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Retention of records in offices of certified public accountants; Management of an accounting practice bulletin, MAP 19

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MAP 19

MANAGEMENT OF AN ACCOUNTING PRACTICE

Retention of Records In Offices of Certified Public Accountants

STAFF BULLETIN
PUBLISHED BY THE
AMERICAN INSTITUTE
OF CPAs, INC., 1963

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This bulletin is a publication of the staff of the American Institute of Certified Public Accountants and is not to be regarded as an official pronouncement of the Institute. It was prepared by Benjamin L. Enloe, CPA, and Robert N. Sempier, CPA, manager, management of an accounting practice. The members of the committee on management of an accounting practice assisted in an advisory capacity.

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Introduction

THE PROPER POLICIES for retention of records are of great importance to all practicing certified public accountants. The primary objective is that the records will be preserved for only as long as they serve a useful purpose and satisfy all legal requirements. At the conclusion of the retention periods they could be destroyed in order to keep the files and filing space within practical limits. In order to obtain information on the prevailing practices regarding the retention of records, fifty firms were asked to complete a comprehensive questionnaire on this subject. In order to insure the greatest co-operation in the project, the fifty firms were selected from Institute members who had been active in other Institute affairs, without regard to geographical distribution or random selection. This bulletin has been prepared from the thirty replies received: four from large national firms, ten from medium-size firms and sixteen from small firms or individual practitioners. In these circumstances, the statistics in this bulletin must be considered as based on a selective sampling rather than on a comprehensive survey.

The retention periods in this bulletin are sometimes expressed

as inclusive years which seem best described as the "Concentration of Prevailing Practice." This means the periods within which the years most frequently reported are concentrated. The full range of retention periods usually has not been given as it was felt that this information would not be useful to the study, although in some instances, unusual situations concerning retention periods outside the areas of concentration have been described. In most instances the concentrated periods include a majority of the years reported, although the full range of years might be much wider.

The study did not attempt to cover:

Requirements for and methods of filing and storage of records

Reference files and research materials

Library material

Staff training materials

Pamphlets, magazines, newspapers, etc.

Tax, SEC and Government services

Staff, interoffice and intraoffice reports

In determining periods for record retention, various considerations including legal requirements should be taken into account. It is impossible to pinpoint legal responsibilities for the length of time accounting records pertaining to clients should be retained because of the multiplicity of factors involved, and because of the variation in legal requirements among the fifty states. Nevertheless, a CPA should be aware of the various pitfalls he might encounter in prematurely discarding records.

There is no statutory authority for length of retention periods for workpapers and other materials relating to clients' affairs. However, from the CPA's own point of view, such items would be essential for defense of a malpractice action. In the light of this, the statutes of limitations on such actions in the appropriate jurisdictions (Federal and/or one or more states) could be material.

In the event the client should become involved in litigation the CPA's records might be important to the client. Accordingly, the various statutes of limitation in a particular jurisdiction relating to contracts, real property and other pertinent areas could be significant. This would be particularly true in special engagements of various kinds, especially where an existing dispute precipitated the engagement. This area is complex because the statutory period for different kinds of actions varies greatly within and among jurisdictions, and may be exceedingly long for some kinds of actions.

Retention of records pertaining to a client's tax affairs (including copies of returns, Revenue Agents' reports, workpapers and office files) should also be considered in the context of statutes of limitations applicable to taxpayers (clients). For Federal tax purposes, the basic statute of limitations is three years; six years if a return omitting over 25 per cent of gross income is filed. There is no period of limitation in the case of fraud or failure to file a return. The period is subject to extension for various reasons detailed in the statute. State and local tax laws, including those applicable to payroll taxes are subject to varying periods of limitation.

A future MAP bulletin will deal specifically with maintenance of files in offices of certified public accountants.

SUMMARY

Correspondence files

RESPONDING FIRMS which have uniform retention practices which apply to *all* client correspondence files, retain them from three years to indefinitely or permanently, more than half retaining them at least ten years. The other responding firms usually retain general or confidential correspondence on client affairs five to ten years; correspondence on client tax affairs is retained indefinitely or permanently for present clients but generally from five to ten years for former clients.

