

## Unclaimed Property Task Force

**Tuesday, August 12, 2014  
1:00p.m. – 3:00p.m.  
Buck Library, Buena Vista, New Castle, DE**

### Meeting Attendance

#### Task Force Members:

##### Present:

Senator Bryan Townsend	<a href="mailto:Bryan.Townsend@state.de.us">Bryan.Townsend@state.de.us</a>	302-744-4165
Senator Greg Lavelle	<a href="mailto:Greg.Lavelle@state.de.us">Greg.Lavelle@state.de.us</a>	302-744-4197
Representative Jeff Spiegelman	<a href="mailto:Jeff.Spiegelman@state.de.us">Jeff.Spiegelman@state.de.us</a>	302-744-4179
Secretary Jeffrey Bullock	<a href="mailto:Jeff.Bullock@state.de.us">Jeff.Bullock@state.de.us</a>	302-739-4111
Secretary Thomas Cook	<a href="mailto:Tom.Cook@state.de.us">Tom.Cook@state.de.us</a>	302-577-8984
Controller General Michael Morton	<a href="mailto:Michael.Morton@state.de.us">Michael.Morton@state.de.us</a>	302-744-4211
Thomas Collins	<a href="mailto:Tom.Collins@debankers.com">Tom.Collins@debankers.com</a>	302-678-8600
Michael Houghton	<a href="mailto:mhoughton@mnat.com">mhoughton@mnat.com</a>	302-351-9215
Edward Ratledge	<a href="mailto:ratledge@udel.edu">ratledge@udel.edu</a>	302-831-1684
Jordon Rosen	<a href="mailto:jrosen@belfint.com">jrosen@belfint.com</a>	302-225-0600
Leonard Togman	<a href="mailto:ltogman@potteranderson.com">ltogman@potteranderson.com</a>	302-984-6005
Robert Tuinstra, Jr.	<a href="mailto:Robert.J.Tuinstra@usa.dupont.com">Robert.J.Tuinstra@usa.dupont.com</a>	302-774-0485

##### Absent:

Representative Bryon Short	<a href="mailto:Bryon.Short@state.de.us">Bryon.Short@state.de.us</a>	302-744-4297
Stan Stevenson, Esq. Office of the Governor	<a href="mailto:sstevenson@rlf.com">sstevenson@rlf.com</a> N/A	302-651-7707

##### Staff:

Michelle Zdeb	<a href="mailto:Michelle.Zdeb@state.de.us">Michelle.Zdeb@state.de.us</a>	302-744-4059
Kiki Evinger	<a href="mailto:Kathryn.Evinger@state.de.us">Kathryn.Evinger@state.de.us</a>	302-744-4297

##### Attendees:

Jamie Johnstone	<u>Organization:</u> DOF	<u>Phone:</u> 302-577-8965
Arsene Aka	DOF	302-577-8964
David Gregor	DOF	302-577-8684
Courtney Stewart	CGO	302-744-4200
Caroline Cross	DOJ representing DOF	302-577-8814
Bob Byrd	Byrd Group, LLC.	302-757-8300
Rick Geisenberger	DOS	302-577-8764

The Task Force Meeting was brought to order at 1:12 p.m.

## INTRODUCTIONS

Senator Bryan Townsend, co-chair, thanked the members of the Task Force and the public for attending the meeting. He confirmed that Senator Lavelle and Michael Houghton, Uniform Law Commission (ULC), would be participating via conference call. The Senator then asked the members of the Task Force and the public to introduce themselves and state the organization they were representing.

## PRESENTATION BY DEPARTMENT OF FINANCE

Senator Townsend turned the floor over to Secretary Thomas Cook, Department of Finance (DOF).

Secretary Cook, Department of Finance (DOF), said the presentation would provide the Task Force members with information on how the unclaimed property area works. The Secretary noted in the future, there will be presentations from the advocates for the holders as well as some of DOF's auditors. He then introduced David Gregor, Deputy Secretary of Finance and State Escheator, as he would be giving the presentation. Secretary Cook further noted he would be happy to answer any questions Task Force members have about the presentation.

Deputy Secretary David Gregor noted the presentation will focus on the enforcement part of the audit process. He would be happy to discuss other aspects of the process if the Task Force has questions about specific aspects. He then began the presentation.

Deputy Secretary Gregor stated that the business does not own the unclaimed property. The holder has no legal right to the property. These types of unclaimed property laws are not unique to Delaware; all fifty states have some sort of unclaimed property laws. This is a complicated issue, but the Deputy Secretary emphasized that the most basic fact of the issue is that the money does not belong to the holders.

