

Office of the Auditor General

Performance Audit Report

Unclaimed Property

Department of Treasury

May 2017



The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

Article IV, Section 53 of the Michigan Constitution



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Office of the Auditor General

Report Summary

Performance Audit

Unclaimed Property (UP)

Department of Treasury (Treasury)

Report Number:
271-0130-16

Released:
May 2017

Michigan's UP program serves as the central depository for abandoned and unclaimed property. The State Treasurer acts as property custodian on the owner's behalf. Most property that is held, issued, or owing in the ordinary course of a holder's business and remains unclaimed by the owner for more than three years after it becomes payable or distributed is presumed abandoned. Every business or government agency holding unclaimed property belonging to someone whose last known address was in Michigan must report its holdings to Treasury. For fiscal year 2016, UP received 9,749 unclaimed property holding reports valued at \$150.3 million and paid 40,069 claims totaling \$89.7 million.

Audit Objective			Conclusion
Objective #1: To assess the sufficiency of UP's efforts to validate the accuracy of claimant information prior to releasing abandoned property.			Sufficient
Findings Related to This Audit Objective	Material Condition	Reportable Condition	Agency Preliminary Response
None reported.			Not applicable.

Audit Objective			Conclusion
Objective #2: To assess the sufficiency of UP's efforts to monitor contractors that provide auditing and financial services.			Sufficient, with exceptions
Findings Related to This Audit Objective	Material Condition	Reportable Condition	Agency Preliminary Response
UP should obtain a Service Organization Controls (SOC) 2, type 2 report from its contractor who serves as the custodian of unclaimed securities transferred to the State. Obtaining the SOC report would provide UP management with independent assurance that the contractor was processing and accounting for unclaimed securities in accordance with contract requirements (<u>Finding #1</u>).		X	Agrees

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Office of the Auditor General
201 N. Washington Square, Sixth Floor
Lansing, Michigan 48913

Doug A. Ringler, CPA, CIA
Auditor General

Laura J. Hirst, CPA
Deputy Auditor General



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Doug A. Ringler, CPA, CIA
Auditor General

May 17, 2017

Mr. Nick A. Khouri
State Treasurer
Richard H. Austin Building
Lansing, Michigan

Dear Mr. Khouri:

I am pleased to provide this performance audit report on Unclaimed Property, Department of Treasury.

We organize our findings and observations by audit objective. Your agency provided a preliminary response to the recommendation at the end of our fieldwork. The *Michigan Compiled Laws* and administrative procedures require an audited agency to develop a plan to comply with the recommendations and submit it within 60 days of the date above to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Doug Ringler
Auditor General

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AUDIT OBJECTIVES, CONCLUSIONS, FINDINGS, AND OBSERVATIONS

VALIDATING THE ACCURACY OF CLAIMANT INFORMATION PRIOR TO RELEASING ABANDONED PROPERTY

BACKGROUND

Unclaimed Property (UP) receives property from businesses and governmental agencies that belongs to someone else, has been dormant for a specified period, and remains unclaimed. Examples of unclaimed property* include uncashed payroll checks, inactive stocks, dividends, checking and savings accounts, and certain physical property (such as safety deposit boxes and tangible property*). The dormancy period for most property types is three years (see Exhibit #1). The State never takes ownership of the property but serves as a custodian for the owner or heir.

UP's main objective is to reunite owners or heirs with their lost or forgotten property. To claim property, the rightful owners or their heirs file an inquiry with UP and provide sufficient documentation as to their right to the unclaimed property. Documentation could include copies of a birth certificate, a driver's license, a social security card, employment records, a will, or a trust. It is UP's responsibility to validate the accuracy of the information received.

AUDIT OBJECTIVE

To assess the sufficiency of UP's efforts to validate the accuracy of claimant information prior to releasing abandoned property.

CONCLUSION

Sufficient.