Routine and nonclient correspondence files are generally retained from two to ten years.

Reports

TWO-THIRDS OF the responding firms retain indefinitely the office copies of all reports issued. The other third have a similar practice for most reports for present clients and retain most reports for former clients from six to ten years.

There is no uniformity in retention periods for extra copies of reports although one-fourth of the respondents retain them

one year or less. Drafts of reports and financial statements are usually retained three to ten years. One office copy of printed reports containing an opinion of the firm and reports relating to clients from other CPAs are usually retained indefinitely or permanently for present clients, but there is considerable variation for former clients. Most respondents do not retain other copies of printed reports or retain them for only a short time.

Permanent files

MORE THAN 80 PER CENT of the responding firms maintain separate "Permanent Files" for the papers and information which would be of continuing interest in subsequent recurring engagements (see item 9, page 17, for the usual contents of these files). Current permanent files are usually retained indefinitely or permanently and inactive files are usually retained from four to ten years.

Audit working papers

ABOUT HALF of the responding firms have uniform retention practices applying to all audit working papers other than permanent file papers. A majority of them retain the papers of present clients indefinitely or permanently and retain those of former clients four to ten years. The other half of the respondents retain certain papers (see list in item 16, page 19) from six years to permanently for present clients and from five to ten years for former clients. The shortest retention period for any of the individual papers is from one to six years and segregation is usually made at the time of their destruction.

Working papers for special engagements

MOST RESPONDING FIRMS made no distinction in their retention practices for working papers accumulated for special engagements.

Detailed schedules used in an audit but not retained in working papers

ABOUT 30 PER CENT of the responding firms do not retain all detail schedules used in conducting an audit, or client furnished materials used for testing or general information, provided certain data concerning these schedules are included in the papers. Typical materials not retained are listed in item 20 (page 21).

When the examination has been completed and reviewed, point sheets and "to do" lists are discarded by one-fourth of the responding firms.¹

Tax returns and files

ABOUT THREE-FOURTHS of the responding firms have indefinite or permanent retention periods for office copies of present client tax returns and tax working papers; also for tax data and Revenue Agents' reports received from these clients. A smaller proportion of the responding firms retain these tax materials of former clients for indefinite or permanent periods but more than half retain them ten years or more. Most firms retain all these materials at least five years.

About two-thirds of the respondents either do not retain extra copies of client tax returns or retain them for only a few years. A majority of the respondents retain drafts of present client tax returns for long periods and about 40 per cent retain those of former clients for ten years or more.

General

ONE-THIRD OF the responding firms permit exception to their retention policies, usually upon partner or executive committee

¹For a discussion of working papers and their relevancy from an evidentiary viewpoint see Chapter 6 entitled "Working Papers" in Saul Levy's *Accountants' Legal Responsibility* (AICPA 1954).

approval. One-fourth of the respondents reported legal counsel approval of their retention policies. Most respondents cremate, shred or tear-up papers which are destroyed.

Records of firm's own office records

RETENTION PERIODS for these records are not readily summarized. Reference should be made to item 29 (page 24).

The results of the survey are reported more completely in the sections which follow.

Correspondence Files

1. Sixty per cent of the responding firms have uniform retention practices which apply to *all* client correspondence files and the retention periods are:

<i>Years retained</i>	<i>Per cent of respondents applying the practices to</i>	
	<i>Present clients</i>	<i>Former clients</i>
3-5	3%	17%
6	10	10
10	10	10
Indefinite	27	13
Permanent	10	10
	60%	60%

2. Forty per cent of the responding firms have retention practices which depend on the nature of the client correspondence files and the retention periods are:

	<i>Years retained*</i>	
	<i>Present clients</i>	<i>Former clients</i>
a. General correspondence on client affairs	5-10	5-10
b. Correspondence on client tax affairs	(See note)	5-10
(Note: Two-thirds reported permanent retention periods for present clients and one-third reported indefinite periods. One-fourth reported permanent retention periods for former clients.)		

*Concentration of Prevailing Practice, as defined in Introduction.

