

AUDIT OF PUBLIC REVENUES

Sub-theme I

The significance of public revenues for public financial managers and for the Legislature's budget authority

Discussion paper

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1 Introduction

The objective of sub-theme I is to establish a foundation for sub-themes II and III with regard to the size, structure and management of public revenues in the various European countries. This overview has not been restricted to tax revenues but extends to other kinds of non-tax revenues, such as property income, administrative fees, sales, capital revenues, and European Union (EU) subsidies and grants. In the collection of data, tax allowances were treated as a special category (loss of revenues). Attention was also paid to the identification and description of the various organisations that deal with public revenues.

The sub-theme I working group, comprising the Supreme Audit Institutions (SAIs) of Austria, Lithuania, the Netherlands (Chair) and Portugal has prepared the discussion paper before you, summarising the information and concepts contained in, and the issues raised by, the country responses of 33 EUROSAI members¹ to the Sub-theme I Principal Paper. Some of the background information gathered by the Sub-theme III Working Group has also been included to provide a more complete picture. The discussion paper forms the basis for the sub-theme plenary session to be held during the EUROSAI Congress in Bonn in 2005, and for the preparation of conclusions and recommendations to be adopted by the Congress.

In addition to this discussion paper, a detailed analysis of the questionnaire results is available in the separate document – the Questionnaire Results Paper.

For the collection of the data, the working group used the figures and definitions of the International Monetary Fund (IMF), wherever possible². All members of EUROSAI were invited to confirm and complete a table with IMF-based data regarding the public revenues of their country. Eleven countries did so, and on the basis of the IMF figures (when available) the working group completed the

¹ Austria, Belarus, Belgium, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, Germany, Greece, Iceland, Ireland, Italy, Kazakhstan, Latvia, Lithuania, Malta, The Former Yugoslav Republic of Macedonia, Moldavia, The Netherlands, Poland, Portugal, Russian Federation, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, Ukraine, United Kingdom, the European Court of Auditors.

² To provide an insight into changes in public revenues over time, data are presented for a series of years, namely 1992-1997-2002. Where no data were available for 1992 and/or 1997 and/or 2002 another year has been selected, as close as possible to the standard year. It was not possible to indicate the actual year (where this differs from the norm) in the individual tables.

country tables for a further 19 countries (those from whom a completed questionnaire or full country paper had been received³). The graphs and data analysis in this paper and the accompanying annex are therefore based on information from 30 countries.

2 Public revenues

How important are public revenues?

The importance of public revenues is self-evident: without revenues, there can be no expenditure. Public revenues cover a broad spectrum. All countries tend to have comparable types of revenue, although the relative importance of the taxation types differs per country. It should also be kept in mind that public revenues are a significant instrument in the implementation of government policies. Some have their origins in tax legislation, others in the provision of services or in capital gains. Revenues extend to other kinds of (non-tax) revenues, such as property income, administrative fees, sales, capital revenues, European Union subsidies and grants. Although revenues proceeding from borrowing may represent a significant part of the State budget, these revenues have not been included in this discussion in order to keep the subject manageable.

In recognition of the importance of an efficient revenue collection system, Supreme Audit Institutions have for quite some time prioritised the establishment of revenue audits as a specialized and independent domain. The subject of the audit of public revenues was addressed by the INTOSAI Congresses held in Rio de Janeiro, Brazil in 1959, in Madrid, Spain in 1974 and in Lima, Peru in 1977. The theme has also been taken up at regional level, for example within the framework of the 4th ASOSAI Research Project on “Government Revenues – Accountability and Audit” (1998)⁴.

At the IX INCOSAI in Lima, Peru, the Lima Declaration of Guidelines on Auditing Precepts was adopted, which has since had a major influence on the development of government auditing in many countries of the world. Section 18, paragraph 3 states that all public financial operations, regardless of whether and

³ The country papers and completed questionnaires can be viewed on the VI EUROSAI Congress website (www.eurosai-2005.de).

⁴ See www.asosai.org.

how they are reflected in the national budget, shall be subject to audit by Supreme audit institutions. Excluding parts of financial management from the budget shall not result in these parts being exempted from audit by the SAIs. Article 20 is specifically dedicated to tax audits. It provides for auditing the regularity, the systems and efficiency of tax collection as well as revenue target achievement and providing advice to the legislative body, and thereby provides SAIs with the key tools for successful revenue auditing. As a result, the fundamental principles enshrined in the Lima Declaration are still valid for revenue auditing today.

The importance of the Lima Declaration is underlined in the preamble of the INTOSAI Code of Ethics and the Auditing Standards, issued in 1992 by the Auditing Standard Committee and restructured and approved in 2001 in Seoul, South Korea. Whilst these are not mandatory for members of INTOSAI, the Auditing Standards reflect 'best practice' consensus amongst SAIs. Each SAI must judge the extent to which the standards are compatible with the achievement of its mandate.

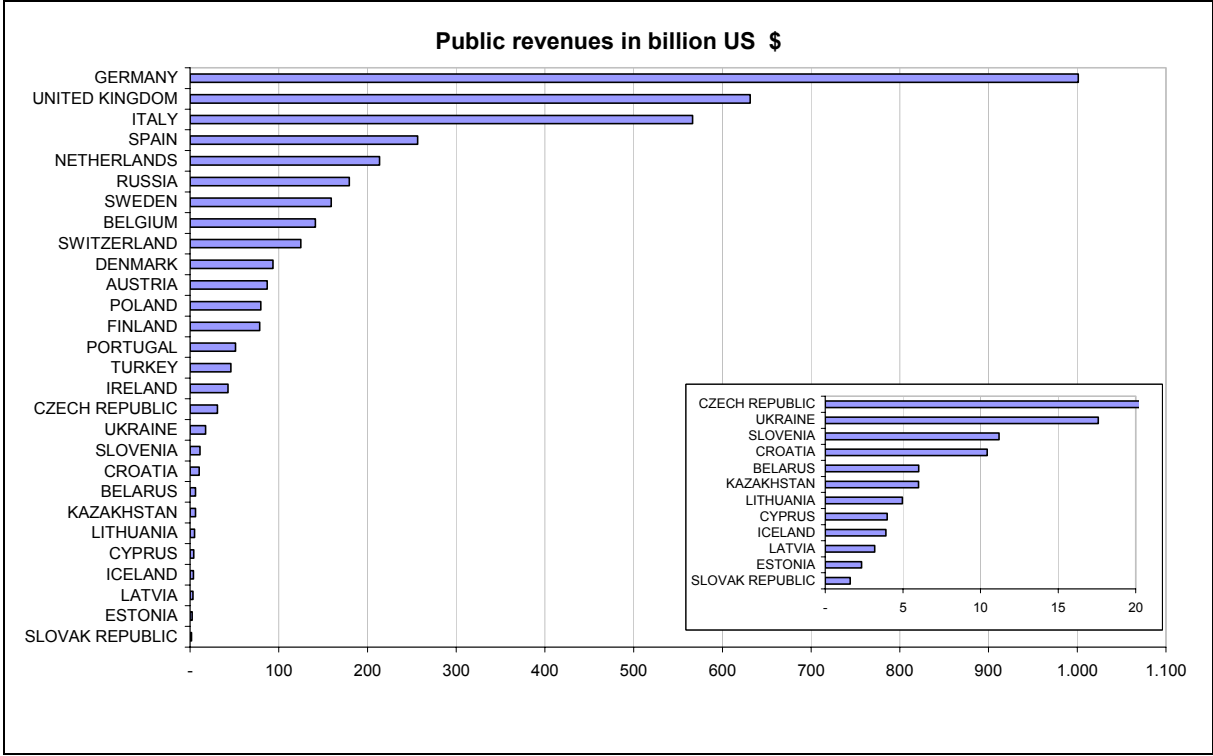
The INTOSAI Auditing Standards provide a general framework for the establishment of procedures and practices to be followed in the conduct of an audit. Some standards are related to the audit of revenues (see paragraphs 2.2.7 and 3.6.4, for example). The framework, however, provides no specific guidance for the audit of revenues, including tax audits. Nor do other auditing standards (e.g. EUROSAI, International Federation of Accountants – IFAC) provide such guidance.

