STATE OF DELAWARE
OFFICE OF AUDITOR OF ACCOUNTS

R. THOMAS WAGNER, JR., CFE, CGFM, CICA
AUDITOR OF ACCOUNTS

PHONE: 302-739-4241
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August 4, 2011

The Honorable Karen Weldin Stewart
Insurance Commissioner
Department of Insurance
841 Silver Lake Blvd.
Dover, DE 19904

Dear Commissioner Weldin Stewart:

As you are aware, my Office contracted with Santora CPA Group to perform the financial audit of the Department of Insurance (DOI) for fiscal year end June 30, 2010. While this financial audit of DOI was voluntary and performed at your request, a public reporting of the outcome is necessary. The DOI financial statements for fiscal year end June 30, 2010, are not presented for reasons explained by the firm.

If you elect to continue preparation of department financial statements, our office will serve as your point of contact for obtaining an audit of those financial statements. If not, you will continue to obtain the required level of audit coverage under the State-wide Comprehensive Annual Financial Report.

Sincerely,

R. Thomas Wagner, Jr., CFE, CGFM, CICA
Auditor of Accounts

401 FEDERAL STREET • TOWNSEND BUILDING • SUITE ONE • DOVER, DE 19901
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Santora CPA Group
Right, By Your Side

William A. Santora, CPA
John A. D'Agostino, CPA, MST
Heath N. Kahrs, CPA
Ciro Adams, CPA

Robert Freed, Principal
Linda A. Pappajohn, Principal
Stephen M. Conyers, CPA, Principal
Stacey A. Wynne, CPA, CFE, CICA, Principal

June 6, 2011

The Honorable R. Thomas Wagner, Jr.
State Auditor
Office of Auditor of Accounts
401 Federal Street
Townsend Building, Suite One
Dover, DE 19901

Karen Weldin Stewart, CIR-ML
Delaware Insurance Commissioner
Delaware Department of Insurance
841 Silver Lake Blvd.
Dover, DE 19904

Dear Mr. Wagner and Commissioner Stewart:

As of the date of this letter, the Department of Insurance (the Department) has not provided the information necessary to complete the June 30, 2010 audit.

As noted in our engagement letter:

"If circumstances arise relating to the condition of the Department's records, the availability of appropriate audit evidence, or indications of a significant risk of material misstatement of the financial statements because of error, fraudulent financial reporting, or misappropriation of assets, which in our professional judgment, prevent us from completing the audit or forming an opinion, we retain the unilateral right to take any course of action permitted by professional standards, including declining to express an opinion, declining to issue a report, or withdrawing from the engagement."

We noted two material weaknesses in our letter to the Department, as required by Statement on Auditing Standards (SAS) No. 115, *Communicating Internal Control Related Matters Identified in an Audit* (see copy attached). As a result of the material weakness over financial reporting, the Department was not able to provide us with financial statements, including footnotes and supplementary information, that are in conformity with accounting principles generally accepted in the United States of America.

Therefore, we are withdrawing from the engagement.

Respectfully submitted,

John A. D'Agostino

Enclosures

Santora CPA Group
Right, By Your Side

William A. Santora, CPA
John A. D'Agostino, CPA, MST
Heath N. Kahrs, CPA
Ciro Adams, CPA

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Stacey A. Wynne, CPA, CFE, CICA, Principal

To the Insurance Commissioner and Management
Delaware Department of Insurance
Dover, DE

In planning and performing our audit of the financial statements of Delaware Department of Insurance (the Department) as of and for the year ended June 30, 2010, in accordance with auditing standards generally accepted in the United States of America, we considered the Department's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control 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 certain deficiencies in internal control that we consider to be material weaknesses.

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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis. We consider the following deficiencies in the Department's internal control to be material weaknesses:

2010-1 - Financial Reporting

Criteria

According to the National Council on Government Accounting Concept Statement No. 1, *Objectives of Financial Reporting*, "The overall goal of accounting and financial reporting for governmental units is to provide: 1) financial information useful for making economic, political and social decisions, and demonstrating accountability and stewardship; and 2) information useful for evaluating managerial and Departmental performance."

