

The Auditor-General
Audit Report No.48 2003–04
Performance Audit

The Australian Taxation Office's Management and Use of Annual Investment Income Reports

Australian Taxation Office

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Canberra ACT
27 May 2004

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Australian Taxation Office in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit and the accompanying brochure. The report is titled *The Australian Taxation Office's Management and Use of Annual Investment Income Reports*.

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

Yours sincerely

A handwritten signature in black ink, appearing to read 'P. J. Barrett', is positioned above the printed name.

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

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* 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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Contents

Abbreviations	6
Summary and Recommendations	9
Summary	11
Introduction	11
The Audit	12
Key Findings	12
Overall conclusion	17
Summary of ATO's response	18
Recommendations	19
Audit Findings and Conclusions	23
1. Background and Context	25
Background	25
The Audit	32
2. Governance Arrangements	34
Introduction	34
Audit approach	35
AIIR as a whole of ATO resource	35
AIIR as a whole-of-government resource	38
AIIR data and ATO's strategic approach	39
3. Receipt of AIIR Data	42
Introduction	42
Audit approach	45
Application of the AIIR legislative framework	45
Engaging investment bodies to clarify responsibilities	52
Ensuring the integrity of AIIR data	53
4. Management of AIIR Data	56
Introduction	56
Audit approach	61
Identity matching of AIIR data	61
Unmatched AIIR data	64
ATO source data is complete, valid and reliable	68
ATO data quality standards	71
5. Use of AIIR Data	73
Introduction	73
Audit approach	76
The compliance value of AIIR data	76
Opportunities to pursue wider systematic use of AIIR data	84
Appendix	91
Appendix: Agency response	93
Index	100
Series Titles	102
Better Practice Guides	106

Abbreviations

ABR	Australian Business Register
ABS	Australian Bureau of Statistics
AIIR	Annual Investment Income Report
AIS	ATO Integrated System
ANAO	Australian National Audit Office
ANTS	A New Tax System
ATO	Australian Taxation Office
ATOMS	ATO Matching System
CDMP	Corporate Data Management Plan
CSA	Child Support Agency
DIMIA	Department of Immigration and Multicultural and Indigenous Affairs
DMSC	Data Matching Steering Committee
DoB	Date of Birth
GST	Goods and Services Tax
HECS	Higher Education Contribution Scheme
IMS	Income Matching System
INB	Individuals Non Business
IT	Information Technology
ITAA	Income Tax Assessment Act
LB&I	Large Business and International
MIPS	Magnetic Information Processing Services
MoU	Memorandum of Understanding
NIMS	Non Individual Matching System
PAYG	Pay As You Go
PRG	Potential Revenue Gain
PTax	Personal Tax
SB	Small Business

SFSS	Student Financial Supplement Scheme
SMSF	Self Managed Superannuation Fund
TFN	Tax File Number
TFNII	Tax File Number Integrity and Improvement
TSF	Transaction Search Facility

Summary and Recommendations

Summary

Introduction

1. In 2002–03, the Australian Taxation Office (ATO) collected revenue of \$185 billion.¹ Self-assessment and a broad range of compliance strategies support collection of this revenue. The ATO relies upon risk management approaches and the integrity features built into the tax system to identify instances where taxpayers fail to comply. The ATO's compliance strategies aim to optimise collections and instil confidence in the community that the taxation system is operating effectively.
2. The ATO's use of third party investment income information is an important part of the ATO's compliance strategies. There has been a legislative requirement for banks and other financial institutions to provide detailed information about certain common financial transactions since 1936. Parliament's requirements for this information have been widened over the years in terms of the transactions reported upon and the institutions required to provide the information.
3. The Annual Investment Income Report (AIIR) was a significant feature of the TFN legislation introduced by Parliament in 1988² and was, amongst other things, 'designed to improve the efficiency of the ATO's income matching system'.³ The AIIR is a legislatively required data reference set used to validate certain classes of investment income that have to be reported on income tax returns. Since 1992, investment bodies⁴ have been providing the ATO with an AIIR containing the details of investment income paid to all investors⁵ each financial year and any tax that may have been withheld on these accounts.

¹ Australian Taxation Office, *Annual Report 2002–03*, p.43. This amount includes collections of \$30.7 billion for the Goods and Services Tax and \$21.6 billion for Excise and other indirect taxes.

² Refer to *Taxation Laws Amendment (Tax File Numbers) Bill 1988*, and House of Representatives Hansard pps 858 to 861, 1 September 1988.

³ Refer to House of Representatives *Hansard* p. 860, 1 September 1988.

⁴ The most significant of these are large financial institutions and public companies. However, the legislation also applies to unit trusts, loans made to government bodies or a body corporate, solicitors who invest client monies, some real estate agents, and betting investment bodies.

⁵ The six categories of investor identified in tax legislation are: individuals, partnerships, trusts, companies, superannuation funds and government agencies. The legislation requires that the AIIR data include the details of all of the investment income (as legislatively defined) of all entities in each of these six categories that receive the investment income from any of the investment bodies covered by the legislation.

The Audit

4. The objective of the performance audit was to report to Parliament our assessment as to how well the ATO manages and uses the AIIR data in taxation administration. The ANAO considered the following four key areas in addressing the audit objective.

- Governance arrangements within the ATO, focussing on whole of ATO and whole-of-government aspects of the AIIR data, as distinct from solely business line applications.
- Receipt of AIIR data and how well the ATO facilitates the collection of complete and valid AIIR data from investment bodies.
- Management of AIIR data through the construction by the ATO of valid entity records by using the AIIR data in conjunction with existing ATO client identification master files.
- Use of the AIIR data on a systematic basis to inform active compliance activities.

Key Findings

Background and Context (Chapter 1)

5. The ATO seeks to optimise revenue collection by achieving, in any particular instance, the most appropriate mix of five key components of tax administration (self-assessment, the Taxpayers' Charter, the compliance model, market segmentation and risk management) relative to taxpayer behaviour. The strategies that the ATO uses to optimise revenue in this way, in turn, determine ATO's resourcing strategies. Getting the mix of the components 'right' across the entire spectrum of taxpayers' behaviour is not a simple matter. The mix is complex and ever changing. It is determined by where risks (not simply revenue) lie, their comparison and what the Parliament and community would reasonably expect. ATO's decisions about the mix, and the consequent resource deployment, depend crucially on the quality and completeness of the data used to inform decision-making.

Governance Arrangements (Chapter 2)

6. Historically, the business group within the ATO that has responsibility for the administration of the taxation of individuals has had responsibility for the administration of the AIIR data and its predecessors. The management and use of AIIR data is provided by Compliance Systems, a business directorate within the Personal Tax (PTax) business line. During the last two years, the Compliance Systems Directorate has achieved improved efficiencies, including: the rationalisation of a number of duplicated systems and work

groups; documenting the Directorate's many systems, databases, practices and procedures; improving internal reporting and supervision arrangements; and raising the Directorate's profile throughout the ATO. The Directorate has also implemented enhanced IT systems that have improved the ATO's use of the AIIR data.

7. The ANAO found that PTax is the only business line in the ATO that uses the AIIR data on a systematic basis. PTax is responsible for the administration of the tax affairs of individual taxpayers. PTax carries out sophisticated data matching, using the AIIR data to verify that individual taxpayers have correctly reported some classes of investment income in their tax returns. The ANAO considers that the AIIR data contains valuable information that can assist in the review of the more complex tax affairs of individuals with tax relevant links to non-individual entities such as partnerships, trusts and private companies, including superannuation funds.

8. We also found the AIIR data contains investment income information that is relevant to the tax payable by non-individuals. The AIIR data has other potential uses apart from the foregoing. For example, it has a role in the identification of individuals, as well as non-individuals, that may have lodgement responsibilities with which they have not complied. The AIIR data also has a whole-of-government role. The Child Support Agency (CSA) and the Department of Immigration and Multicultural and Indigenous Affairs (DIMIA) use the AIIR data. The ANAO considers that there is potential for increased whole-of-government use of the AIIR data in the future. This could arise from heightened concerns about the protection of Australia's security and a stronger interest in the verification of recipients' continuing eligibility for financial payments from the Commonwealth.

9. The ATO has recently established arrangements, including a Data Matching Steering Committee and an AIIR Steering Committee, to improve the co-ordination of activity that has a bearing on the work of Compliance Systems, and to review the management and wider use of the AIIR data across the ATO.

Receipt of AIIR data (Chapter 3)

10. The receipt of AIIR data refers to the receipt by the ATO of all AIIRs from all investment bodies that have an obligation to provide them. It includes the extent to which the AIIRs received by the ATO comply with the ATO's reporting specifications as well as the extent to which the specifications themselves comply with legislation. Steps taken by the ATO to assist investment bodies understand their reporting obligations are also examined. The ANAO found that the ATO does not have effective strategies to ensure that investment bodies with a legislative obligation to provide an AIIR to the ATO are doing so. Further, there is no systematic lodgement enforcement

approach designed to ensure that known investment bodies provide their AIIR to the ATO by the due date. The ANAO considers that an effective and adaptable approach to engaging all relevant investment bodies so that they understand and fulfil their reporting responsibilities is required.

11. The ATO has advised that it now has initiatives underway to improve reporting compliance amongst investment bodies and to improve the integrity and timeliness of the AIIR data sent to the ATO. These include an investment body visit program and a data quality audit that will provide baseline metrics for data quality issues associated with reported AIIR data.

12. We found that there is scope for a review of the current AIIR reporting requirements that would identify the costs and benefits associated with the ATO continuing to receive information from investment bodies relating to certain classes of investment income. This review could also determine the existence of other investment income types that would usefully be covered by the AIIR reporting requirements.

13. We also found that there may be scope to move away from the current technology of receipt of data based on computer tapes, disc, and paper, to a technology based on the ATO's secure access to secure websites and the direct down-loading of AIIR information from them. Adoption of this technology could achieve important efficiencies for the ATO and investment bodies.

Management of AIIR data (Chapter 4)

14. The management of AIIR data refers to the ATO's conversion of data received from investment bodies into a format suitable for income matching and other administrative activities. ANAO found the ATO's identity matching engines, particularly their phonetic scoring capacity,⁶ to be highly effective. Further, they are essential in an environment where the quality of source data continues to be a problem. This is likely to be the case with the AIIR data for some time and is an intrinsic problem with source data provided by the general public, especially to a revenue collection agency.

15. As part of our review of the ATO's management of AIIR data, we looked at the capacity of the ATO to differentiate variations in the quality of the identity matching that is applied to AIIR records. We found that up to 82 per cent of all AIIR records will receive a high quality match. With regard to the lower grades of identity match, we consider that, through implementing ongoing analysis of unmatched and low quality matched AIIR data, the ATO

⁶ This is achieved through the use of a fully customised edit list (name dictionary) capable of identifying typing and spelling errors, ethnic name anglicisation issues, orthographic and phonetic misinterpretation, truncation and abbreviation, missing words and extra words and word sequence variation.

will gain valuable insights into specific data quality areas requiring its attention.

16. The ATO has recently established initiatives to use the AIIR data to assist in the identification, and bringing to account, of those individuals and other entities that are operating outside the tax system.

17. ANAO considers that the improvements now required in the ATO's management of the AIIR data are more likely to come from improvements in the quality of the data, rather than refinements in the power of the identity matching engines. In this regard, we consider there is scope for the ATO to implement mandatory data quality standards.

Use of AIIR data (Chapter 5)

18. Given the large volume of the AIIR data, the more that the ATO can use it systematically in computer-based income matching systems, the greater the value that the ATO might achieve from the data. The AIIR data can also be used in other ways as well, such as for lodgement enforcement and compliance investigations.

19. We found that only the PTax business line had established a systematic income matching capability. Whilst the Small Business business line and Ptax had conducted pilot studies of a non-individual matching capability in the 1990s, the ATO did not proceed to establish this capability. ANAO accepts that the ATO, in carrying out the non-individual matching capability pilot projects in the SB and Ptax business lines, made a reasonable effort to test the usefulness of income matching of non-individual taxpayers.

20. The ATO considers that the absence of a non-individual matching capability does not mean that the ATO is leaving significant risks untreated. The ATO has explained that the tax affairs of non-individual entities are more extensively risk assessed, and that the ATO's active compliance coverage in these markets is also more extensive and intensive than it is for individuals. The ATO considers that the pilot projects justified the ATO not proceeding with a non-individual matching capability at that time. The ATO has pointed out that the decisions it makes about the redevelopment of its Information Technology capability are also made on a risk management basis. In this regard, the ATO notes that there is always a much bigger demand for IT development than can be met with available resources. The ATO advises that of highest priority in determining investments, is the implementation of new Government policy and sustaining current systems. The ATO considers that the issues associated with the establishment of a non-individual matching capability cannot be easily addressed with a simple resource shift and some systems redevelopment.

21. If the ATO is to make the best use of the AIIR data, it will be necessary to achieve at least a satisfactory proportion of the compliance value of the data.⁷ To date, the ATO has not been able to estimate this value.

22. In the absence of valid estimates of the AIIR's compliance value, it is difficult for the ATO to manage and use the AIIR data strategically; that is, on a whole of ATO basis and including all categories of investment income and taxpayer. The ANAO considers that a strategic approach is necessary to obtain the best value from the data. The extent to which the ATO is able to achieve, cost-effectively, the compliance value inherent in the AIIR data, depends on the ATO's appreciation of, and capacity to measure, the compliance value of the data in terms of total Potential Revenue Gain (PRG)⁸ for all AIIR entity records.

23. As part of the audit, the reporting gap associated with the interest income of individuals was examined more closely for the AIIR data for the year 2002, the latest year for which there is full set of AIIR data. The aim was to gain a reliable estimate of the compliance value attached to this subset of the AIIR data.

24. We found that the existing case selection methodology of the IMS case selection team which aims to separate available high quality cases into primary case categories and exclusion categories, prohibits any such estimation. We also found that a proportion of primary cases selected for actioning was shown to be unproductive. In addition, we consider that there may be significant amounts of PRG associated with several of the exclusion categories.

25. The ATO accepts that, within its exclusion categories, there will be cases that are productive and worth pursuing by case actioning teams. The ATO advised that it plans to undertake fresh scoping audits on each exclusion category aimed at updating its risk assessment perspective. This will be used to update existing case selection practices.

26. The ANAO notes that additional revenue may be recoverable from individual taxpayers in relation to discrepancies for other classes of investment

⁷ 'Compliance value' has both quantitative and qualitative dimensions. Quantitatively, it is the estimated amount of additional revenue that may be collected from the recovery of tax due in relation to investment income discrepancies disclosed by the AIIR data. An aggregate measure is the compliance rate, which is defined at Paragraph 5.15. Qualitatively, it includes improvements to compliance that may be attributed to the AIIR data. The ATO uses Potential Revenue Gain to estimate additional revenue collectable from discrepant income, which is itself defined in footnote 87.

⁸ The Potential Revenue Gain (PRG) is the net amount of revenue that could be recovered if the ATO were to take effective administrative action in relation to the transaction. The PRG is the calculated net tax payable after the omitted income is added, less the amount already paid. The PRG is calculated as the difference between tax that would be paid on the income resulting from adding the discrepant income to the individual's taxable income as determined from the individual's tax return and the tax that was actually paid prior to the identification of the discrepancy.

income, such as dividends and distributions from partnerships, trusts (including unit trusts), and private companies.

27. The ANAO also notes that, during the current financial year, the ATO will consider a proposal from the relevant business lines for increased funds for additional case actioning of matched discrepant individuals and non-individuals, along with not lodged and not registered cases.

Overall conclusion

28. The efficient and effective use of AIIR data is an important part of taxation administration. The AIIR legislation creates substantial reporting obligations for investment bodies. The latter are required to provide the ATO with timely and valid data that covers a range of investments and investor categories.

29. Overall, we conclude that the ATO needs to improve the management and use of the AIIR data. While the ATO's AIIR data matching program has proven to be an effective compliance tool with regard to the individual taxpayer market segment, a more strategic approach that is focussed on greater optimisation of the compliance value of the AIIR data is now warranted. The ANAO considers that relatively low cost initiatives taken at the data receipt stage would have significant beneficial consequences of improved compliance, and assist the ATO to better optimise the collection of tax revenue.

30. The ATO has recently introduced several initiatives to improve the management and use of the AIIR data. These include the creation of a Data Matching Steering Committee to develop an overall approach to, and the better targeting of ATO data matching activities; the implementation of a number of steps aimed at improving AIIR lodgement compliance and awareness amongst investment bodies; the creation of data integrity teams responsible for improving the quality of data sent in by investment bodies; and the implementation of initiatives to improve use of AIIR data in the non-individual market segments.

31. The ANAO has also identified a number of improvements to strengthen the ATO's management and use of the AIIR data. These include:

- the development of performance information to better inform the ATO about the management and use of the AIIR data;
- a review of AIIR reporting requirements and opportunities for changes to the approved form of AIIR reporting;
- the implementation of data quality standards and guidelines;
- opportunities to improve the compliance value of AIIR data through ongoing analysis of unmatched and low-quality matched data; and

- measures to make better use of the data, particularly in the non-individual market segments.

Summary of ATO's response

32. We are pleased that the ANAO concludes that our AIIR data matching program is an effective compliance tool with regard to the individual taxpayer market segment. It is important to have this confirmation given that the prime purpose for which we developed our data matching capability was to treat risk in the individual market.

33. We also note ANAO acknowledgement of the effort we are making to refine that capability and possibly extend it into other compliance markets to complement our other important compliance efforts. Any decision to invest in an extension of the current capability will need to take account of the total compliance risks that warrant treatment, as well as the choices we face with other systems investment decisions, especially given our current Change Program.

34. While we view our data capture/matching processes and systems as already highly effective compliance tools, we believe the ANAO's recommendations set an appropriate direction to assist us to build on that capability and proficiency.

35. The ATO's full response is reproduced in the Appendix of this report.

Recommendations

The ANAO's recommendations with report paragraph references and ATO's abbreviated responses are set out below. More detailed responses are shown in the body of the report. The ANAO considers that the ATO should give priority to Recommendations 6, 1, 8 and 7, in that order.

**Recommendation
No.1
Paragraph 2.33**

The ANAO recommends that, to make more strategic use of the AIIR at both the whole of ATO and whole-of-government levels, the Data Matching Steering Committee compile suitable performance information which can be used to inform the ATO Executive about the management and use of the AIIR data, including:

- a statistically sound estimate of the total amount of additional revenue that could be collected, including any additional resource allocation required, using the AIIR data; and
- a range of descriptive indicators relating to AIIR data, including:
 - contribution of the AIIR data at the whole-of-government level;
 - contribution of the AIIR data at the whole of ATO level;
 - compliance risks identified by the AIIR data;
 - quality of the AIIR data;
 - reporting behaviour of the AIIR reporters (i.e. the investment bodies that submit AIIR reports); and,
 - standard measures of time, cost and quality of performance of relevant components within the Compliance Systems Directorate.

ATO Response: Agreed.

**Recommendation
No.2
Paragraph 3.31**

The ANAO recommends that, in order to assess adequately the AIIR non-lodger risk, and to determine the completeness of the AIIR data set, the AIIR Steering Committee take responsibility for the implementation of a systematic approach to lodgement enforcement so that all known investment bodies are aware of, and fulfil, their legislatively defined reporting responsibilities.

ATO Response: Agreed.

**Recommendation
No.3
Paragraph 3.40**

The ANAO recommends that the ATO bring to the attention of the Treasury the scope for a review of the legislation supporting the current AIIR reporting requirements, that aims to identify the costs and benefits associated with:

- determining the existence of investment income types that are outside current AIIR reporting requirements but that would assist the ATO with income matching activities;
- examining the usefulness of all transactions covered by the current AIIR reporting requirements, in particular, the need for the AIIR legislation to continue to require information on assessable income derived from investment related betting chances; and
- implementing changes to the approved form of the AIIR, including a consideration of moving to secure online access, in order to improve the efficiency of the transmission and receipt of AIIR data from investment bodies.

