STATE OF CONNECTICUT

AUDITORS' REPORT
STATE TREASURER - DEPARTMENTAL OPERATIONS
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2006

AUDITORS OF PUBLIC ACCOUNTS

KEVIN P. JOHNSTON ❖ ROBERT G. JAEKLE

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February 20, 2008

AUDITORS' REPORT
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FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2006

We have made an examination of the financial records of the Office of the State Treasurer (State Treasurer, or Treasury) as they pertain to the Agency's departmental operations for the fiscal years ended June 30, 2005 and 2006. This report on that examination consists of the Comments, Condition of Records, Recommendations and Certification that follow. We also issued separate audit reports covering the State Treasurer - State Financial Operations for the fiscal years ended June 30, 2005 and 2006.

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 internal control 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 is organized into several divisions and performs a number of functions. This report is concerned with the departmental operations of the Treasury and includes our review of the Business Office, Personnel, Informational Services, and the Unclaimed Property Division. Our review of financial operations of the Treasury 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 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 State Treasury as of June 30, 2006, were as follows:

State Treasurer*:
Denise L. Nappier

Deputy Treasurer:
Howard G. Rifkin

Assistant Deputy Treasurer and Chief of Staff:
Linda Hershman

Assistant Deputy Treasurer, Second Injury Fund and Unclaimed Property:
Maria M. Greenslade

Chief Investment Officer:
Susan B. Sweeney

Assistant Treasurer Cash Management:
Lawrence Wilson

Assistant Treasurer, Policy:
Meredith A. Miller

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.

New Legislation:

Public Act 05-189 exempts the value of gift cards from the escheat law, among other provisions, effective October 1, 2005. Public Act 05-273 re-imposes the prohibition against imposing dormancy charges on gift cards, effective July 13, 2005.

Public Act 05-05, of the October 25, 2005 Special Session, allocated $17,000,000 and $16,000,000 of escheat revenues for the fiscal year ended June 30, 2006 and 2007, respectively, to the Citizens' Election Fund. Thereafter, transfer amounts will be adjusted using the changes in the consumer price index. The State Elections Enforcement Commission administers this fund, which is a publicly-financed campaign fund from which payments are made to participating candidates. These funds would have been previously deposited into the General Fund. This Act was effective December 7, 2005.

RÉSUMÉ OF OPERATIONS:

Department Revenues:

Departmental revenues were mainly from the Second Injury and Compensation Assurance Fund (SIF), Workers' Compensation Administration Fund (WCA), Grants and Restricted Accounts Fund and the General Fund. SIF's revenues consisted mainly of assessments levied against self-insured employers and companies writing workers' compensation or employers' liability insurance and totaled $95,796,021 and $60,704,589 for the fiscal years ended June 30, 2005 and 2006, respectively. WCA Fund assessment receipts totaled $14,134,974 and $19,062,676 for the fiscal years ended June 20, 2005 and 2006, respectively. More detailed information concerning the SIF and the WCA Fund is included in our Auditors' Reports on the State Treasurer – State Financial Operations. The General Fund's and Grants and Restricted Accounts Fund's revenues, a large percentage of which consisted of restricted account and special revenue fund transfer receipts to cover charges from the Combined Investment Fund and Second Injury Fund, and Unclaimed Property Division's receipts, amounted to $293,425,583 and $269,115,921 for the fiscal years ended June 30, 2005 and 2006, respectively. A summary of the General Fund's and Grants and Restricted Accounts Fund's revenue is presented below:

	Fiscal Year Ended June 30,	
	2005	2006
Unclaimed Property Receipts	$154,663,059	$57,779,706
Special Revenue Fund Transfers	112,619,927	132,357,395
All other receipts	26,142,597	78,978,820
Total Revenues	**$293,425,583**	**$269,115,921**

Department Expenditures:

The operations of the Treasury for the fiscal years ended June 30, 2005 and 2006, excluding expenditures classified as "debt service paid" and "workers' compensation awards" that are included in the separate audit report on State financial operations, are summarized below:

	Fiscal Year Ended June 30,		
Net Expenditures by Fund:	2004	2005	2006
General Fund-Budgeted	$ 3,263,926	$ 3,404,601	$ 3,770,933
General Fund-Non-Functional	10,862,104	20,476,540	26,035,261
Capital Projects Fund	31,263	48,843	13,840
Special Revenue Fund	71,824,201	72,737,451	85,519,170
Net Expenditures	**$85,981,494**	**$96,667,435**	**$115,339,204**

The Special Revenue Fund was the major funding source for the Treasurer's Pension Funds Management Division, Second Injury Fund, Bond Issue Costs, and a Bank Compensation Account during the fiscal years ended June 30, 2005 and 2006. Operating Expenditures of the Unclaimed Property Division and a Special Assessment account are also paid from the Special Revenue Fund. General Fund – Non-Functional expenditures were for reimbursements of unclaimed property. A comparison of departmental expenditures categorized by account code is as follows:

Net Expenditures by Major Object:	2004	2005	2006
	Fiscal Year Ended June 30,		
Personal Services & Employee Benefits	$14,834,519	$16,164,745	$17,523,978
Employee Expenses, Allowances & Fees		107,986	122,299
Purchased & Contractual Services	60,121,618	59,400,448	71,275,136
Motor Vehicle Costs		37,802	41,959
Premises & Property Expenses		62,909	86,728
Information Technology		268,067	141,656
Purchased Commodities	148,280	126,957	90,433
Capital Outlays - Equipment	14,973	21,981	21,754
Unclaimed Property	10,862,104	20,476,540	26,035,261
Net Expenditures	**$85,981,494**	**$96,667,435**	**$115,339,204**

