

The Auditor-General

# **Risk Management in ATO Small Business Income**

**Australian Taxation Office**

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Australian National Audit Office

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Canberra ACT  
4 December 1997

Dear Madam President  
Dear Mr Speaker

In accordance with the authority contained in the *Audit Act 1901*, the Australian National Audit Office has undertaken a performance audit in the Australian Taxation Office and I present this report and the accompanying brochure to the Parliament. The report is titled *Risk Management in ATO Small Business Income*.

Yours sincerely

A handwritten signature in black ink, appearing to read 'P. J. Barrett'.

P. J. Barrett  
Auditor-General

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

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

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# Abbreviations

ANAO	Australian National Audit Office
APS	Australian Public Service
ASL	Average Staffing Level
AS/NZS	Australian and New Zealand Standard
ATO	Australian Taxation Office
CCM	Core Case Management System
CIRU	Compliance and Industry Research Unit
FBT	Fringe Benefits Tax
FTE	Full time staff equivalent
HOTSA	Health of the System Assessment
INB	Individuals Non-Business (ATO Business Line)
IT	Information Technology
MAB	Management Advisory Board
MIAC	Management Improvement Advisory Committee (a former sub-committee of MAB, no longer in existence)
NBI	Net Business Income
NTS	National Taxpayer System
OPS	Operational Performance Standard
PAYE	Pay As You Earn
PPS	Prescribed Payment System
QA	Quality Assurance
QMS	Quality Management System
RKR	Record Keeping Review
SBI	Small Business Income (ATO Business Line)
SoH	State of Health report
T&P	Tax and penalties
The Board	ATO Management Board



## **Part One**

# **Summary and Recommendations**



# Summary

1. This audit is designed to complement similar performance audits on risk management in several agencies of the Australian Public Service (APS). In particular, it follows Audit Report No.37 1996-97 tabled in Parliament on 18 June 1997 and entitled *Risk Management - Australian Taxation Office*. That audit focused on broad strategic issues relevant to risk management in the Australian Taxation Office (ATO) as a whole. This audit follows the issues identified in that report into the day-to-day management of the Small Business Income (SBI) program (called a business line by the ATO) as an example of how risk management operates in a significant element of the ATO.

## The Small Business Income business line

2. The SBI business line is responsible for administering the:

- income tax system for all business taxpayers with annual gross turnovers of less than \$10 million; and
- fringe benefits tax (FBT) for all taxpayers.

3. SBI's purpose is to ensure that taxpayers within its area of responsibility comply with the tax laws. In line with Government policy, it is to achieve this purpose at minimum cost to the taxpayer.

4. Revenue collected by SBI totalled \$13.3 billion in 1995-96 and \$13.6 billion in 1996-97. SBI had an average staffing level (ASL) of 3 152 in 1996-97, and its total expenditure for the same year was in excess of \$190 million.

5. Along with the rest of the APS, SBI has been experiencing a period of change, including new structures, and a change in Government with its consequential changes to governmental priorities. Within the small business environment, rapid advances in technology, whilst providing opportunities for the ATO and the small business community, provide expanded opportunities for the avoidance or evasion of tax. For example, the Internet and electronic commerce will potentially

allow the purchase of goods and transfer of funds worldwide with little if any permanent record of these transactions.

6. The ATO was among the first APS agencies to introduce formal risk management principles to its strategic planning framework.

7. SBI has invested considerable effort in its introduction of risk management principles. Its Risk Management Project Team has applied the Management Advisory Board/Management Improvement Advisory Committee (MAB/MIAC) guidelines to the SBI environment and has implemented a formal risk management framework across the business line.

## **Audit objective**

8. The objective of the audit was to report to the Parliament on the economy, efficiency and administrative effectiveness of the risk management process in the SBI business line.

## **Audit scope and criteria**

9. In the opinion of the ANAO, the SBI business line was an appropriate element to review because:

- it has been assessed by the ATO as the business line dealing with the greatest risks of compliance and risk to the revenue;<sup>1</sup>
- it deals with very significant amounts of revenue - some \$13.6 billion. As a result, even small improvements have the potential to result in significant gains for the revenue of the Commonwealth. Also, it is the second largest business line, accounting for some 15 per cent of ATO expenditure in 1996-97. This provides scope for reductions in administrative costs; and

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<sup>1</sup> The ANAO independently assessed that SBI had the greatest potential for improvements in systemic revenue collection, especially in relation to the *tax gap*.

- in line with broad ATO strategies, its work is broadly similar to other areas of the ATO and therefore lessons learnt through this audit can be applied more widely within the ATO, as well as to the public sector generally.

**10.** The audit applied the key steps of implementing an effective risk management framework to SBI. The findings of the audit have been presented in terms of this model, with specific attention given to issues regarding the:

- treatment of risks, particularly initiatives to improve compliance; and
- monitoring and review of risk treatments, focusing on issues such as performance information and benchmarking.

**11.** The criteria for the audit are derived substantially from the MAB/MIAC guidelines on risk management and Audit Report No.37. They were used as a basis for examining SBI's risk management processes and are set out in paragraph 1.26.

## **Overall conclusion**

**12.** The ANAO acknowledges the significant advances made by SBI in introducing risk management since 1994-95 and that the process of improvement has continued during the course of the audit. We would expect that the benefits of this improvement will be seen in enhanced efficiency for SBI, as well as better compliance with tax laws and a positive effect on revenue collected.

**13.** The ANAO concluded that SBI is progressing well towards the full implementation of an economic, efficient and administratively effective risk management regime. Although recognising this progress, the audit identified a range of associated issues that, if attended to, should result in making it more tightly focused and efficient.

## **Key findings**

### ***SBI's risk management process***

**14.** By appointing a risk management project team, SBI has demonstrated a strong commitment to apply and promote risk management throughout the business line. The ANAO concluded that SBI's risk management process was sound and followed the MAB/MIAC guidelines on risk management. In particular, we found that:

- SBI's stakeholder analysis was comprehensive and contributed to its business planning;
- SBI had developed risk criteria that were used subsequently in its risk management process;
- the prioritisation and assessment by SBI of its identified risks was thorough; and
- SBI is in the early stages of implementing a systematic program of monitoring and review.

**15.** The audit concluded that SBI was likely to benefit from ongoing improvements in its risk management by:

- explicitly describing actual issues at risk as opposed to nominating a topic or generic strategic area;
- a stricter analysis and ranking of the nature and probability of individual risks. We note that SBI is already moving in this direction; and
- continuing to refine its systematic process of monitoring and reviewing its risks and risk treatment strategies.

### ***Compliance improvement strategies***

**16.** SBI uses a range of strategies to improve compliance, including audits, record keeping reviews, education seminars and tax rulings. In considering how SBI deals with its compliance risks, the ANAO has concentrated on the use of auditing by SBI as a compliance strategy. This is because auditing is a critical risk treatment and research has stressed the significance of auditing in an overall compliance strategy.

**17.** The role of auditing as a compliance strategy is well developed. It has been identified as an appropriate treatment strategy for approximately three out of every five identified risks to compliance. However, the audit coverage of the small business taxpaying population has been declining to the point where it averages less than one percent of the population. This compares with a target of two percent for the whole of the taxpaying population at around the start of the decade. SBI currently does not have a target for audit coverage.

**18.** Our audit recognised the need for a more empirically-based assessment of the relative impact of various compliance strategies before judgements on this issue can be made. The systematic evaluation of ongoing projects with this in mind would be a first step to developing the necessary data base. Without reliable compliance measurement, it is difficult for SBI to assess or demonstrate the impact of its programs on the level of compliance.

**19.** SBI does not fully quantify the costs or benefits of the various separate strategies it uses to address its risks, such as conducting audits, providing rulings or through education. As a result it is difficult to consider the most cost-effective strategies for any identified risk. There are various ways of ascertaining the costs of strategies. One such solution may be the adoption of a full activity based costing system, although we recognise that this would be a costly endeavour. However, a suitable system would be a valuable tool in focusing attention on the costs of the various activities and identifying where significant improvements in efficiency can be made. It would also help to identify what are the most cost-effective strategies to achieve the aims of the organisation, in addition to promoting a cost-conscious mentality among staff and management.

### ***Performance Information***

**20.** The ANAO concluded that SBI performance information would benefit from refining its range of indicators, to provide information on the efficiency of SBI's operations so that it may better evaluate its performance, including from the perspective of its clients.

**21.** Although SBI's consultation with stakeholders has been extensive, regular, ongoing feedback from clients on SBI performance has not been integrated into SBI's formal performance measures. Accordingly, we consider that there is room for more systematic monitoring of the operating environment, including tax agents and small business organisations, by ensuring that there are formal, ongoing measures that assess SBI's performance from the perspective of stakeholders.

### ***Quality and benchmarking***

**22.** There are many areas of good practice within SBI. However, performance is patchy. SBI has deferred its introduction of a suitable quality management system (QMS). The ANAO has recommended that the QMS be introduced as soon as possible in order to support the achievement of nationally consistent business outcomes within SBI. The audit also points out that the nature of the ATO's work lends itself to benchmarking performance within SBI, across business lines and even internationally. Benchmarking has been found in other organisations to be an effective way of improving performance. We considered that SBI would benefit from undertaking more extensive benchmarking of its performance to assist in identifying areas for management improvement.



# Recommendations

**Recommendation No.1** The ANAO *recommends* that, as part of its ongoing improvement when identifying risks, SBI describe the inherent nature of the risks rather than generic risk topics.  
Para. 2.38

**ATO Response:** Agreed with qualification.

**Recommendation No.2** The ANAO *recommends* that when analysing risks SBI extend the use of its qualitative risk analysis matrix, which transforms the combined likelihood and consequence ratings for each risk into a quantifiable risk level, to earlier stages of the risk assessment process.  
Para. 2.45

**ATO Response:** Agreed.

**Recommendation No.3** The ANAO *recommends* that when deciding on which risks are to be addressed, SBI examine in detail the costs and benefits associated with the various options for treatment.  
para. 2.58

**ATO Response:** Agreed with qualification.

**Recommendation No.4** The ANAO *recommends* that SBI's operational plans contain more time frames in order to monitor progress on achievements.  
para. 2.76

**ATO Response:** Agreed.

**Recommendation No.5** The ANAO *recommends* that SBI determine the various mixes of strategies directed to improving compliance (and particularly the role of auditing in these mixes) on the basis of an assessment of their likely impact on that goal.  
para. 3.27

**ATO Response:** Agreed.

**Recommendation No.6**      The ANAO *recommends* that as part of the planning of its compliance projects, SBI ensure that a risk assessment and explicit stakeholder analysis are undertaken and that each project has formal performance indicators.

para. 3.48

**ATO Response:** Agreed.

**Recommendation No.7**      The ANAO *recommends* that SBI evaluate all its compliance projects against the objectives of the project to allow relative assessment of the various strategies for dealing with compliance risks.

para. 3.52

**ATO Response:** Agreed.

**Recommendation No.8**      The ANAO *recommends* that SBI ensure that where compliance projects have identified areas for cost-effective improvements in compliance, then these projects are fed back into SBI's escalation and risk assessment processes for consideration and reallocation of priorities.

para. 3.55

**ATO Response:** Agreed.

**Recommendation No.9**      The ANAO *recommends* that SBI ensure its systems permit ready access to the up-to-date, aggregated results of compliance activities in order to monitor and analyse performance.

para. 4.17

**ATO Response:** Agreed with qualification.

**Recommendation No.10**      The ANAO *recommends* that SBI ensure that performance targets are included in plans at the operational level wherever practicable.

para. 4.27

**ATO Response:** Agreed.

**Recommendation No.11**

para. 4.49

The ANAO *recommends* that SBI:

a) include measures which allow it to assess the efficiency of its processes at an appropriate level for reporting to ATO management, the Government, the Parliament and the public;

b) ensure that there are formal, ongoing measures within the performance measurement framework that assess its performance from the perspective of stakeholders; and

c) include measures that assess the quality of its processes.

**ATO Response:** Agreed with qualification to a) and agreed to b) and c).

**Recommendation No.12**

para. 4.57

The ANAO *recommends* that SBI undertake more extensive benchmarking of its performance to assist in identifying areas for management improvement.

**ATO Response:** Agreed.

**Recommendation No.13**

para. 5.8

The ANAO *recommends* that SBI consider reactivating the Quality Management System project as a matter of priority and that the process be completed in order to support the achievement of nationally consistent business outcomes.

**ATO Response:** Agreed.

**Recommendation No.14**

para. 5.21

The ANAO *recommends* that SBI review the cost-effectiveness of its case management systems to ensure that they produce reliable and informative data that will assist in the development of risk management strategies

**ATO Response:** Agreed.

**Recommendation No.15**

para. 5.24

The ANAO *recommends* that SBI:

- a) enhance its understanding of its compliance costs and in particular, the cost-effectiveness of compliance strategies; and
- b) review the feasibility of recording information relating to compliance strategies on the one system.

**ATO Response:** Agreed.

## **Part Two**

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# **Audit Findings and Conclusions**



# 1. Introduction

*This chapter describes the background to the audit and sets out its objective, strategy and methodology.*

## Background to the audit

**1.1** This audit is designed to complement similar performance audits undertaken by the Australian National Audit Office (ANAO) in the Australian Public Service (APS). The principles of risk management underlie a number of our recent audits conducted in several portfolios.

**1.2** This is the second audit conducted by the ANAO on the theme of risk management in the Australian Taxation Office (ATO). The first audit was tabled in Parliament in June 1997 and was titled *Risk Management - Australian Taxation Office* (Audit Report No.37 1996-97). That audit focused on broad strategic issues relevant to risk management in the ATO as a whole, and aimed to assist the agency to focus better on the implementation of risk management principles. The ATO accepted all the recommendations of that report. This audit follows the issues identified in the earlier report into the day-to-day management of the Small Business Income (SBI) business line. It is designed to complement the earlier report on the ATO, as well as Audit Report No.6 1997-98 on the Australian Customs Service *Risk Management in Commercial Compliance*.

## The ATO

**1.3** The ATO's Purpose is to:

*Manage and shape systems (Tax, CSA and Superannuation) that support and fund services for Australians.<sup>2</sup>*

**1.4** The ATO is the Commonwealth's primary revenue collection agency, responsible for collecting over 80 per cent of total government revenue. It collected close to \$99 billion in 1995-96 and over \$107 billion in 1996-97.

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<sup>2</sup> ATO Corporate Plan 1997-2000.

**1.5** Since 1986, the ATO has introduced progressively a system of taxpayer self assessment for income tax in an attempt to achieve a better balance of compliance strategies. As a result, the ATO largely has ceased the examination of returns by tax assessors prior to raising assessments and issuing notices to taxpayers. This shifted the ATO's primary focus from processing returns and issuing assessments to assisting taxpayers to meet their obligations and taking enforcement action against those who do not. Such a self assessment system is a large scale exercise in risk management. The risk is that taxpayers will not comply with the tax law, either deliberately or inadvertently. Particular aspects of this risk relate to the understatement of income, overstatement of deductions and failure to lodge tax returns.

**1.6** In 1994 the ATO was restructured to allow for the specific requirements of client segments to be addressed. This business line structure segmented taxpayers into Individuals Non-Business, SBI, Large Business Income,<sup>3</sup> and Withholding and Indirect Taxes. The Child Support Agency was also given status as a business line. A number of service lines were also introduced. A further business line, Superannuation, was established at the start of 1996-97. The SBI business line is the focus of this audit.

### ***The SBI business line***

**1.7** SBI is the business line responsible for administering the:

- income tax system for all business taxpayers with annual gross turnovers of less than \$10 million; and
- fringe benefits tax (FBT) for all taxpayers.

**1.8** SBI's purpose is to ensure that taxpayers within its area of responsibility comply with the tax laws. In line with Government policy, it is to achieve this purpose at minimum cost to the taxpayer. SBI has recently introduced a formal risk management framework to manage its risks effectively. This audit focuses on the economy, efficiency and administrative effectiveness of the implementation of that framework.

