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DIVISION OF REHABILITATION AND LIQUIDATION – MONITORING AND OVERSIGHT PROCESSES AND STEWARDSHIP OF INSURER ASSETS

Department of Financial Services

Audit performed by the Office of Inspector General to evaluate whether internal controls over the Division of Rehabilitation and Liquidation's monitoring and oversight processes and stewardship of insurer assets are adequate and operating effectively

A handwritten signature in blue ink, reading "Teresa Michael".

Teresa Michael, Inspector General
Office of Inspector General
Department of Financial Services

July 29, 2016



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EXECUTIVE SUMMARY

Consistent with the approved *Annual and Long Term Audit Work Plan*, the Office of Inspector General (OIG) performed an operational audit of the Florida Department of Financial Services' Division of Rehabilitation and Liquidation's (DRL) monitoring and oversight processes and stewardship of insurer assets. The DRL serves as the court-appointed Receiver for insurers placed into receivership pursuant to Chapter 631, Florida Statutes. Our audit revealed the following:

- ❖ **Finding 1:** The Estate Management Section's policies and procedures are not sufficient to ensure that all of its duties and responsibilities are timely and properly performed.
- ❖ **Finding 2:** "Initial Receivership Actions – Checklists" were not always properly and timely completed or adequate to ensure that required tasks were performed.
- ❖ **Finding 3:** Procedures for auditor independence are not sufficient to ensure that the Estate Management Section's audits are objectively performed and auditors are independent.
- ❖ **Finding 4:** Digital signature audits do not effectively ensure that digital signatures are properly secured or deleted, when required.
- ❖ **Finding 5:** The Estate Management Section's audits of claims processes were not always effectively or efficiently performed. In addition, Estate Management's audits did not address the revenue-generating functions of the receiverships.
- ❖ **Finding 6:** The Claims Section could not provide source documentation showing the appropriateness of all proposed claim payments.
- ❖ **Finding 7:** Insurer accounts receivable balances were not always properly or consistently recorded or reported and sufficient documentation was not always available to show that accounts receivable balances were properly analyzed and valued.
- ❖ **Finding 8:** Internal controls were not adequate to ensure that insurer accounts receivable are properly tracked and managed.
- ❖ **Finding 9:** The Asset Recovery Section's collection activities and account adjustment documentation were not always sufficient to demonstrate that appropriate effort was undertaken to obtain a maximum recovery of marshalled assets.
- ❖ **Finding 10:** Records management policies and procedures were not sufficient to ensure that original records and non-public personal financial and health information is safeguarded and that the chain of custody is maintained.
- ❖ **Finding 11:** The DRL's procedures for the periodic review of information technology (IT) system access privileges were not adequate to ensure that the reviews were properly and timely completed.
- ❖ **Finding 12:** The DRL's administration of insurer IT systems was not always adequate to demonstrate that access was properly authorized.
- ❖ **Finding 13:** Certain security controls related to IT system access and monitoring need improvement.

ACKNOWLEDGEMENTS

The OIG would like to thank the management and staff of DRL for their input, cooperation and assistance throughout the performance of this audit. We appreciate the time spent gathering and providing documentation, participating in interviews and responding to our many inquiries.

BACKGROUND

The DRL coordinates and directs the conservation, rehabilitation and liquidation of insolvent or otherwise delinquent insurance companies pursuant to Chapter 631, Florida Statutes.

Florida's insurance companies are regulated by the Office of Insurance Regulation (OIR). When an insurer fails to maintain the required surplus or certain other delinquency conditions are noted, OIR undertakes regulatory actions in an effort to remediate the issue. If those actions are unsuccessful, and as a last resort, OIR may recommend that DRL initiate a receivership proceeding. Upon such a recommendation, DRL will petition the Second Judicial Circuit Court in Leon County (the Court) to be appointed as Receiver for the insurance company. The Court oversees the actions of DRL (in its capacity as Receiver), makes decisions related to matters presented to the Court, and approves distributions to claimants and certain other actions, including discharge of the receivership estate.

The DRL maintains offices in Tallahassee and Miami and, as of December 31, 2015, employed approximately 95 staff. The DRL functioned as Receiver for 41 insurers for the fiscal year ended June 30, 2015, and, as of December 31, 2015, was Receiver for 32 insurers. Recoveries, excluding those from litigation, exceeded \$31 million for the fiscal year ended June 30, 2015. In addition, DRL disbursed over \$21 million to claimants during that fiscal year.

The DRL's receivership duties vary according to the type of receivership. Its major duties in a rehabilitation and liquidation are:

Major Duties

Rehabilitation

- ✓ Take control of and protect the property and assets of the insurer
- ✓ Conduct the business of the insurer
- ✓ Formulate a plan to remove the causes and conditions necessitating the rehabilitation

Liquidation

- ✓ Close the insurance company
- ✓ Cancel outstanding insurance policies
- ✓ Marshal and liquidate the company's assets
- ✓ Identify claims and distribute assets to claimants
- ✓ Respond to consumer inquiries

As Receiver for an insolvent insurer, DRL serves in a fiduciary capacity and, therefore, must act in the best interests of the policyholders, creditors and other claimants, and the public. This duty extends to all actions taken by the Receiver, which affects these parties' interests, including establishing a system to equitably apportion any unavoidable loss and to maximize recovery of assets for the benefit of the insurer's estate, the policyholders, creditors and other claimants, and the public.

The DRL appoints a Deputy Receiver to each company placed into receivership. The Deputy Receiver essentially acts as the Chief Operating Officer for the company during the on-site period¹ and has authority for all decisions (i.e. which hard drives to copy, which assets to dispose of, etc.) and

¹ The on-site period occurs immediately after issuance of the Order of Rehabilitation/Liquidation. During this time, DRL sends a team of staff to the insurer's offices to conduct various tasks specified within the Order.

approves all purchases and payments. Through the Deputy Receiver and its Estate Management Section,² DRL monitors and oversees the receivership estates by:

- Monitoring and tracking the receivership process to facilitate the timely administration of the estates;
- Managing on-site activities;
- Performing various audits of claims and other DRL activities; and
- Developing a history of each receivership and reviewing and updating receivership-related content on DRL's website.

Each of DRL's nine sections play an important role in the liquidation process and work in concert to wrap-up the insurer's affairs. For example, the Information Technology (IT) Section takes control of the company's IT systems and administers access to those systems, ensures that appropriate safeguards are implemented to secure the systems and data, and ensures that critical electronic data necessary to administer the receivership estate is obtained and provided to the appropriate parties. The Asset Recovery and Management Section (Asset Recovery) secures the company's premises and assets, disposes of the assets and collects/recovers amounts due to the receivership estate. The Claims Section identifies, processes, and evaluates all claims filed in a receivership estate; and negotiates and resolves claimant objections to the Receiver's recommended claim classification and payment amount. The Accounting Section identifies and records assets and liabilities, accounts for all transactions, receives and disburses funds, and handles the financial reporting and tax compliance responsibilities of the receivership estate.

FINDINGS AND RECOMMENDATIONS

Finding 1: Estate Management's Policies and Procedures Are Not Sufficient to Ensure That All of Its Duties and Responsibilities Are Timely and Properly Performed.

Issue

Receivership operations are complex, multi-faceted and involve numerous and extensive tasks that frequently take years to complete for a given receivership estate. As a fiduciary, DRL must be able to demonstrate that it acted diligently, prudently and in good faith in administering the receivership and managing company assets. These factors necessitate the implementation and maintenance of effective internal controls embodied in sound organizational policies and procedures, which set forth those tasks that must be performed, the manner in which the tasks are to be performed, as well as the responsibilities of various staff for those tasks.

In reviewing Estate Management's policies and procedures and through discussions with DRL staff, we noted the following:

² In 2015, the Estate Management section was split into two sections: External Affairs and Estate Management. External Affairs performs consumer response and certain other duties.

- a. Estate Management is charged with “monitoring and tracking the receivership process to facilitate the timely administration of the estate.”³ However, none of the Estate Management policies set forth procedures denoting how this function will be accomplished.
- b. Estate Management is responsible for managing on-site activities. However, DRL Policy R7-11 *On-Site Activity* does not (nor does any of the other Estate Management policies) set forth sufficient procedures to ensure that on-site activities are adequately managed. For example, the Policy does not discuss the means through which the Deputy Receiver will manage the on-site activities, the tasks to be performed prior to and during the on-site period, how the Deputy Receiver will ensure the completion of the required tasks, how key decisions will be made and documented (e.g., retention of company employees, hiring of a forensic accountant), etc. The Policy also does not outline the role and responsibilities of the Deputy Receiver and each of the on-site team members.
- c. Estate Management is required “to keep an accurate record of all on-site activities of a receivership.”³ While the assigned Deputy Receiver for a given receivership conducts frequent meetings in an effort to monitor completion of on-site tasks, no official notes, minutes, or other documentation is maintained for these meetings. In addition, many critical on-site decisions (e.g., use of a forensic accountant, disposition of assets, retention of company staff, etc.) are made collaboratively by the Deputy Receiver, other members of the on-site team, and DRL management. However, little, if any, documentation is maintained to evidence these decisions, including who made the decision, what the decision was, whether the decision was authorized, the rationale for the decision or when the decision was made. As a result, it was not always possible to determine whether appropriate action had been taken by staff during the on-site period.
- d. A substantial portion of Estate Management’s effort is devoted to the performance of audit-related functions. However, this responsibility is not included within Estate Management’s “Scope of Duties and Responsibilities” as set forth in DRL Policy R7-01.

