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☛ Details: Legislative Audit Bureau Letter Report June 2008: Unclaimed Property Program

(FORM UPDATED: 08/11/2010)

WISCONSIN STATE LEGISLATURE ... PUBLIC HEARING - COMMITTEE RECORDS

2007-08

(session year)

Joint

(Assembly, Senate or Joint)

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- Miscellaneous ... **Misc**

Letter Report

Unclaimed Property Program

June 2008



Legislative Audit Bureau

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Janice Mueller
State Auditor

June 12, 2008

Senator Jim Sullivan and
Representative Suzanne Jeskewitz, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Sullivan and Representative Jeskewitz:

We have reviewed the Office of the State Treasurer's administration of unclaimed property that financial institutions and certain other businesses are required by statute to remit to the State on behalf of owners. As of March 2008, the Office held an estimated \$354.2 million in unclaimed cash and unliquidated securities, as well as the unliquidated contents of safe deposit boxes.

In fiscal year (FY) 2006-07, the Office received \$84.3 million in unclaimed cash and liquidated assets; paid more than \$22.0 million in claims, primarily to individuals; and deposited \$50.0 million in unclaimed property to the Common School Fund, which provides low-interest loans to municipalities and helps to support school libraries. The program's FY 2006-07 administrative expenditures—which are funded with program revenue—totaled \$4.7 million. Most administrative expenditures were payments to a private contractor, Affiliated Computer Services, Inc., which identifies and collects unclaimed property and provides other services to assist 7.75 full-time equivalent employees of the Office in administering the program.

As part of our annual financial audit of the State of Wisconsin, we reviewed the Office's internal controls over the unclaimed property program and performed limited testing. Overall, we found the Office's internal controls to be reasonable. We did, however, identify several areas for improvement, which are summarized in this letter report.

In addition, we identified policy issues the Legislature may wish to consider related to allowing a portion of unclaimed property to be deposited to the General Fund and altering the treatment of gift certificates and gift cards as unclaimed property.

We appreciate the courtesy and cooperation extended to us by staff of the Office of the State Treasurer during our review.

Sincerely,

Janice Mueller
State Auditor

JM/BN/ss

Enclosure

UNCLAIMED PROPERTY PROGRAM

Under ch. 177, Wis. Stats., the Office of the State Treasurer receives unclaimed property from financial institutions, insurance companies, and certain other businesses and seeks to return it to the individuals, businesses, and other entities that are its rightful owners. Unclaimed property can include cash from savings accounts, checking accounts, dividends, certificates of deposit, matured life insurance policies, death benefit checks, utility deposits, and unclaimed wages, as well as noncash items such as the contents of safe deposit boxes and unliquidated stocks, bonds, and mutual fund shares. Property is deemed unclaimed if ownership has not been actively acknowledged for a period that varies with the type of property and ranges from 1 to 15 years. Holders of unclaimed property are required to send written notification to the owner's last-known address within 120 days before delivering property to the Office.

The Office accounts for the unclaimed property it receives in perpetuity or until the property is claimed by its owner or the owner's heirs. As of March 2008, the value of unclaimed property accounted for by the Office was estimated to be \$354.2 million, including \$312.2 million in cash and \$42.0 million in unliquidated stocks, bonds, and mutual fund shares. Noncash items, including the contents of unclaimed safe deposit boxes, may be liquidated by the Office provided it accounts for the proceeds on behalf of owners or their heirs. Unclaimed property is accounted for in a continuing program revenue appropriation authorized under s. 20.585(1)(j), Wis. Stats. As required by s. 177.23(1), Wis. Stats., after estimating the amounts that will be returned to owners or heirs and taking into consideration its own administrative costs, the Office periodically deposits the remaining unclaimed property proceeds to the Common School Fund.

