



Selecting Cases for Audit

Margaret Cotton
Pacific Islands Tax Administrators
Association Conference
8-10 August 2006
Cook Islands

What we are going to cover today

- My background
- Case selection
- Customising the model to PI environments
- Realistically what can be done now
- Workshop
- Further assistance and contacts

My background

- Qualifications in Law & Accountancy,
- New Zealand Inland Revenue
- National Manager Technical Standards
- Change Manager for Audit Strategy project



Case selection: why it is important

- Role of Revenue Authorities is to maintain and improve compliance.
- Revenue Authorities manage risk with scarce resources through assistance, education and enforcement
- Case selection is about effective use of the audit or enforcement resource
- Theory: Good case selection leads to more effective audits which means more compliance and ultimately more revenue is collected.

Case selection: why it is important

Audit Strategic Principles

1. Audit has a key role in the wider process of compliance management
2. The outcome of Audit activity is maintaining and improving compliance
3. Audit activity should be strongly focused on the identification of compliance risk, based on credible intelligence
4. Audit activity should concentrate on high risk and be visible throughout the community
5. Audit activity should involve a range of interventions which maintain and improve compliance
6. Audit activity should support measures to reduce compliance costs

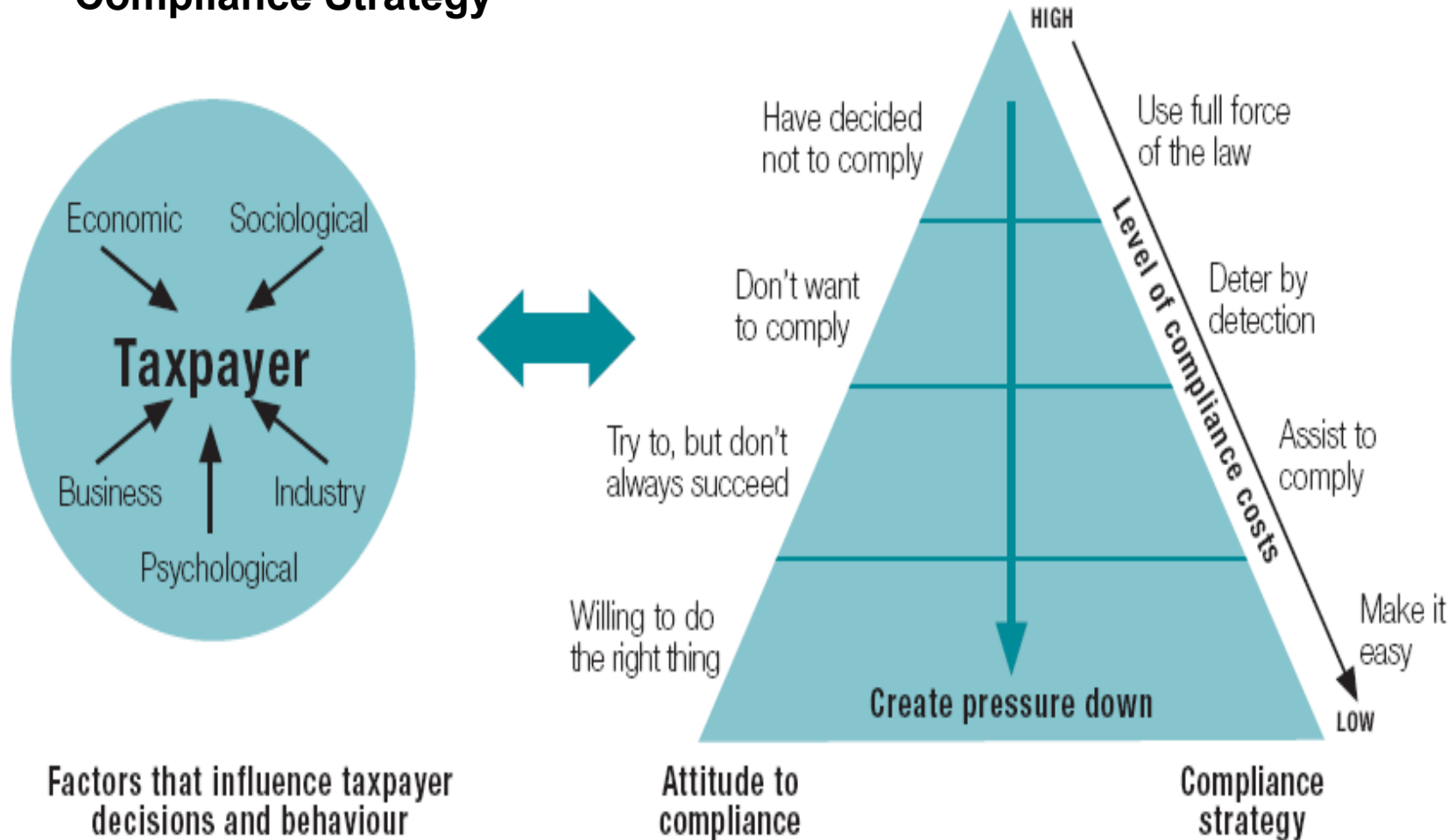
Case selection: a model

- New Zealand Inland Revenue audit strategy programme
- Approved February 2006
- Ongoing implementation