Failure to establish adequate policies and procedures for significant Estate Management responsibilities, and to further define the positions responsible for those tasks, may result in significant receivership tasks not being timely and properly performed. In addition, without documentation of key decisions and the efforts undertaken during a receivership, DRL may not be able to demonstrate compliance with applicable rules and that it acted diligently and in good-faith in performing its fiduciary duties.

Recommendation

We recommend that DRL update its policies and procedures to address all significant functions of the Estate Management Section, define the roles and responsibilities of all positions involved in applicable processes, and reflect current practices and organizational changes. Consideration should also be given to consolidating the various sections’ on-site policies into a single policy that applies to all DRL sections.

³ DRL Policy R7-01 *Estate Management Scope of Duties*.

Finding 2: “Initial Receivership Actions – Checklists” Were Not Always Properly and Timely Completed or Adequate to Ensure That Required Tasks Were Performed.

Issue

When an Order of Liquidation is entered by the Court, DRL sends a team of staff to the insurance company’s office to perform the tasks set forth in the order. The team typically includes individuals with expertise in the following areas: legal, accounting, asset recovery, records management, claims, information technology and human resources. The team takes control of the company’s bank accounts, assets, and IT systems; gathers information needed to wrap-up the affairs of the company (i.e., pay claims, dispose of assets, collect receivables, pay taxes, etc.); and conducts such other necessary activities. This time period, called the “on-site” period, in a receivership is dynamic and multi-directional, and DRL must act quickly to ensure that assets and data aren’t compromised or removed.

Consistent with guidance contained in the National Association of Insurance Commissioners (NAIC) *Receiver’s Handbook for Insurance Company Insolvencies* (the *NAIC Handbook*),⁴ DRL uses a series of “Initial Receivership Actions - Checklists” (Checklists), which are modeled after those contained in the *NAIC Handbook*. The Checklists cover each of the functional areas⁵ that must be addressed during the receivership and contain numerous and extensive tasks that must be performed to successfully liquidate a company. The Checklists are a vital control for ensuring the timely and proper completion of all critical and necessary tasks during the on-site period.

We reviewed the Checklists completed for three receiverships with on-site activities during the audit period and noted the following:

- a. Five of 33 Checklists were not filled-out. While Estate Management maintained two policies addressing on-site activities,⁶ neither mandated completion of the Checklists or otherwise established a means to ensure that all required on-site tasks were completed.
- b. In reviewing the 28 Checklists that were filled-out:
 - 1) Three were significantly incomplete.
 - 2) Twelve identified tasks to be completed by another DRL section. However, those sections did not sign-off on the task(s) to indicate completion.
 - 3) Twenty identified tasks with an “ongoing” or “to be determined” status.
 - 4) One was filled out after the on-site period was over.
 - 5) One noted that certain steps were not applicable, although it appeared that the tasks were applicable and should have been performed.

⁴ The *NAIC Receiver’s Handbook* contains information compiled from numerous authorities including actuaries, accountants and consultants who regularly work on receiverships.

⁵ Human Resources and Payroll; Agents Balances/Subrogations; Accounting; Claims; Legal; Underwriting; Reinsurance; Tax and Compliance; Property, Real Estate and Facilities Control; Customer Service; and Information Technology Systems.

⁶ DRL Policies R7-12 *Records of On-Site Activities* and R7-11 *On-Site Activity*

- c. Estate Management policies did not require a supervisory review and approval of the Checklists and, for most of 28 Checklists that were filled out, no documentation was provided to evidence a supervisory review.
- d. For one receivership, one member of the on-site team utilized an alternate instrument (versus the established Checklist) for the functional area to gather information and document steps performed during the on-site period. However, this instrument did not contain all of the steps set forth on the Checklist. As such, it is not clear whether all required tasks were performed.
- e. In reviewing the various Checklists, we noted that there was some level of overlap between certain Checklists. In addition, DRL staff noted that the Checklists needed to be updated and did not sufficiently address all unique tasks necessary for Health Maintenance Organizations (HMOs). Staff also noted that, due to the magnitude of tasks to be performed on-site and the limited duration of the on-site period, certain tasks had to be performed after the on-site period. As such, it was not readily evident whether all required steps had been timely or properly completed on-site for the three receiverships.

Failure to properly utilize and complete the Checklists increases the risk that critical tasks may be overlooked during the on-site period and further limits DRL's ability to ensure and demonstrate that the on-site activities were properly administered.

Recommendation

We recommend that DRL update its policies and procedures to ensure that on-site activities are adequately documented and tracked so that all required tasks are properly and timely completed. Should DRL continue to use the Checklists, they should be updated to: 1) reflect those steps that should be performed on-site versus those that will be completed later; 2) remove duplicate steps; and 3) align the steps on each Checklist with the Section/individual responsible for those tasks. The Checklists should also include a documented supervisory review and approval and be maintained in a central repository. Finally, the Checklists would be more effective if they were tailored to the type of company in receivership (Property & Casualty versus HMO, etc.).

Finding 3: Procedures for Auditor Independence Are Not Sufficient to Ensure That the Estate Management Section's Audits Are Objectively Performed and Auditors Are Independent.

Issue

The Estate Management Section conducts a series of audits related to DRL's claims processes, as well as an audit of DRL's digital signature⁷ processes. These audits, conducted by individuals independent of those processes, are a fundamental control which serves to ensure the accuracy and integrity of the claims and check distribution processes. In reviewing DRL's policies and procedures related to these audits, we noted the following:

⁷ DRL uses digital signature images on checks for \$5,000 or less.

- a. The DRL Policy⁸ requires the auditor to be “independent of the audited process/results (i.e., the auditor must not have been associated with the process results being examined)” and lists certain disqualifying factors that would impair the auditor’s independence. However, the Policy does not require the auditor to certify his/her independence related to his/her performance of an audit. In addition, the Policy does not sufficiently address the various factors that might impair the auditor’s independence, such as a family member having a claim with the company in receivership.
- b. While the claims audits conducted by Estate Management are intended to be independently performed, the auditor relies on DRL’s IT Section to select the claims to be audited. However, as noted in DRL Policy R7-8,⁹ the IT Section is not independent of the claims processes.
- c. Estate Management has a separate policy for each type of claims audit performed. While most of these policies restrict the Director of Claims from signing the audit report, there is no such restriction noted in DRL Policies R7-05 *Check/Accounting Fraud Audit* and R7-06 *Unclaimed Property - Holders Report Audit*.

The absence of adequate processes for determining and maintaining auditor independence and objectivity in the audit process diminishes the credibility of the audit process and DRL’s ability to show that the claims and other processes were diligently performed and administered in a manner to ensure the integrity of those processes. Auditor independence also increases DRL’s ability to detect fraudulent acts and transactions and, therefore, demonstrate proper and prudent performance of its fiduciary responsibilities.

Recommendation

We recommend that DRL enhance its policies and procedures to ensure that Estate Management auditors are independent and can independently and objectively perform the various assigned audits. Independence would require the auditors to be free of all impairments, including personal, organizational and external factors.

Finding 4: Digital Signature Audits Do Not Effectively Ensure That Digital Signatures Are Properly Secured or Deleted, When Required.

Issue

The DRL issues a high volume of claims distribution checks \$5,000 or under. To improve the efficiency of the distribution process, DRL uses digital image signatures on the checks. In addition, DRL utilizes an extensive number of bank accounts which are transitory in nature. As a result, accounts are opened and closed frequently, which necessitates that digital signature authorities be regularly updated. Therefore, safeguards must exist to ensure that the creation and deletion of digital signature images is strictly controlled and unauthorized individuals cannot access the digital

⁸ DRL Policy R7-8 *Selecting Auditor, Determining Sample Size, and Producing Sample*

⁹ Section VII.C. of DRL Policy R7-8 *Selecting Auditor, Determining Sample Size, and Producing Sample* notes that “[r]eceiver staff working in Accounting, Claims, or Information Technology Services are ‘associated with the process’ and are not considered independent ...”

signatures. To ensure that digital signatures are authorized and properly secured, DRL Policy¹⁰ requires Estate Management to conduct unannounced, quarterly audits of the digital signatures.

In reviewing five digital signature audit reports, we noted the following:

- a. Digital signature audits were not conducted quarterly, as required by DRL Policy R7-7.
- b. Digital signature audit procedures were not sufficient to accomplish all of the stated audit objectives. One audit objective listed in Policy R7-7 is to “verify that no digital image signatures of terminated employees reside on the Receiver’s computer network system.” However, at no point during the audit does the Estate Management auditor inspect any network folders other than those where the digital signatures are expected to be.
- c. Estate Management is reliant on DRL’s IT Section to perform the audits, since Estate Management does not have access to view the folders where the digital image signatures are stored or to view the permissions granted to users with access to the folders. Accordingly, although Policy R7-7 requires that the audits be unannounced, Estate Management is not able to do this given their reliance on the IT Section to perform the audit.
- d. Digital signatures were not always properly deleted. In reviewing five digital signature audits, we noted two instances where the auditor indicated that he witnessed the deletion of certain digital signatures for a separated employee. However, a subsequent audit indicated that digital signature images still existed for the employee. Estate Management noted that this discrepancy was likely due to the fact that digital signatures can be stored in multiple folders and the auditor may not have checked each of the signature folders and, therefore, failed to notice that digital signatures still existed for the separated employee.
- e. One privileged user,¹¹ a database administrator, was granted access to the digital signature folders contrary to DRL Policy R3-2.14,¹² which limits access to certain positions and further states that “groups and users of the Claims Distribution Database and the Operating Database will not have any access to any of the functions necessary to print a check with a digital image signature.” In addition, documentation was not maintained to indicate that the privileged user’s access was authorized, nor the date access was granted and removed.

