

The Auditor-General
Audit Report No.54 2011–12
Performance Audit

The Engagement of External Debt Collection Agencies

Australian Taxation Office

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of Australia 2012

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Canberra ACT
27 June 2012

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Australian Taxation Office with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit and the accompanying brochure to the Parliament. The report is titled *The Engagement of External Debt Collection Agencies*.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely



Ian McPhee
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office (ANAO). The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act* 1997 to undertake performance audits, financial statement audits and assurance reviews of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Australian Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Abbreviations

ASB	Assisting Small Business
BAU	business as usual
BCPs	business continuity plans
COAs	Certificates of Assurance
DBL	Debt business line
DCEP	Debt Collection Enhancement Program
DEM	Debt Executive Management
DRST	Debt Referral Support Team
ECA	external collection agency
EDC	Extended Debt Collection
GFC	global financial crisis
ICT	information and communications technology
OSPERT	Operations Sub Plan Enterprise Reporting Team
PMU	Production Management Unit
SPS	Security Policy and Services (branch)
TA	Trusted Access (branch)

Summary and Recommendations

Summary

Background and context

1. The Australian Taxation Office (ATO) has responsibility for administering Australia's tax and superannuation systems, and seeks to build confidence in its administration through helping people to understand their rights and obligations, improve ease of compliance and access to benefits, and manage non-compliance with the law.¹ A key factor in maintaining community confidence in the fairness and equity of Australia's tax and superannuation systems is the efficient and effective management of debt.

2. In 2010–11 the ATO collected \$273 billion in net revenue, and at 30 June 2011 managed collectable debt arrears of \$14 billion – that is, debt that is not subject to objection or appeal, or some form of insolvency administration. Prior to 2010–11, the ATO had reported an upward trend in the value of collectable debt in every financial year following the introduction of *A New Tax System* in 2001–02.² Between 2003–04 and 2004–05, collectable debt increased from \$7.5 billion to \$9.6 billion, representing almost 28 per cent growth over the period. This increase was the subject of discussion in the Senate Economics Legislative Committee in June 2004³ and again in February 2005, when the ATO was asked if there were any new strategies to address debt levels.⁴

3. In response, during 2005–06, the ATO restructured its administrative arrangements for the management of debt, establishing the Debt Business Line (DBL) and introduced a number of new approaches to contain and reduce debt

¹ ATO, *Making a difference: The intent behind our strategic statement 2010–15 Booklet*, June 2010, p. 3, available from < <http://www.ato.gov.au/corporate/content.aspx?doc=/content/00244655.htm> > [accessed August 2011].

² ANAO Audit Report No.42 2006–07, *The ATO's Administration of Debt Collection–Micro-business*, June 2007, p. 38. The Report noted there are many more taxpayers in the new tax system than previously and thus many more taxpayers that could potentially fall into tax debt. It also noted the increase in the value of collectable debt coincided with an increase in the level of household and corporate debt in Australia.

³ Economics Legislation Committee, Budget Estimates, *Committee Hansard*, 3 June 2004, p. E172-3. In response to the Committee, the (then) Commissioner of Taxation signalled to the committee that the ATO would be getting firmer with people who were not paying their tax.

⁴ Economics Legislation Committee, Additional Estimates, *Committee Hansard*, 17 February 2005, p. E127-8. In response to the committee, the (then) Commissioner of Taxation indicated that one new strategy was that he had recently taken the decision to devote a substantial number of additional resources to enable the ATO to action more promptly a range of smaller debts.

levels. The ATO also conducted three short pilot programs trialling different approaches to collecting debt, including the use of external collection agencies (ECAs). The three pilot programs were:

- using advanced dialler technology, allowing the ATO to engage with a greater number of taxpayers more efficiently⁵;
- phoning taxpayers after-hours, where previous attempts to contact them had been unsuccessful; and
- between April and May 2006, referring approximately 11 000 selected lower value and aged debt cases to an ECA for collection action.

4. Using advanced dialler technology and contacting clients after hours reflected enhancements to debt management techniques the ATO already used, but referring debts to an ECA was a new approach for the ATO. The ATO considered that the referral of selected debt cases to an external collection agency would provide an effective response to the management of large numbers of low value debts. Collectively these debts represented significant revenue, but individually were low in value and unlikely to be actioned by the ATO.

5. The contact strategy employed by the ECA during the pilot program was a correspondence and telephone based campaign, consisting of an initial demand letter to the taxpayer, and subsequent follow-up letters if the initial correspondence was not answered. Where contact through correspondence was ineffective, taxpayers were then contacted by telephone. The payment arrangement for the ECA consisted of a flat fee per debt case referred, irrespective of the outcome achieved.

6. In September 2006, the ATO completed a post implementation review of the pilot program. The review highlighted challenges for the ATO in expanding the outsourcing⁶ of debt collection beyond the small pilot program,

⁵ Dialler technology is an automated dialling capability for the management of outbound phone calls. It automatically dials numbers from a pre-set list, filtering out numbers that are unanswered, busy or disconnected.

⁶ Outsourcing is the establishment of a contract or arrangement where a person or organisation, external to the participating Commonwealth organisation, performs tasks or provides services that could have been done by Commonwealth employees, regardless as to whether the external provider has undertaken the whole of the function or part thereof.

but found that an ECA could effectively operate on behalf of the ATO and collect outstanding debt.

7. The ATO subsequently conducted a procurement process, and finalised contract negotiations with four ECAs in October 2007, for the provision of debt collection services from 2007–08 to 2010–11. Known as the referral program, debt cases referred to ECAs are those related to income tax, activity statement and superannuation guarantee charge debts, classified by the ATO as lower value, non-complex debts.⁷ In September 2011, following a second procurement process, the ATO established a panel of four ECAs under a Deed of Standing Offer (DoSO)⁸, for the period 2011–12 to 2014–15.

8. The contact strategy set out in the ECAs' contracts and DoSOs was similar to that employed during the pilot program, with a set number of phone calls and letters.⁹ Payment arrangements during the first four year period were based on a flat fee per debt case referred, subject to the type and value of the debt. Under the DoSO, a flat fee arrangement has been retained, although based on the volume of cases referred (rather than the type or value of the case) with lower rates for greater volumes of referred cases.

The ATO's debt management framework

9. The ATO's framework for managing debt focuses on early intervention as aged debt is more difficult and more expensive to follow-up.¹⁰ Firmer action is taken against those taxpayers who make no effort to manage their debt, or who deliberately and consistently engage in behaviours to avoid their tax obligations. In instances where there is greater risk of a debt not being recovered—for example, a business may be considered not to be viable in the longer term—the ATO may take strategic recovery action, including initiating

⁷ A non-complex debt is a debt arising from one type of tax, for example, income tax.

⁸ In a panel arrangement, a deed of standing offer or a contract exists between an agency and each supplier on the panel detailing: the type of property or service the supplier will provide; the set/indicative price for the property or service; and the manner in which in the agency will procure the property or service from the supplier, including any process for competition between panel members, where appropriate.

⁹ Under the first contract period, the ECAs' service offer included a set number of telephone call and letters per debt case referred. Subject to the category and/or value of the case and how quickly the taxpayer engaged with the ECA, ECAs would undertake between two and five telephone calls, and issue between three and five letters. Under the DoSOs, the number of telephone calls and letters issued per debt case has been standardised to three telephone calls and three letters, regardless of the value or category of the debt.

¹⁰ Aged debt is defined by the ATO as debt outstanding for more than two years.

bankruptcy or business wind-up proceedings. The structure of the DBL reflects those three elements of the debt management framework: *early collections*, *firmer action*, and *strategic recovery*.

10. During 2011, over 70 per cent of activity statement and superannuation guarantee charge debt cases referred to ECAs had been outstanding for less than six months. This is consistent with the ATO's *early collections* approach to debt, but reflects a significant change in the age profile of debts from those referred during the pilot program, and since commencement of the contracts with ECAs in 2007. Over time, the value of referred debts has also changed. During the pilot program, the ATO trialled the referral of low value debts (less than \$7500), but within the first year of the ECA contracts (2007–08), higher value debts were also referred. Debts to a maximum value of \$75 000 are now routinely referred for ECA action, and these may increase to \$150 000 as further liabilities are accrued by taxpayers while debts are being managed by ECAs.

11. As at December 2011, just under 1.8 million debt cases with a combined value of approximately \$7 billion have been referred to ECAs. Of this amount, the ECAs have collected just over \$2 billion, or 29.1 per cent of the total debt referred¹¹, at a cost of \$54 million in ECA fees (not including the pilot program).

12. Responsibility for the administration of the ATO's arrangements with ECAs is undertaken by teams within the *early collections* branch of the DBL, with input from other areas across the ATO. The Trusted Access (TA) and Security Policy and Services (SPS) branches provide specific services in relation to the secure management of ATO data by external contractors.

International comparisons

13. In examining the debt management practices of comparable revenue administrations of Organisation of Economic Co-operation and Development (OECD) member countries, a number of different positions are evident. The United Kingdom Government announced, in June 2010, that Her Majesty's Revenue and Customs (HMRC) would continue to use private sector debt collection agencies, following a successful small-scale trial. In contrast, the

¹¹ Payments related to ECA actions are recognised by the use of specific payment codes. From 1 July 2011, following an account sampling exercise, 65.3 per cent of any other payments made to debt cases being managed by ECAs are attributed to ECA activity.

United States of America Inland Revenue Service (IRS) announced in March 2009 that it would not renew its contracts with private collection agencies (three years after it started referring federal taxation accounts in debt). The IRS Commissioner commented that he believed this work was best done by IRS employees. In the same year, the Canada Revenue Agency (CRA) ceased the outsourcing of the collection of defaulted student loans to private collection agencies, an arrangement that had been in place for some 20 years. The CRA decided to action all collection activities in-house as it had the necessary infrastructure in place to collect debts, including a call centre using dialler technology, and considered that it could undertake these activities more cost effectively.

Audit objectives and criteria

14. The objective of the audit was to assess the effectiveness of the ATO's administration of external debt collection arrangements.

15. The ANAO examined whether:

- contractual and administrative arrangements were appropriately planned and executed, and support the ATO's objectives in using the services of external collection agencies;
- the operational strategy for selecting and referring debt cases to external agencies was effective; and
- appropriate performance measures have been developed to monitor and report the services provided by the external agencies.

16. The outsourcing of tax debt collection by the ATO had been raised in two previous ANAO audit reports.¹² In 1999–2000, the ATO had agreed with an ANAO recommendation that the ATO outsource the collection of some tax debt if the evaluation of outsourcing showed that it was cost effective and that compliance with the Taxpayers' Charter would be maintained. ANAO Audit Report No.42 2006–07 noted the ATO's 2006 debt initiatives, including the debt referral pilot, and the ATO's assessment that it had partially implemented the 1999 report's recommendation through the pilot and subsequent evaluation.

¹² ANAO Audit Report No.23 1999–2000 *The Management of Tax Debt Collection*, Canberra 1999, and ANAO Audit Report No.42 2006–07, *The ATO's Administration of Debt Collection—Micro-business*, June 2007.

The ATO sought, and received, funding in the 2007 Budget to pursue the initiative.

Overall conclusion

17. The referral of collectable debt to ECAs was trialled through a pilot program in April 2006, and subsequently fully implemented by the ATO through the establishment of contracts with four ECAs in October 2007. It was one of several new measures to contain and reduce the amount of outstanding collectable debt, which had increased yearly since 2001–02, with the annual rate of increase peaking in 2004–05 at almost 28 per cent. Individually the debt cases referred to ECAs are low in value and unlikely to be actioned by the ATO, but collectively represent significant revenue.

18. The ATO is now in the fifth year of referring lower value, non-complex income tax, activity statement and superannuation guarantee charge debt cases to ECAs for collection action, employing a correspondence and telephone based approach. The initiative provides the ATO with a flexible mechanism to action a workload that would otherwise remain unactioned. During the period of the outsourced arrangements (from October 2007 to 31 December 2011), the ATO has referred just under 1.8 million debt cases, with a combined value of approximately \$7 billion, to the ECAs for collection action. Of this amount, the ECAs have collected just over \$2 billion, or 29.1 per cent of the total debt referred, at a cost of \$54 million in ECA fees.¹³ In approximately 50 per cent of referred cases, ECAs achieve either payment in full, or negotiate payment arrangements with taxpayers.

19. The ECAs have collected a significant amount of debt, generating very few taxpayer complaints and there have been no known breaches in the security of taxpayers' data. At the operational level, the ATO has successfully implemented a comprehensive arrangement that was, at the time, a new approach to collecting tax and superannuation guarantee charge debt. However, at the strategic level, the ATO could more effectively set out how the referral program is integrated with the ATO's broader approach to debt management, and the comparative advantages that underpin the use of ECAs.

¹³ The ATO's contracts with ECAs are based exclusively on a flat fee payment structure. The ATO, as a general principle, does not link debt collection to employee remuneration, and has extended this principal to the arrangement with ECAs. Commission-based pricing has not been used at any stage of the outsourced arrangements.

20. The ATO has effectively established an outsourcing arrangement that ensures taxpayers are treated in the same way whether contacted by the ECA or the ATO (the ATO refers to the 'seamlessness' between taxpayers' engagement with an ECA agent or ATO employee). The ATO has developed administrative processes and systems to support the referral of debt cases to ECAs, and continues to develop elements of the program. These elements include options to provide more timely and accurate updates to ECAs where taxpayers' details have changed since the case was referred; and, of critical importance to the ATO's continued use of ECA services, ensuring measures are fully in place to safeguard the security of taxpayers' data. The ATO had developed a data security framework, but lack of clearly defined roles and responsibilities of key ATO staff in implementing the requirements of the framework reduced the assurance that taxpayers' data was being appropriately managed. Documentation supporting the selection and referral of debts from the ATO's business systems also requires review and updating, to maintain the integrity and consistency of the processes.

21. Since commencement of the outsourced arrangements, the strategy underpinning the referral of debt to ECAs has changed. Initially, the ATO's strategy for the referral program was to target lower value, aged debts, aiming to engage with taxpayers with long outstanding obligations. However, within the first year of the outsourced arrangements, the value of debts selected for referral had increased tenfold, and newer debts, some of them less than three months old, are now routinely referred. This supports the ATO's early intervention approach to debt management, but does not align with the earlier strategy of targeting aged debt, for which the ECAs were initially engaged.

22. The ATO has not clearly defined how the referral program is integrated within the ATO's broader approach to debt management. The ATO's in-house capacity for actioning outstanding debt has significantly improved since 2006, and it now uses many of the modern approaches, including advanced dialler technology, used by private debt collection agencies. The ATO has recognised the need to assess the relative cost comparisons between ECAs and the ATO's equivalent processes, but to date has not established the costs of the outsourcing arrangement and undertaken this comparison.

23. Understanding the comparative costs of the referral program and the ATO's internal processes would support better selection of debt cases for referral, and the management of those that are unresolved by ECA action. The ATO undertakes little analysis on the characteristics of the debt and of the taxpayer that would indicate those cases that:

- are more likely to respond to an ECA;
- finalise as a result of a reminder or demand letter, without the need for telephone follow-up; and
- may self finalise without any follow up collection action.

ECAs are paid a fee per debt case referred and, in around 50 per cent of all debt cases there is no reduction in the level of debt, irrespective of the age, value or category of debt. These cases remain, essentially, lower value cases that the ATO has found it difficult to resource and does not routinely follow-up; and they do not readily fit within the ATO's parameters for *firmer action* or *strategic recovery*. While the ATO is now developing a more comprehensive approach to dealing with these cases, they could have been more effectively managed.¹⁴

24. The ATO does not assess the impact of the referral program on broader debt management measures, namely the reduction in the overall level of debt holdings and changes in taxpayers' compliance behaviour. Both of these measures were identified as part of the ATO's original intent in using outsourced debt collection services. In 2010–11 the level of collectable debt reduced by 4.0 per cent from the previous year (from \$14.7 billion to \$14.1 billion), the first reduction in 10 years.¹⁵ The concerted effort to reduce debt holdings also involved the ATO writing off a total of \$3.8 billion in outstanding debt, compared with \$1.7 billion the previous year.¹⁶ The ATO considers the referral program has contributed to the 2010–11 reduction, but there is no direct measure to assess this. Additionally, the ATO does not measure changes in taxpayers' behaviour as a result of contact by an ECA, or survey the broader community's sentiment about the strategy of engaging ECAs.

25. The ANAO has made three recommendations aimed at improving key aspects of the ATO's administration of the referral program. The first two recommendations are aimed at providing assurance in relation to the secure

¹⁴ Debt cases can remain with an ECA for up to 180 days, before they are retrieved by the ATO. This means that the management of the debt case returns to the ATO.

¹⁵ Commissioner of Taxation's *Annual Report*, 2010–11, p. 51.

¹⁶ The \$3.8 billion was composed of debts that are either irrecoverable at law (bankruptcy or wind-up) or uneconomical to pursue (where cost of recovery exceeds likely collections).

management of taxpayers' information, and the integrity of the ATO's systems and processes for selecting and referring debt cases to ECAs. The third recommendation relates to the better integration of the referral program into the ATO's broader debt management strategy.

Key findings by Chapter

Establishing the outsourcing arrangements (Chapter 2)

26. The ATO conducted a short pilot program in 2005–06, trialling the referral of a small number of debt cases to an ECA. The main intent of the pilot program was to collect sufficient information to assess the effectiveness of using ECAs to supplement the ATO's debt collection activities. Secondary intentions were to:

- reduce the value of debt holdings within the ATO;
- improve ongoing taxpayer compliance; and
- engage taxpayers who had not responded to previous initiatives.

27. The results achieved in the pilot indicated that an ECA could collect taxation debt, but an evaluation of the pilot program identified some risks to the ATO in expanding the arrangements. Specifically, these risks included that there was no available infrastructure to support the secure transfer of large volumes of debt cases, with taxpayers' details, between the ATO and selected ECAs.¹⁷

28. Additionally, the relatively small scale of the pilot program (11 000 cases) supported some measurement of the results achieved by the outsourcing of debt that have not been captured or reported by the ATO following the expansion of the referral program. These include:

- the assessment of any reduction in outstanding debt. The review of the pilot program included that there was a 17.9 per cent reduction in outstanding debt, but this reduction referred only to the total value of the debt cases referred during the pilot; and

¹⁷ The transfer of debt cases during the pilot program had been undertaken by the manual uploading of taxpayers' information on to optical disks, and delivering the disks by hand to the ECA.

- the overall impact of the outsourcing arrangement on taxpayers' compliance behaviour. The review of the pilot program included that 56 per cent of taxpayers remained compliant after their debt case was finalised (noting however, that the review was completed just three months after the end of the pilot program).

These measures were identified as intended outcomes from the ATO's use of ECAs, but to date, the ATO has no arrangements in place that would indicate, even at a general level, any impact the referral program has had on these measures.

29. The piloting and implementation of the outsourcing of debt was undertaken within relatively short timeframes, and many aspects of contract management were not in place at the start of the program, including collection guidelines and performance measures for ECA services. Both the ATO and ECAs commented that the first two years of the program reflected a period of learning, with the ECAs reviewing every aspect of their operations to meet ATO requirements; and the ATO better understanding the services ECAs could deliver.

30. Payment arrangements set out in the ATO's contracts with ECAs reflected a flat fee per debt case referred for the first three months of the contract, before converting to a commission based structure. However, as a general principle, the ATO advised that it does not pay commission for debt collection. Consistent with this principle, the ATO later decided against the commission based approach set out in the ECAs' contracts, and it was not implemented. The ATO did not consider all possible options for paying ECA fees; ECAs are paid a flat fee for each debt referred, irrespective of the outcome achieved. While the ATO did negotiate a reduction in the overall level of fees across the four providers, variations in the prices charged by each provider for delivering essentially the same services continued throughout the four years of the contracts. Price variations are even more pronounced under the new DoSOs, with one provider offering significantly lower prices than the other three.

31. During the first contract, debt cases were allocated fairly evenly between the ECAs, irrespective of any differences in their fees as there was little variation in their performance. The overall amount of work allocated to the ECAs was driven primarily by the funding available to pay those fees. The specific program funding received by the ATO was supplemented by the

transfer of funds from other areas in the DBL, often towards the end of the financial year.

32. In recognition of the fluctuating nature of the funding and the consequences for the amount of work referred to ECAs, the ATO decided to engage providers under a DoSO for the period 2011–12 to 2014–15. These new arrangements will reduce the administrative burden on the ATO as the amount and type of work for ECAs varies—contract variations are more complex than the issuing of official work orders. However, the ATO has not determined an allocation method for sharing work across the panel. Weighing providers' performance and costs (while ensuring the more expensive providers receive enough work to remain viable as panel providers to the ATO), and the overall amount of work that may be available, will require appropriate planning.

33. The management of risks to the secure transfer and management of taxpayer data is fundamental to the success of the debt referral program. While the ATO has final accountability for the security of taxpayers' data, each ECA has contractual responsibilities for implementing appropriate arrangements. Within the ATO, staff managing the referral program utilise the services of two specialised branches:

- the Trusted Access branch that deals with information and communication technology arrangements; and
- the Security Policy and Services branch that has responsibility for the development of strategic and physical security policy.

34. The ATO had developed a framework to safeguard the management of ATO data. However, key elements of the framework have not been fully implemented, including the contractual requirements that ECAs would participate in an annual security review. There was no internal agreement as to where responsibility lay for initiating assurance activity, such as a security review, or for addressing identified issues within an agreed timeframe. The roles and responsibilities between the relevant branches evolved over the contract, and would benefit from further definition so that the required assurance regarding the security and management of taxpayers' information is provided.