The basic purpose of unclaimed property programs is to reunite the rightful owner with their property. If an owner is unable to be found, that property should be used for the public good. The State Legislature determines what is considered a "public good" through the budgetary process. Holders should not be unfairly rewarded by claiming the true owner's property. This decision to use unclaimed property for the public good if no owner can be easily found has been confirmed with multiple U.S. Supreme Court (SCOTUS) decisions.

DOF would like to see more voluntary compliance with reporting unclaimed property. In order to encourage voluntary reporting, Delaware has engaged in education and outreach. There have been several public-private task forces aimed at addressing problems in the field. There is a uniform reporting format between all fifty states and the Delaware SOS Voluntary Disclosure Agreement (VDA) adopted in 2012, which allows for perpetual amnesty. The Deputy Secretary noted this is very business friendly. Despite all of these efforts, most states, including Delaware, only have voluntary compliance percentages in the single digits. There are hundreds of thousands of entities in the State of Delaware and only 3,500 – 4,000 of them file each year. Compliance is definitely an issue DOF is dealing with.

Delaware needs a healthy enforcement program because it is necessary to increase voluntary compliance. If there is no threat of an audit there is no incentive to enter the VDA. Deputy Secretary Gregor referred to a handout provided by DOF titled "Escheat Breakdown: FY 2000 to FY 2014." He noted that in FY's 2000 – 2002 the State's Average Cash Annual Filings

were \$87.4 million and Average Enforcement was \$45.7 million. It was around this time that DOF started having an employee, with an auditing background, working solely on unclaimed property rather than having several employees split their time between other fields in DOF. This led to a steady increase in annual cash filings and enforcement, with Delaware's FY's 2012 – 2014 Average Cash Annual filings at \$249.7 million and average enforcement \$175.8 million. He did not think that this would have been the case if Delaware had eliminated or reduced its enforcement program. States that discontinue audit programs have seen decreases in voluntary compliance. Noncompliance puts businesses that do comply at a disadvantage, since they are spending time to report to DOF, and that is unfair. Enforcement is a necessary component of any audit process.

In most instances, states do not have the resources or expertise to engage in complicated audits that involve multi-state entities. Contractors have filled that void. States have used contractors in the audit process for thirty years. Contract examiners allow for multi-state audits, which reduce the administrative burden on holders. Holders often seek a “global settlement” so that they are completely audited only once.

The role of the contractor is limited to the examination of the holder's books and records. Only the State selects the holders to be examined, and they are engaged throughout the entire process. Contractors cannot initiate an audit. The State resolves all contested issues during the exam, maintaining daily contact and making monthly reviews of all cases. The State encourages holders who are having difficulties with contractors to contact the State to resolve the problem. The State alone makes the decision regarding final liability. The contractor makes a recommendation but the State makes the final call; the contractors are not involved at all in making the final decision.

Delaware is not unique in its use of contractors. All states use them. With one possible exception, all states employ some element of contingency format in their billings. DOF has received two main criticisms about contractors. The first is that contractors are “aggressive.” This criticism lacks specificity and supporting examples of contractors behaving “aggressively.” Contractors can only operate under the laws that are set by the State and the State makes all final decisions. DOF is interested in hearing specific examples of instances when contractors behaved aggressively.

The second criticism is that because there is a contingency fee that it is believed that contractors “inflate” assessments. Contractors produce findings based on an examination of the holder's actual books and records. The State alone makes the call on the amount of an assessment and on holder remediation. In terms of estimation, Deputy Secretary Gregor said this is an issue of fairness. If a company turns over the required records then estimation is not necessary. If they do not, whether because they no longer have the records or they refuse to turn them over to the State, then estimation is necessary to complete a fair audit.

Secretary Cook asked Deputy Secretary Gregor to explain more about how base years are chosen to base an audit on when estimation is necessary.

Deputy Secretary Gregor said it is necessary to have data to base an audit on. Depending on the scope of the look-back, it is necessary to have base years that best reflect the activities, procedures, and accounting policies of a company during the years that are being estimated. It is not uncommon for DOF and the holder to have a negotiation over base years. The holder may want certain years to be used as the base years because they know that they implemented a new

accounting system shortly prior. The State may feel that, because the look-back period extends to 1986, that an earlier set of base years would be more indicative of the state of the company during the years that records are not available. This is a negotiation and no two holders are the same.

Secretary Cook wanted to emphasize that this process of determining base years is a negotiation. There is a discussion between the State and holders.

Leonard Togman, public, retired attorney at Potter Anderson, asked what DOF would do if there were no records at all available for earlier periods in a company, if only very recent records were available.

Deputy Secretary Gregor answered that if that was the case then the State would have to use the most recent records as a base period. He said that Michelle Whitaker, DOF Audit Manager, (not present) would have a better sense of what would be done in that situation and he offered to note Mr. Togman's question and get back to him.

