

TAX SERVICES

RECONSTRUCTING YOUR FINANCIAL INFORMATION

Many of our clients and friends have lost all or a substantial part of their financial records. In such cases, financial data will need to be reconstructed so tax returns can be completed, insurance claims made, etc.

For tax purposes, you have the right to substantiate income and deductions by a reasonable reconstruction of your financial information where your loss of records is due to destruction by fire, flood or other casualty. At the same time, the courts have stated that you must provide more than vague generalizations or mere estimates. Thus, you will have to make a determined attempt to reconstruct any lost data.

Your first step is to determine what data is actually lost. You may be able to recover substantial data if you followed an adequate back-up routine. Check your back-up files to restore at least part of what you have lost. However, be sure to identify what data will be lost when using the backup (e.g., through what date does the backup data cover). Second, don't assume your computers and other equipment will not function. Have an expert determine whether any data can be recovered from your damaged computers. Finally, contact your CPA and other advisors to determine what data they possess. For example, Bourgeois Bennett's files, both paper and electronic, survived substantially intact. Although one of our computer servers failed, we were able to transfer our backup data to another server.

Your suppliers, banker, customers, etc. may also have data concerning your business. A major supplier, for example, can send you summaries of your purchases for the year. Think out of the box on this one. Your third party pension administrator may be able to help you fill in the gaps on salaries and wages (if your payroll service cannot do so).

Various tax agencies can help. Request copies of returns already filed. Prior sales tax returns, for example, may help you reconstruct income.

Reconstructing cash transactions is a major part of restoring financial information. Request copies of canceled checks and past statements from your bank. Identify the source of deposits as best

you can. One approach you can follow, for example, is to specifically identify *non-taxable* deposits (such as cash transfers between accounts) and assume remaining deposits are income, although there is the risk that this approach will overstate income.

Your prior financial statements and tax returns can be a source. Many of your expenses may be a consistent percentage of income from year to year. Other expenses may be directly linked to another expense (such as payroll taxes being closely linked to salaries). However, if you use historic percentages, you still must be able to show that these percentages would not have changed in the year you are reconstructing or you must make the proper adjustment.

The IRS has reconstructed taxpayer data for years, both to prepare returns for taxpayers who haven't filed and to test income and deductions for taxpayers who have. The Service has developed numerous techniques to reconstruct data. Some of these techniques may help you. For example, IRS agents examining bars and restaurants can project income by multiplying the number of bottles of liquor purchased by the number of drinks that can be prepared from a single bottle and then multiplying the results by the average price of a mixed drink. You may be able to develop similar rules of thumb.

Finally, as you reconstruct your data, don't take your eyes off the future. Develop better record retention and backup routines as you go. Consider other steps to take. For example, replace desktop computers with lap tops, which can more easily be moved in emergencies. As another idea, our firm has maintained an internet-based bulletin board that we have used to share information among staff about our tax preparation software. This bulletin board became an invaluable means of communicating with each other when cellular phone systems were down, our office e-mail wasn't functioning, etc. Finally, every firm should have an employee contact list and a disaster recovery plan

Your various professional advisors can help you in many ways. If you need assistance, don't hesitate to call us.



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