

AUDIT OF PUBLIC REVENUES

Sub-theme III

Audit approaches and audit impact

Discussion paper

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Table of contents

| | |
|--|-----------|
| Introductory remarks | 3 |
| Audit authority in relation to different levels of government – cooperation with Regional Audit Institutions. | 4 |
| Audit objectives. Types and scope of audit. | 5 |
| Audit objectives | 5 |
| Types of audit | 5 |
| Audited bodies (auditees) | 6 |
| Audit approach (methodology) | 7 |
| Audit planning | 7 |
| Audit methods | 8 |
| Involvement of third parties – internal auditors, experts | 9 |
| IT tools | 9 |
| Access to IT systems of the tax authority | 9 |
| Audit impact | 11 |
| Reporting – schemes and receivers | 11 |
| Certification of accounts | 11 |
| Major audit findings | 12 |
| Key results | 12 |
| Recovered revenues | 13 |
| Follow-up activity | 13 |
| Advisory function | 13 |
| Case studies | 15 |
| Discussion points | 16 |

Introductory remarks

The Supreme Chamber of Control as the chair of the Sub-theme III Working Group would like to thank to the members of the group (Germany, Romania, France) and the chairs of the other two groups (the Netherlands, the United Kingdom) for their contribution during the elaboration of this paper.

We would like also to thank to all the SAIs that responded to the principal paper¹. The total number of countries covered in this study is 26 plus the European Court of Auditors.

The studied materials were different as far as the level of details is considered. Some countries answered directly to the questions included in the questionnaire, while others provided only general comments on the highlighted problems. Therefore, in some cases it was impossible to draw concrete conclusions.

The main objective of this paper is to present approaches applied in public revenues auditing and the impact this kind of audit has on the functioning of public finance (especially on public revenue). All information regarding background for public revenue auditing (i.e. basic figures for taxes, tax administration organization etc.) are covered by Sub-theme I and II papers.²

Every section of this paper is organized in the following way:

- results summarizing information from country papers,
- conclusions.

Generally, the structure of this paper reflects the structure of the principal paper. At the end of the paper we suggest some discussion points (*issue areas*), which should be treated as a starting point for discussion at the Congress. In order to learn from

¹ The SAI of the following countries responded to the principal paper: Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, Germany, Greece, Ireland, Italy, Kazakhstan, Macedonia, Malta, Moldova, the Netherlands, Norway, Poland, Portugal, Russia, Slovakia, Spain, Sweden, Switzerland, Turkey, the United Kingdom, Ukraine and the European Court of Auditors. The country papers submitted later than October, 31 (the original deadline: September, 30) have not been covered by this paper – therefore, some of the countries that have sent their papers have not been included in the analyzed group.

² Answers to the questions 1-8 from questionnaire for subtheme III regarding *The importance of audit of public revenues* and *Audit Environment* are included in subtheme I discussion paper.

each other and to make the discussion more substantial *case studies* selected from responding countries will be presented at the Sub-theme III session.

Audit authority in relation to different levels of government – cooperation with Regional Audit Institutions.

Results:

Some SAIs are not entitled to audit all levels of government. In those countries – but also in the countries where SAIs are entitled to audit all levels of government – there is usually a complimentary system of Regional Audit Institutions (RAIs). Apart from SAIs and RAIs, there can be other institutions (listed below) authorized to audit revenues of the local government:

- a department or division within the corresponding ministry (at least 2 countries),
- private sector auditors - e.g. engaged on contract by the SAI (at least 2 countries).

There are many forms of cooperation between the RAIs and the SAI in the surveyed countries: written exchange of information, regular meetings of working groups, bilateral and multilateral audit agreements, joint audits, determination of priorities for the audit in the local administration, exchange of employees, professional training.

Conclusions:

- not each of the SAIs may audit local government, therefore there is a need for different forms of close cooperation between SAIs and RAIs.

Audit objectives. Types and scope of audit.

Results:

Audit objectives

The goals of public revenue auditing are formulated in a different way in almost every country. Anyway, they can be summarised under the following three objectives:

- verification of the legality of transactions and administrative decisions related to tax assessment and collection,
- verification of the reliability of financial data presented by tax authorities,
- verification of efficiency and effectiveness of tax administration activity.

In the studied group there is only one SAI that is not entitled to audit public revenues.

Types of audit

In order to fulfil the above-mentioned audit objectives, different types of audit are applied, respectively:

- Regularity or compliance audit
- Financial (certification) audit
- Performance (VFM) audit.

In the process of auditing public revenues, the countries in the analyzed group apply:

- only financial or regularity audit (4 countries),
- a combination of financial and regularity audit (1 country),
- a combination of financial and performance audit (9 countries and the ECA),
- a combination of regularity and performance audit (4 countries),
- a combination of regularity, financial and performance audit (6 countries).

