ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

FORUM ON TAX ADMINISTRATION: SMALL/MEDIUM ENTERPRISE (SME) COMPLIANCE SUB-GROUP

Overview Note

Evaluating the effectiveness of compliance risk treatment strategies

November 2010

CENTRE FOR TAX POLICY AND ADMINISTRATION

ABOUT THIS DOCUMENT

Purpose

This note, intended primarily for senior managers of national revenue bodies, provides an overview of the accompanying detailed guidance note '*Evaluating the effectiveness of compliance risk treatment strategies*' and accompanying documentation.

Background to the Forum on Tax Administration

The Forum on Tax Administration (FTA) was created by the Committee on Fiscal Affairs (CFA) in July 2002. Since then the FTA has grown to become a unique forum on tax administration for the heads of revenue bodies and their teams from OECD and selected non-OECD countries.

In 2009, participating countries developed the *FTA vision* setting out that… *The FTA vision is to create a forum through which tax administrators can identify, discuss and influence relevant global trends and develop new ideas to enhance tax administration around the world***.** This vision is underpinned by the FTA's key aim which is to…*improve taxpayer services and tax compliance – by helping revenue bodies increase the efficiency, effectiveness and fairness of tax administration and reduce the costs of compliance.*

To help carry out its mandate, the FTA is directly supported by two specialist sub-groups—Compliance and Taxpayer Services—that each carry out a program of work agreed by members. Both OECD and selected non-OECD countries participate in the work of the FTA and its sub-groups.

The Compliance Sub-group's mandate, in broad terms, is to provide a forum for members to:

- periodically monitor and report on trends in compliance approaches, strategies and activities;
- consider and compare members' compliance objectives, the strategies to achieve those objectives and the underlying behavioural compliance models and assumptions being used;
- consider and compare member compliance structures, systems and management, and staff skills and training; and
- develop and maintain papers describing good country practices as well as develop discussion papers on emerging trends and innovative approaches.

Since its inception, the Sub-group has focused its work on issues associated with improving the tax compliance of small to medium enterprise (SME) taxpayers.

Caveat

National revenue bodies face a varied environment within which to administer their taxation system. Jurisdictions differ in respect of their policy and legislative environment and their administrative practices and culture. As such, a standard approach to tax administration may be neither practicable nor desirable in a particular instance. The documents forming the OECD tax guidance series need to be interpreted with this in mind. Care should always be taken when considering a country's practices to fully appreciate the complex factors that have shaped a particular approach.

Inquiries and further information

Inquiries concerning any matters raised in this information note should be directed to Sean Moriarty (Head, International Co-operation and Tax Administration Division) at e-mail (Sean.moriarty@oecd.org)

Summary

Revenue bodies have a responsibility to use their limited resources in the most cost effective manner. In a tax compliance context, exercising this responsibility requires them to have a systematic approach for managing tax compliance risks, aiming to ensure that such risks are properly identified, assessed, prioritised and treated. Given the cyclical nature of this process, a key requirement is that revenue bodies are able to understand the impacts achieved and effectiveness of their risk treatment strategies.

This guidance note sets out a practical methodology for conducting outcome evaluations of compliance risk treatment strategies in priority areas. It draws on innovative work, based on considerable research, carried out by one OECD revenue body, and considerable further assistance from a number of other revenue bodies that have been intensifying their efforts to better understand the impacts/effectiveness of their compliance program activities. After outlining a number of important concepts and issues that are often raised in an evaluation context (e.g. output/ outcome program model and attribution), the guidance note introduces and elaborates a four phase compliance effectiveness methodology:

- Phase 1 is about understanding and articulating the risk and making sure it aligns with the revenue body's business intent.
- Phase 2 is about clearly expressing a revenue body's desired outcomes from its compliance strategies and what would be different if it was successful. It also involves identifying the right mix of strategies which treat the drivers of compliance behaviour and not just the behaviour.
- Phase 3 involves identifying potential indicators for each compliance strategy and validating them to ensure they are viable and useful, and capable of providing a credible picture of the effectiveness of a revenue body's compliance strategies.
- Phase 4 deals with evaluating and reporting on the extent to which a revenue body has been effective in changing compliance behaviour, building community confidence, or both, over the immediate, intermediate and long term.

