Cash Intensive Businesses Audit Techniques Guide - Chapter 5 - Examination Techniques

NOTE: This document is not an official pronouncement of the law or the position of the Service and can not be used, cited, or relied upon as such. This guide is current through the publication date. Since changes may have occurred after the publication date that would affect the accuracy of this document, no guarantees are made concerning the technical accuracy after the publication date.

Contents

Examination Techniques for a Cash Business 2

Purchases can Reveal Sales 2

Sources 3

Hidden Family and Employee Transactions 3

Check Cashing Services 4

Indirect Methods 4

The Percentage of Markup Method should be considered in the following cases: 6

Percentage Computation Methods (Mark up method #1) 7

Unit and Volume Method (Mark up Method #2) 7

Fully Developed Cash T Account Method 8

Source and Applications of Funds Method 9

Bank Deposit and Cash Expenditures Method 10

Net Worth Method 13

Key Points to Audit of Books and Records 14

Examination Techniques for a Cash Business

Since many businesses in this industry are cash oriented, have weak internal controls, lack an audit trail, and have inadequate books and records, the examiner's audit should focus on probing for unreported income.

It is the responsibility of the business owner to maintain the documents needed to verify their reported income. When the source documents are available, there will be more than one way to test income and other transactions, because different documents will have the same information (a bill of lading and a sales invoice, for example) to check for consistency. When the source documents are not available the examiner must look for ways to discover if all income is reported.

The most likely method for a cash intensive business that does not report their full income is to skim cash prior to its entry in the accounting system. This can be done by failing to deposit all of the funds, by failing to use a cash register to record sales or by failing to report an income stream. The result is that the books will reconcile to the return and the bank deposits, but income will be missing. Skimming can be discovered through excess expenditures or when markup percentages are corrected.

Someone with access to incoming checks can remove a check before it is recorded. Later the check can be added to a cash register in exchange for cash in the same amount. If a check for $500 is taken from the mail, it can later be substituted into the cash register for $500 in cash. This way the total receipts will match the amount deposited. However, when the examiner checks the amount of cash received and the cash deposited, a discrepancy will be evident. The examiner should follow up with the person who worked the register and ask about the check included in that drawer. If necessary, follow up with the payer and find out how it was delivered to the business

Purchases can Reveal Sales

A quick first step is to look for a purchase that will reveal sales. For example, when a smog certificate is required on each vehicle sold, the number of smog certificates purchased will equal the number of vehicles sold. Once the examiner knows the correct number of items sold, either the taxpayer can produce the missing data or sales can be determined by multiplying the number by the average of the reported sales.

When workers wear uniforms the uniform service invoices can be inspected. They usually list the number of pants and shirts laundered and include the worker's name embroidered on the shirt. Compare the names on the uniform invoices to the names on the W-2's to determine if there are more people wearing uniforms than working. (Also, anyone who has ever worn a uniform for work knows the employer doesn't pay for that- so be sure to check payroll deductions for the amount paid by the employee.)

When a vehicle is towed to a repair shop, the shop initially pays the tow truck, and then passes the cost on to the customer. Use the tow receipts as a sample to ensure each vehicle's repairs are reported on a sales invoice. If necessary the examiner can locate the customers and contact them to provide their work invoices that were never reported in the shop's sales.

Another avenue to pursue when the taxpayer does not produce contracts, but it is unlikely the particular industry would do business without them, is to summons the deposit slips, deposit sources and cancelled checks to reveal customers and suppliers. The suppliers, identified through the taxpayer's cancelled checks, can be contacted to obtain their invoices. In the building industry, the invoices will reveal the delivery addresses and can identify specific homes that were built.

Some of these techniques are similar to the percentage markup method that will be discussed later.

Sources

There are times when it is easier to find unreported income. Following are a few examples.

Selling the business – When a business is being offered for sale the new owner and possibly a lender will be looking at financial records. It is in the taxpayer's interest to give these sources the correct business information, first because the healthier the business the better price it will garner, but also because the potential buyer may be in the same business and will recognize problematic records. They may think if the records are shoddy, what else is wrong. If the examiner learns of purchase negotiations, it would be helpful to speak with the potential buyer. If there have been potential buyers in the past it would be helpful to interview them.

