TECHNICAL NOTES AND MANUALS

# Revenue Administration: Taxpayer Audit—Development of Effective Plans


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# Revenue Administration: Taxpayer Audit—Development of Effective Plans

Edmund Biber

**This technical note addresses the following questions**

- What is the value of audit planning?
- What should be considered in planning an effective taxpayer audit program?
- How is an audit strategic plan developed?
- How is an audit operational plan developed?
- How is an audit case plan developed?
- How can plans be evaluated?

## I. What Is the Value of Audit Planning?

**The role of audit extends beyond verification.** It is generally accepted that a tax audit is an examination to determine whether a taxpayer has correctly reported and assessed their tax obligations. However, the role of an audit program in a modern tax administration must extend beyond merely verifying a taxpayer's reported obligations and detection of discrepancies between a taxpayer's declaration and supporting documentation.

**A well managed audit program plays a major role in managing compliance.** An effective audit program will have significantly wider impacts than just raising revenue directly from audit activities. By selecting the highest risk cases, efficiently detecting non-compliance, applying appropriate sanctions, and publicizing results of audit activity (either generally or specifically), taxpayers are put on notice that attempting to avoid tax will result in a high likelihood of detection and imposition of significant sanctions. Thereby, a well planned audit program can provide the administration with significant leverage across the community rather than only impacting on the taxpayer selected for audit and collecting the tax that should have been paid in the first place. Additionally, a tax system that is perceived to be fair and equitable by punishing taxpayers who do not comply builds com-

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munity confidence and encourages compliance from the broader population as compliant taxpayers support the administration's efforts to deal with non compliance.

The impact of an effective audit should be seen in terms of the following effects:

- Corrective – making adjustments to rectify instances of non compliance.
- Deterrent – influencing the behavior of the audited taxpayer or group of taxpayers to be compliant in future.
- Preventative – persuading the broader community to comply.

**A well structured audit program plays an important part in improving the effectiveness of other parts of the administration.** As well as detecting and addressing non-compliance, audit can provide valuable support in the following areas:

- **Information and Intelligence.** By having extensive access to the business community, the audit program can gain a lot of information and intelligence that may inform the revenue administration of practices that may be jeopardizing compliance and revenue collection. This information is critical to the development of appropriate treatment strategies in other parts of the administration, for example, taxpayer service, policy and legislation, collections and filing and payment enforcement, issuing taxpayer alerts,[1] as well as influencing the selection of future audit and investigation cases.
- **Addressing deficiencies in the law.** Auditors will often detect taxpayer practices that exploit weaknesses in the law. Although not classified as evasion, these systemic avoidance practices may actually undermine the original intent of the relevant laws. Instances should be escalated to policy and legislation managers to address the issues through amending legislation. Furthermore, if auditors observe recurring patterns of avoidance, it may indicate inappropriate penalty provisions that may need to be amended to provide an adequate deterrent.
- **Law clarification and education.** The audit program also plays an important part in clarifying the law and educating taxpayers on appropriate compliance measures, such as legal filing requirements, deductibility of expenses, and improved record keeping. As well as providing direct guidance to taxpayers during audit activity, the audit program should refer common areas of non-compliance to the taxpayer services program managers so that they can be addressed in wider taxpayer education initiatives.

**The trend to self assessment has increased the importance of the audit program.** The spread of VAT has increased the dependence of administrations on self assessment[2] and there has been general trend to adopt the same approach to the administration of income tax. Given the role of audit in influencing compliance and the significant proportion of an administration's resources devoted to the audit function,[3] it is critical that audit activities are driven by well designed

[1]For example, the Australian Taxation Office (ATO) issues "Taxpayer Alerts" as an early warning of concerns about significant and emerging potential aggressive tax planning issues.

[2]It is widely accepted that VAT must be a self-assessed tax.

[3]The audit program generally receives the largest slice of a tax administration's resource allocation, often over 30 percent. Refer to "Tax Administration in OECD and Selected Non-member Countries: Comparative Information Series (2006)".

plans that will deliver improved compliance. Effective planning is required to ensure that the audit program is adequately developed to: (1) focus on and address the most significant risks; (2) target non-complaint taxpayers and not harass compliant taxpayers; (3) make optimal use of limited resources, and (4) influence compliance across the broader taxpayer community.