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. Payment processing procedures made pursuant to these contracts were reviewed as part of this audit. Returns of unclaimed property increased significantly since the fiscal year ended June 30, 2004, due in part to more property being submitted by holders. Personal services expenditures were paid from the following sources:

	Fiscal Year Ended June 30,	
General Fund:	**2005**	**2006**
Budgeted Accounts	$ 3,089,871	$ 3,485,301
Grants and Restricted Accounts Fund:		
Pension Fund Management	2,695,010	3,088,219
Second Injury Fund	6,735,713	6,687,561
Unclaimed Property	2,734,494	3,154,130
Short-Term Investment Fund	873,497	1,094,927
Capital Projects Fund	36,160	13,840
Totals	**$16,164,745**	**$17,523,978**

Total personal services expenditures increased 9 and 8.4 percent in the fiscal years ended June 30, 2005 and 2006, respectively. Increased expenditures for annual salary increments, benefits and collective bargaining increases accounted for nearly all of the increase. Employment statistics for the Treasury for full-time permanent positions are as follows:

		June 30,	
General Fund:	**2004**	**2005**	**2006**
Budgeted Accounts	44	44	46
Grants and Restricted Accounts Fund	101	103	104
Other Funds	4	5	8
Totals	**149**	**152**	**158**

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 cash receipts to be deposited into the General Fund with the exception of periodic transfers to the Citizens Election Fund and a restricted unclaimed property account within the General Fund. The restricted account funds are used to pay the Unclaimed Property Division's administrative costs. These transfers totaled $4,000,000 and $10,000,000 for the fiscal years ended June 30, 2005 and 2006, respectively. 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 other claims. It further consists of unclaimed wages and customer overpayments held by business associations, and various court deposits. A comparison of unclaimed property receipts as presented in the Treasurer's Annual Report, for the fiscal years ended June 30, 2005 and 2006, is as follows:

	Fiscal Year Ended June 30,		
Unclaimed Property Receipts:	2004	2005	2006
Financial institutions	$ 49,332,658	$ 21,554,761	$15,993,361
Business corporations	41,678,929	30,844,314	35,493,021
Insurance companies	6,144,911	12,006,573	10,248,539
Securities liquidated	1,413,120	89,090,535	13,617,580
Governmental and public agencies	3,469,330	2,064,213	7,336,064
Dividends on securities held	709,614	635,778	837,416
Interest penalty assessments	236,608	466,465	108,807
Reciprocal exchange with other states	927,228	1,266,224	734,910
Miscellaneous	510,789	730,511	364,623
Totals	**$104,423,187**	**$158,659,374**	**$84,734,321**

The fiscal year ended June 30, 2005, included a sale of $89,090,000 of securities held by the Unclaimed Property Division. Receipts were generally greater for financial institutions and business corporations during the fiscal year ended June 30, 2004, because of Public Act 03-01 of the June 30, 2003, Special Session, reduced the dormancy periods from five to three years. This resulted in larger receipts for certain types of property for the fiscal year ended June 30, 2004. Unclaimed Property administrative expenses as reported in the Treasurer's Annual Report are as follows:

	Fiscal Year Ended June 30,		
	2004	2005	2006
Salaries and fringe benefits	$2,295,637	$2,735,640	$3,154,315
Data processing and hardware	1,020,881	909,520	3,237,913
All other	236,078	436,189	266,173
Totals	**$3,552,596**	**$4,081,349**	**$6,658,401**

In addition, $8,168,755, $2,404,738, and $1,225,874 in fees were netted against unclaimed property receipts during the fiscal years ended June 30, 2004, 2005 and 2006, respectively. Such fees consisted of fees for participation in out-of-state audits, and brokerage fees for the sale of securities. Fees for the fiscal year ended June 30, 2004, include $6,907,921 associated with the receipt of cash and securities from the demutualization of insurance companies. These receipts and fees were not recorded on the books of the State Comptroller until the later part of the fiscal year ended June 30, 2006, as fees were previously netted from revenues, but were disclosed 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:

	Fiscal Year Ended June 30,		
	2004	**2005**	**2006**
Stocks and Bonds	$ 93,320,395	$30,734,531	$56,899,213
Mutual Funds	10,951,926	12,949,888	1,901,472
Totals	**$104,272,321**	**$43,684,419**	**$58,800,685**

During the fiscal year ended June 30, 2005, securities totaling $89,090,535 were sold, and accounted for the majority of the reduction in the value of the portfolio from the fiscal year ended June 30, 2004. Mutual funds were sold during the fiscal year ended June 30, 2006. The large balance in the portfolio for the fiscal year ended June 30, 2004, was because of stocks from demutualized insurance companies were added to the inventory, as was additional property related to the reduced dormancy period.

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 $10,862,104, $20,476,540 and $26,035,261 for the fiscal years ended June 30, 2004, 2005, and 2006, 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 31-355b). 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 (Fund). The Treasurer is the custodian of the Fund. Per Section 31-349e of the General Statutes, there is an advisory board to advise the custodian of the Fund 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 Reports on the State Treasurer – State Financial Operations for the fiscal years ended June 30, 2005 and June 30, 2006.

