It's <u>Not</u> a Tax (But It Sure Feels Like One)

Unclaimed Property Best Practices and Audit Defense

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Learning Outcomes –
What Audience Will Gain From this Session

- Best Practices – What are they? Why do you need to know them?
- Pre-Audit Considerations – What do you need to be prepared for the "Notice of Audit"?
- Audit Methodology – What are the recent audit methodology refinements and how do they affect holders?

Best Practices

Examples of Best Industry Practices

- Determine potential unclaimed property exposure
  - Identify property types to be reviewed (e.g., payroll, vendor checks, suspended royalties, etc.)
  - Look at each line of business – property types may vary across lines of business
- Perform early outreach to payees as a first round of due diligence prior to the statutory due diligence period
  - The earlier the better – follow up while the trail is fresh!
  - Outreach letters typically sent within 90-180 days
  - Less formal than statutorily required due diligence
  - Make sure to keep good records of communication

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Examples of Best Industry Practices (continued)

- Develop Comprehensive Policies and Procedures
  - Develop and maintain detailed processes and procedures for tracking and reporting unclaimed property
  - Form a committee responsible for compliance. Include key personnel, including, but not limited to, internal audit, legal counsel, treasurer, comptroller and/or tax director
- Set the Tone At the Top
  - Have a policy signed by a "high level" officer indicating company complies with unclaimed property laws, and delineating what group is responsible for such compliance
  - Make sure policy is disseminated to all subsidiaries and accounting/payment centers

Examples of Best Industry Practices (continued)

- Conduct internal audits of unclaimed property processes and procedures
- Offer educational programs to <u>all</u> personnel responsible for unclaimed property compliance
- Indentify and monitor Third Party Administrators (TPAs)
  - Know what TPAs are doing; conduct periodic review of their unclaimed property compliance activities
  - Review service contracts with legal
  - In most cases, escheat liability cannot be transferred to TPA's (holder is ultimately responsible)
  - If TPA is reporting on holder's behalf, make sure TPA is complying with unclaimed property obligations

Examples of Best Industry Practices – M&A Considerations

- States and contract auditors are increasingly reviewing significant M&A transactions

- In a stock transaction, the acquiring entity is generally liable for all unclaimed property liabilities associated with the acquired entity that arose pre-closing

- M&A unclaimed property due diligence – before the transaction is completed – understand unclaimed property compliance history or lack of compliance history of the target

Pre-Audit Considerations

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- Establish an audit team
  - Select one point of contact to represent the company
  - Select representatives for each property type under audit
    - Payroll, Accounts Payable, Accounts Receivable, Royalties
  - Consider hiring consultants and attorneys with audit defense experience
- Execute Non-Disclosure/Confidentiality Agreement
  - Will help limit auditor soliciting additional states to participate
  - Include any provisions based on holder's business needs
- Communication is key
  - Communicate with the project team, the auditor, and the state
  - Be sure to obtain copies of state authorizations for the audit

Pre-Audit Considerations (continued)

- Determine level of historic compliance
  - Which states and which property types
- Consider internal control process
- Identify risk areas through internal review
  - Develop internal assessment of potential liability
- Research and document business positions
- Maintain normal compliance
  - Do not add additional property to normal process
- Assess which records are available per company's record retention policy

Audits and Notification

- Types of Audits
  - Third Party Contingency Audits (Multi-State)
  - Direct State Audits
- How does it occur?
  - Receive letter by "mandate" state
  - May receive telephone call/letter from state representative

Audit Triggers

- Size of the company
- State of incorporation
- Principal place of business
- Publicity about a company or industry
- Industry
- Merger or acquisition activity
- Errors or omissions in Annual Reports or VDA's

Recent Refinements in Contract Auditor Methodology

Recent Refinements in Contract Auditor Methodology

- Audits of Equity-Related Property
  - Until very recently, contract auditors traditionally did not conduct audits of equity-related property; some now have a comprehensive IDR and audit team asking for detailed information in this area, and routinely have conducted securities audits concurrently with the General Ledger audits
- Audits of Rebates/Promotional Incentives
  - Traditionally focus of ACS audits; now other contract auditors are beginning to focus on this property type

Recent Refinements in Contract Auditor Methodology (continued)

- M&A Scoping
  - Contract auditors are becoming increasingly sophisticated in this area – asking more questions and requiring more documentation; information requested includes dates of acquisitions, state of incorporation of acquired entity, copies of the Purchase and Sale Agreement, etc.
- A/R Credit Balances
  - Contract auditors now seek considerable detail associated with remediation of A/R balances, and during remediation seek to trace the credit balance through the entire general ledger transaction process

Recent Refinements in Contract Auditor Methodology (continued)

- Bifurcation of ROEs
  - Contract auditors frequently did not issue a ROE (Report of Examination) on any one property type until the conclusion of the audit of all property types. Now, ROEs are issued by property type once the review of the property type is complete. In addition, contract auditors are increasingly bifurcating ROE's, and issuing ROEs on AP and payroll, even though a review of other property types – commonly A/R credit balances – have not been resolved. This allows contract auditors, and the states they represent, to collect funds in a more expeditious fashion, thus allowing contract auditors to be paid "sooner rather than later".
- GRIR
  - Although DE has essentially exempted this area, other contract auditors still pursue this property type for several key states, notably NJ and NY. It doesn't appear these issues are "going away".

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