Failure to properly monitor the creation and deletion of digital signatures increases the risk that signatures may be obtained and used for unauthorized purposes. In addition, checks may be issued with signatures that are not authorized, which may result in checks having to be reissued or not being honored by the bank.

Recommendation

We recommend that DRL reassess its policies and procedures related to the digital signatures to ensure that the signatures are properly secured and accessible only to those individuals with a business need to access the folders. The DRL should consult with DFS’s Division of Information Systems to identify tools that can be used to increase the security of the signature files and assist in

¹⁰ DRL Policy R7-7 *Auditing Security & Use of the Digital Image Check Signatures*

¹¹ A user that is authorized (and, therefore, trusted) to perform security-relevant functions that ordinary users are not authorized to perform.

¹² DRL Policy R3-2.14 *Digital Image Check Signature*

monitoring/restricting access to the secure folders. In addition, the digital signature audits should be improved to increase their effectiveness, and training or written instructions should be provided to the Estate Management auditor to ensure that the audits are properly performed.

Finding 5: The Estate Management Section's Audits of Claims Processes Were Not Always Effectively or Efficiently Performed. In Addition, Estate Management's Audits Did Not Address the Revenue-Generating Functions of the Receiverships.

Issue

Estate Management is responsible for conducting reasonable and sufficient audits of claims, payments, and reporting processes that occur during DRL's administration of a receivership estate. The audits are intended to ensure that certain process objectives are met and provide reasonable assurance that there is no fraud or other misconduct in those processes. If issues are noted during an audit, they are resolved and the underlying report is finalized and forwarded to DRL's Legal Section for filing with the Court. In this manner, Estate Management's audits serve as a key control to ensure the accuracy of the reports submitted to the Court, as well as the accuracy and validity of the payments made to claimants. The following audits are performed:

Type of Audit*	Objective(s)**
Interim Claims Report (ICR) Audit	To determine that quality claims evaluations are produced by DRL's Claims Section.
Final Claims Report (FCR) Audit	To determine whether the resolution of claimant objections filed with the Court are correctly reported in the FCR and that all other information originally reported to the Court in the ICR remains the same.
Claims Distribution Report (CDR) Audit	To determine whether the resolution of claimant objections filed with the Court are correctly reported in the CDR and all other information originally reported to the Court in the FCR remains the same.
Check/Accounting Fraud (CAF) Audit	To determine that all distributions are for the correct amount and sent to the correct person.
Unclaimed Property - Holders Report (UPHR) Audit	To ensure that information sent to the Division of Unclaimed Property matches the information in the disbursement reports.

*Audits are typically performed in the listed sequence (ICR → UPHR). Each type of audit is usually performed for a given receivership and more than one audit within an audit type may be performed (e.g., First Interim Claims Report, Second Interim Claims Report, etc.).

**Each audit also includes an objective to ensure that no fraud is perpetuated in the claims evaluation process.

We reviewed 15 claims-related audits for five receivership estates and noted the following:

- a. The DRL Policies¹³ require that the audit objective(s) and certain other elements be included in the audit report. However, only one of the 15 audit reports correctly stated the objective(s)

¹³ DRL Policies R7-02 *Interim Claims Report Audit*; R7-03 *Final Claims Report Audit*; R7-04 *Claims Distribution Report Audit*; R7-05 *Check/Accounting Fraud Audit*; and R7-06 *Unclaimed Property - Holder's Report Audit*

of the audit, and eight of the 15 audit reports did not include mandatory report elements. For example, two FCR/CDR audit reports did not include discussion of the early access distributions, the amount to be distributed, the total dollar amount of the adjudicated claims, and the number of checks to be issued for the distribution. Failure to include these required elements in the report limits the usefulness of the reports as the reader is not informed of the nature and extent of work performed and certain key facts. As a result, the reliance that may be placed on the audit results is reduced.

- b. Seven of the 15 audit reports contained errors, inaccuracies and inconsistencies in the information reported. For example, one CAF audit report noted that 15 checks exceeding \$5,000 had been presented unsigned to the auditor. However, a review of the check register identified 16 checks in excess of \$5,000. In one FCR audit report, the number of claims reported did not agree with the number of claims reported in the underlying Interim Claims Report. The inconsistency was not discussed in the FCR audit report, nor was it reconciled, contrary to DRL Policy R7-03 *Final Claims Report Audit*.
- c. Claims report audits were not sufficiently reviewed by a supervisor to ensure that the information presented in the reports was consistent, accurate and reconciled with source information. Although eight of the 15 audit reports did not include mandatory report elements and/or contained errors, inaccuracies and inconsistencies as noted above, the reports were signed by a supervisor affirming that the reports satisfied all of the requirements of the applicable policy.
- d. For one UPHR audit report, the report noted that the audit performed was limited. However, the report did not disclose the reason(s) for the limitation or indicate how the audit scope had been limited. Accordingly, it was not possible for users of the audit to determine the level of assurance provided by the audit.
- e. While a key objective of the claims report audits is to produce a validated report for filing with the Court, we noted that the report filed with the Court did not always agree with the validated version. Specifically, in reviewing six reports filed with the Court, we noted, in three of the reports, 11 differences (i.e, claimant name change, address changes, change in amount recommended for payment, etc.) between the validated report and the report filed with the Court. This was primarily due to changes made to update claimant information after the date the claims report was run and produced to Estate Management for audit. While all of these changes appeared valid, there was no evidence to show that Estate Management had been advised of the changes to the claims report and, therefore, that the changes had been validated.
- f. For the CAF audit, the Estate Management auditor is presented with the physical checks to be issued in the distribution. The DRL Policy R7-05¹³ notes that “if the audit takes more than one day, all distribution checks must be returned to the Accounts Payable (A/P) Supervisor for safekeeping each evening before the close of business.” For three of the six CAF audits reviewed, the audit took more than one day. Accordingly, the checks were returned to the A/P Supervisor each day. The transfer of custody each night defeats a key objective of the audit, that being to ensure that the check information is not inappropriately altered from the information approved by the Court’s Order authorizing the distribution. With the existing

procedure, someone in Accounts Payable or with access to the safe could alter check information and it would likely escape the notice of the Estate Management auditor.

g. The efficiency and effectiveness of the audit procedures could be improved. For example:

- 1) The FCR and the CDR audits largely comprise a comparison of the report with a previously-filed claims report for the receivership. For example, the FCR is compared with the related ICR. To do this, the auditor manually compares the claims information on one report to the related information on the second report. Claims reports vary in size, but some can exceed 1,000 pages. Certain tools in Adobe Acrobat can perform the comparison more reliably and in a fraction of the time it takes to manually perform the task.
- 2) The DRL Policy R7-03¹³ requires the auditor to complete an AUD-2 form for each sampled claim¹⁴ in the FCR audit. In reviewing five FCR audits, AUD-2 forms were only completed in one audit. Upon inquiry of the auditors, it was noted that a majority of the tasks on the AUD-2 form duplicate those on the AUD-1 form, which is completed during the ICR audit.
- 3) A major duty in a receivership is to marshal and liquidate the insurance company's assets. This would include selling investments, real and personal property, collecting amounts due to the insurance company, etc. The proceeds of these dispositions will be used to pay claims and offset the costs of receivership activities. While these revenue-generating activities exceeded \$31 million during the fiscal year ended June 30, 2015, Estate Management does not perform any audits of these processes.

Estate Management's audits and oversight activities are an important control to ensure that receiverships are properly and diligently administered. Failure to conduct sufficient monitoring and oversight of key receivership activities may result in errors, abuses and other deficiencies not being timely identified and corrected.

Recommendation

We recommend that DRL enhance its audit-related policies and procedures to better ensure that audits are properly performed and consistent with the (enhanced/implemented) policy, and the resulting reports are accurate and clearly convey the work performed and level of assurance provided by the audit. Audit procedures, tools and forms should also be evaluated to increase the effectiveness and efficiency of the audits and ensure that documentation is maintained to evidence the work performed. In addition, Estate Management should conduct audits over revenue-generating processes and securely maintain custody of the checks through the duration of the CAF audits.

¹⁴ For the five FCR audits reviewed, sample sizes for four of the audits ranged from 858 to 2,453.

Finding 6: The Claims Section Could Not Provide Source Documentation Showing the Appropriateness of All Proposed Claims Payments.

Issue

Towards the end of the claims evaluation process, the Claims Section prepares a Claims Distribution Listing (CDL), which identifies those claimants and claims to be issued a payment during the distribution. This CDL, along with the Claims Distribution Report, is subject to audit by Estate Management, who will verify that the information on the CDL is in agreement with the CDR and the court-approved Final Claims Report. If differences exist, the auditor will verify that the changes are appropriate and documentation exists to support the changes.