Results indicate that the majority of the SAIs apply a complex approach to public revenue auditing.

Even if the SAI carries out different types of audit, the majority of their effort is placed in financial/regularity audit. The SAIs reported that about 60% of their resources goes to financial/regularity audits, while the rest goes to performance auditing. However, some countries reported that in recent years there has been a shift towards increasing the number of performance audits. To sum up, financial/regularity audit is the main part of the SAIs' work in the area of public revenue auditing, but performance audit has become more important in recent years.

Within each of the mentioned audit types some countries reported on the following sub-types:

- horizontal audits or cross-sectional audits – carried out on a government-wide basis to cover a particular issue
- audit surveys – deciding about the further work,
- follow-up audits – investigating whether corrective actions have been undertaken,
- selective audits – investigation related to specific enquiries and cases.

Audited bodies (auditees)

All the SAIs can audit the tax administration, but only a few (4 countries) reported that they can audit directly private tax collectors (employers paying tax on behalf of taxpayers) or taxpayers. However, the majority of countries reported that SAIs can audit them indirectly – within the framework of cooperation with the relevant tax services.

Conclusions:

- Financial/regularity audit is the base for the SAIs' activity, but the number of conducted performance audits has increased in recent years,
- Since performance audit has become a more important part of SAIs' activity in recent years, there is a need to discuss possible benchmarks in the activity of tax administrations for appropriate evaluation of their efficiency,

- More complex audits require an answer to the question *how to organize them in an optimum way: whether to conduct performance and financial/regularity audit separately, or not.*
- Since taxpayers are not audited by the majority of the SAIs, there is a need for cooperation with tax audit services – this is the only way to completely verify the correctness of the collection process accomplished by the tax administration.

Audit approach (methodology)

Results:

Audit planning

Almost all the SAIs covered in this study reported that they operated basing on annual audit plans. In a few cases (2 countries), annual plans are divided into smaller periods (quarters or semesters). Concurrently, the SAIs also try to plan in a longer perspective; medium-term audit plans are in place (for strategic purposes – setting up priorities).

Annual audit plans cover audits that are required by law (usually certification/financial audits), ordered or requested by the parliament or its committees, suggested by the government (usually the SAIs are free to accept or reject such requests) and, finally, audits conducted at the SAIs' own initiative. For the audits left to the SAIs' own initiative, the SAIs choose audit subjects (topics), basing on the risk assessment (that usually starts already at the stage of the state budget execution) and the materiality of the analyzed problems. In the group of the countries that reported in the questionnaire on the composition of the annual plan, the vast majority of audits conducted during the year is determined by the SAIs themselves – the legally required audits are only 10-30% of the total number of audits carried out during a year.

Usually, there is no special planning procedure for revenue audits; there is a general framework regarding both revenue and expenditure audits. In the countries with well-developed internal audit systems (with a long tradition) internal audit work is used in the process of audit preparation. During the designing stage of a particular audit

program, the SAIs take into account previous audits' results. They also conduct a system analysis (legal position, macroeconomic environment etc.), and/or they carry out risk analysis that allows to determine the level of testing (the details to be investigated) during the audit.

Audit methods

Generally, public revenue auditing is conducted within the framework of methodologies developed by the SAIs, basing on the international standards of INTOSAI or/and IFAC. In other words, the SAIs have usually their own auditing handbooks/guidelines, which have been developed taking into account the above mentioned standards and *best practice* coming from their own experience.

Depending on the risk analysis and materiality levels, different methodologies are applied in public revenues auditing (among others):

- audit sampling and other selective testing procedures (applied if there is no possibility to examine all information regarding audit subject),
- evaluation of internal audit systems and the use of internal auditors' work,
- assessment of audit risk,
- analytical procedures (based on indicators, tendencies and other significant qualitative reflections of auditee's activity),
- on-the-spot verification,
- use of the work of experts,
- questionnaires, interviews etc.

Usually, a combination of qualitative and quantitative methods is used. The scope of applied methodologies may vary in different kind of audits (financial versus performance audit). Generally, techniques for public revenue auditing are the same as in any other kind of audit – only their combination may differ. For example, the majority of countries reported the use of sampling and analytical procedures, i.e. tools applied when there are a lot of data to be covered in an audit.

Involvement of third parties – internal auditors, experts

In the analyzed group of the countries almost all audit work is carried out by the SAIs themselves. It does not mean that the SAIs do not use external sources of information. Especially, in the countries with an established long tradition of internal audit departments, the SAIs use their work quite extensively. The SAIs from the countries where internal audit departments are relatively new in the administration declared that as internal audit systems will be developing, they will be using more and more of internal auditors' work. As far as the use of the expert work is considered, the SAIs reported that it is used very seldom (limited sources for this kind of activity) and only in cases when an audit has to cover a specific, highly specialized, area.

