

LEGAL, REGULATORY AND PRACTICAL ISSUES RELATING TO ELECTRONIC FILING

There are many issues to consider when moving from paper to electronic record keeping. Unfortunately there is no single prescriptive position: the various legal, regulatory and professional influences on different businesses mean that business managers must be alert to any required standards within their particular industry.

Issues that this paper(!) addresses include

- Backup.
- Archiving.
- Longevity.
- Security, against loss and inappropriate alteration.
- Contractual issues, court proceedings, and evidence.
- Specialist law, such as that relating to land (the “12 years rather than 6 years” rule).
- The operational needs of the business (ie how long do we, as managers of our businesses, need access to the various papers and files that we receive and produce).
- The views and requirements of influential 3rd parties, including
 - HM Revenue & Customs (Tax and VAT)
 - Auditors
 - Regulators, including Data Protection
 - Industry-specific bodies (such as professional bodies, and others with supervisory or Code of Conduct responsibilities).
 - Government legislation (eg Certificate of Employer's Liability Insurance): here and abroad (Eg impact of US Sarbanes Oxley Act on corporations with a US presence).

- Transitional arrangements
- Best practice
- Document retention policy
- What to do in the event of contractual or other disputes

BACK-UP

Effective backup of documents is generally more easily achievable once the move has been made from paper to electronic files. A robust electronic backup routine will include daily (or more frequent in some critical real-time businesses) saving of data to storage media separate from the business' operational system.

Don't forget that a copy of this must be stored offsite in case of physical destruction of, or theft from the main site, and the offsite copy must be refreshed regularly.

One other trap to avoid: the situation where a system is being restored from the backup media, and a fault in the system that caused the initial problem corrupts the backup copy. So the backup must either be duplicated or incapable of being overwritten.

Remember that daily backup will faithfully copy the latest state of the system. If someone inadvertently or otherwise deletes valuable data (such as the Customer Information System) and the system is backed up before this problem comes to light, the new backup is of no value in solving this problem. The key issue is that earlier copies of the backups must be kept available. Most businesses now keep the daily backups for the preceding week or fortnight. In addition, it is prudent to retain the backups from the preceding key dates in the business calendar: probably year-end, and quarterly accounting dates. This takes us across the boundary from backup (essentially a short-term routine) to **archiving**, which is the longer term record keeping.

LONGEVITY

How long to keep the original papers? And how long to keep the electronic records? These issues are very dependant upon the type of business and transaction, the laws and regulatory issues, and the amount (value) of the transaction. (For example, it took banks a long time to realise that the cost of storing paid cheques for relatively small values far exceeded the value at risk as a result of early disposal.) A number of longevity issues are discussed below in the context of 3rd party requirements.

SECURITY - Risk of loss, fire/flood, theft, corruption, malicious alteration.

Electronic data is generally easier to protect against most of these risks than the paper originals, provided that backup routines have been carefully thought through. (To ensure that the backup data is not vulnerable to the same incident that creates the need to restore from backup.)

Electronic filing systems should have a robust system of permissions, ensuring that only those staff who need to can access important data. The system's permissions architecture must be sufficiently sophisticated to enable company management to allow some staff to view and use data, but to deny alteration or deletion of such data. The system should also incorporate a revisions record to identify files that have been edited.

Password procedures should, as always, be properly enforced and policed, and permissions should be reviewed when staff members leave or move to other duties. This is analogous to retrieving the filing cabinet keys from departing staff, but is considerably more effective.

ARCHIVING

As mentioned above, the longevity of record keeping depends upon many factors. However, a key issue to address is that archives must preserve records in such a way that they do not deteriorate in the short term, and cannot be altered – either accidentally or deliberately.

Computer storage is now becoming very cheap, and media such as WORM drives, DVD and CD ROM discs will last much longer than the requirement for their contents – provided that they are stored in proper conditions. Archiving should use media that cannot be re-written, and one copy should be kept off-site in case of physical disaster.