With respect to revenues, the Public Sector Committee (now the International Public Sector Accounting Standards Board) of the International Federation of Accountants in January 2004 released an Invitation to Comment about Revenues from Non-Exchange Transactions (including taxes and transfers). This document presents proposals for the recognition and measurement of revenues from non-exchange transactions in the general purpose financial statements of the public sector entities.

The importance of public revenues and of developing adequate standards for auditing them underlines the relevance of the theme of the VI EUROSAI Congress in Bonn.

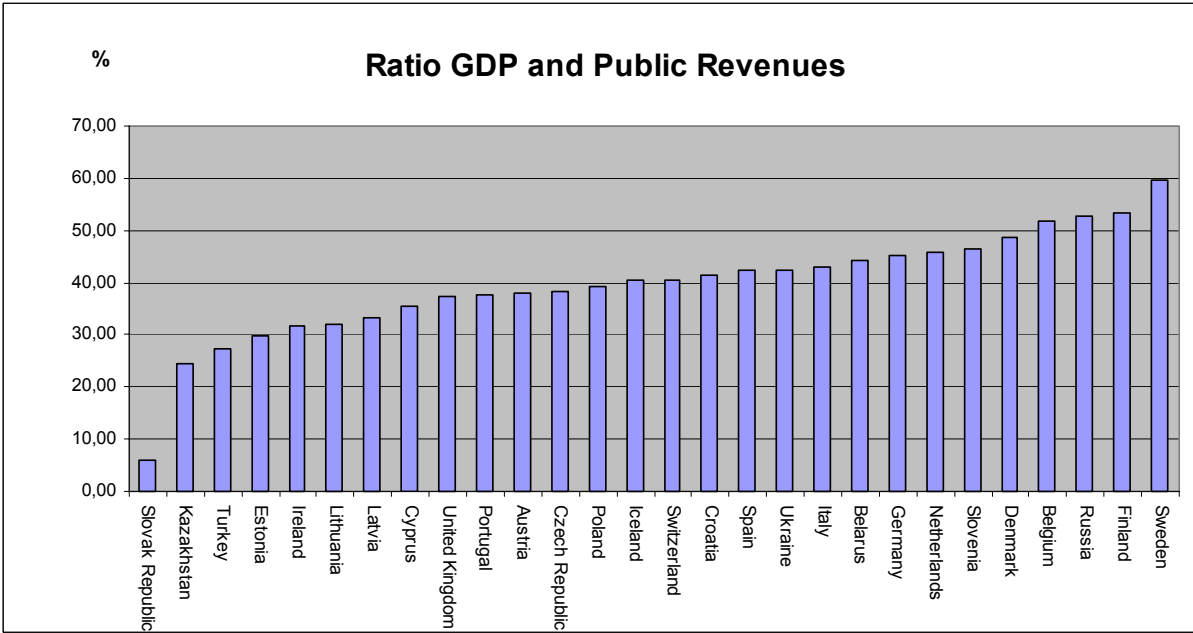
The following graph presents the magnitude of public revenues per EUROSAI country for the year 2002.

Graph 1



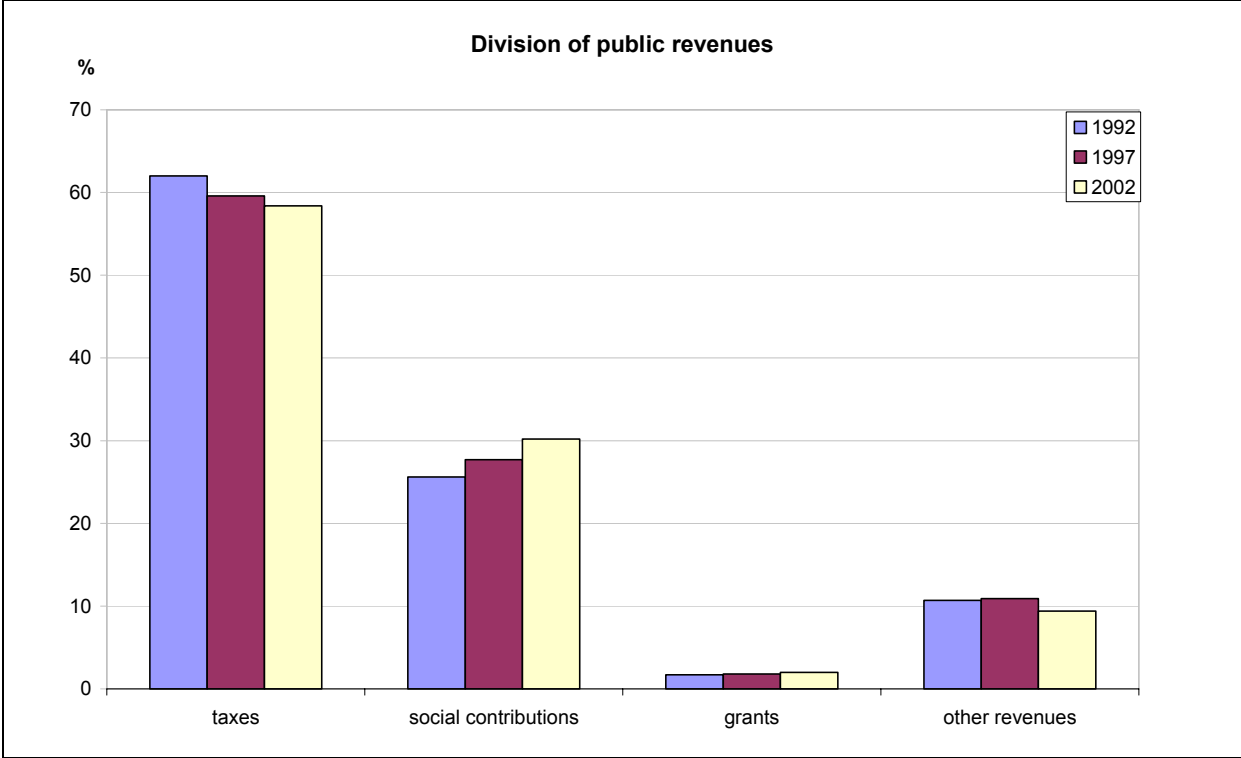
The following graph shows the ratio between GDP and public revenues.

Graph 2



The following graph shows the division of the total public revenues at the level of central government for the years 1992, 1997 and 2002.

