AUDIT OF PUBLIC REVENUES

Conclusions
and Recommendations

(2 June 2005)
Preamble

The VI EUROSAI Congress held in Bonn from 30 May to 2 June 2005 dealt with the audit of public revenues by Supreme Audit Institutions (SAIs). Obtaining and maintaining a sound basis of revenue is of fundamental significance for effective governmental policy-making. Given the importance of an effective revenue collection system, SAIs have developed the audit of revenues into a specified and technical field of their audit work. The focus of the Congress discussions on the audit of revenues was placed on the following three sub-themes:

Sub-theme 1  The significance of public revenues for public financial managers and for the Legislature’s budget authority
Sub-theme 2  The role of the SAI in the budgetary cycle
Sub-theme 3  Audit approaches and audit impact

Three international working groups of SAIs chaired by the Netherlands (Sub-theme 1), the United Kingdom (Sub-theme 2) and Poland (Sub-theme 3) prepared the deliberations of the Congress. They drafted discussion papers on the three Sub-themes summarising the findings and the lessons learnt by the current 47 EUROSAI members. By contributing detailed country papers, EUROSAI’s members helped to provide a broad basis of information and experience for Congress deliberations. By doing so, they laid the foundations for generating the key findings, conclusions and recommendations developed by the Congress in the course of its deliberations at Petersberg near Bonn.

The Congress thus continued a friendly cooperation that has already existed among EUROSAI’s members for 15 years and that aims at the sharing of information, opinions and lessons learnt. In pursuit of these objectives, the conclusions and recommendations stated below serve to further enhance technical skills, cooperation and mission performance of EUROSAI’s members in public revenue auditing. They allow for the different frameworks in which EUROSAI’s members perform their functions paying due regard to the respective mandate of each SAI.
1 The Significance of Public Revenues for Public Financial Managers and for the Legislature’s Budget Authority

1.1 The powers of SAIs to audit all public financial operations are underlined in the Declaration of Lima adopted in 1977. With respect to tax revenues the declaration calls for them to be audited as extensively as possible. The principles and standards laid down in the Declaration apply equally to public expenditure and to public revenue. EUROSAI reiterates its commitment to the Declaration of Lima, the Magna Carta of government auditing, which still provides an adequate normative framework for the audit of revenue budgets by SAIs.

1.2 Although the Declaration explicitly refers to tax, the following aspects are also applicable to all public revenues:
- the emphasis on conducting legality and regularity audits of the collection of public revenues,
- the importance of also examining the efficiency of the system of revenue collection when auditing the collection of revenues,
- the need to review the achievement of revenue targets and
- the importance of proposing improvements to the legislative bodies.

1.3 Below the level of the Declaration of Lima there are some specific audit guidelines on specific types of public revenues (e.g. VAT). Therefore, the Congress welcomes initiatives from EUROSAI members or European working groups who already have such guidelines to share those with other SAIs.

1.4 EUROSAI acknowledges that taxes and social contributions are the most important categories of public revenues. There has been little change over the years in the composition of the public revenues. Reporting by tax authorities on non-financial information is rare. It should be encouraged in the interests of transparency.

1.5 Whilst the composition of public revenues is quite stable, EUROSAI sees that the collection processes are changing rapidly due to new legislation, reorganisations of tax administrations and increasing automation. SAIs ought to take these changes into account when preparing their audit strategies. In developing their audit strategies, SAIs ought also to be sensitive to the broader audit context, including tax culture and public willingness to comply with the requirements to pay tax. The latter has a strong influence on the strategy and organisation of the tax administration.
1.6 Confronted by limited resources, SAIs need to look for an efficient distribution of their existing capacity. Developing a specific strategy for the audit of public revenues, within which risk analysis plays an important role, is an important step towards optimising their audit work. Above all, this concerns taxes as the main source of public revenues and the most susceptible to a major loss in revenue.

Important indicators for the SAIs’ risk analysis in the field of tax audit activities are

- the volume of revenues generated from a particular type of tax,
- the complexity and effectiveness of applicable tax regulations,
- the error-proneness of tax collection,
- the strength of the audit strategy and the internal control processes within the tax authority,
- the likeliness of taxpayers avoiding or evading tax liability,
- the extent of the access rights of the tax authorities to tax-related data,
- the processes of restructuring and modernisation.