	<i>Years retained*</i>	
	<u><i>Present clients</i></u>	<u><i>Former clients</i></u>
c. Correspondence on confidential client matters, such as proposed registration statements, acquisitions, personnel changes, etc. (However, permanent retention periods were reported for present and former clients by some firms.)	5-10	5-10
d. Routine correspondence such as letters of introduction, transmittal letters, etc.	2-10	2-10
3. The prevailing retention periods for nonclient correspondence files (professional and civic affairs, etc.), as reported by respondents, were from three to ten years.		

Reports

4. Two-thirds of the responding firms retain indefinitely the office copies (the official record copies) of all reports which are issued whether the reports are for present or former clients.
5. The other one-third of the responding firms stated that the office copies of most reports for present clients are retained permanently or indefinitely; all reported retention periods of six years or more for these office copies.
6. The final third of the respondents retain office copies of most reports for former clients from six to ten years.

*Concentration of Prevailing Practice, as defined in Introduction.

7. Retention periods for reports other than the office copies (whether filed in working papers or otherwise) were said to be the following:

	<i>Years retained*</i>	
	<i>Present clients</i>	<i>Former clients</i>
a. Extra copies of reports (Note: There is no uniformity in retention periods for these extra copies. The range is from one year or no retention [about one-fourth of the firms] to permanent retention.)	(See note)	(See note)
b. Drafts of reports and financial statements	3-10	3-10
c. Printed reports containing an opinion of the firm: One office copy	Indefinite or Permanent	Considerable variation
Other copies (Note: A majority of the firms do not retain or retain only for a short period.)	(See note)	(See note)
d. Reports relating to clients from other CPAs	Indefinite or Permanent	Considerable variation

Permanent Files

8. More than 80 per cent of the responding firms maintain

*Concentration of Prevailing Practice, as defined in Introduction.

separate "Permanent Files" for the papers and information which would be of continuing interest in subsequent recurring engagements.

9. Respondents reported that the following were considered to be of continuing interest and, as stated in item 8, usually included in Permanent Files:

Reported by 80 per cent or more of all respondents—

- a. Memoranda submitted to the client on the review of the system of internal control together with notation of related discussions with officials
- b. Statement of policy with respect to depreciation, depletion, maintenance and repairs, together with supplemental data as to rates and annual provisions
- c. Status of Federal and state income taxes
- d. Litigation, lawsuits, unsettled claims, guarantees and other contingent liabilities
- e. Excerpts or copies of important contracts, leases and other agreements
- f. Funded and other indebtedness: Covenants in respect to current ratios, sinking fund requirements, limitation of dividends and other matters; also schedule of amortization of bond discount and expense
- g. Preferred stock: Dividend limitations, redemption and call prices, dividend arrearages and other information
- h. Excerpts from or copies of minutes
- i. History of capital stock, capital surplus and corporate reorganizations; history of invested capital developed for tax purposes
- j. Articles of incorporation, and excerpts from or copies of bylaws or partnership agreements

- k. Organization charts, list of branches, physical facilities and places of business with dates visited
- l. History and nature of business, methods of operation, products and production
- m. Accounting organization, procedures and control, organization chart, accounting manual, chart of accounts, special procedures, reviews of internal control
- n. Historical summary of retained earnings
- o. Copies of data filed with the Securities and Exchange Commission and of stock listing applications, if any

Reported by 60 per cent of the respondents—

- a. Memoranda on examinations, settlement of accounts, changes in accounting practices, valuation of inventories, and similar items
 - b. Copies of audit reports
 - c. Audit programs
 - d. Copies of authorized signatures
 - e. Summaries or detailed schedules of fixed assets and allowances for depreciation
10. Seventy per cent of the responding firms have a uniform retention policy for all permanent files and the prevailing periods reported were: Indefinite or permanent periods for current permanent files and four to ten years for inactive files.
11. Some respondents reported individual retention periods for the materials listed in item 9 above. Most of the retention periods were of considerable length, usually a minimum of six years.