• *ATO Response:* Agreed.

**Recommendation
No.4
Paragraph 3.47**

The ANAO recommends that the ATO implement a co-ordinated communication strategy designed to identify, and improve the awareness of, investment bodies that may have AIIR reporting obligations, but are not currently AIIR reporters.

ATO Response: Agreed.

**Recommendation
No.5**

Paragraph 4.34

The ANAO recommends that the ATO conduct ongoing analysis of unmatched and low-quality matched AIIR data and that this analysis provide the basis for the ATO's overall approach to data integrity assurance for AIIR data.

ATO Response: Agreed.

**Recommendation
No.6**

Paragraph 4.51

The ANAO recommends that, to improve data quality and the effectiveness of AIIR data matching against client identification masterfiles, the ATO implement mandatory data quality standards for use throughout the ATO.

ATO Response: Agreed.

**Recommendation
No.7**

Paragraph 5.49

The ANAO recommends that, to optimise the compliance value of the AIIR data, the ATO:

- evaluate the enhancement of the ATO Matching System (ATOMS) so that the ATO can take into account the income received by individuals from unit trust distributions, partnerships, trusts, and private companies;
- calculate annually the gap between aggregate investment income of individuals reported by investment bodies, and that reported by taxpayers, and use this information to assist with resource allocation decisions; and,
- adopt, within the context of its overall risk management framework, a more strategic approach to the use of the data, having regard to valid measures of cost/benefit value of the AIIR data.

ATO Response: Agreed.

**Recommendation
No.8
Paragraph 5.68**

The ANAO recommends that, to improve the use of AIIR data relating to non-individuals, and achieve the greater cost effectiveness in tax administration that the systemic use of the data enables, the ATO:

- evaluate the adaptation of ATOMS for matching AIIR records belonging to superannuation funds, trusts, and partnerships and government agencies;
- conduct a scoping study for the adaptation of ATOMS for matching AIIR records belonging to specific categories of companies identified in relation to compliance risk factors; and
- evaluate the use of multiple year analysis of the AIIR data.

ATO Response: Agreed.

Audit Findings and Conclusions

1. Background and Context

This chapter establishes the background to the audit, provides an overview of the AIIR legislative framework, and the general use of data matching activities in the ATO, and outlines the audit approach.

Background

The Australian Taxation Office and its use of third party investment income information

1.1 In 2002–03, the Australian Taxation Office (ATO) collected revenue of \$185 billion.⁹ It employed almost 22 000 staff (including ongoing and non-ongoing employees) at 30 June 2003 located in some 46 offices throughout Australia. The Office is structured into business and service lines,¹⁰ which are organised around market segments, revenue products and services.

1.2 As a result of changed accountabilities for the tax law develop and design function announced by the Treasurer in May 2002, since 1 July 2002 the ATO has not had responsibility for tax policy and legislation. Those responsibilities now rest with the Department of the Treasury.

1.3 The ATO maintains a self-assessment system and a broad range of compliance strategies to support the collection of taxation revenue. The ATO relies upon risk management approaches and the integrity features built into the tax system to identify, cost effectively, instances where taxpayers fail to comply. The ATO's compliance strategies aim to optimise collections and instil confidence in the community that the taxation system is operating effectively.

1.4 The ATO's use of third party investment income information is an important part of the ATO's compliance strategies. There has been a legislative requirement for banks and other financial institutions to provide detailed information about certain common financial transactions since 1936. The Parliament's requirements for this information have been widened over the years in terms of the transactions reported upon and the investment bodies required to provide the information.

1.5 This information is now provided to the ATO by banks and other financial institutions through the Annual Investment Income Report (AIIR).

⁹ Australian Taxation Office, *Annual Report 2002–03*, p.43. This amount includes collections of \$30.7 billion for the Goods and Services Tax and \$21.6 billion for Excise and other indirect taxes.

¹⁰ Business lines that have an external client focus are organised around either market segments or revenue categories (e.g. Small Business, GST). The ATO has service lines that have an internal client focus and provide goods and services (i.e. outputs) only for internal ATO use (eg. information technology and payroll management).

The AIIR data is used to improve compliance of all taxpayers by, for example, the verification of investment income in tax returns, or the identification of persons or entities with tax obligations that have not lodged returns.

AIIR legislative framework

1.6 In 1988, the Parliament introduced a range of legislative measures designed around the Tax File Number (TFN) to improve compliance with taxation obligations.¹¹ A significant feature of the TFN legislation was the introduction of the AIIR requirements. The AIIR was a fundamental part of measures that were essentially ‘designed to improve the efficiency of the income matching system’.¹² The Second Reading Speech that accompanied the introduction of the TFN legislation explains further that ‘the Bill will also introduce an obligation on employers and investment bodies who store information on computer to supply information reports to the Commissioner in a form suitable for processing by the tax office computer system’.¹³ These requirements expanded considerably those that had begun in 1936.¹⁴

1.7 The investment arrangements to be covered by the legislation were described as fitting into two groups:¹⁵

Interest income received from investments with banks and other financial institutions, and with companies, government and semi-government authorities and solicitors’ trust funds; and

Dividends from share investments and distributions from cash management and property trusts.

1.8 The AIIR requirements became law in 1989 and applied to all new accounts opened or investments made on or after 1 July 1991.

¹¹ Refer to *Taxation Laws Amendment (Tax File Numbers) Bill 1988*, and House of Representatives Hansard pps 858 to 861, 1 September 1988.

¹² *ibid.*, p. 860.

¹³ The legislation requires organisations that have the capacity to store information on a computer to supply the information to the Commissioner of Taxation in a form suitable for processing by the ATO computer system. However, the legislation does not require organisations to establish computer systems to store information.

¹⁴ Since 1936, all companies and financial institutions have been required to provide the ATO with detailed information about the persons and entities to which investment income (chiefly interest and dividends) had been paid. The requirements were set out in the then Income Tax Regulation 11 (2). The requirements have been gradually expanded until Regulation 11 (2) was repealed and replaced by the current provisions.

¹⁵ *op cit.*, p. 860

1.9 As a result, since 1992, investment bodies¹⁶ have been providing the Commissioner with an AIIR containing the details of investment income paid to all investors¹⁷ each financial year and tax withheld on these accounts. Section 202D of ITAA36 sets out in tabular form the details of the classes of investments, and investors that investment bodies are required to report upon.¹⁸ These requirements impose a legislative obligation on all of the investment bodies included in the following table:

Table 1.1

AIIR terms defined in Section 202D of ITAA 1936

Item	Investment	Investor	Investment Body
1	Interest-bearing account with a financial institution	The person in whose name the account is held	The financial institution
2	Interest-bearing deposit (other than a deposit to the credit of an account) with a financial institution	The person in whose name the deposit is made	The financial institution
3	Loan of money to a government body or to a body corporate	The person in whose name the money is lent	The government body or body corporate
4	Deposit of money with a solicitor for the purpose of: (a) being invested by the solicitor; or (b) being lent under an agreement to be arranged by or on behalf of the solicitor	The person for whose benefit the money is to be invested or lent	The solicitor
5	Units in a unit trust	The person in whose name the units are held	The manager of the unit trust
6	Shares in a public company	The shareholder	The company
7	An investment-related betting chance	The betting investor	The betting investment body

Source: S202D of ITAA 36

¹⁶ The most significant of these are large financial institutions and public companies. However, the legislation also applies to unit trusts, loans made to government bodies or a body corporate, solicitors who invest client monies, some real estate agents, and betting investment bodies.

¹⁷ The six categories of investor identified in tax legislation are: individuals, partnerships, trusts, companies, superannuation funds and government agencies. The legislation requires that the AIIR data include the details of all of the investment income (as legislatively defined) of all entities in each of these six categories that receive the investment income from any of the investment bodies covered by the legislation.

¹⁸ In addition, there were two specific amendments to the TFN legislation. One was about investment related betting chances (See *Taxation Laws Amendment Bill (No.3) 1991*, Senate Hansard pps 3236, 14 November 1991). The other was connected to the introduction of the Farm Management Deposit Scheme (See *Taxation Laws Amendment (Farm Management Deposits) Act 1998*, House Hansard pps 4066, 28 May 1998).

1.10 Investment bodies must lodge an AIIR with the ATO four months after the end of the financial year to which it relates. However, the ATO may grant an extension of this deadline, where the investment body has lodged an extension for time to lodge report request, prior to the initial due date of the report.

1.11 The ATO has issued investment bodies with detailed specifications detailing the reporting requirements for the AIIR.¹⁹ Section 202G of ITAA36 make these specifications regulations under Regulation 56 ITR36.

The ATO's use of data matching

1.12 The ATO's use of AIIR data is a part of its wider data matching functions. The use of data matching as a compliance strategy within the ATO has grown in prominence during recent years. The ATO's income matching generated an additional \$129 million revenue in 2002–03.²⁰ Furthermore, the ATO derives significant benefits from data matching in other areas of taxation administration. There are, also, whole-of-government benefits, as other Commonwealth agencies, such as Centrelink and the Child Support Agency, derive significant benefits from the assistance provided by the ATO.

1.13 An example is the matching undertaken by the ATO on behalf of the Data Matching Agency,²¹ which produces significant additional financial benefits for the Commonwealth. From 1998 to 2001 the program has delivered some \$476 million in net benefits or revenue recovered.²² A further \$87.8 million in net benefits was recovered during the 2002 financial year.²³

1.14 Data matching is one of the most cost-effective tax administration tools available to the ATO. There are three main three reasons for the ATO use of data matching. They are to:

- improve the quality of data held on ATO's databases;
- uncover and reduce fraud; and
- encourage better compliance.²⁴

¹⁹ The specifications are discussed further in Chapter 3.

²⁰ Refer to page 11 of the ATO Compliance Program for 2003-04.

²¹ The Data Matching Agency is established under the *Data Matching Program Assistance (Assistance and Tax) Act 1990* (the Act) to match data by agencies participating in the Data Matching Program. The ATO is a source agency under the Act and provides data on the identity and taxable income for people in receipt of personal assistance payments to the Data Matching Agency. Under the Act, the CEO of Centrelink (the Services Delivery Agency) ensures that there are officers of the Agency who are responsible for the matching of data.

²² Refer to page 20 of Data-matching program Report on progress 1998–2001.

²³ Refer to page 19 of Data-matching program Report on progress 2001–2002.

²⁴ See paragraph 3.2 of *Numbers on the Run: Review of the ANAO Report No.37 1998–99 on the Management of Tax File Numbers*. House of Representatives Standing Committee on Economics, Finance and Public Administration Commonwealth of Australia 1999.

ATO's general administrative framework

1.15 The general administration of AIIR, and use of compliance assurance strategies in relation to AIIR data in particular, occurs within the ATO's general administrative framework. The ATO's approach to tax administration is based on five related components: self-assessment; the Taxpayers' Charter; the compliance model; market segmentation; and risk management. These components consist of principles, models and operating concepts designed to make it as easy as possible for individuals and organisations to comply with verification processes, based on a risk management approach.²⁵

Interaction of the components

1.16 The five components interact at different levels. Self-assessment places responsibilities on taxpayers to voluntarily comply with their tax obligations. In support of self-assessment, the ATO adopts a compliance program consisting of a range of education and other compliance strategies to enable and encourage taxpayers to comply. The Taxpayers' Charter builds on this concept by explaining that the ATO will treat its clients as being honest in their tax affairs unless the ATO considers that they are not acting honestly. The Compliance Model shapes the compliance actions and strategies that the ATO takes in response to non-compliance.

Optimising collections

1.17 The ATO advised that it is strongly of the view that the best compliance outcomes come from a self-assessment system wherein taxpayers and tax practitioners understand their obligations, are able to readily obtain the information they need, and can easily access quality systems and processes to interact with the ATO. That means there is a strong emphasis within the Compliance Program on education and service delivery to taxpayers and tax agents. Concurrently, there is a strong ATO focus on getting the right level of active compliance coverage across the community (and its various segments), plus following up those 'at risk' taxpayers that choose not to voluntarily comply. The ATO considers this approach allows it to 'optimise collections'.

1.18 The ATO seeks to optimise revenue collection by achieving, in any particular instance, the most appropriate mix of the five components relative to taxpayer behaviour. This, in turn, determines ATO's resourcing strategies. Getting the mix 'right' across the entire spectrum of taxpayer behaviour is not a simple matter. The mix is complex and ever changing. It is determined by where risks (not simply the revenue) lie, their comparison and what the

²⁵ Further information on the ATO's general administrative framework, including an explanation of these five components, can be found on the ATO website at:

<http://www.ato.gov.au/corporate/pathway.asp?pc=001/001/002/001&mfp=001&mnu=221#001_001_002_001>.

Parliament and community would reasonably expect. A key component of the ATO's decisions about the mix and the consequent resource deployment is the quality and completeness of the data used to inform decision-making.

Recent developments

1.19 The ANAO notes the following two recent developments that are likely to impact on the ATO's future use of data matching, including, the management and use of AIIR. These are the:

- introduction of a 'Change Program' by the ATO, designed to make community dealings with the tax office easier, cheaper and more personalised; and
- Government's announcement of its intention to undertake a review of aspects of income tax self-assessment.

The Change Program

1.20 The ATO has recently embarked on an easier, cheaper and more personalised approach to dealing with taxpayers, called the Change Program. The Change Program places an increased importance on client profiling, analytics and smarter IT interfaces with taxpayers and the public, as part of an easier and cheaper experience with the ATO.

1.21 The ATO has developed key principles to guide the design and development of the products and services that will form part of the easier, cheaper and more personalised program. These include making online access a more standard mode of interaction with the ATO, having better informed ATO responses, and simplifying recordkeeping requirements.

Review of Self-Assessment

1.22 The Government has also recently announced its intention to undertake a review of aspects of income tax self-assessment, to examine whether the right balance has been struck between protecting the rights of individual taxpayers and protecting the revenue for the benefit of the whole Australian community. The review will examine a range of issues, including: the statutory timeframes for amending assessments; the duration of the tax audit process; the reliance that taxpayers should be able to place on ATO advice; and aspects of the General Interest Charge.²⁶

²⁶ Refer to the Treasurers press release at www.treasurer.gov.au/tsr/content/pressreleases/2003/098.asp.

Previous reviews

1.23 The ATO's use of the third party information received from financial institutions has been commented upon in Auditor-General's reports since the mid 1980s. The main reports are the following:²⁷

- *Processing and Assessment of Income Tax Returns by the ATO* AGPS 1984;
- *Checking of Dividends and Interest Disclosed in Income Tax Returns by the ATO* AGPS 1984;
- *ATO External Sources of Information*, Report of the Auditor General March 1986;
- *ATO Partnership and Trust Distributions*, Report of the Auditor General March 1986;
- *ATO—Taxpayers in Unincorporated Businesses* AGPS 1987;
- *Income Matching System—Australian Taxation Office*, Audit Report No.1 1995–96 AGPS 1995; and
- *Management of Tax File Numbers—The Australian Taxation Office*, Audit Report No.37 1998–99 ANAO 1999.

1.24 A recent report of the House of Representative's Standing Committee on Economics, Finance and Public Administration has also made findings and recommendations of relevance.²⁸

1.25 These reports conclude that there was considerable scope for the ATO to improve the efficiency and effectiveness of ATO data matching. The reports also commented upon the ATO's use of the AIIR data (or its predecessors) in the matching activity examined. Key issues raised in these reports include:

- the incompleteness and variable quality of the information used by the ATO;
- less than optimal compatibility between relevant IT systems;

²⁷ Other reports of relevance are:

The Collection of Sales Tax by the ATO, AGPS 1984;
Processing of Income Tax Instalment Deductions by the ATO, AGPS 1984;
ATO Disclosure of Diesel Fuel Rebates Report of the Auditor-General, AGPS March 1986;
ATO Unpresented Group Certificates, AGPS August 1986;
ATO Prescribed Payments System, AGPS September 1986;
ATO Prescribed Payments System, Audit Report No. 28 1991–92;
ATO Management of Appeals and Review, Audit Report No. 24 1993-94;
ATO Wool Tax Audit, Report No. 3 1994-95;
The Management of Tax Debt Collection—The Australian Taxation Office, Report No 23 1999–2000.

²⁸ op cit.

- weaknesses in the ATO’s ability to conduct a full cross-referencing of relationships among companies, partnerships, trusts and individual taxpayers; and
- taxpayers not reporting all of the investment income that is reported to the ATO by investment bodies.

1.26 These reports are referred to in the following chapters, where appropriate, as aspects of each of these reports have a continuing relevance to the ATO’s management and use of the AIIR data.

The Audit

1.27 The objective of the performance audit was to report to Parliament our assessment as to how well the ATO manages and uses the AIIR data in taxation administration. The ANAO considered four key areas in addressing the audit objective. These were the AIIR governance arrangements, and the receipt, management, and use of the AIIR data. These key areas formed the basis of the report, depicted in Figure 1.1.

Figure 1.1

Audit Report Structure

Chapter 1 Background & Context <ul style="list-style-type: none"> • AIIR legislative framework • ATO use of data matching • ATO general administrative framework • Recent developments • Previous reviews • Report structure 		
Chapter 2 Governance Arrangements <ul style="list-style-type: none"> • AIIR administrative arrangements • Whole of ATO aspects • Whole of Government arrangements • AIIR data & ATO’s strategic approach 		
Chapter 3 Receipt of AIIR Data <ul style="list-style-type: none"> • Reporting specifications • Gaps in legislation • Relationship management • Ensuring the integrity of AIIR data 	Chapter 4 Management of AIIR <ul style="list-style-type: none"> • Identity matching engines • Unmatched records • Reliability & accuracy of AIS • ATO data quality standards 	Chapter 5 Use of AIIR <ul style="list-style-type: none"> • ATO matching systems • Compliance Value of AIIR • Opportunities for wider systematic use

Audit methodology

1.28 The audit involved fieldwork in the ATO's National Office, and Belconnen, Brisbane, Chermside, Sydney City, Hurstville, St Leonard's, Melbourne, Dandenong and Box Hill offices. In addition to document and file reviews, the audit team interviewed a range of staff responsible for the receipt, management and use of the AIIR data.

1.29 A feature of the audit was the assistance provided by ATO data analysis and profiling staff through their completion of a number of targeted data analysis studies. These studies focussed on the quality of AIIR data, the extent to which all AIIR data is used and the potential for the recovery of additional revenue from the data. It involved the examination by ATO's skilled analysts of large volumes of AIIR transactions using the ATO's computer systems to perform targeted data matching of AIIR data with several key data sets and the manual examination of hundreds of AIIR and tax records in some instances.²⁹

1.30 The audit was undertaken in accordance with ANAO auditing standards and cost \$360 000.

Acknowledgements

1.31 The ANAO recognises, and is grateful for, the contribution of ATO officers, particularly those officers in the Compliance Systems Directorate of the Personal Tax (PTax) business line, who assisted in the conduct of this audit.

²⁹ The quantitative data in this audit has been drawn from various sources indicated in the text. Unless otherwise shown, the data has been examined for reasonableness, but not audited.

2. Governance Arrangements

This chapter examines the ATO's approach to the management and use of the AIIR data on a whole of ATO and a whole-of-government, as distinct from a solely business line, basis.

Introduction

2.1 As noted in Chapter 1, the introduction of the AIIR was designed to improve the efficiency of the ATO income matching system. As a result, since 1992 the ATO has received a variety of investment income information for a broad range of individual and non-individual investors.

2.2 The ATO's strategic statement is to optimise collections and make payments under the law in a way that instils community confidence that the system is operating effectively. ATO's corporate planning is based on the ATO Plan (comprising four Sub-plans in 2002–03 and five Sub-Plans in 2003–04).³⁰ These Sub-Plans determine corporate priorities and allocate resources by setting out the highest-level risks to ATO business outcomes relevant to their areas of focus.

2.3 Historically, the business group within the ATO that has responsibility for the administration of the taxation of individuals, has had responsibility for the administration of the AIIR data. The historical focus has been on ensuring that individual taxpayers correctly report any investment income that they have received, and pay the correct amount of tax on that income.