FACTORS IMPACTING CONCLUSION

- Each of the 59 claims reviewed was properly approved and paid to the rightful claimant.
- Each of the 20 reports reviewed from holders* of abandoned property was accurate as to the number of units and value.
- UP monitored property edit reports to ensure that changes to abandoned property holdings were supported and accurately recorded.
- All claims forwarded to addresses that received 5 or more claim payments during fiscal years 2015 and 2016 were properly approved and paid to the rightful claimant.
- All claim payments made to UP staff were properly approved and appropriate.

* See glossary at end of report for definition.

MONITORING AUDITING AND FINANCIAL SERVICES CONTRACTS

BACKGROUND

UP contracts with six entities to complete audits to help ensure that holders of unclaimed property forward the property to the State. The contractors are to audit, identify, and deliver unclaimed property from holders that are subject to report such property. The contractors must submit written monthly reports detailing the work accomplished during the reporting period and are reimbursed based on the value of the property remitted to the State.

UP also contracts for financial services specific to unclaimed intangible property*. UP forwards this property to a contractor who serves as the custodian, accounts for securities and related dividends and interest, and aids in the liquidation or transfer of these securities. The contractor is required to sell the unclaimed intangible property when directed by the Department of Treasury (Treasury). In addition, the contractor must deposit dividends, interest, and other cash receipts from the held securities into a money market account and remit those funds monthly to Treasury.

AUDIT OBJECTIVE

To assess the sufficiency of UP's efforts to monitor contractors that provide auditing and financial services.

CONCLUSION

Sufficient, with exceptions.

FACTORS IMPACTING CONCLUSION

- Each compliance requirement we reviewed from the auditing and financial services contracts was monitored by UP staff.
- UP reviewed monthly reports submitted by auditing contractors to identify holders that did not submit abandoned property to the State on a timely basis. UP pursued late fees and interest from applicable holders as allowed for by law.
- UP periodically ensured that the financial services contractor traded securities at market value.
- A reportable condition* exists related to UP not requiring the financial services contractor to obtain a Service Organization Controls (SOC) 2, type 2 report*.

* See glossary at end of report for definition.

FINDING #1

Enhanced review of contractor activities needed to ensure that internal control functions as designed.

The contractor transferred \$83.7 million to UP between October 1, 2014 and September 30, 2016.

UP should obtain a SOC 2, type 2 report from its contractor who serves as the custodian of unclaimed securities transferred to the State. Obtaining the SOC 2 report would provide UP management with independent assurance that the contractor was processing and accounting for unclaimed securities in accordance with contract requirements.

UP contracted with a custodian to maintain and account for unclaimed securities transferred to the State. These securities consist of stocks, mutual funds, bonds, debentures, and associated dividends or interest. The contractor is also responsible for the liquidation or transfer of securities to unclaimed property owners at the direction of the State. Use of a contractor subjects UP to additional risks because the securities are accounted for using processes established by the contractor. To measure and mitigate these risks, UP needs information about the contractor's processes. Between October 1, 2014 and September 30, 2016, the contractor transferred \$83.7 million to UP for proceeds from stock sales, dividends, cash-in-lieu of fractional shares, as well as cash distributions from stock mergers. During our audit period, UP's oversight of the contractor's internal control* was based on information provided by the contractor.

An effective method to assess internal control and risks associated with contracted services is to obtain an independent analysis of the design and operating effectiveness relevant to the processes that the contractor uses. This analysis, referred to as a SOC report, is completed by an independent certified public accountant. The analysis provides a validation of the contractor's description of the processes' internal control and reports on the suitability of the design and operating effectiveness of those processes. SOC 2, type 2 reports can address any combination of five predefined control principles: security, availability, processing integrity, confidentiality, and privacy.

UP's contract with the security custodian did not require the contractor to obtain a SOC 2 report, and UP did not request the contractor to have one completed.

RECOMMENDATION

We recommend that UP obtain a SOC 2, type 2 report from its contractor who serves as the custodian of unclaimed securities transferred to the State.