Operational strategy (Chapter 3)

35. The ATO transfers debt cases to and from ECAs on a weekly cycle, and with the transmission, includes updates to cases already under ECA

management. However, for a range of reasons, the information may be out-of-date when ECAs contact taxpayers, reducing taxpayers' confidence in the authenticity of the call, and the standard of the service provided by the ECA. To assist in this regard, the ATO maintains a team of around six staff to respond to in-bound calls from ECAs. Referred to as the Debt Referral Support Team (DRST), it has been in place since the commencement of the contracts with ECAs in 2007–08. However, data on the number and nature of inbound calls is only available from July 2009. The ANAO's analysis of this data indicates that four enquiry categories¹⁸, generally relating to account balance and other account detail issues, comprise the majority of inbound calls to the DRST. The ATO estimates that approximately 80 per cent are routine enquiries for information that is necessary to undertake debt collection activity. The DBL has developed several options to address this inefficiency, but these have not been progressed.

36. The profile of debt cases referred to ECAs has changed since commencement of the referral program, but they remain predominantly lower value cases that the ATO would not otherwise action. Cases that are still outstanding when they are retrieved by the ATO often remain in this category, and do not fall within the parameters for other debt treatments, including firmer action or strategic recovery. The ATO has taken an intermittent approach to the management of retrieved cases, and may refer the cases to another ECA for replication of the collection action, where no result has been achieved from the first referral. The ATO continues to explore different ways to deal with these cases, but could have better planned for their management in the original design of the program.

37. The ATO selects debt cases for referral from two business systems: activity statement and superannuation guarantee charge debt cases from the Legacy system, and income tax cases from the Enterprise system. The processes supporting the selection and referral of cases for ECAs from these systems are different: those for the Enterprise system are relatively simple in comparison to the requirements for the older Legacy system. Documentation

¹⁸ The four enquiry categories that account for the majority of inbound calls to the DRST are: account balance enquiry—relating to the current balance that is owed, as well as the nature of the debt; account enquiry (other)—not related to the account balance, for example, bank details for the taxpayer; payment enquiry—relating to the last payment received by the ATO, and the method of payment; and contact details required—taxpayer's contact details are incomplete or out of date.

setting out the processes for both systems is incomplete, and further work is required to develop comprehensive documentation to support consistency and the integrity of the referral program.

Performance management (Chapter 4)

38. Over the term of the referral program the ATO has refined and implemented a range of performance measures and reporting requirements to assess the performance of contracted ECAs. The ATO, in co-operation with the contracted ECAs, has developed and implemented a scorecard to assess ECA performance. The scorecard is based on requirements set out in ECA contracts and collection guidelines and is prepared on a quarterly basis. The scorecard results for 2009–10 to 2010–11 show marginal differences in ECA performance, with specific scores being extended by up to three decimal points to differentiate between ECAs. The purpose of each of the performance categories in the scorecard is not clearly defined, and undertaking the quarterly performance process involves considerable time and effort by both ECA and ATO staff. There would be merit in the ATO reviewing the scorecard to provide assurance that it is an effective mechanism for measuring ECA performance.

39. The ATO advised that one of the main reasons for using the scorecard to monitor ECA performance is to drive competition between ECAs. However, the contractual arrangement effectively positions ECAs as an extension of the ATO's operations; all ECAs provide the same services as the ATO. This 'seamlessness' may impact on performance outcomes by limiting any specific expertise the ECAs could apply to the collection of tax and superannuation debt.

40. The ATO does not set out specific objectives for the referral program. The success of the outsourcing initiative is based on the projected number of debt cases that may be referred to the ECAs each year, and the estimated amount of debt they could be expected to collect. The expected number of cases to be referred to ECAs, and the amounts collected, were overtaken within the first few months of the program's operation. The figures were not revised throughout the first contract period (2007–08 to 2010–11) to reflect this situation. Over these four years, the original collection target for ECAs was \$310 million, based on the referral of less than 700 000 cases. However,

approximately 1.6 million cases were actually referred resulting in actual ECA collections of more than \$1.1 billion¹⁹, exceeding the target by more than 290 per cent.

41. The ATO produces several reports on the results achieved by the ECAs, but none provide a comprehensive view of the broader impact of the referral program, or of its total costs. The high value of the reported collection results may mask and reduce the business imperative to do so, including to compare the costs of the program with in-house activities. Since the 2006 pilot program, the ATO has implemented a range of new debt collection approaches, including the use of dialler technology developed in the private sector. Evaluating the program in a comprehensive way could encourage achievement of further efficiencies in the ATO's processes.

Summary of agency response

42. The ATO provided the following summary comment to the audit report:

The ATO welcomes the recognition by the ANAO of the evolving nature of the debt referral program. The ATO continues to pursue contemporary approaches in the management and collection of debt, providing support and assistance to taxpayers willing to work with us to manage their outstanding tax and superannuation debt. This support includes the earlier initiative to offer general interest charge free payment arrangements to assist taxpayers manage through the global financial crisis.

The ATO recognises that its ability to influence (and measure) payment compliance behaviour must be considered in the wider context of the many factors that impact on a taxpayer's ability and willingness to meet tax and superannuation obligations in an ever-changing environment. We will continue to take a differentiated approach by considering individual taxpayer circumstances as this is consistent with the broader ATO approaches and underpins our enhanced collection program. This includes taking appropriate action where taxpayers are unwilling to work with us or are no longer viable. The ATO is committed to continuous improvement and recognises the review highlights several opportunities to strengthen and further improve the

¹⁹ The collection amount of \$1.1 billion is for the period 2007–08 to 2010–11 only and excludes \$200 million in collections achieved by the ECAs but assigned by the ATO to the ATO's 'dialler' teams and \$684 million in collections for the first six months of this financial year, 1 July to 31 December 2011.

management of the program, with an emphasis on increased analysis and evaluation of costs to enhance our decision making processes.

The ATO agrees with the three recommendations contained in the review.

43. ATO's full response is included at Appendix 1 of the report.

Recommendations

Set out below are the ANAO's recommendations and the ATO's abbreviated responses. The ATO's response to each recommendation is included in the body of the report, immediately following each recommendation.

Recommendation No.1 To provide assurance that taxpayers' information for the referral program is being adequately protected, the

Paragraph 2.93

ANAO recommends that the ATO:

- clearly defines the respective roles and responsibilities of the Debt business line and the Trusted Access branch and the Security Policy and Services branch; and
- implements all elements of the security framework, particularly the scheduling of reviews, and the completion of Certificates of Assurance and other requirements as set out in the Deeds of Standing Offer with the ECAs.

ATO Response: Agreed

Recommendation No.2 To maintain integrity and consistency in the processes for selecting and referring debt cases to external

Paragraph 3.50

collection agencies, the ANAO recommends that the ATO reviews and updates the Legacy and Enterprise systems and procedural documentation.

ATO Response: Agreed

**Recommendation
No.3**

Paragraph 4.55

In recognising the evolving nature of the referral program, the ANAO recommends that the ATO:

- establishes the relative costs of the use of external collection agencies and the ATO's internal processes;
- improves analysis to support the selection of debt cases for referral; and
- clarifies the program's position in relation to the broader debt management framework.

ATO Response: Agreed

Audit Findings

1. Background and Context

1.1 The Australian Taxation Office (ATO) is responsible for administering Australia's tax and superannuation systems, and seeks to build confidence in its administration through helping people to understand their rights and obligations, improve ease of compliance and access to benefits, and manage non-compliance with the law.²⁰

1.2 The ATO's Strategic Statement 2010–15 and supporting documentation set out its corporate vision and strategic themes, including to deter, detect and deal with those who have not complied with their tax and superannuation obligations.²¹ An important component of this strategy, and a key factor in maintaining community confidence in the fairness and equity of Australia's tax and superannuation systems, is the efficient and effective management of debt.

Tax and superannuation debt in Australia

1.3 In 2010–11 the ATO collected \$273 billion in net revenue. A further \$14 billion of collectable debt—that is, debt that was not subject to objection or appeal, or some form of insolvency administration—was outstanding as at 30 June 2011. The major components of this debt were:

- Activity Statement debt, \$8.2 billion;
- Income Tax debt, \$5.5 billion; and
- Superannuation Guarantee Charge debt, \$0.3 billion.²²

1.4 While a portion of this debt accrued in 2010–11, the age of the debt varies, with around \$2 billion being outstanding for two or more years.²³ Businesses operating in the micro enterprises market segment (those with an annual turnover below \$2 million) typically account for around two thirds of

²⁰ ATO, *Making a difference: The intent behind our strategic statement 2010–15 Booklet*, June 2010, p. 3, available from <<http://www.ato.gov.au/corporate/content.aspx?doc=/content/00244655.htm>> [accessed August 2011].

²¹ *ibid.*, p. 4.

²² Commissioner of Taxation, *Annual Report 2010–11*, Australian Taxation Office, Canberra, 2011, p. 51.

²³ ATO advice, 2 March 2012.

total debt holdings. As at 30 June 2011, this market segment accounted for 65.6 per cent of total collectable debt.

Trends in the level of collectable debt

1.5 Since the introduction of *A New Tax System* in 2001–02, the ATO has reported an upward trend in the value of collectable debt in all but one financial year, 2010–11.²⁴ Between 2003–04 and 2004–05, collectable debt increased from \$7.5 billion to \$9.6 billion, representing almost 28 per cent growth over the period. In the Commissioner of Taxation’s Annual Report 2004–05, the management of debt was recognised as a particular area of focus, with the Commissioner stating that:

During the year we adopted new strategies and increased the resources devoted to debt collection. It is clear that more will need to be done in the coming year.²⁵

1.6 Table 1.1 sets out the total net revenue collected by the ATO and total collectable debt for each year, from 2001–02 to 2010–11.

²⁴ ANAO Audit Report No.42 2006–07, *The ATO’s Administration of Debt Collection—Micro-business*, June 2007, p. 38. The Report noted there are many more taxpayers in the new tax system than previously and thus many more taxpayers that could potentially fall into tax debt. It also noted the increase in the value of collectable debt coincided with an increase in the level of household and corporate debt in Australia.

²⁵ Commissioner of Taxation, *Annual Report 2004–05*, Australian Taxation Office, Canberra, 2005, p. 9.

Table 1.1**Revenue and collectable debt for the period 2001–02 to 2010–11**

Year	Total net revenue (\$b)	Collectable debt (\$b)	% of Collectable debt to revenue	% Growth in collectable debt	Number of debt cases (million)
2001–02	168.60	5.49	3.25	25.68	1.21
2002–03	185.04	6.90	3.72	9.13	1.32
2003–04	198.73	7.53	3.79	9.00	1.43
2004–05	215.00	9.61	4.46	27.62	1.49
2005–06	232.65	10.20	4.38	6.13	1.54
2006–07	250.01	10.78	4.31	5.68	1.54
2007–08	270.86	10.89	4.02	1.02	1.31
2008–09	264.53	12.15	4.59	11.57	1.34
2009–10	253.19	14.70	5.81	21.00	1.48
2010–11	273.00	14.10	5.20	- 4.00	1.46

Source: ATO information published in the Commissioner of Taxation's Annual Reports.

1.7 The impact of the global financial crisis (GFC) on the Australian economy resulted in decreases in net revenue in 2008–09 and 2009–10, and a further increase in the level of collectable debt. Businesses had responded very quickly to the GFC by slashing production and running down inventories. In the December quarter 2008, Australian businesses ran down their stocks by \$3.4 billion (in real terms), the largest fall on record.²⁶ In response to the stressed business environment created by the GFC, the ATO introduced a number of measures to assist personal and business taxpayers to manage their debt and, where viable, allow them to continue to trade.²⁷ Figure 1.1 shows the percentage movements in collectable debt for the period 2001–02 to 2010–11, broadly reflecting the period of growth in collectable debt following the

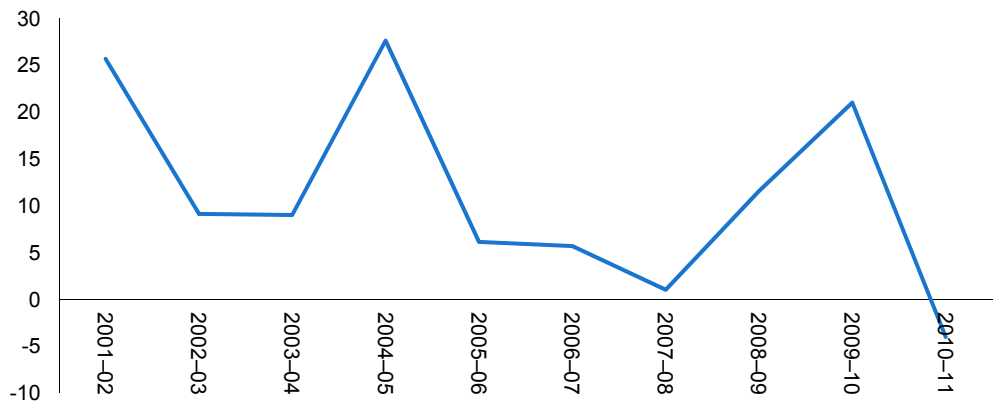
²⁶ Dr Steven Kennedy, *Australia's response to the global financial crisis*, Department of the Treasury, 24 June 2009, p. 4, available from <http://www.treasury.gov.au/contentitem.asp?NavId=&ContentID=1576> [accessed 26 August 2011].

²⁷ The ATO advised that measures included negotiating flexible payment arrangements aligned with taxpayers' cash flows, and establishing a specialist team to assist taxpayers experiencing serious hardship.

introduction of *A New Tax System*, the ATO’s response in 2005–06, and the impact of the GFC on debt levels.²⁸

Figure 1.1

Percentage growth in collectable debt from 2001–02 to 2010–11



Source: ANAO analysis of ATO information published in the Commissioner of Taxation’s annual reports.

1.8 Post the GFC, the Australian economy is still being affected by uncertainty in global financial markets, and in this environment the ATO is carefully managing its approach to debt collection to contain debt levels at acceptable limits. In the Commissioner of Taxation’s Annual Report 2010–11, the Commissioner reflected that:

...weaker than expected economic conditions and natural disasters placed a significant strain on some people in coping with their tax and superannuation obligations. They required a flexible and empathetic approach from us. On the other hand, we observed an increase in opportunistic non-compliance and attempts to cheat the system, requiring vigilance and quick responses on our part.²⁹

²⁸ Economics Legislation Committee, Additional Estimates 2004–05, *Committee Hansard*, 17 February 2005, p. E126. In response to a question about the growth in collectable debt, the Commissioner of Taxation stated: ‘A system (of taxation) has been introduced whereby there is much more regular interaction with the ATO. Where there are much more regular payments, it is not unusual for that to lead to higher levels of debt, merely because there are more frequent payment points’.

²⁹ *Annual Report 2010–11*, op. cit., p. 5.

The ATO's response to the growth in collectable debt

1.9 In 2005–06, building on new strategies adopted in the previous year and to facilitate a focus on collecting debt, the ATO established the Debt Business Line³⁰ (DBL) and implemented a number of new initiatives and administrative processes that included:

- transferring several debt teams from different areas of the ATO to the DBL, to better co-ordinate debt campaigns;
- a new framework for managing debt that emphasised early action on debts—aged debt³¹ is harder and more expensive to follow up—and sought to action up to 80 per cent of debt as it became overdue; and
- trialling new methods of collecting debt through three pilot programs, using the technical capabilities delivered by the ATO's Change Program.³²

1.10 Prior to these new arrangements, debt cases had been managed in specific functional areas until the account was paid in full (or the taxpayer entered into a payment arrangement), or it was referred to a specialist debt area for some type of firmer action. Under the previous approach the ATO estimated that, as at October 2005, around one million debt cases worth \$1.5 billion would not be actioned.

1.11 The three pilot programs undertaken in 2005–06 to trial new approaches to recovering outstanding debt were:

- calling some taxpayers after-hours, where previous attempts to contact them had been unsuccessful;

³⁰ Prior to this arrangement the ATO's management and collection of debt was centred in the Debt and Lodgement Business Line.

³¹ Debt that has been outstanding for more than two years.

³² The ATO's Easier Cheaper More Personalised Change Program (2002–2011) delivered an integrated and flexible ICT system to improve the client experience and enable ATO staff to undertake all work electronically using end-to-end and ATO-wide work processes. *The Australian Taxation Office Change Program*, ATO, February 2011, available from <http://www.ato.gov.au/content/downloads/CR00271687.pdf> [accessed August 2011].

- applying dialler technology that allowed the ATO to engage with a greater number of taxpayers more efficiently³³; and
- contracting the services of an ECA to action debts under \$7500, where there had been no response to ATO auto-generated letters.

1.12 The ATO considered that the pilot programs produced some very positive results, helping to reduce the growth of collectable debt to just over six per cent in 2005–06.³⁴ Specifically, the referral of selected debt cases to an ECA was assessed as providing an effective response to the high number of low value debts. Collectively these debts represented significant revenue, but individually were low in value and unlikely to be actioned by the ATO.

1.13 Based on the results achieved in the pilot projects, the ATO sought additional government funding to expand these new debt collection initiatives, known collectively as the Debt Collection Enhancement Program (DCEP). The Federal Budget, 2007–08, included \$125.7 million over four years for the ATO to implement the components of the DCEP: the introduction of advanced dialler technology; the outsourcing of the collection of low value debts to ECAs; and following up taxpayers with outstanding aged debts, and superannuation guarantee charge debts.

1.14 Implementing advanced dialler technology and contacting some clients after hours reflected enhancements to the debt management techniques the ATO was already using. However, contracting the services of ECAs marked a new direction and approach for the ATO, and heralded a period of significant change in the ATO's overall approach to debt management.

1.15 While tax and superannuation debt have some unique features³⁵, over an extended period the ATO has moved from a focus that viewed the collection of tax and superannuation debt as requiring ATO specific treatment,

³³ Dialler technology is an automated dialling capability for the management of outbound phone calls. It automatically dials numbers from a pre-set list, filtering out numbers that are unanswered, busy or disconnected.

³⁴ Commissioner of Taxation, *Collecting taxpayer debt and outstanding employee superannuation entitlements*, 27 May 2007, available from <<http://www.ato.gov.au/content/00100397.htm>> [accessed August 2011].

³⁵ Notably, unlike private sector entities, the ATO cannot avoid additional liabilities being established on the basis of a debtor's poor credit risk or payment history. The ATO must continue to engage taxpayers even if they have a poor tax payment history, knowing that these taxpayers will continue to be active in the tax system and will be required to lodge returns and statements and meet future payment obligations.

to one that adopts many of the commercial methods and technologies applied in private sector entities and by debt collecting agencies.

Engagement of external debt collection agencies

1.16 There are around 900 debt collection businesses in Australia that range from small local firms to the Australian or Asia Pacific divisions of multinational companies. Debt collection activity in Australia is regulated by laws in both Commonwealth and state and territory jurisdictions. A number of industry associations represent creditors, collectors, investigators and repossession agents, and promote professional practices and ethical conduct across the industry. Generally, third party debt collection businesses act as:

- mercantile agents: acting as an agent for the original creditor, collecting the debt on their behalf (contingent debts); or
- debt purchasers: purchasing the right to collect the debt at a discount from the face value of the outstanding debt.

1.17 The mix of these activities varies between debt collection businesses: some are predominantly involved in purchased debts, while others focus exclusively on contingent debts.³⁶ Debt collection businesses contracted by the ATO are acting as mercantile agents. The ATO uses the terms mercantile agent and external collection agency interchangeably. This report uses the term external collection agency (ECA).

Contracting external debt collection agencies

1.18 In May 2007, based on a positive internal review of the pilot program conducted in 2006, the ATO released a request for tender for debt collection services for a four year period, 2007–08 to 2010–11. The tender process resulted in the ATO entering into contracts with four ECAs. Two were large multinational corporations, and the other two were smaller agencies, described by the ATO as ‘niche’ providers.

1.19 In October 2011, the ATO finalised a second request for tender for debt collection services, for another four year period, 2011–12 to 2014–15. After a tender evaluation process, arrangements were negotiated for a panel of

³⁶ ASIC and ACCC, *Debt collection practices in Australia: Summary of stakeholder consultation*, May 2009, p. 3., available from <<http://www.accc.gov.au/>> [accessed 13 October 2011].

providers under a Deed of Standing Offer³⁷ (DoSO) with three of the four agencies that had provided services under the previous contracts, and one new agency.

The ATO's arrangements for managing debt

Debt management framework

1.20 Underpinning the ATO's approach to debt collection is the 'community first' principle, which recognises that the majority of taxpayers are willing to do the right thing, and an appropriate response to taxpayer debt must reflect the level of risk associated with each individual case. The ATO has an ongoing engagement with taxpayers and recognises their capacity to earn income and to meet future tax obligations may change. Consequently, debts may be owed by otherwise compliant taxpayers experiencing a period of unforeseen financial difficulty.³⁸ The community first principle requires the ATO to recognise these types of circumstances in determining an appropriate collection strategy.

1.21 The ATO aims to assist both personal and business taxpayers to manage their obligations and prevent their debt from escalating by focusing on early intervention, and by engaging with taxpayers as soon as the debt arises. Firmer action is taken against those taxpayers who make no effort to manage their debt, or who deliberately and consistently engage in behaviour to avoid their tax and superannuation obligations. In these circumstances, recovery options available to the ATO include garnishee notices, statutory demands and director penalty notices.³⁹

1.22 The ATO may also take more targeted strategic recovery action, particularly where a business is considered not to be viable in the longer term,

³⁷ In a panel arrangement, a deed of standing offer or a contract exists between an agency and each supplier on the panel detailing: the type of property or service the supplier will provide; the set/indicative price for the property or service; and the manner in which the agency will procure the property or service from the supplier, including any process for competition between panel members, where appropriate.