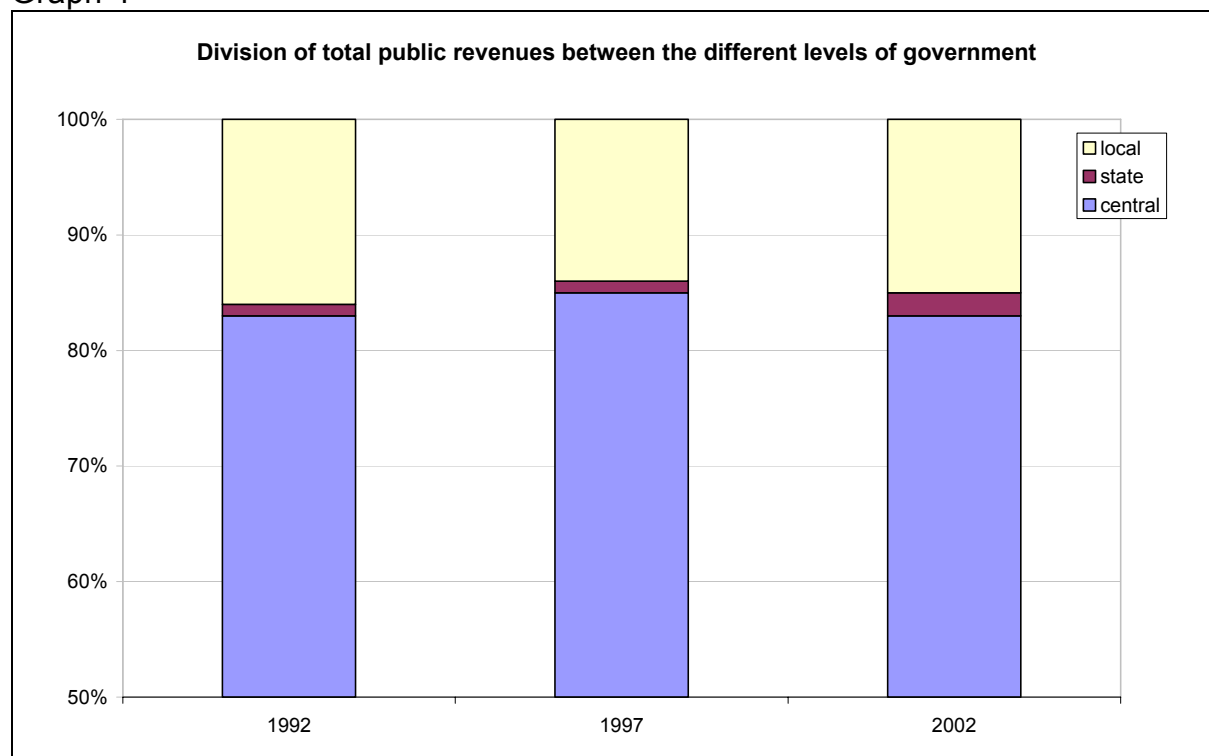
Graph 3:



The graph shows no substantial changes in the division of the total public revenues over the chosen years. Taxes and social contributions are by far the most important categories of public revenue for all countries (see annex table 2).

Each level of government has its own revenues. In most countries the state and local levels receive a set portion of the tax income. In the graph below these financial flows are eliminated. The graph shows the division of the total public revenues over the three levels of government.

Graph 4



The allocation of responsibilities and revenues among different levels (central, state, local) of government varies noticeably across the countries. Usually, the central government collects the majority or all of the revenues. From the graph it is clear that the central government is in general responsible for the collection of about 85% on average of the total public revenues (see annex table 3). Only a relatively small amount of receipts is collected directly by local government, but there is a tendency towards increasing the share of own revenues in the total revenues of the local authorities. Only a few countries have also a state-level.

2.1 Tax revenues

Social contributions taxes or not?

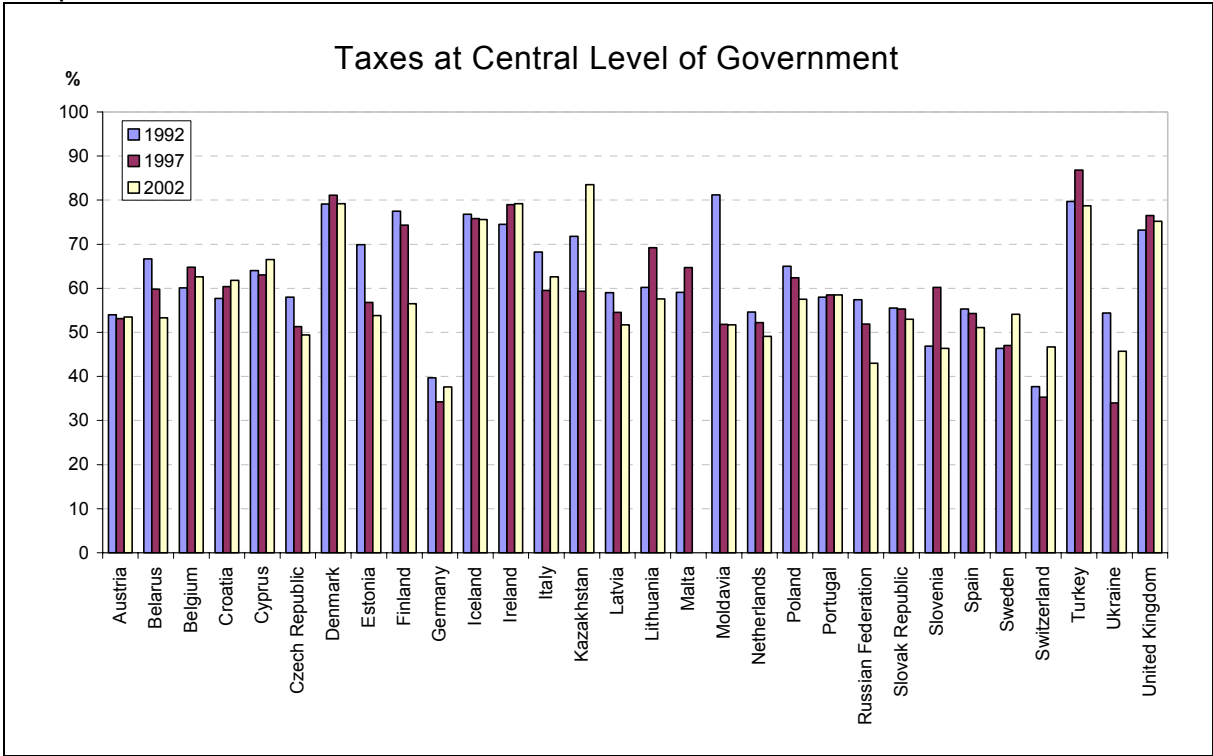
Due to their obligatory nature, social contributions can be regarded as a form of taxation. Opinions differ on this point. In this paper, they are included as a separate category. Therefore, when the tables and text refer to taxes, social contributions are not included.

In almost all countries, the portion of public revenues taken up by social contributions is rising. Over the years in question, the average percentage has increased from 26% to 30%. A few countries have percentages higher than 40%

and at the same time there are a small number of countries with social contributions below 20% (see annex table 4). The different trends in tax revenues and revenues from social security contributions are likely to be attributable to the fact that, in many EUROSAI countries, tax revenues have declined due to poor economic growth and tax reductions, while social security contributions have increased mainly owing to the unfavourable economic and demographic trends.

In the EUROSAI member states, tax revenues are the most important source of revenue for funding public expenditure budgets. Taxes levied by central government account for between 45% and 85% of the total public revenues.

Graph 5:



Over the period analysed, the average tax portion of the total revenues declines slightly from 62% in 1992 to 57% in 2002. More details can be found in the table 5 in the annex.

The ratio of the revenues from direct taxes to the revenues from indirect taxes differs widely among countries. In about 30 % of the analysed countries (mostly the West-European countries) the portion of direct taxes is equal or higher than 50% of the amount of taxes.

