

The Auditor-General
Audit Report No.39 2004–05
Performance Audit

**The Australian Taxation Office's
Administration of the Superannuation
Contributions Surcharge**

Australian National Audit Office

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of Australia 2005

ISSN 1036-7632

ISBN 0 642 80836 8

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Canberra ACT
13 April 2005

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*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *The Australian Taxation Office's Administration of the Superannuation Contributions Surcharge*.

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 'Ian McPhee', is positioned above the printed name.

Ian McPhee
Auditor-General

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

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. 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 | 7 |
| Glossary | 8 |
| Summary and Recommendations | 11 |
| Summary | 13 |
| Introduction | 13 |
| Audit Objective | 13 |
| Key Findings | 14 |
| Overall Conclusion | 19 |
| Summary of ATO's Response | 20 |
| Recommendations | 22 |
| Audit Findings and Conclusions | 31 |
| 1. Background and Context | 33 |
| Background | 33 |
| Superannuation Contributions Surcharge | 34 |
| Context | 38 |
| Audit Objective and Methodology | 42 |
| 2. Governance | 45 |
| Introduction | 45 |
| The impact of past ATO decisions on the current management of the Surcharge | 46 |
| Effective Surcharge planning processes | 51 |
| Effective Surcharge risk assessment processes | 56 |
| A structured approach to monitor and report Surcharge performance | 62 |
| Additional Surcharge funding provided in the 2004–05 Budget process | 67 |
| 3. Surcharge Systems | 68 |
| Introduction | 68 |
| Data capture (sub-process 1) | 71 |
| Data processing (sub-process 3) | 75 |
| Recent and future developments in the management of Surcharge systems | 96 |
| 4. Exceptions Management | 97 |
| Introduction | 97 |
| Identity matching exceptions | 99 |
| SCS exceptions | 109 |
| The ATO's proposed approach to resolving the Surcharge exception backlogs | 116 |
| 5. Surcharge Compliance Management | 122 |
| Introduction | 122 |
| Surcharge compliance framework | 123 |
| ATO market segment compliance activity | 132 |
| Key Client Group | 133 |
| Large and Medium Fund Group | 138 |
| Small Fund Group | 140 |
| Individuals (members) | 144 |

| | |
|--|------------|
| Appendices | 147 |
| Appendix 1: Agency response | 149 |
| Appendix 2: Calculation of the Surcharge | 161 |
| Appendix 3: The Surcharge collection mechanism | 164 |
| Appendix 4: History and background relevant to the introduction and administration of the Surcharge..... | 165 |
| Appendix 5: Stakeholder reaction to the introduction of the Surcharge | 169 |
| Appendix 6: ANAO analysis of Adjusted Taxable Income and Surcharge rate data..... | 171 |
| Appendix 7: ATO Governance arrangements | 175 |
| Appendix 8: ATO compliance reporting framework..... | 176 |
| Appendix 9: Surcharge data capture and identity matching..... | 177 |
| Appendix 10: Surcharge assessment run (data processing)..... | 178 |
| Appendix 11: Superannuation Contributions Surcharge system change management process | 180 |
| Appendix 12: ATO estimate of Surcharge exceptions revenue compared to Surcharge revenue collections | 181 |
| Appendix 13: SCS exception creation points | 182 |
| Appendix 14: SCS exception categories | 183 |
| Appendix 15: ATO Compliance Model | 185 |
| Appendix 16: MCS lodgement statistics for member records | 186 |
| Appendix 17: Growth in SMSFs since being regulated by the ATO..... | 187 |
| Index | 188 |
| Series Titles..... | 190 |
| Better Practice Guides..... | 193 |

Abbreviations

| | |
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| AGS | Australian Government Solicitor |
| APRA | Australian Prudential Regulation Authority |
| ANAO | Australian National Audit Office |
| ATI | Adjusted Taxable Income |
| ATO | Australian Taxation Office |
| BSWG | Business Systems Working Group |
| CRM | Client Relationship Manager |
| CRBP | Compliance Review Benchmarking Project |
| ETP | Eligible Termination Payment |
| IVR System | Interactive Voice Recognition System |
| IT | Information Technology |
| ITR | Income Tax Return |
| MCS | Member Contributions Statement |
| OPA | Output Pricing Agreement |
| RoCS | Register of Complying Superannuation Funds |
| SASP | Self Assessing Superannuation Provider |
| SDLC | Systems Development Life Cycle |
| SILG | Superannuation Industry Liaison Group |
| SMSF | Self Managed Superannuation Fund |
| TFN | Tax File Number |

