

**STATE OF DELAWARE 403(b) PLAN**  
**COMMUNICATION WITH THOSE CHARGED**  
**WITH GOVERNANCE AT THE**  
**CONCLUSION OF THE AUDIT**  
**SUMMARY OF FINDINGS AND**  
**RECOMMENDATIONS**  
**DECEMBER 31, 2015**

**STATE OF DELAWARE 403(b) PLAN**  
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**I. COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE  
AT THE CONCLUSION OF THE AUDIT**

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August 9, 2018

To the Plans Management Board  
State of Delaware 403(b) Plan  
Delaware State Treasury  
820 Silver Lake Blvd., Suite 100  
Dover, DE 19904

We have audited the financial statements of State of Delaware 403(b) Plan (Plan) for the year ended December 31, 2015, and have issued our report thereon dated August 9, 2018. Professional standards require that we provide you with information about our responsibilities under *Generally Accepted Auditing Standards* and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our engagement letter to you dated March 16, 2017. Professional standards also require that we communicate to you the following information related to our audit.

**Significant Audit Findings**

**Qualitative Aspects of Accounting Practices**

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Plan are described in Note 2 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. All significant transactions have been recognized in the financial statements in the proper period.

The Plan's financial statements, notes to the financial statements, and required supplementary information (RSI) were prepared in conformity with Government Accounting Standards Board (GASB) Statement No. 67, *Financial Reporting for Pension Plans - an Amendment of GASB Statement No. 25*. Statement No. 25 remains applicable to pension plans that are not administered through trusts covered by the statement and to defined contribution plans that provide post-employment benefits other than pensions. Statement 67 replaces the requirements of Statement No. 25 as it relates to pension plans that are administered through trusts or equivalent arrangements that meet certain criteria. The State of Delaware 403(b) Plan is administered through custodial arrangements. Both Statement No. 25 and Statement No. 67 cover defined benefit pension plans in more detail and only cover note disclosures for defined contribution plans.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

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**Significant Audit Findings - Continued**

**Qualitative Aspects of Accounting Practices - Continued**

The financial statement disclosures are neutral, consistent, and clear.

**Difficulties Encountered in Performing the Audit**

We encountered no significant difficulties in dealing with management in performing and completing our audit.

**Corrected and Uncorrected Misstatements**

Professional standards require us to accumulate all misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. The attached schedules and appendices summarize corrected and uncorrected misstatements of the financial statements. The material misstatements noted in the Posted Adjusting Journal Entry section detected as a result of audit procedures were corrected by management.

**Disagreements with Management**

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

**Management Representations**

We have requested certain representations from management that are included in the management representation letter dated August 9, 2018.

**Management Consultations with Other Independent Accountants**

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Plan's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

**Other Audit Findings or Issues**

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Plan's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

To the Plans Management Board  
State of Delaware 403(b) Plan  
August 9, 2018  
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**Significant Audit Findings - Continued**

During our audit, we became aware of matters that are opportunities to strengthen the system of internal control and improve operating efficiency. The attachments to this letter summarize our findings and recommendations.

**Other Matters**

We applied certain limited procedures to the Management Discussion & Analysis, which is required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

**Restriction on Use**

This information is intended solely for the use of the Plans Management Board, plan administrator, and management of State of Delaware 403(b) Plan and is not intended to be, and should not be, used by anyone other than these specified parties. We thank the management and staff of State of Delaware 403(b) Plan for their cooperation and courtesies extended to us during the performance of our audit.

Very truly yours,

*Belfint, Lyons & Shuman, P.A.*

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## **II. SUMMARY OF FINDINGS AND RECOMMENDATIONS**

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**STATE OF DELAWARE 403(b) PLAN**  
**INFORMATIONAL FINDING NUMBER 1**  
**DECEMBER 31, 2015**

**Deemed Distributed Loans on the Plan's Financial Statements (Informational Finding)**

**Background** - When participants default on their plan loans, plans must treat the defaulted loan as a deemed distribution and issue a Form 1099-R to the participant. Accounting policies require that distributions be recorded when paid, which means that the Plan's distribution expense should reconcile to the gross distributions presented on the Forms 1099-R.

However, some 403(b) vendors that issue collateralized participant loans do not offset the deemed distributed loans against the relevant participant accounts until the participants take a full distribution of their remaining account balances. Hence, the defaulted loans continue to be part of the participant accounts even after the participants have received a Form 1099-R for the deemed distribution. Additionally, these vendors continue to accrue interest on the defaulted loans, which is not reportable for tax purposes. The defaulted loan balance plus interest would only be relevant for determining the availability and amount of future loans, but new loans are not permitted by the plan.