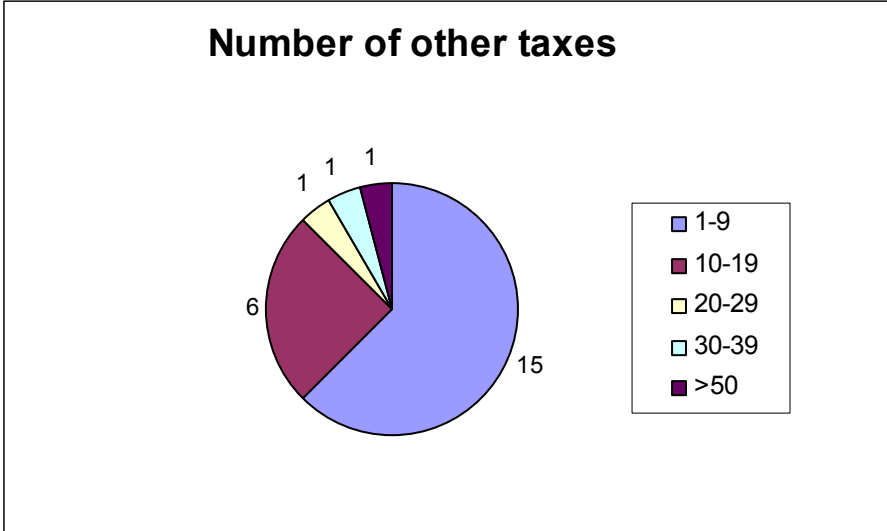
Where countries have several levels of government, each of them receives a portion of the tax revenues. A minority of countries (30%) reported that there were taxes shared by the local and central government.

The taxes most often mentioned by the respondents are income tax, corporate taxes, Value Added Tax (VAT), and excise and duties. These four taxes account for between 34 and 95 % of the total public revenues of the central governments.

The majority of countries (18) reported that these 4 taxes account for 60 to 90% of the total revenue. The number of 'other tax types' range from 1 to 50, as shown in the diagram below.

This is shown in the graph below

Graph 6



Although the contribution to the total revenues of the four largest taxes shows a wide spread, there are no apparent abnormalities. The numbers are spread evenly across the range. A large number of *other taxes* might be expected where the revenue of the four largest taxes is relatively small, or vice-versa. The figures do not reveal such a correlation, however.

Reorganisations widespread

Each country has its own tax authority. For audit purposes, it is important to have an insight into the tax authority's organisation and working practices, as well as into its relationship with parliament and the public.

Generally, in those countries where taxes are collected both by the central and by the local governments, there are two separate tax administrations reporting to the corresponding bodies. The central tax administration reports to the Ministry of Finance and the local tax administration – to the local government.

There are at least three dimensions of specialization in tax administration across the analysed countries:

- territory specialization – tax offices specialize in the bodies in a specified territory,
- homogenous taxpayers specialization – tax offices specialize in large corporations, medium and small companies, and individuals,
- tax specialization – tax offices specialize in different kinds of taxes.

The work of the tax administration is considered by most countries to be an inherent governmental function that cannot be transferred to third parties. However, a small number of countries did report that third parties are engaged in the execution of parts of the tax authority's primary process. The transfer of responsibility for liability calculations from the tax-authority to the taxpayer him/herself has not been counted as outsourcing.

Most countries indicated that there have recently been significant changes in either the organizational structure of the tax authority – a result of information system changes and/or European Union influences – and/or changes in the taxation process. About half of the responding countries have integrated their tax and customs authorities. Most of the changes have had a positive influence on the efficiency and effectiveness of the tax administration.

Does Parliament have influence on the tax authority's audit policy?

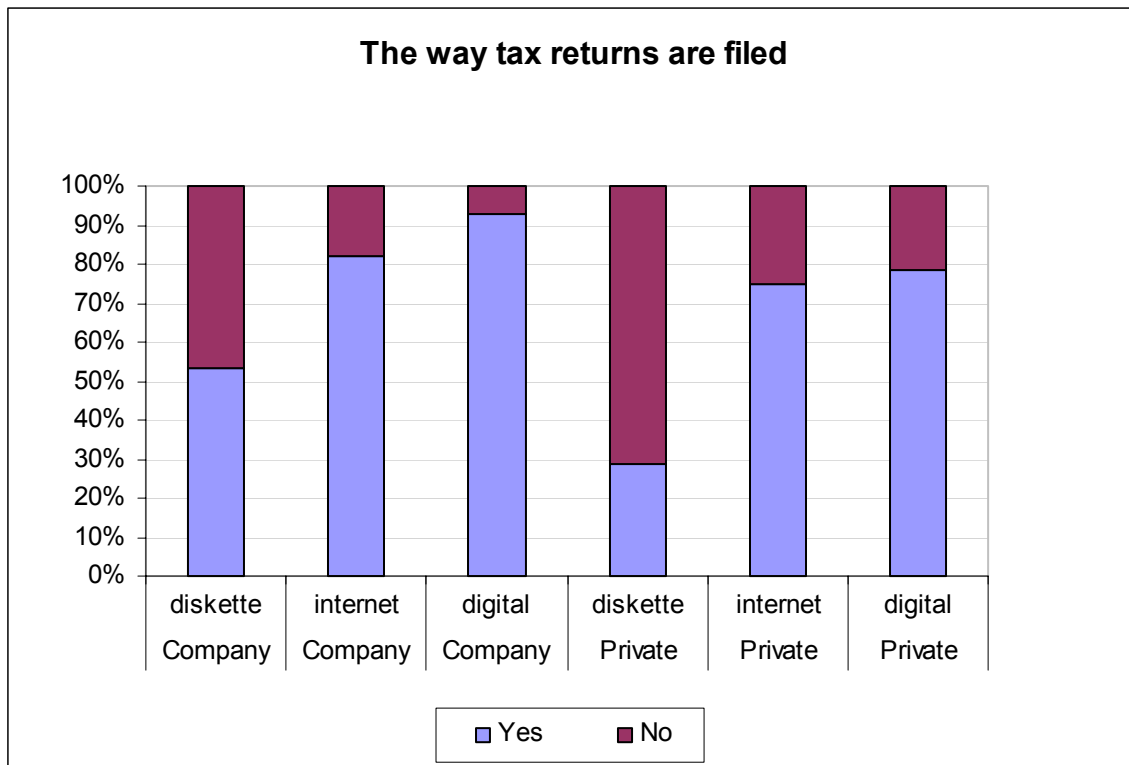
Most countries stated that Parliament is involved in the creation and modification of taxation and in setting the level of taxation. According to most Supreme Audit Institutions, Parliament does not have a direct influence on the tax authority's audit policy. A few countries responded that if shortcomings come to light (for instance via the media) Parliament calls the responsible minister to account, which can indirectly influence the audit policy.

Automation increasing

About 80% of the countries allow businesses and private taxpayers to file their tax returns digitally (by internet and/or by diskette). Only a minority of countries do not offer private taxpayers the possibility of filing electronically.

The graph below shows the way tax returns are filed.