Case selection: the New Zealand model

Compliance Strategy

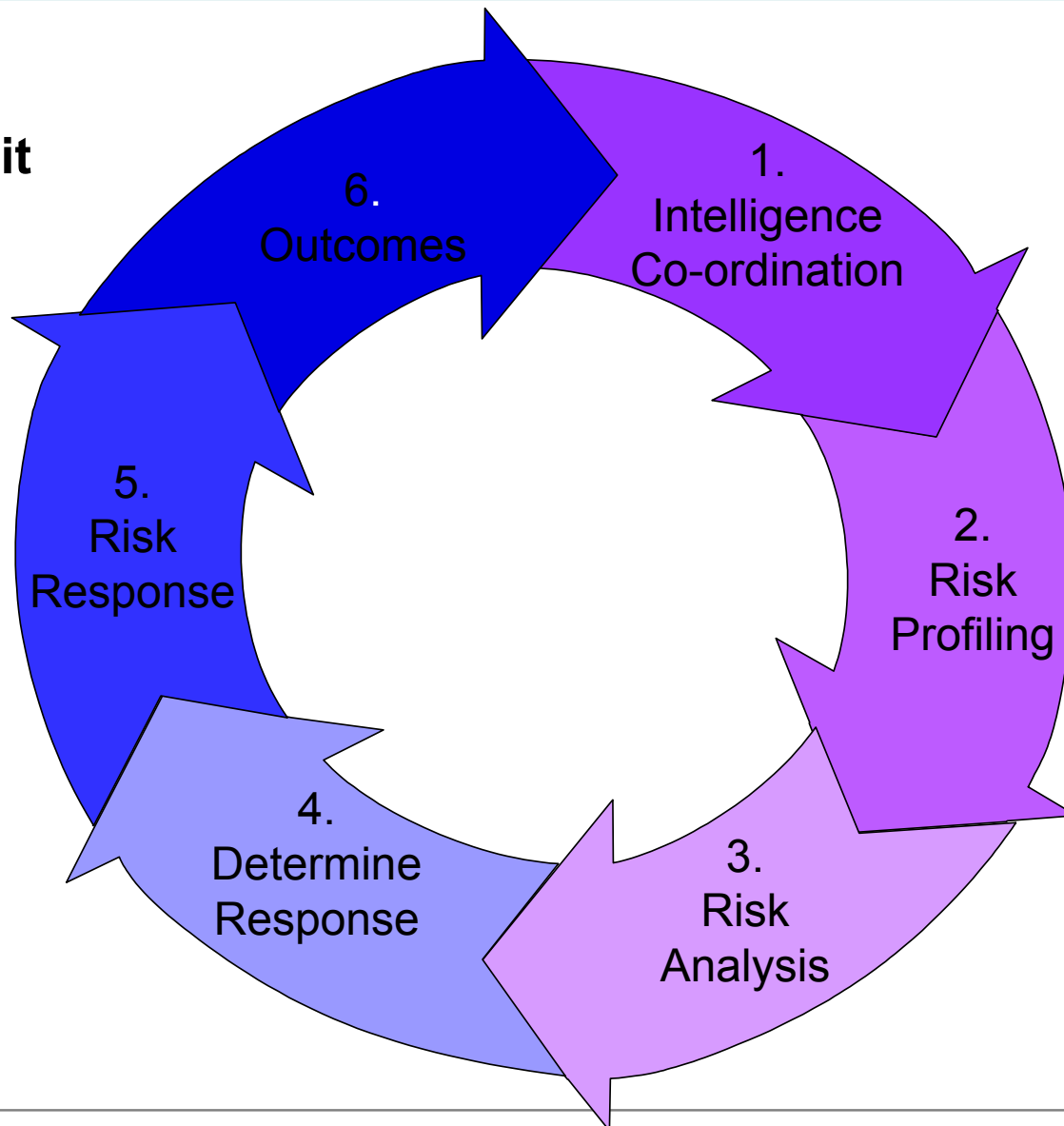


Case selection: the New Zealand model

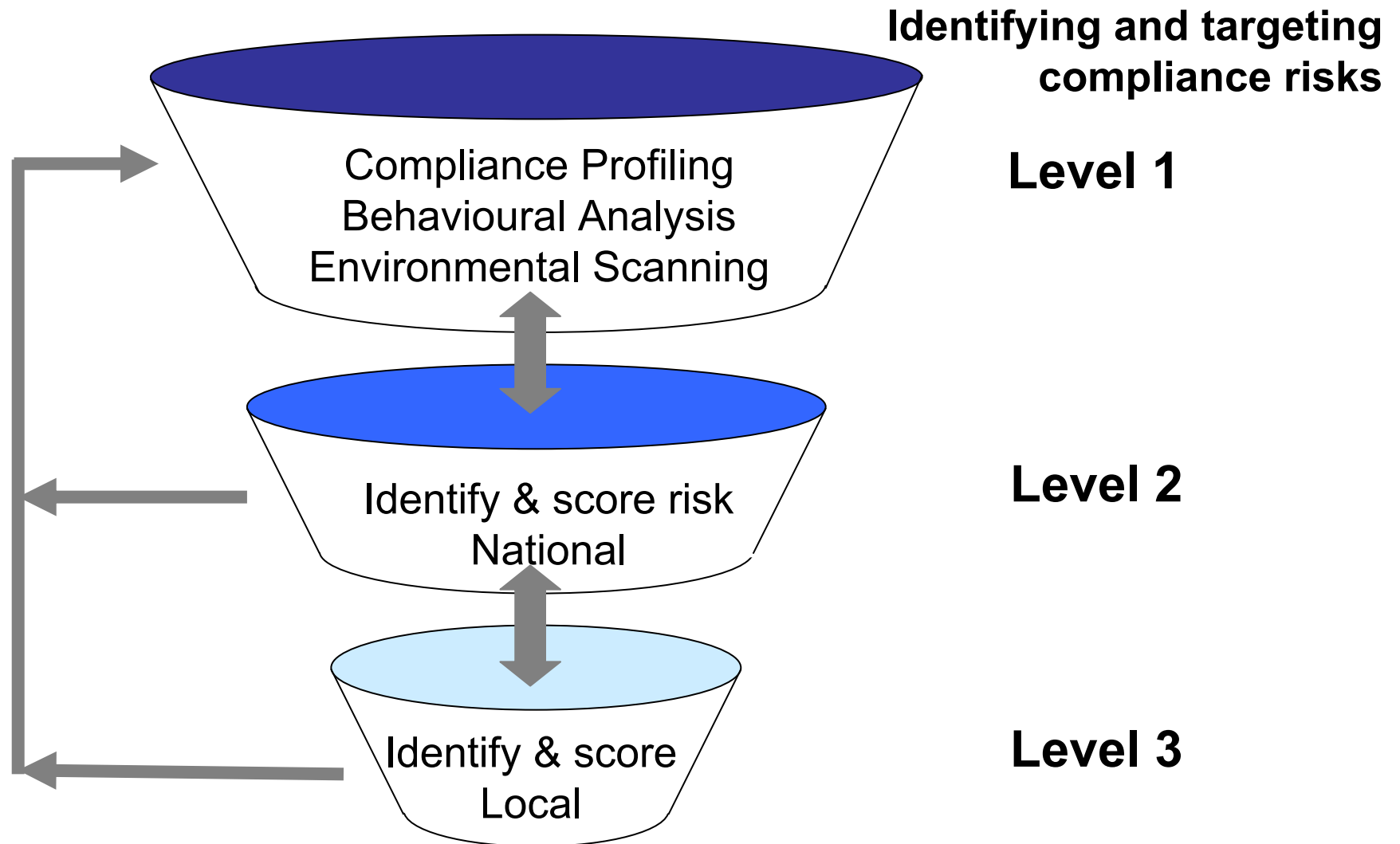
- Issues New Zealand faced
 - Minimal national co-ordination
 - Some risk areas over resourced and some risk areas under resourced
 - Audits were carried out when there may have been a more effective response to the risk.
