

What Do I Keep? What Do I Archive? What Do I Destroy?

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Best Practice Considerations for Formalizing Your Tax Data and Document Retention Policy and How Technology Can Help

The issues of data and document retention are increasingly complex and ambiguous as they relate to corporate tax. First, the evolution of enterprise-class software systems—ERP systems such as SAP and Oracle Financials, as well as “niche” enterprise applications such as enterprise content management (ECM) software—along with a mature Internet are challenging the very definitions of records and documents and introducing new ways to manage information such as structured and unstructured data.

Different departments within the same company can often have conflicting positions on the issue of data retention. Legal departments want to get rid of as much as possible as soon as possible. Corporate IT departments seek to archive and quarantine data whenever possible, given their mandates of conserving disk space, reducing storage costs, maintaining system performance, and reducing the exposure of confidential data to unauthorized viewers. Tax departments (“Tax”), on the other hand, don’t have

an issue with retention; they want to keep everything forever. Finally, there’s heightened legislative pressure and scrutiny from tax authorities. Sarbanes-Oxley, federal regulations such as Gramm-Leach-Bliley, and many newly-passed state laws that regulate confidential information are all adding pressure and contributing to the policy confusion.

This article discusses these evolving forces that are impacting data retention and document management trends and best practice strategies that can be employed. The authors will discuss where Tax fits into the record retention lifecycle, and drill down into the issues that shape strong record retention policies. Finally, the authors suggest ways to evaluate solutions that support the need to retain information cost effectively and with regulatory compliance in mind.

THE NATURE OF DOCUMENTS AND THEIR RELEVANCE TO TAX

The issues of data and record or document retention have been both complex and ambiguous as they relate to corporate tax. For the purposes of this article, the terms “record” and “document” are interchangeable. Any distinction between them, if there ever was one, has pretty much disappeared in the digital age. Records and documents both contain data, both represent business transactions (as far as Tax is concerned), both are considered “files,” and both may be stored, archived, retrieved, and destroyed using the same technology.

Broadly speaking, records consist of either structured data or unstructured data. Structured data is organized in a manner that enables users of that information to identify and separate the context of the information from its content. Data stored in the fields and rows in relational database tables is the

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most common example of structured data. It is easy to see that in a database application, for example an ERP system, the context or user interface can easily be separated from the content or data fields on the screen. The data fields are stored separately from the user interface and can therefore be accessed in a number of different ways. By contrast, a spreadsheet is often considered unstructured because the context and content combine and are stored together. Yet the definition of unstructured data is often not so clear and consistent. Today, we communicate primarily through the use of unstructured data: Email, spreadsheets, word processing documents, presentations, graphics, and instant messages are the lingua franca of business, and all are examples of unstructured data.

Theoretically this should not necessarily pose a problem for Tax, which traditionally has preferred to retain documentation. But the daunting proliferation of documents has made Tax's job of document retention increasingly difficult—even more so when records are chaotically dispersed on scores of desktops throughout an organization.

OPPOSING FORCES DRIVING RECORD RETENTION POLICY

Tax has always been legally required to retain records for some period of time and be able to produce them when requested. Even when no longer required to do so (such as after a statute of limitations has expired), Tax has traditionally opted to preserve records. This sometimes comes from the desire to become the corporate historian of financial records or the recognition by Tax that certain future tax accounting may require the ability to retrace the cost basis for a given transaction. Therefore, for tax professionals it is easier to save everything than try to identify what is absolutely needed.

The increasingly stringent regulatory landscape is also making it ever more difficult to manage the retention of records. Virtually all areas of an organization now have to address document retention. For instance, Graham-Leach-Bliley, the Privacy Act, the Paperwork Reduction Act, HIPAA, the PATRIOT Act, and of course Sarbanes-Oxley all contain sections that specifically refer to document retention. State and industry regulations add yet another level of requirements.

External regulations and internal policy compel an organization to implement data retention policies, demonstrate a record's authenticity, and maintain an audit trail of any revisions. Sarbanes also provides

penalties of up to 20 years in prison for the premature destruction of documents. Meanwhile, IRS revenue procedures specifically require not only record retention and availability, but also clear documentation to establish a record's authenticity and integrity. In addition, some tax records require special rules as they relate to the type of information that must be maintained. Examples include T&E expenses (records must indicate time, place, and purpose of expense); business use of automobiles (destination, business purpose, and presumptive business benefit of each trip); and charitable contributions (varies, depending on the amount).

With this many regulations, covering this level of detail, and the penalty for non-compliance that severe, Tax could be forgiven for opting to save as much as possible for as long as possible.

Legal departments want to get rid of as much as possible as soon as possible, but corporate IT departments seek to archive and quarantine data whenever possible.

