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Auditing with Electronic Accounting Software

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Why is IRS Using Accounting Software to Conduct Audits?

Reduces burden as taxpayers no longer have to print records stored electronically

Provides a complete set of taxpayer's accounting records

Increases audit efficiencies



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IRS Requesting Electronic Accounting Software Records

Examiners will request electronic files in the majority of audits

Form 4564, Information Document Request, will be used to request:

- Copy of original electronic accounting software backup file
- Administrator's username & password

Backup file provided on CD, DVD, or a flash/jump drive



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What if IRS Cannot Read Taxpayer's Electronic Data?

IRS has the ability to accept and read accounting software used by most small businesses

Taxpayers should consult with the examiner before submitting electronic files



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How Electronic Data Will Be Used by IRS

Most accounting software programs can generate large number of reports

Reports can be modified to fit examiner's needs

Software allows the examiner to test the integrity and veracity of the accounting records

Additional IDRs may be issued to obtain actual source documents



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What is IRS's legal authority?

Requesting accounting records in electronic format:

- IRC Section 6001
- Reg. 1.6001-1(a) and -1(e)
- Revenue Ruling 71-20
- Revenue Procedure 98-25

Rev. Proc. 98-25 does NOT exempt a taxpayer from providing electronic records, if such records exist



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What if Taxpayer Refuses to Provide Electronic Data?

Taxpayers are responsible for maintaining their own books and records in sufficient detail to support the income and deductions

Required to present to IRS upon request

IRC Section 7602(a)(1) grants the Service the authority to summons, if necessary



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Requesting Administrator's Username & Password

If concerned about providing “Admin” password:

- Change the Admin password to a temporary one before creating backup
- Then change the Admin password back to favorite one in the main working file

The temporary password must offer administrator access to backup file provided to IRS



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Electronic Data Includes Transactions Beyond Audit Year

Most software does NOT allow option to include only specific time period when creating backup file

IRS will only review data that is relevant to tax year(s) under exam

This may include reviewing transactions from month prior to and after tax year or tax periods before and after, if transactions in those timeframes are relevant to the data sought

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Electronic Data Includes Sensitive Information

Electronic backup files may include sensitive customer & vendor information

Security and privacy of taxpayer data is the IRS's highest priority

Sensitive information is protected by strict federal disclosure laws

IRC Section 6103 prevents IRS from making unauthorized disclosures



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Archiving Old Accounting Software Data

Most accounting software programs allow “clean-up” of old data

This is permitted for dates prior to years under audit

If scope is expanded, may request another backup created prior to “clean-up”

- IRS needs a copy of the *original* data to test the integrity and veracity of the accounting records. Taxpayers should NOT reconstruct records



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