**Publicizing audit programs can influence compliance behavior.** Administrations are increasingly releasing compliance plans to alert taxpayers as to risk areas or issues that are causing concern and what action (including audit) is being taken to address the concerns.[4] Although not publishing the whole audit plan, the practice of highlighting risk areas and the number of audits being conducted in specific market segments and industry sectors alerts taxpayers to risks of non compliance.

## II. What Should Be Considered In Planning An Effective Taxpayer Audit Program?

**Development of audit plans requires more than quantifying the number of audits to be undertaken.** There needs to be a comprehensive approach to the planning of strategies to address all of the elements of an effective audit program.

**Organizational structure, roles and responsibilities.** Planning should take into account the organization of audit activities within the administration, clearly reflect the nature of work to be performed, and articulate respective accountability. The three approaches to organization described below have become accepted as good practice.

- ***Headquarters and Operations.*** Two clearly distinguishable divisions are required to manage an effective audit program with clearly articulated roles: (1) headquarters—responsible for design, strategic management, monitoring, and support of the audit function; and (2) operations—responsible for the delivery of the audit program.
- ***An integrated functional approach.*** Increasingly administrations have integrated the management of direct and indirect taxes to have one audit function responsible for all audit activity across all tax types. This approach facilitates the development of comprehensive national audit plans and balancing the allocation of available audit resources according to assessment of risk.
- ***Segmentation and specialization.*** As taxpayers have different characteristics and present different risks to revenue, administrations have been gradually moving towards grouping taxpayers according to common characteristics. For instance, it is common for administrations to have a dedicated Large Taxpayer Office (LTO), with specialist teams for particular industry sectors, for example: banking; mining; and telecommunications. Even if not provided as part of the formal organizational structure, the characteristics of taxpayer and industry segments need to be accommodated in the development of audit plans as they represent distinct risks and will require different audit treatment. Segmentation also aids the administration in recognizing the different levels of complexity in audit work and distinguishing the competency requirements, classification and remuneration of auditors to plan staffing accordingly.

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[4]ATO annually publishes a "Compliance Program" that includes references to audit results of the previous year and planned current year audit activities and other initiatives to address risks to compliance. New Zealand Inland Revenue Department publishes an "Output Plan" that includes details of the budget devoted to audit activities and associated outputs and performance measures.

**Range of plans.** Each layer of the audit program needs to have cascading and interrelated plans with clear objectives that reflect the administration's strategic plan. Planning and performance monitoring should be conducted at three levels:

- ***Strategic*** – a business plan for the audit program, linked to the administration's strategic plan and compliance plan reflecting audit organizational structure, policies and procedures, and setting objectives, strategies, activities, resources, timelines, performance measures, and responsibilities.
- ***Operational*** – allocation of resources and articulation of audit coverage for market segments, industry sectors, and regions, and quantifying types of: (1) audits to be conducted; (2) taxes or issues to be examined; and (3) taxpayer entities to be addressed in a given period.
- ***Case*** – plan to address areas of risk for each audit case to ensure that appropriate methods, techniques, and processes are employed during the audit.

Each level is interdependent on the others and hence must complement each other. A great strategic plan is of little value if it is not supported by an operational plan that reflects the strategic priorities, and a case plan that does not address risks and policies identified in higher level plans will not lead to achievement of objectives. The process for developing effective plans at each level is detailed below.

**Legislation.** To be effective, an audit program needs to be supported by a legislative framework that: (1) requires taxpayers to maintain appropriate books and records; (2) provides the administration with adequate powers to conduct wide ranging enquiries; (3) allows delegation of the powers to staff conducting audits; (4) allows reconstruction of income and reassessments of tax using a range of methods and techniques within a generous timeframe; (5) gives taxpayers a right of appeal; (6) places a burden of proof on the taxpayer; and, (7) applies sufficient penalties to deter non compliance. Management needs to monitor the audits to ascertain if the legislation is deficient, not understood, or inconsistently applied, in any of these areas, and develop plans to address such deficiencies. Plans may include: proposing amendments to existing laws or developing a tax procedure code;[5] testing the law and establishing precedent before the courts; clarifying the law through interpretive rulings and education; and improving the training of auditors.

**Risk-based approaches.** As noted above, the audit program plays an important part in managing compliance and is expected to contribute to a range of corporate objectives beyond raising revenue from the detection and correction of understatements. Plans therefore need to be anchored on strategies that complement each of the objectives, allocate resources to activities that address risks, and prioritize actions according to the greatest impact on the achievement of objectives.