Based on the Plan's accounting policies to report as plan assets the deemed distributions that have not been offset against the participant accounts, the asset balance is therefore overstated in the amount of the defaulted loans, and in future years, interest income is overstated.

**Informational Finding** - The following represents the total defaulted loans plus interest on the books of each vendor that do not offset the defaulted loans against the participant accounts.

<u>Vendor</u>	<u>2015 Loan Balance per Confirms</u>	<u>Active Loans</u>	<u>Defaulted Loans</u>
AXA	\$ 15,335	\$ 15,335	\$ -
Horace Mann	114,060	94,329 *	19,731
ING	4,705	-	4,705
Kades Margolis	11,608	11,608	-
MetLife	656,654	44,412	612,242
New York Life	28,813	28,813	-
Security Benefit	101,923	15,328	86,595
Symetra	102,548	21,751	80,797
VALIC	206,881	-	206,881
Total per Confirms	<u>\$ 1,242,527</u>	231,576	<u>\$ 1,010,951</u>
Total per Financial Statements		<u>876,067</u>	
Difference - Waived Adjustment		<u>\$ (644,491)</u>	

\* Fixed account balance of \$94,329

**STATE OF DELAWARE 403(b) PLAN**  
**INFORMATIONAL FINDING NUMBER 1 - CONTINUED**  
**DECEMBER 31, 2015**

**Deemed Distributed Loans on the Plan's Financial Statements (Informational Finding) - Continued**

**Resolution** - Since the waived adjustment amount is not material to the financial statements, and it represents a timing difference until the participants take a terminating distribution, BLS will continue the past practice of reporting the loan balance presented on the compilation, which includes some of the defaulted loan balances.

**STATE OF DELAWARE 403(b) PLAN**  
**INFORMATIONAL FINDING NUMBER 2**  
**DECEMBER 31, 2015**

**Security Benefit Investment Detail Report Does not Tie to the Total of the Participant Account Balance Report**

**Finding** - Security Benefit provided BLS with an audit package that consisted of a participant account balance report and schedule of investments for the Plan. Initially, the assets on the participant account balance report totaled \$70,084,050 and the schedule of investments totaled \$71,100,430 as of December 31, 2015, a difference exceeding one million dollars.

**Resolution for 2015** - BLS used the participant account report because it included the largest total investment amount and we were able to reconcile the beginning balance to the prior year's ending balance after eliminating IRA accounts and adding missing participant statements.

**Recommendation** - It is imperative to be able to verify the completeness and accuracy of data, and that the total assets per the participant account balance report agree with total investment balances. BLS recommends that the State follow up with Security Benefit to establish important parameters of how all statements and reports must be complete and accurate, including all and only State of Delaware 403(b) Plan accounts, which should lead to the same total assets whether the report is produced by participant, by investment, or otherwise.

**STATE OF DELAWARE 403(b) PLAN  
SCHEDULE OF FINDINGS AND RECOMMENDATIONS  
YEAR ENDED DECEMBER 31, 2015**

**FINANCIAL STATEMENT FINDINGS**

**Reference Number:** 2015-001

**Type of Finding:** Significant Deficiency

**Participant Loans Issued After January 1, 2009**

**Condition:** The State of Delaware 403(b) Plan document effective January 1, 2009 expressly prohibited loans to be issued as of that date. A Voluntary Compliance Program (VCP) application has been filed and approved, requesting that loans issued through 2014 be grandfathered. All vendors were instructed to stop issuing loans. However, three vendors issued new loans during the 2015 plan year: New York Life, Symetra, and Security Benefit.

**Criteria:** The plan provisions noted in the plan document must be followed.

**Cause:** The cause of the operational failure is not a lack of understanding by the State of Delaware 403(b) Plan officials. Vendors are not following the terms of the plan document.

**Effect:** The effect of the issuance of loans is an operational failure. Although the loans that are outstanding do not lead to materially misstated financial statements, the effect of not following plan provisions could be a possible disqualification of the Plan under the applicable provisions of the Internal Revenue Code, which would cause the Plan to lose its tax-favored status.

**Recommendation:** Although the State of Delaware 403(b) Plan officials have notified vendors, it appears that three vendors did not update their processes. Plan officials should consult with legal counsel regarding the required corrections. Additionally, plan officials should contact the offending vendors directly to communicate that loans may no longer be issued and to discuss possible ways in which the vendor can appropriately control the loan processes for the State of Delaware 403(b) Plan. It would be ideal if the vendor could remove the ability of its employees to process loans for this Plan through automation. Legal counsel should be consulted regarding an update to the VCP application.