³⁸ Applying the community first principle provides taxpayers every opportunity to meet their taxation obligations and encourages them to work with the ATO if they are having problems.

³⁹ The Commissioner of Taxation may issue garnishee and director penalty notices, and statutory demands. A garnishee notice is a notice issued by the Tax Commissioner to a third party, such as a bank, compelling it to pay funds held on a taxpayer's behalf to the ATO to recover a tax debt. A statutory demand requires a company to pay the entire tax debt, or enter into a payment arrangement with the ATO within 21 days of the demand being served. Director penalty notices make a director personally liable for outstanding company PAYG withholding tax amounts.

and there would be little likelihood of the tax debt ever being paid. Recovery action in these circumstances may include bankruptcy or wind-up proceedings to recover outstanding debt. In 2010–11 the ATO also piloted the use of professional firms to conduct independent business viability assessments for businesses with complex financial arrangements and significant outstanding debt.⁴⁰ The ATO may write-off all, or part, of a debt if it is assessed as non-recoverable or uneconomical to pursue. In 2010–11 the ATO wrote-off a total of \$3.8 billion in outstanding debt, compared with \$1.7 billion in the previous year.⁴¹ The number and value of debts in each broad category—early intervention, firmer action and strategic recovery—varies from day-to-day as debts flow through the system, and may arise from single or multiple taxes managed through running balance accounts.⁴²

1.23 In taking the decision to pilot the outsourcing of debt collection activities, the ATO recognised the potential risk to its reputation in allowing a third party to act on its behalf, and the importance of maintaining the privacy and security of taxpayers’ personal details. This perspective is consistent with the ANAO’s view in the 1999–2000 performance audit report on debt management. In this report the ANAO recommended the ATO outsource the collection of some tax if the evaluation of outsourcing showed it was cost effective and compliance with the Taxpayers’ Charter would be maintained.⁴³

Administrative arrangements for debt management

1.24 The DBL is one of five business lines within the ATO’s Operations sub-plan⁴⁴, with responsibility for developing and implementing specific strategies to support two of the ATO’s corporate priorities for 2011–12, namely,

⁴⁰ *Annual Report 2010–11*, op. cit., p. 84.

⁴¹ *ibid* p. 51.

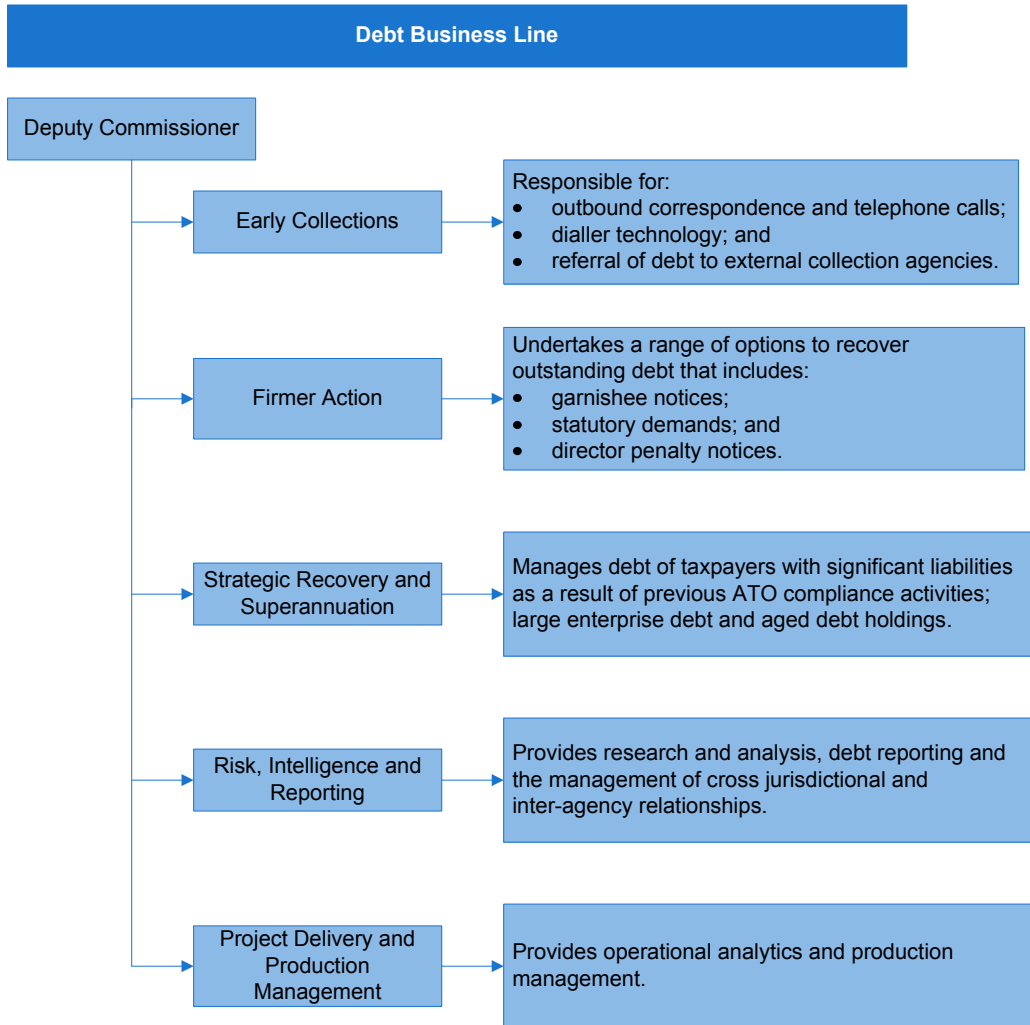
⁴² A debt that arises from two or more types of tax, for example activity statement and income tax debt, is referred to as a composite debt, as opposed to a debt that arises from a single tax. A running balance account is a record of the net balance of a taxpayer’s liabilities and credits. Outstanding debts may be offset by running account balance surpluses.

⁴³ The Taxpayers’ Charter sets out how the ATO will conduct its dealings with taxpayers. It helps taxpayers understand their rights, the service and other standards they can expect from the ATO. It also sets out their taxation obligations and how to respond if they are dissatisfied with the decisions, actions or service of the ATO, or want to make a complaint.

⁴⁴ The ATO Plan is managed through four sub-plans: Compliance Sub-Plan, Corporate Service and Law Sub-plan, Enterprise Solutions and Technology Sub-plan and the Operations sub-plan. Business and Service Lines provide the operational delivery vehicles for the relevant sub-plan.

reducing the stock of aged debt and maintaining the ratio of collectable debt to receipts at approximately five per cent.⁴⁵ Changes in the structure of the DBL between 2005–06 and 2010–11 reflect a gradual transition to the current administrative arrangements that are aligned around the debt management framework—*early collections*, *firmer action*, and *strategic recovery*—with two additional areas providing strategic reporting, analysis and production management. Figure 1.2 sets out the structure of the DBL as at December 2011.

⁴⁵ ATO, *Corporate Plan 2011–12*, June 2011, available from
<<http://www.ato.gov.au/corporate/content.aspx?doc=/content/00283916.htm>> [accessed August 2011].

Figure 1.2**Structure of the Debt Business Line as at December 2011**

Source: ANAO analysis of ATO documents.

1.25 The DBL is managed by the Debt Executive Management (DEM) team that includes senior executive staff from all areas of the business line. At the operational level, staff from the five areas of the DBL participate in the Debt Operational Planning Group (Debt OPG), and a representative from this group attends the monthly DEM meetings, and provides a liaison function between the groups.

1.26 The management of ECA contracts (known as the referral program), is the responsibility of teams within the *early collections* area, based in Melbourne. The selection of debt cases for ECA action is undertaken by the DBL's Project Delivery and Production Management branch; and specific services in relation to the secure management of ATO data by external contractors is provided by the Trusted Access (TA) and Security Policy and Services (SPS) branches.

1.27 As at 31 December 2011, the DBL employed around 1997 staff⁴⁶, operating from 16 sites across Brisbane, Sydney, Melbourne, Adelaide, Perth and several regional centres. The staffing profile of the DBL, as at 31 December 2011, included 473 staff in 37 *early collections* teams using modern dialler technology to action outstanding debt and to support debt collection campaigns. The DBL's 2011–12 operating budget was \$158.9 million at the start of the year. The ATO advised that internal budget changes throughout the year would reduce that by some \$1.6 million.

International experience in using external debt collection agencies

1.28 Revenue and taxation offices in countries affiliated with the Organisation for Economic Co-operation and Development (OECD), have taken different positions on the use of ECAs. Positions taken by the United Kingdom (UK), the United States of America and Canada were reviewed by the ANAO.

United Kingdom—HM Revenue and Customs

1.29 In 2008, as part of its debt management strategy, HM Revenue and Customs (HMRC) started to investigate the use of private sector debt collection agencies. An audit report produced by the National Audit Office the same year also recommended that the department should explore using the private sector to collect some debt.⁴⁷

1.30 A small-scale pilot using two debt collection agencies was conducted between May 2009 and January 2010, with the report of the final evaluation

⁴⁶ Staffing numbers include ongoing, non-ongoing and casual employees.

⁴⁷ National Audit Office HC 1152 Session 2007–2008, *HM Revenue & Customs: Management of Tax Debt*, London, 20 November 2008.

provided in April 2010.⁴⁸ In the UK trial, ECAs were paid a commission of the amount of debt collected; there was found to be no value in creating structures and incentives to make the ECAs compete with one another; and taxpayers could make payments directly to the ECAs. The report also noted that an assessment of the impact of using ECAs on individuals' compliance could be monitored by the long-term behaviour of the debtors involved; and consideration should be given to addressing potential legislative constraints to allow ECAs more freedom of action (for example, in making doorstep collections and in applying time to pay arrangements).⁴⁹ This final evaluation concluded that the trial was a success, and in the June 2010 Budget the United Kingdom Government announced that the department would continue to use private sector debt collection agencies.⁵⁰

1.31 The HMRC Business Plan 2011–15 includes strengthening the department's debt collection techniques by placing up to £1 billion of lower value debt with external debt collection agencies. This arrangement was implemented in November 2011, and the business plan indicated it would remain in place until April 2012.⁵¹ Under this arrangement, the HMRC will write to the debtor providing a final warning letter in an attempt to agree to a time to pay, prior to referral to an external debt collection agency.⁵²

United States of America—Inland Revenue Service

1.32 The United States of America Inland Revenue Service (IRS) began referring federal taxation accounts in debt to private collection agencies in September 2006.⁵³ However, following a review of the IRS's use of these agencies, including the cost effectiveness of the program, the IRS announced in

⁴⁸ HM Revenue & Customs, *Debt management and banking: Adding capacity and capability pilot—Final Evaluation*, London, April 2010.

⁴⁹ *Debt management and banking: Adding capacity and capability pilot—Final Evaluation*, op. cit., London April 2010.

⁵⁰ HM Revenue & Customs, *2009–10 Accounts*, London, July 2010, p. 169.

⁵¹ HM Revenue and Customs, *Business Plan 2011–15*, available from <<http://transparency.number10.gov.uk/transparency/srp/view-srp/32>> [accessed 14 October 2011].

⁵² HM Revenue and Customs, *Modernising HMRC Debt Collection*, Media release, 28 July 2010 <<http://nds.coi.gov.uk/clientmicrosite/Content/Detail.aspx?ClientId=257&NewsAreaId=2&ReleaseID=414723&SubjectId=366>> [accessed 14 June 2011].

⁵³ IRS, *IRS outlines taxpayer protections in private debt collection program*, Media release, 23 August 2006, available from <<http://www.irs.gov/newsroom/article/0,,id=161300,00.html>> [accessed 14 October 2011].

March 2009 that it would not renew its contracts with private collection agencies, with the IRS Commissioner commenting that he believed this work was best done by IRS employees.⁵⁴

Canada—Canadian Revenue Agency

1.33 In August 2005, the Canadian Government transferred the functions and resources of the debt collection activity previously administered by Human Resources and Social Development Canada, to the Canadian Revenue Agency (CRA).⁵⁵ Currently, the CRA has responsibility for around 85 per cent of outstanding debt owed to the Federal Government, and advised that it does not outsource any debt collection activities, and has no plans to do so.

1.34 However, until 2005, Human Resources and Social Development Canada had outsourced the collection of defaulted student loans to private collection agencies (PCAs) for some 16 years. This arrangement continued during the first four years following the machinery of government changes.

1.35 The CRA tightly managed all aspects of the outsourced arrangement. The PCAs were required to comply with all relevant legislation and to follow directives, including how and when clients could be contacted, scripting that could be used in conversation with clients and approved letter templates were to be used. The PCAs were also required to implement a range of security measures and undergo site inspections. The PCAs were engaged on a commission basis (but were not extended the delegation to take legal action where a debt was not paid), receiving a set amount for each dollar collected. The volume of work allocated to them was based on their performance and compliance with their contractual obligations.

1.36 In 2009 the CRA decided to action all collection activities in-house. The agency had the infrastructure in place to collect debts, including a call centre using dialler technology. The CRA considered that it could undertake collection activities more cost effectively. This arrangement also eliminated a

⁵⁴ IRS, *IRS conducts extensive review, decides not to renew private debt collection contracts—IRS Employees More Flexible, More Cost Effective*, Media release, 5 March 2009, available from <<http://www.irs.gov/newsroom/article/0,,id=205021,00.html>> [accessed 14 October 2011].

⁵⁵ *Collections Integration*, Canadian Revenue Agency.

range of administrative overheads, including staff dedicated to allocating and monitoring the work of PCAs.⁵⁶

Audit objective, criteria and methodology

1.37 The objective of the audit was to assess the effectiveness of the ATO's administration of external debt collection arrangements.

1.38 The audit assessed whether:

- contractual and administrative arrangements were appropriately planned and executed, and support the ATO's objectives in using the services of external collection agencies;
- the operational strategy for selecting and referring debt cases to external agencies was effective; and
- appropriate performance measures have been developed to monitor and report the services provided by the external agencies.

Audit methodology

1.39 The audit was conducted by examining electronic records, documentation and reports held by the ATO; interviewing ATO staff; and observing the operations of the four ECAs under contract to the ATO during June and July 2011. The audit team also interviewed selected taxation professionals and a representative from Financial Counsellors Australia.

1.40 The audit was conducted in accordance with the ANAO Auditing Standards at a cost of \$353 795.

Report structure

1.41 Figure 1.3 sets out the structure of the report, that reflects the audit criteria outlined in paragraph 1.38.

⁵⁶ Teleconference between ANAO and the Canadian Revenue Agency, 27 April 2012.

Figure 1.3

Report structure

Chapter 1 <i>Background and Context</i>	<ul style="list-style-type: none">• Tax and superannuation debt in Australia• The ATO's response to the growth in collectable debt• Engagement of external debt collection agencies• The ATO's arrangements for managing debt• International experience in using external debt collection agencies• Audit objective, criteria and methodology
Chapter 2 <i>Establishing the Outsourcing Arrangements</i>	<ul style="list-style-type: none">• Introduction• Pilot program to refer debt cases to an external collection agency• Establishing and implementing contracts for the outsourcing of debt collection services• Funding the debt referral program• Security requirements for managing ATO data
Chapter 3 <i>Operational Strategy and Stakeholder Engagement</i>	<ul style="list-style-type: none">• Introduction• Selection and referral of debt cases• Management of retrieved cases• ICT systems and processes supporting the selection and transfer of debt cases to the ECAs• Stakeholder engagement and complaints management
Chapter 4 <i>Performance Management</i>	<ul style="list-style-type: none">• Introduction• Performance management of ECA services• Measuring and reporting the value of collections resulting from ECA action

2. Establishing the Outsourcing Arrangements

This chapter examines the ATO's planning and implementation of the contractual arrangements and administrative processes to support the ATO's use of external collection agencies.

Introduction

2.1 The ATO's decision in 2005–06 to trial the services of an external collection agency (ECA) was a key component of a new approach to debt collection, although the possibility of outsourcing selected debt cases had been under consideration for some five years prior to the pilot program being conducted. In 1999–2000, the ATO agreed with an ANAO recommendation to:

*outsource the collection of some tax debt if the evaluation of outsourcing shows that it is cost effective and that compliance with the Taxpayers' Charter would be maintained.*⁵⁷

2.2 In 2003, the ATO commissioned a review of its debt collection practices.⁵⁸ The review recommended that the ATO develop a 'watching brief' on the United States of America's (USA) Inland Revenue Service's proposal to contract the services of external debt collection agencies. The ATO accepted the recommendation, noting that outsourcing possibilities had been considered in the past and would remain a possibility contingent on the effectiveness of any such initiative.⁵⁹ Staff from the ATO had visited a number of state revenue authorities in the USA earlier that year, finding that reports on such arrangements were 'mixed'.

2.3 While the ATO had considered outsourcing, there was no evidence of any action having been taken to progress such an initiative, prior to the growth

⁵⁷ The ATO assessed that it had partially implemented Recommendation No.4 of ANAO Audit Report No.23 1999–2000 *The Management of Tax Debt Collection*, Canberra 1999, through the 2006 pilot program and subsequent evaluation, and Budget funding to pursue the initiative. op. cit., ANAO Audit Report No.42 2006–07, pp. 123–4.

⁵⁸ ATO, *Ledlin Partners Report to the Australian Taxation Office*, 23 September 2003, available from <<http://www.ato.gov.au/content/37887.htm>> [accessed 13 July 2011].

⁵⁹ ATO, *Australian Taxation Office response to the Ledlin Report*, 23 September 2003, available from <<http://www.ato.gov.au/corporate/content.aspx?doc=/content/37886.htm>> [accessed 13 July 2011].

in collectable debt being raised by the Senate Economics Legislative Committee in June 2004⁶⁰ and again in February 2005, when the ATO was asked if there were any new strategies to address debt levels.⁶¹

2.4 Following these Senate Committee discussions, the ATO moved quickly to identify a reputable ECA, and to undertake and evaluate a pilot program to outsource selected debt. The ATO was under significant time constraints as progress was to be reported to the Senate Committee at the end of February 2006.

2.5 The ATO undertook the pilot program from April to June 2006. Based on the results achieved over the three month trial, the ATO subsequently procured the services of four ECAs, effectively adding external debt collection services to the ATO's debt collecting capability. To assess the implementation of the outsourcing arrangements⁶², the ANAO examined the ATO's:

- development and evaluation of the pilot program where a limited number of debt cases were referred to a preferred ECA;
- establishment of contracts with four ECAs to provide debt collection services for the period 2007–08 to 2010–11, and a panel of four ECAs for services from 2011–12 to 2014–15;
- funding for the debt referral program; and
- administration of measures supporting the security and privacy of taxpayers' information when debt cases are under ECA management.

⁶⁰ Economics Legislation Committee, Budget Estimates, *Committee Hansard*, 3 June 2004, p. E172-3. In response to the Committee, the (then) Commissioner of Taxation signalled to the committee that the ATO would be getting firmer with people who were not paying their tax.

⁶¹ Economics Legislation Committee, Additional Estimates, *Committee Hansard*, 17 February 2005, p. E127-8. In response to the committee, the (then) Commissioner of Taxation indicated that one new strategy was that he had recently taken the decision to devote a substantial number of additional resources to enable the ATO to action more promptly a range of smaller debts.

⁶² Contracts or arrangements where a person or organisation, external to the participating Commonwealth organisation, performs tasks or provides services that could have been done by Commonwealth employees, regardless as to whether the external provider has undertaken the whole of the function or part thereof.

Pilot program to refer debt cases to an external collection agency

2.6 The ATO's business case for piloting the services of an ECA from April to June 2006 noted that debt holdings were expected to continue to increase, particularly small residual debts that the ATO had consistently found it difficult to resource for collection activity. The ATO explained the outsourcing of some debt collection activity as extending the ATO's capacity to contact more taxpayers with an outstanding debt, and an attempt to engage taxpayers with long outstanding obligations.⁶³ The ATO also believed that referring debts to an ECA would send a clear message to the community that the ATO was pursuing taxpayers who failed to meet their obligations.

2.7 To meet the security requirements associated with referring taxpayers' information to an external agency, the ATO procured the services of the ECA that had been providing debt collection services to Centrelink for several years.⁶⁴ Centrelink had an established Secure Link⁶⁵ with the ECA and, while the ATO initially mandated its use, technology constraints prevented the application of this secure transfer capability for the pilot program.

2.8 Consequently, the transfer process for the pilot program consisted of debt case files being uploaded onto encrypted optical disks, delivered by an ATO staff member to the ECA, and then uploaded onto the agency's computer servers. This arrangement was approved by the ATO's Security Policy and Services (SPS) branch solely for the purposes of the pilot program.

2.9 Payment to the participating ECA was on a fee-for-service basis, rather than on a percentage commission of the value of debts collected (unlike Centrelink's arrangements with their contracted ECAs, that are based on commission payments). All debt payments, whether paid in full or where a payment arrangement was negotiated, were made directly to the ATO through established payment channels—the ECA was not authorised to accept any payments.

⁶³ House of Representatives, Question on Notice No 3449, 15 August 2006.

⁶⁴ The ATO followed a procurement process that allowed them to select a preferred service provider, rather than going to the market. Constraints in the scope of the Centrelink contract precluded the ATO from 'piggy-backing' on the contract arrangements from the Centrelink panel.

⁶⁵ A Secure Link is a secure electronic connection between two parties' computer systems that ensures the protection of the transfer of data.

