

STATE OF CONNECTICUT

**AUDITORS' REPORT
STATE TREASURER - DEPARTMENTAL OPERATIONS
FOR THE FISCAL YEAR ENDED JUNE 30, 2001**

**AUDITORS OF PUBLIC ACCOUNTS
KEVIN P. JOHNSTON ♦ ROBERT G. JAEKLE**

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September 5, 2002

**AUDITORS' REPORT
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FOR THE FISCAL YEAR ENDED JUNE 30, 2001**

We have made an examination of the financial records of the State Treasurer as they pertain to the Agency's departmental operations for the fiscal year ended June 30, 2001. This report on that examination consists of the Comments, Recommendations and Certification which follow. We also issue separate audit reports covering the State Treasurer - State Financial Operations and the Investment Advisory Council for the June 30, 2001 fiscal year.

This audit has been limited to assessing the State Treasurer's compliance with certain provisions of financial related laws, regulations and contracts, and evaluating the State Treasurer's internal control structure policies and procedures established to ensure such compliance. Financial statement presentation and auditing are done on a Statewide Single Audit basis to include all State agencies, including the State Treasurer.

COMMENTS

FOREWORD:

The State Treasurer operates primarily under the provisions of Article Fourth of the State Constitution and Title 3, Chapter 32 of the General Statutes. The Treasury Department is organized into several divisions and performs a number of functions. This report is concerned with the departmental operations of the Treasury Department and includes our review of the Business Office, Personnel, Informational Services and the Unclaimed Property Division. Our review of financial operations of the State Treasurer that have Statewide impact has been issued under separate cover to include the Pension Funds Management Division, the Debt Management Division, the Cash Management Division, the Connecticut Higher Education Trust and the Second Injury Fund. A separate report on the Investment Advisory Council has also been issued. A listing of officers and officials and a description of the major functions of the divisions covered in this report follows.

Officers and Officials:

The officers and officials of the Treasury Department as of June 30, 2001, were as follows:

State Treasurer: *

Denise L. Nappier

Deputy Treasurer:

Howard G. Rifkin

Assistant Deputy Treasurer:

Timothy Bannon

Assistant Treasurer, Pension Funds Management Division:

Gregory D. Franklin

Assistant Treasurer, Cash Management:

Lawrence A. Wilson

Assistant Treasurer, Policy:

Meredith A. Miller

Assistant Treasurer, Second Injury Fund:

Alberta Mendenhall

Assistant Treasurer, Unclaimed Property:

Madelyn Colon

Assistant Treasurer, Debt Management:

Catherine Boone

* As used in ensuing comments of this report, the term "Treasurer" refers to the State Treasurer.

RÉSUMÉ OF OPERATIONS:

Department Revenues:

Departmental revenue consisted mainly of Second Injury and Compensation Assurance Fund (SIF), Workers' Compensation Administration Fund (WCA) and General Fund revenue. SIF revenues consisted mainly of assessments levied against self-insured employers and companies writing workers' compensation or employers' liability insurance and totaled \$96,802,844 for the 2000-2001 fiscal year. WCA Fund assessment receipts totaled \$19,761,469 for the 2000-2001 fiscal year. More detailed information concerning the SIF and WCA is included in our Auditors' Report on the State Treasurer – State Financial Operations. The General Fund revenues, a large percentage of which consisted of restricted account transfer receipts, to cover Combined Investment Funds' and Second Injury Fund's charges, and Unclaimed Property Division receipts, amounted to \$155,575,926 for the 2000-2001 fiscal year and \$156,794,898 for the 1999-2000 fiscal year.

A summary of General Fund revenue is presented below.

	<u>2000-2001</u>	<u>1999-2000</u>
Unclaimed property receipts	\$ 36,120,942	\$ 34,301,163
Restricted account transfers	117,794,263	107,314,253
All other receipts	<u>1,660,721</u>	<u>15,179,482</u>
Total General Fund Revenue	<u>\$155,575,926</u>	<u>\$156,794,898</u>

Department Expenditures:

Civil List expenditures for operations of the Treasury Department for 2000-2001, excluding expenditures classified as, "debt service paid" and "workers' compensation awards" which are included in the separate audit report on State financial operations, are presented below, along with the prior year's expenditures:

	<u>2000-2001</u>	<u>1999-2000</u>
Net Expenditures by Fund:		
General-Budgeted	\$ 3,377,581	\$ 3,323,736
General-Restricted	63,116,456	62,183,175
General-Non-Functional	9,838,935	9,475,207
Capital Projects	62,249	56,336
Special Revenue	9,605	44,970
Enterprise	11,510	7,330
Fiduciary	<u>808,345</u>	<u>875</u>
Net Expenditures	<u>\$ 77,224,681</u>	<u>\$ 75,091,629</u>

General Fund restricted accounts were the major funding source for the Treasurer's Pension Funds Management Division, Second Injury Fund, Bond Issue Costs and a Bank Compensation Account. Operating expenditures of the Unclaimed Property Division and a Special Assessment account are also charged to General Fund Restricted accounts. General Fund Non-Functional expenditures were for reimbursements of unclaimed property.

An analysis of departmental expenditures categorized by object is as follows:

	<u>2000-2001</u>	<u>1999-2000</u>
Net Expenditures by Major Object:		
Personal services	\$ 10,127,517	\$ 9,894,522
Contractual services	53,353,637	52,508,835
Commodities	107,525	146,265
Sundry charges	2,918,657	2,943,639
Equipment	70,065	122,286
Unclaimed property	9,838,935	9,475,207
Expenditures by Agency Funds & Other	808,345	875
Net Expenditures	<u>\$ 77,224,681</u>	<u>\$ 75,091,629</u>

Contractual and personal services are the major expenditures of the Treasury, other than debt service cost. The most significant cost item in contractual services is the payments of the investment advisor performance fees by the Pension Fund Management Division (PFMD). Payment processing procedures made pursuant to these contracts were reviewed as part of this audit. Returns of unclaimed property remained relatively constant between fiscal years.

