</u>	
<u>Bonds</u>		
Government	\$ 608,466	\$ 619,089
States, Territories and Possessions	890	898
Political Subdivisions of States, Territories, and Possessions	1,085	1,185
Revenue & Special Obligations	25,499	25,864
Single Class Mortgage-Backed/ Asset-Back Securities	107,134	109,342
Multi-Class Residential Mortgage- Backed/Asset-Back Securities	42,523	44,087
Other Multi-Class Commercial Mortgage- Backed/Asset-Backed Securities	1,019	1,025
Industrial & Miscellaneous	509,538	531,134
<u>Total Bonds</u>	<u>\$ 1,296,154</u>	<u>\$ 1,332,624</u>
<u>Common Stocks</u>	<u>\$ 107,381</u>	<u>\$ 107,381</u>
<u>Preferred Stocks</u>	<u>\$ 170</u>	<u>\$ 183</u>
<u>Short-Term Investments</u>	<u>\$ 85,991</u>	<u>\$ 85,991</u>

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 and 2009

NOTE B – INVESTMENTS (Continued)

<u>December 31, 2009</u>		
	<u>Book/Adjusted</u> <u>Carrying Value</u>	<u>Market Value</u>
<u>Bonds</u>		
Government	\$ 740,625	\$ 750,254
Revenue & Special Obligations	7,208	7,067
Single Class Mortgage-Backed/ Asset-Back Securities	137,009	140,500
Multi-Class Residential Mortgage- Backed/Asset-Back Securities	22,381	23,236
Industrial & Miscellaneous	463,115	479,524
<u>Total Bonds</u>	\$ 1,370,338	\$ 1,400,581
<u>Common Stocks</u>	\$ 99,871	\$ 99,871
<u>Short-Term Investments</u>	\$ 90,344	\$ 90,344

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, 2010 and 2009. Pertaining to marketable equity securities, both December 31, 2010 and December 31, 2009 showed net unrealized capital gains (in thousands) of \$17,931 and \$7,875, respectively.

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

	<u>December 31, 2010</u>		
	<u>(Amounts in Thousands)</u>		
	<u>Coal</u>	<u>Commercial</u>	<u>Total</u>
<u>Loss Reserves</u>			
Indemnity	\$ 29,150	\$ 596,639	\$ 625,789
Medical	2,342	131,423	133,765
Bulk	15,966	898,212	914,178
<u>Total Loss Reserves</u>	\$ 47,458	\$ 1,626,274	\$ 1,673,732
<u>IBNR Loss Reserves</u>	\$ 995	\$ 111,468	\$ 112,463
<u>Net Losses</u>			\$ 1,786,195
Add:			
Assumed Outstanding Loss Reserves (Including IBNR)			2,945
Less:			
Discount of Reserves			(484,220)
Recoverable Reinsurance (Including IBNR)			(180)
<u>Net Unpaid Losses</u>			\$ 1,304,740

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 and 2009

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

	December 31, 2009		
	<u>(Amounts in Thousands)</u>		
	<u>Coal</u>	<u>Commercial</u>	<u>Total</u>
<u>Loss Reserves</u>			
Indemnity	\$ 32,651	\$ 645,652	\$ 678,303
Medical	2,101	132,558	134,659
Bulk	16,007	874,984	890,991
Total Loss Reserves	<u>\$ 50,759</u>	<u>\$ 1,653,194</u>	<u>\$ 1,703,953</u>
<u>IBNR Loss Reserves</u>	<u>\$ 1,284</u>	<u>\$ 145,786</u>	<u>\$ 147,070</u>
<u>Net Losses</u>			\$ 1,851,023
Add:			
Assumed Outstanding Loss Reserves (Including IBNR)			2,753
Less:			
Discount of Reserves			(501,725)
Recoverable Reinsurance			<u>(4,350)</u>
<u>Net Unpaid Losses</u>			<u>\$ 1,347,701</u>

NOTE D - RETIREMENT CONTRIBUTIONS

Membership in the State Employees' Retirement System is mandatory for all state employees, except various officials including elected officials, appointed heads and deputies of administrative departments, departmental or advisory boards or commissions, legislative employees, Department of Education employees, and school employees. The administering agency is the State Employees' Retirement Board.