Audit Working Papers

This section deals with the working papers (other than those discussed under the heading of permanent files) accumulated

during the course of an audit performed for the purpose of rendering an opinion on financial statements, whether or not accompanied by a long-form report. However, excluded from consideration in this section are the working papers covering special engagements as they are covered in a subsequent section. (Note: Some CPAs file reports, correspondence, tax returns, tax papers and other material in the audit working papers. The practices relating to these documents are explained in other sections.)

12. There was about equal division among respondents as to whether all working papers are retained the same length of time or whether certain papers are retained for longer periods than others.
13. Where respondents have uniform retention policies for all working papers, the majority of firms retain those of present clients for indefinite or permanent periods but some firms retain them for periods ranging from five to twenty years. A majority of these firms retain working papers of former clients for four to ten years.
14. Where a distinction is made in retention periods, the shortest retention periods for any of the individual working papers (herein referred to as papers of temporary value) were reported by most firms as from one to six years for both present and former clients.
15. More than half of the respondents said that papers of temporary value were separated from the other papers at the time of their destruction.
16. Respondents who retain certain working papers longer than the minimum retention periods reviewed a tentative list of such papers and 80 per cent of them confirmed the following items as being included in their lists.
 - a. Working trial balances
 - b. Memoranda on auditing and accounting points

- c. Profit and loss summary schedules
- d. Summary schedules of balance sheet accounts
- e. Trial balances of general ledger accounts
- f. Adjusting and reclassification journal entries
- g. Internal control questionnaires
- h. Representation letters from officials
- i. Letters from attorneys
- j. Schedules for certain specific items or accounts:
 - Federal income taxes
 - Lifo inventories
 - Fixed assets
 - Allowances for depreciation
 - Funded debt
 - Capital stock
 - Retained earnings

Two additional items (leading or lead schedules and audit programs) were also included in the lists by 60 per cent of the firms.

- 17. Where the firms retain certain working papers longer than others, the retention periods for these papers for present clients usually ranged from six years to permanently. The retention periods for former clients were usually from five to ten years.

Working Papers for Special Engagements

- 18. Eighty-five per cent of all responding firms make no distinction in their retention practices for working papers accumulated for special engagements, such as:
 - a. Securities and Exchange Commission registration statements
 - b. Stock Exchange listing statements

- c. Acquisitions, mergers or sales of all or a portion of a business
- d. Bankruptcy and other reports to courts
- e. Fraud investigations
- f. Selected financial information, such as percentage lease data, price redetermination data, wage escalation data, profit-sharing plans, etc.
- g. Unaudited financial statements, whether annual or interim
- h. Engagements under the general heading of Management Advisory Services, Systems, etc.

Detailed Schedules Used in an Audit But Not Retained in Working Papers

Some CPAs do not retain all detailed schedules used in conducting an audit, or client-furnished materials used for testing or general information, provided the working papers include summary schedules, statements of work done, clear identification of items selected for tests and conclusions reached.

- 19. Under circumstances similar to the above, about 30 per cent of all responding firms do not retain certain materials in their working papers and other files.
- 20. The following list typifies the materials which are not retained, as reported by responding firms:
 - a. Payroll test schedules
 - b. Detailed schedules of prepaid and accrued expenses
 - c. Lists of unclaimed wages
 - d. Detailed insurance schedules
 - e. Detailed description of vouchers selected for examination
 - f. Detailed description of cash disbursements tested
 - g. Detailed schedules of fixed asset additions

- h. Detailed lists of capital stock outstanding
 - i. Local and payroll tax schedules
 - j. Lists of expense vouchers in petty cash funds
 - k. Detailed aging schedules of receivables
 - l. Purchase and sales commitment schedules
 - m. Detailed schedules showing apportionment of general and administrative expenses to subsidiaries
 - n. Detailed analyses of intercompany accounts
 - o. Detailed inventory schedules
 - p. Clients' count sheets of inventories not counted by auditors
 - q. Client-prepared schedules showing details of changes in property accounts
 - r. Copies of statements sent with confirmation requests
 - s. Outstanding check lists (except lists of open items)
 - t. Departmental analyses of cost of products sold
 - u. Client-prepared cost sheets on which no work is indicated
 - v. Trial balances of receivables, payables, etc.
 - w. Obsolete and superseded permanent file material
 - x. Superseded schedules, drafts and printers' proofs
 - y. Client-prepared summaries of profit and loss accounts by months
 - z. Copies of clients' work sheets
21. When the examination has been completed and reviewed, point sheets and "to do" lists are discarded by one-fourth of the responding firms. A majority of the others retain them for ten or more years or indefinitely.