The Office also accounts for escheated property, which reverts to the State when an owner dies with neither a will nor living heirs. Unlike unclaimed property, escheated property is not held in perpetuity. Instead, by statute, living heirs have only ten years to claim it. However, like other unclaimed property, unclaimed escheated property or the proceeds from its sale are deposited by the Office to the Common School Fund.

Staffing and Expenditures

In June 2007, 7.75 of the Office's 12.70 full-time equivalent employees administered the unclaimed property program. These employees, whose positions are funded with program revenue, publicize the unclaimed property program, respond to inquiries, and review and approve claims. However, as shown in Table 1, nearly three-quarters of the program's administrative expenditures in fiscal year (FY) 2006-07 were for contracted services that include auditing and identifying unclaimed property, collecting certain unclaimed property held by businesses and remitting it to the State, accounting for and holding unclaimed securities, and supporting Wisconsin's computerized database of unclaimed property.

Table 1

**Unclaimed Property Program
Administrative Expenditures
FY 2006-07**

Type	Amount	Percentage of Total
Contracted Services	\$3,470,600	74.3%
Employee Salaries	436,200	9.3
Printing	292,100	6.3
Other Expenditures ¹	235,400	5.0
Employee Fringe Benefits	224,100	4.8
Other Professional Services	13,400	0.3
Total	\$4,671,800	100.0%

¹ Includes rent, telephone, postage, travel, training, and other supplies and services.

The program's administrative expenditures have varied widely from year to year, as shown in Table 2, because payments for certain contracted services vary with the value of the unclaimed property recovered. For example, in FY 2003-04, the Office paid Affiliated Computer Services, Inc., (ACS) \$7.0 million to identify and remit to the State \$56.2 million related to unclaimed insurance company "demutualization" securities, which were created when regulatory changes allowed the conversion of mutual insurance companies to stock companies, and which became unclaimed property when policyholders who were entitled to either shares of stock or cash could not be located by the companies, either because they were deceased or because they had moved.

Table 2

**Changes in Administrative Expenditures
(in millions)**

FY	Expenditures	Change	Percentage Change
2002-03	\$1.3	-	-
2003-04	8.2	\$6.9	530.8%
2004-05	2.5	(5.7)	(69.5)
2005-06	5.2	2.7	108.0%
2006-07	4.7	(0.5)	(9.6)

Contracted Services

Under three contracts, ACS received \$3.3 million of the Office's \$3.5 million in payments for contracted services in FY 2006-07:

- Under a three-year contract for audit services to identify unclaimed property held by businesses, which began in July 2005, ACS obtains possession of the unclaimed property and remits it to the State. During FY 2006-07, ACS identified \$23.8 million in unclaimed property held by businesses but owed to Wisconsin residents, for which the Office paid a flat commission rate of 12.5 percent of the amount identified, or almost \$3.0 million. This contract, which expires on June 30, 2008, is renewable for one additional two-year period.
- Under a three-year contract to hold, account for, and sell unclaimed securities such as stocks, bonds, and mutual fund shares collected on behalf of the State, the Office paid ACS \$272,400 in FY 2006-07. This contract expired on June 30, 2007, but it has been renewed through June 30, 2008, and is renewable for two additional one-year periods.
- Under an annual contract with ACS Wagers, which is a division of ACS that provides software support for unclaimed property programs in at least 35 states, the Office pays a minimum of \$35,000 annually for support that includes writing computer programming and training staff to use Wisconsin's computerized database for managing unclaimed property. During FY 2006-07, the Office paid \$44,300 for these services. The Office paid a one-time fee of \$80,000 in 2004 to upgrade the software.

The Office also has three-year contracts with three other contractors—Audit Services, U.S., LLC; Kelmar Associates, LLC; and Abandoned Properties Experts, LLC—that provide audit services to identify unclaimed property held by businesses. These three companies receive between 12.0 and 12.5 percent of the amount of unclaimed property they remit to the State. During FY 2006-07, the Office paid \$127,000 to Audit Services. No payments were made to the other two contractors because they did not recover any unclaimed property for the State. These three contracts, which expire on June 30, 2008, are all renewable for one additional two-year period, and the Office plans to renew them for FY 2008-09. The Office indicated that once renewals for its contracts for audit services are exhausted, it will request new proposals for auditing services from contractors.