 - Needed co-ordinated approach
 - Needed to look beyond 1 year
 - Need to use alternative responses where they would be more effective
 - Needed to develop audit staff to respond to future known risks

Case selection: the New Zealand model

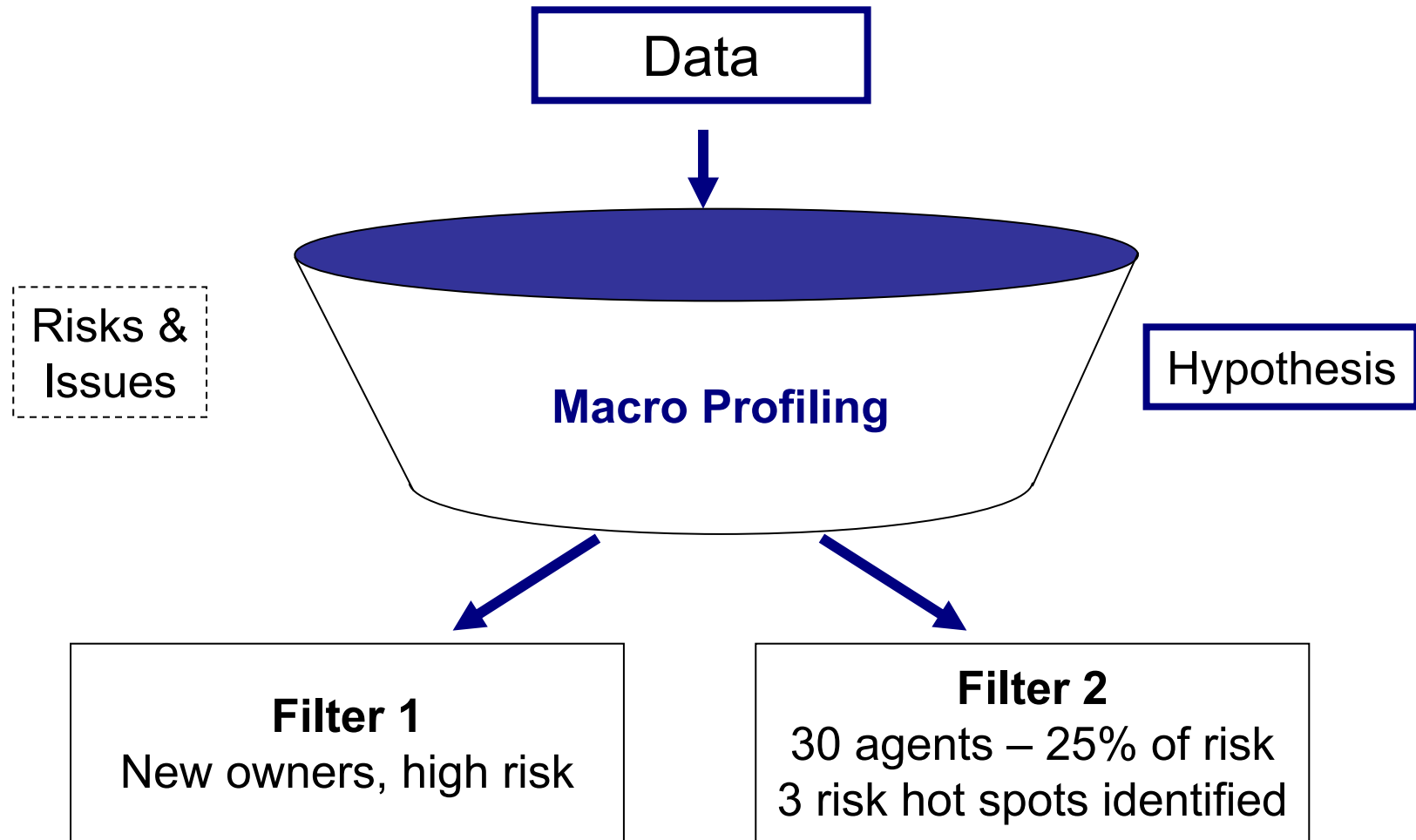
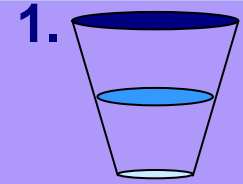
6 phase Audit approach