2.4 The AIIR data contains valuable detail that can assist in the clarification of the more complex tax affairs of individuals with tax relevant links to non-individual entities, such as partnerships, trusts and private companies, including superannuation funds. The AIIR data also contains investment income information that is relevant to the assessment of the tax payable by non-individuals. The AIIR data also has a role in the identification of individuals, as well as non-individuals that may have lodgement responsibilities with which they have not complied.

³⁰ The ATO Plan 2002–03 comprises four Sub-Plans: Compliance; Operations; People and Place and Information Technology. The ATO has introduced a fifth Sub-Plan, The Change Program, to the ATO Plan in 2003–04. The Change Program Sub-Plan covers corporate activities that endeavour to make it easier for taxpayers to comply with their tax obligations by providing products and services that are easier, cheaper and more personalised.

Audit approach

2.5 The ANAO reviewed the governance arrangements impacting on the management and use of the AIIR data within the ATO. We also considered the potential use of AIIR data at the whole-of-government level. We reviewed how the ATO:

- has positioned the AIIR data as a whole of ATO resource;
- uses AIIR data as part of ATO strategic planning activities;
- manages AIIR risks as part of its general approach to risk management; and
- recognises the AIIR data as a whole-of-government resource and promotes the use of the data across government.

AIIR administrative arrangements

2.6 The management and use of AIIR data is administered by Compliance Systems, a business directorate within the Personal Tax (PTax) business line. Whilst the Compliance Systems Directorate is the custodian of the AIIR data within the ATO, it has other functions and responsibilities. These include the receipt and management of a range of external information received by the ATO. The Directorate is responsible for the ATO Matching System (ATOMS). This system identifies discrepancies between the information on a taxpayer's income tax return and third party information in the possession of the ATO, including the entity records derived from the AIIR data supplied by investment bodies. It also manages teams of computer programmers that develop and maintain the Directorate's IT systems.

2.7 The Compliance Systems Directorate is funded from the Compliance and IT sub plans. The total budget for Compliance Systems for 2002–03 was about \$14 million. It consists of \$11 million in the ATO's IT Plan and about \$3 million in the Compliance Plan of PTax.

AIIR as a whole of ATO resource

2.8 We found the only systematic use of AIIR data is by ATOMS staff within Compliance Systems as part of its automated income matching for individual taxpayers. At one stage, as discussed in paragraphs 5.7, 5.8 and 5.52 to 5.64, the ATO examined the scope for the systemic use of the AIIR data in other business lines, and considered that the proposal could not be justified.

2.9 ATOMS is responsible for following up over 230 000 discrepancies annually that account for the recovery of an estimated \$129 million revenue. It should be noted (as described later in paragraphs 5.2 to 5.5 and 5.13 to 5.41)

that ATOMS processes databases additional to AIIR. As a result, the total number of discrepancies actioned, and the total amount of additional revenue recovered, are not all attributable to AIIR.

2.10 The ANAO found that, for 2002, the ATO did not use about one-third of the useable AIIR data. Approximately 86 per cent of the AIIR records are those of individuals; the remaining 14 per cent are those of non-individuals.³¹ However, as the ATO uses only high quality matches and does not use any non-individual AIIR records, only 71 per cent of the total AIIR transactions for 2002 were actually made available for use in income matching activities. The ANAO notes, furthermore, that because of continuing data quality problems and restrictions that may arise from time to time on the ATO's income matching, a small (but unknown) percentage of these transactions will not be used.

2.11 Whilst ANAO accepts that the tax administration of large businesses, as carried out in the LB&I business line, precludes income matching because of the complexity of the tax affairs of those entities, income matching may well be appropriate for business lines such as Small Business (SB) and Superannuation. The merit of the SB business line income matching has been acknowledged by the ATO in response to earlier reports of the Auditor-General.³² The ANAO has identified the potential value of income matching using the AIIR data by these two business lines. Furthermore, ANAO has also identified the value of the AIIR data for the identification of entities that would be administered by the LB&I business line that have not lodged tax returns.

2.12 Whilst the PTax Executive receives information about the use and value of the data in that line, it does not receive advice about the extent to which PTax administration is achieving a satisfactory proportion of the compliance value of the data. As other business lines do not use the data systematically, their Executive does not receive any information about the compliance value of the data to their business line or the proportion of it achieved.

2.13 The ANAO considers the ATO can make wide use of AIIR data, both within PTax and across other business lines. In the past, the ATO itself has seen value in the wider use of AIIR data. In 1995 an ATO research paper concluded:³³

It is clear that there is a relationship between the extent of third party reporting coverage and the overall compliance levels. While this cannot be directly

³¹ The composition of the AIIR data is examined in Chapter 4.

³² *Income Matching System—Australian Taxation Office Audit Report No 1 1995-96* AGPS 1995. Recommendation No.7 p. xxi.

³³ *Compliance Research: Interest Income*. A paper presented at the ATO 1995 Compliance Research Conference. Internal ATO research paper 1995.

quantified, a major compliance improvement strategy should be to raise the compliance levels on the matched cases by ensuring that the third party reporting coverage is extended as far as practicable.

Recent ATO initiatives for the wider use of AIIR data

2.14 The ATO has recently established arrangements, including a Data Matching Steering Committee (DMSC) and an AIIR Steering Committee, to improve the co-ordination of activity that has a bearing on the work of Compliance Systems, and in particular the management and use of the AIIR data across the ATO.

2.15 The role of the DMSC is to ensure that business outcomes within Compliance and Operations are met through ATO Data Matching system deliverables by developing an overarching picture of ATO data matching activities and identifying areas where data matching (and the results of data matching processes) could be better used in business and compliance areas. The Assistant Commissioner (Compliance Business Systems Capability) chairs the Committee. The DMSC will aim to play a leading role in developing an integrated and holistic approach to data matching within the ATO. This includes promoting greater usage of AIIR data across ATO business lines.

2.16 The DMSC has moved to implement new arrangements for data matching coordination in the ATO that include:

- the introduction of a Corporate Management Practice Statement on external data matching which sets out endorsed procedures for obtaining data from an external source and the management and use of the data. The statement will also provide policy in relation to:
 - corporate control over data acquisitions, including those acquired through legislative provisions;
 - corporate systems for recording those data streams; and
 - corporate evaluation of those data streams.
- the appointment of a Data Matching Gatekeeper, who will be responsible for compiling a register of all external data entering the ATO and for ensuring that various ATO requirements associated with data matching activity requests have been met.

2.17 The AIIR Steering Committee brings together key senior officers who have functional responsibility for aspects of the AIIR. These include: officers from the Operations service line which has responsibility for the withholding events on the AIIR data, and AIIR lodgement enforcement functions; the LB&I business line which manages the relationship between the ATO and the large investment bodies that provide the majority of the AIIR data; PTax which has responsibility for ATOMS and tax legislative technical issues associated with

the AIIR; the Change Program which has responsibility for a range of data quality, analytic software and ATO administrative design issues; and Compliance Systems. The National Director Compliance Systems, who is the custodian of the AIIR data, convenes this Committee.

AIIR as a whole-of-government resource

2.18 At the time of the audit, apart from the ATO, two Commonwealth agencies were making direct use of the AIIR data. These were the Department of Family and Community Service's Child Support Agency (CSA) and the Department of Immigration and Multicultural and Indigenous Affairs (DIMIA).

2.19 About 1 800 officers of the CSA are authorised registered users of the ATO's Transaction Search Facility (TSF) and access AIIR data by this means. The TSF enables authorised officers to search and retrieve AIIR and other data about an individual or entity. It is not a systematic matching facility. CSA's use of the TSF goes back to the time when CSA was an administrative unit of the ATO. The facility is useful to the CSA in the administration of child support arrangements. The TSF is reviewed in Chapter 5.

2.20 DIMIA and the ATO have been examining the use of AIIR and other data to assist DIMIA locate persons who are unlawfully in Australia. This can also be of assistance to the ATO as some of these persons might also fail to fulfil their tax obligations. DIMIA can also assist the ATO identify other persons and entities who may be in breach of their tax obligations. The exchange of information between the two agencies, consistent with relevant laws, can be beneficial to both agencies.

2.21 The ANAO notes that the ATO is in the process of concluding a Memorandum Of Understanding (MoU) with the CSA about CSA's access to use of the AIIR data and associated data sets through the TSF. ANAO supports this initiative and notes that the MoU could include performance information about the value of the AIIR data to CSA that would assist the ATO better manage whole-of-government benefits and risks.

2.22 The ANAO notes that the ATO and DIMIA had commenced discussions about a MoU to regulate DIMIA's access to a modified form of the TSF. As the ATO and DIMIA have a range of interactions across various areas of both organisations that may be regulated by specific MoUs, there is a need to make sure that there is good co-ordination between the activities that may be covered by various MoUs. We understand that both agencies are giving consideration to this matter.

2.23 The ANAO suggests that, as part of the finalisation of any MoU with DIMIA, the ATO consider the adoption of a requirement for regular performance information feedback relating to the usefulness of the AIIR data

to DIMIA in helping to identify over-stayers. This is currently being considered by both agencies.

2.24 DIMIA has advised the ANAO that the proposed MoU between DIMIA and the ATO on the *Exchange of data for the purpose of locating persons who are unlawfully in Australia* will include measures of relevant outcomes, including the number of unlawful non-citizens located in Australia as a result of data exchange under the MoU.

2.25 The ANAO considers that there is potential for increased whole-of-government use of the AIIR in the future. This could arise from heightened concerns about the protection of Australia's security and a stronger interest in the verification of recipients continuing eligibility for financial payments from the Commonwealth. If this does occur, it is important that consistent MoUs are developed. It would seem appropriate to discuss such developments with the Privacy Commissioner at an early stage.

2.26 The ANAO also considers that the ATO could better promote the identity matching capability of Compliance Systems as a facility that other Commonwealth agencies might consider using. In this regard, the ANAO notes that there is international recognition of the ATO's expertise in this area (especially by some national revenue agencies of OECD member states) and that there has been an increasing whole-of-government interest in identity matching.

AIIR data and ATO's strategic approach

2.27 We found that only PTax, and the recently established Serious Non-Compliance business line, factor the use of the AIIR data into their strategic planning activities. The other business lines do not. As a result, the type of performance information about the management and use of the AIIR data that we expected to find is not compiled.

2.28 The ANAO considers that the ATO would be better able to achieve the full value of the AIIR data if it compiled key performance measures. A statistically sound estimate of the total amount of additional revenue that could be collected using the AIIR data is one key measure. However, there is a range of descriptive indicators about the AIIR data that are also needed. These include measures showing the:

- contribution of the AIIR data to the achievement of whole-of-government concerns;
- contribution of the AIIR data to the achievement of the ATO's goals and objectives;
- compliance risks identified by the AIIR data;

- quality of the AIIR data;
- reporting behaviour of the AIIR reporters; and
- standard measures of time, cost and quality of performance of relevant components of the Compliance Systems Directorate.

2.29 The ATO advised the ANAO that a recent data matching planning workshop, sponsored by the DMSC, has recommended that the ATO develop high level analysis to enable the DMSC to gauge the improvement of ATO matching. This will include an analysis of the number and value of reporters who report on time, and the number and value of transactions matched over time. The ANAO supports this initiative and suggests that this is extended to incorporate the types of performance information detailed above.

2.30 Compliance Systems evaluates a range of risks associated with the AIIR data. However, since the ATO as an organisation does not make widespread, systematic use of AIIR data, it is difficult for the Directorate to evaluate risks on an ATO wide basis. As the data is relevant to the ATO as a whole, the management of risks associated with the data should be compiled on a whole of ATO basis.

2.31 The AIIR data also has a whole-of-government use, but existing arrangements do not address whole-of-government risks. The ATO does not have data about the financial or other benefits that the AIIR data generates for agencies outside of the ATO. As a result, the ATO cannot take into account whole-of-government risks or benefits in the decisions it takes about the use and management of the AIIR data.

2.32 ANAO finds that the ATO's current use of the AIIR data conforms with relevant privacy and the security standards and guidelines. In addition, the ANAO notes the intention of the DMSC, through the Data Matching 'Gatekeeper', to centralise the responsibility for the appropriate application of privacy protocols to future data matching activities.

Recommendation No.1

2.33 The ANAO recommends that, to make more strategic use of the AIIR at both the whole of ATO and whole-of-government levels, the Data Matching Steering Committee compile suitable performance information which can be used to inform the ATO Executive about the management and use of the AIIR data, including:

- a statistically sound estimate of the total amount of additional revenue that could be collected, including any additional resource allocation required, using the AIIR data, and
- a broader range of descriptive indicators relating to AIIR data, including:
 - contribution of the AIIR data at the whole-of-government level;
 - contribution of the AIIR data at the whole of ATO level;
 - compliance risks identified by the AIIR data;
 - quality of the AIIR data;
 - reporting behaviour of the AIIR reporters (i.e. the investment bodies that submit AIIR reports); and,
 - standard measures of time, cost and quality of performance of relevant components within the Compliance Systems Directorate.

ATO Response

2.34 The ATO agrees with the recommendation. The charter of the ATO Data Matching Steering Committee includes development of suitable performance measures as suggested by ANAO. That work has commenced and will cover the measures and indicators suggested by ANAO.

3. Receipt of AIIR Data

This chapter examines how the ATO applies the AIIR legislative framework to AIIR reporting specifications; manages its relationship with investment bodies; the systems, processes and controls used to capture AIIR data; and the importance of data integrity assurance activities.

Introduction

3.1 The accurate receipt of complete and valid AIIRs from investment bodies is vital to the efficient and effective management and use of the AIIR data. The receipt of AIIR data is influenced by the extent to which the ATO:

- ensures that AIIR reporting specifications correctly reflect the requirements of the AIIR legislative framework;
- manages its relationship with investment bodies such that reporting responsibilities are well understood;
- accurately captures AIIR data for processing by Compliance Systems; and
- obtains appropriate assurance over the integrity of the AIIR data received.

AIIR reporting specifications

3.2 Since the introduction of the AIIR legislation³⁴ the ATO has developed and promulgated detailed reporting specifications to enable investment bodies to submit AIIR data in a format suitable for processing by ATO computer systems. The AIIR specifications have been refined and improved over the last decade. As legislation has been amended, so too has it been necessary to change the specifications.³⁵ There has also been a need to improve the specifications in order to improve the general understanding of AIIR reporting requirements. For example, in some cases, it has been necessary to clarify details such as data field definitions. Importantly, the reporting specifications highlight the need for investment bodies to provide the ATO with up to date, accurate and complete information.

³⁴ The AIIR legislative framework is discussed in Chapter 1.

³⁵ The major legislative changes since the introduction of the specifications have been outlined in Chapter 1. The most notable of these include the introduction of investment related betting chances in 1992, Farm Management Deposit Scheme (FMD) reporting requirements in 1998 and the lowering of the reportable interest threshold from \$120 to \$1 for the 2000–01 financial year.

3.3 There are three types of reporting specifications available for use by investment bodies. Each type caters for a different medium of reporting. These are:

- Magnetic Media Specification, Annual Investment Income Report, Version 7.0, May 2000;
- PC Systems Specification, Annual Investment Income Report, Version 2.0, July 2001; and
- AIIR Paper Reporting Specification, Version 2.0, July 2001.

3.4 More than 99 per cent of the AIIR data received by the ATO in a given year is submitted in a format to which the Magnetic Media Version 7.0 specifications apply.³⁶ The alternative specifications for Paper and PC Systems based reporting assist smaller investment bodies comply with their reporting requirements. This is consistent with the intent of the AIIR legislation not to impose a burden on those reporters unable to supply data in a computer form.

Investment body relationship management

3.5 Seven types of investment body are defined in the AIIR legislation. These include:

- financial institutions;
- government bodies;
- body corporates;
- solicitors;
- unit trusts;
- public companies; and
- betting investment bodies.

3.6 During the mid to late 1990s the ATO issued AIIR bulletins to known investment bodies to raise awareness about changes to reporting specifications, and to highlight common reporting problems. Further, during the 1990s the then Interest and Royalties Withholding section of the ATO conducted a series of consultative forums for interest and dividend payers. These enabled large financial institutions and some public companies to keep up to date about relevant changes.

³⁶ These specifications aim to provide sufficient information to enable investment bodies (or software developers acting on their behalf) to develop software for the supply of AIIR on magnetic media and are promoted by the ATO as a cost effective and expedient alternative to paper lodgement. Magnetic media recognised by the ATO include mainframe tapes, cartridges, DATs, disks, ZIP disks and CD ROMs.

3.7 The ANAO notes that in 2000 the ATO advised Parliament that its staff liaised with the major investment bodies on a regular basis, through the dividend and interest forums. The forums were seen to help with the identification of potential data problems, assist the ATO to respond to these problems, and provide feedback on new specifications and other matters.³⁷

AIIR data capture

3.8 AIIR data capture refers to the process of accurately replicating AIIR data submitted by investment bodies into a standard electronic format that can then be processed by Compliance Systems. This process does not include the procedure of ascertaining that investor information attached to AIIR data records is consistent with internal ATO databases. We have referred to this procedure as the creation of a valid entity record. It is discussed in detail in Chapter 4 of this report.

3.9 The receipt of all magnetic media from investment bodies (including test data sent in by software developers) is undertaken by Magnetic Information Processing Services (MIPS), a division of the Operations service line. MIPS conduct a series of checks on all magnetic media received prior to transmitting this data to Compliance Systems for processing. All non-magnetic media AIIR data is keyed into the system directly by Compliance Systems staff.

3.10 The accurate capture of AIIR data is controlled through the application of batch specifications that apply business rules, and edit and validation checks, to the AIIR data received by Compliance Systems.

Data integrity assurance

3.11 Edit and validation checks undertaken as part of the data capture process confirm that AIIR data received from investment bodies is in the format stipulated by the reporting specifications. These checks are an important insight into the quality of data received from investment bodies.

3.12 In addition to these checks, the ATO has taken steps to ensure that the databases of particular investment bodies are based on complete and valid investor information, consistent with that held by the ATO. The ANAO notes that in 2000 the ATO advised Parliament that improved reporting from larger financial institutions was in part due to the liaison role played by these data

³⁷ Refer to page 6 of the ATO submission, No.23, to *Numbers on the Run: Review of the ANAO Report No.37 1998–99 on the Management of Tax File Numbers*. House of Representatives Standing Committee on Economics, Finance and Public Administration Commonwealth of Australia 1999. which can be found at <<http://www.aph.gov.au/house/committee/efpa/tfnaudit/subs.htm>>

integrity staff, who would regularly visit a selection of the larger investment bodies.³⁸

Audit approach

3.13 Having regard to the legislative framework set out in Chapter 1, the ANAO reviewed ATO's operational arrangements for the receipt of AIIR data from investment bodies. Specifically, we looked at how the ATO:

- applies the AIIR legislative framework, in particular, to the reporting specifications issued to investment bodies;
- engages investment bodies to clarify reporting responsibilities; and
- obtains assurance over the integrity of AIIR data received.

Application of the AIIR legislative framework

Ensuring the completeness of reporters

3.14 The ANAO found that, when the AIIR was first introduced, the ATO attempted to indirectly identify potential investment bodies using existing ATO databases and general ATO client knowledge. However, this examination was limited to the larger financial institutions, unit trusts and public companies.

3.15 The ATO has also taken action to ensure that an investment body that has submitted an AIIR in a prior year lodges a return in a subsequent year.³⁹ The ANAO found that, in 1999, the ATO attempted, somewhat unsuccessfully, to identify solicitors who may have reporting obligations as detailed in item 4 of Table 1.1.⁴⁰

3.16 The ATO has undertaken no specific initiative to identify investment bodies that may have AIIR reporting responsibilities for the interest earned on the loan of money to a government or body corporate (as detailed in item 3 of Table 1.1). An example of this is incorporated real estate agents that may have AIIR reporting obligations as a result of interest earned on client monies held in trust.