2.10 Debt cases referred during the pilot program were mostly aged, low value cases up to \$7500.⁶⁶ The cases were income tax and activity statement debts, where the client was not in any formal payment arrangement with the ATO and the debt was unlikely to self-finalise.⁶⁷ The ATO estimated that a pool of over 100 000 debt cases would be available for the pilot program although not all could be actioned given the short time the pilot would be conducted. Just over 11 000 cases were actually referred to the ECA during the pilot program, in two tranches on 4 April and 22 May 2006, at a cost of \$370 000 in ECA fees. Table 2.1 sets out the number and types of debt cases that were referred to the ECA; the total value of the referred debt; and the amount paid by taxpayers against these debts during the pilot program.

Table 2.1

Number, type and value of debt cases referred to the ECA, and payments received during the pilot program, April to June 2006

No of cases	Case type	Total value of debt	Total payments received	Payments attributed to ECA action
6 713	activity statement and income tax	\$38 590 911	\$21 771 972	\$16 645 701
4 400	activity statement, income tax and activity statement (inactive)	\$21 383 106	\$ 5 441 452	\$4 439 596
11 113	All cases	\$59 974 017	\$27 213 424	\$21 085 297

Source: *Debt Referral Pilot: Post Implementation Review*.

2.11 The contact strategy employed by the ECA was a correspondence and telephone based campaign, consisting of an initial demand letter to the taxpayer, and subsequent follow-up letters if the initial correspondence was not answered. Where contact through correspondence was ineffective, effort was focused on outbound telephone contact.

2.12 A dedicated team of nine full-time ATO staff was established to support the initiative, with this number increasing to 15 by the end of the pilot

⁶⁶ For the purposes of debt collection, the ATO assesses debts valued at up to \$7500 as 'low' value and low risk, and targets internal resources to actioning higher value and more complex debts.

⁶⁷ Where a taxpayer pays a debt without follow-up collection action, or a taxation refund or credit negates the debt, a debt is referred to as 'self-finalising'.

program. The ATO advised that, with hindsight, the project was probably over staffed, but this was essentially a risk mitigation strategy to supervise every aspect of the pilot, including having ATO staff on-site supervising the ECA's operations. The level of resources allocated to the pilot program also allowed the ATO to develop an early version of collection guidelines to support the ECA's operation, and provided an early insight into the roles and responsibilities of both the ATO and ECA staff in the outsourcing of debt collection services.

Pilot program post implementation review

2.13 The main intent of the pilot program was to collect sufficient information to assess the effectiveness of using external collection agencies to supplement the ATO's debt collection activities. Secondary intentions were to:

- reduce the value of debt holdings within the ATO;
- improve ongoing taxpayer compliance; and
- engage taxpayers who had not responded to previous initiatives.

2.14 The post implementation review of the pilot program examined key aspects of the collection processes and stakeholders' experiences. Given the sensitivity of referring taxpayers' information to an external agency and the associated risks for the ATO, documentation in relation to the pilot reflects a tightly controlled operation. The review noted that the pilot had received considerable media attention, promoting a community perception that the ATO was serious in pursuing outstanding tax debt, with only 23 complaints being received.

2.15 Analysis of the results achieved during the pilot program show that of the 11 113 debt cases referred just over 19 per cent (2136 cases) were paid in full, and 3668 taxpayers (33 per cent) had entered into a payment arrangement by the end of the three-month period. These early figures indicated that approximately 52 per cent of taxpayers responded to an approach by the ECA to pay their debt.

2.16 The contact by an ECA rather than the ATO was seen as the significant factor, with both the ECAs and ATO advising the ANAO that taxpayers were more likely to respond to an approach by a debt collection agency as the

community viewed this as an escalation of the management of the debt.⁶⁸ This is despite options for firmer action remaining with the ATO, and referral to an ECA in relation to a tax debt does not affect a taxpayer's credit rating.⁶⁹ However, the ATO had considered that the use of ECAs afforded it a leverage opportunity because of the perception among some taxpayers that failure to respond to a collection agency would adversely affect their rating.

2.17 The amount of debt recovered from the referred cases, and attributed to action by the ECA, was identified using a sampling methodology developed by the ATO in conjunction with the Australian Bureau of Statistics, to estimate collections against specific liabilities.⁷⁰ Applying this methodology to the pilot results, the ATO assessed that:

- 78.3 per cent of total payments collected could be attributed to collection activity undertaken by the ECAs; and
- 35.5 per cent of the total debt referred was collected.

The results also indicated that, for all debt cases referred to the ECA, approximately \$6 million was received voluntarily from taxpayers, or self-finalised, while the cases were under ECA management.

2.18 The review found that many taxpayers seemed unaware of their ATO debt when contacted by the ECA, and recommended that in any future transactions the ATO should contact all taxpayers prior to their case being referred to an ECA. In approximately 38 per cent of debt cases referred during the pilot program, the ATO had not contacted the taxpayer for at least 12 months prior to the taxpayer being referred to the collection agency; in

⁶⁸ An earlier finding in ANAO Audit Report No.4 2004–05 *Management of Customer Debt—Centrelink*, Canberra 2004, on the effectiveness of ECAs' operations in Centrelink's management of debt was that the operations of the ECA under contract to Centrelink possessed a superior recovery infrastructure to that of Centrelink, and the ECA's use of online technology, automated diallers and scriptors contributed to the efficiency of their operations. While similar factors may have contributed to a greater debt collection rate by the ECA compared to that achieved by the ATO in 2006, the ATO has since adopted many of the same modern technologies and approaches used in commercial debt collection agencies, and private sector entities.

⁶⁹ If asked, ECA staff will confirm that the referral of a debt to an ECA will not affect a taxpayer's credit rating. This information is not included in any of the ATO's correspondence with taxpayers prior to their debt being referred to an ECA for collection, but is included in its complaint response letter. The information is also available on the ATO website.

⁷⁰ All payments made as a result of ECA action are made through existing ATO payment channels. During the pilot program, the ATO had limited capacity to identify payments resulting from ECA action but had better developed this capacity when it expanded the outsourcing of debt collection activities.

3.5 per cent of cases, this period was longer than two years; and in 1.5 per cent of cases no previous contact had been made with the taxpayer in relation to the debt.

2.19 The review also highlighted the work required to establish an expanded arrangement whereby large volumes of debt cases (with taxpayers' details) could be securely referred to, updated, and retrieved from, an external agency. The review noted that the debt referral pilot had been established under very tight timeframes, and the exercise demonstrated the need to allow adequate lead times for the establishment of key elements of infrastructure. The transfer of taxpayers' data between the ATO and the ECA by the manual transfer of optical disks was an inefficient process and was not viable for any large-scale operation.

2.20 Risks identified in the review, also associated with expanded outsourcing of debt collection services, included that:

- it may be difficult to pay providers on a commission basis as it is difficult in the current systems to ascertain whether payments received by the ATO are for current liabilities or debt referred to an ECA. The manual process for estimating payment attribution used in the pilot program could be managed for a limited number of referred cases, over a short timeframe;
- the referral of debts would not change the compliance behaviour of some taxpayers. The review noted that the pilot program had only operated for three months, and the ATO needed to continue with the referral of debts to send a strong message to the community that firmer action will be taken where taxpayers do not meet their obligations; and
- debts paid in full would not finalise in the system, due to outstanding general interest charges.⁷¹

2.21 Based on the results achieved in the pilot program, and notwithstanding the issues and risks identified with greater use of ECAs, the

⁷¹ This issue was later mitigated by providing ECAs with access to a general interest charge calculator and extending to them the same delegations as ATO staff to remit general interest charges (up to \$10 000) as part of the collection process. ATO advice (of 7 February 2012) stated this ensures taxpayers are included in the parameters of the ATO's community first approach.

review recommended that the ATO Executive proceed to tender for the procurement of a panel of ECAs to provide debt collection services to the ATO.

Conclusion

2.22 The pilot program met an immediate need in the ATO to test an initiative to contain and reduce the growth of collectable debt from almost 28 per cent growth during the previous year, 2004–05. However, while the ATO had considered the option of outsourcing selected debt cases for some six years prior to undertaking the pilot program, many aspects of the trial could have been better planned.

2.23 The pilot program was conducted on a small scale and over a short period of time. This allowed the ATO to manage elements of the trial in ways that could not be applied to the on-going referral of larger volumes of debt cases. While the review identified many of the issues and risks associated with an expansion of the outsourcing arrangements, the practicalities of how these would be addressed were still to be worked out.

2.24 Additionally, the pilot program did not provide guidance to the ATO on contract or pricing structures that would best suit the ATO's requirements: individual contracts or panel arrangements; and flat fee or commission-based pricing. While the ATO has subsequently advised that, as a general principle, it does not pay commission for the collection of debt, during the pilot program and in establishing contracts with ECAs the following year, commission-based pricing was included as a payment option.

2.25 The review of the pilot program concluded that the pilot 'has proved the concept that tax debts can be collected by ECAs' but it did not establish that this could be done efficiently and effectively on a much larger scale. Also, the review did not address how the ATO would capture any reduction in debt holdings as a result of outsourcing, or measure the impact on taxpayer compliance—two other intents of the pilot program.

Establishing and implementing contracts for the outsourcing of debt collection services

2.26 The ATO considered securing the continued services of the ECA participating in the pilot (while a procurement process was undertaken), with the expectation that a panel of ECAs would be operational by the end of December 2006. However, the ATO recognised the risk that continuing the direct sourcing arrangement could compromise the procurement process and it

was not pursued. Additionally, there was no capability at that time for the secure transfer and handling of high volumes of debt cases, and no funding allocated to support the new initiative.

Request for tender and contract arrangements, 2007–08 to 2010–11

2.27 The ATO went to the market for ECA services in May 2007. The request for tender (RFT) sought to engage the services of a single debt collection agency, on a non-exclusive basis, with the discretion of engaging additional providers during the term of the contract.⁷² The contract would be for an initial two-year period with options for two one-year extensions. The RFT stipulated that tender submissions should include pricing options based on both a flat fee structure per debt case actioned, and on a commission (or percentage) of debt collected. The types of cases that would be referred were those arising from income tax, activity statement and superannuation guarantee charge debts.

2.28 Documentation in relation to the procurement process reflects that the ATO maintained the option to engage either a single provider or multiple providers, and to negotiate payment arrangements on a flat fee per debt case, and / or commission basis, until the tender selection process was finalised. The outcome resulted in the ATO undertaking, in October 2007, final price and servicing negotiations with four ECAs, and entering into contracts with them. While the ATO often refers to the contracts (including in many of the documents relating to the period) as having established a 'panel of providers', the individual contract with each ECA did not constitute a procurement based on panel arrangements.

2.29 The ATO's contracts with each ECA included high-level service agreements underpinned by more detailed reporting requirements. The contracts also established the prescriptive nature of the ATO's management of the ECAs, including the requirement that agencies would use the ATO's approved standard letter templates, and seek the ATO's approval for all scripts to be used in contact with taxpayers, as well as agreed hours that taxpayers could be called.

⁷² AusTender, *ATO–Debt Collection Services*, 2007, available from <<https://www.tenders.gov.au/?event=public.atm.showClosed&ATMUUID=4A0668D6-F921-5003-E8D620D40D129AC5>> [accessed 21 July 2011].

2.30 The contracts also allowed for collection guidelines to be developed by the ATO, in consultation with the ECAs. Based on the guidelines developed during the pilot program, the new guidelines were to be finalised during the contract implementation phase and incorporated into the ECAs' individual contracts through contract variations. As a minimum, the guidelines would include instructions and operational requirements for establishing taxpayers' proof-of-identity; negotiating payment arrangements; and managing complaints. They would also provide the basis for the development of the ATO's performance measures for the services provided by the ECAs, further discussed in Chapter 4.

2.31 While the contracts set out the broad parameters for the outsourcing of debt collection, both the ATO and the ECAs advised that their joint approach, particularly during the first two years of the new measure, reflected a 'partnership' between them, rather than the implementation of defined contractual requirements. Providing services to the ATO required the ECAs to review all aspects of their professional and operating standards; and as the contracts progressed, the ATO was able to better refine and define the quality of services required, and the pricing it could command. The first contracts with ECAs were often referred to by the ATO as a period of learning, with many aspects of the arrangement evolving and developing over the four year term.

ECA services and pricing structures

2.32 Services provided by the ECAs were similar, with each debt case receiving a specified number of letters and phone calls, and there was a set charge for tracing services where taxpayers' details were out-of-date. However, there were variations in the ECAs' pricing structures for actioning specific types and values of debt, on both a flat fee and commission basis. Negotiations between the ATO and the selected ECAs moderated the pricing proposals at contract finalisation, although there were still variations between them. The final contracts included an agreed fee and commission structure, setting out a flat fee arrangement for the initial contract start-up period, before a switch to commission-based pricing.

2.33 However, the ATO chose not to pursue commission-based pricing as a payment option, despite its inclusion in the RFT and ECA contracts. The ATO advised that:

As a general principle, the remuneration of ATO employees is not directly linked to collection results. In addition, engaging collection agencies on a commission basis is more suitable in the private sector as agencies have the

authority to take legal action to recover the debt. The basis of the ATO engagement of collection agencies project was to undertake low complexity work. The ATO views legal action as high complexity work and not suitable for outsourcing.

2.34 The ATO rejected commission-based payments for ECA services, and continues to do so. For the second contract period, 2011–12 to 2014–15, the ATO has negotiated a flat fee structure with the ECAs based on the volume of debts referred, rather than on the type and value of the debt cases (further discussed later in this chapter). However, there is little evidence that the ATO has considered any other pricing structure, and the benefits that might be delivered to the efficiency and effectiveness of the referral program. While there were no consequences from the ATO's late change in relation to how the ECAs would be paid, such a key issue should have been considered and settled before the ATO released the RFT.

2.35 In relation to the flat fee payment regime, there were 24 contract variations (CVs) reducing the fees across the four agencies over the contract period. However, the results show that for the categories of debt included in the table, variations in the prices charged per debt case referred continued throughout the contract. Table 2.2 provides an example of the changes in pricing (between the highest and lowest fees per debt case charged by the ECAs) for actioning income tax and activity statement debt cases valued at less than \$2500 and for superannuation guarantee charge debts, from tender submission to the end of the first contract period.⁷³

⁷³ The audit report reflects the differences in fees charged by the ECAs, rather than include commercial-in-confidence information on the fees charged by each ECA.

Table 2.2

Differences between the highest and lowest fees per debt case charged by the ECAs, for the period May 2007 to September 2011, for specific categories of debt

Type of debt	Difference in fees in tender submissions May 2007	Difference at finalisation of contracts October 2007	Difference at last contract variations	Percentage change over period
Income Tax debt (< \$2500)	\$42.50	\$29.15	\$17.96	- 57.7 per cent
Activity Statement debt (< \$2500)	\$42.50	\$29.15	\$17.96	-57.7 per cent
Superannuation Guarantee debt	\$46.90	\$46.90	\$45.85	-2.2 per cent

Source: ANAO analysis of ECA tender submissions, ATO negotiated outcomes and contract variation documents.

Note: Comparison of price variation is determined on the highest and lowest prices as stated for the collection of a debt product common to all four ECAs.

2.36 Throughout the term of the contracts, downward pressure on the level of fees charged by the ECAs resulted from competition between the agencies, as they compared their individual performance results. The ECAs had full access to their own performance ratings and could identify their position in relation to the other three ECAs (further discussed in Chapter 4).

Arrangements for the secure transfer of data between the ATO and ECAs

2.37 As previously discussed, in the pilot program the ATO had transferred debt cases by using optical disks, and delivering the disks to the ECA's premises. New transfer arrangements were required to support the secure transfer of large volumes of debt cases to four ECAs under the newly established contracts.

2.38 The ANAO reviewed the development of these new arrangements (the information and communications technology (ICT) infrastructure - the Secure Link) to support the transfer of data between the ATO and ECAs; and the communication between the ATO and third party providers that had been contracted to undertake the work.

2.39 While the ICT arrangements were sufficiently progressed to allow the first secure transfer of debt cases to one ECA on 21 November 2007, by June 2008 ongoing performance and reliability issues with the Secure Link were undermining the whole program. The ICT arrangements that had been provided did not accommodate the increasing size of files as the referral program ramped-up, and larger volumes of debt cases were being transferred between the ATO and four ECAs.

2.40 A business requirement to improve performance of the Secure Link was requested in July 2008, and an upgrade was completed in August 2008.⁷⁴ The issue had created operational problems, and may have been avoided by more thorough planning and preparation, but did not present any risk to the security of ATO data, and no security breaches occurred.

Request for tender and contract arrangements, 2011–12 to 2014–15

2.41 In April 2011, the ATO issued a second RFT for the provision of debt collection services for a further four year period, 2011–12 to 2014–15. Factors supporting the continuation of the outsourcing arrangements included that the ECAs added significant value to the early intervention strategies of the ATO, and allowed staff to support higher debt management priorities. However, no formal evaluation was undertaken of the first contract period that may have influenced this second procurement for debt collection services. The ATO advised that the new RFT reflected:

- more confidence in the ATO's knowledge of the market and pricing mechanisms for ECAs;
- the benefits of the arrangement in encouraging competition between the service providers; and
- measures to improve the ECAs' compliance with the ATO's ICT and physical security requirements.

2.42 Similar to the first contract, the 2011–12 to 2014–15 arrangements are based on an initial two year period with options for two one-year extensions. However, this time the ATO sought submissions based on a Deed of Standing

⁷⁴ The upgrade involved changing from an Integrated Services Digital Network (ISDN) to an Asymmetric Digital Subscriber Line (ADSL). The ISDN and ADSL are digital transmission systems that transmit voice and data over normal telephone wires and are used for Internet connections. The newer ADSL technology has faster transfer rates and is less costly to set up and to maintain.

Offer (DoSO), and the establishment of a panel of ECAs, rather than on the basis of establishing individual contracts with each ECA.

2.43 In hindsight, the ATO advised that a DoSO arrangement would have better suited the services provided during the first contract, as the exact timing and volume of work that may be referred to ECAs cannot be accurately forecast. Changes under the previous arrangements required formal contract variations with each agency, rather than the administratively simpler exchange of Official Orders required under a DoSO.

2.44 Evaluation of the tender submissions resulted in the ATO selecting a panel of four ECAs: three that had provided services during the previous four years, and one new provider. The tender evaluation report indicated that seven submissions met the ATO's requirements, and the final ranking of the four providers was based on the prices included in the agencies' individual submissions. The panel arrangement was estimated to cost \$59.5 million in ECAs' fees over four years.

2.45 The ATO advised that four providers was the optimum number for the panel, so that the ATO needs can be met while maintaining a value proposition for both the ATO and the contractors. However, no analysis was provided to support this position. For example, entering into service arrangements with three providers may have reduced the ATO's administrative requirements, and extending the panel to more than four providers may have retained the services of an ECA that had been satisfactorily delivering services for the previous four years.

ECA services and pricing structures

2.46 Services provided by ECAs are based on a set number of letters and phone calls per debt case referred, similar to the first contracts established with ECAs. However, ECA payments, while still on a fee (as opposed to commission) basis, are calculated on the volume of cases referred rather than the value or category of each debt case, as in the previous contracts. For example, all debt collection cases are based on a fixed price up to a maximum of 50 000 cases referred, with the rate changing for higher volumes of cases.

2.47 The ECAs also provide a volume discount on trace and collect cases, based on a minimum number being referred each year. Table 2.3 sets out the variances between the highest and lowest fees charged by the four ECAs for debt collection, trace and collect services and reminder calls, expressed as a percentage of the highest fee. These figures show that there is significant

variation between the fees charged for the same services, with the highest fee being more than double the lowest fee.

Table 2.3

Variances⁽¹⁾ between the highest and lowest fees charged for services provided by ECAs, for the period 2011–12 to 2012–13

ECA service provided	Volume of cases		
	<50 000	50 000—100 000	>100 000
Collect only	63%	60%	57%
Trace and collect	69%	67%	63%
Reminder calls only	65%	63%	61%

Source: ANAO analysis of ECAs' fee structures.

Note 1: Variances between highest and lowest fees expressed as percentage of the highest fee.

2.48 Fees are fixed for the initial two years of the DoSO, 2011–12 to 2012–13, and then subject to review with each one year term option. Comparison between the highest and lowest fees reflects a difference in cost to the ATO, with one ECA charging a significantly lower price than the others. While the ATO has to be satisfied that the providers, irrespective of their individual pricing, meet all the standards and operating guidelines required in delivering services, the lower costs offered by one provider will have implications for the ATO in the allocation of work across the panel. In the first contract period, with minor exceptions, the ATO allocated work equally between the four ECAs, irrespective of the price differences between them.

2.49 Establishing panel arrangements with the ECAs allows the ATO to have quick and easy access to their services, without having to go through the requirements of a tender process for every acquisition. Advice provided in the ANAO's *Better Practice Guide, Developing and Managing Contracts*, includes that:

For each panel procurement, agencies need to ensure that there is sufficient documentation to provide an understanding of the reasons for the procurement, including approvals and authorisations and the basis for those decisions. In the context of a panel procurement, agencies should therefore document how a procurement made under a panel arrangement achieves value for money.⁷⁵

⁷⁵ ANAO Better Practice Guide, *Developing and Managing Contracts*, p. 24. Published February 2012.