As well as delivering a certain amount of revenue, objectives are likely to include: improving compliance; operating within specific budget constraints; minimizing taxpayer compliance costs; and securing community confidence in the tax system. Risks to attaining those objectives will usually include: lack of understanding of taxpayer characteristics, behavior, and areas of non compliance; insufficient or inappropriate allocation of resources to non compliant sectors; poor

[5]Single legislative act establishing common administrative provisions relating to all tax types rather than having these scattered throughout various substantive laws in respect of each tax.

case selection; unsuitable audit methods and techniques; inadequate legal support; weak management and auditor capability; and an ineffective penalty regime. Each level of planning: strategic; operational; and case; needs to be accompanied by strategies to address the risks to attaining the objectives of the particular strategy.

**Scope of audits.** The nature of audits conducted should reflect the risks to be addressed and desired audit coverage of the taxpayer population. For instance, it is inappropriate to conduct all audits on the basis of comprehensive examination of documentation across all tax obligations and all periods that could be open for amendment. Such an approach will invariably waste resources targeting compliant taxpayers and limit the number of audits that can be undertaken. A balanced operational audit plan will optimize resource usage and coverage by utilizing a wide range of audit 'products'. A brief description of types of audit is provided at Box 1.

**Methods and Techniques.** An effective case plan will be cognizant of a range of investigative and analytical approaches that may be adopted by auditors to verify compliance. Practices will vary depending upon the area of risk and the circumstances of the particular taxpayer. For example, the nature of the taxpayer's operations, adequacy of books and records, and materiality of potential adjustments, will influence decisions regarding the type of tests to be undertaken and whether the auditor can rely on the records to address specific issues or needs to use indirect methods.[6] Case plans need to be flexible enough to be altered as the audit progresses and new

### Box 1. Description of types of audit

**Registration checks.** A quick check on businesses to establish that they are correctly registered.

**Advisory audits.** A visit to newly established businesses advising obligations in terms of tax types, filing of returns, payment of amounts due, records to be maintained. Very appropriate when introducing new laws.

**Record keeping audits.** The visit points out the obligations of the taxpayer in regard to the keeping of records and followed up with penalties if the taxpayer continues to disregard record keeping requirements.

**Desk audits.** Basic checks conducted at the tax office when the auditor is confident that all necessary information can be ascertained through in-office examination.

**Single (or specific) issue audits.** Focusing on a single tax type or a single period.

**VAT Refund audits.** Verifying the taxpayer's entitlement to a refund prior to processing the refund. Usually undertaken for first refund claims as well as where the refund claim varies significantly from established patterns and trends.

**Audit projects.** Audits can be organized as a separate project for specific groups of taxpayers: an industry (e.g., construction); or a line of business (e.g., retail) and/or certain items from the declaration or profit and loss account (e.g., depreciation); to address a particular risk or to establish the degree of non-compliance in a particular sector.

**Comprehensive (or full) audits.** All tax obligations over a number of tax periods. As they are usually time consuming, they should only be applied to those taxpayers if there is an indication of under reporting that will impact across taxes.

**Fraud Investigations.** Involve the most serious cases of non compliance that have criminal implications—fraud, evasion, and criminal activity. Require special skills in investigation and evidentiary requirements.

matters come to light, yet sufficiently ordered to be in line with formally articulated audit policies and procedures. Strategic plans need to provide for enhancement of auditor capabilities, audit tools,[7] and quality assurance processes, to support good case management practices and consistent application of policies and procedures.

**Performance management.** Integral to any audit plan is a suite of performance measures to assess effectiveness. As well as stipulating the indicators of successful performance, plans should also provide for the mechanisms to monitor results in terms of outputs and outcomes.[8] Approaches to evaluating achievements are discussed below.

## III. How Is An Audit Strategic Plan Developed?

The strategic planning process for an audit program is an extension of the same process for the overall tax administration. This involves the development of a business plan for the audit program that explains how the functional area will be managed to deliver key objectives by sequentially addressing each of the areas (A – G) described in Box 2.