Personal services expenditures in the 2000-2001 and 1999-2000 fiscal years were paid from the following sources:

	<u>2000-2001</u>	<u>1999-2000</u>
General Fund:		
Budgeted Accounts	\$ 2,970,332	\$ 2,916,411
Restricted Accounts:		
Pension Fund Management	1,032,455	953,775
Second Injury Fund	4,176,925	4,235,650
Unclaimed Property	1,365,770	1,200,668
Short-Term Investment Fund	480,039	493,996
Special Assessment Fund	62,450	55,300
Other Civil List Funds	39,546	38,722
Totals	<u>\$ 10,127,517</u>	<u>\$ 9,894,522</u>

Total personal services expenditures increased by approximately 2.4 percent in the 2000-2001 fiscal year. Increased expenditures for annual salary increments and collective bargaining increases accounted for nearly all of the increase.

Treasury employment statistics for two years follow:

	<u>June 30,</u>	
	<u>2001</u>	<u>2000</u>
Full-time Permanent:		
General Fund:		
Budgeted Accounts	46	45
Restricted Accounts	105	106
Other Funds	<u>6</u>	<u>6</u>

Totals	<u>157</u>	<u>157</u>
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Unclaimed Funds:

The administration and disposition of property held by banking and other organizations for the benefit of owners who cannot be located is provided for in Sections 3-56a to 3-74a of the General Statutes. The Statutes provide for all escheat receipts to be deposited into the General Fund with the exception of periodic transfers to a restricted unclaimed property account within the General Fund. The restricted account funds are used to pay unclaimed property's administrative costs. These transfers totaled \$3,400,000 for the 2000-2001 fiscal year. The receipts presented below, show revenues prior to their reallocation to adjust for these transfers.

Unclaimed property includes unclaimed bank accounts and insurance policies and claims. It further consists of unclaimed wages and customer overpayments held by business associations and various court deposits. A comparison of unclaimed property receipts of the escheats revenue accounts for the 2000-2001 and 1999-2000 fiscal years follows:

	<u>2000-2001</u>	<u>1999-2000</u>
Financial institutions	\$10,214,502	\$ 11,328,402
Business corporations	12,026,482	11,773,024
Insurance companies	10,243,121	8,834,188
Securities tendered	1,010,844	706,297
Governmental and public agencies	3,174,113	1,233,364
Dividends on securities held	771,776	747,125
Interest penalty assessments	725,742	146,677
Reciprocal exchange with other States	812,583	1,789,265
Miscellaneous	541,784	540,820
Totals	<u>\$ 39,520,947</u>	<u>\$ 37,099,162</u>

Unclaimed Property administrative expenses as reported in the Treasurer's Annual report are as follows:

	<u>2000-2001</u>	<u>1999-2000</u>
Salaries and fringe benefits	\$1,900,906	\$1,691,026
Data processing and hardware	883,587	600,610
All other	313,763	148,606
Totals	<u>\$3,098,256</u>	<u>\$2,440,242</u>

In addition, during the 2000-2001 fiscal year, \$742,514 in fees were netted against unclaimed property receipts. Such fees consisted of fees for participation in out-of-state audits and other percentage based fee relationships. These receipts and fees are not recorded on the books of the State Comptroller, but are reported in the Treasurer's Annual Report.

The Unclaimed Property Division also receives abandoned stocks, bonds and mutual funds as authorized under Section 3-56a and Section 3-56b of the General Statutes. According to the Treasurer's Annual Report, the estimated market values were as follows:

	<u>June 30, 2001</u>	<u>June 30, 2000</u>
Stocks and bonds	\$ 53,362,736	\$ 49,569,572
Mutual funds	<u>13,373,611</u>	<u>14,420,453</u>
Totals	<u>\$ 66,736,347</u>	<u>\$ 63,990,025</u>

Section 3-69a of the General Statutes states, in part, that unclaimed property claims allowed shall be paid from the unappropriated resources of the General Fund. Unclaimed property cash disbursements were \$9,838,935 and \$9,475,207 for the 2000-2001 and 1999-2000 fiscal years, respectively.

Second Injury and Compensation Assurance Fund:

The operations of this fund are provided for by various statutes of the Workers' Compensation Act, Chapter 568, of the General Statutes (notably Sections 31-310 and 31-349 through 31-355a). This Act provides protection for employees suffering occupational injuries or diseases and establishes criteria determining whether benefits due employees are to be paid by the employers (or their insurance carrier) or out of the Second Injury Fund (SIF). The Treasurer is the custodian of the SIF. Per Section 31-349e of the General Statutes, there is an advisory board to advise the custodian of the SIF on matters concerning administration, operation, claim handling and finances of the fund.

Comments regarding the financial operations of this fund are included under separate cover in our Report on the State Treasurer – State Financial Operations for the fiscal year ended June 30, 2001.

PERFORMANCE REVIEW:

In accordance with Section 2-90 of the General Statutes, audits conducted by the Auditors of Public Accounts may include an examination of performance in order to determine an Agency's effectiveness in achieving expressed legislative purposes. We have conducted such a review of the Investigations Unit within the Second Injury Fund (SIF).

Pursuant to Section 31-349a of the General Statutes, Special Investigators in the SIF investigate indications of claim fraud and employers' compliance with the law that mandates workers' compensation insurance coverage. Section 31-288 of the General Statutes states that whenever an investigator finds that an employer is not in compliance with the workers' compensation insurance requirements, such investigator shall issue a citation requiring such employer to appear at a hearing before the Workers' Compensation Commission. The Workers' Compensation Commission can assign the Special Investigators to examine insurance coverage and penalties for noncompliance can

total \$55,000. The number of actual SIF claims that require investigation have been decreasing because the Second Injury Fund stopped accepting new claims for injuries occurring on or after July 1, 1995, in accordance with Public Act 95-277. According to the State Treasurer's Annual Report, the number of open active SIF claims have dropped from 5,700 to 4,671 since 1995. Some investigations are conducted by outside vendors on contract with the State Treasurer's Office.

