

Indicators concerning the taxpayer's external and internal risk environment

Introduction

Tax examiners and auditors should be aware that detecting possible corruption begins as early as at the assignment of the file and before field work begins. Both tax examiners and auditors should, as with any other file, familiarise themselves with the particulars of the taxpayer's business and its industry.

Once in the field, before a tax auditor can decide whether corruption may be present, he or she should perform a thorough review of the taxpayer's business environment, a tour of the business premises and an in depth review of the taxpayer's records. Only by doing so, will the tax auditor be able to obtain a clear picture of the taxpayer's transactions and how stakeholders might be involved in corruption. In terms of the business environment, the tax auditor needs to determine the strengths of the taxpayer's internal controls and assess if possibilities exist for the owners or management to pay bribes without detection.

The tax auditor can use the tour of premises and time spent on site to note the presence of any indicators of possible bribery or corruption. By asking questions relevant to their tax enquiries with respect to who negotiates and signs contracts and authorises payments, the tax auditor may be able to identify weaknesses in controls and opportunities for corruption. By connecting the dots, for example from a review of expense accounts typically used in bribery transactions, identifying the key players in the transactions and any relationships between them, questioning the use of an intermediary such as a consultant, reviewing contracts and the value of goods transferred, reviewing correspondence, banking records, travel logs, other key documents and by perhaps using information external to the taxpayer's records, the tax auditor can be comfortable that payments should be disallowed, subject to their domestic tax laws.

Indicators

Indicators concerning the taxpayer's external risk environment

- Operates in, or is related to companies operating in, a high risk country.¹
- Operates in a high risk industry,² such as:
 - ◆ Public works and construction
 - ◆ Utilities
 - ◆ Real estate, property, legal and business services
 - ◆ Oil and Gas
 - ◆ Mining
 - ◆ Power generation and transmission
 - ◆ Pharmaceutical and healthcare
- Operates in a highly regulated sector, or one which requires government authorisations and licenses.

Indicators concerning the taxpayer's internal risk environment

Indicators concerning the taxpayer's legal structure and connections

- Complex or international legal structure with no apparent commercial, legal or tax benefits.
- Owns or controls a legal entity with little or no commercial purpose, particularly one located offshore.
- Employs, or has business connections with, close relatives of the owner or senior management.
- Employs, or has business connections with, Politically Exposed Persons (PEPs) or relatives of PEPs.

Indicators concerning the taxpayer's internal controls

- Management has a lax or non-existent anti-corruption philosophy and regime.
- Few or no internal controls in place, such as an independent internal audit function, to detect and deter corruption.
- Weak controls over the hiring and use of consultants.

Indicators concerning the taxpayer's background and history

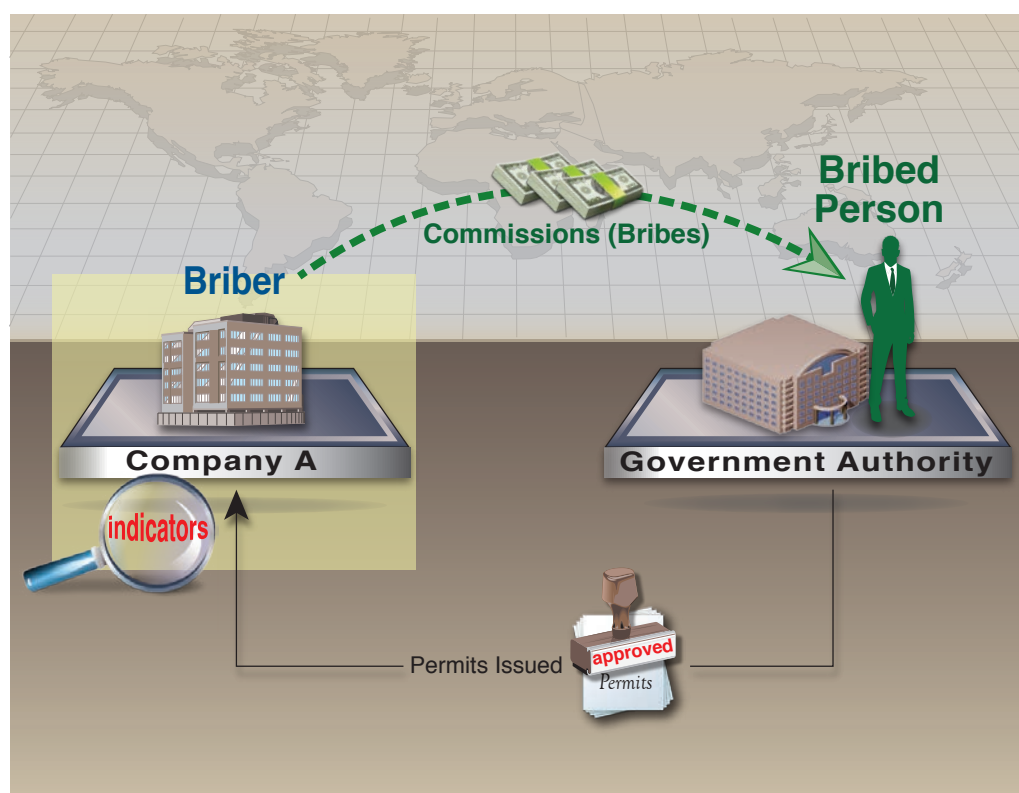
- Previously faced suspicions or litigation concerning any kind of financial crime.