As noted above, plans need to address a wide and varied range of audit objectives and strategies, both external (e.g. taxpayer non-compliance) and internal (e.g. auditor capability), at both headquarters and operational levels of the audit program. Formulating a business plan along the lines shown in Box 2 will provide a comprehensive picture of how audit will contribute to meeting corporate objectives, together with a clear indication of what contribution is expected from all those involved in the audit program and how performance will be measured.

## IV. How Is An Audit Operational Plan Developed

**Based on the strategic plan, the operational plan quantifies the audits to be conducted, staffing levels, and workload commitments for each operational area.** An example of a basic national audit operational plan with a description of each component is shown at Box 3. The steps involved in developing the plan are described below.

***Step one: disaggregate the taxpayer population.*** To match the organizational segmentation and specialization discussed above, it is necessary to establish the taxpayer population "owned" by each operational group, for instance, in the example at Box 3 the three segments could be attributed to the offices managing large, medium, and small taxpayers.

Using data from tax registrations and declarations, the population of each area should be further broken down into homogeneous groups based on:

- Predominant business activity or industry
- Location of operations
- Type of tax obligation—e.g. VAT, income tax, PAYE, excise;
- Type of entity ownership—e.g. company, individual, partnership, trust

[7]Tools may include procedural manuals, practice notes, process maps, industry and taxpayer profiles, computers and IT applications that aid audit case selection, planning, and execution.

[8]For example, outputs may be the number of audits, amended assessments, or revenue generated, and outcomes may be improvements in levels of compliance, quality of audits, or auditor productivity.

**Box 2. A typical structure of an audit business plan and relevant explanations.**

**A - Objective**

| B<br>**Strategies**<br>(How will the objective be achieved) | C<br>**Activities**<br>(what will be done) | D<br>**Resources**<br>(Staffing and administrative budgets) | E<br>**Timelines**<br>(When) | F<br>**Performance measures**<br>(Outputs/ Outcomes)<br>(Quantity/ Quality) | G<br>**Responsibility**<br>(Accountability—who's PA will this appear in) |
|---|---|---|---|---|---|
| | | | | | |

**A**—Each key objective is articulated. The objectives must be aligned to the corporate plan and should be SMART: Specific; Measurable; Achievable; Realistic; and Timely. For example, to complement the corporate objective of improving compliance, audit may have an objective to: *Adopt risk based approaches to case selection.*

**B**—For each objective, strategies should address risks to meeting objectives. For example, for the above objective, strategies may include: profiling of large taxpayers; and introducing automated risk ranking systems.

**C**—Activities should define what needs to be done to implement strategies—what needs to happen. For example, for the above strategy, activities may include: develop a profiling template and data base; capture the characteristics of the largest 300 taxpayers into the database; develop financial analysis tools to interrogate database; assign risk levels to each of the largest 300 taxpayers.

**D**—Resources—Should be expressed in staff numbers—annual full time equivalent (FTE)—required to do the task. For example four staff for three months equals 1FTE. Unless resources are allocated to the activities, the plan will be merely a "wish list". Assigning resources results in assignment of priorities.

**E**—Timelines define the milestones for the activities. For example large taxpayer profile database register to be established by June 30, 2010. Timelines also reflect priority.

**F**—Performance measures—Rather than using the general term *"Increased compliance",* performance indicators need to be expressed in terms of measurable indicators in respect the particular strategy being addressed. Following the above example, a performance indicator may be: 75 percent of large taxpayer audits selected on the basis of profile analysis by January 2011.

**G**—Nominate personal accountability for this strategy or activity. This should then be included in that person's performance agreement or expectation statement. Be specific; do not use the term "all managers" or "Commissioner". For example: assign the profiling exercise to the Large Taxpayer Office Research and Planning Division.

- Maturity of operations—e.g. new business, established business;
- Sphere of operations—local or multinational; and
- Turnover ranges.

For example, 325 large taxpayers may be represented by: 35 banking and financial institutions; 45 mining companies; 45 in telecommunications and information technology; 80 in manufacturing; 35 in property development and construction; 65 in services and other industries; and 20 government agencies. Of the 80 in the manufacturing industry, 45 may be foreign owned corporations with 25 percent of those operating in several regions across the country.

As each group will have its own distinct characteristics and risks, breaking up the total numbers into smaller identifiable groups will allow better targeting of activities to address risks.

