



# INTERNAL CONTROLS IMPACT ON UNCLAIMED PROPERTY COMPLIANCE

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With you today



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# Agenda

- ▶ Internal audit process
- ▶ Unclaimed property overview
- ▶ Understanding impact of internal controls on unclaimed property reporting
- ▶ Global mapping
- ▶ Creating strong internal controls around unclaimed property
- ▶ Best practices
- ▶ Final comments

# Internal audit process



# What is internal audit?

*“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. ... Professionals called internal auditors are employed by organizations to perform the internal auditing activity.”*

- Institute of Internal Auditors

# Internal audit approach

We have a five-phase process to address key risk areas of an organization and to drive value throughout each phase.



# Risk assessment process

## Identify

- Identify risks based on experience, regulation, trends

## Assess

- Prioritize risks on the likelihood that they will occur and the magnitude of impact if they did occur

## Respond

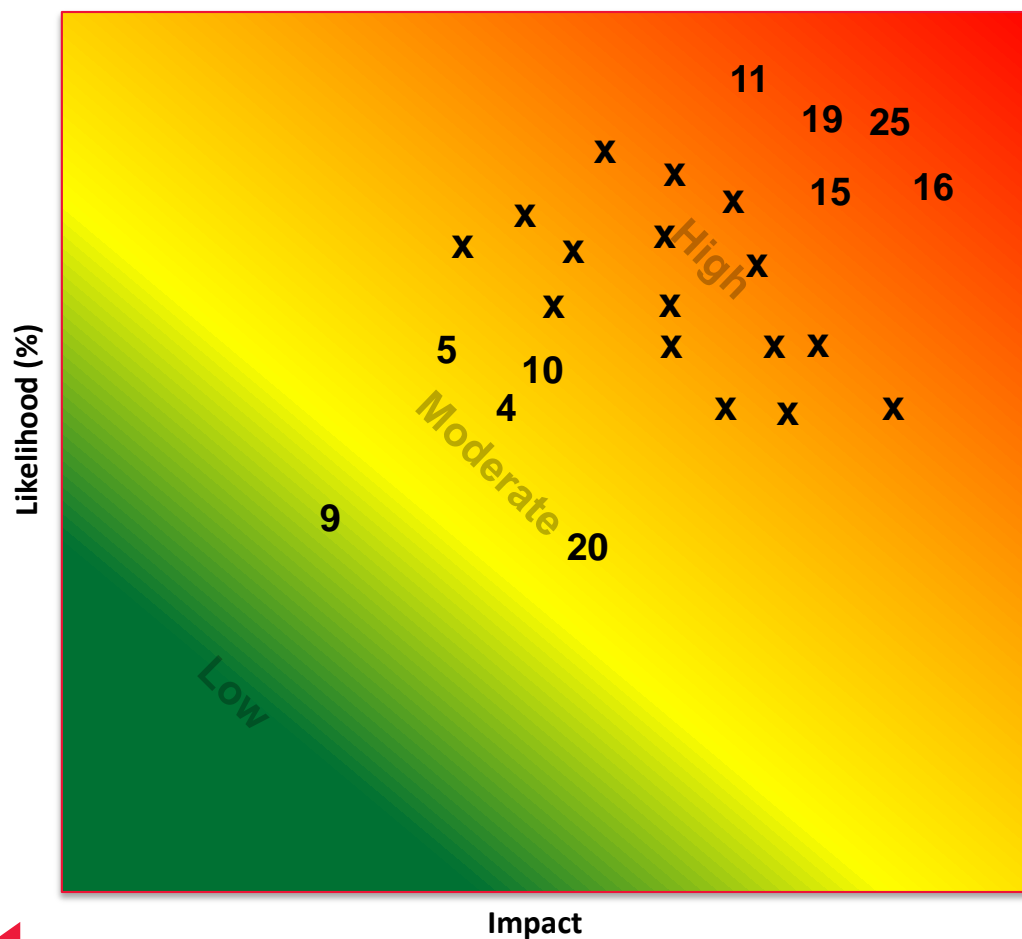
- Accept, avoid or mitigate (share , transfer, reduce, control, or audit) based on management's risk tolerance

## Monitor

- Update based on changing risk environment, your organization's changes, mitigation action plans

# Risk universe

The risk assessment links internal audit procedures to the Company's risk management framework.



