



# LGT

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## FINANCIAL FOCUS



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*Your Accounting for a New Economy*

# Are You Prepared for Your Audit?

As a result of the downturn in the global economy, federal and state governments are struggling like never before. This has led to an unprecedented raise in the number of audits for both private citizens and businesses alike. Before you're hit with an unexpected audit, it's a good idea to ask yourself – "Am I ready?"

### **Before Your Audit**

- **Review Your Tax Returns** – Do your homework. Collect and go over all of your returns and documentation for the years in question. Be ready to explain how and where you and your tax professional came up with the figures.
- **Pinpoint Potential Problems** – Be ready to identify and have documentation supporting all income sources and expense deductions.
- **Research the Law** – You are legally responsible to illustrate your right to all deductions and benefits claimed on your tax return.
- **Neatness Counts** – Many auditors feel the organization and neatness of your recordkeeping directly reflects on the accuracy of your return. It builds your credibility in the eyes of your auditor, and if your recordkeeping appears to be well organized they are much more likely to give you the benefit of the doubt.

### **What Is Likely To Be Requested Of Your Small Business In An Audit**

If your small business is being audited, at the minimum, the IRS will expect you to produce the following documents:

- **Bank Statements, Canceled Checks and Receipts** – Most auditors will want to see records from both your personal and business accounts. Be sure to keep all business-related canceled checks, invoices or sales slips. If any expenses were paid in cash, keep the documentation (notes, receipts, or petty cash vouchers) showing the payments.
- **Electronic Records** – Almost all records are kept electronically today. Most banks don't even return cancelled checks anymore and a lot of business expenses are paid for with credit and debit cards. Your bank and credit card statements can now be used as proof of payment by the IRS, but they must show the name, date, amount and address of the payee.
- **Books and Records** – Tax law doesn't require small businesses to keep a formal set of books. However, if you do maintain more formal records such as ledgers or journals the auditor is entitled to see them. Most businesses will keep at least some financial information on computer and the auditor will request to see a print out.
- **Appointment Books, Logs and Diaries** – Most service related business track some activities and expenses using calendars, business diaries, appointment books and logs. These can be used to help justify an expense to the auditor as long as it appears to be reasonable. You are also required to keep additional records for certain equipment considered listed property if it's used for both business and personal purposes. This property can include computers, cell phones and vehicles.
- **Auto Records** – Any vehicles used for business purposes require detailed documentation that records the portion used for business. A log is often the best way to keep track of this. You will want to track your mileage, gas and repair receipts with notations of the trips and how they were used for business.
- **Travel and Entertainment Records** – Tax law requires that out-of-town business travel and entertainment expenses require much more detailed record keeping than just about any other expenses. You must have a written record of the purpose for the business trip or entertainment expense and receipts for it as well. Once again, a log can be a valuable tool for keeping up with all T&E expenses.
- **Expenses for Renting or Buying Property** – Be sure to bring in a copy of your lease agreement or purchase contract for any property used in association with your business. This will give you the documentation to claim this property as business expenses as well as provide a beginning tax basis of the property to claim depreciation.

The important thing to remember is that you maintain adequate records that way you are able to produce them when asked by the auditor. If you are unable to do so, the auditor is legally permitted to estimate your income and expenses as well as impose a separate penalty for failure to keep records.

If you become the target of an audit or have any questions concerning tax law, do not hesitate to contact the LGT tax team by calling (214) 871-7500 or toll-free (877) 231-7500.

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