CONTRACTUAL ISSUES

As a general rule, English courts have for some time been accepting documents in a wide variety of forms, including paper, film, and electronic. Occasionally situations arise when the authenticity of a document is challenged (eg the signature on a contract) and in such circumstances, the court must decide based on the overall weight of evidence.

There is a BSI Code of Practice (PD0008, of 1999) that covers the “Legal Admissibility and Evidential Weight of Information Stored Electronically”. This does not guarantee the admissibility of a document in court, but can be persuasive, as it sets out best practice for a company to show that the contents of a computer file have not changed since the time the file was stored. In the case of an image file, it deals with the issue as to whether this is a true image of the original document.

The Limitation Act 1980 stipulates that claims for breach of contract or negligence become statute barred 6 years after the date that the cause of action arises. For this reason, 6 years is generally regarded as a good rule of thumb for the retention of many records. (See also HM Revenue & Customs, and Auditors, below.) Bear in mind that the 6 years runs from the time that a potential claim first arises, rather than necessarily from the date of the contract itself. Different periods apply to personal injury claims, land and other contracts under seal (see below).

LAND, and other transactions under seal

The Limitation Act 1980 allows 12 years for the pursuit of claims arising from deeds or contracts under seal, hence most substantial land transactions are caught within this provision.

THE NEEDS OF THE BUSINESS – BE AMOUNT CONSCIOUS

At this point, it is worth reiterating: we should be amount conscious. For example, there is little point in retaining the paperwork relating to contracts for stock exchange purchase & sales for 6 years or more when individual transaction values are – say – under £100. Electronic filing offers us the chance to store so much data at minimum cost that the retention period is less of an issue. (NB in all cases to abide by the rules of any relevant Regulatory Body & the Data Protection Act.)

Secondly, there may be circumstances when it is appropriate to adopt electronic filing – for the benefits of retrievability, flexibility with sharing of documents, space saving around the office, etc – whilst keeping the original documents in secure and less expensive off-site storage. Take for example the case of a building society, with hundreds of thousands of mortgage documents. It might only ever need to retrieve 1 in every 500 of these documents, when a borrower defaults and court action is needed. One solution is for all the mortgage documents to be captured electronically, giving staff far greater accessibility to these files: and the originals are packed off in labelled boxes to a professional archive where storage space is cheap, secure and well managed. Far better than having the originals filed in bulging cabinets upstairs.... Routinely, the staff may need access within seconds to an electronic copy of any of these documents: but they have weeks to retrieve the 1 in 500 that is going to court.

3RD PARTY REQUIREMENTS

HM REVENUE & CUSTOMS

HMRC is pretty co-operative in this context. Its guidance is as follows, and I have italicized extracts taken directly from their guides and correspondence with us – “*The form in which documentation is stored (for example, whether it is in electronic or paper form) is at the discretion of the company, so long as it can be made reasonably accessible to the tax administration.*” (There are a few exceptions where paper originals must be kept: see below.)

Your company will not need to keep the original records if all the information they contain is kept in an acceptable alternative form. Acceptable alternatives include optical imaging systems...

Some general rules apply to enterprises that are required to make tax returns. These are contained within FA98/SCH18/para21, TMA70/S12B, and TB37C (part 2). Essentially, *records kept must be sufficient to enable the taxpayer to deliver a correct and complete return, and records must be preserved until the latest of:*

- *6 years from the end of the period concerned*
- *the date on which any enquiry into the return is completed*
- *the date on which the Inland Revenue [HMRC] is no longer able to open an enquiry.*

Records to be kept & preserved include:

a. all receipts and expenses in the course of the company's activities

b. all sales and purchases made in the course of any trade

Supporting documents relating to items a & b above such as accounts, books, deeds, contracts vouchers, receipts.

Crucially, the obligation to preserve records may be satisfied by preserving the information contained within them (FA98/SCH18/para22).

