



ABANDONED PROPERTY SERVICES LLC

Evaluating and Remediating The Unclaimed Property Risk

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The risk of exposure associated with failure to comply or with inadequate unclaimed property compliance has never been greater. The current economic situation has incited state governments to seek additional revenues through increasing the number and complexity of state unclaimed property audits. Even though states are reducing their government workforces, they are increasing the number of audits by outsourcing audits to third party contractors. The result is the increased risk that a noncompliant business will be exposed and incurs significant liability plus penalties and interest.

Due to the increased risk of audit, many businesses are considering their potential exposure. (An initial compliance risk checklist is provided below as a measure to stimulate discussion regarding this risk within your business.)

The “proactive” approach to minimizing risk and exposure occurs in one of two situations:

1. **Businesses with Compliance History:** These businesses are re-evaluating their compliance policies and procedures, disbursement accounts, credit write-off information and compliance history, etc., to ensure they have been fully compliant (and/or that any recently acquired companies are in compliance). During this evaluation, the business may identify areas of exposure.
2. **Businesses with No Compliance History:** If the business has no compliance history, they must perform a similar but more extensive review than the business that has some compliance history. Most likely, the business will identify areas of potential exposure.

Being proactive in identifying and remediating risk may save a business thousands of dollars in exposure including penalties and interest that states charge for noncompliance in unclaimed property audits. Like any preventative measure, initiating the process and taking the first step is all important.

Identifying Areas Potential Exposure

The first step toward addressing the unclaimed property risk is to identify the areas of potential exposure. At a high level, identifying the potential areas of exposure requires review of:

- The availability and accessibility of records and information
- The organizational structure and financial reporting systems to develop an understanding of transaction flows and methodologies.
- The acquisitions and dispositions of divisions or related companies to determine the likelihood of liability within those entities.
- The various disbursement and miscellaneous income accounts to determine the extent of unclaimed property exposure by account.
- The general ledger accounts for potential sources of unclaimed property
- The policies and procedures relating to transaction flows and the pertinent accounts

To perform this review, it may become necessary to create a task force which includes key personnel from business areas that initiate and manage disbursements including payroll and accounts payable and from the account receivable, internal audit, and legal departments. The task force would be charged with gathering data pertaining to outstanding checks, unused credits, unused cash on account, outstanding suspense account items, etc. from all of the appropriate company units, divisions and subsidiaries. Depending upon the situation, it may be more effective for the business to hire unclaimed property experts to guide the task force in performing the review.

The extent of the data collected may be dictated by the business' record retention policy and the unclaimed property "reach back" period of the business' state of incorporation. Due to United State Supreme Court decision¹, if the business holding the property has name and address information for the person or entity that is owed the property, the law of the state of the address of this person or entity as recorded in the business' records controls. On the other hand, if there is no address information for this person or entity, the property must be reported and remitted in accordance with the state of incorporation of the business holding the property. For this reason, if a business is being audited for unclaimed property by its state of incorporation, that state's reach back period is highly significant.

For example, the state of Delaware, where many businesses are incorporated has a reach back period to 1981 (30 years) for businesses that have not reported unclaimed property to that state. If the business does not have records as far back as 30 years, the third party auditors hired by Delaware may estimate liability for the years. (Note that most states use a reach back period that

¹ Texas v. New Jersey, 379 U.S. 674 (1965).

is the dormancy period for the property type in question (usually 3 years to 7 years) plus 10 years.)

Considering the states' potential "reach back" periods, retrieving and reviewing records dating as far back as possible is important. Of course, businesses usually retain records only as far back as 3 to 5 years and accessing older records may not be practical due to their location or the cost of recovering them.

Analyzing and Minimizing Exposure

Once the pertinent data is gathered, the task force must analyze the data to determine if there are outstanding items that meet or exceed applicable state dormancy periods. Any such items that have a value exceeding a designated materiality limit should be researched to determine if they:

1. Are outstanding only due to an accounting error; or
2. May be validly offset (unused credits); or
3. May be exempted from the applicable state's unclaimed property law

Accounting error examples for which an outstanding accounts payable items may be reversed are:

- Checks re-issued without voiding original.
- Duplicate items on Vendor Master
- Duplicate payments
- Checks written to the wrong payee

Further, in some cases, unused credits may be offset against outstanding debits for a particular customer. In addition, some outstanding items may meet the criteria in the applicable state laws that make them "exempt" from the due diligence and reporting requirements. A few states have business to business exemptions and/or "de minimis" exemptions that may apply to particular items. It is advisable to seek the advice of legal counsel when considering whether an exemption provision is applicable.