Internal Control – Integrated Framework, published by COSO, defines financial reporting objectives as follows: "Financial reporting objectives address the preparation of reliable published financial statements, including interim and condensed financial statements and selected financial data derived from such statements…Reliable financial statements are a prerequisite to obtaining investor or creditor capital, and may be critical to the award of certain contracts or to dealing with certain suppliers. Investors, creditors, customers, and suppliers often rely on financial statements to assess management's performance and to compare it with peers and alternative investments. The term 'reliability' as used with financial reporting

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objectives involves the preparation of financial statements that are fairly presented in conformity with generally accepted or other relevant and appropriate accounting principles and regulatory requirements for external purposes."

The financial statements are the responsibility of management. A proper system of internal controls over financial reporting is essential in order to prevent, detect, and correct misstatements and to ensure that such information is useful in decision-making and evaluating managerial and Departmental performance, as well as demonstrating accountability and stewardship. Controls must be properly designed, in place, and operating effectively to ensure that the Department's accounting and financial information is fairly stated in accordance with generally accepted accounting principles (GAAP).

Condition

We noted that the Department relied heavily on the audit process to detect reporting errors. Various errors were noted during the audit, including:

- A payroll accrual was omitted from the financial statements to account for the payroll expenditures paid out in July 2010 that related to June 2010 ($336,605).

- Deferred revenue was not recorded in the financial statements for amounts not expected to be collected within the 60-day period of availability of funds ($1,407,121).

- Grants receivable for the State Health Insurance Assistance Program grant were omitted from the financial statements ($31,442).

- An accrual was omitted from the financial statements to account for the contractual services expenditures paid out in July 2010 that related to June 2010 ($616,913).

- Cash receipts that were included in the amounts presented in the Department's financial statements were $190,199 lower than the cash receipts confirmed by the State Treasurer's Office.

In addition, the following disclosures were missing from the Department's financial statements:

- Footnote regarding appropriation 0099 funds and management's rationale for exclusion from the Department's financial statements.

- Summary of Significant Accounting Policies footnote disclosures regarding estimates, grants, and accounting pronouncements.

- Disclosure regarding the Department's policy for custodial credit risk associated with deposits or an indication that it does not have such a policy.

- Disclosure for the pension plan regarding the types of benefits offered and the authority for establishing and amending benefits, the authority for establishing and amending the funding policy, information on both required and actual contributions, and how the required contribution rate is determined.

- Footnote regarding accounts receivable and deferred revenue.

- Footnote disclosing the budgetary basis used in the Budget vs. Actual schedule, and reconciliation if budgetary basis differs from GAAP.

- Footnote regarding the composition of and purpose for amounts transferred from the Department (shown as other financing uses).

We further noted that the Department's Budget vs. Actual schedule did not reconcile to the financial statements.

Cause

The personnel assigned to complete the financial statements are not formally-trained accountants, and therefore, do not have the necessary skills and experience to accurately prepare the Department's financial statements, including footnotes, in accordance with the requirements of GAAP.

Effect

Due to the deficiencies noted in the processes used to compile financial statement information and the reliance on the audit process to detect and correct such errors, material misstatements to the financial statements could go undetected.

Recommendation

We recommend that management implement Department internal controls and policies and procedures regarding financial statement preparation and review to ensure that the information presented is in accordance with GAAP.

Auditee Response

See the attached response letter from the Department.

Auditor Comment

The Department could not provide a reconciliation or analysis to explain the variance of $190,199 between the cash receipts reported in their financial statements to the cash receipts confirmed by the State Treasurer's Office received as part of our audit procedures. As a result, the variance remains unreconciled as of the date of this letter.

2010-2 - Procurement

Criteria

The provisions of State procurement law are detailed in 29 Del. C., c. 69, *State Procurement*. Documentation regarding the history of each procurement exceeding the $50,000 threshold is required to be maintained by State departments and agencies in vendor files including: proof of advertisement, a copy of the Request for Proposal (RFP), proposals received in response to the RFP, documentation of review of proposals and the selection of the successful bidder (including the rationale if the lowest cost bidder is not selected), and standard contractual language for final contract agreements.

Condition

We tested 100% of contractual services expenditures to vendors that were subject to the provisions of 29 Del. C., c. 69 (i.e. exceeded the $50,000 threshold) and that were required to be bid directly by the Department (i.e., were not included in the Statewide approved vendor list). In our testing of contractual services expenditures to these seven vendors totaling $16,115,718, we noted that the Department did not have the required signed contracts or vendor files, and therefore, did not adhere to the provisions of 29 Del. C., c. 69 in the selection these vendors.

Cause

Management failed to adhere to the required procurement procedures as detailed in 29 Del. C., c. 69.