Other Matters:

Claimant fraud was discovered by the Unclaimed Property Division in two cases when the rightful owners presented their claims at a later date. These cases were referred to the Treasurer’s legal unit or the Attorney General’s Office:

- One fraud for $151,420 appears to have been a case of identity theft. The rightful owner claims he was incapacitated on May 28, 2002, when the original claim was paid. He was made aware when the Internal Revenue Service asked him to pay taxes on the property he had "claimed" and sold for a profit. With advice from the Attorney General's Office, the Division paid the rightful owner $151,420 on June 29, 2006.

- Another fraud for $36,674 was paid to an improper claimant because two people had identical first, middle, and last names. The claimant who fraudulently claimed the funds knew that she was not entitled to the funds, but signed an affidavit that certified she was the rightful owner. The Division paid the rightful owner on June 29, 2006, and reported the loss in accordance with Section 4-33a of the General Statutes on March 20, 2007, after we inquired about the status of the claim.

CONDITION OF RECORDS

The following nine recommendations resulted from our current review of the Office of the State Treasurer's departmental operations.

Holder Processing Deficiencies and Publication of Owners' Names:

Criteria: Section 3-62g of the General Statutes requires the Treasurer to assume custody of property and be responsible for all claims to unclaimed property owners. Generally, the Treasurer requires that insurance companies, banks, corporations, mutual fund companies and others that hold unclaimed property (holders) remit to the Treasury (a) cash representing unclaimed insurance proceeds, dormant bank accounts, outstanding checks, and dormant safe deposit box contents, as well as (b) stocks and mutual funds from dormant accounts or demutualizations. Property owner information is stored in a database, which is used for claims processing and is the source for the Statewide publication. Section 3-66a of the General Statutes requires the Treasurer to publish the names of unclaimed property owners (that have not previously been published) at least once every two years. Section 3-65a, subsection (d), requires that the Treasurer keep a permanent record of all reports submitted. Section 3-67a, subsection (c), requires that certain owners' records be updated accordingly.

Condition: Our review disclosed property in the custody of the Unclaimed Property Division that was not loaded into the database of owners' names. Property must be loaded into the database to be either published or claimed. The backlog of property that was not loaded as of September 1, 2006, includes an estimated $91,574,227 in cash and securities. The Division informed us that $900,849 of securities and cash were currently not in the State's custody, but were being held by others as of June 30, 2006, and that a project was initiated to inventory all the reports submitted by holders that contain listings of unclaimed property, many of which could not be easily located. The Division's records were not always reliable when presented to us.

The Division did not publish owners' names prior to December 31, 2006, as required by Statute, and instead published them in the Fall of 2007.

During our current audit for the fiscal years ended June 30, 2005 and 2006, we tested 42 holder reports and found a number of processing errors or deficiencies. In three cases, information in the database did not always agree to the hard-copy reports. In three other cases original reports totaling $12,185 and 194 shares were not readily available; two were reprinted by the Treasury from its database, and one was not available for review.

Cause: Prior to March 2006, operations within the Unclaimed Property Division were not managed as needed; in addition, permanent records were not maintained, a planned project to use scanning technology was abandoned, and internal controls were not always followed.

Effect: If care is not taken to appropriately assume and account for unclaimed property, owners' names will not be published, records will be lost, claims will be delayed, and there may be an increased risk of loss.

Recommendation: In accordance with Sections 3-62g, 3-66a, 3-65a, subsection (d), and 3-67a, subsection (c), of the General Statutes, the Unclaimed Property Division should act responsibly to assume, account for, update, publish, and keep a permanent record of unclaimed property. (See Recommendation 1.)

Agency Response: "The Unclaimed Property Division is continuing to devote additional resources to improve controls and minimize, if not eliminate, future errors. During the 2005-06 fiscal years, the Division received approximately $250 million of unclaimed property and paid claims totaling over $46 million, representing 34,717 claims paid, an increase of 9,411 claims and $26.2 million over the prior audit period.

With respect to the publication requirements, an administrative determination was made to delay publication, in part, as a result of the installation of a new data base in December 2006 and the subsequent training and utilization of the system, which requires prudence and good judgment. It is the view of the Treasury that this new system, used in approximately 40 other states, will help address many of the ongoing issues related to loading holder reports, reconciliation of property and other issues raised in this and previous audits of the Division."

Claims Processing Deficiencies in the Unclaimed Property Division:

Criteria: Section 3-62g of the General Statutes requires the Treasurer to be responsible for all claims to unclaimed property owners. Section 3-70a, subsection (b), specifies that the Treasurer shall consider each claim within ninety days after it is filed. Proper internal controls should ensure that rightful owners are paid accurately.

Condition: During December 2006, old data was transferred to a new computer system. Due to the risk of errors in entering the data, a key control existed to verify claims back to the original source documents. Although the Treasury stopped this verification procedure, an alternative procedure to verify that no data entry errors occurred was not developed for the old data. Since the database was not static and could be changed, the risk of fraudulent information increased.

We tested 50 claims and detected numerous payment errors as well as several instances when proper internal controls were not followed. Our findings are included below:

- One claim was paid to an individual without proper support for $950.

- One claim was paid to the incorrect person in the amount of $1,388.

