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REVENUE SERVICE AUDIT DEPARTMENT

BUSINESS PROCESSES AND INFORMATION TECHNOLOGY (IT) SOLUTIONS

CURRENT STATUS AND RECOMMENDATIONS

FINAL

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USAID ECONOMIC PROSPERITY INITIATIVE (EPI)

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ABSTRACT

Significant improvement to a country's business environment can be achieved only with complex reorganization of key government institutions and public service providers. Such complex reorganization requires political will, administrative power, and the capability to engage information and communication technology for building solutions aligned to business needs and allowing for interoperability.

A business enabling environment, environments in which businesses establish and operate easily and without overwhelming administrative burden, is a precondition for each country's economic growth.

During the last few years, Georgia was a leader in the *Doing Business Survey*. (http://doingbusiness.org/rankings - Georgia is ranked 12 in 2010 among 183 countries; the break-point was in 2008) Despite this, the Georgian government is determined to work toward the country's economic prosperity through further improvements within the business environment and by establishing public service practices that are compliant with international standards. The USAID-funded Economic Prosperity Initiative (EPI) is designed to provide technical support to the Georgian government in achieving its goals.

One of the areas that should be addressed to improve the business environment (BE) is public services to businesses, which include tax administration and customs services. This document addresses tax audit functions of the tax administration.

At the beginning of 2011, the Revenue Service (RS) published its "*New Course*" paper outlining several main directions, including implementation of the new tax code, allowing for reliable services, and fair administration.

Some initiatives are already under way, including:

- Organizational changes;
- Development and implementation of e-audit and audit case management software solutions;
- Establishment of a mediation process as an integral part of the tax audit process;
- Development of manuals, guides, and templates for tax audits in order to impose standards; and
- Establishment of a tax audit quality control practice.

The leadership of the RS and the Audit Department realize and admit the need for changes to the existing practices in the areas of compliance risk management, tax audit planning and execution, and the quality of tax audits. They are determined to introduce new models of tax audits; a relevant quality control system; and a standard, manageable, and controllable business process widely supported by IT solutions in order to achieve their objectives. The leadership also realizes that these changes are possible only with highly qualified human capital. This is why the immediate short-term goal is to build capacity and capability through formal and informal training programs.

While the current status of a tax audit's organizational structure and operational levels has its justification in economic and political events, which occurred during the last few years, it is time for significant transformations in organizational structure and the scope of tax audits.

This should be accomplished by building on human capacity, capabilities, and operations in order to achieve Georgia's economic goals.

This report addresses three main topics: organizational structure of the Audit Department, business processes, and IT solutions facilitating those business processes.

Due to the agility of the BE during the period of this assignment: April 18-May 20, 2011, not all business processes were documented.

Information and facts reflected in this report were gathered from research on regulations, existing documents, and multiple working meetings with managers and employees of the RS, mainly from Audit Department.

CONTENTS

I. EXECUTIVE SUMMARY

The Revenue Service (RS) is committed to undertaking a significant transformation to its Audit Department's organization, functions, and performance. Despite the fact that there is no written strategy and approach for these changes, the efforts in establishing standards, introducing innovations, adjusting activities to international practices and standards, and paying attention to human capital development is a proven "*New Course*," outlined in a high-level program, announced by the RS leadership at the beginning of 2011.

The Audit Department is the focus of this analysis and it was completed at the time of ongoing changes to the department's organizational structure, management, and functions. This made it impossible to identify and document all business processes (BPs) and to redesign them, taking into account information technology (IT) capabilities. However, this paper contains a comprehensive list of BPs that exist, or should exist, within the Audit Department, as well as examples of the "to-be" process, which can serve as a pattern to follow when efforts and time are spent for the complete documentation of the Audit Department's BPs, along with identifying and prioritizing areas for computerization.

A comprehensive description of all BPs within the Audit Department will be possible once the organizational reorganization is completed, functions are defined, and roles and responsibilities are determined and documented. The description of BPs will depict what, when, and who will execute specific activities for a servic. The "how" will be included when the reengineering of the BPs for the purposes of defining requirements for the software is complete.

Some critical issues related to the tax audit operations that need more attention and careful review follow below.

CENTRALIZED VS. DECENTRALIZED TAX AUDIT OPERATIONS

With the closing of the West Georgia RS Bureau, tax audit operations are now completely centralized within the Headquarters (HQ) Office of the RS Audit Department. The centralization of tax audit operations began when businesses and human capital were concentrated in Tbilisi. However, such a practice is not generally acceptable because (1) it eliminates the distinction between centrally established and managed policy and procedures and tax audit operations, which leads to the lack of control mechanisms; (2) it is not an effective tax audit due to the disconnection of auditors from the environment within which businesses operate; and (3) it is not cost-effective.

A completely decentralized tax audit operations is not the best solution also, because it leads to: (1) underutilization of tax audit staff; and (2) decreases the possibility of developing high-expertise, which impacts the quality of tax audits.

Therefore, **a balanced model** is recommended, which determines the tax audit operations in a few regional centers covering the entire country. This transformation can start with moving tax audit operations from the HQ to Tbilisi regional tax offices.

At the same time, the government should develop mechanisms for attracting businesses to establish and operate outside Tbilisi. Government programs for developing certain regions

and specific business sectors can be designed and promoted. Those programs can include tax breaks as a mechanism for attracting investments in those regions and sectors. Simultaneously, the RS should design and execute programs for building capacity and in-depth experience for tax audits in the regions.

Removing operations from the HQ Audit Department will confirm that it will focus on (1) developing and maintaining policy and procedures, including manuals, guides, templates (standard working documents), and IT solutions, as well as (2) capacity and in-depth experience of quality control, compliance risk management, and tax audit planning.

TAX AUDIT TYPES (MODELS)

During the last few years, desk audits were the only existing form of tax audits performed in Georgia and this explains why a desk audit can be a full tax audit and can last quite a long time. The framework for desk tax audits, as defined by the new *Tax Code*, is quite loose. It is necessary that additional regulations be created for defining the business rules within which a desk tax audit should be performed. Usually the scope of a desk tax audit refers to a specific issue (topic) and does not require much time and specialization. The issues under a desk tax audit are usually resolved through identification and collection of documents and cross-checking/comparing data from those documents.

The RS already made a decision to restore the field tax audit practice. A few working groups are established to create manuals, guides, standard templates, and a new e-audit software tool that will be used by auditors when carrying out field audit activities. (*Although not finalized, the software is already in use*).

Before commencing the usage of those manuals, guide templates, and tools, it is important to understand that:

- The staff involved in tax audits should be trained on how to use those materials and tools.
- Those materials need to be organized into a database and be accessible by authorized staff for view and download.

To improve performance, auditors should be trained at the Faculty of Tax Administration and Customs on:

- Accounting (introductory, intermediary, and advanced training courses should be designed and offered);
- Tools to use during the audit process (templates, working documents, computer systems); and
- Basic knowledge and skills of the most popular accounting computer systems the business entities use

All BPs within the Audit Department should be documented. Redesigning of BPs should target optimization and should take into consideration IT capabilities. In addition, redesigning BP requirements for software need to be defined. Implementation of redesigned BPs should occur simultaneously with the implementation of software supporting/facilitating those BPs.

When redesigning BPs, the interoperability between RS departments, as well as interoperability with external institutions, should be envisaged. Some of the proposed “to-be” BPs, included in this report (see Appendix B), are cross-institutional.

The completion of tasks for documenting all BPs, redesigning them, and developing and implementing new software products requires time and specialized skills and can be effectively completed after the organizational structure is finalized, functions of each division/unit are defined, and roles and responsibilities are defined and documented. Owners and managers of BPs should be leading the efforts for redesigning BPs and implementing them.

Attachments to this paper (see Appendix B) provide (1) a list of identified Audit Department BPs; (2) diagrams of some “as-is” BPs; and (3) some proposed “to-be” BPs.

NEW MODELS OF TAX AUDIT

One priority of the RS is to design and implement **new and innovative models of tax audit,** designed to increase the effectiveness and efficiency of tax audits along with building capabilities and skills allowing correct implementation and management of those innovative models.

The working group, tasked to come up with the most suitable model for Georgia, should determine a relevant regulatory and operational environment for the implementation of the new models. Also, lessons learned from other countries should be analyzed and taken into consideration. Two examples of tax audit models not currently available in Georgia are provided in this paper, including tax audit outsourcing in Pakistan and managed self-tax audits in New Mexico, in the United States. After thoroughly researching nonstandard tax audit models applied in other countries, it is recommended that the RS conduct a study trip to gain first-hand information about the benefits of those models and potential pitfalls during their implementation.

MEDIATION

A mediation process was recently introduced as an integral part of finalizing a tax audit. It has proven to be a success and is very popular among taxpayers as a means for resolving disagreements on findings and assessments between the taxpayer and the tax audit team. This is a good approach for building relationships with taxpayers, improving the quality of tax audits, and discovering weaknesses and/or gaps within tax legislation.

The mediation process is in its initial (pilot) implementation. It is recommended that standard documents (templates) be designed and used for the mediation. Standardization will determine manageable and controllable processes. A software solution for managing mediation cases can also be developed and implemented.

RISK-BASED AUDIT SELECTION

The selection of cases for audit is not currently based on results from an existing Risk-Based Audit Selection (RBAS) system. There is resistance to using those results. The resistance is based on doubts about the criteria representation and reliability of the results. Initially, this is quite an unexpected reaction, because the criteria are widely discussed before being adopted for use. A criteria improvement process involves specialists from all levels within the Audit Department and passes through at least two levels of approvals. The current risk-scoring model has some deficiencies and new software should be developed. Fifteen criteria were hard-coded into the software. Recently, 39 new criteria were approved, but have yet to be run on the production database.

An attachment to this paper provides background for developing a new model of risk scoring and high-level software requirements for by maintaining a knowledge database about risk

criteria sets, calculating of scores, and ranking tax returns for tax audit. Recommendations for establishing a risk management processes is also provided, emphasizing a broader scope of risk management than a risk-scoring subject.

Usually risk management is established at the highest level within the organization and deals with all risks management. The two risk analysis units currently existing at the RS should work in very close cooperation and coordination with risk management.

IT SOLUTIONS

During the last three years, many new IT solutions have been developed and implemented, allowing taxpayers to easily submit tax returns and other required documents, pay their tax liabilities, and monitor their tax accounts.

The e-audit software, under development, should be finalized and all auditors should be trained on how to use it. Periodic revisions and improvements should be made based on additional collected data as well as the auditors' feedback.

Another type of software currently under development is an audit case tracking system. It is integrated with e-audit application. However, there are still some steps within the tax audit processes that continue to be carried out manually.

Unfortunately, the IT staff continues to be the driving force in any business application development and implementation. The role and responsibilities of the business experts and business owners is very limited. I would recommend establishing IT governance processes, which will ensure defining policy, standards, and involvement of businesses into development and implementation processes. IT Governance will also determine prioritization of the IT projects and higher quality of information and computer technologies (ICT) services.

Most of the IT solutions were developed under time restraints, without having the time to develop and follow a general concept and design of the RS e-portal. The IT Division at the RS is well aware of this and is planning to redesign the e-portal and introduce new online services for taxpayers and the RS employees (Currently, there is no software allowing any self-services for the RS employees).

Mainly because of time and funds constrains, the formal training of the IT staff was neglected. It is "must" to confirm annual training for all the IT staff in order to keep the staff abreast of the innovations, which will ensure a higher quality of the ICT services and a faster development of new applications. A list of formal training was prepared by the manager of the IT Center at the RS and is attached to this report. Training needs are driven by initiated and planned IT projects. The immediate needs are identified and will be worthy to be realized as soon as possible.

It was observed that currently, auditors do not interact with any computer systems, so a unit for so-called "information support and provision" was established. It is not acceptable for auditors to create paper documents and later for someone to capture the information from those documents into the computer systems. With the implementation of the e-audit software, we hope that this will change. All auditors should be able to work with computer systems during the audit process and enter/record all activities and findings by themselves. Only when specific document/information is needed, the Information Provision Unit should act.

QUALITY MANAGEMENT SYSTEM

One of the new initiatives at the RS is establishing a tax audit quality control practice. Quality control is one of the processes of a quality management system (QMS) (for example ISO 9000:2000), which is usually based on established standard operating procedures (SOPs) and control procedures.

A precondition for quality control is a complete and accurate documentation of all roles and responsibilities; BPs; designing and adopting standard documents; and implementing manuals, guides, and instructions.

It is recommended at the early stages to appoint a person responsible for building a QMS at the RS. The Audit Department can be used as a pilot for building a QMS across the RS.

An initial draft of the quality control procedure is prepared by the Legal Division. Generally, the quality control should check and confirm that the tax audit was executed in accordance with regulations and following adopted and recommended BPs, documents, methodologies, etc. Also, it should check whether the tax audit was documented as prescribed by regulations (including internal regulations).

Discrepancies with prescribed standards have to be documented and used for:

- Planning training sessions for auditors;
- Improving SOPs and documents; and
- Identifying gaps within regulations and preparing draft amendments to them.

Working documents for tax audit quality control have to be designed and adopted also.

Recommendations summary:

- Establish a modernization unit at the highest level within the RS agency to provide project management (PM) support to any new projects or initiatives as well as to coordinate the donors' funded projects activities to confirm a synergy effect to results. This unit should plan the activities, control the schedules, and take over risk management and change management related to any undertaken project.
- Finalize the organizational restructuring of the Audit Department and document each division and unit's functional responsibility along with roles and responsibilities of the higher and lower managers.
- Create and approve audit manuals, guides, and internal regulations for all types of activities. The Audit Department is responsible for desk audit, field audit, post-clearance audit, support to appeal cases, mediation, quality control, etc.
- Create and maintain a digital library of all manuals, guides, procedures, templates, etc. and confirm employees' access to them.
- Develop a strategy for decentralization of tax audit operations and plan for achieving a targeted level of decentralization.
- Document all BPs within the Audit Department.
- Review and improve current IT solutions.

- Redesign Audit Department BPs, taking into consideration the technology capabilities and defining requirements for software solutions.
- Plan the implementation of new BPs along with development and implementation of IT solutions to facilitate BPs of the Audit Department that are consistent with the overall strategy for the computerization of the RS and interoperability of the RS with other state and private institutions.
- Establish all formal risk management processes.
- Establish a tax audit quality control practice, as part of the QMS (ISO 9000:2000 standards).
- Revise the existing concept for risk scoring and develop new computer systems for scoring tax returns and ranking taxpayers for tax audit.
- Provide training for managers at any level and encourage women appointment to management positions to achieve a gender balance (*world trend in involving women in management*).
- Develop and implement annual training programs for the Audit Department's staff, especially for staff carrying out tax audits – introductory and advanced training on accounting, English language, specifics of business sectors operations, and usage of information systems (*knowing how a specific computerized accounting system works will help the auditor to make a sound request for information from the taxpayer's accounting system*).

Recommended EPI project activities:

- Support to establishing a modernization unit and bring it to operation (PM, risk management, communication, and change management).
- Support to defining and documenting the Audit Department's organizational structure, functions by divisions and units, and roles and responsibilities of managers at any level within the Audit Department.
- Draft a strategy for decentralization of tax audit operations and develop a strategy coordinated with other project components for businesses and economic development.
- Document Audit Department BPs and redesign them, taking into consideration the technology capabilities and defining requirements for the software to support those BPs.
- Support to capacity and skills building; designing training courses for the Audit Department's staff.
- Support to the IT Division in establishing IT governance processes, review, and redesign of an e-portal for online services and cross-institutional services.
- Support in establishing risk management processes, a concept for a risk-scoring system, and defining requirements for the development of a new IT solution for a risk-based audit selection system that will also be used for experimental risk-scoring work.

II. APPENDICES

A. FINDINGS AND RECOMMENDATIONS

B. ADDITIONAL INFORMATION

A. FINDINGS AND RECOMMENDATIONS

The Georgian Revenue Service (RS) is under ongoing organizational, functional, and operational transformation.