Effect

The Department is in violation of 29 Del. C., c. 69.

Recommendation

We recommend that management implement Department internal controls and policies and procedures to ensure that the requirements of 29 Del. C., c. 69 are followed in the bidding and selection of vendors for all contractual services.

Auditee Response

See the attached response letter from the Department.

Auditor Comment

The Department could not provide signed contracts or vendor files during the audit or through the date of this letter to demonstrate compliance with the provisions of 29 Del. C., c. 69 in the selection of the seven vendors totaling $16,115,718.

This communication is intended solely for the information and use of management, others within the Department of Insurance, and is not intended to be and should not be used by anyone other than these specified parties. However, under 29 Del. C., Section 10002(d), this report is a public record and its distribution is not limited. This report, as required by statute, was provided to the Governor, Controller General, Attorney General, Office of Management and Budget, and Department of Finance.

August 2, 2011
Newark, Delaware

Karen Weldin Stewart, CIR-ML
Commissioner

Delaware Department of Insurance

August 2, 2011

Kathleen A. O'Donnell, CPA-PA, CISA, CGFM, CGAP
Chief Administrative Auditor
Delaware Office of Auditor of Accounts
Townsend Building, Suite 1
401 Federal Street
Dover, DE 19901

RE: Response to Santora Comment Letter ("Santora Letter") Dated June 6, 2011

Dear Ms. O'Donnell:

I would like to take this opportunity to thank the Accounting Firm, Santora CPA Group, and the State Auditor's office for assisting with our most recent audit. I requested this initial audit to provide the Department of Insurance a baseline from which to develop rigorous financial controls and Generally Accepted Accounting Principles ("GAAP") compliant financial statements. My goal is to have a fully transparent process in place at the Department of Insurance.

One of the things I learned after taking office in 2009 was that the DOI's financial reporting process needed to be improved. As a result, the DOI has been working diligently to improve these processes. I believe these processes will enhance my ability to manage the DOI's resources more effectively and efficiently that will improve the transparency of the Department.

After working to improve the process, I wanted to make sure that we were making adequate progress in this area so I requested an audit. Fiscal Year 2010 was the first year the DOI attempted to produce a Comprehensive Annual Financial Report ("CAFR") on GAAP basis and the first time historically the DOI was subjected to an audit on this process.

My staff is working diligently to correct all of the issues identified in the letter from the Santora Group dated June 6, 2011. Attached to this letter is a comprehensive and detailed explanation addressing the particular issues identified in the Santora Letter. Included in our response is the Department's action plan for corrective action. As you can see, a significant amount of work has already been completed and corrective plans have been developed to address each item. Some of these issues are simple, whether to properly characterize an item or prepare reconciliation, others require much more system wide and operational changes that will take some time to implement.

My commitment to this process is as strong as it was when I sought this elected office. My staff and I share this commitment. We are committed to developing a fully transparent financial reporting process at the DOI during Fiscal Year 2012 and beyond.

Again, thank you for your assistance and work on this project. I look forward to working with the State Auditor's office in the future.

Respectfully,

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Enclosure

Karen Weldin Stewart, CIR-ML
Commissioner

Delaware Department of Insurance

August 2, 2011

Response to Santora Letter

In response to Santora letter dated June 6, 2011, you stated that your firm was withdrawing from the engagement because:

"We noted two material weaknesses in our letter to the Department, as required by Statement on *Auditing Standards (SAS) No. 115, Communicating Internal Control Related Matters Identified in an Audit* (see copy attached). As a result of the material weakness over financial reporting, the Department was not able to provide us with financial statements, including footnotes and supplementary information that are in conformity with accounting principles generally accepted in the United States of America."

My staff and I have prepared the following response to each "Condition" or "Material Weakness". The Department's response to each error or comment within each condition appears in bold letters immediately underneath each one.

Condition One

We noted that the Department relied heavily on the audit process to detect reporting errors. Various errors were noted during the audit, including:

A payroll accrual was omitted from the financial statements to account for the payroll expenditures paid out in July 2010 that related to June 2010 ($336,605).

> **This accrual was omitted from the financial statements. The Department's contractual services expenditures were properly paid and will be properly accounted for on the financial statements. In addition, the Department is going to utilize the services of a CPA firm to assist in developing written procedures for preparing the financial statements and training staff to ensure that all appropriate accruals are made and the financial statements are properly prepared.**

Deferred revenue was not recorded in the financial statements for amounts not expected to be collected within the 60 day period of availability of funds ($1,407,121).

