

2009



Status Report
of the
Auditor General of Canada
to the House of Commons

Chapter 3
Auditing Small and Medium Enterprises—
Canada Revenue Agency



Office of the Auditor General of Canada

The 2009 Status Report of the Auditor General of Canada comprises a Message from the Auditor General of Canada, Main Points—Chapters 1 to 5, an appendix, and five chapters. The main table of contents for the Report is found at the end of this publication.

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Chapter

3

Auditing Small and Medium Enterprises
Canada Revenue Agency

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Auditing Small and Medium Enterprises

Canada Revenue Agency

Main Points

What we examined

The primary goal of the Canada Revenue Agency as Canada's tax administrator is to ensure that taxpayers comply with their obligations and that Canada's tax base is protected. The Agency's Small and Medium Enterprises (SME) Program and the Underground Economy Initiative, which is part of the Program, are designed to deal with the risk of non-compliance with tax laws. Of the 5,600 Agency employees who carry out compliance activities in the SME Program, more than 1,000 work on the Underground Economy Initiative.

The underground economy is defined for tax purposes as activities that result in income earned but not reported. This can include illegal activities such as smuggling, drug trafficking, and money laundering, but also "hidden" legal transactions in goods and services. The Underground Economy Initiative deals with hidden legal transactions. Other Agency programs deal with illegal activities, non-filers, and non-registrants.

We audited the Underground Economy Initiative in 1999 and the SME Program in 2004. For this chapter, we followed up on selected areas of those audits. We examined the progress made by the Agency in implementing our previous recommendations on assessing the risks of non-compliance, targeting SME taxpayers to audit for compliance, promoting compliance, and measuring the performance of its compliance activities. Our conclusion about the Agency's overall progress was based on the relative importance of each recommendation, the complexity of implementing it, and the length of time the Agency has had since the original audit to implement the recommendation.

Why it's important

The revenues that the Canada Revenue Agency collects are used to fund government programs across Canada. Compliance with tax laws contributes to the economic and social well-being of all Canadians.

The Agency believes that the incidence of non-compliance is relatively low but financially significant. The results of its compliance program activities in the 2006–07 fiscal year accounted for an estimated \$12.7 billion in additional taxes, close to \$2.5 billion of which was related to small and medium enterprises. The Agency has said that

growing self-employment, globalization of the economy, and growing use of information technology to conduct business have increased the challenges of combating non-compliance. Furthermore, businesses that do not report all the income they earn put businesses that do at a competitive disadvantage and cause honest taxpayers to bear the tax load of those who cheat.

What we found

- Overall, the Agency has made unsatisfactory progress in addressing the recommendations we selected from our previous reports for follow-up. Progress on 7 of the 13 recommendations is satisfactory. However, of the 13 recommendations, we considered 6 to be the most important and progress was unsatisfactory on 4 of those 6 recommendations.
- Progress is unsatisfactory on three key recommendations aimed at improving how the Agency assesses the risks of non-compliance and targets taxpayer files to audit for unreported income. About half of its underground economy audits over the past five years did not detect unreported income, and the amount of unreported income that has been detected has remained relatively constant. Low-risk files represent a far higher proportion of audited files than those rated as high-risk by the Agency's computerized risk assessment system. Although a study by the Agency found that its file screeners needed to have more confidence in the accuracy of the computerized risk ratings, the Agency has done little to validate those ratings. The Agency has also failed to strengthen its Core (random) Audit Program. The results of a strengthened program could be used to improve the computerized risk assessment system.
- The Agency has made significant progress in reviewing all of the threats to the tax base. One of the four biggest threats it identified is the underground economy, and the Agency has developed an action plan to address it. It has also developed a Compliance Measurement Framework to improve how it monitors compliance. In addition, it has prepared a compliance monitoring report each year using the indicators in the Framework.
- The Agency has increased its outreach activities to promote compliance and taxpayer awareness of what the underground economy costs society. It has also recently developed its first national compliance communications strategy on this subject.

- Despite a commitment to do so, the Agency still does not report additional taxes on unreported income that are identified by its audit activities.

The Agency has responded. The Agency does not agree that its overall progress in addressing our recommendations is unsatisfactory. It believes that we have placed too much emphasis on certain recommendations in arriving at our conclusion.

Introduction

3.1 The mission of the Canada Revenue Agency (the Agency) is to administer tax, benefits, and related programs and to ensure compliance on behalf of governments across Canada, thereby contributing to the ongoing economic and social well-being of Canadians. As Canada's tax administrator, the Agency's primary goal is compliance—ensuring that taxpayers meet their obligations and protecting Canada's tax base.

3.2 Non-compliance matters to Parliament and to all Canadians because the revenues that the Agency collects are used to fund government programs across Canada. The Agency has plans and programs to manage the risks of non-compliance. In 1999, we audited the Agency's Underground Economy Initiative, and in 2004, we audited the Agency's compliance activities directed toward **small and medium enterprises**.

Small enterprises—Individuals who are in business, trusts, and private corporations with less than \$1 million in annual revenues.

Medium enterprises—Individuals who are in business with annual revenues greater than \$1 million and corporations with annual revenues between \$1 million and \$50 million.

3.3 For tax purposes, the underground economy is commonly defined as activities that result in income that taxpayers have earned but not reported. This may include illegal activities, such as smuggling, drug trafficking, and money laundering, as well as legal transactions in goods and services that are hidden, resulting in under-reporting of taxes. Furthermore, businesses that do not report all the income they earn put businesses that do at a competitive disadvantage and cause honest taxpayers to bear the tax load of those who cheat. With respect to the underground economy, the Agency's program dealing with small and medium enterprises addresses the legal but hidden transactions for enterprises that file returns. Other Agency programs deal with illegal activities, non-filers, and non-registrants.

3.4 The Agency strives to achieve high levels of compliance by taxpayers to protect Canada's tax base. It believes that the incidence of non-compliance is relatively low. However, the results of its compliance program activities demonstrated that such non-compliance is, in total, financially significant. As stated in its 2006–07 Annual Report, the Agency identified an estimated \$12.7 billion in additional taxes, close to \$2.5 billion of which was related to small and medium enterprises. In the Agency's Small and Medium Enterprises Program, there are more than 5,600 full-time employees doing audits and other compliance activities. More than 1,000 of those employees worked on activities concerning the underground economy.

3.5 The underground economy intersects with the small and medium enterprise sector. In particular, two of the underground

economy risk indicators—cash transactions and poor accounting records—are often present in small enterprises.