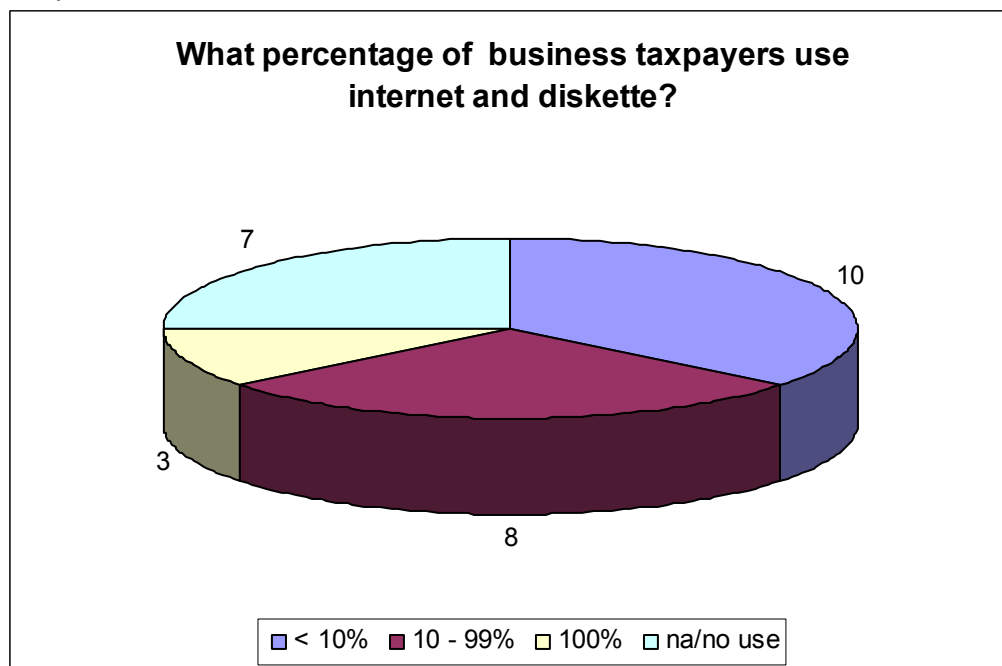
Graph 7



In a relatively large number of countries (10) the percentage of businesses that make use of the above-mentioned facilities is less than 10 %. Eight countries show percentages between 10 and 100%. Three countries show percentage 100%. For private taxpayers, the percentages are slightly higher.

The next graph shows the use of internet and diskette

Graph 8



The full spectrum of 0% to 100% can be seen with regard to the use of digital facilities.

In many EUROSAI member states, considerable progress has been made on the electronic filing and processing of tax data. Electronic filing is clearly a trend.

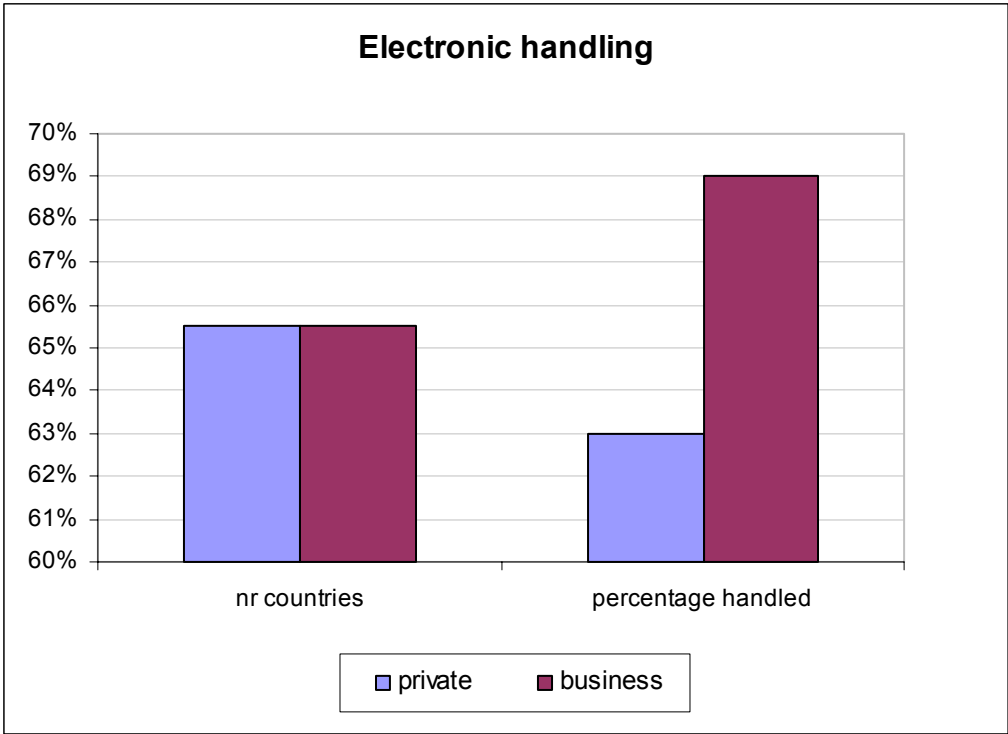
Computerised tax auditing not yet widespread

The majority of countries do have electronic access to data for processing tax returns, especially with regard to private individual salaries, prior year records and ownership of immovable property and vehicles. Regarding the ownership of vessels, mortgages and personal credits, most countries do not have electronic information available for processing.

In most EUROSAI countries, little progress has been made in the computerisation of tax assessments and tax audits. A relatively small number of countries have fully automated their tax audits. The portion of tax audits that are handled by computer is higher for business taxpayers than for private taxpayers. Some countries stated that only validity checks are carried out by computer.

The graph below shows the level of automation of the tax audit.

Graph 9

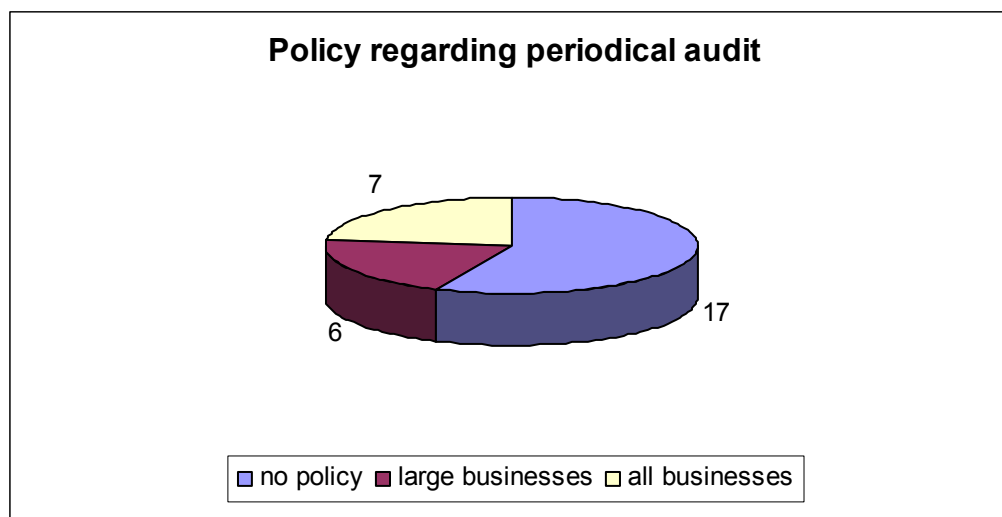


Is auditing the taxpayer every year a must?

Approximately half the countries analysed have policies regarding the periodicity of tax audits. The majority of EUROSAI member states make an effort to carry out tax audits at regular intervals, at least in cases where large taxpayers are concerned.

The next graph gives an indication of the existence of a tax-audit policy.

Graph 10



Non-financial information rare

All EUROSAI member states provide their Parliaments with financial information on tax revenues, either separately or as part of a greater whole. In most cases this occurs as a part of the annual report on the Ministry of Finance. Only a small number of tax administrations provide information in their annual report on aspects other than financial figures.

Eleven countries always include non-financial aspects in their annual report, such as the level of service, the number of tax penal proceedings and data on the accuracy of the processing of tax cases. Five of those countries include non-financial aspects in their annual report related to specific questions of parliament. In three countries the tax administration reports every year on effectiveness and efficiency indicators.

