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# Compliance Risk Management – Indicators and Treatment Strategies

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**ABSTRACT:** For an economy to make both ends meet it has to always struggle to strike a balance between the limited resources and unlimited wants. The government is always trying to move the resources from the haves to the have-nots with the help a system called as taxation. Tax payers need to comply with the taxation rules and it is very essential for the government to identify and channelize the non compliance of tax laws among the people. There are a few set guidelines which can be followed to manage the risk. This article briefs about the ways to identify, measure and manage the compliance risk. There are various reasons for non-compliance and there are also treatment strategies or improving and managing compliance provided by the Organisation for Economic Co-operation and Development (OECD) among the people is also included. The Tax Administrators have various crucial roles to play in the economy to improve the compliance behaviour among the tax payers.

**KEYWORDS:** Economy, Risk Management, Tax Administrators, Compliance.

## I. INTRODUCTION

**Risk Management** - Risk is part and parcel of life, may it be for an insect as tiny as an ant or a human being or a corporate entity. Everyone has accepts this fact and moves ahead, each one has their own ways to mitigate the risk. Considering organisation in specific, they have internal rules, guidelines, and procedures to reduce risks by providing employees with guidance on how they should approach routine day-to-day tasks. Policies and procedures help to perform the roles in a better way they retain the confidence and relationships among the stakeholder, increase the opportunities and reduce the fear of risk.

## II. RELATED WORKS

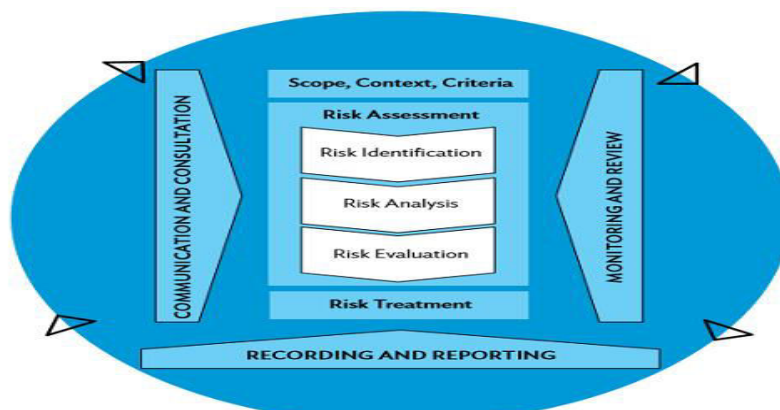
None of them can escape from the risk, there have been ways to mitigate it. Employees of every organisation have to face some amount of risk in their routine tasks. Those how do not manage it will not be able to stand and will lose credibility according to Annette Chooi (2020). It is the responsibility of the revenue authorities to identify, assess, prioritise and analyse the compliance behaviour of the tax payers. Numerous treatment strategies are established to improve and enforce compliance says ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (2004). The ISO 31000:2018. Risk management — Guidelines precisely display the framework and process of identifying and managing the risk. Managing risk is iterative and assists organizations in setting strategy, achieving objectives and making informed decisions. Effective compliance strategies and treatments aspire to impact the main motives or drivers underlying compliance behaviour. Treatments and interventions should always fit the specific circumstances and drivers of individuals, groups or businesses. Establishing and sustaining strong taxpayer norms is the key to attaining high levels of taxpayer compliance says the report of ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (2010). Tax compliance evaluation in a context is still a relatively immature and evolving practice in only few revenue bodies the content should not in any sense be regarded as definitive or complete. Rather, it reflects the early approaches and experiences of pioneering efforts by a few selected revenue bodies to better understand the impacts and effectiveness of their compliance strategies. OECD report on risk treatment evaluation (2010).

## III. METHODOLOGY

This paper is based on descriptive research technique. Data cited here in is collected through secondary data. Sources such as ORGANISATION FOR ECONOMIC CO-OPERATION DEVELOPMENT (OECD) reports, Governance Brief Issue , Companion Guide, GST website, ISO Risk management Guidelines and many more website and magazines are referred for the literature review.

**Enterprise Risk Management-** Performances of the organisations are base upon the way they manage the overall risk. The responsibility and authority of managing risk is at all the levels, be it a strategic or operational level. Risk management is the core of every business operation or activity and not just a support function that can be delegated to a single area.

