

STATE CONTROLLER'S OFFICE

Does Not Always Ensure the Safekeeping, Prompt Distribution, and Collection of Unclaimed Property

REPORT NUMBER 2002-122, JUNE 2003

State Controller's Office response as of June 2004

Audit Highlights . . .

Our review of the State Controller's Office (controller), Bureau of Unclaimed Property (bureau), revealed the following:

- The bureau's computerized Unclaimed Property System lacks sufficient controls to prevent unauthorized changes, and the duplication of account data, potentially resulting in the payment of fraudulent or duplicate claims.*
 - The bureau's manual tracking of securities is unreliable and the bureau is inconsistent in how quickly it sells securities.*
 - The bureau excludes more than \$7.1 million in unclaimed property from its Web site.*
 - The bureau does not consistently review and distribute claims in a reasonable amount of time.*
 - The bureau does not ensure that it receives all of the reported contents of safe deposit boxes.*
 - The controller's Financial-related Audits Bureau did not pursue an estimated \$6.7 million in unclaimed property from one holder.*
-

The Joint Legislative Audit Committee (audit committee) requested that we evaluate the process used by the State Controller's Office (controller) Bureau of Unclaimed Property (bureau) for identifying unclaimed property from corporations, business associations, financial institutions, insurance companies, and other holders. Further, the audit committee asked us to determine whether the bureau distributes unclaimed property to eligible recipients accurately and in a timely manner. We were also asked to evaluate the bureau's process of safeguarding unclaimed property in its custody. Lastly, we were to determine whether the bureau evaluates claimant satisfaction, is responsive to complaints, and has a process in place to identify and implement corrective action.

Finding #1: Inaccurate data contained in the bureau's property system has resulted in the payment of fraudulent and duplicate claims.

The bureau relies on its computerized Unclaimed Property System (property system) to track unclaimed property escheated to the State by persons and businesses holding unclaimed property (holders) and to disclose that the controller has the unclaimed property. However, the property system is not sufficiently reliable. Our primary concern is that the controller has not implemented controls to prevent bureau employees from making unauthorized changes to the system, despite knowing about this problem for eight months. Further, the property system does not generate reports that would reveal when unauthorized changes are made and by whom. These flaws allowed two student assistants to conspire to modify owner names in the data and allowed their accomplices to fraudulently claim some of the property.

Prior to 2002, the property system lacked effective controls to prevent duplicate data from being loaded into the property system. Although the controller took action to correct this weakness, as of May 6, 2003, the bureau had not yet removed all of the duplicate data from its property system. While the Information Systems Division reports it has taken action to prevent payments on properties listed on the duplicate reports, some of the properties are still on the bureau's Web site. Individuals using the Web site to determine whether the controller has their property may inadvertently conclude that they are owed more than the actual amount.

The bureau does not reconcile the total amount remitted for each holder report to the total of all the individual accounts loaded into the property system by that report. This may result in claimants not receiving funds to which they are legally entitled. In addition, the bureau's staff manually entered nearly 6,700 holder reports directly into the property system due to problems with a holder's electronically submitted reports. In doing so, the bureau bypassed most of the automatic system checks that could have identified errors in the data, such as checking for duplicate information. The bureau has established a procedure to verify the data in these records as claims come in, but it does not intend to verify all of the data entered directly into the property system.

To increase the reliability of the data in the property system, the bureau should do the following:

- Implement the programming changes necessary to ensure that employees cannot make unauthorized and unmonitored changes to the property system.
- Remove all duplicate account data from the property system.
- Ensure that both current and newly hired staff review unclaimed property accounts entered manually when claims are filed against the property to determine the accuracy of the data.

To ensure the accuracy of the data loaded into the property system, the bureau should require its staff to reconcile the total amount remitted by each holder to the total of all the individual records in the property system for that report.

Controller's Action: Corrective action taken.

The controller modified its property system to limit on-line property updates and to generate audit reports that allow supervisory review of any such on-line transactions. Additionally, the controller developed a plan to delete all the duplicate reports from the system, including modifying the property system to prevent the duplicate properties from appearing on the bureau's Web site.

Furthermore, the controller conducted training classes to ensure that all staff continues to adhere to current procedures for verification of claims filed for properties on the reports entered manually. The controller retrained staff on proper procedures for holder overpayments. Additionally, the controller made the necessary programming changes to fix system problems, including the development of a periodic report to identify any out of balance reports.