Case selection: the New Zealand model

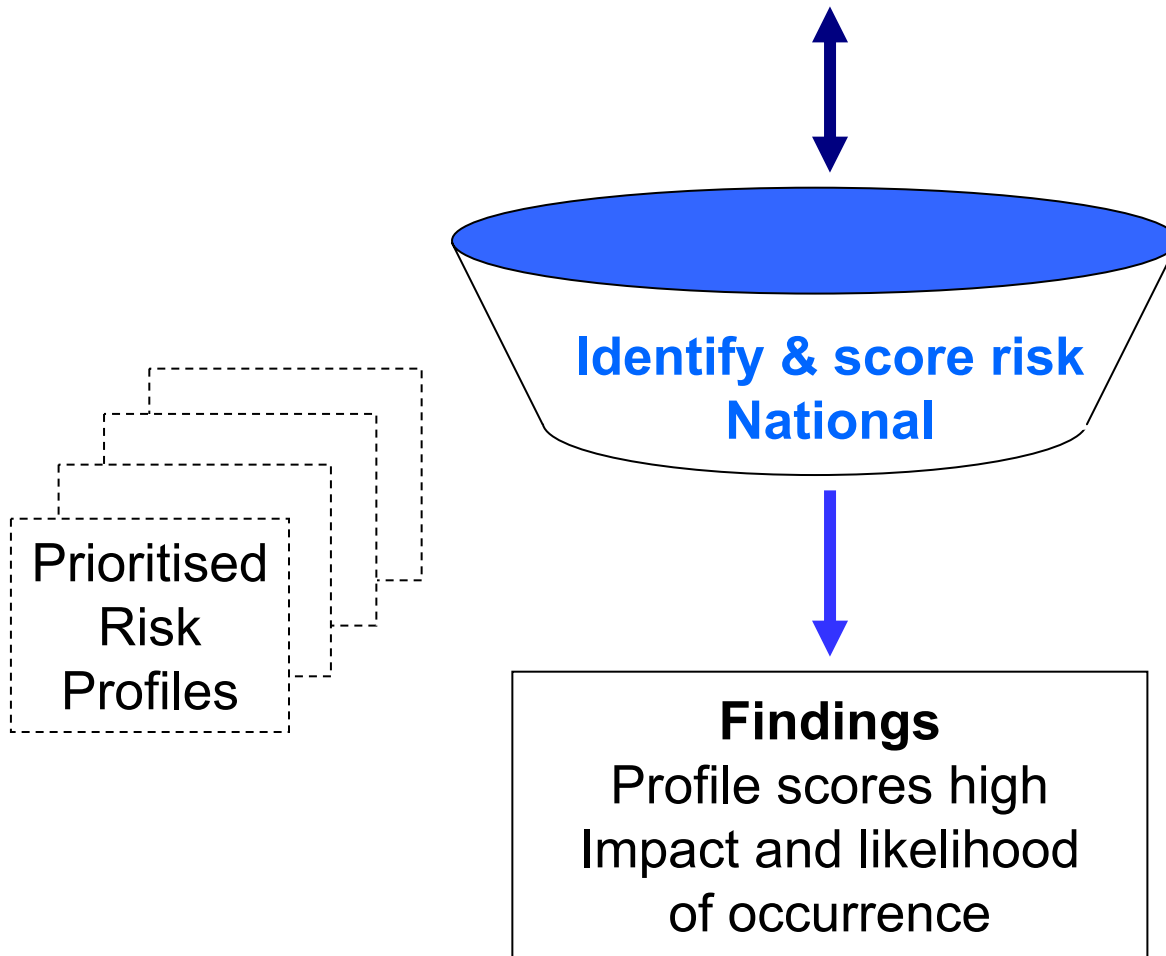
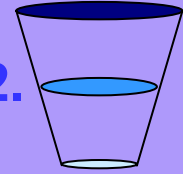