2.50 The ATO acknowledges that each ECA has the capability and capacity to manage the projected ATO case load independently, but to maintain panel arrangements contractors need to receive sufficient work to cover overheads and the transition costs associated with providing services to the ATO. The ATO did not negotiate on price in finalising the DoSO with each agency, but advised that the ECA with the lowest fee has the potential to represent the price benchmark, and a greater proportion of cases would subsequently be referred to this provider. Allocating a greater proportion of work to the lowest cost provider, while providing sufficient work to the other three ECAs (given the set-up and infrastructure costs ECAs incur in providing services to the ATO) to maintain the panel arrangement, will require appropriate management. The ATO advised it is aware of this issue and is prepared to manage it, but had not worked out an approach at the time.

Administrative processes for paying ECA fees

2.51 For the first contract period, the ATO developed a five-step process that allowed the ATO and each ECA to verify the number and category of debt cases referred over the preceding month, and for the ECA to submit an invoice for payment to the ATO.

2.52 The ANAO examined the payment process for August and September 2011 (prior to the new panel arrangements being finalised). The ATO's reports that set out the number of cases referred to each ECA, reconciled with the ECAs' invoices detailing the number of referred cases, as well as the flat fee charge for each category of debt case. The process was transparent and easy to follow, with appropriate quality checks, and provided an effective means for the payment of services provided by the ECAs.

2.53 The invoicing and payment process for ECAs' fees is simpler under the DoSO, as the ATO only has to monitor the total number of debt cases referred to each agency and, based on the volume of cases, ensure that the incremental discount is factored in as the volume of referred cases reaches relevant milestones.

Conclusion

2.54 Many aspects of the debt referral program were immature in the first year of the contract, 2007–08. Key aspects of the specification of services were developed as the contracts progressed; the ICT requirement to support the transfer of a large volume of debt cases was poorly planned; and the ATO had

not fully considered the structure for paying ECA fees, deciding against a commission-based mechanism after the first contracts had been finalised.

2.55 The ATO could more effectively have planned for the outsourcing of debt collection services, based on the issues identified during the pilot program, and on insights gained over many years through various reports and reviews. However, any issues that arose were resolved during the implementation of the first contracts, reflecting the good-will and partnership approach taken by the ECAs and the ATO to implement the program.

2.56 The program was more mature for the second contract period, commencing in 2011–12, but the ATO missed an opportunity to identify areas for change or improvement in contract and sourcing arrangements, in not undertaking a formal evaluation of the first four years of operations. The ATO did assess that procuring ECA services under a DoSO better suited the outsourcing arrangement, but it has not formally considered how the panel arrangements could operate most effectively with four different providers and fee arrangements.

Funding the debt referral program

2.57 As previously mentioned, the 2007 federal budget provided the ATO with an additional \$125.7 million over four years to fund the Debt Collection Enhancement Program (DCEP). Of this funding, the ATO allocated just over \$37 million to fund the referral program to action income tax, activity statement debt, and superannuation guarantee charge debts.

2.58 In addition to DCEP funding, the ATO has received other government funds to target debt, some of which has also been allocated to support the referral of debt cases to ECAs. These funds are the:

- Assisting Small Business (ASB) program: in the 2009 budget, the ATO received \$100.2 million over four years for this initiative; and
- Extended Debt Collection (EDC) program: in the 2010 budget, the ATO was allocated \$337.5 million over four years, to manage the risks associated with net outflows from the GST system, including the collection of outstanding debt. Of this funding, the ATO allocated approximately \$40 million (over four years) to the referral program—\$30.8 million for ECA fees to action activity statement debts, and \$9 million for staffing. The nature of this funding meant that it could only be allocated to action activity statement debts.

From 2008 onwards, the ATO has also transferred funds from the ATO's business-as-usual (BAU) funding to pay ECA fees, including underspend in other areas of the business line.

2.59 While each program had a portion of funding allocated to ATO staffing and other operational costs, the main expenditure in relation to the referral program is the amount paid in ECA fees. Table 2.4 shows the ATO's total expenditure on ECA fees, by funding source, from commencement of the first contract period in 2007–08, and the first six months of the new DoSO arrangement, 1 July 2011 to 31 December 2011.

Table 2.4

ECA fees paid, by funding source 2007–08 to 31 December 2011

Year	DCEP	EDC	ASB	Other/BAU	Total amount (excl GST)
07–08	\$6 540 296	\$0	\$0	\$0	\$6 540 296
08–09	\$6 820 578	\$0	\$0	\$1 496 744	\$8 317 322
09–10	\$14 421 471	\$0	\$0	\$4 441 093	\$18 862 564
10–11	\$5 551 832	\$5 369 000	\$939 545	\$3 292 980	\$15 153 357
Total	\$33 334 177	\$5 369 000	\$939 545	\$9 230 817	\$48 873 539
11–12 ⁽¹⁾	\$0	\$2 344 282	\$0	\$2 810 468	\$5 154 750
Total	\$33 334 177	\$7 713 282	\$939 545	\$12 041 285	\$54 028 289

Source: ATO Finance and Reporting.

Note 1: 1 July to 31 December 2011.

2.60 The amount paid in fees to the ECAs between 2007–08 and 2010–11 reflects the referral of 1 349 211 debt cases, an increase of 185 per cent on the 473 500 cases the ATO estimated would be referred during this period (refer Table 4.2⁷⁶). The ATO was able to support the increase in the volume of referred cases through supplementing specific program funding with the transfer of funds from other sources.

2.61 From October 2011, at the start of the new DoSO arrangement, \$23.8 million remained in EDC funding to support the referral of activity

⁷⁶ There are slight variations in the number of referred cases included in different tables throughout the audit report. These variations result from the ATO accessing the referral data on different days, or at the end of one week and the start of another, for various reporting requirements. For example, the flat fee report is run at the end of the month, while the collections and retrievals report is run weekly.

statement debt. However, this would not support the volume or categories of debt cases referred in previous years, and was below the estimated total of \$59.5 million in ECA fees for the four years of the DoSO. Between 1 July and 31 December 2011, the ATO has transferred over \$2.8 million in BAU funding for the referral of other categories of debt.

Official work orders issued under the Deed of Standing Offer

2.62 Under the newly established DoSO, as at 30 April 2012, official work orders issued by the ATO support the provision of up to \$8 million in ECA services to the end of the financial year, 2011–12. Table 2.5 summarises these work orders, reflecting a reduction in the value of the work that may be referred in the second half of the financial year. The ATO advised that an additional \$480 000 has been transferred from BAU funding to the debt referral program, but there are no plans to transfer any further BAU funds.

Table 2.5

Value of work orders issued to ECAs, 2011–12

ECAs work orders, 2011–12	October— December 2011	January—June 2012	TOTAL
Total value of work orders issued	\$5 million	\$3 million	\$8 million

Source: ANAO analysis of ATO official orders, as at 30 April 2012.

2.63 The selection of debt cases for referral and the allocation of work to ECA panel members will be influenced by available funding. The ATO advised that it has:

...a long-term commitment to the use of external collection agencies as an integral part of its debt collection activities. Additional funding provided by the Government in the 2012 Federal Budget - \$106 million over four years and \$195.3 million to extend the GST compliance program for a further two years - includes specific funding for the use of external collection agencies in collecting debt on behalf of the ATO.

Conclusion

2.64 The reallocation of BAU funds and underspend from other areas in the ATO supported an increase in the volume of cases that could be referred to ECAs. However, it is expected that there will be fluctuations in the allocated work as available funding fluctuates. One provider has a lower price structure than the other members of the panel. The ATO will need to manage the circumstances in order to support allocating a greater proportion of work to

the lowest cost provider, while providing sufficient work to the other three ECAs (given the set-up and infrastructure costs ECAs incur in providing services to the ATO) to maintain the panel arrangements. The ATO subsequently advised that additional funding provided by the Government in the 2012 budget includes specific funding for the use of external collection agencies.

Security requirements for managing ATO data

2.65 Assurance that the ECAs are compliant with all security requirements for the management of taxpayers' information is critical to the success of, and the community's confidence in, the ATO's use of ECAs. Two branches in the ATO provide an internal advisory and support service to the whole organisation in relation to the security of ATO information, including the referral program:

- the Trusted Access (TA) branch, within the Enterprise Solutions and Technology sub plan, provides assurance on information and communications technology (ICT) security arrangements; and
- the Security Policy and Services (SPS) branch, part of Property Security and Environmental Services within ATO Finance, is responsible for the development of strategic and physical security policy.

The ANAO reviewed the ATO's ICT and physical security arrangements to safeguard the privacy of taxpayers' information held and managed by the ECAs.

ICT and physical security of ATO data during tender evaluation and pre-commissioning

2.66 Reviews of the ECAs' ICT systems and office premises conducted by the TA and SPS branches as part of the tender evaluation (August to September 2007) found variations in the standards of the agencies' security posture. The ECA that had delivered the pilot program was found to be generally compliant with the ATO's ICT requirements, although the assessment noted there was still room for improvement. Another ECA was found to have some security weakness that could be readily remediated. However, the ICT arrangements in the remaining two agencies were not as well developed. One would be required to implement a range of additional controls, while the other exhibited a notable lack of security controls that reflected standards well below those required by the ATO.

2.67 Reviews conducted by the SPS branch focussed on the physical security of the agencies' premises. The reviews found that none of the ECAs had suitable arrangements for the storage of ATO classified information. While the agency involved in the pilot program required some remediation, the other ECAs were assessed as 'marginal' or 'not recommended' as service providers to the ATO, without substantial additional controls.

2.68 Implementing the additional controls identified during the tender evaluation caused delays in the referral of debt cases to the agencies, including to the agency that had participated in the pilot program the previous year. The referral of debt cases to the first agency was delayed until November 2007, with the last of the three agencies coming on-stream in May 2008.

2.69 An ICT pre-commissioning review was conducted on each of the four agencies, on all their sites. However, only two of the agencies underwent a physical pre-commissioning review of all their sites. The ATO was unable to provide documentation to support how the other two agencies were assessed as having met the additional physical requirements identified in the tender evaluation.

ICT and physical security of ATO data: ongoing assurance

2.70 Ongoing assurance that the contracted ECAs are meeting all ICT and physical security requirements is a shared responsibility between the ATO's TA and SPS branches; and the debt referral team, specifically the ECA contract manager. Assurance is provided through: annual reviews; the management of security issues and risks; the submission of monthly Certificates of Assurance (COAs); and the provision of business continuity plans (BCPs).

Annual security reviews

2.71 The ATO's 2007–08 to 2010–11 contracts with ECAs included that the contractor(s) must participate in security reviews annually.⁷⁷ Reports outlining any issues or recommendations identified during these reviews would be provided to the ATO's debt referral team.

2.72 Over the four-year contract, the ANAO's review of the relevant documentation indicated that only one annual review had been undertaken for each ECA. This finding was inconsistent with a response to a Question on

⁷⁷ ATO *Debt Collection Services Contract*, Schedule 1, section.U.

Notice the ATO provided to the Senate Standing Committee on Economics, June 2011, that stated⁷⁸:

The ATO conducts comprehensive annual reviews of the information technology systems and accommodation security of the debt collection agencies. These reviews test that all security requirements in relation to the storage and handling of taxpayer information as specified in the contracts, are being strictly adhered to.

2.73 On 1 May 2012, the ATO advised that a request to the Department of Parliamentary Services to remove the word ‘annual’ from the response provided to the Senate Standing Committee had been actioned.

Managing security issues and risks

2.74 The TA and SPS branches manage ICT and physical security issues and risks through separate risk register databases. The TA database was established in July 2009, and issues identified in ECA reviews conducted prior to this date are not included in the database. However, issues identified for two ECAs have been ‘completed’ and are recorded on a separate spreadsheet. The SPS branch also added ECA issues to their database in July 2009 but maintains a separate record of prior issues and their status for the debt referral program.

2.75 As at December 2011, there were no outstanding issues on the SPS database, but 41 ICT related issues remained on the TA database, all of which had been outstanding for at least 14 months. Of the 41 issues, 23 were rated as ‘moderate’ to ‘high’ levels of risk; and 18 rated ‘partially non compliant’. Seventeen of them were against one ECA, and included issues relating to:

- data classification: the agency’s existing policies did not fully align with the (then) Australian Government Protective Security Manual⁷⁹, and protective markings are only applied to hardware and printouts;

⁷⁸ Senate Standing Committee on Economics, *Budget Estimates*, 31 May—2 June 2011, Question Number BET 39.

⁷⁹ Now referred to as the Australian Government Protective Security Policy Framework it sets out the minimum physical requirements for Australian Government agencies, and is produced by the Attorney Generals Department.
<http://www.ag.gov.au/www/agd/agd.nsf/Page/ProtectiveSecurityPolicyFramework_Content> [accessed 2 December 2011].

- documenting security clearance and briefing requirements: no System Security Plan (SSP) exists that identifies access requirements, security clearance levels and briefings for access to the ECA system;
- information security non-compliance with controls: the ECA has not documented why they are not complying with certain controls as required by the Australian Government Information Security Manual; and
- information technology security: no encryption is used for hardware for working off-site.

2.76 The TA and SPS branches advised that they provide an internal advisory function to the debt referral project, and provide review reports to the debt referral team, specifically the ECA contract manager. However, it was not evident which area or staffing group has responsibility for ensuring that ICT and physical security reviews of ECAs' operations are routinely scheduled and implemented, and that issues identified in these reviews are appropriately addressed within an acceptable timeframe. The TA branch advised the ANAO it did not know what the key risks would be at the outset of the outsourcing arrangement, as this was a new initiative for the ATO, and their current role is: 'to provide assurance of the compliance and broad security assessment, and is not the primary method of security assurance for an outsourced capability'.

2.77 The allocation of responsibilities is central to the ATO's commitment to the secure management of taxpayers' information. The lack of clarity and accountability for these responsibilities creates its own risk that the ATO has not effectively managed.

Certificates of Assurance

2.78 Included in the ECAs' contracts is the requirement to complete monthly COAs⁸⁰, and to submit these to the ATO within three working days after the preceding month. To complete the COAs, the ECAs are required to self-assess that 19 principal controls are in place, including that staff have appropriate clearances for access to 'in-confidence' information, and have the correct ATO authorisations. Of the 19 controls in the COA, 10 relate directly to controls that

⁸⁰ *Debt Collection Services Contract*, op. cit., clause 34.6.

provide assurance about the secure management of taxpayer information by both the ECAs and their contractors.

2.79 Completed COAs are reviewed by the debt referral team, and any issues relating to ICT or physical security matters would be escalated to the TA or SPS branches, respectively. Completing COAs provides some assurance to the ATO that issues of material importance are documented and appropriately managed, although the self-assessment nature of these certificates means that the ATO cannot be completely assured that this is the case. An example of the COA is at Appendix 2.

2.80 The ATO advised that the COA process commenced in January 2008, but any certificates submitted prior to July 2009 could not be located. The ANAO reviewed all of the 104 COAs submitted by the ECAs in the period 1 July 2009 (some two years after commencement of the ECA contracts) to 30 August 2011.

2.81 The COAs require the ECAs to provide a *Yes* or *No* response that a control is in place and is effective. Every response across the 104 COAs for the 19 controls was affirmative. While the ECAs' responses indicated they had these effective controls in place, the uniformly positive responses seem at odds, to a degree, when compared with the findings of the limited reviews undertaken by the ATO. For example, the response from one ECA included the same comment against the IT Security control for 13 months (July 2009 to July 2010), indicating that they were 'currently working with Tax on resolving areas highlighted in the IT security audit' (that had been conducted on 4 December 2008).

2.82 There would be merit in the ATO examining the COA process. The ATO's Legal Services and Contract Management Units advised that, where assurance is required to be given by the contractor, the COA process should contain cross references to the relevant contract clause. In completing the COAs, ECAs are self-assessing that they are meeting requirements set out in their contract or DoSO, and where a control is not being performed, the issue presents a risk to the secure management of ATO data and should be addressed promptly. Additionally, how the same IT security control could be outstanding for 13 months reflects the lack of clear lines of responsibility within the ATO for resolving the issue.

Business Continuity Plans

2.83 The ANAO reviewed ECA Business Continuity Plans (BCPs) and supporting email endorsement and correspondence from the debt referral

team. All ECAs had met the contractual requirement to submit a BCP within one month of the contract commencement, and annually thereafter. However, in the first year of the contract, 2007–08, two ECAs provided summary documents rather than the full BCPs. Neither of these summaries addressed all the criteria required in the BCP, and the ATO was unable to provide the completed documents for these ECAs.

2.84 For subsequent years, one ECA continually failed to include information in their BCP relating to the requirement to provide training to key personnel, and to have in place a testing and maintenance program in regard to business continuity management. While the ATO advised that the ECA was asked to complete the BCP, no evidence was provided to indicate that this had actually occurred, or was followed up by the ATO.

2.85 The ATO provided the BCPs submitted by the four ECAs under the new DoSO arrangement, and advised that they are still being reviewed by the ATO's information technology area, to ensure compliance.

Management of ECA contract termination

2.86 Included in the ECAs' contracts was the requirement to provide the ATO with a transition-out plan that sets out the process that would apply should the ATO and the ECA terminate their agreement. The process includes the return of hardware to the ATO, and provision for a verification audit to be conducted by the TA branch.

2.87 In September 2011, the transition-out plan came into effect for the ECA that had been providing services to the ATO, but was not awarded a new contract. The plan was designed to support prior knowledge that the contract would not be renewed, setting out specific processes that would be implemented six and three months prior to the end of contract. However, in this instance, there was no prior knowledge that the arrangements between the ATO and the ECA would be terminated, as the ECA had submitted a tender for a further contract.

2.88 While the contract required that the ECA continued to provide debt collection services for up to six months (specifically, 180 days) after the termination or expiry of the contract⁸¹, the ATO recognised that the changed

⁸¹ ATO *Debt Collection Services Contract*, Section 17.3.1 (e).

circumstances presented an element of increased risk to the security of taxpayer data. Additionally, the process and timing for the verification audit (that the transition-out plan had been completed) was yet to be established by the TA branch. A revised transition-out strategy was developed and implemented in January 2012 that expedited the transitioning of debt cases back to the ATO more quickly.

Conclusion

2.89 Meeting ICT capability and security and physical security requirements are critical to the success of the referral program and arrangements to ensure that these elements of the program were both appropriate and effective should have been in place at the outset. The relationship, roles and responsibilities between the groups providing assurance in relation to the ongoing security and privacy of ATO data have evolved over the life of the contract.

2.90 There have been no known security breaches relating to taxpayers' data. However, the lack of agreement between the relevant branches as to where responsibility lay to schedule reviews and to regularly follow up on the findings raised, and a difference of opinion about when the reviews were actually required, presented a potentially serious risk to the secure management of ATO data. Inappropriate use of ATO data presents a high level of risk to both individual taxpayers and the ATO's reputation and engagement with the Australian community.

2.91 The requirement for ECAs to submit monthly COAs is an important component of the ICT and physical security requirements, but either they were not submitted by ECAs during the first two years of the contract, or they have been misplaced by the ATO. The ATO advised that, during this period, appropriate clearances and authorisations for ECA personnel were manually maintained on a separate register and updated weekly. However, COAs deal with essential aspects of the ECAs' operations, there is no evidence that other key issues were addressed, including critical aspects of ICT and physical security.

2.92 The ANAO notes that the ATO has commenced work to determine roles, expectations and responsibilities between key groups to provide the required assurance to the referral program. The TA branch also provided the ANAO with a draft version of 'Information Security Guidelines for Contractors'. The Guide aims to assist contract managers to understand ICT security arrangements, and recognises that a program's contract manager is

not usually required to have the skills to effectively monitor the complex ICT and physical security arrangements that support the secure handling of ATO information.

Recommendation No. 1

2.93 To provide assurance that taxpayers' information for the referral program is being adequately protected, the ANAO recommends that the ATO:

- clearly defines the respective roles and responsibilities of the Debt business line and the Trusted Access branch and the Security Policy and Services branch; and
- implements all elements of the security framework, particularly the scheduling of reviews, and the completion of Certificates of Assurance and other requirements as set out in the Deeds of Standing Offer with the ECAs.

ATO response

Agreed. The ATO considers the security of taxpayer information of utmost importance and is committed to ensuring that taxpayer information is protected. Implementation of this recommendation will further strengthen our administration of security requirements.

3. Operational Strategy and Stakeholder Engagement

This chapter examines the ATO's systems and processes to select, refer, update and retrieve debt cases referred to the contracted external debt collection agencies. It also examines the ATO's communication strategy and management of complaints.

Introduction

3.1 The ATO refers selected debt cases to the ECAs on a weekly basis by secure electronic transfer. Included in these transmissions are updates on cases that are already under management by the ECAs. Debt cases may remain with an ECA for up to 180 days, unless the debt is paid in full, payment arrangements are established, or the ATO retrieves the case for some other reason, including that the debt has been escalated and will be managed by ATO staff.

3.2 Many debt cases remain unresolved when they are retrieved by the ATO, and the debt amount may actually have increased while the case was under ECA management. The ATO is still responsible for these debts and for determining appropriate further treatment.

3.3 To assess the arrangements supporting the debt referral program, the ANAO examined the ATO's processes for:

- selecting and referring debt cases to the ECAs;
- updating debt cases already under management by the ECAs; and
- the management of retrieved cases.

3.4 The ANAO also examined the ATO's ICT systems and processes supporting the selection and transfer of debt cases to the ECAs; and the arrangements for engaging stakeholders and managing complaints.

Selection and referral of debt cases

3.5 The ATO's operating systems are coded to identify those debt cases that meet the ATO's criteria for referral to ECAs, including the type of debt—income tax, activity statement or superannuation guarantee charge debt—and that the case is 'active'. The coding can be adjusted to allow changes in the characteristics and or volume of debt cases that are to be referred to ECAs.

