

Chapter 12 Revenue

Random Audit Programme – Revenue

Random Audit Programme

12.1 Chapter 11 sets out the results of audits carried out by Revenue in 2008. Most audits are targeted at those cases which are perceived to represent the greatest risk of underdeclaration. However, each year a number of cases are selected for audit on a random basis. Chapter 2.9 of the 2002 Report set out the results of a review of the Random Audit Programme (RAP) in place at that time. The review found that although initial selection of cases was on a random basis, screening of those cases at District level resulted in an element of risk assessment being introduced. As cases were not selected purely on a random basis, the results could not be used to accurately estimate the overall level of non-compliance.

12.2 It is recognised that there is a cost to Revenue in implementing a random audit programme both in terms of staff and other administrative costs, and the impact of the diversion of resources from risk based audits that are likely to produce a higher yield. A random audit programme also imposes an additional burden on the selected taxpayers of whom the majority would be tax compliant. However, its value lies in its potential to objectively determine the level of actual compliance within the taxpaying population and allow Revenue to focus their compliance activities.

12.3 Following its examination of the Chapter, the Committee of Public Accounts (PAC) recommended that random audits should be factored into Revenue's audit strategy and the results used to estimate the scale of undeclared tax liabilities³⁷. The Revenue response to the PAC Report acknowledged that a random audit programme

- was beneficial in improving risk identification and the validation of the risk criteria used to select cases for targeted audits
- had the capacity to provide a statistically valid compliance measure and that, over time, the results would give some indication of the scale of undeclared tax liabilities
- ensured that no taxpayer was exempt from audit

12.4 The programme was re-launched in 2005 with case selection on a fully random basis. Since 2005, the annual RAP has sought to carry out a comprehensive audit on some 400 randomly selected taxpayers. Selection of cases and compilation and analysis of the results is carried out centrally by Revenue's Planning Division, while audit staff in the District responsible for each case carry out the audits. To date, all of the audits have not yet been completed for any of the re-designed RAPs.

Audit Focus

As the re-launched RAP was now entering its fifth year, I was concerned at the ongoing failure to complete the required set of audits. This militated against exploitation of the benefits of random audit in terms of using the results to assess the level of overall compliance, to measure performance and to inform the risk assessment process.

³⁷ Committee of Public Accounts, Second Interim Report for 2002, June 2005.

Objectives of the RAP

12.5 The stated objectives of the RAP for 2007 and 2008 were to ensure all taxpayers had an equal chance of being selected for audit and to validate the risk based approach. Earlier programmes also set an objective of measuring and tracking compliance.

Selection of Cases

12.6 Cases are selected at random by Revenue's IT Division from those cases having a 'live' registration for at least one of the following taxes – Income Tax, Corporation Tax, VAT, Employer's PAYE/PRSI, Relevant Contracts Tax or Capital Gains Tax. PAYE only cases are excluded. Income Tax and Corporation Tax cases that have markers on the computer record showing that they have not commenced trading, have ceased trading or have no net liability are also excluded.

12.7 Basic checks are carried out centrally on the selected cases to ensure that they meet the criteria for selection. Where it is clear from the taxpayer's record that the case does not meet the criteria for selection but the relevant case markers do not reflect this fact, the case is excluded. Any case that is under investigation or is already the subject of an audit is also excluded. Cases are then allocated to the Regions (including Large Cases Division) in accordance with the ratio of cases per Region that emerged from the initial random selection. More than the 400 cases required are initially selected to allow for validation and subsequent replacement of invalid cases.

Type of Audit

12.8 A comprehensive audit (i.e. examination under all taxheads) is required to be carried out on each case. The audits are carried out on the same tax period for each case (e.g. the 2007 RAP required that the audit be carried out on 2005). As for all audits, random audits are conducted in accordance with the Code of Practice for Revenue Auditors³⁸. There are no separate quality control procedures for random audits. They are covered by Revenue's standard quality control processes.

Audit Procedures

12.9 A sample of audit files for random audits from the 2007 programme was examined during this review. In general, the level of testing carried out and the computation of the tax liability was clear from the files. However, in a small number of instances, that audit trail was more difficult to follow. Revenue should ensure that the same rigour is applied to random audits as is applied to the general risk-based audits.

Random Audit Results

12.10 Districts submit quarterly returns to Planning Division showing the current status of all of the audits in the programme. An overall evaluation of the results of the programme has not been carried out to date by Revenue on the grounds that all audits have not yet been completed for any of the programmes since the RAP was re-designed in 2005.

³⁸ Code of Practice for Revenue Auditors, Office of the Revenue Commissioners, 2002.