Glossary

| | |
|--------------------------------------|--|
| ATO corporate management | ATO corporate management is the range of ATO senior decision-making forums, which are responsible for the ATO sub-plans, products, markets and capabilities. |
| default assessment | A default assessment applies the Surcharge at the maximum Surcharge rate and may be issued on a member's surchargeable contributions when the member fails to quote their TFN to the ATO. |
| firecall | Firecall is a special access authority built within ATO systems, which bypasses regular security controls to allow staff to perform emergency system and data fixes. ATO policy states that 'Firecall use is the exception and not the rule'. |
| identity matching exception | Identity matching exceptions arise where an MCS cannot be matched to a member's ITR before it is processed by the SCS system to allow the Commissioner to make a Surcharge assessment. |
| Member Contributions Statement (MCS) | A Member Contributions Statement (MCS) is an ATO approved form that indicates the value of a member's superannuation contributions. In addition to the value of a member's contributions, the MCS should also contain the members Tax File Number (TFN), which the ATO uses to match the MCS to other taxation information to calculate the Surcharge. |
| member | Means a member of a superannuation fund or of an Approved Deposit Fund (ADF), the holder of a Retirement Savings Amount (RSA), or the purchaser of an annuity from a life assurance company or from a registered organisation |
| nil assessment | A nil assessment is made when, having received member contribution information (as part of one or many member accounts submitted by a holder) for a member, the Commissioner has calculated the Surcharge and has determined that there is no Surcharge payable. |

| | |
|--|--|
| Please Quote Tax File Number (PQTFN) letters | PQTFN letters request that a member supplies their TFN to the ATO. It also specifies that, by not doing so, the member will be subject to a default assessment. |
| Superannuation Contribution Surcharge (SCS) system | The Superannuation Contributions Surcharge system is primary IT system used by the ATO to calculate the Surcharge. |
| SCS exception | SCS exceptions arise when an event occurring during processing (within the SCS system) either prevents the ATO from making an assessment, or indicates that the ATO should review an assessment at a later time. This usually involves the SCS system not being able to interpret a member's MCS or Income Tax Return (ITR) record. |
| Surcharge assessment run | The Surcharge assessment run (the assessment run) is a term used by the ATO to refer to a group of data processing functions, which are used to calculate a member's liability for the Surcharge. These data processing functions include the capture and processing of Surcharge contributions data, which are obtained from a number of relevant Surcharge forms (such as MCSs). |
| Surcharge collection mechanism | The calculation of the Surcharge involves the collection of data from a number of different sources, and involves several ATO systems. These systems and processes are known as the Surcharge collection mechanism. |
| Surcharge exception | An exception is broadly defined as an event that interrupts workflow through a process or system that requires correction by manual or electronic intervention. In terms of the Surcharge, this refers to both SCS exceptions and identity matching exceptions, which prevent the Commissioner from being able to assess a member for the Surcharge. |

Summary and Recommendations

Summary

Introduction

1. The Superannuation Contributions Surcharge (the Surcharge) was introduced in 1996–97 to make superannuation arrangements fairer, more equitable and better suited to the needs of the modern workforce.
2. The calculation of the Surcharge depends on a number of factors, including the superannuation fund type and the particular income tax arrangements of a superannuation fund member.¹ In simple terms, the Surcharge is levied on the surchargeable contributions of a member whose Adjusted Taxable Income (ATI) exceeds the minimum Surcharge threshold in a given income year. The ATO determines a member's ATI and calculates a member's Surcharge liability by matching and combining data from an individual's income tax return², with the member contribution data the ATO receives via a Member Contribution Statement (MCS).³ The holder of the surchargeable contributions (the holder)⁴ provides this statement to the ATO.