## Highest Risks:

- 25 Revenue
- 16 Technology
- 19 Leases
- 11 Acquisitions
- 15 Financial Reporting

## Lowest Risks:

- 9 **Unclaimed Property**
- 5 Human Resources
- 4 Contract Management
- 10 Privacy and Security
- 20 Regulatory Compliance

### DEFINITIONS

**Impact:** financial consequence of the risk occurring

**Likelihood:** estimated probability that the risk is currently active or could occur during the next 12-18 months





# What is unclaimed property and why is it a risk?

Unclaimed property are funds in financial institutions or companies that have had no activity generated or contact with the owner for a period of time.

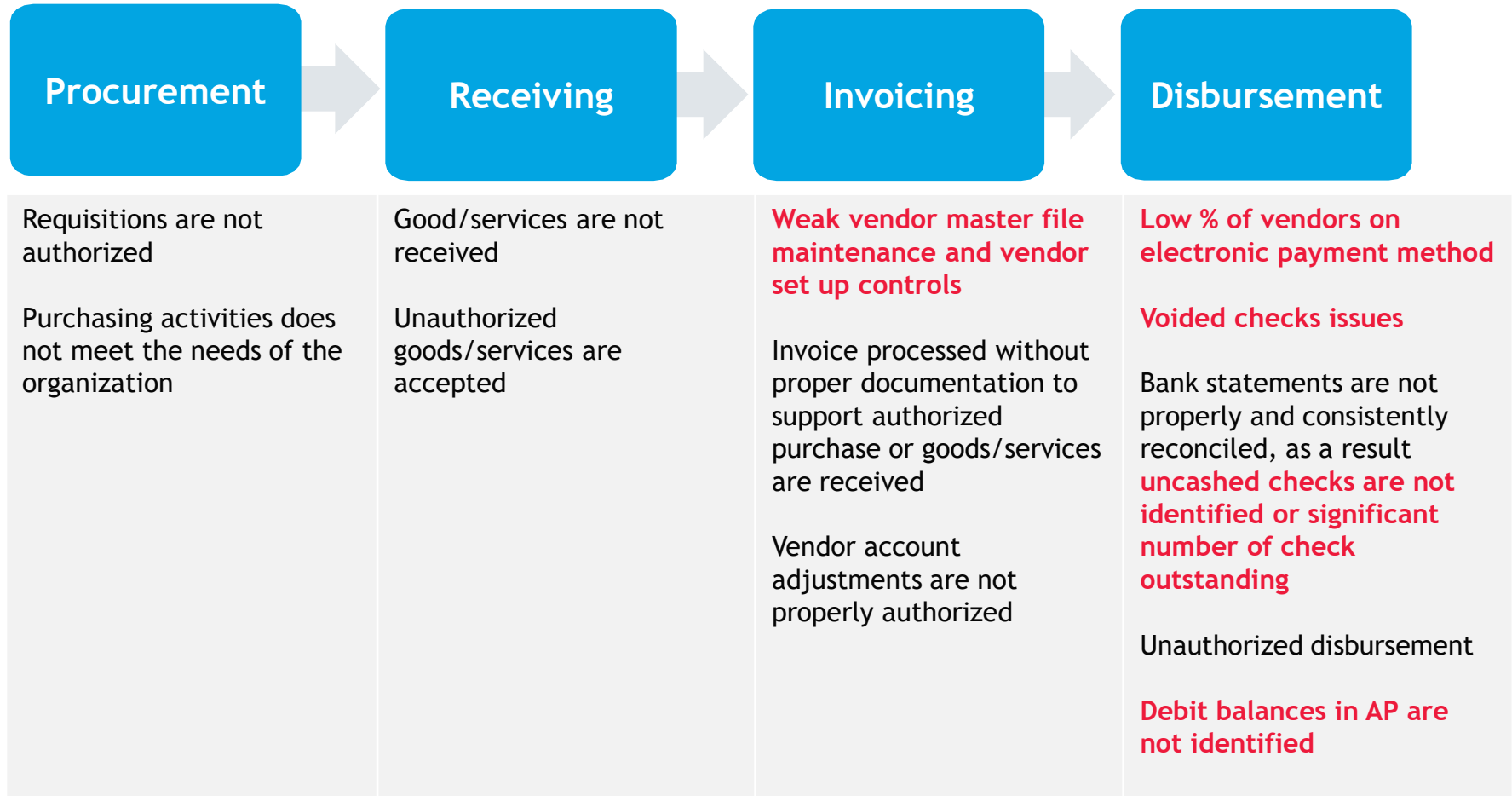
**Why is unclaimed property important to you?** *Because companies with unclaimed property may be subject fines and penalties if they are not reporting and submitting these funds to the government, timely. This may result in significant and material exposures due to long look-back periods and extrapolation techniques employed by the states.*