Two countries state that the minister responsible for the tax authority declares that the operations are in order (issues an 'in control statement').

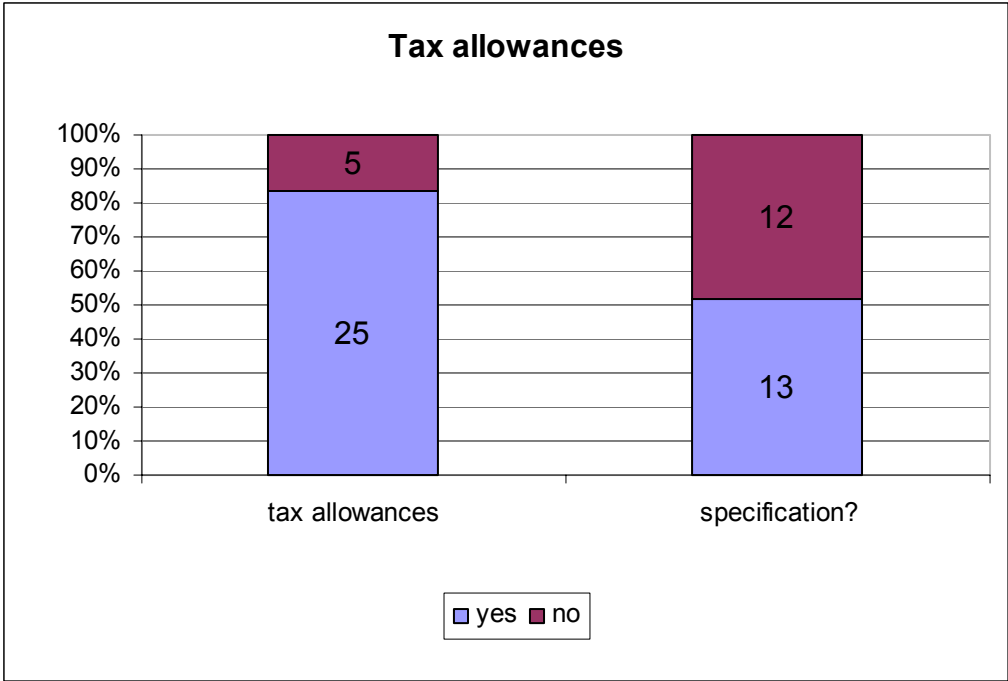
Tax allowances as a political instrument

Apart from fiscal objectives (such as covering public expenditures), tax policy in many EUROSAI countries also seeks to encourage economic performance and growth. In some countries, tax incentives with the character of subsidies reach a considerable magnitude.

Almost all countries allow tax expenditures (allowances). In most cases they are granted to improve the environment and to facilitate investments by companies. Half of the countries could not specify the amount involved in tax allowances. For the countries that could, the amount varies widely. Three countries reported that the tax allowances are not audited. Twelve countries answered that the responsible minister does not report on the efficiency and effectiveness of the tax allowances.

If tax allowances are allowed and the insight into amounts involved is shown in the next graph

Graph 11



Tax incentives can, in principle, only be granted by an Act of Parliament. 50% of respondents indicated that the tax authority has powers to allow exemptions, deductions and tax relief. These respondents added that this occurs “within the boundaries of the law”.

2.2 Other revenues and grants

Not to be underestimated

The category *other revenues and grants* is made up of a multitude of large and small financial flows. There are substantial differences in their importance between the countries and over the years. In many EUROSAI countries, *other public revenues* are usually of minor significance when compared to taxes, and are very diverse in nature.

Other public revenues are used largely for general budget funding purposes. Only by way of exception, or act of parliament, may certain revenues be used for specific purposes.

At the central level, the proportion of the *other revenues and grants* related to total public revenues varies considerably from one country to the next. For the years 1992, 1997 and 2002, the average percentage of this category was some 12% of the total public revenues. In 58% of the countries this category of revenues was below the average of 12%.

At the level of local government, the percentages of the category *other revenues and grants* are substantially higher than at the central level. The main reason for this is the financial flow from the level of central government to the other governmental levels. The average is about 43%. At the local level the percentage of countries in which the percentage of other revenues and grants are below that average is also 43%. (see table 6-7 in the annex).

All sorts

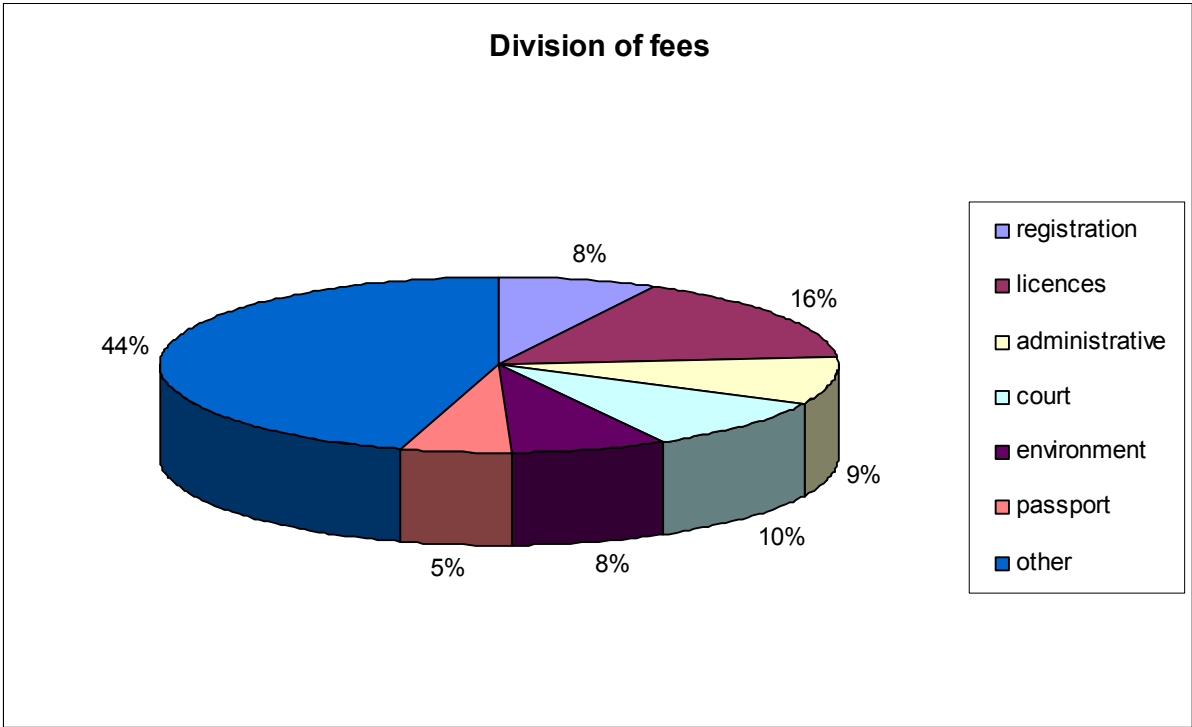
On the one hand, there are items such as fees for licences and other administrative fees from the sale of services. On the other hand, there is a wide range of financial flows of varying sizes, for example revenues from the sale of public land and natural resources and the income from state properties.

Fees a different category

Within the same country, public revenues from fees differ enormously in amount and in type between the different levels of government (where different levels exist), because they are linked to a wide variety of public services. There are compulsory fees and voluntary fees. Compulsory fees are levied for services, where the state has a monopoly – for example, passport fees. Voluntary fees are charged for various services, where the state does not have a monopoly.