3.17 The investment sector is dynamic and the legislation applies to a substantial range of entities that might not know of their AIIR obligations. Examples include solicitors and real estate agents, some of which are large

³⁸ *ibid.*

³⁹ *ibid.*

⁴⁰ There was a mass mail out undertaken across Australia using solicitor contact details purchased by the ATO from a direct marketing agency.

firms. The ANAO considers that the ATO needs to carry out a systematic search, to make sure that all investment bodies with statutory AIIR reporting obligations are aware of their compliance requirements.

3.18 In addition, periodic stocktakes of potential AIIR reporters (as defined in the legislation) appear to be necessary. In this regard, the ATO advised the ANAO that it intends to implement a pre-lodgement awareness exercise that aims to identify potential suppliers of AIIR data from a number of sources.⁴¹ Following this, the ATO intends to crosscheck this list against the AIIR 2003 lodgement file list. It is then intended that awareness letters will be issued to investment bodies identified that have failed to lodge an AIIR.

3.19 The ANAO considers that the ATO matching system (ATOMS)⁴² could potentially provide the functionality for the ATO to identify gaps in completeness for certain classes of investment income (interest and dividends). ATOMS produces summary screens that illustrate whether relevant entries on the Tax Return Data Base (TRDB) data, for a specific type of investment income, exceed those received through the AIIR data. To use these screens as suggested would require the ATO to identify groups of taxpayers where there are significant discrepancies. In some cases, contact with the taxpayers may be necessary to identify the source of the discrepant interest or dividend income.⁴³

3.20 There is also scope for the ATO to undertake data matching projects, using other data sets already acquired elsewhere in the ATO, to identify entities that may have AIIR reporting responsibilities. For example, the Superannuation business line currently maintains a list of complying super funds that may be used to measure the proportion of all complying funds that are currently being covered by the AIIR data set. It is possible that where there are gaps in this list, these arise because an investment body has failed to lodge an AIIR.

3.21 Other areas of the ATO, such as the new Serious Non Compliance business line compile databases that would be relevant to the identification of entities that may have AIIR reporting responsibilities. These databases could also form a part of any planned data matching projects.

⁴¹ These sources will include a number of regulatory websites, such as APRA and the ASX, other areas within the ATO that deal with potential investment bodies or suppliers of AIIR data, business periodicals such as the *Financial Review* and *Business Review Weekly* and historical AIIR lodgement listings for the 2001 and 2002 financial years.

⁴² The ATOMS system is discussed in Chapter 5.

⁴³ This is because the respective labels on the income tax return that feed into the TRDB will not have this information.

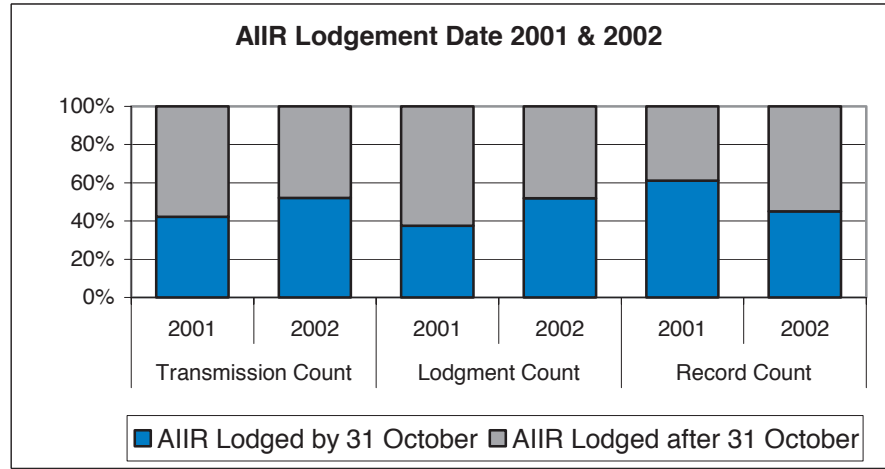
Lodgement enforcement of the AIIR

3.22 The reporting specifications require investment bodies to lodge their AIIR within four months following the end of the financial year to which it relates (i.e. by 31 October).⁴⁴ We note, however, that extensions beyond this date are allowed, and in the past have been frequently granted, provided that they are arranged with the ATO in the manner that the regulations allow.⁴⁵

3.23 As Figure 3.1 below illustrates, a large number of investment bodies lodge their AIIR after the 31 October deadline. For example, in the 2001 and 2002 reporting years approximately half of the AIIR records were received after the 31 October deadline. ATO advised that this was allowed in part due to the absence of any operational requirement to have this data in on time.

Figure 3.1

Breakdown of AIIR lodgements received by 31 October⁴⁶



Source: ATO

⁴⁴ There is provision within the *Taxation Administration Act 1953* for penalties to be applied for late lodgement, however, the ATO has advised that in practice these have never been applied.

⁴⁵ Requests must be in writing, explaining the reasons why the report cannot be lodged and must be received by the ATO before the due date of the report. Confirmation of extensions granted will be sent in writing, with the expected lodgement date set at that time. Generally, further extensions will not be granted after the set date.

⁴⁶ The three levels of detail reflected in this figure are transmission count, lodgement count and record count. Transmission count refers to the number of transmissions of AIIR data captured by Compliance Systems. Lodgement count refers to the number of lodgements received from an investment body. Record count is the number of transactions for each investor reported by the investment body.

3.24 The ANAO was advised by the ATO that this trend would continue for AIIR 2003, with about 25 per cent of expected AIIR records remaining outstanding as at 20 February 2004. The ANAO considers that AIIR lodgement by the due date has a bearing on the efficiency and effectiveness of all subsequent, current and potential ATO use of the AIIR data. This is particularly relevant now as the new ATOMS system provides for continuous updating of records. We note, however, that the identification of investment bodies that have AIIR reporting obligations they have not met, requires agreement within the ATO about which business line is responsible and accountable for lodgement enforcement.

3.25 We found that the lodgement enforcement function once rested unambiguously with the predecessor of Compliance Systems Directorate in PTax. The ANAO noted that the Operations team in Compliance Systems is funded out of the ATO's Compliance Plan and that team's budget did not include resources for AIIR lodgement enforcement as the Operations service line had been assigned the lodgement enforcement function for the whole ATO. However, that service line had also not been funded for AIIR lodgement enforcement.

3.26 We also found that co-ordination arrangements between Compliance Systems and Operations need to be improved, so that AIIR lodgement enforcement activities are performed efficiently and effectively. This was illustrated with the introduction of the registration requirements for the Australian Business Register (ABR).

3.27 With the introduction of A New Tax System (ANTS) the ABR was established. Amongst other things, non-individuals that intend to function in the Australian economy are required to register with the ABR. This step is necessary to obtain an ABN, a TFN, to register in relation to the GST, or for the payment of PAYG as well as for a range of other tax purposes.⁴⁷ Question 41 of the application to register for companies and other organisations states:⁴⁸

Will the applicant:

- Pay royalties, dividends or interest to non residents, OR
- Withhold or report investment income paid to Australian residents?

3.28 The data generated by the answers to this question could assist the ATO ensure the completeness and accuracy of AIIR investment body reporting. However, we found that this question has elicited no useful data for

⁴⁷ Including Fringe Benefits Tax (FBT), luxury car tax, wine equalisation tax, diesel fuel rebate, diesel and alternative fuels grants, and other elements of the tax system.

⁴⁸ Refer to Question 41 of *Instructions to register for companies and other organisations*, NAT 2941-3.2003.

this purpose, because the ambiguity of the question prevents it from revealing any reliable information relating to entities that have registered on the ABR, and may have an AIIR reporting responsibility.⁴⁹ The ANAO understands that there was no consultation with Compliance Systems in the drafting of this question, or discussion about the need for the question, or use to which the information might be put.

3.29 The ANAO considers that the recent initiatives adopted by the ATO to improve internal communication about AIIR relevant matters will overcome the consultation shortcomings noted. We were also informed during the audit, that the ATO has recently decided that the Operations line will have responsibility for AIIR lodgement enforcement. For this new arrangement to function effectively, it will be necessary for the ATO to assess the AIIR lodgement enforcement function and resource it accordingly. The ANAO considers that this assessment is now timely, and a strategy should be developed to make sure that all known investment bodies comply fully with their AIIR reporting responsibilities.

3.30 The ATO advised that the recently established AIIR Steering Committee is responsible for improving communication with investment bodies. ATO has recently instigated a 'Top 100' exercise, focussing on the 100 investment bodies that lodged AIIR 2002 data with the largest number of transaction records. The ATO will be contacting entities that have not yet lodged an AIIR for 2003 to seek lodgement of their AIIR.

Recommendation No.2

3.31 The ANAO recommends that, in order to assess adequately the AIIR non-lodger risk, and to determine the completeness of the AIIR data set, the AIIR Steering Committee take responsibility for the implementation of a systematic approach to lodgement enforcement so that all known investment bodies are aware of, and fulfil, their legislatively defined reporting responsibilities.

ATO Response

3.32 The ATO agrees with the recommendation. The AIIR Steering Committee, which is a sub-committee of the ATO Data Matching Steering Committee, has instigated a follow up program to identify and secure information from investment bodies required to lodge AIIR data. Concurrently, we are reminding all known investment bodies of their legislative reporting responsibilities.

⁴⁹ This was compounded when the trigger relating to a 'yes' response to this question was found to be not functioning correctly. This trigger was subsequently fixed and, following some sampling of the entities that had indicated yes to this question, it was found that the majority of these had made an error.

Identifying possible gaps in the legislative framework

3.33 The AIIR was introduced to assist the ATO with its income matching activities. ANAO considers that there is a range of transactions outside the current AIIR reporting requirements that could assist the ATO's income matching activities. Examples of such transactions include those relating to:

- debentures;
- capital gains;
- real estate moneys held in trust;
- real estate sourced income; and
- resident royalty income.

3.34 Further, since the introduction of AIIR in the early 1990s, there may be a number of new income generating investment products to which the AIIR reporting arrangements might be considered applicable.

3.35 The ANAO found aspects of the current AIIR legislative framework may warrant review in order to assess their potential usefulness to ATO income matching activities. The 1991–92 Budget Papers detail the Government's Decision to impose income tax on prizes received from prescribed lottery arrangements.⁵⁰ To implement this Decision, s202D of ITAA 1936 was amended to require the receipt of information from betting investment bodies, on investment related betting chances, as a separate AIIR record.⁵¹ The ANAO found that current AIIR reporting specifications do not contain requirements relevant to this amended legislation. This data is not captured by the ATO.

3.36 The ANAO was informed by the ATO that it is currently reviewing the situation, to see how it can sensibly move forward to educate and support investment bodies to specifically capture this information, without committing

⁵⁰ *Budget Statements 1991–92*, section 4.11.

⁵¹ See item (7) of S 202D of ITAA 1936, which has been reproduced in Table 1.1. The addition of investment related betting chances to this table creates a requirement for the ATO to capture information on the winnings from investment related betting chances, where relevant, as part of the AIIR.

Section 26AJ of ITAA 1936 provides that winnings from certain investment-related lotteries drawn or decided on or after 24 December 1991 are assessable income. The three essential elements that determine whether an arrangement is an investment related lottery include:

- the prize is won in a lottery or similar arrangement;
- the chance to win the prize (the 'betting chance') arises because the taxpayer holds an investment with an investment body (eg a bank); and
- the betting chance must not otherwise be taxable.

The prize may take the form of cash or property and services (in which cases there is a requirement for the betting investment body to determine the arms length value of the prize).

investment bodies or the ATO to spending large amounts of money for what are potentially small sums. ATO consider that betting chances are not a high revenue risk. ATO also noted that investment bodies would be able to provide information on the winnings from investment related betting chances by reporting this as an 'other' interest payment in the existing AIIR reporting specifications.

3.37 There is also scope for the ATO to explore the introduction of more efficient methods for capturing the AIIR data that have regard to technology now in use. The current methods are legislatively specified.⁵² The larger investment bodies that submit most of the AIIR data have a wide range of online facilities for their customers and business partners. Furthermore, the ANAO notes that ATO is increasingly looking to expand the way it deals online with business and other key stakeholders. We consider that it is timely for the ATO to explore the feasibility of implementing secure real time access, at least for AIIR received from larger investment bodies. This may require legislative change.⁵³

3.38 The ANAO was advised during the audit that the Change Program has identified real time processing as a significant issue, and that the AIIR Steering Committee will liaise with the Change Program to explore the feasibility of adapting this to the AIIR.

3.39 In view of these considerations and the twelve years that have elapsed since the AIIR reporting requirements were established, ANAO considers that it is now timely for the ATO to bring to the attention of the Treasury the scope for a review of the legislation supporting the current AIIR reporting requirements.

⁵² Section 202G of ITAA 36 indicates that, if an investment body keeps the relevant AIIR data electronically, then they must lodge the AIIR electronically, in accordance with the specifications given by the Commissioner in a gazette notice. The specifications given in the gazette notice represent the approved form for the AIIR, as required by Reg 56 (1) of ITR 36.

⁵³ The ANAO notes that in relation to the assessment and collection of Member Contribution Statements (MCS) for the purpose of administering the superannuation surcharge legislation, in addition to MIPS and the Corporate External Gateway, the ATO permits superannuation providers to utilise Electronic Commerce Interface and ATO-certified software through the Electronic Lodgement Service (Refer to part 3, reporting procedures, page 10 of the MCS instructions, which can be found at <http://www.ato.gov.au/content/downloads/mcs_0204_v3.pdf>). We consider that, given the similarities between the receipt of third-party AIIR data and member contribution statement data for the administration of the superannuation surcharge, the ATO should consider available data receipt options used by the Superannuation business line in relation to improving the efficiency of AIIR data receipt.

Recommendation No.3

3.40 The ANAO recommends that the ATO bring to the attention of the Treasury the scope for a review of the legislation supporting the current AIIR reporting requirements, that aims to identify the costs and benefits associated with:

- determining the existence of investment income types that are outside current AIIR reporting requirements but that would assist the ATO with income matching activities;
- examining the usefulness of all transactions covered by the current AIIR reporting requirements, in particular, the need for the AIIR legislation to continue to require information on assessable income derived from investment related betting chances; and
- implementing changes to the approved form of the AIIR, including a consideration of moving to online access, in order to improve the efficiency of the transmission and receipt of AIIR data from investment bodies.

ATO Response

3.41 The ATO agrees with the recommendation. The ATO Data Matching Steering Committee has a role to ensure we are administering AIIR legislation in the best practical way. That includes assessment of AIIR outcomes, risks and process improvement opportunities. In terms of process improvement, the Committee will consider the suggested on-line access facility.

3.42 In terms of any aspects of the AIIR legislation that are not working as intended (and that we cannot resolve through changes to Tax Office administrative practice), the Committee will, as needed, bring those matters to the attention of Treasury. Note that any decision to extend the scope of data matching to new areas is a matter for Government and its priorities and would need to consider compliance costs.

3.43 We note ANAO's comment on the scope for a review of the AIIR legislation and will pass those comments onto Treasury.

Engaging investment bodies to clarify responsibilities

3.44 The ANAO found that since the introduction of *A New Tax System* (ANTS) in 2000, the ATO has ceased AIIR consultative arrangements that it had in place with investment bodies, including the investment body AIIR bulletins and the interest and dividend payers' consultative forums.

3.45 We found that in recent years the main contact between the ATO and investment bodies has been ad hoc. It is limited to addressing more serious

data errors of large investment bodies identified by ATO staff during the management and use of the AIIR data. The ATO advised that the recently established AIIR Steering Committee will be responsible for managing a range of co-ordination issues, and has undertaken to re-establish AIIR communication channels with the larger investment bodies, via the LB&I industry liaison program. We support this initiative. However, we note that initiatives are still needed to address the communication needs of other investment bodies.

3.46 The ANAO considers that the ATO also needs to communicate effectively with investment bodies that fall outside the domain of the LB&I industry liaison program. ANAO understands that the SB business line administers the tax affairs of most of these entities. We consider that it is now appropriate for the ATO to agree on an effective strategy to communicate with all investment bodies, data suppliers, software developers, and other stakeholders, regarding AIIR matters. Part of this will be strong co-ordination between the several elements of the ATO that are involved in the AIIR process, namely PTax, Operations, LB&I and SB.

Recommendation No.4

3.47 The ANAO recommends that the ATO implement a co-ordinated communication strategy designed to identify, and improve the awareness of, investment bodies that may have AIIR reporting obligations, but are not currently AIIR reporters.

ATO Response

3.48 The ATO agrees with the recommendation. The ATO, through the AIIR committee, is undertaking a general campaign of education which includes identifying all potential lodgers of AIIR information. The ATO will provide information to these investment bodies, reminding them of their legislative responsibility.

Ensuring the integrity of AIIR data

Application of batch specifications

3.49 The ANAO found that the ATO applies its business rules, edit and validation checks in the batch specifications consistently, to data received by Compliance Systems.

3.50 The checking of the data undertaken by the application of batch specifications cannot detect all errors. Checking will detect errors of form, but not necessarily errors of content. Batch specification checks will produce a range of lodgement level error and statistical counts and percentages.

Compliance Systems staff have in the past used the results of these checks to guide the work of teams responsible for ensuring the integrity of data received.

Data integrity assurance activities

3.51 A key source of assurance on the integrity of the AIIR data received from investment bodies comes from the ability of the ATO to apply simple tests of reasonableness for key edit and validation rules. These tests also address matters of content rather than form.

3.52 As the conduct of such tests requires judgement and familiarity with the complexity of the data, these tests cannot readily be totally reduced to computer-based procedures that operate without human intervention. The ATO has employed data integrity staff to analyse the outputs from edit and validation checks. ANAO noted that this practice ceased in recent years. In previous years when the ATO carried out these checks, the data integrity staff also proactively followed up findings about shortcomings in data quality with investment bodies. ANAO understands that in some instances ATO staff would work with major investment bodies to rectify systematic problems resulting in the correction of large amounts of data.

3.53 The ANAO considers that systematic data quality problems from large investment bodies are an increasing problem for the ATO. We found, for example, that for AIIR 2001 some larger investment bodies sent in AIIR data for all of their savings accounts, including those that had earned under \$1 in interest.⁵⁴ This created a significant skew in the number of AIIR records received for the 2001 year.⁵⁵ Had the ATO continued with the earlier data integrity arrangements, the problem would have been detected early and rectified quickly.

3.54 The consequence of not analysing the outputs of edit and validation checks can also be seen from the following example, relating to the requirement not to populate structured name fields⁵⁶ associated with non-individual records.⁵⁷ At the ANAO's request, the ATO conducted a detailed study into the frequency of this practice within the AIIR 2002 data set.

3.55 From AIIR 2002 there were 358 932 transactions (note that this represents less than 1 per cent of all AIIR 2002 records) that failed to comply

⁵⁴ This is contrary to the requirements of the AIIR legislation.

⁵⁵ Refer to Figure 4.2 of this report to see what impact this had on the overall AIIR historical matching rate.

⁵⁶ Structured name fields are present in the reporting specifications to be used in conjunction with identifiers (i.e. TFNs) attached to individuals. Where there is a non-individual identifier attached to a set of records we would expect see the unstructured name field populated and the structured name fields for first given name, second given name and surname left blank.

⁵⁷ Refer to *AIIR Magnetic Media, Version 7.0, reporting specifications*, definition and edit rules, 7.85, 7.86 and 7.87.

with the requirement to not populate structured name fields associated with non-individual records. We found that 20 specific investment bodies reported 59 per cent of the transactions contributing to this reporting problem. About 20 per cent of these transactions could not be matched successfully (i.e. obtain a high quality match) and had about \$76 million in interest attached to them.

3.56 The prevalence of these transactions is the result of investment bodies failing to submit AIIR data in accordance with the reporting specifications. The ANAO consider that in the absence of data integrity teams that act on the output of edit and validation checks and assist investment bodies rectify matters, this reporting problem will continue.

3.57 The ANAO found that another avenue of data integrity assurance, the liaison role with some of the larger financial institutions, undertaken by data integrity staff, was also discontinued in 2000.⁵⁸ The ATO advised that the visits frequently failed to uncover data integrity problems that only came to light at a later date.