Audit Objective

3. The objective of the audit was to assess the ATO's administration of the Surcharge. Specifically, the audit sought to:
 - report on the environment into which the Surcharge was introduced, including the legislative intent behind the Surcharge, and the current Surcharge environment;
 - examine and report on aspects of Surcharge governance;
 - assess the systems, processes and controls the ATO uses to:
 - match Member Contributions Statements (MCS) data with income tax return data using Tax File Numbers (TFNs);

¹ A 'member' means a member of a superannuation fund or of an Approved Deposit Fund (ADF), the holder of a Retirement Savings Amount (RSA), or the purchaser of an annuity from a life assurance company or from a registered organisation.

² This will generally be the taxable income detail for the member, along with any reportable fringe benefit information and deducted personal superannuation contributions.

³ A Member Contributions Statement (MCS) is an ATO approved form that indicates the value of a member's superannuation contributions. In addition to the value of a member's contributions, the MCS should also contain the member's Tax File Number (TFN), which the ATO uses to match the MCS to other taxation information to calculate the Surcharge.

⁴ In most cases (except those cases where the contributed amounts have started to be paid out to the member) this will be the relevant superannuation fund that has control of the member's contributed superannuation amounts.

- process Surcharge information; and
- issue Surcharge liability assessments.
- assess the mechanisms the ATO uses to assess, classify, manage and rectify existing Surcharge exceptions, and prevent future exceptions from occurring; and
- examine the mechanisms and strategies the ATO uses to provide assurance that members and holders of contributions are complying with their Surcharge obligations.

Key Findings

Background and Context (Chapter 1)

4. At the time the Surcharge was introduced in 1996–97, the ATO rated it as one of the most difficult administrative challenges it had ever faced.⁵ Implementing the Surcharge involved the single largest data load over the shortest period that the ATO had ever undertaken (up to that point in time).

5. Prior to the introduction of the Surcharge in 1996–97, industry stakeholders voiced strong opposition to the mechanism⁶ to collect the Surcharge. This mechanism placed significant obligations on the superannuation industry to collect and provide large amounts of superannuation contributions information to the ATO for processing.

6. In addition, the ATO advised that it had to administer the Surcharge in an environment where there were considerable and ongoing amendments to the Surcharge legislation and significant ATO resources were required for tax reform.

7. Since the Surcharge was introduced, Surcharge revenue collections increased significantly from \$286 million in 1998–99 to \$1 050 million in 2003–04 (a 267 per cent increase). Over the same time period, there has been a moderate increase in the number of members paying the surcharge from 552 000 to 640 000 (a 16 per cent increase).⁷

8. To manage the complex task of processing and calculating the Surcharge, the ATO developed the Superannuation Contributions Surcharge

⁵ Letter sent from the then Assistant Treasurer, Senator the Hon. Rod Kemp to the then Minister for Finance and Administration, the Hon. John Fahey MP, 22 October 1997.

⁶ The Surcharge collection mechanism relies on the provision of superannuation contributions information by holders (superannuation funds and other providers of superannuation services).

⁷ Surcharge revenue figures and the number of members paying the Surcharge, have been sourced from ATO superannuation systems. These systems are discussed in Chapter 3.

(SCS) system. Although among the ATO's largest IT systems, the SCS system is used to collect significantly less revenue than other ATO IT systems of a comparative size. For example, the Pay As You Go Withholding (PAYGW) system was used to collect \$90 billion in revenue in 2003–04. In comparison, the SCS system was used to collect \$1 billion in Surcharge revenue. The ANAO considers that the introduction of the SCS system by the ATO in a short period of time, and with a limited budget, was a commendable achievement.

9. When the Surcharge was introduced, the additional administrative responsibility to supply contributions information to the ATO, attracted criticism from Superannuation industry representatives as being costly and inefficient. During the audit, we interviewed key stakeholders concerning their views on the ATO's current Surcharge administrative practice. Although the majority of those interviewed accepted the intent of the Surcharge policy, which is to bring equity to the superannuation system, they remained critical of the Surcharge collection mechanism.