More specifically, as regards preserving records on optical imaging systems, the method should capture all the information needed to demonstrate that a complete & correct tax return has been made, and are capable of yielding up that information in legible form. Precisely what information needs to be preserved in this way will vary from business to business. But standard information, such as contractual terms and conditions printed on all invoices need not be reproduced as part of the record of each transaction.

Companies which store information in accordance with the Code of Practice on the Legal Admissibility of Information stored in EDM Systems (BSI DISC PD0008) will automatically satisfy the tax requirements.

Paper originals

The exceptions where the original record must be retained are set out in Para 22 of Sch 18 to the Finance Act, 1998. These are set out in detail in the next paragraph, but *essentially, these are vouchers for tax suffered, or for tax credits in respect of incomings.*

Originals must be retained for

- i. Statements in writing of the amount of a qualifying distribution and tax credit (Section 234(1) of the Taxes Act, 1988.*
- ii. Certificates of deduction of income tax from annual payments and other amounts – Section 352(1) of the Taxes Act 1988.*
- iii. Certificates of deductions on account under the Construction Industry Scheme – Section 559 & 566 of Taxes Act 1988.*
- iv. Records relating to tax paid, or payable, under the law of a territory outside the UK.*

(Photocopies of foreign tax assessments remain acceptable for the purposes of claiming double taxation relief on dividend income from abroad.)

PAYE Details, Wages and Income Tax records – details of wages, benefits in kind, and other PAYE matters must be kept by companies for at least 3 years after the end of the tax year to which the details relate. However, there is no requirement that these be in paper format.

HM REVENUE & CUSTOMS - VAT

The VAT guidelines are equally obliging. The definitive guidance is set out in 2 important VAT publications, Notice 700/21 (“Keeping Records & Accounts”) and 700/63 (“Electronic Invoicing”). These are available from www.HMRC.gov.uk.

Key extracts are as follows (with direct quotations *in italics*):

- *You don't have to keep these records in any set way. But they must be complete and up to date, and the figures that you have used to fill in your VAT return must be easy to find.*
- *If you keep all or part of your records and accounts on a computer, you must make sure that you can meet your legal obligations to account for VAT properly, provide information to the VAT authorities when they visit you, and keep records in the required detail for the required length of time.*
- *You must keep all your business records for at least 6 years.*
- *Storage of electronic invoices (both issued and received): the same rules apply to storage of electronic invoices as to paper invoices (ie the 6 year rule.)*

AUDITORS

Public Limited Companies are required by the Companies Act 1985 to keep “accounting records” for a period of 6 years. However, there is no stipulation that these should be in paper format.

Our auditors have stated that they have no problem with electronic records “...***provided we can assess the security of the system and satisfy ourselves as to the company’s procedures for ensuring the stored image is the same as the original, and it is not possible to alter the image once stored.***”

File Stream Document Management allows users with appropriate permissions to modify documents (for example, to add an electronic signature, or a “Paid” stamp). However, the modified document is clearly flagged with “Permanent Annotation” and the history of the document is available at the right-click of a mouse – with the original document always preserved and retrievable. The only exception to this is if a user with full Delete Permission deletes the document (leaving the business in a similar position as if an employee had destroyed an original paper document. However, File Stream Document Management gives additional protection in that only users given specific rights to delete documents can do so.) NB: If desired, users can be set up with permission to delete from their inbox (allowing deletion of routine correspondence no longer needed) but without permission to delete documents that have already been indexed.

REGULATORS

For better or worse, the influence of the Regulator is widening rapidly. Any business that is subject to regulatory oversight must understand in detail the industry-specific rules relating to document retention, and the distinction (where made) between paper originals and electronic copies. There are far too many regulators to mention them by name, but 2 in particular deserve mention:

The Data Protection Act 1998 is policed by the Information Commissioner. Detailed guidance is beyond the scope of this paper, but the Data Protection Act has far-reaching implications for businesses that store personal data in electronic format, and it is vital that business managers understand its implications for their own electronic records.

