OBM | Office of Internal Audit

Department of Commerce

Unclaimed Funds Audit

Audit Period: July 1, 2010 to March 31, 2011

Report number: 2011-COM-02 **Issuance date: April 26, 2011**

Contents

Executive Summary

Background

The Ohio Department of Commerce Division of Unclaimed Funds (Division) was created to protect Ohio citizens who have inactive accounts with financial institutions and other entities. The Division is responsible for the safekeeping and return of monies designated as "unclaimed." Each year, due to death, inadvertence, or forgetfulness, more than 200,000 people and organizations lose track of monies, rights to monies, and intangible properties in Ohio. Enacted in 1968 to protect people who lost track of their money, the unclaimed funds laws allow the Division to ensure that holders report and/or remit unclaimed funds to the State.

The Division has more than 4,500,000 accounts worth approximately $1,400,000,000 in its custody, and works to locate missing owners and reunite them with their lost assets. The purpose of the Division's Community Outreach Program is to make the public aware that unclaimed funds are being held by the Division on behalf of private individuals and organizations, and to assist in returning those funds to their rightful owners.

The scope of this audit included the processing of non-cash unclaimed items (safekeeping items), the reconciliation or validation of unclaimed funds, and the communication of requirements for unclaimed funds reporting. It also included a review of IT controls in place for the applications, related databases, and interfaces supporting the unclaimed funds processes as well as vendor management. Our audit did not include the processing of unclaimed funds in the form of cash or cash equivalents which is audited by the Auditor of State.

During the audit, OIA identified opportunities for COM to strengthen internal controls and improve business operations. A summary, along with detailed observations, have been provided. OIA would like to thank COM staff and management for their cooperation and time in support of this audit.

This report is solely intended for the information and use of agency management and the State Audit Committee. It is not intended for anyone other than these specified parties.

Scope and Objectives

OIA staff was engaged to perform assurance work related to the Unclaimed Funds processes at the Department of Commerce. This work was completed between September 20, 2010 and April 13, 2011. The scope of this audit included the following area:

- Unclaimed Funds

The following summarizes the objectives of the review along with a conclusion on the effectiveness of management's internal controls.

Objective	Conclusion[1]
Evaluate the design and effectiveness of COM's controls over the processing of non-cash unclaimed items (i.e. securities, safe deposit box contents, etc.) including receipt, safeguarding of assets, and claim settlement.	**Improvements Needed – See Observation 1 (IT Observations – Security Records)**
Evaluate the design and effectiveness of COM's controls over the process to reconcile or validate reported unclaimed funds with actual unclaimed funds being held by financial institutions and other entities.	**Improvements Needed – See Observation 2**
Evaluate the adequacy of COM's communication to unclaimed funds owners, financial institutions and other entities, related to the unclaimed funds requirements of the ORC and OAC (i.e. public notice, reporting requirements, etc.).	**Well-Controlled**
Evaluate the adequacy of COM's oversight and vendor controls in place for the unclaimed funds processes.	**Well-controlled with Improvements Needed**

[1] Refer to Appendix A for classification of audit objective conclusions.

Summary of Observations

The Summary of Observations and Recommendations includes only those risks which were deemed high or moderate. IT security records and low risk observations and recommendations were discussed with individual agency management and are not part of this report. However, the IT security records and low risk observations and recommendations were considered as part of the audit objective conclusions on the prior page.

No.	Observation	Risk
1.	**Inventory of Safekeeping Items -** Procedures do not include timelines for recording unclaimed items in the system. Items received in 2010 have yet to be recorded in the system. Test results revealed discrepancies between items in the vault and those recorded in the system. Also, duties are not segregated appropriately.	**Moderate**
2.	**Unclaimed Funds Examinations -** Policies and procedures exclude examinations of financial institutions and do not assess a fee or penalty for holder noncompliance. Moreover, procedures around follow-up after the closing examination meeting were not included in their policies and procedures manual.	**Moderate**

Detailed Observations and Recommendations

Observation 1 – Inventory of Safekeeping Items

Ohio Administrative Code (OAC) 1301:10-5-03(C) states, "Upon receipt by the director of the contents of such safe deposit box or other safekeeping repository, along with the inventory report, an inventory of the property shall be performed by the director to determine any discrepancies with the report filed by the holder and to identify that property which the director is statutorily authorized to receive."