Publicizing Unclaimed Property

The Office is statutorily required to publicize, before July 1 of each year, the names of the owners of unclaimed property valued \$50.00 or more in newspapers in the county of each owner's last-known address. In addition, the Office publicizes the names of all owners of safe deposit boxes whose contents it holds. As allowed by statutes, only the names of owners of unclaimed property received during the past year are publicized. However, the Office maintains a searchable, online database and participates with 36 other states in another online database of unclaimed property owners. Both databases include the names of all the owners of

unclaimed property valued \$5.00 or more and of unclaimed safe deposit box contents, regardless of when received. As of February 2008, the Office's online database listed the owners of nearly 736,000 items of unclaimed property.

During 2007, the current State Treasurer promoted the unclaimed property program by visiting all 72 counties and by attending the State Fair and several county fairs. In addition, upon request, the Office provides county treasurers with lists naming owners of unclaimed property whose last-known addresses were in their counties and provides legislators with lists naming owners whose last-known addresses were in their districts. Staff indicated these lists generally include owners of property valued at \$5.00 or more and owners of unclaimed safe deposit box contents, but neither the online databases nor the lists provided to county treasurers and legislators generally include more than 400,000 items of unclaimed property that are valued at less than \$5.00. We note that differences in the value of property included in various lists provided by the Office have, on occasion, caused some confusion.

Program Activity

In FY 2006-07, the Office received \$84.3 million in unclaimed property and approved payment of nearly 24,000 claims. Over the five-year period shown in Table 3, the number of claims paid by the Office increased 80.7 percent. The amounts shown include cash and proceeds from the liquidation of noncash items such as stocks, bonds, mutual fund shares, and the contents of safe deposit boxes.

Table 3

Unclaimed Property Activity

FY	Unclaimed Property Received ¹ (in millions)	Number of Claims Paid	Claims Paid	
			Total Paid ² (in millions)	Average Claim
2002-03	\$24.2	13,132	\$ 9.4	\$716
2003-04	59.2	14,606	11.3	774
2004-05	27.0	24,083	15.2	631
2005-06	47.3	22,312	19.3	865
2006-07	84.3	23,725	22.0	927

¹ Includes cash and proceeds from the liquidation of noncash items such as stocks, bonds, mutual fund shares, and safe deposit box contents.

² Includes cash and proceeds from the liquidation of noncash items. Does not include the value of unliquidated noncash items returned to owners or heirs, which is not tracked by the Office.

Under s. 177.22, Wis. Stats., the Office is generally required to liquidate noncash items within three years after receipt in a manner that affords the most favorable market value. Securities are required to be held for at least one year, unless the Office determines that it is in the best interest of the State to sell sooner. For example, it may be more cost-effective to sell a single share of stock immediately than to incur costs associated with accounting for dividends and transferring ownership if the stock is later claimed. Securities are sold at prevailing prices at the time of sale, and the contents of unclaimed safe deposit boxes are sold periodically at auction or, since April 2007, on eBay. During FY 2006-07, the Office received \$42.8 million from the liquidation of securities and \$26,000 in proceeds from the auctions of safe deposit box contents, including \$8,100 from eBay auctions.

The Office holds and accounts for the proceeds of liquidated assets in perpetuity on their owners' behalfs. If owners claim securities or safe deposit box contents before they are liquidated, the Office transfers ownership or, at the claimant's request, liquidates the property and transfers cash. Each fiscal year from FY 2004-05 through FY 2006-07, the Office returned an average of 302,000 shares of stocks and mutual funds to their owners.