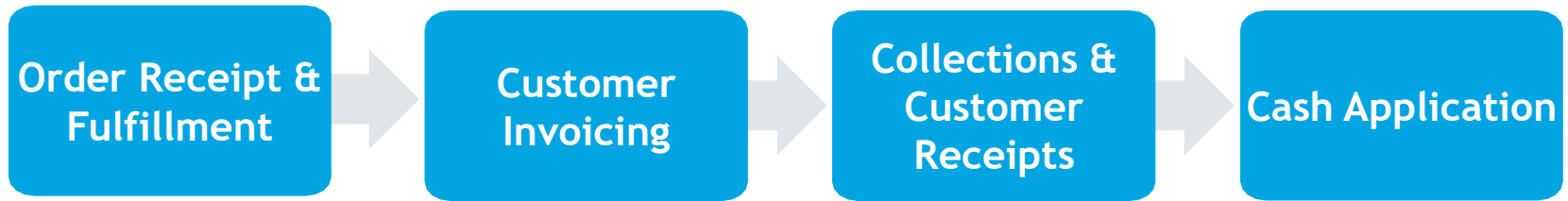
# Why unclaimed property is missed

- ▶ Companies may think they do not have any unclaimed property
- ▶ Companies may think reporting is voluntary
- ▶ Unclaimed property is a compliance function within a company that is not known or owned by anyone
- ▶ Management may be unaware or may underestimate the financial impact of non-compliance
- ▶ There may be no policies or procedures that cover this area of compliance

# Procure to pay



# Order to cash process



Inefficient order management system

Orders are incorrectly fulfilled

Invoicing delays and inaccuracies

Invoiced incorrect account

**AR aging not performed to detect and analyze accounts**

Lack of follow up activity on past due accounts

**Multiple systems used (system conversion)**

**Weak or lack of write off policy**

**Customer overpaid, as a result a credit balance exists**

# Unclaimed property overview



# Unclaimed property overview

- ▶ All 50 states and the District of Columbia have enacted unclaimed property laws
- ▶ The purpose of unclaimed property laws is to ensure the protection of abandoned property until the rightful owner is located
- ▶ Moreover, states use any derivative funds earned on such property for the public good
- ▶ Unclaimed property is **not** considered a tax
- ▶ States actively pursue unclaimed property as an additional source of revenue for the state, which avoids raising taxes



# Unclaimed property overview

- ▶ States' unclaimed property laws apply to all entity types, including:
  - Corporations
  - S Corporations
  - Partnerships
  - Limited Liability Companies
- ▶ Generally **intangible personal property** for which there has been no owner activity for a specified period of time (“i.e., dormancy period”)



# Unclaimed property types

## Examples of unclaimed property:

- ▶ Uncashed payroll or commission checks
- ▶ Uncashed payable/vendor checks
- ▶ Gift certificates/gift cards
- ▶ Customer merchandise credits, layaways, deposits, refunds or rebates
- ▶ Overpayments/unidentified remittances
- ▶ Suspense accounts
- ▶ Unused/outstanding benefits (non-ERISA)
- ▶ Credits written off to miscellaneous income/bad debt expense accounts



# Jurisdictional priority rules

- ▶ The U.S. Supreme Court in *Texas v. New Jersey*, established the following unclaimed property jurisdictional priority rules:
  - First, to the state of the owner's last known address, if known, and it has an escheat law; or
  - Second, to the state of the holder's corporate domicile (i.e., state of incorporation for incorporated entities and state of formation/ principal place of business for unincorporated entities).
- ▶ Priority rules in *Texas v. New Jersey* were reaffirmed and retroactively applied in the subsequent cases *Pennsylvania v. New York* (escheat of money orders) and *Delaware v. New York* (unclaimed dividends and interest).