12.11 The results (as at June 2009) of the RAPs for 2006 to 2008 are set out in Figure 42. As can be seen from that figure, the number of non-yielding cases is between 67% and 72%, which is in line with the number of non-yielding cases from the RAPs of 1998 to 2002 as reported in the 2002 Chapter. This would indicate that, over an extended period, around 30% of self-employed taxpayers (including proprietary directors) and businesses under-declare their tax liability in any given year. The table shows the audit yield from the specific year being audited (the base year) as well as any yield that arises during the course of the audit from other years. While the average additional tax yield for the base year fell from €3,882 in 2006 to €2,036 in 2007, there has been a slight increase to €2,696 for the 2008 audits. The total average yield, which takes account of the yield from all tax periods audited, has fallen from €5,585 in 2006 to €4,878 in 2008. It is too early to say whether the increase in the number of non-yielding cases and the fall in average yield since 2006 could be an indication of improved compliance generally or could simply reflect the higher number of outstanding cases for later years which Revenue has noted generally include the more difficult cases that are more likely to produce a yield.

12.12 The Accounting Officer stated that although none of the re-launched random audit programmes had been completed to date, the 2006 programme was 98% complete, the 2007 programme was 94% complete and the 2008 programme was 81% complete.

Figure 42 Random Audit Results 2006 to 2008

	2006	2007	2008
Number of Cases			
Sample Selected	402	401	403
Completed Cases	383 ^a	376	327
Incorrect Period Audited	11	2	—
Cases on Hands at 30 June 2009	8	23	76
Yield			
	€	€	€
Yield for Base Year	1,479,200	765,571	881,498
Yield from Other Years	709,974	1,116,557	713,566
Total Yield	2,189,174	1,882,128	1,595,064
Average Yield for Base Year	3,882	2,036	2,696
Total Average Yield	5,585	4,979	4,878
Yielding cases as a % of completed cases	31%	33%	28%

Note:

a Includes two dropped cases

Review of Results of 2007 Programme

12.13 Revenue do not analyse the results of random audit cases under the trade sector in which the case operates. Such an analysis by Revenue could provide information on compliance risks and taxpayer behaviour in particular sectors. As part of this review, the results of the cases completed to date from the 2007 RAP were examined. The trade sector in which each case operated was determined from the tax record. The percentage of yielding and non-yielding cases in each sector is shown in Figure 43 which also shows the proportion of revenue collected from each sector based on receipts under the main tax headings and the percentage of random audits carried out in each sector. The quality of this analysis is subject to the accuracy of the trade sector code recorded on the tax record.

12.14 Some sectors show significant departures from the overall totals of 33% yielding and 67% non-yielding. Care is required in using these sectoral figures, particularly where a small number of cases were audited in a sector. Review of the six sectors where more than 25 random audits were completed, suggests significant differences in the pattern of yielding audits. Two of these sectors (construction and transport) have a higher level of yielding cases than the average at 45% and 52% respectively. While three other sectors (agriculture, community and proprietary directors) have a relatively lower number of yielding cases at 25%, 21% and 8%, respectively. On the basis of a smaller number of completed audits (15 and 11 respectively) the outcome of 40% of yielding cases in the health sector and 46% in the wholesale trade sector may also merit further review. This simple analysis demonstrates the value that could be obtained from a more detailed sectoral analysis of the results of random audits, not least in determining whether the results of random audits support Revenue's view of where risk lies.

Figure 43 RAP 2007 – Sectoral Analysis

% of Revenue Collected in Sector^a	% of Random Audits in Sector	Sector	Yielding Random Audits
%	%		%
2	14	Agriculture, Hunting, Forestry, Fishing.	25
10	5	Manufacturing	18
13	15	Construction	45
5	2	Motor Industry	67
8	3	Wholesale Trade of Personal and Household Goods	46
8	4	Retail Trade of Personal and Household Goods	38
3	3	Hotel and Restaurant	33
5	8	Transport, Storage and Communications	52
11	2	Financial Industry	50
16	17	Professional Services	35
6	1	Public Administration, Education and Defence	60
4	4	Health Industry	40
2	8	Community, Social and Personal Service Activities	21
— ^b	11	Proprietary Directors	8
7	3 ^c	All Other Sectors	9
100	100	Total	33

Notes:

- a Includes Domestic VAT, PAYE, Self-Assessed Income Tax, Corporation Tax and Capital Gains Tax only. Percentages are based on revenue collected in 2007.
- b Revenue collected in this sector is included in the All Other Sectors category.
- c These are cases for which trade sector codes could not be identified.

12.15 While acknowledging the value of sectoral studies and welcoming any ideas on how to improve Revenue's analytic capability in relation to the various economic sectors, the Accounting Officer stated that in her view a random sample based on the general body of taxpayers could not be validly used to make inferences about specific economic sectors. Separate random samples of those sectors would be required in order to do this.

Audit Yield and Declared Liability

12.16 The total additional base year yield from the 2007 RAP audits completed to date is some €765,571 (€540,682 tax and some €224,889 in interest and penalties). A key element in establishing the significance of this outcome would be provided by relating it to the original declared liability for the audited cases. Revenue does not, at present, collate this information, although it is planned to do so³⁹.

12.17 My audit established the original declared liability in respect of the cases from the 2007 programme for two sectors, wholesale trade of personal and household goods and professional services. In this sample test, the audit yield as a percentage of the original declared liability was just over 2% — 0.6% for wholesale trade and 4% for professional services. The percentage uplift for each of the two sectors examined analysed by taxhead is set out in Figure 44. The regular performance of this type of analysis for all RAP cases would provide an indication, on a monetary basis, of where non-compliance is concentrated.