3.58 The ANAO noted that recent technological advances may provide the ATO with better ways in which to conduct wide scale sampling and data verification activities. This has the potential to improve the cost effectiveness of data integrity staff.

3.59 The ATO advised that it had recently undertaken steps to enable Compliance Systems to re-introduce data integrity staff. The first priority of these staff will be to address any urgent problems, and then to prepare a business case for the re establishment of the function. Following this, the ATO intends to re-introduce an investment body visit program, that will target investment bodies or suppliers of AIIR data that are found to have consistent reporting problems (for example the frequency of data errors is high and repetitive). Examples of data problems would be shown, data deficiencies highlighted and the impact of data errors explained. Feedback from the investment body would also be sought.

⁵⁸ As noted at Para 3.12, this was at the same time that the ATO had advised the inquiry that improved reporting performance from some of the larger financial institutions was in part a result of these visits. (See *Numbers on the Run Review of the ANAO Report No.37 1998–99 on the Management of Tax File Numbers*. House of Representatives Standing Committee on Economics, Finance and Public Administration Commonwealth of Australia 1999).

4. Management of AIIR Data

This chapter examines the identity matching routines used by the ATO to establish valid AIIR entity records, including the treatment of any unmatched records, the completeness and reliability of ATO client identification master files and the ATO approach to data quality standards.

Introduction

4.1 Management of AIIR data refers to the ATO's conversion of the data received from investment bodies into a format suitable for income matching⁵⁹ and other administrative activities. Other than the quality of AIIR data received,⁶⁰ the ATO's success in efficiently converting the raw data from investment bodies relies on the effectiveness of ATO identity matching routines, including the accuracy and reliability of ATO data against which the AIIR data is matched. Successful conversion is also influenced by the importance placed by the ATO on data quality standards and the effort taken to understand and resolve the reasons for data that cannot be converted or cannot be matched against the ATO's taxpayer databases.

The construction of valid AIIR entity records

4.2 The transactions in the AIIR data received by the ATO are not aggregated to uniquely identified investors. As a result, the ATO has to create entity records by bringing together all of the AIIR transactions that belong to the one entity into the one entity record. In this Report we refer to the result of this process of aggregation as the construction of a valid AIIR 'entity record'.

4.3 The ATO confirms the identity of the investor by comparing the identifiers⁶¹ reported in the AIIR with existing taxpayer data held by the ATO on the client identification master files.⁶² The construction of entity records is fully automated through the use of intelligent software known as 'matching engines'. At the completion of the identity matching process, only valid entity records for individual taxpayers are transferred to the ATO matching system

⁵⁹ Income matching involves the ATO comparing data received from third parties, in the case of AIIR, investment bodies, against the details disclosed in a taxpayer's income tax return and stored by the ATO in its Tax Return Data Base (TRDB).

⁶⁰ The quality of AIIR data received and how this affects the effective management and use of the AIIR data is discussed in Chapter 3.

⁶¹ For structured (individual) names the identifiers used in the matching process include TFN or ABN; Surname; First given name; Other names; Address; Postcode; and Date of Birth. For unstructured (non-individual) names the identifiers used in the matching process include TFN or ABN; Name; Address and Post Code.

⁶² The master files are compiled predominately from ATO Integrated System (AIS) data held by the ATO.

(ATOMS). Here they are used, in conjunction with other ATO income data, in the active compliance activities of the Personal Tax (PTax) business line.

ATO matching engines

4.4 A central facility in the identity matching engines used by Compliance Systems is the special purpose phonetic scoring software that the ATO has developed over the last decade. Amongst other things, it assigns a score out of 100 for two names being matched. This score defines the grade of the identity match giving considerably more flexibility than software that gives a simple 'yes' or 'no' match. The use of a methodology based on the phonetic structure of names provides a high level of sophistication to the matching process. The ATO is, therefore, able to differentiate the quality of the match and the likelihood of the two names being the same. The engines provide the ATO with a corporate level data matching service and can be used to cater for a broad range of matching related activities.

4.5 Batch Matching Engine Version 5.0 is the flagship for most Compliance System's identity matching. Amongst other features it has:

- traditional hard-matching techniques⁶³ that do not involve phonetic software;
- sophisticated phonetic matching algorithms that allow for error and variation in real world data;⁶⁴ and,
- 55 levels of confidence allowing users to determine which grades of match to use in their business systems.

4.6 About 400 000 000 transactions are processed through the Batch Matching Engine Version 5.0 annually including all of the AIIR data, as well as Centrelink statements, PAYG, Family Tax Benefit, HIC transactions, Baby Bonus, Higher Education Contribution Scheme/Student Financial Supplement Scheme (HECS/SFSS) transactions and a large range of ad hoc projects. The Batch Matching Engine can process up to 30 000 000 transactions per night.

4.7 The matching routines are applied to both individual and non-individual records. The engine produces high match rates with or without identifiers, with match rates typically exceeding 90 per cent on individual data streams and 80 per cent on non-individual data streams. The remaining data is

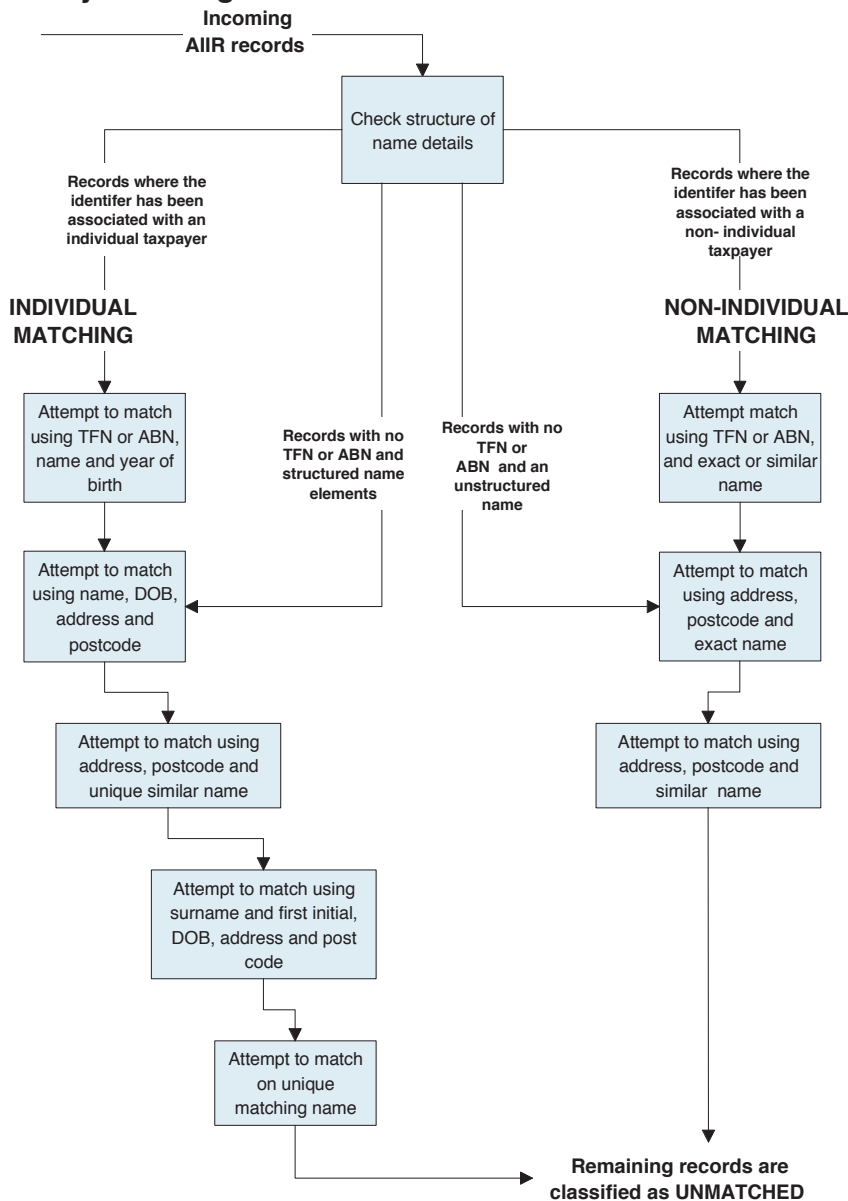
⁶³ Names are compared on a character for character basis with some allowance for variation with second given name/initial in structured names. Some non-individual 'hard matching' will also include standardisation of entity type acronyms such as Pty Ltd. Matching that fails at this level is generally retried through phonetic modules.

⁶⁴ This is achieved through the use of a fully customised edit list (name dictionary) capable of identifying typing and spelling errors, ethnic name anglicisation issues, orthographic and phonetic misinterpretation, truncation and abbreviation, missing words and extra words and word sequence variation.

classified as unmatched. The following figure provides an overview of the identity matching process:

Figure 4.1

Identity matching overview



Source: ATO

4.8 The identity matching routines applied to AIIR data received from investment bodies invariably create a pool of unmatched data. Unmatched data is defined by the ATO as all of the transactions to which no identifier has been attributed.

4.9 Compliance Systems matching engine staff generally classify unmatched data into one of the following five categories:

- exemption code reported;⁶⁵
- no identifier reported;⁶⁶
- invalid identifier reported;⁶⁷
- valid identifier reported;⁶⁸ and
- ABN/TFN reporting problem.⁶⁹

4.10 These categories can be further separated into groups that provide a useful basis from which the ATO can isolate potential areas requiring specific examination.

4.11 The first group includes the exemption code and no identifier reported categories. Many of the records covered by these categories are likely to relate to investors who will either have no obligation to lodge a tax return with the ATO or have already had income tax withheld at a rate 48.5 per cent of the

⁶⁵ Exemption codes may be quoted where the investor is under 16 years of age, a pensioner, in relation to certain Centrelink benefits, entity is not required to lodge an income tax return, is in the business of providing consumer or business finance, a Norfolk Island resident or a non-resident of Australia for taxation purposes.

⁶⁶ A transaction will be included in this category when nothing is reported on the 'Investor Tax File Number field' and 'Investor Australian Business Number field' of the AIIR. Where this occurs the investment body must withhold an amount equal to 48.5% of the investment income earned by the investor and forward this to the ATO.

⁶⁷ A transaction will be included in this category when the identifier reported is invalid. That is, it fails one of the ATO algorithms applied to either the TFN or the ABN, or the role status associated with the identifier has been culled or cancelled. As two identifiers can be reported on the same transaction, the number reported on 'Investor Tax File Number field' is checked first to identify if it is invalid. Then, the number reported on 'Investor Australian Business Number field' is checked to determine if it is invalid.

⁶⁸ A transaction will be included in this category when a valid and active TFN or ABN is reported. As two identifiers can be reported on the same transaction, 'Investor Tax File Number field' is checked first to identify a valid number. If no valid identifier is found, then the 'Investor Australian Business Number field' is checked. 'Investor Australian Business Number field' is a field where an investor provides their ABN for investments related to the investors business. However, Compliance Systems processing rules accept TFN's reported in this field.

⁶⁹ A transaction will be included in this category when two different identities are found for the transaction and the system cannot distinguish the correct identity. One of the identities is found from the 'Investor Tax File Number field' while the other is found from the 'Investor Australian Business Number field' in the investor data record supplied to the ATO.

investment income reported, owing to failure to quote their TFN in connection with the investment.⁷⁰

4.12 The second group includes the invalid identifier reported, valid identifier reported and ABN/TFN reporting problem categories. These categories arise as a result of data quality deficiencies inherent in the reported data.

ATO data quality

4.13 In a previous audit, the ANAO found that the ATO promulgated a Corporate Data Management Plan (CDMP) that was supported by a fully developed philosophy about data quality.⁷¹ The Commissioner issued the guidelines in 1991. They were directed at the achievement of sustainable data quality and set out data management principles, procedures and rules.⁷² The CDMP was designed to translate the philosophy into operational practice. It concluded that an organisation faced with data integrity problems might periodically clean up data sets or it might identify the sources of poor quality data and ensure that poor quality data no longer enters its databases. The CDMP was a corporate initiative designed to clean up data corporately at source. Although the ATO's business and service lines were expected to implement the CDMP, this did not happen.⁷³

4.14 Previous ANAO reports⁷⁴ of ATO administration have contained findings about shortcomings in the quality of ATO's data and systems and recommendations to overcome them. Our review of these reports, and the ATO's own work on data and systems quality, show that there is a network of

⁷⁰ Notwithstanding this, the ANAO considers that many of these records will also prove useful to the ATO for compliance purposes. For example, the ATO may want to verify that an entity has properly quoted an exemption code.

⁷¹ *Management of Tax File Numbers*, The Auditor-General Report No.37, 1998–99, pps 79–80.

⁷² *ibid.*

⁷³ *ibid.*

⁷⁴ *Checking of Dividends and Interest Disclosed in Income Tax Returns by the ATO*, AGPS 1984.

ATO Partnership and Trust Distributions Report of the Auditor General, March 1986.

ATO Unpresented Group Certificates, AGPS August 1986.

ATO Prescribed Payments System, AGPS September 1986.

ATO Taxpayers in Unincorporated Businesses, AGPS 1987.

ATO Prescribed Payments System, Audit Report No.28 1991–92.

Income Matching System—Australian Taxation Office, Audit Report No.1 1995–96 AGPS; and

Management of Tax File Numbers—The Australian Taxation Office, Audit Report No.37 1998–99.

The Management of Tax Debt Collection—The Australian Taxation Office, Audit Report No.23 1999–2000.

key concepts relevant to defining data and systems quality. These concepts and our consideration of ATO data quality are discussed at paragraph 4.49.

Audit approach

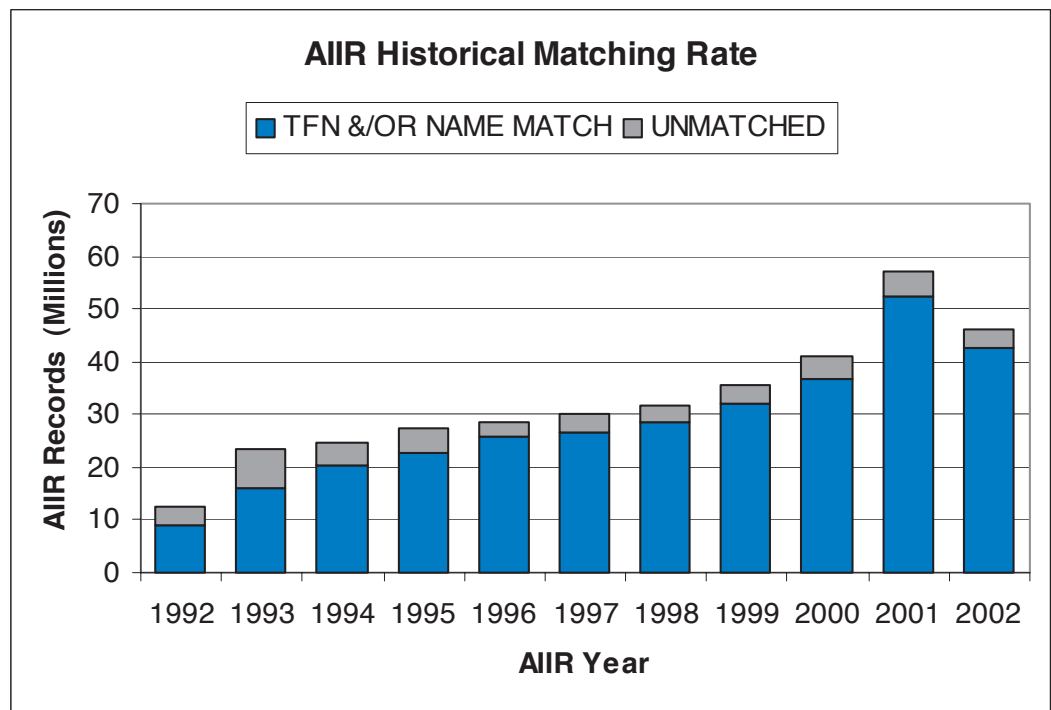
4.15 The ANAO reviewed the ATO's arrangements for the management of the AIIR data. We considered whether:

- ATO performs effective identity matching of AIIR data;
- unmatched AIIR data is scrutinised and resolved in order to improve the management process;
- ATO source data used to confirm AIIR entity records is complete, valid and reliable;
- ATO have established data quality standards for use across the organisation.

Identity matching of AIIR data

4.16 The ATO has continued to develop the automated identity matching routines that are applied to AIIR records since their introduction in 1991. The identity matching engine is now a highly sophisticated and effective tool that confirms the identity of a significant proportion of the entity records to be made available for use by the ATO. During this time ATO has reduced the levels of unmatched data from almost 29 per cent to fewer than 8 per cent of all AIIR records received. These trends are shown in Figure 4.2 below:

Figure 4.2
AIIR historical matching rate



Source: ANAO interpretation of ATO data

4.17 Not all of the matched records are used for income matching purposes as only high-grade matches are used for that purpose. The ANAO notes that of the 92+ per cent of AIIR 2002 transactions that received an identity match, only 82 per cent of these were of a quality sufficient to be used for income matching activities. In addition, non-individual transactions account for 11 per cent of the high quality matches.⁷⁵ As the ATO does not make systematic use of these transactions, only 71 per cent of the total AIIR transactions for 2002 were actually made available for use in individual income matching activities. This is illustrated in the following table which breaks down the match quality received for AIIR 2002 records:

⁷⁵ It is to be noted that in general there is a much higher dollar value of investment income associated with a non-individual than with an individual record. Refer to Chapter 5 for more discussion about the potential use of non-individual AIIR records.

Table 4.1**AIIR 2002 Match Quality Breakdown**

Match Quality	Individual Records	% of Individual Records	% of Total Records	Non-Individual Records	% of Non-Individual Records	% of Total Records	Total Records	% of Total Records
HIGH	33,288,935	82	71	5,366,948	82	11	38,655,883	82
MEDIUM	2,971,421	7	6	238,603	4	1	3,210,024	7
LOW	1,528,924	4	3	6,784	0	0	1,535,708	3
UNRELIABLE	2,713,664	7	6	905,098	14	2	3,618,762	8
	40,502,944			6,517,433			47,020,377	

Source: ANAO interpretation of ATO data

4.18 The ANAO considers that the improvements now required in the ATO's management of the AIIR data are more likely to come from improvements in the quality of the data, rather than refinements in the power of the identity matching engines. The ATO's refinement of these engines is approaching the point where only small improvements to the efficiency of identity matching might now be achievable, using current methodologies. The ANAO consider that the challenge for the ATO is to focus on improving the quality of the data it receives from investment bodies⁷⁶ and to make systematic use of non-individual data.⁷⁷

4.19 With regard to the systematic use of non-individual transactions, ANAO notes that the SB business line is currently implementing a Tax Performance Review strategy for their small and medium enterprise clients, and that the processes to be developed will cover income from interest and dividends. In this context, SB will be exploring opportunities to use outputs from the income matching system as an input to the review. ANAO notes, however, that any such opportunity will be contingent on the development of an systematic approach to the use of non-individual records (refer to Chapter 5 of this report).

4.20 The ANAO also notes that the Superannuation business line is considering the use of AIIR data, to assist in ensuring that all income is declared in the tax returns of funds (including Self Managed Superannuation Funds), and that this is expected to form part of the compliance program for 2004–05.

⁷⁶ Refer to our discussion of data integrity assurance activities in Chapter 3.

⁷⁷ This is discussed in Chapter 5.

Unmatched AIIR data

4.21 ANAO found that some matched transactions, such as low-quality matches, are not included in the AIIR entity records upon which administrative action might take place. As a result they are excluded from tax administration. Accordingly, we have included low-quality matches in our analysis of unmatched records.

4.22 Unmatched and low-quality matched records have a compliance value and may have potential collectable revenue associated with them. With the assistance of the ATO, the ANAO initiated several studies designed to estimate this value and to understand additional features of this data.