Debts may also be referred a second time, to a different ECA, where there has been no payment outcome from the first referral.⁸²

3.6 The referral process does not ‘match’ any particular type of debt case to an individual ECA, (except to exclude the original ECA if the case is being re-referred) and, during the first contract period, did not take into account any differences in fees between the ECAs. This may change under the newly established ECA panel arrangements, should the ATO seek to maximise the cost savings offered by the fee arrangement of one of the agencies.

3.7 Advice provided by the ATO on adjustments made to the selection coding for the period 2007–08 to 2010–11, included those that supported:

- increases in the value of debt that could be referred (up from the original \$7500 threshold, refer Table 3.1); and
- DBL operational requirements, (for example during February and March 2010, no income tax cases were referred to ECAs to allow the transitioning of the management of income tax cases to a different operating system within the ATO).

3.8 Adjustments to the selection coding that required contract variations were fully documented. However, the majority of changes did not require a contract variation, were operational in nature and were negotiated and implemented informally through email exchanges between relevant debt teams.⁸³

Pre-referral warning letters

3.9 In April 2010, the ATO modified its procedures to require a pre-referral warning letter be sent to taxpayers, giving them 14 days to respond to the ATO prior to their case being referred to an ECA. This was a recommendation made some four years earlier in the review of the pilot program. In 2008, the ATO had trialled sending a pre-referral warning letter to taxpayers. The ATO issued approximately 2000 letters and these resulted in a 30 per cent engagement rate.

⁸² The ATO does not generally capture or report data on the number of debt cases referred for a second time, but provided information for the week of 28 June 2011. In that week, of the 11 857 debt cases selected for referral, 486, or just over 4 per cent, were referred for a second time.

⁸³ The ATO advised that, commencing July 2010, minutes prepared for the DBL Executive Management team keep them informed of high level changes to selection criteria, for example decisions concerning the use of the funds allocated to the referral program.

3.10 Following the trial, not all taxpayers selected for referral action were issued a warning letter (until the requirement was introduced in 2010) due to a range of factors, including limitations on the number of letters the ATO could produce at any one time, and the potential for the initiative to limit the number of cases available for referral. These operational concerns may have reduced collections from taxpayers who may have paid their debt on receipt of the warning letter, and caused the ATO to incur ECA costs that were not warranted.

Changes in the value and age of referred cases

3.11 The ATO's initial intent in establishing the outsourcing arrangements was to target mainly aged, low value debt. However, within a few months of commencing the contracts with ECAs, debts with increased thresholds became eligible for selection. As the contracts progressed, newer debts were also selected. Table 3.1 shows the number of debt cases referred to ECAs by threshold value during the years 2007–08 to 2010–11, and for the first six months of 2011–12. The table is not sufficiently detailed to reflect small changes in threshold values that have been applied at different times including:

- for a period during 2010–11, an increase in the lower value cases threshold, from \$7500 to \$10 000; and
- data available for October to December 2011, during the first three months of the new DoSO arrangement, breaks down the lower value thresholds to: less than \$2500; \$2500 to \$10 000; and \$10 000 to \$25 000. In the table, these are combined and included in the \$7500 to \$25 000 column.

The data in the table indicates the overall number by value of debt cases referred to ECAs since commencement of the outsourced arrangement.

Table 3.1

Number of debt cases referred to ECAs by threshold value (\$'000), for the period 2007–08 to 31 December 2011

Year	Total number of referred cases	Number of cases by categories of threshold value					
		<\$7.5 (\$'000)	\$7.5–\$25 (\$'000)	\$25–50 (\$'000)	\$50–\$75 (\$'000)	\$75–\$100 (\$'000)	\$100–\$150 (\$'000)
07–08	195 733	182 899	7 950	3 394	1 374	81	35
08–09	224 887	218 098	5 005	1 524	258	1	1
09–10	481 660	409 876	42 459	23 732	5 585	0	8
10–11⁽¹⁾	412 274	375 893	24 095	10 443	1 840	1	2
Total	1 314 554	1 186 766	79 509	39 093	9 057	83	46
1 July–30 Sept 2011	94 272	83 747	7 109	2 801	615	0	0
1 Oct–31 Dec 2011	88 461	0	88 402	59	0	0	0
Total	1 497 287	1 270 513	175 020	41 953	9 672	83	46

Source: ANAO analysis of ATO Flat Fee Reports.

Note 1: No income tax cases were referred to ECAs in November and December 2011.

3.12 The ATO advised that any debt above \$75 000 is not a planned referral, but the value of the debt may increase after selection—account balances can fluctuate regularly due to the lodgement of activity statements or income tax returns. Where a debt has increased after referral to an ECA, the ATO applies a business rule (referred to as the ‘21 day’ rule) that automatically retrieves debt cases where the balance of the case has remained at the increased level for 21 days, or three weeks. A case will be retrieved from an ECA when the balance of the debt has exceeded:

- \$50 000 for three weeks, for cases with referred debt of less than \$10 000; or
- \$150 000 for three weeks, for cases with referred debt greater than \$10 000.

3.13 Where a debt case exceeds the ECAs' delegations⁸⁴, ECA staff can still proceed with a telephone call to the client to discuss the debt, but are required to seek approval from the ATO for any payment proposal negotiated with the taxpayer. During site visits the ANAO observed the ECA operations, and on one occasion noted that an ECA staff member did not immediately seek approval for a negotiated payment above the \$150 000 delegated authority, when the ANAO team was present.

3.14 In relation to the change in the age of debt cases being referred to ECAs, the ATO does not produce any reports on the age profile of these debts but provided information for activity statement and superannuation guarantee charge debts for 2011. Table 3.2 sets out the number and age of these debt cases referred to ECAs during 2011.

Table 3.2

Age profile of AS and SGC debt cases referred to ECAs during 2011

Age Profile	Number of debts referred	Percentage of total debt referred
0–3 months	112 561	46.8
3–6 months	61 739	25.7
6–9 months	27 794	11.6
9–12 months	12 241	5.1
More than 1 year	26 159	10.8
TOTAL	240 494	100.0

Source: ATO.

3.15 While the data is for a limited reporting period, the figures do indicate that for these selected cases, debts less than six months old represented over 70 per cent of cases referred to ECAs, with over 46 per cent being less than three months old. This reflects a significant change from the initial intent of the referral program, to target mostly aged debt and to engage with taxpayers with long outstanding obligations. This change supports the ATO's 'early collection' strategy—aged debts are harder and more expensive to collect.

⁸⁴ The relevant Instruments of Authorisation that support the delegations extended to ECAs to: (a) permit the payment of the whole or any part of any tax-related liability of \$150 000 or less by instalments for a period of up to 24 months; (b) remit general interest charges of \$10 000 or less; and (c) remit administrative penalties imposed by law relating to failure to lodge documents on time of \$10 000 or less. These delegations are consistent with those of ATO staff who perform similar duties.

However, the timing of the referral of very new debt is a problematic issue as taxpayers may just be a little late in paying their debt. The ATO advised that newer debt cases that may self-finalise are not identified through the case selection processes. These cases are isolated for a short time from the initial ATO automatically generated letters, and prior to a case becoming eligible for referral.⁸⁵

Volume of referred cases

3.16 Potential constraints on the volume of debt cases that can be referred to the ECAs each week include: the number of available cases that meet the selection criteria applied at that time; the amount of funding available for the payment of ECA fees; and workload capacity in other areas of the ATO. For example, competing demands on the ATO's printing production (for pre-referral warning letters) or call centre capacity if a large volume of debt cases was to be referred. The ATO advised that funding is the main factor in deciding the number of cases referred. Available funding for the payment of ECA fees may constrain or increase the number of cases that can be referred. Funding may become available, often at short notice, towards the end of the financial year from underspend in other areas of the ATO.

3.17 Table 3.3 sets out the total number and type of debt cases referred for ECA collection for the period 2007–08 to 31 December 2011.

⁸⁵ New debt cases with certain risk scores indicate they may self-finalise. Generally, activity statement payments are due on the same day as the taxpayer's activity statement is lodged, and depending on the assessed level of risk, these cases may be held for up to 30 days before an ATO demand letter is sent. For income tax cases, generally the tax is due 21 days after the date for lodgement and an ATO demand letter could issue after this date. In both situations, a pre-referral warning letter could then be issued if the taxpayer does not engage with the ATO concerning the debt.

Table 3.3

Number and type of debt cases referred for the period 2007–08 to 2010–11, and 1 July to 31 December 2011

Year	Type of debt referred to ECA			
	Total	Activity statement	Income tax	Superannuation guarantee charge
2007–08	196 230	164 679	30 353	1 198
2008–09	229 375	159 531	68 904	940
2009–10	509 394	443 038	65 620	736
2010–11	414 212	279 923	134 268	21
Total	1 349 211	1 047 171	299 145	2 895
2011–12	142 573	121 256	21 317	0
Total	1 491 784	1 168 427	320 462	2 895

Source: ANAO analysis of ATO Debt referrals reports.

3.18 As previously noted, the referral process does not ‘match’ any particular type of debt case to an individual ECA (except to exclude the original ECA if the case is being re-referred), and during the first contract period, the ATO did not take into account variations in ECAs’ fees.

Updating referred cases

3.19 The ATO provides the ECAs with weekly updates on referred debt cases, including where a taxpayer’s contact details have changed or a payment has varied the amount of the debt since the case was referred. Updated information received by the ECAs is also provided in daily reports to the ATO. However, taxpayers’ details may still be out-of-date when they are contacted by an ECA. When ECA staff require more information, they have phone access to the ATO’s Debt Referral Support Team (DRST). Based in Melbourne and part of the debt referral team, the DRST has an average of six staff and provides an exclusive service to the ECAs.

3.20 The need to update information is not usually identified until the taxpayer is contacted by an ECA staff member, resulting in the taxpayer being put ‘on-hold’ while details are checked with the DRST. This causes inconvenience to the taxpayer and may raise their concerns about the authenticity of the caller if ECA staff have the wrong information.

3.21 The DRST's phone service has been in place since the commencement of the contracts with ECAs in 2007–08. However, the ATO advised that data on the number and nature of inbound calls received prior to July 2009 has been lost as a result of a system failure. From the data available, the ANAO's analysis identified that four enquiry categories account for the majority of inbound calls to the DRST. These categories are:

- account balance enquiry—relating to the current balance that is owed, as well as the nature of the debt;
- account enquiry (other)—not related to the account balance, for example, bank details for the taxpayer;
- payment enquiry—relating to the last payment received by the ATO, and the method of payment; and
- contact details required—taxpayer's contact details are incomplete or out of date.

Table 3.4 sets out the total number of calls to the DRST and the number of calls in each of these categories, for the period 2009–10 to 2010–11, and 1 July to 31 December 2011.

Table 3.4

DRST inbound call analysis—1 July 2009 to 31 December 2011

Year	Number of calls received	Reason for call to DRST			
		Account balance enquiry	Account enquiry (other)	Payment enquiry	Contact details required
2009–10	80 189	18 652	29 330	8 917	1 491
2010–11	98 142	29 237	25 322	9 775	1 849
Total	178 331	47 889	54 652	18 692	3 340
2011–12 ⁽¹⁾	30 898	10 066	4 753	3 290	417
Total	209 229	57 955	59 405	21 982	3 757

Source: ANAO analysis of Debt Referrals Team and Vendor Reports, and inbound Call Reporting databases, July 2009 to December 2011.

Note 1: 2011–12 shows figures from 1 July to 31 December, 2011.

3.22 The balance of 66 130 calls, or approximately 32 per cent of total DRST inbound calls, was spread evenly across the other call categories, including general interest charge remission checks. Overall, the ATO estimates that approximately 80 per cent of inbound calls received from the ECAs are routine

enquiries for information that is necessary to undertake debt collection activity. Despite the effort invested in updating taxpayers' records, the routine nature of these enquiries indicates the processes are not optimal, resulting in the inefficient use of both the ATO's and ECAs' time and resources. Processes supporting the provision of timely and accurate information to ECAs would reduce the need for dedicated ATO resources, and present a more professional experience for taxpayers.

3.23 In response to this issue, in February 2009 the DBL developed a proposal to provide ECA staff with a limited level of access to the ATO's systems, similar to the access provided to external contractors providing 'overflow' services for the ATO call centres. The proposal was assessed and rejected on the basis that it would not be cost effective for the ATO.⁸⁶ A later proposal in March 2010 for systems' enhancements that would better support the ECAs by providing them with more timely and frequent updates, was assessed and subsequently withdrawn. The project was based on the assumption that it related only to activity statement debt, and it was later realised that income tax debt was also a requirement. The ATO made the business decision to cease the project until such time as all referral debt cases are stored and operated within the same operating systems.

3.24 The ATO advised that other means of providing ECAs with access to the ATO's systems have been informally discussed, but not progressed. These include the option to co-locate contracted ECA(s) within ATO premises; and the provision of one 'stand alone' computer in the ECA premises that would be accessed exclusively by an ECA supervisor. The ATO subsequently advised that a submission is being prepared to progress the 'stand alone' computer option, for submission to, and possible endorsement by, the DBL Executive by July 2012.

Conclusion

3.25 The ATO adjusts selection coding to change the characteristics and volume of cases for referral, subject mainly to the level of funding available to

⁸⁶ *ATO System Access for External Collection Agents, Concept Brief*, February 2009. The Enterprise Solutions Technology Outsourcing Management Team in conjunction with TA branch advised that this option would need to be implemented in a relatively large scale in order to be cost effective as there would be considerable hardware and infrastructure costs associated with the extension of the ATO Network.

pay ECA fees. Over the course of the contract, the value and age of debt cases referred to the ECAs has changed. The initial strategy—to outsource the collection of low value, aged debt—no longer applies. Referred debt cases remain non-complex cases⁸⁷, but the value of those eligible for referral has increased 10 fold (although the ATO still categorises them as lower value debts); and the focus (particularly for activity statement and superannuation guarantee charge debts) is now on newer debts.

3.26 While recognising the importance of adapting and changing debt collection approaches, it is also important for the ATO to formally define the strategy underpinning the use of ECAs. In doing so, the ATO would be consciously placing the referral program within the DBL's debt collection framework.

3.27 ECAs are regularly required to contact the DRST team for updates to taxpayers' data, reflecting the inefficient use of both ECA and ATO resources. Different system and process options to provide timely and accurate updates have been developed but not endorsed by the ATO. While the ATO advised that the issue is again being progressed, confirmation of the referral program's priority in relation to the allocation of DBL resources would facilitate determining the priority given to developing a business case to improve the program.

Management of retrieved cases

3.28 All debt cases referred to an ECA are retrieved by the ATO 180 days after referral, or sooner if the debt has been paid in full, a payment arrangement has been established, or the debt has escalated and will be managed by ATO staff. When a debt case is 'retrieved' by the ATO, the management of the case returns to the ATO. Taxpayers' details remain with the ECAs and are archived within the ECAs' systems.

3.29 The Debt Retrieval Report provides information on the number of all debt cases (activity statement, income tax and superannuation guarantee charge debts) the ATO retrieves from the ECAs each month. The report includes a breakdown of the reason for their retrieval by four categories: cases retrieved with a nil debt balance; the number with active payment

⁸⁷ A non-complex debt is usually a single debt arising from one tax.

arrangements in place; where a case has reached 180 days; and 'all other' categories. Table 3.5 shows the number of retrieved cases in each category, for the years 2007–08 to 2010–11, and the part year, 1 July to 31 December 2011–12.

Table 3.5

Retrieved cases 2007–08 to 2010–11 and 1 July to 31 December 2011

Year	Number of cases referred	Number of retrieved cases	Reason for retrieval			
			Nil balance	Active payment arrangement in place	Reached 180 days with no payment in last 60 days	All other cases retrieved
2007–08	196 230	24 929	20 482	1 489	0	2 958
2008–09	229 375	308 049	159 193	1 282	140 107	7 467
2009–10	509 394	369 426	222 654	1 174	65 976	79 622
2010–11	414 212	462 947	188 731	3 667	165 459	105 090
Total	1 349 211	1 165 351	591 060	7 612	371 542	195 137
2011–12 ¹	142 573	201 351	100 598	1 275	53 917	45 561
Total	1 491 784	1 366 702	691 658	8 887	425 459	240 698

Source: June 2011 EDR Retrieval Report: Pivot Table 4—Total cases retrieved by reason.

Note 1: 1 July to 31 December, 2011.

3.30 From October 2010, the reporting capability for income tax debt cases has varied following the transfer of the management of income tax cases to the ATO's Enterprise system. The Enterprise system generated Debt Referrals Retrieval Outcomes reports (for income tax cases only) are more refined than those produced for the combined activity statement, superannuation guarantee charge and income tax retrieved cases, and include a breakdown of income tax debt cases where action by an ECA did not result in the case reverting to a nil balance. Table 3.6 illustrates the results achieved for income tax cases referred to an ECA, for the period 1 October 2010 to 31 December 2011.

Table 3.6**Retrieved income tax cases from 1 October 2010 to 31 December 2011**

Entire debt collected		Partial debt collected				No debt collected			
		More than 50 per cent		Less than 50 per cent		No change in case balance		Case balance increased	
Cases	%	Cases	%	Cases	%	Cases	%	Cases	%
1 October—30 June 2011					80 677 cases retrieved				
21 424	26.57	2539	3.15	5026	6.23	46 196	57.26	5478	6.79
1 July—31 December 2011					55 580 cases retrieved				
14 755	26.55	2018	3.63	3458	6.22	30 493	54.86	4856	8.74
TOTAL									
36 179	25.55	4557	3.34	8484	6.23	76 689	56.28	10 334	7.58

Source: ANAO analysis of Enterprise Debt Referrals Retrieval Outcomes Reports.

3.31 The data set out in both tables indicates around 50 per cent of all debt cases referred to an ECA result in no reduction in the amount of debt owed (a result similar to that achieved in the pilot program). The figures are more accurate for the Enterprise system generated reports on income tax cases, reflecting that in almost 64 per cent of cases there was no reduction to, or an increase in, the amount of debt owed over the reporting period. Neither of these reports identifies the outcomes achieved from cases that have been referred to a second ECA, in situations where there was no result from the first referral.

3.32 The Enterprise system's reporting capability for income tax cases is still being developed, and the reports are placed on the ATO's Reporting (Cognos) portal.⁸⁸ There has been limited analysis of the information provided in these reports. For example, the more detailed information may support analysis that would better target income tax debt cases to those taxpayers more likely to respond to ECA action.

3.33 The same breakdown of data can be produced for activity statement and superannuation guarantee charge cases, but data from the Legacy system requires considerable manipulation to get a similar report. This work is only

⁸⁸ The reports are held in a restricted folder on the portal that is accessible to a small number of users within the Debt Referrals and Operations Enterprise Reporting areas.

undertaken in response to specific requests. Significant investment would be required to provide the same system-based reporting capability for activity statement and superannuation guarantee charge referred debt cases through the Legacy system. The ATO considers that the current reporting suite meets the ATO's needs and there is no justification to commission a costly system enhancement at this time. In consequence, the ATO has not undertaken any analysis of referred cases that may indicate any specific characteristics of the debt or the taxpayer that would best respond to ECA action.

ECA status codes for retrieved debt cases

3.34 Additional information on retrieved cases is provided by the ECAs in their monthly report to the ATO by allocating a status code to each case where there has been no collection amount, or where there is an arrangement to pay, at the time of retrieval. Valid from December 2010, the list of fourteen codes the ECAs utilised included: actions exhausted, refusal to pay, debt disputed, application for release from debt on grounds of hardship.

3.35 The ATO advised that these codes were reviewed in October 2011 to better reflect the most recent action the ECA has taken on the debt case, and to support more effective streaming of retrieved cases when they are returned to ATO management. Retrieved cases could be referred for the most appropriate treatment action, for example, firmer action or non-pursuit.

3.36 However, information provided by the ECAs is not uploaded into the ATO's systems and therefore is not utilised in determining further action on retrieved cases. A system enhancement that will allow the ECAs to add a status code to the data file prior to the case being retrieved by the ATO, is scheduled to commence in June 2012.

Strategies for the management of retrieved cases

3.37 Provision of the status codes updates by ECAs should assist with the management of retrieved debt cases with debt outstanding following action by the ECAs. They will also complement the most recent refinement to the DBL's debt management strategy, *'Debt Right Now!'*. Introduced in 2010–11, this

strategy provides a more comprehensive measure of risk to prioritise debt cases and to determine collection treatments than was previously used.⁸⁹

3.38 However, since commencement of the outsourcing arrangements, the ATO has undertaken intermittent activities to manage retrieved debt cases that remain outstanding, and no separate reports are available on the results achieved. The activities included:

- an action strategy developed in February 2009, that was based on the premise that ECAs are referred debt cases that are otherwise not actioned by ATO Debt resources, and to have unresolved retrieved cases escalated for firmer action would be unrealistic as the majority are at debt levels that would not meet Firmer Action priorities. The strategy proposed a number of options, including identifying cases that would be automatically re-routed within the ATO's systems for bulk non-pursuit action⁹⁰;
- in April 2009, the extension of bulk non-pursuit parameters to support their application to retrieved cases, noting that the parameters at that time did not have regard to the relatively new initiative of collection attempts by an ECA; and
- in December 2010, strategies were identified to address the current stock of retrieved cases; and future cases retrieved on a weekly basis. The strategies included streaming retrieved cases within specific debt levels (less than \$50 000) to ATO 'dialler' campaigns within the Early Collections area of the DBL. The minute noted the new retrieval rules that had been created to ensure all activity statement retrieved cases stream directly back to the appropriate '*Debt Right Now!*' (DRN!) treatment.