Level 1: Macro Profile

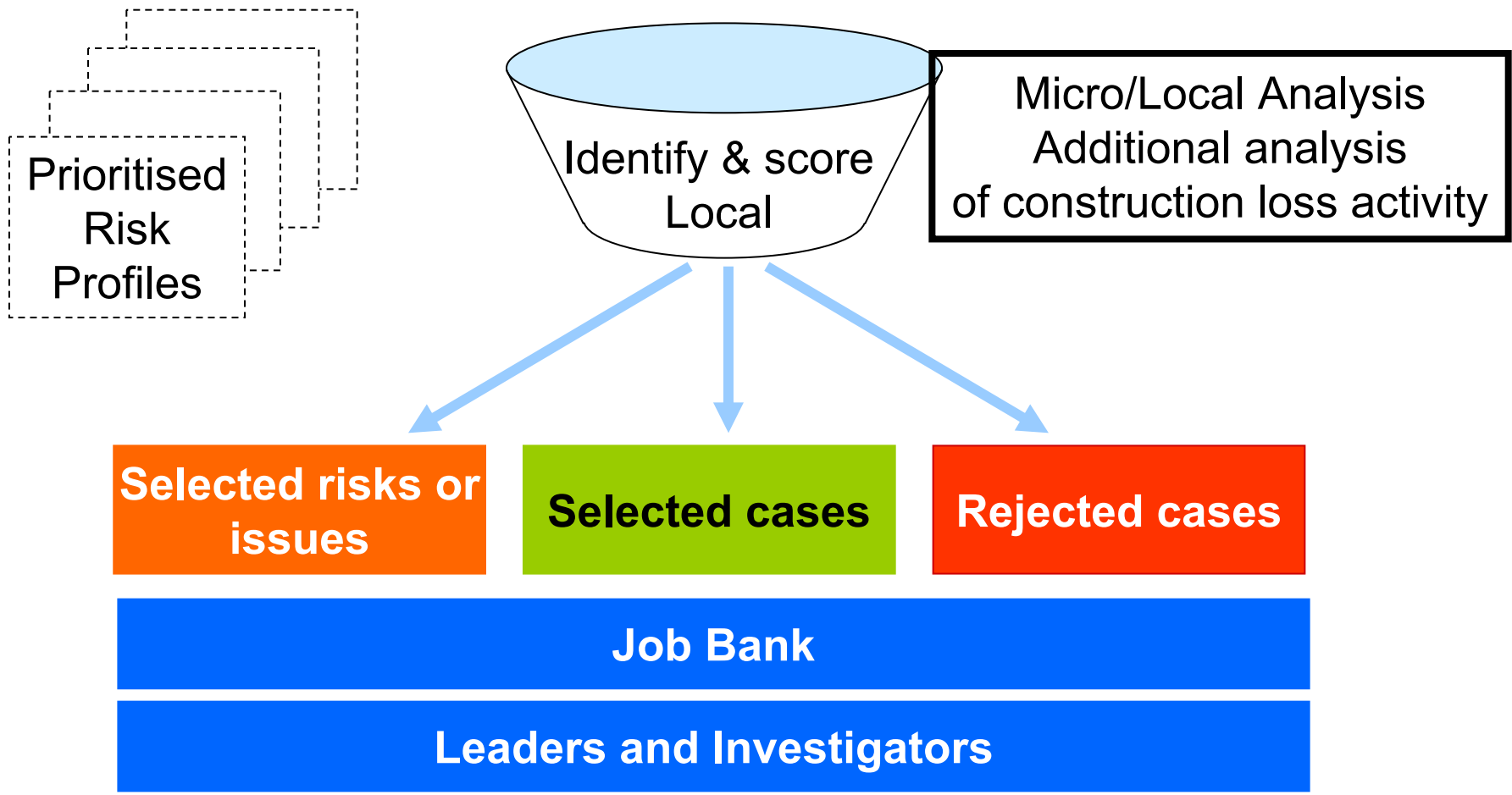
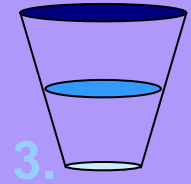


Level 2: Scoring national risk

2.