**1.9** SBI is the second largest business line accounting for some 15 per cent of ATO expenditure in 1996-97. SBI's total expenditure for 1996-97 was \$190.44 million, with salary and administrative costs totalling \$176.20 million for its average staffing level (ASL) of 3,152. It was responsible for the collection of \$13.3 billion in 1995-96 and \$13.6 billion in 1996-97 (refer Table

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<sup>3</sup> Now Large Business and International.

<sup>4</sup> Risk Management in ATO Small Business Income



1.1a below). It has been assessed by the ATO as the business line dealing with the greatest risks to compliance and to the revenue.

**1.10** Table 1.1b provides ratios based on Table 1.1a. It reveals that revenue collected per ASL has increased from 1995-96 to 1996-97, as has revenue collected per dollar of salary and administrative expenditure. Salary and administrative expenditure per ASL has also increased marginally over the same period after the cost of redundancies has been excluded.

**Table 1.1a**  
**SBI background data for 1995-96 and 1996-97**

<i>Year</i>	<i>Region<sup>4</sup></i>	<i>No. of Taxpayer (T/Ps)<sup>5</sup></i>	<i>Total Revenue Collected (\$ m)</i>	<i>ASL</i>	<i>Salary &amp; Admin. (S&amp;A) Expenditure (\$ m)</i>	<i>Cost of Redundancies (\$)</i>	<i>Net.(S&amp;A Expenditure (less redundancies) (\$ m)</i>
<b>1995-96</b>	National		-	106	7.88	-	-
	Eastern	1,126,458	5,256	1,238	63.41	-	-
	Northern	661,354	1,811	547	28.01	-	-
	Southern	942,548	4,096	1,042	53.68	-	-
	Western	708,030	2,156	576	29.70	-	-
	Total	3,438,390	13,319	3,508	182.68	-	-
<b>1996-97</b>	National	-	-	79	7.66	0.89	6.77
	Eastern	1,126,458	5,393	1,072	59.32	4.13	55.19
	Northern	661,354	1,726	507	27.25	1.03	26.22
	Southern	942,548	4,182	931	51.42	3.55	47.87
	Western	708,030	2,338	63	30.55	1.80	28.75
	Total	3,438,390	13,639	3,152	176.20	11.40	164.79

<sup>4</sup> The ATO is divided into four regions: Northern (Queensland and the Northern Territory), Southern (Victoria and Tasmania), Eastern (New South Wales) and Western (South Australia and Western Australia). In addition, the ATO has a National Office in Canberra.

<sup>5</sup> 1996-97 number of taxpayers is based on the 1995-96 figure because 1996-97 returns have not been lodged yet. The 1995-96 number of taxpayers is derived from those taxpayers who lodged 1995-96 returns in 1996-97.

**Table 1.1b**  
**SBI ratios for 1995-96 and 1996-97 based on Table 1.1a<sup>6</sup>**

<i>Year</i>	<i>Region</i>	<i>Revenue Collected per T/P (\$)</i>	<i>Revenue Collected per ASL (\$m)</i>	<i>Revenue Collected per \$1 S&amp;A Exp. (\$)</i>	<i>No. of T/Ps per ASL</i>	<i>S&amp;A Exp. Per T/P (\$)</i>	<i>S&amp;A Exp. per ASL (\$)</i>
<b>1995-96</b>	National	-	-	-	-	-	74,114
	Eastern	4,666	4.25	82.88	910	56.30	51,238
	Northern	2,738	3.31	64.66	1,210	42.35	51,246
	Southern	4,346	3.93	76.30	905	56.95	51,527
	Western	3,045	3.74	72.60	1,229	41.94	51,559
	Total	3,874	3.80	72.91	980	53.13	52,071
<b>1996-97</b>	National	-	-	-	-	-	85,939
	Eastern	4,788	5.03	97.72	1,051	48.99	51,497
	Northern	2,610	3.40	65.83	1,304	39.64	51,713
	Southern	4,437	4.49	87.36	1,012	50.79	51,393
	Western	3,302	4.15	81.34	1,258	40.60	51,072
	Total	3,967	4.33	82.77	1,091	47.93	52,286

Source: SBI and Revenue Analysis Branch, ATO.

**1.11** Figure 1.1 is derived from SBI's *Review of the Small Business Market* and compares small business returns and net business income.<sup>7</sup> It identifies the major classes of small business taxpayers, which is the way SBI segments its clientele, and what contribution each makes to net business income from the small business sector. SBI used this analysis as the basis for determining specific risks for each class. It shows that a relatively small component of the taxpaying public contributes a higher proportion of tax revenue.

<sup>6</sup> S&A Expenditure for 1996-97 excludes the cost of redundancies.

<sup>7</sup> Net Business Income (NBI) equals business income less business deductions.

**Figure 1.1:**  
**Comparison of Small Business Returns and Net Business Income – 1993-94 and 1994-95<sup>8</sup>**

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<sup>8</sup> Returns are lodged in the year following the financial year to which they refer (for example, 1993-94 returns are lodged in 1994-95). 1993-94 and 1994-95 data is the most recent available.

**1.12** SBI has been experiencing a period of change. It has revised its structure since 1 July 1996 and, along with the rest of the ATO, it is encountering significant changes to its computer infrastructure, business systems, management structures and work arrangements.

**1.13** Other significant aspects of change for SBI include:

- the Government has set new policies particularly in relation to small business, including small business deregulation policies;<sup>9</sup> and
- rapid advances in the technological environment for small business. Whilst providing opportunities for the ATO and the small business community, this also provides expanded opportunities for the avoidance or evasion of tax. For example, the Internet and electronic commerce will potentially allow the purchase of goods and transfer of funds worldwide with little if any permanent record of these transactions.

### ***Risk management***

**1.14** Risk management has been defined as:

*...the systematic application of management policies, procedures and practices to the tasks of identifying, analysing, assessing, treating and monitoring risk. (emphasis added)<sup>10</sup>*

**1.15** Risk management is a logical and systematic process that can be used when making decisions to improve the efficiency and effectiveness of performance. It is a management tool to identify and deal with current risks and prepare for future contingencies. Managing risk involves taking action to avoid or reduce unwanted exposure to the costs or other effects of these events, or to maximise the potential of any opportunities identified.<sup>11</sup>

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<sup>9</sup> Small business deregulation policies aim to rationalise the contact by small business with government agencies (including the ATO) and reduce the paperwork required to be completed by small businesses to meet government requirements.

<sup>10</sup> AS/NZS 4360.

<sup>11</sup> MAB/MIAC Report No. 22.

**1.16** Expected outcomes from an effective risk management process include better allocation of resources, higher standards of accountability, greater creativity and innovation in management practices, as well as enhanced decision making ability and cost-effectiveness.<sup>12</sup> When effective risk management is applied to an agency such as the ATO, potential improvements include increased revenue for the Commonwealth through the collection of revenue duly payable that is currently uncollected, better advice to government to enhance Budget forecasting and increased customer service for taxpayers. A reduction in the overall cost of collection ratio is also a potential result from the ATO's introduction of risk management principles.

**1.17** The ATO was among the first APS agencies to introduce formal risk management principles to its strategic planning framework.

**1.18** In line with this corporate direction, SBI has adopted risk management principles. Its Risk Management Project Team has applied the Management Advisory Board/Management Improvement Advisory Committee (MAB/MIAC) guidelines to the SBI environment and has implemented a formal risk management framework across the business line.

## **Objective and scope of the audit**

### ***Objective***

**1.19** The objective of the audit was to report to the Parliament on the economy, efficiency and administrative effectiveness of the risk management process in the SBI business line.

### ***Scope***

**1.20** As indicated in the audit objective, the scope of the audit was on the operations of the SBI business line.

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<sup>12</sup> *ibid.*

**1.21** In the opinion of the ANAO, the SBI business line was an appropriate element to review because, as indicated above in paragraph 1.9:

- it has been assessed by the ATO as the business line dealing with the greatest risks of compliance and risk to the revenue;<sup>13</sup>
- it deals with very significant amounts of revenue - some \$13.6 billion. Consequently, even small improvements have the potential to result in significant gains for the revenue of the Commonwealth. Also, it is the second largest business line, accounting for some 15 per cent of ATO expenditure in 1996-97. This provides scope for reductions in administrative costs; and
- in line with broad ATO strategies, its work is broadly similar to other areas of the ATO and therefore lessons learnt through this audit can be applied more widely within the ATO, as well as to the public sector generally.

### **Focus**

**1.22** The focus of the audit has been predominantly on SBI's risk management activities which support and flow from the ATO's Health of the System Assessment (HOTSA) process. The HOTSA is the ATO's formal risk management process which forms part of its strategic planning framework. It has been undertaken on an annual basis across all ATO business lines since 1994-95. The HOTSA was the focus of Audit Report No.37 1996-97.

**1.23** The audit applied the key steps of implementing an effective risk management framework to SBI. The findings of the audit have been presented in terms of this model, with specific attention given to issues regarding the:

- treatment of risks, the link between strategic planning and risk treatments, and initiatives to improve compliance (including auditing); and
- monitoring and review of risk treatments, focusing on issues such as performance information and benchmarking.

**1.24** The audit report structure is shown in Figure 1.2.

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<sup>13</sup> The ANAO independently assessed that SBI had the greatest potential for improvements in systemic revenue collection, especially in relation to the *tax gap*.

**Figure 1.2:**  
**Structure of audit report**

## Methodology of the audit

**1.25** The audit was conducted in accordance with the ANAO auditing standards at a cost to the ANAO of \$309,000.

### **Criteria**

**1.26** The criteria for the audit are derived substantially from the MAB/MIAC guidelines on risk management and Audit Report No.37. In particular, the audit set out to determine:

- how SBI has established both the internal and external context in which it operates;
- what information it has used to identify risks;
- how it has analysed those risks;
- how it has assessed and prioritised those risks;
- the mix of resources it has allocated to treat the risks; and
- how it reviews and monitors both the risks and management of those risks.

**1.27** Other sources of criteria include:

- auditing standards in relation to the audit function;
- the joint Department of Finance/ANAO Better Practice Guide in relation to Performance Information;<sup>14</sup>
- general principles of project management; and
- relevant sections of the ISO 9000 series in relation to quality management.

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<sup>14</sup> *Performance Information Principles*, November 1996.



## ***Audit evidence***

**1.28** Evidence for the audit was collected by:

- interviews with SBI management and staff at various levels and in all major areas of the business line;
- consultation with a range of taxpayer and professional bodies with substantial interaction with the ATO and SBI in particular; and
- analysis of data derived from various sources within the ATO, including annual reports, internal reports and plans, statistical reports, files and working papers.

## ***Fieldwork***

**1.29** The ANAO undertook fieldwork in each of the ATO's four regions involving visits to fourteen branch offices. As necessary, additional work was undertaken to ensure that conclusions reflect up to date policy and practice within the ATO at large and SBI in particular. The audit also included an examination of several functions performed at the National Office in Canberra.

**1.30** The ANAO engaged the services of the risk management expert Dr Dale Cooper of Broadleaf Capital International to assist the audit team with analysing the risk management strategies used in SBI.

## 2. SBI's Risk Management Process

*This chapter discusses SBI's risk management process, including the recent development and implementation of its risk management system, and then looks at how that process has been integrated into SBI's strategic planning activities. It finds that generally, the risk management methodology has been well implemented and identifies areas for ongoing improvement that are likely to benefit SBI.*

### Background

**2.1** The ATO was among the first agencies in the APS to introduce a formal risk management process as part of its strategic planning framework. This process is called the HOTSA and has been undertaken on an annual basis across all ATO business lines since 1994 -95.

**2.2** Both Australian/New Zealand Standard 4360<sup>15</sup> and the MAB/MIAC guidelines describe a six-step methodology for successful risk management. Appendix 1 provides an outline of each step. This methodology was discussed in detail in Audit Report No.37 1996-97, which also described suitable risk management arrangements and their relationship to ATO strategic planning and the HOTSA. In particular, it set out the kinds of linkages that, in our opinion, should exist between the ATO's corporate planning and risk management, and strategies or business planning of the individual business and service lines.

**2.3** The following discussion identifies the extent to which SBI's risk management process has been consistent with the methodology. The discussion on the last two steps of the risk management process, the *treatment of risks* and *monitoring and review*, particularly in relation to compliance risks and performance information, are discussed in more detail in Chapters 3 and 4 respectively.

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<sup>15</sup> Australian/New Zealand Standard 4360, 1995 *Risk Management* (AS/NZS 4360).

## Risk management in SBI

**2.4** In order to supplement the preparation of its HOTSA, SBI introduced State of Health (SoH) reporting in early 1995. This was the first formal risk management process undertaken by SBI since the ATO introduced its business and service line structure at the start of 1994-95. The SoH process required each SBI portfolio (functional area) to prepare a report that identified and assessed its key risks.

**2.5** A decision in July 1995 by the ATO Management Board (the Board) following the first HOTSA in 1994-95 required SBI to undertake a comprehensive review of its market and present new ways of addressing compliance and costs of compliance to the taxpayer. When making this decision, the Board acknowledged that SBI had the ATO's major unaddressed compliance risks. In response to this requirement SBI undertook the *Review of the Small Business Market* which was completed in February 1996. The Board approved the results of the Review. The key findings from the market consultation phase of the review of the market included:<sup>16</sup>

- risk management techniques needed to be used on an on-going basis;
- ATO actions to increase compliance often translated to additional costs for small business;
- there was a community perception that the ATO does little about the cash economy;
- new audit products were needed;
- coverage of the small business market with existing audit products was low; and
- small businesses recognised that there was an extremely low possibility of being subjected to an audit which promoted risk taking.

**2.6** Following the Review, SBI revised its segmentation of its clientele (refer back to Figure 1.1). The Review, together with the additional information obtained and the consequent new compliance strategies developed from this research, influenced the emergent risk management process in SBI at the time.

**2.7** A project team dedicated to developing SBI's risk management process was formed in mid-1996. The project team, currently known as the SBI Risk Management Project Team, held its first meeting in August 1996. Its aim was

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<sup>16</sup> *Review of the Small Business Market*, Preliminary Findings Report to the ATO Management Board, Small Business Income, 9 February 1996. SBI has advised that it did not necessarily agree with the views of the market reflected in this report submitted to the SBI Executive.

to develop a profile of risks and recommendations regarding treatments and resourcing. The Executive required this material by March 1997 for use in the business planning process for 1997-98. The Risk Management Project Team adopted the MAB/MIAC risk management guidelines as the basis for SBI's risk management framework. It has sought to apply this model to the SBI environment. The progress made against each of the six steps of the methodology is discussed later in this chapter.

**2.8** The Project Team recently introduced a formal risk management system to SBI. It also prepared extensive supporting documentation covering both the design and components of the system. This documentation includes a risk management policy, conceptual framework, document management system, risk management model and its components such as the risk database and risk register. It also includes a process, known as the *escalation process*, to bring emerging risks identified by staff and others to the attention of senior management.

**2.9** The ANAO considers that the process of risk management needs to be both top-down and bottom-up, but in different ways. That is, the procedures and processes must start from the top, as must the overall structure (including objectives and criteria); but risks are often identified most precisely at operational levels throughout an organisation. In its application of risk management, SBI has used both top-down and bottom-up approaches to the identification of risks to ensure there is ownership and understanding of the process throughout the business line.

**2.10** Figure 2.1 illustrates this risk management model as it is used by SBI.

Figure 2.1:  
SBI Risk Management Model

Source: SBI Project Management Team.

## **SBI's performance against the six-step methodology**

### ***Step 1: Establish the context***

**2.11** Risk management takes account of an organisation's strategic and organisational contexts and risk management processes. The outcomes from this stage include:

- an analysis of stakeholders and the objectives relating to them;
- the development of a set of risk management criteria; and
- the formation of a plan for risk management.