Robert Tuinstra, Jr., Delaware Business Roundtable (DBR), asked how many years back the State is looking in this type of audit.

Deputy Secretary Gregor answered that the look-back period goes to 1986.

Mr. Tuinstra, Jr. asked for clarification that the State was looking for a transaction from that period in order to find if there was an error. He then asked what level of record the state was looking for.

Deputy Secretary Gregor stated that finding an error would be the reason the State was looking back in that time period. He said that often the State would be looking for checks and invoices. If a company does have records from every year from 1986 to present then the contractor would utilize a sampling method so that every single document does not have to be reviewed. A sample from the whole would be taken and the State and holder would agree that, within a 5% margin of error, it would be representative of the company's history.

Mr. Togman asked if the State would ever use an outside arbiter if there was a disagreement between the State and the holder.

Deputy Secretary Gregor said he did not think so. During the long process of the audit there is a lot of give and take between the State and the holder. These types of disagreements tend to come at the end of an examination.

Caroline Cross, Esq., DOJ representing DOF, member of the public, stated that there are times when there is a disagreement. However, both sides realize that the cost of pursuing external arbitration is usually greater than the amount of property that is causing the disagreement.

Representative Spiegelman asked if the amount of time it takes to complete an audit is contingent on the size of the company or if there was an average amount of time.

Deputy Secretary Gregor said that the length of the exam usually depends on how long it takes companies to produce records rather than the size of the company. Negotiations over the sampling and the base period also take time. Other times companies refuse to cooperate or do not have an accounting process.

Secretary Jeff Bullock, Department of State (DOS), added that the complexity of the company also influences the amount of time an audit takes. In some cases, a company may have acquired other companies since 1986. Each company may have used a different accounting system before being acquired, which makes reviewing records more difficult.

Deputy Secretary Gregor stated that there is a process called “scoping” that is used in this type of situation. If a company has subsidiaries that are primarily located in another state and that do not have a Delaware charter then the audit might not examine that subsidiary because there is a low likelihood that Delaware would be entitled to any property. Any subsidiary that operates in Delaware or that is incorporated in Delaware would be of interest to the audit.

Representative Spiegelman asked if this could be a multi-year process.

Deputy Secretary Gregor said that it could. It is not uncommon for the holder to change representation or advocate which would slow or speed the process. This is a complex process that takes time. Approximately 80% of the holders cooperate with the audit process.

Mr. Houghton said that in his practice the length of audits has extended considerably over the past decade. Most audits he used to participate in took between 18 months and two years to complete. Many audits now go well over three years, sometimes taking up to four or five years. He did not think the reason for this was because of the complexity of the company or unwillingness to participate on the part of the holder. He said that there are so many audits in progress currently that the audit department may be overwhelmed and therefore be unable to complete audits promptly.

He asked if the Division of Revenue has any views on how to expedite audits and if they have any statistics related to the average length of audits.

Deputy Secretary Gregor said that he did not have any statistics readily available to confirm the length of audits. If it is true that audits are taking up to five years because DOF is overwhelmed, then he would be interested in investigating that issue and gathering data on it. There is a perception that the State is too aggressive in these audits. The State does have means to compel a company to release information related to the audit, such as issuing a summons or going to court, but the State has been reluctant to use these means because it did not want to be thought of as aggressive. However the DOF is rethinking this strategy because they are being called aggressive anyway.

Secretary Bullock said that the length of the audit is a very important issue. Before DOS started the VDA program, Secretary Bullock called the companies who had been unhappy in the past with their audits. He spoke with the CFO of a large Fortune 500 company who said that if the State cannot complete audits within a year that they are doing something wrong. He agreed.

When the VDA program started, the goal was to complete audits within nine months. He was told by members of the financial community, including some members of this Task Force, that this was an unrealistic goal. Within the first few months of the program he realized they were right.

One of the first changes DOS made to the law was to allow them more time to complete an audit. Some things sound great in theory but do not work in practice. The capacity of the State, holder, and people who work for the State and who work for the holder to complete the work must be considered. VDA's now take about eighteen months. Because there is a large amount of work to be completed in that timeframe, DOS is putting people on schedules to make sure the work is completed on time. There are some companies who are an exception and complete their audit in nine months, but this is not the norm. Sometimes the CEO's prioritize the audit and it gets done faster, but most of the time it is not prioritized.

Representative Spiegelman brought up the question of "fairness" that was discussed at the previous meeting. He asked if increasing the number of audit firms would help solve the issue of fairness as well as reduce the amount of time it takes to do an audit.

Secretary Bullock agreed it would, but said that the length of time is not solely dependent on the State but also on the holder and the people they have working for them. That is a finite population as well and they are overworked. It is necessary to look at capacity throughout the process, not just on the State's side of things.