**Views of Responsible Plan Officials and Planned Corrective Actions:** We will contact legal counsel and begin the process of adding the loans to a VCP filing.

**Responsible Positions:** Promotions and Outreach Manager and Investments and Operations Manager

**STATE OF DELAWARE 403(b) PLAN**  
**SCHEDULE OF FINDINGS AND RECOMMENDATIONS - CONTINUED**  
**YEAR ENDED DECEMBER 31, 2015**

**FINANCIAL STATEMENT FINDINGS - CONTINUED**

**Reference Number:** 2015-002

**Type of Finding:** Material Weakness

**Security Benefit Plan Assets - Inappropriately included IRA accounts and Excluded Plan Participant Accounts**

**Condition:** The Security Benefit confirmations included Individual Retirement Accounts (IRA) of \$203,554, and excluded participant accounts totaling \$1,434,147.

**Criteria:** Plan statements and confirmations provided by vendors should be complete and accurate, including all accounts that belong to the State of Delaware 403(b) Plan, but not IRA accounts that are not part of the Plan.

**Cause:** Security Benefit personnel produce reports from individual contract statements and the computer system seems to be unable to identify all and only contracts that belong to the State of Delaware 403(b) Plan.

**Effect:** The misstatements are not currently material to the plan financial statements, but could lead to a material misstatement of the financial statements.

**Recommendation:** We recommend that State of Delaware 403(b) Plan officials work with Security Benefit personnel to ensure complete and accurate confirmations and statements are issued to the State of Delaware plan officials, the compilation company, and the auditors, as applicable.

Resolution: BLS proposed adjustments to the financial statement to:

1. Eliminate the IRA account balances,
2. Add 14 of the 17 account balances for which statements were subsequently provided, and
3. Record distributions for three accounts which Security Benefit represents were rolled over to IRAs, even though they do not appear on any distribution reports. See Finding 2015-003.

**Views of Responsible Plan Officials and Planned Corrective Actions:** All Security Benefit accounts have been added to the State's TPA, PlanWithEase. We will work with our TPA and PWE to eliminate the IRA accounts and will be able to "tie in" the excluded accounts from the 2015 audit.

**Responsible Positions:** Promotions and Outreach Manager and Investments and Operations Manager

**STATE OF DELAWARE 403(b) PLAN**  
**SCHEDULE OF FINDINGS AND RECOMMENDATIONS - CONTINUED**  
**YEAR ENDED DECEMBER 31, 2015**

**FINANCIAL STATEMENT FINDINGS - CONTINUED**

**Reference Number:** 2015-003

**Type of Finding:** Significant Deficiency

**Missing Distributions for Participants with Beginning Account Balances**

**Condition:** Security Benefit was unable to provide the 2015 statements for three participants who had account balances as of December 31, 2014, but not as of December 31, 2015. The three participants are not included in any of the distribution reports provided to BLS.

**Criteria:** Rollovers to IRA accounts and distributions to participants should be reflected in distribution reports for the Plan. Participant account statements for each person's last year of participation in the Plan should be available.

**Cause:** Security Benefit indicated that the accounts were no longer associated with the State of Delaware 403(b) Plan, since they had been rolled over to IRA accounts. However, the distribution reports provided to BLS do not include rollover distributions for the three participants in question. As an alternative procedure, BLS requested to see account activity through the date of the distribution for the three participants, but participant statements were not provided.

**Effect:** BLS recorded the December 31, 2014 account balances for the three participants as distributions during 2015, but was unable to verify the existence, amount, and proper tax treatments of the rollovers or distributions.

**Views of Responsible Plan Officials and Planned Corrective Actions:** The State will make a request directly to Security Benefit for the noted participant(s) statements to provide backup for the distributions.

**Responsible Positions:** Promotions and Outreach Manager and Investments and Operations Manager

**STATE OF DELAWARE 403(b) PLAN**  
**SCHEDULE OF FINDINGS AND RECOMMENDATIONS - CONTINUED**  
**YEAR ENDED DECEMBER 31, 2015**

**FINANCIAL STATEMENT FINDINGS - CONTINUED**

**Reference Number:** 2015-004

**Type of Finding:** Material Weakness

**Material Adjustment to Plan Financial Statements**

**Condition:** As a result of our audit fieldwork, we had to propose a material reclassification adjustment to the compiled financial statements totaling \$15,380,908.