Governance (Chapter 2)

10. An effective governance framework is essential to the effective management of the Surcharge, as it supports good practice in the ATO and provides the public with assurance that the Surcharge is applied equitably. The ATO advised the ANAO that in 1999–2000, several significant events, including the implementation of tax reform, meant that the ATO had to make some difficult decisions regarding Surcharge administration and resourcing for the immediate future. These were to not:

- undertake further development of Surcharge IT processing systems;
- rectify large numbers of Surcharge exceptions⁸; and
- pursue the collection of TFNs from members, to assist with the process of matching member contributions to income tax returns.

11. Although these decisions were understandable given the taxation environment that existed at the time, they have adversely affected, and continue to adversely affect, the ATO's ability to administer the Surcharge effectively. Had a fully effective governance framework been in place, key risks (such as the exception backlogs) could have been identified and reported earlier, and mitigation strategies implemented in a more timely manner.

12. In 2002–03 the ATO invested considerable resources to improve its administration of the Surcharge. As a result, there were noticeable

⁸ An exception is broadly defined as an event that interrupts workflow through a process or system that requires correction by manual or electronic intervention.

improvements in Surcharge governance in 2003–04 in comparison to previous years, particularly with regard to external reporting. That said, we identified several areas that require significant improvement. These include establishing:

- procedures and protocols for recording key Surcharge management decisions;
- a robust and coordinated Surcharge planning process and methodology at the operational level;
- a sound Surcharge risk management framework, which complies with ATO corporate risk processes and underpins planning and reporting; and
- effective internal reporting procedures to report Surcharge performance and risks, and to provide ATO corporate management with the information needed to make informed decisions.

13. The ANAO recognises that the ATO is working to address these areas to improve their administration of the Surcharge.

Surcharge Systems (Chapter 3)

14. Efficient and effective Surcharge systems, processes and controls are critical to the effective administration of the Surcharge, given the large amounts of Surcharge data that needs to be processed, and the complexity of the calculations needed to be performed to assess the Surcharge. Although the ATO is able to process large quantities of Surcharge information, and collect significant amounts of Surcharge revenue, we consider that it has not been able to provide adequate assurance that this is done efficiently and effectively. In particular:

- coordination between the ATO's Operations Service Line and the Superannuation Business Line needs to be improved to facilitate the more efficient and effective capture of Surcharge data from holders for processing;
- Surcharge processing procedures documentation is incomplete, and in some areas, does not exist;
- Surcharge information technology (IT) system baseline specifications do not exist, and there is not a consistent approach to document and retain Surcharge IT system change specifications;
- business managers, who should have a comprehensive understanding of Surcharge legislation and ATO policy, are not required to review and approve major changes to Surcharge systems;

- the ATO does not use a consistent approach to record changes to Surcharge systems;
- the majority of systems changes are emergency fixes, which are not subject to the same levels of scrutiny as other system changes; and
- the Superannuation Business Line is the largest user of the ATO's Firecall utility⁹, suggesting it is being used as part of 'business-as-usual' activity, contrary to its original purpose.

15. During the audit, the ATO commenced a number of reviews aimed at identifying areas of weakness within Surcharge systems, and developing strategies to strengthen the procedures and controls applicable to Surcharge processing activities. The ATO advised that, as a result of these reviews, new measures had been put in place to improve the efficiency and effectiveness of Surcharge processing activities, and to mitigate risks related to the operation of Surcharge IT systems.

Surcharge Exceptions (Chapter 4)

16. Surcharge exceptions are an area of significant concern for the ATO, as they prevent the Commissioner of Taxation (the Commissioner) from making Surcharge assessments. The ATO acknowledges that its overall management of exceptions since the introduction of the Surcharge has been less than adequate. Decisions not to resolve Surcharge exceptions have resulted in large backlogs (in excess of 11 million exceptions as at August 2004), which continue to grow markedly each year. The ANAO estimates that there is a range of between \$360 million and \$750 million in uncollected Surcharge revenue associated with these backlogs.

17. In 2002–03 the ATO commenced initiatives such as the reintroduction of the Please Quote TFN (PQTFN) letter process and the Exceptions Taskforce, to reduce exception backlogs and to minimise the potential for future exceptions to occur. The ANAO considers that for these initiatives to be successful, the ATO should:

- resolve all Surcharge exceptions in accordance with applicable Surcharge legislation and good administrative practice;
- utilise existing mechanisms, such as PQTFN letters and default assessments to encourage members to quote their TFNs to the ATO for Surcharge matching purposes;

⁹ Firecall is a special access authority built within ATO systems, which bypasses regular security controls to allow staff to perform emergency system and data fixes. ATO policy states that 'Firecall use is the exception and not the rule'.