## *Stakeholder analysis*

**2.12** Consultation with all stakeholders makes it more likely that a particular plan is relevant, understood, used by managers and staff and implemented effectively.

**2.13** SBI has established a system of regular contact with tax agents and other relevant professional bodies as important groups of stakeholders. It uses various forums for this purpose including, particularly, the Commissioner's Small Business Consultative Forum, the ATO Tax Practitioners Forum and working groups such as the Cash Economy Task Force.

**2.14** SBI has also identified the importance of its relationship with a new government and the strategic direction reflects the government's emphasis on the small business community. Similarly, SBI identified the ANAO and the Commonwealth Ombudsmen as stakeholders. Other stakeholders whose interests may be taken into account include the Department of Finance and Administration, Treasury, Australian Securities Commission, Australian Federal Police, Director of Public Prosecutions, Courts (including tribunals such as the Administrative Appeals Tribunal) and other relevant government agencies that need to be addressed as part of the risk management process. Also important are Parliament, the media, and peak social groups such as the Churches, the Australian Council of Social Services, and the Brotherhood of St Lawrence as well as industry bodies, tax agents and accountants.

**2.15** In addition, staff and unions have been identified as significant stakeholders for SBI. A major redesign of work processes has also been undertaken with the view to improving SBI staff productivity. This process, involving management, staff and unions, was commenced with the restructuring of the ATO from functional activities to business lines in July 1994. The revised arrangements were due to come into place on 1 July 1997. The ANAO did not audit these new arrangements (the audit was substantially complete at the time they came into operation) and was therefore unable to express an opinion concerning their suitability. However, the ANAO noted the activity as relevant in establishing a suitable risk management context.

**2.16** SBI has clearly addressed the context in which it operates and many of the relevant stakeholders have been identified in its risk assessment process for 1996-97. However, stakeholders or a stakeholder analysis were not specifically mentioned in the SBI business plans for 1996-97 or 1997-98. SBI advised that although it was not explicitly mentioned in the business plans, stakeholder analysis had been done by:

- consultation with staff and other business lines;

- consideration of issues raised from external focus groups conducted at the corporate level; and
- research it had undertaken into taxpayer attitudes and the *Review of the Small Business Market* research.

**2.17** SBI informed the ANAO that it had taken into consideration the information already available in recent reports, such as the extent of ongoing liaison and small business concern with costs, and decided that it was not appropriate to embark on a further process of consultation for the 1997-98 plans.

**2.18** The ANAO noted that stakeholder analysis was undertaken as part of SBI's HOTSA process. SBI has also taken internal stakeholders into consideration and has identified natural linkages and opportunities where it will work with other business lines to improve its business.

**2.19** The ANAO concluded that SBI's stakeholder analysis was comprehensive and contributed to its business plans for 1996-97 and 1997-98.

### *Risk management criteria*

**2.20** Criteria provide the framework upon which assessment and prioritisation of identified risks can occur and decisions regarding appropriate treatment of risks can be made. They also form a common, consistent basis against which to compare seemingly different risks across the organisation. Well-developed and consistent criteria help to ensure the *transparency* of the process, mitigate the risk of individual bias and minimise unnecessary subjectivity in the decision process.

**2.21** SBI developed risk criteria for the purpose of completing its HOTSA. The ATO advised that draft versions of the criteria were developed in 1996 and early 1997, with a final version applied to SBI's HOTSA process in March 1997. To compare various types of risks and risk areas, SBI applied different weights to each of the five risk criteria which reflect their relative importance to SBI. These criteria, with SBI's weighting applied to each of them, are as follows:

- maintain the current revenue base (40 per cent);
- improve taxpayer compliance in specific areas (20 per cent);
- improve broad community support for the tax system (20 per cent);
- reduce taxpayers' costs of compliance (5 per cent); and

- improve productivity in SBI (15 per cent).

SBI has advised that the above elements help focus its attention on those risks that have the greatest impact on the business line. They have little bearing on the final allocation of resources, as the risk weighting is only one factor considered in resourcing decisions.

**2.22** The ANAO concluded that these criteria were developed following sufficient analysis of the SBI environment, including stakeholder expectations, and were appropriately used subsequently in SBI's risk management process.

### *Risk management plan*

**2.23** The risk management process itself requires planning and the allocation of resources. A single document that sets out such a plan did not exist until the 1997-98 SBI Risk Management Plan was completed in September 1997. The ANAO considered that the effectiveness of the Plan would have been increased if it had been completed and operational by the start of 1997-98.

**2.24** The ANAO acknowledges that the SBI Risk Management Project Team had prepared documentation that covered both the design and components of SBI's risk management system (see above) prior to completion of the SBI Risk Management Plan. However, the ANAO considered that these documents lacked the required planning and resource allocation information for effective management of the risk management system which was subsequently included in SBI's Risk Management Plan.

**2.25** We concluded that the plan satisfied MAB/MIAC guidelines and AS/NZS 4360 requirements regarding planning and resource allocation for establishing the context, however it had not been produced in a timely manner.

### ***Step 2: Identify the risks***

**2.26** The aim of this stage of the risk model is to generate a comprehensive list of relevant risks and to document in a risk database what each risk involves. This documentation should contain a brief description of the risks, including possible causes, initiating events, potential outcomes and existing controls. To be effective risk identification must be comprehensive and a structured approach is strongly recommended.

**2.27** The ANAO considered that risk identification was relatively comprehensive within SBI. The risk database listed 63 different strategic risk



areas as at March 1997.<sup>17</sup> The detailed proformas that support each strategic risk area list further major risks associated with each. In addition, when a risk is identified, SBI requires a set of 52 generic questions to be answered. These questions are designed to ascertain what is happening and what might happen, how frequently and what the consequences are of that risk occurring or would be if the risk concerned actually occurred. Appendix 2 provides an extract of questions from the list of 52 generic questions.

**2.28** These strategic risk areas tend to reflect general business areas and the specific risk itself is not always apparent. Although in most cases there is considerable detail and in many cases the intent is clear, the major risks are not recorded consistently across the risk areas, and are not always stated explicitly.

**2.29** For example, instead of *integrity of the tax system – public confidence*, it would be more explicit to state the risk as *the public lose confidence in the integrity of the tax system and the ATO loses community support*.<sup>18</sup> In these circumstances, decisions based on information couched in these general terms can involve assumptions about shared experiences and values that may no longer be valid. In the same strategic risk area, the risk *cash economy* conveys little about the precise risk that is intended. This could be interpreted as many people who are employed in industries to which PPS applies are being paid in cash without tax being deducted, or alternatively, that there is a large cash economy outside the scope of PPS.

**2.30** The ANAO recognises that there will be a degree of expert knowledge and common understanding involved in SBI's operations. However, where that common understanding finds expression only in general terms there is a risk that those general terms will in time no longer reflect precise common understandings. Although the SBI officers who completed the risk management proformas probably have a clear idea of their intentions, others may not have the same interpretation of these statements. This lack of common understanding will be compounded over time as other activities and priorities intervene and as the people who prepared the risk proformas transfer to other responsibilities.

**2.31** SBI has informed the ANAO that it has instigated a process of having one person within the Compliance and Industry Research Unit (CIRU) liaising with respondents providing data for inclusion on the risk database. This is

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<sup>17</sup> The risk database actually contained 93 risk proformas, however some of these proformas addressed the same strategic risk area.

<sup>18</sup> *SBI Risk Database*, risk no.4, 11/3/97.

intended to ensure consistency of understanding, limit repetition and provide clarity where overlaps potentially exist.

**2.32** Many of the strategic risks identified actually consist of a number of individual risks that may require different risk treatments to manage them. Two examples below taken from SBI risk assessment documentation illustrate this.

**2.33** *Strategic Risk Area 20, Tax Shelters, Primary Production Prospectus Cases:* The major risks stated in this document relate to the tax-driven nature of the schemes, a range of compliance issues, high compliance costs for both investors and the ATO and lack of consistency by the ATO.

**2.34** *Strategic Risk Area 49, Sydney 2000 Olympics:* SBI identified the following issues: financing contracts, overseas athletes, entertainers and professional sports people, building and infrastructure development, plant and equipment, software, retail trade, sponsorship and licensing, intellectual property, related industries, Sydney Organising Committee for the Olympic Games (SOCOG) liaison, fraud and serious evasion. These issues involve a number of discrete risks that may require a variety of risk treatments.

**2.35** On the other hand, *Strategic Risk Area 87, FBT*, where the risk analysis has been done in detail, provides an example of good practice that could be adopted more widely. This document provides a clear articulation of risks to FBT and a clear analysis of the potential impacts associated with those risks. The FBT documentation then goes on to discuss risk treatments and details the resources required to treat these risks. In the ANAO's view this could serve as a better practice model against which other areas of SBI could be benchmarked.

**2.36** The ANAO considers that while there is some necessity to look at risks in aggregate, it is desirable to describe explicitly the actual issue at risk rather than nominate a topic or strategic area.

**2.37** SBI agrees that, as part of ongoing improvement in relation to identification processes, it is desirable to describe explicitly the actual issue at risk rather than nominate a topic or strategic area. SBI advised that it has already commenced this more extensive analysis particularly in relation to the 'top thirteen' SBI risks.

### ***Recommendation No.1***

**2.38** The ANAO *recommends* that, as part of its ongoing improvement when identifying risks, SBI describe the inherent nature of the risks rather than generic risk topics.

### **ATO Response**

**2.39** Agreed with qualification. SBI accepts that risks should be described clearly wherever practicable. Initially, however, some risks may only be described generically, until further research has been undertaken into constituent elements and causes.

### ***Step 3: Analyse the risks***

**2.40** The purpose of the risk analysis stage is to estimate likelihood and effects (consequences) of risk events and to develop risk levels based on these factors as a precursor to setting risk priorities. These risks refer to both risks that are already occurring and risks that can occur in the future. The analysis should include:

- a description of each risk and how it might arise;
- possible initiating factors;
- the main assumptions; and
- a list of the principal sources of information.

**2.41** SBI's analysis of risks takes place at various levels of the organisation. In these circumstances it is important that the analysis process is consistent with results in comparable risk assessments. In other words, a risk analysis by a manager in Sydney relating to FBT should be made on the same basis as an analysis of the PPS system in Melbourne. This implies a systematic set of criteria for analysis that should include both quantitative and qualitative elements.

**2.42** During the HOTSA process, those responsible for identifying SBI's risks assigned each risk area a risk level directly. In the cases examined by the ANAO, this was done without explicit or documented reference to the likelihood of the risk occurring or its consequences. SBI provided guidance to staff to analyse risks using a simple scale shown on the HOTSA proforma.<sup>19</sup> The Risk Management Project Team then applied a comprehensive scale involving an analysis of likelihood and consequences as a basis for verifying risk ratings and ensuring consistency.

**2.43** The ANAO considers that it would be preferable if those providing the initial identification and analysis also identified the probabilities and consequences attaching to the risks.

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<sup>19</sup> Each business line was issued with a HOTSA proforma to help achieve consistent approaches across business lines when preparing their HOTSAs.

**2.44** The SBI risk criteria provide a sound basis for analysing the consequences of risk events.<sup>20</sup> SBI has begun to use a qualitative risk analysis matrix which transforms the combined likelihood and consequence ratings for each risk into a quantifiable risk level. However, it recognises the need, as an ongoing improvement, to extend the use of a table structure for use by all staff when analysing risks.

### ***Recommendation No.2***

**2.45** The ANAO *recommends* that when analysing risks SBI extend the use of its qualitative risk analysis matrix, which transforms the combined likelihood and consequence ratings for each risk into a quantifiable risk level, to earlier stages of the risk assessment process.

### **ATO Response**

**2.46** Agreed. SBI agrees to extend the use of its qualitative risk analysis matrix to all stages of the risk assessment process.

### ***Step 4: Assess and prioritise the risks***

**2.47** The risk assessment stage involves decisions about the importance of the identified risks. The output from this stage should be a list of risks in priority order. The process usually involves a comparison of likelihoods, consequences and initial risk levels taking into account the criteria and context established in Step 1.

**2.48** In order to understand the risk environment fully, all risks should be ranked. It then becomes a management decision on which risks receive treatment (those described as *unacceptable* in the context of the MAB/MIAC Guidelines). For this reason, to gain optimum results the SBI Executive should take responsibility, either directly or through some established mechanism (for example, the risk management committee or corporate governance framework) for the assessment and prioritisation of identified risks.

**2.49** The ANAO reviewed SBI's risk assessment and prioritisation documentation for the 1997 HOTSA process and found that it was comprehensive. This included the *SBI Strategic Risk Areas - Summary Sheet* which listed all 63 strategic risk areas identified in the HOTSA process in priority order based on the risk assessment methodology (using the risk criteria mentioned above).

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<sup>20</sup> Note the comments on the importance of consistent and transparent criteria in Step 1.

**2.50** We were advised that the SBI Executive endorsed the risk assessment and prioritisation processes developed by the Risk Management Project Team and that it made final decisions on the prioritisation and categorisation of risks.

### ***Step 5: Treat the risks***

**2.51** Before decisions are made regarding which risks should be treated, information on the method of treatment, the costs involved and the evaluation of treatments needs to be available. This involves developing a business case to allow decisions to be made on the costs and benefits of risk treatments and both the likelihood of success and how that success will be measured. This may extend to giving consideration to opportunity costs (that is, the costs and benefits of utilising one treatment at the expense of the other).

**2.52** The MAB/MIAC Guidelines and AS/NZS 4360 specify action plans as an output from this step in the process. The latter notes that action plans should:

*...identify responsibilities, schedules, the expected outcomes of treatments, budgeting, performance measures and the review process to be set in place.<sup>21</sup>*

**2.53** These could be incorporated at a summary level by simple amendments to the existing SBI risk management proformas. It is not expected that complete action plans be included in risk registers, as they are more appropriately included in operational plans. However, it would be useful to provide summaries in risk registers.

**2.54** Performance of this part of the risk management process across SBI varies in quality. The FBT strategic risk analysis and proposed treatments reflect detailed management effort and are an excellent example to follow. Particularly noteworthy are:

- action plans including specific strategies;
- targets and performance measurements; and
- staff resources.

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<sup>21</sup> AS/NZS 4360, paragraph 4.5.3.

**2.55** However, the ANAO noted that the analysis does not include administration and other costs. This is relevant to SBI's need for a comprehensive approach to the costs of its activities which is discussed in Chapter 5.

**2.56** SBI informed the ANAO that details of plans, resourcing levels and costs of treating major risks are recorded by SBI. This information is collated using the risk identification process (the 52 generic questions) and is taken into account in the assessment and prioritisation steps. SBI further advised that once it has decided which risks are not acceptable, the SBI Executive then decides on plans, resource levels and costs associated with each risk to be treated. Decisions about these matters are documented in the SBI Business Plan and in more detail in the project plans which are developed by project leaders.

**2.57** The ANAO considers that determining the costs, in addition to benefits, associated with particular risk treatments is important for effective decision making. For example, an issue may not be a high risk, but because it may be a low cost to treat, the treatment may be cost-effective.

### ***Recommendation No.3***

**2.58** The ANAO *recommends* that when deciding on which risks are to be addressed, SBI examine in detail the costs and benefits associated with the various options for treatment.

### **ATO Response**

**2.59** Agreed with qualification. SBI accepts the direction inherent in this recommendation. While risks are currently subjected to some cost benefit analysis, this analysis could be improved. It is not clear at this stage whether the improved cost benefit analysis can effectively extend beyond combinations of risk treatments to particular risk treatments.

**2.60** The ANAO acknowledges that it may not be feasible to undertake effective cost benefit analysis to the level of particular risk treatments in every possible occasion. However, we consider that SBI should be moving towards measuring the costs and benefits of particular risk treatments where practicable.