To claim unclaimed property, including the proceeds from its sale, individuals, businesses, and other entities must first make an initial inquiry with the Office, which responds with a claim form that includes the name of the owner and the nature and dollar value of the property. Between FY 2004-05 and FY 2006-07, the Office mailed an annual average of 77,000 claim forms to those inquiring about unclaimed property.

Returned claim forms must be notarized, and the claimant must prove rightful ownership of the property in question by providing documentation such as birth or death certificates, bank statements, insurance policies, pay stubs, personal checks, and billing statements. Claimants must also submit their current address, social security or other identifying number, and date of birth. Under s. 177.24(2), Wis. Stats., the Office has 90 days to review each claim; however, staff indicated that claims are typically reviewed within six weeks of receipt. The Office may refer any claim to the Department of Justice (DOJ) for its review to ensure the Office's conclusions are appropriate. Currently, the Office has a written interagency agreement with DOJ to refer for review all claims for properties valued at \$20,000 or more. DOJ staff, whose positions are funded with general purpose revenue (GPR), estimate they currently spend eight to ten hours each week reviewing claims.

As shown in Table 4, only 1.2 percent of claims paid in FY 2006-07 were \$10,000 or more, but those 279 claims represented 35.3 percent of the value of unclaimed property returned in that year. In contrast, nearly 5,000 claims paid in FY 2006-07 were for less than \$50.00. However, it should be noted that some small-dollar claims may also have included unliquidated securities whose value is not tracked by the Office and therefore not included in the table.

Table 4
Distribution of Claims Paid
 FY 2006-07

Claim Amount	Claims Paid	Percentage of All Claims Paid	Value of All Claim Payments ¹	Percentage of Total Payments ¹
\$0.00 to \$49.99	4,861	20.5%	\$ 111,900	0.5%
\$50.00 to \$99.99	4,004	16.9	280,300	1.3
\$100.00 to \$249.99	3,907	16.5	623,100	2.8
\$250.00 to \$999.99	6,844	28.8	3,659,600	16.6
\$1,000.00 to \$9,999.99	3,830	16.1	9,572,600	43.5
\$10,000 or More	279	1.2	7,772,200	35.3
Total	23,725	100.0%	\$22,019,700	100.0%

¹ Does not include the value of returned but unliquidated noncash items such as stocks, bonds, mutual fund shares, and safe deposit box contents.

Although most claims are paid to individuals, in FY 2006-07 the Office returned \$3.3 million, or approximately 15 percent of the value of all claim payments, to businesses, primarily for uncashed checks. In addition, it transferred a total of \$837,000 in unclaimed property to other states based on owners' last-known addresses. Finally, \$331,000 in unclaimed property was transferred to the Department of Revenue under s. 71.91(6), Wis. Stats., because its owners owed delinquent taxes, and \$155,000 was transferred to the Department of Health and Family Services under s. 867.035, Wis. Stats., to recover the costs of certain Medical Assistance payments made on behalf of the owners.

As shown in Table 5, the Office deposited \$50.0 million in unclaimed property to the Common School Fund in FY 2006-07. Since FY 2002-03, \$120.5 million in unclaimed property has been deposited to the Common School Fund, which provides low-interest loans to Wisconsin municipalities and earns interest for distribution to school districts to support school libraries. The Office has discretion in determining the amount to be deposited, and the amounts vary each year depending upon how much unclaimed property it has received and how much it has returned to owners. The Office exercises caution in determining the amount it will deposit, in order to ensure that its program revenue appropriation authorized under s. 20.585(1)(j), Wis. Stats., will be sufficient to pay the amount of unclaimed property estimated to be returned in the upcoming year, as well as the Office's estimated administrative expenditures. As of June 30, 2007, the balance in the program revenue appropriation was \$31.2 million, after taking into consideration amounts to be transferred to cover administrative costs.

Table 5

Deposits of Unclaimed Property to the Common School Fund
(in millions)

FY	Amount
2002-03	\$16.0
2003-04	20.0
2004-05	17.0
2005-06	17.5
2006-07	50.0

In the event claims for unclaimed property exceed the amounts available in the continuing program revenue appropriation after deposits have been made to the Common School Fund, claims may be paid from the sum-sufficient GPR appropriation authorized by s. 20.585(1)(e), Wis. Stats. We are not aware of any instances in which this has occurred.

Internal Controls and Security of Property

The 80.7 percent increase in claims paid by the Office can be attributed in part to unclaimed property information becoming more readily available on the Internet. In addition, holders of unclaimed property are increasingly likely to collect social security numbers, which can be used to identify rightful owners. Both of the program's growth and the possibility that claimants could falsify documents to inappropriately receive property held by the Office are risks inherent in administering the program. Therefore, it is important that the Office maintain proper internal controls to safeguard unclaimed property and to ensure that it is distributed only to rightful owners.

As part of our overall audit of the State's FY 2006-07 financial statements, we performed additional procedures to assess the Office's internal controls over the unclaimed property program and tested program transactions by:

- reviewing available procedure manuals;
- reviewing the Office's reconciliations of amounts recorded on WiSMART, the State's central accounting system, to unclaimed property records maintained by the Office;
- testing a selection of 37 claims paid during FY 2006-07, including the 7 largest claims, to ensure the Office and DOJ required reasonable documentation to prove rightful ownership; and
- reviewing and testing controls over the custody and safeguarding of the contents of 25 safe deposit boxes and other nonfinancial items in the Office's possession.

Overall, we found that the Office has reasonable controls to account for and safeguard unclaimed property and to ensure that unclaimed property is returned only to rightful owners. For example, it requires documentary evidence, such as bank statements and pay stubs, for large dollar claims. In addition, claims are reviewed by more than one staff member to ensure they are valid. As noted, the Office provides additional scrutiny to larger claims by referring those greater than \$20,000 to DOJ for review.

However, given the number of staff the Office has assigned to the program, the complete separation of duties that is ideal for proper internal controls is not always possible. For example, the Office's procedures require two individuals to be present when payments from unclaimed property holders are opened, but on occasion only one individual is present because of staff absences. It is therefore possible that checks could be misappropriated, although controls limit the likelihood of this occurring without being detected.

We found that the Office's unclaimed property records were appropriately reconciled and that the claims we tested were adequately supported by documentation. Safe deposit box items selected for review were generally properly accounted for and in the Office's possession. We did, however, identify four concerns.

First, the Office's public, online database includes the names of all owners whose unclaimed property is valued at \$5.00 or more, as well as the names of all owners of unclaimed safe deposit box contents. However, the value of the unclaimed property is not listed. Office staff indicate that when some owners learn their unclaimed property involves small dollar amounts, they choose not to file a claim. To assist potential claimants and reduce staff time spent responding to initial inquiries, some states' databases are more specific. For example, Minnesota notes whether the value of unclaimed property is less or more than \$100.00. We suggest the Office include a \$50.00 threshold for its online database, which is the level for which it is statutorily required to advertise the unclaimed property received each year.

Second, it is important that the Office monitor the internal controls and procedures of ACS and its subcontractors, which provide assistance in administering the unclaimed property program. Frequently, state agencies and other organizations require their contractors be subject to internal control reviews performed by certified public accounting firms. For example, the State of Wisconsin Investment Board requires independent auditor reports for banks and custodial agents and reviews the reports to ensure their internal controls are functioning as expected. The Office receives auditor reports for ACS, but it does not require or receive similar reports for Mellon Bank, which holds the unclaimed securities. In addition, at the time of our review the Office had not reviewed the reports it received. We suggest that the Office request and review auditor reports to ensure contractors' internal controls and procedures are operating as intended, and if not, take steps to eliminate the risks that exist due to improper controls.

Third, we are concerned because the Office does not have formal policies and procedures for creating lists of owners of unclaimed property and providing them to county treasurers and legislators. As noted, these lists have therefore on occasion been inconsistent: some included all owners with property valued at \$5.00 or more and matched the online databases, while others included owners with property valued less than \$5.00. In addition, the Office's databases include confidential information that could inadvertently be included in a list provided to others, and its current procedures do not require staff to document the lists provided. We

suggest the Office develop formal, written policies and procedures related to providing lists of unclaimed property to external parties.

Finally, we tested the Office's records for the contents of 25 randomly chosen unclaimed safe deposit boxes and for other nonfinancial items, to ensure that items were held in the Office's vault and that in the event they were sold, the proceeds were properly credited to the owners' accounts. To segregate and safeguard these items, each owner's contents are included in a separate envelope filed in the vault. We found small discrepancies in the accounted value of the contents of 2 of the 25 records we reviewed. While not material, these exceptions indicate the need for the Office to take care in accounting for the contents of safe deposit boxes and other nonfinancial items.

Policy Issues

During the course of our review, we identified two policy issues the Legislature may wish to consider. First, as noted, Wisconsin's unclaimed property proceeds are deposited to the Common School Fund. Article X, s. 2 of the Wisconsin Constitution defines several sources of Common School Fund income, including, "the clear proceeds of all property that may accrue to the state by forfeiture or escheat." In FY 2006-07, the Office deposited \$57,000 in escheated property to the Common School Fund, which is 0.1 percent of the total amount of unclaimed property deposited by the Office to the Fund that year.

There have been many clarifications by the courts of the meaning of the term "clear proceeds," including what the State can properly deduct from clear proceeds for administrative costs, but there appear to have been fewer cases defining the term "escheat" and whether it specifically includes the unclaimed property of owners or heirs. As a result, the State has adopted a broad interpretation of escheat, and all unclaimed property is deposited to the Common School Fund. However, other states are increasingly using proceeds from their unclaimed property programs to help fund state expenditures. It may be possible to amend s. 177.23, Wis. Stats., to continue to require that amounts that accrue to the State by escheat—as classically defined when Wisconsin's Constitution was adopted in 1848—be deposited to the Common School Fund, while amounts that accrue to the State as unclaimed property be deposited to State's General Fund. While an attempt to make this change would have the benefit of increasing GPR to provide fiscal relief in a time of budget constraints, such a law change would likely be challenged on constitutional grounds by the State Treasurer and the trustees of the Board of Commissioners of Public Lands, which administers the Common School Fund. They will likely argue that all unclaimed property must be paid to the Common School Fund because an opinion of the Attorney General in 1972 stated that "in modern usage 'escheat' is not restricted solely to this classic situation" and that other states' "unclaimed property statutes similar in nature to Ch. 177 are a form of escheat." We note that it is rare for an individual to die with neither a will nor living heirs.

Second, 2001 Wisconsin Act 109 amended statutes to exclude unused gift certificates issued by retailers and others from treatment as unclaimed property. Previously, unused gift certificates, including electronic gift cards, were considered abandoned if not used within five years of issuance. Based on readily available information, most other states, including Illinois, Iowa, Michigan, and Minnesota, consider unused gift certificates as unclaimed property. Reported

estimates of the percentage of gift certificates—including gift cards—that go unused varies from 10 percent to 19 percent.

Given the increased use of gift cards, the Legislature may wish to consider a return to once again treat gift certificates, gift cards, and other gift obligations as unclaimed property. Such a change would likely be challenged by retailers and other issuers. It is noted that the Legislature considered two proposals during the 2007 regular session related to gift obligations, although neither proposal was enacted. The first would have required sellers to conspicuously disclose any expiration dates, terms, and service charges related to gift certificates, gift cards, and similar items. The second would have prohibited selling gift obligations with expiration dates and reducing their value except when they are partially redeemed by the holder. Neither proposal included changes to once again treat gift certificates, gift cards, and other gift obligations as unclaimed property.

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