Special Investigators also conduct asset searches to determine whether employers without insurance coverage have the ability to repay the SIF for claims paid on their behalf. According to the Annual Report of the State Treasurer, recoveries of amounts paid on uninsured employer cases for the fiscal year ended June 30, 2001 amounted to \$504,003.

There are six Special Investigators in SIF and they are assigned to specific Workers' Compensation Commission districts throughout the State. The average caseload is about 30 open cases per investigator. Special Investigators are assigned cases by both the Second Injury Fund and the Workers' Compensation Commissioners. It is estimated that 65 percent of the Special Investigators caseload consists of cases assigned by the Workers' Compensation Commission; however, all of the costs of operating the Investigations Unit are paid with Second Injury Fund monies.

Our review indicated that Special Investigators in the SIF appear to be meeting the statutory mandate of Section 31-349a to investigate SIF claims and employers' compliance. Because the Workers' Compensation Commission (WCC) also receives programmatic benefits from the efforts of the Special Investigators in the SIF, we believe that some portion of this cost should be allocated to the Workers' Compensation Commission. Since the Special Investigators in the SIF play an integral role in enabling the Workers' Compensation Commission to meet its goals and objectives; have a direct reporting relationship to Workers' Compensation Commissioners; and are physically located at WCC district offices, we believe it would be more efficient and effective if the Investigations Unit was part of the Workers' Compensation Commission organization.

The following findings resulted from our performance review of the Second Injury Fund Investigations Unit.

Placement of the Investigations Unit within the Second Injury Fund:

Criteria: Pursuant to Section 31-349a of the General Statutes, investigators in the State Treasurer's Second Injury Fund (SIF) investigate claims and employers' compliance with the law that mandates workers' compensation coverage. The Agency that is statutorily responsible to ensure that employers carry out their legal responsibilities, among other issues pertaining to workers' compensation laws, is the Workers' Compensation Commission (WCC). Services provided by the Investigation Unit to satisfy requests made by other agencies to administer the program should be reimbursed, if applicable.

Condition: Currently the Investigation Unit is located within the Office of the State Treasurer and receives approximately 65 percent of their caseload from the Workers' Compensation Commission, and the remainder from the Second

Injury Fund (SIF). Many cases presented to the investigators are requests to verify whether an employer has insurance coverage or, in the case of an uninsured company, whether the employer has assets the State can claim. As the SIF is responsible to pay injured workers' benefits only after the Workers' Compensation Commissioner orders the Fund to pay, it seems the investigators' work is more closely related to the operations and objectives of the WCC. Organizationally, it appears the Unit would be more efficient if it operated under the direct control of the Workers' Compensation Commission instead of an Assistant Treasurer within the Treasury. We also noted that for the year ended June 30, 2001, the SIF incurred \$876,734 of expenses for investigations and the WCC did not reimburse for the portion of the services provided to them.

Cause: Public Act 95-277 amended Section 31-349 of the General Statutes to close the SIF to most claims after July 1, 1995. This Act served to considerably reduce the Unit's caseload pertaining to SIF cases and cause the Unit to handle an increasing caseload directly from the Workers' Compensation Commission.

Effect: The Investigations Unit may not be used as efficiently or effectively as possible if they are not under the direct control of the Workers' Compensation Commission. Costs of the Unit are not being reimbursed appropriately.

Recommendation: The costs of operating the Office of the Treasurer's Second Injury Fund Investigations Unit should be allocated between the Second Injury Fund and the Workers' Compensation Commission and consideration should be given to placing the Treasurer's Second Injury Fund Investigations Unit under the direct control of the Workers' Compensation Commission. (See Recommendation 1.)

Agency Response: "The Fund's Improvement Project Task Force is in the process of identifying efficiencies in the areas of Investigations and Uninsured Employer Claims and will evaluate the audit recommendation of allocating investigators cost as it relates to the Commission.

In 1993, jurisdiction over Fund investigators was transferred from the State Treasurer's office to the Workers' Compensation Commission (PA 93-228) followed two years later with the transfer of the investigators back to the Treasurer's Office (PA 95-277). State Legislature minutes appear to indicate the Investigations Unit was transferred to the Fund to ensure proper supervisory oversight in order to aggressively pursue all claims, and to ensure that compensation from the Fund was awarded to valid claimants. The Commission receives the first notice of an uninsured employer claim and the investigation assignments occur as a result of a referral through Commission staff. The Commissioners do not directly provide instruction to the

investigators. This office, therefore, does not support the Audit recommendation that it undertake a study to determine the efficacy of transferring the investigators back to the Workers' Compensation Commission.

In addition, the work of the investigators has not been significantly impacted by the statutory closure to second injury claims. The Fund has responsibility for second injury claims prior to July 1, 1999 including uninsured employer claims, widow and dependent benefit claims, and concurrent employment claims. The last actuarial review performed in 1998 projected that the Fund's liability for these claims extend to the year 2016."

Auditors' Concluding Comment:

Clearly, the Second Injury Fund Investigations Unit should be under the control of the Workers' Compensation Commission which has the ability to determine, adjudicate, and enforce law under the Workers' Compensation Act, rather than the Second Injury Fund which inherits the responsibility to pay injured workers only when the Workers' Compensation Commissioner orders it to do so.

Lack of Equipment Resources in the Second Injury Fund Investigations Unit:

Criteria: The Investigations Unit within the Second Injury Fund should be provided with the relevant tools and resources needed to fulfill their job duties and to help them meet the program's goals and objectives in an efficient and effective manner.