Finding #2: The bureau may incorrectly bill holders for interest penalties.

Inaccuracies in the property system may result in the incorrect billing of holders for interest penalties from which they should be exempt under the controller's amnesty program. Beginning in 2000, holders were allowed amnesty for their past failures to report unclaimed property on or before November 1, 1999, and were exempted from paying an interest penalty. However, the bureau did not include an amnesty indicator in the property system for all qualifying holder reports, and the controller has not modified its program that calculates interest penalties to exclude holder reports that were granted amnesty. The controller will have to correct both problems to avoid inappropriately billing the holders that it granted amnesty.

To prevent the billing of penalties for late reporting to holders granted amnesty, the controller should do the following:

- Identify reports covered by the amnesty program that do not currently have an amnesty indicator and add it.
- Modify its program that generates bills for interest penalties to exclude those reports with an amnesty indicator.

Controller's Action: Corrective action taken.

The controller reconciled all amnesty reports in the tracking system and the unclaimed property system. Further, the controller reviewed interest billings previously issued to verify that no erroneous billings were issued for approved amnesty reports. Additionally, the controller modified its procedures to ensure that all interest billings are reviewed and that no amnesty reports are incorrectly billed for interest. Lastly, the controller developed a plan for programming changes to prevent generating interest billings for approved amnesty reports.

Finding #3: Although holder reports must be processed in order to account for property escheated to the State, thousands of holder reports await processing.

To allow for the tracking and eventual disbursement of unclaimed property, the bureau must process the holder reports by loading the detailed owner data into the property system. Although the bureau must complete this process to be able to disclose on its Web site that it has the owner's property, to pay claims, to bill holders for interest due on late filings, and to reconcile the amounts reported by the holders to the amounts actually remitted by the holders, it told us that, as of June 5, 2003, it had not uploaded more than 8,500 holder reports, some as far back as 1996. More than 4,500 of these reports are less than one year old and are not considered a backlog.

During discussions with the bureau, we learned that two conditions contributed to its backlog of holder reports:

- Electronic reports in unreadable formats.
- Large increases in the number of holder reports submitted.

To enable the bureau to upload data reported in formats that it cannot access, it should do the following:

- Continue its efforts to contact the holders and request that they resubmit the owner data in the current reporting format.
- Consider contracting with an outside entity to read the remaining reports or to convert them into a usable format.

To allow for the timely notification to owners that the State has their property and the prompt billing of interest penalties, the bureau should ensure that it uploads holder reports within 12 months of receipt.

Controller's Action: Corrective action taken.

The controller completed its analysis of the backlogged reports and contacted the holders as necessary for any reports that need to be submitted in a different form. Further, the controller developed alternatives for reading or converting any remaining reports, including options to contract with an outside firm, if necessary, to read or convert the data. Also, the controller has developed a plan to process reports within a year of receipt.

In September 2003, the controller implemented a plan to liquidate the holder report backlog and to process holder reports within a year, with the exception of problem reports. The controller's efforts have significantly reduced the backlog from approximately 9,000 at the high point, to 2,894, as of May 31, 2004. The controller's liquidation efforts will continue, and it expects further reductions.

Finding #4: The bureau's tracking of securities in its custody needs improvement.

Because the bureau cannot use the computerized property system to track changes in securities, it tracks these manually, increasing the probability of error and the number of staff needed to accommodate the workload. We found that the bureau's manual tracking of securities is unreliable and that the bureau is inconsistent in how quickly it sells securities. Moreover, because the bureau tracks securities by company name rather than by individual owner, when corporate actions such as stock splits result in the issuance of additional securities, the bureau does not consistently associate the new securities with the original securities. This results in securities for the same owner being sold on different dates for different prices, further complicating the bureau's reconciliation process, increasing both the potential for errors and the risk of allegations that the bureau has mismanaged owners' assets.

To eliminate the bureau's manual tracking of securities and dispel any impressions that it exercises judgment in deciding when is the best time to sell securities, thereby reducing the potential for errors, eliminating unnecessary work, and reducing the potential

for litigation against the State, the controller should seek legislation to require it to sell securities immediately upon receipt. To ensure that the holders remit all of the reported securities, the bureau should compare the shares received to the shares reported by the holders, using the holder report summary sheets.