Edward Ratledge, public, University of Delaware Director of the Center for Applied Demography & Survey Research (CADSR), asked about the sampling process for the look-back period Deputy Secretary Gregor referred to in his presentation. He asked if larger companies required more complicated sampling methods. He questioned whether these more complicated sampling methods and larger sample sizes increased the risk for error and inflation.

Deputy Secretary Gregor answered that the contractors they hire use stratified samples. Within the strata they are making an estimate of the mean and the standard deviation. A larger standard deviation results in a larger mean and heavier sample. In some audits, there are some strata that have extreme outliers that have to be more closely examined. They do a 100% sample on those outliers and then as the amounts get lower and the standard deviation gets tighter there can be a lower sampling rate. This process does take time.

Deputy Secretary Gregor continued with his presentation. Delaware does not use a straight contingency model. They had used an hourly model in the past, but holders complained that the examination was being dragged out to inflate billable hours. The State also made payments and did not always see results. Currently, Delaware uses a hybrid model of an hourly rate up to a percentage cap. This model guards against both complaints of running up hours and inflating findings. The cap saves the State money. The hourly rate is based on rates that the Big-4 accounting firms were receiving, though with a discount then applied.

In 24% of cases there are no findings; the holder owes the State nothing. This could be because the holder is entirely in compliance or because they have gone bankrupt. If the State used only a straight hourly model then there is no incentive for the contractor to close the case. In a straight contingency model, if it looks like there will not be any findings the contractor would receive nothing; they could possibly decide to cut their losses and move on to another

more lucrative case without finishing. The hybrid model protects against both of these scenarios in those 24% of cases where there are no findings.

Mr. Tuinstra, Jr. asked if the contingency model was based on the findings or the ultimate resolution.

Deputy Secretary Gregor answered that it is based on the ultimate resolution. Kelmar will be presenting at the next Task Force meeting and will be able to discuss this issue further. They are comfortable with the State making the final call on audits.

Mr. Togman asked for clarification that in cases where there are no findings, contractors are paid for a straight hourly audit.

Deputy Secretary Gregor said that is correct.

Mr. Houghton asked how many audits result in zero findings. He has been working in this field for over twenty years and knows of only one time that has happened.

Deputy Secretary Gregor answered that Kelmar reports that in their audits, they receive zero findings results 24% of the time.

Mr. Houghton asked if they were specifically zero findings or if there was some other basis for there being no finding of liability, like the company had gone bankrupt.

Deputy Secretary Gregor agreed that it could be many factors that caused the zero findings, including bankruptcy.

Mr. Houghton asked how many states have contract auditors that have contracts that are the length of time that Delaware's have, which could extend from five to nine years.

Deputy Secretary Gregor said he did not know the answer to that but would be happy to get further information about the contracts Delaware auditors sign. Since the auditing process is so lengthy, it is necessary to have longer contracts so that the contract does not expire in the middle of an audit. Contractors would be able to walk away from an audit and then the State would have to start from scratch on that audit. This would be unfair to the holder as well who will have sunk time and money into the audit already.

Mr. Rosen asked if the contractor is responsible for audits dragging out. He asked if DOF has considered a periodic review of audits to see if contractors tend to drag out audits that have smaller findings to get a greater hourly rate. He also said that consulting is a business that generally charges \$175/hour. When the State uses the hybrid model they pay them \$150/hour up front. When the audit is settled they get paid 12% of a diminishing percentage over a certain threshold. Some of the hourly contracts are \$495/hour. Deputy Secretary Gregor had explained that this is based on the rates the Big-4 accounting firms charge, but Mr. Rosen said that those firms are not average accounting firms in Delaware. Most firms are much smaller and charge much less. He asked why the State is paying so much for these services.

Deputy Secretary Gregor said that they do not think that the contractors are dragging audits out. He said it was important to understand that the unclaimed property audit does not proceed in lockstep. The State is working on several different aspects of the audit at the same time, such as payroll, accounts payable, and securities. Often, lots of progress will be made on one aspect while there may be disputes in others that hold up the process.

Ms. Cross agreed that this was the case. She has attended several of Ms. Whitaker's monthly meetings with contractors and says that she and her team examine the progress being made very thoroughly. It would be very difficult for contractors to drag the process out without Ms. Whitaker noticing.

Deputy Secretary Gregor said that in regard to Mr. Tuinstra, Jr.'s other question about why the State is paying so much for these services, there are a lot of people involved in the process and there are few people who are experts in the field. Only certain people have this expertise and a good reputation. It is a niche market.

Deputy Secretary Gregor returned to his presentation. He confirmed that the reason that contracts with contract auditors are so long is because unclaimed property exams typically take years. A shorter contract length would mean renegotiating payment with exams only partially complete. The cost is locked in but operations are not. The State can stop assigning cases or reassign cases from a particular contract auditor at any time.