- as part of a comprehensive compliance program, assess the quality of MCS data submitted by members and holders, and implement strategies to improve the quality of MCS data; and
- where possible, and subject to future system redevelopment activity, assess the costs and benefits of introducing short term, automated measures to resolve current and future SCS exceptions.

18. More recently, the ATO has decided to resolve a large number of the outstanding Surcharge exceptions by excluding particular categories of members from being assessed for the Surcharge. These include:

- members who are deceased;
- members aged 55 years and over and in receipt of retirement income; and
- exceptions relating to members' MCSs reported to the ATO for the 1997, 1998 or 1999 financial years.

19. The ATO advised that it has made significant progress in rectifying its exception backlogs using this approach. Specifically it advised, as at 5 March 2005, approximately 380 000 processing exceptions have been set aside in accordance with the Commissioner's general discretionary powers and 234 000 exceptions have been resolved. The ATO has raised additional Surcharge assessments to the value of \$67 million. This includes matching TFNs to 1.5 million of these cases which generated 4 480 assessments with Surcharge revenue value of approximately \$3.5 million.

20. Given the ATO's past experience with the management of Surcharge exceptions, the ANAO considers that the ATO needs to ensure that its approach to resolving Surcharge exceptions is logical, transparent and equitable.

Surcharge Compliance Management (Chapter 5)

21. A comprehensive and integrated Surcharge compliance framework is essential to the effective administration of the Surcharge, and to ensure that all taxpayers are treated equitably. Although the ATO is currently undertaking steps to improve Surcharge compliance, we found that the ATO's current Surcharge compliance framework is less than adequate, and past compliance enforcement activity has been less than effective. This is evident in poor lodgement compliance statistics for all market segments (particularly for small funds), as well as the high number of unresolved Surcharge exceptions.

22. We recognise that it would be costly for the ATO to enforce full compliance by members and holders with their Surcharge lodgement obligations. However there are steps the ATO can take to maximise the benefit of its existing compliance resources. These include:

- developing a robust Surcharge compliance framework, including methodology to analyse and report on holder and member Surcharge compliance;
- obtaining a more comprehensive knowledge of the Surcharge population through the analysis of Australian Prudential Regulation Authority (APRA) and ATO data, and by clearly defining and analysing market segment data;
- enforcing compliance through the use of legislative mechanisms such as contravention notices;
- developing a comprehensive Surcharge compliance strategy;
- introducing compliance mechanisms to identify which holders are lodging poor quality data, and acting on that information; and
- clearly defining cross-Business Line dependencies, and establishing procedures for cross-Business Line compliance activity.

23. Not only would these steps improve member and holder compliance with their Surcharge obligations, but it would also significantly lessen the impact of other Surcharge administrative problems such as the rectification of exceptions, a large number of which result from poor quality data provided by holders. The ANAO recognises that the ATO has now invested significant resources to address these issues.

Overall Conclusion

24. The introduction of the Surcharge presented a difficult challenge for the ATO. The mechanism chosen to collect Surcharge revenue was complex, and required that the ATO collect large amounts of superannuation contributions information from superannuation providers. Following the establishment of the Surcharge, additional pressures were placed on the ATO's capacity to administer the Surcharge, including: significant and ongoing amendments to Surcharge legislation; the introduction of tax reform; and reductions in ATO funding for the Surcharge.

25. Overall, we concluded that the ATO's administration of the Surcharge has not been managed well. In particular, we found a number of administrative deficiencies relating to: past Surcharge governance arrangements; Surcharge systems, processes and controls; the past

management of Surcharge exceptions; and Surcharge compliance. The ATO has put into place a number of mechanisms to address these problems and to improve its administration of the Surcharge.