Condition: Resources common to provide the appropriate level of investigative services are currently not provided to the investigators within the Second Injury Fund. Tools such as video recording devices and portable computers can enhance the efficiency and effectiveness of the operations of the Second Injury Fund investigators. Although there are seven investigators, only two video recording devices are available and the other five are no longer in service. We also believe it would be more efficient to provide each investigator with a laptop computer to facilitate the reporting process.

Cause: Certain items such as video cameras have not been replaced when broken; laptops have been considered, but never received.

Effect: Investigators are unable to perform their duties as efficiently and effectively as possible.

Recommendation: Investigators should be provided with the tools needed to perform their duties efficiently and effectively. (See Recommendation 2.)

Agency Response: "The Fund agrees with this finding and the Second Injury Fund Division has

already begun processing the necessary requests for equipment upgrades in the current fiscal year.”

CONDITION OF RECORDS

Timeliness of Deposits:

Criteria: Section 4-32 of the General Statutes requires each State agency to deposit and account for revenues within 24 hours of receipt.

Condition: We were notified by Treasury officials of three incidents when cash received by the Unclaimed Property Division was not deposited within 24 hours. The instances involved receipts of \$27,919, \$1,800, and \$918 that were deposited and accounted for one, two and seven days late, respectively. The late deposits were reported to the Governor and other State Officials on January 23, 2002.

Cause: Staff turnover and reorganization may have contributed to this condition.

Effect: Receipts were not deposited in a timely manner as required by Section 4-32 of the General Statutes. Delays in depositing compromise physical control over undeposited checks.

Recommendation: The Office of the State Treasurer's Unclaimed Property Division should deposit in accordance with Section 4-32 of the General Statutes. (See Recommendation 3.)

Agency Response: "The three late deposits as noted by the audit comment resulted from employee errors. The Unclaimed Property Division's mail receipts procedures were strengthened by assigning specific responsibility, providing for additional supervisory oversight and providing for more stringent guidelines regarding the security of receipts. In addition, the specific employees responsible for the violations were counseled, retrained and one employee received a written warning. We will continue to make every effort to make timely deposit of receipts."

Holder Reporting and Publishing of Property Owners' Names:

Criteria: Items that are escheated to the State include cash, stock, mutual funds, and safe deposit box contents including savings bonds. Banks and other organizations report their holdings to the Unclaimed Property Division annually. In most cases the holders send the unclaimed property to the Treasury; in the case of safe deposit box contents, Treasury staff are required to physically retrieve the items from the banks. In accordance with Section 3-62g of the General Statutes, the Treasurer shall assume custody of this property and be responsible for all claims thereto. After the Treasury receives the unclaimed property, the Division usually posts the owners' names to the database of owners. This database is then used to accumulate

the information for the statewide publication of owners' names. Under Section 3-66a of the General Statutes, the Treasurer must publish the names of owners whose property value exceeds a minimum of fifty dollars.

Condition:

Our review disclosed property in the custody of the Unclaimed Property Division that was not loaded to the database of owners' names. As these names were not loaded to the Division's database, they were also not published as required by Section 3-66a of the General Statutes. Most of the property listed below was submitted by holders for the reporting years of 1998, 1999 and 2000, but not loaded to the system as of December 31, 2001. Property not loaded appropriately includes:

- 252 holder reports that represented \$6,195,702 of unclaimed cash and 641,036 shares of unclaimed stock; the number of actual owners that this property represented could not readily be determined.
- 28 banks continued to hold the contents of 1,184 safe deposit boxes that were reported as abandoned property but not yet retrieved by Treasury staff. These contents should have been in the State Treasurer's custody, if not auctioned in accordance with Section 3-68a of the General Statutes. Although savings bonds were retrieved in previous years, they were not loaded to the system as abandoned property due to owners.
- In one case 38,104 shares of stock were loaded to the database before being verified as accurate. The reported shares were not verified as received by the State and owner names were posted as if they owned shares of another company's stock.

We also noted that the Treasury publishes names on the Internet for less than the minimum required by statute. According to the Treasurer's Annual Report, the amount of actual checks processed for the fiscal year ended June 30, 2001 increased 160 percent from the prior fiscal year from 4,466 to 11,605 checks processed while the actual cash returned to owners increased only 4 percent from \$9,475,207 to \$9,838,935. Publishing claims less than the required minimum does not appear to be cost effective or efficient.

Cause:

The staff usually responsible for processing holder reports was required by the Division to address other important projects. Logistical problems associated with the storage of property prior to sale prevented timely retrieval of safety deposit box contents. The cause for publishing claims less than the statutory minimum was not determined.

Effect:

Delays in collecting safe deposit box contents from banks may compromise controls over unclaimed assets; failure to record all owner names in the

database will cause the publication of these owners' names to be delayed; and noncompliance with the publication minimum appears to have placed a substantial administrative burden on the claims processing staff.

Recommendation: The Office of the State Treasurer's Unclaimed Property Division should comply with Section 3-57a of the General Statutes and their own internal procedures to appropriately collect and manage all unclaimed property including contents from safety deposit boxes. The Treasury should also comply with the publication requirements of Section 3-66a of the General Statutes by loading all holder reports prior to publication and consider cost effectiveness when using other means to publish unclaimed property. (See Recommendation 4.)

Agency Response: "There are four audit issues included in this recommendation that require a response.

First, the Unclaimed Property Division has now loaded to its owner database all safe deposit box contents that were auctioned in 1998. Property auctioned in October 2001 is first being reconciled and verified and then loaded onto the owner database in accordance with UCPD guidelines. In addition, UCPD has begun scheduling safe deposit box pick-ups now that the recent disposal of auctioned property has provided the necessary space in the unclaimed property vault that holds safe deposit box contents.