IT tools

In their audit work, the SAIs actively use IT tools. In the studied group, only 3 countries declared they do not use any specific software package for public revenue auditing. Generally, there are two kinds of software applications used:

- tools applications supporting auditors in the use of statistical and mathematical methods,
- archiving applications allowing auditors to organize documents produced and collected at each stage of the audit.

There are applications developed independently by SAIs and standard packages used by many SAIs. In the case of tools applications 5 countries reported the use of IDEA (Interactive Data Extraction and Analysis), 3 – ACL (Audit Command Language).

Access to IT systems of the tax authority

As far as SAIs' access to computerized systems of tax authorities is considered, there were three kinds of answers reported in the country papers:

- None (5 countries).

- No direct (on-line) access, but access is possible indirectly – on the request of the SAI (8 countries).
- Yes (11 countries + the ECA).

The results indicate that access to computerized systems of tax authorities is in most cases possible, but it is not necessarily direct.

Conclusions:

- Although annual planning is the basic form of planning across the analyzed countries, the medium-term planning perspective becomes more popular.
- The majority of audits is conducted at the SAIs' own initiative. Therefore, risk analysis, and materiality analysis set up the main course of actions for audits.
- Public revenue auditing is conducted on the basis of methodologies that are in line with the INTOSAI or/and IFAC standards.
- The majority of the analyzed countries use software applications in order to support auditors with data processing and/or archiving audit documents.
- The majority of the studied countries has access – direct (on-line) or indirect (on request) – to computerized systems of tax authorities.

Audit impact

Results:

Reporting – schemes and receivers

Generally, there are three main potential recipients of the SAIs reports: auditees, supervision bodies (including both administrative units and the Parliament) and the public. The most important one among them is the Parliament – a body that all the SAIs are obliged to report to.

Auditees are usually informed about audit results in the form of management letters. It allows them to autonomously adopt self-corrective measures in relation to the concluding remarks and recommendations included in the letter.

The final reports are usually sent also to the responsible minister, which is another way of exerting pressure on the auditee to implement the recommendations. The minister is a very important recipient of audit findings in case of public revenue auditing, since the Ministry of Finance coordinates the work of the whole tax administration.

A very effective tool for exerting pressure on auditees to implement recommendations is also informing the public about general audit results. Some of the SAIs publish their reports on their websites. Audit findings are also announced at press conferences and briefings. The SAIs applying such an approach reported that their audit findings received a lot of attention from the media (the press, TV).

Certification of accounts

Generally, the SAIs issue different opinions reflecting different audit findings – there are at least three levels of evaluation: negative, positive, and positive with reservations. There is no universal pattern for a final opinion – its shape is usually prescribed by the law. Some SAIs use a commercial style opinion, while others (a vast majority) use a country-specific approach. In case of financial audit, the SAIs issue an opinion on the accounts (usually some kind of assurance that the accounts are correct) – but it is a general opinion rather than an opinion issued specifically for public revenue.

Major audit findings

The main audit findings for public revenues reported by the studied group of countries are as follows:

- Some of the legally prescribed revenues have not been collected (poor assessment both for tax and non-tax revenues) or no action has been undertaken in order to collect receivable taxes and other revenues (high level of tax and non-tax arrears). Both situations result in tax loss.
- Weakness and loopholes in the legal framework – the regulatory area is a very usual cause of irregularities found in tax administrations.
- Unsatisfactory internal control procedures resulting sometimes in a poor quality of management in the tax administration.
- Delay in document processing, in the transfers of the collected money to the accounts of the state budget, in the registration of certain revenues and in the issuing of decisions by tax administrations.
- Lack of sufficient security in the tax IT-systems.
- Imperfect tax reimbursement systems – tax expenditure schemes are sometimes impossible to be evaluated from the point of view of their effectiveness.

The reported results present a great variety of problems faced in public revenue auditing. Depending on the type of audit, different types of findings can be discovered. Financial/regularity audits usually indicate weaknesses in the legal framework, internal audit systems etc., while performance audits focus more on efficient management systems. Generally, only both types of audit together can give the full picture of tax administrations' operations – whether they are correct and efficient, or not.

Key results

The major results achieved by the SAIs in the area of public revenue auditing:

- Repayment of tax foregone (5 countries).
- Better compliance (14 countries).

- Change in legislation (9 countries).

As one can see, revenue audits are, first of all, focused on the problem whether tax administration fulfils all the legal and performance requirements. This is usually a basis for legal system improvements (if there are any weaknesses or loopholes). Repayment of the tax foregone is relatively seldom in the studied group of countries.