# Extrapolation

- ▶ Many states, including Delaware, use extrapolation techniques to establish a historic liability, at times dating back 15 - 30 years (e.g., NY back to 1992 on audits), in the event all records requested are not available and/or complete.
- ▶ The determination of whether or not to extrapolate may depend on factors such as:
  - Historical unclaimed property reporting practices
  - Filing history
  - Materiality of errors found for periods where records were reviewed
  - Record availability and reliability by property type
  - Statutory authority to extrapolate.

# Extrapolation

## ACCOUNTS PAYABLE - 1 YEAR EXAMPLE

$$\frac{\text{Accounts Payable O/S Checks - 12/31/2004}}{\text{Federal 1120 Sales - 12/31/2004}} = \% \times \text{Federal 1120 Sales (prior years)}$$

# Extrapolation

## PAYROLL - 1 YEAR EXAMPLE

Unremediated Payroll O/S Checks –  
12/31/2004

Federal 1120 Payroll – 12/31/2004

= %

x

Federal 1120 Payroll  
(prior years)

# Extrapolation

## A/R - 1 YEAR EXAMPLE

- ▶ If all sales are on account, the following extrapolation can be used:

Unremediated Net Credits<sup>1</sup> –

12/31/2004

—————  
Sales -  
12/31/2004

= % x Sales (prior years)

- ▶ Holder should review credits written off (e.g. to miscellaneous income/expense account) to any amounts of bad debt as this is a viable position to offset net credits that is often overlooked.

*1. In many cases the net credits were written off to miscellaneous income, allowance for doubtful accounts, or bad debt expense and documentation to prove it is not escheatable is unavailable.*

# Exposure quantification

Base Period	Total Unclaimed Property Liability (ALL STATES) for Base Period (a)	=	Escheat Percentage (c) (Unclaimed Property Liability(a)/Total Sales (b))
	Total Sales (1120) for Base Period (b)		
Projection Years	Escheat Percentage(c) * Total Sales in Non-Base Period(d)	=	Total Projected Liability(e)
	Total Projected Liability(e) + Address Property(f)		
			Total Liability Owed (Projection and Address)

# Extrapolation example

Year	Sales	Total Unremdiated Unclaimed Property	Unremediated Unclaimed Property w/ Delaware Address	Extrapolated Liability Sourced to Delaware	Total Delaware Assessment
2005	750,000,000	250,000	12,500	Use Actual Data	12,500
2004	700,000,000	650,000	5,500		5,500
2003	680,000,000	320,000	11,200		11,200
2002	675,000,000	90,000	8,300		8,300
2001	665,000,000	110,000	4,500		4,500
2000	550,000,000	Documents Unavailable	Documents Unavailable	225,072	225,072
1999	625,000,000			255,764	255,764
1998	600,000,000			245,533	245,533
1997	550,000,000			225,072	225,072
1996	540,000,000			220,980	220,980
1995	525,000,000			214,841	214,841
1994	510,000,000			208,703	208,703
1993	495,000,000			202,565	202,565
1992	475,000,000			194,380	194,380
1991	460,000,000			188,242	188,242
1990	425,000,000			173,919	173,919
1989	400,000,000			163,689	163,689
1988	390,000,000			159,597	159,597
1987	365,000,000			149,366	149,366
1986	345,000,000			141,182	141,182
Actuals	10,725,000,000			1,420,000	42,000
Error Rate		0.04092%			
Application of Penalties and Interest					3,763,631
Total Delaware Assessment					6,774,536

# Understanding impact of internal controls on unclaimed property reporting



# Understanding controls over unclaimed property reporting

- ▶ Understanding your company's controls over unclaimed property reporting can help mitigate future unclaimed property risk
- ▶ Implementing the following three step process can help decrease unclaimed property risk while increasing overall efficiency of processes that impact unclaimed property reporting:
  1. Map internal accounting processes that impact your company's overall compliance with unclaimed property laws
  2. Identify common stress points to highlight weaknesses in current established processes
  3. Develop action plan for addressing weaknesses identified in step #2

# Common pitfalls - accounts payable

- ▶ Duplicate vendors set up in system
  - Potential multiple payments - same invoice to different vendor numbers
- ▶ Lack of vendor master maintenance
  - Stale vendor information that results in incorrect payment processing that leads to unresolved invoices/payments
- ▶ Low percentage of vendors on electronic payment method
- ▶ No standard process and documentation for voided checks
- ▶ Manual reconciliation of bank accounts in Excel
- ▶ No policy and procedure to address rejected electronic payments such as ACH/wires
- ▶ No shared service platform giving rise to varying policies and procedures throughout company
- ▶ No process in place to address outstanding checks when changing bank accounts

# Common pitfalls - accounts receivable

- ▶ System conversion - Billing occurs in predecessor system; cash receipt applied in new system creating perceived credit balances
- ▶ Small dollar write off policy that allows for writing off of amounts to P&L
- ▶ No established cadence to follow up on credits on account
- ▶ Credits on account not communicated to customers on a periodic basis
- ▶ No process for addressing customer balances for inactive customers
- ▶ Improper documentation retained for adjustments to customer accounts
- ▶ Reporting amounts to states due to current customers
- ▶ Not offsetting credits potentially due to prior bad debts written off
- ▶ Netting across customer accounts when not legally permitted by contract
- ▶ Not reporting of stale credits simply because of ongoing relationship with customer
- ▶ Not communicating in writing outstanding credits to customers
- ▶ Offsetting credits to future invoices without proper communication with customers (“kicking can down the road”)

# Global mapping

# Global mapping process - unclaimed property

- ▶ Phase I - Global Mapping Scoping & Planning
  - Identify legal entities & property types for review
  - Understand current escheatment practices
  - Understand current ERP, Billing, Order Entry and Other Systems
  - Review trial balances & A/R Agings
  - Establish Workplan & Preliminary Questionnaires (if applicable)
  
- ▶ Phase II - Onsite Functional and Personal Interviews
  - Conduct & Document Interviews - Accounts Payable
  - Conduct & Document Interviews - Payroll
  - Conduct & Document Interviews - Accounts Receivables
  - Conduct & Document Interviews - TPAs
  - Conduct & Document Interviews - Royalties
  - Conduct & Document Interviews - Other Properties

# Global mapping process - unclaimed property

## ▶ Phase III - Global Mapping Analysis & Sample Testing

- Prepare Global Mapping Flowcharts
- Review Global Mapping Flowcharts with process owners
- Finalize Global Mapping Flowcharts & Analysis
- Perform sample transactional or system testing (if applicable)

## ▶ Phase IV - Report Findings & Recommendations

- Prepare Global Mapping Report
- Review Global Mapping Report with process owners
- Finalize Global Mapping Report
- Communicate & Evaluate Implementing Recommendations on Global Mapping findings

# Creating strong internal controls around unclaimed property



# Key processes and controls

## UNCLAIMED PROPERTY

### Key Focus Areas:

- ▶ Identifying and quantifying unclaimed properties
- ▶ Connecting with the property owner
- ▶ Reporting abandoned unclaimed property
- ▶ Remitting the funds to the appropriate state if the owner can not be reached



# Unclaimed property controls

## Key Accounts and Processes are Identified

Including:

- ▶ Amount threshold (e.g. over \$50)
- ▶ Dormancy period (e.g. 5 years)

## Examples of accounts with reportable unclaimed property:

**Treasury/AP:** Uncashed checks (e.g., vendor checks, money orders, travelers checks)

**Accounts receivable:** Billing, credit balances, and refunds.

**Insurance claims:** Insurance proceeds

**Revenue:** Sales rebates are not processed.

**Inventory:** Goods received/not invoiced

**Deposits:** Lease or customer deposits

**Equity:** Unexchanged shares of stock related to a merger or acquisition (i.e., Shareholders fail to exchange old shares for shares of the new company as a form of payment).

**HR/Payroll:** Salaries and wages, and commission expense

# Best practices



# Unclaimed property

## BEST PRACTICES

The following best practices can be incorporated into all holder's compliance process to mitigate future escheat liabilities:

- ▶ Compliance
- ▶ Policies & Procedures
- ▶ Accounting Practices & Control Reviews (Global Mapping)
- ▶ Voluntary Disclosure Process
- ▶ Refund Opportunities

# BDO's proven escheat compliance process



# Policies and procedures

## AR

- ▶ Interview Process Owners
- ▶ Obtain Sample A/R aging
- ▶ Complete A/R questionnaire
- ▶ GL system review
- ▶ Verify unapplied cash practices
- ▶ Verify de minimis write-off practices
- ▶ Identify manual and automatic writeoffs (if any)
- ▶ Document A/R process; draft policy and procedures
- ▶ Setup A/R escheat liability GL account
- ▶ Augment policy and procedures for escheat best practices and compliance timeline

## AP

- ▶ Interview Process Owners
- ▶ Obtain sample check register or outstanding checklist and void reports
- ▶ Complete A/P questionnaire
- ▶ GL system review
- ▶ Verify stale date and void practices
- ▶ Identify manual and automatic writeoffs (if any)
- ▶ Document A/P process; draft policy and procedure
- ▶ Setup A/P escheat liability GL account
- ▶ Augment policy and procedures for escheat best practices and compliance timeline

## Payroll

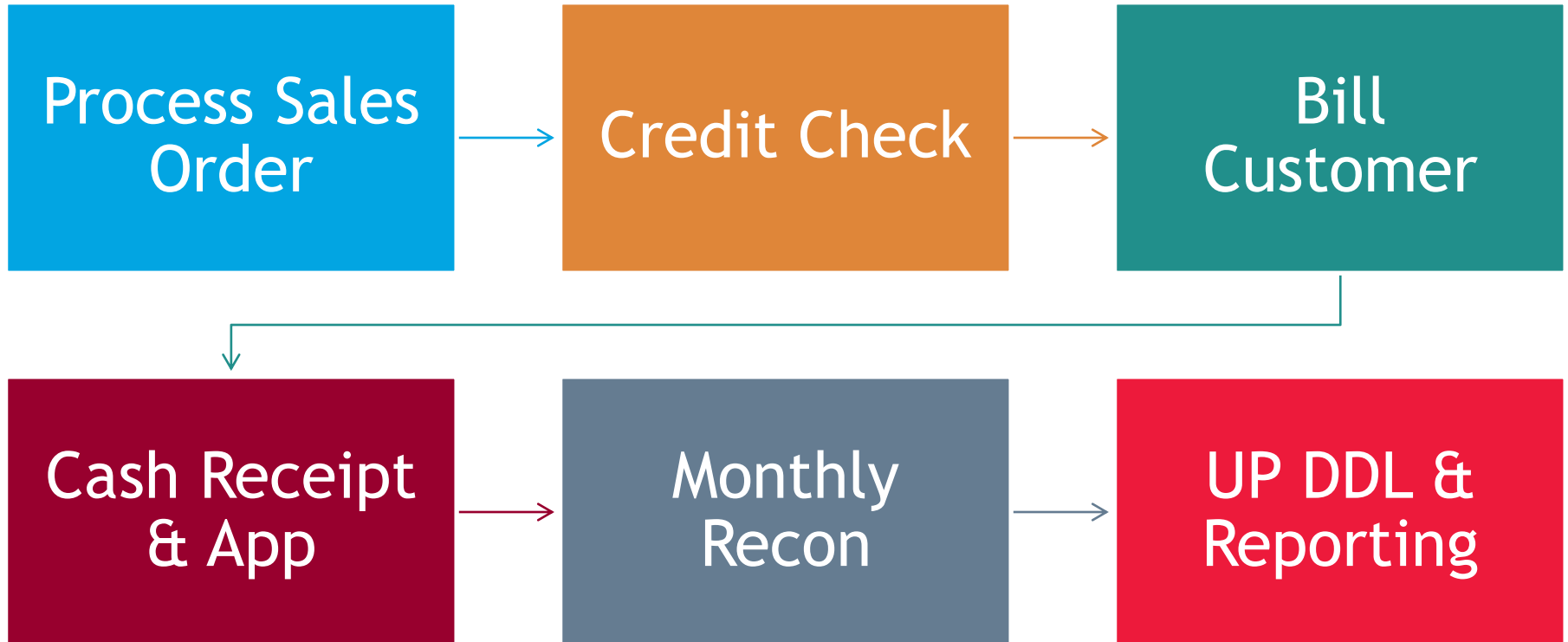
- ▶ Interview Process Owners
- ▶ Determine if payroll done in house or outsourced (ADP)
- ▶ Obtain sample check register or outstanding checklist and void reports
- ▶ Complete payroll questionnaire
- ▶ GL system review
- ▶ Verify stale date and void practices
- ▶ Identify manual and automatic writeoffs (if any)
- ▶ Document payroll process; draft policy and procedure
- ▶ Setup payroll escheat liability GL account
- ▶ Augment policy and procedures for escheat BPs and compliance timeline

## TPA

- ▶ Interview Process Owners
- ▶ Complete TPA Matrix
- ▶ Obtain TPA Plan Documents
- ▶ TPA Confirmation Affidavits
- ▶ GL system review
- ▶ Identify manual and automatic writeoffs (if any)
- ▶ Document TPA process; draft policy and procedure
- ▶ Setup TPA escheat liability GL account
- ▶ Augment policy and procedures for escheat best practices and compliance timeline

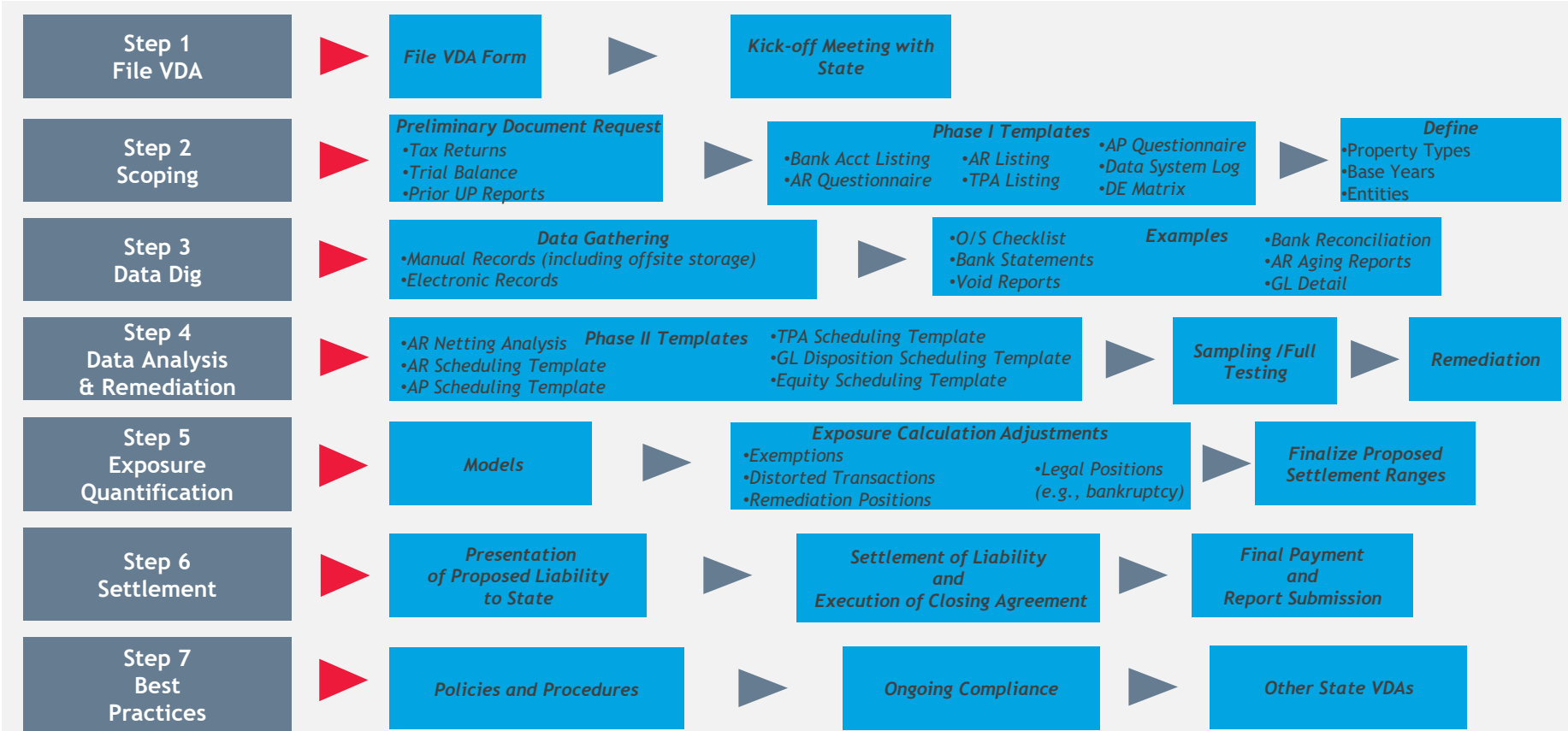
# Accounting practices and control reviews

## GLOBAL MAPPING



# Voluntary disclosure/amnesty process

BDO has developed a pre-approved process to assist clients in entering into the newly established VDA program with most state jurisdictions. BDO has worked closely with the state representatives to develop pre-approved templates that will be used at every stage in the process and has agreed to methodologies to be utilized in quantifying exposures for various property types.



# Final comments





## Final comments

- ▶ Review your internal audit plan for calendar 2019 and 2020
- ▶ Incorporate an internal feasibility review of unclaimed property policy and procedures and compliance practice
- ▶ Evaluate developing stronger internal controls and training
- ▶ Inquire what internal controls are around M&A transactions with respect to escheat liabilities and practices
- ▶ Determine if external feasibility review necessary to ascertain legacy exposure and booking appropriate ASC 450 reserves
- ▶ **Check internal mail for DE audit or Secretary of State letters, some come with a 60 day tag - discuss with consultants best approach to dealing with letters**

Thank you! Questions?

# Bios

# Biography

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Ricardo has over 13 years of experience advising multinational and domestic companies on unclaimed property matters. Ricardo has provided clients with unclaimed property general consulting, audit defense, and compliance services in many industries including healthcare, manufacturing, entertainment, and retail.

As the firm's West Coast Unclaimed Property Practice Leader, Ricardo has established professional relationships with many of the state unclaimed property administrators in handling client matters, and has successfully negotiated voluntary disclosure agreements on behalf of clients and provided audit representation services.

In addition, Ricardo has significant escheat planning experience and has helped many clients mitigate exposures through intercompany planning techniques and strategies.

# Biography

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Dexter has over 15 years of experience in accounting and finance, enterprise risk assessment, internal audit, compliance program assessments, HIPAA privacy, and SOX compliance support to clients in health care, higher education, construction, non-for-profit organizations and publicly listed companies..

Dexter has managed outsourced or co-sourced internal audit departments, advising them on enhancements to their financial and operational processes, internal controls, and systems.

Prior to BDO, Dexter was with Moss Adams' Advisory and Healthcare Consulting practice and was a manager of internal audit for a Fortune 500 health care company, where he was responsible for conducting internal audit and the company's yearly SOX compliance efforts including risk assessment, control design and effectiveness testing, and validation of management reports.

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Shirley has over 25 years of experience in delivering internal audit and enterprise risk services to public, pre-public and private companies. She has led efforts to design and implement scalable internal control frameworks at not-for-profits, start-ups and emerging growth companies. She has assessed large scale program management organizations that identified gaps and improved internal controls.

She has directed internal audit and Sarbanes-Oxley 404 engagements, has performed countless fraud and privacy assessments and has served as interim Compliance and Privacy Officer. In her roles as co-sourced internal audit director, compliance and privacy officer, and construction lead auditor, Shirley has prepared enterprise risk assessments, developed and executed internal audit work plans, written or updated policies and procedures, managed whistleblower hot lines, led training, conducted investigations including those under attorney-client privilege, evaluated contract compliance, created and measured key performance indicators, and overseen transactions testing.



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