Alternatively, the controller should consider having holders deliver duplicates of the securities they have transferred into the controller's name to a specified broker authorized to accept them on the State's behalf. The controller should instruct and give the broker authorization to sell the securities immediately upon receipt. This may also require legislation. Additionally, the bureau should immediately sell all securities already in its custody.

If the bureau is unable to sell securities immediately upon receipt, it should do the following:

- Reconcile the securities remitted to the securities reported within one month of the receipt of the securities, for securities not already in its custody.
- Modify the property system to allow it to track all changes to securities, including the effective dates, receipts, sales, disbursements, and corporate actions, on an owner-by-owner basis. The bureau should ensure that it updates the property system to account for securities currently tracked in its manual ledgers. This process should be automated to allocate changes in the number of securities to the affected accounts with minimal human intervention.
- Sell all securities related to a particular account within two years of the initial receipt, regardless of corporate actions. Additionally, the property system should be modified to generate a monthly report to alert the bureau to securities approaching the two-year deadline for sale, regardless of the timing of corporate actions.

In either case, the bureau should do the following:

- Review all of its manual ledgers to ensure that it has accurately recorded all corporate actions, receipts, sales, and disbursements of securities. Once this review is complete, the bureau should discontinue the use of its manual ledgers.
- Complete its reconciliation of the securities remitted to the securities reported for all securities not previously reconciled.

Legislative Action: None.

Although the controller did not seek legislation to require it to sell securities immediately upon receipt, as discussed in the following paragraph it did address the issue internally.

Controller's Action: Corrective action taken.

The controller directed staff to immediately sell securities received with holder reports. Further, the controller developed a plan to accelerate the sale of securities currently in house. Additionally, the controller reviewed options to streamline the process of escheating securities to facilitate the more immediate sale of securities. Future contracts with third-party contractors include a requirement that securities be delivered to the controller-contracted broker for immediate sale. The controller created standardized procedures for making entries into the security ledgers to improve consistency of entries in the ledgers, including a quality review of the entries. Additionally, the controller developed a plan to improve the timeliness of reconciling the remitted securities to reported securities.

Finding #5: Property belonging to governmental agencies and some private entities are excluded from the bureau's Web site.

We also found that the bureau excludes a large amount of unclaimed property reported to it for federal and state departments, local governments, schools and school districts, other states, and some private entities from its Web site. As of April 30, 2003, the bureau held more than \$7.1 million in unclaimed property for various entities that it has not posted on its Web site. Even if the entities check the Web site to see if the State has some of their property, they would erroneously conclude that it does not.

To fully inform all entities that it has their unclaimed property in its possession, the bureau should do the following:

- Discontinue excluding any properties from its Web site.
- When it receives unclaimed property belonging to any governmental entity, notify that entity. If it does not receive sufficient information to determine which governmental entity the property belongs to, it should seek additional information from the holder.

Controller's Action: Corrective action taken.

The controller issued instructions to holders in writing and through the Web site of their responsibilities to notify owners prior to the escheatment of accounts. Additionally, the controller discontinued its practice of excluding government properties from its Web site. Further, the controller developed a plan to notify government agencies of potential unclaimed properties in excess of \$1,000 on an annual basis and simplified the process for transferring property to them.

Finding #6: The bureau does not approve and distribute claims in a timely manner.

The Unclaimed Property Law (law) requires the bureau to consider each claim for the return of property within 90 days after it is filed and to provide written notice to the person claiming the property (claimant) if the claim is denied. Although the law does not specifically require the bureau to approve or deny claims within 90 days, we believe that once the claimant has provided all required documentation, 90 days is a reasonable amount of time for the bureau to either approve or deny the claim. However, the bureau does not consistently do so. Claims for securities generally take longer to review and to distribute to the claimant than claims for most other types of property. Lastly, although the bureau has received numerous complaints regarding the timely distribution of claims, it has not streamlined the claim distribution process.

To ensure that it distributes assets to bona fide claimants in a timely manner, the bureau should do the following:

- Review all claims and either approve or deny them within 90 days of receipt.
- Distribute assets on approved claims within 30 days of approval.

Controller's Action: Corrective action taken.

The controller identified means of streamlining the approval of claims by increasing the threshold for applying its streamlined claim approval process from \$1,000 to \$5,000. Additionally, the controller created a new unit to process unclaimed property claims from heirfinders and investigators.