Recovered revenues

Only 4 SAIs reported that they calculate the sums recovered as an effect of their audits. Generally, there are two approaches applied to the calculation of the recovered money. The first one takes into account the money directly paid back to the budget (or the value of recaptured public property). According to the second methodology, it is necessary to estimate money saved by the implementation of the audit recommendations.

Follow-up activity

As far as the follow-up activity of the SAIs is considered, almost all the studied countries (19) and the ECA reported that they verify (monitor) implementation of their audit recommendations. The SAIs usually start every audit from the assessment of progress made by the auditee in the implementation of the previously made audit recommendation. Findings from that stage of examination are included in final reports – with the emphasis on the recommendations followed and recommendations ignored. In that context, it is a very uncomfortable situation for auditees if no progress is reported from year to year – especially if such information is made public.

Usually, all the audited bodies are requested (by law) to report within a specified period of time to the SAIs or the Parliament on their reactions to audit findings, comments and recommendations. It is also a common example of the follow-up since it forces auditees to implement recommendations.

Advisory function

The SAIs usually have no legal authority to advise the Parliament or the government at the stage of developing tax regulations. However, they can comment on proposals

during the drafting stage on request of those institutions. In such cases the SAIs' comments are based on their audit recommendations. Besides, audit recommendations themselves point out weaknesses in the regulatory area and this is how changes in the existing law may be prompted.

Conclusions:

- A broad system of reporting – covering the informing of the Parliament, the Government, auditees and the public about audit findings – is a principal condition for effective external audit.
- Informing the public about audit findings via internet or other media increases pressure on audited bodies to implement audit recommendations.
- There is no specific and universal format of opinion used for evaluating public revenue systems.
- The reported results present a great variety of problems faced in public revenue auditing.
- The majority of revenue audits focuses on the problem whether tax administration fulfils all the legal and performance requirements.
- The calculation of the recovered money in public revenue auditing is not popular among the SAIs.
- All the SAIs reported that they verified (monitored) implementation of their audit recommendations.
- The SAIs play an important role in the development of the legal framework in the area of public revenue – both via a direct advisory function or indirectly by audit recommendations regarding changes in the law.

Case studies

22 out of the 26 countries covered by this study and the European Court of Auditors reported examples of public revenues audit worth discussing at the VI EUROSAI Congress. Those case studies – as mentioned at the beginning of this paper – will be a major point of discussion at the sub-theme III session. In this way, the main objectives for discussion in the sub-theme III, as defined in the principal paper, i.e.:

- definition of the major problems that Supreme Audit Institutions (SAIs) deal with while carrying out public revenue audit;
- searching together for solutions of discussed problems; and
- sharing experience among SAIs

can be effectively and efficiently achieved.

The case studies reported in country papers reflect the variety of approaches applied in public revenues auditing and its impact on the public finance system in specific countries. Since it is impossible to present all the examples at the Congress it was decided to select *case studies* related to the problem '*Tackling the tax fraud – SAIs' role and methods of audit*'. In our opinion international context of that problem can enhance the need for cooperation among SAIs.

Each of the selected *case studies* will present the SAI's approach to audit through the following stages: audit planning, audit execution and post-audit activities. Each stage should be described by tools used and results achieved.

Discussion points

Case studies and the SAIs' own experience presented at the Congress should help to answer the following questions during the discussion at the Sub-theme III session:

1. (*6th ISSUE AREA*) What **types of audit** might be particularly helpful for examining public revenues?
 - Should SAIs focus more strongly on **performance (value-for-money) audits**? For what fields of audit would performance audits be appropriate (evaluation of tax incentive schemes, efficiency of the tax authority)?
 - For what audit fields would **regularity and compliance audits** be appropriate (for identifying weaknesses in the application of tax laws or in tax assessment and tax collection)?
 - Is it advisable to **combine performance audits and regularity and compliance audits in a single exercise**?
2. (*7th ISSUE AREA*) What **methods of audit design and audit conduct** have proven to be particularly successful (risk analyses, use of specific IT for auditing, follow-up audits, reliance on experts)?
3. (*8th ISSUE AREA*) What **types of cooperation** are useful?
 - How can **SAIs' cooperation be enhanced** in the field of taxation and especially in combating organised cross-border tax fraud? Are there adequate **legal provisions** in place (e.g. for the exchange of data)?
 - How might **SAIs whose mandates cover national, regional and local levels of government cooperate in the field of revenues**?
 - Is cooperation with the tax authorities, especially with the respective **internal audit service**, useful?

Each of the case study presenters will be asked to comment on the above mentioned questions basing on the presented example.