How do Assessors examine business records

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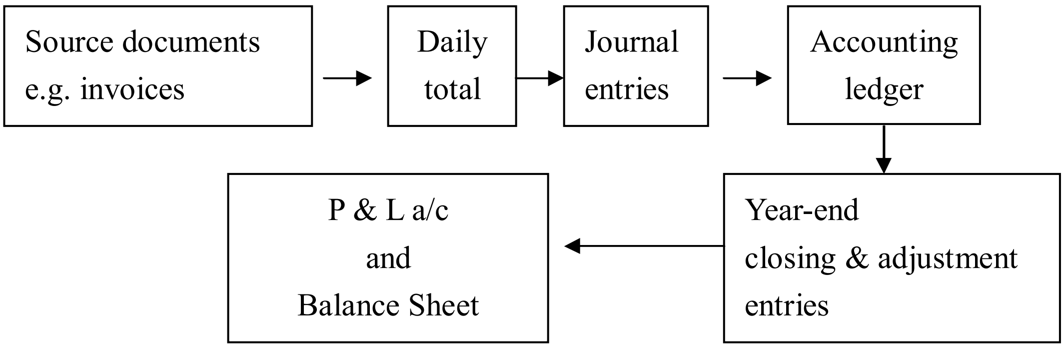
Examination of Accounting Records

By examination of accounting records, the assessor seeks to ascertain the profits **omitted** (including items not found in the records) or **understated** (including suppression of sales, unsubstantiated purchases or expenses). In cases of wilful evasion, the examination may produce evidence for criminal prosecution (e.g. sales omission, non-existed purchases / expenses).

Proper flow of accounting information



Assessor's assessing guidelines

Watch the transactions of substantial amounts near the year end: they may involve unsubstantiated purchases / expenses. Check the resultant settlement in the following year.

Beware of year-end adjustments: they may involve transactions with proprietor/partner/director or profit appropriation e.g. a debit entry to subcontractor's expenditure.

Subcontractor's expenditure	XXX		
Account payable		XXX	(where to? actual payment?)

Trace the source documents. Look for their final disposal (may be in the following year or later). Review bank statements of business and and also of proprietor/partners/director to search the payment.

Treat ALL deposits to business bank accounts as business receipts except advances from owners, their relatives or proved to the otherwise by taxpyers.

Watch ALL withdrawals to identify non-business payments or disallowable expenses.

<u>Assumptions generally adopted by Assessors</u>

Sole proprietorship: internal control is weak especially when the business was closely run by the owner.

Partnership: internal control is better, look for joint-name bank accounts (**NOT** partnership account) of partners, may be for distribution of omitted sales/unsubstantiated expenses. Trace the source of deposits and check whether any similar withdrawals from the bank account(s) of the partnership on the same day (possibility of false purchases or expenses).

Corporation: the accounts are more reliable, beware of specific omission/understatement of sales through current account with director(s) or third party; unsubstantiated purchases/expenses. Also look for omission of cash sales.

Sales: for those businesses with more sale outlets, internal control on sales, especially cash sales, will be better. So, greater effort will be put on purchases / expenses, year-end entries and the closing stock level.

<u>Queries generally raised by Assessors</u>

1. Nature of accounting records maintained:
   - Who prepared such records
   - Frequency of updating
   - who handle the cash received, any control over receipt and disbursements
   - any cash register
   - any cash reconciliation statement prepared on close of day
   - how the cash receipts were reflected in the bank books/statements
   - Non-cash sales – ascertain the internal control on receipt of cheque from clients.
2. Ascertain the genuineness of the accounting records kept:
   - whether the records were recently prepared
   - any cross-reference to the invoices/vouchers
   - If no proper accounting records, consider penalty action on breach of S.51C and proceed with indirect method of quantification of income omitted/understated such as Assets Betterment Statement (ABS), bank analysis, or ratio projection. He may base the records of current year for projection of back years.
   - If proper records kept, review the proprietor/partner/director's current account, business bank statements and month-end and year-end adjustments, especially for those items related to proprietor/partner/director's current account , advances or accounts payable etc.