1.7 The analysis of the country papers submitted by EUROSAI’s members has shown a number of cases where cash flows that, strictly speaking, have the nature of expenditures are transferred to revenue budgets, especially in the form of tax subsidies. Tax relief schemes of this kind have reached a considerable magnitude in some countries. However, up until now there is still insufficient insight into the effectiveness of tax subsidies. SAIs should develop more reliable findings about the volume and target achievement of such tax subsidies. Some country papers noted the extent and complexity of tax legislation that can lead to tax shortfalls and tax exceptions. The Congress therefore advocates conducting a coordinated audit of tax subsidies that is open to all EUROSAI members.

2 The Role of the SAI in the Budgetary Cycle

2.1 The revenue estimates prepared by the executive branch have a significant impact on Parliamentary decision-making. SAIs recognise the increasing external interest in their being more involved in the revenue budget process. In this regard, the SAI has a particularly privileged, independent and important position in relation to government revenue budget data, assumptions and forecasts. Indeed the SAI may be the only body with independent access to the detailed underlying data. But it is not the role of the SAI to formulate revenue forecasts on which budgets are based.
2.2 In accordance with the Declaration of Lima, SAIs should, however, carry out ex-post analyses of revenue estimates, thereby encouraging reasonable revenue forecasting. The expectations placed on SAIs by Parliaments, some governments and by the people at large are changing and rising. If these expectations develop further, as they may well do, SAIs must be careful not to be forced into adopting measures that would diminish their capacity to act as effective, independent external auditors. However, refusing to change also brings the risk that that may diminish their standing and the respect in which SAIs are held. It is therefore important for each SAI to work out what their strategies should be for the future.

2.3 Before undertaking any revenue budget work an SAI must have the legal competence to carry out this work. But SAIs also need to ensure that they have the necessary technical skills and resources. However, revenue estimates are based on forecasts of overall economic trends and on policy objectives and they both carry a high inherent risk of error. The SAI has to recognise these constraints and to accept that it may prove very difficult for them to find sufficient, relevant and reliable independent evidence to support their evaluation of revenue budgets and forecasts.

2.4 As part of their budgetary analysis function, many SAIs are authorised to provide expertise on matters associated with the estimate of tax revenues and other public revenues. SAIs may wish to look into the estimating methods and decision-making procedures by means of which budgetary revenue forecasts are developed. SAIs might identify weaknesses in the estimating methodology and point out ways of enhancing revenue forecasting. By doing so, SAIs would make a major contribution to improving the quality of revenue forecasts and future budget estimates, and improve the transparency of budget approvals. Therefore, SAIs should, wherever possible, undertake audits aimed at increasing the transparency of data, fiscal models, methodologies and processes for drawing up the revenue budgets and forecast.

2.5 The extent of SAIs’ involvement in reviewing the preparation of the budget varies extremely. Some SAIs undertake formal ex-post audits leading to opinions related to revenue budgets. Some SAIs also carry out an audit of the budget estimates and provide advice to governments and parliaments in the area of revenues. SAIs may draw on the lessons learnt from earlier work on the various sources of revenues. Such involvement is designed to enable governments and parliaments to scrutinise the budget estimates in the light of such lessons learnt from past audit exercises.
2.6 In countries where SAIs so far have not been authorised to play any advisory role on revenue budgets in the course of the budget process, it may be desirable for SAIs to have their mandate expanded accordingly. SAIs recognise that in many areas there is not enough good data to support revenue budget audit work. Some countries have a better track record of macro-economic data than others. Where there is sufficient, good-quality data SAIs should consider the case for auditing the reasonableness of the revenue budget assumptions. In undertaking this work SAIs may take into account the standards issued by IFAC.

2.7 One major point of emphasis of revenue auditing is the execution of tax legislation. SAIs auditing revenues place focus on whether the competent authority complies with revenue legislation and collects revenues timeously, completely and equally. When doing such work, SAIs rely on the applicable provisions of revenue legislation and assess their practical impact. Such audit missions may reveal that the outcomes of administrative action are not commensurate with the objectives of the legislation enacted.