What we found in 1999

3.6 In 1999, we examined the way the Agency implemented its Underground Economy Initiative. We reported that

- the actual tax recoveries attributable to the detection of unreported income were much less than the \$500 million that the Agency reported to Parliament;
- it was difficult to assess the overall success of the Initiative in combating the underground economy, because the Agency had not identified indicators for measuring the Initiative's performance;
- the Agency had not assessed the role that social marketing might play in making the public aware of the costs of the underground economy to society;
- as planned, the Initiative took a balanced approach, in our view. But as implemented, the Initiative was not balanced, because all of its resources were allocated to enforcement; no public awareness activities were carried out, and activities designed to promote businesses' voluntary compliance declined over time; and
- the Agency had committed to conducting research to support its enforcement activities and its choice of four targeted sectors, but the research was incomplete.

3.7 The Standing Committee on Public Accounts issued a report recommending that the Agency address the issues raised in our 1999 audit of the Underground Economy Initiative. In response to this report, the Agency agreed to increase its community visits and build relationships with private sector associations. It also committed to improving its performance reporting to Parliament regarding these visits and partnerships, and regarding its social marketing efforts and progress on the Initiative. In addition, the Agency agreed that it should record and report the additional gross income and taxes identified by the Initiative.

3.8 We followed up on the status of implementation of the 1999 recommendations in 2001. We concluded that the Agency had been working to address the recommendations, but that several areas continued to require attention, such as identifying and reporting performance indicators, reporting results of detection of unreported income, and targeting high-risk files for audits of unreported income.

What we found in 2004

3.9 In 2004, we examined the activities of the Agency's small and medium enterprise audits. We reported the following:

- The Agency's aim was to improve compliance, but it did not have the necessary information to measure compliance over time and the effectiveness of its activities. The Agency was developing a Compliance Measurement Framework and related measures/indicators.
- Forty percent of all small and medium enterprises audited in a given year had little or no potential tax at risk, according to the Agency's computerized risk assessment system.
- Audits of taxpayers the system identified as having high potential for non-compliance yielded much higher reassessments than audits selected by other means.
- The Core (random) Audit Program is important for determining the degree, the nature, and the causes of non-compliance. The Agency had been slow to assess the results of the Program, and had to suspend it in 2004.

Important changes since previous audits

3.10 In 2006, the Compliance Programs Branch was reorganized following a functional review. This reorganization brought together all the small and medium enterprise issues and services for the Branch, including underground economy activities, into one directorate.

3.11 The Agency has said that recent trends in self-employment, globalization of the economy, and information technology have increased its challenges in combating non-compliance. Studies carried out since 2004 have indicated that

- what people hear and feel about how the government spends their taxes is linked to how they feel about tax compliance;
- the public perceives the prevalence of the underground economy as high; and
- tax practitioners regard the underground economy as a major problem, but as long as society generally accepts it, solving this problem will be a challenge.

Focus of the audit

3.12 This audit followed up on selected recommendations from our 1999 and 2004 audits that dealt with four themes—assessing and addressing the risks of non-compliance, targeting taxpayers to audit for compliance, promoting compliance in the underground economy, and reporting on performance. We therefore followed up on 13 of the 21 recommendations (main and sub-sections included) originally reported. We considered 6 of the 13 recommendations, found in Exhibits 3.1, 3.2, 3.3, 3.7, 3.9, and 3.11, to be the most important. We did not follow up on the other eight recommendations, all found in Chapter 5 of the March 2004 Report of the Auditor General of Canada, because they relate to other subjects. Nor did we cover areas in the Small and Medium Enterprises Program and the Underground Economy Initiative that were not related to our previous recommendations.

3.13 Our audit focus was to assess whether the Agency had made satisfactory progress in implementing the selected recommendations from the previous reports and in addressing the issues related to those recommendations. In particular, we assessed whether the Agency can demonstrate that it

- has systems and practices in place to assess and address the risks of non-compliance in the small and medium enterprise sector, including those participating in the underground economy;
- selects and audits small and medium enterprises of high risk or priority;
- promotes taxpayer awareness of income reporting obligations through outreach and communications in the underground economy; and
- develops appropriate measures and reports on the effectiveness of its small and medium enterprise compliance program activities.

3.14 More details on the audit objective, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations

Assessing the risks of non-compliance

Two initiatives strengthen compliance research and monitoring

3.15 Our 2004 Report recommended that the Canada Revenue Agency (the Agency) ensure that it identify and consider all threats to the tax base in a consistent manner. The Agency agreed and committed to developing a Compliance Measurement Framework and to undertaking monitoring and research to identify compliance trends and problems.

3.16 Compliance Measurement Framework. The Agency developed the Compliance Measurement Framework, a tool for monitoring and measuring compliance, to evaluate and refine approaches to addressing compliance issues. The Framework is intended to provide greater focus and more rigour to compliance research and strategic analysis. It is also intended for use as a basis for research planning, monitoring, and reporting. The Framework was fully implemented in the 2004–05 fiscal year. It includes many indicators that the Agency can use to monitor compliance trends and adjust its compliance strategies.

3.17 Compliance monitoring reports, consisting of the analysis of compliance indicators, the socioeconomic context of tax compliance, and the monitoring and contextual analysis of relevant public opinion research, have been prepared annually since the implementation of the Framework.

3.18 The Framework has also been used to guide the Agency's compliance research agenda. The agenda has three main areas of research: compliance monitoring, baseline research to identify emerging issues and trends, and program studies. While the research done has helped the Agency understand compliance trends and the factors that influence compliance, we found that the Agency's overall approach to compliance research needs more rigour. For example, the Agency

- has not updated its formal compliance research agenda since 2006, despite intentions to update the agenda on an ongoing basis;
- has kept virtually no records since 2004 to show that research proposals were evaluated in a consistent manner before being accepted or rejected, although an evaluation framework is in place; and

- did not track its use of research results to ensure that, where such actions were appropriate, new insights were incorporated into its risk assessment systems.

These elements limit the effectiveness of the Agency's compliance research, which plays an important role in understanding the risks of non-compliance.

3.19 The Agency is currently taking steps to improve. For example, it recently reviewed the roles and responsibilities of its compliance research and risk assessment program in the Compliance Programs Branch and outlined a plan to enhance and integrate risk and research activities over the next two years.

3.20 Compliance review. In 2005, the Agency also completed a comprehensive review of the risks to the Canadian tax base. This review identified four major risks that the Agency needed to focus on: aggressive tax planning, GST/HST non-compliance (and fraud), the underground economy, collections, and non-filers/non-registrants. With respect to the underground economy, we note that since then, the Agency has developed a strategy with an action plan that includes 28 items grouped under 5 themes:

- strengthening Agency-wide capacity,
- providing effective direction of compliance work,
- producing effective communications,
- increasing engagement with stakeholders, and
- increasing research capacity.