In testing 27 proposed payments with a total amount due to claimants of \$110,369.29 included on the CDL¹⁵ for one receivership, we noted the following:

- a. For three payments with a total amount due of \$10,151.79, DRL could not provide underlying claims records or other supporting documentation.
- b. For one payment, the total amount due the claimant on the CDL was \$2,939.61. However, supporting documentation for the claim only totaled \$1,986.64, for a difference of \$952.97. Upon inquiry, Claims staff stated that additional bills had been discovered and added to the claim during the evaluation process. However, they were unable to locate the additional claim paperwork.
- c. For one payment, the total amount due the claimant was shown as \$2,836.42 on the CDL. However, the supporting documentation for the claim totaled \$3,360.96, for a difference of \$524.54. Upon inquiry, Claims staff stated that the amount due shown on the CDL (\$2,836.42) was incorrect and the result of an input error.

Absent sufficient supporting documentation, DRL is not able to demonstrate that distributions are proper and, therefore, that it acted prudently in administering receivership assets.

Recommendation

We recommend that DRL strengthen its policies and procedures to ensure that supporting documentation is maintained for claims payments.

¹⁵ The CDL included 1,890 distributions with a total amount due to claimants of \$1,394,275.09.

Finding 7: Insurer Accounts Receivable Balances Were Not Always Properly or Consistently Recorded or Reported and Sufficient Documentation Was Not Always Available to Show That Accounts Receivable Balances Were Properly Analyzed and Valued.

Issue

The DRL's Asset Recovery Section is responsible for the marshalling and disposal of insurer assets. This includes, among other assets, the identification, tracking and collection of accounts receivable¹⁶ due or potentially recoverable to the company in receivership. For the most part, Asset Recovery staff is assigned specific companies and responsible for all collection activities for those companies. In addition, DRL often contracts with forensic accountants or other professionals to assist in identifying/collecting receivables.

During the on-site period, DRL staff work with insurer staff to update account receivables balances. Once this is done, DRL prepares a "Liquidation Balance Sheet," which reflects the assets and liabilities of the insurer as of the date of liquidation. Given the financial condition and uncertainties related to the reasons for the insolvency, recorded balances as of the date of liquidation (hereafter referred to as "beginning balance") are afforded some degree of skepticism and sometimes later determined to be invalid or inaccurate. As such, thorough analysis is critical to determining the validity and accuracy of accounts receivable balances. In addition, timing is critical as receivables ordinarily become less collectible over time.

In reviewing DRL's identification and tracking of insurer accounts receivable for three receiverships, we noted the following:

- a. Limited, if any, analysis was performed by DRL on-site for two receiverships to verify that accounts receivable balances were properly brought current to the date of liquidation by insurer staff. Failure to timely ensure that balances are brought current to the date of liquidation may result in receivables not being properly valued and reduce chances of collection due to lack of access to knowledgeable company staff and/or delays in reconciling balances.
- b. For one receivership, documentation was not available to demonstrate that proper analysis was performed to validate the beginning balance for a pharmacy rebates receivable. The insurer's accounting records reflected a beginning balance of approximately \$6.1 million, which was due from its contracted Pharmacy Benefits Manager (PBM). However, the Liquidation Balance Sheet prepared by DRL indicated a \$0 balance. Upon inquiry as to the discrepancy, DRL noted that the receivable had been offset against amounts due to the PBM related to pharmacy benefits services provided in June 2014. However, the amounts due to the PBM for June 2014 services totaled approximately \$2.3 million,¹⁷ substantially lower (\$3.8 million) than the amount the insurer reflected it was owed. While DRL noted that it had

¹⁶ Per DRL Policy R12-01 *Scope of Duties and Responsibilities*, accounts receivable are amounts due to the insolvent or impaired company from customers who have received services.

¹⁷ PBM Invoice #0005523652 for \$2,864,062.94 and Invoice #0005523650 for \$214,513.57 less DRL wire transfer totaling \$789,731.54.

determined that the insurer's beginning balance for the pharmacy rebates receivable was overstated, DRL was not able to provide documentation to show that it had reconciled the pharmacy rebates account or otherwise investigated the discrepancy to determine the amount due and the reason for the discrepancy.

- c. Beginning "other receivables"¹⁸ balances were not properly nor consistently recorded in DRL's accounting system¹⁹ as specified by DRL Policy R3-7.1.²⁰ That Policy requires "the company's other receivables balances as of the date of liquidation are recorded as the beginning balances," typically with a 100% allowance.²¹ In reviewing other receivables balances, we noted:
 - 1) For one receivership, the company's other receivables balances as of the date of liquidation totaled approximately \$77.7 million.²² However, DRL did not record approximately \$3.4 million of these receivables (Claims Refund Receivable and Accounts Receivable-P2P) in its accounting system.¹⁹ While DRL noted that there was no basis or estimated realizable value for these assets and, therefore, they were not recorded in the company's general ledger, DRL was not able to provide any analyses to support this determination.
 - 2) For a second receivership, the company's trial balance identified approximately \$10 million of other receivables. However, DRL did not record these amounts in its accounting system.
- d. Beginning reinsurance receivables were not properly nor consistently recorded in DRL's accounting system, as specified by DRL Policy R3-7.1. That Policy requires "the company's reinsurance recoverable balances as of the date of liquidation are recorded as the beginning balances." In reviewing reinsurance receivables for two receiverships, we noted:
 - 1) For one receivership, the company's reinsurance receivables as of the date of liquidation totaled approximately \$19 million. However, DRL recorded only \$4.5 million as the opening balance in its accounting system. It was further noted that, as of April 1, 2016, DRL had collected \$11,442,193 related to this receivable.
 - 2) The DRL did not consistently record beginning balances for reinsurance receivables in its accounting system. While a beginning balance was recorded for one receivership reviewed, no beginning balance was recorded for a second receivership whose reinsurance receivable totaled \$270,947.
- e. As noted in Finding 7.c. above, DRL did not always record other receivables in its accounting records. It was further noted that other receivables balances were not always properly or accurately reported in the State of Florida's annual financial statements. For one

¹⁸ Any receivable except for reinsurance.

¹⁹ DRL sets up a general ledger within its accounting system (MS Dynamics) for each company in receivership in order to separately account for transactions related to each company.

²⁰ DRL Policy R3-7.1 *Recording Assets and Liabilities for Companies in Liquidation - Basis of Accounting*

²¹ An allowance is an estimate of the amount of the company's receivables, which the company expects may not be collected.

²² Per the company's trial balance.

receivership, subrogations and unearned commissions accounts receivable totaling \$725,487 and \$550,²³ respectively, were not recorded in DRL's accounting records nor the State of Florida's financial statements for the fiscal year ended June 30, 2015. For a second receivership, subrogation accounts receivable totaling approximately \$1,395,550.66, identified by First Recovery Group (FRG), were also not recorded in DRL's accounting records nor the State of Florida's financial statements for the fiscal year ended June 30, 2015.²⁴

- f. Historical or other analysis had not been performed to establish allowances for doubtful accounts.²¹ While DRL indicated that there was no uniformity in collections between the various receiverships, DRL was not able to provide any documentation to show that it had performed such analysis, nor was it able to provide any analysis to show how it determined that allowances could not reasonably be estimated. In addition, although industry benchmarks are available for certain types of receivables (subrogations), DRL did not utilize such benchmarks to establish reasonable allowances. Accordingly, for all receivables other than reinsurance, DRL's stated and written policy was to record a 100% allowance.

Failure to properly evaluate and record accounts receivable balances in the accounting records limits DRL's ability to track and monitor accounts receivable balances and properly and accurately meet its financial reporting obligations. Additionally, failure to establish adequate controls over the receivables processes increases the risk that balances will not be timely and properly collected and/or assets may be misappropriated.

Recommendation

We recommend that DRL enhance its policies and procedures related to the identification, tracking, recording, reporting and collection of accounts receivables. Internal controls should be strengthened to facilitate robust management of collection activities and limit the potential for fraud, errors or misstatements. Written policies and procedures should be updated to reflect these improved controls and also to ensure that all significant functions are addressed within the policies and procedures. In addition, DRL should continue its efforts to obtain a collections management software.

Finding 8: Internal Controls Were Not Adequate to Ensure that Insurer Accounts Receivable Are Properly Tracked and Managed.

Issue

During the 2015 fiscal year, DRL recovered in excess of \$31 million²⁵ related to asset dispositions, collections of accounts receivable and other activities. Accounts receivables balances and detail are maintained in a series of Excel spreadsheets, which are the primary means used to maintain and track individual accounts receivable balances. To maximize recovery and ensure that all amounts potentially recoverable are properly administered, satisfactory controls must be in place related to accounts receivable.

²³ Represents the estimated recoverable amount per DRL as of June 30, 2015.

²⁴ Represents the total amount of loss for claims in which subrogation was being sought, per FRG.

²⁵ Does not include amounts recovered through litigation.