4.23 In relation to the 2002 unmatched data (which account for some 3.6 million transactions, or approximately 8 per cent of all 2002 AIIR transactions) this analysis indicates the following:

- Fifty-three per cent of the transactions relate to records that have an exemption code reported.
- Thirty-three per cent have no identifier reported.
- That transactions with a valid identifier reported that remain unmatched account for around 11 per cent of the unmatched data.
- There is over \$10 billion in reported interest, \$4.7 billion in reported franked dividends and \$2.3 billion in reported unfranked dividends represented by these transactions.
- Some transactions with a valid identifier reported could not be matched. This may be symptomatic of data quality problems with either the identifier reported or the data held by the ATO. There is over \$2.6 billion in reported interest and \$1.8 billion in reported unfranked dividends attached to these transactions.
- The exemption code reported category includes over \$3.3 billion in reported interest associated with companies, the majority of these being non-residents, investors in the business of providing consumer or business finance, or entities that are not required to lodge a tax return.
- Some investment bodies continue to report investor data with an invalid identifier attached to the investor data record. For instance, investment bodies reported a total of 17 982 (less than 1 per cent of all unmatched transactions) transactions that had attached invalid 8 digit TFNs. These transactions account for almost \$131 million in reported interest.

- There are 63 462 transactions (less than 2 per cent of all unmatched transactions) that have been matched to two different identifiers. This represents \$834 million in reported interest.
- Specific reporting problems are sometimes associated with a specific investment body. For example, we found that one investment body had reported 443 valid identifiers. However, the name reported had zeroes inserted in the name field. This prevented the matching routine finding the correct identity for these records. Almost \$6 billion of reported interest income was associated with these records.
- Over 15 per cent of all unmatched transactions had an interest reported amount greater than \$100 associated with them.

4.24 Compliance Systems also performed a detailed analysis of the high value unmatched transactions associated with AIIR 2002. This indicated that many of the high value unmatched transactions arose from errors in the relevant identifier fields. ANAO considers that the presence of these unmatched transactions is indicative of deficiencies in the quality of data integrity assurance activities applied to the receipt of the AIIR data. It is unlikely that these transactions reflect taxation compliance problems of the entities concerned.⁷⁸

4.25 Compliance Systems also conducted a detailed analysis of a selection of the 2002 low-quality matched AIIR data. In relation the 2002 low-quality matched data (which account for some 1.1 million transactions, or approximately 3 per cent of all AIIR 2002 transactions), this analysis indicates that:

- 115 investment bodies had reported 86 per cent of the records;
- no identifier reported account for about 57 per cent of the low quality matched records;
- exemption codes represent about 36 per cent of these records;
- transactions with a valid identifier reported account for around 7 per cent of these records;
- there is over \$226 million in reported interest and \$215 million in reported franked dividends attached to these records;
- almost all of the transactions (approximately 99 per cent) belonged to individual taxpayers and accounted for over \$152 million in reported interest and about \$200 million in reported dividends. However, there was almost \$74 million in reported interest and about \$28 million in

⁷⁸ Refer to our discussion of data integrity assurance activities in Para 3.51.

reported dividends associated with the residual 1 per cent of these records that belonged to non-individuals; and

- there are instances where the reported valid identifier is different to the found identifier. In these cases there may be scope to determine which identity is correct by contacting the investment body.

4.26 The ANAO notes that many records that fall into the exemption code reported or no identifier reported categories will validly remain unmatched. The ATO may, however, improve the potential for this data to be used for compliance purposes, by focusing on the accuracy of the supporting identity information attached to these records.

4.27 The ANAO considers that the remaining categories of unmatched data are indicative of data quality problems that arise where the identifier attached to the AIIR record, appears to have no clear link to the entity that has reported this income to the ATO via their income tax return. Many of these transactions, especially the high value ones, could be matched if the ATO contacted the relevant investment body or supplier of the AIIR. We consider that it is important that work similar to that conducted for this audit continue. Such work could provide the basis for the overall approach of the ATO to data integrity assurance for AIIR data, and the work of the ATO's recently established data integrity teams.⁷⁹

Failure to lodge

4.28 Early in 2003, the ATO adopted a more systematic and regular approach to identifying and bringing to account those individuals and other entities that are operating outside the tax system.⁸⁰ Over the years, the ATO has had a range of specialised projects that have addressed, in various ways, the identification and bringing to account those with tax obligations who have never lodged tax returns, or who may not have lodged for several years. However, the new, more systematic initiative is directed at all taxpayer types (i.e. individuals, partnerships, trusts, companies, superannuation funds and government agencies) and using a wide range of sources of information, especially those already held by the ATO.

4.29 In response to ANAO's concerns, and the analysis of the unmatched and the low-quality matched AIIR data undertaken as part of the audit, the ATO has established a project to thoroughly examine relevant subsets of the

⁷⁹ Refer to paragraph 3.59 for a discussion of the role of the data integrity teams.

⁸⁰ To ensure the coordination of Those Outside The System (TOTS) lodgement focussed activities across all business lines, in July 2003, the ATO established a non-lodger project team, supported by a cross-line steering group. As part of the TOTS team brief the ATO has introduced a number of specific non-lodger projects targeting a range of occupations and business types.

unmatched and low-quality matched AIIR data. This project is being carried out within the framework of the ATO's approach to identifying and bringing to account those with lodgement obligations who might have never lodged, or at least, not lodged for several years. It will also include an analysis of data received annually from PAYG Payment Summaries, AUSTRAC Records, Barter Exchanges and data received from local government and industry. The strategic intent of the project is to improve current data matching capability for the purpose of non-lodgement and cash economy detection.

4.30 The ATO advised that it will also be examining matched unissued records, to gauge the extent of possible lodgement obligations and the potential revenue that could be associated with these records.⁸¹ Where required, lodgement enforcement staff in the Operations service line will assist in securing any necessary lodgements.

4.31 The ANAO's analysis identified a number of AIIR transactions, in which the investment entity was a superannuation fund that had failed to lodge returns in 2001 or 2002, or could not be matched to a superannuation fund on the ATO's database of taxpayers. The data identified over 6 000 Self Managed Superannuation Funds (SMSF) that failed to lodge income tax returns for 2001, and about 20 000 that had not lodged a tax return for 2002. The AIIR data revealed that these SMSFs had been in receipt of investment income. A significant proportion of these appear to be in receipt of investment income in excess of \$10 000. The SMSFs identified in the AIIR data include those with a valid TFN or ABN that could not be matched to an existing ATO record, those with an invalid TFN or ABN, and those without a valid TFN or ABN. The data also identified a number of larger funds that had taxable income but had not lodged a tax return.

4.32 The ATO has advised that the Superannuation business line will examine the cases identified by the AIIR data and take the necessary administrative action to achieve compliance from the entities concerned.

4.33 LB&I business line could use the AIIR data to identify entities for which it has administrative responsibility that have failed to lodge. Almost all of the entities within its area of responsibility will be in receipt of investment income, and will, therefore, be present on the AIIR data.

⁸¹ ANAO understands that matched unissued cases relate to the high quality matched discrepant cases identified by ATOMS that, as a result of data quality concerns relating to the Potential Revenue Gain identified through the case selection process, have not resulted in a letter being issued to a taxpayer.

Recommendation No.5

4.34 The ANAO recommends that the ATO conduct ongoing analysis of unmatched and low-quality matched AIIR data and that this analysis provide the basis for the ATO's overall approach to data integrity assurance for AIIR data.

ATO Response

4.35 ATO agrees with the recommendation. The ATO has commenced analysis of the unmatched records identified from 2002 AIIR records. Analysis will also be undertaken to see if our automated matching processes can be enhanced to increase the matching rate or improve any data integrity issues giving rise to low quality matches. Work will also occur to sample a range of low quality matched records to identify the clients associated with those records and determine if any revenue risks exist.

4.36 The ATO has separately initiated a project to designed to contribute to the identification of taxpayers currently outside the tax system. That project will also provide the opportunity to identify and test different matching approaches, independent of the AIIR process, to see where improvements might be made.

ATO source data is complete, valid and reliable

4.37 ATO Integrated System (AIS) data forms the basis of the client identification master files⁸² that Compliance Systems use to construct AIIR entity records. Consequently, the reliability and accuracy of AIS data is a key contributor to the effectiveness of the identity matching routines applied to AIIR data.

4.38 We found a number of data quality concerns about the AIS data. These include duplicate registrations; incomplete or out of date name, address and date of birth (DoB) details; the absence of current residential and business addresses in AIS tables; and fragmenting of data holdings across the Australian Business Register (ABR) and AIS.

4.39 We also noted that often the full name or DoB for an entity record is in TRDB but not in AIS. Further, we found that AIS is only updated with tax return information where the taxpayer has ticked the relevant box in their tax

⁸² Name, address and date of birth (DOB) details from AIS and TRDB (for up to date address information), are periodically extracted to create the master files. If a valid TFN is reported, the details stored for that TFN are used in the matching process. But if no TFN is reported, or the reported TFN is not correct, the matching engine uses the reported name to search for 'candidate' records in the master files, then uses name, address and DOB (where relevant) to match the reported taxpayer details with the details of each candidate retrieved.

return, to advise that there has been a change of name, or that there is a difference in surname. Also, AIS does not incorporate any of the additional information received through regular tax returns lodged with the ATO, (or from other sources) into a name or address history.

4.40 The ANAO also found that the auto registration procedures introduced for permanent migrants has already produced 313 confirmed duplicates. The presence of duplicate TFNs impedes the efficiency of AIIR identity matching. We found that one of the main reasons for this, was that those responsible for the development of these procedures chose to develop their own identity matching solution, despite the fact that the matching engines in use within Compliance Systems already contain adequate functionality to assist with this process.

4.41 The risks associated with allowing data quality standards to fall, and from an absence of quality assurance procedures, can be illustrated by the 755 021 PAYG 2002 payment summary records, captured through imaging techniques, resulting in unusable data being able to enter ATO systems. This reduced the effectiveness of identify matching.

4.42 Given these data quality concerns with AIS, even with a TFN or ABN to extract the correct records from the master files, if the information in AIS is unreliable, it will impact adversely on the ATO's data matching work, including its work relating to AIIR data. We consider reliable and accurate client identification master files to be fundamental for the ATO to be able to get the most out of its use of AIIR entity records. Continuing shortcomings impedes the ATO's capacity to make the best use of the AIIR data.

4.43 The ANAO notes that the House of Representatives Committee for Economics, Finance and Public Administration, as part of the *Numbers on the Run Inquiry* recommended that:

The ATO or an appropriately qualified consultant review the databases and information sources the ATO currently has access to in order to determine the value of systemic data matching against this information.⁸³

4.44 While there continues to be shortcomings in the completeness, validity and reliability of the ATO source data, the ATO is taking action to remedy many of the shortcomings, especially in relation to the tax records of individuals. The ATO has responded to the need to improve the integrity of individual information stored in AIS through the establishment of a Tax File Number Integrity and Improvement (TFNII) project team. The primary focus of the TFNII team has been on identifying and resolving redundant TFN

⁸³ Refer to page xvi, Recommendation 6 from *Numbers on the Run: Review of the ANAO Report No.37 1998–99 on the Management of Tax File Numbers*. House of Representatives Standing Committee on Economics, Finance and Public Administration Commonwealth of Australia 1999.

records. However, it also has a secondary focus on updating the client register, including AIS. Some key outcomes reported by this team for the 2002–03 financial year include the following:

• Deceased Records updated	771,022
• Resolution of duplicate TFN records	55,494
• TFN records identified as left the country and expired visa	579,290
• Inactive TFN records identified	1,100,000
• Updated date of birth	101,000
• Updated Proof of Identity status	455,050
• Total records identified or updated records	3,061,856

4.45 The ANAO notes that, in accordance with a specific Output Pricing Agreement outcome, the TFNII project has focussed on the identity records of individuals. In relation to non-individual records, the ATO has also established a team responsible for improving the integrity of the ABN, through predominately focusing on improving the accuracy of the ABR. ANAO considers that part of any planned approach to improving the quality of the ABR, should also be extended more generally to include a focus on improving the accuracy and reliability of non-individual data held by the ATO on AIS.

4.46 The ANAO considers that despite the current under use of non-individual AIIR data by the ATO, there is greater need for accuracy and reliability with these records, due to the fact that they do not contain identifiers (in particular DoB information) comparable to those of individual records. Improving the quality of non-individual records will also allow the ATO to fully address the *Numbers on the Run* recommendation reproduced above.

4.47 In this regard, we found that the ATO has recently started work, using some 37 000 internally identified potential duplicate non-individual cases, as part of a broader objective of establishing a non-individual duplicate detection facility.

4.48 The ATO also advised that arising from the recent Data Matching Planning Workshop, it intends to engage consultants, as part of the Information Management Change Program, to undertake a data quality audit that will obtain baseline metrics for data to determine the current state of captured data. The quality of name and address information held on AIS would form part of the audit. The final report will include a business case setting out costs and returns associated with resolving the data issues identified.

ATO data quality standards

4.49 The accuracy and reliability of AIS data (and therefore client identification master files) and AIIR data received from investment bodies will be most influenced by the importance placed by the ATO on data quality. There is a range of key concepts that are used in the evaluation of data quality. These concepts refer to such issues as the accuracy of data, the usefulness of the data to the organisation, the use of appropriate technology, and quality assurance standards. We applied these data quality concepts to the AIIR environment and found as follows.

- **Accuracy**—AIIR information distributed for use within the ATO has sometimes been incomplete and unreliable.
- **Usefulness**—The potential usefulness of the AIIR data has not been fully realised.
- **Technology**—There are duplicate systems for identity matching and TFN allocation that detract from the usefulness of Compliance System's work in relation to AIIR data to the ATO.
- **Quality assurance standards**—The ATO does not have mandatory corporate quality assurance standards. The need for strong data quality assurance standards is particularly important in relation to the external data that is captured and entered into ATO systems.

4.50 In order to address existing issues relating to accuracy, usefulness, technology and quality assurance standards, we consider that the ATO urgently requires mandatory guidelines, for use throughout the ATO, that are directed at achieving sustainable high quality data. This was the goal of guidelines issued by the Commissioner in 1991. We consider the full implementation of such guidelines is a prerequisite to the successful operation of the ATO Change Program that, amongst other things, aims to provide taxpayers with real time access to ATO data and systems.

Recommendation No.6

4.51 The ANAO recommends that, to improve data quality and the effectiveness of AIIR data matching against client identification masterfiles, the ATO implement mandatory data quality standards for use throughout the ATO.

ATO Response

4.52 The ATO agrees with the recommendation. The ATO has engaged consultants as part of its Change Management Program to conduct a data quality assessment. That assessment will obtain baseline metrics for a subset of client data to determine the current state of captured data. It will also provide a broad set of recommendations and principles to address the data issues identified. The recommendations will include a methodology for ongoing data analysis and quality assurance. The ATO Chief Knowledge Officer position will have responsibility for implementing this framework.

5. Use of AIIR Data

This chapter reports upon the use made by the ATO of the AIIR data, emphasising the steps that could be taken to achieve an increased proportion of the compliance value of the data and illustrating current and potential areas worthy of pursuing systematic use of the data.

Introduction

5.1 For the ATO to make best use of the compliance value⁸⁴ inherent in the AIIR data, it is necessary to adopt a systematic approach. This includes the use of the data in income matching activities, as well as other administrative activities, such as lodgement enforcement and compliance investigations.

ATO and income matching systems

Individual taxpayers

5.2 The ATO has had an income matching capability for individual taxpayers for almost 25 years. This capability identifies discrepancies between the information on a taxpayer's income tax return and third party information in the possession of the ATO, including the entity records derived from the AIIR data supplied by investment bodies. It is a computer-based system that has been in operation since the late 1970s.

5.3 The ATO's income matching system was substantially improved and strengthened following the introduction of the Tax File Number (TFN) system in 1988.⁸⁵ There has been a range of such systems in use in the ATO over the last 20 years, and they have been the subject of audit comment since 1984. In addition, a recent report of the House of Representative's Standing Committee on Economics, Finance and Public Administration has also made findings and recommendations of relevance.⁸⁶ Several of the themes that have been common to audit comment over this period are discussed in this chapter.

5.4 The ATO Matching System (ATOMS) is an improved information matching system that became operational during 2003. As with its predecessors, it only matches the records of individuals. The ATO does not

⁸⁴ 'Compliance value' has both quantitative and qualitative dimensions. Quantitatively, it is the estimated amount of additional revenue that may be collected from the recovery of tax due in relation to investment income discrepancies disclosed by the AIIR data. An aggregate measure is the compliance rate, which is defined at Paragraph 5.15. Qualitatively, it includes improvements to compliance that may be attributed to the AIIR data. The ATO uses Potential Revenue Gain (defined in footnote 88) to estimate additional revenue collectable from discrepant income, which is itself defined in footnote 87.

⁸⁵ Refer to our discussion of the legislative framework in Chapter 1.

⁸⁶ The relevant reports are listed in Chapter 1.

have the capacity to match non-individual records on a systematic basis. ATOMS consists of a computer based data extraction and matching system, and teams of case actioning officers who may perform administrative action where it reveals a discrepant income.⁸⁷ Amongst other things, the matching process is triggered by a change of relevant data, either on the AIIR data or the tax return database. This means that the matching is continuing throughout the year.

5.5 ATOMS sorts the high quality reported transactions by 'income type' (eg. interest, or dividends, or employment) within each TFN. The total amount of income and credit, if applicable, is computed, for each income type. ATOMS compares the total figure with the data in the relevant label(s) extracted from the tax return for that TFN. It performs a further calculation known as Potential Revenue Gain (PRG).⁸⁸ It calculates the amount of tax shortfall, net of credits, for each TFN. It also calculates the total omitted income (or over-claimed credit or tax offset) for each TFN. ATOMS can estimate the PRG of each individual taxpayer's income tax discrepancy detected by the matching routine. ATOMS cannot estimate the PRG for non-individuals.

5.6 In 2003 ATOMS enabled the ATO to recover a total of \$129 million in additional revenue. Not all of this is attributable to the AIIR data. Some results from the matching of employment or Centrelink or other classes of assessable income. ANAO estimates that about one third of the additional revenue of \$129 million recovered could be attributed to AIIR transactions, and two thirds could be attributed to the other data sets.

Non-Individual taxpayers

5.7 In 1994 the predecessor of PTax, the Individuals Non-Business Division (INB), established a pilot system to match partnership, trusts and company AIIR data against the tax records of individuals. This was known as the Non-Individual Matching System (NIMS). It was designed to examine compliance of those individuals who receive additional taxable income from partnerships, trusts or companies, or who may have income tax relevant relationships with them. In 1995, the Auditor-General recommended that the ATO enhance the income matching system to improve the matching of

⁸⁷ The discrepant income is the result produced by comparing the Employment, Welfare, Investment and other amounts reported about the taxpayer by a relevant reporting body against the tax return amounts disclosed by a taxpayer.

⁸⁸ The Potential Revenue Gain (PRG) is the net amount of revenue that could be recovered if the ATO were to take administrative action in relation to the transaction. The PRG is the calculated net tax payable after the omitted income is added, less the amount already paid. The PRG is calculated as the difference between tax that would be paid on the income resulting from adding the discrepant income to the individual's taxable income as determined from the individual's tax return and the tax that was actually paid prior to the identification of the discrepancy.

partnership and trust distributions received by individual taxpayers.⁸⁹ The ATO agreed with this, stating that the capacity would be functional from 1995. NIMS was designed, in part, to support this.

5.8 In 1998–99 the SB business line established a pilot project that examined the scope for using NIMS to improve the efficiency and effectiveness of the administration of its functions. SB looked at interest, dividend and unit trust distributions, received by companies and partnerships. The SB research followed up 1 844 potentially discrepant non-individual cases having a notional discrepant income of \$214 million. It indicated that there was no significant revenue leakage associated with matched discrepant information generated from NIMS. ANAO understands that the NIMS software has no further use in the ATO, because of legislative and systems changes made since it was designed.