**2.61** Chapter 3 examines in more detail how this process works in relation to ensuring compliance with the tax law.

## ***Step 6: Continually monitor and review***

**2.62** As risks and organisational priorities change through time and a changing environment, risks and risk treatments should be monitored as part of the management cycle. Ongoing review is essential to ensure that management plans remain relevant. It is also beneficial to monitor the effectiveness of risk treatment plans and strategies as well as the management system set up to control implementation of treatments.

**2.63** The responsibilities, resources, accountability mechanisms, reporting requirements and timeframes for monitoring and reviewing risk management should be clearly articulated. Adequate performance indicators need to be devised to measure and monitor (either frequently or periodically) critical success factors. The validity of assumptions used in undertaking the risk assessment also should be reviewed periodically.

**2.64** SBI has introduced a risk escalation process that, if it operates effectively, will ensure that emerging risks are identified quickly and brought to the attention of the appropriate managers at an early stage.

**2.65** It is critical that monitoring and review focus on the implementation and success rates of risk treatments. The costs and benefits of the various risk treatments should be considered to ensure that the most appropriate treatment option is being utilised (this is discussed further in Chapter 3). The SBI risk proformas do include a section dealing with expected results from strategies proposed to treat risks. However, few of the 63 identified risks mentioned specific measures of success.

**2.66** SBI has attempted to put a systematic process of monitoring and review in place. At the time of the audit, the details of this process had not been finalised. However, SBI informed the ANAO that since April 1997, the Risk Management Project Team has been developing and finalising arrangements for the ongoing management and operation of the Risk Management System (see above) with particular attention to systematic monitoring and review of risks and risk treatments.

**2.67** According to its Operational Plan, the Project Team is to report to the SBI Executive each quarter on risk management including, in particular, identification of any emerging risks. It is also to include details of progress on individual risk action plans and the cost-effectiveness of treatment action. Furthermore, review of the performance of the project team against its business plan will be conducted by the National Program Manager (NPM) and as part of the ATO corporate governance process.

**2.68** The ANAO did not find evidence that at the time of the audit the validity of assumptions used in undertaking the risk assessment had been reviewed. However, this should be a responsibility of the Risk Management Project Team given that it is responsible for the ongoing management and operation of the risk management system.

**2.69** The ANAO's conclusion is that SBI is in the early stages of implementing a systematic program of monitoring and review. Continually refining this process would contribute to making SBI's risk management process more comprehensive. The increase in costs involved in monitoring and review is marginal as SBI already has the mechanism (the Risk Management Project Team and Compliance and Industry Research Unit) to undertake evaluations. There may be some additional costs in undertaking independent evaluations, for example, by using expert risk management consultants. The major benefits are expected to be more cost-effective or better-targeted risk treatments. This should result in higher levels of revenue collected or lower levels of revenue lost and it is likely that administrative costs would decrease.

**2.70** The ANAO suggests that SBI continue to refine its systematic process of monitoring and review of its risks and risk treatment strategies.

## **Integration of risk management into strategic planning activities**

**2.71** For risk management to be effective, it should be integrated efficiently and effectively into strategic planning activities. We examined the way in which SBI integrated its risk management process into strategic planning activities. We found that, in general, SBI:

- integrated its identification of risks through the HOTSA process into the development of the ATO's corporate aims well;
- contributed to the identification of the key ATO corporate risks;
- directly linked its business planning<sup>22</sup> to the ATO Corporate Plan;
- directly linked its strategic planning with objectives to specific outcomes, relevant strategies and performance measures;

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<sup>22</sup> SBI sees *business planning* as referring to all levels of planning, the corporate plan being the highest and the workplans being the lowest.



- has made the priority risks out of the risk management process the central element of the SBI Business Plan and all work being undertaken in SBI is being done on these priority risks;
- allocated priorities to intended actions and identified appropriate officers responsible for their execution in its business plan; and
- linked its proposed risk treatments to its planning processes.

**2.72** Although there is conformity to the audit criteria in a general sense, the ANAO noted the following areas where improvements could be made.

**2.73** Firstly, although SBI took account of the ATO's Corporate Plan in developing its own business plan, the links between the two levels were not addressed explicitly. We consider that it would have been preferable to make these links explicit in order to maintain the visibility of the ATO's corporate direction at all levels of the organisation.

**2.74** The business plan included a detailed analysis of actions to be taken during the planning period for each of the priority risks. However, this analysis did not include day-to-day operational issues, such as processing tax returns and answering inquiries, within SBI. The general goals of the organisation in this respect have not been aligned with tasks to achieve goals for these activities.

**2.75** Although several plans set specific targets and time frames, for example, relating to initiatives concerning debt collection, hobby businesses and FBT, time frames are not set consistently in the general plan or in all of the National Priority summary plans. It is important to include time frames in plans at this level in order to monitor progress on achievements.

#### ***Recommendation No.4***

**2.76** The ANAO *recommends* that SBI's strategic and operational plans contain more time frames in order to monitor progress on achievements.

#### **ATO Response**

**2.77** Agreed.

## 3. Dealing with Compliance Risks

*In this chapter the ANAO examines the way in which SBI deals with compliance risks and finds that, in line with international research and practices, SBI adopts a range of strategies to improve compliance by taxpayers with the tax laws. However, the ANAO notes that there is no empirical basis for determining the mix of strategies. In particular, the ANAO was unable to identify a common set of criteria or weighting system determining the level of audit to risk attributes in all cases.*

### Introduction

**3.1** One of the major risks faced by the ATO is that taxpayers will not comply with the tax law. Factors influencing compliance include the taxpayers' demographics, opportunities for non-compliance, community attitudes and the structure of the tax system. All of these aspects are taken into consideration in SBI's process of identifying its risks. As referred to in paragraph 1.23, this chapter deals with the treatment of risks, particularly initiatives to improve compliance (including auditing), and the link between strategic planning and risk treatments.

### SBI's approach to compliance

**3.2** The ATO addresses identified risks of non-compliance in a number of ways. These approaches can be broadly classified as legislative, administrative and audit, noting that rulings and some administrative arrangements can be deemed educational in nature. These approaches are listed below.

## ***Legislative***

- *Reportable Payments System (RPS) / Prescribed Payments System (PPS)* - provide mechanisms for taxpayers (payees) in particular industry groups (for example, RPS - clothing, fishing, and fruit and vegetables; PPS - construction and transport) to meet their tax obligations as they earn income under contract. These are aimed at treating the risk of the cash economy and improving public confidence in the tax system.
- *Law clarification* - the objective is to resolve uncertainty in the small business sector regarding the tax law.
- *Private Binding Rulings (PBRs)*- provide guidance for both the public and staff on matters of policy, procedural instruction and interpretation of tax laws.

## ***Administrative***

- *TaxPack* - provides taxpayers with basic information on the operation of the tax system and their tax entitlements and obligations under tax laws.
- *Record Keeping Reviews (RKR)*s - established in response to concerns about the non-compliance rate of small businesses. The ATO rationale is that if the standard of record keeping is improved, it is easier for small businesses to comply with tax laws.
- *Data matching to identify defective returns* - this is used to focus enforcement efforts to a greater extent on those who are not meeting their obligations under the law, identify areas where taxpayers and other clients need assistance in meeting their obligations under the law, and manage and improve ATO data quality.
- *Prosecutions* - target serious, blatant or persistent non-compliers for whom there are no other effective means of ensuring compliance.
- *Industry or specific initiatives (such as the cash economy, test case litigation, public education)* - target non-compliance through compliance improvement projects and/or help and education programs.
- Focusing on intermediaries such as tax agents and industry bodies for leveraged activities - liaising with third parties to advise taxpayers of their obligations.

## **Audit**

- *Income tax audit activities* - including leveraged activities; and
- *FBT audit* - including leveraged activities.

## **Using a mix of strategies to improve compliance**

**3.3** SBI uses a mix of these strategies to target particular risks of non-compliance. This mix of compliance improvement activities aims to achieve a high level of compliance in the most cost-effective manner.

**3.4** The ANAO examined the types of strategies used by SBI to improve compliance. To do this, we looked at those entries in SBI's risk database that focus on improving compliance to see how it was prepared to address each of these identified strategic risk areas.

**3.5** As at September 1997, SBI had 60 entries in its risk database of strategic risk areas where the focus was on improving compliance. Of these, 46 (77 per cent) were classified as current projects, although the ANAO was advised that some of the strategic risk areas that were not being addressed now and would be dealt with in the future had resources assigned to them.

**3.6** Figure 3.1 shows in percentage terms the various ways SBI proposed to deal with the risks it had identified as relating to improving compliance. It includes both current projects and those that will be dealt with in the future. Note that percentage values in Figure 3.1 relate to the percentage of all strategic risk areas relating to improving compliance. For example, 50 per cent of all strategic risk areas use auditing as part of their strategy and are current projects; 7 per cent of all strategic risk areas have identified auditing as part of the approach to risk treatment and will be dealt with in the future.

**3.7** The chart also indicates that auditing is the most common treatment for focusing on non-compliance. Some 57 per cent of all SBI strategic risk areas that focus on improving compliance use this taxpayer treatment as part of the total mix of strategies adopted. Leverage and Help taxpayer treatments are also fairly prevalent with approximately one in every two of the identified strategic risk areas using these treatments. In contrast, changes to tax legislation and RKR's are used less frequently as strategies to improve compliance (32 per cent and 20 per cent of the strategic risk areas respectively).

**Figure 3.1:**  
**Use of taxpayer treatments in SBI strategic risk areas that focused on improving compliance**

<b>KEY:</b>	<b>Audits</b>	Face to face audits
	<b>Leverage</b>	An activity that may influence the compliance
	attitude of	many taxpayers
	<b>Help</b>	Help and education
	<b>Legislation</b>	Changes to tax legislation
	<b>RKRs</b>	Record Keeping Reviews
	<b>Other</b>	Other strategies

Note: Strategic risk areas being addressed may employ more than one strategy.

Source: ANAO analysis on data supplied by SBI Risk Management Project Team.

**3.8** The ANAO concluded that SBI uses auditing as its major option for improving compliance. However, we noted that it is rare for auditing to be the sole taxpayer treatment for a strategic risk area and that it is commonly used as one in a mix of strategies to address a particular strategic risk area.

## ***Research background on auditing***

**3.9** Auditing has long been regarded as a key component of any compliance strategy. The place of auditing in an overall strategy to deal with tax compliance has been the subject of substantial research, most of it related to overseas experience. On the one hand, the research seems to indicate:

- there is empirical evidence that taxpayer compliance is indeed influenced by detection and punishment; however, it was noted that if these were the only factors influencing taxpayer compliance, the overall compliance level would be much lower than what is observed;
- there are relatively weak deterrent effects from audits. For most audit classes examined, audits have positive effects on compliance but the magnitudes of the effects are small. Other non-audit activities may have a significant compliance effect; and
- policies that increase the public's sense of moral duty to comply should be the most effective strategy for improving compliance.

**3.10** On the other hand, there is also a substantial body of research that points to the direct impact of auditing on levels of revenue collected and subsequent improvements in taxpayer compliance. Although the thrust of the studies is towards broadening the scope and mix of compliance strategies, many of them emphasise the need to maintain auditing as a key strategy. The ANAO concurs with this view.

**3.11** In considering how SBI deals with its compliance risks, the ANAO has concentrated particularly on the use of auditing by SBI as a compliance strategy. This is because auditing is the most commonly proposed risk treatment in the risk database for identified risks to compliance (as discussed in paragraphs 3.7 and 3.8 and Figure 3.1). The research discussed above has also stressed the significance of auditing in an overall compliance strategy. Therefore, from an overall risk management point of view, it is important to assess how auditing is carried out and how effectively it has been utilised as a strategy to improve compliance.

## **Auditing in SBI**

**3.12** An audit is a verification process that seeks to ascertain whether a taxpayer has complied with certain obligations. As outlined earlier in the chapter, SBI conducts audits of income tax and FBT matters. Within SBI, an audit arises from:

- a project usually initiated in line with strategic objectives and identified high risk taxpayer groups; or
- an indication of some potentially material irregularity in an individual return.

### ***Costs and returns of income tax and FBT audits***

**3.13** The ANAO looked at the relative returns on auditing, that is, what is the return for one dollar spent on auditing. This analysis of returns of income tax and FBT audits, which is shown in Table 3.1, is based on direct salary costs only of auditing and does not include any component for overhead costs.<sup>23</sup> The ATO's costing system does not provide information to cost activities more accurately (see discussion below).

**3.14** Table 3.1 shows that there has been only a slight increase in the return per direct salary dollar spent on income tax audits whereas the return per direct salary dollar spent on FBT audits has varied markedly. SBI has advised that reasons for this variability in the return on FBT audits include decreasing taxpayer numbers (102 166 at the start of 1994-95 as opposed to 86 938 at August 1997-98), a shifting emphasis between national projects and single issue projects, and the nature of FBT issues that were the subject of the audits.

**3.15** When income tax and FBT audits are combined, it is evident that the return per direct salary dollar spent on auditing has remained relatively static (\$15.58 in 1994-95 as opposed to \$16.07 in 1996-97).

**3.16** A review of the results in Table 3.1 suggests that a main factor influencing the overall direct return on auditing is the resources committed (based on a comparison of estimated direct salary cost of auditing with return on auditing). Other factors include case selection, the complexity of a taxpayer's arrangements, the extent of cooperation by the taxpayer, the nature of the audit, and so on. Although this analysis suggests that the return on one dollar invested in auditing has remained static, the ANAO considers that the capacity to conduct cost/benefit analysis is hampered by the absence of a costing system that incorporates all direct and indirect resources as well as the indirect compliance effects from this and other compliance initiatives.

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<sup>23</sup> As an indication, the Department of Finance and Administration suggests that where labour on-costs and all administrative expense overheads are distributed by means of an overhead rate on direct annual salaries, and in the absence of specific cost information, the total overhead rate to be used is 154.4 per cent of direct annual salaries.

**Table 3.1:**  
**Costs and Returns of Income Tax and FBT Audits 1994-95 to 1996-97<sup>24</sup>**

**INCOME TAX AUDITS**

	ASL	Total SBI Salary Exp. (\$'000s)	Workforce Hours Available <sup>25</sup>	Hours Spent on Income Tax Audits	% Time of Work-force Spent on Income Tax Audits	Estimated Direct Salary Cost on Income Tax Auditing <sup>26</sup>	Return on Auditing (Tax raised and Penalties Applied)	Return per Direct Salary Dollar Spent on Auditing
1994-95	3,460	137,186	5,594,820	375,313	6.7%	\$9,202,743	\$141,828,773	\$15.41
1995-96	3,524	174,141	5,698,308	369,028	6.5%	\$11,277,541	\$187,432,642	\$16.62
1996-97	3,152	167,738	5,096,784	209,811	4.1%	\$6,904,997	\$115,589,021	\$16.74

**FBT AUDITS**

	ASL	Total SBI Salary Exp. (\$'000s)	Workforce Hours Available	Hours Spent on FBT Audits	% Time of Work-force Spent on FBT Audits	Estimated Direct Salary Cost on FBT auditing	Return on Auditing (Tax raised and Penalties Applied)	Return per Direct Salary Dollar Spent on Auditing
1994-95	3,460	137,186	5,594,820	38,239	0.7%	\$937,620	\$16,201,524	\$17.28
1995-96	3,524	174,141	5,698,308	45,852	0.8%	\$1,401,256	\$36,007,748	\$25.70
1996-97	3,152	167,738	5,096,784	37,107	0.7%	\$1,221,213	\$14,960,358	\$12.25

**TOTAL AUDITS**

	ASL	Total SBI Salary Exp. (\$'000s)	Workforce Hours Available	Hours Spent on Total Audits	% Time of Work-force Spent on Total Audits	Estimated Direct Salary Cost on Auditing	Return on Auditing (Tax raised and Penalties Applied)	Return per Direct Salary Dollar Spent on Auditing
1994-95	3,460	137,186	5,594,820	413,552	7.4%	\$10,140,363	\$158,030,297	\$15.58
1995-96	3,524	174,141	5,698,308	414,880	7.3%	\$12,678,797	\$223,440,390	\$17.62
1996-97	3,152	167,738	5,096,784	246,918	4.8%	\$8,126,210	\$130,549,379	\$16.07

Source: ANAO analysis on data provided by SBI from the ATO's Core Case Management System.