- Sixteen payments, including 14 duplicate payments, were made in error totaling $19,469. In most of these cases, the database contained inaccurate information.

- Four of eight claims that were paid dividends were paid incorrectly. The total amount overpaid for these claims was $1,459. One of these incorrect dividends was applied to all owners of those shares, which indicates the database contained inaccurate information.

- Four claims were paid incorrectly due to miscalculation of stock sale proceeds. One of these claims was overpaid $5,405 and three were underpaid a total of $32. The error that resulted in two of these underpayments was applied to all owners of that property, which indicates the database contained inaccurate information.

- Five of 11 claims that were paid interest were paid incorrectly. These payment errors totaled $364.

- Seven claimants received a total of 18.9 shares of stock worth $236 in error. The database contained inaccurate information because a reverse stock split was not accounted for correctly by the Division.

We also discovered during our review that several key controls were not always followed:

- Fifteen of 50 holder reports were not properly posted to either reflect a claim had been made against the property or to verify that the owners' information and claim amounts were correct.

- One claim payment was not updated to reflect paid status in the computerized database; this would allow the claim to be processed for payment again.

- One claim did not include adequate owner-provided documentation to support payment of the claim.

- Five of 50 claims did not have proper approvals.
- Two claims were processed by overriding system controls: In one case

the division overrode the system to facilitate a payment to a claimant whose property was previously paid to another person incorrectly. The second case involves the posting of mutual fund dividends which requires certain paid claims to be marked unpaid in order for updates to post properly.

We also note that 39 of the 50 claims tested were processed well beyond the 90-day consideration period, with an average waiting period of 185 days, and the longest claim having a 649-day processing period.

Cause: The Treasury has placed unwarranted faith in the reliability of the database and internal controls were not always followed.

Effect: Claimants may not receive the full value of their property in a reasonable amount of time or may be overpaid, and poor adherence to established internal controls increases the risk that improper payments could occur.

Recommendation: The Unclaimed Property Division should comply with Section 3-62g and Section 3-70a, subsection (b), of the General Statutes, and should follow internal control procedures designed to prevent improper payments. (See Recommendation 2.)

Agency Response: "UCP's procedures to prevent overpayments are constantly being reviewed and strengthened. Almost all of the overpayment errors were recovered or are in the process of being recovered. In response to previous audits highlighting delays in paying claims, more than six weeks in 2006 was spent updating the database to reflect the payment history for claims going back to 1993. As a result of this effort, there is no longer a need to determine if a claim had been previously paid through a separate manual process as recommended in this audit. As we previously reported to the Auditors' of Public Accounts continuing the manual process will merely cause a delay in reuniting claimants with their abandoned property. In addition, the Division is continuing its work updating and reconciling its stock holdings."

Auditors' Concluding Comments: The Treasurer's response that "UCP's procedures are constantly being reviewed and strengthened" is inaccurate. In fact, the controls have been weakened to the point that we believe they are insufficient to prevent improper payments, which is a significant weakness noted in our Auditors' Certification. There are certain other points within the Treasurer's response that also appear to need clarification:

- Procedures should be in place to *prevent and detect* errors, not just to recover the improper payments after they are paid.
- Despite the Treasury's best efforts to "update the database" with

paid claim information, we found during our testing that not all paid claims were marked “paid,” which resulted in claims being paid twice. Also, updating the “paid” status in the database does nothing to verify that the information in the database is reliable, thus requiring other necessary controls.

- It is certainly appropriate to delay claims if you cannot be assured the correct claimant is being paid the correct amount of property.

We will continue to reiterate the importance of efficient and effective internal controls as there is a continued risk that assets could be misappropriated.

Reporting of Illegal, Irregular or Unsafe Handling of Funds:

Criteria: Section 4-33a of the General Statutes requires the Treasury promptly notify the Auditors of Public Accounts and the State Comptroller of any unauthorized, illegal, irregular or unsafe handling or expenditure of State funds or breakdowns in the safekeeping of State resources.

Condition: The Treasury was aware that in four cases, $44,248 of illegal, irregular or unsafe handling or expenditure of State funds or breakdowns in the safekeeping of State resources occurred, however, it was not promptly reported to the Auditors of Public Accounts and the State Comptroller as required under Section 4-33a of the General Statutes. Only after we brought it to the Treasury’s attention were the appropriate reports filed with our Office. Of the $44,248, $7,574 has been either accounted for or recovered. The remaining amount of $36,674 was due to claimant fraud, which was referred to the Treasurer’s legal counsel.

Cause: The Treasurer’s Office failed to report accordingly to the Auditors of Public Accounts and the Office of the State Comptroller.

Effect: Reporting of illegal, irregular or unsafe handling or expenditure of State funds did not occur promptly.

Recommendation: The Treasurer’s Office should comply with Section 4-33a of the General Statutes to report all illegal, irregular or unsafe handling of State funds promptly. (See Recommendation 3.)

Agency Response: “Although the four cases were reported to the State Comptroller and Auditors, but not promptly, the Unclaimed Property Division has reviewed procedures to ensure the prompt notification in the future per Section 4-33a. The case involving the $36,674 fraud was forwarded to the State Attorney General’s Office by the Treasury legal office.”