Finding #7: The bureau does not compare the contents of safe deposit boxes it receives to the holder-prepared inventories.

To determine the adequacy of the bureau's safekeeping of the contents of safe deposit boxes, we reviewed a sample of 32 safe deposit boxes. We expected that the bureau's inventories would conform materially to the holders' inventories; however, we found that the bureau does not reconcile the holders' inventories to its own inventories or to the boxes' contents to ensure that it has received all of the property listed. Instead, the bureau creates its own inventories from the contents actually received and usually disregards the holder inventories. The bureau's process of creating its own inventories results in unnecessary work and does not ensure that it has received all of the reported contents of the safe deposit boxes. If the bureau compared the contents received to the contents reported by the holder, it would be able to identify any missing property and take prompt action to request that the holder either explain the difference or remit the missing property. Doing so would reduce its liability for items that were not remitted by the holder.

To ensure that it has properly accounted for all of the owners' properties, the bureau should develop a standard inventory form for holders to use to report the contents of safe deposit boxes and for the bureau to use to verify that it has received all of the reported contents from the holders. This standard form should include a section for the bureau to indicate its receipt of all of the reported contents, the date of review, and any follow-up required for contents that were reported but not remitted by the holder.

Controller's Action: Corrective action taken.

The controller developed and implemented a standard inventory form for use by financial institutions when sending safe deposit box contents. The controller will use the new form to reconcile the receipt of items, and it also posted the form and instructions to its Web site.

Finding #8: Although state law allows the bureau to auction the contents of safe deposit boxes, it did not auction property for almost two years.

The law allows the bureau to sell the contents of safe deposit boxes in its custody to the highest bidder at public sale, including sales via the Internet. Although the bureau is not required to sell the contents of safe deposit boxes, failure to do so results in

higher costs to the State to store and safeguard those contents. The floor of the bureau's vault is crowded with the safe deposit box contents it has received from holders but has not sent to storage, and its shelves are overflowing with binders and the bagged contents of safe deposit boxes. We found that the bureau had not conducted an auction for almost two years, resulting in the overcrowding of its safe deposit box vault with the contents of safe deposit boxes that it has received from holders.

To reduce the overcrowding in its safe deposit box vault, the bureau should conduct an auction of the contents of safe deposit boxes at least monthly.

Controller's Action: Corrective action taken.

The controller completed a pilot project for conducting on-line Internet auctions of safe deposit box contents. Further, the controller implemented an on-going on-line auction using new procedures and system updates to verify that sale proceeds are received for all items sold. The controller explored the need for additional space for secured storage of the safe deposit contents to reduce the overcrowding. The controller completed its Request for Proposal with a public auctioneer, which conducted a public auction of unclaimed property. Additionally, the controller created new procedures to verify and reconcile public auction proceeds to the actual hammer price from the auction. In February 2004, the controller also implemented programming changes to allow it to post the proceeds of unclaimed property auctions to the owner's account. This change includes new procedures and system updates and provides a more accurate method of maintaining auction proceed records.

Finding #9: The controller does not ensure the collection of all unclaimed property.

The controller's Financial-related Audits Bureau (audit bureau) does not always fully pursue unclaimed property that its auditors have a reasonable basis for believing should be remitted to the State. Specifically, we found that even though its auditors estimated in January 2002 that one holder failed to remit \$6.7 million beginning as far back as 1978, the audit bureau did not move forward to substantiate or invalidate the estimated findings. After we brought this to the controller's attention, the audit bureau reopened the examination of the holder. Assuming that the audit bureau substantiates the \$6.7 million and the

holder remits the funds on June 30, 2003, the estimated interest penalty would be nearly \$8.2 million, resulting in the potential collection of more than \$14.9 million. By not exercising due diligence in pursuing the collection of unclaimed property that there is a reasonable basis to believe should have been remitted, the controller is not fulfilling its responsibility to reunite owners with their lost or forgotten property.

To ensure that it collects all unclaimed property, the controller should complete its examination of estimated unclaimed property that its auditors have a reasonable basis for believing should be remitted to the State. Further, the bureau should ensure that it bills and collects the applicable interest penalties based upon the results of the audit bureau's examination.

Controller's Action: Pending.

The controller's examination of the holder is in progress. Further, the controller is attempting to obtain access to information that will help it substantiate or invalidate the estimated unclaimed property. After the controller completes the examination, it plans to bill the holder for any additional audit findings.