<sup>24</sup> The figures in this table refer to face to face audits only and hence do not include RKR's, desk audits or tax agent initiatives.

<sup>25</sup> Workforce hours available equals ASL multiplied by the average hours worked each year by a full time staff equivalent (FTE) staff officer. Average hours worked each year by a FTE staff officer is estimated at 1,617 hours based on a working week of 36.75 hours.

<sup>26</sup> ATO only records direct salary of audits. It does not incorporate full activity based costing (refer paragraphs 3.14 and 3.15).



**3.17** Similarly, this analysis does not incorporate the indirect revenue benefits that can be derived from an effective audit presence. For example, for some taxpayers, their perception that they will probably be caught if they do not comply with the tax law is an important consideration in their decision on whether to comply (the penalties for tax evasion are also an important element of such a decision). However, in relation to the broader compliance effects of auditing, there is no empirical evidence that would confidently quantify the effects of reductions (or, more accurately, the perception of reductions) in audit coverage of the taxpaying population.<sup>27</sup> As a consequence, it is very difficult to analyse and assess the consequences of changes in auditing rates empirically; rather, this tends to be based on anecdotal evidence, qualitative material and judgement.

**3.18** As the ATO does not maintain a comprehensive activity based costing system, we found that SBI was unable to identify resources used on auditing. The ANAO was advised by SBI that the number of staff (average staffing level) working on audits is not available because staff are allocated on a project basis and can be used for audit or other compliance improvement activities. For example, an officer could audit a taxpayer one day and be conducting seminars the next. Decisions regarding what should be done on a day-to-day basis are taken at project level, with some discretion given to individual officers. The ATO advised that it is in the process of improving the quality of the recording of rationale for particular decisions.

**3.19** The adoption of an activity based costing system would be a significant investment. However, a suitable system that provides full costs would be a valuable tool in focusing attention on the costs of the various activities and identifying areas where significant improvements in efficiency are likely. It would also help to identify what are the most cost-effective strategies to achieve the aims of the organisation, in addition to promoting a cost-conscious mentality among staff and management. This is discussed further in Chapter 5.

**3.20** Currently, SBI's strategic audit planning is influenced by its assessment of the priority risks it faces. For example, the newsagency industry was selected for a compliance project because it was one of the industries listed by CIRU as being a high risk industry and because, as a cash industry, it is one of the ATO's high priority areas for audit activity. As another example, the compliance project on shareholder and beneficiary loan accounts arose because the ATO identified the disclosure of income from shareholder and

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<sup>27</sup> As the ANAO has acknowledged, there is difficulty in confidently quantifying the indirect revenue benefits. However, qualitative analysis that includes the audit coverage and taxpayer demographics (for example, distribution of liabilities, number of taxpayers, geographic location, etc.) may enable the ATO to assess indicatively the potential for greater indirect revenue benefits to be derived from the targeting of audit activities.

director loans as one of ten major risks to collecting the government's budget revenue in 1994-95. Improvements in SBI's understanding of full costs associated with audits will assist SBI to improve its strategic audit planning.

### *Audit rates*

**3.21** When self assessment was introduced the then ATO Commissioner spoke of trying to achieve a two percent audit coverage of the taxpaying population each year.<sup>28</sup> However, the ATO has recognised that it cannot use audit alone as a means of ensuring taxpayer compliance and has endeavoured to target its approaches better in an era of diminishing resources. Its approach has been to tailor the level and mix of coverage for each area according to the specific characteristics of the area and the resources available.

**3.22** The ANAO found that SBI income tax audit coverage has been in the range of 0.15 to 0.30 per cent (that is, 15 to 30 per thousand taxpayers) over the three year period ended 30 June 1997.<sup>29</sup> This is lower than the desired levels stated when self assessment was introduced. A low audit coverage has direct implications for taxpayer compliance rates because, as pointed out in the 1996 *Review of The Small Business Market* (refer paragraph 2.5), compliance is not likely to increase if taxpayers see that there is a decreasing chance of being audited.

**3.23** As discussed earlier in the chapter, auditing is often employed as part of a mix of strategies to treat an identified compliance risk. The effectiveness of auditing within the mix is measured by the impact it has upon the achievement of the overall strategic objective, namely, improved compliance particularly through deterrence.

**3.24** Determining which compliance strategies to undertake to treat an identified compliance risk requires an understanding of:

- the compliance and/or revenue effects of each of the proposed strategies;
- the extent of the likely time delay between the compliance initiative and its influence on compliance;

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<sup>28</sup> Boucher, Trevor, *Self-Assessment of Income Tax*, *Australian tax forum: a journal of taxation policy, law and reform*. Vol. 3 No.1, 1986, p.51.

<sup>29</sup> This figure is based solely on face to face audits and excludes other ATO compliance activities such as RKR's.

- the threshold level for each strategy. That is, given the likely effects, is there a level of activity at which it is not sensible to undertake it because it would not have any significant impact on compliance or revenue;<sup>30</sup> and/or
- the threshold level for different combinations of strategies (for example, an audit activity may influence a significant number of taxpayers if it is part of a wider mix of strategies that affect significant numbers of taxpayers).

Looked at in this light, the role of auditing and other strategies (whether they are alternative or complementary) can be assessed.

**3.25** The ANAO could not find any evidence that there is a logical and consistent basis for determining the various proposed mixes of strategies including the required levels of audit coverage to target individual taxpayer segments. Without specifying required audit coverage, it is difficult for SBI to determine whether the various resource-constrained strategy mixes are viable.

**3.26** We consider that the identification of target audit coverage for individual taxpayer segments is a necessary benchmark for evaluating the effectiveness of compliance improvement strategy alternatives. This target coverage would provide a benchmark for evaluating whether proposals which have had to be revised in light of resource availability are also cost-effective.

### ***Recommendation No.5***

**3.27** The ANAO *recommends* that SBI determine the various mixes of strategies directed to improving compliance (and particularly the role of auditing in these mixes) on the basis of an assessment of their likely impact on that goal.

### **ATO Response**

**3.28** Agreed. Decisions on the appropriate combination of risk treatments are currently taken having regard to the attributes of particular risks, cost benefit considerations, time, previous experience with similar risks etc. The initial combination of risk treatments may be varied over time once the risk is better understood. SBI accepts this decision making process needs to be improved.

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<sup>30</sup> For example, if resources allow only 50 audits to be conducted in a large industry (when analysis suggests that at least 200 are required), the effect of the audit program on compliance levels in that industry, even when combined with other strategies, may not be cost-effective.

## Achieving audit outcomes

**3.29** The ANAO reviewed how SBI's auditing function is achieving its aim of improving compliance. This involved analysing auditing results over the last three years for income tax audits, FBT audits and RKR's.<sup>31</sup> In particular, we looked at:

- the percentage of total audits that led to adjusted assessments;
- tax raised and penalties applied (T&P);
- T&P per total audit;
- T&P per audit that led to adjusted assessments; and
- audits per number of taxpayers.

### *Income tax audits*

**3.30** Most of SBI's revenue from its audit activity (at least 80 per cent, often considerably more) arises from its income tax audits. According to the ATO's Core Case Management system (CCM), in the last three years, the revenue from T&P has ranged from over \$115 million to \$187 million.

**3.31** The issue of whether compliance has been improved by SBI's audit program is especially pertinent given that this is its main objective. We found that the percentage of income tax audits that led to adjusted assessments has remained at around the 70 per cent level over this period. These compliance projects target those industries and taxpayers where non-compliance is a major issue. That the percentage of income tax audits leading to adjusted assessments has remained constant is reflective of one of two possibilities:

- there has been no change to both SBI's case selection of non-compliant taxpayers and the compliance level of taxpayers; or
- the improved case selection has been offset by an improvement in taxpayer compliance and so there is no net change to the percentage of income tax audits that led to adjusted assessments.

**3.32** Further, although T&P per total audit and per productive audit have both increased during this time, there was insufficient information available to

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<sup>31</sup> This analysis is provided as an indicative guide as there is some concern over the reliability of data contained in CCM (refer discussion on CCM in Chapter 5).

ascertain whether these increases were the result of improved case selection, and hence whether the mix of strategies is improving overall compliance.

### ***FBT audits***

**3.33** Although FBT audits account for a minor proportion of SBI's revenue from its audit program, these audits contribute to increasing taxpayer compliance through maintaining SBI's visibility in the taxpayer community. The ANAO found that audit coverage of the FBT taxpayer population had declined from around 2 per cent in 1994-95 and 1995-96 to around 1 per cent in 1996-97.<sup>32</sup> We note that relatively, the FBT audit coverage was still considerably higher than the income tax audit coverage. This indicated the relative significance that the FBT portfolio placed on audit as a strategy to improve compliance.

**3.34** The percentage of FBT audits that led to adjusted assessments varied considerably over the three years. Potential explanations for this large variation are either possible variability in SBI's practices for selecting non-compliant FBT taxpayers for audit or FBT taxpayers' levels of compliance, or both. In the absence of other indicators, the ANAO is unable to determine the relative weightings of these factors, and therefore identify the cause of the variation.

### ***Record keeping reviews***

**3.35** A RKR is a review of a small business taxpayer's records to establish whether the records are kept to a sufficiently high standard and to educate the taxpayer, if required, of the need for and benefits of well kept records. If a taxpayer's records are found to be inadequate then the taxpayer is required to improve these records until they meet the required standard. It is assumed that if the standard of record keeping is improved, it is easier for small businesses to comply with tax laws, and contribute to improving overall taxpayer compliance.

**3.36** The ANAO concluded that RKRs play an important role in SBI enforcement, marketing and visibility as well as educating the taxpayer community, especially new entrants, of the need for and benefits of well kept records. Although RKRs do not account for direct revenue, they have a major role in promoting compliance in order for the ATO to collect as much duly payable tax revenue as possible.

**3.37** The ANAO analysed the estimated direct salary cost of SBI's program of RKRs. As can be seen from Table 3.2 below, this cost has been steadily

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<sup>32</sup> This figure is based solely on face to face audits.

increasing over the three years commensurate with the number of RKRs undertaken. Clearly, SBI has been placing more emphasis in terms of resources on RKRs. The emphasis is in line with SBI's focus from the start of 1996-97 on its new entrant clients. This focus is a reflection of the importance SBI places on helping taxpayers establish good practices when establishing a new business and thus influencing compliance from the start of a business' existence.

**3.38** The reasons for allocating additional resources to this activity, when compared with more formal auditing activities or other strategies, were not evident.<sup>33</sup> Improvements outlined earlier in this chapter will assist SBI to establish the basis for resourcing of this activity clearly. Similarly, it is difficult to determine whether compliance has improved generally as a result of RKRs.

**Table 3.2:**  
**Costs and Returns of Record Keeping Reviews 1994-95 to 1996-97**

	<i>ASL</i>	<i>Total Salary Exp. (\$'000s)</i>	<i>Workforce Hours Available</i>	<i>Hours Spent on RKRs</i>	<i>% Time of Workforce Spent on RKRs</i>	<i>Estimated Direct Salary Cost</i>
1994-95	3,460	137,186	5,594,820	76,206	1.4%	\$1,868,591
1995-96	3,524	174,141	5,698,308	111,564	2.0%	\$3,409,400
1996-97	3,152	167,738	5,096,784	167,503	3.3%	\$5,512,633

Source: ANAO analysis on data provided by SBI from the ATO's Core Case Management System.

### ***Monitoring of audit results***

**3.39** The ANAO considered that SBI should be moving towards a position where it can determine, monitor and report on the relative returns of its audit and its various other activities. We acknowledge the difficulty of measuring the indirect benefits of these activities. However, SBI would benefit from the capacity to benchmark its audit program and other activities with other business lines and other revenue collection agencies, both nationally and internationally. Such benchmarking could focus on the methods by which the audit program is conducted in each region and how its delivery could be

<sup>33</sup> SBI has advised that RKR work was reviewed as part of the Compliance Enforcement Strategy, and the then Department of Finance (now the Department of Finance and Administration) accepted that RKRs had generated \$285 million over two years.

improved. By comparing results by region (or branch), it is possible to identify best practice or areas for improved efficiency (see section on Benchmarking in Chapter 4, *Performance Information*).

**3.40** At the moment, audit results are not being comprehensively monitored and analysed systematically and consistently to enable the identification of deficiencies. For example, there is insufficient information to establish the causes of the decline over the past three years in the average time spent on both total and productive income tax audits. Likewise, the ATO cannot establish why the proportion of total time spent on income tax audits and the amount of T&P revenue has been similar between the Eastern and Southern regions in the last two years, even though the Eastern region completed considerably more of these audits.

## Project case studies

**3.41** SBI has undertaken numerous industry-based audit projects as part of the implementation of its risk management strategies in relation to compliance with the tax law.

**3.42** The ANAO analysed in detail four compliance projects undertaken by SBI in recent years. These were the:

- restaurant pilot project;
- taxi industry project;
- newsagency industry project; and
- commissioned insurance agents project.

**3.43** These case studies were used to analyse SBI auditing by considering each project's planning, management, performance information and results. A summary of each project is given at Appendix 3.

**3.44** The ANAO concluded that selection of the industries concerned for compliance projects was soundly based and the decision to undertake the projects was linked to risks identified by SBI. This linking to SBI's strategic planning is important if the auditing program is to be effective.

**3.45** For three of the four projects, we found no evidence of a formal project plan. We consider that it is important for project plans to be of an adequate standard and endorsed by the SBI Executive. These project plans should

include the project's objectives, resources, timing, methodology, evaluation and cost/benefits.

**3.46** Two of the four projects undertook a project risk assessment. We consider this is an essential part of the operational planning of the audit. Furthermore, only one of the projects undertook an explicit stakeholder analysis. In our view, all projects should undertake a project risk assessment and stakeholder analysis in order to assist with project management and clearly identify the objectives of each project.

**3.47** Formal performance indicators were lacking in three of the four projects. Two of them had no formal performance indicators at all. The ANAO considers that the absence of effective performance information hinders effective audit planning and project management. Performance information in SBI is described further in Chapter 4.

### ***Recommendation No.6***

**3.48** The ANAO *recommends* that as part of the planning of its compliance projects, SBI ensure that a risk assessment and explicit stakeholder analysis are undertaken and that each project has formal performance indicators.

### **ATO Response**

**3.49** Agreed. Compliance projects that have commenced recently reflect improved planning and documentation.

**3.50** The ANAO also observed that only two of the four projects undertook evaluations at their conclusion and that there was no evidence that lessons learned from any of the four projects were used for projects undertaken subsequently. We consider that this information would be extremely useful in the strategic planning of SBI's compliance activities.

**3.51** All of the projects examined involved an auditing component significantly greater than for the population at large. Proper evaluation, carried out systematically, would help SBI identify the extent to which the various strategies employed in the projects contributed to the eventual outcome. This systematic evaluation involves assessing each project against a predetermined set of criteria and also collecting similar information about all projects so that they can be aggregated. However, for this to occur it is important that evaluation criteria and information needs are identified at the beginning and then implemented throughout the life of the project. These criteria and information requirements ideally should allow for the aggregation of assessments and identify common trends. Evaluations of this nature are seen as a suitable first step in establishing an empirical basis for determining



appropriate compliance strategies for completing a project and for use in future compliance initiatives.