The Department of Commerce Division of Unclaimed Funds (Division) is responsible for the safekeeping and return of monies, rights to monies, or intangible property including safe deposit box contents (i.e. safekeeping items) designated as unclaimed. The Division currently has a Safe Deposit Box Log (i.e. receipt tracking spreadsheet) and systematic inventory procedures in place to manage safekeeping items. However, their policies and procedures do not include guidelines regarding when items are to be recorded in the system (Wagers). The time lapse between receipt and when the items are recorded in the Wagers ranged from 0 to over 6 months during 2008 and 2009. Items received in 2010 (starting in early September) have not been recorded in Wagers to date. Test results revealed two of 25 safekeeping accounts tested contained additional items in the vault that were not noted within Wagers. Moreover, the Accountability Section Researcher currently receives safekeeping items, performs the inventory count, and has the ability to record and edit inventory records.

The lack of timely and accurate inventory process and improper segregation of duties increases the risk of missing items or theft.

Recommendation

Consider implementing a formal timeline for inventory in their policies and procedures. In addition, management should consider re-emphasizing the importance of accurate and timely inventory to personnel involved in the process. Furthermore, to reduce the risk of theft of safekeeping items, management should consider, to the extent practicable, converting the items to cash via auction or other means and ensure adequate segregation of duties over the safekeeping items inventory process.

Management Response

All holders, except Life Insurance companies, are required to report/remit unclaimed property, including Safekeeping (SK) items, to the Division by November 1 of each year. As a result, a massive amount of reports/remittances and SK items are received within a short period of time (end of October through first week in December). All these reports have to be processed and the checks deposited within 48 hours pursuant to statute by the limited staff of the Accountability Section. Therefore, priority is given to processing holder reports and deposit of holder remittances. Then, as staff becomes available, the physical inventory of the SK items commences and items are entered into the Wagers System. The time lapse between receipt of SK items and commencement of physical inventory can vary depending upon the volume of holder reports/remittances received in any given year.

Due to personnel limitations, the Accountability Section Researcher is currently the only staff member dedicated full-time to the SK items. Additionally, the Researcher is the only one dedicated full-time to assisting Claims Section Examiners with the payment of SK claims. These duties often are being performed simultaneously, due to the Division's workflow. This results in non-segregation of duties. As a Division policy, 2 employees are required to be present before any SK box is opened. The Researcher has to wait until one of the Accountability employees become available to assist him with the physical count of the SK contents.

To resolve this problem, the Division will recommend changing the reporting date of SK items to February 1 or August 1. By doing this, the processing of November 1 regular holder reports will be completed and Section staff can then concentrate on the receipt, physical inventory, and entry to Wagers, of SK reports.

Regarding the testing of 25 SK boxes, the testing consisted of comparing the actual items to the holder's inventory list, and then comparing that list to what was entered in Wagers. The Auditors selected 25 safe deposit boxes. Two (2) safe deposit boxes out of the 25 tested had one (1) item each listed on the holder's inventory but not entered in Wagers.

This is 2 individual safe keeping items out of several hundred individual items contained in 25 different safe deposit boxes. No items were missing and this was most likely an entry error. Any discrepancies such as this would be noticed and corrected when the items are re-inventoried when payment of a claim is made.

To safeguard against the Researcher having the ability to perform inventory count, record and edit data, we would realign position duties in the Accountability Section to ensure dual control over these procedures.

Risk	Remediation Owner	Estimated Completion Date
Moderate	Superintendent of Unclaimed Funds	September 2011

Observation 2 – Unclaimed Funds Examinations

The Department of Commerce Division of Unclaimed Funds (Division) is responsible for the examination of the records of any holder or person who could be a holder of unclaimed funds in order to determine compliance with Ohio Revised Code (ORC) Chapter 169. Ohio Administrative Code (OAC) 1301:10-3-04 enumerates the factors to be considered by the director in determining whether reasonable cause exists to believe that a holder has failed to comply with ORC Chapter 169 and, therefore, may be subject to an involuntary examination. Additionally, this section illustrates the timetables for the remittance of unclaimed funds that are identified as a result of an examination.

The Compliance Supervisor currently uses a methodology including the factors in OAC 1301:10-3-04(E) to select unclaimed funds holders for examination. However, the recently developed policies and procedures manual exclude examinations of financial institutions and do not assess a fee or penalty for holder noncompliance. Moreover, procedures around follow-up after the closing examination meeting were not included in their policies and procedures manual.

The lack of formal policies and procedures regarding financial institutions and failure to financially penalize those who don't comply with reporting requirements increases the risks of unreported unclaimed funds and noncompliance.