3.39 The ATO advised that streaming activity statement retrieved cases directly back for DRN! treatment is the main strategy now in place for the

⁸⁹ The measure of risk is based on a taxpayer's capacity and propensity to pay, with their lodgement and payment compliance being important considerations in determining the risk rating for each debt case.

⁹⁰ The ATO's bulk non-pursuit processes remove large numbers of debt cases where there is little possibility of collection and it is not economical to pursue the debt. Debt cases subject to bulk non-pursuit are mostly tax debts of less than \$2,500. These debts may be re-raised where, for example, a taxpayer subsequently lodges an income tax return that results in a credit of over \$500. The ATO does not report on the number and value of retrieved cases that are subject to bulk non-pursuit.

management of these cases, although the identification of appropriate debt cases under bulk non-pursuit guidelines is also applied. For income tax cases, the ATO advised that, from September 2011, all income tax cases over \$25 000 were subject to further collection action by the ATO.

3.40 Taken together, these activities suggest a less than strategic approach to managing back-logs of retrieved cases that remain outstanding after ECA action. The original business case for piloting, and subsequently contracting, ECA services noted that the ATO had difficulty allocating resources to the collection of high numbers of low value cases. This position is re-stated in the action strategy of February 2009, (referred to above), 'that ECAs action debt cases that are otherwise untouched by ATO Debt resources', and remain in the same debt category when retrieved. The ATO continues to explore different ways to deal with retrieved cases.

Conclusion

3.41 The ATO's approach to retrieved cases reflects a still developing aspect of the outsourced arrangements. Information about retrieved cases is not analysed so that options to improve the efficiencies of the program might be further considered, including for income tax cases where quite detailed reporting is available. The ATO has not explored any cost savings that might be gained by better targeting cases for ECA action, and ECA fees are paid for each debt case, irrespective of the outcome achieved.

3.42 While the ATO appears to be investing time and effort to better deal with retrieved debt cases that remain outstanding (or have increased in value), there may have been value in considering the management of retrieved cases in the pilot program, and options such as the application of bulk non-pursuit could have been considered at the beginning of the outsourced arrangements.

ICT systems and processes supporting the selection and transfer of debt cases to the ECAs

3.43 The ATO's ICT systems and processes supporting the selection and transfer of debt cases to ECAs are critical to the success of the outsourced arrangements and were examined by the ANAO.

3.44 Following the transfer of the management of income tax cases to a new operating system in October 2010, cases for referral to the ECAs were sourced from two ATO systems: activity statement and superannuation guarantee charge debts are sourced from the Legacy system, and income tax debt cases

from the new Enterprise system. Both systems are supported by the Production Management Unit (PMU) and Operations Sub Plan Enterprise Reporting Team (OSPRT).

3.45 The information transferred from the ATO to the ECAs for each debt case includes the taxpayer's contact details, Tax File Number, tax agent's details and Australian Business Number (where applicable), and the amount of outstanding debt. Each ECA also receives a summary file from the ATO that includes the number and value of new cases being transferred for that particular week.

3.46 The processes for selecting, transferring, updating and retrieving debt cases for the referral program are different for each system. Selecting debt cases from the Legacy system for referral to the ECAs is a relatively complex manual process, involving three stages. In contrast, selecting debt cases from the ATO's Enterprise system is a simpler, one step process.

3.47 The processes applied in the selection, preparation and collation of debt case files in both the Legacy and Enterprise systems are not consistently documented. There is no formal change management process supported by approved documentation; and the documentation for the end-to-end co-ordination process is outdated (July 2008) and does not reflect changes that have been implemented over the term of the contracts with ECAs. The absence of documented and endorsed procedures increases the risk that the information being processed may be compromised and that the completeness and integrity of the underlying data used to produce the information cannot be preserved.

3.48 It is important that the ATO reviews and updates the process documentation for both the Legacy and Enterprise environment, as appropriate. This documentation should provide details of the dependencies, relationships and the change management procedures for case selection as well as updating the end-to-end process document.

Conclusion

3.49 The lack of documentation to support the processes for the selection of debt cases from both the ATO's Legacy and Enterprise systems creates risks to the effective administration of the program. Given the evolving nature of the operational arrangements, it is important that this situation is appropriately addressed.

Recommendation No. 2

3.50 To maintain integrity and consistency in the processes for selecting and referring debt cases to external collection agencies, the ANAO recommends that the ATO reviews and updates the Legacy and Enterprise systems and procedural documentation.

ATO response

Agreed.

Stakeholder engagement and complaints management

Stakeholder engagement

3.51 In November 2007, the ATO's Strategic Communication and Issues Management team developed a strategic communications framework for the Debt Collection Enhancement Program (DCEP). The purpose of this framework was to provide an appropriate level of information to stakeholders and interested parties to enable them to appreciate the use of referral to improve the debt collection performance of the ATO.⁹¹ The framework outlined the principles guiding DBL communication, and identified target audiences, key messages, and communication activities that would support the successful implementation of the DCEP. Documentation setting out the framework included that there would be bi-annual reviews, additional reviews at other times as deemed necessary, and evaluation of the effectiveness of the communication.

3.52 However, the ATO advised that most of the DCEP-specific communication activities occurred in the first year of the project. By 2008–09, the DCEP communication products were absorbed into the overall Debt communication program, reflecting the maturity of the initiatives, such as dialler and referrals into the ATO's operating model, and no reviews or evaluation of DCEP communications were conducted. The actual information about debt referral provided to the general public was also less than originally outlined in the strategic communications framework.

⁹¹ *Debt Collection Enhancement Project—Strategic Communications Framework*, 30 November 2007, p. 3.

3.53 The ATO undertakes a number of independent surveys of the community's views and perceptions of the services provided by the ATO, including an annual Community Perceptions Survey. No element of these surveys has addressed community views of the ATO's use of ECAs and there would be merit in the ATO expanding the annual survey to include aspects of the referral program.

3.54 The ATO maintains contact with key stakeholders through several forums and committees, including the ATO's Tax Practitioner Forum (ATPF). The ANAO examined ATPF minutes from five quarterly meetings covering the period 2006–07 to 2009–10, and it was evident that the ATO had provided information on the engagement of ECAs, discussed aspects of the arrangements, and also responded to issues that were raised.

3.55 The ANAO also interviewed two representatives from the forum, as well as a representative from Financial Counselling Australia, who have been involved with the debt referral program since it commenced.⁹² The ATPF representatives were generally positive about the quality and timeliness of information provided by the ATO in relation to the contracting of ECAs, commenting that the ATO had listened and responded to any concerns that were raised, particularly in the early stages of the program. Ongoing, there was still some concern about delays in processing payments and updating clients' records prior to cases being referred. The representative from Financial Counselling Australia held a similar view, about how the ATO had kept the membership network well informed about the debt referral program, and made specific reference about the positive work being undertaken by the ATO's specialist unit that assesses taxpayers' applications for relief from debt.

Complaints management

3.56 Complaints in relation to the operations of the ECAs acting on behalf of the ATO can be lodged with the ECAs, the ATO, or the Commonwealth Ombudsman. Processes for the management of complaints in relation to the ATO's outsourcing arrangements for debt collection are set out in the ECAs'

⁹² Financial Counselling Australia is the peak body representing financial counsellors. Financial counsellors provide information, support and advocacy to assist people in financial difficulty.

collection guidelines, and support the ATO's complaints handling policy.⁹³ ECAs are required to immediately suspend debt collection action on a case that is the subject of a complaint, until the complaint is investigated. Complaints are initially handled by the ECA, and may be followed-up by the ATO if they are not resolved.

3.57 The number of complaints directed at the referral program is low in relation to the volume of cases the ATO refers to ECAs. Over the period of the first contract 2007–08 to 2010–11, and including the pilot program, a total of 1610 complaints were lodged from a population of some 1.35 million referred cases, representing 0.11 per cent of the total number of debt cases referred.

3.58 Complaints about the ATO's arrangements with ECAs that are lodged with the Commonwealth Ombudsman were most recently reported in the 2008 Taxation Ombudsman Activities report. In 2008, the Ombudsman office received 1154 complaints about the ATO. Of these 20 per cent (or approximately 230 complaints) related to debt collection, of which the ATO's use of ECAs accounted for 13 per cent (or 30 complaints). Findings in the Ombudsman report stated that:

We reviewed the ATO's policies and procedures for referring debts to external debt collecting agencies. While it is understandable that people are concerned about their credit rating and privacy, outsourced debt collection arrangements include privacy and security safeguards and do not impact on taxpayers' credit ratings. We confirmed that the ATO correspondence to taxpayers advises them of the privacy and security safeguards and that their credit rating is not affected.⁹⁴

3.59 Advice received from the Ombudsman's office indicates that, since 2008, the level of complaints about the ATO's debt recovery activities has generally remained constant, and the amount and type of complaints about the referral of debts to external collection agencies has not changed noticeably.

⁹³ The ATO's complaints policy is set out in the Taxpayer's Charter, and the ATO aims to respond to a complaint within three working days of it being lodged, and to maintain contact with the person lodging the complaint, until the complaint is resolved.

⁹⁴ Commonwealth Ombudsman: *Taxation Ombudsman Activities 2008*, Canberra 2009, p. 9-10.

Conclusion

3.60 The ATO has not fully implemented its original communications plan for the debt referral program, providing less media and web-based information on the outsourced debt collection arrangements than was originally intended. The ATO has not included ECA arrangements in any of its taxpayer surveys, thereby missing the opportunity to assess the community's understanding of, and attitude towards, the use of ECAs.

3.61 While these issues have little effect on the overall operation of the referral program, the lack of promotion of the ATO's use of ECAs does not align with the ATO's belief that outsourcing collection activities would have a positive impact on taxpayers' compliance behaviour. Data on retrieved cases indicates that the results achieved by ECAs have changed little from the pilot program, suggesting that the outsourcing of debt collection has had no impact, over the longer term, on taxpayers' compliance behaviour. There would be merit in the ATO taking some steps to measure the broader impact of using ECAs. The ATO acknowledges that deeper analysis is required to better understand the impact of the referral strategy on taxpayers' compliance behaviour.

4. Performance Management

This chapter examines the ATO's performance measures to monitor and report on the services provided by the ECAs, and the debt referral program.

Introduction

4.1 The ATO does not set out specific objectives for the referral program. Rather, the success of the initiative is measured by the amount of debt the ECAs collect. At the operational level, the ATO applies a performance scorecard⁹⁵ to measure and monitor the standard of services provided by the ECAs. Other measurements that may provide a broader assessment of the impact of the program are not captured or reported by the ATO, including those set out in the original intent of the pilot program, namely:

- to reduce the value of debt holdings within the ATO; and
- to improve on-going taxpayer compliance.

4.2 Data reported by the ATO shows the overall value of debt holdings, but does not provide information on the value or number of debt cases on hand (in the categories of debt that would be eligible for referral to ECAs) or how the referral program contributes to overall debt holdings. As previously discussed, the ATO has not undertaken any analysis or survey work that would indicate community attitudes towards the use of ECAs, or what impact the initiative may have on taxpayers' compliance behaviour.

4.3 The ANAO examined the two approaches the ATO has developed to assess the results achieved by the outsourcing of collection activities, at the operational and program level. These are:

- the performance of the contracted ECAs; and
- calculating and reporting the amount of debt collected by the ECAs.

The ANAO also examined the costs of referring debt cases to ECAs.

⁹⁵ ATO Deed of Standing Offer with ECAs describes the performance scorecard as a measurement tool used to assess the Contractor's performance on a quarterly basis in accordance with the performance quadrants.

Performance management of ECA services

4.4 The performance measures and reporting requirements for an ECA operating on behalf of the ATO were initially outlined in the Request for Proposal to support the pilot program conducted in 2006. The measures were further developed with the contracted agency during the pilot program and throughout the four-year contracts with providers, from 2007–08 to 2010–11.

Performance measures applied during the pilot program, April to June 2006

4.5 In addition to compliance with all relevant state, territory and Commonwealth regulations, the collection processes adopted by the ECA in the pilot program had to be approved by the ATO and comply with all legislation, regulations and guidelines the ATO was bound by when performing equivalent activities. The contracted agency also had to provide detailed reports on the interaction with each client, as well as any ad hoc reports the ATO requested.

4.6 To monitor and assess the quality of the ECA's services during the pilot program, the ATO developed the Referred Debt Quality Assurance Review (QAR) model. The model was based on the ATO's QAARE Judgement Model⁹⁶, used by the ATO at that time to assess the quality of oral and written advice provided to taxpayers.

4.7 The referred debt QAR model covered four key areas of the ECA's collection activity. These were to check if the agent had: properly prepared prior to calling the taxpayer; followed correct proof of identity procedures; conducted appropriate payment negotiations with the client; and, after the call, noted any updates and other relevant information about the case.

Performance measures applied during the contract, 2007–08 to 2010–11

4.8 No performance measures were applied to the ECAs' services during the first year of their contracts in 2007–08, with the period described by the

⁹⁶ The ATO QAARE Judgment model allows for examination and evaluation of specific components of advice provided by the ATO. The model recognises for components of a quality decision: the **Q**uestion, the **A**nswer and **A**ction, the **R**eason underlying the answer and the **E**xpression used in providing the advice.

ATO as 75 per cent implementation and 25 per cent operation. The ATO advised that ATO staff were on-site at the ECAs' premises to assist with implementation issues. In 2008–09, the ATO measured each ECA's performance against three indicators, and then compared each ECA. These indicators were: the dollar return per case referred (based on the value of the amount of debt collected divided by the amount paid in fees to the ECAs); the number of complaints received; and the nature of these complaints.

4.9 From July 2009, the ATO introduced a quarterly assessment of ECAs' operational performance in the form of a scorecard. A second version of the scorecard, with minimal differences, was introduced in April 2010. A third version came into effect in the fourth quarter of 2010–11 and, as with previous versions, encompasses detailed requirements included in the service specifications in ECA contracts, the ECA collection guidelines, and the ATO's Integrated Quality Framework.

4.10 The scorecard (version three) is made up of four performance categories and associated sub-categories, that are weighted equally to contribute 25 per cent each to an overall score; and the overall score is based on the average score across all categories.⁹⁷ Results are manually calculated by ATO staff and assessed against performance ratings from one, where performance is unsatisfactory, to five, where performance is exceptional.

4.11 The four categories and corresponding sub-categories include:

- *financial performance*, the collection percentage is calculated by dividing the total amount of debt collected by the value of the debt referred; and the return per dollar on the total amount of debt collected divided by the amount of fees paid to the ECAs for the same period;
- *internal operations* assesses how well the agencies have adhered to their contractual obligations; and the maintenance of an issues register;
- *community confidence* is measured by the number of abandoned calls and inbound call waiting times; and the number of taxpayers that keep to a payment negotiation; and

⁹⁷ Each quadrant has a 25 per cent weighting. Quadrant components are allocated a raw score for performance which are weighted and then converted back to an overall result out of 5 via a set formula.

- *quality assurance* assesses each agency's interaction with taxpayers including their use of scripting and appropriate POI processes; and the number of complaints lodged.

4.12 While there were minimal differences between versions one and two of the scorecard, version three involved changes to two of the four categories. One change supports more accurate measurement of the amounts collected during the performance period. The other aligns ECA reporting with the key performance indicators used in the *Early Collections* area of the DBL, to support a comparison of the results achieved by ECA and ATO staff. In particular comparing the 'kept' rates—that is, where a taxpayer maintains the terms of the negotiated payment—for payment arrangements achieved by the ECAs provides a useful comparison with those achieved by the ATO. As at December 2011, no reports were provided that set out the results against these indicators, and no formal analysis of the 'kept' rates was provided to the ANAO.

4.13 The ATO advised that the development and implementation of the scorecard has been undertaken co-operatively with the contracted ECAs, and built on scorecards already in use by the ATO. The ATO also consulted with Centrelink, given that agency's experience in outsourcing debt. Evolving over the term of the contract, the ATO considers the scorecard has proven to be an essential tool in developing high standards of service to both the ATO and to the community.

4.14 The ATO advised that the performance measures in the scorecard are designed to support 'seamlessness' between the collection services delivered to the community by either an ECA operative or ATO staff member.

Preparing the scorecard

4.15 The scorecard is prepared on a quarterly basis from ATO data; monthly 'floor walking' visits by ATO staff to agencies' sites to examine aspects of their operations; and from 15 reports submitted by each ECA at regular daily, weekly and monthly intervals. The reports are:

- five reports provided daily: four that provide updates to taxpayer details and one that lists the taxpayers that have requested a Statement of Account;
- four reports provided weekly: three that detail the status of payment arrangements; number of calls made and the outcome of these calls; and the number and description of 'other' types of contact with

taxpayers (for example, SMS or voice message); and the fourth report records any events that had a direct impact on the ECAs' ability to undertake normal operations; and

- six reports provided monthly: the retrieved case status report; a 'snapshot' report that outlines the number of contacts made with a taxpayer; cheques received register; updates to the issues register; a report on the success of tracing actions where ATO contact details have been exhausted; and a Certificate of Assurance (COA) that certifies all principle controls have been performed within the preceding month.

4.16 The ECAs' timeliness in submitting these reports to the ATO, and their accuracy, contributes to the agencies' overall scorecard results. The ECAs participate in their own reviews, and each agency can assess their own performance against the other three agencies, although they are not able to identify the results of a specific agency.

4.17 The ANAO examined the working papers for performance results relating to the fourth quarter (April–June) 2011; visited the operations of the contracted ECAs during July and August 2011; and reviewed the ECAs' collected scores. Table 4.1 sets out the consolidated quarterly performance results for each agency, for the period 2009–10 to March 2011, using versions one and two of the scorecard; and for the fourth quarter of 2010–11, using version three of the scorecard. Scorecard results for the first quarter, 2011–12 are only available for the three ECAs that have continuing arrangements with the ATO under the newly established DoSO, and are as follows: agency 1, 4.83; agency 2, 4.86; and agency 4, 4.73.

Table 4.1**ECA quarterly scorecard results for the period 2009–10 to 2010–11**

ECAs	2009-10				2010-11			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Agency 1	4.025	4.05	4.4	4.125	4.45	4.375	4.525	4.16
Agency 2	4.75	4.9	4.825	4.45	4.85	4.75	4.65	4.74
Agency 3	3.775	4.175	4.5	4.325	4.4	4.75	4.525	4.65
Agency 4	4.2	4.575	4.525	4.15	4.775	4.7	4.4	4.56

Source: ANAO analysis of ATO data, using versions one and two of the scorecard; and for the fourth quarter of 2010–11, using version three of the scorecard.

4.18 The scores reflect some variances in the ECAs' performance, but the differences are marginal over the two-year period (with scores being changed to reflect up to three decimal points given the close results). The actual measurements that result in a score of one to five are not refined, and it is not always clear how the benchmarks used to define the level of performance are set. For example, in the *community confidence* category, ECAs receive the top score of 5 if 31 per cent or more of their conversations with a taxpayer or third party representative result in a payment arrangement or payment in full. In the *internal operations* category, the full score will be achieved if payment slips sent to taxpayers are clear and readable, but the results for anything less are not outlined in the supporting documentation, other than to state that each occurrence will be assessed based on a risk, and a rating will be determined.

4.19 One ECA commented that submitting reports to the ATO one day after their due date can result in a loss of one full point for this measure, although the quality of service is not affected. Similarly, while management of public funds requires that they be banked promptly after receipt⁹⁸, should a single

⁹⁸ ATO *Chief Executive Instruction 2009/07*, issued in accordance with the Financial Management Act, 1997 (FMA), regulation 6.

cheque not be sent to the ATO on the same day it is received by the ECA, another point can be lost in the relevant category.⁹⁹

4.20 The ATO advised that one of the main reasons for using the scorecard to monitor performance, is:

...for the competitive edge amongst the agencies. Whilst the difference between the agencies is quite minimal, the agencies are extremely focussed on being the top agency and are very critical on their own performance. The scorecard measures their performance against each other and their own internal improvement raises our expectations. Rather than have a standard benchmark for the agencies, comparing the agencies amongst each other allows for effective competition between the agencies and encourages each agency to strive for excellence.

4.21 Conducting the quarterly performance process requires the investment of the ATO's and ECAs' time and resources, although the ATO advised that the ECAs have automated most of the processes for producing the required suite of reports. However, the purpose of each report and performance category in the scorecard is not clearly defined, and it is significantly more complex than the original three performance measures applied in 2008–09. The performance measures would also need to have regard to the circumstances when a new provider is compared against one that has been providing services to the ATO for several years.

4.22 The ATO advised that scorecard results have also been developed to allow the ATO to assess each agency and their capabilities that can be used for 'other purposes', although these are not defined. Additionally, it is less clear how effective administration of panel arrangements will support the use of the performance scorecard. In allocating a greater proportion of work to the less expensive provider, the provider may gain operational efficiencies not available to the other panel members, and be at a competitive advantage.

Conclusion

4.23 The ATO has established a detailed reporting and performance measurement regime that effectively positions the ECAs as an extension of the

⁹⁹ Payments made by taxpayers in response to ECA action are made through existing ATO payment channels such as Australia Post outlets, BPay facilities, and cheques by mail to the ATO. However, a small number of taxpayers send a cheque to the ECAs, and these are accounted for in daily reports to the ATO.

ATO's operations, creating a 'seamless' experience for taxpayers whether engaging with an ECA agent, or ATO staff. The perceived benefits to the ATO from this arrangement include:

- creating competition between the agencies, but based on providing virtually identical services to ATO specifications; and
- reducing the risk to the ATO's reputation or relationship with the community, while having a different point of contact with taxpayers.