MODERNIZATION AND STRATEGY

Signs for willingness and determination for changes in the tax audit domain are noticeable. During the last few weeks of this consultancy, many changes happened in regards to organizational structure and leadership. At least for an outsider, it looks quite spontaneous and driven by ideas that are still not organized into a well-thought and documented strategy for the development of the tax audit within the RS.

The newly appointed head of the Audit Department should take the lead and develop the department strategy. The strategy should not only address the organization and execution of the main business activities the department is responsible for, but also address specific undertakings to address carrier path within the department, change management, communication, and development of tax audit practices as instruments to improve taxpayers' voluntary compliance, not only as tools for collecting more tax revenue.

Specific attention should be paid to the establishment of formal processes for risk management, quality management, and change management.

The IT Center is under pressure to develop applications without having a strategy for the overall IT services for the RS. The role of the businesses in the applications design and development is still quite limited, and in some cases, it is missing. Many projects are technology driven, while they should be business driven. IT services should be considered as a facilitator for achieving business needs and it should be clear that IT solutions are created to answer business needs and to bring value to the business, which requires higher involvement of businesses in the IT solution design and implementation. The latest development of e-audit software is a good example of cooperation between business and IT specialists, but such cooperation should be established in a more formal way.

It is necessary to establish formal processes and organizational structures for IT governance. IT governance will provide directions and controls on IT investments in order to ensure that:

- IT delivers value to the business,
- IT risks are mitigated through alignment with enterprise objectives,
- IT assets are properly allocated, and
- IT performance is measured.

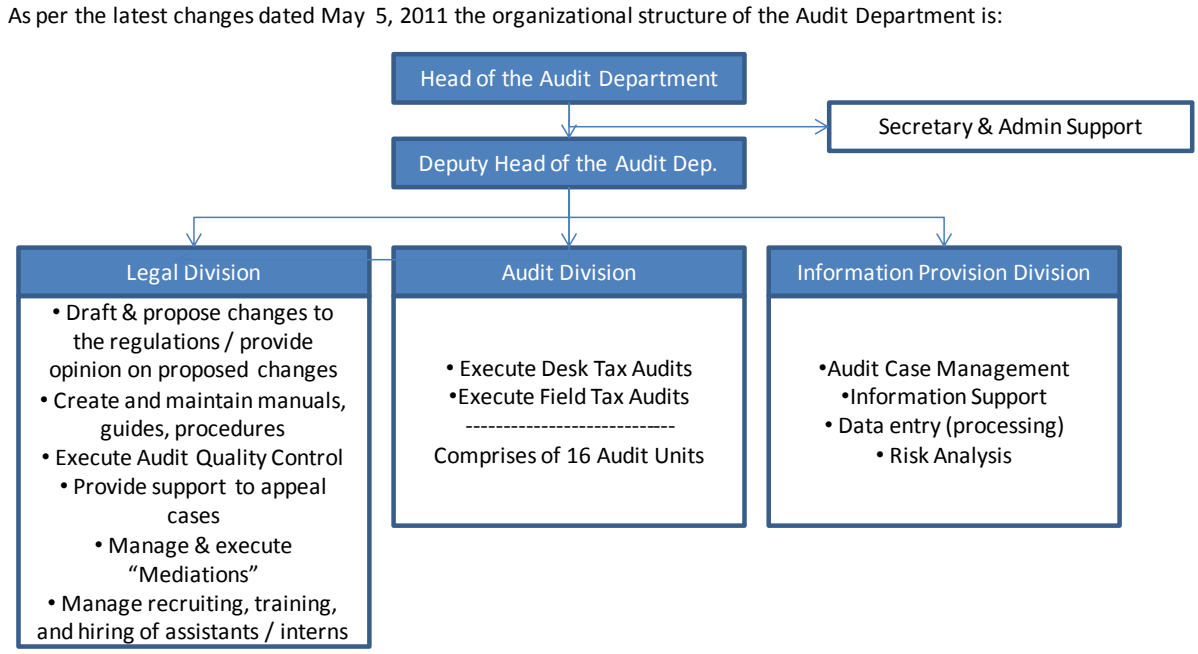
IT Strategy has to be developed and adopted.

As integral part of the IT Strategy, an annual training programs for the IT staff, consistent with an IT strategy and specific projects, should be carried out.

Due to the already initiated and expected transformations, it is recommended that a modernization unit be established at the highest RS level immediately. The role of the modernization unit is to ensure consistency and coordination among undertaken projects, Project Management support and confirm the required change management activities. The unit can also serve as a coordinator for technical support provided by donors' funded projects.

ORGANIZATIONAL STRUCTURE

The latest changes to the organizational structure of the Audit Department are shown in the diagram below:



Currently, RS regional offices do not have Tax Audit Divisions or Units. With the recent organizational changes, "the ongoing control" function was moved from the HQ to the regional offices. Controls, such as chronometric measurements, test purchases, inspections of premises, and stocktaking will be executed by units within the regional RS offices. With the recent closure of the West Georgia Division, tax audit operations were completely centralized within the HQ Audit Department.

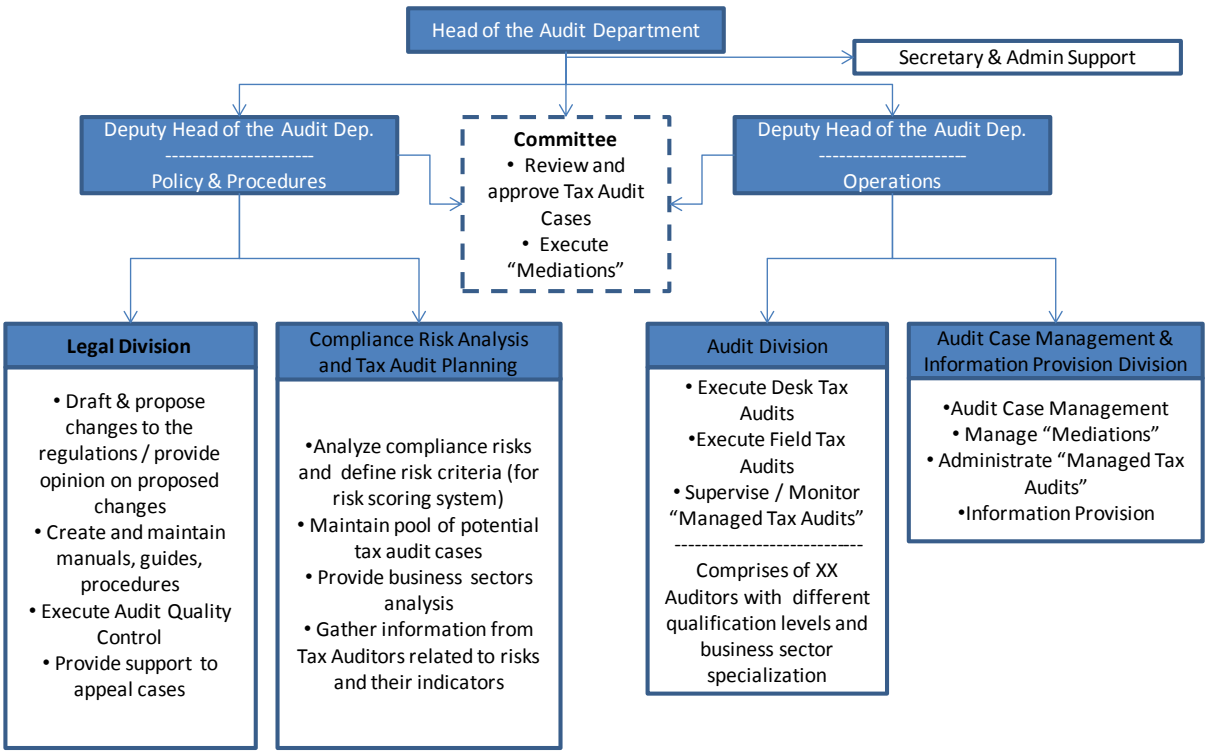
The new organizational structure is still not finalized and documented. The newly appointed head of the Audit Department and his team are working on the new organizational structure.

While there is no recipe for a right or wrong organizational structure for the Audit Department, there are some rules/principles that should be followed:

- Separation between policy/procedures and operations.
- Establishment of performance measurement mechanisms and control functions.
- Decentralization of operations designed to increase the effectiveness and efficiency as well as decreasing the operational cost.

Based on the above rules and on gathered information about existing BPs, the current draft organizational structure is proposed below for consideration. A decentralized (balanced) model can be designed after a comprehensive analysis is conducted and after development of a strategy for tax audit operations.

Proposed organizational structure of the Audit Department – For DISCUSSION:



As mentioned before, tax audit operations are currently executed only at a central level in Tbilisi, where business entities and human capital are mainly located mainly. A pattern of such concentration of businesses and human capital in the country's capital is monitored in all post-socialist countries.

However, maintaining tax audit operations only at the HQ is quite unusual. Centralization of tax audit operations is not cost-effective, especially for field tax audits. Even under current circumstances, tax audit specialists can be relocated to Tbilisi district tax offices and carry out tax audits from there.

Also, it is a "must" that Georgian government creates stimulus for businesses to establish and operate outside Tbilisi and the RS should plan for developing and retaining human capacity for tax audits in regional offices. Such transition could start by confirming the biggest regional tax offices to carry out tax audits, based on business concentration.

The program for decentralization of the tax audit operations should include a suitable structure for executing the role of the committee, proposed to finalize the selection of cases for tax audits and conduct "mediations," at regional levels.

The role of the Information Provision Division should be changed. One of the main functions of this division should be managing tax audit cases, mediation cases, and any new models of tax audits. Its information provision function should be limited to obtaining specific documents from external databases/institutions for the purposes of tax audits. Any activities related to data entry should be moved to a data entry unit under the IT Division, but generally data entry should be significantly decreased and IT solutions should be developed, through which the tax audit team members can capture all necessary information and produce all necessary reports/documents. It is more accurate if the division name is changed to the "Tax Audit Case Management and Information Provision Division."

Finalizing the organizational structure, clearly defining the functions of each division and unit within the divisions, and defining the roles and responsibilities of the managers is a precondition for developing and implementing streamlined BPs that will result in high quality of performance and transparency of operations.

This report does not intend to comprehensively address all organizational structure issues, but just to emphasize the importance and urgency of the completion of this task.

EPI can provide focused technical support for:

- Finalizing the organizational structure and documenting functions, roles, and responsibilities
- Preparing a strategic plan for transforming the tax audit operations during the next few years.

Also, EPI can provide focused support to the head of the Audit Department in preparing staffing requirements for each division/unit and program for staff performance measurement and promotion.

The current practice of selecting candidates for interns, training them, involving them in the real work, and hiring as employees only a few of them is quite inhabitual and is not cost-effective. Selected people go through multiple filtering exams and the entire process takes around six months.

Involving those people in real tax audits, while they are still not RS employees is a breaching of Article 39: Tax secret. A person should not have access to a taxpayer's financial data until the person is not hired as an employee of the RS.

Any recruiting and training activities at RS should be managed only by the Human Resources (HR) Department

RISK MANAGEMENT PROCESSES

Taxpayers' compliance addresses four areas: (1) registration compliance; (2) filing compliance (tax returns and other required documents/reports); (3) payment compliance (paying tax and other liabilities within the deadlines); and (4) compliance related to accuracy in accounting and reporting.

Each tax administration struggles to gain a higher level of voluntary compliance of taxpayers, while managing risks. The following formal processes should be established for compliance risk management:

1. Plan risk management – The process of defining how to conduct risk management activities.
2. Identify risks – The process of determining which risks may affect the taxpayers' compliance and documenting their characteristics (*for initial risks identification, the most frequent method is brainstorming).*
3. Perform qualitative risk analysis – The process of prioritizing risks for further analysis or action by assessing and combining their probability of occurrence and effect.
4. Perform quantitative risk analysis – The process of numerically analyzing the effect of identified risks on overall objectives.
5. Plan risk responses – The process of developing options and actions to enhance opportunities and to reduce threats to RS objectives.
6. Monitor and control risks – The process of implementing risk response plans, tracking identified risks, identifying new risks, and evaluating risk process effectiveness.

Generally, process 1 plans how to execute all remaining processes in a repeatable manner.

One of the existing risks related to collecting taxes is underreporting of tax liabilities. Tax audits are business activities engaged in discovering the underreporting of taxes. Increasing the effectiveness of tax audits is conditional to identifying cases for audit that will lead to discovering underreporting (purposely or due to wrong interpretation of the law or just due to mistake).

The compliance risk-scoring technique helps to identify cases for tax audit with higher probability/potential to discover underreporting of tax liabilities, which will increase the productiveness of tax audits. Therefore, compliance risk scoring is just one possible activity to address a specific risk. The risk management within RS is broader and this paper does not intend to discuss it. It addresses, in more detail, only compliance risk scoring as a method to identify taxpayers for tax audit or other controlling activities, based on the level of risk score.

Currently, 15 risk criteria are used by the risk analysis unit for calculating risk scores. Three of those criteria are for individual taxpayers (entrepreneurs) and 12 for business entities. There is software applying those criteria to the two groups of taxpayers. Formulas for those criteria are hard-coded into the software, which creates problems for the risk analysis group to apply another set of criteria or to experiment. Recently, 39 new criteria were approved, but have not been actually used for scoring.

The results from the current system are not utilized. The Tax Audit Division is quite skeptical in using those results. It is hoped that by moving the risk analysis unit within the Audit Department, this resistance will be overcome. Also, auditors will provide valuable information to the risk analysis unit for a better identification of risk indicators.

Currently, an adopted model for risk-score calculation is very general: the same set of criteria is applied to all business entities; there is no grouping of taxpayers by revenue (turnover) or business sectors and all criteria participate with the same weight.

It is strongly recommended that the existing risk-scoring model be revised and that new software for calculating risk scores be developed.

Attachment 4 to this paper (see Appendix B) provides guidelines for a risk-scoring model and provides a high-level conceptual model and requirements for software facilitating compliance risk scoring. Information about how countries belonging to the Organization for

Economic Cooperation and Development address and deal with compliance risks is also available at this link: http://www.oecd.org/dataoecd/44/19/33818656.pdf

The EPI project can provide support to:

- Establishing risk management processes.
- Developing a model for tax returns risk scoring.
- Defining requirements for the software for managing a risk-knowledge database, executing tax returns scoring, managing scoring results, and any follow-up support in system development and implementation.
- Reviewing the criteria, their formulas, and scoring allocation rules.

NEW TAX AUDIT MODELS

A good tax audit model to start with is called “managed field tax audits,” a practice in use by the U.S. Internal Revenue Service in New Mexico. These are tax audits initiated by the taxpayer, but allowed and monitored by the tax authority. More information can be found at: http://www.tax.newmexico.gov/Businesses/Pages/Managed-Audits.aspx

The Georgian RS has been considering the outsourcing of tax audits. It is important to elaborate on “outsourcing” before discussing an example of the Pakistani approach. IA brief clarification on “outsourcing” follows, as well as a brief description on the process that has to be followed when making decisions on what to outsource.