**Criteria:** Strong internal control requires adequate review and adjustment of the year-end accounting data and financial information used to prepare the State of Delaware 403(b) Plan's financial statements in accordance with generally accepted accounting principles (GAAP).

**Cause:** The main reason for the material reclassification adjustment is that vendors do not report investment classifications, distributions, and exchanges in accordance with generally accepted accounting principles.

**Effect:** The effect was a material reclassification adjustment to the compiled financial statements totaling \$15,386,908.

**Resolution:** Plan officials have engaged a single vendor to receive contributions and to perform reconciliation of distributions to 1099-R reports and exchanges between vendors, which should net to zero. See Finding 2015-002 regarding vendor confirmations that are not complete and accurate.

**Views of Responsible Plan Officials and Planned Corrective Actions:** Per Finding 2012-5, the State has updated its confirmation request to the vendors to request full detail in regards to participant accounts. The adjustments will be made on the financial statements to reflect the assets that were not included initially.

**Responsible Positions:** Promotions and Outreach Manager and Investments and Operations Manager

**STATE OF DELAWARE 403(b) PLAN**  
**SCHEDULE OF FINDINGS AND RECOMMENDATIONS - CONTINUED**  
**YEAR ENDED DECEMBER 31, 2015**

**CURRENT STATUS OF PRIOR YEAR FINDINGS**

**Reference Number: 2014-001**

**Type of Finding: Material Weakness**

**Completeness of Plan Assets**

**Condition:** The unadjusted financial statements of the State of Delaware 403(b) Plan omitted certain assets by legacy vendors Kades Margolis and MetLife. Additionally, the unadjusted financial statements of the State of Delaware 403(b) Plan excluded certain MetLife legacy vendor contracts that received contributions and incorrectly included certain pre-2009 MetLife contracts. The total net understatement was \$796,077.

**Current Status:** This finding has been fully addressed.

**Reference Number: 2014-002**

**Type of Finding: Material Weakness**

**IRA Assets Included in Plan Assets and Other Inappropriately Excluded Plan Assets on Financial Statements**

**Condition:** The unadjusted financial statements of the State of Delaware 403(b) Plan included Individual Retirement Accounts, which totaled \$255,337. Additionally, legacy vendor Security Benefit's confirmation excluded five contracts totaling \$781,527 and a Rydex account totaling \$50,397.

**Current Status:** This finding has been corrected in the 2014 financial statements, but Security Benefit has not updated its systems to properly identify State of Delaware 403(b) Plan contracts. See current year finding 2015-002.

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### **III. ADJUSTING JOURNAL ENTRIES**

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**STATE OF DELAWARE 403(b) PLAN**  
**Schedule of Posted Adjusting Journal Entry**  
**December 31, 2015**

<u>Account</u>	<u>Description</u>	<u>Debit</u>	<u>Credit</u>
<i>Posted Adjusting Journal Entry #1</i> - To adjust compilation to audited numbers.			
1001	Fixed Annuities	\$ 2,469,298	\$ -
6001	Participant Contributions	398,272	-
6010	Net Appreciation in Fair Value of Investments	260,904	-
6012	Interest Income on Notes Receivable from Participants	41,808	-
7002	Administrative Expenses	4,652	-
8001	Transfer in (out) of Plan	12,205,974	-
1002	Variable Annuities	-	1,807,107
5001	Net Assets	-	853,858
6002	Rollover Contributions	-	323,545
6011	Interest and Dividends	-	799,541
7001	Benefits Paid to Participants	-	11,596,857
		<u>\$ 15,380,908</u>	<u>\$ 15,380,908</u>

**STATE OF DELAWARE 403(b) PLAN**  
*Schedule of Waived Journal Entries*  
 December 31, 2015

<u>Account</u>	<u>Description</u>	<u>Debit</u>	<u>Credit</u>
<b>Waived Journal Entry # 1</b> - To adjust note receivable from participant balance to remove defaulted loans from outstanding balance.			
5001	Net Assets	\$ 644,491	\$ -
1003	Notes Receivable from Participants	-	644,491
	<b>Total</b>	<b>\$ 644,491</b>	<b>\$ 644,491</b>
<b>Waived Journal Entry #2</b> - To remove IRA contracts included in the investment beginning balance.			
5001	Net Assets	\$ 203,554	\$ -
1002	Variable Annuities	-	203,554
	<b>Total</b>	<b>\$ 203,554</b>	<b>\$ 203,554</b>