Transaction Search Facility

5.9 The Transaction Searching Facility (TSF) is a powerful search and retrieval engine available to authorised ATO and Child Support Agency of the Department of Family and Community Services staff.⁹⁰ The same restricted access controls that apply to the use of the ATO's mainframe systems apply to the use of the TSF. It allows users to initiate an immediate search against a pool of more than 260 million transactions (records) from various external sources. The ATO's Compliance Systems Directorate has processed these transactions in order to generate comprehensive client profiles.

5.10 The TSF enables all AIIR data, together with a range of other data sets, to be scrutinised for the last three recorded financial years.⁹¹ The TSF searches and retrieves all data from these data sets that is relevant to the inquiry about an individual or entity. Searches may be initiated using a TFN or ABN or both together, a name and date of birth combination, a name and postcode or partial postcode combination, or just an address. However, it should be stressed that the TSF does not compare anything against tax return data. The TSF cannot be

⁸⁹ *ATO Income Matching System*, ANAO Audit Report No.1 1995–96, 28 July 1995, Recommendation No.7 p. xxi.

⁹⁰ The TSF was introduced in October 1996 for use by CSA staff only and contained only AIIR data. It followed their request for AIIR data for the financial year 1995 to be loaded to the data warehouse and, based on its great value to them, a request for ongoing access to AIIR data for later years and a more convenient way of getting access to it. The current version, which includes more than one dozen data sets additional to the AIIR, was introduced in February 2003. To become a user, a staff member must be registered as such by Compliance Systems who authorise the staff member's access and enable the staff member to access the TSF.

⁹¹ The other data sets are: The PAYG payment summary records, including Eligible Termination Statements; ABN/TFN withholding records; Group Certificate records; all Centrelink payments; partnership and trust distributions; Australian Electoral Commission records; Health Insurance Commission records; TFN/Employment Declarations. Access to prior year records requires an overnight search.

used to check the investment income reported by non-individual entities in their tax returns, nor can it be used to check the investment income reported by individuals in their tax returns, that is derived from companies, partnerships or trusts. Nevertheless, the retrieved data could be used as an input to any other separately developed process, if it was required. However, TSF has no current capability to check investment income reported in tax returns.

5.11 About 5 000 staff are currently active users of the TSF registered within the Compliance Systems Directorate. Of these, about 3 200 are ATO staff. It has become an essential tool for staff within a variety of ATO business functions, across several business lines. The viewing and retrieval of data is restricted to the particular user.

Audit approach

5.12 The ANAO reviewed the use of the AIIR data by the ATO's business and service lines. Our focus was on the extent to which the ATO makes the best use of the data. This would be indicated by the ATO obtaining an optimal compliance value from the data. We evaluated this by estimating the gap between two independent measures of the aggregate investment income earned by taxpayers. One measure is the aggregate investment income reported by taxpayers on their tax returns. The other is the aggregate reported by investment bodies in the AIIR data. We reviewed the extent to which the ATO regularly use the data for active compliance activities.

The compliance value of AIIR data

5.13 The extent to which the ATO is able to make best use of the compliance value inherent in the AIIR data will be informed by the ATO's appreciation of, and capacity to measure, the compliance value of the data in terms of total PRG for all AIIR entity records.⁹²

5.14 The importance of the ATO being able to do this was emphasised in an ATO compliance research report of in 1995 which noted:

At a strategic level the identification of the level of compliance (and the associated revenue at risk) would assist in decisions as to whether or not the allocation of the ATO's resources in this area of activity were adequate in the light of other identified areas of risk.⁹³

⁹² There are also other considerations to take into account. These include the detection and prevention of compliance problems, especially those of the more serious kind.

⁹³ *Compliance Research: Interest Income*. A paper presented at the ATO 1995 Compliance Research Conference. Internal ATO research paper 1995.

Compliance Rate

5.15 There are several key steps to follow in order to obtain a satisfactory financial estimate of the compliance value of the AIIR data. First of all, it is necessary to estimate the compliance rate in the data. The compliance rate is the percentage of the total investment income that should have been disclosed on tax returns that was actually disclosed on those returns.

5.16 As a proportion of taxpayers will be exempt from tax on investment income, it will be necessary to subtract this proportion from the initial estimate of the compliance rate. Furthermore, a proportion of taxpayers may be incorrectly identified as not having disclosed investment income. There is a further proportion of taxpayers with a valid discrepant income, that may not be the subject of particular administrative action by the ATO for a range of valid reasons. It will be necessary to subtract these proportions, as well. The result of these calculations will be an estimate of the potential income of taxpayers that may be discrepant. The final step is to estimate the Potential Revenue Gain (PRG) that would result from this discrepant income. The result, when aggregated for all high-grade matched AIIR data, is the compliance value of that data.

5.17 ANAO analysed the AIIR data to estimate the compliance value. We found that to date the ATO has not been able to estimate this value.

Some investment income still not reported

5.18 ANAO, with the assistance of ATO staff, estimated the gap between aggregate investment income of individuals reported by investment bodies and that reported by taxpayers to the ATO (the reporting gap) for the period 1995–2002.

5.19 The analysis reveals the following about the reporting gap.

- There has been a consistent level of under-reporting of interest income in the tax returns of individuals, as compared to the interest details collected by the ATO through the AIIR. However, the incidence of under-reporting appears to have increased markedly in 1999. For the three-year period 1999 to 2001, the data suggests that there was almost \$1 billion dollars more interest reported in the AIIR by the investment bodies, as earned by individuals, than was reported by those individuals on their tax returns. This apparent trend is supported by a corresponding decline in the proportion of all tax returns lodged that contain interest income.
- For gross dividends received, the number of individuals on AIIR is greater than the number of individuals with tax returns for each comparison year. However, the value of gross dividends reported on AIIR is less than the value declared on individual tax returns for each year between 1995 and 2001. This has constantly increased every year to almost \$4.9 billion in 2001.

5.20 Whilst the data suggests trends of concern, there are a number of possible factors, in addition to those relating to the compliance rate discussed at 5.16, that might contribute to these discrepancies including, amongst others:

- the requirement to report interest on AIIR for every account greater than \$1 in the 2000–01 financial year;
- reporting problems with values and identities attached to AIIR transactions;
- individuals that are not required to lodge a tax return but for whom an income amount has been reported on AIIR eg exempt taxpayers, including non residents and pensioners; and
- information received by the ATO on paper has not been entered into the system.

5.21 Further, ANAO considers that a major contributing factor to the robustness of any analysis between AIIR and the TRDB is the quality of the AIIR data received. However, notwithstanding this, and the possible partial explanations mentioned above, ANAO finds that a reporting gap remains, particularly for interest income reported to the ATO since 1999.

Previous research

5.22 In 1984, the Auditor-General estimated the amount of interest omitted from tax returns (the reporting gap) for 1981–82 to be \$3 583 million and equated to a PRG of around \$500 million.⁹⁴ These estimates were calculated by comparing Australian Bureau of Statistics (ABS) National Accounts household income figures about dividends and interest, with aggregate amounts disclosed by individuals to the ATO.

5.23 In 1986, ATO research estimated the compliance rate for that year to be 83 per cent. The amount of interest omitted from tax returns was estimated to be in the order of \$2 100 million (the reporting gap) and equated to a PRG of about \$500 million.⁹⁵ The compliance rate was estimated by ATO staff, verifying whether an individual had disclosed on their tax return the interest reported in the data supplied by investment bodies. The verification was carried out by the inspection of a random sample of income tax returns.

5.24 In 1995, ATO research estimated that the compliance rate for 1992 was 89 per cent. The amount of interest omitted from tax returns was estimated to be in the order of \$1 190 million (the reporting gap) and equated to a PRG of

⁹⁴ *Checking of Dividends and Interest Disclosed in Income Tax Returns by the ATO* AGPS 1984, pp.29 to 37, and p.47.

⁹⁵ *Compliance Research: Interest Income. A paper presented at the ATO 1995 Compliance Research Conference.* Internal ATO research paper 1995.

around \$570 million.⁹⁶ The compliance rate was estimated by a procedure very similar to that used in the 1986 research.

5.25 The ANAO notes that the four studies reviewed above used different methodologies and that the analysis was limited to individuals. As the studies summarised above show, the reporting gap for individual taxpayers has steadily narrowed during the last 20 years. ANAO notes that this outcome is the consequence of the ATO's compliance strategies and investments in IT hardware and software. Nevertheless, there are indications of an increasing incidence of under reporting by individual taxpayers of their investment income since 1999.

Under-reporting of interest income a continuing problem

5.26 Arising from the analysis conducted for the ANAO during the audit, the ATO carried out a more extensive analysis of the AIIR data for 2002. This showed that there were around 2.7 million high quality matched individual taxpayers, who may have under reported interest income in their tax returns. The value of this reporting gap was \$763 million, with approximately \$200 million in PRG associated with these cases.

5.27 As explained above, it is necessary to make several adjustments to this aggregate before being able to attempt to calculate the compliance rate, and from this, the compliance value of the AIIR data. The ATO carried out this analysis and advised that:

- approximately 2 million of these cases, worth an aggregate discrepant income of \$34 million, were not economical for the ATO to pursue. This is because to do so would be administratively inefficient, as the cost of following up these cases exceeds the PRG associated with the omitted income; and
- the remaining 682 191 cases appeared, prima facie, to be worthy of further analysis.

5.28 The ATO carried out additional analysis on these potentially economic to pursue cases. This analysis revealed that the IMS case actioning team plan to action some 137 775 of these cases, with a discrepant value of some \$165 million, as part of its primary case selection activities.⁹⁷ Based on the ATO analysis, we estimate that there would be approximately \$58 million in PRG associated with these cases.

⁹⁶ op cit.

⁹⁷ The ANAO notes that this represents a 30 per cent overall increase in the proportion of interest income discrepancies actioned in comparison to previous years.

5.29 The remaining 544 416 cases, with a discrepant value of \$564 million, belong to categories that see them excluded from primary case selection.⁹⁸ The categorisation of available matched discrepant cases into potentially productive pools has been done by IMS Cases Selectors for a number of years, based on their experience and case selection scoping trials. This is an attempt by the ATO to maximise the compliance rate of the cases selected for actioning. There are many dozens of exclusion categories used in the case selection process. For example, some of the main ones include cases where:

- there is the high potential of the amounts being included at other labels in the tax return;
- the potential revenue associated with the omitted income would be administratively inefficient for the ATO to pursue;
- the taxable income of the taxpayer is below the tax-free threshold;
- other discrepancies exist in the taxpayers tax return but one or more is a credit (which generally means that tax has been deducted at source); and
- multiple exclusion categories exist.

5.30 The ATO advised that, in practice, the isolation of cases into exclusion categories is a technique of case selection and when resources permit Case Selectors may examine these case pools more closely to seek out any remaining cases that have the potential to be productive.

5.31 The ANAO considers that there may be significant amounts of PRG associated with the exclusion categories. Only through regularly revisiting and assessing the exclusion category assumptions will the ATO be able to gain an accurate appreciation of the compliance value of this subset of the AIIR data.

5.32 The ATO accepts that, within each of the listed exclusion categories, there will be cases that will be productive and worth pursuing by the IMS case actioning team. There are plans to undertake fresh scoping audits on each category aimed at updating the risk assessment perspective on each category. This will be used to update existing case selection practices and case attribute considerations.

⁹⁸ The ATO advised that this 'categorisation' of cases has been done for a number of years, based on the IMS case selectors experience, and case selection scoping trials.

5.33 The ANAO supports this initiative, and encourages the ATO to continually seek to test the rationale behind its categorisation of cases in order to optimise the actual cases selected.⁹⁹

5.34 The ANAO notes that the studies conducted for this audit do not take into account investment income received by partnerships, trusts or private companies that is subsequently distributed to individuals. There may be additional revenue potentially collectable as a result of under-reporting by individuals of investment income from these sources. However, it has not been possible to estimate this amount. In addition, it was not possible to estimate the extent to which there is a gap in the reporting of investment income by non-individuals, nor estimate any additional revenue potentially collectable, as a result of any such gap.

5.35 As noted in Paragraph 5.19, there appears to be concerns in the reporting of dividend income by individual taxpayers. Detailed analysis of the data is necessary to evaluate the extent to which these apparent trends reflect the behaviour of taxpayers or data quality issues. The ATO has undertaken to carry out this analysis.

5.36 The ANAO notes that the current level of funding of the case actioning of discrepancies identified by ATOMS is not based on an analysis of the compliance value of the AIIR data, or any other substantive risk analysis that the ANAO could sight. Rather, it reflects an historical approach and appears to have regard to other priorities.

5.37 As the quality of the AIIR data improves, as a result of initiatives now underway and planned, the efficiency of ATO's detection and processing of discrepant cases should improve, enabling the ATO to recover a greater proportion of the compliance value of the AIIR data at a lower overall cost. ANAO acknowledges that ATOMS is an improvement on the previous IMS system. There is, nevertheless, scope for additional enhancements for greater efficiency and effectiveness.

Enhancing the functionality of ATOMS

5.38 ANAO has also brought to the ATO's attention, the merits of ATOMS processing all categories of AIIR transactions (i.e. all investment types for both individuals and non-individuals), as well as the need for the ATO to fully document the current facility and its rationale. An enhanced ATOMS could process two main additional categories of AIIR transactions.

⁹⁹ This is reinforced by the fact that the ATO continues to experience a significant proportion of no further action rates from their primary pool of interest income cases selected. For AIIR 2002, the ATO has experienced no further action rates of approximately 29 per cent.

5.39 The first of these relates to unit trust distributions. At the time of the audit, ATOMS was not able to process AIIR data about unit trust distributions in the detection and calculation of discrepant income.

5.40 The second relates to the investment income of partnerships, trusts and private companies that is distributed to individuals. The AIIR data contains potentially complete information about the investment income of partnerships, trusts and private companies. This could be used to assist the verification of any income received by individuals from these distributions. But to do this effectively, requires a system that can link the distributions reported on the tax returns of the relevant non-individual entities, to the distributions reported by the individual taxpayer.

5.41 PTax still does not have a system that can verify that distributions of income from partnerships, trusts and private companies to individual taxpayers are correctly reported in the individuals' tax return. As a result, the ATO is not able to use the AIIR data relating to the investment income of partnerships, trusts and private companies when it could be used to detect discrepancies in the income received by individuals from these sources.

Cost/Benefit Ratios

5.42 ANAO notes that the ATO does not have a valid estimate of the cost/benefit value of the AIIR data. The Data Matching Information Matching System (IMS) Program Protocol, provided to the Federal Privacy Commissioner, summarises the costs and benefits of the ATO's IMS.¹⁰⁰ As the IMS uses the AIIR data, the ratios reported in the Protocol may be taken to indicate the value of the AIIR data. ANAO cautions against this view. As the ATO's IMS uses other data sets apart from the AIIR, the cost/benefit value of IMS is not a measure of the cost/benefit value of the AIIR data alone. Furthermore, the AIIR data is used more widely throughout the ATO and by other agencies such as CSA. These benefits are not captured by the calculations in the Protocol.

5.43 The data in the Protocol brings together the monetary value of some costs and some benefits of the IMS. It is by no means a cost benefit analysis of the ATO's investment in the IMS. A cost benefit analysis of the ATO's investment in IMS or in the AIIR data would require much more than the tabulations in the Protocol.

5.44 Cost/benefit analysis is a quantitative analytical method that assists decision makers in the efficient allocation of resources.¹⁰¹ The strength of the method is that it provides a disciplined framework for analysing data in a

¹⁰⁰ ATO Information Matching System Program Protocol, Version 1.0, February 2002

¹⁰¹ *Handbook of Cost Benefit Analysis Department of Finance AGPS 1991. Chapter 1.*

logical and consistent way. A cost/benefit analysis aims to determine the net present value of benefits that are solely attributable to the investment being evaluated.

5.45 A cost/benefit analysis of the ATO's investment in the AIIR data would require the bringing together of the ATO's investment in the data, and all of the benefits from the use of the data, including those obtained by other agencies. A time frame of between three and seven years would be nominated and, by choice of the right discount rate, it may be possible to calculate the net present value of the ATO's investment in the AIIR data. ANAO considers that the ATO Executive would find valid measures of the cost/benefit value of the AIIR data useful, when considering the deployment of resources for AIIR activity.

5.46 If the ATO is to make the best use of the AIIR data, it will be necessary to achieve at least a satisfactory proportion of the compliance value of the data. To date, the ATO has not been able to estimate this value.

5.47 In the absence of valid estimates of the AIIR's compliance value, it is difficult for the ATO to manage and use the AIIR data strategically, that is, on a whole of ATO basis and including all categories of investment income and taxpayer. The ANAO considers that a strategic approach is necessary to obtain the best value from the data. The extent to which the ATO is able to achieve, cost effectively, the compliance value inherent in the AIIR data, depends on the ATO's appreciation of, and capacity to measure, the compliance value of the data in terms of total PRG for all AIIR entity records.

5.48 The ATO has emphasised to ANAO that it considers that not actioning all individual interest income discrepancies and not having a non-individual matching capability does not mean that it is leaving significant risks untreated or that the matters could be easily addressed with a resource shift and some systems development. The ATO advises that this is far from the case.

Recommendation No.7

5.49 The ANAO recommends that, to optimise the compliance value of the AIIR data, the ATO:

- evaluate the enhancement of the ATO Matching System (ATOMS) so that the ATO can take into account the income received by individuals from unit trust distributions, partnerships, trusts, and private companies;
- calculate annually the gap between aggregate investment income of individuals reported by investment bodies, and that reported by taxpayers, and use this information to assist with resource allocation decisions; and,
- adopt, within the context of its overall risk management framework, a more strategic approach to the use of the data, having regard to valid measures of cost/benefit value of the AIIR data.

ATO Response

5.50 The ATO agrees with the recommendation. The ATO has embarked on a major Change Program that includes the review of many tax office information technology and processing systems. As part of the ATO planning process, including planning for 2004–05 and the broader Change Management Program, consideration will be given to the investment of resources to continue the enhancement of ATOMS and action resultant cases. Decisions in this regard will take into account the cost/benefit value and be considered within the overall IT and compliance risk assessment and planning frameworks.

5.51 The ATO Data Matching Steering Committee has the role to manage our strategic approach to the use of AIIR data. That will include annual assessment of any gap between aggregate investment income reported by investment bodies and taxpayers, and any assessed potential revenue risk, taking into account broader data matching considerations and organisational compliance priorities.

Opportunities to pursue wider systematic use of AIIR data

The Non-Individual Matching System

5.52 We found that only the PTax business line had established a systematic income matching capability. The Non Individual Matching System (NIMS) was designed as a tool that could help verify the income tax return information of individuals that had tax relevant information associated with non-individual

entities. It was not designed to use the AIIR to verify the income reported by non-individual entities in their tax returns, or to identify non-individual entities that may have failed to comply with lodgement requirements. Since 1984, successive Auditors-General have reported findings about the significant compliance and revenue gains that would accrue to the Commonwealth, if the ATO established an income matching capability for non-individuals and have, accordingly, recommended that the capability be established while being sensitive to the issues of personal privacy. As described in paragraphs 5.7 and 5.8, the ATO had established a pilot system (NIMS) to match partnership, trusts and company AIIR data against the tax records of individuals.

5.53 PTax and the SB business line did not proceed with the NIMS projects for several reasons. These included the poor quality of AIIR data about partnership investment income, weaknesses in the quality of the data on the ATO's mainframe systems, and weaknesses in the design of NIMS. There were extensive errors in the sample of AIIR data selected for NIMS to process. Incorrect TFNs, income returned at another tax return label, income returned in another year, and the income being a net amount (with no tax consequence), were reasons for the discrepancies not being valid instances of omitted income. The work of analysing the NIMS results was a largely semi-manual exercise in checking printouts produced by the NIMS software. There were also design inadequacies with the NIMS prototype in so far that there was no capability to check the values at other return form labels. Extensive culling of the NIMS printouts was required, along with manual checking of tax return labels online. The task of issuing query letters to the taxpayers was also manually based.

