The Three R's: Records, Retention, and Retirement

What records to retain, and what to retire? A systematic approach helps keep you covered.

by
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Recordkeeping is obligatory for all contractors. But this constant paper flow also creates a need for policies regarding how long a firm should retain its various business records.

Unfortunately, no common guidelines apply to all contractor records. The length of time necessary to retain different records varies with the contractor and the circumstance. But the need to establish record retention policies remains. In any circumstance, three primary considerations should govern development of a firm's records retention policies.

First, a contractor must satisfy all applicable. legal requirements. In some instances, federal laws set retention standards; in others, state and local laws apply. When doubt exists, seek competent legal advice.

The second consideration is the firm's own administrative and operating needs. For example, if inquiries seldom arise about paid invoices after six months, then retaining such invoices longer than a year or two probably becomes unnecessary.

Of course, some contractors may choose to exercise an abundance of caution. In such instances, retaining larger dollar invoices for longer periods becomes a logical compromise.

Common sense, then, becomes the third criterion that governs records retention policies. Retain any particular set of records as long as they might have managerial, legal, or historical relevance to the business. Discard records after time erases their relevance.

As for particular business records, logically, contractors should retain their general ledgers permanently. Ledgers provide an accounting summary of a firm's operations since inception, and can have important management and historical implications.

However, it is seldom necessary to permanently retain original records of all business transactions summarized in the general ledger. So, cancelled checks for smaller dollar payments may be retained up to seven years to meet different state requirements. But a contractor may choose to retain cancelled checks for important transactions permanently.

Consider the logical business criteria that marks the distinction. Smaller dollar payments become insignificant in any audit or dispute that may arise. The absence of those records—particularly after seven years—becomes immaterial.

At the same time, contractors should permanently retain checks that evidence larger dollar payments. Obscure, unanticipated challenges can bring the need for that evidence long after the payment.

The same principles underlie retention of accounts receivable records. Retaining smaller-dollar invoices for paid amounts longer than one or two years seldom makes sense; but retaining largerdollar paid invoices might prove useful on occasion.

Since contractors produce special or made-to-order works, they may want to retain invoice copies for a longer period. Firms also should retain related purchase documents. In both instances, the documents can become evidence in any legal challenge that can arise long after delivery.

Apply the same principles to other basic accounting documents. Fiscal year-end financial statements, and any records related to a contractor's financial structure, should be retained permanently. Ancillary records, such as bank reconciliations and deposit receipts, seldom need to be held longer than a year. The retention period for records falling between these two extremes, should be three, five, or seven years.

The logic that governs retention of accounting records also applies to legal documents. Contractors should retain documents pertaining to largerdollar, more significant matters for a longer term. A shorter retention period applies to smaller-dollar, less significant matters.

Deeds, major contractors, leases, corporate bylaws, minute books, copyrights, and trademarks registrations, should be retained permanently.

However, contractors can discard expired contracts and leases after seven years. That also applies to most cancelled stock certificates. Again, use discretion and retain documents that might relate to legal issues that could arise in the future.

Retention schedules for legal documents apply specifically to completed, executed legal documents. Memos and associated work papers can be discarded soon after the final legal documents apply, since completed, documents govern legal considerations involved.

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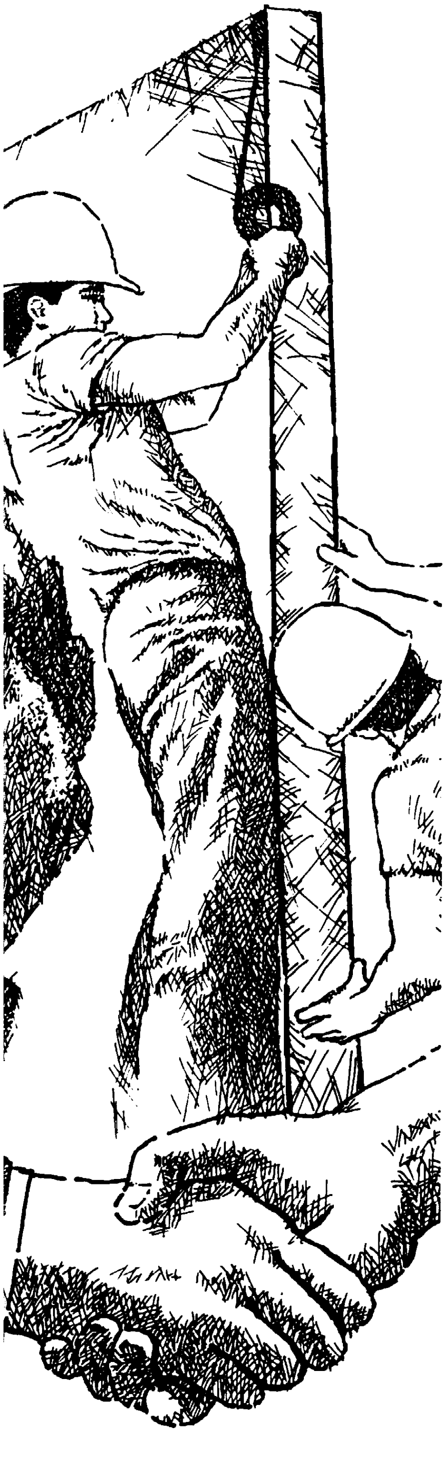