The next logical step in minimizing exposure is to attempt to contact the owners of the uncashed or unused items not otherwise reversed due to the discovery of an accounting error, offset or applicable exemption. By contacting the owner/vendor/customer, the business seeks to confirm that the item in question is still owed. For example, if the item in question is an used credit and the customer is contacted with regard to the credit, the customer may indicate that the credit indeed had been applied to a specific invoice or may indicate that they intend to take the credit on a pending or upcoming order. If either of these responses is received, the communication and the

customer's answer should be reduced to writing and the customer should be asked to confirm his or her response by signing the written document. This document then becomes evidence to support that the item is not "unclaimed" or "abandoned" and therefore, not subject to state due diligence, reporting, and remittance requirements.

By performing the accounting error research, making pertinent offsets, appropriately applying exemptions, and making contact with the owner of potential unclaimed property, the amount of property for which due diligence must be performed and that must be reported and remitted to the state(s) can be minimized. However, it is very important that supporting documentation be maintained for any items that have been reversed due to the research, offset or exemption and through owner contact. In the event of an unclaimed property audit, the auditor most likely will question such reversals and the retained documentation can be used as substantiation.

Task force staff that has undergone the review, analysis and minimization process may become aware of methods for preventing or avoiding outstanding items in the future. This knowledge can be utilized to formulate policies and procedures that integrate into periodic routines for minimizing future reportable unclaimed property. Examples of procedures initiated due to the review are: 1) notifying a customer of an outstanding check or credit item within three months of issue; and/or, 2) distributing payroll by direct deposit.

Remediating Exposure

Once the task force has identified, analyzed and minimized potential unclaimed property, the remaining past due items should be addressed. Of course, the optimum result is to:

1. Eliminate past due unclaimed property by reporting and remitting it to the state(s); and
2. Avoid any penalties and/or interest for failure to timely report and remit the property.

While this result may not be completely achieved in terms of avoiding all penalties and interest assessments, creating a plan that includes voluntary disclosure and state negotiation are key in remediating as much penalty and interest exposure as possible.

Understanding the state requirements for voluntary disclosure is important to effective remediation. Generally, states that permit businesses to undergo a voluntary disclosure process do so only if the business has not reported unclaimed property in the past, is not currently undergoing an audit by the state or its agents or has not recently been notified by the state or its agents of their intent to perform an audit. However, some states may, in certain instances permit

a business to avail itself of the voluntary disclosure process if it has a reporting history but has failed to report a particular property type.

A state may have a formal or an informal voluntary disclosure process. States with formal processes require the business to apply for the process and if approved, then require the holder to submit particular documentation including a report and remittance. The state and the business may enter into a “voluntary disclosure agreement”. Other states have a more informal process where a letter on the business’ letterhead suffices as the application and the filing of a typical annual report and remittance is all that is required. The analysis performed by the business of its liability is very important in narrowing and substantiating exposure and in completing the state’s requirements.

Consider, however, that some states provide a release of liability for the property reported and remitted as a result of the voluntary disclosure process. This release exonerates the business for any past due-related penalties and interest and can be the state’s method of waiving its right to audit the business for the time period of dormancy represented by the property remitted. On the other hand, some states do not provide releases and/or do not waive their right to audit the business for the time period represented by the past due property remitted in the voluntary disclosure effort.

One of more difficult aspects of voluntary disclosure occurs when working with the business’ state of incorporation. As noted early, the “reach back” period for the state of incorporation is especially important when records are not available or difficult to access. Calculating acceptable estimates of the property due when records are not available for the “reach back” period can be tricky and expert assistance with sample design and exposure extrapolation may be warranted. A voluntary disclosure effort with the state of Delaware could reduce the reach back period to 1991 instead of 1981.

Some state negotiation and discussion may be necessary as a part of the remediation effort in order to achieve a satisfactory result for the business. It may be essential for the business and/or its representatives to meet with state officials to explain the business’ remittance scheme and its substantiation. The business’ exposure analysis and supporting documentation compiled in the analysis and minimization effort are essential in corroborating the business’ remittance scheme.

State negotiation also may be appropriate when the business is not permitted to avail itself of a state’s voluntary disclosure process due to its reporting history. However, it is important to

consider a state's recent law changes and trends and to have a firm grasp on the business' exposure prior to making contact with the pertinent state(s).

Future Compliance

After a business has remediated its risk, the final step is to insure that compliance is maintained at the least possible cost in the future. To do so requires that potential unclaimed property is minimized by implementing and following the appropriate policies and procedures and staying current on the ever-changing state due diligence and reporting/remitting requirements. The procedures for annually complying with due diligence and reporting/remitting requirements and for maintaining current knowledge of state requirements should become a part of the business' policy and procedure manual.

Conclusion

While remediating unclaimed property risk may seem a complex task, it presents opportunities as well. The review and analysis can assist staff and contracted experts in identifying strategies, processes and procedures for not only minimizing past due liability but for mitigating future exposure as well. The goals of significant risk and exposure reduction for past due property, reducing the penalties and interest on such property, and minimizing future liability, can be accomplished through a well-devised review, analysis and remediation effort.

FOR MORE INFORMATION:

www.abandonedpropertyservices.com

FOR A **FREE** UNCLAIMED PROPERTY WEBINAR GO TO:

www.abandonedpropertyservices.com/resources/free-webinar

***About Abandoned Property Services, LLC (APS):** APS serves the unclaimed property compliance needs of all types of businesses. APS provides policy /procedure and liability prevention consulting, audit defense and compliance maintenance via its annual reporting and due diligence services. Annual reporting and due diligence services are facilitated by APS' specially-devised and perpetually updated "in-house" systems.*

APS, LLC was formed in 2003 with the mission of providing high quality, effective, efficient and affordable unclaimed property compliance and audit support services to the business community. To this end, the fourteen (15) APS staffers have over 160 years of combined unclaimed property experience including unclaimed property consulting for big four accounting firms, and serving as unclaimed property officials for Illinois, New York, and Oregon. APS, LLC's principal office is located in New York, New York. For more information, please visit the APS LLC website at www.abandonedpropertyservices.com or contact Carla McGlynn at 21-594-1034, ext 227 or cmcglynn@apsescheat.net OR Karen Anderson at 317-577-9530 or kanderson@apsescheat.net
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ABANDONED PROPERTY SERVICES LLC

UNCLAIMED PROPERTY COMPLIANCE CHECKLIST

<Company Name>

<Date>

Unclaimed Property Compliance Checklist				
	Yes	No	N/A	Notes
History / Data				
1. Does our company file unclaimed property reports?				
2. If our company files unclaimed property reports for which years and states do we have report evidence? (add this information under "Notes")				
3. Has our company ever been audited by a state unclaimed property auditor or third party unclaimed property auditor?				
4. Does our company have established policies and procedures for unclaimed property compliance?				
5. Does our company hold amounts for unknown payees?				
6. Does our company maintain customer accounts on US books that are managed by a foreign office?				
Property Type Specific Questions				
7. Does our company have uncashed payroll, commission or expense checks older than one year?				
8. Does our company have uncashed vendor checks older than one year?				
9. Does our company have unused credits or deposits older than one year?				
10. Does our company offer a refund or rebate program?				
11. Does our company issue gift certificates/cards and/or merchandise credits?				
12. Does our company have any unpaid refunds or gift certificates/cards older than one year?				
13. How does our company post unidentified receipts?				
14. Does our company maintain a liability/reserve account for uncashed checks and unused credits, gift certificates/cards, etc.?				
15. Does our company issue stock?				
a. If yes, does our company pay cash or stock dividends?				
b. If yes, does our company have amounts held for shareholders that did not redeem their shares?				
c. If yes, does our company have shareholder accounts in undeliverable mail status with dividends unpaid for a year or more?				
16. Does our company offer a dividend reinvestment plan?				
17. Does our company issue bonds for which it pays interest to bondholders?				
a. If yes, does our company have bond interest checks that interest checks that are outstanding more that 3 years?				
18. Does your company contract with a third party to make disbursements on its behalf (i.e. a paying agent, transfer agent, payroll disbursement agent, etc.)?				

Related Questions				
19. Has our company acquired other companies which may have unclaimed property liability?				
20. Does a third party contractor issue our company's payroll, employee benefits, retirement, or other check disbursements?				
a. If yes, does our company insure that our contractor complies with state unclaimed property laws or provides us with information/funds in order to comply with state unclaimed property laws?				
21. Does our company have a written policy regarding the disposition of customer credits or purchases?				
22. Does our company maintain customer information for each credit or payment?				
a. If yes, how long does our company maintain customer/payee information?				

<p>If you answered "yes" to any of the questions 7 - 17 above, your business may be holding reportable unclaimed property. Contact APS, LLC to discuss your business' compliance alternatives.</p>