The State is responsive to the business community and this issue is important to the State as well. The DOF has participated in two previous task forces (2000 and 2006). The appeals process was also developed to benefit the business community. DOS has implemented the VDA program which has been successful with over 550 companies in compliance. The fact that the State is responsible for audits and overseeing contractors will not change; the State makes all critical decisions in the examination process. The reason the rate of returns is lower than in other states is because the SCOTUS has upheld that in cases of owner unknowable property, the state of incorporation can claim it. In the last year, DOF has made great strides in reuniting unclaimed property with owner, including increasing due diligence letters. In FY 2013, the State collected \$191.7 million under "Extraordinary Items."

Representative Spiegelman asked why there was such a large increase in the equity processing between FY's 2013 and 2014.

Deputy Secretary Gregor said that this occurred because in FY 2013 there was no equity processing done. Around that time was when DOF increased their due diligence, but they could not process them all at once. They also started doing a better job processing claims. There has been an increased focus on customer service: \$104 million was returned to owners in FY 2014 claims.

Senator Townsend asked if the fees paid to Kelmar were listed under "Operating Expenses."

Deputy Secretary Gregor said yes. Prior to FY 2011 the DOF had statutory authority to take the net of what contractors gave them for any type of abandoned property. The property escheated

was put into a custodial account and the contractors took their share and left the rest for the State. Annual internal review of DOF records resulted in DOF now listing this as gross revenue.

Senator Townsend asked how easy it would be to extrapolate backwards to find out how much money was paid to contractors in years before it was required to be reported.

Deputy Secretary Gregor said that they have done that.

Senator Townsend asked if it would be easy to put that in a spreadsheet similar to the “Escheat Breakdown: FY 2000 to FY 2014” that the Task Force was examining.

Deputy Secretary Gregor said that it could be done and that he would provide that information to the Task Force members.

Jordon Rosen, Delaware State Chamber of Commerce (DSCC), asked if the State regulates people who want to charge a fee for finding unclaimed property.

Deputy Secretary Gregor said that one of the reasons that DOF likes working with contracting companies like Kelmar is that their only job is as a contractor; they do not represent other parties at all. There is no blurring of lines. Some firms may advocate for states and holders at the same time. DOF has no official position on those firms that represent more than one interested party.

Ms. Cross said that there is no statute regarding this type of business practice. DOF receives weekly requests from finders asking DOF to divulge information related to finding unclaimed property to use for a profit. There are very strict confidentiality rules and this information is never turned over to them. DOF does its best to protect owners from this type of predatory practice. The State does not charge a fee to unite unclaimed property with owners.

Mr. Togman asked what made the State start paying out claims.

Deputy Secretary Gregor said that the State has always been paying out claims. However, when the State realized it was not adequately performing its due diligence, it sought to rectify that by increasing notification for owners of unclaimed property. Over 160,000 pieces of mail were sent out to notify owners. This is now standard practice.

Mr. Togman said that for several years when people’s names were published in the newspaper notifying them of their unclaimed property, including his own, that when they submitted the required forms they got no response.

Deputy Secretary Gregor said that he apologizes if that was the case. There was a backlog and things were not being done as efficiently as they could have. They have made significant administrative changes in order to improve service. Currently they are trying to update their technology to allow forms to be submitted electronically in pdf form.

## **OPEN DISCUSSION BY TASK FORCE**

Mr. Houghton made several comments. Firstly, one of the recommendations that came out of the 2006 Task Force Report was to examine the means of the Division of Revenue, including salary level and staffing, to try to enhance the internal capacity to use internal staffing to improve productivity rather than contracting the work out to contingent-fee contract auditors. He thinks this is something that this Task Force should reexamine.

Secondly, Mr. Houghton said that it is his understanding that Kelmar is now representing over forty states and is increasing its commitment to states. Kelmar is dedicating significant resources to serving these states. Mr. Houghton thinks that there is a connection between this increased workload for Kelmar and the increase in the amount of time it takes for them to complete an audit. This amount of work they have for other states may be impacting the work they do for Delaware. He asked if the DOF agrees that there is a correlation.

Thirdly, Mr. Houghton addressed Secretary Cook's earlier comments regarding auditors being described as "aggressive" and his interest in hearing about specific examples of auditors behaving in this manner. He said he does not think that there is any one particular incident. When holders call auditors "aggressive" Mr. Houghton believes they are referring to aspects of the auditing program, such as the long look-back period and the estimation process. The labeling is a broad critique of the entire Delaware audit system. He asked what the DOF's position was on shortening the look-back period.

