

**ACTIVITY REPORT 2004
OF THE WORKING GROUP ON VALUE ADDED TAX**

ATTACHMENT No. 2

**GUIDANCE FOR THE AUDITING OF VALUE ADDED TAX SYSTEMS:
A COMMON UNDERSTANDING OF THE EU VAT WORKING GROUP**

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1 Purpose of Guidance

1.1 Introduction

The tax system relies on taxpayers making accurate self-assessments of the tax they owe. The Tax Administration has to carry out a range of activities to encourage taxpayers to comply with their tax obligations. These range from services such as providing education to taxpayers about their obligations to make it easier for them to comply; to enforcement action such as prosecuting those who do not.

Taxpayers have to know that there are efficient systems in place to ensure that all people pay taxes due. An important component of promoting compliance is properly controlling the taxpayers in order to detect non-compliance with tax laws and to deter potential non-compliance in the future. This is an important task in the Tax Administration's hands that has to be dealt with seriously and efficiently.

The Supreme Audit Institutions (SAIs), when auditing the revenues and the systems put in place to manage them by Tax Administration bodies play an important role in protecting public financial interests. A strong external audit function fulfilled by the SAIs is an important element in the framework to counter fraud, corruption and irregularities in the public sector, by providing a prevention and deterrent effect through oversight. The audit results give the SAIs the opportunity to make recommendations and proposals to accelerate important initiatives and to promote regulations and measures to improve tax management.

In this scope it is essential that SAIs use standards, good guidance and efficient procedures for their audit activity to ensure reasonable expectations of detecting material fraud or error. The strategies for auditing the management of tax revenues have to be further developed for the promotion of education leading to a culture of good governance.

The Value Added Tax Working Group of the European SAIs therefore decided in September 2003 in Bonn to set up guidance which prescribes the principle requirement that should be met by the individual SAIs. Having in mind that there are considerable, partly unexpected differences in the audit functions of Member States the Group's intention is to give guidance for all Audit entities in the countries of the European Union, which has to be seen in the light of the individual legislation.

1.2 Scope of the Guidance

The Guidance for auditing tax management systems sets out the standards, which the tax auditors of the SAIs of the European Union regard as appropriate for a satisfactory audit of tax management systems by an External Auditor. Auditing Standards provide minimum guidance for the auditor that helps determine the extent of auditing steps and procedures that should be applied in the audit. Auditing Standards constitute the criteria or yardstick against which the quality of the audit results is evaluated.

The Auditor-General, or SAI, and his/her staff of a Member State of the European Union is accountable to his/her parliament for the external audits of the financial authorities of his country. He/she and – to the extent possible – his/her staff should be completely independent and solely responsible for the conduct of the audit.

It is his/her duty to comply at all times with the relevant provisions of the mandate of the SAI and the Financial Regulations and further terms of reference of his country. It is understood however that these regulations leave the auditor with an appropriate degree of discretion to determine the precise scope, nature and extent of audit procedures.

As Members of the International Organization of Supreme Audit Institutions (INTOSAI), SAIs have agreed to comply with the Auditing Standards issued by INTOSAI. Where appropriate, tax auditors will additionally apply the auditing standards recognized in their own countries.

The mandate of the Auditors includes financial audit, compliance audit and performance audit. The Auditors of European SAIs certify the compliance of the financial statements with legislative provisions. In addition, the reports include further observations noted in the course of these audits, including performance audit matters if applicable.

2 Role of the SAIs

2.1 General Principles

The legislator, the public institution and private citizen want and need to know if government funds are handled properly in compliance with law and regulations. Moreover they need to know if the government authorities are working with economy, efficiency and effectiveness.

To help the SAIs to produce this information, guidance is useful. The information about the true and fair presentation of a country's Financial Statements by Government has to be provided by audit work that ensures the information is intelligible, pertinent, prudent, independent and reliable.

Definitions:

General interest

This information has to be delivered only when a defined materiality level is reached.

Audit work

This implies that the information has to be obtained by an audit methodology.

Intelligible

The information has to be understandable by the members of Parliament.

Pertinent

The information provided has to be useful.

Independent

The information has to be neutral and free.

Reliable

The information has to be supported by strong evidence

2.2 The Role of the SAIs in auditing public revenues

2.2.1 Fields of competence

For most of the SAIs the information they provide to Parliament covers three scopes:

- | |
|--|
| <ol style="list-style-type: none">1. Audit of the Financial Statements (true and fair view)2. Regularity (taxation in compliance with laws, rules and regulations)3. Good governance (economy, efficiency and effectiveness) |
|--|

Those audits are undertaken through financial, regularity and performance work. Although some SAIs are also responsible for the audit of Revenue Systems and reporting on those systems to Parliament.

While managing, collecting and controlling the revenues from taxes, many irregularities could be committed by tax officials or the tax payers. Some of these can be defined as fraudulent actions or cases of corruption. It has to be added that the connection existing between persons, goods and businesses all over the territory of the EU, and even all over the world, makes the detection and prosecution of crimes and irregularities more difficult.

Some SAIs have other particular competences like:

- | |
|---|
| <ol style="list-style-type: none">1. Jurisdictional competence,2. Advisory competence (Legal advice and/or Budget advice). |
|---|

Those SAIs with jurisdictional competencies in relation to administrative/ accounting liabilities, make an additional contribution with regard to concrete irregularities or cases containing corruption or fraudulent practices concerning the public funds.