4.24 The ATO advised that developing such an operating model supports a flexible and more economical alternative (although this has not been costed) to comparable in-house collection activities; and one that can readily respond to fluctuating and unplanned changes in the volume of business referred. On the downside, the 'seamlessness' in the services limits any specific expertise the ECAs could apply to the collection of debt.

4.25 Completing the performance reports requires considerable time and resources, and there would be merit in the ATO conducting a review of the performance measures applied to the ECAs. Such a review would provide confidence that the scorecard is meeting the needs of the ATO and is not unduly burdensome for both ATO staff and the ECAs.

Measuring and reporting the value of collections resulting from ECA action

4.26 The ATO's key indicator for measuring the success of the debt referral program is the amount of debt collected by the ECAs. In the 2007 budget, primary deliverables from the funding provided to the ATO for the DCEP, were:

- a reduction in collectable tax debt to manageable levels via a particular focus on the aged debt component; and
- a reduction of outstanding SGC debts.¹⁰⁰

4.27 The ATO measures and reports annually on the levels of collectable debt, and measures outstanding superannuation guarantee charge debt, but the impact of the referral program on either of these deliverables is not

¹⁰⁰ ATO *New Policy Costing—Debt Collection Enhancement*, 15 February 2007.

explained. As previously noted, the ATO does not report on changes to debt holdings in the categories of debt cases that could be referred to an ECA; and aged debt is no longer the primary focus of the referral program.

4.28 A 2007–08 ATO internal report on the debt referral program indicated a planned increase in the number of debt cases that would be referred the following year, from an estimated 153 500 to 189 000. Set against this assessment, a DCEP brief in the same year expected that the number of cases referred would reduce from 163 000 in 2007–08, to 53 500 per annum by 2010–11, as the program was expected to restrict growth in the base and age of low value debt.

4.29 The ATO estimated that, as at October 2005, around one million debt cases worth \$1.5 billion would not be actioned under the debt management approach the ATO used at the time. At 30 June 2011, there were 1 161 742 debt cases at debt levels less than \$7500, with a total value of \$1.772 billion. The potential benefits of shrinking the debt base do not seem, on these figures, to have eventuated. However, the changes to economic conditions caused by the global financial crisis resulted in an increased flow of debt cases, and growth in debt has been restricted.

4.30 The ATO's measure of the success of the referral program—the overall amount of debt collected by the ECAs—is measured against ATO estimates of the number of cases that may be referred and the amount of debt that may be collected, in a reporting period. The ATO does not assess the impact of the referral program on broader debt management measures, namely the reduction in the overall level of debt holdings; and changes in taxpayers' compliance behaviour.

Payment attribution to measure collection amounts

4.31 Collections received by the ATO and attributed to ECA action are identified by a specific code included in the electronic funds transfer (EFT) bar code attached to every referred debt case.¹⁰¹ The ATO has four specific ECA head of revenue (HoR) accounts that are identified by agency specific bar codes.

¹⁰¹ The bar code is included in the payment slips the ECAs send to taxpayers with demand letters. Where a taxpayer pays a referred debt through electronic funds transfer—Bpay, internet banking—the EFT code will attribute that payment to the relevant collection agency.

4.32 Where a taxpayer makes a payment without a payment slip, or uses a payment slip that does not include the ECA EFT bar code, any payments received on the client account while their debt case is under management by an ECA are reported under an ATO HoR. These payments may still be the result of ECA action but are not easily identified as such.

4.33 In 2007–08, reporting on the amounts collected by the ECAs indicated that 75 per cent of the ATO HoR collections related to the referred debt cases and could be attributed to ECA activity, pending further internal sampling.¹⁰² However, this sampling was not undertaken until July 2011, and so collections resulting from ECA action during the first contract, 2007–08 to 2010–11, were based solely on debt amounts recorded in ECA HoR accounts.

4.34 The sampling exercise undertaken in July 2011 was not automated, and took approximately two months to complete. Based on the results of the sampling exercise, the ATO's reporting of collection amounts achieved by the ECAs, from 1 July 2011, includes ECA HoR amounts, and 65 per cent of ATO HoR amounts, for all referred debt cases. It is a different methodology to the one applied in the pilot project in 2006, and, given the time and resources required in conducting the exercise, there is no planned schedule for further sampling. The ATO advised that automating the sampling process will occur, but it is not a current priority.

Reporting collection amounts

4.35 A number of reports on the debt referral program are prepared and distributed to different areas of the DBL and more broadly within the ATO. As at October 2011, the key monthly reports prepared on the debt referral program include:

- Commitment to Government (CtG) reports that are designed as 'dashboard' indicators of the collection results achieved from the expenditure of program funding, including DCEP, ASB and EDC funds. These are the main reports provided to the ATO Executive;
- debt referral reports, that set out the number, type and value of debt cases referred to, and retrieved from, the ECAs and include total collection amounts; and

¹⁰² ATO, DCEP monthly reports, 2007–08.

- flat fee reports that are used primarily in the reconciliation of invoices submitted by the ECAs for services provided in the previous month.

Operational data provided in the debt referral reports is applied in the ECAs' performance scorecard; and at the program level, the key reported figure is the amount of revenue collected against projected targets, and by project funding.

Projected and actual value of debt collected

4.36 As previously discussed, funds have been allocated to the referral program from different sources within the ATO (refer Table 2.4). These are the DCEP, the EDC program, the ASB project, and additional funds transferred to the initiative from other areas in the DBL or broader ATO. The ASB and 'other' funding sources tend to be smaller amounts and are included in the Commitment to Government reports for DCEP and EDC programs.

Debt Collection Enhancement Program funded referred cases

4.37 For referred cases funded through the relevant component of the DCEP, targets for the amounts to be collected by the ECAs in each year of the 2007–08 to 2010–11 contracts were set out in the ATO's 2007 new policy costing estimates. These estimates were based on projections of the volume of debt cases that would be referred over the same period. Table 4.2 sets out the ATO's projected and actual debt case referral numbers and collection amounts for DCEP funded referrals, for the period 2007–08 to 2010–11.

Table 4.2

DCEP projected and actual referrals and collections for the period 2007–08 to 2010–11

Year	Number of Referrals		Value of Collections	
	Projected ⁽¹⁾	Actual	Projected (\$'000,000)	Actual (\$'000,000)
2007–08	163 000	196 230	\$91	\$110
2008–09	153 500	229 375	\$57	\$229
2009–10	103 500	509 394	\$53	\$401
2010–11	53 500	414 212	\$26	\$210
TOTAL	473 500	1 349 211	\$227	\$950

Source: ANAO analysis of ATO DCEP Commitment to Government reports, 2007–08 to 2010–11.

Note 1: Projected referrals data from New Policy Costing, 15 February 2007, p.19.

4.38 While the overall referral target of \$227 million was exceeded by some \$723 million (318 per cent of the estimated amount) the actual value of collections was achieved from the referral of over a million cases, against estimates based on the referral of less than half a million cases. The volume of referrals was overtaken in the first year of the contract, and neither the projected case numbers nor estimated collections were revised as the ECAs' contracts progressed. The increased number of referrals was supported by additional funding of some \$10 million, transferred from other funding sources to DCEP debt referral.

4.39 DCEP funding for 2010–11 was subject to the provision of a report to the (then) Department of Finance and Administration in October 2009, setting out achievements against specified revenue targets. In preparation, an ATO Internal Audit examined the DCEP and concluded that, while revenue targets had been met, there were some areas that required further attention, namely the management of funds received and the documentation of the methodology for preparing progress reports.

4.40 While there were no formal recommendations (and the overall risk rating was low), ATO internal audit findings included that during 2007–08 there were a number of approved budget shifts between different cost centres, but no documentation of the reasons for those changes.¹⁰³

Extended Debt Collection program funded referred cases

4.41 For referred cases funded through EDC, targets for the amounts to be collected by the ECAs in each year of the four year program were set out in the ATO's EDC program outline, based on projections of the volume of debt cases that would be referred. Table 4.3 sets out the EDC projected and actual referrals and collections for 2010–11, the first year of this program, and for the period 1 July to 31 December 2011.

¹⁰³ ATO Internal Audit advised that no further reviews or audits of DCEP or debt referral have been undertaken by them, and no responses have been received to their October 2009 review findings.

Table 4.3**EDC projected and actual referrals and collections for the period 2010–11, and 1 July to 31 December 2011**

Year	Number of Referrals		Value of Collections	
	Projected	Actual	Projected (\$'000,000)	Actual (\$'000,000)
2010–11	200 000 ⁽¹⁾	259 913	\$82	\$213
2011–12	100 000 ⁽²⁾	60 428	\$41 ⁽²⁾	\$451
Total	300 000	320 341	\$123	\$664

Source: ATO EDC Commitment to Government reports, 2010–11 and 2011–12.

Note 1: Projected referrals, Extended Debt Collection (EDC) program, 27 October 2011.

Note 2: Pro-rata for six months of the financial year.

4.42 In 2010–11, actual referrals for the number of EDC funded debt cases was almost 30 per cent more than projected, but actual collections exceeded estimates by \$131 million (approximately 160 per cent). For the first six months of 2011–12, actual cases referred were around 40 per cent less than projected, but actual collections exceeded estimates by approximately \$400 million, (1000 per cent).

4.43 Unlike the CtG reports, debt referral reports for the first six months of 2011–12, reflected that a total 142 573 cases were referred. This figure includes the 60 428 EDC funded cases, plus an additional 82 145 combined activity statement and income tax debt cases, funded by almost \$3 million in BAU expenditure, transferred to the debt referral program (but recorded in the ATO's BAU cost centre).

4.44 Year to date total collections achieved by the ECAs, reported in the December 2011 debt referral report for the first half of 2011–12, actually amounted to almost \$684 million. This amount, for the first time, included ECA HoR amounts plus 65.3 per cent attribution of ATO HoR amounts. There would be merit in the ATO reviewing the projected collection amounts, to better reflect more realistic targets based on the available funding.

External reporting of collection results

4.45 Collection results achieved by the debt referral program were reported, for the first time, in the Commissioner of Taxation's Annual Report for 2010–11. Previous annual reports had included reference to the pilot program and the contracting of ECA services. The 2010–11 Annual Report reflects the data in the ATO's internal debt referral report that 414 212 cases were referred

to the ECAs during the financial year, resulting in \$623 million in collections.¹⁰⁴ However, this is inconsistent with the combined collection figure reported in the CtG DCEP and EDC reports for the same period that totalled \$423 million, some \$200 million less.

4.46 The ATO advised that the larger amount reported in the annual report includes approximately \$200 million in collections achieved by the ECAs from the referral of a number of higher value debt cases that would normally have been actioned by the ATO's 'dialler' teams. As a result, a decision was made to assign this amount to the ATO's 'dialler' teams, contributing to that program meeting projected targets, but undermining the accuracy of reporting against specific debt collection initiatives.

Referral program costs

4.47 The ATO has undertaken limited analysis of the costs of referring debt cases, and the high value of the reported collection results may have masked or reduced the business imperative to do so.

4.48 The DBL plan for 2010–11 includes reference to the 'need to fully understand the relative cost comparisons between external agencies and our internal processes'. As at December 2011, the ATO did not have reliable figures to support these cost comparisons, and had not defined what aspects of the processes would be compared. The ATO advised that:

...currently there is no work being undertaken to enable a cost comparison between different types of collection action, ie Automated Action, Early Collections, Large and Consolidations, Firmer Action, Strategic Recovery and External Agencies. As it is in the early stages of development no accurate comparisons are available at this time. Moving forward, there is an intention to automate the process, and have it readily available in the future.

Fully understanding the costs of the program and comparing these to the ATO's in-house capability may assist in identifying ways to achieve cost savings, and provide for better integration with the ATO's broader debt management strategy. Considering the experience of other revenue agencies in using outsourced debt collection services may also be of value.

¹⁰⁴ *Annual Report 2010–11*, op. cit., p. 51.

Conclusion

4.49 The success of the debt referral initiative is centred on the amount of debt collected by the ECAs against projected targets. In absolute terms, the ECAs have collected a large amount of outstanding debt. However, the targets have not been revised over the life of the contract, making them less relevant as a relative measure of the success of the program.

4.50 The majority of reports on the referral program are prepared to meet the day-to-day management information needs of different areas of the ATO, and do not readily provide a comprehensive and strategic level view of the overall referral initiative. The sources of funds that support referrals are reported against different cost centres and in various reports, but not in a format that sets out the total costs of the referral program, showing both the ATO's operational costs as well as amounts paid in ECA fees.

4.51 While analysis of debt holdings is complicated by the constantly changing value and age of debt cases and the impact of broader economic conditions, there would be merit in the ATO undertaking some measurement and reporting of this aspect of the referral program. Periodic reporting of the total amount of collectable debt in the categories of debt that are the target for the referral program; the number of debt cases on hand; and the age of the debt cases would go some way to measuring the impact of the referral program on debt holdings, including any effect on taxpayers' compliance rates.

4.52 The amount paid in ECA fees is relatively small in comparison to the amount of debt collected, but the full cost of the ATO's administration of the program is an important factor in assessing its overall success. The ATO's internal approach to debt collection has changed significantly since the pilot program in 2006, when ECAs were using more advanced approaches and systems for collecting debt than those that were applied in the ATO. In the intervening years the ATO has adopted many of these strategies, including advanced dialler technology, and continues to apply more refined risk analysis and treatment strategies in the management of debt.

4.53 Understanding the comparative costs of the referral program and the ATO's internal processes would support better targeting of debt cases for referral, and the management of those cases that are unresolved by ECA action. As previously discussed, ECAs are paid a fee per debt case referred, and in around 50 per cent of referred cases there is no reduction in the level of debt, irrespective of the age, value or category of debt.

4.54 The ATO could more effectively analyse and evaluate the costs of the program, and consider efficiencies that could be achieved, including the targeting of debt cases for referral. Such an analysis would also assist the ATO in more clearly outlining the ATO's future use of the outsourcing arrangement. In undertaking this work, it may be useful for the ATO to consider the different experiences of revenue and taxation offices internationally, including the United Kingdom, the United States of America, and Canada.

Recommendation No. 3

4.55 In recognising the evolving nature of the referral program, the ANAO recommends that the ATO:

- establishes the relative costs of the use of external collection agencies and the ATO's internal processes;
- improves analysis to support the selection of debt cases for referral; and
- clarifies the program's position in relation to the broader debt management framework.

ATO response

Agreed. We acknowledge that establishing a more rigorous relative cost comparison between the use of external collection agencies and the ATO's internal processes would assist us in further refining the debt referral program. This will be complemented by improved analysis to support the selection of debt cases for referral. This analysis would also assist in clarifying our use of External Collection Agencies' (ECAs') services in relation to the broader debt management framework. While the External Collection Agencies are currently supporting our early intervention strategy, further analysis would assist in deciding the future use of ECAs.



Ian McPhee
Auditor-General

Canberra ACT
27 June 2012

Appendices

Appendix 1: Detailed agency response to the proposed audit report



Australian Government
Australian Taxation Office

SECOND COMMISSIONER OF TAXATION

Ms Barbara Cass
Group Executive Director
Performance Audit Services Group
Australian National Audit Office
GPO Box 707
CANBERRA ACT 2601

13 June 2012

Dear Ms Cass

RE: Australian National Audit Office Performance Audit of engagement of external debt collection agencies.

Thank you for your letter dated 16 May 2012 and for the opportunity to provide comments on the proposed report on the Performance Audit: Engagement of External Debt Collection Agencies.

The Tax Office agrees with the three recommendations as presented in the section 19 report.

I would like to thank the Australian National Audit Office audit team for the professional manner they have adopted in undertaking this performance audit.

Attached is the Tax Office response to recommendations (Annexure 1) and summary of our comments to be used in the report brochure (Annexure 2).

If you require further information on this matter, please contact Steve Vesperman Deputy Commissioner, Debt.

Yours sincerely

David Butler
Second Commissioner
Australian Taxation Office

Cc:

Mr Mark Harradine, Executive Director, ANAO Performance Audit Services Group
Ms Jane Whyte, Audit Manager, ANAO Performance Audit Services Group

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Annexure 1

Rec	ANAO Recommendation	ATO Response
1	<p>To provide assurance that taxpayers' information for the referral program is being adequately protected, the ANAO recommends that the ATO:</p> <ul style="list-style-type: none"> clearly defines the respective roles and responsibilities of the Debt business line and the Trusted Access branch and the Security Policy and Services branch; and implements all elements of the security framework, particularly the scheduling of reviews and the completion of Certificates of Assurance, and other requirements as set out in the Deed of Standing Offer. 	<p>Agreed.</p> <p>The ATO considers the security of taxpayer information of utmost importance and is committed to ensuring that taxpayer information is protected. Implementation of this recommendation will further strengthen our administration of security requirements.</p>
2	<p>To maintain integrity and consistency in the processes for selecting and referring debt cases to external collection agencies, the ANAO recommends that the ATO reviews and updates the Legacy and Enterprise systems and procedural documentation.</p>	<p>Agreed.</p>
3	<p>In recognising the evolving nature of the referral program, the ANAO recommends that the ATO:</p> <ul style="list-style-type: none"> establishes the relative costs of the use of external collection agencies and the ATO's internal processes; and improves the analysis to support the selection of debt cases for referral. clarifies the program's position in relation to the broader debt management framework; 	<p>Agreed.</p> <p>We acknowledge that establishing a more rigorous relative cost comparison between the use of external collection agencies and the ATO's internal processes would assist us in further refining the debt referral program. This will be complemented by improved analysis to support the selection of debt cases for referral. This analysis would also assist in clarifying our use of External Collection Agencies' (ECA's) services in relation to the broader debt management framework. While the External Collection Agencies are currently supporting our early</p>
		<p>intervention strategy, further analysis would assist in deciding the future use of ECAs.</p>

Annexure 2

Summary of Tax Office's response

The ATO welcomes the recognition by the ANAO of the evolving nature of the debt referral program. The ATO continues to pursue contemporary approaches in the management and collection of debt, providing support and assistance to taxpayers willing to work with us to manage their outstanding tax and superannuation debt. This support includes the earlier initiative to offer general interest charge free payment arrangements to assist taxpayers manage through the global financial crisis.

The ATO recognises that its ability to influence (and measure) payment compliance behaviour must be considered in the wider context of the many factors that impact on a taxpayer's ability and willingness to meet tax and superannuation obligations in an ever-changing environment. We will continue to take a differentiated approach by considering individual taxpayer circumstances as this is consistent with the broader ATO approaches and underpins our enhanced collection program. This includes taking appropriate action where taxpayers are unwilling to work with us or are no longer viable. The ATO is committed to continuous improvement and recognises the review highlights several opportunities to strengthen and further improve the management of the program, with an emphasis on increased analysis and evaluation of costs to enhance our decision making processes.

The ATO agrees with the three recommendations contained in the review.

Appendix 2: Certificate of Assurance

Certificate of Assurance

I, <ECA signatory's name> of <name of ECA> certify that to the best of my knowledge, and consistent with our internal Quality Assurance processes, the principal controls as listed below have all been performed for the month of <insert month and year> as required.

Any exceptions or issues identified during the month have been documented below.

Control	Evidence	Control in Place & effective Yes/No	Issues / Comments/ Action Taken
'In-Confidence' Clearance Controls	All personnel with access to 'In-Confidence' Tax Office information have appropriate clearances.		
'Protected' Clearance Controls	All personnel with access to 'Protected' Tax Office information have appropriate clearances.		
Authorisations	All personnel working on Tax Office information have been duly authorised by the Tax Office delegate.		
Personnel no longer in the employ of the Agency	The Tax Office has been notified of all duly authorised or security cleared personnel that have left the employment of the Agency.		
Security	All incidences of failure/breach of security immediately reported.		
IT Security	IT Security within the organisation continues to meet Tax Office requirements.		
Physical Security	Physical Security within the organisation continues to meet Tax Office		

Control	Evidence	Control in Place & effective Yes/No	Issues / Comments/ Action Taken
	requirements.		
Staff access and training	Effective controls are in place to ensure that authorised staff who have access to Tax Office information and data have been effectively trained in and adhere to procedures as required.		
Collection Guidelines	Procedures detailed within the Collection Guidelines are being followed at all times.		
Reporting	Reporting processes are in place to monitor performance against agreed business objectives and service levels.		
Business Continuity Plan	A current and effective Business Continuity Plan is in place (including date it was last updated).		
Quality Management Plan	A plan is place, being followed and all processes and personnel are subject to a Quality Assurance Review a minimum of once each quarter.		
Systems and processes	No changes to the service have been made without the written approval of the Tax Office representative.		
Payment Slips	Payment Slips have been produced to ATO specification on all correspondence.		
Letters	No changes to the content or presentation of Tax Office approved letters have been made, and no new letters have been created, without the written approval of the Tax Office representative.		
Letters Issued	Each case referred in the month has a letter sent within 10 days from the referral date, unless otherwise agreed.		

Control	Evidence	Control in Place & effective Yes/No	Issues / Comments/ Action Taken
ATO Logo	The ATO logo has been used for no other purpose than in the ATO branding of the payments slips printed on, or attached to, the letters.		
Storage Retrieval & Destruction	Records held by the agency have been stored and destroyed in accordance with the Australian Taxation Office Security Guidelines.		
Subcontractors	Contracts with Subcontractors used to perform any part of the Debt Collection Services contain provisions similar to those specified in Paragraph 6.4.3 of the Contract.		

Other Comments:

Signature:

Name:

Position:

Date:

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