AGENCY PRELIMINARY RESPONSE

UP provided us with the following response:

Treasury agrees with the recommendation. A policy did not exist at the time of contract execution requiring that a SOC 2, type 2 report be provided by the vendor annually. As noted in the Office of the Auditor General report, UP's contract with the

* See glossary at end of report for definition.

security custodian did not require the contractor to obtain a SOC 2 report and UP did not request the contractor to have one completed.

Treasury does support the recommendation that a SOC 2, type 2 report be provided if the result of a risk assessment determines a SOC 2, type 2 is necessary. If a SOC 2, type 2 is necessary, Treasury will issue a Statement of Work (SOW) to the vendor requesting the vendor provide a proposal for providing the required SOC report. Upon receipt of the vendor proposal, Treasury will, in conjunction with Department of Technology, Management, and Budget Procurement, conduct a risk/benefit analysis based on the cost of the SOW and will secure funding for the work if the analysis indicates a SOC 2 report is warranted.

During the audit, as a result of a request from UP, the contractor provided a SOC 1, type 2 which indicated the contractor's financial and security internal controls are effective.

SUPPLEMENTAL INFORMATION

UNAUDITED
Exhibit #1

UNCLAIMED PROPERTY
Department of Treasury

Abandonment Periods for Select Accounts
For Fiscal Years 2015 and 2016

<u>Typical Holder</u>	<u>Type of Asset</u>	<u>Abandonment Date</u>
Financial organization	Check, cashier's check, or certified check	3 years after it was payable
Financial organization	Savings account, checking account, or time deposit	3 years after last deposit/withdraw
Financial organization	Certificates of deposit	3 years from maturity date or, if automatically renewable, 15 years since first renewal
Financial organization	Mutual fund shares	3 years after last owner-initiated contact
Financial organization	Safe deposit box contents	3 years after the rental period expires
Financial organization	Christmas club funds	3 years from last deposit
Financial organization	Loan collateral	3 years after the loan was paid in full
Insurance company	Life insurance benefit or endowment payment	3 years after funds became due
Insurance company	Premium refund	3 years after the date the credit occurred
Business	Gift cards	3 years after becoming payable or 3 years of inactivity
Business	Commissions on sales	1 year after payment date
Business	Dividend payment	3 years after payable date
Business	Shares of stock	3 years after last owner-initiated contact
Business	Utility deposits	1 year after termination of service
Business/Governmental unit	Customer overpayment	3 years from payment date
Business/Governmental unit	Unpaid wages	1 year after becoming payable
Business/Governmental unit	Health saving accounts	3 years from last transaction
Governmental unit	Municipal bond principal and interest	1 year from maturity date
Governmental unit	United States government securities	1 year from payment
Title company	Escrow accounts	3 years
Court order	Child support payments	1 year after payment was made

Sources: *Michigan Compiled Laws* and Department of Treasury Manual for Reporting Unclaimed Property.

UNCLAIMED PROPERTY
Department of Treasury

Unclaimed Property Activity
For Fiscal Year 2016

	Claims Issued	Percent of Claims Issued	Claim Payments Issued	Percent of Claim Payments Issued	Number of Holders Reporting	Percent of Holders Reporting	Cash Holdings Received ¹	Percent of Cash Holdings
\$0.00	152	0.38%	\$ 0	0.00%	407	4.17%	\$ 0	0.00%
\$.01 to \$10.00	1,458	3.64%	7,584	0.01%	917	9.41%	3,477	0.00%
\$10.01 to \$100.00	10,559	26.35%	597,696	0.67%	2,010	20.62%	92,699	0.06%
\$100.01 to \$250.00	8,177	20.41%	1,321,814	1.47%	1,251	12.83%	209,852	0.14%
\$250.01 to \$500.00	5,755	14.36%	2,061,544	2.30%	975	10.00%	349,557	0.23%
\$500.01 to \$1,000.00	4,497	11.22%	3,182,479	3.55%	867	8.89%	627,363	0.42%
\$1,000.01 to \$2,500.00	4,248	10.60%	6,806,135	7.59%	1,107	11.36%	1,782,374	1.19%
\$2,500.01 to \$5,000.00	2,234	5.57%	7,847,941	8.75%	645	6.62%	2,299,615	1.53%
\$5,000.01 to \$10,000.00	1,549	3.87%	10,847,682	12.09%	520	5.33%	3,679,473	2.45%
\$10,000.01 to \$50,000.00	1,201	3.00%	24,761,732	27.61%	657	6.74%	14,489,674	9.64%
\$50,000.01 to \$100,000.00	148	0.37%	10,015,202	11.17%	161	1.65%	11,508,365	7.66%
\$100,000.01 to \$1,000,000.00	88	0.22%	18,140,120	20.22%	209	2.14%	58,956,189	39.24%
> \$1,000,000.01	3	0.01%	4,103,683	4.57%	23	0.24%	56,258,136	37.44%
Totals	40,069	100.00%	\$89,693,613	100.00%	9,749	100.00%	\$150,256,772	100.00%