Indicators concerning attempts to impact the tax examination or audit

- Attempts to influence the tax examiner or auditor, including by offering a bribe.
- Attempts to hinder the tax examination or audit, for example by refusing to answer questions or withholding financial information or correspondence.

Examples

Operations in a high risk country

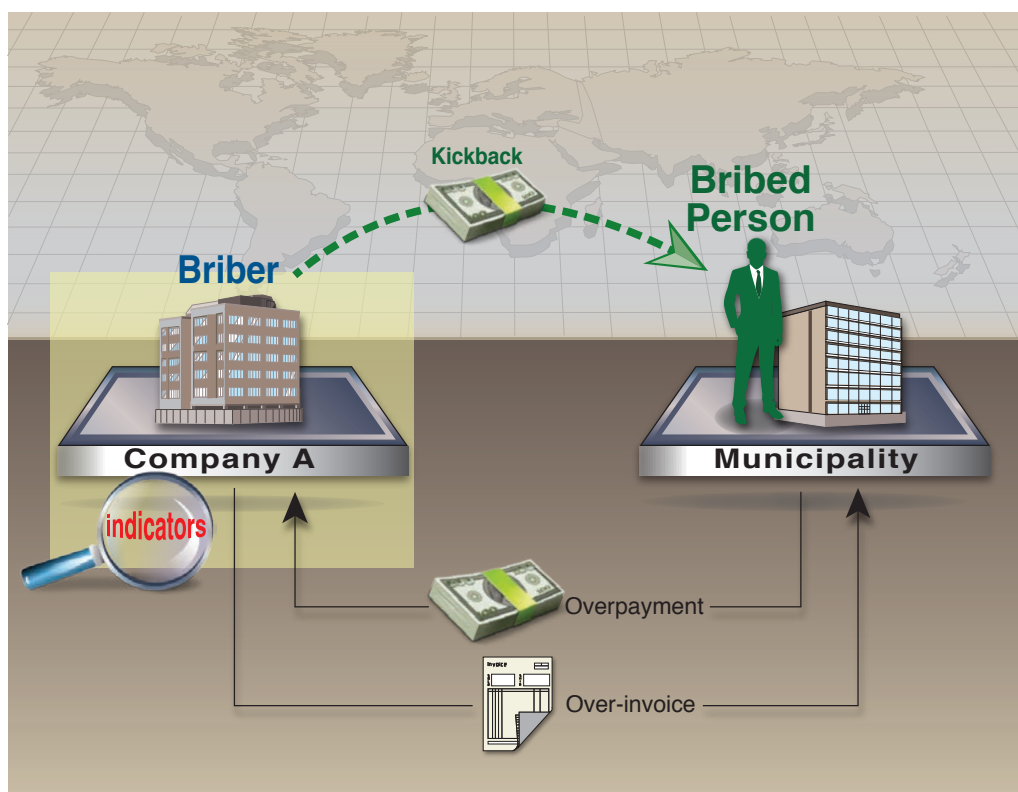


Company A (Briber) was a construction company building a large scale industrial facility in Country X, which has a very low score on the Transparency International Corruption Perceptions Index. During a tax audit, the tax auditor discovered cash payments described as “commissions” totalling USD 400 000. However, the management of Company A were unable to give a convincing explanation of these large cash payments, and the tax auditor further found that there were no underlying invoices for the payments (the company had used ‘self-prepared vouchers’ to raise the payments). This led to the tax auditor conducting further

enquiries which revealed that, during the course of construction, Company A had needed specialised industrial machinery to be shipped to the work site. This required a delivery permit to be obtained, which Company A knew could take a long time and might be refused. Company A therefore approached officials in the Government Authority (Bribed Person) and offered to pay cash bribes in return for them issuing the permit promptly.

In this case, the key indicator that caused the tax auditor to suspect possible corruption was that Company A was undertaking a large project in a high risk country. Other indicators included the fact that Company A was operating in a sector which required government licences, large payments were being made in cash, and these payments were made on the basis of self-prepared vouchers.

Business connections with a close relative



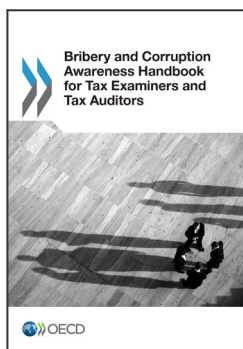
A Municipality is one of the largest customers of a small painting company, Company A (Briber). During a tax audit of Company A, the auditor discovered evidence that the amount of paint being used by the company on its work for the Municipality was much lower than the contracts would suggest, and its gross profit was significantly higher than would be expected within the industry, indicating that the company may be over-invoicing for this work.