Deputy Secretary Gregor said in regards to Kelmar and the expanding scope of their business, he did not believe that an increase in the number of states they are serving is impacting their business. As they have taken on more states as clients they have expanded their business and increased the number of people working for them.

In terms of the 2006 Task Force Report, the previous chairperson was defeated in an ensuing election. This could have contributed to the report not being widely distributed. A lot of resources shortly after the report was released were geared toward internal control and regulation. The Great Recession came shortly after that, which slowed reform down even more. Hiring was frozen in all State agencies. This is why the State had to contract work out rather than hire more people to do the work internally. Now more people can be hired but the department has to decide the best way to utilize them. Additionally there is the fear that DOF will hire more people, take two years to train them, and then they will be lured away by one of the private auditing firms who offer higher salaries. It would be a lost investment for the State. It is an issue worth talking about and DOF is interested in hiring more people, but this situation is a potential reality that has to also be considered.

Representative Spiegelman asked if in a perfect world where DOF would be able to hire all the people it needed, if there would be an increase in the gross amount to the State because the State would be able to address more backlogged cases or will cases just be handled internally a little more easily.

Deputy Secretary Gregor answered that in-house people would not be the people who would be assigned to the large interstate cases. DOF would assign those to regional contractors.

Representative Spiegelman asked if this would be difficult to sell as an investment.

Deputy Secretary Gregor said that it probably would be.

Secretary Cook remarked that there are people who ask for this expansion of the department who at the same time oppose the expansion of government; it is a double edged sword.

Senator Lavelle said that a case could be made to promote efficiency overall, to incentivize employees to work for the State and to stay. This would save the State a lot of money. Senator Lavelle said that the 1981 look-back period was very aggressive and was out of step with other states. He asked whether any study or analysis has been done to examine what the effect on revenue would be if the look-back period was significantly reduced.

Secretary Bullock said the more important question is if someone could quantify how changing the look-back period was going to improve compliance. The VDA program offers a shorter look-back period and 2/3 of companies still have not signed up. Changing the look-back period seems to have had no impact.

Mr. Togman stated that 30% sign-up to the VDA is still somewhat successful.

Senator Townsend remarked that it would be difficult to find out if the companies joined because of the decreased look-back period or for some other reason.

Mr. Tuinstra, Jr. said that one of the issues around perceived fairness is the look-back period. One of the reasons that companies are more compliant with tax than with unclaimed property is because there is a well-known and well-defined look-back period that is shorter. Companies maintain their records in preparation for a possible audit. The unclaimed property look-back period covers more than twenty years; finding records that old is next to impossible for companies. Companies are trying to defend against the extrapolation of data, but they need to have records to support their version of the extrapolation. They are often not expecting such a long look-back period and Corporate America does not usually keep transactional-level data that old.

Mr. Rosen said that he remembered in the previous meeting that the Division of Revenue said that they did not want to be flooded with tons of \$0 filings. Some companies have the perception that if they do not have escheatable property then they do not have to file. When they do file their escheatable property they are surprised with an audit. They do not realize that they should have filed every year regardless of whether they had any escheatable property. With no filings there is no statute of limitations and they are suddenly required to produce twenty plus years of records when the standard for record keeping is only about seven years. This is a question of fairness of the process.

Mr. Rosen agreed with Secretary Bullock that there may be no connection between the length of time of the look-back period and compliance. However, he said the State should make it as easy as possible for companies to comply. He asked why the State does not consider including an unclaimed property line on the annual franchise tax form. That would give businesses a sense of certainty that the three year statute of limitations would start. It would be done electronically so that the DOF would not be inundated with forms. Alternatively, it could be added to the business entity tax return. There are some difficulties associated with this, but the

idea is to make it easier for companies to report and be certain that there was a shorter statute of limitations.

Mr. Tuinstra, Jr. agreed with Mr. Rosen. In the tax world, you file a \$0 return because you want the statute of limitations to start, which is the protection. It should be the same way in unclaimed property. There is always a question of whether a company is underreporting or is not filing, and Mr. Tuinstra, Jr. said he has no problem with extending the statute of limitations if that is the issue, but it should be clear what responsibilities companies have with regards to keeping records and filing.

Secretary Bullock said he agrees that the process should be easier. However, DOS is not a tax collection agency so the methods Mr. Rosen described would not be the right mechanism. A lot of companies do not have a \$0 return. They are simply not meeting their requirements under the law. If they had come into compliance 15 – 20 years ago they would not have as long of a look-back period.

Mr. Tuinstra, Jr. said that he has no sympathy for a non-filing company that is deliberately playing the audit lottery.

Secretary Bullock said that the companies that are being targeted for auditing are large companies that are deliberately not filing and that there is a greater chance of escheatable property being collected.

