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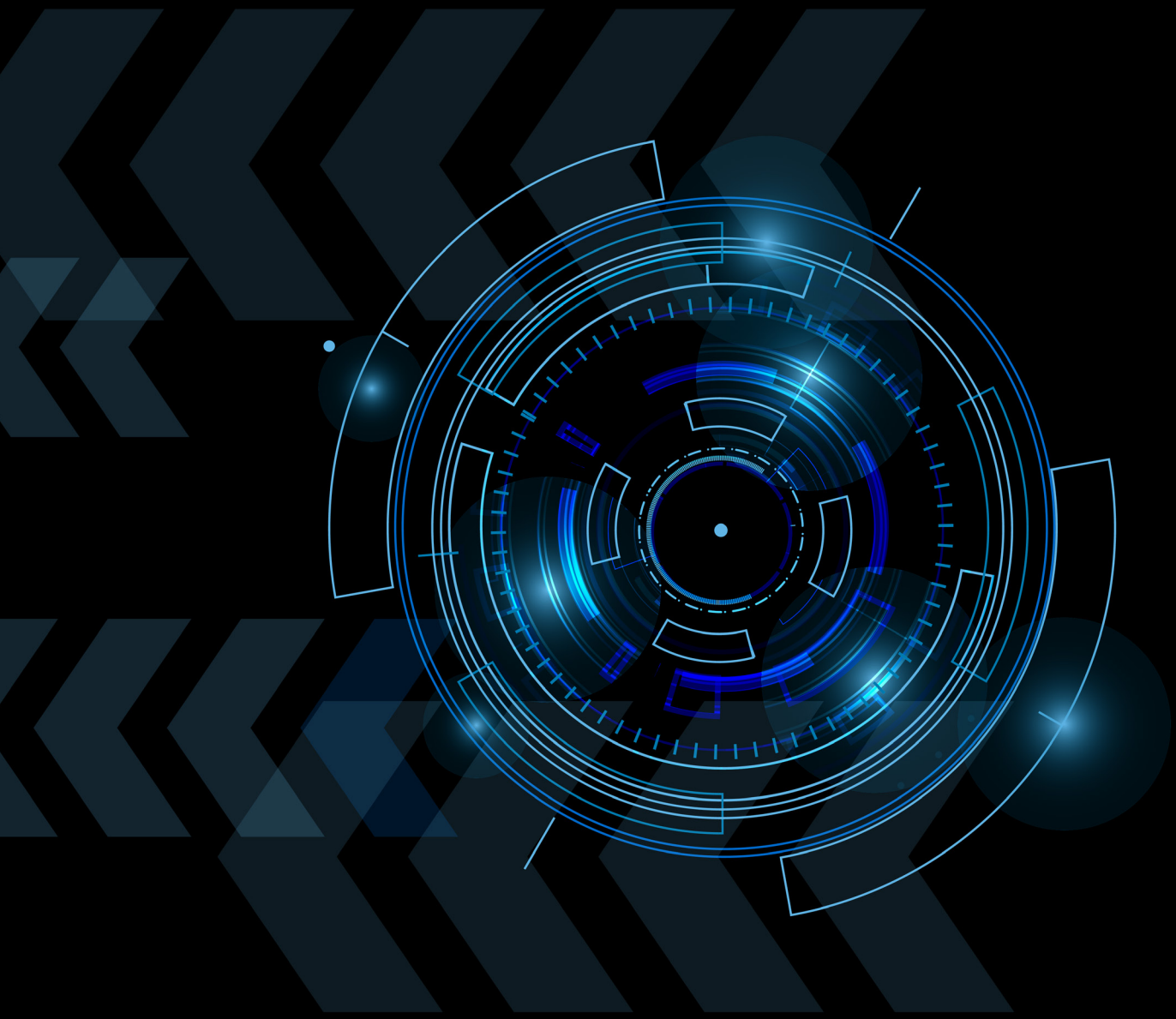


Your business needs periodic health checks, too

Annual physical exams. Having our cars serviced at regular intervals. Testing our smoke and carbon monoxide alarms. The list of things we are supposed to periodically check may not be endless, but it's pretty long. These periodic checks are not ends in themselves; rather, they are diagnostic and preventive—designed to determine whether there are any problems and, if so, to find them early and treat them before they become or cause bigger problems.

Businesses also need to undergo periodic checks of their own, and more specifically, of their entity data. It's vital to assess, reconcile, and remediate potential inconsistencies and problems that can jeopardize everything from day-to-day operations to the very survival of the business. Determining the existence of these problems and addressing them early could potentially be lifesaving for businesses of all sizes and types in every industry.