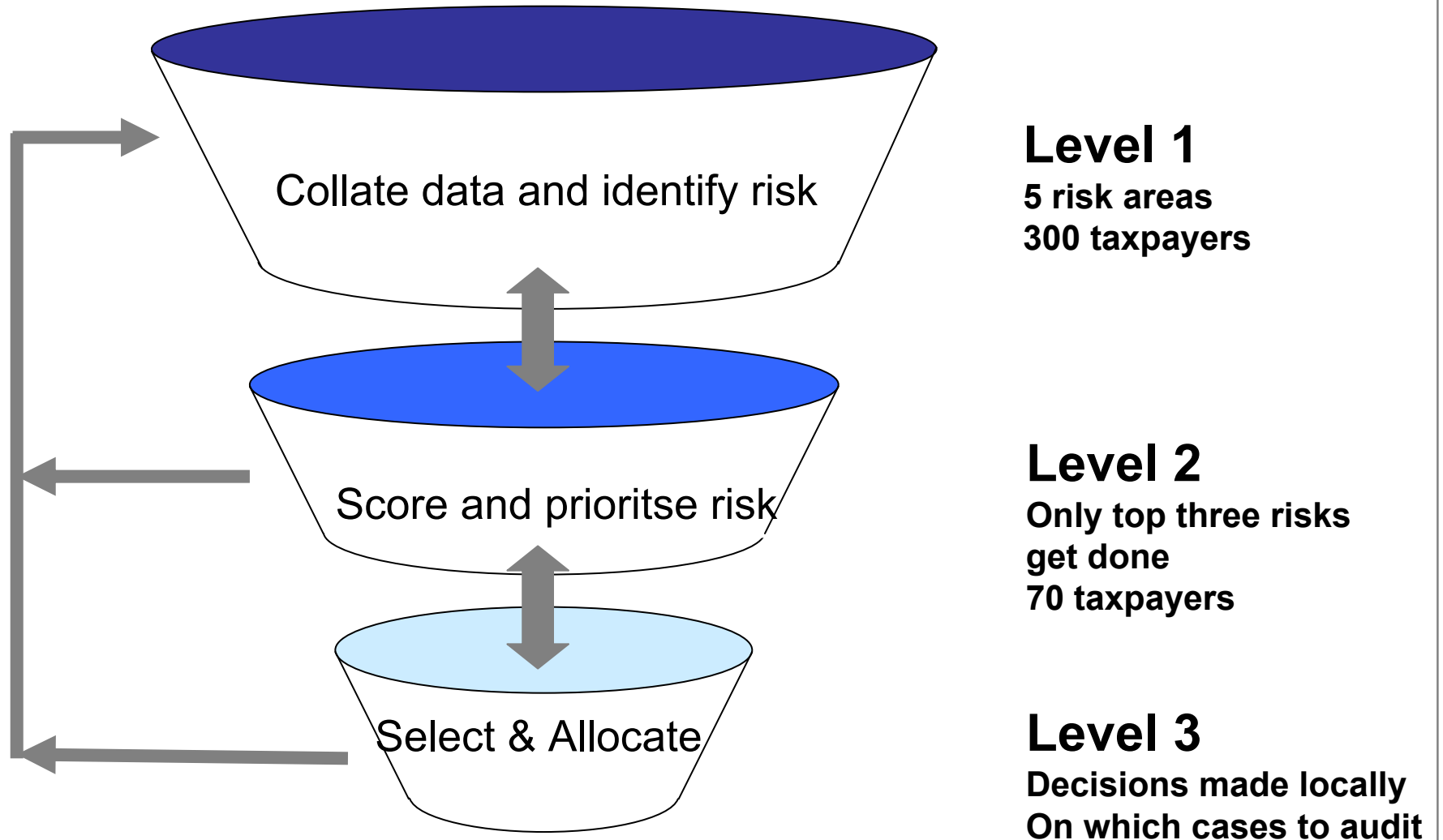
Level 3: Micro Analysis



Case selection: the New Zealand model

- National Intelligence function:
 - Identification of national risks
 - National coordination of
 - intelligence & risk analysis activities
 - data gathering, storage & quality
 - knowledge capture, sharing & use
 - tools, technology & support
 - Macro analysis & environmental scans
- Local Intelligence function:
 - Input to the national risk assessment process
 - Identification of local, regional and/or segment risks
 - Local responsibility for:
 - intelligence & risk analysis activities, case selection & support
 - data gathering, storage & quality
 - knowledge capture, sharing & use
 - tools, technology & support
 - Support ongoing cases

Customising the model: to recap filtering & prioritising risk

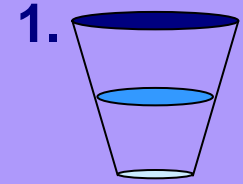


Customising the model to a PI environment

- Phase 1, determines the risks at national level,
 - What are the risks across all FSM
- Phase 2 ranks the risks nationally
- Phase 3 ranks and allocates resources to the risk at local level
 - Yap, Chuuk, Kosrae, Pohnpei
- Case selection and allocation within those priorities is made on the basis of:
 - risk
 - availability of skills and people
 - other enforcement options.



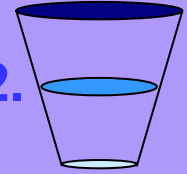
Customising the model to a PIC - FSM



- Level 1, FSM determines the risks at national level,
 - A brainstorming session determines likely areas of high risk:
 - E.g. non-resident contractors, tourism, construction, new VAT registration, foreign owned companies, remilitarization of Guam
 - For some or all of these areas consider what is the actual risk:
 - all non-resident contractors or only those employed by XX company
 - All foreign owned companies or only those engaged in fishing
 - If fishing companies, is it all fishing companies or only those from YY country, or only those who fish for ZZ fish stock
 - All new VAT registrations or only those with zero rated or exempt supplies

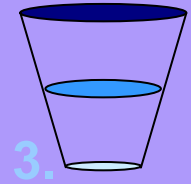
Customising the model to a PIC - FSM

2.

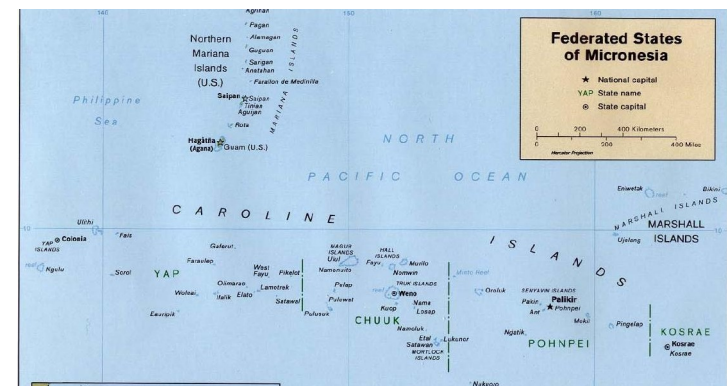


- Level 2: FSM ranks the risks nationally
 - Determine which factors will be used to rank the risk eg
 - Likelihood of risk
 - Occurrence/impact – regularity, number of taxpayers involved
 - Amount of revenue involved
 - Likely leverage from audit activity
 - Timing
 - Public interest
 - Other government activity
 - Skills of staff available
 - Rank the risks and determine national priorities.

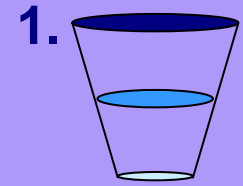
Customising the model to a PIC - FSM



- Level 3: FSM ranks and allocates resources to the risk at local level
 - Cases allocated to local offices - Yap, Chuuk, Kosrae, Pohnpei
 - Local office determines order of cases based on skill of local staff and prioritising of the risks locally,
 - What if Chuuk has more high risk cases than Kosrae but same number of staff?
 - If one risk is across all offices can all the cases be co-ordinated?
How do we ensure coverage and high risk cases are done



Customising the model to a PIC - Palau

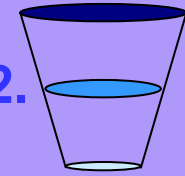


- Level 1, Palau determines the risks at national level,
 - What are the risks with GRT, VAT:
 - Under reporting of revenue
 - Entities outside the tax system
 - Complexity of compliance requirements
 - For some or all of these areas consider what is the actual risk
 - Which businesses are likely to under report?
 - In what circumstances are they likely to under report?