Like other organizations the tax authorities (TA) who are responsible for collecting the taxes for the government. The TA may be charged with difference services such as collection, investigation of tax evasion or carrying out of audit duties. Choices must be made as to what task must be carried out, when and how. Similarly choices must be made about which risk must be reduced, to what extent and which risk can be put up with. They too have limited resources allocation and hence care must be taken for systematic risk management. In doing so, organizations are better placed to explain their choices to various stakeholders. The International Standard Organisation has framed a standard risk management process. The risk management is a top to down process which provides reliable, tested framework, a commonly agreed terminology and a comprehensive implementation process.



Source: International Standards Organization 31000:2018 Risk Management Guidelines.

ISO. 2018. Risk Management—Guidelines (ISO Standard No. 31000:2018). This is a generic risk management standard developed by ISO Technical Committee 262, Risk Management.

Risks can be mitigated and risks can also be tolerated based on the level of severity first and then also based on the likelihood of occurrence. Risks demonstrate themselves differently but few are common in both public and private organisations. Few of the common enterprise risks are listed below:

- Interruptions and/or failure of information technology systems;
- Data breaches;
- Financial mismanagement, including fraud and corruption;
- Human resource gaps, including insufficient or inadequately qualified staff and risks to staff wellbeing, health, and safety;
- Infrastructure vulnerabilities, such as power failures, fires, and data loss; and
- Failure to achieve core organizational business outcomes (for revenue bodies, this is known as compliance risk).

The following sections focus on approaches adopted by revenue bodies in managing risks to achieve core business outcomes.

Tax authorities may strive to attract 100% compliance with tax laws which apparently is an unattainable task. This legal act of seizing money in the name of tax is tolerated by the citizens to some level because they believe that the authorities do it for some elusive objectives. Revenues are not collected 100% due to the loop holes in the administration and constantly changing compliance policies. Tax payers constantly face compliance risks. Compliance risk is the possibility for losses and legal penalties due to failure to comply with laws or regulations. Compliance cannot be addressed in totality but can possibly be managed effectively. Compliance risk management is a structured process for the systematic identification, assessment, ranking, and treatment of tax compliance risks (e.g., failure to register, failure to properly report tax liabilities etc). Like risk management in general, it is an iterative process that consists of well-defined steps to support improved decision-making. Compliance Risk Management (CRM) is a systematic step towards managing tax compliance, selecting proper techniques to treat them according to severity and its nature of behaviour.



**Compliance Risk Management Framework**

Source: OECD. 2004. *Compliance Risk Management: Managing and Improving Tax Compliance*. Paris.

**Operating context**

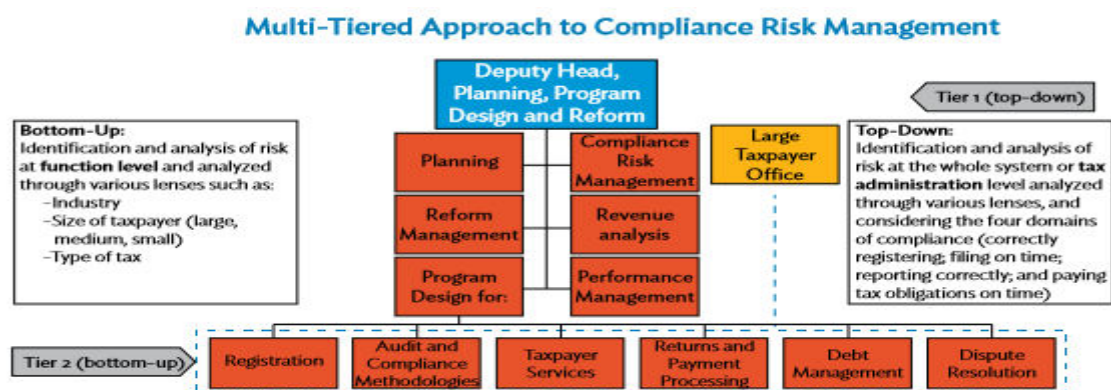
Operating context explains about the environment in which businesses operate their day to day activities. These activities are surrounded and bound by controllable and uncontrollable factors which can also be termed as external and internal factor of the business environment. Operating contexts are dynamic hence require continuous monitoring. Controllable factors such as organisational culture, organisational structure, information technology and business systems, and staff and business capabilities. Factors in the uncontrollable environment affect the operating context are legislation, government policy, public opinion and economic conditions. These factors all potentially impact upon the compliance risks being faced, the allocation of resources or the manner in which the compliance risks might be addressed. The tax authorities need to monitor the different environments may be by setting a separate monitoring unit which would be a part of CRM team. The use of emerging techniques such as predictive modelling and social network analysis also supports better policy development and systemic approaches to prevention and early detection of noncompliance. Tax authorities must use data and its analysis for effective CRM (Compliance Risk Management). Tax gap is the difference the amount to be collected by the tax authorities and the actual amount of tax received/collected. Inefficiencies in law and administrative effectiveness influence the tax gap.

**Identifying, Assessing, and Prioritizing Risks**

Identification of non compliance can be done by market segmentation i.e., individual tax payers and industry grouping. Common segments include 'small' businesses, 'medium-sized' businesses, and 'large' businesses, and these are often defined on the basis of turnover or gross revenues, but may also be defined on the basis of assets or number of employees. Other segments may be based on industry type (profession and business), the type of tax (direct, indirect) or the type of risk (domestic versus international tax, tax avoidance). Data can be collected case by case selection using the tax return data, aggregated according to industry tax profile, Macro level statistical analysis. Information can be collected on taxpayers profile of tax obligation, Tax issue profiles, Trend analysis, Third Party information, risk based resource allocated, macroeconomic information, economic time series public information and past audit results, and corporate Risk Culture. Intelligence of TA (Tax Authorities) can be applied to the strategic level to Individual Social/Psychological behaviour profile including Client Relationship Management information, feedback intelligence can be applied by scanning the environment, risk impacts measured using – reputation, costs of compliance and revenue from audit programs by this the future probability of noncompliance can be assessed.

Assessment of risk can be done by using macroeconomic level indicator for early detection of non compliance. Example a simultaneous review of GDP and tax collection in an economy can be helpful. Assessment can be one with the help of public opinion indicator such as attitudes behaviour, perception, motivation, and awareness to understand and encourage compliance risk. Assessment of risk can be done based on the likelihood of its occurrence. The levels of risk likelihood can be on the scale of rare, unlikely, moderately likely, and almost certain. The objective definition of the scale variables can also be defined in certain terms or numerically. Ex. Rare = likely to occur once in 25 years. After assessment of the risk the TA needs to prioritise the risk by drawing a matrix of consequences of risk and likelihood of risk. Consequence of risk can be low, medium, high, very high or extreme. After prioritising the risk the treatment can be provide to different lines of authority in the organisation. Line of authority can be operation/lower level, middle level, senior level or executive level manager. For example, it is appropriate that risks rated as highest on the scale of consequence and likelihood (e.g. a 'severe' risk) will be managed at the highest level of management in the organisation. This will typically involve close and detailed liaison with government representatives and perhaps other agencies as well. Identification and assessment of risk requires adequacy of data, accuracy and privacy of data.

Example: In the United Kingdom, the Data Protection Act 1998 prevents auditors from receiving information they know they are not entitled to receive. For identification of risk the courts can be a source of valuable third party intelligence in the identification of discrepancies between declared income and actual income

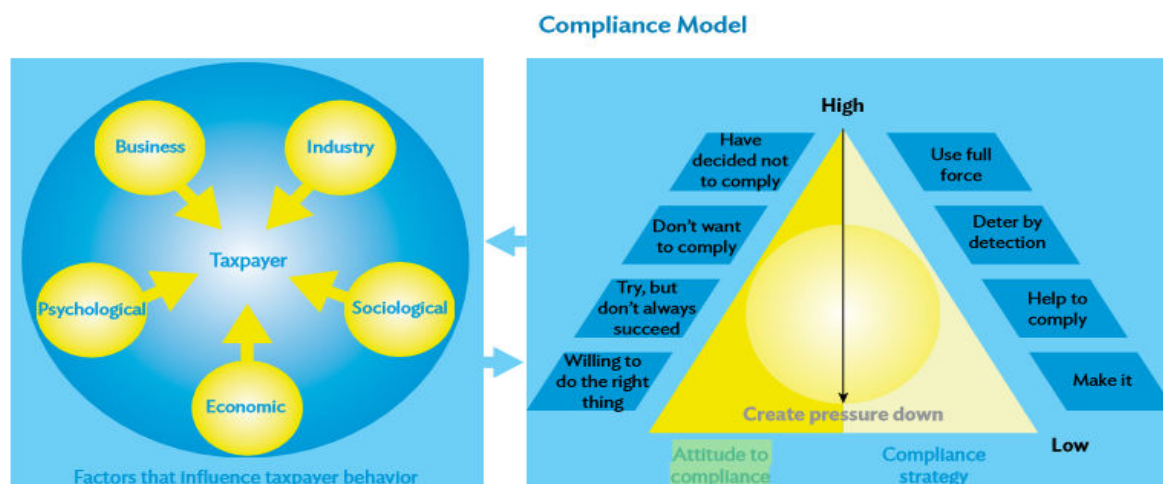


Source: S. Betts and A. Chooi. 2019. Fiscal Affairs Department, Revenue Administration: *Managing Risks to Revenue, Part II Managing Cross-Cutting Compliance Risks 2019*. Washington, DC: International Monetary Fund (forthcoming).

### Analyzing Compliance Behaviour and Determining Treatment Strategies

The administration of tax system and approach of tax payers towards their tax obligation are unparalleled. Understanding of motivations and influencers of non compliance behaviour is essential. Generic factor influencing compliance behaviour can be business factor which includes: type of activity, structure, size, age, focus, financial investments, and business intermediaries. Industry factors such as size of industry, major players, profit margins, costs, industry regulations, level of competition and infrastructure issues. Sociological factors could be Cultural norms: Ethnic background, attitude to government, age, Gender, educational level. Economic factors such as: Investment, demographic interest rates, tax system, government policies, international influence, inflation and markets. Psychological factors such as: Greed, Risk, Fear, Trust, values, fairness/Equity and opportunity to evade. On their own efforts or by partnering with educational institution the TA need to research identify and encourage more compliance. Different factor influences different compliance risk in different segments.

Treatment to promote compliance behaviour can be done in many different ways based on the influencing factor. Some tax compliance treatments are surprisingly cheap to implement. For example, redrafting of letters and notices to improve the importance of key information (such as placing this information in a box or presenting it in a different colour) and varying the tone or language are just two examples of simple interventions which have been found to improve the success of the interaction in influencing taxpayer compliance behaviour. Along with education of compliance proper facilitation also plays an important part in improving the tax compliance.



Note: This Compliance Model was first developed by the Australian National University Centre for Tax System Integrity, in conjunction with the ATO, at the Australian National University and has since been widely promulgated, including by the OECD.

One needs to identify the behaviour systematically and then apply the treatment. The TA needs to understand 'what is happening exactly', for example whether income is being under reported or books are being duplicated or expenses are being over claimed. Then the next step is to identify 'who is doing it'. Then the crucial step is to diagnose 'why they are doing it' whether there is knowledge gap, or deliberate dishonesty, or it is due to the low cost of compliance. Penalising without understanding the symptoms behind the cause of the problem is futile. For example, the behaviour of the target population may be to always submit tax returns late (failure to file). Further analysis and investigation might determine the reason to be third party entities not making necessary information (e.g. details of dividend distributions) available to the target population in a updated and timely manner. Treatment strategies must be fair and integrate; it should follow a flexible, customised approach. People should comply not because of risk of detection but because they trust that the evaders will be caught. The tax administration must strive to build community confidence to achieve compliance. The tax payer must be clear with their obligations and the TA must make the obligation easy to comply with. With the help of media and publishing information the TA must make their power and activity visible to the public. TA can also provide incentives to encourage compliance such as allowing waivers of penalties and interest. Community awareness of tax compliance must increase through press and media communications. TA can influence compliance by building and sustaining relationships with industry associations, tax practitioners, trade unions and other community group. TA can instil incentives to motivate compliance. Although there should also be treatments for non compliance such as surprise walk in visits can be made for serious audits. Posting letters informing non compliance information received from third party and prosecutions wherever necessary.

### Planning and implementing strategies

The planning and implementation is based on the 3 pillars such as resources to implement the strategy, design and methodology and also execution capabilities. Resources may be human, material and financial. For preparation of treatment strategy design to improve compliance it is better to prepare it by including people such as industrialist, accountants, other government agencies, lobby groups and community associations, the reason being increase in fairness and trust in the plan, they will provide workable insights to the plan there by help reach the ultimate goal of influencing compliance behaviour. The execution of the plan must involve effectiveness, the plan should be just in its approach by the TA, and this would be even easier for the TA if they are provided proper training for execution coupled with infrastructure.

Evaluation of the outcomes: it is necessary to evaluate the treatment strategy laid out through proper measurements. Evaluation of strategy would be success if the below questions are answered satisfactorily:

- Target- What risk is being addressed?
- Objectives- What is the suitable treatment strategy planned to achieve?
- Methodology- What are the measurement methodologies used (including timeframes and external factors that could affect the measures and how they may be interpreted?)
- Measures- What compliance indicators were used in identifying the problem? What changes are expected to be seen in these indicators as a result of the strategy?
- Data- What data will be collected and how will it be collected to support the evaluation?

Target: What are the obligations of the compliers have to be jotted down. Such as: appropriate registration of the tax payers, filing (lodging tax forms on time), reporting of business information (complete and accurate information), and payment of liability towards the authority. These parameters will provide the basis for proceedings of evaluation.

Objective: it seeks to attain the desired purpose of the plan. One must be careful in setting the objective. Monitoring one objective may not cover all the objectives which may end up risking negative behaviour towards other objectives.

Methodology: move towards the plan to make it executed. There may be different methods such as selection base on past audits, random audits, trend series analysis, interview, observations or surveys.

Measures: it measures the indicators of compliance behaviours. Tracing of the current compliance trend through different data sources and indicators such as macro indicators ex. GDP, non compliance indicators ex. ratio of business expenses relative to business income, public opinion indicator ex. Information through client survey and program impact indicator ex. Effect of audit on the compliance of the client must be measured.

Data: Data are derived from many sources, including programme operational data, tax return entries and external data. Data should be subject to quality standards and tested and filtered prior to analysis.

## Voluntary Compliance Measures and Indicators

### Correct registration:

- ✓ Trend in % change in registration overall\*
- ✓ Trend in % change in registration for each tax type\*
- ✓ Trend in % of business registrants and company registrants also registered for tax

### On-time returns filing:

- ✓ Trend in % of files received on time overall
- ✓ Trend in % of files received on time for each tax type

### Correct reporting:

- ✓ Trends in revenue by tax type
- ✓ Trends in tax to gross domestic product ratios:
  - Overall
  - Corporate income
  - Personal Income
  - Value-added Tax/Goods and Services Tax
  - Property taxes
- ✓ % of income (such as for Personal Income Tax, Corporate Income Tax, and Value-added Tax) subject to assurance checks:
  - Third-party reporting and matching
  - Withholding
  - Cooperative compliance agreements and tax assurance checks
  - Risk reviews and audits
  - Trends in discrepancies between return and third-party information matching
  - Trends in voluntary disclosures
  - Trends in flow of funds to known tax havens (low tax and/or high secrecy jurisdictions)
  - Tax gap trends (if available)

### On-time payment:

- ✓ Trends in level of arrears as a percentage of total collections
- ✓ Trends in on-time and enforced payment of audit related debts
- ✓ Trends in on-time and unprompted payment

### Community confidence:

- ✓ Monitor trends in community perception of\*\*:
  - The effectiveness of the tax administration
  - Views about compliance levels across business segments and sectors
  - Attitudes toward voluntary compliance
- ✓ Monitor trends in complaints about shadow economy
- ✓ Monitor service standards

\* These measures must be supported by an initial cleansing of the register to remove duplicates and inactive registrations, and an ongoing program maintains the register.

\*\* These measures require independent community perceptions surveys designed to measure both taxpayer satisfaction as well as perceptions about the performance of the revenue body and the fairness of the tax system (drivers of voluntary compliance).

Source: Author's compilation and Organisation for Economic Co-operation and Development (OECD). 2010. *Guidance Note: Evaluating the effectiveness of compliance risk treatments*. Paris: OECD Forum on Tax Administration. <https://www.oecd.org/ctp/administration/46274278.pdf>.

## Treatment Strategy



**Education:**

- Develop and disseminate awareness material and online calculators.
- Educate employees about their rights and obligations to register and file and provide help, if sought.

**Facilitation:**

- Hotlines to help employers get it right.
- Hotlines for employees to report problems.
- E-filing system designed to better support employers.
- Mandate e-filing and e-payment.
- Targeted information about sanctions (such as denial of deductions and penalties) for noncompliance.
- Offer voluntary disclosure incentives (reduced penalty).

**Simplification (Reduce compliance cost):**

- Develop and promote simple e-filing and e-payment options.
- Provide free payroll software for small employers.

**Detection:**

- Centralize employee data into a national data base.
- Identify employers from third-party data such as published financial statements, government registers, registrar of companies and business register, and companies accessing government incentives.

**Enforcement:**

- Advisory visits to smaller businesses to facilitate correction.
- Cooperative governance checks for large businesses to test systems.
- A small number of audits on businesses with potentially higher nondisclosure levels.
- Targeted prosecution of serious offenders (employers and employees).
- Publicizing of the results of enforcement (at an aggregate level) and providing information on how to correct mistakes.

**IV. CONCLUSION**

Compliance risk can be identified, assessed, analysed and evaluated. Compliance behaviour can be understood and various treatment strategies can be applied to rectify the compliance behaviour among the tax payers. Tax administration should put in effort to plan and then implement to improve the compliance behaviour among the tax payers with proper methodology of identify and lessening the compliance risk behaviour. Education, facilitation, simplification, detection and enforcement are the key treatment strategies for inculcate the compliance behaviour.

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