### ***Recommendation No.7***

**3.52** The ANAO *recommends* that SBI evaluate all its compliance projects against the objectives of the project to allow relative assessment of the various strategies for dealing with compliance risks.

#### **ATO Response**

**3.53** Agreed.

**3.54** All four projects concluded that they had a positive effect on improving compliance in the industries concerned. Three of the four projects concluded that further compliance work was required in the industries targeted. The ANAO recognises that this would be dependent on resources available, and noted that the decision was taken not to escalate one of the projects from a regional project to a national one. However, we consider that where areas for cost-effective improvement in compliance have been identified by SBI regional projects, then these projects should be escalated to give them wider prominence in SBI nationally.

### ***Recommendation No.8***

**3.55** The ANAO *recommends* that SBI ensure that where compliance projects have identified areas for cost-effective improvements in compliance, then these projects are fed back into SBI's escalation and risk assessment processes for consideration and reallocation of priorities.

#### **ATO Response**

**3.56** Agreed.

## **Conclusion**

**3.57** The ANAO concluded that SBI in its approach to compliance uses a range of appropriate strategies. To some extent these strategies have been a successful application of a risk management methodology. However, the relative effects of these strategies cannot be assessed because:

- there is an inadequate empirical basis for such judgements; and

- systems are not in place to determine the relevant costs of the various approaches.

## 4. Performance Information

*This chapter discusses how well SBI uses performance information to monitor and review its risks and risk treatments to achieve its objectives effectively and efficiently. It concluded that SBI's performance information framework is appropriately structured to allow for information about risks and risk treatments to be collected and reported. Greater attention to measures of efficiency and quality would enable SBI to obtain the full benefits of a performance measurement system.*

**4.1** Performance measurement is a key mechanism for the monitoring and review of risk treatment strategies. It allows an organisation to obtain regular and ongoing feedback on the effectiveness of its risk treatments. Performance information should also allow the organisation to assess its performance against key organisational priorities, as well as obtain feedback from its stakeholders on its performance.

### The better practice model for performance information

**4.2** In evaluating the performance information framework used by SBI, the ANAO compared it with the better practice model for performance measures set out in our Better Practice Guide of 1996 *Performance Information Principles*.

**4.3** We determined that for performance information, the following criteria are important.

**4.4** The ANAO reviewed a sample of SBI's performance indicators. The sample consisted of the SBI operational performance standards (OPS), both strategic and processing, listed in the 1995-96 SBI Business Plan. These same standards were also set for 1996-97. We also analysed a draft of new SBI measures for 1997-98, which provide a good indicator of where the organisation is heading in terms of the development of its performance measures.

**Table 4.1:**  
**Better practice criteria for performance information**

<ul style="list-style-type: none"><li>• Performance measures are developed at each level within the framework of the objectives and strategies of a program, and cascade through the organisation.</li></ul>
<ul style="list-style-type: none"><li>• Lower-level indicators can be aggregated at the level above to provide a summary of performance.</li></ul>
<ul style="list-style-type: none"><li>• Performance information for all key aspects of SBI's business is collected regularly, monitored to assess current performance, and accumulated over periods of time to identify trends of performance.</li></ul>
<ul style="list-style-type: none"><li>• Performance information incorporates external factors to assess their impact on performance.</li></ul>
<ul style="list-style-type: none"><li>• Targets are set against measures to allow continuous improvement across the organisation.</li></ul>
<ul style="list-style-type: none"><li>• Performance information includes a range of indicators that allow SBI to measure its performance in terms of quality and efficiency.</li></ul>
<ul style="list-style-type: none"><li>• Performance measures are reliable, valid and provide a comprehensive measure of performance.</li></ul>

Source: ANAO Better Practice Guide on Performance Information Principles.

## Structure of performance measures

*The performance information framework within the ATO*

**4.5** Up until the end of 1996-97, the corporate objective of the ATO was:

*To collect the revenue, properly payable, so as to fund services and support for the people of Australia.*<sup>34</sup>

<sup>34</sup> SBI 1995-98 National Business Plan. Note paragraph 1.3 outlines the ATO's current Purpose.

**4.6** The ATO developed goals against this corporate objective. The four focus areas of these goals until the end of 1996-97 (these changed in 1997-98) were:

- Focus area 1* Taxpayers, CSA and other clients comply with their obligations under the law.
- Focus area 2* The costs to the community of complying with the laws ATO administers will be reduced.
- Focus area 3* The ATO is, and is seen to be, professional and fair in all it does.
- Focus area 4* Productivity will improve as a result of the ATO staff's flexibility, ATO staff's commitment to the ATO, and the ATO's commitment to its staff.

**4.7** Ten key performance indicators were developed by the ATO to measure performance in these areas. In 1995-96 and 1996-97 SBI was required to report to the Board against six of these indicators.

### ***SBI performance information***

**4.8** SBI has two types of performance indicators: strategic OPS, which it reports to the SBI Executive and the Board, and the lower level processing OPS, which are monitored by Regional Management Teams. The lower level OPS are drawn from the high level OPS, and the results against them feed into the goals at the higher level. Responsibility for ensuring that performance measures are set and accountability for outcomes against them is maintained is allocated to specific individuals.<sup>35</sup>

**4.9** The SBI Business Plan is the key to risk treatment for the business line. It is important to apply measures to the implementation of the plan to ensure its effectiveness. The ANAO found that the summary plans against the priority risks each include performance indicators to measure achievement of the goals.

**4.10** The ANAO examined the relationship between the ATO and SBI corporate strategies and objectives and the SBI performance measures, and concluded that measures cascaded logically through the organisation. The

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<sup>35</sup> SBI: 1995-96 ATO Operational Performance Standards: Performance Report July 1995 - June 1996 (from corporate planning)

ATO's four focus areas provide an effective framework within which SBI's specific measures are defined.

## **Aggregation of performance information**

**4.11** For 1997-98, each region reports against the standard set of SBI OPS, which are aggregated into national SBI performance reports. In addition, each of the regions nominates its own priority risks based on the HOTSA process and reports against a standard set of indicators specific to these areas. The regions add their own measures in these priority areas to reflect specific issues. This allows for measures against targeted priority areas to be tailored to the circumstances in each region within a consistent framework. This means that performance information can be aggregated at a general level for SBI to assess its performance nationally in each risk area.

**4.12** The ANAO concluded that SBI's strategic planning process provides an adequate framework to ensure that performance measures across the regions are consistent and to some degree can be aggregated at the level above, while still allowing the measurement priorities to be tailored to suit each region.

## **Collection, monitoring and accumulation of performance information**

### ***Accumulation of audit results***

**4.13** The ANAO found that in general SBI's performance indicators adequately reflected all key aspects of its business, including compliance improvement activities. As outlined in Chapter 3, audits are a key compliance improvement activity for SBI's business, forming part of the risk treatment strategies for approximately three out of every five identified risks to compliance. However, we could find no evidence that accumulated audit results were monitored and analysed systematically and consistently at a national level. Audit results are monitored at the regional level, though the data does not appear to be totally accurate. A main reason for this is that SBI does not have auditing results readily available on the Core Case Management system (CCM), due to delays in inputting the data. Audit data should be easily retrievable so that performance can be monitored and analysed.

**4.14** As discussed in Chapter 3, formal performance indicators were used in only one of the four project audits viewed by the ANAO. This means that it is difficult to accumulate information about the performance of project auditing.

SBI told the ANAO that individual project results are reviewed by the SBI Executive and the ATO Cross Line Business Forum. However, we were advised that the only time audit results are reviewed together is during the preparation of the Annual Report or as part of research.

**4.15** Without systematic and consistent monitoring of collected audit results combined with the results of other compliance activities, SBI is unable to assess how well its compliance activities are performing and whether improvements in efficiency can be made. In addition, this would allow SBI to benchmark its compliance results including the mix of strategies as a whole internally, with other business lines, and with agencies external to the ATO, such as State revenue offices or international tax administrations.

**4.16** The ANAO considers that enhancing its systems to facilitate input of data and permit ready access to up-to-date, aggregated results of auditing and other compliance activities would improve SBI's ability to monitor and benchmark these compliance results.

### ***Recommendation No.9***

**4.17** The ANAO *recommends* that SBI ensure its systems permit ready access to the up-to-date, aggregated results of compliance activities in order to monitor and analyse performance.

### **ATO Response**

**4.18** Agreed with qualification. SBI agrees with the direction of this recommendation. It will evaluate its existing systems to gauge whether it is cost effective to extend the functionality of those systems or to develop new systems. The pace of implementation will be subject to overall corporate priorities.

**4.19** As suggested in Chapter 2, the ANAO considers that there is benefit in SBI ensuring that it systematically and consistently monitors and analyses the results of its compliance activities to assist in the identification of areas for improvements in efficiency (refer paragraphs 2.62-2.70).

### ***Collection and monitoring of performance information***

**4.20** The ANAO found that performance reports include data from previous periods to demonstrate the change in performance over time. However, current reporting arrangements provide for two reports: a quarterly corporate

governance report<sup>36</sup> and a regular SBI performance report. Both reports are based on the same set of indicators, but cover different aspects of performance. The ANAO observed that the reporting on some indicators is duplicated, although the substance of the reporting may be substantially different depending on the report in which it is presented.

**4.21** The overlap between the reports suggests that the two are not designed to be complementary. This separation of the performance reporting makes it difficult to assess overall performance. The ANAO acknowledges that SBI's corporate governance report addresses a limited range of issues required by the ATO Management Board, some of which relate to performance. However, there is no single performance report that contains the results of SBI's performance against all of its indicators. The ANAO considers that producing one consistent and universal performance report that did this would facilitate the monitoring of performance information and make it easier to identify trends over time. It would also result in the more efficient use of resources in the collection and presentation of performance information.

### ***Assessing external factors***

**4.22** The ANAO found that SBI's performance measures reflect the importance of client service. However, all of the measures that are client focused assess client satisfaction from the perspective of SBI, rather than from the client perspective. For example, instead of surveying clients on their perceptions of the service provided, SBI's client measures are internal measures such as the time it takes to finalise correspondence. Although this is an important indicator, if all client service indicators are focused in this way the clients are never consulted on what they see as constituting good service.

**4.23** Such measures need to be complemented with measures from the clients' perspective for SBI to gain a full understanding of its client service performance. We found that there is no regular, ongoing consultation with clients that is included in the performance information reports to assess whether SBI is fulfilling its clients' needs. SBI has informed the ANAO that it will be an active participant in the corporate surveys of taxpayers mentioned in the 1997-2000 Corporate Plan.

**4.24** The ANAO recognised that the bulk of the contact with SBI's clients occurred through the Individuals Non-Business (INB) shopfront, with which SBI staff were not directly involved. SBI had conducted two major client reviews to obtain client feedback on its performance. However, consultation with its

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<sup>36</sup> The corporate governance report process is the mechanism the ATO Management Board uses to monitor progress and achievement against business lines' Corporate Plans which are based on the risk management process.



clients was not a feature of its formal performance measurement system. SBI would benefit from a regular and consistent means of obtaining input from its clients into its performance monitoring. Inclusion of this information in SBI's formal performance information framework would ensure that it provides a comprehensive reflection of the business line's performance in all areas. This focus on having one comprehensive performance report relates to the reporting arrangements discussed under the previous section.<sup>37</sup>

## ***Targets***

**4.25** The ANAO found that although just over half of the current measures at each level had targets set against them, it is proposed to reduce this proportion significantly. We consider that a greater proportion of targets against measures would improve the effectiveness of the measures as an instrument for assessing performance and therefore decision making. SBI argues that the reduction in the use of targets reflects a move to a more strategic approach at a national plan level, with risks and strategic responses taking the place of targets at this level; lower level plans will continue to have targets.

**4.26** The ANAO generally agrees with this approach at the strategic level, though we suggest that SBI could maintain some of its targets and adjust or modify them accordingly to reflect its strategic approach. However, for the full benefits of a performance measurement system to be obtained, SBI should ensure that performance targets are included at the operational level wherever practicable.

## ***Recommendation No.10***

**4.27** The ANAO *recommends* that SBI ensure that performance targets are included in plans at the operational level wherever practicable.

## ***ATO Response***

**4.28** Agreed. Performance targets are included in all regional business plans.

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<sup>37</sup> Audit Report No.22, 1996-97 *ATO Client Service*, examines the ATO's quality of client service and discusses how the ATO could further improve the quality of its service to clients.

## Measuring quality and efficiency

**4.29** The ANAO evaluated SBI's performance measures against quality and efficiency, both of which have been recognised as important by the ATO. The importance of efficiency measures has been recognised in the ATO's focus area 4 (see paragraph 4.5) and is one of the ATO's 1997-98 corporate outcomes, whereas the importance that the ATO places on quality is evidenced by its adoption of quality assurance systems.

### *Consideration of efficiency*

**4.30** The ANAO found that none of SBI's measures related directly to measuring its efficiency. The performance measures analysed were almost all output oriented, with very little consideration of inputs. No significant changes to this are present in the draft measures for 1997-98. In our opinion, there is room for improvement in this area.

**4.31** SBI monitors its staff in cost centres<sup>38</sup> according to the project to which their time is allocated. The system does not measure the proportion of time spent on specific tasks, but rather the number of staff allocated to that task. Discussions with SBI revealed that it can align its inputs with its outputs on a macro level, and at a very detailed section level, but is unable to provide an indication of its efficiency on an activity basis.

**4.32** SBI advised that it monitors its efficiency through budgetary constraints, and recognises the importance of efficiency in its 1997-98 Corporate Plan outcome. However the ANAO observes that it is not recognised in its performance measures. SBI could not demonstrate that it has a formal mechanism to measure its efficiency regularly and consistently for reporting to senior management and its stakeholders. SBI has advised that it is attempting to improve its efficiency measurement through the various contestability processes currently being undertaken and the evaluation processes evident in its risk management methodology. The ANAO considers that SBI's limited cost data hampers its ability to identify activities whose efficiency could be improved, thereby rectifying and improving its overall efficiency.

**4.33** The ANAO noted that the issue of measuring efficiency applies more widely to the ATO. We observed that prior to 1997-98, it was not one of the specific focus areas set by the Board or corporate planning areas, and this may have in part explained the absence of efficiency measures at the business line level. SBI has argued, however, that productivity measures at the business

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<sup>38</sup> A cost centre is a part, segment or sub-unit of an organisation whose manager is accountable for costs (expenses) only.

line level, such as taxpayer and collections per tax officer ratios, are used as measures of efficiency and have been presented to the Executive regularly. The ANAO considers that explicit efficiency as opposed to productivity measures would have been more effective in improving efficiency at the operational level.

**4.34** We note that one of the ATO Corporate Outcomes in 1997-98 addresses the issue of efficiency (*an efficient, adaptive organisation*). However, we suggest that this is subject to varying interpretations and that it should be reworded to emphasise more specifically the measurement, reporting and improvement of ATO efficiency. The ANAO notes that efficiency performance indicators are included in the 1997-2000 ATO Corporate Plan. We further suggest that SBI should devote its attention to this area to improve the management of its business.

### ***Reflecting the importance of quality processes***

**4.35** Quality measures provide an assurance of the internal and external effectiveness of the organisation. The analysis conducted by the ANAO revealed that none of the measures currently being applied assesses the quality of SBI's performance.

**4.36** The performance standard *resolve 20 nationally significant SBI issues* is an example of how OPS measure quantity and not quality. It implies that SBI sees meeting its performance targets for quantity as an assurance that its quality is also sufficiently high. The consequences of this are that its performance measures do not allow SBI to:

- identify areas for improvement in its outcomes and the way it reaches them; or
- benchmark its processes internally or externally.