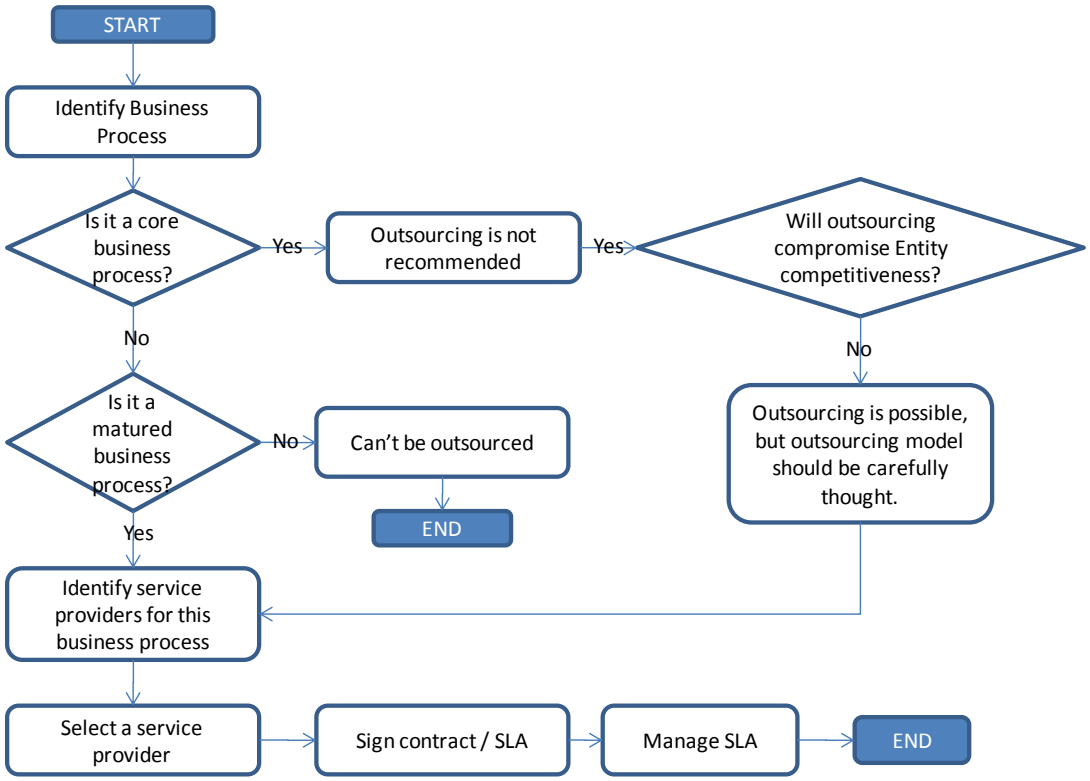
WHAT IS OUTSOURCING?

Outsourcing is a management strategy by which an organization delegates functions or activities, formerly performed inside the organization, to specialized and efficient service providers. Outsourcing has often been suggested as a means of reducing organizational costs, providing flexibility and “capturing” innovation.

During the last decade, “outsourcing” became very popular and used not only in traditional domains, such as HR services and software development, but also in almost everything that can bring cost reduction.

The process to follow, when a decision has to be made regarding what to outsource, is presented in the following diagram:

Decision- Making Process for Outsourcing a Business Process for Organization XXX



Example of tax audit outsourcing in Pakistan

Despite tax audit is outsourced through pre-selected and approved tax audit provider, the Pakistani Revenue Services still monitor, control, and have a final approval power on the audit results. Below is a high-level description of the process applied by the Pakistani revenue authority:

Abbreviations used in the below description: FBR – Federal Board of Revenue and CIR – Commissioner Inland Revenue

Step 1: Selection of taxpayer for tax audit – done by the FBR/CIR.

Step 2: Selection of the tax auditor from a pool of approved companies – done by the FBR/ CIR

Step 3: Consent and confirmation of a tax auditor's independence

Step 4: CIR issues an engagement letter that needs to be accepted by the tax auditor and by the taxpayer

Step 5: Risk evaluation and pre-audit meeting – all parties attending (CIR, tax auditor, and taxpayer)

Step 6: Finalization of an audit plan – CIR and tax auditor

Step 7: Execution of an audit plan (tax auditor)

Step 8: Submission of a draft tax audit report to CIR by a tax auditor

Step 9: Discussions on a draft audit report among the tax auditor, CIR, and the taxpayer

Step 10: Submission of a final tax audit report to CIR by a tax auditor

The Georgia RS, should find the most suitable new model for tax audit to implement, based on its capacity, specialization, service providers' capabilities, and legal framework.

BUSINESS PROCESSES (BP'S)

A BP is a collection of related, structured activities or tasks that produce a specific service or product (result) when executed in a specified sequence. A BP can often be visualized with a flowchart.

There are three types of BPs:

1. Management processes - the processes that govern the operations. Typical management processes for the Audit Department are audit-planning BPs.
2. Operational processes - processes that constitute the core business and create the primary value stream. Typical operational processes for the Audit Department are selecting and approving an audit case; executing a desk tax audit; executing a field tax audit; etc.
3. Supporting processes – the processes that support the core processes. Examples of such processes for the Audit Departments are requesting and obtaining a court decision, including an expert in the field tax audit case.

Each BP has a specific objective. BPs are usually defined by the organization's business activities and in many cases crosscutting functional silos. Each BP can be decomposed into several subprocesses, which have their own attributes, but also contribute to achieving the goal of the superprocess. Analysis of BPs typically includes the mapping of processes and subprocesses down to activity level.

The RS currently does not have BPs for the Audit Department documented. Based on the tax code and multiple meetings with managers and practitioners at the Audit Department, a list of BPs has been identified and attached to this report in Attachment 1 (see Appendix B). The list is not exhaustive. Each division within the Audit Department should review the list and update it, after the final organizational and functional reorganization of the department is completed. Some of identified BPs were documented as they are currently, based on interviews with the head of the Information Provision Division and an auditor. Attachment 2 (see Appendix B) contains those BPs as diagrams (flowcharts).

Due to the limited time and ongoing organizational changes, it was impossible to identify business owners and work with them to document more BPs and discuss the need of BPs improvements and/or reengineering. The analysis and reengineering of BPs should be carried out by teams with IT staff participation. Several examples of re-designed BPs are provided in Attachment 3 (see Appendix B) to this document.

Standard documents / templates are integral part of BPs documentation.

Currently, the adopted standard documents/templates at the RS Georgia are:

- Order for tax audit;
- Notification to time period for planned field tax audit; and
- Tax Audit Act (under approval) – for full audit (should have different versions; depends on the scope of the audit).

More templates/standard forms should be designed and adopted when BPs are documented.

The Audit Department should maintain an updated database (library) of all BPs, along with templates and working documents. All tax auditors should have access to this library and be able to retrieve and use any of the approved templates and read any of the BPs. These BPs and adopted templates along with existing manuals, guidance, and methodologies are a base for executing a tax audit quality control. Therefore, those engaged in quality control reviews should also be familiar with those BPs and templates.

This analysis also demonstrated that improvements to the tax audit classification approach should be made. It is critical to have proper classification for maintaining an accurate and consistent database and for producing meaningful reports. As per the tax code, there are two types of tax audit: desk and field. This determines the place where the tax audit activities take place.

Based on the priority, the tax audits can be classified as “immediate” (defined by the tax code) and “not immediate.” “Not immediate” can be divided by priority in three groups: high, medium, and low priority and will be scheduled and executed on that basis.

Also, it is critical to define the scope of the audit. By default, desk audits are with limited scope – usually on a certain topic (specific type of tax or specific line item on tax return). Regarding field audits, they are so called full audits – addressing all type of taxes or on a specific type of tax. More detail classification on the possible scopes need to be defined.

Another important characteristics of a tax audit are:

- the tax period subject to tax audit; and
- The origination of the tax audit case, in order to direct the communication properly.

The table below presents all those parameters that should be taken into consideration when creating classification rules for tax audits:

Place	Scope	Priority	Source	Tax Period
Desk	Full	Immediate	Investigation	Y2010
Desk	Topic (1,2,..)	High	Liquidation	Y2010
Field	Full	Medium		J-June’09
Field	Topic (1,2,3..)	High		
Desk	Topic (6)	Low	RBAS System	

Recommendations:

- Document all BPs and templates.
- Create a library of BPs and templates.
- Work to improve and redesign BPs along with defining requirements for software.
- Implement new BPs and software solutions.
- Maintain a library of updated BPs and templates. Confirm employees' access to the library – develop and implement relevant IT solutions.

EPI support should include:

- Reengineering all BPs (including templates – working papers).
- Defining requirements for the software facilitating all BPs (functional, cross functional, and cross-institutional) and confirming the required interoperability level.

IT SOLUTIONS FOR AUDIT DEPARTMENT

Recently, new IT solutions for supporting tax audits were developed and are under pilot implementation. Some of the components are not completed and some of the activities continue to be carried out in a mixture of manual and computerized manners.

The new system, referred to in this report as the "audit case management system" consists of few different components:

Component 1 confirms functionalities for audit-case tracking and capturing information from different sources through the live of the audit case: from its origination to its completion.

Component 2 is designed to be used by the auditors and provides functionalities confirming the fast execution of some audit operations, based on data from tax returns and other sources, such as e-invoices, financial statements, previous audits, customs, etc.

Component 2 is a typical example of an e-audit tool. It was discussed with the IT team to define a standard for importing data from taxpayers' accounting and financial systems. Currently, the tool relies on data captured into the RS databases through different applications. One good feature that can be added to the system is selecting a sampling of data from all existing data for a specific tax audit.

Component 3 provides functionalities for requesting and receiving specific information or documents in suitable format.

Component 4 is designed for managers. It allows managers to have a complete view of completed or ongoing tax audits as well as utilization of auditors. (The head of the RS uses this).

Ongoing changes in the organizational and functional structure of Audit Department impose dynamic changes to the existing software solutions. Also, those IT solutions do not offer complete computerization of all business processes, Still some of the activities within a tax audit case continue to be manually maintained. Several proposed "to-be" BPs, described in Attachment 3 in Appendix B, provide ideas for relevant software solutions to fill in the existing gaps.

The Audit Department leadership should Efforts and time should be dedicated in identifying and documenting all BPs within the Audit Department, including those that are cross functional and cross-institutional.

This can be done only by a team including business matter specialists and systems analysts. Such a team will be capable of redesigning BPs and requirements for software facilitating those BPs, based on which systems can be designed to be consistent with existing RS IT solutions and adopted country standards for interoperability and e-government.

It is strongly recommended that the RS develop and adopt IT strategy to guide IT projects within the following few years. Several other projects that are underway and will have impact on the ICT services at the RS including:

- Creating a warehouse database and reporting portal.
- Redesigning and reorganizing online services (RS e-portal).

For the Audit Department, the following IT solutions need to be developed and implemented:

- IT solutions maintaining libraries of policies and procedures.
- IT solutions facilitating quality controls.
- Risk-based audit selection system.
- IT solutions facilitating other cross-institutional BPs, already outlined in this paper.

B. ADDITIONAL INFORMATION

DELIVERABLES

ATTACHMENT 1: AUDIT DEPARTMENT BP'S

The list is neither exhaustive nor complete. With the ongoing organizational and functional changes, some processes could be removed and others probably should be added.

1. **Support to Appeal Cases**

   BP101: Identify appeal cases that need support and assign an appeal case to a staff member.

   BP102: Prepare supporting facts/materials for an appeal case and participate in appeal case sessions.

   BP103: Document the support provided to an appeal case; scan and attach provided evidence to an appeal case.

2. **Quality Control of Tax Audit Cases**

   BP201: Select a tax audit case for quality control and authorize it.

   BP202: Execute quality control on a tax audit case and maintain a database with suggestions for improvements to the audit procedures, forms, and methodologies. (Create QMS processes).

   BP203: Draft improvements and adopt changes to tax audit BPs and/or working papers.

3. **Policy and Procedures**

   BP301: Create tax audit manuals, guides, forms, and procedures for the tax audit.

   BP302: Review and update tax audit manuals, guides, forms, and procedures for tax audit.

   BP303: Maintain a manual for a mediation process.

   BP304: Constantly improve the mediation process and manual.

   BP305: Maintain a manual for tax audit quality control.

   BP306: Constantly improve the manual for tax audit quality control.

4. **Tax Audit Planning**

   BP410: Create a pool of cases for potential tax audit (tax audit planning)

   BP411: Submit a request for immediate field tax audit (investigation, financial police, auditor, etc.).

BP412: Identify a case for tax audit and submit a memo (auditor during ongoing tax audit).

BP413: RBAS System (run it annually and then quarterly for newly submitted tax returns).

BP420: Compliance Risk Analysis

BP421: Maintain risk criteria, score allocation rules, taxpayers groups definition - knowledge database; define parameters for executing the RBAS System (set of risk criteria, group of TPs, and tax periods). Provide recommendations for using the output of the RBAS system (business sectors experts to interpret the output of the RBAS System).

BP422: Identify new risks, relevant formulas for calculating those risks and propose changes to approved risks to be used into RBAS systems

5. **Tax Audit Execution**

BP510: Select cases from the pool of potential audit cases **and prepare** them for tax audit

- Cases for immediate field tax audit
    - Could include: (1) sealing documents and imposing a lien (requires an order); (2) requesting and obtaining a court decision
- Cases for desk tax audit
    - Include (1) Analysis and additional information; (2) Scope definition – usually limited on specific issue (topic)
- Cases for field tax audit
    - Includes (1) Analysis and additional information; (2) Scope definition – full or on specific tax
- Cases for “Managed” tax audits
    - Includes (1) Assessment of whether TP meets the requirements for “managed” audit; (2) preparation of a draft contract for “managed” audit – *New Mexico has 2 types of managed tax audits*

BP520: Review and approve cases for tax audit (includes approval of scope and appointing of auditor(s) to carry out the activities) – Committee Sessions

BP530: Open a tax audit case – issue requires orders and notifications

BP540: Executing a desk tax audit

- Starts with preparing a tax audit plan.
- Could include: (1) requesting additional documents and/or information; (2) identification of administrative infringement and issuing of an administrative act for imposing a fine.
- Ends with a draft tax audit act.

BP550: Executing a field tax audit

- Starts with preparing a tax audit plan.
- Could include: (1) Involving an expert, (2) Cancelation of the audit, (3) Temporary stopping/then resuming the audit, (4) Audit time extension, (5) Mediation, (6) Ongoing control activity (Chronometric measurement, inspection, test purchase, etc.) – base for execution is an order and a report should be furnished at the end, which need to be reviewed and signed by the TP also.
- Ends with a draft Tax Audit Act.

BP560: Finalizing the draft audit act includes (1) review and signing by the TP; (2) review and approval by the Head of the Tax Audit Division; (3) "mediation" – if TP applies for it.

BP570: Close a tax audit case - Capture data from final audit act into computer system along with tax assessments, which generates taxpayer's liabilities and notifications.

6. **Manage Mediations**

BP601: Manage mediation requests:

- Accept a request for mediation (TP request a mediation).
- Schedule a mediation session and inform participants.

BP602: Execute mediation and document the results using standard templates. The agreements reached should be recorded and both parties should sign and receive a copy of this record. Also relevant changes need to be made on the Draft Tax Audit Act.)

7. **Post-clearance Audit**

BP701: Select TP for post-clearance control (PCC) and authorize an audit case

BP702: Execute PCC

BP703: Finalize PCC

8. **Ongoing Controls**

BP801: Identify a case for ongoing control: monitor/control/enforce and authorize a case (Order is needed).

BP802: Execute an ongoing control: monitoring/control/enforcement and documents actions and results (Report produced should be signed by the assigned TA officer and TP, and if TP disagrees, a notation should be made).

9. **Supplementary BPs**

BP901: Involve an expert in the field tax audit.

BP902: Cancel a tax audit.

BP903: Stop/resume a field tax audit.

BP904: Change a member of an audit team (remove, add, replace).

BP905: Request additional documents / information from TP.

BP906: Identify administrative infringement and documents it (impose fine).

BP907: Request ongoing control activity as part of the ongoing tax audit.

BP908: Seal documents and imposing lien.

BP909: Request and obtain a court decision.

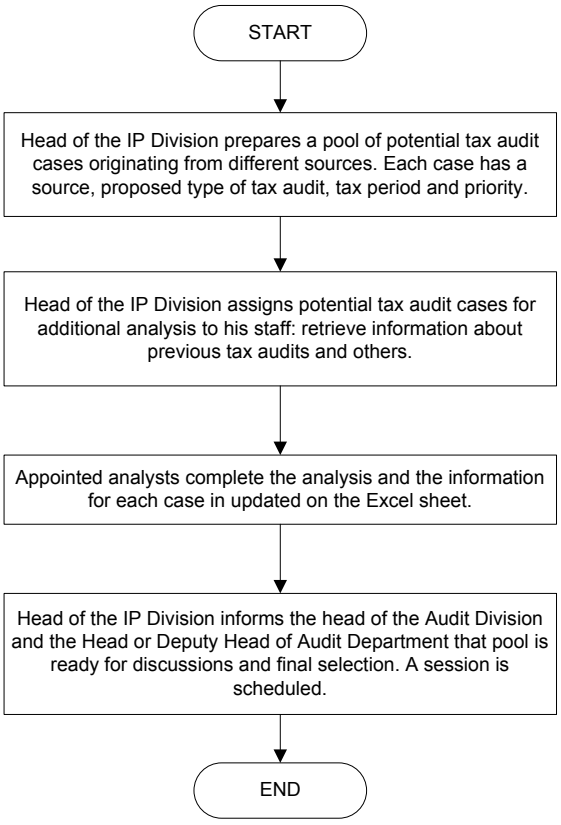
BP910: Request and obtain changes in the scope of the audit (type of taxes and/or issues and tax periods)

BP911: Request and obtain time extension for the completion of a field tax audit. (Separate order is issued in case of granting an extension. The order is linked to the order for a tax audit.)