Bonds and Safe Deposit Box Contents in the Unclaimed Property Division:

Criteria: Sections 3-62g and 3-66a of the General Statutes require the Treasurer to assume custody of property, be responsible for all claims, and publish the names of (previously unpublished) unclaimed property owners. In addition, Sections 3-68a, subsection (a), and 3-69a of the General Statutes, require that safe deposit box contents delivered to the Treasurer be sold at the Treasurer's discretion with the cash proceeds deposited into the General Fund. Proper internal controls over safe deposit box items and bonds would help to ensure that items are appropriately safeguarded. Section 4-32 of the General Statutes requires each State agency to deposit and account for revenues, including cash from safe deposit boxes, within 24 hours of receipt.

Condition: The Unclaimed Property Division's inventory listings of savings and other bonds, as well as safe deposit box items held at the Treasury are not maintained or complete, and owners' names, if eligible, have not been published accordingly. During our current audit, we noted the inventory listing of safe deposit box items did not contain all property held in the safe, and it was difficult for the Division to track certain items, including cash. In three instances, items that were found among the contents of one owner's safe deposit box appear to belong to another owner, and in three other instances, the information submitted by the holder was not included on the master inventory list.

We also found evidence that $60 received on or before August 20, 2003, was not deposited until August 11, 2006. This cash was deposited and accounted for in the State's records nearly three years late.

Cause: Internal controls over the handling of the safe deposit box property and inventory of bonds in the Unclaimed Property Division were not followed.

Effect: Publication of names is delayed, property and cash is not safeguarded, and General Fund proceeds are not realized in a timely manner.

Recommendation: The Unclaimed Property Division should improve controls and comply with Sections 3-62g and 3-66a of the General Statutes, for its inventory of bonds and safe deposit boxes, and should also comply with Sections 3-68a, subsection (a), 3-69a, and 4-32 of the General Statutes for its inventory of safe deposit box items. (See Recommendation 4.)

Agency Response: "The Division has begun inputting all United States Saving Bonds presently on-hand into the new database. As reported in our previous audit report, due to a 2003 change in the law governing unclaimed property, the Division no longer accepts safe deposit box contents; only the proceeds from the sale of safe deposit box contents, which is conducted by the holder. There is however, some tangible personal property from safe deposit boxes that were transmitted to the Division prior to enactment of the law change, which is being inventoried, recorded and is planned for liquidation."

Revenue Examinations, Updating Records and General Fund Receipts:

Criteria: Section 3-65a, subsection (g), of the General Statutes, authorizes the Treasurer to examine the records of any holder of property presumed abandoned to determine whether the holder has complied with the Statutes relating to the Unclaimed Property Division.

Section 3-67a, subsection (c), of the General Statutes, requires that whenever property other than money is paid or delivered to the Treasurer, the Treasurer upon receipt shall credit to the owner's account any dividends, interest or other increments realized or accruing on the property at or before the property is sold. Section 3-68a of the General Statutes, allows the Treasurer to sell unclaimed stock certificates at the Treasurer's discretion.

Condition: Since March 2005, examinations of holder records have been put on hold for companies within Connecticut. During the fiscal years ended June 30, 2003 and 2004, these examiners' findings totaled $2,604,697.

The Treasury sold stocks and mutual funds before properly updating the property records within its database. In addition to noncompliance with the General Statutes, there are other administrative burdens associated with this decision, including having to reconcile and update property records for historical corporate actions, and returning property to owners in an accurate and timely manner.

The Division is currently holding $93,851,952 as of May 31, 2007, in its portfolio, from which the General Fund does not benefit until it is sold.

Cause: The Division has reassigned the examiners to help reconcile and update information in the database and the Treasurer's Office does not appear to have a plan to address its accumulation of securities.

Effect: Owners' records are not updated to reflect the total property received on their behalf, and the General Fund is not receiving the cash benefits from either the examiners' audits or the securities accumulating in the portfolio.

Recommendation: The Treasurer should resume examinations of Connecticut companies as allowed under Section 3-65a, subsection (g), of the General Statutes, should comply with Section 3-67a, subsection (c), in a timely manner, and should establish a plan to liquidate securities and forward the proceeds to the General Fund. (See Recommendation 5.)

Agency Response: "In direct response to previous Audit comments an administrative decision was made to redeploy Division examiners to the task of reconciling securities, including securities received from 1985, that were never updated and placed on the database, before claims are processed. Owners' records not reflected accurately in the database delays payments to claimants. A judgment was made that addressing the reconciliation of securities held by the State was a priority in reuniting claimants with their abandoned property, in part by redeploying personnel, and is an integral part of a comprehensive plan to address this issue. It is certainly the intention of the Division to pursue timely in-state auditing as the effort to reconcile securities begins to wind down. The Division is finalizing several issues related to the liquidation of securities before implementing a formal plan."

Contractual Services:

Criteria: According to Section 4a-59 of the General Statutes, all contracts for the purchase of goods or services shall be approved as to form by the Attorney General. Section 4-219 of the General Statutes requires that amendments to existing personal service agreements be submitted to the Secretary of the Office of Policy and Management for review and approval. The Unclaimed Property Division within the Treasurer's Office had contracted with a firm to conduct reviews of abandoned property in the custody of out-of-state holders including demutualized insurance companies. The fee for service under this contract was 12 percent of the unclaimed property discovered with companies that had no prior history of filing with the State Treasurer's Office and six percent of the unclaimed property found with companies that have a history of filing abandoned property holder reports with Treasury.