Mr. Tuinstra, Jr. said that not all the companies the Task Force will hear from may fall in that category.

Deputy Secretary Gregor said that one of the things he wants to emphasize is that contractors only audit the companies the State tells them to. They only operate within the policies and statutes that the State allows. Contractors did not create the look-back period. If holders are unhappy with the look-back period they should direct those complaints at the State and not at the contractors.

Secretary Bullock stated that he has no problem reducing the look-back period. He is focused on increasing compliance.

Mr. Rosen said that he believes if companies deliberately do not comply, they need to accept the consequences. However, the State needs to make sure that holders know what their responsibilities to the State are in terms of filing and to make it as easy as possible to file.

Senator Townsend asked if other members of the Task Force wanted to respond to a point Mr. Rosen made earlier regarding holders being lured into believing that they do not have to file. He did not recall hearing that being the case.

Mr. Rosen agreed that he would like a response to that question since it is a very troubling idea.

Secretary Cook said there is no penalty for filing a \$0 unclaimed property return.

Senator Townsend asked if there were instructions given telling companies not to file if they have a \$0 return, which leaves the statute of limitations open for them.

Mr. Tuinstra, Jr. said he did not think there was any sort of proclamation to businesses stating that they do not have to file.

Senator Townsend said that many corporations know that they have an obligation to file and are choosing not to. It is very different if they are hearing some sort of instructions from the State telling them they do not have to file if they have no unclaimed property, and that they would be doing the State a favor by not filing. He said that he would be shocked if that was the case but he wanted to get clarification from Secretaries Cook and Bullock that this was untrue.

Deputy Secretary Gregor stated that he wanted to be clear that these are property rights of owners. Those rights exist in perpetuity. The look-back period does not matter; it is always the owner's property.

Senator Townsend said that the unclaimed property framework is very mature. Delaware benefits uniquely from this situation despite the fact the goal is to reunite owners with their property. The cost and reality of doing business is that sometimes property is in a gray area. The idea that the State would come in and take the property, and estimated property from years prior, is controversial. He found it interesting that the DOF's presentation did not mention estimation at all. His assumption is that contractors do estimate and that they do so at the instruction and guidance of the State.

Deputy Secretary Gregor said that was correct but the State approves the methodology the contractors use to estimate.

Representative Spiegelman said that the issue of the long look-back period is at the heart of the Temple Inland case in federal court.

Deputy Secretary Gregor said that if the State avoids property cases that are murky or that are in a gray area that would incentivize businesses to have sloppy record keeping as a way to avoid being audited.

Senator Townsend agreed but said that he found DOF's position that their focus was on returning abandoned property to the owner difficult to believe because the majority of the property ends up going to the State because it is owner unknown.

Deputy Secretary Gregor said that if a property is owner unknown it should not unjustly enrich the holder, it should be used for the public good.

Mr. Houghton said that it is much easier for businesses to pursue a claim if it is addressed property, but this is not often the case. The reason he is focused on the look-back period is because he believes that it is part of the system that needs to be modified.

Mr. Togman said that he agreed with Mr. Houghton. He asked Deputy Secretary Gregor how many companies filed in 1981.

Deputy Secretary Gregor said that he did not know.

Mr. Togman said that he has been in this field a long time. In 1981, the only people who were filing were banks and insurance companies because they were the only ones who knew about abandoned property and escheat. This is an issue of fairness. The point is that no one knew about this field in 1981 or 1986 and it is unfair to punish businesses today when they did not know they had to file back then.

Mr. Togman also stated that there is a real risk of federal legislation from these unfair practices. Since Delaware is an outlier among other states regarding the look-back period, the State should consider reducing the look-back period.

Representative Spiegelman agreed with Mr. Togman and Mr. Houghton, stating that the State is currently being sued on those grounds in the Temple Inland case.

Deputy Secretary Gregor said that he did not disagree that the look-back period as a matter of policy is something that may need to be reconsidered. However, he wanted to make sure that it was that aspect of the process that was being considered “aggressive” and not the behavior of the contractors. The policies of the department are separate from the behavior of auditors. He is willing to discuss changes in department policy that may make the department seem less aggressive.

Mr. Tuinstra, Jr. asked if there are unclaimed property guidelines or best practices manual that has been published. California has their tax audit manual published online, including timelines. Making these guidelines readily and publically available could increase fairness.

Deputy Secretary Gregor said that there are guidelines approved by DOF but they are not published for the public.