Getting a loan – When a business is looking for funding or to expand, they will need to supply the lender with healthy financial statements. Similarly, if the sole proprietor, majority shareholder or partner is seeking personal loans, banks will want to see the business financials. These financial statements are usually accurate. When an application is made for a loan, the taxpayer is required to list income and expenses, and attests the information is true by signing and dating the application. Loans funded and loans applied for can be summonsed.

Divorce – A disadvantaged spouse can attest to the amount of money flowing into the household by verifying what was spent. The spouse may also have knowledge of hidden assets or unidentified sources of income, such as sideline sales or another cash business.

Employees – especially mistreated employees can discuss business practices they have observed over time. They can say who handled cash and what procedures were overridden. Employees may also be able to prove they were paid in cash to avoid payroll taxes.

Hidden Family and Employee Transactions

When employees or workers in the business are extended family members or fellow immigrants, there can be diverted profits in the form of unreported benefits. A convenience store owner, who pays very little to employees, may also allow the worker to remove inventory for personal use. The examiner should be alert to store owners offering workers:

- free or low rent in their residential rental properties
- payment of personal expenses
- removal of inventory for personal use

When a cash intensive business makes payments in cash and there is no information reporting made or it is not required to be made

Check Cashing Services

A check cashing service may refer to a large or small company that will cash personal or payroll checks for a fee. The check cashing service earns its income by charging a percentage of the amount of the check.

Some convenience stores will offer this service, typically charging a 3-5% fee. For example, cashing a $1,000 payroll check at a local convenience store may cost between $30-$50.

As with a bank, the check casher will require identification, and may not accept certain types of checks, based on their experience. A business that has been in operation for several years will not usually have losses from check cashing. Whenever losses or bad debts are claimed, the examiner must determine that sufficient efforts were made by the business. Contact should be made with the customer to ensure the funds were not repaid to the business in cash and the collection was not recorded.

Indirect Methods

A request for a **specific item** (that is, a specific bank deposit) is not an indirect method. Also, if during an indirect method analysis an examiner finds a specific adjustment – that item is not considered an "indirect method adjustment"; that is, an adjustment based upon circumstantial evidence. That adjustment is direct evidence of unreported income.

If, after completing the minimum income probes, the examiner determines that there is a reasonable indication of potential unreported income, then a more in-depth examination of income will be made. [IRM 4.10.4.5]

This decision point must be documented. The documentation should include a narrative explaining how the evidence at this point establishes the likelihood of unreported income, including:

- a summary of the facts relevant to the decision,
- procedures and audit techniques used up to that point,
- manager's comments (if appropriate),
- any other information relevant to the decision, and
- Conclusions.

Example: *The taxpayer stated in the initial interview that all income is deposited to the business bank account, and gross receipts are determined by totaling bank deposits. However there appear to be significant cash expenditures for business and personal expenses with no method to include the cash paid out in income. The gross profit percentage (GPP) is well below industry averages. At this point, the Cash T indicates a cash shortage of approximately $40,000. A Fully Developed Cash T method will be performed to capture the cash paid out and calculate the correct income.*

Or,
Example: *The taxpayer stated in the initial interview that gross receipts from the convenience store are determined from cash register tapes. The comparison of the daily tapes to the books during a sample period shows no discrepancy. While the net profit from the business is only $20,000, the general ledger shows owner withdraws for personal use in excess of $78,000. The Cash T, using the self identified owner withdraws as PLE, shows a cash shortage of $100,000 and indicates the books are not credible. Manager recommends a Source and Application of Funds method be used to determine the correct income.*

Or,
Example: *The cash intensive business, which is the only reported income for this family of four, consistently reports ordinary income of $20,000 to $30,000 in the past 6 years. During the same period, the taxpayer has accumulated two rental properties whose FMV is in excess of $180,000. Both properties report unusually small rents and substantial expenses, resulting in losses. Property improvements are observed and the taxpayer confirms the improvements are made in the exam year, however no expenditures can be found for the improvements. A Source and Application of Funds method will be used to calculate the taxpayers' total income from all sources.*

The documentation can be inserted into the RGS leadsheet for Minimum Income Probes.

Before beginning any examination of income the examiner must determine what is included in income on the books and tax return, and how the amount was determined. Only then can adjustments be made.

For example, if the taxpayer's books report receipts from A, B and C, but an analysis of the bank accounts show receipts deposited from A, C, D and E, the deposits of D and E should be added to the reported income.