ATTACHMENT 2: "AS-IS" BP'S

Nine BPs have been depicted "As-Is" in the diagrams below. Most of them are related to identifying, preparing, approving, and executing tax audits.

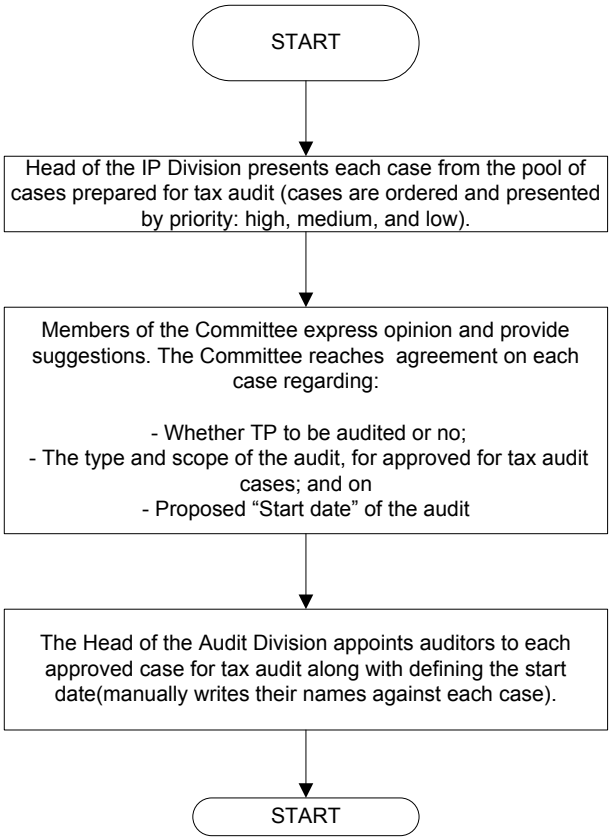
BP510: Select and prepare tax audit cases



Q: How frequently this business process is executed?
A: No established pattern. Whenever a need arise.
Source: Investigation, Financial police, Auditor, Special government program, RBAS System, etc.

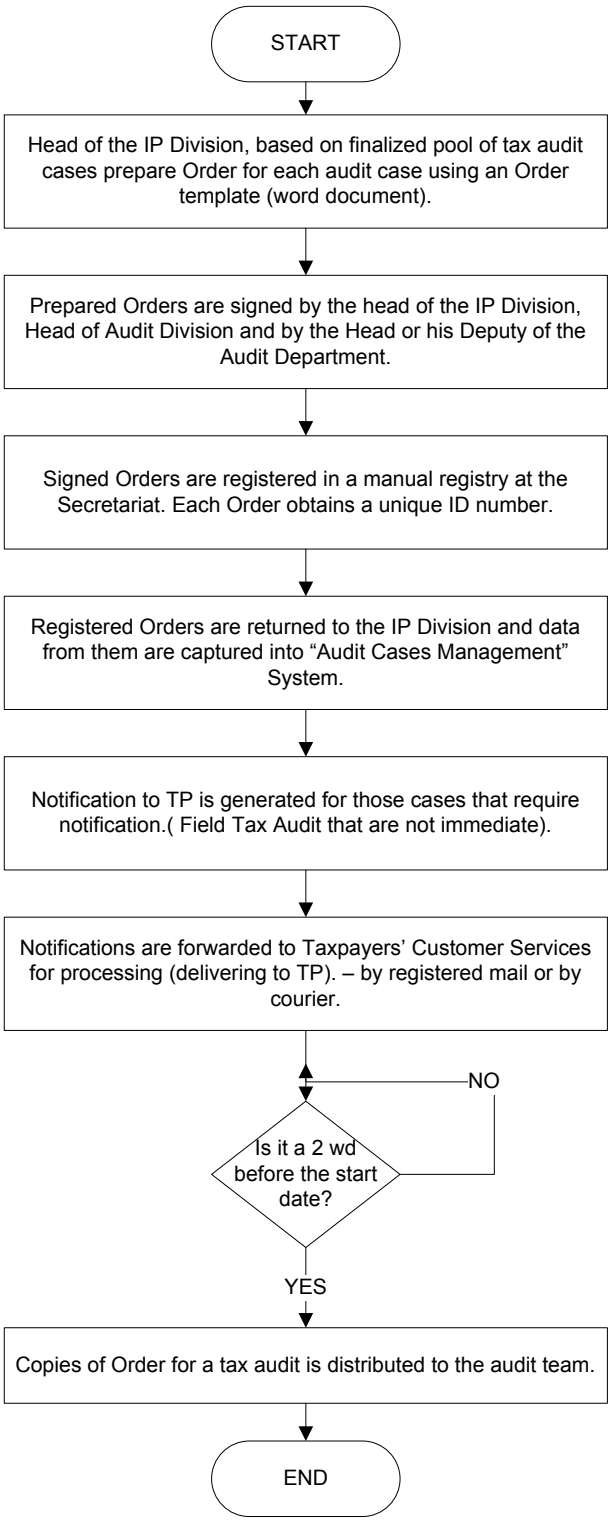
IP Division – information Provision Division

BP520: Review and approve a case for tax audit

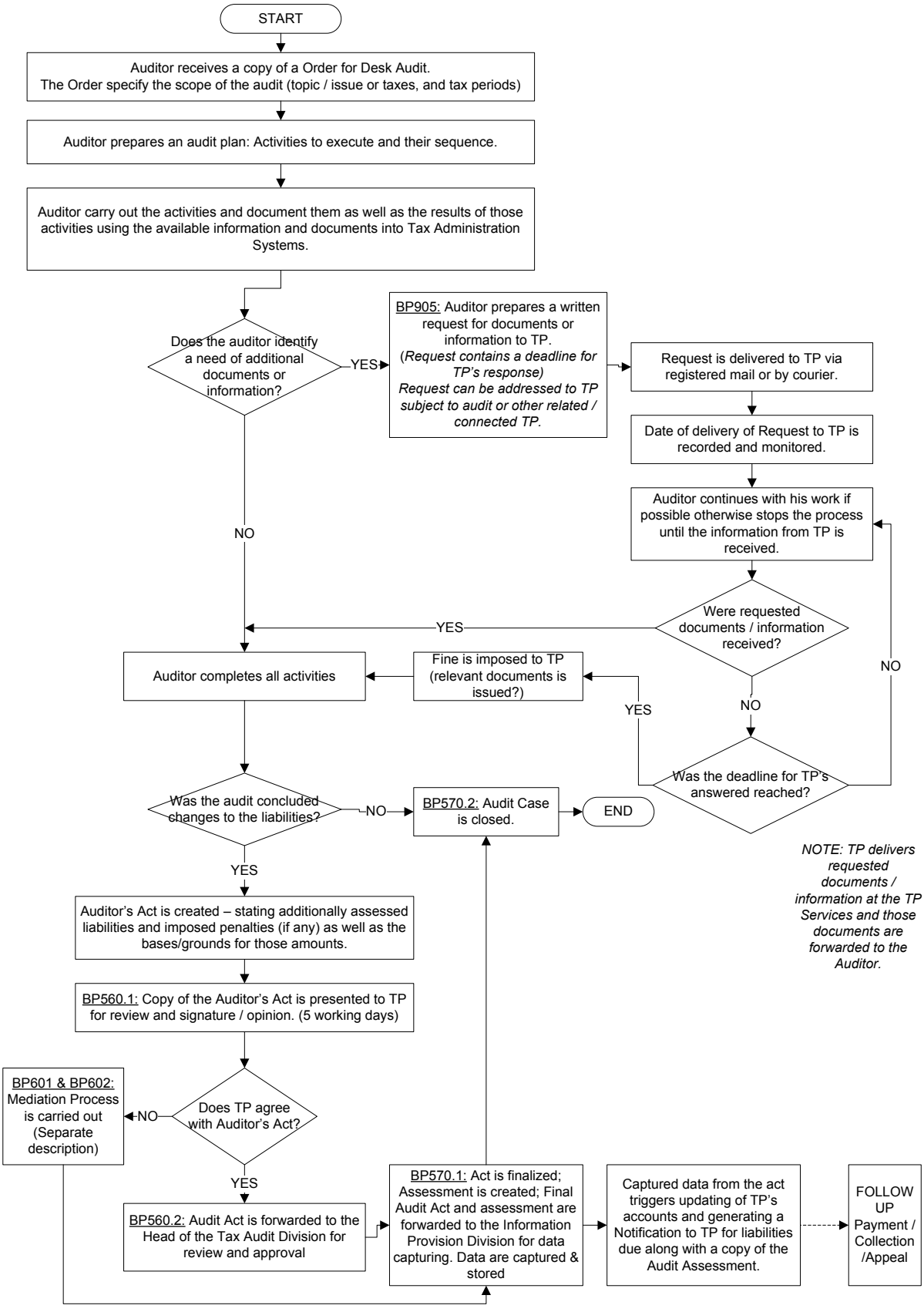


NOTE:
Such formal Committee doesn’t exist. It needs to be established & regular sessions should be held.
- Requests for immediate (urgent) tax field Audits are processed without Committee sessions.