The UK Financial Services Authority has influence in virtually every business involved in lending, finance, investment, or financial advice. Its “Know Your Customer” rules are strict, but do allow scope for electronic filing. For example, the FSA Handbook makes the following stipulation about record keeping in its Money Laundering rules

“A relevant firm must make and retain, for the periods specified in (2), the following records: in relation to evidence of identity:

- (i) a copy of the evidence of identity obtained under ML 3; or
- (ii) a record of where a copy of the evidence of identity can be obtained...”

Note that there is no

stipulation as to the *format* of this record, so a suitable electronic record, preserved for the stipulated period, is acceptable.

INDUSTRY-SPECIFIC BODIES (such as professional bodies, and others with supervisory or Code of Conduct responsibilities).

A number of bodies have some degree of responsibility for setting standards within their industry, including Accountancy, Architecture, Medicine, Charities, Broadcasting and the media, and many others. Estate Agency looks likely to be the subject of more stringent regulation in the near future.

In this context, it is impossible to give specific guidance except to reiterate the point made at the outset: that managers must understand the rules on record keeping within their own industry. However, for the most part, failures in record keeping relate to loss of records, rather than the format

of those records. The infamous demise of Arthur Andersen, once the King of audit firms, will be forever linked with their shredding of vital paper evidence. In most situations, electronic records will be easier to maintain in good order, quicker to access and use, cheaper to archive, and safer from accidental or intentional destruction.

GOVERNMENT LEGISLATION

This aspect has been partly covered within the sections above relating to tax, Data Protection, and the role of the regulators. Other noteworthy examples include the recent requirement to retain Employers Liability Insurance records for 40 years.

However, there is one additional aspect that should not be overlooked. The impact of other Governments' actions.

The US Sarbanes-Oxley Act 2002 – very much a result of the Enron and Arthur Andersen case – imposes extreme personal and corporate penalties for destroying or tampering with corporate documents in an attempt to thwart official investigation. Any corporation with a presence in the USA needs to be aware of the provisions of this legislation.

TRANSITIONAL ARRANGEMENTS

When making the change from paper to electronic records, it is considered best practice to run both systems side-by-side for a short period to ensure that the electronic record is running as planned, and that data retrieval and backup is robust. A recovery from backup data must be successfully achieved before paper originals are destroyed.

BEST PRACTICE

A number of bodies publish guidelines. In addition to the BSI Code mentioned above, the UK Public Record Office has its own guidance. A particularly relevant publication is that of the Institute of Chartered Secretaries and Administrators – The ICSA Guide to Document Retention.

DOCUMENT RETENTION POLICY

A business should define its approach to document management and retention, setting this out clearly in writing, and identifying the senior manager responsible within the company or division. It is beyond the scope of this document to make detailed recommendations, but the policy should make reference to any particular regulatory and legal issues that affect the business, and should inform staff members where and from whom within the business they can seek guidance. The policy should include guidance on -

WHAT TO DO IN THE EVENT OF CONTRACTUAL OR OTHER DISPUTES

This should include an immediate suspension of the destruction of relevant records (electronic or paper) communication of the change in procedure to all relevant employees, and a regular reminder of this issue (people join, and leave... and forget).

Where an issue is potentially serious, consider reference to the company's legal advisors, as there may be issues of legal privilege or disclosure relating to documentation, etc. Bear in mind that all documents and correspondence can be subject to court subpoena, including emails.

CONCLUSION

In most situations, electronic record keeping will not, in itself, be a major legal issue: the more important challenge for the business manager is to judge what to keep, for how long, and how to

ensure that documents remain easily accessible. A good electronic filing system will almost certainly serve this purpose better than the paper originals.

Finally, although this note provides general guidance, it cannot substitute for detailed legal advice tailored to the needs of the specific business and industry.

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