Contributions on behalf of active members are required to be made by the Commonwealth or other employers into the State Employees' Retirement Fund. Commonwealth law determines all member contribution rates. The active plan member contribution rate is 5 percent of employee compensation for most employees in Class A; for Class AA members, the contribution rate is 6.25 percent. The Commonwealth contributes the additional amount necessary to fund the program. The Commonwealth's composite contribution rate is paid on a percent of employee compensation. The Commonwealth's contribution rate was 3.15 percent for the period January 1, 2010 to June 30, 2010 and 4.11 percent for the period July 1, 2010 to December 31, 2010. SWIF's retirement contributions (in thousands) were \$635 and \$573 for the calendar years ended December 31, 2010 and 2009, respectively.

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 and 2009

NOTE D - RETIREMENT CONTRIBUTIONS (Continued)

Data with respect to the excess, if any, of the actuarially computed value of vested benefits over the total of the pension fund and any balance sheet pension accruals, less any pension prepayments or deferred charges, are not available on a department basis.

Post Employment Health Care Benefits: In addition to providing pension benefits, SWIF provides certain health care benefits for retired employees that meet specified length-of-service and age requirements. These benefits are provided through insurance companies whose premiums are based on the benefits paid during the calendar year. SWIF recognizes the cost of providing these benefits, which for the calendar years ended December 31, 2010 and 2009 totaled \$2,305 and \$2,577, respectively, as paid (in thousands).

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 3.25 percent for the calendar years ended December 31, 2010 and December 31, 2009. 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, 2010 and 2009, 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	
2010	\$1,554,136	\$226,197	\$31,327	\$43,747	\$258,099	\$1,509,814
2009	1,635,237	248,059	29,934	55,039	304,055	1,554,136

NOTE F – SURPLUS AS REGARDS POLICYHOLDERS

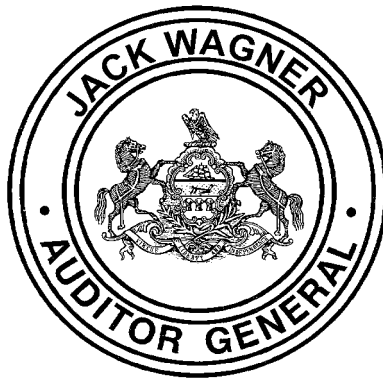
By statute, the State Workers' Insurance Board (board) is required to set aside a percentage of premiums to sufficiently maintain the surplus to cover the catastrophe hazard of all the subscribers in the fund and to guarantee the solvency of the fund. The statute also provides that

STATE WORKERS' INSURANCE FUND
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 and 2009

NOTE F – SURPLUS AS REGARDS POLICYHOLDERS (Continued)

the board shall have the power to reinsure any risk which they may deem necessary. Accordingly, with the assistance of Guy Carpenter and Company, 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.



**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***

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

We have audited the accompanying Statement of Admitted Assets, Liabilities and Surplus-statutory basis of the State Workers' Insurance Fund (SWIF) as of December 31, 2010 and 2009, and the related Statement of Operations and Changes in Surplus-statutory basis and the Statement of Cash Flows-statutory basis for the years then ended and have issued our report thereon dated January 20, 2012. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered SWIF's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the statutory financial statements, but not for the purpose of expressing an opinion on the effectiveness of SWIF's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of SWIF's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A deficiency in internal control over financial reporting 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 significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the Finding Section as Finding No. 1 to be a significant deficiency in internal control over financial reporting.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the SWIF statutory financial statements are free of 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 statutory 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.

SWIF's response to the finding identified in our audit is described in the accompanying Finding Section as part of Finding No. 1. We did not audit SWIF's response and, accordingly, we express no opinion on it.

This 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 these specified parties.