Customising the model to a PIC - Palau

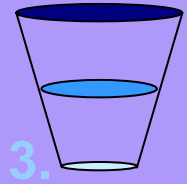
2.



- Level 2: Palau ranks the risks nationally
 - Determine which factors will be used to rank the risk
 - Likelihood of risk,
 - Occurrence/impact – regularity, number of taxpayers involved
 - Amount of revenue involved
 - Likely leverage from audit activity
 - Public interest
 - Timing
 - Other government activity
 - Skills of staff available
 - Rank the risks and determine national priorities.



Customising the model to a PIC - Palau



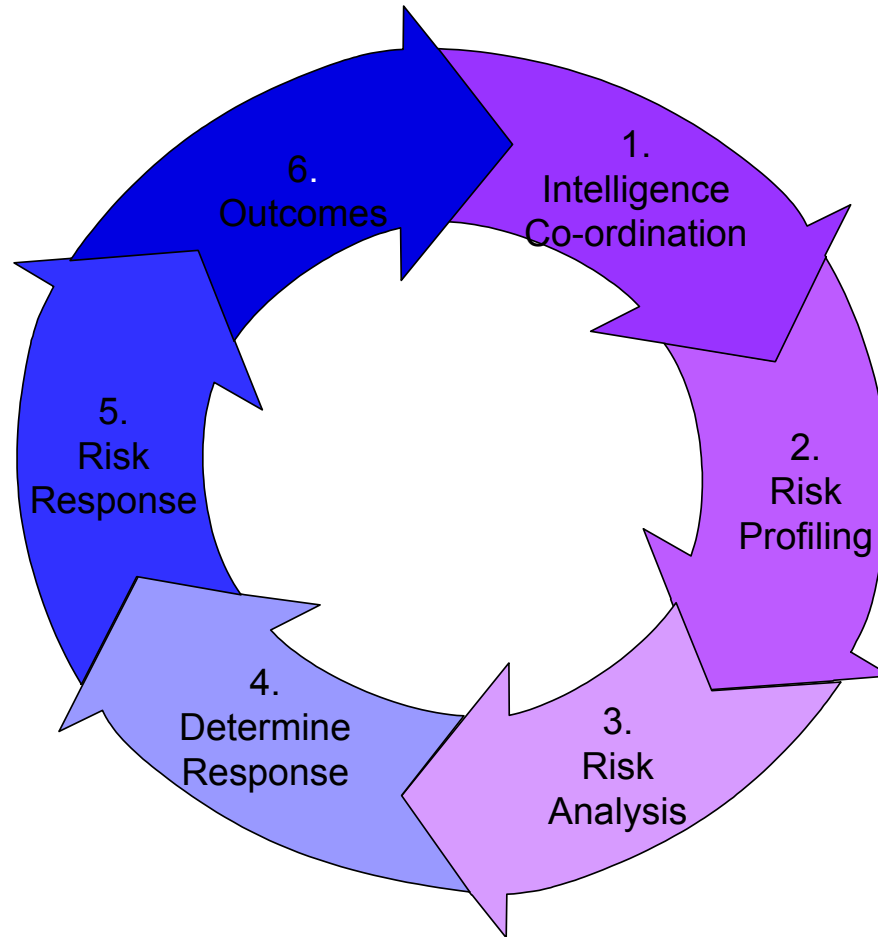
- Level 3: Rank and allocate resources to the risks using local knowledge.
 - Cases allocated based on skill of staff and priority
 - What about activity on the outer islands of Peleliu and Anguar? Or at Melekeok where the new capitol building is situated
 - Can all under reporting cases be co-ordinated even though they involve different industries?
 - How many cases need auditing to influence others to voluntarily comply?



Customising the model to a PIC: year end review

Did we achieve the outcomes we expected?
Performance measures? Y/N

Did we have the right data? Y/N



Did we profile the risks properly? Y/N

Was the risk response the right one? Y/N

Was our analysis correct? Y/N

If no, what can we do better

If no, what can we do better?

Realistically, what can be done now – identify categories of risk

Revenue Type	Industry	Technical Area	Other

Realistically, what can be done now – identify categories of risk

Revenue Type	Industry	Technical Area	Other
Income Tax			
Gross Revenue Tax			
Value Added Tax			
Presumptive Tax			
Duties			
Sales Tax			
Land Tax			
25			

Realistically, what can be done now – identify categories of risk

Revenue Type	Industry	Technical Area	Other
Income Tax	Tourism		
Gross Revenue Tax	Non-resident contractors		
Value Added Tax	Petroleum		
Presumptive Tax	Agriculture		
Duties	Airlines		
Sales Tax	Land Development		
Land Tax	Fishing		
	International service Providers		

Realistically, what can be done now – identify categories of risk

Revenue Type	Industry	Technical Area	Other
Income Tax	Tourism	Wages & Salary	
Gross Revenue Tax	Non-resident contractors	Depreciation	
Value Added Tax	Petroleum	Capital/Revenue	
Presumptive Tax	Primary Producers	Cash suppression	
Duties	Airlines	Transfer pricing	
Sales Tax	Land Development	Repairs & maintenance	
Land Tax	Fishing	Illegal Income	
	International service Providers	Charitable/exempt income	