The guidance note gives emphasis to the identification and development of practical measures and indicators that, set at the commencement of risk treatment action, can be used to gauge progress and assess the merits of risk treatment strategies in terms of improved taxpayer compliance and confidence in a revenue body's administration. To illustrate these aspects, the note includes a large number of case study examples from a cross-section of revenue bodies, describing specific measures and indicators used to evaluate the impacts of specific risk treatments and, for most, the impacts observed. The note acknowledges that for some strategies there will be limitations as to degree of precision/confidence that can be attached to conclusions concerning their impacts and effectiveness.

Finally, the note acknowledges that it is not possible, nor even desirable, for a revenue body to fully evaluate every specific risk treatment carried out, given the burden this would present. Accordingly, it recommends that revenue bodies adopt a pragmatic approach in deciding what is important in an evaluation context and provides practical guidance to assist in exercising such judgments. The note is accompanied by two other documents that provide important reference information —a background note '*Selected revenue body and other experience with implementing risk treatment evaluation*' and a companion guide '*Methodological techniques for use in evaluating the effectiveness*'.

Recommendations

- Revenue bodies are strongly encouraged to examine the evaluation guidance provided and to consider its relevance and practical application in their respective contexts;
- Revenue bodies are strongly encouraged to have in place a sound and practical approach to evaluation that can be relied to provide credible evidence pointing to the effectiveness of their key compliance risk treatment strategies.

I. Measuring effectiveness

Background and introduction

1. At meetings of the FTA's Compliance Sub-group in 2008 and 2009, members acknowledged that there was a critical gap in the detailed practical guidance available to revenue bodies for fully implementing the recommended risk management process. This gap concerned a practical methodology for evaluating the impacts of specific compliance risk treatment strategies. It was also acknowledged that work in this area was underway in both the Australian Taxation Office (ATO) and European Commission (EC), which might serve as valuable input to the FTA's own guidance. Members accordingly agreed to initiate work in this area, emphasising that the guidance should build on work already done and not aim for absolute precision, recognising that evaluation in the field of taxpayers' compliance was 'more of an art than a science'. Furthermore, it should encompass ideas for its practical implementation.

2. The guidance note now prepared, which is described briefly in Section II of this note, draws on the formal compliance effectiveness methodology and related practices developed by the ATO. Considerable further assistance in developing the guidance, including with an extensive set of case studies, was received from revenue bodies in Australia, Canada, Denmark, New Zealand, Singapore, Sweden and the United Kingdom, and through discussion with other members of the FTA's Compliance Sub-group. The guidance note is accompanied by two other documents:

    - A background note *'Selected revenue body and other experience with implementing risk treatment evaluation',* which describes practical aspects of the approaches and experiences of other bodies and a few selected revenue bodies in implementing risk treatment evaluation in their own administrations; and

    - A companion guide '*Methodological techniques for use in evaluating the effectiveness*', which draws on materials prepared for the EC's risk management framework and provides an overview of the more common methodologies that can be considered in an evaluation context.

Benefits and costs of evaluating compliance risk treatment strategies

3. While revenue body experience with evaluation of specific risk treatment strategies is relatively limited it is possible to identify in broad terms the nature of the benefits and costs associated with its implementation.

4. Concerning benefits, revenue body experience and general literature concerning evaluation point to the following:

    - improved knowledge of the impacts achieved from specific strategies;

    - for some strategies improved knowledge of the efficacy of specific risk treatments;

    - an improved/added focus on the underlying risk treatment choices and, by implication, on effective treatments;

    - the building of a credible evidence base to support future decision-making;

    - over the longer term, a more 'outcomes-focused' workforce; and

    - improved accountability through a capacity to provide evidence-based assurances that effective programs are being maintained and resources are not being wasted.

5. Implementing and administering evaluation does present a range of initial and ongoing investments/ costs that must be made by a revenue body. The more significant are:

   - senior management time in leading and promoting the revenue body emphasis on risk treatment evaluation;
   - the establishment and operation of an evaluation capability;
   - costs associated with acquiring new data and improving administrative data systems;
   - the time associated with training line management officials on new requirements to properly implement risk treatment evaluation;
   - the costs associated with producing and disseminating documentation/ publications concerning risk treatment evaluation; and
   - other activities and efforts designed to build an evaluation culture and integrating it with wider corporate culture focused on compliance risk management.

II. Methodology for evaluating the impacts of compliance strategies

Understanding compliance effectiveness

6. Compliance effectiveness is the extent to which the actual outcomes of a revenue body's compliance strategies align with its desired outcomes—*Did the strategies employed have the effect or impact on compliance behaviour and/or community confidence that were expected of them*?

7. The compliance effectiveness methodology described briefly in this note is a tool that can be used to plan the right mix of strategies, measure their effectiveness and identify opportunities for continuous improvement. A revenue body can use it for both planning and evaluation purposes. What it learns about its effectiveness may inform its future planning and help reshape its compliance improvement strategies. There are four iterative phases in the recommended methodology (Figure 1 refers):

   - **Phase 1** is about understanding and articulating the risk and making sure it aligns with the revenue body's business intent.
   - **Phase 2** is about clearly expressing a revenue body's desired outcomes from its compliance strategies and what would be different if it was successful. It also involves identifying the right mix of strategies which treat the drivers of compliance behaviour and not just the behaviour.
   - **Phase 3** involves identifying potential indicators for each compliance strategy and validating them to ensure they are viable and useful. The suite of indicators should be capable of providing a credible picture of the effectiveness of a revenue body's compliance strategies.
   - **Phase 4** deals with evaluating and reporting on the extent to which a revenue body has been effective in changing compliance behaviour, building community confidence, or both, over the immediate, intermediate and long term.

8. Phases 1, 2 and 3 focus on planning to be effective while phase 4 focuses on evaluating the extent to which a revenue body has been effective.

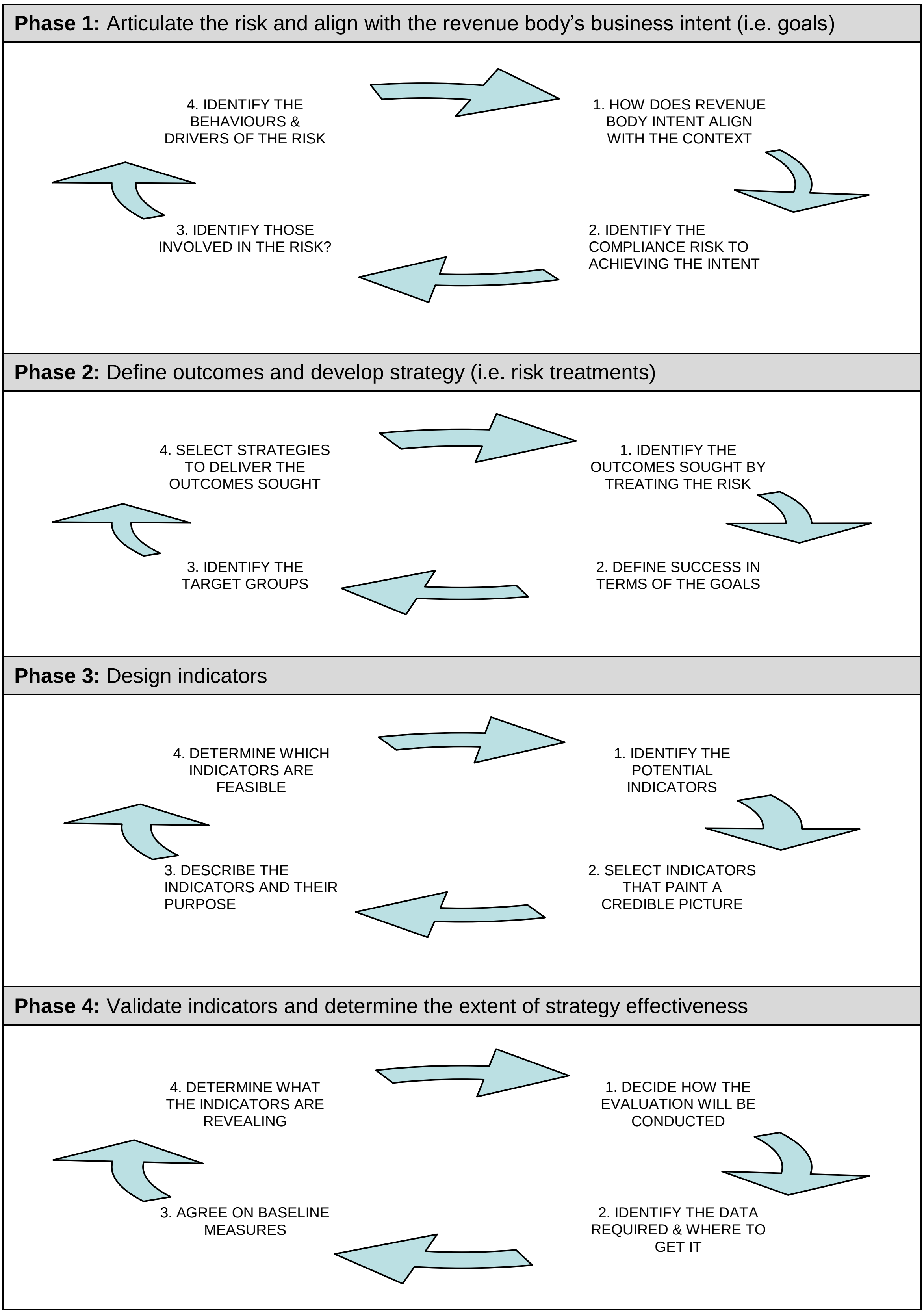
9. When evaluating compliance effectiveness a revenue body needs to answer the following questions: 1) Is there a ***change*** in compliance behaviour and/or community confidence? and 2) And if there is a change, did a revenue body's actions cause it (i.e. attribution)?

10. To understand this, a revenue body needs to explore behaviour at the broad or macro level [1] to identify any observable changes, and at the strategy or micro level to determine whether those changes can be attributed to its compliance strategies.

11. The final point to note is that it is simply not feasible, particularly given the costs involved, for a revenue body to conduct full evaluations of every compliance strategy it undertakes. In this regard, the guidance note emphasises the need for revenue bodies to adopt a pragmatic approach in deciding which strategies should be subject to full evaluations and those which can be subject to less intensive and resource demanding effort, a so called '*lighter touch'* approach. To assist in this respect, it provides practical guidance on the types of situations where detailed full evaluations may be warranted.

[1] The broad or macro level is a "high level" view that can bring to note year to year changes and, with enough data over time, trends in compliance in the general population.

Figure 1. Compliance effectiveness methodology



Compliance Effectiveness Methodology— Overview of each phase

Phase 1: Articulate risk and align with the revenue body's intent (i.e. goals)

Phase 1 is about understanding and articulating the risk and making sure that it aligns with a revenue body's business intent. This phase starts after the risk has been identified, quantified and prioritised through a revenue body's corporate risk management framework.

1. How does revenue body business intent align with the context?

Compliance effectiveness indicators must be relevant to what an organisation is aiming to achieve. To ensure relevance in the measurement process, the indicators should be aligned to the strategic goals and objectives of the organisation (or a specific service area). This question is designed to ensure the work area's intent aligns with the revenue body' business intent, thus enabling effectiveness in achieving the intent to be measured.

2. Identify the compliance risk to achieving the intent

The risk should be expressed as a threat posed to achieving the business intent rather than in terms of observed behaviours. The focus of the methodology is on the risk to achieving a revenue body's intent which has a broader focus that includes community confidence. Focusing on the observed behaviours may result in strategies that treat the symptoms and not the causes.

3. Identify those involved in the risk

It is important to identify all of the participants who contribute to the risk, either directly or indirectly. Participants could include taxpayers, suppliers, tax professionals, employees, promoters, customers, bookkeepers and financiers. Identifying all the participants will ensure that the compliance strategy looks to address the drivers of the compliance behaviours of all those involved in the risk.

4. Identify the behaviours and drivers of the risk

As compliance effectiveness is about achieving positive and sustainable changes in taxpayer behaviour, observed through the key compliance obligations of registration, filing, reporting and payment, it is essential to determine how the risk manifests in regard to these obligations. It is important to know what is driving or causing the risk.

By first applying a revenue body's compliance model, particularly the BISEP factors [2] where these are taken account of, to identify and understand the drivers of the behaviours, a revenue body is then better able to develop treatment strategies and leverage opportunities appropriate to the particular circumstances. It is also important to understand the pattern of risk (endemic, sporadic, bedding-down) in determining the desired outcomes, developing strategies and formulating the indicators.

Phase 2: Define outcomes and develop strategies (i.e. risk treatments)

Phase 2 is about clearly expressing the outcomes a revenue body wants to achieve and explaining what would be different if it was successful. This phase also involves identifying the right mix of treatment strategies. A revenue body's strategies treat the drivers of the non-compliance, and not just the observed behaviours.

[2] The relevance of BISEP factors (i.e. business, industry, sociological, economic and psychological factors) was described in the FTA's 2004 guidance note '*Managing and Improving Taxpayers' Compliance*', see page 39.

1. Identify the outcomes sought by treating the risk

Effectiveness is about the alignment between actual and desired outcomes. The focus here is on broad, aspirational outcomes rather than immediate, desired effects.

The desired outcomes should be expressed in terms of the expected impacts on the target groups and those around them (the ripple effect) in relation to the key compliance obligations and community confidence. They should be commensurate with the level of risk. This will assist with the development of strategies and indicators. For example, a risk at the corporate level would be defined and addressed differently to a risk at the sub-plan or business line level. This is important as if a risk is at the business line level but the desired outcome is articulated at the corporate level it will be difficult to identify appropriate strategies and design indicators. Clearly identifying all of the desired outcomes will assist in determining the goals for success, and will help to ensure the compliance strategies are working towards those outcomes.

2. Define success in terms of the goals

Before the compliance strategy is determined, success needs to be clearly defined. Success must be defined in terms of the specific goals that represent the desired new behaviours or changes in community confidence. These success goals must be expressed in measurable terms.

3. Identify the target groups

The target groups include the immediate group as well as any surrounding groups (grouped by region, industry, tax agent or another characteristic) that are likely to be affected by the compliance strategies. The broader taxpayer population can also be affected by compliance strategies targeted at a specific group. The impact on these additional groups represents the ripple effect. Although the validity of results associated with broader impacts will decline the further away the affected groups are from the immediate impacts, if the trends of all results are the same there can be more confidence in the effectiveness of the strategies.

4. Select strategies to deliver the outcomes sought

This step involves identifying the compliance strategies that will be developed and implemented to treat the compliance risk and move us towards achieving the desired outcomes. The strategies should address the target groups and the drivers of their behaviours, and align with the success goals and desired outcomes. Strategies include help and education, verification and enforcement. The mix of strategies employed will depend on the target groups and what drives their behaviour, as these are the key leverage points. In planning for outcomes to be sustainable, possible unintended consequences should be anticipated and strategies identified to address any that are significant.

Note: The guidance note includes a large variety of case study examples from selected revenue bodies, each of which describes for a specific risk or range of risks, the objectives (i.e. success goals of the strategy, the target group identified, and key elements of the risk treatment strategy.

Phase 3: Design indicators

Phase 3 involves identifying potential indicators and applying a series of business validation tests to ensure that they are viable. Useful indicators will assist in evaluating the extent to which the success goals and desired outcomes have been achieved.

1. Identify potential indicators

It is important to understand the difference between measures and indicators. Measures correspond to expected direct results, while indicators are less direct proxy measures and are used where direct measures are too difficult or costly to obtain. They are the signs, clues or markers of progress or success. All indicators that could potentially be used to measure the success of the compliance strategies should be identified and articulated. Efforts should be made to avoid measuring only what is easy to measure.

While indicators are generally quantitative they can be based on both quantitative and qualitative information sources. For example, where taxpayer attitudinal information is gained from a survey (qualitative information source) the indicator value may be represented by a change in the proportion (%) of the surveyed population who may agree with the survey question.

2. Select indicators that paint a credible picture

A suite of potential indicators is necessary, as a single indicator will not provide sufficient information to assess the overall effectiveness of a compliance strategy. But there should also be a limit to the number of indicators. If there are too many, it is likely that the necessary monitoring and assessment will not occur. The indicators should 1) demonstrate performance against the relevant compliance obligations or community confidence; 2) provide information from the perspectives of the immediate target groups, the surrounding population and the broader community where appropriate; and 3) reflect immediate (<2 years), intermediate (2–3 years) and/or long-term (>3 years) effects.

While indicators are not definitive measures, collectively they should be able to show whether the success goals are being met – if so, the picture of effectiveness is credible.

Note: The guidance note identifies a variety of indicators that can be considered for the different risk types, drawing on the country case study examples provided.

3. Describe the indicators and their purpose

Indicators should be described in neutral terms, such as 'a *change* in the proportion of late lodgers to the total population' rather than 'a *reduction* in the proportion of late lodgers'. Expressing the indicator with reference to an index, rate or ratio may help with defining and measuring the indicator. A neutral description will allow for a relative comparison before and after the compliance intervention. Expressing the indicator as 'the *number* of' is an absolute measure and will not give insight into the relative or proportionate change.

Purpose refers to the evidence the indicators will provide in relation to achieving the success goals. The purpose may be to demonstrate a change in compliance behaviour relative to the four key compliance obligations of registration, filing, reporting and payment or in community confidence.

4. Determine which indicators are feasible

Indicators should be viable. There are various tests that can be applied (e.g. the SMART test – whether the indicators are specific (S), measurable (M), achievable (A), relevant (R) and timed (T). And consideration can also be given to whether the indicators are attributable, comparable, able to be substantiated and unbiased to determine their feasibility. Any limitations or weaknesses that are exposed in this process should be documented. External factors that impact on achieving the desired outcomes should also be considered, as they can affect the usefulness of the indicators particularly in relation to attribution. It is important to be able to differentiate the effect of a revenue body's compliance strategies from any other factors.

Phase 4: Validate indicators and determine extent of strategy effectiveness

Phase 4 deals with the technical validation of the indicators and the evaluation and reporting of effectiveness. In this phase, the potential indicators identified in phase 3 are validated from a technical perspective, and the effectiveness of the strategies in changing behaviour over the immediate, intermediate and long term is evaluated. There is an underlying assumption that the strategies will be implemented.

1. Decide how the evaluation will be conducted

An evaluation plan setting out the process to establish and monitor the selected indicators needs to be developed. This plan should include the analytical tools or measurement comparisons that will be used in evaluating effectiveness. Measurement comparisons include baseline comparisons, randomised controlled trials and benchmarks.

Note: The guidance note, and the accompanying companion note—*Methodological techniques for use in evaluating the effectiveness*—provide elaborated descriptions of techniques that can be used to evaluate effectiveness.

2. Identify the data required and where to get it

It is important to understand and document the nature of the required data, the sources of the data, both internal and external, and any limitations of the data. The set of indicators to be used for evaluation purposes must be able to be supported by our business systems, indicate actual performance over time and be obtainable at a reasonable cost. It may be necessary to establish systems and controls to collect, record and analyse the data and ensure its integrity.

3. Agree on baseline measures

To enable comparisons before and after implementation of the compliance strategy it is important to determine what the starting point or baseline is prior to implementation. It also needs to be established whether these baseline data are readily available. If baseline data are not available, then data from the first year of implementation can be used as the starting point for measuring the impact of the compliance strategies in future years.

4. Determine what the indicators are revealing

The final, critical steps in the methodology involve interpreting the indicator results and documenting and reporting the findings in a way that informs decision-makers.

It is important to provide credible evidence of the impact of a revenue body's compliance interventions on the key compliance obligations and/or community confidence – the actual outcomes. All assumptions and inferences made must be recorded and their impact on the indicators explained. This includes attribution issues to determine how much of the impact or effect is due to the compliance strategies, and how much is/may be due to external factors. Sufficient evidence must be provided to support the conclusions. The evidence and conclusions should be capable of independent verification.

Effectiveness is the extent to which the actual outcomes align with the desired outcomes. Where they do not align, the reasons why must be explored and explained. In the interests of continuous learning and improvement, what processes worked well and what did not should also be reported and our approaches adapted. This picture or 'story' of effectiveness should feed into future planning processes.

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