January 20, 2012

JACK WAGNER
Auditor General

FINDING
DECEMBER 31, 2010

DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND

FINDING NO. 1 – General Computer Controls in SWIF Need Improvement

Condition: Our review of general computer controls at SWIF for the calendar year ended December 31, 2010 disclosed the following internal control deficiencies that need to be addressed by SWIF management:

1. A lack of segregation of duties exists because programmers for the PowerComp application (workers compensation policy and claim software) also have the ability to promote a change into the production environment.
2. The implementation of program changes is not appropriately controlled or documented. Documentation of the movement of program changes to production is not maintained.
3. Documentation is not maintained to evidence management authorization is requested and obtained prior to initiating all application changes.
4. A monitoring process has not been implemented over the production environment to detect changes moved into production that did not follow the standard process.
5. There are no formal procedures in place if data migration is performed as a result of new/upgraded application software to perform reconciliations to ensure the data migrated successfully and accurately.
6. Hardware Against Software Piracy (HASP) security keys which allow administrative access to the Onbase application (imaging software) were unaccounted for, and the report documenting the inventory of all HASPs was inaccurate.
7. The Freedom Financial application (general ledger and financial reporting software) has an excessive number of administrators and privileged users. All users with access to the application have both administrative and privileged user access.
8. Password requirements for the PowerComp, Freedom Financial and Iworks (investment portfolio software) applications are not configured to enforce adequate complexity settings, i.e., there are inadequate settings for minimum length, password complexity, password expiration, and user lockout after multiple failed login attempts.
9. In order to access application functionality, users are not required to authenticate using a unique user ID and password for the PowerComp and Freedom Financial applications.
10. Periodic access reviews to determine the appropriateness of users with privileged access have not been implemented for the Freedom Financial and Onbase applications.
11. Password requirements for the Simplex application which controls door access in the Scranton State Office Building are not configured to enforce adequate complexity settings. Furthermore, a unique user ID and password is not utilized to access the software, and an excessive number of individuals (8) have administrative access to the software.
12. There is no written system development life cycle established to outline requirements for planning, designing, developing, testing, approving, and implementing new applications and upgrades to existing applications, including vendor-developed software.

FINDING (Continued)
DECEMBER 31, 2010

DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND

FINDING NO. 1 – General Computer Controls in SWIF Need Improvement (Continued)

13. There is no formal methodology or written policies regarding end-user computing.

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: The logical access deficiencies (i.e., inadequate password complexity settings, lack of unique user IDs and passwords, no password expiration, and no user lockout after multiple failed logon attempts) are due to software limitations, and vendor-implemented settings that have never been changed. The excessive number of users with privileged access to some applications is due to vendor implementation that has never been reviewed or changed. Regarding the Hardware Against Software Piracy (HASP) security keys, the inaccuracy and incompleteness of the report appears to be a lack of periodic management oversight. The lack of a formal systems development methodology is attributable to SWIF waiting for the Department of Labor & Industry to complete its efforts in developing a methodology. The remaining deficiencies related to system maintenance and program change exist because approvals are not documented and/or maintained. The segregation of duties weakness is attributable to a lack of staff and will be corrected when the vacant position is filled.

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.

FINDING (Continued)
DECEMBER 31, 2010

DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND

FINDING NO. 1 – General Computer Controls in SWIF Need Improvement (Continued)

AGENCY RESPONSE

(Note: Agency's response numbers correspond to the numbers in the condition of the finding.)

1. The lack of segregation of duties currently exists due to the vacant Database Administrator position assigned to support the SWIF program area. In order to provide the appropriate database maintenance and production support, it was necessary for us to contract with the Vendor to allocate a portion of their resources to augment the L&I Bureau of Enterprise Architecture DBA staff. Due to intellectual property constraints with the PowerComp system, this work could not be done by any other vendor.

The other segregation of duties issue existed due to the vacant Data Analyst 2 position created with the promotion of this resource to an Application Developer 1. This position was filled in early December 2011 and we are currently completing training for the new resource and have initiated requests terminating the access for the AD1. In response to these findings, OIT will look at how to restrict access while still being able to provide the necessary support, such that should there be continuation or recurrence of a vacant position, procedures will be in place to segregate duties to the extent possible and provide for documented tracking of the work being performed.