Figure 44 Percentage Increase in Liability for Two Sample Sectors

Sector	Income Tax	VAT	Employers' PAYE/PRSI	Total
	Percentage Increase in Declared Liability from Random Audit			
	%	%	%	%
Wholesale Trade	2.1	0.3	1.3	0.6
Professional Services	4.5	7.3	0.3	4.0
Total	4.5	2.0	0.8	2.2

Note: Percentages have been computed using audit yield before interest and penalties

12.18 This analysis of audit yield and declared liability in two sectors demonstrates that the percentage of yielding audits by sector as set out in Figure 43 can only be taken as indicative and that a more in-depth review of compliance within sectors on the lines of that presented in Figure 44 would be needed in order to draw firm conclusions capable of driving Revenue's compliance actions. However, subject to that the potential of the information yielded should not be underestimated. Overall, the benefit of random audit results lies in their connection to real world client behaviour, thus providing a solid basis to ground compliance actions.

Type of Non-Compliance

12.19 The reason for the additional liability as agreed is summarised in the audit report on every yielding Revenue audit, including random audits. Revenue does not collate this information in respect of the yields arising on the random audit programme.

12.20 My examination sought to establish from the relevant Revenue audit records the type of non-compliance that led to the audit yield in a sample of 25 cases. In nine of these cases the taxpayer made a voluntary disclosure of underdeclared tax. The reasons in each of the 25 cases could be broadly categorised as follows

³⁹ The Central Statistics Office has requested this information as they wish to use it to estimate the increase required to the calculation of GDP arising from undisclosed income.

- Understatement of liability 15 cases
- Technical tax matter 9 cases
- Other 1 case.

12.21 It is difficult to be fully certain of the cause of the increased liability when not directly involved in the audit and therefore such categorisation is best done by those who conducted the audit. Analysis of the reasons for audit yield on random audits into appropriate categories could allow Revenue to categorise risks identified as well as provide valuable information into patterns of non-compliance and intelligence on taxpayer behaviour. It would also be beneficial in seeking to broaden understanding of the underlying causes of non-compliance.

Measuring Compliance

12.22 The ultimate measure of performance of a State Revenue service is the extent to which it minimises uncollected tax. Uncollected tax is often classified into two categories that are commonly referred to as the “tax gap” and the “audit gap”.

12.23 The “tax gap” is a wider concept covering all recorded and unrecorded economic activity in the State including the “grey economy”. It has been defined as the difference between the total amount of tax due if all those liable to tax complied with all legislative provisions, including registration, and the amount of tax actually paid.

12.24 The Accounting Officer stated that Revenue did not attempt to estimate the tax gap.

12.25 The “audit gap” is a more immediate target for Revenue activity, in that it refers to the difference between the amount of tax that would be collected if all taxpayers were audited and the amount they voluntarily pay under the self-assessment system.

12.26 A well-designed and well-operated random audit programme would provide a realistic indication of the valuation of the audit gap through the extrapolation of its results. The quality of information is dependent on the selection process, a commitment to completion of all audits within a reasonable period, the accurate recording of the required details and fully collating all relevant information.

12.27 While estimation of the amount of the audit gap provides a guide to the application of resources, the movement in the amount from year to year is an important measure of overall performance.

12.28 In relation to the audit gap, the Accounting Officer stated that the percentage of non-yielding audits in the random audit programme had been fairly stable at around 70% over a number of years. She stated that many of the yielding random audits were only marginally yielding i.e. yields of less than €2,000.

12.29 Revenue has commenced a project to examine the use of the Risk Analysis, Evaluation and Profiling System (REAP) scoring (see Chapter 13) to track movements in compliance measurement for the whole taxpaying population, for specific groups or for sectors. When a suitable model is developed it can be used to track the risk related to any group of identified cases. Revenue hope to have the general shape of the model ready before the end of 2009.

12.30 The Accounting Officer also informed me that Revenue were examining how elements of the discontinued re-audit programme (see Chapter 3.7 of the 2007 Report) could be incorporated into REAP as a means of tracking compliance. Some 500 cases were to be selected across a range

of audit outcomes but focussing mainly on higher yielding cases. These cases would then be tracked electronically through the REAP system.

Conclusions

A random audit programme has an important role to play in validating risk assessment, measuring both compliance and organisational performance and promoting awareness that every taxpayer has a chance of being audited.

The re-launched random audit programme is now entering its fifth year and if its benefits are to be fully realised, Revenue needs to ensure that there is a clear focus to the programme, audits are completed promptly, audit quality is maintained and full use is made of the results. The results of random audits to date have not been used to measure compliance across the taxpayer population generally.

Revenue should now be in a position to ensure that the programme meets these objectives and to consider how the data provided by the programme can be utilised as a performance measure for the organisation.

The programme could also have a value in targeting sectoral compliance work through its capacity to identify sectors that may need additional in-depth follow up.