3.21 The Agency is implementing its action plan for the underground economy, but we found that it is not systematically tracking its progress on action items, an important step given that the commitments are comprehensive and long-term. Nor has it done an overall assessment of the actions it took and how they met expectations.

3.22 The development of the Compliance Measurement Framework and the compliance review were positive steps in identifying major compliance risks, and we have rated progress in implementing our recommendation as satisfactory (Exhibit 3.1).

Exhibit 3.1 Progress in addressing our recommendation on threats to the tax base

March 2004 Report of the Auditor General of Canada, Chapter 5	
Recommendation	Progress
The Agency should ensure that all threats to the tax base are identified and considered in a consistent manner (adapted from paragraph 5.32)	Satisfactory

Satisfactory—Progress is satisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

Unsatisfactory—Progress is unsatisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

Core (random) Audit Program has not been strengthened

3.23 The Agency also obtains information about the compliance of the small and medium business population through its Core Audit Program, which was first implemented in 1999. The Program selects a random sample of taxpayers' returns every year and is intended to

- measure the non-compliance rates as a basis for monitoring compliance trends over time;
- provide information to validate and refine the Agency's risk assessment systems;
- identify the types of and reasons for error that taxpayers make in calculating tax liabilities and entitlements; and
- improve compliance strategies, such as profiles, indicators of risk, and compliance instruments.

3.24 In our 2004 Report we noted that the Agency had been slow to assess the results of the Program and had to suspend it in 2004. We recommended that the Agency strengthen the Core Audit Program by developing a multi-year plan to cover specific segments of the population, and by setting deadlines for completion of the audit work and the analysis of results. The Agency agreed with our recommendation and also committed to taking steps to improve the integrity of its data collection.

3.25 The Agency developed a multi-year schedule of the segments of the small and medium enterprise population that would be audited each year and set expected timelines for completion of the work and analysis. However, this schedule provided no details on the objectives of the Core Audit Program, the reasons for selecting particular segments of the small and medium enterprise population, and the planned approach to the audits.

3.26 At the time of the 2004 audit, we reported that only the analysis of the 1999 Core Audit Program had been completed and the analysis of the subsequent years' results had not begun. In this audit, we found that since 2004, the Agency has completed its Core Audit Program reports for 2000 to 2005, although none were completed on time. The results of Program audits for 2006 and 2007 have yet to be analyzed by the Agency. We also found that the Agency had difficulty coordinating the completion of the random audits, both at headquarters and at tax services offices. In the tax services offices we visited, we found a lack of buy-in to completing these priority audits. Therefore, we have assessed progress in implementing our recommendation to strengthen the Core Audit Program as unsatisfactory (Exhibit 3.2).

Exhibit 3.2 Progress in addressing our recommendation on strengthening the Core Audit Program

March 2004 Report of the Auditor General of Canada, Chapter 5	
Recommendation	Progress
The Agency should strengthen the Core Audit Program by developing a multi-year plan to cover specific segments of the population, and set deadlines for the completion of the audit work and the analysis of results. (adapted from paragraph 5.44)	Unsatisfactory

Satisfactory—Progress is satisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

Unsatisfactory—Progress is unsatisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

3.27 Other concerns with the Core Audit Program. We found that the only Program objective that the Agency had been able to achieve was measurement of the non-compliance rate. But even then, we found for most years that random audits in statistically significant numbers were not completed by the pre-established deadlines. If the results of such audits were known, they might affect the non-compliance rate estimate and require it to be adjusted. For this reason, the estimate may not be a reliable performance measure, especially when it is used to assess and report on the effectiveness of the Agency's compliance program activities.

3.28 We also found that the sample size was larger than needed to calculate a national non-compliance rate. The Agency chose a sample of 1,000 to 1,700 audits each year, whereas a smaller sample of about 400 would allow an estimate at a national level. The Agency chose the larger sample so that the Program could meet all of its objectives. Despite its use of a large sample, the Program has not produced any reliable information to validate and refine the Agency's risk assessment systems or to provide new insights into risk factors and the underlying causes of non-compliance.

Risk assessment systems were not regularly validated and lack information

3.29 Our 2004 Report recommended that the Agency undertake regular studies to validate the effectiveness of computerized and manual risk assessment systems. The Agency agreed, noting that such studies were already being done and promising to continue to conduct them.

3.30 The Agency has made ongoing changes to the computerized risk assessment systems since 2004, but the changes were not documented fully, so it is impossible to tell whether the analysis of research information and audit results is being used to update the systems. More important than documenting changes is the need to regularly validate those systems.

3.31 We found that the Agency completed the reports on the two comprehensive validation studies that were in draft form at the time of our 2004 audit. Those studies covered the 2000 **taxation year** and showed that there was a significant positive relationship between the taxes the system estimated could be reassessed on audit and those that were actually reassessed following an audit. The Agency has not conducted any similar studies since then and does not have a plan to do regular studies to validate its computerized risk assessment systems. We note, however, that the Agency has done some ad hoc studies since 2004 to test certain aspects of its computerized risk assessment systems. It also did a study on the screening process for audit selection that provided useful information on its manual assessment systems.

3.32 As noted later on in this chapter, it is important for the Agency to validate its risk assessment systems regularly to provide the assurance that the risk ratings of taxpayer files are correct. Such ratings are essential for targeting potential non-compliant taxpayers and for building confidence in the accuracy of the systems' assessments for people who use them. In our view, the Agency has not made satisfactory progress in addressing our recommendation on validating its risk assessment systems (Exhibit 3.3).

Taxation year—Generally, a calendar year for individuals and a fiscal period for corporations.

Exhibit 3.3 Progress in addressing our recommendation on computer-based and manual risk evaluation systems

March 2004 Report of the Auditor General of Canada, Chapter 5	
Recommendation	Progress
The Agency should undertake regular studies to validate the effectiveness of computer-based and manual risk evaluation systems. (adapted from paragraph 5.55)	Unsatisfactory

Satisfactory—Progress is satisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

Unsatisfactory—Progress is unsatisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

3.33 Our 1999 and 2004 Reports made three other recommendations to improve the Agency’s systems for identifying non-compliant small and medium enterprises:

- Link the tax returns of companies or individuals that do not operate at arm’s length to determine their potential tax at risk as a group, and add information to enable the calculation of income tax at risk for trusts and large partnerships.
- Capture additional information on audit results and analyze that information to gather further insights into taxpayer behaviour, reasons for non-compliance, and methods of detection.
- Collaborate with other levels of government and other partners to access the data that can be used to detect unreported income.