Condition: During the fiscal year ended June 30, 2006, the Unclaimed Property Division was billed the full 12 percent fee for the collection of unclaimed stock certificates and cash from a demutualized insurance company that had a history of filing holder reports with the Unclaimed Property Division. The value of the abandoned property delivered was $19,851,144 and the fee paid was $2,131,641 after adjustment for an unrelated credit. After recognizing that an overpayment was made, the contractor agreed to provide a future services credit of $1,187,311, rather than a full refund of the overpayment. The Treasurer's Office agreed in a letter of understanding with the contractor to receive future service credits that would pay for the migration of existing unclaimed property records to a new computerized system or other services. The letter of understanding was not reviewed and approved by the Attorney General or the Office of Policy and Management. In effect, the existing contract with the vendor had been increased significantly and new service deliverables had been added without the benefit of a properly executed contract amendment. Based on our review, the total contractual overpayment amounted to $1,434,048 that should be returned to the State. This amount consists of one half of the 12 percent fee paid on the

$19,851,144 of property plus a $242,980 credit due from another billing by the same vendor.

Cause: Treasury negotiated the future services credit rather than insist on a return of the amount that was overbilled.

Effect: The agreement to provide additional services was essentially a new contract that was executed outside of the statutory requirements for purchasing contractual services. Safeguards to ensure the receipt of contractual deliverables were weakened.

Recommendation: The Treasurer's Office should allow companies to self-report their unclaimed property, comply with all statutory requirements when contracting for services provided by outside vendors and collect contractual overpayments in cash. (See Recommendation 6.)

Agency Response: "We disagree with the findings and conclusions of the Auditors. The memorandum of understanding between ACS and the Division referred to by the Auditors was not for the migration of the existing unclaimed property records to a new computerized system. The migration of existing data is part of the scope of services of a new agreement with ACS, which has gone through the full approval process. Rather, the agreement to apply a credit for future services was reached through a different contract with ACS that covers audit and custody services. We are not aware of any State prohibition to prevent taking a credit from a contractor for future services within a contract that contemplates such services being provided. In our view this agreement covers the services ACS will provide the Division through the agreed upon credit: The training of holders on how to verify and file unclaimed property, the loading of holder reports and reconciliation of securities. The source of this credit was the auditing services ACS performed on the demutualization of Prudential Insurance Company. It was the Division's contention that the timing of the audit conducted by ACS did not warrant the charge of the 12 percent fee allowed in the contract. However, because ACS had already undertaken most of the Prudential examination which resulted in the delivery of a substantial amount of unclaimed property to the State, an agreement was reached that the ACS fee would be reduced to 6 percent, and that this would be applied as a credit towards future services, again, contemplated under the contract."

Auditors' Concluding Comments: Credit amounts due the State should be received in cash. The State is due $1,434,048, which should be returned to the State.

Monitoring of Services:

Criteria: Sound business practices and Statement on Auditing Standard No. 70 require that when an outside service organization performs such services as the processing, executing, and recording of transactions, an outside audit report on the processing of those transactions should be obtained.

Condition: The Treasury hired a company to provide services to the Unclaimed Property Division. That company engaged an independent firm to provide a SAS 70 report to examine the company's ability to provide certain services, which the Treasury hired the company to perform. We requested the report on Controls Placed in Operation and Tests of Operating Effectiveness (SAS 70) for the contractor who provided unclaimed property recovery services, custody, claims processing, and database management services to the Unclaimed Property Division during the fiscal years ended June 30, 2005 and 2006. We were informed that the contractor did not commission a report on internal controls for the custody, claims processing and database management services and does not expect to until 2008. We found that when provided with the report for recovery services, the contractor failed to provide the complete report and omitted an essential section that included the independent auditor's test of operating effectiveness and the results of those tests. The contractor stated it was "not available" for review.

Cause: The Treasury may not have been aware that audits of outside service organizations' processes should be available, and it appears there may be information included in the report that the contractor would rather not disclose to the State.

Effect: The Unclaimed Property Division is unable to monitor and assess its contractor appropriately for areas needing improvement.

Recommendation: The Treasury should require and review SAS 70 audit reports on the processes of outside service organizations that it hires to perform certain services, and the Treasurer should seek to obtain the complete report that was not made available during our audit. (See Recommendation 7.)

Agency Response: "Management has requested the complete SAS 70 report from the vendor. Although the present contract with ACS does not require them to provide the "Independent Service Auditor's Report", generally referred to as SAS 70, the Division has requested a copy of the complete report. It should be noted that the ACS SAS 70 report did achieve an unqualified and clean opinion from their outside auditors."

Subscription for Proxy Voting Services:

Criteria: During the audited period, the Treasury subscribed to a proxy voting service to administer the voting ballot rights of the Combined Investment Funds.

Condition: The proxy voting service received information from the custodian bank that holds the Combined Investment Fund shares regarding the number of ballots that were eligible for voting. In February 2007 Treasury personnel noted that the number of shares being voted did not agree with the Combined Investment Fund's actual holdings. Cases were noted in which only a small fraction of the number of shares on hand was being voted. The fee for this service was $25,000 per year during the audited period.

Cause: The proxy voting service did not reconcile the number of ballots voted to the number of shares held by the Combined Investment Fund.

Effect: The Combined Investment Fund was not able to fully execute its proxy voting rights.