The challenges

What can go wrong? If a business entity is not in good standing in the jurisdictions in which it operates, or if it fails to maintain a required license, it may not be able to engage in its intended activities or avail itself of certain protections that the applicable laws or regulations permit for entities in good standing or properly licensed. Some common examples may include maintaining business operations in a specific jurisdiction or taking certain actions, such as prosecuting and defending against lawsuits. If an entity does not have the required officers or directors or similar officials, contracts and other corporate documents may not be validly executed or enforceable. A failure to file annual reports with secretaries of state and to pay any related franchise taxes can result in the accumulation of interest and penalties. And these consequences may have further repercussions, such as reputational damage when a potential supplier or customer notes that the company is no longer in good standing.

What are the key areas that a periodic checkup can address?

- **Existence in good standing:** Whether your business is organized as a corporation, a partnership, a limited liability company, or otherwise, the parent entity must remain in existence and good standing in order to stay in business.
- **State annual report filings:** Has your business filed all required annual reports in the state in which it is organized or qualified to do business (including making the necessary filings with the secretary of state)? If these reports have been filed, have the required annual franchise or similar taxes been paid? Are any back taxes due?
- **Directors and officers:** Does your business have the required directors and officers or comparable officials? Are the records maintained by the business up to date to reflect the officers and directors serving the organization?
- **Operating licenses:** Is your business authorized to do the things it needs to do? Aside from "merely" remaining in existence in good standing, many types of businesses (e.g., banking, restaurants, and educational institutions) must also obtain and maintain licenses relating to their specific operations. Even nonprofits must maintain state registrations permitting them to solicit contributions within a given state.
- **Processes, procedures, and records:** Are there clear controls indicating which members of your team are authorized to approve expenses, execute agreements and other documents, and take other actions on behalf of your business? How about procedures to be followed in these and other areas? And, does your business maintain comprehensive records of these and the other matters referred to above? The absence of an entity database containing up-to-date records can create or exacerbate problems when the business needs to, but cannot, substantiate compliance with governmental requirements or even your own policies.

Operating in multiple jurisdictions

Having subsidiaries in several jurisdictions, including those outside the United States, can create additional challenges:

- **Multiple jurisdictions:** Within the United States, different states have different requirements relating to the items discussed above. For example, operations that do not require operating licenses in one state may require them in another state, and even where licenses must be maintained in all states, the requirements for maintaining those licenses frequently differ from state to state. Moreover, state laws and regulations are being amended and interpreted on a virtually constant basis. Keeping up with these ever-changing requirements is a time-consuming exercise, but one that must be done for a business to be compliant.
- **International complications:** The challenges associated with multiple subsidiaries within the United States increase when your business also has international subsidiaries. Aside from language differences—which can be significant in themselves—countries have unique filing requirements and regulatory requirements that are very different from one another and that consequently require a different mindset in operating a business.

Assessment, reconciliation, and remediation (ARR)

How do assessment, reconciliation, and remediation work? First, a business should assess the data relating to the above and other matters, to determine whether it is accurate and complete and, where possible, to correct inaccuracies and provide missing data. If, as is often the case, information is stored in different databases or other repositories, the ARR process will consolidate data maintained in-house and will seek to reconcile any inconsistent information to avoid confusion about which information is "right."

The next part of the ARR process is to review books and records, from the parent company through all subsidiary levels, and compare the information they contain to the information maintained in public records and with other third parties. As noted above, the differences across states and international boundaries can make this task daunting.

Finally, where compliance issues, failures to comply with internal processes and procedures, or other deficiencies are found to exist, the ARR process involves the remediation of these anomalies and to set the business on a path of compliance.