The SAIs are responsible for:

- declaring that liability;
- determining its amount;
- requiring reimbursement
- deciding over appeals against their activities.

While exercising their advisory competence, the SAIs can:

- give recommendations in the legislative process ;
- give recommendations in the annual audit report or about separate cases in special reports.

2.2.2 Limits

SAIs do not have responsibilities in the field of criminal law, protection of national or Community financial interests. Other services are responsible for these obligations, co-ordinating their actions where necessary with

- government official services (robust administrative procedures to prevent fraud and corruption),
- public prosecutors (criminal investigations and prosecution),
- criminal courts (ascertaining criminal liabilities and imposing criminal penalties).

SAIs have neither direct competences nor responsibilities in the fight against fraud and corruption. However, the activities of the SAIs, depending on each legal system, help to safeguard and protect public funds (incomes and expenditures) from criminal attacks and from organised frauds or irregularities. SAIs play an important role in preventing, assessing and deterring them.

2.3 Role of SAIs concerning VAT income

2.3.1 The role of EU Supreme Audit Institutions

Auditing (financial/management) the collection and management of taxes (as public funds) is with the mandate of most SAIs. The efficient audit of tax revenues helps to avoid squandering [spending money is not linked to how well it is collected] and public deficit and to prevent the government from increasing the tax pressure on taxpayers.

The European Union member states administer and regulate Value Added Tax (VAT), in accordance with European Directives.

In most of the countries the Tax Administration bodies, connected with the Ministry of Finance, are responsible for the collection of VAT. In some cases other bodies, like customs

collect VAT on intra-community-deliveries, but they are also responsible to the Ministry of Finance. In all EU-countries VAT on imports (deliveries from countries outside the EU) is collected by the customs administration.

2.3.2 Auditing VAT-incomes.

a. Check of VAT control

SAIs can compare the expected VAT-income (budget control) with the actual VAT income (reality) to confirm the effectiveness of the VAT collection process.

b. Assessment of risk

The SAIs have to identify areas at particularly at risk from fraud (e.g. carousel fraud), then assess the adequate development of the functions and policies of the authorities set to mitigate against such risks. Further they can identify specific cases of fraud or irregularities in the management of public funds.

c. Checking the internal control system

The SAIs have to assess the existence and the effectiveness of the internal control developed by the administration to ensure the correct collection of VAT.

The SAIs can assess if the tax management system is adequately developed and can make recommendations to further enhance the control environment.

d. Identifying weaknesses in the national system

The SAIs can identify the weaknesses in the system for national tax management, especially in the field of procedures for the application of tax law. Some SAIs can recommend amendments in the field of legislation.

e. Identifying weaknesses in the EU VAT management

The SAI can check the correct application of intra-community VAT in cooperation with other SAIs.

2.3.3 Results

While conducting the financial, regularity and performance audits, the SAIs have essential tools for identifying and detecting irregularities and fraudulent actions. The SAIs can:

- Communicate in reports to Parliaments, or any other appropriate institution, the results of the audits carried out and, where appropriate, the instances of abuses or irregularities.
- Provide recommendations and guidance in order to enhance management control systems and procedures.
- Detect concrete cases of tax evasion or other irregularities
- Identify concrete cases of tax avoidance in order to recommend improvements in legislation.

2.3.4 Audit work

Conducting audit work on VAT implies:

- Reporting to Parliament or any other competent body on the audit findings.
- Promoting Parliamentary and governmental regulations and measures to improve financial management, identify and prevent corruption and fraudulent actions and preventing money laundering.
- Promoting guidance and good governance and a sound culture against irregular practices.
- Encouraging the performance of the administrative and judicial authorities directly involved in the fight against fraud and corruption.
- Communicating information about suspected criminal/illegal actions to the public prosecutors and the Courts.

Conducting audit work implies that the audit will be conducted with due diligence and consider areas such as:

- Conducting risk analysis
- Use standards, guidelines and procedures for financial, regularity and performance audits to ensure reasonable expectations of detecting material fraud.

This implies:

- assessing and testing internal controls;
 - verifying regularity;
 - carrying out adequate planning, performance and evaluation of audit work;
 - carrying out substantive testing of transactions;
 - ensuring a full understanding of the bodies being audited;
 - complying fully with professional standards.
 - auditing according to general guidelines for auditing.
- Using competent and qualified personnel.

2.3.5 Access to information

Ensuring that the taxpayers are fulfilling their fiscal duties (direct checks on the taxpayers) does not normally fall under the competence of the SAIs. Tax Administration bodies are in charge of carrying out the fiscal inspections over the taxpayers. However, SAIs are in charge of checking Tax Administration's activities in that field.

Therefore, before planning the audit, SAIs should check their legal position regarding access to taxpayers' information contained in the form of tax returns. To meet the audit objective in that case it is essential to have access to tax payers' information.

If, due to confidentiality, access is not possible, audit objectives and procedures should be altered according to the nature of the information to be analysed. In this case the audit can only refer to auditing tax management.

2.4 Reporting

The SAI may report in a variety of ways the results of its examination of revenue and tax management systems. This may take place through:

1. The General annual report (figures about tax and managing comments);
2. The Financial report (budget, incomes);
3. Special reports to be made during the year.

Stakeholders, including legislators, public institutions and citizens need to know if government funds are handled in accordance with laws and regulations. Moreover, they need to know if the government authorities are working with economy, efficiency and effectiveness.