3.34 The Agency agreed with these recommendations and has committed to improving its systems for identifying non-compliant small and medium enterprises. Since 2002, it has been working on the Compliance Systems Redesign (CSR) project, a comprehensive suite of information technology solutions to manage compliance programs more effectively. CSR is expected to cost about \$100 million and includes several components designed to improve the Agency’s systems for identifying non-compliant small and medium enterprises and selecting them for audit. The original forecast completion date for the project was 2007, but this date has been extended to 2011. A pilot of a few CSR applications was launched in October 2008. The first of three releases of applications is expected to take place in October 2009.

3.35 Linking tax returns. We found that, as in 2004, the Agency is able to link the tax returns of a group of companies or individuals that do not operate at arm’s length. However, due to software limitations

and the complexity of the calculation, it is only able to estimate the potential tax at risk for the group through a rough manual calculation. The Agency believes that it will be able to automate this calculation as part of its Compliance Systems Redesign.

3.36 The Agency has added more information on trusts and partnerships to its systems to allow better risk assessment of these taxpayers. For example, it now requires partnerships to file returns very similar to those that corporations file. As well, it is capturing information on income allocated to beneficiaries of trusts.

3.37 Capturing additional information. The Agency has also made some progress in collecting information related to methods of detecting non-compliance. Tax services offices capture information related to the use of indirect verification of income techniques, which is an audit approach for determining whether individuals or businesses not maintaining reliable accounting records have reported all of their income for tax purposes. These taxpayers are often small enterprises found in sectors where cash transactions are common. The techniques involve analyzing bank deposits and assessing net worth to estimate a taxpayer's income. This information is useful to the Agency because it tracks whether tax services offices are using these audit techniques for identifying non-compliant small and medium enterprises.

3.38 The Agency has not made much progress in capturing additional information on audit results and analyzing that information to gather further insights into the reasons for non-compliance. Capturing information on audit results is part of the Compliance Systems Redesign project. There are therefore opportunities to include information on the reason for audit adjustments and the auditor's judgment of the nature and cause of the non-compliance to improve the Agency's understanding of non-compliance. There is also an opportunity to include the capacity to compare the risk assessment system's estimate of tax at risk against actual audit results to quickly validate the system. At the time of the audit, the redesign project was still under development.

3.39 Collaborating with others. Since 1999, the Agency has continued to collaborate with other levels of government to enhance strategies to combat the underground economy. We noted that projects for information sharing were launched between the Agency and several provincial governments and included some municipal sectors and professional or trade associations in those provinces. As a result, the Agency has been able to use data from these sources to identify possible underground economy activities—for example, taxpayers

whose reported incomes were not enough to support their purchases of large assets such as real estate. The Agency still needs to pursue collaborative projects with the remaining provinces and territories.

3.40 In 2006, the Agency initiated a project to gain better access to data held by other government bodies for administration and enforcement of federal, provincial, and territorial taxes. The project’s working group noted that there had been a reluctance to request information. It is now seeking ways to resolve this problem. The project is scheduled to be completed by March 2009.

3.41 The Agency has made satisfactory progress in implementing two of our recommendations to improve its systems for identifying non-compliant small and medium enterprises; however, for the other recommendation, progress is unsatisfactory (Exhibit 3.4).

Exhibit 3.4 Progress in addressing our recommendations on identifying non-compliant small and medium enterprises

March 2004 Report of the Auditor General of Canada, Chapter 5	
Recommendation	Progress
The Agency should improve the Computer Assisted Audit Selection System by linking returns of taxpayer groups that do not operate at arm’s length for the purpose of determining potential tax at risk and adding information to enable the calculation of income tax at risk for trusts and large partnerships. (adapted from paragraph 5.55)	Satisfactory
The Agency should capture additional information on audit results and analyze that information to gather additional insights into taxpayer behaviour, reasons for non-compliance, and methods of detection. (paragraph 5.44)	Unsatisfactory
April 1999 Report of the Auditor General of Canada, Chapter 2	
The Agency should collaborate with other levels of government and other partners to access the data that can be used to detect unreported income. (adapted from paragraph 2.44)	Satisfactory

Satisfactory—Progress is satisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

Unsatisfactory—Progress is unsatisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

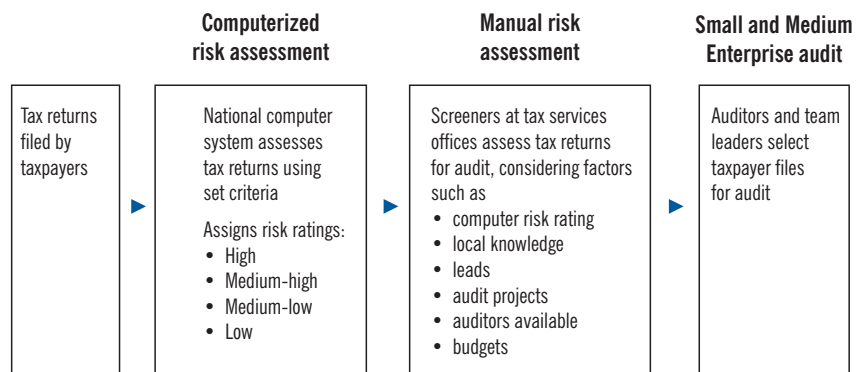
Targeting taxpayers to audit

Many designated low-risk files are being selected for audit

3.42 As part of this follow-up audit, we examined the extent to which high-risk files are selected for audit in the Small and Medium Enterprises Program. Appropriate identification and selection of taxpayers for audit requires reliable risk assessment systems. The national computer system of the Canada Revenue Agency (the Agency) assesses taxpayers, assigning them risk ratings between high and low, based on the potential amount of tax that could be recovered. Each tax services office considers this risk rating as well as other factors when selecting its own files for audit (Exhibit 3.5). The risk ratings are as follows:

- High—more than \$50,000 in potential tax recovery;
- Medium-high—\$10,000 to \$50,000 in potential tax recovery;
- Medium-low—\$1 to \$10,000 in potential tax recovery; and
- Low—\$0 potential tax recovery.

Exhibit 3.5 Tax returns are selected for audit using computerized and manual risk assessment systems



Source: Adapted from Canada Revenue Agency process information

3.43 We found that many of the files audited had not been designated as high-risk by the national computer system. Over a two-year period from fiscal year 2006–07 to fiscal year 2007–08, the Agency audited about 87,000 small and medium enterprise files. Thirteen percent of those files had been designated as high risk by the computer system and they earned 41 percent of the total tax recoveries of the Small and Medium Enterprises Program. At the same time, about 56 percent of the 87,000 audits were designated as zero or low risk by the system, yet these files earned 39 percent of the Program’s total tax recoveries (Exhibit 3.6).