¹Holdings reported with \$0 may have been related to securities or contents of unclaimed safe deposit boxes. Subsequent to the receipt of these types of holdings, the custodian of securities attempts to sell at market value. In addition, Treasury follows its procedures to value contents of safe deposit boxes.

Number of shares deposited with the contractor who was the custodian of securities for the State in fiscal year 2016: 17,236,837

Amount of security sales, dividends, cash-in-lieu of fractional shares, and distributions from stock mergers forwarded to the State during fiscal year 2016 from the contractor who was the custodian of securities:

Transfer Date	Amounts Forwarded to Unclaimed Property
11/01/2015	\$ 638,913
12/01/2015	144,214
01/01/2016	1,098,936
02/01/2016	499,081
03/01/2016	89,305
04/01/2016	40,532
05/01/2016	42,692
06/01/2016	6,368,941
07/01/2016	752,055
08/01/2016	5,459,334
09/01/2016	12,695,315
09/01/2016	526,791
	<u>\$28,356,109</u>

Source: The Office of the Auditor General prepared this exhibit based on information provided by UP.

AGENCY DESCRIPTION

Michigan's UP program is governed by the Michigan Uniform Unclaimed Property Act (Public Act 29 of 1995, as amended). The program is administered by Treasury and it serves as the State of Michigan's central depository for abandoned and unclaimed property. The State Treasurer is the administrator of the Uniform Unclaimed Property Act and acts as custodian of the property on behalf of the owner.

Most property, including any income or increment derived from the property, that is held, issued, or owing in the ordinary course of a holder's business and remains unclaimed by the owner for more than three years after it becomes payable or distributed is presumed abandoned (see Exhibit #1). Every business or government agency holding unclaimed property belonging to someone whose last known address was in Michigan must report its holdings to Treasury. Reports of unclaimed property are due each year by July 1 for property reaching its dormancy period as of March 31. An entity who fails to deliver unclaimed property within the time prescribed shall pay interest on the property or value of the property from the date the property should have been delivered and be subject to a civil penalty of \$100 per day.

UP's goal is to post all unclaimed property on its Web site within 90 days of receiving the property. UP's primary objective is to match claims to owners. To process a claim, UP matches proof provided by the claimant to information and property descriptions provided by the holder. The number of approvals needed to process a claim varies from 2 to 5 depending on the value of the unclaimed property.

For fiscal year 2016, UP incurred expenditures of \$6.0 million. As of September 30, 2016, UP had 26 full-time employees. For fiscal year 2016, UP received 9,749 unclaimed property holding reports valued at \$150.3 million and paid 40,069 claims totaling \$89.7 million (see Exhibit #2).

AUDIT SCOPE, METHODOLOGY, AND OTHER INFORMATION

AUDIT SCOPE

To examine the program and other records related to UP. We conducted this performance audit* in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our finding and conclusions based on audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives.

PERIOD

Our audit procedures, which included a preliminary survey, audit fieldwork, report preparation, analysis of agency response, and quality assurance, generally covered October 1, 2014 through September 30, 2016.