As a result, the tax auditor decided to perform a third party check at the Municipality, which revealed that the painting contracts were being granted by an employee (Bribed Person) who was also a close relative of the owner of Company A. The tax auditor referred these suspicions to the appropriate law enforcement authority, which initiated a criminal investigation. This investigation revealed that the Municipality had no effective controls in place to ensure independence in the awarding of contracts and the same employee had also granted other contracts to friends and relatives. The criminal investigation uncovered that some of the money paid by the Municipality to Company A was being paid back to the municipal employee as kickbacks. Based on the results of the criminal investigation, a prosecution was brought for corruption and organised crimes, which resulted in a number of convictions.

In this case, the key indicator that caused the tax auditor to suspect possible corruption was the fact that municipal contracts were being granted to Company A by a close relative of the company's owner. Other indicators included Company A's very high gross profit margin on contracts with one particular customer, these contracts were approved by a single individual, and the lack of public tenders for the contracts.

Notes

1. High risk countries include those which do not engage in effective exchange of information, have a low score on the Transparency International Corruption Perceptions Index or Bribe Payers Index, or have a high score on the Tax Justice Network Financial Secrecy Index.
2. High risk industries include those with a low score on the Transparency International Bribe Payers Index. The list of industries included above achieved low scores in the 2011 index.



From:

Bribery and Corruption Awareness Handbook for Tax Examiners and Tax Auditors

Access the complete publication at:

<https://doi.org/10.1787/9789264205376-en>

Please cite this chapter as:

OECD (2013), “Indicators concerning the taxpayer’s external and internal risk environment”, in *Bribery and Corruption Awareness Handbook for Tax Examiners and Tax Auditors*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/9789264205376-7-en>

This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

You can copy, download or print OECD content for your own use, and you can include excerpts from OECD publications, databases and multimedia products in your own documents, presentations, blogs, websites and teaching materials, provided that suitable acknowledgment of OECD as source and copyright owner is given. All requests for public or commercial use and translation rights should be submitted to rights@oecd.org. Requests for permission to photocopy portions of this material for public or commercial use shall be addressed directly to the Copyright Clearance Center (CCC) at info@copyright.com or the Centre français d’exploitation du droit de copie (CFC) at contact@cfcopies.com.