> **This revenue should have been recorded on the financial statements but mistakenly left off. It is accounted for in the Department's yearly GAAP package under "Allowance for Doubtful Account". In addition, the Department is going to utilize the services of a CPA firm to assist in developing written procedures for**

preparing the financial statements and training staff to ensure that all appropriate accruals are made and the financial statements are properly prepared.

Grants receivable for the State Health Insurance Assistance Program grant were omitted from the financial statements ($31,442).

The template that the State Auditor's Office provided did not include grants. All grants will be included on the financial statements in the future.

An accrual was omitted from the financial statements to account for the contractual services expenditures paid out in July 2010 that related to June 2010 ($616,913).

This accrual was omitted from the financial statements. In addition, the Department is going to utilize the services of a CPA firm to assist in developing written procedures for preparing the financial statements and training staff to ensure that all appropriate accruals are made and the financial statements are properly prepared.

Cash receipts that were included in the amounts presented in the Department's financial statements were $190,199 lower than the cash receipts confirmed by the State Treasurer's Office.

We followed up with the State Treasurer's Office regarding this comment and found that our financial statement does reconcile to the cash receipts per their records. We believe that the auditors may have been attempting to reconcile to a different report. The DOI recommends that further discussions between the Auditor's Office, the Department, and Treasurer's Office occur to identify the appropriate report needed to reconcile cash receipts.

In addition, the following disclosures were missing from the Department's financial statements:

Footnote regarding appropriation 0099 funds and management's rationale for exclusion from the Department's financial statements.

The appropriate disclosure will be made for this item in future financial statements. The DOI is going to utilize the services of a CPA firm to assist in developing written procedures for preparing the financial statements, including footnotes, and training staff to ensure that all appropriate accruals are made and the financial statements are properly prepared.

Summary of Significant Accounting Policies footnote disclosures regarding estimates, grants, and accounting pronouncements.

The appropriate disclosure will be made for this item in future financial statements. The DOI is going to utilize the services of a CPA firm to assist in developing written procedures for preparing the financial statements, including footnotes, and training staff to ensure

that all appropriate accruals are made and the financial statements are properly prepared.

Disclosure for the pension plan regarding the types of benefits offered and the authority for establishing and amending benefits, the authority for establishing and amending the funding policy, information on both required and actual contributions, and how the required contribution rate is determined.

The appropriate disclosure will be made for this item in future financial statements. The DOI is going to utilize the services of a CPA firm to assist in developing written procedures for preparing the financial statements, including footnotes, and training staff to ensure that all appropriate accruals are made and the financial statements are properly prepared.

Footnote regarding accounts receivable and deferred revenue.

The appropriate disclosure will be made for this item in future financial statements. The DOI is going to utilize the services of a CPA firm to assist in developing written procedures for preparing the financial statements, including footnotes, and training staff to ensure that all appropriate accruals are made and the financial statements are properly prepared.

Footnote disclosing the budgetary basis used in the Budget vs. Actual schedule, and reconciliation if budgetary basis differs from GAAP

The appropriate disclosure will be made for this item in future financial statements. The DOI is going to utilize the services of a CPA firm to assist in developing written procedures for preparing the financial statements, including footnotes, and training staff to ensure that all appropriate accruals are made and the financial statements are properly prepared.

Footnote regarding the composition of and purpose for amounts transferred from the Department (shown as other financing uses).

The appropriate disclosure will be made for this item in future financial statements. The DOI is going to utilize the services of a CPA firm to assist in developing written procedures for preparing the financial statements, including footnotes, and training staff to ensure that all appropriate accruals are made and the financial statements are properly prepared.

We further noted that the Department's Budget to Actual schedule did not reconcile to the financial statements.

The Department's Budget has not historically contained contingent/extraordinary expenses and revenues. The appropriate adjustments will be made for these types of items in future financial statements.

Cause

The personnel assigned to complete the financial statements are not formally-trained accountants and; therefore, do not have the necessary skills and experience to accurately prepare the Department's financial statements, including footnotes, in accordance with the requirements of GAAP.

The DOI is going to utilize the services of a CPA firm to assist in developing written procedures for preparing the financial statements, including footnotes, and training staff to ensure that all appropriate accruals are made and the financial statements are properly prepared.