METHODOLOGY

We conducted a preliminary survey of UP to formulate a basis for establishing our audit objectives and defining our audit scope and methodology. We:

- Interviewed UP staff to obtain an understanding of processing holdings, verifying claim payments, and using contractors for auditing and financial services.
- Reviewed applicable laws, policies and procedures, and other relevant information provided by UP.
- Reviewed Treasury's evaluation of internal control for claims processing and holder reports and receipts.
- Completed limited testing of claims paid to verify UP's process for identifying owners of unclaimed property.
- Reviewed tangible property maintained in the secured custody room and observed the processing of mail directed to UP.
- Reviewed the process to sell unclaimed tangible property at a State-sponsored auction.

OBJECTIVE #1

To assess the sufficiency of UP's efforts to validate the accuracy of claimant information prior to releasing abandoned property.

To accomplish this objective, we:

- Identified the population of claims that UP paid during fiscal years 2015 and 2016.

* See glossary at end of report for definition.

- Reviewed a random sample of 59 claims to determine if claims paid were accurate, paid to the rightful claimant, appropriately approved, and adequately documented. Our sample was randomly selected to eliminate any bias and to enable us to project the results to the entire population.
- Ensured that payments to UP employees were appropriately supported and properly approved.
- Reviewed claim payments made to addresses that received 5 or more claim payments from October 1, 2014 through September 30, 2016 to ensure that these claims were properly approved and paid to the rightful claimant.
- Analyzed the claim payment population for fiscal years 2015 and 2016 by the initial approver for any unusual items.
- Verified that UP supervisory staff reviewed weekly property edit reports for the months of May 2016 and June 2016 to ensure that property edits were appropriate and supported.
- Identified the population of holders that reported abandoned unclaimed property to Treasury during fiscal years 2015 and 2016.
- Reviewed a random sample of 15 holder reports involving 677 intangible properties received during fiscal years 2015 and 2016 to ensure that intangible unclaimed property was dormant for the required period of time, processed in a timely manner, and appropriately posted to the UP Web site. Our sample results cannot be projected to all fiscal year 2015 and 2016 holdings because Treasury processed additional holder reports for this period after our sample selection.
- Reviewed a judgmental sample of 5 holder reports involving 15 properties received during 2015 to ensure that tangible property was dormant for the required period of time, processed in a timely manner, and appropriately posted to the UP Web site. We judgmentally selected the 5 holder reports based on the number of items reported and the nature of the holder's business. Therefore, we could not project the results to the entire population.
- Verified for a random sample of 5 employees that access to the UP information technology system was consistent with the employees' job descriptions.
- Verified that all employees of UP received training in fiscal year 2016 related to the confidentiality of information.

OBJECTIVE #2

To assess the sufficiency of UP's efforts to monitor contractors that provide auditing and financial services.

To accomplish this objective, we:

- Reviewed the contracts for auditing and financial services to identify compliance requirements that should be monitored by Treasury.
- Met with UP staff to discuss their efforts to monitor contractor activities and contract compliance requirements.
- Reviewed the February 2016 monthly status reports from the auditing contractors to determine if UP pursued holdings and related fees and interest payments from entities identified by the auditors as not reporting abandoned property on a timely basis.
- Reviewed revenue amounts received during fiscal years 2015 and 2016 from the financial services contractor for the sale of securities, dividend payments, cash-in-lieu of fractional shares of stock, and distributions from stock mergers.
- Reviewed the process that UP utilizes to reconcile proceeds from the sale of securities by the financial services contractor.
- Reviewed the unit price received by the financial services contractor for 50 securities traded during May 2015 or May 2016 to ensure that the contractor obtained market value for the traded units. We judgmentally selected the 50 securities based on various criteria, including the number of units traded and price per unit. Therefore, we could not project the results to the entire population.
- Determined if the financial services contractor provided a SOC 2, type 2 report to UP that assesses the contractor's internal control.

CONCLUSIONS

We base our conclusions on our audit efforts and any resulting material conditions* or reportable conditions.