Conversely, if the taxpayer's books report the amounts on the cash register tapes,

To the extent possible, examiners should attempt to identify the source and nature of deposits or receipts that were omitted. For example, if examiners only add total business bank deposits and compare the total to the receipts on the return, no consideration is given to the taxpayer's method of payment of business and personal expenses (cash expenditures must be added to bank deposits).

When the taxpayer has a double entry set of books, it is important to reconcile the cash accounts and make sure the other accounts tie into the balance sheet. In this case, if all income is believed to be included, the examination should concentrate on an analysis of the cash accounts and a review of the taxpayer's withdrawals from the business and personal living expenses.

The following indirect methods will be discussed: Fully Developed Cash T-Account, Source and Applications, Net Worth and Bank Deposits and Cash Expenditures method. Each has its own strengths and weaknesses, but all revolve around the principal of comparing the taxpayer's stated income against expenditures. When using any of these methods, it is not necessary to examine other income or expenses because all adjustments are captured in the calculation.
Percentage of Markup Method (and Unit Volume Method)

The Percentage of Markup Method is an Indirect Method that can overcome this weakness in reconstructing taxable income. It is similar to how State Sales Tax Agencies conduct audits. The cost of goods sold is verified and the resulting gross receipts are determined based on the actual markup.

The Percentage of Markup Method should be considered in the following cases:

- Inventories are the principle income producing factor,
- Cost of goods sold or merchandise purchased are from a limited number of suppliers,
- Suppliers can be ascertained with reasonable certainty, and,
- Per unit sales price can be determined with reasonable consistency.

A Percentage of Markup Method permits examiners to use a common denominator within the business records to identify unreported income. The denominator should be verifiable through a third party such as a supplier, if necessary. The examiner must comply with the provisions of RRA 98 concerning 3rd party contacts. Examiners apply a multiplier to the common denominator to establish gross receipts. The Markup Method is especially effective in businesses where the supply chain is regulated or limited.

A thorough interview with the TP to solicit their statements and validate any differences between industry standard ratios and their business is critical to the Service being sustained is.

The method has been successfully applied in the following cases:

- Gas retailers (fuel volume from the wholesaler times average price equals gross receipts);
- Drinking establishments (liquor purchases divided by average drinks per bottle times average price per drink with allowance for spillage);
- Package liquor store (purchase of liquor times average markup); and,
- Coin laundries (water consumed divided by average water consumed times price per load equals gross receipts).

Business mark-up standards can be obtained from sources such as:

- Robert Morris & Associates (RMA)
- Bureau of Labor Statistics
- Association and Industry Publications and Websites
- Practitioners Publishing Company (PPC) manuals and other similar industry guides

Percentage Computation Methods (Mark up method #1)

Where gross profit percentages are fairly uniform for a specific trade or industry, an acceptable gross profit percentage may be used to determine if the taxpayer's gross profit compares with similar businesses. Problems to be considered here are the type of merchandise, size of operation, locality, period covered, general merchandising policy, and the influence these factors might have on the percentage.

Where a percentage relationship between a business expense, such a commissions, and gross income, is established early in the audit, such percentage could be used to verify gross income.

For a detailed discussion of the percentage computation method, see IRM 4.10.4.6.6, Examination of Income, for detailed guidance.

Unit and Volume Method (Mark up Method #2)

Where agents know the number of units handled or produced by the taxpayer and know the price or profit per unit, they can recompute gross income. This method can be used in both service industries and in the manufacture or sale of goods or property.

A percentage or unit mark-up methodology permits an examiner to use a common denominator within the business records to project unreported income. This denominator should be verifiable through a third party such as a supplier. The examiner would apply a multiplier to the common denominator to establish gross receipts. For example, if the examiner has confidence that a restaurant's reported labor costs of $150,000 is accurate and the normal labor burden for the establishment is 30 percent, then gross receipts should be $500,000 ($150,000 / .30 = $500,000).

This methodology has been successfully applied in past cases:

- Gas retailers (fuel volume from the wholesaler times average price equals gross receipts);
- Coin laundries (water consumed divided by average water consumed times price per load equals gross receipts); and,
- Tip income (average charged tip rate times gross receipts equals reportable gross tips).

The problems associated with this method are (1) accounting for no-charge units (samples or tests units), (2) accounting for waste material, and (3) clear-cut factual situations are seldom encountered. See below for Comparative Analysis and Ratio Analysis.