While conducting the financial, regularity and performance audits in the tax field, it is the SAIs role to provide information of general interest to Parliament or the government on the appropriateness and reliability of the tax management system. This information can be provided as a part of the general annual report of the SAI or in special reports to Parliament.

The content of the annual report will depend on the nature of the institution and the regulatory and legal requirements it is subject to. The duty of SAIs is to express an opinion about the Financial Statements produced by government. This part is derived from Financial and Regularity Audits. In other parts SAIs report, e.g., about the results of their performance audits.

3 General Principles for Tax Auditors

3.1 Code of Ethics

Like the work of all public service auditors, the work of tax auditors should be governed by highest ethical standards. They should adhere to the Code of Ethics as set up in Chapter 1 of the Auditing Standards issued by the Auditing Standards Committee at the XIVth Congress of INTOSAI in 1992 in Washington D.C., United States as amended by the XVth Congress of INTOSAI 1995 in Cairo, Egypt (details see www.intosai.org).

According to these Standards Auditors should be straightforward and honest in performing professional work. They must be fair and should not allow prejudice, bias, or influence of others to override objectivity. The Auditors should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as incompatible with integrity, objectivity and independence.

3.2 Confidentiality and Tax Secrecy

All Auditors should respect the confidentiality of information acquired during the course of performing professional services and should not use or disclose any such information without proper and specific authority or unless there is a legal or professional right or duty to disclose.

For tax auditors dealing with taxpayers' data it is of highest importance to adhere to confidentiality and tax secrecy. Taxpayers' obligations to deliver complete tax returns may mean that they contain sensitive data. This requires the protection of data against publication or other improper use.

In every European Member State there is special legislation exactly prescribing the extent of protection, the application of criminal law in cases of violations and cases in which it is allowed to reveal data. This legislation has to be followed strictly: Consequently, tax data

- should neither orally nor in writing be disclosed to third parties if not explicitly allowed by law (generally when the disclosure is needed for a taxation or audit procedure).
- have to be kept secret from Parliamentary Bodies or other entities outside the tax administration.
- may be exchanged between SAIs of Member States of the European Union only under the regulations for intra-community information exchange making use of the options of the Central Liaison Offices.

3.3 Special Professional Competence of Tax Auditors

All Auditors provide professional services. That implies that there is a level of competence necessary and that the knowledge, skill, and experience of the Auditors will be applied with reasonable care and diligence. Tax Auditors should ensure that they perform only services, which they are competent to carry out. Otherwise advice and assistance should be obtained to ensure that the services are performed satisfactorily.

As tax legislation is often subject to changes and financial jurisdiction has a large influence on the law, tax auditors have extremely high requirements in training their professional capacity. They should perform professional services with highest competence and have a continuing duty to maintain professional knowledge and skill at the required level to ensure that the audited entity receives the advantage of competent professional service based on up-to-date developments in practice, legislation, and techniques.

4. Comprehensive Risk Assessment

4.1 Types of Risks

In the context of the audit work, risk relates to events or dangers that may cause material misstatements in the financial statements. There may be conditions that increase risk and these include:

- previous experience or incidents that call into question the integrity or competence of management or other staff;
- particular financial or reporting pressures or targets within the client;
- weaknesses in the design and operation of the accounting and internal control systems; and
- inadequate control over data in an information systems environment.

To properly audit a tax management VAT system, the auditor must first undertake a comprehensive risk assessment to find the audit risks posed by VAT systems. This will allow the auditor to properly direct audit resources to those areas which are of the greatest risk. The audit of VAT systems is likely to be complicated by the fact that the audit will need to include an examination of complex IT systems, and in several EU member states the IT systems are likely to be legacy systems which are nearing the end of their useful life. As a result it may be difficult to identify appropriate resources to attack all of the areas of risk that are identified as a result of the risk analysis exercise.

4.2 Identification of Risks

The first source of information should be the clients' own risk assessment procedures. SAIs should ask their client's management what procedures they have to examine risks to their organisation, what risks they have identified and what procedures they have in place to address and minimise the risks.

Management is expected to have embedded risk management procedures but if this is not the case or they are weak, auditors should advise them about risk assessment techniques and thereby add value to the client and work with them to improve the corporate governance within the organisation.