Second, as the auditors have identified, 252 holder reports out of 2,185 received since 1998 have not been loaded onto the database system due to delays by the holders in identifying some owners' names and, in some cases, because the holder reports do not agree with the cash or stock certificates received.

The 38,104 shares not verified as noted by the auditors were part of 140,000 shares that were uploaded to the database from one holder report submitted on diskette. The Unclaimed Property Division loaded all the information onto the database in order to permit identified owners of stock to collect their property. New procedures are being drafted to instruct the staff on how to handle transfers to the database of this type of incomplete information if received in the future.

Third, the Unclaimed Property Division was aware of a shortage in the number of staff required to record, verify and reconcile holder report information onto the database and hired an additional staff member in September 2001.

Fourth, my administration will continue to publish all amounts of unclaimed property over \$10 on the World Wide Web using the State of Connecticut Office of the Treasurer web site. Although the auditors have interpreted

Section 3-66a of the CGS as only requiring property amounts above \$50 to be published, the statute does not restrict property amounts under \$50 from being published.

It is, and will continue to be, the policy of this Administration to do the necessary outreach, within reason, to return unclaimed property to its rightful owners as part of our ongoing fiduciary responsibility.”

Claim Payment Errors in the Unclaimed Property Division:

Criteria: In accordance with Section 3-62g of the General Statutes, upon delivery of abandoned property, the Treasurer shall assume custody and be responsible for all claims thereto. When returning stock to their rightful owners, the Treasury should remit all dividends, considering the effects that corporate actions have on amounts due to the claimants. Section 3-70a specifies that the Treasurer shall consider each claim within ninety days after it is filed.

Condition: The Unclaimed Property Division of the State Treasurer’s Office is responsible to return any cash, shares and proceeds from corporate actions, such as dividends to their rightful owners. During our test of claim disbursements we noted that, of the stock claims tested, the complex claims that included dividend payments were all calculated and paid incorrectly. Total payment errors accumulated to \$24,857; these amounts represented underpayments of \$20,429 and overpayments of \$4,428. The net effect of these errors on payments to claimants resulted in two claimants being overpaid \$686 and three claimants being underpaid a total of \$16,687. Our audit also revealed that stock claims are not processed in a reasonable amount of time; five of ten stock claims took between 115 and 360 days to process. A review of current Agency records found that, of 25 stock claims reviewed, ten were outstanding for over 400 days.

Cause: Stock claims can be very complex and have corporate actions that make calculation of claims very difficult. The Division’s automated system does not always record corporate action amounts due to owners accurately; employees and management appear to have placed too much reliance on the system and do not recognize errors when processing or approving claims.

Effect: As evidenced above, the results of our tested sample did not provide us with any assurances that complex stock claims with dividends were paid out accurately.

Recommendation: The Treasurer’s Unclaimed Property Division should pre-audit complex stock claims before the claims are paid; this pre-audit process should include a manual recalculation of all dividend-related stock claims to provide assurances that such claims are paid correctly. The Division should also recover any overpayments and fully compensate those claimants who were

underpaid. (See Recommendation 5.)

Agency Response: “A senior Unclaimed Property Division supervisor will review all complex claims before released for final payment processing.

The two claimants who were overpaid \$686 have additional claims pending and the Unclaimed Property Division will deduct the overpayments made on the previous claims from these new claims.”

Stock Inventory in the Unclaimed Property Division:

Criteria: The State Treasurer’s Unclaimed Property Division should maintain a stock inventory that is completely independent of the custodian’s inventory record. Changes affecting the inventory records should be accumulated through the appropriate source documents and provide a clear audit trail. The stock inventory should be reconciled to the custodian’s records. The procedures required to facilitate this process, as well as procedures to determine when sale of stock should occur under Section 3-68a of the General Statutes, should be in writing. The Division should provide each employee with a copy of the procedure manual.

Condition: The Unclaimed Property Division does not maintain a stock inventory that is completely independent of their custodian’s records as they do not incorporate a separate list of disbursements to update their records and a clear audit trail is not always provided. The Division’s reconciliation does not clearly explain all timing differences, income items, and total cash held by the custodian. The process of accounting and reconciling the stock inventory, as well as the possible sale of this inventory is not documented in written procedures. Staff members of the Unclaimed Property Division do not each have their own procedure manual.

Cause: The reconciliation process as established, needs further improvement.

Effect: Potential errors or omissions by the stock custodian may not be detected if the Division fails to keep separate, independently prepared records of securities. Written procedures aid in the understanding and management of policies and procedures.

Recommendation: The Office of the State Treasurer’s Unclaimed Property Division should improve controls over the maintenance and reconciliation of the escheated stock inventory and provide each employee with a comprehensive procedure manual. (See Recommendation 6.)

Agency Response: “Following the prior audit, additions and deletions to the stock inventory are being reconciled using records independent of the stock inventory changes

reported by the custodian, as recommended by the auditors of public accounts. No errors, omissions or irreconcilable differences have been recorded using the new reconciliation process.

During the fiscal year ended June 30, 2001, the custodian agreement was assigned to another party requiring that two inventory reconciliations be performed for several months. Until we were able to reconcile the stock inventory to the new custodian's records, the full implementation of the new reconciliation process had to be delayed."

Accumulation of Stock and Mutual Fund Securities by the Unclaimed Property Division:

Criteria: Section 3-69a of the General Statutes requires that all funds received, including the net proceeds from the sale of property, shall be deposited in the General Fund.

According to 3-68a, subsection (d), of the General Statutes, the Treasurer shall proceed with the liquidation of most all abandoned property within one year after its delivery to the Treasury except for abandoned stock certificates which shall not be liquidated earlier than three years after it was delivered unless the Treasurer finds that it is in the best interests of the state to do so. Section 3-68a, subsection (d) further explains that if the Treasurer sells any stock certificates before the expiration of such three-year period, any person making a claim pursuant to this part before the end of the three-year period is entitled to either the proceeds of the sale of the securities or the market value of the securities at the time the claim is made, whichever amount is greater. If the Treasurer does not sell the stock, a person making a claim is entitled to their shares of stock, and any related dividends, splits or other related corporate actions.