In reviewing controls related to the tracking and management of accounts receivable, we noted:

- a. Internal controls over the Excel spreadsheets used to track accounts receivable in the Tallahassee office were not adequate to ensure a proper separation of duties or reduce the risk of errors and fraud. We reviewed two accounts receivable spreadsheets for one receivership and noted that the assigned Analyst entered the debtor account information into the spreadsheets, as well as payments made on the account and account adjustments/write-offs. The Analyst also communicated with the debtors, prepared and sent bills and various collection notifications, verified payments and reconciled the collection spreadsheets to DRL's accounting system. Individuals responsible for maintaining the receivables accounts and related subsidiary ledgers should not perform billing functions, record cash receipts, record account adjustments, or approve account adjustments. In addition, reconciliations between the Excel spreadsheets and DRL's accounting system should not be performed by someone able to record transactions in the Excel spreadsheet. Reconciliations should be approved by someone other than the preparer of the reconciliation.
- b. Aging reports for applicable accounts receivable were not always prepared and reviewed. This is due in large part to the lack of an automated accounts receivable management system. Aging reports are a key control for timing collection activities, estimating allowances and bad debt (and, therefore, projecting cash flows) and determining the effectiveness of collection efforts. Since Asset Recovery staff is assigned multiple companies, each with multiple categories of receivables/assets to collect, better functionality is needed to ensure that collection efforts are timely and effective.
- c. The DRL Policies do not require the use of write-off or adjustment forms for reducing accounts receivable balances. Although such forms were generally used, they were not always used. As a result, it was not always evident whether the basis for certain write-offs, credits or adjustments to accounts receivable balances were consistent with DRL Policy R12-10 *Asset Recovery and Management of Uncollectible Assets* and, therefore, whether adequate due diligence was performed to recover assets prior to recommending a write-off, credit or adjustment of the account.

Failure to properly segregate incompatible duties in the receivables processes increases the risk of fraud and misappropriation. In addition, deficiencies in internal controls over the tracking and management of accounts receivable may reduce DRL's ability to maximize recoveries.

Recommendation

We recommend that DRL strengthen internal controls over insurer accounts receivable to ensure that incompatible functions are properly separated, receivables are effectively managed, and account adjustments are consistent with policy and adequately documented. In addition, DRL may consider an independent documented review of account adjustments.

Finding 9: Asset Recovery's Collection Activities and Account Adjustment Documentation Were Not Always Sufficient to Demonstrate That Appropriate Effort Was Undertaken to Obtain a Maximum Recovery of Marshalled Assets.

Issue

The DRL Policy R12-10 *Asset Recovery and Management of Uncollectible Assets* delineates the procedures for handling insurer assets (including accounts receivable) deemed uncollectible. The Policy identifies various criteria for considering an asset uncollectible, as well as criteria for determining whether adequate due diligence was performed to recover an asset prior to recommending a write-off, credit or adjustment. Further, the Policy establishes write-off²⁶ authorization thresholds and documentation standards for write-offs.

In testing six adjustments and settlements for two receiverships, we noted:

- a. For one receivership, limited, if any, monitoring or analysis was performed of the contracted subrogation collection agent to determine the adequacy of the contractor's collection efforts. In addition, DRL had not performed any sort of benchmarking, based on its own historical data or industry standards to determine reasonable ranges for recovery rates or, further, calculated the recovery rate for this particular contractor. For one of two recoveries tested, we noted that the contractor failed to seek DRL approval for settling the claim for less than 66% of the total due as required by contract. In addition, the Asset Recovery Analyst assigned responsibility for this company did not routinely check recovery amounts to verify that DRL approval was sought for all applicable recoveries.
- b. For a second receivership, the reporting requirements included in the contracts with two law firms assigned responsibility for subrogation collections were not sufficient to permit effective monitoring of the firms. For example, the contracts only required bi-annual status reports from the firms and did not require the firms to submit an initial assessment of the referred claim as to the merits of the case, suggested recovery strategy, potential for recovery, etc. Additionally, although one of the contracts was executed in December 2014, as of May 9, 2016, the firm had not submitted any of the required bi-annual status reports to DRL.
- c. The DRL Policy R12-10 does not adequately identify or define the data element (i.e., overall settlement amount, amount of write-off, amount of total loss, or some other amount) to be used in determining settlement, compromise and write-off approval thresholds. As a result, it was not always clear whether settlements/write-offs were properly authorized. For example, one subrogation claim with a total loss of \$9,858.67 was settled for \$5,000, resulting in \$4,858.67 being unrecovered. The settlement was approved by the Miami Operations Manager, who indicated that additional approvals were not required since the settlement amount (\$5,000) was greater than DRL's anticipated recovery value (\$3,000).²⁷ However,

²⁶ For the purpose of this report, the term "write-off" is used broadly to reflect an adjustment to an accounts receivable balance. This may include settlements/compromises of the account for less than the amount due, assignment of the account to third parties, or other reductions to the amount due.

²⁷ Anticipated recovery values are established by the Asset Recovery Analyst based on professional judgment as to the collectability of the total loss amount.

Policy R12-10 requires the Director of Asset Recovery to authorize settlements \$5,000 or less; and the Director of Asset Recovery and the Estate attorney to authorize amounts greater than \$5,000, but less than \$20,001.

- d. For one subrogation settlement, the settlement justification did not sufficiently detail the efforts taken by the contracted law firm to recover the receivable, as required by Policy R12-10. The subrogation claim, which had a total loss of \$143,933, was settled in April 2015, for \$55,000 with \$88,933 (approximately 62%) being unrecovered. The claim was initially assigned to the law firm by the insurer in September 2013, and DRL, as Receiver, contracted with the firm in December 2014.²⁸ The firm did not provide DRL with an initial assessment of the case and, other than negotiations with the adverse party, it was unclear what, if any, effort was expended by the attorney prior to settling the case, which was settled without the attorney filing suit against the adverse party. As the hiring of experts, investigation, and determination of costs was determined mostly, if not entirely, by the insurer and the adverse party's insurer prior to the case being referred to the firm, it is also not clear what actions, if any, the firm took on the case from September 2013 through the date of settlement. Further, as noted in Finding 9.b. above, the firm failed to provide the contractually required status reports detailing its efforts to pursue recovery.

Failure to adequately monitor contracted collection agents and adhere to established DRL procedure may result in less than optimum recoveries of amounts due to the insurer, resulting in smaller payments to claimants.

Recommendation

We recommend that DRL enhance its policies and procedures to strengthen monitoring of contracted collection agents and more clearly define thresholds for authorizing settlements and write-offs. Write-off/settlement procedures would be further strengthened by requiring the use of a specified form to document the settlements/write-offs. In addition, contract reporting requirements should be revised to provide for more frequent and robust reporting including a detailed assessment of the referral and case activity.

Finding 10: Records Management Policies and Procedures Were Not Sufficient to Ensure that Original Records and Non-Public Personal Financial and Health Information is Safeguarded and That the Chain of Custody is Maintained.

Issue

One of a receiver's main priorities during the on-site period is to locate, secure and organize the records of the insurer in receivership. This task is of paramount importance to successfully completing the receivership. In addition, per the NAIC *Handbook*, when fraud by officers or others with access to data is suspected, special care must be taken to preserve the records and maintain the

²⁸ The insurer was ordered into liquidation on June 3, 2014, and the law firm was subsequently advised by DRL to suspend activity pending execution of a new contract.

chain of custody.²⁹ Consideration must also be given to the secure handling of non-public personal information since insurance companies and HMOs are subject to a variety of state and federal statutes and regulations regarding the protection and non-disclosure of non-public personal financial and health information, such as the Gramm-Leach Bliley Act (GLBA) and the Health Insurance Portability and Accountability Act (HIPAA). In addition, DRL Policy and other laws³⁰ require the Division to establish and maintain a system of internal controls to properly safeguard confidential information, whether that information exists in electronic or paper form.

The DRL's Records Management Section serves as the physical custodian for receivership estate records and is responsible for administering the movement of files within the Division and the warehouses, inventorying records and coordinating on-site records management functions. As such, the Records Management Section established certain policies which govern records retention and disposal including DRL Policy R9-2 *Management of On-Site Estate Records*, which sets forth the procedures for seizing, inventorying, and transmittal of estate records, as well as the destruction of obsolete records.

In reviewing various DRL policies and other documents related to the handling of receivership estate records and through discussion with DRL staff, we noted the following:

- a. None of the Records Management policies discussed or included procedures related to maintaining the chain of custody for applicable records. While DRL used a "Chain of Custody Documentation" form to record the transfer of custody of certain items, the form and specific procedures for its use are not discussed in DRL policies.
- b. None of the Records Management policies discussed or included procedures related to the safeguarding of non-public personal financial and health information or other similar information that may be subject to HIPPA, GLBA or other laws. Further, policies did not include procedures related to the transmission of this data/information to third parties and how DRL would notify these entities of their responsibilities with respect to the data/information.
- c. Policy R9-2 contains conflicting and ambiguous requirements related to the safeguarding and handling of original insurer records. Section VI.B. of the Policy notes that, "[o]nly copies of original records may be released for utilization by Receiver staff, contractors and outside entities." However, other provisions within the Policy seem to indicate that original records may be transmitted to a third party administrator, ancillary receiver, and/or guaranty association. In practice, original records are transferred to the guaranty associations³¹ and certain DRL staff do maintain original records.
- d. Although original records are often transmitted to the guaranty associations, it is not clear that DRL has the statutory authority to transfer **original** records. Section 631.395, Fla. Stat., authorizes DRL to perform various tasks and notes that the authorization shall include,

²⁹ The chronological documentation or paper trail, showing the seizure, custody, control, transfer, analysis, and disposition of physical or electronic evidence necessary in order for the evidence to be admitted into evidence in a court proceeding.

³⁰ DRL Policy 1-6 *Internal Controls Policy*. See also Section 626.9651, Florida Statutes.

³¹ DRL Policies R9-4 *Disposing of Division and Estate Records* and R6-08 *Coordination with Guaranty Association* note specifically that original records are, or may be, transmitted to the guaranty associations.

