

## State Unclaimed Property Audits in a Challenging Economy

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As the nation suffers from economic woes, state budgets suffer as well. Slow economic times mean less tax revenue for state budgets, leaving state governments to find other means to shore up their revenues. For many states unclaimed property receipts are a significant source of "non-tax", "non-user fee" revenue. During these economic times, many states may attempt to increase their unclaimed property revenues as a method for compensating for falling tax and user-fee revenues.

Consider that for the state of Delaware, unclaimed property is the state's third largest source of revenue at \$375 million in FY2008, according to Delaware's Economic and Financial Advisory Council's Revenue subcommittee's background estimates released Sept. 16, 2008. States such as New York and California have significant annual unclaimed property revenue as well: \$597 million and \$670 million dollars respectively.

To increase these revenues, states are likely to increase the number of audits they perform. And, to perform these audits during a time when states will not receive new revenue for in-house audit staff, many states may request additional audits to be performed by third-party auditors, which most states now hire each year.

### Selection of Businesses for Audit

In the past states and their third-party auditors have selected particular businesses for audit for a variety of reasons. The following provides insight as to the criteria/reasons a business may be selected for an unclaimed property audit.

- 1. Failure to Comply or Inadequate Compliance** – Of course, the states are attempting to identify companies that may not be compliant with the unclaimed property law or that may be compliant regarding some but not all pertinent property types. States like California and Maryland look at state tax records to determine if a company that has been paying taxes is also reporting unclaimed property.

Delaware reviews incorporation records to identify businesses of significant

size which are incorporated in Delaware but that have not reported unclaimed property. Other states will compare the unclaimed property reporting of a company in a certain industry and of a certain size with a similar company. If the reporting has been vastly different (less money remitted, certain property types omitted from reporting, etc.) and there is no obvious explanation, the state may schedule an audit.

**2. State Schedule** – Consider that some states, like New York, have audit schedules for companies within their state and those companies are periodically audited on that schedule. In addition, New York routinely schedules audits of companies throughout the state on a select basis.

**3. Past Due Property Potential** – The second tier of audit selection criteria are directed at businesses that have a greater likelihood of holding past due unclaimed property. The criteria include things like whether a business has undergone a merger or made significant acquisitions. Also, one of the criteria may be industry type. For example, some states and their third-party auditors believe that account receivable credits are often not reported or are under-reported. For this reason, businesses that may have more accounts receivable transactions that result in credits, i.e., manufacturers, distribution companies, etc., may be targeted for audit.

Recently, there has been a focus on auditing businesses that administer individual retirement accounts (IRAs). As IRAs are relatively new on the financial planning landscape and the baby boomer generation is entering retirement, more of these IRA accounts are entering the mandatory payment phase when the state unclaimed property laws require reporting and remitting if the mandatory payment checks are not cashed.

**4. Size of the Business/Number of Transactions** – While this probably falls into the "Past Due Property Potential" category, it warrants separate mention. Larger organizations with several subsidiaries are more likely to have unclaimed property or have some subsidiaries that may not be compliant and are more likely to have more transactions that could cause uncashed checks or unused credits. For these reasons, they are often the targets of audits.

**5. Luck of the Draw** – Sometimes a compliant business is selected for audit and there seems to be no rhyme or reason for the selection. It is assumed that the business was selected at random by the state to assure compliance with its unclaimed property law, much like an individual who is compliant with income tax laws being selected for an income tax audit.

Businesses should not be surprised if they receive an unclaimed property notice from a state auditor or a state's third-party auditor. In these challenging economic times, states are searching for non-tax revenue and unclaimed property audit findings may be an untapped source of significant revenue.

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