Recommendation: The Treasurer's Office should enforce contractual provisions with the proxy voting service that clearly delineates the responsibilities for calculating available shares for voting and require more complete reporting on shares voted. (See Recommendation 8.)

Agency Response: "The Treasurer's Office is in the final stages of executing a contract with the proxy voting service that delineates the custodian bank as responsible for calculating shares available for voting. The new contract also will require the proxy voting service to provide more complete reporting on shares voted."

Personnel Appointments and Regulations of the State Treasury:

Criteria: Section 3-13a of the General Statutes allows the Treasurer to appoint personnel to assist the Chief Investment Officer in investing the retirement pension and trust funds of the State. The Regulations of State Agencies help to clarify the General Statutes and should reflect current information.

Condition: Employees are being appointed to Divisions other than the Pension Fund Management Division using the authority provided in Section 3-13a of the General Statutes. Regulations of State Agencies, including those related to Treasury personnel, need to be updated.

Cause: The Treasury did not adhere to the parameters established in Section 3-13a of the General Statutes.

Effect: Employees appear to have been appointed without the appropriate authority.

Recommendation: The Treasurer's Office should not use Section 3-13a, of the General Statutes as authority to make appointments to Divisions unrelated to the Pension Fund Management Division and should update its Regulations. (See Recommendation 9.)

Agency Response: "We concur with the auditors' suggestion that the Regulations of State Agencies should be updated, and we are also considering the need for statutory clarification of positions of this type as the Treasury has gone through a number of organizational changes since this provision was first adopted."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

Our prior audit examination resulted in 13 recommendations, of which seven were repeated or restated in our current audit report. The following is a summary of those recommendations and the action taken by the Office of the Treasurer.

- The Treasurer's Unclaimed Property Division should comply with Sections 3-62g, 3-66a, 3-67a, subsection (c), and 3-70a, subsection (b), of the General Statutes, and resolve the backlogs related to updating property to the database and repaying stock claims. The Division is attempting to resolve the backlogs and we will not repeat this finding.

- The Treasurer's Unclaimed Property Division should consider selling stocks as they escheat to the State and immediately forward the cash proceeds to the General Fund. This recommendation is restated and included in Recommendation 5.

- The Unclaimed Property Division should deposit funds in accordance with Section 4-32 of the General Statutes. Another instance of late deposit was found and this recommendation has been included in Recommendation 4.

- The Unclaimed Property Division should follow-up on receivables in accordance with Section 3-66c of the General Statutes, and enhance efforts to collect longstanding receivable amounts. There has been substantial improvement in this area and this recommendation has been resolved.

- The Unclaimed Property Division should allow companies to self-report their unclaimed property, seek to reclaim all or a portion of the $6,865,646, and should exercise certain contractual provisions that could result in substantial savings to the State. The Treasury did not seek to reclaim any portion of the $6,865,646, and also attempted to exercise certain contractual provisions, however, the manner in which they did so did not appear appropriate, and we have included these current circumstances in Recommendation 6.

- The Unclaimed Property Division should verify the file to be published for the "Big List," not make unnecessary expenditures, and should publish only an online Holder Reporting Manual to reduce State expenditures in the future. Although Holder Reporting Manuals were printed, no other unnecessary expenditures came to our attention and we will not be repeating this recommendation.

- The Unclaimed Property Division needs to improve its handling of the inventories of savings bonds and safe deposit box contents and ensure that owners' names associated with such property are made public. There was no improvement in this area and this recommendation is repeated as Recommendation 4.

- The Unclaimed Property Division should comply with Section 3-70a, subsection (b), of the General Statutes, should follow internal control procedures designed to prevent overpayments and should recover overpayments. We found the Division abandoned a key control, which helped to verify whether system data was correct, and the Division made numerous overpayments, underpayments, improper and duplicate payments since our prior audit. This recommendation is repeated in Recommendation 2.

- In accordance with Sections 3-62g and 3-66a of the General Statutes, the Unclaimed Property Division should act responsibly to assume, account for, and publish unclaimed property. There continue to be deficiencies in this area and this is repeated in Recommendation 1.

- In accordance with Section 3-67a, subsection (c), of the General Statutes, the Unclaimed Property Division should credit the appropriate amounts to owners' records and update its database to a current status. The database is still not current, and we will include this issue in Recommendation 5.

- The Treasurer's Office should comply with Section 5-248i of the General Statutes and have signed agreements approved by the Commissioner of Administrative Services for all employees that are working at home. We found agreements were approved and documented and will not repeat this recommendation.

- The Treasury should comply with its policy regarding administrative or disciplinary action when excessive absenteeism is considered the result of abuse of sick or other leave. We found improvement in this area and are not repeating this recommendation.

- The Treasurer's Office should establish and enforce a policy documenting the standard work schedule for each employee and should verify employees are working their approved schedules to ensure the State gets the full value for wages paid to employees. It was determined that the Treasury is attempting to implement changes to ensure that all employees are working their approved schedules and we are not repeating this recommendation.

Current Audit Recommendations:

The following nine recommendations resulted from our current review.

1. **In accordance with Section 3-62g, 3-66a, 3-65a, subsection (d), and 3-67a, subsection (c), of the General Statutes, the Unclaimed Property Division should act responsibly to assume, account for, update, publish and keep a permanent record of unclaimed property.**

   Comments:

   As of September 1, 2006, an estimated $91,574,227 of property has not been posted to the database of owners' names. Owners will not be able to claim their property until it is posted to the database.