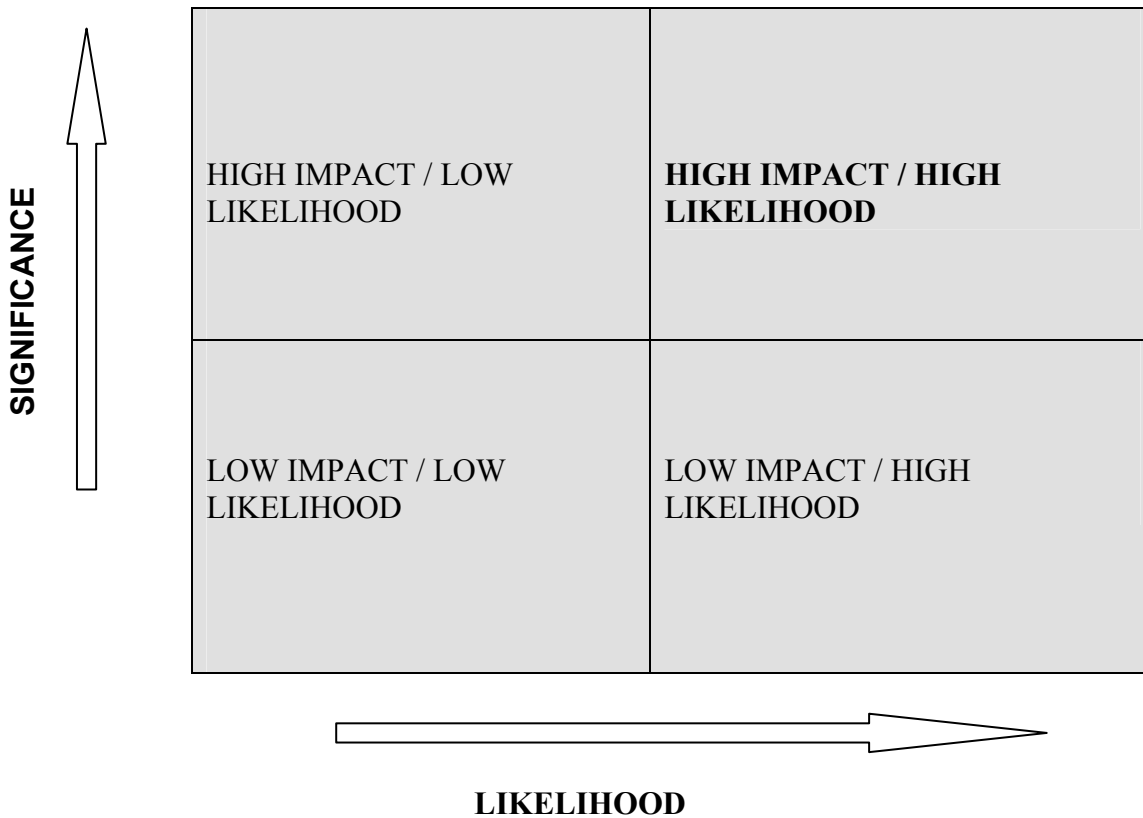
SAIs also perform a risk assessment and use the information gathered in their understanding of the business. Information about risks is likely to be obtained primarily from high level documents such as senior management board minutes, from discussions with management and from the work carried out to review the accounting and internal control systems. It is important to remember that to obtain a full understanding of how management addresses risk and to determine the impact on the audit approach auditors must discuss the risks identified.

Broadly risk will fall into entity level risks, i.e. those risks to which the tax management VAT authority is exposed, and those which pertain to specific account areas or transaction streams within the authority. It is also helpful to consider risk under a number of additional headings to properly identify and in turn prioritise those risks to which the organisation is exposed.

4.3 Prioritisation of Risks

Whilst auditors often identify a large number of risks, they need to focus on those risks that are more likely to happen and that would have a material impact on the financial statements. They therefore need a system for prioritising the risks identified. The risk-mapping diagram below is one way of doing this to ensure that audit procedures are designed that address those risks that are likely to be significant in the context of their impact on the financial statements.

RISK MAPPING DIAGRAM



The matrix should be used by placing the risks identified into the appropriate boxes. A risk that has a high probability of occurring and that would be significant is placed in the top right hand box of the model. A risk that would have a low significance and that is less likely to occur is placed in the bottom left hand box.

The second part of the risk assessment exercise, involves using ones judgement to decide which risks can be ignored and which need to be examined in more detail and addressed by our audit procedures.

Auditors may decide to ignore those risks that are of low significance and low likelihood (i.e. in the bottom left hand box) because it is unlikely that they could have a material impact on the financial statements. Those risks that are both of a high significance and highly likely to occur (i.e. top right hand box) will need to be specifically addressed by during the audit.

Auditors should use their judgement to determine which of the risks in the other two boxes will need to be addressed by specific audit procedures. In some cases it may be sufficient to raise the issue with management rather than carry out additional audit procedures.

Management's response to the risks identified will be an important factor in determining the extent and nature of the audit procedures and is covered below.

It is important that the risk assessment draws on the audit team's knowledge of the client and that the whole audit team appreciates what risks there are, and their importance relative to the financial statements. In addition, it is vital that any changes to the risk assessment and consequent amendments to the planned audit procedures be communicated to the team at an early stage. This might often happen for example, in the light of management's response to our risk assessment.

The complexity of VAT systems means that any risk assessment exercise is likely to be a complicated one; however, the following areas are considered as key to gaining an overall understanding of the risk profile of VAT systems.

4.4 Legislation

VAT laws in each EU member state are laws based on the EU 6th Directive on Tax. It is a complex piece of legislation and given that society and technology changes rapidly, businesses are always ready to identify ways to minimise their tax burden.

Given that VAT laws are supposed to be standard throughout EU member states the legislative picture is further complicated by the fact that individual member states have areas of derogation meaning that they have national exemptions for certain areas of VAT policy. This will result in greater complexity for traders who are involved in intra community trade and thus subject to potentially different legislation.

National legislation will also impact on the approach that has to be taken towards any examination of the differences between tax avoidance (legal) and tax evasion (illegal), which may involve tax consultants seeking to establish legal precedent as a means of minimising VAT payable by clients, which can result in rulings from tribunals and the courts on the way the tax rules are applied. Consequently, this complicates the interpretation of the law and the work of the enforcing agency, or tax management authority in each member state.

The auditor will also need to have knowledge of other legislation which may impact on the audit of a tax management VAT system. There may be legislation concerning data protection or tax secrecy and equity which will impact on the availability of information. The auditor may also be constrained by the access to individual tax payer or trader records which differs from member state to member state.