Deviations from industry norms are not sufficient in and of themselves to begin an in-depth indirect income probe method. IRM 4.2.4.4

For a detailed discussion of the unit and volume method, see IRM 4.10.4.6.7, Examination of Income Handbook for detailed guidance.

Fully Developed Cash T Account Method

The fully developed Cash T lists all known types of income and all known expenditures as "cash transactions" flowing in and out of the cash account. Income items will appear as "debits" on the left side, and expenditures will appear as "credits" on the right side. If the expenditures of cash exceed the sources, either the taxpayer underreported his/her income or over reported his/her expenses.

This method is useful when cash income is being skimmed from the business AND the examiner can accurately determine personal living expenses.

Cash Expended less Cash Received = Unidentified Income.

The Cash Transaction method is closely akin to the Source and Application of Funds method. The basic format for a T-Account is shown as follows.

T-Account	
CASH RECEIVED	**CASH EXPENDED**
Gross Receipts (per Return)	Business Expenses (less depr.)
Gross Rents	Rental Expenses (less depr.)
Wages/Miscellaneous Income	Personal Living Expenses
Interest/Dividend Income	Purchase of Assets
Cash on Hand (at beginning)	Cash on Hand (at year end)
Cash in Bank (at beginning)	Cash in Bank (at year end)
Loans Received	Loan Payments
Nontaxable Income	
Accounts Receivable (at beginning)	Accounts Receivable (at year end)
Accounts Payable (at yar end)	Accounts Payable (at beginning)
Total Cash Received	Total Cash Expended

Therefore: Total Cash Expended less Total Cash Received = Unidentified Income.

A deficit would indicate that an understatement of income or an over-statement of expenses exists.

If an adjustment is needed to reclassify an expense from a business to personal expense, or visa versa, a reclassification would be needed on the application side of the account; but there would be no effect on the understatement or overstatement.
If the adjustment results for an expense that was not incurred, the application side of the account would have to be reduced and the understatement or over inflation correspondingly reduced. The similar adjustments would apply to the source side for reclassification of income or for reduction of sources for non-receipts.

Important Areas to Consider

- Cash in banks may require an adjustment to reflect checks or deposits outstanding at the beginning and end of the period. The balance for the Cash T should be the balance shown in the check register or books.
- Remember that only cash transactions are reflected; thus, dividends accrued but not paid should not be shown.
- Cash on hand at the beginning of the period should be firmly established.
- Remove personal withdraws from purchases. Add the personal withdraws to PLE.
- Business expenses do not include such items as depreciation, bad debts, spoilage, inventory, etc. that do not represent cash transactions.
- Loan payments and specific asset purchases should be checked carefully to avoid duplication.
- If you use the Cash T as an indirect method no further examination of income or business expenses is needed- both will be captured in the indirect computation. Therefore, no audit adjustments to expenses and deductions should enter into the computation.
- Adjustments necessary for an accrual taxpayer are: the inclusion of the beginning accounts receivable and the ending accounts payable balances as CASH RECEIVED, and the ending receivables and beginning accounts payable as CASH EXPENDED.

Source and Applications of Funds Method

Where the T-account considers expenditures, the Source and Application of funds method uses changes in assets and liabilities, along with expenditures for nontaxable income and nondeductible receipts. The applications (increases in assets, decreases in liabilities and nondeductible expenses) are compared against the sources (decreased in assets, increases in liabilities or nontaxable receipts). Any excess of applications over the sources is considered an understatement of adjusted gross income. This method is more time-consuming than the T-account and Bank deposits methods in that all the balances of assets and liabilities must be determined at both the beginning and end of the year. This method is more easily used when the taxpayer has a statement of assets and liabilities readily available. A suggested format is noted below. See IRM 4.10.4.6.4.4, Examination of Income, for additional guidance.

Example

Funds Applied		Sources of Funds	
Increase in Cash-on-hand	$XX	Decrease in Cash-on-hand	$XX
Increase in Assets	$XX	Increase Payables	$XX
(I.e. Accounts Receivable, Real Estate, Savings Acct.)	$XX	Increase in Depreciation	$XX
Decrease in Payables	$XX	Reserve	$XX
Decrease in Depreciation Reserve	$XX	Nontaxable Capital gains	$XX
Personal Living/Income	$XX	Tax Exempt Interest	$XX
Taxes	$XX	Nontaxable Income (I.e. Gifts, Insurance)	$XX
Nondeductible Loss	$XX	Decrease in Assets	$XX
Total	$XXX	Total	$XXX
Understate of Income:		$XXX	
(Excess Applications over Sources)			

Important Areas to Consider:

- Do not include trade accounts receivable or payables on the cash basis.
- Cash on hand should be firmly established for the beginning of the period.
- All nontaxable sources of funds: loans, gifts, inheritances, etc. should be sought out and properly entered.