Personnel-related paperwork is another records category typically considered in a contractor's retention policies. Equal employment opportunity laws and the growing incidence of wrongful discharge suits have made personnel record retention policies more significant.

Contractors should observe guidelines set by law, union agreements, or industry conventions. But in any case, contractors should keep specific personnel records long enough to defend potential challenges to their hiring or firing practices.

Employment applications should be

retained no less than three years, though union contractors may want to retain applications longer.

Records related to fired employees should be kept for at least five years.

To avoid crammed cabinets and messy decks, contractors must learn the "Three R's" of recordkeeping, retention, and retirement. A systematic approach to deciding what records to retain and what to keep will help make sure needed documents are at hand when needed.

The absence of a valid, documented reason for termination can open a contractor to lawsuits for alleged sex or racial discrimination, even long after the employee's dismissal.

Different principles apply to salary and wage records. Original attendance records and time sheets typically can be discarded after six months, since the information is summarized on the payroll records.

Payroll records call for longer retention periods. Legally, contractors must retain FICA earnings records for at least four years. Also, records pertaining to a firm's retirement programs must be kept on a permanent basis as a practical necessity.

Information included in a contractor's tax returns deserve special consideration in its retention policies. In most instances, contractors can discard sales or gross receipt tax computation records after five years. The same holds true for excise tax computations.

Contractors should retain federal and state income tax returns for at least seven years. However, as returns become more complicated in growing firms, retaining returns permanently often makes good business sense.

Tax authorities can challenge returns after the legal three-year limitation when any suspicion of fraud exists. And even unfounded suspicions may lead to challenge. Retaining tax returns permanently helps contractors retain information necessary for their defense.

The same principle applies to documentation that underlies entries in tax returns. Preliminary work papers can be discarded when other documentation traces the relevant information.

The final area of concern is the less critical paper flow that remains essential for the typical contractor's operations. No categorical guidelines exist. Simply consider the specific items and the potential for needing those documents one, three, or five years in the future.

Cost also becomes an important consideration in establishing retention policies for those items. Weigh the costs incurred in storing the items against the potential expenses from lacking one to meet some unforeseen, unpredictable need. The less likely any future need will arise, the less likely contractors need to retain the items for extended periods.

For example, in the absence of current problems, routine sales paperwork, receiving sheets, and most purchase orders, can be discarded after a year.

Contractors can discard expired contracts after seven years.

SUGGESTED RETENTION OF RECORDS

Document	Retention Period
ACCOUNTING:	
General ledger	Permanently
Canceled checks	7 years, or permanently for large checks
Invoices	1-2 years, or longer for large invoices
Purchase documents	As needed
Financial statements	Permanently
Bank reconciliations	1 year
Deposit receipts	1 year
LEGAL:	
Deeds	Permanently
Major contracts	Permanently
Leases	Permanently
Corporate bylaws	Permanently
Minute books	Permanently
Copyrights/patents	Permanently
Trademark registrations	Permanently
Expired contracts	7 years
Canceled stock	7 years
Memos/work papers	Discard once contract is completed
PERSONNEL	
Employment applications	3 years, or longer for union employees
Termination records	5 years
Attendance records	6 months
Time sheets	6 months
FICA earnings records	4 years
Pension records	Permanently
TAXES:	
Federal tax returns	7 years, or permanently
State tax returns	7 years, or permanently
Work papers	As needed

The above are only suggestions. No guidelines are suitable for every contractor in every circumstance, and must be modified to meet specific or risks.

Records retention policies should not remain a management afterthought. Failure to set sensible policies can leave contractors at a disadvantage if any challenges to their past activities arise.

At the same time, contractors should retain payroll records, and invoices for sales and purchases, as long as seven years. Both records might be useful for some beneficial management analysis, or for defending tax returns or audited financial statements.

Again, no record retention guidelines are suitable for every contractor in every circumstance. Any of the above guidelines may be altered to meet specific needs or compensate for special risks. Remember, the examples are only suggestive.

Still, records retention policies shouldn't remain a management afterthought. Failure to set sensible policies can leave contractors at a disadvantage if any challenges to their past activities arises.

About the Author . . . Joseph Arkin is a Miami-based CPA who writes extensively for trade and professional magazines.