Key Audit Questions

- Are staff sufficiently trained and qualified to understand and interpret the laws governing VAT?
- Is there sufficient guidance to staff regarding laws?
- Are staff informed of legislative changes that may affect their area of work?
- Is there sufficient support for queries that cannot be dealt with by staff?
- Are there clear guidelines over the interpretation of sub judice or tribunal cases and the reporting of findings relating to them?

4.5 Audit Risk

Audit Risk is usually considered to be the risk that the auditor will give the wrong opinion on a set of financial statements, however in the case of an examination of VAT systems it is far more likely that a discharge on the effectiveness of the systems will be given rather than an opinion in the standard financial audit sense. The principles used to conduct the audit should be the same as for all assignments – to ensure that staff are appropriately skilled and trained, and that they conduct their work to an appropriate standard.

A number of key administrative risks are included below which should be used by auditors to consider potential areas of weakness. This is by no means an exhaustive list but points to some of the failings which if manifested could increase risk within the tax management VAT authority.

Bankers unable to provide service e.g. Liquidation, failure to meet contract, disaster, strike etc.	Post not identified (ie. sorted by post code)	Delays in receiving work for processing <ul style="list-style-type: none"> ▪ Postal delays ▪ Workflow not fast enough to feed process ▪ Workflow not prioritised to meet demands 	Post not prioritised in Validation	VAT Returns/Cheques either delayed/lost/maliciously destroyed or stolen in Validation.
Wrong information on traders' ledgers and incorrect enforcement/repayment action	VAT Returns/Cheques either delayed/lost or maliciously destroyed between Validation and Cheque Lodgement.	Batches not prioritised in Cheque Lodgement.	VAT Returns /Cheques either delayed/lost or maliciously destroyed within Cheque Lodgement.	Cheque Lodgement unable to provide service to meet Treasury requirements due to <ul style="list-style-type: none"> • Disaster • Accommodation Failure • Departmental Strikes • Cut off time to meet deadlines not met.
Organisation <ul style="list-style-type: none"> • Workflow procedures • Lack of management information relating to key depression/ returns keyed • Processes/procedures not efficient 	Data Back up <ul style="list-style-type: none"> • Tapes not remotely stored • Tapes stored in one area • Tapes taken home for remote storage • Tapes stored in an environment that causes 	<ul style="list-style-type: none"> • No plans in place • Out of date plans • Plans not held remotely by senior managers • No contingency with bankers • No warm stand by site 	Electronic payments manually allocated to an incorrect VAT number.	Monies from Bailiff payments and other direct payments remain unposted as insufficient information received to allocate funds.

	tape deterioration	in the event of disaster.		
Requests for duplicate VAT Recs. could create false credits	VAT Records not raised from daily run or issued with wrong amount	Reconciliation of Surcharge, Penalty and Interest adjustment not undertaken	Daily re-submitted VAT Records from the banking not updated on records - thus the weekly statistics would show incorrect carry forward amounts.	Information entered onto the database could be sabotaged by a team member. There is also the risk of human error and the information just being keyed incorrectly.

4.6 Tax Processing

Many public and private sector organisations make extensive use of information technology to process financial transactions and to produce their financial statements. Most if not all VAT systems that the auditor will encounter will be IT systems – often these will be long standing, legacy systems which are nearing the end of their useful lives. These processing systems will mean that the auditor has to consider risks posed by IT processing functions when planning to carry out the audit. The auditor will not only need to consider whether or not the systems are operating effectively, but whether or not there are appropriate mechanisms in place to back up and restore business critical systems in the event of a key system failure.

It should be emphasised at the outset that the presence of IT does not alter the fundamental audit objectives. However, IT systems have particular characteristics which may influence the auditor's view of risk or require the auditor to adopt a different audit approach. For example, IT systems may:

- allow anonymity and reduce accountability;
- permit unauthorised and unrecorded amendment to accounting data;
- allow duplication of input or processing;
- be vulnerable to remote and unauthorised access;
- conceal or make invisible some processes;
- remove or obscure the audit trail;
- spread data widely across distributed systems, or
- be operated by outside contractors, employing their own standards and controls.

Key Audit Questions

When the tax administration's financial systems are computerised, auditors must consider the impact of those systems on the audit plan. Specifically, they must:

- familiarise themselves with the relationship between the financial statements and the computerised systems which support them;
- assess the need to involve IT audit specialists in the audit;
- consider the impact of IT on the assessment of risk both at an entity level and for each account area;
- consider the scope for using special audit software to support the audit, including identification of the most appropriate means of accessing and analysing transaction data;
- consider whether the audit approach might or should include some reliance on computer controls; and
- identify developing financial systems which will require audit involvement.

4.7 IT Reviews of VAT Systems – Basic Principles

The IT review comprises three parts, as shown below.

Part A - Background information on the administration's IT systems

Part A asks the auditor to gather background information on the administration's IT hardware and software. Information on the size, type and technical complexity of the computer systems enables the auditor to assess whether there is a need for specialist IT audit support. Part A identifies developing financial systems which require future audit involvement. Part A should be completed before the auditor carries out a review of the IT control environment or the application control procedures.

Part B - Review of IT control environment and entity risk assessment

Part B is used to assess the controls and procedures which operate within the IT control environment. Weaknesses identified in the IT control environment may undermine the effectiveness of the control procedures within each financial application.