“release of *copies* of any of the following: 1) Claims files, records, or documents pertaining to claims on file with the insolvent insurer; and 2) Insurance claims filed with the receiver.”

- e. Certain other DRL policies contain provisions that conflict with Policy R9-2 as it relates to the handling and storage of insurer records. While Policy R9-2 restricts the release of original records to DRL staff, DRL Policy R3-1.5 *Records Management – Accounting* notes that the “Estate Accounting Unit shall take charge of company accounting records” and “determines which files need to be maintained in the Accounting Section and which files need to go to the warehouse.” Similar discrepancies were also noted in DRL Policies R6-08 and R9-4.³¹
- f. For three receiverships that had on-site activity during the audit period, DRL did not assign a Records Coordinator to, or include Records Management staff on, the on-site team, contrary to Policy R9-2. These positions are knowledgeable of all aspects of the records inventory process and are responsible for coordinating and directing all on-site staff on the identification and inventory of all records for their respective section.

Maintaining the integrity of original records may be necessary in some instances for litigation purposes. Accordingly, the absence of procedures related to the chain of custody may result in evidence not being properly maintained and controlled and, therefore, not admissible in court. In addition, the use of original insurer records by DRL staff and others for routine business functions increases the risk that records may be lost or destroyed. Also, failure to implement adequate controls over confidential information could result in a data breach.

Recommendation

We recommend that DRL enhance its policies and procedures to include provisions necessary to maintain the integrity of original records and chain of custody. The DRL should determine whether Florida Statutes permits the release of original insurer records to the guaranty associations. In addition, DRL should strengthen its policies and procedures to ensure the protection and non-disclosure of non-public personal financial and health information, including notification provisions for disclosure of this data to third parties.

Finding 11: The DRL’s Procedures for the Periodic Review of IT System Access Privileges Were Not Adequate to Ensure That the Reviews Were Properly and Timely Completed.

Issue

A periodic review of access privileges to IT systems helps ensure that user access privileges are authorized and remain appropriate. Per DRL Policy R8-05 *Application Access Control Procedures*, DRL performs two types of access reviews:

- “Application Access Control Request Form Audits” are performed by the designated Application Access Auditor (ACA) and required no less frequently than quarterly. They are intended to ensure: 1) that application access forms were processed correctly (i.e., the user received the requested access) and 2) that application access was removed for separated employees.

- “Current Access Reviews” are performed by the designated Application Security Officer (ASO) and required no less frequently than quarterly. They are intended to ensure that: 1) access privileges for system users remain appropriate and 2) application access was removed for separated employees.

We reviewed DRL’s procedures related to access reviews for four IT systems: 1) MS Dynamics; 2) FIGA RP; 3) On-Line Claims Processing (OLCP); and 4) Active Directory.³² We noted the following:

General

- a. Responsibility for compliance with DFS Administrative Policies and Procedures (AP&Ps) was not clearly outlined within the Memorandum of Understanding (MOU) and Service Level Agreement (SLA) that DRL maintained with the Division of Information Systems (DIS).³³ Accordingly, DRL maintains its own access control procedures (DRL Policy R8-05), which were not always, where applicable, consistent with AP&P 4-05 *Application Access Control Policy*. In addition, DRL’s access control procedures were not sufficient to ensure that access was properly administered. For example:
 - 1) While the Policy R8-05 limits access to "authorized users in their appropriate roles," it does not restrict access on the basis of least privilege and need to know, which is a more stringent standard.
 - 2) Policy R8-05 does not provide for the appointment of a backup ASO.
 - 3) Current Access Reviews are only required to be documented if discrepancies are found. Accordingly, documentation was not always available to evidence completion of the current access reviews for the FIGA RP system.
 - 4) Current Access Reviews are to be performed by the ASO for a given system versus the supervisors of the staff who have access to the system. Since staff in multiple business units often have access to a single system, the ASO may not be aware of a user's current assignments and access needs.
- b. None of the four IT systems reviewed maintained an adequate historical listing of users which identified the date access was granted and terminated. Accordingly, DRL was not always able to demonstrate that access was authorized prior to being granted, nor that access was timely removed.

Application Access Control Request Form Audits

- c. In testing four Application Access Control Request Form audits conducted during the audit period, we noted that the auditors' procedures were not always sufficient to achieve the objectives of the audit. For example:
 - 1) Each ACA noted that they identify the population of forms to be audited by searching Navigator.³⁴ However, the access forms are only put on Navigator when they are

³² MS Dynamics (accounting system used by DRL); FIGA RP (DRL system used to calculate return premium amounts); and Active Directory (a system tool used by computer administrators to manage end-user computer software packages, files and user accounts).

³³ While DFS IT operations are mostly centralized, DRL maintains its own IT Section. To ensure that roles and responsibilities are clearly established, DRL maintains a MOU and SLA with DIS.

³⁴ DRL’s electronic document management system and network drives.

completed by the IT Section. Accordingly, the population would potentially exclude any forms that had not been processed.

- 2) Each ACA had a different understanding as to what "processed correctly" meant and since Policy R8-05 did not specifically enumerate the procedures to be performed, there was a lack of consistency in what was assessed during the audits. For example, one auditor only reviewed the Application Access Control Request forms to ensure that the forms contained the appropriate approval signatures and the form was properly filled out. Another auditor only verified that the access requested on the form was actually granted to the specified staff, and did not consider whether the form contained the appropriate approval signatures and was correctly completed.
- d. Audits were not performed at least quarterly for the FIGA RP system, as required by Policy R8-05. No audit was conducted for the quarter ended September 30, 2013. One audit covered the period January 1, 2014 through September 30, 2014, and was not completed until March 4, 2015.
- e. Of four audits reviewed, one was not dated, nor was it signed as required by Policy R8-05. Accordingly, it was not evident who completed the audit or whether the audit was timely performed.

Current Access Reviews

- f. For Active Directory, an appropriate segregation of duties was not maintained with respect to the individual(s) assigned responsibility for completing the Current Access Reviews. These individuals were also responsible for administering access and performing other functions in Active Directory. Individual(s) assigned responsibility for completing the Current Access Reviews (the ASO) should not be responsible for adding, modifying and deleting access within the system.
- g. The DRL procedures were not sufficient to ensure that an ASO was continuously assigned for each IT system. No ASO was assigned for the FIGA RP system from July 1, 2013 through January 1, 2015. In addition, ASOs were not assigned for IT management software such as Active Directory.

Failure to sufficiently monitor access and maintain sufficient access control procedures limits DRL's ability to safeguard its IT systems and related data and, further, demonstrate that system access is authorized and necessary for the performance of job duties. In addition, inadequate access controls diminish the reliability of data and increase the risk of destruction or inappropriate disclosure of data.

Recommendation

We recommend that DRL enhance its access control procedures to ensure consistency and compliance with DFS AP&P 4-05. Controls should be strengthened to ensure that access reviews are timely performed and that procedures provide sufficient guidance to result in effective audits. Consideration should be given to the need for the Application Access Control Request Form Audits, which appear to duplicate (in some respects) the Current Access Reviews and serve primarily to

verify whether DRL's IT Section is processing the access control requests forms. Finally, DRL should improve procedures to ensure that an ASO is continuously assigned for all IT systems.

Finding 12: The DRL's Administration of Insurer IT Systems Was Not Always Adequate to Demonstrate That Access Was Properly Authorized.

Issue

During the course of a receivership, DRL and others (i.e., guaranty associations, forensic accountants, etc.) will need access to insurer IT systems and data in order to perform their respective duties. To properly safeguard the insurer's systems and data, DRL must administer access to these systems and data, limiting access to those with a proven need based on the principles of legitimate use, least privilege and separation of duties.

Access to insurer systems is authorized through completion of an "Application Access Control Request for Company Systems" form (Access Forms) that denotes the systems for which access is requested, the type of permissions required, and certain other information. In addition, access must be authorized by the user's supervisor or designee and the ASO for the system.

In reviewing 27 Access Forms for insurer IT systems for two receiverships, we noted deficiencies with 12 of the forms. Specifically:

- a. For six forms, the ASO and supervisor approved the forms approximately four months after system access was provided. In addition, for three of these forms, the level of system access (e.g., read, modify) was not specified.
- b. Six forms were not signed/approved by a supervisor or designee.

To ensure that systems and data are properly safeguarded, access should be fully authorized prior to the user being provided access to the system. Inadequate access controls diminish the reliability of electronic data and increase the risk of destruction or inappropriate disclosure of data.

Recommendation

We recommend that DRL enhance its access authorization procedures to ensure that access to company IT systems is timely and properly authorized and documented. Access forms should be completed in a manner that clearly identifies the systems for which access is requested; the level of access requested; and signatures of all required parties.

Finding 13: Certain Security Controls Related to IT System Access and Monitoring Need Improvement.

Issue

Security controls are intended to protect the confidentiality, integrity and availability of data and IT resources. Our audit procedures disclosed that certain security controls related to system access and monitoring need improvement. We are not disclosing specific details of the issues in this report to

avoid the possibility of compromising system security. However, we have notified appropriate management of the specific details.

Without appropriate security controls related to system access and monitoring, the risk is increased that the confidentiality, integrity and availability of system data and resources may be compromised.

Recommendation

We recommend that DRL improve, for DRL and insurer systems, certain security controls related to system access and monitoring to ensure the confidentiality, integrity and availability of system data and resources.

MANAGEMENT'S RESPONSE

The DRL management concurred with all findings and recommendations. Management's response to the audit is attached hereto as Appendix A. The OIG agrees with the response.