Senator Townsend said that this is a great idea in theory, but it is likely that companies are going to be upset with the situation regardless of whether the process and guidelines are made available to them. The situation is that companies are participating in an auditing process based on sampling and estimation and are often required to write the State a check at the end of the process. He appreciates Deputy Secretary Gregor making the distinction between companies being unhappy with policies and being unhappy with the behavior of contractors. He also commends Secretary Bullock and Secretary Cook and their staffs for being flexible and willing to work with holders to make the process more palatable. It seems absurd that companies are not signing up for the VDA program offered by DOS after all the outreach Secretary Bullock has done. Senator Townsend said companies are gambling on whether they will be audited and he wonders if this is a breach of their fiduciary duties.

Senator Townsend asked Deputy Secretary Gregor if he had been speaking hypothetically when he said that the reason DOF has such long contracts with contractors is so there is a lower risk of them leaving in the middle of an audit and keeping the files and records related to the audit. That would violate Article V of the contract with Kelmar. He asked whether such a thing

has ever actually happened. He asked if there was some way to negotiate that regardless if a contracting firm leaves in the middle of an audit, the State gets to keep the records and files from that audit.

Deputy Secretary Gregor answered that regardless of whether the State can keep the records, they would have to hire a new contracting company which may not want to use the records from the previous company.

Ms. Cross said that there have been cases that have been reassigned to different contractors. Holders are resistant to this because they have already spent time and money with one contractor and do not want to have to start over with another. In one particular case when this happened, DOF settled very favorably to the holder because they could not reasonably expect them to start over with a new contractor after more than three years of working with another.

Senator Townsend said that it seems like contractors leaving in the middle of an audit may be an eventuality. He said that the public has a right to be skeptical of using that as an explanation for why the State has such lengthy contracts with contractors.

Mr. Togman said that easy way to handle this would be to not assign any new cases to a contractor who leaves in the middle of a case.

Deputy Secretary Gregor agreed with Mr. Togman. If there is any sort of inappropriate behavior DOF would no longer assign that contractor cases.

Mr. Ratledge asked how many total audits were closed in FY 2014.

Deputy Secretary Gregor said they closed a tremendous amount in FY 2013, approximately 80 cases. In FY 2014 they closed 15- 20. It varies from year to year.

Thomas Collins, Delaware Bankers Association (DBA), asked Secretary Bullock if he has spoken with companies that have chosen not to join the VDA program and if there is a particular reason they have not joined.

Secretary Bullock said he has not, since by definition these companies do not want DOS and DOF to know that they have not filed. He has heard some reasons secondhand, however. Some companies are worried about what their liability would be. He thinks the biggest reason that companies do not join is because they are not sure they will ever be audited. Large companies sometimes prefer to take the risk of being audited, which is 10% – 20%, than file.

Mr. Togman said that one consideration that was brought up by a company that presented to the 2006 Task Force was that the estimated cost for a client to be reviewed for their exposure for an audit is approximately \$2 million. It is not cost free.

Mr. Houghton asked if there is a connection between companies' decision to file or join the VDA program and DOF's decision to audit.

Secretary Cook said that those companies that have received letters to join the VDA but have refused are the focus of DOF for auditing. He said he has never, and has never directed his employees, to tell companies not to file.

Mr. Rosen clarified his earlier statement that he was not accusing anyone of telling companies not to file. However, because there has been no punishment previously for not filing it was a nonverbal message being perpetrated that it was okay for companies not to file. This ambiguity may be a reason to consider a shorter look-back period. It should be easier for companies to file and be certain of the statute of limitations and how long they need to keep their records.

Senator Lavelle said that the length of the contracts the State has with contractors is an issue worth examining further, since it is likely one of the longest contracts the State has with contractors of any sort. Shorter contracts could be rolled over if necessary. Senator Lavelle said it is important to infuse competition into the field to get better services and lower prices. Reliance on large companies like Kelmar does not do that.

## **PUBLIC COMMENT**

Senator Townsend asked if any members of the public wanted to comment on the Task Force's discussion.

Bob Byrd, Byrd Group, LLC., confirmed that The Council on State Taxation (COST) will be giving a presentation to the Task Force at the next meeting.

## **CONSIDERATION OF TASK FORCE MEETING MINUTES**

Senator Townsend asked the Task Force members if they had any comments or proposed edits to the minutes from the previous meeting.

Mr. Togman stated that he had no changes to propose and that he thought the minutes were very well written.

Senator Townsend thanked his Legislative Assistant, Michelle Zdeb, and Kiki Evinger, Legislative Aide to Representative Bryon Short, for their work preparing the minutes and organizing the meeting. The Senator requested for a motion approve the minutes.

Representative Spiegelman motioned to approve.

Mr. Rosen seconded the motion.

The Meeting Minutes were approved, with all members in favor.

Senator Townsend thanked the Task Force members for attending and for their comments. He then noted the next Task Force meeting will be held on Wednesday, September 10, 2014 from 3 p.m. – 5 p.m. at Buena Vista.

The meeting was adjourned at 3:22 p.m.