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# State Tax Return

## **BUSINESS ARCHAEOLOGY: DIGGING FOR UNCLAIMED PROPERTY**

Dr. Will Yancey, CPA  
Guest Author, Dallas, Texas  
(972) 387-8558

Editor's Note: As part of our series on unclaimed property, the *State Tax Return* is pleased to offer this insightful article by Dr. Will Yancey, CPA, a nationally recognized expert in estimating unclaimed property liability using sampling and data mining techniques. Corporate holders of unclaimed property should consider the lessons of archaeology when updating record classification and preservation rules so the remnants of corporate history are not analyzed to misjudge the corporation as retaining excessive unclaimed property based on projections and estimates.

After receiving degrees from Dartmouth College and Duke University, Dr. Yancey began a career as a professional forester estimating timber value. Later he became an accountant estimating tax and other liabilities. His bean-counting education consisted of two accounting degrees from the University of Minnesota and a Doctor of Philosophy in Accounting from the University of Texas at Austin. Dr. Yancey often speaks at national conferences on tax and unclaimed property. For nine consecutive years he has enjoyed the "balmy January air" in Columbus as a speaker at the Ohio Tax Conference. His skill is explaining concepts of statistics and data analysis so that even math-phobic attorneys can understand. He is a self-employed expert consultant and expert witness for many businesses and advisory firms across the country.

Dr. Will Yancey lives in Dallas with his wife and 18-year-old son. He was active in Boy Scouts as a youth and continues as an adult adviser. He earned the Boy Scout merit badges in Personal Finance and Forestry as a youth, and taught the subjects as an adult. Email him at [will@willyancey.com](mailto:will@willyancey.com).

Responding to an unclaimed property audit is business archaeology. The business holding unclaimed property has to dig through mountains of old accounting data seeking to determine what is unclaimed and what is not. If unclaimed property is discovered, they need to know if it has a last known address. If the property does have an address, it will be given to the rightful owner or remitted to the unclaimed property administrator of that state. The accountants and analysts working on an unclaimed property audit look at lots of data gathering clues. Like archaeologists they have to organize their findings and report what and how much they found.

## **Who are the archaeologists?**

This article explores the accountant's role in an unclaimed property audit by analogy to archaeology. Business holders generally hire a team of experts to help with the unclaimed property audit. Legal counsel advises on the applicable law that defines unclaimed property, possible exemptions, compliance reporting, and protection of confidential records. The accounting data expert digs through the data and quantifies the amounts in the various categories and jurisdictions. Various paraprofessionals assist the legal and accounting experts with retrieving and cataloguing the data. Legal Counsel also works on confidentiality issues so that sensitive business records are guarded.

Competing teams are working on an unclaimed property audit. Both sides say they are seeking the truth: the correct estimate of the unclaimed property. The states' unclaimed property auditors are motivated to find a high number that will be remitted to the states they represent. The holder's counsel may disagree and argue that the auditor is estimating too high. The independent accountant's role is to estimate the right amount from the available data based on the legal counsel's interpretation of the law. Two different accountants may reach different conclusions based on different legal interpretations or different data reviewed.

## **Searching for Rare Events**

Searching for unclaimed property is a search for a rare event like an archaeologist's search for prehistoric human remains. For example, out of 10,000 paper checks issued for accounts payable or payroll, we can expect somewhere between 10 and 100 of them will go uncashed (between 0.1 percent and 1.0 percent). The accounting expert and paraprofessionals review these uncashed checks to determine how many are not unclaimed property because they were reissued, properly voided, rejected by the payee, qualify for a state exemption, or some other reason. If the check has a last known address, the holder may conduct due diligence and to locate the true owner for an explanation and provide a new check for the amount due. After the due diligence and exemptions are applied, the unclaimed property frequency could be very low, such as 3 out of 10,000 paper checks issued (0.03 percent). A skillful accountant uses his or her knowledge of accounting systems and databases to identify and quantify the unclaimed property.

The accountant often applies estimation techniques when records are unavailable. In many unclaimed property audits the holder does not have complete records for all years, all business segments, and all accounts. For example, suppose the holder can retrieve transaction records of amounts issued and unclaimed for the past five years, but not for the prior years. Assume the holder has financial statements with total revenue for all years. The accounting expert can develop a plan for estimating the amount of unclaimed property in the five years with available records. This amount will be used to estimate a ratio of unclaimed-property-to-revenue for the available years. Apply that ratio onto the revenue for the earlier years to estimate the unclaimed property liability for those years. Then subtract the amount of unclaimed property remitted to the

states for those years. The remainder is the holder's liability for unclaimed property for the prior years with unavailable records. Since the last known address is not available for the prior years, the liability is to the holder's state of incorporation.

### **Why does unclaimed property exist?**

To be more effective at searching for evidence, the archaeologist gathers background on the motivations and behavior of the culture being examined. Similarly, with unclaimed property our search will be more effective if we understand why business processes result in unclaimed property. Even if we cannot interview the managers who were responsible for processing the transactions, we can evaluate risk factors associated with unclaimed property.

Unclaimed property is a low frequency event. The vast majority of transactions are cleared without resulting in unclaimed property. Accounts payable and payroll usually have unclaimed property frequency less than one percent. The frequency is higher for gift cards and other stored value cards. With such low frequency, the financial statement auditors tended to pass on these areas as immaterial. As these low frequency events accumulated over the years, the total liability for unclaimed property increased. In recent years the Sarbanes-Oxley requirements motivated more financial statement auditors to dig deeper into unclaimed property.

Unclaimed property categories can occur in many functions: payables, payroll, receivables, treasury, inventory, shipping, gift cards, promotional incentives, and others. Many of the people in the various departments have no knowledge of unclaimed property law and reporting requirements. Each year more plies of paper and electronic transaction data are accumulated. This provides the unclaimed property auditors (the state's "archaeologists") more opportunities for finding unclaimed property that was not reported.

Corporate accounting and finance managers face numerous challenges and demands on their time. Higher priorities are assigned to projects that increase revenue, decrease cost, or conserve cash. Unclaimed property takes a higher priority when there is a demand from external forces such as financial statement auditors, internal auditors, unclaimed property auditors, or class action litigation.

Unclaimed property due diligence and reporting projects appear to yield a low return on investment or benefit-cost ratio compared to other corporate projects. The project benefits are avoiding the costs of adverse unclaimed property audits: audit defense costs, reducing penalties, and shareholder reaction to unexpected liabilities. If the corporate executives estimate there are low probabilities and costs of an adverse audit, they will not approve the employee headcount or consultants for the due diligence and reporting projects. They are playing a risky lottery on unclaimed property audits. The financial and accounting executives face numerous risks every day and make decisions based on their best guess of the probability and expected cost of each project.

## Recommendation

As states experience budget deficits, they will search for more cash from unclaimed property audits. Responding to these audits will require a “business archaeology team” with legal, accounting, and data analysis skills. Holders will need all those skills as they investigate areas where their compliance and documentation may be inadequate. Now is the time to review unclaimed property reporting and voluntary disclosure agreements. “Competing archaeologists” in the form of unclaimed property auditors may be digging into areas not previously audited, and may return to areas where they had findings in the past.



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