Condition: When unclaimed cash is received, the revenues are deposited into the State's General Fund until the rightful owner claims them. During the fiscal year ended June 30, 2001, the State Treasury received approximately \$40 million in unclaimed funds and returned \$9,800,000 to the rightful owners. The net cash remaining of \$30,200,000 was transferred to the General Fund throughout the year. During this time, the State retained the beneficial use of the cash for Statewide operations and invested any excess cash in the State's Short Term Investment Fund. Only property that has been converted into cash can be transferred to the General Fund.

According to the Treasurer's Annual Report for the fiscal year ended June 30, 2001, the Treasury's Unclaimed Property Division holds a securities portfolio valued at \$66,736,347. In accordance with Section 3-69a of the General Statutes, the Treasurer is permitted to sell the securities inventory and forward the proceeds of the sale, in cash, to the General Fund.

In this report, we have disclosed our concerns regarding the receipting, disbursing, inventorying and reconciling of the stock portfolio. The Division currently expends a substantial amount of resources to maintain a custodial bank, software and services to account for and maintain this portfolio. Although the State has been receiving dividend income from this portfolio; the annual yield is far below what the State earns on the General Fund cash in the Short Term Investment Fund. Considering these issues and others noted above, it appears that a sale of such securities may be in the best interests of the State.

Cause: The Division does not have policies or procedures in place to determine if it is the best interest of the State to sell stocks. Also, selling stocks has not been a priority for the Division because of other concerns within the Division.

Effect: Cash is not escheated to the General Fund as originally intended. Processing complex stock claims and accounting for the sizeable stock inventory has proven to include difficult, time-consuming tasks, and appears to have placed an administrative burden on the Division's staff.

Recommendation: The Unclaimed Property Division within the Office of the State Treasurer should develop policies and procedures to determine the most efficient and effective way to manage the sale of the securities inventory, and take appropriate action to transfer proceeds from the sale to the General Fund. (See Recommendation 7.)

Agency Response: "The Unclaimed Property Division is formalizing policies and procedures to document the management, retention and disposal of the securities inventory held on behalf of unclaimed property owners. The last major liquidation of eligible stock certificates occurred in 1998, under a previous administration, without a plan for orderly disposal and in disregard of the State statutes governing the selection of contractor services as noted in the Auditors of Public Accounts report for the fiscal year ended June 30, 1998.

As noted by the auditors, State Statutes require abandoned stock certificates not be liquidated earlier than three years after delivery to the Office of the Treasurer unless the Treasurer finds that it is in the best interest of the state to do so. The statutory option for disposal of stock certificates prior to the three year retention period puts the state at market risk for potential future liability in that any person making a claim pursuant to the end of the three year period is entitled to either the proceeds of the sale of the securities or the market value of the securities at the time the claim is made, whichever is greater.

A preliminary review of the unclaimed property stock inventory is being performed in order to identify stock certificates available for disposal and determine the market value of those certificates. Once this has been

completed, the Office of the Treasurer will be ready to proceed with the selection of an outside contractor, per Sec 4-213 of the CGS, to dispose of the eligible stock certificates.”

Contract Management:

Criteria: In accordance with Section 4-98 of the General Statutes, State appropriations should not be obligated for the payment of services until a properly executed contract is in place. Section 4-215 of the General Statutes requires that personal service agreements be awarded through a competitive selection process.

Condition: We noted that a contract for the provision of consultant services related to the Pension Fund Management Division was not signed and fully-executed until after the beginning of the contract period. Contractual services had a start date of January 1, 2001 but the State Treasurer and the consultant did not sign the contract until October 27, 2001. Payment for consulting services rendered for the period January 1, 2001 to September 30, 2001 was made in December 2001 in the total amount of \$416,250. Another contract for executive search services with a start date of May 4, 2001 was not signed until June 8, 2001.

In the course of our review of administrative payments for the operation of the Unclaimed Property Division, we noted a contract for the provision of claims processing services that resulted in significant unanticipated payments. The contract was originally intended to require an annual base payment of \$365,000 with provision for additional charges if volume exceeded the base. Actual payments made for the period from July 1, 2000 through June 30, 2001 totalled \$708,022. We found that the contract was not written to adequately define what services qualified for the additional fees above the base fee and the growth of additional charges was not monitored.

Cause: Lack of administrative oversight may have contributed to the condition regarding consultant contracts.

Effect: The appropriation encumbrance system does not operate as intended if fund commitments are made after obligations are incurred. Without clearly defining the deliverables that should result in billable fees, contract payments cannot be adequately anticipated or controlled.

Recommendation: The Treasurer’s Office should improve contract management procedures and comply with Sections 4-98 and 4-215 of the General Statutes regarding the management of contracts paid for with State funds. (See Recommendation 8.)

Agency Response: “The Office of the Treasurer concurs with this recommendation. Present

contract approval procedures require that the contractor, Treasurer, and Attorney General formally agree and approve contracts before services are provided. The delay in the signing of the two Private Investment Fund contract agreements was related to certain issues involving the services to be provided under the contract renewal negotiation.

The need for a new Unclaimed Property Division service contract by the end of this fiscal year is recognized and an RFP has been prepared and issued.

The Business Office regularly reissues to all division heads within the Office of the Treasurer the contract approval procedures. The procedures were distributed in April 1999 and October 2001 and will again be redistributed to senior staff members with a reminder to strictly adhere to this policy.”

RECOMMENDATIONS

Status of Prior Audit Recommendations:

Our prior audit examination resulted in thirteen recommendations. The following is a summary of those recommendations and the action taken by the State Treasury.