**4.37** This lack of quality measures in areas where they could cost-effectively be applied is illustrated by other measures within SBI. For example, many auditing projects are assessed only on the basis of the revenue collected as a result of the project. This is considered in more detail in Chapter 3. Measures of revenue are generally a reliable indicator of the success of a project. However, a set of measures focused solely on revenue does not provide a valid indicator of the performance of the project in terms of its efficiency or its strategic success in achieving the goals of the organisation. For example, the project may have collected a significant level of revenue, but to evaluate its success completely would require a comparison of revenue collected with the target for collection, or aligning the outcomes with the resources invested to gain an understanding of its efficiency and cost-

effectiveness. This would provide a more comprehensive evaluation of the project.

**4.38** Quality systems are to be introduced into SBI (see Chapter 5). However, the ANAO noted that it was important to measure the quality of the organisation's performance even if quality systems were not yet fully implemented.

## **Reliability, validity and comprehensiveness of measures**

**4.39** The ANAO reviewed specific measures to assess their reliability and validity. In general the indicators appeared to be reliable, in terms of their ability to produce a consistent measure of performance, but there were some issues concerning their validity, that is, each measure measuring what it purports to measure.

**4.40** For example, one of the measures of debt is *appeals on hand as at 1/1/96 will be 20 per cent less than the number on hand as at 1/7/95*. There is some ambiguity within this measure: it measures both the number of appeals lodged and the number of appeals resolved in the period. The measure for referral of cases for prosecution is also influenced by the number of cases which arise. These indicators do not provide an effective measure of either aspect of performance.

**4.41** The ANAO also assessed the comprehensiveness of SBI's measures, that is, how satisfactorily does each measure cover the activity it purports to measure. For example, the SBI performance standard *resolve 20 nationally significant SBI issues* has been included in the performance measures for both 1995-96 and 1996-97. Initially this was measured from the completion of an issue, but for 1996-97 the measurement of this was changed to the achievement of a significant milestone (not necessarily completion) in an attempt to exclude the influence on completion of factors outside the control of SBI.

**4.42** Although this method of measurement more accurately reflects the performance of SBI, the ANAO considers that a more appropriate and revealing performance standard could incorporate other factors. These factors include how efficiently resources have been utilised in the resolution process, the duration of this process, the suitability of the resolution or whether issues

for resolution are prioritised and the most important issue addressed first. This would provide a better indication of SBI's performance in this area.

**4.43** In most cases the performance measures in SBI can be accepted as reliable, although the ANAO noted some concerns with the validity of some indicators. In a number of instances the indicators do not provide a comprehensive measure of performance in the area on which they are focused. Broadening the measures to assess the quality and efficiency of SBI's processes would enhance the effectiveness of its performance measurement system.

## Conclusion

**4.44** The ANAO analysed the structure, balance and collection of performance information in SBI. We found that SBI has a formal, regularly monitored set of performance measures which are adequately structured within the ATO framework.

**4.45** Analysis of specific measures revealed that, although most provide a reliable indicator of performance, the measures need to be assessed to ensure that they provide a valid and comprehensive measure of performance in all areas. SBI could also benefit from having one consistent and holistic performance report on all of its performance measures. This could be used to report overall performance to senior SBI and ATO management, and be complemented by separate and more comprehensive performance reports at a lower level.

**4.46** The ANAO considered that these issues should be addressed to ensure that SBI has an effective performance measurement system that provides it, ATO management, the Government, the Parliament and the public with a comprehensive understanding of its performance.

**4.47** The ANAO identified the following areas where there is room for improvement:

- regular, ongoing feedback from clients on SBI performance is not integrated into SBI's formal performance measures; and
- an assessment of the quality of SBI's processes is not included in its performance measures.

**4.48** SBI should address these issues to bring its set of measures closer to better practice so that it can benefit fully from its performance measurement system.

## **Recommendation No.11**

**4.49** The ANAO *recommends* that SBI:

- a) include measures which allow it to assess the efficiency of its processes at an appropriate level for reporting to ATO management, the Government, the Parliament and the public;
- b) ensure that there are formal, ongoing measures within the performance measurement framework that assess its performance from the perspective of stakeholders; and
- c) include measures that assess the quality of its processes.

### **ATO Response**

**4.50** Agreed with qualification to a) and agreed to b) and c).

**4.51** SBI believes that the efficiency indicators in the 1997-98 ATO Corporate Plan substantially address part a) of this recommendation. Nevertheless, SBI will review current indicators to gauge whether they could be enhanced. With respect to part b) of the recommendation, SBI expects that the corporate surveys of taxpayers mentioned in the ATO Corporate plan 1997-2000 will assist in meeting this recommendation.

## **Benchmarking**

**4.52** Benchmarking can be described as an ongoing, systematic process to search for and introduce better practice into an organisation, by undertaking internal comparisons within, or external comparisons outside, the organisation.<sup>39</sup> Benchmarking is especially important in a geographically dispersed organisation such as the ATO where the standard of practices can vary appreciably. Benchmarking is a powerful tool for management improvement.

**4.53** SBI identified in its risk database the urgent need to measure and document the degree to which it already has best practice within the ATO. This is seen as important in the current environment of contestability.

**4.54** SBI performance information viewed by the ANAO is reported in a format which does not facilitate benchmarking. Moreover, as has already been discussed, SBI performance indicators generally do not contain quality measures that allow benchmarking. In looking for evidence of benchmarking

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<sup>39</sup> ANAO, *Performance Information Principles*, Better Practice Guide, November 1996, p.12.

within SBI, we noted some areas where there have been attempts to introduce it but found that there is no uniform practice in this regard.

**4.55** The ANAO concluded that there was limited use of benchmarking in SBI and considered that there was scope for its more comprehensive use. Further, we suggest that a consistent and holistic performance report (the need for which was discussed earlier in this chapter) be presented in a format that facilitates benchmarking.

***Recommendation No.12***

**4.56** The ANAO *recommends* that SBI undertake more extensive benchmarking of its performance to assist in identifying areas for management improvement.

**ATO Response**

**4.57** Agreed. SBI will increase its benchmarking activities.

## 5. Quality and the Core Case Management System

*This chapter discusses issues surrounding quality and the audit database, the Core Case Management system (CCM), which affect SBI's ability to engage in effective risk management.*

### Quality

**5.1** In the face of changing risks, it is necessary to review the quality of processes and activities in place in order to assess the effectiveness of current strategies. In this way, poor practices, their consequences and opportunities for improvement can be identified. With respect to the ATO, consequences of poor practices could be the forgoing or reduction in the collection of revenue, the undermining of the integrity of the tax system or inequity in dealing with taxpayers. Reviewing and preserving quality also helps to ensure consistency in policy and procedures across offices and helps to capture and share better practices, which is vitally important for a geographically dispersed organisation such as the ATO.

#### ***Characteristics of a good quality system***

**5.2** Essentially, the definition of *quality* incorporates:<sup>40</sup>

- conformance to specifications or requirements;
- fitness for purpose;
- meeting clients' needs, and exceeding their expectations; and
- doing things right the first time.

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<sup>40</sup> Kehoe, Dennis, *The Fundamentals of Quality Management*, 1995, p.6.



**5.3** From this definition, characteristics of a good quality system follow:<sup>41</sup>

- specifications or requirements need to be clearly defined;
- a *systems* approach is required involving all aspects of the business; and
- responsibilities, processes, methods and materials all need to be prescribed.

### ***SBI Quality Management System***

**5.4** SBI commissioned a review of its quality assurance (QA) processes in the latter half of 1995-96. SBI's review of its QA, undertaken with consultants, was completed in May 1996. In an attempt to make QA in SBI more consistent, the report recommended the introduction of a generic QA methodology for all SBI functions, including the development of quality performance standards for work practices.

**5.5** Following the report, SBI commenced a project to introduce a Quality Management System (QMS). SBI intends the QMS, the implementation of which is currently on hold, will encompass all current policies, procedures and instructions that SBI staff should have access to in order to undertake their work. As at March 1997, at least \$170,000 had been spent on the QMS project,<sup>42</sup> and SBI had identified the risk to SBI's objectives as high if the project does not succeed.<sup>43</sup>

**5.6** SBI advised the ANAO that the QMS project was placed on hold for a period of six to eight months as there were already significant changes underway in SBI at the time the decision was taken in March 1997. It was considered unwise by SBI to start a quality process where the Executive could not fully support its introduction because of the distractions of other work such as planning processes and work and job design.

**5.7** The ANAO considered that if the project does not proceed then the achievement of nationally consistent business outcomes is unlikely. In our view, there would be considerable benefit in reactivating and seeing the project through to completion.

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<sup>41</sup> Ibid, p.6.

<sup>42</sup> 1997-98 salary costs associated with the project are approximately \$500,000 (8 ASL nationally) with administration costs totalling \$50,000.

<sup>43</sup> *SBI Risk Database*, risk no.19, 11/3/97.

## **Recommendation No.13**

**5.8** The ANAO *recommends* that SBI consider reactivating the Quality Management System project as a matter of priority and that the process be completed in order to support the achievement of nationally consistent business outcomes.

### **ATO Response**

**5.9** Agreed.

## **Core Case Management System**

**5.10** The primary information technology (IT) system used by the ATO to keep track of the majority of auditing results<sup>44</sup> is known as the CCM. It is a national, on-line, mainframe system that was designed to allow auditors to build up a database of information about cases actioned by the ATO.

**5.11** CCM was introduced in December 1993 and was implemented ATO-wide under the Income Tax Modernisation process. The CCM maintenance cost for SBI is \$96,000 per annum which is paid to the ATO Integrated System (AIS). This maintenance includes any enhancements to the system.

**5.12** The ANAO found that in practice CCM did not provide the ATO with sufficient support required by audit officers in the current environment. For example, we observed that branch office team leaders and managers used additional systems (usually spreadsheets) for the monitoring of audit performance, work flows, case numbers, and so on.

**5.13** The ANAO was advised that there were two main reasons for using these additional spreadsheets:

- to track collections of tax adjustments and penalties raised. This was because CCM does not account for collections of tax adjustments. Instead, the *National Taxpayer System* (NTS) has to be consulted to see what money has been paid in; and
- it is difficult to measure costs of audits on CCM. Audit costs are considered as part of compliance project costs and it is the responsibility of project managers to track these costs. Project managers find it easier to track these costs on spreadsheets rather than on CCM.

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<sup>44</sup> For example, CCM does not record sales tax audit results which are recorded in a separate register.

**5.14** This use of their own systems by project managers has implications for the consistency of the results gathered across branches, both in terms of the manner by which they are collected and the extent of detail in how they are presented. It is an inefficient use of resources in that staff have to use more than one system to record data.

**5.15** SBI informed the ANAO that the cost-effectiveness of recording all data in the one system has not been explored, and may be significant. It sees that there is a need to explore in detail the desirability of having all in the one system. It advised that the ATO is continuing to explore the options for the appropriate work practice response to audit risks and would not be keen to invest in a CCM upgrade if the upgrade faces the same problems of being unable to meet all user needs in an evolving work practices environment.

**5.16** SBI further advised that CCM was designed to provide support to the way audits were conducted at the time it was developed. While CCM has not increased its capabilities since its inception, the ATO had adopted a wider array of responses to address audit risks. SBI stated that while CCM was designed as a case management system, it was not designed as a project system, a resource system beyond individual cases, a macro audit performance monitoring system, or macro audit case work flow monitoring system. Furthermore, it is a system that is audit-specific and has limited application for other responses to compliance risks. SBI concluded that CCM now only supports some of the functionality that is required by audit officers in the new environment. It is currently considering the broad requirements of case management systems for use across the various SBI functions.

**5.17** The ANAO considered that the problems with CCM indicate that there are significant limitations in SBI's ability to track the cost-effectiveness of audit activities. As discussed in Chapter 3, there are strong reasons to consider a system that allows the relative benefits and costs of various compliance strategies to be assessed. The ANAO recognises that although this would bring benefits, it may also have high costs.

**5.18** SBI's use of CCM to assist in developing risk management strategies is limited because conclusions are drawn from unreliable data. SBI has identified its systems as a high risk, and concluded that its:

*...poor systems have led to: substantial inefficiencies by not being user-friendly, and incomplete and inaccurate data for use in strategic decisions.*<sup>45</sup>

**5.19** SBI has noted that the implications of these problems include that resources are being wasted and questionable risk assessment decisions are being made. SBI advised that the IT needs of SBI are addressed at the corporate level through the ATO-wide IT committees and SBI level through its own committee.

**5.20** The ANAO concluded that CCM has not been upgraded to cater for the changed audit work practices. In particular, it does not provide management with consistent, reliable information for planning and resource allocation. We acknowledge that the collection of more data is dependent upon cost benefit considerations. We also concluded that having invested what is likely to have been a significant amount of money in CCM,<sup>46</sup> SBI should ensure that the system is made more effective in the short-term. In the longer-term, if economic, it should consider replacing it with a system that covers all SBI activities.

#### ***Recommendation No.14***

**5.21** The ANAO *recommends* that SBI review the cost-effectiveness of its case management systems to ensure that they produce reliable and informative data that will assist in the development of risk management strategies.

#### **ATO Response**

**5.22** Agreed.

**5.23** The need for SBI to be able to assess the cost of its auditing can be extended to understanding its compliance costs and in particular, the cost-effectiveness of its compliance strategies. The ANAO sees the recording of all data relating to compliance strategies on the one system as being a possible solution for this.

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<sup>45</sup> *SBI Risk Database*, risk no. 13, 11/3/97.

<sup>46</sup> The cost to SBI to implement CCM is unavailable, but as outlined earlier in the chapter, SBI's contribution alone (other business lines use CCM) to maintain CCM is \$96 000 per annum (refer paragraph 5.11).

***Recommendation No.15***

**5.24** The ANAO *recommends* that SBI:

- a) enhance its understanding of its compliance costs and in particular, the cost-effectiveness of compliance strategies; and
- b) review the feasibility of recording information relating to compliance strategies on the one system.

**ATO Response**

**5.25** Agreed.

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Canberra ACT  
4 December 1997

P. J. Barrett  
Auditor-General

## **Part Three**

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# **Appendices**

## Appendix 1

# Risk Management Methodology

### *Step 1: Establishing the Context*

Figure 1  
Establishing the Context

A risk management exercise should be undertaken within the framework of an organisation's strategic, organisational and risk management contexts (see Figure 1).

**Strategic context:** defines the relationship between the organisation and its internal and external environment, identifying its strengths, weaknesses, opportunities and threats (SWOT analysis). This stage of the process should also involve identifying and communicating with the organisation's major stakeholders and determining their expectations and requirements.

**Organisational context:** requires an analysis of the entity's goals, objectives and policies which then contributes to the establishment of criteria for the risk assessment process. The consequences of goals and objectives not being achieved should be considered at this stage.

**Risk management context:** involves determining the goals, objectives, strategies, scope and parameters of the actual risk management process itself. It is advantageous to define the structure of the process by separating the risk analysis into a set of manageable elements. The risk management context also examines the need for information and research.

## **Step 2: Risk Identification**

### **Figure 2**

#### **Risk Identification**



The aim of this stage of the risk model is to generate a comprehensive list of relevant risks and to document what each risk involves (in a risk register). This documentation should contain a brief description of these risks, including possible causes, initiating events, potential outcomes and existing controls. Risk identification must be comprehensive and a structured approach is strongly recommended.

Risks need to be identified whether or not they appear to be under the control of the organisation and all risks should be considered from the organisation's perspective as well as from the perspective of stakeholders. These risks could be either current or future risks. The scope and depth of risks should be determined as should the need for research and the resources required to undertake that research. Records should be kept for use during future risk identification exercises.

Good quality information is important for the identification of risks. While information should be comprehensive, accurate and timely depending on cost and data sources, in reality complete data rarely is available. Some risks will not lend themselves to objective analysis or observation and the costs incurred in collecting all data might be too great for the benefits provided. It is the responsibility of each level of an organisation's management to determine the extent of detailed information required.