Exhibit 3.6 Both high- and low-risk files earned significant tax recoveries

Risk Level	% of audited files	% of tax recoveries
High	13	41
Medium-high	16	11
Medium-low	15	9
Low	56	39
Total	100	100

Source: Office of the Auditor General analysis based on Canada Revenue Agency statistics

3.44 Agency officials offered several possible explanations as to why so many designated low-risk files are chosen and yet produce large tax recoveries:

- Auditors are following up on information that a taxpayer may be non-compliant obtained from sources other than the national computer system.
- Auditors are working on projects that deal with new and emerging issues that are not yet built into the national computer system.
- The Agency seeks to maintain an audit presence, across all industry sectors and types of taxpayers, to deter non-compliance. It chooses some lower-risk files to achieve this objective and some of them produce large recoveries.
- Available auditors may lack the experience necessary to do complex high-risk files and therefore audit lower-risk files. Some of those files produce large recoveries.

3.45 The findings of a 2007 study supported these explanations. This study was on the audit selection process to identify why screeners in tax services offices were not consistently selecting taxpayer files with similar risk ratings for audit. Screeners are not required to document their decisions; therefore, the Agency does not regularly know the reasons for not selecting designated high-risk files. The study found that there is a large discrepancy between screeners' and the system's perception of tax at risk. Sometimes this discrepancy is due to local knowledge about a taxpayer that is not available on the national computer system. The study notes that screeners need to have more confidence in the accuracy of the system's risk estimates. In our view, greater confidence would contribute to audit efficiency allowing screeners to rely on the system's risk estimates and focus only on those

files that require further manual screening for audit selection. The study's findings and our own underscore the urgent need for regularly validating computerized risk assessments.

3.46 The Agency believes that its Compliance Systems Redesign project will improve its ability to target non-compliant taxpayers and select appropriate files for audit because it will include better risk assessment tools and the capability for screeners to add comments and feedback on the risk assessments. At the time of our audit, the redesign project was still under development.

No unreported income detected in many underground economy audits

3.47 Our 1999 Report recommended that the Agency improve the way it targets and selects income tax files to audit, to increase the effectiveness of the audit activities in its Underground Economy Initiative. The Agency agreed with our recommendation. It said that tax files the computer system designated as high risk for unreported income would be the basis for selecting files to audit.

3.48 We found that the Agency has not developed any specific guidelines to help ensure that screeners select more high-risk files for audit. Furthermore, we note that headquarters' instructions to tax services offices state that the percentage of low-risk files being audited is too high.

3.49 In 1999, we found that about 40 percent of the audit files we selected for review did not involve unreported income. The Agency's data show that, over the last five years, about 50 percent of the underground economy audits did not detect unreported income. This result is troubling because files selected for underground economy audits are expected to have a high risk of unreported income. Furthermore, the Agency's data show that the total amount of unreported income detected in its audits has remained relatively constant at about \$550 million annually over the past five years.

Progress was mixed in addressing two identified compliance problems

3.50 Better audit selection also requires the Agency to address compliance problems promptly to improve the identification of unreported income. We note that progress in addressing two compliance problems that existed at the time of our last audit was mixed. The Agency made good progress on the Contract Payment Reporting System.

Contract Payment Reporting System allows the Agency to better target non-compliance

The Agency identified compliance problems in the construction and home renovation sectors and developed the Contract Payment Reporting System. It launched the System on a voluntary basis in 1996. When it deemed the voluntary participation rate too low, the Agency made participation in the System mandatory, as of 1 January 1999. Under the Contract Payment Reporting System, individuals, partnerships, and corporations whose primary activity is construction must report their payments to sub-contractors to the Agency on an annual basis. The Agency then matches this information against the data it maintains to identify taxpayers who have not filed tax returns or have under-reported their income. The information that the construction and home renovation sectors report allows the Agency to better target non-compliance.

3.51 However, the Agency was slow to address a compliance problem related to the electronic suppression of sales.

The Agency was slow to address the electronic suppression of sales

In the 1990s, the use of software to suppress sales, a practice known as electronic suppression of sales, was identified as a potential non-compliance issue. This suppression can occur in any industry or sector that regularly uses cash transactions, and where the taxpayer uses a point-of-sale system. The Agency was very slow to acknowledge that electronic suppression of sales, originally discovered in one province, could be more widespread in other parts of Canada, with a potential for millions of dollars in tax losses. The Agency's audit manual provides little guidance on effective means of detection or on technical support to deal with this type of compliance problem.

Since 2006, the Agency has made more efforts to deal with this issue. Through pilot projects, the Agency has identified 19 cases in two additional provinces in which it detected more than \$11 million of suppressed sales. IT specialists from other divisions were involved in assisting auditors from the Small and Medium Enterprises Directorate in determining the extent of suppression practices. However, at the time of our audit, the Agency was still unable to determine how serious electronic suppression of sales is across Canada.

3.52 In our view, the Agency has not significantly improved the targeting and selection of underground economy audit files because of its limited success in detecting unreported income in its audits, its mixed progress in addressing identified compliance problems, and the many designated low-risk files selected for audit from the small and medium enterprise population (Exhibit 3.7).

More industry sectors included in underground economy audits

3.53 Our 1999 Report recommended that the Agency reconsider its audit focus for the Underground Economy Initiative, to include taxpayers in all industry sectors with a high risk of unreported income. At that time, it was targeting four sectors.

Exhibit 3.7 Progress in addressing our recommendation on targeting and selection of audit files

April 1999 Report of the Auditor General of Canada, Chapter 2	
Recommendation	Progress
The Agency should improve the targeting and selection of income tax files to increase the effectiveness of its Underground Economy Initiative audit activities in identifying unreported income. (adapted from paragraph 2.63)	Unsatisfactory

Satisfactory—Progress is satisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

Unsatisfactory—Progress is unsatisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

3.54 The Agency agreed with our recommendation and has since revised its focus for the underground economy audits as part of its efforts to combat non-compliance. Since 2000, a minimum of 50 percent of underground economy audits are selected from the hospitality and construction sectors and the remaining percentage is selected from sectors each region chooses, based on local knowledge and experience.

3.55 While the Agency has revised its audit focus, it lacks a documented rationale to support that decision. Furthermore, it has not provided any formal guidance to the regions on how to select local underground economy sectors. Typically, any guidance came through underground economy conferences. As well, we found that the underground economy reports from the tax services offices we visited did not always provide sufficient rationale for the sectors selected. While some latitude is beneficial to enable the regions and tax services offices to use their local knowledge, more central guidance would help ensure that decisions made at the local and regional level are consistent with the Agency's direction and intent in combating the underground economy.

3.56 We also found that the Agency has completed the development of the sector profiles to provide auditors with background information for the four industry sectors targeted prior to 2000. As well, new profiles have since been developed for other sectors.

3.57 In our view, although more work is needed to support the decisions on which sectors to audit, the Agency has made satisfactory progress in implementing both of our recommendations on underground economy sectors (Exhibit 3.8).

Exhibit 3.8 Progress in addressing our recommendations on underground economy sectors

April 1999 Report of the Auditor General of Canada, Chapter 2	
Recommendation	Progress
The Agency should reconsider its audit focus for the Underground Economy Initiative to include taxpayers in all sectors with a high risk of unreported income. (adapted from paragraph 2.50)	Satisfactory
The Agency should complete the development of its sector profiles in order to better audit underground economy issues. (adapted from paragraph 2.47)	Satisfactory

Satisfactory—Progress is satisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

Unsatisfactory—Progress is unsatisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

Promoting compliance

Outreach activities continued, but the approach needs to be strategic

3.58 The Canada Revenue Agency (the Agency) has long recognized the importance of outreach activities as a component of its balanced approach to ensuring tax compliance. Our 1999 Report recommended that the Agency strengthen its Underground Economy Initiative activities to promote businesses’ voluntary compliance. We reported that the number of outreach activities the Agency directed toward business had declined over the years. The Agency agreed with the recommendation and committed, before the Public Accounts Committee, to increasing the number of community visits and to maintaining relationships with private sector associations.

3.59 In this audit, we found that the Agency has conducted more community visits, trade shows, and public speaking engagements since 1999.

3.60 In June 2005, the Agency created the National Outreach Coordinating Committee to help strengthen and enhance outreach expertise across the Agency. Since 2006, the Agency has made the enhancement of the outreach program a major priority, according to the Corporate Business Plan. In the tax services offices we visited, auditors planned and conducted outreach activities with the support of communications experts. However, we found that their approach needed to be better targeted, by linking outreach activities with the potential risks that a national analysis had identified. The Agency also needs to measure the effectiveness and impact of these activities.

3.61 In March 2008, the Agency developed an underground economy planning document that outlined its procedures and expectations for outreach activities. The Agency is now strengthening its outreach program and allocates budgets to support outreach activities. However, the Agency recognizes that it lacks a national outreach strategy that would include plans for headquarters, the regions, and local offices. The National Outreach Coordinating Committee will develop the strategy, but the Agency has not determined timelines.

3.62 Although the Agency needs to make further improvements, we have assessed progress in implementing our recommendation on promoting voluntary compliance as satisfactory (Exhibit 3.9).

Exhibit 3.9 Progress in addressing our recommendation on promoting voluntary compliance

April 1999 Report of the Auditor General of Canada, Chapter 2	
Recommendation	Progress
The Agency should strengthen its Underground Economy Initiative activities to promote voluntary compliance by businesses. (adapted from paragraph 2.37)	Satisfactory

Satisfactory—Progress is satisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

Unsatisfactory—Progress is unsatisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

New national approach planned to promote compliance and taxpayer awareness

3.63 Our 1999 Report also recommended that the Agency complete research to determine how to implement social marketing activities to make taxpayers aware of the costs of the underground economy to society and legitimate business. The Agency agreed and committed to completing research about social marketing and public opinion.

3.64 In this audit, we found that the Agency has completed its research on the home renovation sector and identified several ideas for social marketing initiatives. One of those ideas was the “Get it in Writing!” campaign.

3.65 In 2005, the Agency also launched an initiative to provide periodic tax alerts to taxpayers. Some of these were published in languages other than English and French to reach more Canadian taxpayers.

“Get it in Writing!” campaign increases public awareness

In 2003, the Agency and the Canadian Home Builders Association (CHBA) officially launched a joint consumer awareness campaign, called Get it in Writing!, the goal of which was to increase awareness of the risks involved in dealing with underground contractors without a written contract. Although direct funding has not been provided by the Agency since 2005, the CHBA has continued to maintain its website for this campaign at <http://www.hiringcontractor.com>. “Get it in Writing!” is now a registered trademark of the Canadian Home Builders’ Association.

3.66 We also found that the Agency has conducted public opinion research studies tracking perceptions about tax cheating and examining how to implement its social messaging efforts. For example, in 2007, the Agency conducted a study of the potential impact of compliance communications on taxpayer perceptions about tax cheating. The study found that most people know little about the implications of tax cheating, and concluded that more communication would encourage better compliance.

3.67 Since 2006, the Agency has been working on a new national approach to promote compliance and taxpayer awareness. It has developed its first national compliance communication strategy. The Compliance Programs and Public Affairs branches presented their strategy paper to senior managers in March 2007, and brought forward their related implementation plan in January 2008. The new strategy includes use of communications as a compliance tool to influence both compliance perception and behaviour, as well as to change the way Canadians perceive the Agency and its tax administration, fairness, and effectiveness. The Agency recognizes that it still needs to develop indicators to measure the success of the strategy. In our view, progress in implementing our recommendation on improving taxpayer awareness of the costs of tax cheating is satisfactory (Exhibit 3.10).

Exhibit 3.10 Progress in addressing our recommendation on improving taxpayer awareness of the costs of the underground economy to society

April 1999 Report of the Auditor General of Canada, Chapter 2	
Recommendation	Progress
The Agency should complete research to determine how to implement its social marketing activities to make taxpayers aware of the costs of the underground economy to society and legitimate business. (adapted from paragraph 2.31)	Satisfactory

Satisfactory—Progress is satisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

Unsatisfactory—Progress is unsatisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

Measuring performance

The Agency tracks additional gross income but has not reported it

3.68 Our 1999 Report recommended that the Canada Revenue Agency (the Agency) record and report the additional gross income identified by its Underground Economy Initiative and non-Initiative enforcement activities and the additional taxes due on the unreported income. The Public Accounts Committee made a similar recommendation. The Agency agreed with the recommendations, and it committed to reporting the amounts for Initiative activities and to exploring options for recording the amounts identified by non-Initiative activities.

3.69 The Agency now tracks the amount of additional gross income that is found in all audits of small and medium enterprises. However, this amount is not being published in the Agency's Annual Report. In the 2006–07 fiscal year, the Agency noted in its Annual Report that its underground economy audit activities resulted in additional taxes of \$284 million. The amount reported includes taxes reassessed on the unreported income as well as other adjustments found during the underground economy audits. Furthermore, the amount does not include taxes reassessed on any of the unreported income identified in other audits conducted in the small and medium enterprise sector. It is therefore not a good indicator of the results of audit work that found unreported income. We assessed progress made on our recommendation on recording and reporting the additional gross income and taxes identified through the Agency's activities as unsatisfactory (Exhibit 3.11).

Exhibit 3.11 Progress in addressing our recommendation on recording and reporting additional gross income and taxes

April 1999 Report of the Auditor General of Canada, Chapter 2	
Recommendation	Progress
The Agency should record and report the additional gross income identified by its Underground Economy Initiative and non-Initiative enforcement activities and the additional tax due on this unreported income (adapted from paragraph 2.62)	Unsatisfactory

Satisfactory—Progress is satisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

Unsatisfactory—Progress is unsatisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

The Agency needs indicators and targets for the Small and Medium Enterprises Program

3.70 In the past decade, two events have significantly influenced the Agency in measuring and reporting performance. The first event was when Revenue Canada became an agency in 1999, a status that resulted in more flexibility, but also more accountability. The Agency is required to submit an annual report to Parliament that includes both financial and performance results.

3.71 The other event was the development of the Compliance Measurement Framework in 2004. As mentioned earlier in this chapter, adopting this framework was a positive step forward for the Agency because it has provided a greater focus for compliance research, and for developing compliance indicators and measurement methods.

3.72 The Agency uses many types of indicators to measure performance. Most of them measure outputs, such as the number of audits or the number of outreach activities completed. A few indicators measure outcomes, such as the fiscal impact of tax compliance activities. The fiscal impact is measured as the sum of the additional tax identified, including federal and provincial tax (except for Quebec taxes), interest and penalties, and the current value of future assessable federal tax.

3.73 The Agency also reported the rate of non-compliance for GST/HST registrants in the small and medium enterprise sector—9.1 percent in the 2006–07 fiscal year (for files that found additional federal taxes of more than \$5,000)—and used that rate to measure the trend of non-compliance over time. Since the rate was 12.3 percent in the 2004–05 fiscal year, the Agency concluded that the rate of non-compliance for the small and medium enterprise sector is relatively low and trending downward. However, we note that the rate of 12.3 percent was for the small and medium enterprise sector, whereas the rate of 9.1 percent was for the wholesale trade sub-sector. In our view, these rates cannot be compared for the purpose of identifying a trend.

3.74 The Agency also uses this non-compliance rate as an indicator to measure the effectiveness of its targeted audit selection by comparing the non-compliance rates of random and targeted audits. In the 2006–07 fiscal year, the Agency reported that targeted audits were four times more effective than random audits in identifying non-compliant taxpayers.

3.75 The Agency has made recent efforts to develop indicators and targets for the Small and Medium Enterprises Program. It established a Performance Measurement and Budget Working Group in 2007 with a

mandate to develop and implement a performance management framework and to simplify and streamline the budget allocation process. One of the working group's goals is to identify indicators and targets for measuring the efficiency and effectiveness of the Small and Medium Enterprises Program. At the time of our audit, the working group had begun a pilot project in the Pacific Region. In our view, this is a much-needed initiative, but as it has started only recently, it is too early to assess the results of the pilot project or the initiative.

3.76 Measuring the results of the Underground Economy

Initiative. Our 1999 Report also recommended that the Agency develop indicators to measure and report the results of the full range of Underground Economy Initiative activities. The Agency agreed with the recommendation and said it was developing indicators to measure the performance of all enforcement activities, including the Underground Economy Initiative.

3.77 We found that few indicators exist to measure the results of the Agency's Underground Economy Initiative. Some of the indicators in the Compliance Measurement Framework give a sense of whether the underground economy is growing but do not measure the effectiveness of the Agency's compliance activities. We also found that the Agency has not developed a number of indicators it was considering in 1999 that would have provided information on the effectiveness of Initiative activities—for example, the proportion of taxpayers who continue to report their income properly in the years following an audit that found unreported income.

3.78 The Agency's annual reports provide little information on the results of the Underground Economy Initiative despite the Agency's commitment to do so. The information that is provided deals mainly with outputs such as the number of audits completed or the number of outreach activities done.

3.79 It remains a challenge for all tax administrators to identify robust measures of compliance and non-compliance concerning underground economy activities. The Agency has been studying the issues and staying involved in international consultations to keep abreast of any new developments. It is working with other tax administrations such as the Internal Revenue Service in the United States to identify indicators to measure its underground economy activities. However, in our view, actual progress made in this area since 1999 is unsatisfactory (Exhibit 3.12).

Exhibit 3.12 Progress in addressing our recommendation on measuring the results of the Underground Economy Initiative

April 1999 Report of the Auditor General of Canada, Chapter 2	
Recommendation	Progress
The Agency should develop indicators to measure and report the results of the full range of Underground Economy Initiative activities. (adapted from paragraph 2.70)	Unsatisfactory

Satisfactory—Progress is satisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

Unsatisfactory—Progress is unsatisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

Conclusion

3.80 Overall, the Canada Revenue Agency (the Agency) has made unsatisfactory progress in addressing the recommendations we selected from our previous reports for follow-up. Progress on 7 of the 13 recommendations is satisfactory. However, of the 13 recommendations, we considered 6 to be the most important because they are critical to the success of the program or because the Agency made a commitment to Parliament. Progress was unsatisfactory on 4 of those 6 recommendations.

3.81 The Agency has conducted a major review to identify all of the threats to the tax base, as we recommended in 2004. One of the four biggest threats is the underground economy, and the Agency has developed an action plan to address it. As well, it has improved its monitoring of compliance by developing a Compliance Measurement Framework.

3.82 The Agency has systems and practices in place to assess and address the risks of non-compliance in the small and medium enterprise sector, but they need to be significantly improved. For example, the Agency completed two comprehensive validation studies of its computerized risk assessment systems that were underway at the time of our 2004 audit, but it has no plans to do regular validation studies. A recent study of how screeners in local offices select taxpayers for audit indicates that they need more confidence in the accuracy of the system’s risk estimates. As well, the Core (random) Audit Program has not produced any reliable information providing new insights into risk factors and the underlying causes of non-compliance; this Program needs to be strengthened.

3.83 While the Agency's risk assessment systems identify potentially high-risk small and medium enterprises, and audits of those taxpayers generally result in higher reassessments, the Agency mostly audits other taxpayers. While the Agency provided a number of possible explanations for this situation, it has difficulty demonstrating that it is selecting and auditing small and medium enterprises of high risk or priority. As well, no unreported income was found in about 50 percent of the files selected for underground economy audits over the last five years.

3.84 The Agency has made some progress since 1999 in promoting taxpayer compliance and awareness of what the underground economy costs society. It has increased its outreach activities, but it still needs to develop a national outreach strategy. It has also recently developed a national compliance communication strategy.

3.85 The Agency uses many types of indicators to measure the performance of its Small and Medium Enterprises program, but most of them measure outputs rather than outcomes. Despite a commitment to do so, the Agency has not published the additional unreported income identified by its audits. While identifying robust indicators for measuring underground economy activities is a challenge, the Agency has made little progress in measuring the results of its Underground Economy Initiative since 1999.

About the Audit

Objective

The objective of this audit was to assess whether the Canada Revenue Agency (the Agency) has made satisfactory progress in implementing selected recommendations from Chapter 2 of the April 1999 Report of the Auditor General—Underground Economy Initiative, and Chapter 5 of the March 2004 Report of the Auditor General—Audits of Small and Medium Enterprises.

We assessed whether the Agency could demonstrate that it

- has systems and practices in place to assess and address the risks of non-compliance in the small and medium enterprise sector, including those participating in the underground economy;
- selects and audits small and medium enterprises of high risk or priority;
- promotes taxpayer awareness of income reporting obligations through outreach and communications in the underground economy; and
- develops appropriate measures and reports on the effectiveness of its small and medium enterprise compliance program activities.

Scope and approach

This follow-up audit focused on the activities of the Compliance Programs Branch, particularly in the Small and Medium Enterprises Directorate (which includes the Underground Economy section); the Compliance Strategy Directorate, the Research, Risk and Business Management Directorate; and other directorates and divisions related to small and medium enterprises and underground economy compliance. This audit did not cover the activities of the non-filers/non-registrants program, the enforcement program for illegal activities, or the verification of individual income tax returns. The latter activity was covered in Chapter 3 of our November 2005 Report of the Auditor General—Verifying Income Tax Returns of Individuals and Trusts.

The Agency recently did an internal audit of the implementation of its underground economy action plans. We shared information with the internal auditors, but did not place any reliance on their work because it was still in progress at the time of our audit.

Our audit relied on several approaches. We conducted interviews; reviewed documents and reports, including plans, strategies, evaluations, and studies; and analyzed data from Agency systems. Although a significant part of our work was carried out at the Agency's headquarters in Ottawa, we visited five tax services offices and three regional offices to obtain a better understanding of their perspectives.

Of the 21 recommendations (main and sub-sections included) reported in the previous two chapters, we selected 13 that dealt with the themes of this audit: assessing and addressing the risks of non-compliance, targeting taxpayers to audit for compliance, promoting compliance in the underground economy, and measuring and reporting on performance. We did not select the other eight recommendations, all related to Chapter 5 of the March 2004 Report of the Auditor General of Canada, because they pertain to other subjects, such as GST refunds and legislated penalties.

For purposes of determining the sample size for the Agency's Core Audit Program, we calculated the sample size in such a way as to give a margin of error (a confidence interval) of plus or minus 5 percent, a confidence level of 0.95, and a worst-case non-compliance rate of 50 percent. This calculation resulted in a sample size of 400 for the target populations discussed in paragraph 3.28.

Criteria

Listed below are the criteria that were used to conduct this audit and their sources.

Criteria	Sources
Assessing the risks of non-compliance	
<p>We expected the Agency to make satisfactory progress in implementing</p> <ul style="list-style-type: none"> • recommendations 5.32, 5.44 (1st and 3rd bullets), and 5.55 from our March 2004 Report; and • recommendation 2.44 from our 1999 Report. 	<p>Recommendations and entity responses to Chapter 5 of the March 2004 Report of the Auditor General, pp. 7, 11, and 14, and Chapter 2 of the April 1999 Report of the Auditor General, p.14.</p>
<p>We expected the Agency to undertake monitoring and research to identify compliance trends and problems, and to estimate the extent of non-compliance.</p>	<p>The Agency's description of its overall tax compliance risk management process, which can be found in its response to recommendation 5.32, p.7.</p>
<p>We expected the Agency to implement a strategy to ensure an effective check on non-compliance in the underground economy.</p>	<p>Canada Revenue Agency, Report on Plans and Priorities, 2004–2005, p.16; 2006–2007, pp. 45-46; 2007–2008, p. 30-31.</p>
<p>We expected the Agency to validate systems to ensure effective risk assessment of taxpayer files.</p>	<p>Responses to recommendations 5.44 and 5.55 from Chapter 5 of the March 2004 Report of the Auditor General, p. 11 and 14.</p>
Targeting taxpayers to audit for compliance	
<p>We expected the Agency to make satisfactory progress in implementing recommendations 2.47, 2.50, and 2.63 from our 1999 Report.</p>	<p>Recommendations and entity responses to Chapter 2 of the April 1999 Report of the Auditor General, p. 15 and 17.</p>
<p>We expected the Agency to identify high-risk and priority files for audit consideration.</p>	<p>Responses to recommendations 2.47 and 2.50 from Chapter 2 of the April 1999 Report of the Auditor General, p.15.</p>
<p>We expected the Agency to select taxpayers of high risk and priority for audit and then ensure that it audits those taxpayers.</p>	<p>Response to Recommendation 2.63 from Chapter 2 of the April 1999 Report of the Auditor General, p.17.</p>
Promoting compliance	
<p>We expected the Agency to make satisfactory progress in implementing recommendations 2.31 and 2.37 from our 1999 Report.</p>	<p>Recommendations and entity responses to Chapter 2 of the April 1999 Report of the Auditor General, p.11 and 13.</p>
<p>We expected the Agency to have a strategy to promote taxpayer awareness of income reporting obligations through outreach and communications in the underground economy and small and medium enterprises.</p>	<p>Response to Recommendation 2.37 from Chapter 2 of the April 1999 Report of the Auditor General, p.13. The Agency agreed with the recommendation and made a commitment to the Standing Committee on Public Accounts in its response to the 29th Report of the Committee.</p>
<p>We expected the Agency to develop appropriate measures on the effectiveness of its outreach and communications activities in the underground economy and small and medium enterprise sector.</p>	<p>Response to Recommendation 2.37 from Chapter 2 of the April 1999 Report of the Auditor General, p.13. The Agency agreed with the recommendation and made a commitment to the Standing Committee on Public Accounts in its response to the 29th Report of the Committee.</p>

Criteria	Sources
Measuring and reporting on performance	
We expected the Agency to make satisfactory progress in implementing recommendations 2.62 and 2.70 from our 1999 Report.	Recommendations and entity responses to Chapter 2 of the April 1999 Report of the Auditor General, p.17 and 18.
We expected the Agency to develop appropriate measures and report the effectiveness of its underground economy and small and medium enterprise compliance activities.	Responses to recommendations 2.62 and 2.70 from Chapter 2 of the April 1999 Report of the Auditor General, p.17 and 18. The Agency agreed with the recommendations and made a commitment to the Standing Committee on Public Accounts in its response to the 29th Report of the Committee.

Audit work completed

Audit work for this chapter was substantially completed on 29 August 2008.

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Status Report of the Auditor General of Canada to the House of Commons—2009

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