When selecting activities or programs for audit, we direct our efforts based on risk and opportunities to improve State government operations. Consequently, we prepare our performance audit reports on an exception basis.

* See glossary at end of report for definition.

**AGENCY
RESPONSES**

Our audit report contains 1 finding and 1 corresponding recommendation. Treasury's preliminary response indicates that it agrees with the recommendation.

The agency preliminary response that follows the recommendation in our report was taken from the agency's written comments and oral discussion at the end of our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require an audited agency to develop a plan to comply with the recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

**SUPPLEMENTAL
INFORMATION**

Our audit report includes supplemental information presented as Exhibits #1 and #2. Our audit was not directed toward expressing a conclusion on this information.

GLOSSARY OF ABBREVIATIONS AND TERMS

holder	A person, wherever organized or domiciled, who is in possession of property belonging to another individual or a trustee or who is indebted to another as part of an obligation.
intangible property	Includes all of the following: money, checks, drafts, deposits, interest dividends, and income; credit balances, customer overpayment, gift certificates, security deposits, refunds, credit memos, unpaid wages, unused airline tickets, and unidentified remittances; stocks and other intangible ownership interest in business associations; money deposited to redeem stocks, bonds, coupons, and other securities or to make distributions; amounts due and payable under the terms of insurance policies; and amounts distributable from a trust or custodial fund established under a plan to provide health, welfare, pension, vacation, severance, retirement, death, stock purchase, profit sharing, employee savings, supplemental unemployment insurance, or similar benefits.
internal control	The plan, policies, methods, and procedures adopted by management to meet its mission, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It also includes the systems for measuring, reporting, and monitoring program performance. Internal control serves as a defense in safeguarding assets and in preventing and detecting errors; fraud; violations of laws, regulations, and provisions of contracts and grant agreements; or abuse.
material condition	A matter that, in the auditor's judgment, is more severe than a reportable condition and could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.
performance audit	An audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.
reportable condition	A matter that, in the auditor's judgment, is less severe than a material condition and falls within any of the following categories: an opportunity for improvement within the context of the audit objectives; a deficiency in internal control that is significant within the context of the audit objectives; all instances of fraud; illegal acts unless they are inconsequential within the context of the audit objectives; significant violations of provisions of contracts or grant agreements; and significant abuse that has occurred or is likely to have occurred.

Service Organization Controls (SOC) report

Designed to help organizations that provide services to user entities build trust and confidence in their delivery processes and controls through a report by an independent certified public accountant (CPA). Each type of SOC report is designed to help service organizations meet specific user needs:

- SOC 1 (Report on Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting) - Intended for user entities and the CPAs auditing their financial statements in evaluating the effect of the service organization's controls on the user entities' financial statements.
- SOC 2 (Report on Controls at a Service Organization Relevant to Security, Availability, Processing Integrity, Confidentiality, or Privacy) - Intended for a broad range of users that need information and assurance about a service organization's controls relevant to any combination of the five predefined control principles.

There are two types of SOC 1 and SOC 2 reports:

- Type 1 - Reports on the fairness of the service organization's description of controls and the suitability of the design of the controls to achieve the related control objectives included in the description, as of a specified date.
- Type 2 - Includes the information in a type 1 report and also addresses the operating effectiveness of the controls to achieve the related control objectives included in the description, throughout a specified period.
- SOC 3 (Trust Services Report for a Service Organization) - Intended for those needing assurance about a service organization's controls that affect the security, availability, or processing integrity of the systems a service organization employs to process user entities' information, or the confidentiality or privacy of that information, but do not have the need for or the knowledge necessary to make effective use of a SOC 2 report.

tangible property

Includes items in safe deposit boxes, personal property, or personal effects.

Treasury

Department of Treasury.

unclaimed property

Tangible or intangible property that is unclaimed by its rightful owner.

UP

Unclaimed Property.



Report Fraud/Waste/Abuse

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Hotline: (517) 334-8060, Ext. 1650