The division of the different kinds of fees is shown in the graph below.

Graph 12



Who sets the rates?

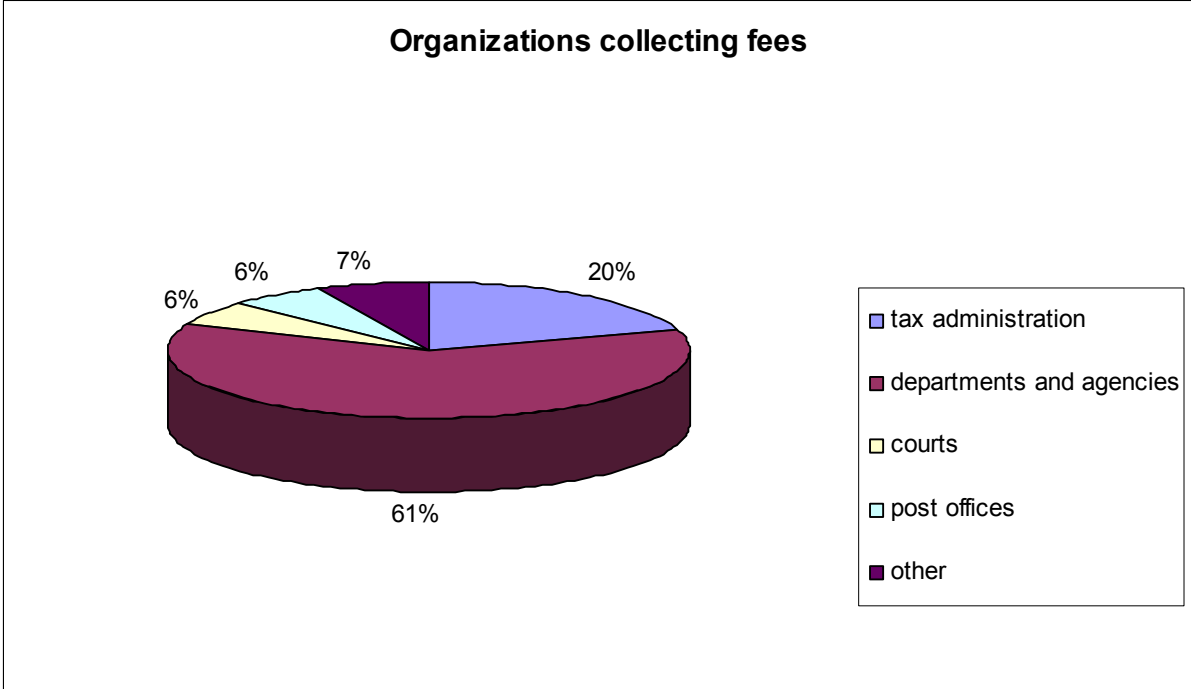
The rates for fees are mostly set by law and regulations. Ministries and the Parliament play an important role here. At the local level, local authorities fulfil that role. Voluntary fees are mostly set by the agencies themselves.

Government-wide collection

Most of the fees are collected through the ministries and/or their agencies. Local authorities are also mentioned by some countries, as well as the public bodies, which provide the services on which fees are levied (e.g. schools and universities).

The organizations responsible for the collection of fees are shown in the graph below.

Graph 13



It must be stressed that in the case of the agencies, the relevant powers have been assigned to them by legislation.

Auditing of fees in order

In nearly all countries fees are audited, either internally or externally. SAIs and regional/local audit offices are mentioned within the area of external audit, as are administrative courts.

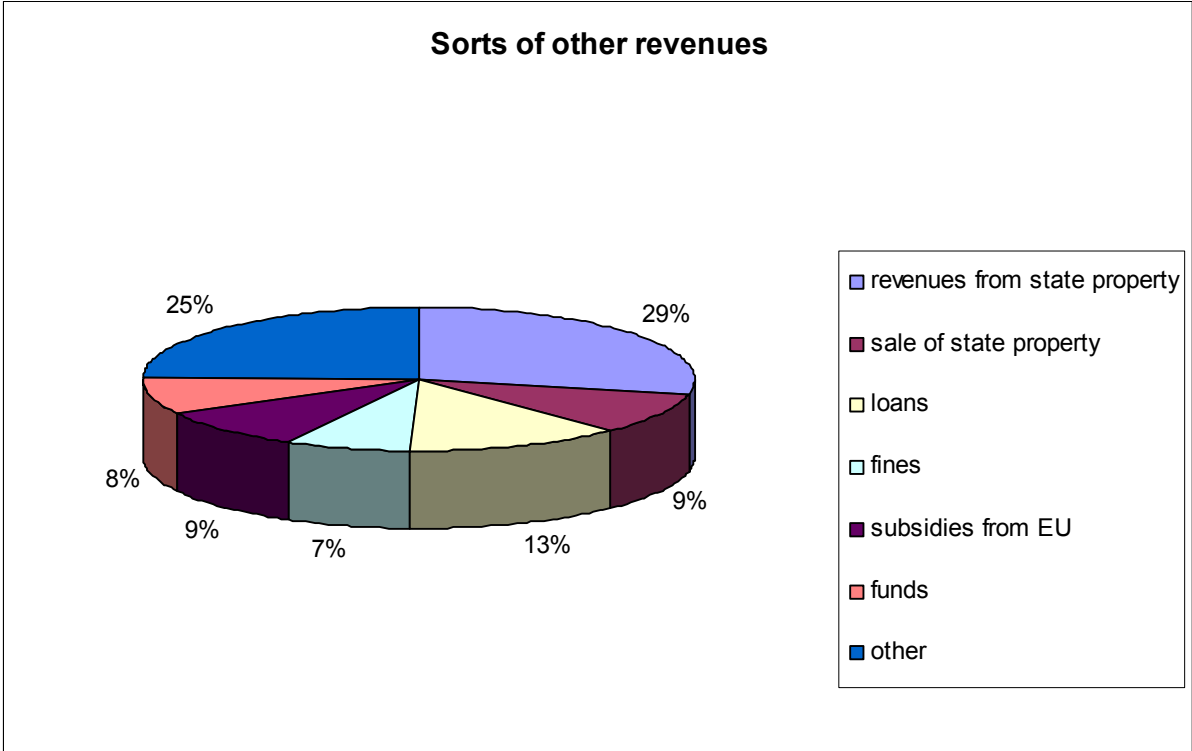
Many countries consider the audit of the fees as a regular task for their Supreme Audit Institution. In some cases a distinction is made between the levels of administration: local fees are audited by the regional/local audit institution and the central fees are audited by the (national) SAI. However, for 17 % of the countries fees are not audited at all.

Government as an entrepreneur

As entrepreneurs, all levels of government manage a wide range of financial flows of varying sizes.

The various sorts of other revenues are shown in the graph below.

Graph 14



By far the most frequently named categories comprise income from the sale of state property, income from state property, revenues from privatisation proceeds and various kinds of economic activity. Also interest on loans, dividend from financial assets' (from state-owned companies) and rent from other assets are mentioned by several countries.