Effect

Due to the deficiencies noted in the processes used to compile financial statement information and the reliance on the audit process to detect and correct such errors, material misstatements to the financial statements could go undetected.

Recommendation

We recommend that management implement Department internal controls and policies and procedures regarding financial statement preparation and review to ensure that the information presented is in accordance with GAAP.

As stated in my cover letter, "My staff is working diligently to correct all of the issues identified in the letter from the Santora Group dated June 6, 2011 ("Santora Letter"). . .... a significant amount of work has already been completed and corrective plans have been developed to address each item. Some of these issues are simple, whether to properly characterize an item or prepare reconciliation, others require much more system wide and operational changes which will take some time to implement."

2010-2 - Procurement

Criteria

The provisions of State procurement law are detailed in 29 Del. C. c. 69, *State Procurement.* Documentation regarding the history of each procurement exceeding the $50,000 threshold is required to be maintained by State departments and agencies in vendor files including: proof of advertisement, a copy of the Request for Proposal (RFP), proposals received in response to the RFP, documentation of review of proposals and the selection of the successful bidder (including the rationale if the lowest cost bidder is not selected), and standard contractual language for final contract agreements.

Condition

We tested 100% of contractual services expenditures to vendors that were subject to the provisions of 29 Del. C. c. 69 (i.e. exceeded the $50000 threshold) and that were required to be bid directly by the Department (i.e., were not included in the Statewide approved vendor list). In our testing of contractual services expenditures to these seven vendors totaling $16,115,718, we noted that the Department did not have the required signed contracts or vendor files and, therefore, did not adhere to the provisions of 29 Del. C. c. 69 in the selection these vendors.

> **We agree that there should be additional information retained in the vendor files to demonstrate compliance with 29 Del. C. c. 69; The Department has changed its documentation retention requirements to ensure that sufficient information will be retained in all vendor files in the future to demonstrate compliance with 29 Del. C. c. 69.**

Cause

Management failed to adhere to the required procurement procedures as detailed in 29 Del. C. c. 69.

Effect

The Department is in violation of 29 Del. C. c.69

Recommendation

We recommend that management implement Department internal controls and policies and procedures to ensure that the requirements of 29 Del. C. c. 69 are followed in the bidding and selection of vendors for all contractual services.

> **The Department has changed its internal controls, policies and procedures to ensure that the requirements of 29 Del. C. c. 69 are followed in the bidding and selection of vendors for all contractual services. In addition, we have established a central filing area with controlled access for all vendor files to ensure that the documentation supporting the Department's compliance with 29 Del. C. c. 69 will be retained in one location with secure access. The Department has signed agreements for 6 of the 7 vendors reviewed by the auditors.**

This communication is intended solely for the information and use of management, others within the Department of Insurance, and is not intended to be and should not be used by anyone other than these specified parties. However, under 29 Del. C., Section 10002(d), this report is a public record and its distribution is not limited. This report, as required by statute, was provided to the Governor, Controller General, Attorney General, Office of Management and Budget, and Department of Finance.

Management

Date of First Engagement	Vendor Name/Type of Service	Audit Finding	Response
July 1995	Regulatory Insurance Services Examination Services	Need centrally located vendor folders – only signed agreement letter.	Dept developing a more complete vendor folder to be in compliance. All leases and contracts will be maintained in the Dept's Financial Srvs. area as the central location for such documentation.
April 1993	INS Consultants Actuary Services	RFP needed – only signed engagement letter.	Dept plans on writing a RFP for this contract this fiscal year.
September 1985	Silver Lake Office Plaza Dover Office	Only a signed lease done through OMB – need centrally located vendor folders.	All leases and contracts will be maintained in the Dept's Financial Srvs. area as the central location for such documents.
August 2009	Regulatory Consultants Inc. Examination Services	RFP needed – only signed engagement letter	Dept is considering writing a RFP if warranted for this contract this fiscal year.
January 2009	Zack Stamp Consulting Captive Bureau	No signed contract – only a signed agreement – need RFP	An RFP was posted, an award was given and a compliant state contract was signed in FY11.
May 2009	EM Ianni Captive Bureau	No signed contract – only a signed agreement – need RFP	An RFP was posted, an award was given but the vendor did not sign the state compliant contract. A new RFP is being drafted to be completed within this fiscal year.
December 2006	Charles Sassaman Workplace Safety	RFP needed – no contract	Dept plans on writing a RFP for this contract this fiscal year.