### Box 3. Example of a basic audit operational plan.

**A—XRA Annual Audit Program: January 1 – December 31, 2010**

| B<br>Taxpayer segment | C<br>Number of T/Ps | D<br>Audit staff | *E*<br>*Total staff days* | *F*<br>*Staff days Specific audits* | G<br>Number of specific audits | *H*<br>*Staff Days Full audits* | I<br>Number of full audits | J<br>Total audits | K<br>Coverage (percent) |
|---|---|---|---|---|---|---|---|---|---|
| Large | 325 | 20 | *4,000* | *2,000* | 100 | *2,000* | 33 | 133 | 41 |
| Medium | 1,118 | 15 | *3,000* | *1,500* | 150 | *1,500* | 60 | 210 | 18 |
| Small | 3,514 | 10 | *2,000* | *1,000* | 200 | *1,000* | 100 | 300 | 8 |
| Total: | 4,957 | 45 | *9,000* | *4,500* | 450 | *4,500* | 193 | 643 | 13 |

A—Plan is usually on an annual basis, but could be adjusted to a six month plan by halving the number of available staff days and audits. Dates are aligned to corporate plan – usually to the fiscal year.

B—Segmentation based on turnover ranges.

C—Number of registered taxpayers.

D—Average number of operational audit staff available for the particular period.

E—Available audit staff days. "D" multiplied by 200 days per staff member available for audit activity, based on: 365 annual days; less 135 days for weekends, public holidays, and leave; less 30 days for training and other duties.

F—Available specific audit staff days. In this example, 50 % of audit time is devoted to specific issue audits.

G—Number of specific issue audits based on average staff days to complete one audit: In this example: Large – 20 days; Medium – 10; and Small – 5. That is, a large taxpayer specific issue audit with a team of two auditors taking an average of 10 days (two weeks) to complete equals 20 staff days.

H—Available comprehensive audit staff days. In this example, 50 percent of audit time is devoted to comprehensive audits.

I—Number of full or comprehensive audits based on average days to complete one audit: Large – 60; Medium – 25; and Small 10. That is, a large taxpayer full audit with a team of two auditors taking an average of 30 days (six weeks) to complete equals 60 staff days. If a team of three auditors is employed on the audit, a completion in 20 days (four weeks) equals 60 staff days.

J—Total audits: Specific issue audits plus comprehensive audits.

K—Coverage equals number of audits expressed as a percentage of the taxpayer population; In this example, Large: 133/325 = 41%; Medium: 210/1118 = 18%; Small: 300/3514 = 8%; and Total: 643/4957 equals 13% coverage.

***Step two: determine the key compliance risks that are to be addressed and categorize respective groups of taxpayers.*** It is well accepted that an audit program cannot hope to audit every taxpayer or address every risk. It is therefore necessary to prioritize the risks.

Basic prioritization may be as simple as determining that large taxpayers present a higher risk than medium taxpayers who in turn present a higher risk than small taxpayers, as represented in the example in Box 3. However an administration needs to go further and describe, prioritize, and assign risks in greater detail. Following the example above, multinational corporations present a greater risk in comparison to local firms due to their opportunity to shift profits offshore.

Therefore, transfer pricing may be rated as a high risk, and as there are 45 multinational corporations, a high risk rating may be assigned to these taxpayers. Conversely, it may be perceived that the 20 government institutions are highly regulated, compliant, and present little risk and therefore assigned a low risk rating.

***Step three: determine amount of available audit resources.*** The number of audits that can be completed has a direct relationship to the resources—staffing and administrative funding—available to the audit program. Corporately, a decision will be made on the proportion of the administration's resources to be devoted to the audit function. Within the audit program, the resources then need to be split between headquarters (design, monitoring, and support) function and the operational areas. Consideration must be made of factors such as auditor's leave and time not directly devoted to audits, for example leave and training.

***Step four: assign resources to areas of highest risk.*** To optimize the impact on compliance, resources need to be allocated to balance coverage across taxpayer segments and tax types, yet address major risks to compliance. Simplistically, if most of the risk is within the large segment, then allocation may represent that in Box 3: total of 50 audit program staff assigned to: headquarters - 5; LTO – 20; Medium – 15; Small – 10; and following the example in step two, 25 percent of LTO staff may be allocated to multinational manufacturing company audits, while only 5 percent may be devoted to government agency audits. It will be necessary to also determine the extent of attention to be given to the respective groupings highlighted in step one.

***Step five: determine the appropriate audit products to be used to address risks.*** There must be an assessment regarding the optimal treatment of risk. For instance, will a desk audit suffice, or will it be necessary to conduct comprehensive audits? The better the knowledge of the business environment and the extent of the risk, the better will be the ability to select the right product.

***Step six: allocate time to audit products.*** Audit coverage will be dependent upon the nature of auditor intervention and the duration of that intervention. The audit products described in Box 1 can be used be used across all segments, however time for completion will vary substantially from segment to segment. In the example at Box 3, the average time to complete a comprehensive audit is: Large - 60 staff days; Medium - 25; and Small -10. Factors influencing the standard time allowed for the completion of an audit include: scope of audit; methodology adopted; type of taxpayer; skill level of auditors; and number of auditors to be allocated to a case.

***Step seven: determine number of audits to be completed.*** Using the staff time allocated to a particular category of work and the time necessary to complete the designated type of audit, extrapolate the number of audits that can be completed. Using the example in Box 3, in the large segment, 2,000 staff days allocated to specific audits at 20 days per specific audit, equals 100 audits; and 2,000 staff days allocated to comprehensive audits at 60 days per comprehensive audit equals 33 audits for a total of 133 audits. The exercise needs to completed across the range of audit types and where possible, for the groupings noted in step one.

***Step eight: determine coverage.*** Applying a percentage to the number of taxpayers to be audited over the number of taxpayers on the register will provide the coverage figure. In the example in Box 3, completing 133 large case audits in a large taxpayer population of 325 will result in coverage of 41 percent.

***Step nine: review and revise coverage to ensure adequate attention to all areas of high risk.*** During the planning exercise constant reference needs to be made back to the risks identified and prioritization to ensure that the coverage is appropriately relative to the level of risk assigned to each group. If the administration is fortunate enough to have ample resources, the planning exercise could be conducted in a different sequence: first, deciding the level of coverage required, e.g. audit 50 percent of large construction companies, and then determining the number of staff required. However, as administrations will usually have a limited pool of resources, it is necessary to base coverage on the number of audits that can be performed by the available number of staff, and varying the level of coverage by altering the mix of audit products. In the example above, changing the large segment staff days (4,000 days) from a 1:1 ratio mix between specific issue audits (2,000 days) and comprehensive audits (2,000 days) to a 3:1 ratio mix, would lead to having 3,000 days for specific issue audits and 1,000 days to comprehensive audits resulting in 150 specific audits and 17 comprehensive audits, totaling 167 audits, and equaling a coverage of 51 percent rather than 41 percent calculated earlier, yet not increasing the number of staff.

***Step ten: aggregate results into a national audit operational plan.*** By combining the audit plans of respective areas: large; medium; and small; a national audit plan is created showing the allocation of all available operational resources across the various sectors of the taxpayer population.

**Once the plan is completed, cases fitting the respective case profiles are selected for audit.** For example, if the plan shows that 25 large multinational manufacturing companies should be audited, it will be necessary to identify the taxpayers exhibiting those characteristics and using the assigned risk ratings, select the highest ranking taxpayers for audit and allocate them to audit teams with the necessary skills to perform the audits.

**The detail of the operational plan will depend upon the availability and integrity of information and staff.** The plan will only be as good as the credibility of the data on which it is based. The first step, disaggregating the taxpayer population, is obviously dependent upon having reliable information enabling the classification taxpayers into respective groupings. Risks can only be addressed if properly identified. Standard completion times for respective audit types must be achievable, and resources need to actually be available and trained in the various audit types detailed in the plan.

## V. How Is An Audit Case Plan Developed

**The process for developing an audit case plan is critical** to ensuring that an auditor adopts the right techniques relative to the risks involved and completing the audit in line with the audit program policies, plans, and procedures. The plan acts as an assurance for auditors and a checking mechanism for supervisors and increasingly taxpayers[9] in that these parties agree to the documented plan and it is a record of what is to be undertaken in the audit and should clearly define responsibilities. Although it is created at the commencement of an audit, it should remain flexible enough to be modified if new issues emerge during the course of the audit. For example, a specific issue audit may need to be escalated to a comprehensive audit or a fraud investigation if evidence of evasion or fraud is detected during the audit. Case planning should involve the following stages.

***Stage one: understand the task and outcomes expected.*** The auditor needs to understand the reason behind the decision to undertake audit activity on the particular taxpayer. This will include: the risk assessed; other activity that resulted in the selection of the taxpayer; and the purpose of the audit activity; e.g. educational, record keeping, detect avoidance, or part of compliance measurement project. Outcomes can be revenue or non-revenue related. They may include: establishing a level of compliance; adjusting understatements; advisory visit to educate taxpayer; and record keeping inspections.

***Stage two: understand the taxpayer's compliance history.*** The auditor needs to examine and analyze filing records, payment records, declarations, financial statements, previous communications with the taxpayer, and previous audit records, to establish patterns and trends in performance and behavior.

***Stage three: understand the taxpayer's operations.*** The auditor should be familiar with the nature of the taxpayer's operations, for example: business activity; ownership; organizational arrangements; size of operations; competitors; likely suppliers and customers; and expected margins. Administrations are increasingly developing sector and taxpayer profiles to provide auditors with this valuable information at the preparation phase of an audit.

***Stage four: audit focus.*** On the basis of the understanding of the taxpayer's business, compliance behavior, and areas of risk, the auditor identifies key areas of focus for examination, for example: sales, cost of goods sold, depreciation, transfer pricing, or withholding taxes. The plan should also include some sequencing of issues to be examined to ensure that the auditor addresses critical areas early in the audit.

***Stage five: scope of the audit.*** By selecting the type of audit and the appropriate methodology, the auditor establishes the scope of the audit. This will entail planning: what information is to be gathered and method of recording; how to access documentation; analysis techniques; interview targets and questions; and use of direct or indirect methods.

***Stage six: understand areas of law and policy.*** The auditor should be familiar with the law and policy that may apply to the focus areas. For example, if the audit involves determining the eligibility for specific deductions, exemptions, or rebates, the auditor needs to be familiar with the relevant provisions of the law and rulings relating to such concessions.

[9] A number of administrations develop an audit plan as a protocol indicating the scope of the audit, duration, personnel, and taxpayer facilitation, in consultation with the taxpayer.

***Stage seven: determine periods of review.*** The number of periods under audit will inform the next stages of the planning process. Unless there is clear indication of understatement in prior periods, the plan should focus on auditing the latest tax period.

***Stage eight: resource and time management.*** Identify resources required to undertake the scope of the audit. The size, complexity, and duration of each activity, experience and expertise of staff, and travel arrangements, will all play a part in assessing requirements. Timeframes and milestones also need to be established to allow easy monitoring of progress of the audit activities, for example: taxpayer interviews; third party interviews; site inspections, document inspections, completion of analysis; issue of position papers; and finalization of audit.

***Stage nine: documentation.*** Recording the planning process by preparing notations under the above headings in a standard working papers file will aid case management.

***Stage ten: authority to audit.*** The auditor's supervisor should endorse the audit plan to provide approval to conduct the audit as planned.

***Stage eleven: changes to plan.*** Circumstances during an audit may necessitate a change to the plan. For example, additional focus areas may be added, additional resources may be required, or scope of audit may be reduced if no concerns are revealed in key focus areas. The reasons for the changes need to be documented, endorsed by the auditor's supervisor, and recorded in the planning section of the audit working papers file.

## VI. How Can Plans Be Evaluated?

**Ultimately, performance will be judged on the achievement of objectives in line with the performance measures noted in the plan.** However, as there are many circumstances that will impact on the execution of the plan, it is not sufficient to merely say: we have achieved our objectives and therefore the plan was good. An effective plan seeks to optimize results (outputs and outcomes) from available resources (inputs) in a particular environment.

Although most administrations will have similar audit objectives, due to diverse risks and dissimilar capabilities, the environment within each jurisdiction will be different, and hence plans should also be different. It is therefore not possible to have one model of an audit plan, whether it is a strategic plan, operational plan, or case plan, to use as a yardstick. However, if the plans conform to the above principles and practices, and the administration employs good systems of governance, they will go a long way to effectively meet the administration's audit objectives. The steps discussed above can therefore be used as a checklist as to the elements that should be covered in the audit planning process.

## VII. Key Points For Tax Administration Design

Audit plans provide the guiding mechanism for managing the functional area that is usually assigned the largest proportion of a tax administration's resources, and is often considered the most critical function in managing compliance. It is therefore essential that formal planning processes are instituted at strategic, operational, and case levels of the audit program in line with the principles and practices detailed in this technical note.

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