Unfortunately, keeping everything is no longer an option. The amount of data businesses produce has exploded, making management difficult and storage so expensive that document destruction, whenever appropriate, is looked at as a valuable cost-cutting measure. As a partial solution, corporate IT departments now routinely move data off production systems and onto backup archives, such as magnetic tape. In addition to saving money, archiving data can also improve overall system performance. For Tax, the significant downside to this is that data on tape backup systems is notoriously expensive to retrieve, impeding any rapid response to support processes such as audits. Further, the longer data is stored, the greater the legal exposure of discovery, not to mention the possibility of theft, loss, or damage, which is why corporate legal departments advocate destroying as much as possible, as soon as possible.

Tax, of course, is caught in the middle. It must preserve a volume of documents to comply with a wide range of regulations—yet internally, corporate tax is being pressured to destroy everything it can as soon as regulations will permit it. Add to these conflicting pressures the sheer numbers of documents businesses are producing, and record retention becomes a Herculean task for traditionally resource-strapped tax departments. The best way to manage this task is

with a robust record retention policy and supporting software technology.

HOW RECORD RETENTION POLICIES ENABLE COMPLIANCE

A record retention policy is the framework by which an organization establishes various classes of business records and sets forth guidelines relative to the retention of those records that the company must follow. Such a framework also includes rules governing the destruction of records at the end of the records' lifecycle, plus procedures for preventing the destruction of the records in the event of litigation or governmental investigation.

Simply put, a good record retention policy enables the company not only to follow both the letter and the spirit of regulatory policy, but also to document the processes for doing so. Once implemented, an appropriate record retention policy clears the way to:

- A statement regarding the need to suspend the policy if litigation or investigation is anticipated, in order to prevent scheduled destruction of documents
- Names and contact information of those responsible for managing the policy

For tax departments, a clearly defined record retention policy enables tax compliance in a number of ways: Accuracy can be improved by having better access to source data for tax calculations; audit trails that catalog changes to documents can be quickly referenced, improving confidence in underlying data and reducing the likelihood of unwanted surprises; and correct document versions can be more readily located during audit to support tax positions.

NEED TO BUILD UPON AND TAP INTO EXISTING SYSTEMS

Tax records are spread throughout an organization's systems and even throughout different modules within a single system. For instance, company income, expense, investment, and legal entity data is often spread throughout the various modules of an ERP system; employee and payroll information is kept in an HR system; tax depreciation information is often kept in a niche application designed specifically for this purpose; certain components of state apportionment data are often kept in an HR/Payroll system; information required to compute cost of goods sold may be kept in an in-house production management system. And there may be a great deal of tax advice and information directly in emails.

Complicating matters yet further is the proliferation of document copies. The "original" document may reside in a source database, but how many times has that document been emailed, or taken from a shared drive and placed on a laptop, or backed up on any number of other systems?

For most tax departments, traditional software technologies that support other processes must be extended and enhanced to support a robust record retention policy. Email, spreadsheets, word processing, and the desktop file system were not designed with the necessary features to support controls, audit trails, and data security. Nor do they share a common document repository, which would facilitate storage. And without a common document repository, it's extremely difficult to retrieve documents with the speed and thoroughness an audit or other regulatory response requires. The shortcomings of these systems can be addressed by incorporating technology that

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- Preserve necessary records
- Eliminate unnecessary records
- Establish the authenticity and accuracy of source records and verify their integrity throughout the information lifecycle
- Establish access controls, track changes, and create audit trails
- Reduce the volume of records stored, and thus the related cost
- Address legal requirements

To establish a record retention policy, here are some high-level considerations:

- Definition of a record and/or document
- The relevant laws and regulations
- Guidelines that can help identify document type and department owner, years to be stored, method of storage, and method of retrieval
- Instructions for employees on how to adhere to the policy and halt unsanctioned document destruction

can simultaneously implement controls to more easily and completely track and manage spreadsheets, word processing, and other types of files, and also import the data they contain for more thorough and current analysis—functions ideally suited to a document management solution.

COMPANIES ARE MOVING FORWARD, OFTEN LEAVING TAX BEHIND

Many companies have recognized the high stakes involved in properly retaining records, and are moving forward on a variety of document retention initiatives. In addition to regulatory compliance, other drivers include:

- Managing risk
- Avoiding spoliation
- Avoiding obstruction of justice
- Reducing storage space and costs
- Accessing and retrieving documents efficiently

Yet the tax department is often left behind or left out of any larger record retention plans an organization may have. Tax may be considered an afterthought—or may not be considered at all—when companies roll out document management solutions. And since getting enough resources, or enough attention from corporate IT, is typically difficult, it can be very difficult for Tax to catch up or resolve this problem on its own.