- The Treasury should comply with existing procedures to ensure all receipts are deposited and accounted for in a timely manner. This recommendation has been repeated as current recommendation 3.
- All escheated property received by the Treasurer's Unclaimed Property Division should be recorded in the database of owners and the Division should devote more resources to address the need for updating owners' records to a current status. This recommendation has been resolved.
- The Treasurer's Unclaimed Property Division should have appropriate segregation of duties for the processing of claims and the approvals of such claims should be done by those individuals with a level of authority commensurate with their job responsibilities. This recommendation has been resolved.
- The Treasurer's Unclaimed Property Division should take steps to ensure that holder reports are entered into the database completely, accurately and in a timely manner so that the database of owners appropriately reflects owners of unclaimed property. This recommendation has been restated to reflect current conditions. See current Recommendation 4.
- The Treasurer's Unclaimed Property Division should maintain a record of stock and mutual fund transactions independent from the custodian's record and address reconciling items in a timely manner. This recommendation has been restated and is presented as Recommendation 6.
- The Treasurer's Office should more fully utilize human resources by ensuring that job duties and responsibilities are commensurate with the titles and salaries associated with personnel positions. We found no additional positions that contained inconsistent duties during the current review.
- The Treasurer's Office should comply with Section 5-248i of the General Statutes and have a signed agreement in place for all work at home situations. The Treasurer's Office implemented procedures to ensure compliance with documentation requirements for work at home situations.
- The Treasurer's Office should improve contract management procedures, properly allocate costs and comply with Sections 4-98, 4-215 and 4-219 of the General Statutes regarding the management of contracts paid for with State funds. Repeated as Recommendation 8.

- The Treasurer’s Office should comply with the State Comptroller’s directives regarding the use of petty cash funds. This recommendation has been resolved.
- The Treasurer’s Office should comply with Section 4-33a of the General Statutes and report all instances of misuse of State property to the Auditors of Public Accounts and the State Comptroller. No violations of this statute were noted during our current review..
- The Treasurer’s Office should more closely monitor the internal computer network for signs of unauthorized usage. Our current review disclosed no further findings.
- The Treasurer’s Office should only provide State vehicles to employees when the vehicle provides the most effective means of providing transportation in the conduct of Agency business. This recommendation has been resolved.
- The Treasurer’s Office should comply with the Statewide guidelines regarding use of cellular phones. This recommendation has been resolved.

Current Audit Recommendations:

The following recommendations resulted from our current review.

- 1. The costs of operating the Office of the Treasurer’s Second Injury Fund Investigations Unit should be allocated between the Second Injury Fund and the Workers’ Compensation Commission and consideration should be given to placing the Treasurer’s Second Injury Fund Investigations Unit under the direct control of the Workers’ Compensation Commission.**

Comments:

Currently the Investigations Unit is located within the Office of the State Treasurer and receives approximately 65 percent of their caseload from the Workers’ Compensation Commission (WCC), and the remainder from the Second Injury Fund (SIF). Many cases presented to the investigators are requests to verify whether an employer has insurance coverage or, in the case of an uninsured company, whether the employer has assets the State can claim. As the SIF is responsible to pay injured workers’ benefits only after the Workers’ Compensation Commissioner orders the Fund to pay, it seems the investigators’ work is more closely related to the operations and objectives of the WCC. Organizationally, it appears the Unit would be more efficient if it operated under the direct control of the Workers’ Compensation Commissioner instead of an Assistant Treasurer within the Treasury.

- 2. Investigators should be provided with the tools needed to perform their duties efficiently and effectively.**

Comments:

Resources common to provide the appropriate level of investigative services are currently not provided to the investigator within the Second Injury Fund. Although seven investigators are employed in the unit, only two video cameras are in service. We also believe it would be more efficient to provide each investigator with a laptop computer to facilitate the reporting process.

3. The Office of the State Treasurer's Unclaimed Property Division should promptly deposit in accordance with Section 4-32 of the General Statutes.

Comments:

We were notified by Treasury officials of three incidents when cash received by the Unclaimed Property Division was not deposited within 24 hours. The instances involved receipts of \$27,919, \$1,800, and \$918 that were deposited and accounted for one, two and seven days late, respectively. The late deposits were reported to the Governor and other State Officials on January 23, 2002.

4. The Office of the State Treasurer's Unclaimed Property Division should comply with Section 3-57a of the General Statutes and their own internal procedures to appropriately collect and manage all unclaimed property including contents from safety deposit boxes. The Treasury should also comply with the publication requirements of Section 3-66a of the General Statutes and consider cost effectiveness when using other means to publish unclaimed property.

Comments:

During our audit, it was discovered that certain types of escheated property were not always loaded to the database of owners' names. As these names were not loaded to the Division's database, they were also not published as required by Section 3-66a of the General Statutes. Most of the property was submitted by holders for the reporting years of 1998, 1999 and 2000, but not loaded to the system as of December 31, 2001.

5. The Treasurer's Unclaimed Property Division should pre-audit complex stock claims before the claims are paid; this pre-audit process should include a manual recalculation of all dividend-related stock claims to provide assurances that such claims are paid correctly. The Division should also recover any overpayments and fully compensate those claimants who were underpaid.

Comments:

The Unclaimed Property Division of the State Treasurer's Office is responsible to return any cash, shares and proceeds from corporate actions, such as dividends to its rightful owners. During our test of claim disbursements we noted that, of the stock claims tested, the complex claims that included dividend payments were all calculated and paid incorrectly. Total payment errors accumulated to \$24,857; these amounts represented underpayments of

\$20,429 and overpayments of \$4,428. The net effect of these errors on payments to claimants resulted in two claimants being overpaid \$686 and three claimants being underpaid a total of \$16,687. Our audit also revealed that stock claims are not processed in a reasonable amount of time; five of ten stock claims took between 115 and 360 days to process. A review of current Agency records found that, of 25 stock claims reviewed, ten were outstanding for over 400 days.