Part C - Review of application controls and account area risk assessment

The auditor should use Part C to examine the control procedures, systems of internal control and audit risks within each material financial application.

4.8 VAT Specific Risks

As VAT is a form of sales tax and is calculated on each transaction there are far too many individual transactions to be calculated by government departments. This means that the transaction data must be collected by the traders and submitted as a VAT return, and therefore VAT information is only going to be as good as the quality of data submitted by traders. It is important that in considering internal control management has put in place appropriate systems to ensure the accuracy of data submitted and the compliance of trader groups.

The data is held on a central VAT registrations database which in most member states will be a complex IT legacy system. This system is used to store the records of all VAT registered traders and can be used to spot trends with the returns data which can be used to direct assurance activity. When the trader first registers for VAT their details are processed by the administration and the nature of the business undertaken by the trader is classified in accordance with a series of classification codes.

For this system of self assessment to be verified the enforcing agency must carry out assurance work to ensure that the returns are truthful and correct (a trader may have made a mistake rather than committing fraud). Given the large volume of VAT returns received by the administration only a sample number of assurance visits can be made. These assurance visits constitute one of the departments' activities to ensure that all revenue due is collected.

Only limited amount of information is included on the return, although this information should be consistent across all member states as its requirements are specified in underpinning EU VAT law. This is used along with other sources of data to determine the level of risk of non-compliance by the business. Information gathered from the VAT registration database can be combined with data from other agencies to determine which traders are of high risk of non-compliance.

Risk analyses using historical data can suggest previous and current trends. They do not allow for predicting or dealing "emerging risks" or rapid changes to the way business operates. Future risk modelling will have to rely on historical trends but be flexible to accommodate. Sector specific risks need to be understood to accurately direct the efforts of assurance and compliance officers.

Key Audit Questions

- Is sufficient information gathered on the VAT returns form to allow for further analysis of the traders' compliance record?
- Are the forms simple to complete?
- Are staff sufficiently trained to interpret and enter the registration and returns data?
- Is the way data entered standardised manner (would two people enter the same data in the same way)?
- Are there sufficient data validation processes?
- Is there sufficient functionality to aid selecting traders with a high risk of non-compliance?
- Is the number of assurance visits justified given the number of registered traders?
- Is there sufficient software functionality to aid selecting traders with a high risk of non-compliance?
- Have the sector risks been identified and are they represented in the risk model giving a higher weighting to the higher risk sectors?
- Is there sufficient flexibility with the models to include any merging trends that aren't represented in the historical data?
- Can government departments share information to help focus their efforts?
- Is data held in a manner such that it can easily be shared?

4.9 International Co-operation Risks

As VAT is a European tax there is a need to ensure that audit activity can properly follow traders who are suspected of breaching control systems, and therefore it is important to consider how auditors can co-operate with other Supreme Audit Institutions and the European Court of Auditors, and the impact this may have on audit activity, for instance from a data protection perspective or from a tax secrecy perspective. It is also important to ensure that the audit activity undertaken does not result in recommendations which are unworkable in respect of individual member states and also do not make compliance costs unacceptably high for compliant traders.

International co-operation is desirable when examining audit issues which cover more than one member state, for instance Intra Community Missing Trader fraud which may take place across a chain of member states. It is important to have in place arrangements for the sharing of information, but this is best enacted through the tax management authority which will already have in place arrangements for sharing information with other member states. There are often concerns about delays in obtaining the effective sharing of information, and it may be that audit activity can recommend ways in which the exchange of information can be speeded-up.

The co-operation of Member States in the field of VAT encounters several risks:

- information stored in the VIES – system is not timely enough and not always reliable
- information is quite old due to the procedures prescribed by the EU
- exchange of information about doubtful deliveries from one Member State to another is too slow and far too seldom.

In that field a close co-operation of SAIs is desirable to tackle these risks. National administrations have little influence on EU-procedures. SAIs can play an active role in updating the system and speeding-up exchange of information to be able to get hold of missing traders and thereby preventing carousel fraud.

5 Control Requirements and Internal Control

The risks posed to the effective collection of VAT by national tax management authorities can be addressed through the correct application of risk management. Management should design and implement effective internal controls to mitigate against the risks that were outlined in the previous chapter which is a mechanism for assessing risk present within a tax management (VAT) system.

It is up to the tax management authority to devise and implement a system of internal control which will prevent the risks referred to in the previous chapter of the guideline from impacting on the entity. It is quite clear the responsibility for devising a system of internal control does not lie with the external auditor, but the auditor should, where possible work with the tax management authority to strengthen internal control. Internal controls may in turn provide the auditor with appropriate assurance in support of an audit report or opinion.

The complexity of auditing the tax management authority, especially in the case of VAT which operates on a Europe-wide basis will mean that it is often necessary to refer issues of internal control to different parties for resolution. The table below illustrates the routes that auditors looking at tax management systems should use to resolve risks and weaknesses in internal control.