Managers should be aware that staff may be reluctant to report all risks, fearing that it might reflect poorly on either themselves or the program. Failure to openly disclose all risks may undermine the ability of management to address and treat those risks with resulting serious consequences for the organisation.

## ***Step 3: Risk Analysis***

### **Figure 3 Risk Analysis**

The purpose of the risk analysis stage is to estimate likelihood and effects (consequences) of risk events and to combine these to develop risk levels as a precursor to setting risk priorities. The analysis should include a description of each risk and how it might arise, possible initiating factors, the main assumptions and a list of the principal sources of information.

It is important that existing controls be considered, as they influence the estimates of likelihood and effects.

### ***Likelihood and consequences***

Different methods of estimating likelihoods and consequences are appropriate for analysing the risks at different levels in the organisation. Quantitative methods may be more appropriate for analysing risks within functional areas for particular purposes.

In estimating the likelihoods and consequences of identified risks, it is appropriate to use a rating scale for each. The likelihood scale should reflect

the frequency or the probability of a risk event occurring; whereas the consequence scale should reflect the effect or damage of a risk event, were it to occur, on the risk assessment criteria determined in Step 1 - *Establishing the Context*.

The ANAO advocates the use of a five-point scale for both the likelihood and the consequence. However, each organisation should tailor a scale according to its particular circumstances and this scale should be used across all parts of the organisation.

### ***Risk levels***

Once the estimate of the likelihood and consequence of a particular risk event has been established, the likelihood and consequence measures are combined to generate an initial risk level for that risk event. The outcomes of the analysis (that is, the likelihood and consequence ratings and the initial priorities) should be recorded in the risk register, as should the controls in existence.

### ***Step 4: Assessing and Setting Priorities of Risks***

**Figure 4**  
**Assessing and Setting Priorities of Risks**

The risk assessment stage involves decisions about whether risks are acceptable or unacceptable. The output from the risk assessment stage should be a list of acceptable risks, showing the reasons why they are considered acceptable, together with a list of unacceptable risks, in priority order, both currently being actioned and requiring further action. The process usually involves a comparison of likelihoods, consequences and initial risk levels with the risk management criteria, determined in Step 1, for assessing whether or not a risk is acceptable (see Figure 4).

All organisations face a multitude of risks. Having the right criteria for ranking unacceptable risks is crucial.

Ranking scales have limitations, so it is beneficial through a review process to perform reality checks on the rankings that have been assigned. The review process should determine an agreed priority rating and assign responsibility for treating each identified risk to staff at appropriate levels of the organisation. The outcomes of the review should be recorded in the risk register. The review process is usually conducted by the appropriate management team.

Often the review process generates a priority triage:

- *Major risks* are generally likely to arise and have severe effects.
- *Moderate risks* may be less likely to arise, or have severe effects, but not necessarily both.
- *Minor risks* are those that can be managed using standard or routine procedures.

## ***Step 5: Risk Treatment***

**Figure 5**  
**Risk Treatment**

Risk treatment should be linked to business planning processes. Treatment should involve the identification and evaluation of options for resourcing identified risks and the preparation and implementation of appropriate plans. Figure 5 depicts the risk treatment process.

After available controls are considered, the highest level of risk should normally receive the highest level of attention, whether through additional resources or other methods of treatment, until such time as that risk has attained an acceptable level of control. This approach is especially important in an environment of diminishing resources.

When management is identifying options for treating risks, they may select one of four classes of responses:

- i) *Risk prevention* - responses directed to eliminating a source of risk, or reducing the likelihood of its occurrence;
- ii) *Effect mitigation* - responses directed to reducing or coping with the consequences of a risk event;

iii) *Risk transfer* - responses directed to transferring the risk to another party, or sharing it; and

iv) *Risk retention* - retaining or accepting the risk.

Several factors should be considered in determining the most appropriate treatment options. These may include the costs and benefits of implementation, the extent to which risk will be reduced, opportunities created by risk and the prevailing perceptions of risk. It is beneficial to complete a Risk Treatment Schedule and Action Plan before risk treatments are performed. Furthermore, it is important that responsibility for risk treatments be clearly assigned and accepted.

Risk treatments rarely eliminate risks, so there will usually be some residual risk. This may be unacceptable and may require further action.

## ***Step 6: Monitoring and Review***

### **Figure 6 Monitoring and Review**

As risks and organisational priorities change through time and a changing environment, risks and risk treatments should be monitored as part of the

management cycle. Ongoing review is essential to ensure that management plans remain relevant. It is also beneficial to monitor the effectiveness of risk treatment plans and strategies as well as the management system set up to control implementation of treatments.

The responsibilities, resources, accountability mechanisms, reporting requirements and timeframes for monitoring and reviewing risk management should be clearly articulated. Adequate performance indicators need to be devised to measure and monitor (either frequently or periodically) the critical success factors. The validity of assumptions used in undertaking the risk assessment also should be reviewed periodically (see Figure 6).

### ***Summing up***

All managers take risks into account when making decisions. It should not be difficult to incorporate risk management processes into a manager's activities. To ensure appropriate rigour and quality and to meet broader management objectives, a detailed specification of the context in which the risk management process is to take place should be developed.

All six steps of the risk management cycle should be repeated regularly so that changes in the internal and external environments can be monitored. This will allow the identification of emerging risks, alterations in risk priorities as circumstances change and the introduction of innovations in the treatment of ongoing risks. It should not be necessary for each cycle to have the same level of resources dedicated to the process. However, an effort should be made to review the risk management process on a regular basis.

## Appendix 2

# Extract from SBI's list of 52 Generic Questions used in its Risk Identification Process

Risk Management Methodology Step <sup>47</sup>	Q. No.	Title of Issue	ATO/SBI Generic Question
<b><i>Establish the Context</i></b>	1	Previously widely recognised risk	Has this issue previously been widely recognised within SBI?
	2	Stakeholders' perceptions of risk	Have stakeholders' perceptions of this risk become broader since it was last recognised in SBI?
	3	Significant current risk	Does this issue now represent a significant current risk or a significant future risk?
<b><i>Identify the Risks</i></b>	18	ATO public credibility	To what extent does the issue represent a risk to the ATO's public credibility as an agency?
	26	Previous degree of risk identified	What was the most recent risk assessment (if any)?
	27	Current degree of action	What current action is being undertaken to address the issue?
<b><i>Analyse and Prioritise the Risks</i></b>	33	SBI financial management	Does this risk involve the internal financial management of SBI funds?
	34	Number of SBI taxpayers	How many SBI taxpayers could be directly involved / affected?
	35	ATO focus areas	Which of the ATO focus areas are significantly involved?
<b><i>Treat the Risks</i></b>	45	Likely indirect treatment benefits	If this risk is addressed in the proposed way, what is the likely additional beneficial indirect compliance effect on taxpayers not directly targeted?
	48	Types of taxpayer treatments	Which taxpayer treatments are involved with either the risk itself or proposed treatment?
<b><i>Continually Monitor and Review</i></b>	52	Likelihood of cost-effective evaluation	To what degree will it be possible to cost-effectively evaluate / monitor the impact of the proposed treatment?

<sup>47</sup> The questions under the *Analyse and Prioritise the Risks* heading combine the *Analyse Risks* and *Assess and Prioritise Risks* steps of the risk management methodology.



## **Appendix 3**

# **Case Studies of SBI Project Audits**

### ***Project No. 1: Restaurant Pilot Project***

#### *Description*

A comprehensive review of the restaurant industry focusing on compliance; including income and deduction issues, as well as CGT, FBT and PAYE issues.

#### *Objective*

To come up with strategies that will effectively manage and maintain the compliance level of the different segments of the restaurant industry.

#### *Reasons for selection*

- Significant revenue identified as at risk, on the basis of variations in recorded and actual turnover figures;
- Substantial proportion of taxpayers visited in the industry during 1995 were considered to be not meeting the record keeping requirements; and
- A lodgement check found 10 per cent non-compliance in terms of lodgement.
- A cost-benefit analysis of the project was not undertaken.

#### *Links to Risks*

- Project risk assessment and stakeholder analysis was conducted.
- The decision to undertake the project was linked to the identified SBI risks, namely the cash economy.
- Although the project relates to compliance improvement, which is one of the focus areas of the ATO, this link was not explicitly stated in the project plan.

## *Methodology*

- Visit restaurants to establish their gross profit ratio (GPR).
- Advise business of variation compared with the previous year, advise of a future revisit, or monitor tax return for need to refer to serious evasion audit.
- Use the established GPR to build up a profile for an industry average.

## *Performance targets and measures*

- Short-term and long-term outcomes and evaluation strategies were stated. However, progress reports did not assess performance against these outcomes.
- Timing: Milestones and goals for completion stated. The timing of the pilot project and the follow-on national project is stated below.
- Proposed resources as at 21 February 1996:

Pilot project (Mar 96-Jun 96)	Salary	\$ 88 000
	Total	\$ 92 199
Proposed National project (1997)	Salary	\$596 338
	Total	\$605 938

## *Results*

- Significant proportion of the taxpayers selected for the trial showed an increase in GPR.
- All taxpayers selected for the trial showed a discrepancy between the cash counted and the cash register readings.
- SBI advised that there was a delay before the pilot project was escalated to a National one. The results of the project were fed into the HOTSA and became an issue for the Cash Economy Task Force. It is now a national project focusing on the cash economy.

## ***Project No. 2: Taxi Industry Project***

### ***Description***

The project aimed to bring about long term compliance in the taxi industry through resolving problems with confusion over taxation issues, difficulties with adhering to taxation requirements, and cultural barriers to correcting these problems.

### ***Objectives***

- To improve compliance within the taxi industry through a program of education, enforcement, and clarification of the law.
- To introduce a system to accurately measure improvements in compliance.
- To make a significant improvement that equated to a specific decrease in the estimated revenue at risk.

### ***Reasons for selection***

Project-based audits showed significant levels of non-compliance, and identified a number of barriers to effectively improving compliance in the industry including:

- difficulties faced by drivers in meeting their taxation liabilities;
- a culture of non-compliance;
- traditionally poor record keeping;
- the problems the ATO had faced with resolving issues in the industry in the past; and
- various other factors including political issues and cultural barriers.

No cost-benefit analysis of the project was undertaken.

### *Links to Risks*

- An assessment of risks to the audit was conducted as part of the plan.
- The decision to undertake the project was linked to the identified cash economy and poor record keeping risks.
- Although the project targeted compliance improvement, a key focus area of SBI and the ATO, this link was not formally stated in the project plan.

### *Methodology*

Twelve teams of seven set up across Australia to:

- Undertake audits, identify non-lodger drivers, implement training in the industry, and action non-compliant persons.
- Develop a computer system to identify non-compliant drivers and to assist in case management.
- Undertake a communication project to ensure that messages reach the targeted audience; develop and implement a taxation training module for the industry's internal training.
- Resolve all uncertain areas of the law.

### *Performance targets and measures*

- There was a quantitative objective to make an improvement that equated to a specified decrease in the estimated revenue at risk.
- No other formal performance measures were set.
- Quantitative and qualitative evaluation of the project was undertaken in the report.
- Resources:

Salary	\$5 717 051
Administration	\$ 160 250
- Timing: the project commenced in July 1993, and the most recent report on it was released in September 1996. No milestones were set.

## *Results*

- Collections as a result of the project, including penalties and interest, were considerable.
- The ATO's ability to achieve an improvement that equated to a specific decrease in the estimated revenue at risk will be dependent on the implementation of an effective withholding system for payments to drivers and a methodology to address readily taxi operators who have understated income.
- Education campaign on tax issues as they apply to the taxi industry.
- Clarification provided to the industry on all areas of uncertainty.
- Identified barriers to dealing with compliance risks.
- Commenced implementation of a strategy to address taxi operators who fail to disclose all income from the operation of their taxi licence.
- SBI advised that as a direct result of the audit, a test case was prepared to test the application of taxation law to taxi drivers. The decision in FC of T v. Delux Red and Yellow Cabs Cooperative Trading Society Ltd was handed down recently. The Commissioner recently appealed against that decision.

### ***Project No. 3: Newsagency Industry Project***

#### *Description*

A scoping project to assess whether a full project-based audit into the industry should be conducted. It focused on what areas would require special attention in an audit, and what areas of taxation were creating confusion in the industry.

#### *Objectives*

To assess:

- the level of compliance in the newsagency industry in Queensland;
- whether to conduct a full audit and on what it would focus; and
- if there were any issues or concerns creating confusion or errors in the taxation affairs of the newsagent proprietors and if so, to make recommendations on ways to address those issues.

#### *Reasons for selection*

- As a cash industry and therefore a high priority area for audit activity, it had been identified as potentially *high risk* by the Compliance and Industry Research Unit, and information had been provided by an *industry expert* that there was a high level of cash not returned in the industry.
- No cost-benefit analysis of the project was undertaken.

#### *Links to Risks*

- The reason to undertake the project was linked to risks identified by SBI.
- Although the project targeted compliance improvement, this link was not formally stated in the project plan.

#### *Methodology*

- A stratified sample of taxpayers was randomly selected. Thirty audits were conducted, with a focus on an independent calculation of gross sales.
- A summary of the project and its findings was published in an industry newsletter at the conclusion of the project.

#### *Performance targets and measures*

- No formal performance measures were set.

- The results of the project were assessed and recommendations made.
- Resources for the project were not quantified.
- Timing: 30 audits were conducted on the 1992 tax returns. No milestones or completion date were stated.

### *Results*

- It was estimated that a large percentage of taxpayers in the industry were fully compliant and the remaining percentage partially compliant. A significant percentage of net income was returned by all taxpayers, but with one notable case excluded this figure was considerably greater. This was classed as a medium to high level of risk to the revenue.
- The results appeared to indicate that follow-on audits in the newsagency industry were warranted. A follow-on audit is dependent on external factors regarding the acceptance of the gross sales methodology.

## ***Project No. 4: Commissioned Insurance Agents Project***

### ***Description***

The project assessed compliance in the disclosure in tax returns of low or no interest loans provided to insurance agents from their employer.

### ***Objectives***

To improve the levels of voluntary compliance by insurance agents in respect to the declaration of benefits received from low or no interest loans received from insurance companies.

### ***Reasons for selection***

- Information was received from insurance agents that there was a large number of insurance agents who were in receipt of a low or no interest loan but who were not disclosing the receipt of their benefit in their taxation returns.
- A scoping project showed that a significant proportion of agents were not disclosing the receipt of low or no interest loan benefits. It also revealed that there was confusion over whether the benefit was subject to tax.
- A cost-benefit analysis of the project was not undertaken.

### ***Links to Risks***

- The decision to undertake the project was linked to risks identified by SBI in the 1996 HOTSA of the insurance industry.
- Although the project targeted compliance improvement, this link was not formally stated in the project plan.

### ***Methodology***

- A three month amnesty was declared for insurance agents to voluntarily disclose that they had failed to make a disclosure in their tax returns about a loan benefit.
- A compliance enforcement phase was then conducted to contact insurance agents who did not come forward voluntarily.

### ***Performance targets and measures***

- No performance targets or formal measures were set in the project plan.



- Resources: not predicted in the project plan. There was a detailed analysis in the report of the time spent, dollars raised and productivity, but the cost of undertaking the project was not calculated.
- Timing: the project commenced in July 1992, with a focus on the years 1989-93. Compliance enforcement action was undertaken from September 1995 and completed in December 1995.
- An evaluation of the project based on detailed quantitative results was conducted.

### *Results*

- Saturation coverage was achieved of insurance agents involved in the life insurance industry in respect of low interest loan benefits.
- The level of compliance on this issue is now very high however the project found that the classification of this area as low risk is a serious drawback in terms of dedicating resources to the detailed examination of a number of other current issues concerning insurance agents.
- The project concluded that the issue of low and no interest loans benefits to insurance agents should be examined in future audits of insurance agents to ensure that compliance remains high.

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