6. The Office of the State Treasurer's Unclaimed Property Division should improve controls over the maintenance and reconciliation of the escheated stock inventory and provide each employee with a comprehensive procedure manual.

Comments:

The Unclaimed Property Division does not maintain a stock inventory that is completely independent of their custodian's records as they do not incorporate a separate list of disbursements to update their records and a clear audit trail is not always provided. The Division's reconciliation does not clearly explain all timing differences, income items, and total cash held by the custodian. The process of accounting and reconciling the stock inventory, as well as the possible sale of this inventory is not documented in written procedures.

7. The Unclaimed Property Division within the Office of the State Treasurer should develop policies and procedures to determine the most efficient and effective way to manage the sale of the securities inventory and take appropriate action to transfer proceeds from the sale to the General Fund.

Comments:

According to the Treasurer's Annual Report for the fiscal year ended June 30, 2001, the Treasury's Unclaimed Property Division is holding a securities portfolio valued at \$66,736,347. The Treasurer should seriously consider whether it is in the best interests of the State to sell the securities inventory and forward the proceeds of the sale, in cash, to the General Fund in accordance with Section 3-69a of the General Statutes.

8. The Treasurer's Office should improve contract management procedures, properly allocate costs and comply with Sections 4-98 and 4-215 of the General Statutes regarding the management of contracts paid for with State funds.

Comments:

We noted that a contract for the provision of consultant services related to the Pension Fund Management Division was not signed and fully-executed until 10 months after the beginning of the contract period. Contractual services had a start date of January 1, 2001 but the State Treasurer and the consultant did not sign the contract until October 27, 2001. Payment for consulting services rendered for the period January 1, 2001 to September 30, 2001 was made in December 2001 in the total amount of \$416,250.

In the course of our review of administrative payments for the operation of the Unclaimed Property Division, we noted a contract for the provision of claims processing services that resulted in significant unanticipated payments. The contract was originally intended to require an annual base payment of \$365,000 with provision for additional charges if volume exceeded the base. Actual payments made for the period from July 1, 2000 through June 30, 2001 totalled \$708,022. We found that the contract was not written to adequately define what services qualified for the additional fees above the base fee and the growth of additional charges was not monitored.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes we have audited the books and accounts of the State Treasurer for the fiscal year ended June 30, 2001. This audit was primarily limited to performing tests of the Agency's compliance with certain provisions of laws, regulations and contracts, and to understanding and evaluating the effectiveness of the Agency's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations and contracts applicable to the Agency are complied with, (2) the financial transactions of the Agency are properly recorded, processed, summarized and reported on consistent with management's authorization, and (3) the assets of the Agency are safeguarded against loss or unauthorized use. The financial statement information related to the Departmental Operations of the State Treasurer for the fiscal year ended June 30, 2001, is included as a part of our Statewide Single Audit of the State of Connecticut for that fiscal year.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial-related audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the State Treasurer complied in all material or significant respects with the provisions of certain laws, regulations and contracts and to obtain a sufficient understanding of the internal control to plan the audit and determine the nature, timing and extent of tests to be performed during the conduct of the audit.

Compliance:

Compliance with the requirements of laws, regulations and contracts applicable to the State Treasurer's Office is the responsibility of the State Treasurer's Office management.

As part of obtaining reasonable assurance about whether the Agency complied with laws, regulations and contracts, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the Agency's financial operations for the fiscal year ended June 30, 2001, we performed tests of its compliance with certain provisions of laws, regulations and contracts. However, providing an opinion on compliance with these provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial or less than

significant instances of noncompliance, which are described in the accompanying “Condition of Records” and “Recommendations” sections of this report.

Internal Control over Financial Operations, Safeguarding of Assets and Compliance:

The management of the State Treasurer’s Office is responsible for establishing and maintaining effective internal control over its financial operations, safeguarding of assets, and compliance with the requirements of laws, regulations and contracts applicable to the Agency. In planning and performing our audit, we considered the Agency’s internal control over its financial operations, safeguarding of assets, and compliance with requirements that could have a material or significant effect on the Agency’s financial operations in order to determine our auditing procedures for the purpose of evaluating the State Treasurer’s financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations and contracts, and not to provide assurance on the internal control over those control objectives.

However, we noted certain matters involving the internal control over the Agency’s financial operations, safeguarding of assets, and/or compliance that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over the Agency’s financial operations, safeguarding of assets, and/or compliance that, in our judgment, could adversely affect the Agency’s ability to properly record, process, summarize and report financial data consistent with management’s authorization, safeguard assets, and/or comply with certain provisions of laws, regulations and contracts. We believe the following findings represent reportable conditions: control deficiencies found in the processing of stock claims by the Unclaimed Property Division; the need to improve controls over the maintenance and reconciliation of the stock and mutual fund inventory records in the Unclaimed Property Division; the need for procedures to manage the sale of stocks and mutual funds held by the Unclaimed Property Division; and the need to improve controls over the management of contracts paid for with State funds.

A material or significant weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with certain provisions of laws, regulations and contracts or the requirements to safeguard assets that would be material in relation to the Agency’s financial operations or noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions to the Agency being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over the Agency’s financial operations and over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material or

significant weaknesses. However, we believe that none of the reportable conditions described above is a material or significant weakness.

We also noted other matters involving internal control over the Agency's financial operations and over compliance which are described in the accompanying "Condition of Records" and "Recommendations" sections of this report.

This report is intended for the information of the Governor, the State Comptroller, the Appropriations Committee of the General Assembly and the Legislative Committee on Program Review and Investigations. However, this report is a matter of public record and its distribution is not limited.

CONCLUSION

In conclusion, we wish to express our appreciation for the cooperation and courtesies extended to our representatives by the personnel of the State Treasurer's Office during the course of our examination.

Thomas Willametz
Administrative Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts