



CONTROLLER AND AUDITOR-GENERAL

Tumuaki o te Mana Arotake

Performance audit report

## Inland Revenue Department: Effectiveness of the Industry Partnership programme





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# Inland Revenue Department: Effectiveness of the Industry Partnership programme

This is the report of a performance audit we carried out under section 16 of the Public Audit Act 2001

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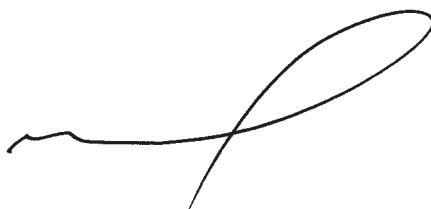
## Foreword

Receiving cash payments but not declaring them for tax purposes is one way of avoiding or evading tax. In 2002, the Inland Revenue Department (IRD) began testing an Industry Partnership programme to try to reduce the incidence of undeclared income from cash transactions in selected industries.

Overall, the programme had some positive benefits for IRD and taxpayers. IRD generally performed well in designing, operating, and evaluating the programme. The programme included a lot of evaluation, monitoring, and self-critique, and subsequent adjustments to the programme. This was one of the programme's strengths. However, IRD could have given greater attention to bringing into the tax system the people and organisations likely to have undeclared cash incomes.

IRD needs to ensure that lessons learned from the programme are recorded and reflected in operational guidance and support resources. During 2008/09, I will be asking IRD to report on its progress with this.

I thank the industry representatives and IRD staff who gave generously of their time and assistance for our audit.

A handwritten signature in black ink, appearing to read "K B Brady".

K B Brady  
Controller and Auditor-General

9 April 2008

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# Summary

If people are not meeting their tax obligations, the revenue from taxes is reduced. The Government has less to spend on goods, services, and payments to or on behalf of New Zealanders. The tax burden is not spread as intended across taxpayers, and some organisations may obtain unfair commercial advantages.

In 2002, the Inland Revenue Department (IRD) began testing an Industry Partnership programme (the programme) to try to reduce the incidence of undeclared income from cash transactions in selected industries. The programme operated from February 2002 to November 2006.

More recently, aspects of the programme have been incorporated within the work of IRD's new Customer Insight Group. The Customer Insight Group is responsible for helping IRD to improve tax compliance through understanding what influences different groups of people. The Customer Insight Group is responsible for ensuring that IRD has this information so the wider organisation can design systems and processes that work for taxpayers.

The programme involved IRD developing relationships with selected industry organisations. The objectives of the programme were to:

- increase the voluntary tax compliance levels within selected industries;
- increase IRD's presence in the community;
- improve the community's perception of IRD as a professional organisation; and
- target audit resources at the highest risk cases within selected industries.

We carried out an audit of the programme. Overall, we found that the programme had some positive benefits for IRD and taxpayers. It has helped to inform the attention the Customer Insight Group pays to people and organisations operating partly or completely outside the tax system (the hidden economy).

## Design of the programme

We expected the programme to have:

- a clearly defined problem to be addressed;
- a common understanding of that defined problem;
- clear objectives;
- a risk-based and/or evidence-based approach to selecting the industries to be covered by the programme; and
- a design consistent with the objectives.

## Our findings

The programme was in keeping with IRD's compliance model and strategic direction, and the rationale and objectives of the programme were well defined.

A key feature of the programme's design was a deliberately unconstrained approach to the activities of field teams working on the programme, balanced by a national team structure.

However, IRD could have given greater attention to bringing high-risk people and organisations (those not recorded within IRD's systems) into the tax system. Capturing more of these people and organisations within IRD's systems might have led to the collection of more tax revenue.

The structure of the Customer Insight Group should enable IRD to better identify tax evasion by people outside, or partly outside, the tax system.

## Operation of the programme

We expected the programme to have:

- policies and procedures to guide staff;
- effective relationships with industry partners;
- produced effective information for industry partners;
- sufficient capacity, including resources; and
- effective planning and performance management systems.

## Our findings

The diverse tax backgrounds of the programme's field team members enabled Industry Partnership clients to have a single point of contact within IRD. The diversity also enabled staff to draw on a wide range of knowledge and select from a range of compliance approaches.

Flexible performance management arrangements for staff and the absence of standardised processes or guidance gave field teams the flexibility to try fresh approaches to compliance.

Staffing arrangements for the programme created conflicting accountabilities for seconded staff and their managers. The programme also lacked a single, cohesive planning framework to ensure that it was consistently implemented.

Aspects of the programme are now being implemented in the Customer Insight Group. Some of the necessary support infrastructure for an effective transition to the Customer Insight Group was not fully in place at the time of our audit

fieldwork. IRD needs to ensure that lessons learned from the programme are recorded and reflected in the operational guidance and support resources for staff, particularly the staff working with people and organisations operating partly or completely outside the tax system.

## **Evaluation of the programme**

We expected the programme to be effectively evaluated. In short, this requires the results of the programme to be measured and acted on.

### **Our findings**

The monitoring and evaluation of results were strengths of the programme.

However, IRD carried out less monitoring and evaluation of Industry Partnership activities across field teams at the sub-programme level. This limited IRD's ability to develop specific tools and approaches for dealing with transactions outside the tax system (the "hidden economy").

Monitoring and evaluation showed positive results in terms of tax collected, tax compliance, and taxpayers' perception of IRD. In the early stages of the programme, external specialists estimated, on IRD's behalf, the tax dollar effects of raised filing rates and lowered tax debt in five industries covered by the programme. The external experts estimated that tax payable increased by \$5.2 million in 2002/03 and by \$4.5 million in 2003/04 because of the programme.

However, attributing changes in tax revenue and compliance directly to the programme was difficult. In some instances, IRD could have better qualified the programme's reported results. IRD needed to present more clearly the results that were directly attributable to the programme.

In some cases, the review of aspects of the programme by IRD's Risk and Assurance section had more positive findings than the evaluation work of programme staff. IRD may want to examine the reasons for this so that any lessons arising from the differences can be used to inform future monitoring, evaluation, and review activities.

## **Achieving the programme's objectives**

We expected that IRD would meet the objectives it set for the programme.

### **Our findings**

In general, IRD's programme objectives were achieved. The exception was directing audit resources toward the highest risk cases within selected industries,

which was only partly achieved. This was because cases were identified largely from IRD's existing information on taxpayers – people who were already in the tax system. Existing taxpayers are not necessarily the highest risk cases.

The high-level objectives set by IRD for the programme did not have definitive targets. The IRD could therefore assess a positive trend in the measure/s for a given objective as achieving the objective.

In our view, as the programme evolved during its five-year life, IRD needed to set measurable targets and assess its progress against specific programme objectives. This would have informed IRD's consideration of the structural and resource options for applying the programme's approach throughout the organisation.

## **Our recommendations**

We recommend that the Inland Revenue Department:

- record and reflect the lessons learned from the Industry Partnership programme in specific operational guidance and support resources for staff focusing on the hidden economy; and
- identify, as part of reporting on the results of a specific programme or initiative that may be affected by a range of variables, those factors contributing to the results that are not attributable solely to the programme or initiative.

# Part 1

## Introduction

- 1.1 In this Part, we describe:
- the cash economy;
  - the Industry Partnership programme; and
  - why and how we undertook our performance audit.

### The cash economy

- 1.2 Transactions outside the tax system are described as the hidden economy. When these transactions are in cash, they are described as the cash economy.
- 1.3 If people are not meeting their tax obligations, tax revenue is reduced. The Government has less to spend on goods, services, and payments to or on behalf of New Zealanders. The tax burden is not spread as intended across taxpayers, and some organisations may obtain unfair commercial advantages.
- 1.4 Potential tax evasion includes:
- informal and unstructured transactions between people (that may or may not involve cash); and
  - income that is undeclared for tax purposes (including transactions involving payment by cash, cheque, EFTPOS, or credit card).
- 1.5 Examples of cash transactions that may fall outside the tax system include people doing cash jobs as part of a business, or paying wages “under the table” in cash.

### The Industry Partnership programme

- 1.6 The Industry Partnership programme (the programme) within the Inland Revenue Department (IRD) sought to reduce the level of undeclared cash income within selected industries. In the long term, IRD hoped that practices within those industries would support a sustainable tax system.
- 1.7 The objectives of the programme were to:
- increase voluntary compliance levels within selected industries;
  - increase IRD’s presence in the community;
  - improve the community’s perception of IRD as a professional organisation; and
  - direct audit resources toward the highest risk cases within selected industries.

### When did the programme operate?

- 1.8 Industry Partnership was launched as a project by IRD in February 2002. It continued as a project until the end of June 2005. From 1 July 2005, the project

was incorporated into IRD's mainstream tax collection operation, but with separate Industry Partnership teams (at both a national and regional level) as part of the arrangement.

- 1.9 From November 2006, Industry Partnership ceased to exist as a specific project or as part of mainstream business resourced with separate Industry Partnership teams. Some of the Industry Partnership programme functions were taken over by IRD's Customer Insight Group. At the time of our audit the Customer Insight Group was newly established.

### How did the programme operate?

- 1.10 For about the first year of the programme, IRD had relationships with two industries: electrical services, and painting and decorating services. More industries were added to the programme in the following years. The industries covered by the programme, the dates from which they were covered by the programme, and the type of relationship IRD had with each industry, are shown in Figure 1.
- 1.11 Between 2002 and 2004, IRD started 20 specific relationships with industries as part of the programme. Thirteen of the 20 relationships were classified as an *industry partnership*, six were classified as an *industry alliance*, and one was classified as an *industry strategic partnership*. These terms are explained in the notes below Figure 1.

### Selecting the industries

- 1.12 The industries covered by the programme were selected using criteria based on information in IRD's information systems. The criteria were the:
- average tax returns outstanding;
  - average tax debt outstanding; and
  - likelihood of a taxpayer having tax discrepancies.
- 1.13 The criteria were calculated for each industry class in IRD's information system. Medium-sized industries were selected from this list, and a subset of 15 industries was chosen for industry partnerships. Medium-sized industries were defined as having between 2500 and 10,000 tax entities recorded in IRD's information system.
- 1.14 IRD told us that industries' concerns about unfair competition and safety issues also influenced the selection of industries.

**Figure 1**

**Timeline of when relationships were formed as part of the Industry Partnership programme**

Industry	Date when added to the programme	Type of relationship
Electrical services	May 2002	Industry strategic partnership
Electrical services	May 2002	Industry alliance
Painting and decorating services	May 2002	Industry partnership
Painting and decorating services	May 2002	Industry alliance
Services to agriculture	March 2003	Industry partnership
Services to agriculture	March 2003	Industry alliance
Entrepreneurial services	March 2003	Industry alliance
Hairdressing and beauty salons	April 2003	Industry partnership
Smash repairing	May 2003	Industry partnership
Automotive repair and services	July 2003	Industry partnership
Long-distance bus transport	July 2003	Industry partnership
Long-distance bus transport	July 2003	Industry alliance
Plumbing services	July 2003	Industry partnership
Taxi and other road transport	November 2003	Industry partnership
Plastering and ceiling services	March 2004	Industry partnership
Carpentry services	April 2004	Industry partnership
Gardening services	June 2004	Industry partnership
Landscaping services	August 2004	Industry partnership
Bricklaying services	September 2004	Industry partnership
Gardening and landscaping services	December 2004	Industry alliance

Notes:

An **industry partnership** is a relationship formed with an association or body directly representing industry members.

An **industry alliance** is a relationship formed with a sector body, or organisation that is representative of, or connected to, members of an industry.

An **industry strategic partnership** is a relationship formed with a quasi-governmental agency or Crown entity that represents, regulates, or funds an industry or sector with which IRD's Industry Partnership programme is working.

## Transition to the Customer Insight Group

- 1.15 In October 2006, IRD announced to its staff that there would be changes to the way Industry Partnership teams operated. In effect, the changes meant that the Industry Partnership initiative ceased to exist as a specific project or as part of mainstream business resourced with separate Industry Partnership teams.
- 1.16 IRD told its staff that one of the reasons for the change was a “more complex and diverse customer base” requiring IRD to “become more agile in the way it meets

customers' increasing service expectations". The advice to staff also indicated that the Customer Insight Group (a new operating group) would be "actively promoting Industry Partnerships". The new operating structure took effect in November 2006.

- 1.17 The Customer Insight Group was part of this new structure. The Customer Insight Group is responsible for helping IRD to improve tax compliance through understanding what influences different customer<sup>1</sup> groups and those outside the tax system. The Customer Insight Group is responsible for ensuring that IRD has this information so the wider organisation can design systems and processes that work for its customers. While the programme included aspects of this approach, it applied to only a small group of industries.
- 1.18 The Customer Insight Group has about 200 staff. It sits within IRD's Service Delivery Group, and receives funding through the resources IRD allocates to the Service Delivery Group.
- 1.19 The Customer Insight Group is structured around four customer groups, and there is a manager for each team looking after a customer group. There are also a Community Relationships team and manager responsible for managing relationships across the four customer groups. These five teams report to a Group Manager.

### **Industry Partnership responsibilities**

- 1.20 Industry Partnership responsibilities are mainly managed by the Customer Insight Group or others within its parent Service Delivery Group. The manager of the Small/Medium Enterprises team within the Customer Insight Group is responsible for existing and future national industry relationships. The manager of the Community Relationships team within the Customer Insight Group is responsible for managing local industry relationships. Day-to-day interactions with existing Industry Partnership customers are handled through IRD's normal business processes within the wider Service Delivery Group. Risk, intelligence, and assurance work related to Industry Partnership customers is managed through IRD's normal business processes within the wider Service Delivery Group. The functions previously provided by the national office team are provided by IRD's relevant support areas outside the Service Delivery Group.
- 1.21 Within the Community Relationships team, different positions are responsible for relationships with different groups. One of these positions is that of Community Compliance Advisor (CCA, but initially called a Community Relationships Advisor). The CCA is responsible for bringing people outside the tax system into the tax

<sup>1</sup> For ease of reading in this report, we have retained the Inland Revenue Department's term "customers" to describe the range of people and organisations it deals with (individual taxpayers, entities that pay taxes, student loan borrowers, child support custodians, parents paying child support, recipients of Working For Families tax credits, and recipients of parental leave payments).

system. At the time of the fieldwork for our audit, the role was relatively well established but yet to be finalised. There were 20 CCA positions, staffed through secondments.

## Why and how we carried out our audit

### Why we carried out our audit

- 1.22 We carried out a performance audit of the programme to see whether it was effective in meeting its objectives. Although the programme was no longer operating, we wanted to test IRD's reported successes of the programme, given the ongoing incorporation of aspects of the programme within IRD's mainstream operations.

### How we carried out our audit

- 1.23 We examined the programme and related strategy, planning, evaluation, monitoring, reporting, and accountability documents. We also examined IRD's information on prosecutions taken as part of the programme, and the number of calls to the Industry Partnership's 0800 telephone number.
- 1.24 We examined reports from the Australian Tax Office, HM Revenue and Customs (the United Kingdom's revenue authority), and the Canadian Revenue Authority.
- 1.25 We met with IRD staff and representatives of four industries included in the programme.
- 1.26 We identified 39 specific audit questions relating to 15 higher level expectations about what constitutes effective programme design, operation, and evaluation. We used these to guide our fieldwork. IRD's performance against our expectations is outlined in Parts 2-5.

### Outside the scope of our audit

- 1.27 We did not:
- quantify, in dollar terms, the effect of the programme on the Government's tax revenue;
  - attempt to quantify the size of the cash economy or the size of the hidden economy; or
  - repeat IRD's analysis of the raw data on taxpayers covered by the programme.



## Part 2

# Design of the Industry Partnership programme

2.1 In this Part, we outline:

- the structure and resources of the programme;
- our expectations of good programme design; and
- our findings.

### Structure and resources of the programme

#### Field teams

- 2.2 There were five field teams and a national office team working on the programme. The five field teams were located at IRD service centres throughout New Zealand.
- 2.3 From 1 July 2004, each field team comprised an encouragement team and an assurance team, generally located together at an IRD regional site.
- 2.4 Encouragement teams typically had 5-8 members. They provided education and services about all types of taxes. They also considered minor tax debt and return issues. More serious tax issues were referred to the assurance team when required.
- 2.5 Staff were seconded to the encouragement teams from the Child Support, Return and Debt Collection, and Services sections of IRD. While on secondment, staff received their pre-secondment salaries. Staff returned to their original sections with the implementation of IRD's new operating structure in late 2006.
- 2.6 Assurance teams typically had 7-8 members. They managed tax compliance issues of people who did not want to comply, or were not complying, with their tax obligations. The assurance teams included specialist debt collection staff, intelligence officers (also known as "seekers"), and investigators.
- 2.7 The intelligence officers' roles were to specifically seek evidence of tax evasion (that is, identify people outside the tax system). These roles were not originally part of the programme design. Intelligence, such as direct observation and third-party information, was also used to identify people outside the tax system.
- 2.8 Staff were seconded to the assurance teams from the Return and Debt Collection, and Audit sections of IRD. Staff returned to their original sections before, or with, the implementation of IRD's new operating structure.
- 2.9 Seconded staff came into their new roles with a good knowledge of substantive tax issues, and received training to make them familiar with different tax types. They received limited training in generic skills such as relationship management, innovation, and strategic thinking relevant to the Industry Partnership way of

working. Generic functional job descriptions and performance management arrangements were not amended to recognise the Industry Partnership work.

- 2.10 The wages and operating costs of staff seconded to field teams from other sections of IRD were paid through the sections from which they were seconded. IRD has estimated the costs of field teams at \$1.575 million in 2003 and \$1.750 million in 2004.
- 2.11 While new initiatives or programmes may at times have their own appropriations, this is not always the case. The Industry Partnership programme is one example. Entities need to ensure that initiatives or programmes are consistent with the purposes of the appropriations from which they are funded.

### National office team

- 2.12 The national office team provided field teams with a range of support services, including:
  - design advice;
  - relationship management with partnered organisations;
  - research and issues gathering (a three-person research and issues gathering team was added in January 2004);
  - evaluation services; and
  - communication support.
- 2.13 The national office team also had a governance role, with responsibility for collating reports from field team leaders and overseeing the programme.
- 2.14 Staff from the national office team made contact with industry groups, explained the purpose of the programme, and represented IRD at national conferences. They remained the primary point of contact with industry associations, facilitating the provision of guidance and advice to industry members.
- 2.15 With the implementation of IRD's new operating structure in late 2006, national office team staff moved to new functional teams, performing equivalent tasks to their Industry Partnership functions.
- 2.16 The funding budgeted for the project for the national office team is shown in Figure 2. For the three years from 2002/03 to 2004/05, \$5.7 million was budgeted for Industry Partnership work (national office team only). IRD told us that, once the Industry Partnership initiative ceased to be a project and was absorbed into IRD's mainstream business from July 2005, the national office team's annual budget of about \$1.6 million was absorbed into the budgets of other teams for the remaining life of the programme.

**Figure 2**

**Industry Partnership project budget 2002/03 to 2004/05, for the national office team**

Component	2002/03	Financial year 2003/04	2004/05
Capital	\$403,955	\$544,000	\$0
Operating	\$1,265,691	\$1,489,300	\$2,000,000
<b>Total</b>	<b>\$1,669,646</b>	<b>\$2,033,300</b>	<b>\$2,000,000</b>

- 2.17 Field teams reported through a Service Centre management hierarchy to the Group Manager Field Delivery. The national office team also reported to the Group Manager Field Delivery. In effect, the programme had a matrix management structure.<sup>1</sup>

## Our expectations

- 2.18 We expected IRD to have designed the programme so that it would support IRD achieving the objectives it set for the programme. We expected the programme to have:
- a clearly defined problem to be addressed;
  - a common understanding of that defined problem;
  - clear objectives;
  - a risk-based and/or evidence-based approach to selecting industries to be covered by the programme; and
  - a design consistent with the objectives.

- 2.19 We also expected IRD to have ensured that important features of the design of the programme were preserved in the transition to the Customer Insight Group, and that any associated risks were well managed.

## Summary of our findings

- 2.20 The programme was well grounded in IRD's compliance model and strategic direction, and the rationale and objectives of the programme were well defined.
- 2.21 A key feature of the programme's design was a deliberately unconstrained approach to the activities of field teams working on it. This flexibility was balanced by a national team structure which provided important direction, business support, and evaluation.
- 2.22 IRD could have given greater attention to bringing high-risk organisations and people not declaring cash income into the tax system, as part of the design of the programme.

<sup>1</sup> A matrix management structure is one where an employee reports to two or more managers.

- 2.23 The structure of the Customer Insight Group, which took over responsibility for aspects of the programme, should enable IRD to better identify tax evasion by people outside the system.

## Problem definition and objectives

- 2.24 The programme focused on the tax risks associated with the cash economy, while also seeking to improve taxpayers' long-term voluntary compliance with tax obligations. The particular aspect of the cash economy targeted by the programme was cash income undeclared for tax purposes.
- 2.25 The purpose of the programme was:
- ... using the compliance model develop, test and implement a relationship-based approach to working with small and medium enterprises within selected cash economy industries to encourage and enable voluntary compliance.<sup>2</sup>*
- 2.26 The programme was intended to translate IRD's compliance approach into practice. The compliance approach drives all of IRD's business.
- 2.27 IRD's approach to compliance recognises that taxpayers have a wide variety of attitudes towards paying tax and that there are a number of factors that influence taxpayers' tax decisions and behaviour.
- 2.28 For those who are willing to meet their tax obligations, IRD tries to make it as easy as possible. This requires IRD to apply a low level of pressure to get those taxpayers to comply. For those who have deliberately decided not to meet their tax obligations, IRD may apply much more pressure to get those taxpayers to comply. IRD is trying to move taxpayers from requiring a high level of pressure to requiring a low level of pressure (see Figure 3).
- 2.29 The design of the programme was consistent with IRD's compliance pyramid and its strategic direction.
- 2.30 The former programme staff we interviewed for our audit had a common understanding of what the programme was and its purpose. This was consistent with the documentary evidence provided to us by IRD.

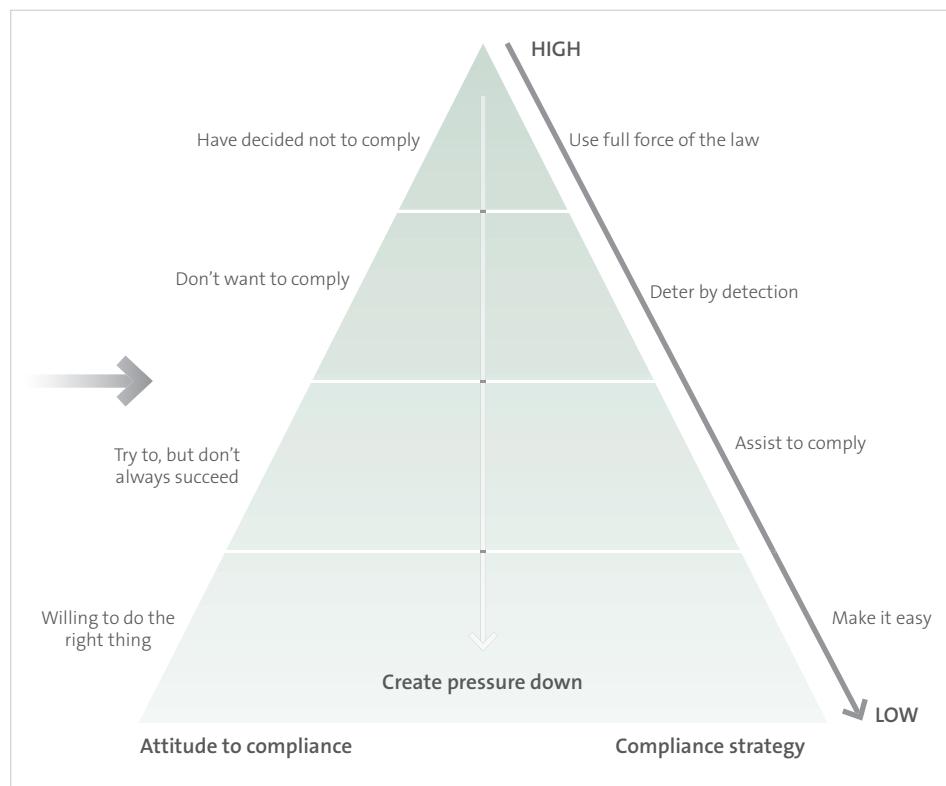
## Risk and evidence base

- 2.31 While the size of the hidden economy is difficult to measure, IRD had previously commissioned external advice on the size of the hidden economy to help inform IRD's activities. IRD assumed that, within the hidden economy, the cash economy "was of sufficient scale to present a loss of revenue by evasion of enough significance to warrant action".<sup>3</sup>

<sup>2</sup> Inland Revenue Department document, 2004.

<sup>3</sup> Inland Revenue Department document, 2002.

**Figure 3**  
Inland Revenue Department's compliance pyramid



Source: Inland Revenue Department.

- 2.32 The programme's design relied heavily on information already held by IRD. This meant that, as a deliberate design feature, there was limited targeting of people outside the tax system. More attention could have been given to how third-party and IRD's own information on people outside the tax system could be more systematically obtained and used as part of the programme.
- 2.33 More attention in the design of the programme to people outside the tax system may have aligned the programme more closely with one of its key objectives – directing audit resources toward the highest risk cases within selected industries.

## Structure and objectives

- 2.34 There were relatively few controls on the regional and national teams carrying out programme work. This relatively unconstrained approach was also a deliberate design feature, reflecting the uncertainties about the size of the hidden economy and the initiatives that might work in addressing it. It was an understandable

approach, given these uncertainties at the time about the sustainability of allocating resources for the programme.

- 2.35 An important feature of the design, particularly at the field team level, was having teams made up of people from different sections within IRD. Assurance teams became part of the programme's field teams after the programme started. This was a design adjustment during the programme. IRD has advised us that, given the relationship management focus and approach to the programme, a "dedicated enforcement function was not necessary at the front end of the process but was introduced later as increased cases were identified and needed specific audit interventions".<sup>4</sup>
- 2.36 Greater emphasis on assurance activity earlier in the programme would have been consistent with programme objectives to increase voluntary compliance and target resources at the highest risk cases within selected industries.
- 2.37 The national team structure was important because it provided direction, supported monitoring and evaluation, and facilitated a whole-of-industry approach for those industries targeted by the programme. It was the major control on the programme.

## Customer Insight Group

- 2.38 The crucial feature of the programme (the relationship-based approach) and an important lesson learned (the need for more attention on people outside the tax system) have been reflected in the design of the Customer Insight Group. A relationship management function is an important part of the Customer Insight Group's design, and is reflected at a structural level as a separate team. A defined role has been created within the Customer Insight Group – the CCA role – with the specific purpose of identifying people outside the tax system. IRD has also told us that its Risk and Intelligence section has a specific focus on people outside the tax system.
- 2.39 Specific transitional risks have been recognised by IRD, including the loss of the national office team.
- 2.40 As we noted earlier, the national office team was a very important control on the programme. This control does not exist in the Customer Insight Group because Industry Partnership responsibilities have been distributed throughout a number of sections. Some are within the Customer Insight Group and others are elsewhere within IRD. The loss of this control is being offset, to some extent, by having a Small and Medium Enterprise (SME) section within the Customer Insight Group responsible for understanding SMEs. The programme previously targeted small- to medium-sized businesses.

<sup>4</sup> Inland Revenue Department correspondence, November 2007.

- 2.41 During 2008/09, we will be asking IRD to report on its progress in ensuring that lessons learned from the Industry Partnership programme are sufficiently recorded and reflected in specific operational guidance and support resources for IRD staff. This is particularly important for those staff focusing on the people operating partly or completely outside the tax system.



## Part 3

# Operation of the Industry Partnership programme

3.1 In this Part, we outline:

- how the programme operated;
- our expectations of effective programme operation; and
- our findings.

## How the Industry Partnership programme operated

- 3.2 The programme involved IRD building relationships with selected industries by understanding and consulting with the industry, identifying any barriers to tax compliance for the industry, and educating the industry where necessary.
- 3.3 A critical component of the programme was encouraging and supporting industries to voluntarily meet their tax obligations. This is known as a voluntary compliance approach. At the same time, IRD wanted to ensure that people who voluntarily met their tax obligations were not commercially disadvantaged for doing so.
- 3.4 As well as helping people to comply, the programme was intended to include targeted tax enforcement action based on improved intelligence about, and case selection of, taxpayers.

## Operating policies and procedures

- 3.5 IRD staff working in field teams generally carried out their existing roles and functions, but in relation only to clients covered by the programme. This work was supported by established processes and procedures for the audit, return and debt collection, child support and services functions, tax education material, job descriptions for the different functional roles, and staff training material.
- 3.6 Specific programme work processes were limited. They included a guide for referring taxpayer cases to other functional staff, and a checksheet for staff making programme-related visits. At least one regional office (the South Island office) developed its own guidelines for field teams.
- 3.7 Differences in how the programme operated were reflected in the structure of field teams, the allocation of portfolios, and the mix and emphasis of activities carried out. In one team, for example, programme staff acted as account managers, dealing with the full range of tax matters associated with IRD clients. Other field teams were less integrated, and staff continued to carry out their separate functions in relation to Industry Partnership clients.

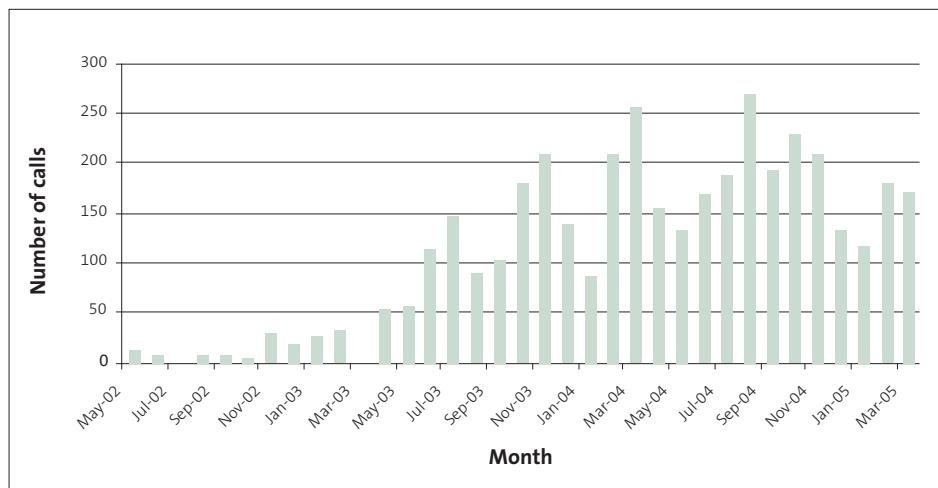
## Relationships and information

- 3.8 IRD used its design and communications capability to enhance industry members' understanding of their tax obligations. Material published and used to support the relationship and promotional work of Industry Partnership teams included:
- simplified tax brochures and booklets;
  - tax material tailored to the needs of specific industry groups;
  - templates for use at specific events and for specific initiatives;
  - explanatory material in electronic format for publication on the websites of industry groups; and
  - articles for publication in industry newsletters or reports or on industry websites.
- 3.9 The programme gave industry members direct access to a range of IRD services to help meet the needs of small- and medium-sized businesses, covering overdue returns and taxes, audits, child support, family assistance, student loans, and employer obligations.
- 3.10 Industry relationships also provided an important channel for communicating information about other services delivered by IRD, increasing awareness of a variety of business and personal tax matters faced by industry members (such as meeting child support obligations), and understanding the implications of the Government's Kiwisaver scheme.
- 3.11 IRD set up a dedicated free telephone number, 0800 TAXTALK, for industry members seeking advice on tax matters. This service was seen as useful, with field team staff providing industry members with direct assistance related to their tax affairs. Call volumes varied according to the different initiatives being run, and varied over time, as shown in Figure 4. The total number of calls to the 0800 telephone number was relatively low.

## Planning and reporting

- 3.12 IRD produced a variety of strategic and operational planning documents for the programme. These included:
- a project initiation paper that defined key milestones up to September 2004;
  - return and debt collection, services, and child support plans (2003);
  - a *Tactical and Operational Plan for Audit Field Delivery* (2003);
  - an *Industry Partnership Project Communications Strategy and Plan* (2003);
  - an *Industry Partnership Business Plan* (2004/05); and
  - an *Industry Partnership Operational Plan* (2005/06).

**Figure 4**  
Call volumes to the 0800 number for industry partners, 2002 to 2005



Source: Inland Revenue Department.

- 3.13 Each field team was expected to spend a specified number of hours on programme work. Hours coded for different types of activity carried out by the teams were tracked. This enabled staff to report on time spent on programme-related activity, and on numbers of advisory initiatives taken.
- 3.14 Investigations and audit staff in field teams were expected to achieve revenue targets consistent with IRD's goal of bringing about higher compliance in the selected industry groups. An internal benchmark rate of return was set at \$365 for each hour for audits of industries covered by the programme. IRD recognised that cases associated with the programme were likely to result in a lower return on investment than that prescribed by IRD's standard output measures. This was reflected in the \$365 hourly return rate target (the hourly return rate target for IRD's other audit work is \$600).
- 3.15 End-of-month field team reports provided information about a variety of activities and their impact, including evidence of positive outcomes and evidence of successful models. These reports were typically free-format descriptive reports.
- 3.16 The results of programme investigations and audits from the field teams were collated monthly in national reports. This data was analysed to show trends in compliance for different industry groups, which was able to be fed back to industry representatives as appropriate.
- 3.17 The format of reporting changed during the life of the programme, moving from a template aligned with IRD's standard reporting framework to a stronger focus on analysis that was tailored to the specific nature of the programme.

## Our expectations

- 3.18 We expected the programme to:
- have policies and procedures to guide staff;
  - have effective relationships with industry partners;
  - produce effective information for industry partners;
  - have sufficient capacity, including resources; and
  - have effective planning and performance management systems.
- 3.19 With responsibility for maintenance of the Industry Partnership approach passing to the Customer Insight Group, we expected that:
- lessons about the operation of the programme, and the gains made in understanding the benefits of different relationship methodologies and communication models in promoting compliance, would be appropriately captured and accessible; and
  - policies and procedures would be in place to ensure a continued focus on the cash economy within the work of the Customer Insight Group.

## Summary of our findings

- 3.20 The multi-functional field teams provided a single point of contact for Industry Partnership clients, and enabled staff to readily select from a range of knowledge and compliance approaches.
- 3.21 Loose performance management arrangements for staff and the absence of standardised processes or guidance gave field teams the flexibility to try fresh approaches to compliance.
- 3.22 Staffing arrangements for the programme created dual accountabilities for seconded staff and their managers.
- 3.23 The programme lacked a single, cohesive planning framework to ensure consistent implementation and focus.
- 3.24 Aspects of the programme were being implemented in the Customer Insight Group – the operational role definitions, information requirements, reporting templates, support services, performance measures, and working relationships needed for an effective transition to the Customer Insight Group were not fully in place at the time of our audit.

## Policies and procedures

- 3.25 We expected Industry Partnership operations to be governed by policies and procedures to promote the most effective use of resources and targeting of

effort, coverage of the selected industries, and to facilitate consistent meaningful analysis of results. We considered IRD's objective of giving field teams the operational autonomy necessary to test and evaluate a range of service delivery options.

- 3.26 We concluded that the absence of standardised policies and procedures gave field teams flexibility to try fresh approaches to compliance. However, it also led to a fragmented approach to best practice.

### Planning and reporting

- 3.27 IRD produced a variety of plans as the programme evolved. However, the programme overall lacked a single, cohesive planning framework to ensure consistent implementation and focus. This contributed to the lack of consistency – particularly in the early stages of programme implementation – in the approach to testing new initiatives, and the capacity of the programme to identify and reach businesses not registered with IRD and outside industry associations.
- 3.28 Disjointed planning also reflected the evolution of the programme and IRD's deliberate "test bed" approach. In an assessment of lessons learned from delivering the programme, IRD noted that field teams needed clear, step-by-step instructions and ongoing guidance. IRD has recognised that the programme suffered from a lack of the strategic and operational planning and direction necessary to promote standardisation of processes, so we have not made any recommendations about planning.

### Relationships and information

- 3.29 Industry groups responded positively to IRD's relationship-based approach, and were receptive to the use of explanatory material for their members about meeting tax obligations. Most communications attention was given to those industry groups with which IRD had formed relationships, and IRD recognised that more effort was needed to reach taxpayers not affiliated to an industry association.
- 3.30 The feedback we received about IRD's explanatory material was positive from both staff and the industry representatives we interviewed. Industry bodies were receptive to using IRD-designed communications products.

### Capacity

- 3.31 The varied tax backgrounds of the programme's field teams provided a single point of contact for Industry Partnership clients, and enabled staff to readily select from a range of knowledge and compliance approaches. This was a fresh

approach to organising work in IRD, and had various operational benefits for the programme. These included:

- the ability to offer a variety of tax-related services to individual taxpayers and industry groups, through a single point of contact, and to address a wide range of tax issues;
- a means for IRD to follow a logical and systematic sequence of interventions with its clients, and to use various tools to encourage compliance, from education and assistance (seen as the preferred initial approach to dealing with outstanding tax issues) to more enforcement-focused actions; and
- the ability to draw on a variety of perspectives and contributions from staff with different business knowledge from different functional groups within IRD, and therefore to readily refer tax cases across the team.

- 3.32 The IRD staff we spoke with were positive about the benefits of learning about other tax types and functions, bringing together different strengths and perspectives from across the organisation. Co-location of team members with different tax backgrounds was seen as promoting joint working, effective communication, and ease of referring tax cases to other functional staff for further action. Staff also told us that their experience with programme work exposed them to a fresh way of working with taxpayers, which they were able to take with them when their secondment ended.
- 3.33 In our view, national office leadership and direction was a valuable component of the programme, providing important focus and direction.
- 3.34 The ability of the programme to achieve the objective of bringing industry members into the tax system relied on IRD having the capacity to access third-party or anonymous information, voluntary disclosures, and other information leading to the identification of businesses not paying tax. IRD anticipated that this information was most likely to come from people within industry, the community, and business intelligence. IRD noted that only limited information was available or passed to its programme staff from those sources. IRD has told us that it now has a more formal process, agreed with the Privacy Commissioner, for using third-party data.

## Resourcing

- 3.35 The staffing arrangements for the programme created dual accountabilities for seconded staff and their managers. These continued when the programme became a mainstream activity.

- 3.36 Staff told us about the tension this arrangement created in some circumstances, with programme expenditure at a field level being effectively controlled by the much larger Service Delivery Group, unclear accountabilities for the results of the programme, and difficulties in measuring staff performance.
- 3.37 A few staff assigned to the programme, mostly in the national office, remained on secondment for the entire duration of the programme. With no defined timeframe for the programme, this temporary staffing arrangement created ongoing uncertainty. The necessary Industry Partnership-specific performance management arrangements, training, support structures, established procedures and processes, and operational tools were not put in place as the programme was extended.
- 3.38 IRD has identified that the secondment arrangements created some instability, because staff may have come and gone from the project more frequently than if they were permanently appointed. We were also told by staff that some secondees were not replaced after they returned to their original roles. This increased the workload for the remaining team members.
- 3.39 IRD has noted the instability resulting from its practice of filling programme posts with staff on secondment. In addition, IRD has told us that, after its experience with long-term seconds to the programme, "the Department has since developed a secondment policy which clearly addresses the length of time that people are able to be on a secondment".

## Performance management systems

- 3.40 The need for a degree of standardisation in staffing arrangements was recognised in a draft strategic direction programme document for 2006 to 2009. This noted the priority of defining and reviewing job descriptions for staff carrying out programme work.
- 3.41 There was regular reporting by field teams on their activities to the national office team, enabling analysis and evaluation of results at a national level. These results showed variations in the mix of activities and in the effect on compliance across regions.
- 3.42 The programme focused on assistance rather than more easily measurable activities such as audit and investigation. This, and the different types of activities carried out locally by the individual field teams, made the results difficult to quantify.

## Transition to the Customer Insight Group

### Planning

- 3.43 A paper prepared by IRD in February 2007 made recommendations for completing the transition process from the programme to the Customer Insight Group. The paper included the following matters for action:
- sharing the lessons learned with all business units for informing future cash economy activities;
  - providing industry knowledge and intelligence to identify future activities;
  - enhancing the industry profiles; and
  - capturing, documenting, and making knowledge available to all IRD staff about programme learning and initiatives in readily understandable and accessible forms.
- 3.44 The paper identified the main transitional risks as:
- the loss of Industry Partnership focus and lessons learned, and organisational knowledge; and
  - a failure to honour commitments made to industries.
- 3.45 The operational role definitions, information requirements, reporting templates, support services, performance measures, and working relationships needed for an effective transition to the Customer Insight Group were not fully in place at the time of our audit.
- 3.46 Some staff told us this had led to an uncertain direction, fragmented working relationships, the absence of a structure for activity reporting, and unclear role definitions. Some also expressed concern about a lack of ongoing access to design and communications resources, outside the Customer Insight Group, to effectively support continuing relationship activities with industry partners.

### Tools, resources, and guidance

- 3.47 In our view, Customer Insight staff assigned to work with the partner industries and target the hidden economy would benefit if the lessons learned from the programme were captured, analysed, and documented. IRD advised us that the lessons were shared through weekly conversations between field Team Leaders and national office staff.
- 3.48 It was not clear to what extent relationships with industry bodies were being actively maintained at national, regional, and local levels in the new structure. There remains a need to support IRD staff with appropriate communications material tailored to the needs of industry groups and their members.

- 3.49 Industry profiles were an important and well-used source of information for Industry Partnership staff and a tool for analysing taxpayer behaviour. They could be updated to meet the purposes of Customer Insight staff.

#### **Recommendation 1**

We recommend that the Inland Revenue Department record and reflect the lessons learned from the Industry Partnership programme in specific operational guidance and support resources for staff focusing on the hidden economy.

#### **The Community Compliance Advisor role**

- 3.50 The role of the CCA reflects the recognition by IRD of the importance of addressing the hidden economy. It provides IRD with a significant opportunity to increase compliance, and broaden the taxpayer base. This role was explained in paragraph 1.21. The role needs to be defined and supported by national training, appropriate decision-making authorities, a clear mandate, impact evaluation criteria, and operating procedures. Work was continuing to define the framework and context for this role at the time of our audit.
- 3.51 The necessary planning framework was not in place for the systematic transfer of information and intelligence from field teams to CCAs. This is important to provide continuity and record best practice for staff working in the new structure.
- 3.52 IRD has recognised, in its planning for the Customer Insight Group, the uncertainties and lack of necessary support associated with the ongoing secondment arrangements for staff to carry out CCA roles. IRD's customer relations business plan identifies a programme to deliver the required training (including new skills sets, and an induction package).



## Part 4

# Evaluation of the Industry Partnership programme

4.1 In this Part, we outline:

- the types of evaluation and monitoring of the programme carried out by IRD;
- our expectations of effective programme monitoring and evaluation; and
- our findings.

### Evaluation and monitoring

4.2 Originally, IRD anticipated building a full statistical model to monitor the outcomes of the programme, but there was not enough historical data available to make this possible. At the beginning of the programme, IRD did not set quantitative measures of the types of activities to be carried out as part of the programme. These measures were also required for statistical modelling.

4.3 A longer time series of information and some activity data is now available, so preparing a statistical model is more feasible. IRD's strategy and evaluation documents for the programme indicate the intention to prepare and introduce a full statistical model.

4.4 IRD used external experts to analyse the results of the programme using an alternative to statistical modelling. The experts used an approach called "ratio analysis". This involved comparing trends in 14 measures of tax compliance (some of which were ratios of one measure to another) for industries in the programme with the trends for similar industries outside the programme. This work was carried out in 2003 and 2004. In 2003, the analysis was done at a regional as well as at a national level.

4.5 IRD also analysed trends in various tax compliance measures during the life of the project component of the programme. There was a move away from this analysis over time because of attribution and data quality issues. These issues are described in paragraphs 4.42-4.48.

4.6 IRD did not attempt to monitor trends in the hidden economy as part of the programme.

4.7 A lot of IRD's data was "cleaned" as part of the programme. The main data quality issue that required data to be "cleaned" related to inaccurate, missing, or outdated Australia New Zealand Standard Industrial Classification (ANZSIC) codes within IRD's transactional information system. These codes were used to identify taxpayers in industries covered by the programme. IRD identified these data quality issues at the start of the programme.

- 4.8 During 2004 and 2005, IRD wrote seven papers that evaluated aspects of the programme and specific initiatives within it. The papers evaluated:
- field team activity;
  - external relationship management;
  - 10 service delivery initiatives;
  - research and issues gathering;
  - communications;
  - data integrity; and
  - field delivery.
- 4.9 A specific research and issues gathering team existed as part of the programme during 2004 and 2005.
- 4.10 In 2005, a survey was used to assess perceptions of the programme. Two Industry Partnership industries were surveyed, and there was also a community perceptions survey.
- 4.11 In 2005, IRD reviewed the systems it had in place to monitor the programme. This work was carried out by its Risk and Assurance section. The review concluded that adequate systems were in place to monitor compliance and the success of the programme.
- 4.12 In 2006, a high-level summary of lessons learned from the programme for the period 2002-06 was written.
- 4.13 A measurement and evaluation framework is still to be developed for the Customer Insight Group.

## Our expectations

- 4.14 We expected the programme to be effectively evaluated. In short, this requires the results of the programme to be measured and acted on. Specifically, we expected:
- regular industry, intervention, and programme level-monitoring or evaluation;
  - the monitoring and evaluation to show positive results in terms of tax collected, at both the industry and programme levels;
  - monitoring and evaluation information to be credible;
  - results of monitoring and evaluation to be fed back into the design, implementation, and management of the programme;
  - monitoring and evaluation to be linked to the programme's overall and operational objectives;
  - attributable results of the programme to be recorded accurately in appropriate reports and documents; and

- the monitoring and evaluation measures and framework to compare favourably with those used by other tax organisations.

## Summary of our findings

- 4.15 IRD's learning approach to the programme was supported by monitoring and evaluation of results, and this was a strength of the programme at an industry level and overall programme level. The monitoring and evaluation measures used for the programme were consistent with the practices of IRD's overseas counterparts.
- 4.16 Less systematic monitoring and evaluation was carried out of Industry Partnership activities across the five field teams – this limited IRD's ability to develop specific tools and approaches for dealing with the hidden economy.
- 4.17 Monitoring and evaluation showed positive results in terms of tax collected, tax compliance, and taxpayers' perception of IRD, but attributing changes in tax revenue and compliance directly to the programme was difficult. In some instances, IRD needed to qualify reported results of the programme but did not do so.

## Monitoring and evaluation

- 4.18 IRD has done a lot of evaluation and monitoring of the programme and it has recognised that the quality and availability of data have constrained this work. As part of understanding the constraints, it has sought external expert advice and has employed internal review mechanisms independent of programme staff.
- 4.19 There has been a lot of monitoring and evaluation of the programme to inform IRD's learning approach to the programme. However, there have been some limitations to this monitoring and evaluation. While there has been a mixture of industry, intervention, and programme-level monitoring and evaluation throughout the programme, there has been limited sub-programme level evaluation (that is, at a regional or individual initiative level). This is an issue that IRD has identified.
- 4.20 In our view, a relative lack of sub-programme level evaluation and monitoring has limited IRD's ability to develop specific tools and approaches for dealing with the hidden economy.
- 4.21 In some cases, the internal scrutiny by staff independent of the programme has been less critical than the evaluation carried out by programme staff. IRD may wish to examine the reasons for this so that any lessons arising from the differences can be used to inform future monitoring, evaluation, and review activities.

## Results of the programme

- 4.22 IRD's monitoring and evaluation show positive results in terms of tax collected and tax compliance.

### Tax payable

- 4.23 IRD's analysis for five industry groups in 2002/03 and 2003/04 showed the programme had raised tax return filing rates and lowered tax debt in these industry groups. This was based on comparisons of trends in those industries with trends in other industries. The five industries covered by the approach and the associated comparison industry for each are shown in Figure 5. In all cases, the comparison groups were broader industry groups.

**Figure 5**  
Industries and associated control industries

Industry covered by the programme	Control industry
Painters and decorators	All construction
Electricians	All construction
Plumbers	All construction
Smash repairers	Motor vehicle retailing and services
Hairdressers and beauty salons	Personal services

- 4.24 On IRD's behalf, external specialists estimated the tax dollar effects of raised filing rates and lowered tax debt in these five industries. The external specialists estimated that tax payable increased by \$5.2 million in 2002/03 and by \$4.5 million in 2003/04 because of the programme. They also estimated that, if these same results applied in the 62 industries identified by IRD as having relatively high cash economy risks (not all of which were covered by the programme), there would be extra tax payable of \$83 million each year, and tax debt would be reduced by more than \$90 million.<sup>1</sup>
- 4.25 The external specialists estimated the benefit-cost of the programme's activities in relation to the five industries to be 6.7 over a decade. In other words, the increased tax payable arising from the programme was estimated as 6.7 times the cost of the programme for these five industries if observed for a decade. This assumed that results observed early in the programme continued in later years.

### Tax compliance

- 4.26 Trends in tax compliance resulting from the programme have been provided in a number of IRD's annual reports. However, care must be taken when interpreting

<sup>1</sup> These figures exclude any demonstration effects of the programme (that is, the changes in other taxpayers' behaviour because of contact with the taxpayers targeted by the programme).

this trend information. While the information describes the trends observed, the trends cannot be attributed solely to the programme. The information is also aggregated for two or more Industry Partnership industries. The stated trend may therefore not be representative of what happened in any given constituent industry. The reported trends in tax compliance were also subject to data quality issues, as outlined in paragraphs 4.42-4.48.

- 4.27 In its 2003 Annual Report, IRD identified trends in tax compliance between 30 June 2002 and 30 June 2003. For the first two Industry Partnership industries, there were decreases in debt cases, and increases in debt for which an arrangement was in place with IRD. These trends are shown in Figure 6. The same annual report also noted that there had been improvements in the child support profile for Industry Partnership participants in these two industries.

**Figure 6**  
Trends in tax compliance during 2002/03

Electricians, and painters and decorators	
Debt cases	19.4% decrease
Average age of debt	8.3% decrease
Debt under arrangement	195% increase
Outstanding returns	7.7% decrease
Average age of outstanding returns	10% decrease

Source: Inland Revenue Department's 2003 Annual Report.

- 4.28 IRD's 2004 Annual Report provided similar information, showing improvements in the debt profile of electricians, and painters and decorators for the first two years of the programme (2002/03 and 2003/04 financial years combined). This information is shown in Figure 7.

**Figure 7**  
Trends in tax compliance during 2002/03 and 2003/04

Electricians, and painters and decorators	
Debt cases	23% decrease
Average age of debt	16% decrease
Debt under arrangement	258% increase
Outstanding returns	27% decrease
Average age of outstanding returns	20% decrease

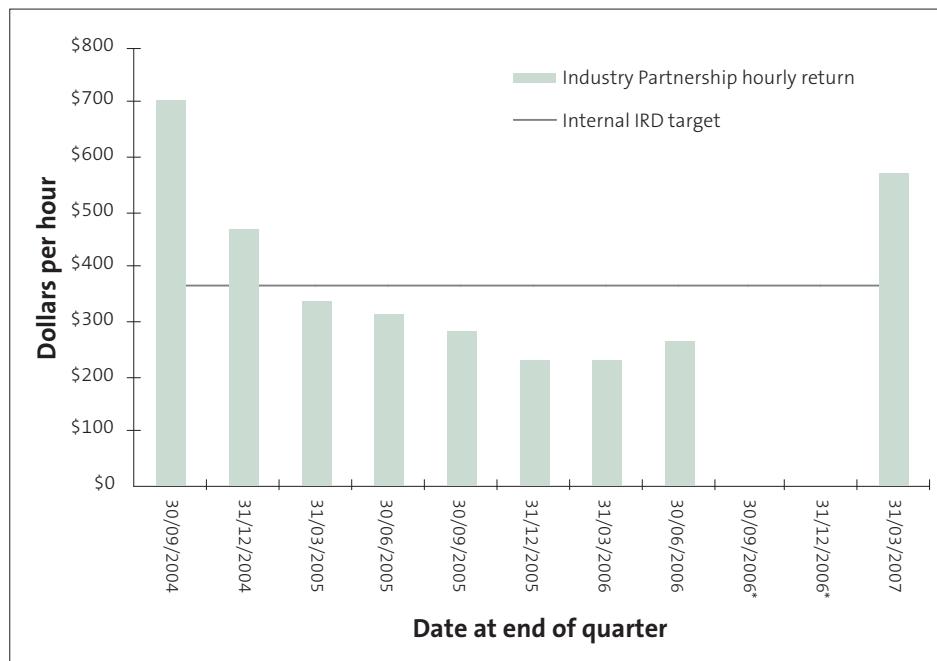
Source: Inland Revenue Department's 2004 Annual Report.

- 4.29 In its 2005 Annual Report, IRD identified trends in tax compliance in the eight industries covered by the programme as at the end of June 2005. The report indicated a reduction in debt cases and outstanding returns in these industries during the life of the programme. The report showed that, between May 2002 and June 2005:
- the value of outstanding tax debt decreased by 5%;
  - the number of debt cases decreased by 24%; and
  - the number of outstanding returns decreased by 19%.

### Audit returns

- 4.30 The hourly rates of return for investigation of Industry Partnership evasion cases are shown in Figure 8 from 2004 to 2007. For some of this period, the rates of return were below the internal benchmark set by IRD. At the beginning and end of the period, the rates of return exceeded the internal benchmark. Rates of return for investigation of evasion cases within Industry Partnership industries have continued to be recorded by IRD after the end of the programme.<sup>2</sup>

**Figure 8**  
Hourly rates of return on Industry Partnership programme investigation of evasion cases, 2004 to 2007



\* The Department did not provide us with data as at 30 September 2006 or 31 December 2006.

Source: Inland Revenue Department.

2 IRD's reporting of rates of return takes into account only the additional tax identified for up to and including the next tax period. At the time of our audit, IRD was developing a process for measuring the dollar value of future tax outcomes (that is, outcomes beyond the next tax period).

## Prosecutions

- 4.31 Information IRD provided to us showed that, between 1 July 2002 and 30 June 2005, it classified 38 of 45 prosecutions of Industry Partnership taxpayers as successful. The same information indicated that these 45 prosecutions were one-third of the total prosecutions taken by IRD during the same period. The breakdown of successful Industry Partnership prosecutions by industry type is shown in Figure 9. Half the successful prosecutions were of agricultural contractors.
- 4.32 IRD sought opportunities, where possible, to get media coverage of successful prosecutions as part of the programme.

**Figure 9**

**Breakdown of successful Industry Partnership programme prosecutions 2002/03 to 2004/05, by industry**

Industry	Prosecutions	
	Number	%
Bricklaying	1	3
Drainlayers	1	3
Electrical Services	1	3
Hair and Beauty	1	3
Landscapers	1	3
Painters and Decorators	1	3
Transport	1	3
Automotive Repairs	2	5
Plastering and Ceilings	2	5
Carpenters	8	21
Agricultural Contractors	19	50
<b>Total</b>	<b>38</b>	<b>100</b>

Note: This includes prosecutions that started before the programme but were successfully completed during the life of the programme. Prosecutions have been included where IRD's information shows that the prosecution relates to an Industry Partnership industry, the prosecution has been successful, and IRD has categorised the prosecution within one of the 2002/03 to 2004/05 financial years.

Source: Inland Revenue Department.

- 4.33 The value of tax discrepancies identified by the successful prosecution of Industry Partnership taxpayers up to 30 June 2005 was \$6.241 million. This was 55% of the total discrepancies covered by all of IRD's successful prosecutions over the same period. It is important to note that identification of the value of discrepancies does not mean that all of these discrepancies are recovered.

## Industry perceptions

- 4.34 In 2004, two years after launching the programme, IRD evaluated the effectiveness of its partnership with two industries with which it had the longest relationship. This research, based on a small number of interviews and focusing specifically on the programme, was compared with the results of a broader community perceptions survey which interviewed a sample of 300 members from the two industry groups. The results for the target industries were assessed against the perceptions of small businesses as a broad group, to identify the impacts of the programme.
- 4.35 This research concluded that the programme had been well received by the two industry groups, and that there were several areas where it had made a positive contribution towards compliance and a change in attitude towards IRD.
- 4.36 The response from the industry representatives we spoke to was positive. We found evidence that the programme was successful in creating a more positive perception of IRD as approachable and willing to help. The IRD's partnership approach was also consistent with the desire of the industry bodies to create a fairer and consistent competitive business environment through tax compliance, and to promote the perceived integrity of their members in the community.
- 4.37 IRD has concluded that the programme "altered the business community's view of [IRD] and generated much goodwill".

## Other results

- 4.38 We saw some evidence that people within Industry Partnership industries, but outside the tax system, were brought within the tax system through the programme. We did not see any systematic analysis by IRD of the number of new taxpayers attributable to the programme.
- 4.39 IRD staff told us that the programme had led to better awareness among taxpayers of a variety of tax matters (such as child support obligations and Kiwisaver). While these matters do not explicitly relate to the cash economy, they are potential benefits of the programme.
- 4.40 IRD learnt from the programme about the effectiveness of a number of approaches and initiatives for managing relationships with industries and targeting the cash economy.

## Data accuracy and analysis

### Data accuracy

- 4.41 IRD had a good understanding of factors that have affected the quality of data within its information systems. This includes the quality of taxpayers' records and the quality of time and activity reporting against the programme. We have not attempted to verify the individual effect of each of these factors. The factors identified by IRD include:
- time constraint targets for call centres;
  - a system that permits the entry of invalid data;
  - reduced customer contact with IRD as a whole, resulting in more outdated contact data;
  - use of incorrect project codes when opening and closing cases;
  - problematic reporting of time spent on programme investigations work;
  - an ACC decommissioning project (this affects industry coding); and
  - data cleansing.

### Trend analysis

- 4.42 The findings of IRD's analysis of trends, as reported in public documents, could have been better qualified. This is because the stated information attributes all of the reported changes in a measure (for example, the percentage of programme taxpayers in debt) to the programme when this was not the case.
- 4.43 Early in the programme, IRD carried out a lot of data cleansing. It included removing inaccurate records of taxpayers. Doing so changed the size of the population of a given Industry Partnership industry within IRD's information system. For example, during 2002/03 IRD removed 2032 records (about 10%) from the population of electricians, painters, and decorators. These 2032 records were then counted as part of the reduction in the number of electricians, painters, and decorators owing tax debt. There were similar issues with the reported results of the programme in terms of taxpayers with outstanding tax returns.
- 4.44 Other non-programme effects may also be reflected in the reported results. As the Canadian Revenue Authority has stated about tax compliance behaviour in general:

*Compliance is sensitive to many factors, such as perception of government, values held by society, the economy, legislation, as well as the public's perception of our tax system ... measures demonstrate the effectiveness of our approach to fostering compliance with tax laws, but also reflect the willingness of taxpayers to meet their own obligations without our intervention.<sup>3</sup>*

<sup>3</sup> Canadian Revenue Agency, *Annual Report to Parliament 2005-2006*.

- 4.45 We were unable to replicate IRD's historical information because the IRD's information system is live. This means records are added or removed from it over time. We cannot assess whether the records removed by IRD as part of its data cleansing had the same or similar characteristics to those of the remaining records for taxpayers in Industry Partnership industries. If the removed records had the same distributions of tax debt or outstanding tax returns, then the information made publicly available by IRD about these attributes of the programme overstates the results of the programme.
- 4.46 IRD was aware of issues with attributing to the programme all of the observed change in an Industry Partnership industry.
- 4.47 IRD needs to be more careful when quoting the results of a programme publicly in instances where there are influences on the results outside the programme. In these situations, we believe IRD should qualify the data so that any attribution limits are clear. In our view, IRD should give special attention to this as it develops a monitoring and evaluation framework and subsequently reports on the results of the Customer Insight Group's work.

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### **Recommendation 2**

We recommend that the Inland Revenue Department identify, as part of reporting on the results of a specific programme or initiative that may be affected by a range of variables, those factors contributing to the results that are not attributable solely to the programme or initiative.

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- 4.48 IRD has told us that the data cleansing work carried out as part of the programme gave it a better understanding of data quality issues and has influenced IRD's subsequent data integrity work.

### **Ratio analysis**

- 4.49 Over time, IRD's ratio analysis will become less reliable. This is because it depends on similar industry groups against which to compare Industry Partnership industries. The technical term for such a comparison industry is a control group. Because control groups were generally broader groupings of industries aligned with a given Industry Partnership industry, there was a risk that the control groups become "tainted" by the Industry Partnership effects. IRD recognised this risk. We did not find evidence of IRD having tested for "tainting" of control groups for the two financial years for which the ratio analysis approach was used, but it had identified "tainting" over time as a risk.

## Using the monitoring and evaluation results

- 4.50 IRD used a set of high-level programme objectives in key documents. However, analysis in these documents was not always explicitly linked to the high-level objectives. Monitoring and evaluation could have been more clearly linked to the high-level objectives.
- 4.51 At a sub-programme level, monitoring and evaluation activities were not in a structured framework. IRD attempted to address this issue during the programme by requiring a template to be completed before any field initiative could start. The template required information on how the initiative would be monitored and evaluated.
- 4.52 There was some evidence of the results of monitoring and evaluation having been fed back into the design, implementation, and management of the programme. For example, suggestions were made to IRD's business initiatives governance board about changes that could be made to IRD's organisation-wide business as a result of the lessons learned from the programme.
- 4.53 IRD reviewed its own feedback mechanisms for the programme. In 2005, IRD's Risk and Assurance section concluded that "processes observed for identifying improvements to the relationships and providing feedback to enhance future partnerships' successes are effective".
- 4.54 While there has been a lot of monitoring, evaluation, and feedback into aspects of programme design, management, and implementation, IRD is not yet at the stage where it can make definitive decisions about the right mix of education and compliance activities for a given operational situation.
- 4.55 A number of IRD staff told us that the programme has had a major influence on the design and existence of the new Customer Insight Group. We have not examined the link between the design of the new group and the programme. However, the new group and the programme do have a number of common features, including helping and understanding the needs of customers and enhancing customer relationships.

## Comparable tax measures

- 4.56 IRD's voluntary compliance model and the programme are similar to approaches taken by the Australian Tax Office, although IRD told us that its programme had a stronger focus on relationships. IRD's Customer Insight approach is similar to an approach being used by HM Revenue and Customs in the United Kingdom.
- 4.57 Early in the programme, IRD contacted other tax jurisdictions about how they measured the hidden economy.

- 4.58 The tax measures used by IRD for the programme are broadly consistent with those used in Australia and Canada. They were also consistent with an approach recommended by the Australian National Audit Office for the Australian Tax Office for work on the cash economy.
- 4.59 The Australian National Audit Office recommended that the Australian Tax Office measure:
- the underlying movements in revenue collection (controlled for impacts outside the tax authority's work);
  - the change in attitude of industry participants and consumers over time; and
  - the tax payments of treated entities compared with those of non-treated entities (that is, outside the programme of work being measured).
- 4.60 IRD has used all three of these approaches, but has not been able to exclude non-IRD influences on underlying movements in revenue collection when carrying out trend analyses. While IRD was not able to exclude non-IRD influences on revenue collection, it sought and used expert advice. In our view, IRD took appropriate steps to address this issue.

## Part 5

# Achieving the programme's objectives

- 5.1 In this Part, we outline our assessment of the extent to which the programme achieved its high-level objectives.

### Programme objectives

- 5.2 In the main, IRD's programme high-level objectives were achieved. The exception was directing audit resources toward the highest risk cases within selected industries, which was only partly achieved. IRD could have given greater attention to bringing into the tax system those high-risk people and organisations not declaring cash incomes. This might have led to the collection of more tax revenue.
- 5.3 The high-level objectives set by IRD for the programme did not have definitive targets. A positive trend in the measure/s for a given objective could therefore be assessed as achieving the objective.
- 5.4 At the project initiation stage, IRD identified key indicators and measures, but not targets, for each high-level objective. It would have been useful for IRD to have used ongoing targets in the programme. IRD told us that at the beginning of the programme it deliberately did not set targets because there would be "no science attached" to them, given the lack of programme history.
- 5.5 In our view, as the programme evolved during its five-year life, IRD needed to set measurable targets for assessing the achievement of specific high-level objectives for the programme. This would have enabled an assessment of the programme's success and informed consideration of the structural and resource options for applying the programme's approach throughout the organisation. However, we note that IRD did set targets for the various operational activities carried out as part of the programme.
- 5.6 Voluntary compliance levels within selected industries have increased during the life of the programme. However, it is not possible to definitively attribute these changes to the programme. Our assessment is that this high-level objective has been achieved, within the constraints of the information available.
- 5.7 The programme has increased IRD's presence in the community. It has also improved the community's perception of IRD as a professional organisation. Both of these high-level objectives have been achieved.
- 5.8 The programme has directed audit resources toward the highest risk cases within selected industries that were identified largely from IRD's existing information on taxpayers. For this reason, it may not have effectively targeted the highest risk cases – those outside the tax system.

- 5.9 IRD has noted that the programme has had limited success in identifying people outside the tax system and has not produced the compliance opportunities that IRD envisaged. We were also told that some industries were targeted on the basis of "quick wins", something that is not necessarily related to the highest risk.
- 5.10 Given both our own and IRD's assessment, we have concluded that the high-level objective to direct audit resources toward the highest risk cases within selected industries has been only partly achieved.
- 5.11 As noted earlier in this report, the CCA role within the Customer Insight Group is meant to find high-risk cases outside the tax system. IRD is giving more attention to this issue, and to the hidden economy as a whole, than it did during the programme.
- 5.12 We were told that IRD's Risk and Intelligence section focuses on people outside the tax system and should enable IRD to better address the highest risk cases.

### Tax collection

- 5.13 Given that the programme did not fully target the highest risk cases within selected industries, it is likely that the programme did not increase the amount of tax revenue collected as was theoretically possible. However, because the size of the hidden economy is not known, it is not possible to identify how much more tax might have been collected.
- 5.14 Given some uncertainties about both the size of the hidden economy and the interventions that might work to address issues within it, the learning approach taken by IRD was generally logical and defensible. The approach was also supported by monitoring and evaluation.

### Overall achievement

- 5.15 Overall, the programme had some positive benefits for IRD and taxpayers, and has helped inform attention being given to the hidden economy within IRD's new Customer Insight Group.





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