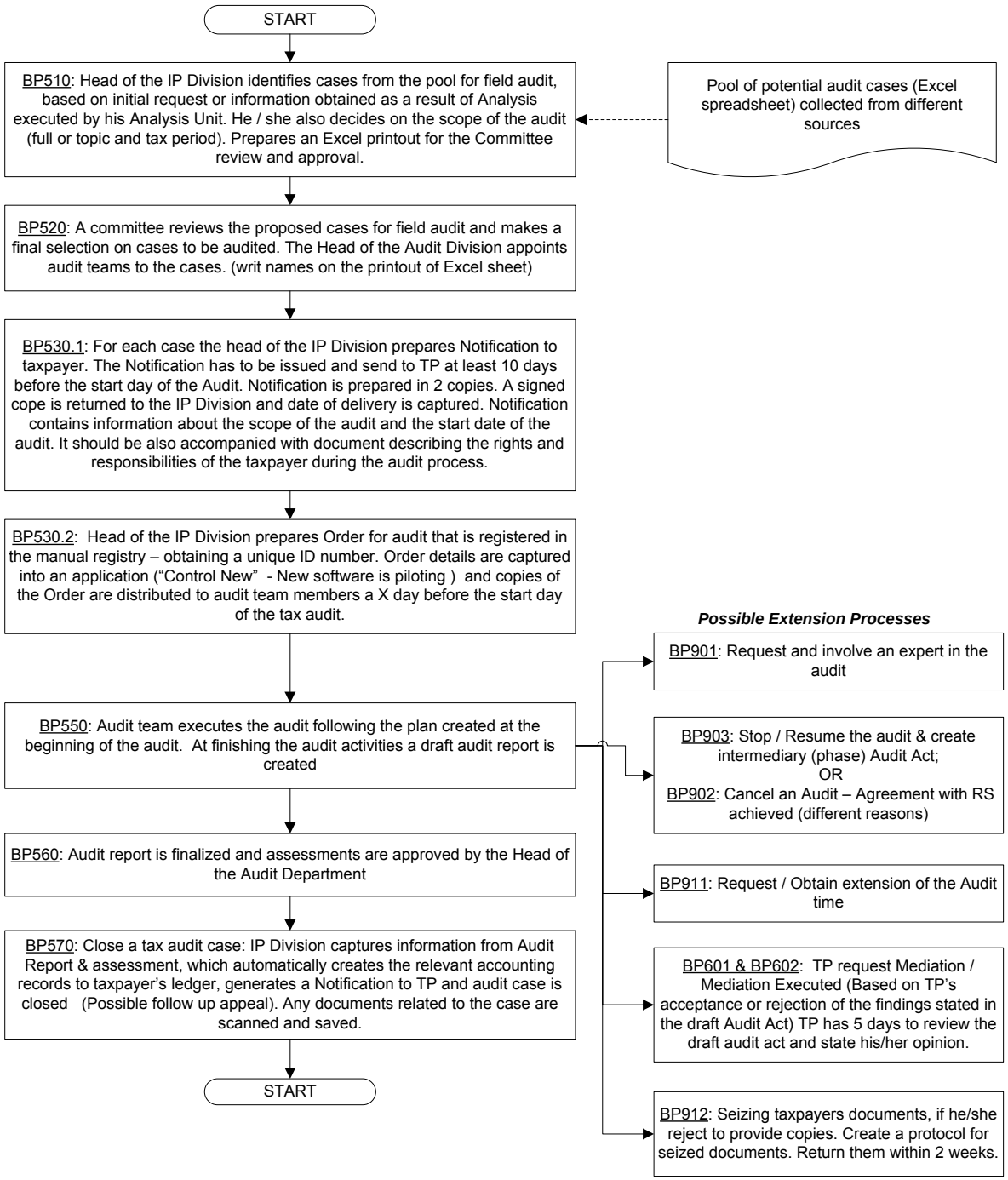
BP530: Open a case for a tax audit



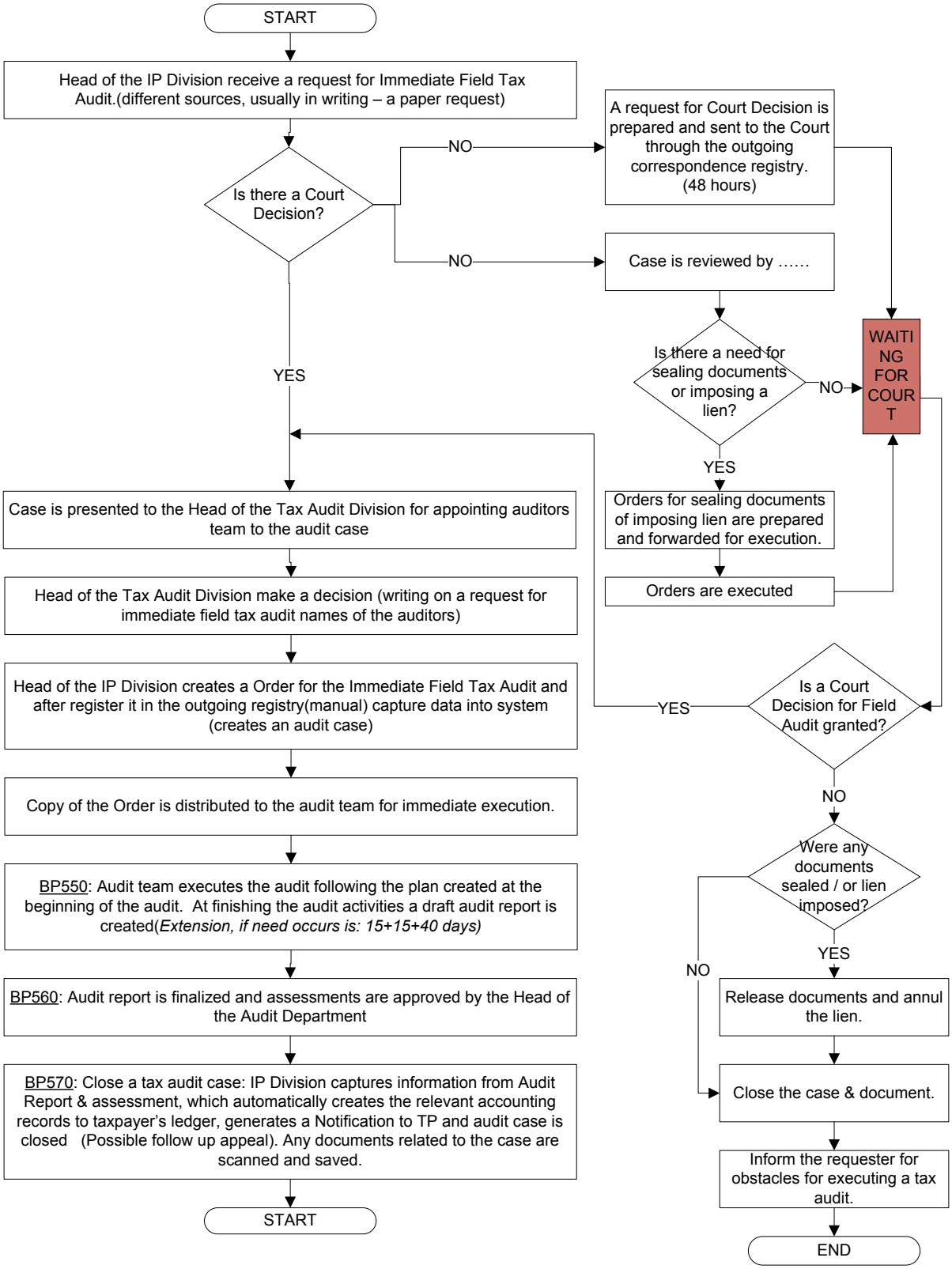
BP540: Desk Tax Audit Execution



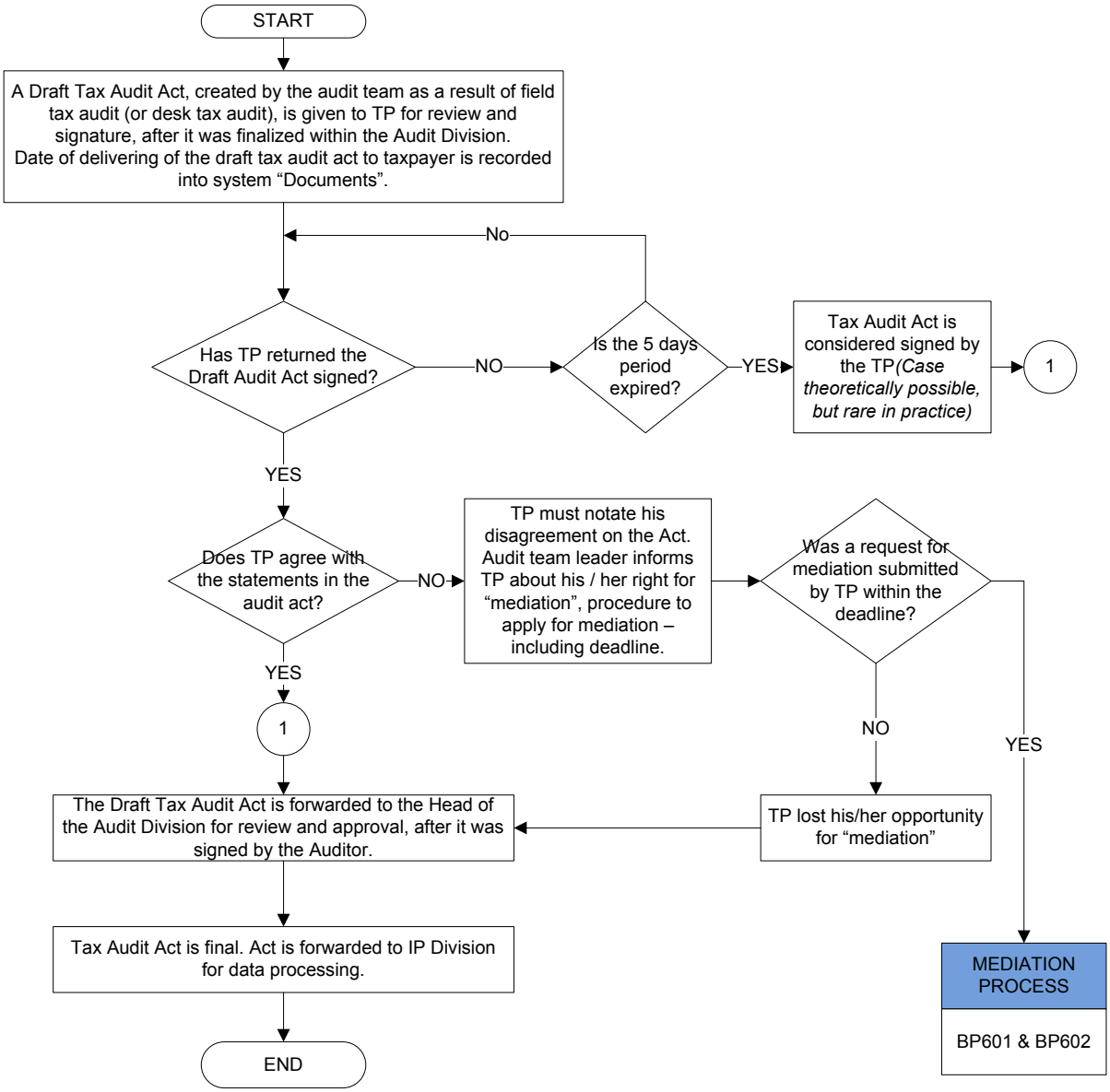
BP5: High-level Field Tax Audit Business Process (comprises of several sub-processes)



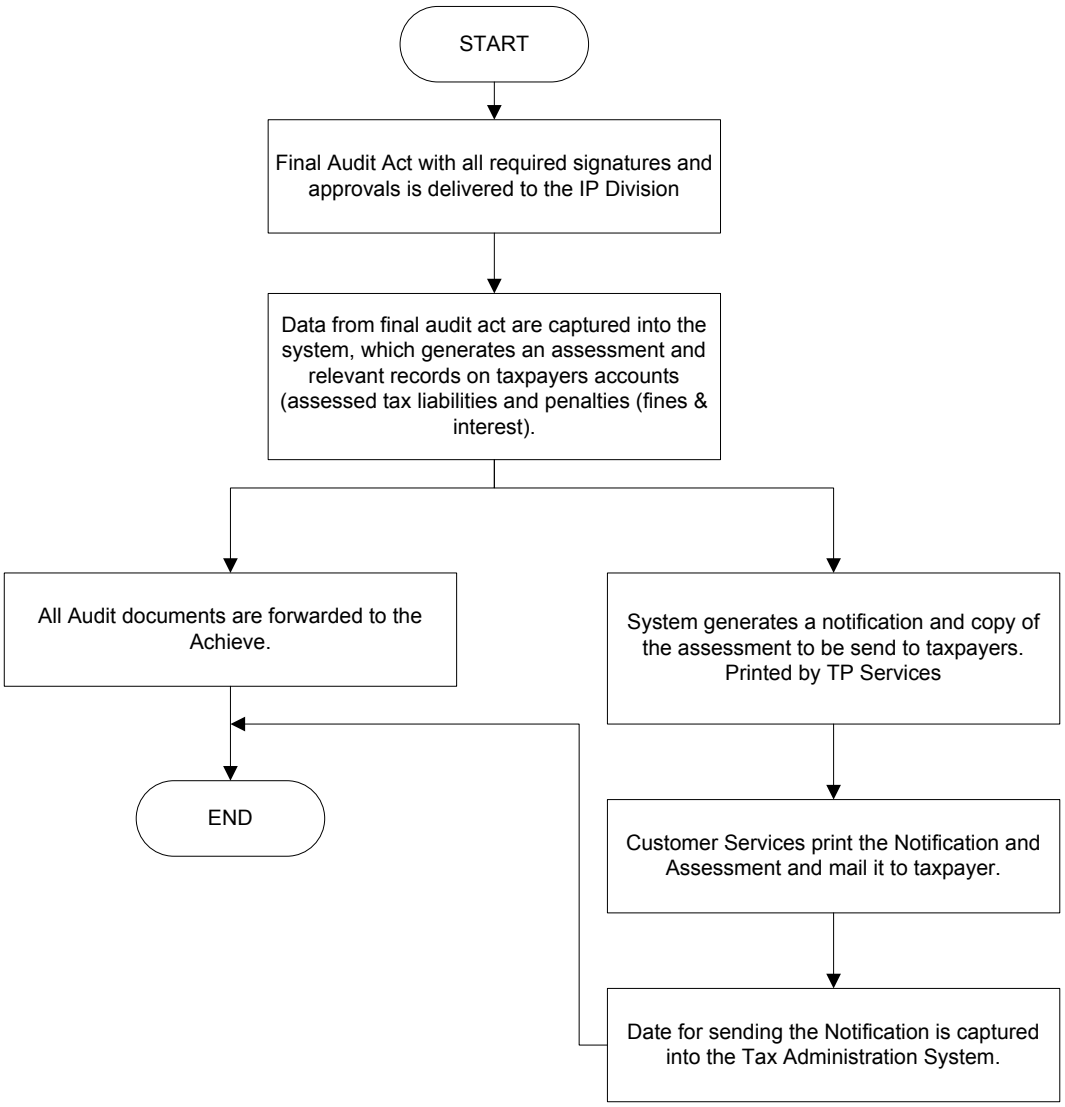
BP551: Immediate Field Tax Audit



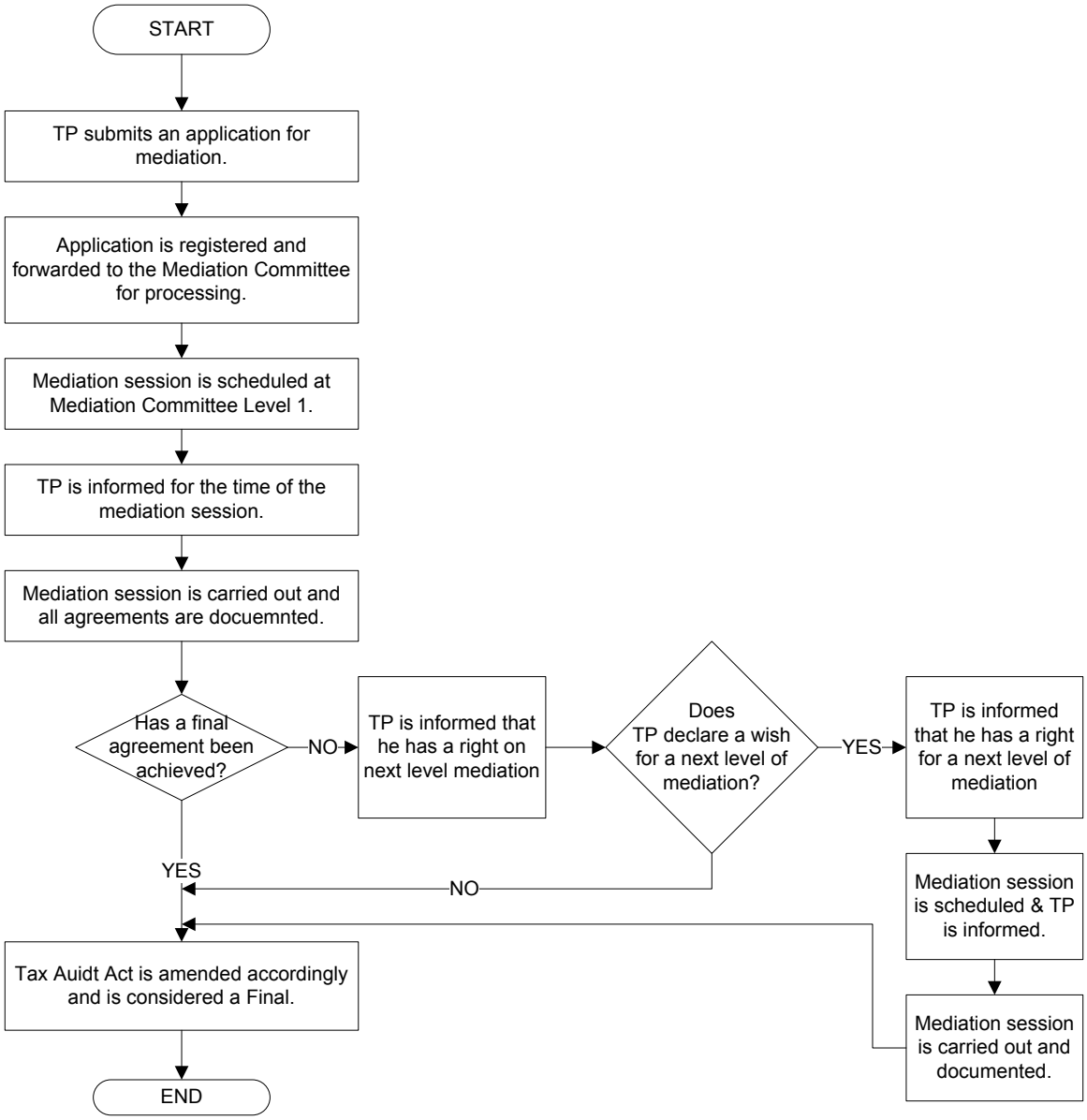
BP560: Finalizing Draft Tax Audit Act



BP570: Close Tax Audit Case



BP60x: Mediation Process



ATTACHMENT 3: "TO-BE" BP'S – EXAMPLES

Following are examples of BPs related to Audit Department activities that are designed taking into consideration the technology capabilities. These examples should be reviewed and approved by the Audit Department before implemented. Their implementation will require development of relevant software solutions.

BP411: Submit a Request for immediate field tax audit

It is important to maintain an accurate and timely pool of requests for tax audit. Requests for immediate field tax audit are usually submitted by Investigation Unit, Financial Police, and sometimes by the auditor, who is doing a field audit on another taxpayer. Such tax audits are based on a court decision and do not require advanced notification to the taxpayer subject to tax audit. Requests submitted by investigation and financial police are usually accompanied with a court decision (warrant). Cases initiated by an auditor require requesting and obtaining a court decision. Before obtaining the court decision, the tax authority can seal documents and impose a lien.

Current practice:

- Handing a court decision and explaining verbally the request;
- Telephone call to the Head of the Audit Department or to the Head of the Information Provision; and
- Memo submitted by auditor to the Head of the Audit Division.

The BP owner should be responsible for maintaining the pool of potential tax audit cases (in the proposed organizational structure, this is under the Compliance Risk Analysis and Tax Audit Planning division). Players in the BP include:

- Authorized employee from Investigation, Financial Police, etc.
- The auditor, a team lead of an audit team carrying out a field tax audit.
- Software applications for maintaining the pool of potential tax audits.

Note: Authorized employees from Investigation, Financial Police, and auditors should have credentials (user name and password) to access the software applications. The same applies to auditors and team leaders (same credentials they use to access and use the Audit Support system).

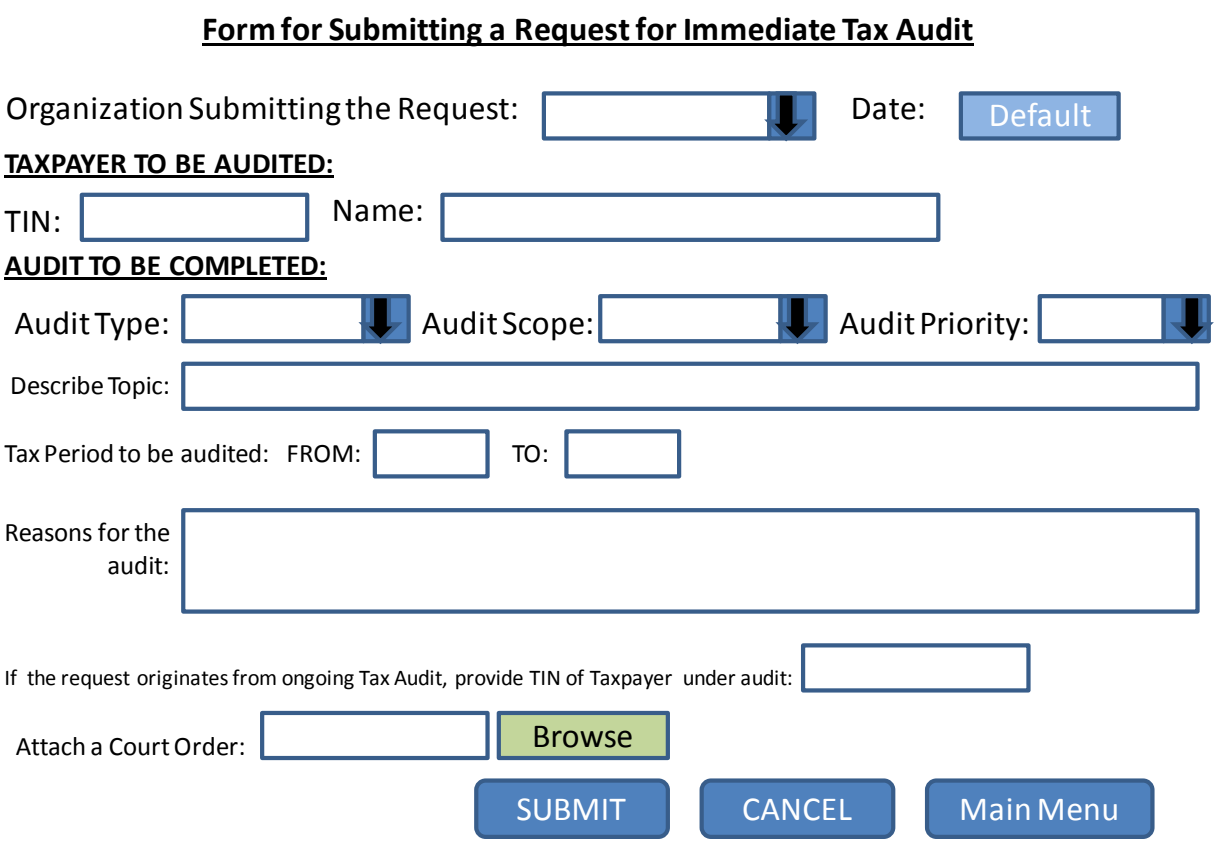
BP Description

START: The need for an immediate tax audit was identified by the Investigation, Financial Police, or an ongoing tax audit of another taxpayer. Tax audit case identification includes: taxpayer to be audited, scope of the tax audit (topic and tax period), justification for initiating a tax audit request – description of reasons (facts, findings). If the originator is Investigation or Financial Police, a court decision will have already been obtained at the time a request is made.

Step 1: Authorized person from Investigation or Financial Police, or an auditor, access the web application and login.

Step 2: Upon successful login, the user should be able to select the option "Submit a request for immediate tax audit."

Step 3: The system should display a form to be filled in by the user. The form could look like this:



Step 4: User fills in the form. The default priority is "Immediate," but can be changed to "high or medium." Audit type includes "desk" or "field;" Audit scope is either "full" or "on topic," and when on topic, an additional description should be provided.

Step 5: User fills in the TIN of the taxpayer under audit if the request originates from an ongoing tax audit. It should not be mandatory and can be left empty. Only valid TIN should be allowed by the system.

Step 6: User attaches a court decision, which is mandatory for any request originating from Investigation and Financial Police.

Step 7: User submits the request. Transmission of data should go through a secured channel.

Step 8: The system returns a confirmation that the request was successfully submitted and provide an ID number for the request. Example of a system notification:

"YOUR REQUEST For Auditing TP: (TIN, Name), WAS SUCCESSFULLY SUBMITTED! IT WAS SAVED UNDER ID: xxx / xxx".

The user should have the option to print or save the notification message.

Step 9: User saves or prints the notification message and logs out of the system if he/she does not want to submit another request or execute another service.

END

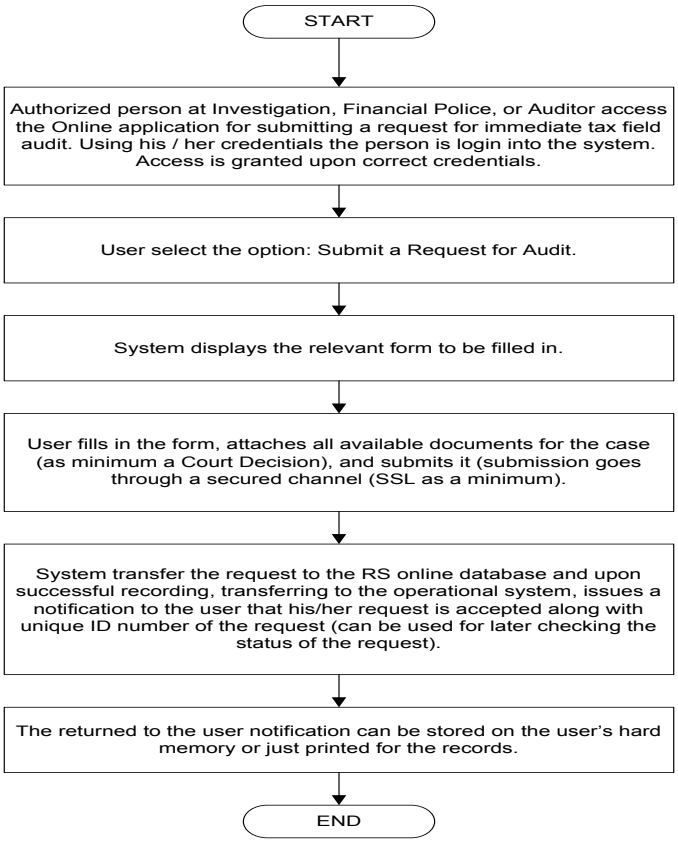
Exceptions

Exception 1: At any moment the user can select the “CANCEL” option, which will return him/her to the Main Menu and none of the information entered until will be saved. From the Main Menu, the user can log out or select any other available option.

Exception 2: If an error occurred after the “submit” button was selected, the session is interrupted and the request is not submitted. The user should call technical support.

NOTE: Users should be able to see the status of a submitted request for tax audit. Upon login and selecting “check the status” of a request, the system should prompt them to enter the ID number of the request (the ID number the system provided in the notification message to the user when a request was submitted). Using the request ID number, the system should retrieve and display the status of the request. For example: Case assigned, audit started on dd/mm/yyyy, pending court decisions, audit completed, etc.)

BP411: Submit a Request for Immediate Tax Audit is presented below:



As already mentioned, some requests for immediate tax audit are made by auditors and in these cases, a court decision needs to be obtained.

BP909: Requesting and obtaining a court decision for executing a tax audit

This process as described, relays on an Web application for cross-institutional services. .This application should be designed and implemented with functionalities and features described in this process.

Roles/Players

- Authorized person at the Tax Audit Department to administer a request for immediate tax audits (Currently, this is the Head of the Information Provision Division – proposed to be renamed as Tax Audit Cases Management and Information Provision).
- Authorized court person to process applications for court warrants.
- Web application supporting this cross-institutional service.

Business Rules

- Court warrant should be obtained within 48 hours.

START: This BP starts with receiving a request for an immediate tax audit without a court decision (warrant) for a tax audit.

Step 1: Head of the IP Division receives a notification (blinking icon on his/her computer as well as an SMS on his cell phone) when a request for immediate tax audit is submitted.

Step 2: He/she enters the application and list of all new submitted requests pops up (min 1)

Step 3: He/she Filters those that do not have a court warrant.

Step 4: Reviews whether all necessary information is in the system. If not, he/she can add information if possible.

Step 5: Selects (1, few, or all) cases without a court warrant and selects functionality for requesting a court warrant.

Step 6: The system loops through the list of cases and generates a message to the court for each case. Date and time for submitting the request to the Court must be captured into the system.

Step 7: An authorized person at the court receives notifications/alerts on his/her computer and an SMS.

Step 8: Request is processed per court procedures.

Step 9: After the court decision is ready, the authorized court personnel scans and saves the decision into the system and returns the case to the RS through the system. Date and time of the operation are captured (timestamp).

Step 10: System alerts the Head of the IP Division, who opens the case and proceeds based on the feedback:

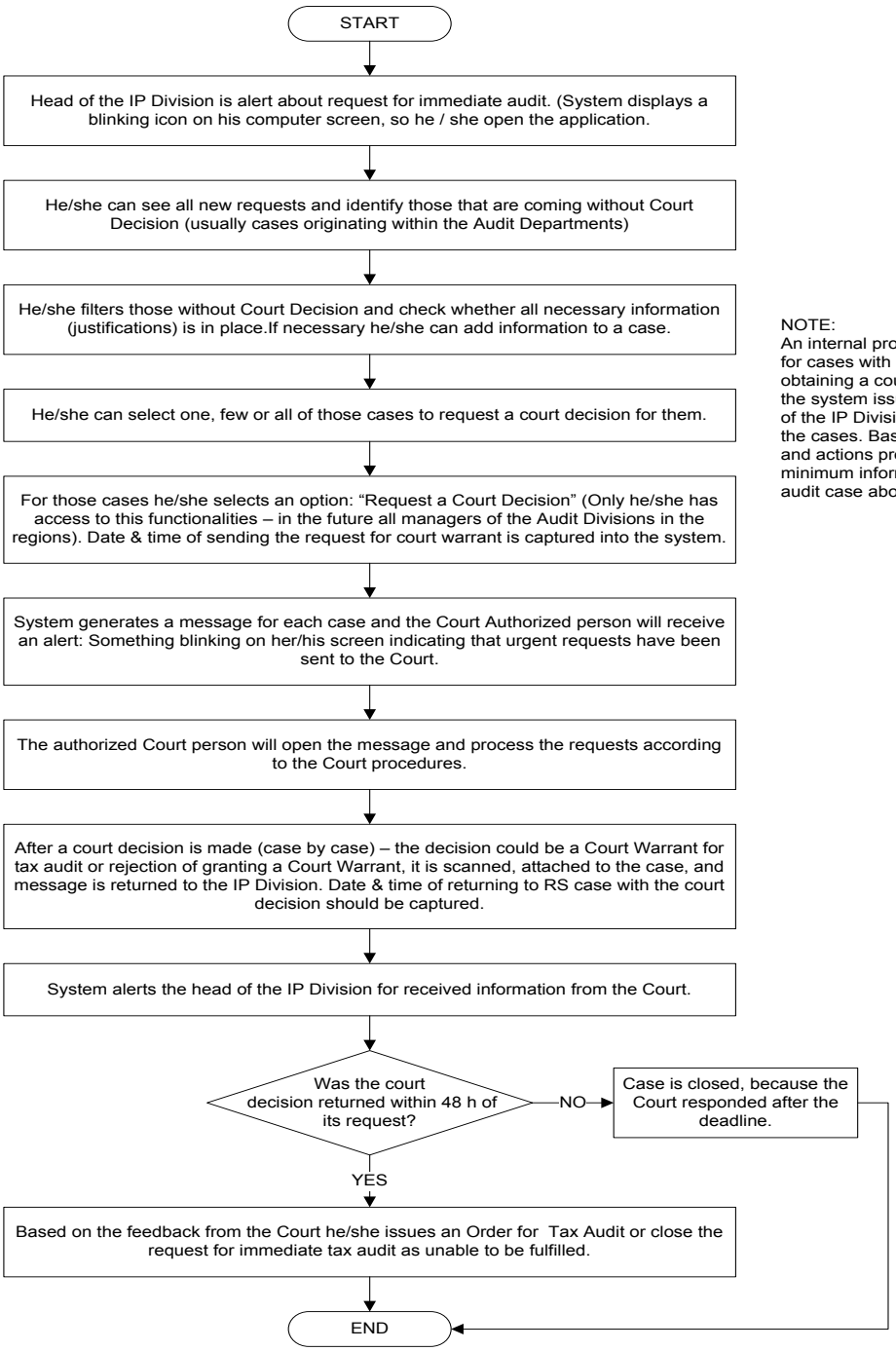
- If court rejects the request for a tax audit, he/she closes the case and through the system, notifies the originator of the case on the status.
- If a court warrant for a tax audit is granted, he/she notifies the originator of the case and proceeds with issuing an order for a tax audit.

END of the process

Exception

An internal routine should check whether a 48-hour period from the time the request was submitted to the court has passed. If so, the case is closed automatically and an automatic notification is sent to the Head of IT Division and originator of the request.

The diagram below demonstrates this BP.



NOTE:
An internal procedure constantly checking for cases with expired deadline (48 h) for obtaining a court warrant. For such cases the system issues alerts to the user (Head of the IP Division) and automatically close the cases. Based on that other notifications and actions probably will be executed. As a minimum informing the originator of the audit case about the status.

BP201: Select a tax audit case for Quality control and authorize it.

Another example of new, redesigned BP provided here is a BP for selecting completed tax audits for quality control. This process, as designed, relies on the existence of computerized support.

Roles/Players:

- Head of the Unit for Tax Audit Quality Control
- System supporting quality control cases

Business Rules

- Quality control is executed on randomly selected completed tax audit cases
- Criteria for selection should ensure a variety of audit types, company size, and cases with and without appeals

Note: Selection should be executed periodically based on the capacity of controllers.

Step 1: Head of the Tax Audit Quality Unit accesses the system for selecting cases for quality control.

Step 2: System displays a form for entering/selecting parameters for cases to be selected. (For example: Need to select four cases that have been completed two weeks ago and were tax field audits, full audits, and on companies whose turnover is between 20 and 10 mln lari.)

Step 3: User enters all required parameters and “Select.”

Step 4: System search for all cases meeting the entered parameters.

Step 5: System loops through the set of identified cases and every 10 seconds selects a case. When four unique cases have been selected, the process stops and the system issues a message along with a list of selected cases.

Step 6: User saves the selection results.

Step 7: User continues with appointing controllers to selected cases. He/she selects this functionality.

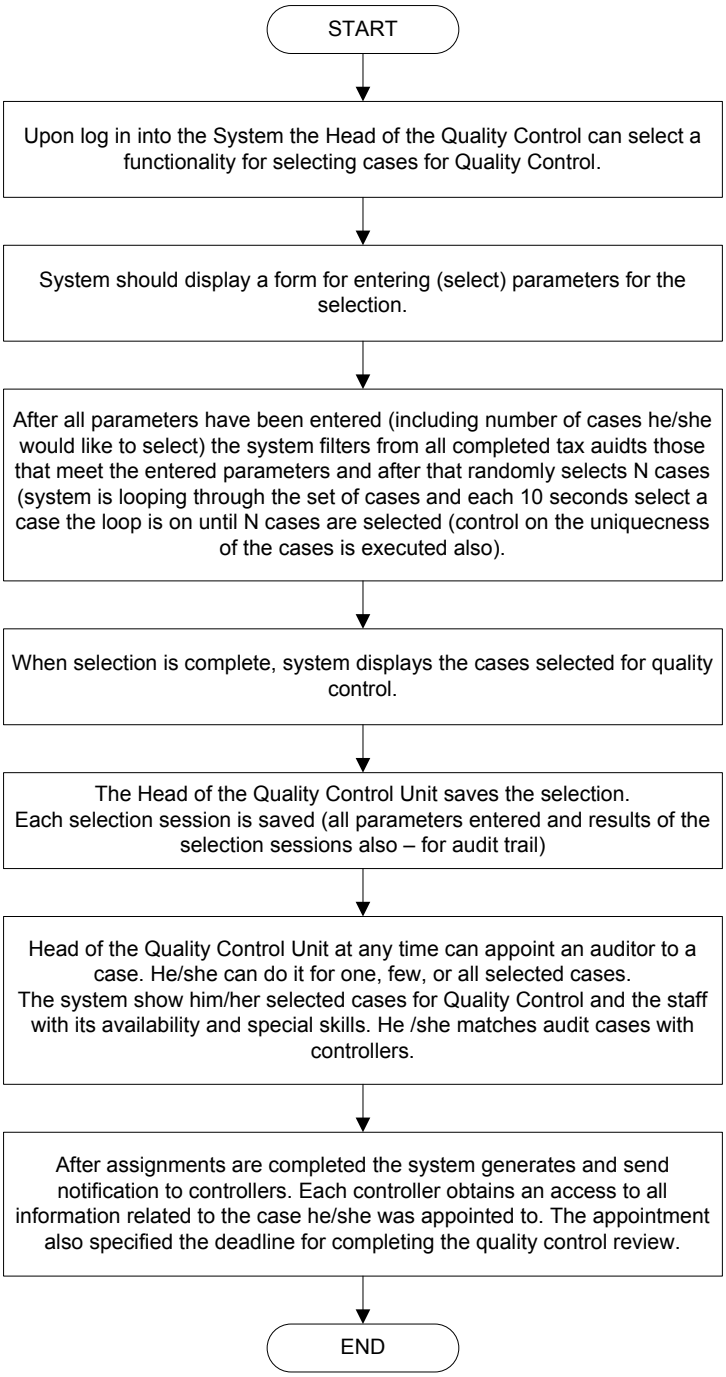
Step 8: System displays, in parallel, cases for quality control and list of controllers, along with their availability.

Step 9: User (Head of the Quality Control Unit) matches each case with a controller. He/she can appoint controllers to selected cases through one or multiple sessions.

Step 10: System generates notifications to controllers who have been appointed for quality control via e-mail/SMS. Controller has access only to cases he/she is appointed to. The appointment also specifies the deadline for completion of the quality control.

END

The diagram below demonstrates this BP:



NOTE: The Head of the Quality Control Unit periodically should use the System functionalities for selecting completed tax audit cases for Quality Control. Select should be random, but still based on some parameter: type of tax audit, type of the taxpayer (Large, medium, small), business sectors of the TP, length of the tax audit, etc. Criteria should be defined and used to ensure specific goals of the quality control unit.

Frequency of the selections is mainly triggered by the capacity of the Quality Control staff.

ATTACHMENT 4: RISK-BASED AUDIT SELECTION SYSTEM

CONCEPT OF THE RISK-SCORING MODEL

Risk-based scoring is one of the techniques used for identifying risky taxpayers and selecting them for tax auditing. Different scoring models exist in different countries. Examples are available at http://www.oecd.org/dataoecd/44/36/33818568.pdf.

This section describes a simple and clear model that has been implemented in several countries. Based on this example, the Georgian RS can develop and implement a model that fits Georgia's environment and goals.

There are several main rules that must be considered when designing a risk-scoring model:

- A set of risk criteria is applicable to a homogenous group of taxpayers;
- A homogenous group of taxpayers are defined usually on the size of the business entities and also by business sectors;
- Each criterion has different significance that can be expressed with criterion weight; and
- Changes in the economic environment create new risk criteria and diminish the significance of already identified criteria, which requires changes to approved sets of criteria to be used for risk scoring.

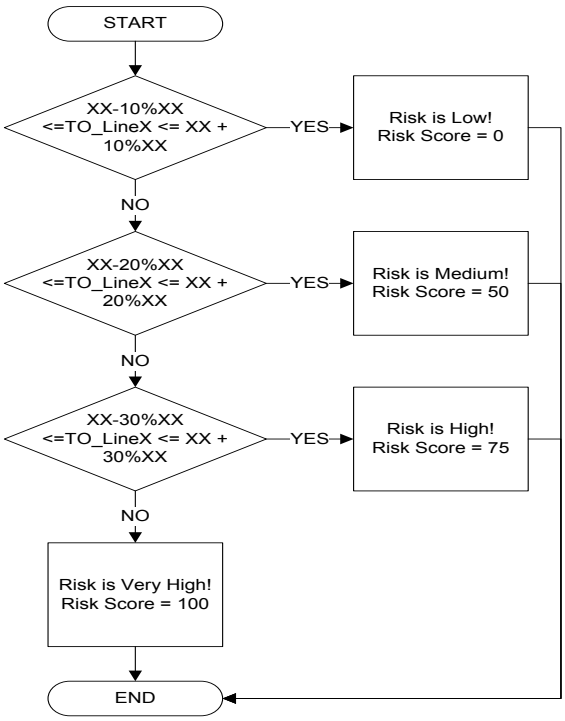
It must be emphasized that taxpayer's tax returns are scored based on criteria/indicators. The criterion/indicator usually uses data from a tax return in correlation with other data (for the same taxpayer or for group of taxpayers) and based on the criterion value a score is allocated.

Example 1: (*for the purpose of explaining the concept*)

VAT tax return – Line X provides a total turnover for the tax period.

Then, one can take the VAT tax returns for the same taxpayer for a one-year period prior to the tax return being scored. Let the average turnover from the tax returns for this one-year period be XX.

Then, one can compare the average turnover for the one year with the turnover from the return underscoring. For the purpose of this explanation, one can mark turnover from the tax return used for scoring, TO_Line X.



If TO_LineX belongs to the interval [XX – 10%xx; XX + 10% xx] THEN Risk score = Low (Score = 0)

ELSE

If TO_LineX is in any of the intervals: [XX – 20%xx; XX-10%xx) or (XX+10%xx; XX+20%] THEN risk is = Medium (Score = 50)

ELSE

If TO_LineX is in any of the intervals: [XX – 30%xx; XX- 20%xx) or (XX+20%xx; XX+30%xx] THEN the Risk is High (Score = 75)

AND in all other cases, where the the TO_Line X differs from the average more than 30%, the risk is very high and the risk score allocated is 100.

When an auditor works with a specific tax return, he/she should see both the score and the explanation of the score. For example, this return's risk is medium because the turnover deviates only 20% from turnovers over a one-year period. Such descriptions should be included in the scoring rules allocation to help the auditor understand the risk score and where to look for during the audit.

Example 2: Ration of Sales of goods with "zero" VAT as percentage of all sales. If the average value of this ration for a one-year period was 3% and suddenly this taxpayer submits a tax return with a ration bigger than 10%, there is a risk that the taxpayer is not reporting correctly.

NOTE – A single criterion cannot provide enough assurance for proper identification. So, for each type of tax at least 10 different criteria are defined and applied. Also, criteria are used with different weights. Each weight represents the criterion importance in identifying the risk.

Also, when among criteria there is a criterion using some averages for a specific business sector, then the set of criteria should be applied only to those taxpayers that belong to this business sector. The criterion value for each taxpayer within the group will be compared to the benchmark value, specific for the business sector.

So, there is a taxpayers' group and a set of criteria that can be applied to those taxpayers tax returns. Usually, a set of criteria is for a specific tax type (VAT, CPT, PIT, etc.).

Each criterion has a formula and rules for allocating risk score depending on the value the formula obtains when used to a specific tax return.

Each criterion also has a maximum score that can be allocated and it is calculated based on criteria weight within the criteria set and the maximum score adopted for a specific tax type.

Example:

If for VAT tax return is adopted that 1000 is the maximum score and there is a set of criteria for VAT tax returns: Cr1, Cr2, Cr3, and Cr4. Let us imagine that relevant weights for those criteria are: 20%, 23%, 43%, and 14%. Sum of the weights must be 100%.

This means that the criteria maximum score will be as follows:

Cr1: Max score = 200

Cr2: max score = 230

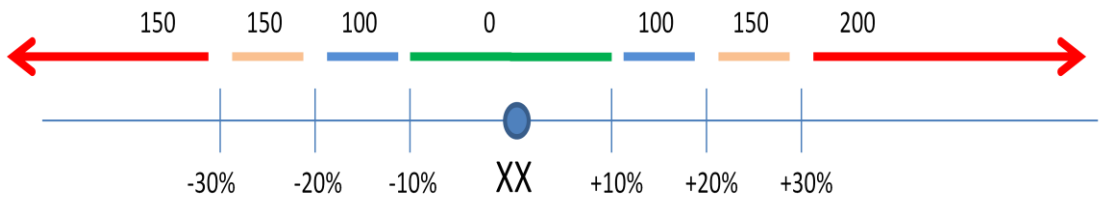
Cr3: Max Score = 430

Cr4: Max Score = 140

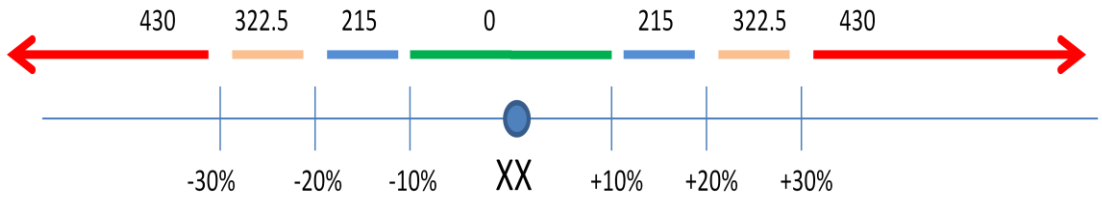
Then for each criterion also, we need to define rules for score allocation depending on the value the criterion will obtain when applied to a specific tax return.

Here we need to keep in mind the nature of the criterion and what are the possible values and also, the fact that we would like to classify the tax returns as returns with low, medium, high, and very high risk.

In the above example, we used the average value of the turnover (criterion) to define four deviations from it and define the four different scores. If this is our Cr1, then the below picture is presenting the score allocation rules.



If it was a Cr4, whose maximum score is 430, then the picture would be:



Note: For each individual criterion, score allocation rules need to be defined. Based on the practice and analysis of the results of an audit, those rules can be changed later. Criterion also should be changed based on analyzing results.

After calculating scores for a tax return for each criterion, the final score is calculated as a sum of scores allocated per criterion.

Total score for Tax Return XX = Score of Cr1 + Score of Cr2 + Score of Cr3+Score of Cr4.

When score is calculated for all tax returns, tax returns can be ordered by total score, and this could be the priority in which tax audits for those taxpayers are executed.

It is common practice that results from a risk scoring system be additionally analyzed by business sectors experts and a subset of results be selected for tax audits.

COMPLIANCE RISK SCORING SYSTEM (CRSS) - High-level Description

Purpose

The purpose of a risk score assessment is to identify tax returns with high compliance risk and recommend them for tax audit. Such a system ensures that all tax returns are objectively assessed and identified for tax audit activities and increases the productivity of tax audits.

The usefulness of the results of this system depends on:

- Representatives of the risk criteria (selected criteria are those that truly identified compliance risks); and
- Data quality (completeness and accuracy of all data in criteria formulas and data from tax returns, previous tax audits, etc.).

Scope

A risk scoring system includes functionalities for:

- Maintaining sets of risk criteria with their formulas and score allocation rules, as well as taxpayer's classifications and links between risk sets and taxpayers groups.
- Executing scoring of a specified set of tax returns using an existing set of risk criteria.
- Maintaining results from scoring sessions and presenting those results in different views, when used for the final selection of cases for tax audit and other control types.

The system aims to ensure a transparent process of selecting cases for tax audit and increasing the productivity of tax audit activities.

Conceptual Model

The system consists of three main modules. Each module comprises several components and each component provides several functionalities.

Module 1: Maintain a database of risk sets, risk criteria with their formulas, score allocation rules, and TP classifications.

Components and their functionalities in this module include:

Component 1: Risk Set

F1: Define a risk set (name and description of which type of tax returns will be applied to which group of taxpayers and maximum score for the set).

F2: Define risk criteria belonging to the risk set (names and brief description).

F3: Set up criteria weights.

F4: Calculate maximum score for each criterion.

Component 2: Risk Criterion

F1: Create a formula for a risk criterion (formula can use different objects – field from a tax return or SQL statement with parameters, TIN, time period, etc.).

F2: Set up score allocation rules for the criterion.

F3: Activate a risk set.

F4: Maintain the validity of a risk set (deactivate or create a variation of it, etc.).

Component 3: Taxpayers Classification

F1: Define taxpayers groups by revenue (turnover).

F2: Define taxpayers groups by business sectors.

F3: Define taxpayers by geographical location and turnover (or other criteria).

Module 2: Execute scoring

Component 1: Set parameters for scoring

F1: Select a taxpayers group.

F2: Select a tax period.

F3: Select a risk set to apply.

Component 2: Execute scoring

Through execution, measuring the time for each discrete step can be embedded to monitor performance.

Module 3: This module has functionalities allowing users to present the scoring results in different views and selects subsets of scoring results for further considerations and usage.

Component 1: Maintain results of each scoring session

All results have to be saved into database, along with information on when the execution was made, on what taxpayers group, for which tax period, and with which set of risks.

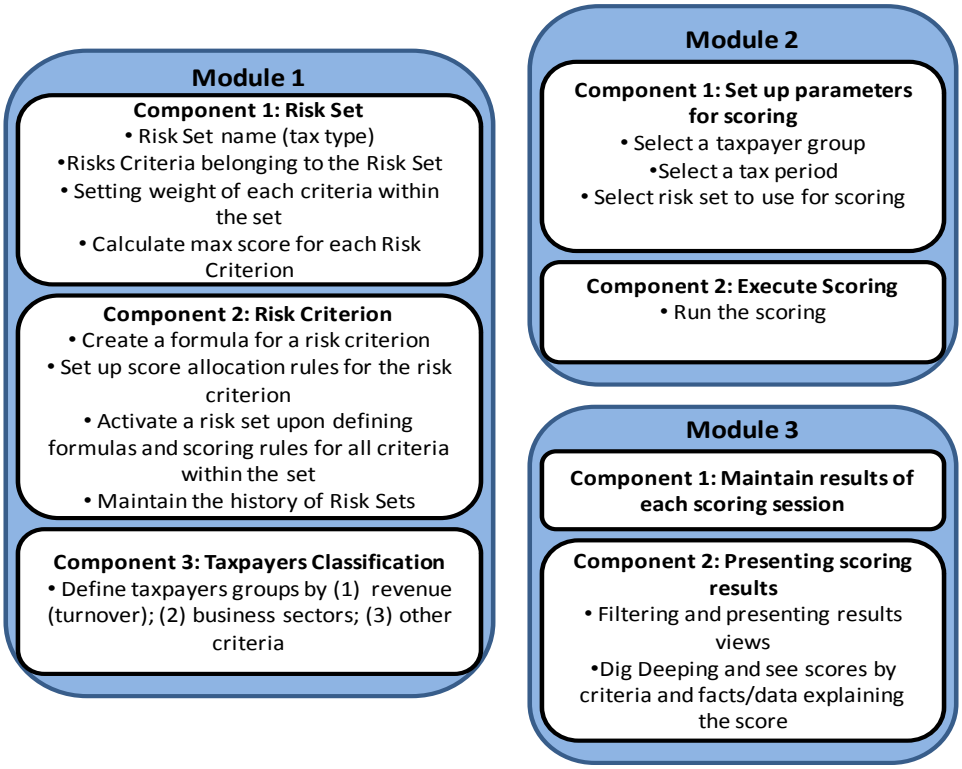
Component 2: Presenting scoring results

F1: Filtering and presenting results views

F2: Viewing scores by criteria and facts/data explaining the score

Graphically, the conceptual model of the CRSS can be represented as follows:

Conceptual Model of the Compliance Risk Scoring System



Detailed requirements are needed for software development.

ATTACHMENT 5: IDENTIFIED TRAINING NEEDS FOR IT CENTER AT THE RS

I. Immediate needs related to already started IT projects

Subject	Training Course	Number of employees to be trained
Oracle	Oracle Database 11g: Administrator Workshop I	3
Oracle	Oracle Database 11g: Administrator Workshop II	
Oracle	11gDWF Oracle Database 11g: Data Warehousing Fundamentals	3
Oracle	11gWBI Data Integration and ETL with Oracle Warehouse Builder: Part 1	
Oracle	11gWBII Data Integration and ETL with Oracle Warehouse Builder: Part 2	
Oracle	BI11gOV Oracle BI: Analytics Overview	5
Oracle	BI11gCR Oracle BI 11g R1: Create Analyses and Dashboards	
Oracle	BI11gBR Oracle BI 11g R1: Build Repositories	
Oracle	10gJP Oracle 10g: Java Programming	4
Oracle	10gJEE_ApsI OracleAS 10g R3: Build Java EE Applications I	
Oracle	10gJEE_ApsII OracleAS 10g R3: Build J2EE Applications II	
ITIL	ITIL foundation Certificate in IT Service Management	5
ITIL	ITIL v.3 - Foundations	
ITIL	ITIL v.3 - Service Offerings and Agreements	
ITIL	ITIL v.3 - Operational Support and Analysis	
ITIL	ITIL v.3 - Release control and validation.	
MICROSOFT	Visual Studio 2010: ASP.NET Developer	5
MICROSOFT	Visual Studio 2010: Microsoft Silverlight 4, MVVM (Model-View-View Model) pattern	5

MICROSOFT	Visual Studio 2010: Developing Web Applications with Microsoft Visual Studio 2010	5
MICROSOFT	Configuring, Managing and Troubleshooting Microsoft Exchange Server 2010	3

II. Needs related to planned IT projects

Subject	Training Course	Number of employees to be trained
Oracle	11gAPLS Oracle Database 11g: Advanced PL/SQL	4
Oracle	10gFBI Oracle Forms Developer 10g: Build Internet Applications	
Oracle	10gRB Oracle Reports Developer 10g: Build Reports	
Oracle	10gTSQL Oracle Database 10g: SQL Tuning Workshop	3
Oracle	DPU Oracle Database: Develop PL/SQL Program Units	3
Oracle	DPLSQL Oracle Database: Program with PL/SQL	
VMWare	VMware vSphere: Install, Configure, Manage [V41]	2
MICROSOFT	Visual Studio 2010: Windows Communication Foundation, SOA concepts	5
MICROSOFT	Visual Studio 2010: WCF Data Services, Applications	
MICROSOFT	Planning, Deploying, and Managing Microsoft Exchange 2010 Unified Messaging	3
MICROSOFT	Configuring, Managing, and Troubleshooting Windows Server 2008 Active Directory Domain Services	

ATTACHMENT 6: TAX AUDIT QUALITY CONTROL

Establishing a tax audit quality control function/practice at the RS is conditional to:

- Establishing and documenting:
  - Tax audit processes.
  - Tax audit working documents (templates), including manuals.
- Defining business rules for tax audit quality control.
- Designing and adopting tax audit quality control business procedures and working documents.
- Training auditors and quality control experts on processes and working documents (library of those processes/procedures and working documents is established, updated, and accessible by auditors and quality control experts).

Business rules (example):

- Quality control is executed on completed tax audits.
- A complete tax audit is considered a tax audit case for which the tax audit act is final and assessed liabilities have been reported on the taxpayer's account.
- The purpose of quality control is to confirm that a tax audit was carried out in accordance with legal provisions and adopted procedures, as well as audit activities and findings that were documented as prescribed by regulations.
- Quality control results are put in for improving the legislation, procedures and working documents, as well as auditor's skills (QC can identify frequent mistakes auditors do and design relevant training programs for improving auditors skills)
- A quality control unit is established.
- Quality control has to be completed within three working days.
- Quality control is executed by a team of at least two experts.
- Quality control should be executed on a variety of tax audit cases – field or desk audits, full or on topic audit, immediate or planned audits, audits on large, small, or medium enterprises, etc.
- Standard working documents should be used during quality control.
- A repository of quality control cases must be maintained. For each case an audit trail should be creatyed (who performed the control and when. All documents and records created during the QA process should be saved and linked to the case. The results of quality control can be used for annual performance evaluations of auditors.
- Quality control experts should know all adopted tax audit procedures, standards, regulations, and working documents.

Software facilitating the quality control procedures and managing quality control cases needs to be developed.

The following BPs for a quality control unit were identified:

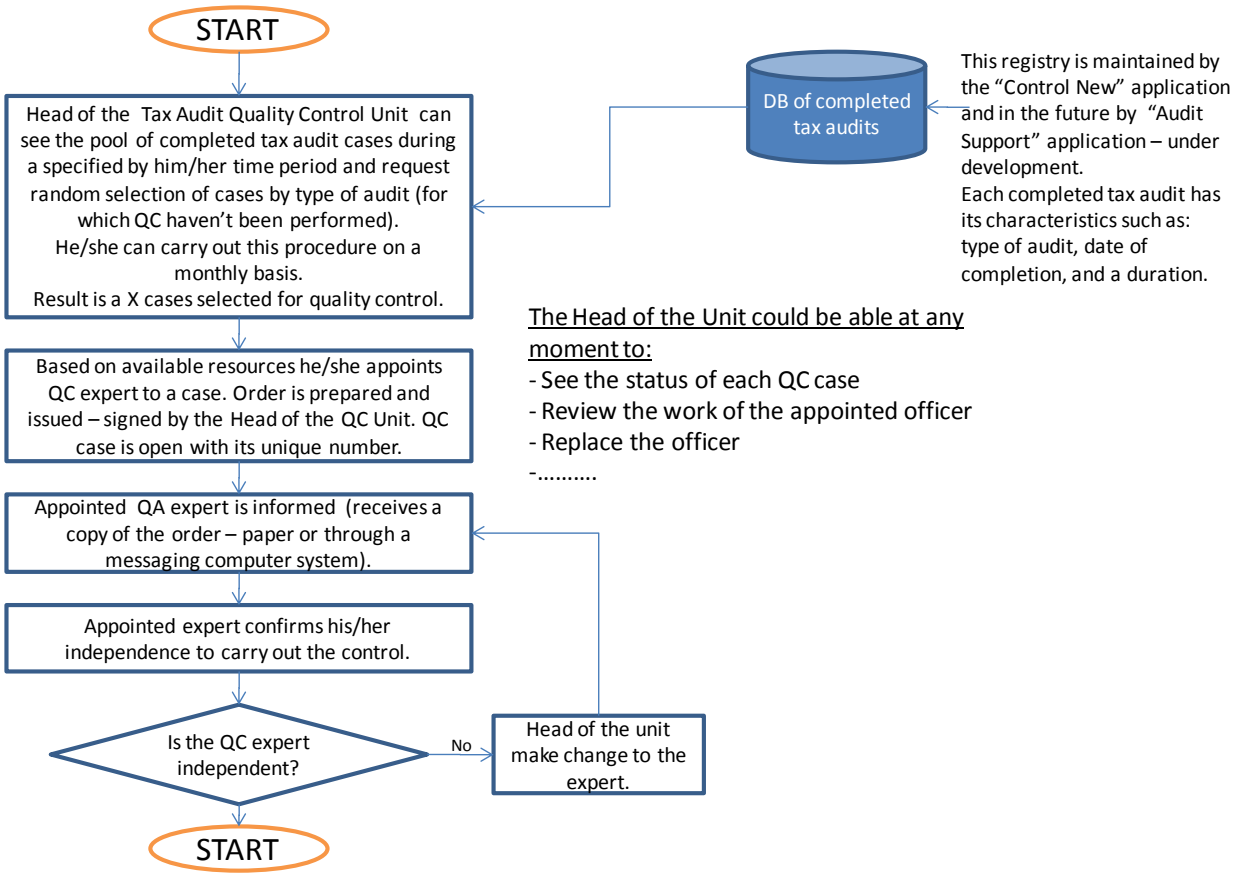
BP201: Select a tax audit case for quality control and authorize it

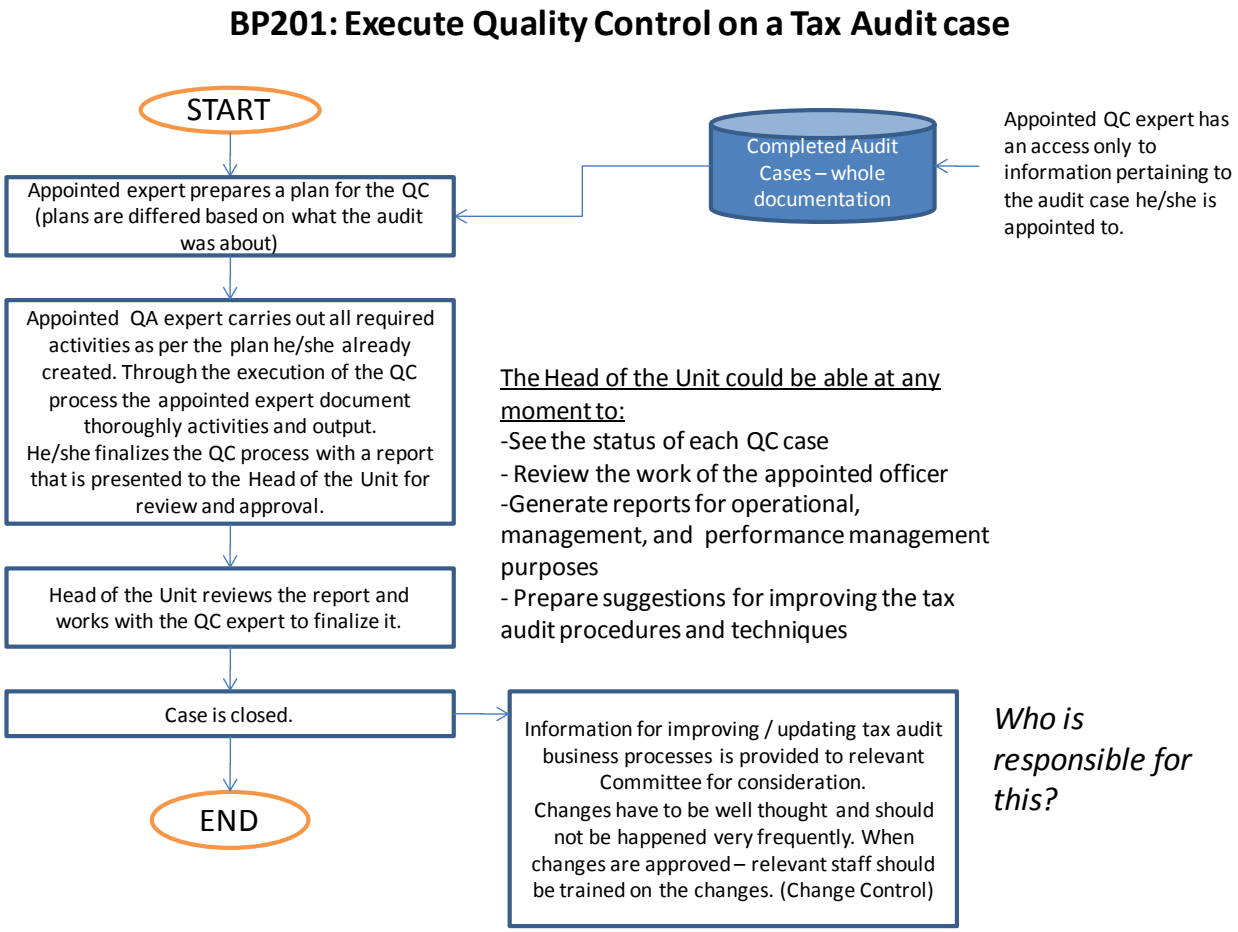
BP202: Execute a documented tax audit quality control case and maintain a DB with suggestions for improvements to the audit procedures, forms, and methodologies. (Create QMS processes)

BP203: Draft improvements and adopt changes to tax audit BPs and/or working papers.

The following two diagrams are high-level presentations of the BP201 and BP202:

BP201: Select a Tax Audit Case for Quality Control & Authorize it





A more detailed presentation and description of BP201 is provided below.

BP201: Select tax audit cases for quality control and appoint an expert to execute quality control

Roles/Players

- Head of the Unit for Tax Audit Quality Control
- System supporting quality control cases

Business Rules

- Quality control is executed on randomly selected completed tax audit cases.
- Criteria for selection should ensure the variety of audit types, company size, and cases with and without appeals.

Note: Selection should be executed periodically based on the capacity of controllers.

Step 1: Head of the Tax Audit Quality Control Unit accesses the system for selecting cases for quality control.

Step 2: System displays a form for entering/selecting parameters for cases to be selected. (For example: Need to select four cases that have been completed two weeks ago and were a tax field audit, a full audit and on companies where turnover is between 20 and 10 mln lari.)

Step 3: User enters all required parameters and presses “Select.”

Step 4: System searches for all cases meeting the entered parameters.

Step 5: System loops through the set of identified cases and every 10 seconds, selects a case. When four unique cases have been selected the process stops and the system issues a message along with list of selected cases.

Step 6: User saves the selection results.

Step 7: User continues with appointing controllers to selected cases.

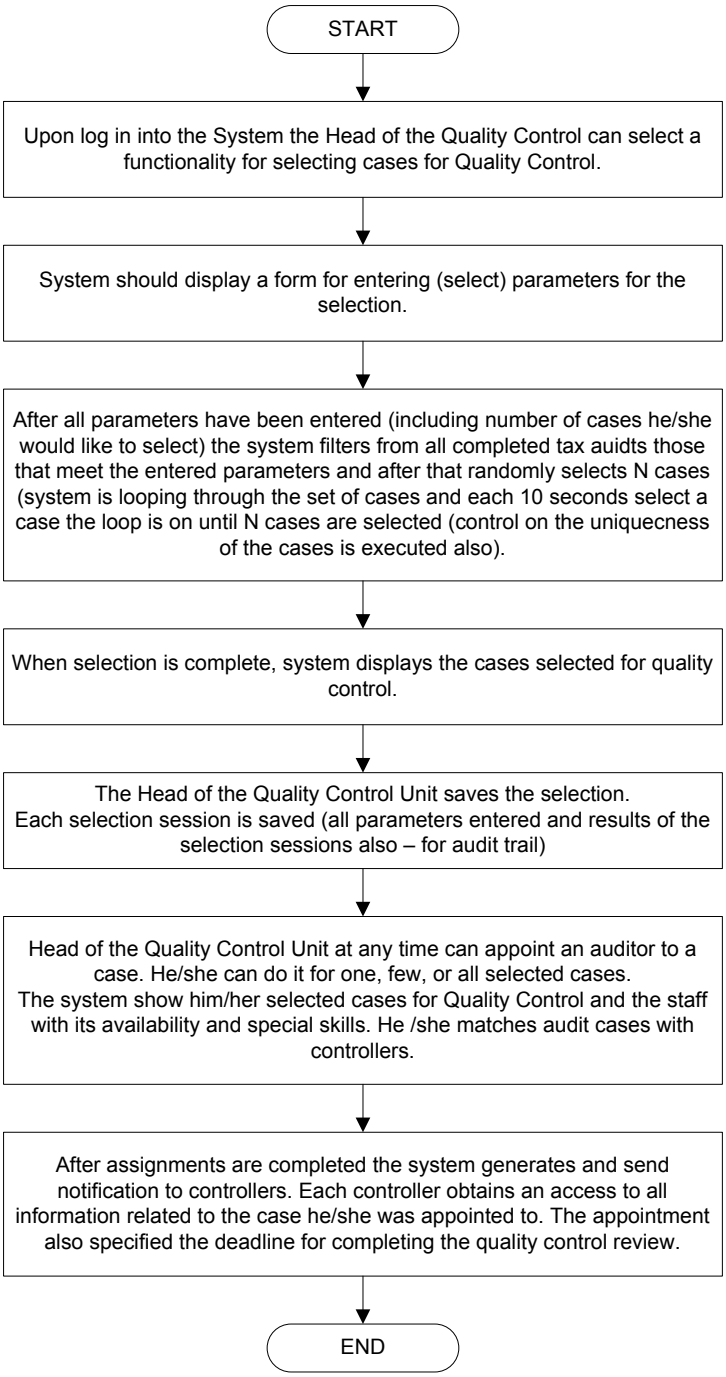
Step 8: System displays, in parallel, cases for quality control and list of controllers, along with their availability.

Step 9: User (Head of the Quality Control Unit) matches cases for quality control with a controller. He/she can appoint controllers to selected cases through one or multiple sessions.

Step 10: System generates notifications to controllers that have been appointed for quality control via e-mail/SMS. Controllers have access only to cases they are appointed to. The appointment also specifies the deadline for the completion quality control.

END

The following diagram depicts this BP:



NOTE: The Head of the Quality Control Unit periodically should use the system functionalities for selecting completed tax audit cases for quality control. Selection should be random, but still based on some parameter, i.e. type of tax audit, type of taxpayer (large, medium, small), business sectors of the TP, length of the tax audit, etc. Criteria should be defined and used in accordance with the specific goals of the quality control unit. Frequency of selections is mainly triggered by the capacity of quality control staff.

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