5.54 Furthermore, a series of changes to the taxing of trust income, at the time the pilot project was being tested, meant that the software that had been written for this aspect of the pilot study would have to be rewritten. Staffing cuts to the INB Business Line in 2000–2001, resulted in the termination of the project before the commencement of any investigation of income derived by individuals from the companies associated with them.

5.55 The ANAO accepts that the ATO, in carrying out the NIMS pilot projects in the SB and INB business lines, made a reasonable effort to test the usefulness of income matching of non-individual taxpayers.

5.56 The ATO considers that the absence of NIMS does not mean that the ATO is leaving significant risks untreated. The ATO has explained that the tax affairs of non-individual entities are more extensively risk assessed, and that the ATO's active compliance coverage in these markets is also more extensive and intensive than it is for individuals. The ATO considers that the NIMS pilot projects, previously mentioned, justified the ATO not proceeding with NIMS at that time. The ATO has pointed out that the decisions it makes about the redevelopment of its information technology capability are also made on a risk management basis. In this regard, the ATO notes that there is always a much

bigger demand for information technology development than can be met with available resources. The ATO advises that of highest priority in determining investments, is the implementation of new Government policy and sustaining current systems. The ATO considers that the issues associated with NIMS cannot be easily addressed with a simple resource shift and some systems redevelopment.

5.57 The decision to proceed no further with the NIMS projects by both business lines is understandable, given the circumstances at the time, and the apparently low risks that the pilot projects revealed. As a result, there is now no income matching system that uses the AIIR data for non-individual taxpayers, namely companies, trusts, partnerships, superannuation funds and government agencies. However, the weaknesses in the NIMS pilot projects are now better understood. Accordingly, the ANAO considers that it is timely for the ATO to reconsider the systematic income-matching potential for non-individuals.

Scope for income matching of non-individuals

5.58 Income matching, using the AIIR data has, improved the efficiency of administration in PTax, because discrepancies of a large number of cases can be routinely addressed. This has enabled tax auditors to focus on more complex, higher valued matters that are also more commensurate with the relative high cost of the tax auditors. As the SB business line may administer the tax affairs of some taxpayers in similar situations, income matching could yield similar efficiencies for SB, as has been achieved by PTax.

5.59 The ATO also has advised that the need to develop an income matching capability for non-individual entity types, and conduct further analysis of investment reports to determine the actual extent of non-disclosed interest and dividend from those entity types, is being re-considered as part of the ATO's normal 2004–05 planning processes.

5.60 The ATO considers that some taxpayers, such as small traders and partnerships, whose affairs are administered by SB, may be subject to the ATOMS. However, the ATO could not provide the proportion of relevant SB line taxpayers that would be subject to ATOMS.

5.61 The ATO also advised that the SB business line is carrying out risk assessments of non-individuals failing to report AIIR investment income reported by investment bodies in the AIIR data, but not included in income tax returns. Whilst the assessment will draw on the earlier study findings, it will examine the situation in relation to current information and from the perspectives of:

- establishing whether non-declaration of investment income presents an inherent, current risk (whether or not the system would identify a discrepancy); and
- the potential of a non-individual matching system to effectively deal with non-compliance.

5.62 The ATO has further advised that Compliance Systems has recently been resourced to facilitate the development of an automated case actioning system of non-individual discrepant cases. The system would have the capacity to handle a variety of different work types.

5.63 The ANAO considers that there are a number of additional factors that the ATO could use to identify subsets of company AIIR transactions for data matching. For example, the ATO has identified a range of industries that have high overall compliance risks. Companies in these industries could be selected for AIIR data matching. The investment income disclosed, and the relationships that can be identified, would be helpful components in the compliance mosaic pertaining to tax affairs of some taxpayers administered by the SB line. Another approach would be to sort companies by the size of investment income identified by AIIR, and match those in the small or medium sized range that might not otherwise be subject to other forms of more intensive ATO examination. Those in the receipt of relatively high levels of investment income could be more closely examined in the first instance.

5.64 The ANAO notes that there is additional complexity associated with the matching of non-individual entities. These entities do not have an identifier comparable to the date of birth. There is also greater complexity associated with the names of these entities, in comparison to the names of natural persons. Furthermore, there may be a range of entities associated with an entity under consideration that are interposed between it and another entity being matched to it. It may be necessary to match them all to a particular entity. This may require a different process of data matching, that has more to do with the identification of networks of degrees ownership or relationships, especially tax relevant ones, than is possible with the methodology of ATOMS. Nevertheless, legislation requires that non-individual entities have a unique Australian Business Number (ABN). If the ABN data is of the requisite quality, then it, in conjunction with other identifiers, could be used to produce high quality matches.

Large Business and International

5.65 There may be scope for the LB&I business line, to use the aggregates of investment income reported on the AIIR data as belonging to taxpayers administered by LB&I, to supplement those already used in its economic and financial analysis software. As previously mentioned, the AIIR data indicates

that there may be up to 1 000 entities that have tax obligations, but which do not seem to be matched to any of the entities currently on LB&I's data bases.

Multi-year analysis of AIIR trends

5.66 The ANAO notes that the ATO generally uses the AIIR data on an annual basis only. However, the AIIR data, if examined over multi-year periods, could provide indications of trends relevant to the ATO's management of compliance matters.

5.67 The ANAO was informed during the audit that ATO intend to develop and utilise design opportunities within ATOMS, that provide for trend analysis functionality where administration of multi-year analysis will be possible. ATO advised that case selection officers would be able to select cases, where a taxpayer is flagged as a repeat offender, despite falling below the relevant case selection threshold for the year. The ANAO supports this, as the AIIR data is potentially a very rich source of information about individuals and entities. Historical analyses could also include:

- tracking investment body reporting performance;
- highlighting possible flags relating to systematic compliance matters such as fraud or systematic evasion or under reporting of investment income; and,
- identifying candidates for lodgement enforcement activities.

Recommendation No.8

5.68 The ANAO recommends that to, improve the use of AIIR data relating to non-individuals, and achieve the greater cost-effectiveness in tax administration that the systemic use of the data enables, the ATO:

- evaluate the adaptation of ATOMS for matching AIIR records belonging to superannuation funds, trusts, and partnerships and government agencies;
- conduct a scoping study for the adaptation of ATOMS for matching AIIR records belonging to specific categories of companies identified in relation to compliance risk factors; and
- evaluate the use of multi-year analysis of the AIIR data.

ATO Response

5.69 The ATO agrees with the recommendation. As part of the ATO planning process, including planning for 2004–05 and the broader Change Management Program, consideration will be given to the investment of resources to begin the enhancement of ATOMS to match non-individual

records. Consideration will also be given to other risk assessment information to identify non-individuals most at risk of not meeting their tax obligations. Decisions in this regard will take into account the cost/benefit value and be considered within the overall IT and Compliance planning frameworks.

Transaction Search Facility

5.70 The ANAO found that the Department of Family and Community Services's CSA and the ATO's SB line are the main users of the TSF.

5.71 The ANAO understands that the usage by SB mainly relates to specific projects that focus on serious compliance matters. It is understood that the AIIR data, often in conjunction with other data sets, has been helpful and in some instances, indispensable, to the successful conduct of those projects. The TSF appears to be used as an important element of specialised investigations assisting with verification of transactions and the identification of links.

5.72 The ANAO finds that, where the details of the entity under examination have already been selected, the TSF is a very useful investigatory and compliance tool for the ATO.



Canberra ACT
27 May 2004

P. J. Barrett
Auditor-General

Appendix

Appendix: Agency response

The ATO's Management and Use of Annual Investment Income Reports (AIIR) in Taxation Administration—Proposed Audit Report

We are pleased that the ANAO concludes that our AIIR data matching program is an effective compliance tool with regard to the individual taxpayer market segment. It is important to have this confirmation given that the prime purpose for which we developed our data matching capability was to treat risk in the individual market.

We also note ANAO acknowledgement of the effort we are making to refine that capability and possibly extend it into other compliance markets to complement our other important compliance efforts. Any decision to invest in an extension of the current capability will need to take account of the total compliance risks that warrant treatment, as well as the choices we face with other systems investment decisions, especially given our current Change Program.

While we view our data capture/matching processes and systems as already highly effective compliance tools, we believe the ANAO's recommendations set an appropriate direction to assist us to build on that capability and proficiency.

Recommendation No.1

The ANAO recommends that, to make more strategic use of the AIIR at both the whole of ATO and whole-of-government levels, the ATO compile suitable performance information which can be used to inform the ATO Executive about the management and use of the AIIR data, including:

- a statistically sound estimate of the total amount of additional revenue that could be collected, including any additional resource allocation required, using the AIIR data; and
- a range of descriptive indicators relating to AIIR data, including:
 - contribution of the AIIR data at the whole-of-government level;
 - contribution of the AIIR data at the whole of ATO level;
 - compliance risks identified by the AIIR data;

- quality of the AIIR data;
- reporting behaviour of the AIIR reporters (i.e. the investment bodies that submit AIIR reports); and,
- standard measures of time, cost and quality of performance of relevant components within the Compliance Systems Directorate.

ATO Response:

The ATO agrees with the recommendation.

The charter of the ATO Data Matching Steering Committee includes development of suitable performance measures as suggested by ANAO. That work has commenced and will cover the measures and indicators suggested by ANAO.

**Recommendation
No.2**

The ANAO recommends that, in order to assess adequately the AIIR non-lodger risk, and to determine the completeness of the AIIR data set, the ATO implement a systematic approach to lodgement enforcement so that all known investment bodies are aware of, and fulfil, their legislatively defined reporting responsibilities.

ATO Response:

The ATO agrees with the recommendation.

The AIIR Steering Committee, which is a sub-committee of the ATO Data Matching Steering Committee, has instigated a follow up program to identify and secure information from investment bodies required to lodge AIIR data. Concurrently, we are reminding all known investment bodies of their legislative reporting responsibilities.

Recommendation No.3

The ANAO recommends that the ATO bring to the attention of the Treasury the scope for a review of the legislation supporting the current AIIR reporting requirements, that aims to identify the costs and benefits associated with:

- determining the existence of investment income types that are outside current AIIR reporting requirements but that would assist the ATO with income matching activities;
- examining the usefulness of all transactions covered by the current AIIR reporting requirements, in particular, the need for the AIIR legislation to continue to require information on assessable income derived from investment related betting chances; and
- implementing changes to the approved form of the AIIR, including a consideration of moving to secure online access, in order to improve the efficiency of the transmission and receipt of AIIR data from investment bodies.

ATO Response:

The ATO agrees with the recommendation.

The ATO Data Matching Steering Committee has a role to ensure we are administering AIIR legislation in the best practical way. That includes assessment of AIIR outcomes, risks and process improvement opportunities. In terms of process improvement, the Committee will consider the suggested on-line access facility.

In terms of any aspects of the AIIR legislation that are not working as intended (and that we cannot resolve through changes to Tax Office administrative practice), the Committee will as needed bring those matters to the attention of Treasury. Note that any decision to extend the scope of data matching to new areas is a matter for government and their priorities and would need to consider compliance costs.

We note ANAO's comment on the scope for a review of the AIIR legislation and will pass those comments onto Treasury.

**Recommendation
No.4**

The ANAO recommends that the ATO implement a co-ordinated communication strategy designed to identify, and improve the awareness of, investment bodies that may have AIIR reporting obligations, but are not currently AIIR reporters.

ATO Response:

The ATO agrees with the recommendation.

The ATO through the AIIR committee is undertaking a general campaign of education which includes identifying all potential lodgers of AIIR information. The ATO will provide information to these investment bodies, reminding them of their legislative responsibility.

**Recommendation
No.5**

The ANAO recommends that the ATO conduct ongoing analysis of unmatched and low-quality matched AIIR data and that this analysis provide the basis for the ATO's overall approach to data integrity assurance for AIIR data.

ATO Response:

The ATO agrees with the recommendation.

The ATO has commenced analysis of the unmatched records identified from 2002 AIIR records. Analysis will also be undertaken to see if our automated matching processes can be enhanced to increase the matching rate or improve any data integrity issues giving rise to low quality matches. Work will also occur to sample a range of low quality matched records to identify the clients associated with those records and determine if any revenue risks exist.

The ATO has separately initiated a project to assist identify taxpayers currently outside the tax system. That project will also provide the opportunity to identify and test different matching approaches, independent of the AIIR process, to see where improvements might be made.

Recommendation No.6

The ANAO recommends that, to improve data quality and the effectiveness of AIIR data matching against client identification masterfiles, the ATO implement mandatory data quality standards for use throughout the ATO.

ATO Response:

The ATO agrees with the recommendation.

The ATO has engaged consultants as part of its Change Management Program to conduct a data quality assessment. That assessment will obtain baseline metrics for a subset of client data to determine the current state of captured data. It will also provide a broad set of recommendations and principles to address the data issues identified. The recommendations will include a methodology for ongoing data analysis and quality assurance. The ATO Chief Knowledge Officer position will have responsibility for implementing this framework.

Recommendation No.7

The ANAO recommends that, to optimise the compliance value of the AIIR data, the ATO:

- evaluate the enhancement of ATO Matching System (ATOMS) so that the ATO can take into account the income received by individuals from unit trust distributions, partnerships, trusts, and private companies;
- calculate annually the gap between aggregate investment income of individuals reported by investment bodies, and that reported by taxpayers, and use this information to assist with resource allocation decisions; and,
- adopt, within the context of its overall risk management framework, a more strategic approach to the use of the data, having regard to valid measures of cost/benefit value of the AIIR data.

ATO Response:

The ATO agrees with the recommendation.

The ATO has embarked on a major Change Program

that includes the review of many tax office information technology and processing systems. As part of the ATO planning process, including planning for 2004–05 and the broader Change Management Program, consideration will be given to the investment of resources to continue the enhancement of ATOMS and action resultant cases. Decisions in this regard will take into account the cost/benefit value and be considered within the overall IT and Compliance risk assessment and planning frameworks.

The ATO Data Matching Steering Committee has the role to manage our strategic approach to the use of AIIR data. That will include annual assessment of any gap between aggregate investment income reported by investment bodies and taxpayers, and any assessed potential revenue risk, taking into account broader data matching considerations and organisational compliance priorities.

Recommendation No.8

The ANAO recommends that, to improve the use of AIIR data relating to non-individuals, and achieve the greater cost effectiveness in tax administration that the systemic use of the data enables, the ATO:

- evaluate the adaptation of ATOMS for matching AIIR records belonging to superannuation funds, trusts, and partnerships and government agencies;
- conduct a scoping study for the adaptation of ATOMS for matching AIIR records belonging to specific categories of companies identified in relation to compliance risk factors; and
- evaluate the use of multiple year analysis of the AIIR data.

ATO Response:

The ATO agrees with the recommendation.

As part of the ATO planning process, including planning for 2004–05 and the broader Change Management Program, consideration will be given to the investment of resources to begin the enhancement of ATOMS to match non-individual records. Consideration will also be given to other risk assessment information

to identify non-individuals most at risk of not meeting their tax obligations. Decisions in this regard will take into account the cost/benefit value and be considered within the overall IT and Compliance planning frameworks.

Jennie Granger
Second Commissioner

30 April 2004

Index

A

AIIR Steering Committee, 13, 20, 37, 49, 51, 53, 94

B

Betting, 11, 20, 27, 42, 43, 50, 51, 52, 95

C

Change Program, 18, 30, 34, 38, 51, 70, 71, 84, 93, 97
Companies, 11, 13, 17, 21, 22, 26, 27, 32, 34, 43, 45, 48, 64, 66, 74, 75, 76, 81, 82, 84, 85, 86, 87, 88, 97, 98
Compliance rate, 16, 73, 77, 78, 79, 80
Compliance Value, 5, 16, 17, 18, 21, 36, 64, 73, 76, 77, 79, 80, 81, 83, 84, 97
Cost/Benefit, 21, 82, 83, 84, 89, 97, 98

D

Data analysis, 33, 72, 97
Data integrity, 17, 21, 42, 44, 45, 54, 55, 60, 63, 65, 66, 68, 96
Data Matching Steering Committee, 6, 13, 17, 19, 37, 41, 49, 52, 84, 93, 94, 95, 97
Discrepancies, 16, 17, 35, 46, 73, 78, 80, 81, 82, 83, 85, 86
Dividends, 17, 26, 31, 46, 48, 60, 63, 64, 65, 74, 78
Duplicates, 69

E

Entity record, 12, 16, 35, 44, 56, 61, 64, 68, 69, 73, 76, 83
Exemption code, 59, 60, 64, 65, 66

G

Government agencies, 11, 22, 27, 66, 86, 88, 98

I

Identifiers, 54, 56, 57, 59, 65, 70, 87
Identity matching, 5, 14, 15, 39, 56, 57, 58, 59, 61, 63, 68, 69, 71
Individuals, 6, 11, 12, 13, 15, 16, 17, 21, 27, 29, 34, 36, 54, 66, 69, 70, 74, 76, 77, 78, 79, 81, 82, 84, 85, 88, 97
Interest, 13, 16, 26, 27, 31, 36, 39, 42, 43, 44, 45, 46, 48, 51, 52, 54, 55, 60, 63, 64, 65, 74, 75, 77, 78, 79, 80, 81, 83, 86
Investment body, 14, 27, 28, 43, 45, 46, 47, 48, 50, 51, 52, 55, 59, 65, 66, 88

L

Legislative framework, 5, 25, 26, 42, 45, 50, 73
Lodge, 28, 46, 47, 49, 51, 59, 64, 66, 67, 78, 94

M

Matching engines, 56, 57, 69

N

Non-Individuals, 13, 17, 22, 34, 36, 48, 66, 74, 81, 82, 85, 86, 88, 89, 98

O

Optimise, 11, 12, 17, 21, 25, 29, 30, 32, 34, 76, 81, 84, 97

P

Partnerships, 11, 13, 17, 21, 22, 27, 32, 34, 66, 74, 75, 76, 81, 82, 84, 86, 88, 97, 98

Potential Revenue Gain (PRG), 6, 16, 67, 73, 74, 77

R

Real estate, 11, 27, 45, 50

Reporting Gap, 16, 77, 78, 79

Royalty, 50

S

Self Managed Superannuation Funds (SMSF), 63, 67

Self-assessment, 12, 25, 29, 30

Solicitor, 27, 45

Specifications, 13, 28, 42, 43, 44, 45, 47, 50, 51, 53, 54, 55

Superannuation, 7, 11, 13, 22, 27, 34, 36, 46, 51, 63, 66, 67, 86, 88, 98

T

Tax File Number (TFN), 7, 11, 26, 29, 31, 44, 55, 59, 60, 69, 73

Third party reporting, 37

Transaction Search Facility (TSF), 7, 38, 75, 89

Trusts, 11, 13, 17, 21, 22, 26, 27, 32, 34, 66, 74, 76, 81, 82, 84, 85, 86, 88, 97, 98

U

Unit Trust, 11, 17, 21, 27, 43, 45, 75, 82, 84, 97

Unmatched data, 59, 61, 64, 66

W

Whole-of-government, 5, 12, 13, 19, 28, 34, 35, 38, 39, 40, 41, 93

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Audit Report No.47

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Summary of Results

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Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)
Department of Employment and Workplace Relations
Department of Transport and Regional Services

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Aid to East Timor
Australian Agency for International Development

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Department of Foreign Affairs and Trade

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Department of Finance and Administration

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ATSIS Law and Justice Program
Aboriginal and Torres Strait Islander Services

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The Administration of Telecommunications Grants
Department of Communications, Information Technology and the Arts
Department of Transport and Regional Services

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Department of Defence

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Australian Prudential Regulation Authority

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The Senate Order for Departmental and Agency Contracts (Autumn 2003)

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Management of the Extension Option Review—Plasma Fractionation Agreement
Department of Health and Ageing

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Management of Risk and Insurance

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Audit Activity Report: January to June 2003
Summary of Outcomes

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Department of Agriculture, Fisheries and Forestry—Australia
Centrelink
Australian Taxation Office

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