2.8 Where SAIs identify such deviations, they are not always attributable solely to administrative shortcomings. Rather than that the deviations may result from the legal provisions themselves, for example, if the legislation is excessively complex and therefore difficult to implement. In those cases, external auditors should not limit themselves to evaluating government operations. Where the SAIs’ mandate permits further involvement, SAIs should use the pertinent audit findings and conclusions generated in this field to provide advice to legislators by pointing out shortcomings in execution owing to impracticable legal provisions and by recommending legislative amendments. The same applies to cases where shortcomings in human and material resources are concerned.

3 Audit Approaches and Audit Impact

3.1 Under their respective mandates, SAIs may use different methodological approaches to the audit of revenues. Regularity and compliance audits are important because they may reveal shortcomings in the implementation of revenue legislation and unequal treatment in connection with the levying of taxes. Performance audits in the field of revenues may be a suitable tool, e.g. to encourage the enhancement of revenue collection efficiency and effectiveness and to monitor restructuring processes within the tax authorities. Combining results from both types of audit, or even combining
sometimes financial and performance approaches in a single project might increase the completeness of results and findings within public revenues auditing. Apart from that, they may also be instrumental to evaluating tax subsidy effectiveness, thus paving the way for verifying target achievement.

3.2 SAIs should apply all the elements set forth in the Declaration of Lima by conducting both regularity and performance audits and combining the above audit criteria and audit methods. SAIs should be committed to auditing revenues as comprehensively as possible and should use the possibility laid down in the Declaration of Lima of accessing individual tax files.

3.3 SAIs should allocate their resources efficiently and effectively on the basis of prior risk analyses and adapt their tax audit work to increasingly computerised environments. To do so, capacities for exchanging data with the fiscal administration are required and SAIs need to keep abreast of the information technology systems used by the tax authorities to be audited. It may be advisable to rely on external experts if SAIs have to assess the use of complex computer programs within the tax authorities as part of their audit work. In addition, it may be useful for SAIs to develop their own computer programs for audit purposes.

3.4 SAIs should follow up on the implementation of their recommendations for addressing the problems stated and enhancing government operations. In order to ensure adequate audit impact, follow-up audits should be carried out at least in those cases with a high risk of revenue losses.

3.5 At the national level, SAIs should seek to cooperate closely and in a well-structured way with other public bodies responsible for auditing revenues. For their own audit assignments SAIs should rely to the extent possible on findings developed by such other bodies. The partners of such cooperation may be external audit bodies of other levels of government and internal audit services belonging to the executive branch.

3.6 The increasing interdependence of national economies has lead to a situation where SAIs may to some extent no longer be able to effectively perform their revenue audit work unless they cooperate with other SAIs. An example for this is the audit of internationally organised tax fraud causing substantial losses in revenues in many countries. International cooperation of the authorities responsible is needed to combat this type of crime. SAIs carrying out audit missions in this field should be committed to working more closely with other SAIs. Where a legal framework for such cooperation, e.g. for an international data exchange, is lacking, SAIs could call upon their respective parliaments to establish such frameworks.
4 Overall recommendations

The VI EUROSAI Congress considered in depth a range of important and complex matters. These all affect the role and work of SAIs and the contribution that SAIs can make to better transparency and to the audit of public revenues. In the light of its deliberations the Congress agreed that

- EUROSAI members be encouraged to reassess their overall strategy for revenue audit,
- there should be a coordinated audit of tax subsidies that is open to all EUROSAI members,
- the offer of the EUROSAI IT working group to explore and report on the relevance of IT in auditing public revenues fraud be accepted,
- EUROSAI members should be encouraged to exchange benchmarking information, definitions and criteria to enable them to compare internationally the costs and performance of tax administrations,
- EUROSAI members should be encouraged to share their initiatives and relevant guidelines on the theme of public revenues via the EUROSAI website.

The Congress also requested that reports on the above points be made to the VII EUROSAI Congress in 2008.