Realistically, what can be done now – identify categories of risk

Revenue Type	Industry	Technical Area	Other
Income Tax	Tourism	Wages & Salary	Political unrest
Gross Revenue Tax	Non-resident contractors	Depreciation	Cost of Living Allowance payouts (eg Fiji)
Value Added Tax	Petroleum	Capital/Revenue	Natural disaster
Presumptive Tax	Primary Producers	Cash suppression	Remilitarization of Guam
Duties	Airlines	Transfer pricing	Government policy changes
Sales Tax	Land Development	Repairs & maintenance	Natural resources diminished
Land Tax	Fishing	Illegal Income	
	International service Providers	Charitable/exempt income	

Realistically, what can be done now – Phase 3 micro data collection

- Build a profile of your risk groups, taxpayers and industries?
 - Who is in the risk group/industry?
 - What is their turnover, is it what you would expect it to be?
 - Is their turnover similar to others in the industry?
 - Are they a new or old taxpayer?
 - What is their compliance history?
 - Are they financially solvent?
 - Do they have international connections?
 - What transactions are they making internationally?
 - How much cash goes through the business?
 - Are their accounts up to date?
 - What other 'gossip' do you know about the taxpayer?
 - Is it a locally based company or a foreign company?
- Build the profile over time.

Realistically, what can be done now

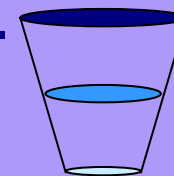
- Store your profiles so they can be accessed and updated easily
- Think about:
 - How to store the data;
 - Computer - Excel, Access, customised program
 - Paper based files
 - Issues with data storage
 - Security
 - Accessibility
 - Updating
 - Ability to compare with others in comparable positions (industry, size, turnover, international connection)
 - Third party information – access and storage

Workshop

- Break into 6 Groups
- Brainstorm possible risk areas(10 minutes)
- Complete the Phase 1 & 2 templates for **2** of those risks (20 minutes)
- Pair up with your other group and rank the top **4** risks (Template 3)
- Back together as a large group discussion on top risks

Workshop: Phase 1- Identifying the risk

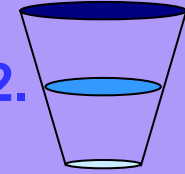
1.



Phase 1: Macro Level Risk Assessment			
Risk Area	Questions	Comments	
Tax Type:	What is the specific risk?		
	When does it occur?		
	Who takes advantage of this risk?	(Industries, named taxpayers, etc)	
	When do they take advantage of the risk?		
	How do they take advantage of the risk?		
	Why do they take advantage of the risk?		
	What other information could you get?		
	Where could you get it from?		

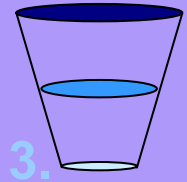
Workshop: Phase 2 – rank and score

2.



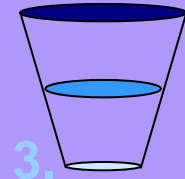
Phase 2: National Ranking & Scoring						
Risk Area		Ranking			Weight	Score
		L	M	H		
Risk 1:	Likelihood of risk					
	Occurrence – regularity (Always = H, Often= M, Sometimes = L)					
	Occurrence – # of taxpayers (<50 = L, 50 - 100 = M, >100 = H)					
	Amount of Revenue (per taxpayer <i>or</i> in total) <\$5,000 = L, \$5,000 - \$50,000 = M >\$50,000 = H)					
	Likely leverage					
	Timing (Urgent = H, Important = M Ideal = L)					
	Other government activity (or importance to Government)					
	Skills of staff					
	Other					

Workshop: Phase 3 – rank and allocate using local knowledge



- Phase 3 requires decisions to be made around:
 - Which national risks will be audited this year?
 - How can responses to national risks be co-ordinated nationally?
 - What percentage of capacity (staff, technology, budget,) will focus on national risk?
 - What percentage of capacity (staff, technology, budget,) will focus on local risk?
 - How will the national risks be responded to?
 - Will all taxpayers in the risk group receive the same response?
 - What happens to newly identified risks?

Workshop: Phase 3 – rank and allocate using local knowledge



3.

Phase 3: Allocation of Risk						
Risk in order of priority	No of Taxpayers and Location				Audit/ Other	Comments
1.	Total taxpayers =					
	Site1	Site2	Site3	Site4		
	# of Tax Pyrs					
2.						
	Site1	Site2	Site3	Site4		
3.						
	Site1	Site2	Site3	Site4		

Case selection: reflections

- Purpose of audit activity is to promote voluntary compliance
- Not possible or appropriate to audit everything
- Need to get value for money from audit dollar and from audit staff
- Three step case selection model:
 1. identify the risks,
 2. rank the risks
 3. select and allocate the cases,

Case selection: reflections

- This model is about building the blocks to ensure:
 - Audit activity is strongly focused on the identification of compliance risk, based on credible intelligence
 - Audit activity concentrates on high risk and is visible throughout the community
 - the right audits are undertaken at the right time with the right staff and voluntary compliance is maximised.

Further assistance and contacts

- **Carson McNeill**

PFTAC

GPO Box 14877

Suva

Fiji

Phone: (+679) 3304045 ex 110

Mobile: (+679) 9356608

Email: camcneill@imf.org

Web: www.pftac.org

- **Margaret Cotton**

C/- PFTAC

GPO Box 14877

Suva

Fiji

Phone: (+679) 3361078

Mobile: (+679) 9380921

Email: cottonmarg@hotmail.com
margaretc@connect.com.fj

Acknowledgements

- Special thanks to
 - John Uwas and the staff in FSM
 - Ricardo Bausoch and the staff in Palau
 - Geoff Stoddart and the staff in Cook Islands
 - Naomi Ferguson and the staff in New Zealand.

Please note the views in this presentation are mine and may not represent the views of the organisations referred to.



**Margaret Cotton
Pacific Islands Tax Administrators
Association Conference
8-10 August 2006
Cook Islands**