2. In November of 2011, a procedure change was implemented in that the Go/No-go verbal approvals for implementation of a PowerComp release are now documented in the meeting minutes.
3. See response to item 2 above.
4. L&I OIT implemented changes to the Enterprise Tivoli Alert system in November 2011 which will notify L&I OIT if notifying unauthorized changes have been made to the production environment.
5. A workgroup will be formed which will include the OIT Standards Committee so that the details of this item can be documented and a determination can be made as to how this should be appropriately addressed. The output of the workgroup will be documented procedures. OIT will work with the SWIF management as appropriate.
6. In December of 2011, a manual process was developed for control of these HASPS. This includes a quarterly physical inventory of each item. We are currently working to enter these physical assets into our Remedy system which is used for physical hardware asset tracking. This will relate a hardware asset with a specific user.

FINDING (Continued)
DECEMBER 31, 2010

DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND

FINDING NO. 1 – GENERAL COMPUTER CONTROLS IN SWIF NEED IMPROVEMENT (Continued)

AGENCY RESPONSE (Continued)

7. SWIF is planning on having the latest upgrade of the Freedom software installed sometime after they complete the 2011 Annual Statement (first quarter of 2012). This version of the software contains password security functionality that can be customized by the Administrator. As part of the upgrade process, SWIF will be assigning an Administrator and backup Administrator for this application.
8. In order to gain access to the PowerComp system, a user has to use their CWOPA account to log into a particular machine. This is the primary mode of authentication.

As noted in #7, SWIF is planning on upgrading to the most current version of the Freedom Financial software during the first quarter of 2012. This version of the software contains password security functionality which includes password complexity, length, expiration, and user lockout. These can all be configured by the Administrator. SWIF has already changed the configuration for the Iworks application to enable user lockout after 3 failed login attempts. There is also a minimum length configured in the application for the password.
9. The primary mode of authentication is the user logon to the hardware; their machine. The secondary mode of authentication for PowerComp is the PowerComp login. If a user is unable to authenticate to their machine using the primary mode of authentication, then they will not be able to access PowerComp. As noted in #7 above, SWIF is planning on upgrading to the most current version of the Freedom Financial software during the first quarter of 2012. As part of the upgrade process, SWIF will be assigning unique user ID's and passwords to staff who require access to this application.
10. SWIF will work on a procedure for periodic access reviews for the Freedom Financial application as part of the planned upgrade noted in #7 above. SWIF is currently working on drafting a procedure to address periodic access reviews for the Onbase application and anticipates this will be in place by end of 1st quarter 2012.
11. Password formats have been changed to follow the CWOPA rules; unique IDs and passwords have been instituted for all users; the 8 users that have administrative access are Operations staff who work different shifts and different days. This was setup this way to insure that there is always a staff person onsite who can make updates and changes to the security database.

FINDING (Continued)
DECEMBER 31, 2010

DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND

FINDING NO. 1 – General Computer Controls in SWIF Need Improvement (Continued)

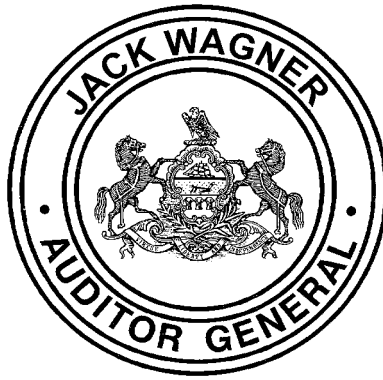
AGENCY RESPONSE (Continued)

12. The system development life cycle for PowerComp is determined by the Vendor, the software intellectual property owner. The Vendor provides system development and support services and their staff follow the Vendor's processes. There is an ongoing effort to establish an enterprise wide policy/procedure for the SDLC.

13. L&I is awaiting a governing policy to be determined by OA and/or OB.

AUDITORS' CONCLUSION

We acknowledge and are encouraged by L&I's willingness to implement actions to correct problems identified during the audit and its actions to improve programs and operations. We will evaluate the progress of all corrective actions in our subsequent audit.



**COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND DISTRIBUTION LIST
DECEMBER 31, 2010 AND 2009**

This report was initially distributed to the following:

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The Honorable Michael F. Consedine Insurance Commissioner	
The Honorable Julia Hearthway Secretary Department of Labor and Industry	
Ms. Elizabeth Crum Deputy Secretary for Compensation and Insurance Department of Labor and Industry	
Mr. Brian Nixon, Director State Workers' Insurance Fund	

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