OBJECTIVES, SCOPE AND METHODOLOGY

Objectives & Scope

The overall objectives of this audit were to evaluate whether the internal controls over DRL's monitoring and oversight processes and stewardship of insurer assets are adequate and operating effectively to ensure receivership functions are properly administered and company resources are properly safeguarded. The scope of the audit covered the period July 1, 2013 to December 31, 2015.

Methodology

This operational audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* published by the Institute of Internal Auditors. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To accomplish our objectives, we reviewed relevant state laws and rules; the NAIC Receiver's Handbook for Insurance Company Insolvencies; the NAIC Uniform Data Standards Operations Manual; various receivership Court filings and orders; and DFS Administrative Policies and Procedures. In addition, we reviewed the following DRL documentation: internal policies and procedures; the results of risk assessments; organizational charts; and financial statements relative to the audit period. We also reviewed contracts and various deliverable reports; accounts receivable monthly reports, liquidation balance sheets, various receivership financial statements, and accounts receivable tracking spreadsheets, collection notices and files; Initial Receivership Actions – Checklists, Estate Management quarterly company meeting reports, Receiver's Distribution Checklist, and Receiver's Closure Checklist; application access control request form audits, Application Access Control Request for Company Systems forms, current access reviews, Active

Directory monthly, quarterly and annual checklists, application security officers and application access auditors listings and on-site IT systems reports; claims reports and associated audits; digital signature audit reports; and other related documentation.

Within DRL, we interviewed the Division Director, Deputy Receivers, the Controller, senior management and other staff involved with DRL's monitoring and oversight processes in order to gain an understanding of those processes and staff duties, as well as any challenges faced by DRL.

Our testing, among other procedures, also included:

- Reviewing five digital signature audit reports and related procedures to determine the effectiveness of monitoring of the digital image check signatures and controls related to maintenance of the digital signatures.
- Reviewing five Application Access Control Request Form Audits and three Current Access Reviews completed for DRL's disbursement-related IT systems, and related procedures, to determine the effectiveness of monitoring of IT system access and controls related to the granting and removal of IT system access.
- Reviewing 28 completed "Initial Receivership Actions – Checklists" and documentation related to the on-site period for three receivership estates to determine the effectiveness of oversight of receivership activities and stewardship of receivership assets during the on-site period.
- Reviewing 27 Application Access Control Request for Company Systems forms for two receiverships and related procedures to determine whether the access that was granted was appropriate and in accordance with DRL policies and controls over the granting of access to company systems were effective.
- Reviewing the Information Technology Systems "Initial Receivership Actions – Checklists" for two receiverships and related documentation to determine the adequacy of controls designed to identify and secure company data during the on-site period, safeguard it throughout the receivership, and verify its accuracy and completeness.
- Reviewing 15 claims-related audits for five receiverships and related documentation and procedures to determine the effectiveness and efficiency of oversight activities over claims distribution processes to ensure that distributions are valid, proper and consistent with the Court's orders and DRL's established policies.
- Reviewing 57 claims for one receivership to determine whether key claims information remained the same from the Interim Claims Report through the Check/Accounting Fraud Audit and any changes were supported by appropriate documentation. For 30 of the claims, the claimant's name, address, and the amount of the claim was verified against source documentation to determine the validity of the claim.
- Reviewing the liquidation balance sheet and related documentation and procedures for three receiverships to determine if appropriate action was taken to identify estate receivables balances as of the date of liquidation, bring these balances current, and ensure that the balances were properly recorded and tracked in the receivership estate's accounting records.
- Reviewing seven adjustments to seven accounts receivables balances for two receiverships (and associated collection activities) and related controls to determine the effectiveness of DRL's administration of receivership accounts receivable. Consideration was given to whether collection efforts were reasonable and consistent with DRL's established policies, appropriate due diligence was performed to maximize recovery, balances were accurately reported in the receivership estate's accounting records and whether controls were adequate

and operating effectively to ensure that receivership assets were safeguarded and recoveries maximized.

Management's Responsibility for Internal Controls

In accordance with Department Administrative Policy and Procedures 1-02 *Internal Controls Policy*, the Department, among its divisions, shall establish and maintain a system of internal controls. The internal controls are management driven and designed to provide reasonable assurance that objectives are achieved. Accordingly, Department management is responsible for establishing and maintaining adequate internal controls to ensure that assets are adequately safeguarded and the accounting records are accurate in regards to DRL's disbursement and receipting processes. The OIG's responsibility is to evaluate the adequacy and effectiveness of DRL's internal controls in relation to its monitoring and oversight processes and stewardship of insurer assets.

Inherent Limitations in Any System of Internal Controls

An audit by its nature, does not include a review of all records and actions of agency management, staff, and vendors, and as a consequence, cannot be relied upon to identify all instances of noncompliance, fraud, abuse, or inefficiency. In addition, because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with procedures may deteriorate. Accordingly, our audit would not necessarily disclose all weaknesses in DRL's internal controls over its monitoring and oversight processes and stewardship of insurer assets to ensure that receivership functions are properly administered and company resources are properly safeguarded.

DISTRIBUTION LIST

Jeff Atwater, Chief Financial Officer
Robert Kneip, Chief of Staff
Drew Parker, General Counsel
Toma Wilkerson, Director, Division of Rehabilitation and Liquidation
Sherrill F. Norman, Auditor General

To promote accountability, integrity, and efficiency in state government, the Office of Inspector General completes audits and reviews of Department of Financial Services programs, activities, and functions.

Pursuant to Section 20.055, Florida Statutes, this audit was conducted in accordance with applicable standards contained in the *International Standards for the Professional Practice of Internal Auditing*, published by the Institute of Internal Auditors, Inc., and *Principles and Standards for Offices of Inspectors General* published by the Association of Inspectors General. This audit was conducted by Angela Begault, C.P.A., Lead Senior Auditor, under the supervision of Leah Gardner, C.P.A., Director of Audit.

Please address inquiries regarding this report to the DFS Office of Inspector General at 850-413-3112.



DEPARTMENT OF FINANCIAL SERVICES

Division of Rehabilitation and Liquidation
www.myfloridacfo.com/division/receiver

July 7, 2016

Ms. Teresa Michael, Inspector General
Office of Inspector General
Department of Financial Services
111 West Madison Street
Tallahassee, FL 32399

RE: Preliminary & Tentative Audit Findings for Monitoring and Oversight Processes and Stewardship of Insurer Assets

Dear Ms. Michael,

We have reviewed the June 10, 2016, Preliminary & Tentative Audit Findings for the operational audit related to monitoring and oversight processes and stewardship of insurer assets for the Division of Rehabilitation and Liquidation. In accordance with your instructions and Section 20.055(6)(d), Florida Statutes, we are enclosing a statement of explanation and proposed corrective action for each finding.

Improving processes is essential to our organization's success and advancement. Additionally, we believe that strengthening our processes will enhance our service to the public. We appreciate the recommendations and we look forward to implementing the changes.

Please contact me if you have any questions related to our response or with our implementation of corrective measures.

Sincerely,

A handwritten signature in blue ink, reading "Toma L. Wilkerson".

Toma L. Wilkerson
Division Director

cc: Drew Parker, General Counsel, DFS



DEPARTMENT OF FINANCIAL SERVICES DIVISION OF REHABILITATION AND LIQUIDATION

MONITORING AND OVERSIGHT PROCESSES AND STEWARDSHIP OF INSURER ASSETS

RESPONSE TO PRELIMINARY AND TENTATIVE AUDIT FINDINGS

Finding No. 1: Estate Management's Policies and Procedures

Estate Management's policies and procedures are not sufficient to ensure that all of its duties and responsibilities are timely and properly performed.

Recommendation: We recommend that DRL update its policies and procedures to address all significant functions of the Estate Management Section, define the roles and responsibilities of all positions involved in applicable processes, and reflect current practices and organizational changes. Consideration should also be given to consolidating the various sections' on-site policies into a single policy that applies to all DRL sections.

Response: DRL will develop policies and procedures to address the significant functions of the Estate Management Section, define the roles and responsibilities of all positions involved, and reflect current practices and organizational changes.

DRL will consider consolidating the various sections' on-site policies into a single policy.

Expected Completion Date for Corrective Action: December 31, 2016

Finding No. 2: Initial Receivership Actions - Checklists

Initial Receivership Actions – Checklists were not always properly and timely completed or adequate to ensure that required tasks were performed.

Recommendation: We recommend that DRL update its policies and procedures to ensure that on-site activities are adequately documented and tracked so that all required tasks are properly and timely completed. Should DRL continue to use the Checklists, they should be updated to: 1) reflect those steps that should be performed on-site versus

RESPONSE TO PRELIMINARY AND TENTATIVE AUDIT FINDINGS

those that will be completed later; 2) remove duplicate steps; and 3) align the steps on each Checklist with the Section/individual responsible for those tasks. The Checklists should also include a documented supervisory review and approval and be maintained in a central repository. Finally, the Checklists would be more effective if they were tailored to the type of company in receivership (Property & Casualty versus HMO, etc.).

Response: DRL will update its policies and procedures to ensure on-site activities are adequately documented and tasks are properly and timely completed to include documented supervisory approval.

DRL will consider the use of checklists which would be substantially similar to the NAIC Receivership Handbook that are tailored to the type of company in receivership. Checklists will be maintained in a central repository.