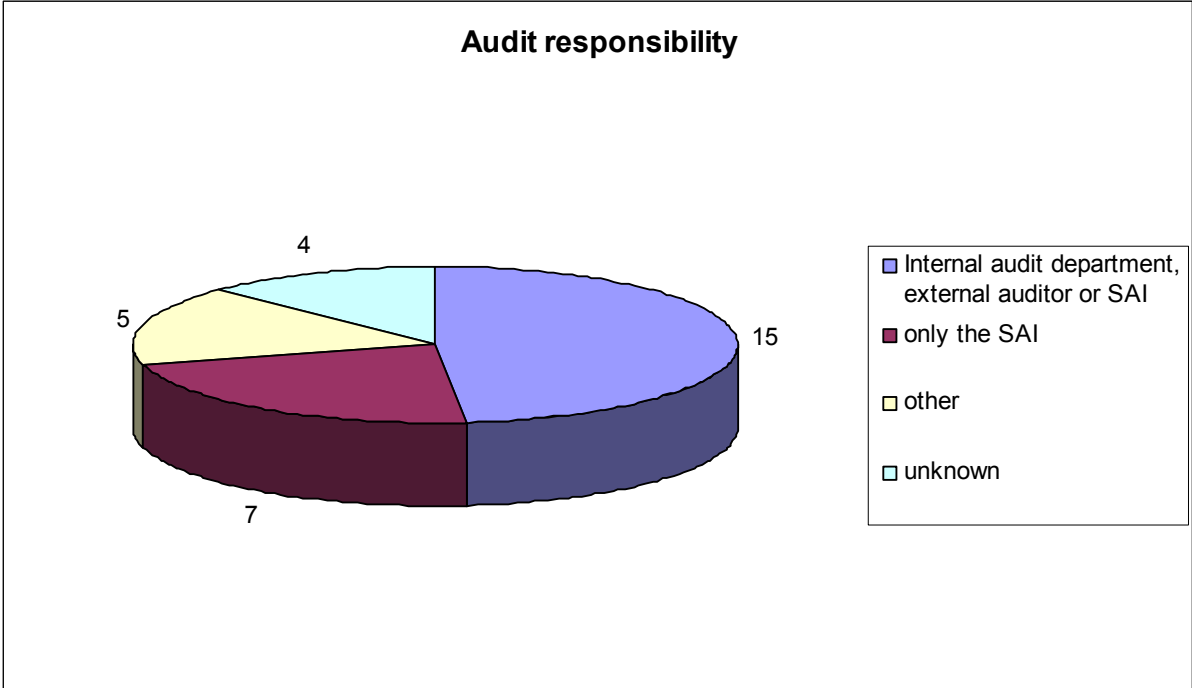
Who is responsible for the management and outcomes?

In most of the countries, the Ministry of Economic Affairs and/or Finance (tax authority) and its/their agencies are responsible for managing the financial flows.

The determination of the amount of payment/revenue is often regulated by law and/or regulations. If it concerns the sale of a major property of the state, the revenue is often the outcome of a negotiation process. If it concerns interest, for example, then the conditions and percentages are laid down in specific documents. Recent trends show a growing consideration for economic factors rather than just administrative procedures.

The audit responsibility is shown in the graph below.

Graph 15



Almost all of the Supreme Audit Institutions have audit powers and use that power on a regular basis.

Some SAIs refer to the audit responsibilities of local authorities and, as far as external control is concerned, to regional audit institutions.

Grants a special category

At the level of Central government not all of the countries have grants. The average percentage of the grants in relation to the total revenues is about 1,8%. In three-quarters of the countries the revenues from grants are even below that level. At the level of local government, almost all countries have grants (mainly revenues from the central level). The average percentage of the total revenues is 29% (see table 8 in annex).

For nearly 30 % of the countries, European Union subsidies form a major source of income. At the local level, 'grants from another level of government' are one of the most important sources of revenue. In 50% of the countries the level varies between 20 and 50%.

3 Observations and Trends

By its very nature and objective, Sub-theme I presents facts about public revenues and their management in the various EUROSAI member countries. For this reason the conclusions of the Sub-theme I working group take the form of trends and issues that have been identified in the process of comparing the country responses, which might directly or indirectly influence the work and working environment of Supreme Audit Institutions. They include possible subjects for audit and issues in general to take into account when planning an audit in the field of public revenues.

Public Revenues Product

1. The importance of public revenues is self-evident. Without revenues, there can be no expenditure. Public revenues cover a broad spectrum. All countries tend to have comparable types of revenue, although their relative importance can differ.

2. The Lima Declaration of Guidelines on Auditing Precepts provides a general framework for the audit of revenues and tax audits. Since then auditing standards have been developed by INTOSAI, EUROSAI and IFAC, but these do not give specific guidance on the audit of public revenues.

3. There are no substantial changes in the composition of the total public revenues over the chosen years. Taxes and social contributions are by far the most important categories of public revenue for all countries.

4. Each level of government has its own revenues. In most countries the state and local levels receive a set portion of the tax income. The Central level of government is in general responsible for 85% on average of the total public revenues.

5. In almost all countries, the portion of public revenues taken up by social contributions is rising gradually, whereas that of taxes is slowly falling. The organization, management and transparency of the social contributions revenues are therefore increasingly important for SAIs.

6. Tax allowances are a form of government expenditure in terms of a loss or postponement of tax revenue. Although they are an important instrument, only a

few SAIs have reliable information about the amounts involved and/or about their efficiency and effectiveness.

7. All EUROSAI member states provide their Parliaments with financial information on tax revenues, either separately or as part of a greater whole (within the budgetary reports). Reporting on non-financial issues is rare.

8. There are substantial differences in the other revenues and grants between the countries and over the years. In all EUROSAI countries, other public revenues are usually of minor significance when compared to taxes, and are very diverse in nature.

9. For both state (sub-national) and local governments, the item 'Revenues from another level of government' forms a substantial part of their total revenues.

Public Revenues Process

10. Most countries show (significant) changes in either the organizational structure of the tax authority due to information systems changes or European Union influences, and/or changes in the taxation process.

11. About half of the responding countries have integrated their tax and customs authorities.

12. In many EUROSAI member states, considerable progress has been made on the electronic filing and processing of tax data. Electronic filing is clearly an increasing trend.

Public Revenues - audit aspects

13. Most countries stated that Parliament does not have (a direct) influence on the tax authority's audit policy.

14. Although the majority of countries do have electronic access to data, computerised tax auditing is not yet widespread. A relatively small number of countries have fully automated their tax assessment procedures.

15. Only half of the countries have policies regarding the periodicity of tax audits. Most EUROSAI members make an effort to carry out tax audits at regular intervals, at least where large taxpayers are concerned.

16. In nearly all countries fees are audited, either internally or externally. Many countries consider the audit of the fees as a regular task for their Supreme Audit Institution. However, in 19% of the countries, fees are not audited at all.

17. The nature of public revenues, the level of automation and the level of internal control are important issues to consider when planning an audit.

18. Most SAIs do not have sufficient audit capacity to audit all sorts of revenues themselves. The importance of a sound risk analysis is often stressed.

4 Congress Issues

The observations and trends of the previous section raise a number of issues, which could be debated by the delegates of the VI EUROSAI Congress in Bonn. What is clear is that although the composition of public revenues has remained reasonably stable over the years, the working environment of SAIs is one of constant change, of innovation, modernisation and political influence. This calls for a clear strategy, for guidance and for cooperation between supreme audit institutions. The following are therefore proposed as a starting point for the discussion: -

Issue area 1

- Are adequate standards and bases for the audit of revenues in place?
- Is there a need for updating the statements of the Declaration of Lima to reflect the progress achieved by SAIs in the audit of revenues?

Issue area 2

- Is there a need for SAIs to shift focus on the audit of public revenues?
- In what fields should they strengthen their audit capacities?
 - In the field of specified taxes such as value-added tax?
 - In the field of tax allowances having the nature of subsidies?
 - In the field of tax administration?
 - In other fields?