The fact that Tax's unique record retention needs set it apart from other organizational areas has further slowed the integration of technology into the Tax function. For example, Tax typically has longer retention periods than other company functions, so it often becomes the last signoff in the chain as to when to destroy. Consider a company that regularly extends the filing deadline for its corporate tax return. The period of time from when a record is created to when the statute of limitations expires and when it could be subject to examination by the IRS could be nearly five years. Extend that by another year or two if the IRS is not current with the company's audit. Then consider state income tax audits or other jurisdictional audits. This retention period is often far greater than that for other business data retention requirements.

So one must be cognizant of Tax's relatively unique document retention needs (at least when compared with other areas of the company) when making a business case to be included in any document management solution—just as any document manage-

MAKE CERTAIN YOU CAN AND WILL ENFORCE THE RETENTION POLICIES YOU PUT IN PLACE.

During an impromptu survey at a recent conference of the Association of Computers and Taxation, attendees at a particular session were asked about whether their companies had a record retention policy. Most of them raised their hands—yes. They were then asked whether they were familiar with the record retention requirements related to the types of documents within their area of responsibility. Most of the hands remained up. This continued for a few more questions, but when the final question was asked—how many of the attendees had actually destroyed a document pursuant to their record retention policy—only two or three hands remained up.

A record retention policy is entirely moot if you never actually destroy documents. Systematic destruction is a fundamental requirement of any good policy and a document management solution should support and drive the policy. Having a policy, then enforcing it in lax fashion (or not enforcing it at all) can leave you highly exposed to civil and legal penalties, for instance if a record needed to support a position during an audit has been destroyed before it was permissible to do so.

In short, you may be better off without any record retention policy than you are with a policy you don't enforce, or fail to enforce consistently.

ment solution being evaluated also should take into account Tax's record retention requirements.

EVALUATING A DOCUMENT MANAGEMENT SOLUTION TO SUPPORT DATA RETENTION—POINTS TO CONSIDER

When deciding on a document management solution, these simple but significant considerations should be kept in mind:

1. The technology should include a centralized data repository, to allow for an up-to-date single version of the truth.
2. The solution should also help create an enterprise taxonomy with each business unit (including tax) having its own business-specific section.
3. The solution should enable fast, granular searching through large amounts of data, across taxonomies. This can cut audit and defense

NOTES FROM THE TRENCHES

The recommendations that follow were culled from answers to a recent Association for Computers & Taxation (ACT) survey that asked the respondents who've actually gone through a document retention policy formation and supporting system implementation to describe important lessons learned:

- Get company leadership as well as end-user buy-in early in the process.
- Make sure you address ease of use of system and security.
- Make sure to maintain obsolete software through the audit period.
- Inform everyone of the Company policies and procedures of record retention.
- Review and understand the current storage medium.
- Review records annually and ensure retention requirements are still in effect for open audit years.
- Make sure data is organized and indexed for retrieval.
- Make certain your team knows about any changes to documents being retained or systems no longer being supported.
- Ensure the tax guidelines are established jointly by tax and legal. For instance, involve your legal counsel to help you interpret the regulations and best ascertain which records to retain, in what format, and for how long.
- Identify and update "owners" of records.
- Communicate exceptions to general record retention rules.
- Set a data retention policy that is tailored to each country. Integrate these data retention policies for each country into one system.
- Archive monthly, segregating each month's files for ease of disposition when appropriate.
- Enforce data retention based on a published central retention schedule.
- If possible, maintain transaction transparency for users.
- Move all data that does not have to be retained through the same process as data that does need to be retained, except with a retention period of 0 years, 0 days.

These responses were originally published in the 2005 Survey on Corporate Tax Automation conducted by the Association for Computers & Taxation (ACT), and are reproduced with the permission of ACT.

costs by a significant margin, as one example of its value.

4. The technology should be flexible enough so that whatever the document retention policies are, the company can implement the technology and then be able to do everything needed (that is, you shouldn't have to spend more of your time managing the technology).
5. The technology should automate processes and controls, and enable the user to do tracking and reporting—for instance, to keep track of all copies of a particular document, regardless of where they may reside (email, network shares, etc.)
6. The solution should enable easily identifying documents that have reached the end of their retention period, for example via time/date stamping, and begin a controlled but automated process for the destruction of documents after their retention periods expire. (There should also be safeguards that effectively preclude the unintentional destruction of documents before their legal or regulatory lifecycles expire.)
7. The technology should be secure, with information access available only to those required to manage it.

CONCLUSION

Tax is effectively caught between the opposing forces of document retention and document destruction. Yet as the traditional "last link" in the overall chain of retention, Tax often finds itself having to manage the overall document retention process without adequate resources to do so. Document management solutions are proving to be a powerful way for Tax to manage this task successfully, and they are well within reach of most tax departments. Tax-specific solutions offer a compelling and rapid return on investment and can often be deployed cost-effectively, with little or no adverse effect on business continuity. A document management solution designed with Tax in mind can also be used as a framework to implement best-practices for record retention, extending Tax's ability to use record retention as another method for attaining and demonstrating regulatory compliance. ■



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