2. **The Unclaimed Property Division should comply with Section 3-62g and Section 3-70a, subsection (b), of the General Statutes, and should follow internal control procedures designed to prevent improper payments.**

   Comments:

   Our review found that key controls were not adhered to and that overpayments, underpayments, and improper and duplicate payments were made.

3. **The Treasurer's Office should comply with Section 4-33a of the General Statutes to report all illegal, irregular, or unsafe handling of State funds promptly.**

   Comments:

   In several cases, the Division failed to report promptly that illegal, irregular or unsafe handling of State funds occurred.

4. **The Unclaimed Property Division should improve controls and comply with Sections 3-62g and 3-66a of the General Statutes, for its inventory of bonds and safe deposit boxes, and should also comply with Sections 3-68a, subsection (a), 3-69a, and 4-32 of the General Statutes for its inventory of safe deposit box items.**

   Comments:

   We found the inventory listings of both the bonds and safe deposit items were incomplete, items that were delivered could not be found easily, and cash of $60 was deposited and accounted for three years late.

5. The Unclaimed Property Division should resume examinations of Connecticut companies as allowed under Section 3-65a, subsection (g), of the General Statutes, should comply with Section 3-67a, subsection (c), in a timely manner, and should establish a plan to liquidate securities and forward the proceeds to the General Fund.

Comments:

Our review found that the Treasury was currently holding an estimated $93,851,952 of stocks and mutual funds as of May 31, 2007, in its portfolio from which the General Fund does not benefit until it is sold.

6. The Treasurer's Office should allow companies to self-report their unclaimed property, comply with all statutory requirements when contracting for services provided by outside vendors and collect contractual overpayments in cash.

Comments:

The Treasurer's Office agreed to a letter of understanding with a contractor that the contractor would provide future services rather than a full cash refund for amounts overbilled by the contractor and overpaid by the State. The letter of understanding was not reviewed and approved by the Attorney General or the Office of Policy and Management. In effect, the existing contract with the vendor had been increased significantly and new service deliverables had been added without the benefit of a properly executed contract amendment. Based on our review, the total contractual overpayment amounted to $1,434,048 that should be returned to the State.

7. The Treasury should require and review all SAS 70 audit reports on the processes of outside service organizations that it hires to perform certain services, and the Treasurer should seek to obtain the complete report that was not made available during our audit.

Comments:

The Treasury should review regularly the processes of its outside service organizations.

8. The Treasurer's Office should enforce contractual provisions with the proxy voting service that clearly delineates the responsibilities for calculating available shares for voting and require more complete reporting on shares voted.

Comments:

The Treasurer's Combined Investment Fund was not able to fully execute its proxy voting rights because the proxy voting service only voted a small fraction of the Fund's actual holdings.

9. The Treasurer's Office should not use Section 3-13a, of the General Statutes as authority to make appointments to Divisions unrelated to the Pension Fund Management Division and should update its Regulations.

Comments:

The Treasurer has been making appointments to Divisions other than the Pension Fund Management Division, which is not permitted by the General Statutes and may have circumvented systems in place for classified employees.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes we have audited the books and accounts of the Office of the State Treasurer for the fiscal years ended June 30, 2005 and 2006. This audit was primarily limited to performing tests of the Agency's compliance with certain provisions of laws, regulations, contracts and grants, 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, contracts and grants 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 Office of the State Treasurer for the fiscal years ended June 30, 2005 and 2006, is included as a part of our Statewide Single Audits of the State of Connecticut for those fiscal years.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial 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 Office of the State Treasurer complied in all material or significant respects with the provisions of certain laws, regulations, contracts and grants to obtain a sufficient understanding of the internal controls 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, contracts and grants applicable to the Office of the State Treasurer is the responsibility of the Office of the State Treasurer's management.

As part of obtaining reasonable assurance about whether the Agency complied with laws, regulations, contracts and grants, 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 years ended June 30, 2005 and 2006, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants. 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 Controls over Financial Operations, Safeguarding of Assets and Compliance:

The management of the Office of the State Treasurer is responsible for establishing and maintaining effective internal controls over its financial operations, safeguarding of assets, and compliance with the requirements of laws, regulations, contracts and grants 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 Office of the State Treasurer’s financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, contracts, and grants, and not to provide assurance on the internal controls over those control objectives.

However, we noted certain matters involving the internal controls 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 controls 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, contracts and grants. We believe the following findings represent reportable conditions: contracting for examinations of holders prior to the mandated self-reporting deadline, insufficient monitoring of vendors and lack of enforcement of certain contractual and statutory provisions, failure to collect all overpayments in cash, circumventing existing limitations on personnel appointments, failure to report all losses as they were detected, lack of a complete updating of owners’ records, need for improved procedures to prevent improper payments and security liquidation, and the need for improved controls over the collecting, managing, publishing, accounting and repaying of unclaimed property.

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 controls over the Agency’s financial operations and over compliance would not necessarily disclose all matters in the internal controls 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, of the reportable conditions described above, we believe the following reportable condition to be a material or significant weakness: need for improved procedures to prevent improper payments related to the Unclaimed Property Division.

We also noted other matters involving the internal controls 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.

Maura F. Pardo
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts