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Unclaimed Property

How to comply with the undisclosed liability and reporting requirements.

By Anthony L. Andreoli and Josiah S. Osibodu
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Unclaimed property has become increasingly important in the past few years as more states conduct unclaimed property audits of entities that hold such assets. In a period of economic downturn, the states see unclaimed property as a viable nontax revenue source. In this environment CPAs should be aware of state laws as well as some of the financial reporting issues surrounding unclaimed property.

This article will be of particular interest to CFOs, controllers and other CPAs with responsibilities in either the accounting or financial reporting areas because of the potential impact unclaimed property has on a company's financial statements. In addition, in the current regulatory climate there are increasing pitfalls for companies with misleading financial statements. This article is designed to acquaint financial executives with the problems associated with improperly classifying unclaimed property liabilities and offers guidance to CPAs on how to avoid them.

Internet resources

Unclaimed Property Holders Liaison Council. Promotes the rights of unclaimed property holders, www.uphlc.org.

National Association of Unclaimed Property Administrators. Nonprofit organization affiliated with the National Association of State Treasurers. Includes a free link to help reunite owners with their unclaimed property, www.unclaimed.org.

Unclaimedfunds.org. Subscription Web site that offers access to 55 searchable databases to locate unclaimed property, www.unclaimedfunds.org.

The basics

Unclaimed property is generally defined as a liability a company owes to an individual or entity when a debt or obligation remains outstanding after a specified period of time. An uncashed payroll or dividend check is a common type of unclaimed property. The value of the negotiable instrument represents the debtor's obligation to the payee. When the payee does not extinguish the debt by cashing the check, this creates a property right protected by state unclaimed property laws.

Example. At the end of a pay period an employer accrues its payroll costs by recording a debit to payroll expenses and a credit to payroll payable. On payday the employer debits payroll payable, credits the payroll cash account and issues a check to the employee. When the employee presents the check to his or her bank, this extinguishes the debt and relieves the employer of the liability. However, if the employee fails to present the check, the employer's payroll liability remains outstanding. The fact that the check goes uncashed does not remove the employee's property right (as evidenced by the payroll check) nor does it eliminate the employer's obligation to compensate the employee. If the employer voids or writes off the stale payroll check, it understates its liability (wages payable). The uncashed payroll check becomes "unclaimed property" after it has remained outstanding for a period of time (one year or more as specified by state statute).

Businesses or holders of unclaimed property first must exhaust all options to locate the property's rightful owner through a process of due diligence before determining in which state to report the abandoned property. CPAs can help by ensuring the company has policies and procedures in place to track potential unclaimed property amounts and comply with applicable reporting and remittance requirements of the various states.

Here are some policies CPAs can recommend companies implement:

- Control all unclaimed property through separate accounts that are subject to a high level of internal control.
- Require that all transactions in and out of the accounts have supervisor review and approval.
- Capture and retain sufficient data on the name, address and taxpayer identification number of the property owner to enable the company to properly report the unclaimed assets to the state.
- Follow up on outstanding checks and credits after six months (not after two or three years when the trail is cold).

In addition CPAs should remind companies to be attentive to the potential unclaimed property exposure inherent in any business acquisition and emphasize the importance of due diligence efforts before a company completes any significant merger or acquisition.

Missing records and the use of estimates

Given the long-term nature of unclaimed property, CPAs continually encounter problems with the availability of company records or the lack of certain types of records. Because of inadequate record-retention policies, most unclaimed property holders do not maintain their records intact beyond six or seven years. In many cases companies discard supporting detail for general ledger entries, such as journal vouchers, journal sheets and the like after three to seven years.

When investigating a company, a state unclaimed property examiner frequently faces a similar lack of supporting detail and may be forced to estimate the company's liability—potential to its disadvantage. State examiners have used estimation techniques for decades. Several areas of auditing use these techniques as well—for example, when an entity loses records due to fire, flood or other natural disaster. Sales and use tax auditors also regularly employ estimates to produce audit findings.

Section 30(e) of the 1981 Uniform Unclaimed Property Act specifically permits the use of estimates where sufficient records are not available to identify unclaimed property amounts. When performing routine tests, an unclaimed property examiner may discover the holder has written off or otherwise removed certain items from its books. Companies seeking to anticipate their potential liability from a state audit will find examiners use a variety of estimation techniques depending on the factual circumstances he or she encounters. This includes standard statistical and mathematical tools and models such as regression analysis, ratio analysis and curve-fitting techniques.

CPAs can recommend a company take several proactive steps to avoid having state auditors estimate its unclaimed property liability.

- All entities should adopt polices and procedures relating to how long they keep certain records, keeping in mind there is no statute of limitations on unclaimed property.
- Each organization should recognize that state unclaimed property laws typically require retention periods longer than tax statutes, with 10 years being an average.
- An entity should undertake a periodic review to ensure it observes proper unclaimed property procedures and identifies and reports potential unclaimed property at the right time to the proper jurisdiction.

Estimating a potential liability

Companies often mistakenly believe the lack of historical books and records translates to no unclaimed property liability and that state unclaimed property auditors will be unable to issue an assessment. As noted above, when books and records are not available to determine a holder's actual unclaimed property liability, auditors can estimate it. But CPAs should emphasize to their employers and clients that estimation techniques are not a substitute for recognizing an actual liability.

CPAs should use these techniques to determine a company's liability only as a last resort.

Unclaimed property holders have unsuccessfully argued that states should not use estimation and statistical sampling to project liabilities. The courts have held properly grounded statistical sampling and estimation techniques to be a reliable way of determining unclaimed property liability when records are not available (as in State of New Jersey v. Chubb).

When its historical books and records are missing, a company can estimate its unclaimed property liability using a formula: P x X % = U. In this formula P represents the population of accounting transactions, X represents the unclaimed factor expressed as a percentage and U represents the unclaimed property liability based on the assumption that in a specified population of accounting transactions a certain percentage will end up being unclaimed. The percentage varies based on property type, unclaimed amount, industry, size of company, internal control structure and other relevant variables.

To estimate a client or employer's liability, CPAs first must establish the population of accounting transactions. This may be the company's annual expenses, outstanding checks during a given period of time or accounts-receivable credits at a particular point in time. Frequently, a CPA's judgment is critical in determining the "population technique" used in a given situation. The CPA's next step is to determine the unclaimed factor by analyzing a sample to find the frequency of unclaimed items. Then he or she can plug these numbers into the equation to compute the liability.

Where companies report unclaimed property. For nearly half a century, states have tussled with the complex issue of which has the superior right to escheat—or hold as a custodian for the owner—unclaimed or abandoned property. In the seminal case Texas v. New Jersey, the U.S. Supreme Court held that using the state of the creditor's last known address was a simple and factual way to address the problem. For "ease" in administering the law, the Court decided to use the state of the owner's last known address (as evidenced by the holder's books and records) as the state with the superior claim. According to the Court, however, if this state is not identified or does not have an unclaimed property law, the state of the debtor's incorporation may claim the property.

Noncompliance with unclaimed property laws

Failure to comply with state unclaimed property laws can prove to be costly to a holder. For example, an entity that fails to file annual unclaimed property reports significantly increases the likelihood of an audit. States and their agents routinely audit companies that do not file annual unclaimed property reports or those that consistently file negative reports certifying they have no unclaimed property. The administrative and economic stake is much higher once the state issues an audit assessment; under the rules of most states, a holder then has the burden of refuting the presumption of abandonment and proving the assessment is incorrect.

States also can statutorily assess interest and penalties, the cumulative effect of which could be material to a company's financial reporting. For example, assume a holder's annual unclaimed property audit liability is $50,000. Based on the average reach-back (or look-back) period of 15 years for holders that never have filed unclaimed property reports, the assessment increases to $750,000. In addition, the state can levy a failure-to-file penalty of up to 25% of the assessment, which in our example is $187,500. In most instances the state also can impose compound interest, ranging from 10% to 15% of the assessment. Depending on the number of years under audit, the initial unclaimed property audit liability could double after penalties and interest. In addition to the civil sanctions various states' unclaimed property laws impose, some states also file criminal charges against companies that fail to comply with reporting requirements.

Based on the hypothetical illustration above, the cost of not complying with state unclaimed property laws could be significant enough to have an adverse effect on the company's financial statements. This would require it to make a full disclosure and force it to restate earnings for prior years.

Recognition and disclosure issues

In many instances companies do not recognize and disclose their unclaimed property liability on their financial statements as GAAP requires. The remainder of this article discusses issues related to recognizing and disclosing unclaimed property liability under FASB Statement no. 5, Accounting for Contingencies. It defines a "contingency" in part as "an existing condition, situation, or set of circumstances involving uncertainty as to possible gain (a 'gain contingency') or loss (a 'loss contingency') to an enterprise that will ultimately be resolved when one or more events occur or fail to occur."

Statement no. 5 says the accounting treatment for a loss contingency depends on whether the likelihood of the future event giving rise to a loss, impairment or liability is

> *Probable*. A future event or events that are likely to occur.
>
> *Reasonably possible*. A future event or events the probability of which is more than remote but less than likely.
>
> *Remote*. A future event or events with only a slight chance of occurring.

According to Statement no. 5, an entity should accrue a loss contingency by a charge to income if it satisfies both of these criteria:

- Prior to the issuance of the financial statements, the available information indicates it is probable the entity has incurred a liability at the financial statement date.
- The amount of the loss can be reasonably estimated.

To prevent the financial statements from being misleading, Statement no. 5 says it may be necessary for the entity to disclose the loss contingency even if it has not satisfied both of these accrual criteria. The statement also says the entity should disclose a loss contingency where there is a reasonable possibility it may have incurred a loss or liability. In the latter situation, the disclosure must include the nature of the contingency and an estimate of the possible loss or range of loss or state that the company cannot make such an estimate. Statement no. 5 doesn't require disclosure of a loss contingency involving an unasserted claim or assessment unless the entity considers it probable the claim will be asserted and there is a reasonable possibility the outcome will be unfavorable.

The issue of quantifying the liability is typically raised when a state notifies a company of its selection for an audit. The company can determine how much it needs to disclose through either a self-assessment process or an audit by an outside party.

The potential undisclosed liability

In general a loss contingency could result when the holder of unclaimed property determines a potential liability. For example, in some situations a holder may need to estimate the unclaimed property liability; in others, the liability may be readily apparent without resorting to estimation techniques. Companies have sought to reclassify these obligations as "miscellaneous income" or make some other financial statement adjustment. This accounting practice conflicts with state unclaimed property laws, which are designed to preserve the property rights of the "lost" owner and prevent unjust enrichment of the company or holders of unclaimed property.

From the perspective of Statement no. 5, companies should answer these questions:

- Is the existence or enforcement of unclaimed property laws probable in their state of incorporation or in the state of their customer's (vendor's, shareholder's, bondholder's, employee's) last known address?
- Can the company quantify or estimate those liabilities outstanding for more than three to five years?

If the answer is "yes" to one or both questions, a company is obligated to reflect an unclaimed property liability on its financial statements and provide additional disclosures in accordance with Statement no. 5.

Example. An employer knows a former employee has not cashed a payroll check. The employer should accrue an unclaimed property liability to reflect the fact some state is likely to seek to recover the unpaid amount as unclaimed property. Applying the standards of Statement no. 5, a company must accrue a loss contingency if information exists the liability is probable at the date of the financial statements and it can reasonably estimate the value of the loss. Because there is an outstanding payroll debt to an employee and states have unclaimed property laws, this satisfies the "probable" element for accrual and the company should accrue the uncashed payroll check and reflect it on its financial statements as an unclaimed property liability.

Customer overpayments (accounts-receivable credit balances) can also be a source of unclaimed property. When customers erroneously overpay, they are entitled to a refund. If the company does not properly classify the liability for the customer overpayment as such, its assets are overstated and its liabilities understated.

Using the standards in Statement no. 5, a holder should evaluate whether it must reflect the outstanding customer overpayment as an unclaimed property liability on its financial statements. The first element for accrual is satisfied because of the probability the company incurred a liability and because the states actively enforce unclaimed property laws. Second, a refund of the overpayment is due to the customer in an amount the company can reasonably estimate (the difference between the original amount due and the amount the customer paid). Therefore, the company should recognize the unclaimed property liability on its financial statements.

The importance of compliance

The increasingly mobile nature of our society and the increased attention states are giving to unclaimed property make it likely this area will continue to grow in importance for CPAs, their clients and employers. It is incumbent upon CPAs, therefore, to help companies proactively develop an action plan to ensure compliance with unclaimed property laws, as well as to give a high priority to it within the organization. CPAs also must help clients or employers assess the financial statement impact of unclaimed property to reduce or eliminate the possibility of significant misstatements.

Practical tips to remember

CPAs can help clients or employers avoid problems with unclaimed property by making sure the company has policies and procedures in place to track such property and comply with applicable state reporting and remittance requirements.

Before a client or employer merges with or acquires a business, CPAs should pay close attention to the potential unclaimed property exposure inherent in any such transaction and make sure due diligence efforts cover this issue.

To avoid having state auditors estimate a company's unclaimed property liability, all entities should adopt polices and procedures concerning how long they keep certain records. State unclaimed property laws generally require retention periods averaging 10 years.
To prevent financial statements from being misleading, a company may need to take the precaution of disclosing a loss contingency for unclaimed property even if the company has not satisfied the accrual criteria in FASB Statement no. 5.

Anthony l. Andreoli, CPA, is national director of the unclaimed property services group at Deloitte & Touche in Los Angeles. He previously acted as a consultant to more than 40 states in developing their unclaimed property programs. He recently was a coauthor of CCH's multistate tax library volume on unclaimed property law, compliance and enforcement. His e-mail address is aandreoli@deloitte.com.

Josiah s. Osibodu, CPA, is a senior manager in Deloitte & Touche's unclaimed property services group in Pittsburgh. His e-mail address is josibodu@deloitte.com.

TAX MANAGEMENT

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Sarbanes-Oxley Act: Using §404 Review Process To Comply With State Unclaimed Property Laws

BY ANTHONY L. ANDREOLI, CPA
AND JOSIAH S. OSIBODU, CPA

INTRODUCTION

The Sarbanes-Oxley Act of 2002 established new federal requirements designed to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the act. One of the key provisions of the act is found in §404, which essentially directs the Securities and Exchange Commission to issue rules requiring that annual reports filed with the SEC clearly state the responsibility of management to establish and maintain adequate internal controls over financial reporting, as well as management's opinion about the effectiveness of these controls.

One potential pitfall in these new reporting requirements is the impact that they might have on the treatment of unclaimed property. In this article, the authors discuss the interface between Sarbanes-Oxley and unclaimed property reporting responsibilities at the state level. Specifically, the article examines why an unclaimed property review under §404 might be needed, delineates how property can be inadvertently omitted from the review process—thereby causing potential material errors in the financial statements—and provides practical suggestions on how to avoid omissions of unclaimed property during the review process.

Anthony Andreoli is the national director of, and Josiah S. Osibodu a senior manager in, Unclaimed Property Services with Deloitte Tax LLP. This article does not constitute tax, legal, or other advice from Deloitte Tax LLP, which assumes no responsibility with respect to assessing or advising the reader as to tax, legal, or other consequences arising from the reader's particular situation.

By way of background, Sarbanes-Oxley generally applies to issuers of SEC registered securities and certain other SEC registrants as well as to certain professional service providers. Furthermore, some companies that are not otherwise subject to the act have elected to voluntarily comply with its provisions because they view the act as representing "best practices" that improve the accuracy of their financial reporting.

OVERVIEW OF UNCLAIMED PROPERTY

All 50 states as well as the District of Columbia, Guam, Puerto Rico, and the Virgin Islands have enacted unclaimed property legislation. With states facing increasing budgetary concerns, collection of unclaimed property has become an attractive way for states to obtain additional revenues without raising taxes.

When the owners of intangible (and in some cases tangible) personal property fail to claim it after a requisite period of time—referred to by most states as the "abandonment" or "dormancy" period—the property generally reverts to the state. Our increasingly mobile society generates large amounts of unclaimed property. For example, an individual may have switched jobs and failed to cash or receive his or her last paycheck, may have moved to a different city and forgotten about a small bank account balance, or may have failed to re-

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ceive dividends checks and/or shares in a new company created by corporate merger or takeover.

Companies, generally referred to in unclaimed property parlance as "holders," are required to report and remit their unclaimed property each year to the various states in accordance with the priority "rules of jurisdiction" established by the U.S. Supreme Court.[1] Upon its receipt of the property, a state is generally required to hold that property in perpetuity on behalf of the owner. But in practice, only a small percentage of unclaimed property is ever claimed; thus, these funds become, in effect, a source of interest-free revenue to states. A holder's failure to report and remit unclaimed property in accordance with applicable state law can result in imposition of interest and penalties.

An unclaimed property analysis can add substantial value to the §404 review process by assisting management in identifying the critical areas where problems can arise and in formulating possible solutions.

In recent years, almost all states have retained third-party contract auditors to conduct unclaimed property audits. Because these auditors often represent numerous states, an audit conducted on behalf of one state may in essence be a multi-jurisdictional audit. These third-party auditors are typically compensated with a percentage (up to 12 percent) of the funds they recover for the states. State budgetary woes, along with the states' use of third-party auditors, may account for recent increased frequency of audits in this area.

As part of their unclaimed property laws, most states have enacted an "anti-limitation" provision that bars the application of traditional statutes of limitation. Thus, the unclaimed property audit look-back periods can extend for long periods (*e.g.*, 15–25 years). Some states, for example, take the position that it is permissible to extend an audit back to a company's original date of incorporation. Accordingly, many states routinely use estimation techniques to make large assessments for periods for which records may be wholly or partially incomplete.

These extensive audit look-back periods can be problematic for holders that might not have sufficient records to establish affirmative defenses to assessments for early periods.

IMPORTANCE OF SECTION 404 REVIEW

Under §404, a company must specifically document management's assessment of the effectiveness of the company's internal control structure. However, depending upon the company, as well as the types and amounts of unclaimed property it may have, there could be inadequate processes and procedures in place to identify the risk of a material misstatement on the financial statements.

The term "materiality" is used to describe the significance of financial statement information to decision makers, such as shareholders. In one sense, information could be considered material if it is probable that its omission or misstatement would influence or change a decision of the stakeholders, such as investors or lenders. In its "Statement of Financial Accounting Concepts No. 2," the Financial Accounting Standards Board stated that "the omission or misstatement of an item in a financial report is material if, in light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or omission of the item."[2]

Because unclaimed property audits routinely address long audit periods, an amount attributable to a year early in the period (for example, 15 years in the past) might not have been considered material at the time, but could become "material" when combined with applicable interest and penalties over the subsequent 14 years. For example, an annual unclaimed property liability of $50,000 for a company that has not reported its unclaimed property could result in an assessment of $750,000 when penalties (imposed in some instances at rates exceeding 20 percent) and compound interest (ranging from 10 percent to 15 percent in the various states) are imposed.[3] Accordingly, addressing unclaimed property during the §404 review may be appropriate to ensure compliance with the act and to avoid potentially misleading financial statements.

Risk areas relating to unclaimed property are not always easy to detect. Myriad issues may arise from a taxpayer's core business (such as how to handle accounts receivable) as well as from the taxpayer's vendor payments. For example, retailers might have substantive issues both with payroll and with unredeemed gift certificates and gift cards. An unclaimed property analysis can add substantial value to the §404 review process by assisting management in identifying the critical areas where problems can arise and in formulating possible solutions. The nature and scope of this type of analysis will necessarily vary depending upon the size of the organization, its unclaimed property compliance history, prior merger and acquisition activities, availability of detailed records, and the complexity of the organization's accounting systems.

The rest of this article focuses on common omissions of unclaimed property, as well as practical suggestions that may be considered in the §404 review process.

HOW UNCLAIMED PROPERTY IS OMITTED

It is not uncommon for unclaimed property to be inadvertently omitted from the §404 review process. Among the common scenarios we encounter are:

[1] *Texas v. New Jersey*, 379 U.S. 674 (1965), established priority rules for reporting and remitting property (*e.g.*, the primary rule holds that the property reverts to the state of the owner's last known address; under the secondary rule, the property reverts to the state of the holder's domicile).

[2] *See* FASB, Statement of Financial Accounting Concepts No. 2, Qualitative Characteristics of Accounting Information, 132 (1980).

[3] *See* Andreoli and Osibodu, "Unclaimed Property" *The Journal of Accountancy*, February 2004, for a more detailed discussion of this issue.

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- failure to implement policies and procedures to identify and track unclaimed property;
- failure to maintain proper records to refute the presumption of abandonment that a state may assert during an unclaimed property audit review;
- lack of awareness within management concerning the technical rules supporting unclaimed property laws;
- failure to perform due diligence during a merger or acquisition to establish whether the target company or seller has complied with unclaimed property laws;
- reclassification of outstanding obligations to ''income'' without taking into account the application of unclaimed property laws;
- decentralized accounting systems and operations that may result in pockets of isolated compliance within the organization—such as one business group or division being in compliance while others are not; and
- failure to address unclaimed property compliance as it relates to third-party administered programs (*e.g.*, outsourcing of stock and dividends, payroll and benefit programs).

Avoiding Omission Of Unclaimed Property

To reduce the likelihood that unclaimed property will be omitted during the §404 review, we recommend that taxpayers consider taking the following steps:

Look at Existing Activities

First, during the review, an assessment of the company's financial records and business activities should be performed to reveal the existing unclaimed property compliance activities of the organization and to identify those areas where unclaimed property issues could arise. Are unclaimed property policies and procedures in place? What is the prior unclaimed property compliance history? Do the organization's general ledger accounts reflect ''unclaimed property liability''? If the organization has geographically decentralized accounting centers, are the different centers knowledgeable regarding their duties as related to unclaimed property laws? How is information from the operating departments (*e.g.*, accounts payable, accounts receivable, payroll, etc.) accumulated for purposes of unclaimed property reporting?

Set Up Knowledge Management System

Second, during the §404 review, knowledge management procedures should be created to ensure that institutional knowledge is shared and retained generally rather than residing solely with a few individuals. Experience indicates that dissemination of unclaimed property knowledge can be achieved by establishing an unclaimed property committee comprised of four to seven individuals from the various operating departments, as well as individuals from the controller, treasury, legal counsel, and internal audit and tax departments. For example, with retailers, someone knowledgeable about gift certificates and gift cards might be an excellent candidate, while in the oil and gas industry someone from the land department or division order group would be a logical candidate for the committee. The committee should meet periodically, keep minutes or records of its actions, and assist with knowledge dissemination.

Review the Appropriateness of Records

Third, the §404 review can assist in determining whether the appropriate records are in place as necessary for unclaimed property documentation purposes. Many states take the position that if a check has been issued and remains outstanding at the end of the dormancy period, then a ''prima facie'' case of abandonment has been made. This position shifts the burden to the company to establish any affirmative defenses (*e.g.*, payment via a reissued check, extinguishment of the underlying debt, etc.).

Unfortunately when they don't have the underlying accounting records, many companies erroneously assume that there is no unclaimed property. State auditors routinely use estimation techniques to make assessments in these situations; a company is usually better off when the records are available. The review process can determine whether appropriate record retention schedules are in place and are being observed. Most states have a 10-year retention policy in the unclaimed property area, which may be different from the corresponding policy for tax or other financial records.

Evaluate Internal Controls

Fourth, the §404 review can assist in determining whether appropriate internal controls are in place to prevent fraud. Financial statement fraud is defined by the American Institute of Certified Public Accountants (AICPA) as ''an intentional act that results in a material misstatement of the financial statements.''[4] Applying this standard, states might view as fraudulent any instances in which management knowingly reclassifies into income large outstanding balances of unclaimed checks or customer overpayments instead of reporting these amounts to the states as unclaimed property.

Sufficient Monitoring Controls

Fifth, the §404 review can assist in detecting whether sufficient monitoring controls are in place. In some situations, it may be appropriate for the company's internal auditors to periodically review certain business units to determine if they are in compliance with unclaimed property laws by reviewing whether the various units are adhering to the company's unclaimed property policies and procedures.

Report Potential Control Weaknesses

Sixth, the §404 review can assist in evaluating whether there are processes in place for employees to report potential control weaknesses relating to unclaimed property transactions appearing on the general ledger and for determining appropriate follow-up actions.

Consider the Impact of Business Reorganizations

Seventh, the §404 review can assess whether there are processes in place for analyzing the implications of significant business changes, such as mergers and ac-

[4] See AICPA (2002) Statement of Auditing Standards (SAS) No. 99, Consideration of Fraud in a Financial Statement Audit.

quisitions. In some situations, companies focus on their core businesses but, surprisingly, have no systems in place to monitor previous unclaimed property compliance of acquired companies.

Identify Training Needs

Eighth, the §404 review process can assist in identifying whether appropriate training initiatives are in place. Given the fact that many states amend their unclaimed property laws each year, it behooves companies to keep abreast of changing rules through a recurring training program. Addressing this need for training, Unclaimed Property Holders Liaison Counsel (a group consisting of various companies) offers training programs to the holder community.

Use Technology Effectively

Ninth, during the §404 review process, consideration should be given to new technology applications as well as to enhancements to existing applications. Many companies, particularly those with decentralized accounting operations, may want to consider the use of an ''intranet site'' to manage their unclaimed property data. The information pertinent to unclaimed property reporting requirements for all 50 states can also be housed in the intranet site for ready access by all groups. Information made available on a site of this nature might include: abandonment periods for various property types, reporting due dates, due diligence requirements to locate missing owners as required by the various states, and aggregate amount reporting requirements for small amounts.

Consider the Practices of Third Parties

Finally, the §404 review process can assist in identifying situations where unclaimed property exposure could result from the actions of third-party agents. Many companies fail to realize that their third-party agents, such as stock and dividend transfer agents, administrators of benefit plans, and providers of payroll services, can trigger unclaimed property liability for the company through their actions or omissions. Holders that use third-party providers to process potential unclaimed property items must keep in mind that outsourcing these functions does not extinguish holder liability.

SUMMARY

Section 404 of the Sarbanes-Oxley Act of 2002 is intended to ensure that appropriate internal controls are in place to facilitate accurate and reliable financial reporting. While general ledger accounts are selected for testing based on their materiality to the overall financial statements, consideration should be given during the §404 review to address any unclaimed property exposure that might result from these accounts. For example, general ledger accounts may generate unclaimed items. Cash accounts may potentially create various types of unclaimed checks. Accounts receivable accounts may create unclaimed credit balances or overpayments, and unearned income accounts (*i.e.*, sales of gift certificates or cards) may create unredeemed balances. Also, miscellaneous income accounts may reflect reclassification of various unclaimed items not reported as required by an applicable state.

Given the complexities of the myriad situations in which unclaimed property can arise, the increased attention in this area by many states and their contract auditors, and the potential adverse financial impact that may result from unclaimed property audits, it is important for companies to conduct unclaimed property reviews as part of their §404 review process.

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