RECORDS RETENTION GUIDELINES

We are often asked about how long specific records should be kept. Discarding records that should be kept poses a wide range of potential tax and legal problems. Keeping them too long wastes precious space and resources. But how long should the firm's files be kept? The answer varies depending on firm policies and the type of files. Generally, the files should be kept as long as they serve a useful purpose or until all legal and regulatory requirements are met.

Businesses often base how long they keep files on the length of the statute of limitations for breach of contract, breach of fiduciary duty, and professional liability claims. The statutes, of course vary with each state.

As to your tax records, the statute of limitations period for income tax returns is generally three years. It is six years if there is a substantial understatement of gross income. A good rule of thumb is to add a year to the statute of limitations period. Using this approach, taxpayers should keep most of their income tax records a minimum of four years, but it may be more prudent to retain them for seven years. Regardless of the tax assessment periods, taxpayers should retain certain records for longer periods, and in some cases, indefinitely. Tax returns, results of an audit by a tax authority, general ledgers, and financial statements should normally be kept indefinitely.

Sample record retention periods are presented in Appendix I. Please note that this table should only be used as a guide. You should consult with your attorney and insurance carrier when establishing a record retention policy. We also recommend reviewing your record retention policy annually and updating it as necessary considering changes in governmental and professional requirements and the cost of retaining records.

It is also important to note that the IRS permits taxpayers to store certain tax documents electronically. Although these IRS rules are aimed primarily at businesses and sole proprietors, they presumably apply to individuals as well. These rules permit taxpayers to convert paper documents to electronic images and maintain only the electronic files. The paper documents can then be destroyed. Certain requirements must be met to take advantage of an electronic storage system. Appendix II discusses the requirements for maintaining computer records.

Appendix I - Records Retention Periods

TYPE OF RECORD	TIME PERIOD TO RETAIN
<u>ACCOUNTING RECORDS</u>	
Auditors' report/Annual financial statements	Permanently
Bank statements and deposit slips	7 years
Cancelled checks:	
- Fixed assets	Permanently
- Taxes (payroll related)	7 years
- Taxes (income)	Permanently
- General	7 years
- Payroll	7 years
Cash disbursements journal	Permanently
Cash receipts journal	Permanently
Chart of accounts	Permanently
Deeds, mortgages, bills of sale	Permanently
Electronic payment records	7 years
Employee expense reports	7 years
Fixed asset records (invoices, cancelled checks, depreciation schedules)	Permanently
Freight bills and bills of lading	7 years
General journal	Permanently
General ledger	Permanently
Inventory listings and tags	7 years
Invoices: sales to customers/credit memos	7 years
Patent/trademark and related papers	Permanently
Payroll journal	Permanently
Production and sales reports	7 years
Purchases	7 years
Purchase journal	Permanently
Purchase orders	7 years
Sales or work orders	7 years
Subsidiary ledgers (accounts receivable, accounts payable, equipment)	7 years
Time cards and daily time reports	7 years
Training manuals	Permanently
Trial balance - year end	Permanently
<u>EMPLOYEE BENEFIT PLAN RECORDS</u>	
Actuarial reports	Permanently
Allocation and compliance testing	7 years
Brokerage/trustee statements supporting investments	7 years
Financial statements	Permanently
General ledger and journals	Permanently
Information returns (Form 5500)	Permanently

TYPE OF RECORD	TIME PERIOD TO RETAIN
EMPLOYEE BENEFIT PLAN RECORDS	
Internal Revenue Service/Department of Labor correspondence	Permanently
Participant communications related to distributions, terminations, and beneficiaries	7 years
Plan and trust agreements	Permanently
INSURANCE RECORDS	
Accident reports and settled claims	6 years after settlement
Fire inspection and safety reports	7 years
Insurance policies (still in effect)	Permanently
Insurance policies (expired)	7 years
LEGAL DOCUMENTS	
Articles of Incorporation and Bylaws	Permanently
Buy-sell agreements	Permanently
Contracts and leases (still in effect)	Permanently
Contracts and leases (expired)	7 years
Employment agreements	7 years
Legal correspondence	Permanently
Minutes	Permanently
Partnership agreements	Permanently
Stock certificates and ledgers	Permanently
PERSONNEL RECORDS	
Child labor certificates and notices	3 years
Employment application (from date of termination)	2 years
Employment eligibility verification (I-9 Form) (from date of termination)	3 years
Help wanted ads and job opening notices	2 years
Personnel files (from date of termination)	4 years
Records of job injuries causing loss of work	5 years
Safety: chemical and toxic exposure records	30 years
Union agreements and individual employee contacts (from date of termination)	3 years
TAX RECORDS	
IRS or FTB adjustments	Permanently
Payroll tax returns	7 years
Property basis records	Permanently
Sales and use tax returns	Permanently
Tax returns and cancelled checks for tax payments	Permanently

Appendix II – Maintaining Computer Records

Requirements For Maintaining Computer Records

Basically, most businesses are subject to the IRS computer record retention rules. The rules of Rev. Proc. 98-25 are summarized as follows:

1. Computerized records must provide sufficient information to support and verify entries made on the taxpayer's returns and to determine the correct tax liability.
2. Computerized records must contain sufficient transaction-level detail that the information and the source documents underlying the computerized records can be identified.
3. All computerized records must be made available to the IRS upon request and must be capable of being processed. In addition, the taxpayer must provide the IRS with the resources to enable it to process the computerized records.
4. Taxpayers using the computer-to-computer exchange of information (Electronic Data Interchange or EDI) must retain the records that alone, or in combination with any other records, contain all the information that the IRS requires of hardcopy books and records.
5. The taxpayer must promptly notify the IRS if any computerized records are lost, stolen, destroyed, otherwise no longer capable of being processed, or found to be incomplete or materially inaccurate.

The IRS can modify or waive any part of the computerized record retention requirements to which a taxpayer is subject by way of a record retention limitation agreement with the taxpayer. Failure to comply with the record retention requirements for computerized systems may subject the taxpayer to significant penalties and fines.

Electronic Storage Systems

The IRS has also issued guidance on using electronic storage systems to satisfy record keeping requirements. Rev. Proc. 97-22 applies to income tax records of taxpayers who are required to maintain books of account or records. In general, these rules state that an electronic storage system must:

- ensure an accurate and complete transfer of the hard copy or computerized books and records to an electronic storage medium;
- index, store, preserve, retrieve, and reproduce the electronically stored books and records;
- include reasonable controls to ensure the integrity, accuracy, and reliability of the electronic storage system and to prevent and detect the unauthorized creation of, addition to, alteration of, deletion of, or deterioration of the electronically stored books and records;
- include an inspection and quality assurance program evidenced by regular evaluations of the electronic storage system, including periodic checks of electronically stored books arid records;
- include a retrieval system that has an indexing system;
- exhibit a high degree of legibility and readability when displayed on a video display terminal and when reproduced in hard copy; and
- provide support for the taxpayer's books and records.

For each electronic storage system used, the business must maintain, and make available to the IRS upon request, complete descriptions of the electronic storage system including all procedures relating to its use and the indexing system.

In addition, an electronic storage system cannot be subject to any agreement that would limit or restrict the IRS's access to and use of the electronic storage system on the business's premises or any other place where the electronic storage system is maintained.

Once a taxpayer has verified that the storage system complies with and will continue to comply with the Rev. Proc. 97-22 requirements, the taxpayer may destroy the original hard copies and delete the original computerized records other than certain machine-sensible records that must be retained. But since each state may have its own guidelines for storing and processing records in an electronic format, you should also review applicable state law when using electronic storage systems.