Expected Completion Date for Corrective Action: December 31, 2016

Finding No. 3: Auditor Independence

Procedures for auditor independence are not sufficient to ensure that Estate Management's audits are objectively performed and auditors are independent.

Recommendation: We recommend that DRL enhance its policies and procedures to ensure that Estate Management auditors are independent and can independently and objectively perform the various assigned audits. Independence would require the auditors to be free of all impairments, including personal, organizational and external factors.

Response: DRL will amend its policies and procedures to identify independence criteria and require the auditor to complete a certification statement attesting to their independence related to the performance of the audit.

Estate Management will work with ITS to determine the requirements for a standalone utility or report that Estate Management auditors could run independently to produce the random audit sample.

Expected Completion Date for Corrective Action: March 1, 2017

Finding No. 4: Digital Signature Audits

Digital signature audits do not effectively ensure that digital signatures are properly secured or deleted, when required.

Recommendation: We recommend that DRL reassess its policies and procedures related to the digital signatures to ensure that the signatures are properly secured and accessible only to those individuals with a business need to access the folders. DRL should consult with DFS's Division of Information Systems to identify tools that can be used to increase the security of the signature files and assist in monitoring/restricting access to the secure folders. In addition, the digital signature audits should be improved to increase their effectiveness and training or written instructions should be provided to the Estate Management auditor to ensure that the audits are properly performed.

Response: DRL will review its policies and procedures related to digital signatures to ensure changes can be made to address security and accessibility issues. Training will be provided to ensure the audits are properly performed.

Expected Completion Date for Corrective Action: September 30, 2016

Finding No. 5: Estate Management's Audits of Claims Processes

Estate Management's audits of claims processes were not always effectively or efficiently performed. In addition, Estate Management's audits did not address the revenue-generating functions of the receiverships.

Recommendation: We recommend that DRL enhance its audit-related policies and procedures to better ensure that audits are properly performed and consistent with the (enhanced/implemented) policy, and the resulting reports are accurate and clearly convey the work performed and level of assurance provided by the audit. Audit procedures, tools and forms should also be evaluated to increase the effectiveness and efficiency of the audits and ensure that documentation is maintained to evidence the work performed. In addition, Estate Management should conduct audits over revenue-generating processes and securely maintain custody of the checks through the duration of the CAF audits.

Response: DRL will enhance audit-related policies and procedures in order to produce more consistent, accurate and reliable audits. DRL will amend its policy to ensure that Estate Management maintains custody of checks through the duration of Check/Fraud Audits.

DRL will evaluate tools and forms that can be utilized to increase the effectiveness and efficiency of the audits.

RESPONSE TO PRELIMINARY AND TENTATIVE AUDIT FINDINGS

DRL will consider developing a policy to address audits of revenue-generating processes.

Expected Completion Date for Corrective Action: March 31, 2017

Finding No. 6: Claims Payment Documentation

The Claims Section could not provide source documentation showing the appropriateness of all proposed claims payments.

Recommendation: We recommend that DRL strengthen its policies and procedures to ensure that supporting documentation is maintained for claims payments.

Response: DRL will update policies and procedures to ensure that supporting documentation is maintained for claims payments.

Expected Completion Date for Corrective Action: October 31, 2016

Finding No. 7: Reporting of Accounts Receivable Balances

Insurer accounts receivable balances were not always properly or consistently recorded or reported and sufficient documentation was not always available to show that accounts receivable balances were properly analyzed and valued.

Recommendation: We recommend that DRL enhance its policies and procedures related to the identification, tracking, recording, reporting and collection of accounts receivables. Internal controls should be strengthened to facilitate robust management of collection activities and limit the potential for fraud, errors or misstatements. Written policies and procedures should be updated to reflect these improved controls and also to ensure that all significant functions are addressed within the policies and procedures. In addition, DRL should continue its efforts to obtain a collections management software.

Response: DRL will enhance our policies and procedures related to accounts receivables and management of collection activities. DRL will continue its current efforts to obtain an accounting information system which may include a collections functionality.

Expected Completion Date for Corrective Action: December 31, 2016

Finding No. 8: Internal Controls Related to Accounts Receivable

Internal controls were not adequate to ensure that insurer accounts receivable are properly tracked and managed.

Recommendation: We recommend that DRL strengthen internal controls over insurer accounts receivable to ensure that incompatible functions are properly separated, receivables are effectively managed, and account adjustments are consistent with policy and adequately documented. In addition, DRL may consider an independent documented review of account adjustments.

Response: Employees actively performing collection activities will no longer have the ability to update or change the collection tracking mechanisms. Staff members involved in posting transactions to the collection tracking mechanisms will not be involved in the monthly reconciliations between the accounting system and the collection tracking mechanisms.

In addition, DRL Policy R12-10 – Asset Recovery and Management of Uncollectible Assets will be revised to clarify the definitions of adjustments, settlement and write-offs. The Revised policy will also clarify the required documentation and approval authority levels related to such actions.

Expected Completion Date for Corrective Action: September 30, 2016

Finding No. 9: Asset Recovery's Collection Activities

Asset Recovery's collection activities and account adjustment documentation were not always sufficient to demonstrate that appropriate effort was undertaken to obtain a maximum recovery of marshalled assets.

Recommendation: We recommend that DRL enhance its policies and procedures to strengthen monitoring of contracted collection agents and more clearly define thresholds for authorizing settlements and write-offs. Write-off/settlement procedures would be further strengthened by requiring the use of a specified form to document the settlements/write-offs. In addition, contract reporting requirements should be revised to provide for more frequent and robust reporting including a detailed assessment of the referral and case activity.

Response: DRL will revise Policy R12-10 – Asset Recovery and Management of Uncollectible Assets to clarify the definitions of adjustments, settlement and write-offs. The Revised policy will also clarify the required documentation and approval authority levels related to such actions.

RESPONSE TO PRELIMINARY AND TENTATIVE AUDIT FINDINGS

DRL will improve contract requirements and monitor contracts for regular reporting and detailed assessments of recommendations.

Expected Completion Date for Corrective Action: September 30, 2016

Finding No. 10: Records Management Policies and Procedures

Records management policies and procedures were not sufficient to ensure that original records and non-public personal financial and health information is safeguarded and that the chain of custody is maintained.

Recommendation: We recommend that DRL enhance its policies and procedures to include provisions necessary to maintain the integrity of original records and chain of custody. The DRL should determine whether Florida Statutes permits the release of original insurer records to the guaranty associations. In addition, DRL should strengthen its policies and procedures to ensure the protection and non-disclosure of non-public personal financial and health information, including notification provisions for disclosure of this data to third parties.

Response: DRL will enhance its policies and procedures that pertain to the management and handling of records. The policies and procedures will provide how the chain of custody of records is maintained and the procedure for release of records to the guaranty associations. In addition, the DRL policies and procedures will address the handling of records to ensure the protection and non-disclosure of non-public personal financial and health information, including notification provisions for disclosure of this data to third parties.

Expected Completion Date for Corrective Action: December 31, 2016

Finding No. 11: Periodic Review of IT System Access Privileges

The DRL's procedures for the periodic review of IT system access privileges were not adequate to ensure that the reviews were properly and timely completed.

Recommendation: We recommend that DRL enhance its access control procedures to ensure consistency and compliance with DFS AP&P 4-05. Controls should be strengthened to ensure that access reviews are timely performed and that procedures provide sufficient guidance to result in effective audits. Consideration should be given to the need for the Application Access Control Request Form Audits, which appear to

RESPONSE TO PRELIMINARY AND TENTATIVE AUDIT FINDINGS

duplicate (in some respects) the Current Access Reviews and serve primarily to verify whether DRL's IT Section is processing the access control requests forms. Finally, DRL should improve procedures to ensure that an ASO is continuously assigned for all IT systems.

Response: The Division's Application Access Control policy (R8-05) was revised effective April 29, 2016, and now includes substantially similar language to DFS AP&P 4-05 on the principles ASOs should apply in controlling access to secure applications. We will further enhance the R8-05 policy to strengthen access review monitoring. As part of these additional enhancements, we will eliminate the need for the Application Access Control Request Form audits as a separate audit. Finally, we will update our procedures to insure that departing ASO's are timely replaced and trained.

Expected Completion Date for Corrective Action: December 31, 2016

Finding No. 12: Access Authorizations for Insurer IT Systems

The DRL's administration of insurer IT systems was not always adequate to demonstrate that access was properly authorized.

Recommendation: We recommend that DRL enhance its access authorization procedures to ensure that access to company IT systems is timely and properly authorized and documented. Access forms should be completed in a manner that clearly identifies the systems for which access is requested; the level of access requested; and signatures of all required parties.

Response: DRL will enhance the Application Access Control Request for Company Systems form to include a section in which the technician providing the access will indicate the exact system names to which the user was given access, the level of access, and the date on which access was provided. The related policy will be modified to indicate that access will only be provided if all required signatures are included on the request form.

Expected Completion Date for Corrective Action: December 31, 2016

RESPONSE TO PRELIMINARY AND TENTATIVE AUDIT FINDINGS

Finding No. 13: Security Controls Related to IT System Access and Monitoring

Certain security controls related to IT system access and monitoring need improvement.

Recommendation: We recommend that DRL improve, for DRL and insurer systems, certain security controls related to system access and monitoring to ensure the confidentiality, integrity and availability of system data and resources.

Response: A response will be provided verbally.

Expected Completion Date for Corrective Action: