

AUDIT REPORT

Division of State Lands: Trust Property Section Internal Controls Review



Bill Bradbury, Secretary of State
Cathy Pollino, Director, Audits Division

Summary

PURPOSE

This audit was conducted at the request of the director of the Division of State Lands (division). Our objective was to assess the division's controls over the collection, accounting, and disposition of trust property assets, which are managed by the division's Trust Property section, and make recommendations for improvement.

In addition, we made efforts to determine if the division incurred losses resulting from the trust property control weaknesses identified below. Our review did not identify any specific losses. In many instances, however, we could not determine whether losses had occurred because the division's records were insufficient.

RESULTS IN BRIEF

We found that:

- Employee computer access to the unclaimed property computer system was not adequately limited.
- Physical access to trust property assets was not properly secured.
- Procedures were not sufficient to ensure that maximum sales prices were received for trust properties at auction.
- Segregation of duties was inadequate for inventorying, accounting and disposing of estate assets.
- Procedures were not sufficient to adequately reconcile auction proceeds, estate records, and trust property records.
- Procedures to manage unclaimed securities were not sufficient.
- The division repurchased securities for claimants and did not pursue recovery of overpayments made to claimants. These actions do not appear to comply with state law.

Additional issues we believe warranted the attention of the division, but did not merit formal reporting, were conveyed to the division in Management Letter 141-2001-12-01, dated December 28, 2001.

RECOMMENDATIONS

We recommend that the division:

- Review employee access to the unclaimed property computer system, and ensure that accesses granted are properly segregated and limited. In addition, access to the system and employee access to trust property asset storage areas should be adequately segregated.
- Strengthen physical security over trust property assets to ensure the safekeeping of assets.
- Obtain appraisals for valuable assets, establish a record of minimum bid amounts before assets are transferred to the custody of the auctioneer, and determine which locations will maximize public participation and bring the highest market price.
- Segregate the recording, accounting and disposition duties for the estate process.
- Perform timely reconciliations of various trust property transactions and records.
- Manage unclaimed securities transferred to the division and deposit the amounts into the Common School Fund. Take steps to ensure that unmanaged securities are identified to their rightful owners.
- Discontinue the practice of repurchasing securities for claimants.
- Strengthen controls to prevent overpayments to claimants, and aggressively pursue the return of overpayments by submitting delinquent accounts for collection to the Department of Revenue or a private collection agency.

AGENCY ACCOMPLISHMENTS

During the audit, division management significantly reduced employee access to trust property records and assets. In addition, improvements were made to the physical security over asset storage areas.

AGENCY RESPONSE

The Division of State Lands generally agrees with the recommendations.

Introduction

The Division of State Lands is the administrative arm of the State Land Board. The Land Board, created

under the Oregon Constitution, consists of the Governor, the Secretary of State, and the State Treasurer. The Board is responsible for managing the assets of the

Common School Fund, a constitutional trust fund dedicated to providing support for Oregon's public kindergarten through 12th grade schools. These assets include

proceeds from the sale or lease of state lands, as well as sale proceeds of unclaimed and escheat property.

State law and Oregon administrative rules provide direction to the division for managing unclaimed and escheat property.

Unclaimed Property

Under the Unclaimed Property Act, the division director acts as trust agent for "abandoned funds."

Unclaimed property is an asset that has been inactive for an extended period and is being held by a business or public entity on behalf of an individual or other entities. Holders of unclaimed property (banks, businesses, insurance companies, etc.) are required by law to make a reasonable effort to locate the owner. If this search is unsuccessful, the holder remits the asset to the division.

Unclaimed properties received and held by the division include funds held in savings or checking accounts, unpaid wages or commissions, securities, uncashed dividends, refunds, paid-up life insurance policies, utility deposits and contents of safe deposit boxes. The division holds items with commercial value for one year while trying to locate the owner, and then sells the items at oral public auction. The money realized from the sale is available in perpetuity for claim by the owners or their heirs.

The proceeds from unclaimed property are held in the Common School Fund. The division receives approximately \$10 million of unclaimed property each year. According to the division, owners or heirs claimed assets totaling about \$6 million in the year 2000.

Escheat Property

Upon notification of the death of a person with no apparent heirs or valid will, the division is responsible to ensure the protection of assets and to search for heirs and a valid will. If

the search is unsuccessful, the division is appointed to administer the estate.

Real and personal property of the estate is recorded and sold through oral, public auction. The proceeds, net of expenses and payments to creditors, are held in the Common School Fund for 10 years and are available for claim by proven heir during this period.

If there is no claim within 10 years, the funds are permanently deposited into the Common School Fund and are no longer available for claim.

Audit Results

Computer System Access

Division employees use a computer system to track unclaimed properties, and properties subsequently claimed. Our initial review of employee access profiles to the system determined that access within the system was not adequately limited.

Specifically, we found that:

- Fifteen employees had excessive access that allowed them to create, modify, and delete records. These functions should be segregated.
- Employees with significant access also were allowed physical access to the unclaimed property storage areas. These functions should also be segregated.

Guidelines for information system controls recommend that employee access to information be restricted to a "need to know" basis, dependent upon specific position responsibilities. In addition, allowing employees unnecessary access to the computer system along with access to unclaimed property storage areas increases the risk that employees could misappropriate assets and modify division records to conceal the activity.

Division management had not reviewed and approved employee access rights to ensure that access

was granted on a need-to-know basis and responsibilities were adequately separated.

Agency Accomplishments

During the audit, division management significantly reduced employee access to the unclaimed property records and assets. Three employees, however, continue to have conflicting or inappropriate access. Further restrictions therefore are needed to adequately protect resources.

We recommend that the division:

- Modify the access of the three employees noted above to further reduce the risks to unclaimed property.
- Review staff position descriptions and responsibilities to ensure that key controls are in place and procedures are adequately segregated. As part of this review, the division should confirm that employee access is provided only as needed to perform specific position duties.
- Review employee access to the storage areas in conjunction with the computer system access to ensure that staff does not have access to both unclaimed property and asset records.

Agency's Response:

The Division of State Lands generally agrees with the recommendations. We have made the necessary changes outlined in the recommendations.

Physical Security of Trust Property Assets

The division is responsible for the safekeeping of trust property assets. The trust property section maintains storage areas for unclaimed property from safe deposit boxes and estates. Assets are stored until sold at public auction. Per state rule, the division may sell unclaimed safe deposit box contents after holding them for at least a year.

Our review found that the division could improve the physical security of trust property assets. Several weaknesses existed, including:

- Some assets received by the division were not adequately secured upon receipt. In addition, the division did not inventory all items received in a timely manner.
- Allowing too many employees access to asset storage areas.
- Inadequate physical security over storage areas.
- Assets transferred to auction sites were not adequately secured during transport.

Inadequate physical security increases the opportunities for misappropriation, theft or loss of trust property assets.

Agency Accomplishments

During the audit, division management reduced employee access to the asset storage areas. Changes also were made to physical security over the storage areas. However, the changes to physical security did not completely reduce the risks to trust property assets.

We recommend that the division:

- Immediately secure assets upon receipt. Employees who record items should not have access to those items after the recording is completed.
- Restrict the number of employees allowed entry to the storage areas.
- Strengthen physical security measures over asset storage sites.
- Increase security measures during transport of items to auction sites. The division should consider requesting its contracted auctioneer transport the assets.

Agency's Response:

The Division of State Lands generally agrees with the recommendations. The Division has

taken actions to comply with the intent of the recommendations.

Auctions

The division contracts with a private auctioneer to conduct oral public auctions for unclaimed safe deposit box contents and assets from estates of Oregon citizens who die intestate with no known heirs. In the past, auctions have been held at various Oregon locations, including Albany, Portland, and Florence.

Selling Items to Maximize Sales Prices

State law directs the division to take steps to maximize the sales prices for trust property assets. The law instructs the division to hold public sales in cities that offer the most favorable market for the property involved, and allows the division to decline bids they consider insufficient. The division does not currently use the Internet to auction items.

We noted weaknesses in the auction process that may prevent the division from maximizing sales proceeds. In particular, we noted that the division:

- Did not obtain appraisals on a regular basis for valuable items sold at auctions. For example, the division commonly auctioned jewelry and collectible coins without obtaining appraisals.
- Did not resolve conflicting appraisals before selling a gem at auction in March 2000. Two appraisals ranged from \$1,400 to \$16,700, and the item sold for \$1,000.
- Did not establish minimum bid amounts for items prior to auction.
- Conducted auctions at locations that may not maximize sales prices.

We recommend that the division:

- Obtain appraisals for valuable assets and establish a record of

desired minimum bid amounts before assets are transferred to the custody of the auctioneer.

- Examine the market for trust property assets and determine auction locations that offer the most favorable markets.
- Explore using the Internet to auction items.

Agency's Response:

The Division of State Lands agrees in part with the recommendations. The Division is implementing the necessary changes. TPS will include our existing and other appropriate guidelines for determining location of an auction in the revision of our rules.

DSL is required by rule to dispose of property by public, oral auction. If possible, we will amend our rule to address this recommendation or, if necessary, submit a legislative concept to give the Division greater flexibility.

DSL has explored the possibility of conducting sales through the Internet, but needs to explore the requirements in more detail to determine whether it would be profitable.

Reconciliation of Auction Proceeds

The auctioneer collects the proceeds from the sale of trust property assets. The proceeds, along with copies of sales receipts, are remitted to the division. The division's trust property section retains the sales receipts and records the sale amounts in the unclaimed property computer system and estate records. The division's accounting section receives and deposits the cash proceeds to the Common School Fund; however, the division rarely performs a reconciliation of auction receipts to the amount deposited to the Common School Fund.

In addition, the auctioneer's contract requires the auctioneer to video or audio record all auctions for the division. According to division

staff who observed the auctions conducted during the period we reviewed, the auctioneer video recorded only some of the auctions, but did not provide a copy of the videos to the division. Also, audiotapes were not provided. We asked the auctioneer for copies of the video or audiotapes during our fieldwork; however, the auctioneer stated that he did not retain copies. Obtaining copies of auction video or audio recordings could help the division ensure that all auction proceeds are received from the auctioneer.

Finally, the auctioneer's records of lot contents did not always agree with the division's records. Descriptions differed or were not included in the auctioneer's records. In addition, the auctioneer often split lots to single out items in hopes of getting a better price for them. In doing so, the auctioneer assigned new lot numbers to the items, making it difficult to trace the items back to the division's original records. Without accurate auction records that agree with the division's records, the division has little assurance that all unclaimed and escheat property was sold intact. Furthermore, the division may not be able to match all sold property to owners. In the event of a subsequent claim, the division would be unable to calculate an accurate amount for the claim.

We recommend that the division:

- Reconcile auction proceeds to amounts deposited in the Common School Fund.
- Obtain copies of the auction video or audiotapes as a record of auction sales.
- Ensure that the auctioneer provides sufficiently descriptive records for tracing auctioned property.
- Develop a process for tracking split lots to account for the separated property.

Agency's Response:

The Division of State Lands agrees with the recommendations, but disagrees with the auditors' findings in part. The auditors stated that there is no reconciliation between SFMS and the auction proceeds. Although reconciliation is always done, it is not always adequately documented. We have implemented procedures to assure that staff provides written documentation for each reconciliation.

We have implemented changes to address the remaining recommendations.

Estates

The division's director becomes the personal representative for the estates of deceased individuals without apparent heirs. The division searches for heirs and, if none are found, records assets and then sells those assets at auction. The proceeds of those sales, as well as any funds from bank accounts or securities, are placed in the Common School Fund.

Internal control principles require that duties be segregated to protect assets. The functions of authorizing transactions, recording transactions, and maintaining asset custody should be segregated.

Serious internal control weaknesses existed in the division's estate processing. One employee performed all of the duties related to estates, including:

- Performing the search for heirs;
- Recording property;
- Determining amounts owed to creditors from estate assets and initiating those payments; and
- Transporting estate items to storage areas and auction sites.

We recommend that the division segregate the estate property duties by:

- Training other division staff members to assist with recording,

accounting and disposition of estate assets.

- Assigning an employee with duties separate from recording, accounting, and disposing of estate assets to perform monthly reconciliations between estates' balances and accounting records. In addition, we recommend that management review these reconciliations.

Agency's Response:

The Division of State Lands generally agrees with the recommendations. The Division has implemented changes to address the recommendations to the fullest extent possible at this time. All recommendations cannot be implemented without additional staff.

Securities Management

The division receives unclaimed securities from stock and mutual fund companies, safe deposit box contents and from other sources. State law instructs the division to sell securities to maximize returns.

The division contracts with a stockbroker to manage and sell securities. The division has not prepared reconciliations of its cash accounts held by the stockbroker, nor of receipts from securities sales and other activities. As a result, the division could not provide records of receipt for transactions totaling more than \$27,000.

In addition, the division did not have a structure in place to account for and manage its mutual funds.

The division had at least \$2.9 million of unsold mutual funds as of June 2001. Some of these mutual funds have been held since 1986. According to division management, the division has not developed a process to effectively manage and sell mutual funds.

Furthermore, the division has not managed 74 stock certificates received because they are not certain to whom these stocks belong. The

stock certificates were not entered into the unclaimed property computer system upon transfer and information was not maintained to allow the division to readily identify the certificates' apparent owners.

Finally, the division receives dividends for both securities holdings. The division has not reconciled dividend receipts to investment statements to ensure that all dividends were received.

During our review, we found an undeposited dividend check for more than \$200 that had been in the mutual funds files more than four months. A reconciliation could have identified the missing check.

We recommend that the division:

- Manage unclaimed mutual funds when they are transferred to the division and deposit the amounts into the Common School Fund.
- Attempt to identify the owner's names for the unmanaged stock certificates.
- Reconcile sales and dividend receipts to investment statements.

Agency's Response:

The Division of State Lands generally agrees with the recommendations. We have made changes necessary to address the recommendations.

Claims

Individuals often come forward to claim property held by the division. These individuals must provide evidence of their right to the property. If the claim is valid, the division returns either the property or the property's cash proceeds to the claimant.

We noted two areas relating to the claims process where the division needs to make improvements.

Repurchase of Securities

The division purchased approximately \$248,000 of securities on six occasions from April 1998

through June 2001. The securities, which had been previously converted to cash, were repurchased by the division under pressure from claimants. According to *Oregon Administrative Rule*, a person claiming securities held by the division is entitled to those securities. If the division sold the securities, the claimant is entitled to the cash proceeds. In addition, state law prohibits the state or any of its agencies from purchasing securities, except as specifically authorized by law.

We recommend that the division discontinue the practice of repurchasing stocks for claimants and provide claimants the proceeds from securities sales. When legal questions arise from claims on securities, the division should consult with the Attorney General.

Agency's Response:

The Division of State Lands generally agrees with the recommendations. The TPS is no longer repurchasing stock.

Pursuing Overpayments

Occasionally, the division mistakenly overpays a claimant. An overpayment may occur if the division pays out a claim prior to confirming the amounts entered in the unclaimed property computer system agree with information submitted by the holders. When the division discovers an overpayment, a letter is sent to the claimant requesting a return of the overpayment. If the claimant does not respond to the division, no further action is taken, resulting in a loss of funds. State law requires that a state agency, unless otherwise prohibited by law, assign every liquidated and delinquent account to a private collection agency or to the Department of Revenue.

We recommend that the division:

- Strengthen controls to prevent overpayments to claimants.
- Aggressively pursue the return of overpayments by submitting

delinquent accounts for collection to the Department of Revenue or a private collection agency.

Agency's Response:

The Division of State Lands generally agrees with the recommendations. To the extent possible, the Division has implemented changes to address the recommendations. Some changes must be delayed until DSL is able to address the collection of overpayments through guidelines in our rules scheduled for adoption in June 2002.

Reconciliations to Accounting

The unclaimed property computer system can be used to determine the net dollar amount of unclaimed property (total receipts of unclaimed property less claims paid). The system also provides underlying detailed information for the division's financial records. However, the net amount of trust property assets in the division's financial accounting records was approximately \$8 million less than the amount in the unclaimed property computer system. Reconciliations help identify errors or losses that may have occurred. Not reconciling these records may impair the division's ability to identify errors or losses. The division has not performed reconciliations between balances in the unclaimed property computer system and the financial accounting records for many years. Best practices recommend monthly reconciliations between accounting records and underlying detail records. Management review completes the reconciliation process.

We recommend that the division:

- Identify and correct the transactions to eliminate the \$8 million difference between the two systems.
- Perform a monthly reconciliation of balances between the unclaimed property computer

system and the financial accounting records.

- Perform timely reviews of the reconciliations.

Agency's Response:

The Division of State Lands generally agrees with the recommendations. The Division is initiating processes to address these issues.

Other Matters

We also noted the following concern during our review:

The division had not monitored the contract with its stockbroker. The contract, effective August 1999 through August 2001, specified a maximum payment of \$25,000 for the two-year period. Commissions and fees were deducted directly from transaction proceeds. The stockbroker sent a statement to the division after each sale showing the amount of commission deducted. The division, however, had not received summary statements of amounts deducted by the stockbroker as required by the contract, and had not kept a running total of commissions and fees paid to ensure that the contracted maximum payment amount was not exceeded. Twenty-three months into the contract period, the stockbroker had been paid approximately \$49,000. Although the payments appeared reasonable and appropriate for the work performed, the contract had not been revised to reflect this higher payment level.

We recommend that the division require the stockbroker to submit monthly status reports including the total amount of commissions paid to date, as required by the division's contract with the stockbroker. The division should monitor the commissions to ensure that amounts paid do not exceed the contracted amount.

Agency's Response:

The Division of State Lands generally agrees with the recommendations. The Division has implemented this recommendation.

Objectives, Scope and Methodology

The audit was conducted at the request of the director of the Division of State Lands. Our objective was to review the controls over trust property assets, which are managed by the Trust Property section of the division.

Specifically, we reviewed the controls over:

- Processing of holder reports and receipt of unclaimed property items.
- Computer system access.
- Physical security of trust property assets.
- Auctions and other processes of converting trust property assets into cash deposited with the Common School Fund.
- Estate administration.

- Securities management.
- Claimants filing for and receiving trust property assets.

Our work included inquiries of division personnel, examination of state law and rules and review of policies and documents relating to our objective.

In addition, we made efforts to determine if the division incurred losses resulting from the trust property control weaknesses identified in this report. Our review did not identify any specific losses. In many instances, however, we could not determine whether losses had occurred because the division's records were insufficient.

Fieldwork was conducted from June through October 2001.

The Secretary of State, a statewide elected official, serves as the constitutional Auditor of Public Accounts. The Director of Audits carries out the constitutional audit responsibility on behalf of the Secretary of State. The Secretary of State also serves as a member of the State Land Board, the body that oversees the Division of State Lands, the subject of this report. The reporting relationship between the Director of Audits and the Secretary of State did not impair the work planned or completed or the findings reported.

We conducted our audit according to generally accepted government auditing standards.

This report, which is a public record, is intended to promote the best possible management of public resources. Copies may be obtained by mail at Oregon Audits Division, Public Service Building, Salem, Oregon 97310, by phone at 503-986-2255 and 800-336-8218 (hotline), or internet at Audits.Hotline@state.or.us and <http://www.sos.state.or.us/audits/audithp.htm>

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The courtesies and cooperation extended by the officials and staff of the Division of State Lands were commendable and much appreciated.

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