Risk Type	Responsibility for Control Systems
Legal	<p>National legal controls to minimise risk lie with national legislative arrangements. Over taxation this is usually through the Ministry of Finance or equivalent.</p> <p>Weaknesses in legislation which pose a risk to tax management should be reported through the audit report to Parliament to ensure that appropriate changes can be made to mitigate against the risk.</p>
Audit	<p>Weaknesses discovered as a result of audit work undertaken should be reported to management so that these can be resolved as soon as possible. Where this results in financial loss, then it may also be appropriate to report to Parliament the results of the audit work undertaken.</p> <p>Management of the entity is at all times responsible for devising, implementing and maintaining an effective system of internal control.</p>
Taxation processing	<p>Control systems to ensure the correct processing of taxation are the responsibility of the tax management authority and should be reported to the authority. Where there are serious control weaknesses which may result in financial loss, then the issue could also be reported to Parliament.</p>
VAT	<p>VAT is established under EU Directive, and implemented under national law in each member state. Where there are weaknesses in the overall VAT system these should be reported to the European Commission. This would usually be through the Ministry of Finance, although it would also be possible, should work be co-ordinated with the European Court of Auditors to work with the Court to bring these weaknesses to the Commission's attention. If the weakness in the VAT system which impacts on internal control is as a result of poor national legislation or as a result of derogation, then the internal control weaknesses and implications should be reported to the Ministry of Finance.</p>
International 1: Intra-community-deliveries	<p>Because of the national nature of tax management legislation and systems, it is sometimes difficult to escalate concerns over risks which emerge because of the nature of international trade, for instance Missing Trader Fraud.</p> <p>Auditors should be sure to raise weaknesses in this area to the attention of their tax management authorities, but also recommend that the authorities co-operate with authorities in other member states to ensure the effective tackling of risk, rather than the transfer of risk between member states.</p> <p>Auditors should also look at ways in which they can liaise</p>

	with each others to share concerns and best practice between member states and in so doing to create a concerted attack on internal control weaknesses. Auditors should also consider procedures through which better bilateral co-operation can be arranged to share information effectively.
International 2: Deals with third countries	In cases of imports and exports a close co-operation between tax and customs authorities at the EU-external borders is needed. It is the task of customs to physically check whether goods have left the country. This is a high risk area where auditors should give advice to tackle the risks involved.

Effective internal control can be an important source of audit assurance. It is therefore important for auditors to work closely with Internal Audit Offices to understand weaknesses in internal control which have been uncovered as a result and to take account of these in reaching an audit opinion, or in reporting internal control weaknesses.

Further guidance on the principles of internal control which auditors should take account of can be found in the INTOSAI auditing standards at www.intosai.org along with the INTOSAI guidance promulgated by the Internal Control Standards Committee.

It is important to emphasise that from an internal control perspective, auditing a tax management system is not different to any other type of audit. It needs to adhere to the same standards and to be carried out to satisfy core audit objectives. Responsibility for the adequacy of internal control systems lies with management and not with the auditor; likewise although audit work may uncover evidence of fraud, the discovery of fraud is not the auditor's responsibility, although if it is uncovered then it is important that if found it is reported appropriately.

6. Financial, Regularity and Performance Audits

There are three objectives of tax audit:

- To contribute with the results of the audit of tax to the procedure of the certification of the accounts
- To check whether tax administration complied with law and regulations.
- To assess economy, efficiency and effectiveness of the tax administration's activities.

6.1 Financial Audit

The general objective of the Tax Administration audit is to enable the auditors to express an opinion on the fair presentation of the financial statements of the entity's financial position at a certain date and on its operations for the period ended on that date (normally 31 December).

The aim of the analysis of the Tax Administration's financial statements should determine whether:

- the financial statements are accurate, complete and consistent with the daily records and ledgers;
- the financial statements are prepared in accordance with accepted accounting standards and laws governing them;
- the financial statements are presented with due consideration to the special circumstances of the tax collector bodies;
- sufficient disclosures, especially in tax accounts, properly detailed and broken down, have been presented in relation to the various elements and that these elements are properly evaluated, measured and presented; and
- the State Tax Revenues Account (Treasury Account) shows a fair presentation of the management results of taxes duties, in accordance with generally accepted accounting standards.

6.2 Regularity Audit

The general objective of regularity audits is whether rules and procedures for the management of tax revenues are carried out by the tax bodies in accordance with laws and regulations. For revenue income there are a number of specific audit objectives:

- Whether the Treasury Account shows properly the results of the management of tax duties, in accordance with the general accepted accounting standards.
- The assessment of the fulfilment by the Tax Administration of the laws, rules and regulations concerning the control of revenues from tax duties.
- The evaluation of the taxation management procedures related to the pursuit and control systems of the taxes duties.
- The evaluation of the taxation inspection management procedures according to laws and regulations, as well as its impact on the taxes collection. SAIs also follow the objective of fine-tuning legal provisions if their legal provisions allow for.

These objectives can be more detailed and multiplied if the audit scope requires it.

6.3 Performance Audit

The general objective of the Tax Administration audit is to enable the auditor to assess the effectiveness achieved, whether objectives are fulfilled, as well as to comment on the economy and efficiency of the resources used to achieve those objectives. This can be done by a thorough analysis of the local taxation system or by applying “best practise”. Especially in the field of the harmonised Value Added Tax there is a possibility to compare between the EU – Member States with a profit for everybody.

Depending on the extent of the SAI’s individual audit statute specific objectives can be:

- The assessment of the anti-tax-evasion and anti-tax-avoidance measures carried out by the Tax Administration, as well as the impact on the taxes collection.
- The detection of anti-evasion measures not taken by the administration.
- The assessment of the effects of legislation as to whether the results are in line with the legislators’ intentions.
- The detection of legal gaps in taxation law which expose the administration to fraud and make recommendations to close them.
- The evaluation of the tax duties fulfilment measures carried out by the Tax Administration, as well as the impact on the tax collection.
- The analysis of the tax inspection/auditing systems and its impact on tax collection.
- The valuation of the register of taxable persons and its impact on tax collection.
- The assessment of the effectiveness of the tax information systems.