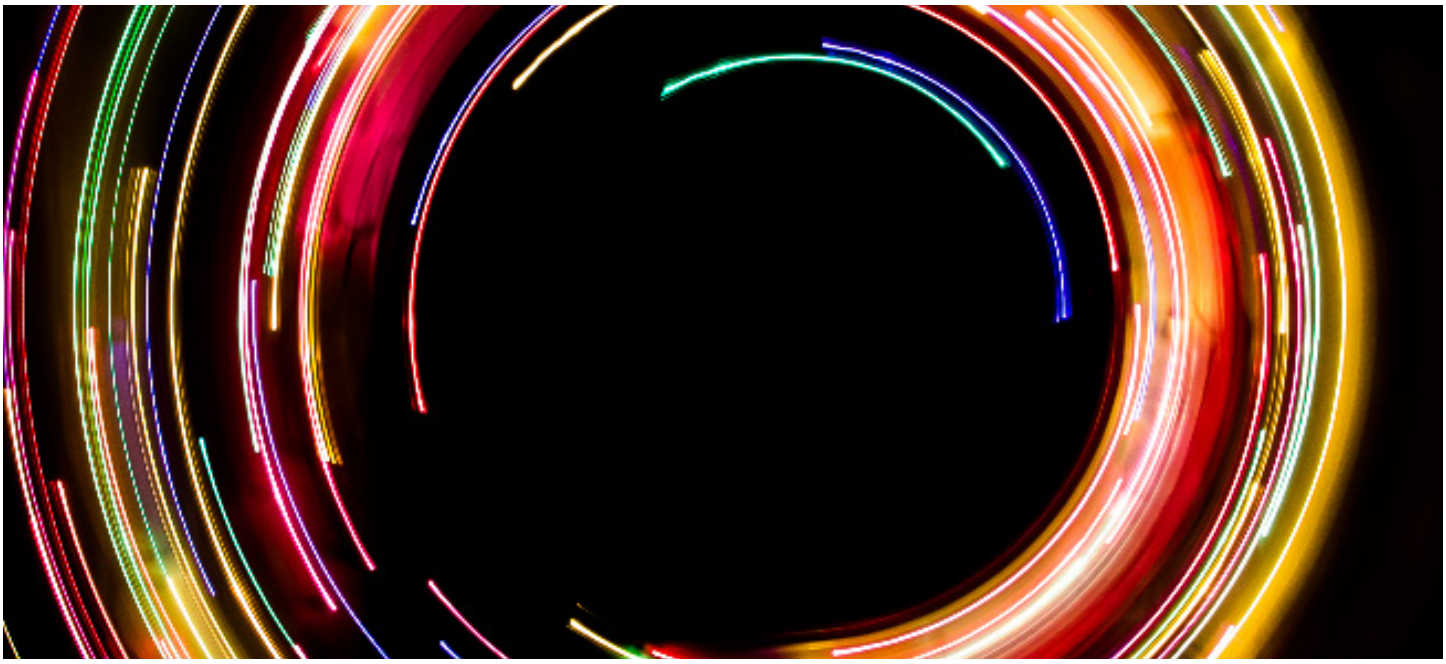
Importantly, the remediation process also entails establishing processes for continuous monitoring of emerging entity-related data issues, risks, and opportunities across the enterprise.

When

Many compliance systems contemplate annual checks of one sort or another. For example, for publicly traded companies, stock exchange listing standards call for annual review of committee charters, corporate governance guidelines, and other documents, and also require boards of directors to engage in annual self-evaluations to determine whether or how they can improve their effectiveness.

An annual ARR process may also be advisable; a less frequent process may result in problems being overlooked or allowed to grow, making subsequent remediation more difficult. However, other cadences or out-of-cycle processes may be appropriate. For example, an out-of-cycle ARR process may be advisable in the following circumstances:

- **When regulations are in flux:** The enactment of a new series of laws that create a new regulatory scheme or make major changes in an existing regulatory scheme. The enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act following the 2008 financial crisis is a good example of such a development.
- **Transitioning to a new system, joining a legacy system or database, or consolidating multiple databases:** Companies periodically update their systems. Implementing an ARR process as part of the transition to a new system can help to ensure the orderly transfer of all data and that no data is lost. Similarly, when an acquisition results in a new operation joining a legacy system, or when a company has multiple databases, whether resulting from prior acquisitions or otherwise.
- **Other event-driven changes:** Acquisitions and divestments provide another opportunity to conduct an ARR review and can assist in facilitating a smooth post-merger integration process. However, other developments, such as a name change, can trigger significant regulatory compliance requirements and offer another reason to conduct an ARR process.



Who

Responsibility for conducting an ARR process may vary from business to business, but it should generally include supervision from the legal function—and often include the corporate secretary—and the tax department. A team approach is highly desirable, as the nature of the business and the relevant legal and other requirements calls for a multidisciplinary approach.

In addition, businesses may want to consider engaging an outside service provider to perform an ARR process. The use of a service provider can free up time of the internal staff and/or avoid or limit the need to add staff. A service provider also can approach a periodic check with a greater degree of objectivity; if an internal reviewer was involved in the creation of a database or was responsible for maintaining a company's good standing or complying with external or internal requirements, he or she may be less likely to view the records in an unbiased manner.

However, perhaps the strongest rationale for using a service provider may be the broader degree of perspective or experience that can be brought to bear. This can be very important when a company operates in numerous jurisdictions and/or in countries other than the United States. A service provider, particularly one with global operations, will likely have far greater resources to facilitate compliance for the business across the United States and the world.

Next steps

A periodic health check, whether of a person or a business, does not provide any guarantees; a person who undergoes rigorous annual physical exams can still become gravely ill or worse. A technological disruption can cause a business to fail. However, in the case of both individuals and businesses, a periodic health check can avoid or significantly reduce the risk that a preventable problem will cause harm. For your business, an assessment, reconciliation, and remediation process will serve this purpose and should be considered on a regular basis.

Start the conversation

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