Bank Deposit and Cash Expenditures Method

The bank deposit and cash expenditures (BD&CE) method compares the total deposits plus cash expenses minus nontaxable sources of income to the total receipts shown on the return.

This method is useful if the taxpayer deposits all receipts into the bank accounts AND the examiner can accurately determine personal living expenses. For these reasons, the BD&CE method is usually not recommended for cash intensive businesses.

Any excess of the cash flow over the receipts shown on the return is additional income or inflated expenses.

The bank deposits method is based on the theory that by showing the disposition of monies, the total amount received can be determined.

Net Deposits + Undeposited Cash Expenditures = Total Receipts

Net deposits are the total of all deposits to all bank accounts, less nontaxable income (loans, inheritances, pensions, gifts, life insurance proceeds, etc., whether or not deposited). In this formula, transfers between banks and redeposit's are eliminated in the computation to arrive at Net Deposits.

Cash expenditures can be calculated by total outlays less checks written. Total outlays consist of all expenditures by check or cash, business and personal, whether for payment of expenses, purchases of assets, or repayment of loans. Checks written are determined by adding total deposits to beginning bank balances and deducting ending bank balances. In the savings account, withdrawals are analogous to checks written.

Important Items to Consider:

- A rough bank deposit computation needs to consider if there are additional bank accounts (additional banks?) and/or cash expenditures.
- Accrual method taxpayer: Adjustments should be made for accounts receivable and for accounts payable. For instance, an increase in accounts receivable would be added to total receipts.
- Cash on hand should be determined as accurately as possible for the beginning of the period(s).
- Where there are sales of fixed or capital assets, the basis must be eliminated as nontaxable.
- Where there is inventory, the purchase figures should be used as business expenses, not the cost of goods sold.
- In some cases, the bank deposits analysis may be more easily applied to a factual situation with the same results by using a revised formula, as follows:

  Total deposits:
  Add: Cash expenditures or receipts not deposited
  Less: Identified sources of funds
  Equals: Unidentified income.

There are two basic formulas for making a bank deposit computation. One is used to determine gross receipts (total of all taxable receipts of the taxpayer) and the other one is used to determine gross business receipts. See IRM 4.10.4.6.4., Examination of Income for additional guidance.

Discussion of Bank Deposits Analysis

A bank deposits analysis will be upheld in court. See ***Rifkin v. Commissioner***, T.C. Memo. 1998-180, ***aff'd***, 225 F. 3d 663, (9th Cir. 2001) and ***Cohen v. Commissioner***, T.C. Memo. 2001-249. In some of the cases, when the taxpayer supplies incomplete or no records the Service may look at the bank deposits to evidence income. ***Nicholas v. Commissioner***, 70 T.C. 1057, 1064 (1978); ***Sproul v. Commissioner***, T.C. Memo. 1995-207. Once a bank deposit analysis is performed, the burden normally is on the taxpayer to prove that the deposits do not represent unreported income.***Id.***

In ***Clayton v. Commissioner***, 102 T.C. 632, 645 (1994), the United States Tax Court discusses the bank deposits method:

Bank deposits are prima facie evidence of income, ***Tokarski v. Commissioner,*** 87 T.C. 74, 77 (1986), and the taxpayer has the burden of showing that the determination is incorrect. ***Estate of Mason v. Commissioner***, 64 T.C. 651, 657 (1975), ***aff'd***, 566 F.2d 2 (6th Cir. 1977). In such case the Commissioner is not required to show a likely source of income, ***id***, although here she has done so. The bank deposits method assumes that all money deposited in a taxpayer's bank account during a given period constitutes taxable income, but the Government must take into account any nontaxable source or deductible expense of which it has knowledge. ***DiLeo v. Commissioner***, 96 T.C. at 868.

The United States Supreme Court has stated that in using the bank deposits method, the Revenue Agent is generally required to investigate any leads regarding nontaxable sources of income that are "reasonably susceptible of being checked." ***Holland v. United States***, 348 U.S. 121, 135-136 (1954).