These objectives can be more and more detailed if the performance audit scope advises it.

7. Audit techniques

The previous chapter (Financial, Regularity and Performance audits) has already presented the objectives and outputs of main types of audits that SAIs usually perform on the tax administration. This chapter describes the recommended audit techniques that could be used to achieve best results in meeting these objectives.

7.1 Financial and Regularity audits

The audit approach for Financial and Regularity audits should take a standard audit approach for auditing financial statements with the following specific issues that relate to tax administrations and taxes:

7.1.1 Planning and supervision

The planning process should be carried out focusing on the following areas:

- tax management bodies (organization, segregation of duties, legal provisions, etc.);
- budgetary concepts (choosing income budget chapters, concepts, sub-concepts, items, etc);
- procedures' analysis (choosing different areas in the tax Administration's activities such as management, tax collection, inspection/auditing, accountancy, human resources and training, etc.).

7.1.2 Follow-up of previous audits

The auditor in charge of carrying out the audit should take into account the material findings and recommendations from previous audits, especially those that have influence on:

- Status and age of tax debts,
- Quality of internal control in the tax collection process,
- Integrity of tax files/data (both paper and electronic versions),
- Fulfilment of international obligations (e.g. VIES)

Follow-up activities should help the auditor to determine whether the auditee has taken timely and appropriate corrective action regarding findings in past audits.

7.1.3 Study and evaluation of the internal control

Focussing on the income budget, the auditor in charge should obtain a sufficient understanding of safeguarding the collection of taxes and of the prevention or timely detection of non-authorized transactions and non-authorized access to collected taxes causing losses in public funds.

When testing compliance, the auditor should evaluate the tax administration's internal control capabilities to detect and/or prevent the potential damage to the tax collection process.

7.1.4 Concerning regularity audit, specifically

The scope should include an examination of the tax administration's financial system and transactions to determine whether the entity has complied with specific applicable laws, rules, regulations, procedures, etc. Especially, in auditing the regularity of revenues, such as taxes, the auditor should carry out an examination to determine whether the applicable rules and procedures governing incomes provide an effective check on the collection and proper bookkeeping of revenues.

7.1.5 Evidence

Relevant, sufficient and reliable evidence should be obtained to provide the auditor with a reasonable basis to support the conclusion expressed in the report.

7.1.6 Working Papers

The work of the auditor should be contained in working papers that have to be recorded at the SAI. These papers have to contain the objectives, scope, and methodology, including any sampling criteria used; documentation of the work performed to support significant conclusions, including descriptions of transactions and records examined and evidence of supervisory reviews of the work performed.

Those papers should allow reviewing the quality of the audit carried out by providing the written working documentation for obtaining the evidence supporting the audit conclusions.

7.1.7 Audit Methods

Once the general and particular objectives have been settled by the auditor, the standard audit methods should be used for carrying out the work: interviews, questionnaires, collection of laws, rules and regulations concerning the tax administration activities as well as its financial statements, flowchart and procedures manual analysis, sampling, statistics analysis, bank mailing, sufficient ratios analysis, etc.

7.2 Performance audits

In addition to Financial and Regularity audits and the audit approach presented in the previous chapter, there are a number of questions that should be resolved by Performance audits. In that field an intensive use of the following audit techniques that are usually connected with performance audits is recommended:

7.2.1 Comprehensive usage of analytical and/or statistical analyses

In auditing tax and tax collection processes the assessment of economy, efficiency and effectiveness is especially useful, because there are a number of inefficiencies and in some

cases even types of fraud that can be detected only through analytical procedures and/or statistical comparisons with similar population.

For example: If the tax is not declared there is no material source of information in the tax administration that could help auditors (and tax administration) to identify such taxes/revenues as missing. The assessment can only be achieved through indirect analytical/statistical analyses.

Because of the uniqueness of the tax administration process auditors should make use of operative international databases about fiscal data (e.g. VIES), that would help to evaluate the operational effectiveness of the tax process in every single country.

7.2.2 Evaluation of completeness, effectiveness and feasibility of performance indicators

There are a number of performance indicators that tax administration usually use for performance evaluations of tax processes and tax management. It should be the role of SAIs to assess those performance indicators in respect of the completeness, effectiveness and feasibility. Should there be no legal obligation for SAIs to check the correctness of calculating the indicators, the calculations should be tested by performance audits on a voluntary basis. For easier comparison auditors should use the experience of other SAIs to obtain a set of recommended indicators for benchmarking tax processes and tax administrations.

7.2.3 EU-wide cooperation

Because of the cross-border nature of VAT, there is a strong need for establishing permanent international cooperation in performing audits of the VAT collection process and related issues (effectiveness of internal control in the VAT collection process, availability and integrity of data in VIES, etc.). The administrative cooperation has its legal basis in the Council Regulation (EC) No 1798/2003 (Official Journal of the European Union L 264, p. 1).

Further such cooperation in executing performance audits helps develop SAIs' competence by sharing methodology and audit approaches.

However, in the individual EU Member States there are different roles and responsibilities of SAIs, that reflect different mandates and natures of the audit, the standards to be used and methods of reporting to the legislatures or the governments. For this reason and to avoid any legal problems SAIs should use either a concurrent or at least a coordinated audit approach for auditing international tax issues.