Recommendation

Consider developing formal policies and procedures regarding the examination selection process and follow-up procedures which include sufficient detail to ensure Division compliance with ORC and OAC requirements. Consider performing unclaimed funds examinations of financial institutions. Also, it was noted that the outcome of examinations performed thus far in this fiscal year resulted in substantial findings. Management should consider exercising the option to assess penalties or fees; utilizing the assistance of the Attorney General's Collections Enforcement Division or court orders to encourage compliance with unclaimed funds reporting requirements.

Management Response

The examination selection process is specified in section 1301:10-3-04 (E), O.A.C. under Examination of Accounts and the Division has been following this section since it was enacted. The only issue not addressed in section 1301:10-3-04 (E), O.A.C is the method of selecting companies for examination related to the size of the companies. The criterion is now part of the Compliance Section Field Examination policy and procedures manual.

The follow-up procedures for examinations are specified in section 1301:10-3-04, O.A.C. The O.A.C. requirements are reflected in the Compliance Section Field Examination Policy &

Procedures Manual and include additional procedural detail relating to Closing Review Process.

The Division has a collection process after the presentation of the Total Unclaimed Funds Reporting Liability (TUFRL), but it is not documented in the O.A.C. or the division's policies and procedures. Once the TUFRL is presented to the company's contact they have 30 days to do one of the following:

1) File an Annual Report of Unclaimed Funds for the Total Unclaimed Funds Reporting Liability.
2) File an Annual Report of Unclaimed Funds for the undisputed portion of the Total Unclaimed Funds Reporting Liability and file the Notice of Appeal for any disputed portion.
3) File a Notice of Appeal for the Total Unclaimed Funds Reporting Liability.

The collection procedure begins two (2) weeks after the expiration of the 30 day period by running a Crystal report to identify companies that are two (2) or more weeks overdue. Then those companies with overdue reports are contacted via email. If they fail to respond within seven (7) days, they are contacted by phone. This process continues weekly until a report is received or additional documentation eliminating the findings is received. If the company fails to respond after several phone calls or emails the division may take action as specified in sections 169.12, O.R.C. and section 169.99, O.R.C.

This process has been added to the Division's policies and procedures manual.

The issues of the Division of Unclaimed Funds examining financial institutions, assessment of penalties and interest and utilizing the assistance of the Attorney General's Collections Enforcement Division or court orders to collect unclaimed funds will be reviewed.

Risk	Remediation Owner	Estimated Completion Date
Moderate	Superintendent of Unclaimed Funds	September 2011

Appendix A – Classification of Audit Objective Conclusions and Observations

Classification of Audit Objective Conclusions

Conclusion	Description of Factors
Major Improvements Needed	Weaknesses are present that could potentially compromise achievement of its overall purpose. The impact of weaknesses on management of risks is widespread due to the number or nature of the weaknesses.
Improvements Needed	Weaknesses are present that compromise achievement of one or more control objectives but do not prevent the process from achieving its overall purpose. While important weaknesses exist, their impact is not widespread.
Well-controlled with Improvements Needed	The processes have design or operating effectiveness deficiencies but do not compromise achievement of important control objectives.
Well-Controlled	The processes are appropriately designed and are operating effectively to manage risks. Control issues may exist, but are minor.

Classification of Audit Observations

Rating	Description of Factors	Reporting Level
High	Observation has broad (state or agency wide) impact and possible or existing material exposure requiring immediate agency attention and remediation.	State Audit Committee, Senior Management, Department Management
Moderate	Observation has moderate impact to the agency. Exposure may be significant to unit within an agency, but not to the agency as a whole. Compensating controls may exist but are not operating as designed. Requires near-term agency attention.	State Audit Committee, Senior Management, Department Management
Low	Observation poses relatively minor exposure to an agency under review. Represents a process improvement opportunity.	Department Management, Senior Management (Optional), Audit Committee (Not reported)

Appendix B – Audit Follow-up Procedures

OIA will periodically follow-up on management's plans to remediate high and moderate risk audit observations. Follow-up activities may generally be broken down into three categories:

Detailed Detailed follow-up is usually more time-consuming and can include substantial audit customer involvement. Verifying and testing procedures implemented as well as substantiating records are examples. The more critical audit observations usually require detailed follow-up.

Limited Limited follow-up typically involves more audit customer interaction. This may include actually verifying procedures or transactions and, in most cases, cannot be accomplished through memos or telephone conversations with the audit customer but requires onsite observation or testing.

Informal This is the most basic form of follow-up and may be satisfied by review of the audit customer's procedures or an informal telephone conversation. Memo correspondence may also be used. This is usually applicable to the less critical observations.

Low risk audit observations will not result in an OIA audit follow-up, although these observations will be factored into the continuous risk assessment process for future OIA engagements.