Deposits, of course, will be considered income when there is no evidence they are anything else. ***United States v. Doyle***, 234 F. 2d 788, 793 (7th Cir. 1956); ***Kleinman v. Commissioner***, T.C. Memo. 1994-19. In Kleinman, the Tax Court stated, "respondent made a diligent attempt to follow all leads in order to trace nontaxable items," and found nothing more was required of the Service.

Some leads are not reasonably susceptible of being checked. In ***Daniels v. Commissioner***, T.C. Memo. 1992-692, the Tax Court found that certain claims a taxpayer made for which he had no documentary proof was not reasonably susceptible of being checked by the Service. The Court observed:

Petitioners did not offer any information which respondent failed to investigate. A taxpayer cannot complain about the sufficiency of an investigation where he has offered no leads. ***United States v. Penosi,*** 452 F. 2d 217, 220 (5th Cir. 1971); ***Blackwell v. United States***, 244 F. 2d 423, 429 (8th Cir. 1957).

For a bank deposits analysis, the revenue agent will be able to demonstrate that:

- Every bank statement, deposit slip, and canceled check has been reviewed,
- All deposits make into all of the taxpayers' accounts have been totaled,
- All possible transfers of funds between accounts have been searched for and credited to the taxpayer. When a revenue agent only obtains a one-month sample of deposited items, which casts doubt on the effectiveness of the Service's independent review to ascertain if there were any transfers between accounts. All nontaxable sources of income have been eliminated.

Net Worth Method

The net worth method is founded on the basic accounting theory of the Balance Sheet:
Assets, less Liabilities = Net Worth

- Include all assets and liabilities, business and personal.
- The increase in Net Worth is the difference between beginning net worth and net worth at the end of the period.
- Add: Non-deductible expenditures (checks and cash).
- Subtract: Nontaxable income.
- Equals: adjusted gross income (taxable income for Forms 1120 and 1065).

This method is best used when income records appear to be false, incomplete, or missing, and there are substantial assets.

Other Areas of Concern

- Establish a "tight" opening net worth statement (tie down cash on hand to a maximum accumulation).
- Assets should be listed at cost.
- Accounting method of taxpayer should be used (cash, accrual).
- Compute reserves for depreciation/amortization as per return.

Examples of non-deductible expenditures to be added:

- Personal living expenses.
- Income tax payments.
- Non-deductible portion of capital losses.
- Losses on sale of personal assets.
- Gifts made.

Examples of nontaxable income to be subtracted:

- Tax-exempt interest
- Nontaxable pensions
- Nontaxable insurance proceeds
- Gifts received
- Inheritances
- Veterans Benefits
- Dividend Exclusions
- Excludable sick pay.

For a detailed discussion of the net worth method, see IRM 4.10.4.6.7, Examination of Income, for detailed guidance.

Key Points to Audit of Books and Records

- Gross income tests
- Reconcile the return to the books of original entry.
- Verify income by those methods determined to be necessary in your pre-audit analysis and initial interview.
- Verify the sources of capital contributed to the business.
- Test/review cancelled checks
- Check endorsements and bank stamps for irregularities, leads to other bank accounts, or to other taxpayers.
- Are all asset acquisitions and liability reductions reflected? (The payments may be made by some other means.)
- Are personal expenses paid out of the personal accounts or paid by cash or other means?
- Stock accounts, Savings accounts, Real Estate.
- Review the original documents and analyze the cash flow compared to AGI.
- Inspect the monthly or quarterly stockbroker's statements to ascertain that all transactions are properly reported.
- Inspect the business premises
- Miscellaneous Considerations
- Inspect and compare the tax returns of the preceding and subsequent open years.
- Be curious about the unusual deductions, entry, transaction, etc.
- Determine reasonable answers to:
- Significant documents lost or destroyed.
- Poor internal control, sloppy records, erasures and vague entries.
- Transactions with related entities.
- Have an audit plan.
- The importance of workpapers
- An agent or auditor's workpapers are important evidence in the argument or trial of any issue.
- Workpapers should be complete and concise.
- They should contain only factual information.
- No opinions should be expressed about either the taxpayer or his representative.
- The information should be directly tax related.
- If a document (check, contract, receipt, etc.) appears to be essential to the support of any issue, a copy of the document should be obtained wherever possible, rather than a hand transcription of the document.