Tax Returns and Files

22. The prevailing retention practices for tax returns and tax files, as reported by responding firms, are listed hereunder:

	<i>Years retained</i>	<i>Per cent of respondents applying the practices to</i>	
		<i>Present clients</i>	<i>Former clients</i>
a. Office copies of client tax returns	Indefinite	50%	20%
	Permanent	30	10
	10 or more	3	27
b. Extra copies of client tax returns (Note: About two-thirds of the firms either do not retain these extra copies or retain them for only a few years.)		(See note)	(See note)
c. Drafts of client tax returns	Indefinite	40	10
	Permanent	23	10
	10 or more	7	20
d. Tax data received from clients	Indefinite	50	13
	Permanent	27	10
	10 or more	7	33
e. Tax working papers	Indefinite	50	13
	Permanent	23	10
	10 or more	10	33
f. Revenue Agents' reports	Indefinite	60	17
	Permanent	27	10
	10 or more	—	30

General Note: Most firms retain the material listed under (a), (d), (e) and (f) for five or more years.

23. All respondents reported that their retention practices were the same for audit and nonaudit tax clients.

General

24. Where applicable, almost all responding firms reported that their retention policies were uniform in all offices.
25. One-third of the firms who have uniform retention policies permit exceptions, usually upon partner or executive committee approval.
26. About one-fourth of the responding firms reported that their retention policies had been approved by their legal counsel.
27. More than half of the responding firms cremate papers upon destruction and another third shred or tear-up the papers.
28. Only one responding firm makes microfilm duplicates of reports and papers before they are destroyed.

Records of Firm's Own Office Records

29. Responding firms reported retention periods for the items listed hereunder.

	<i>Years retained*</i>
A. Accounting Records	
a. Accounts payable invoices and credits	3-6
b. Accounts receivable (Clients' ledger sheets)	10 or more
c. Bank statements and cancelled checks	4-10
d. Bank reconciliations	3-10

*Concentration of Prevailing Practice, as defined in Introduction.

	<u>Years retained*</u>
e. Budgets	Considerable variation
f. Fixed asset records	Indefinite or permanent
g. Cash receipts and cash pay- ment books	Indefinite or permanent
h. Employee expense reports	3-6
i. Expense analysis reports	4-6
j. Financial statements	
Office copy	Indefinite or permanent
Working copy	1-6
k. General journals	Indefinite or permanent
l. General ledger	Indefinite or permanent
m. Expense ledgers and sum- maries	Indefinite or permanent
n. Correspondence	Considerable variation
o. Cost ledgers	Considerable variation
p. Petty cash books and vouchers	3-6
B. Payroll and Related Records	
a. Productivity reports	3-6
b. Individual earnings records	10 or more
c. Labor distribution cost records	Considerable variation
d. Payroll registers	10 or more
e. Payments and reports to gov- ernment	10 or more
f. Retirement and pension plans	10 or more
g. Time sheets	3-6

*Concentration of Prevailing Practice, as defined in Introduction.

	<u>Years retained*</u>
h. Unclaimed wage records	4-6
i. Employee contracts	4 or more
j. Individual personnel files	Indefinite or permanent
k. Correspondence	Considerable variation
C. General Records	
a. Authorization and appropri- ations for major expendi- tures	} Indefinite or permanent
b. Surety bonds	
c. Articles of copartnership	
d. Deeds	
e. Fidelity bonds of employees	
f. Leases	
g. Minutes	
h. Mortgages	
i. Correspondence	
j. Insurance policies	Considerable variation Related to expiration

*Concentration of Prevailing Practice, as defined in Introduction.