26. We made 17 recommendations relating to the following areas:

- establishing a robust and well documented planning, risk management and reporting framework and methodology for Surcharge related activities;
- developing and maintaining high quality Surcharge procedures and systems documentation;
- developing and using a robust, consistent, and secure methodology for changes made to Surcharge systems;
- resolving all Surcharge exceptions in accordance with applicable Australian Government Solicitor advice;
- developing a robust Surcharge compliance framework, including methodology to analyse and report on holder and member compliance; and
- enforcing holder and member compliance through the development and implementation of a comprehensive Surcharge compliance strategy.

27. The ATO agreed to all 17 recommendations made in the audit.

Summary of ATO's Response

28. The ATO regards implementing the Surcharge as one of its most difficult challenges. This was not necessarily because of the measure itself, rather the environment in which it was introduced. At the time the ATO was under considerable pressure implementing numerous amendments to the superannuation legislation and the introduction of a major tax reform program. Overall the Surcharge system has been implemented and is delivering, in aggregate, its projected outcomes. Since its introduction the number of taxpayers paying the Surcharge has grown by 18 per cent and revenue by 267 per cent.

29. At the same time the ATO has not performed to the high standard the community expects. The ATO is dedicated to addressing these shortcomings and has made significant progress to ensure they do not recur.

30. The ATO also acknowledges that Surcharge exceptions could have been better managed. Each year the ATO receives 16.5 million Member Contribution Statements. Around 1 million of these cannot be matched to a

TFN and it is these cases that are the bulk of the exceptions in the current processing backlogs. However, only a small proportion of these backlog exceptions will ultimately generate a Surcharge liability. On average, the exceptions would represent 6.8 per cent of total Surcharge revenue. By 30 June 2005, all of the backlog exceptions will have been processed and procedures will be in place to ensure that Surcharge exception backlogs do not recur. The ATO's full response is at Appendix 1.

Recommendations

Set out below are the ANAO's recommendations aimed at improving the administrative practices of the ATO relating to the administration of the Superannuation Contributions Surcharge. Report paragraph references and abbreviated ATO responses are also included. More detailed responses are shown in the body of the report. The ANAO considers that the ATO should give priority to Recommendations 1, 3, 6, 7, 8 and 12.

**Recommendation
No.1
Para 2.22**

The ANAO recommends that the ATO, in accordance with the Australian Standards on record management, and as part of an all-inclusive Surcharge governance framework, implement mechanisms to provide assurance that all major decisions affecting the Surcharge are fully recorded.

ATO Response: Agreed.

**Recommendation
No.2
Para 2.39**

The ANAO recommends that, to improve its approach to Surcharge planning, the ATO's Superannuation Business Line:

- develop and implement a planning methodology at the operational level, which clearly links to the priorities, outcomes and risks identified in strategic level plans;
- implement, monitor and report on integrated, quantitative and qualitative performance measures that will provide a consistent and meaningful measure of Surcharge performance over time; and
- monitor and report against plans at the operational level.

ATO Response: Agreed.

**Recommendation
No.3**

Para 2.61

The ANAO recommends that, to improve Surcharge risk management, the ATO:

- develop and apply a consistent Surcharge risk management methodology at the operational level, based on sound analysis and information, which clearly links to the risks identified in strategic level plans and is consistent with ATO corporate risk management policy;
- as part of the ATO Certificate of Compliance process, undertake regularly an assessment of Surcharge system risks, to identify key Surcharge controls; and
- undertake an assessment of fraud control risks for Surcharge information technology systems, and ensure that ATO staff responsible for implementing applicable risk mitigation strategies are aware of, and report regularly against, these risks.

ATO Response: Agreed.

**Recommendation
No.4**

Para 2.75

The ANAO recommends that, to provide a comprehensive, consistent and integrated approach to Surcharge internal reporting, the ATO develop and implement a robust Surcharge reporting framework, underpinned by sound planning and risk management processes, which clearly link to other relevant ATO strategic level plans.

ATO Response: Agreed.

**Recommendation
No.5
Para 3.20**

The ANAO recommends that, to provide assurance that Surcharge contributions data is captured in a timely and efficient manner, and to improve accountability, the ATO's Superannuation Business Line and the Operations Service Line:

- develop, agree and document the terms and conditions for the extraction of Surcharge contributions data provided on magnetic media, and the placement of these data onto relevant ATO IT systems for processing; and
- develop and report against performance indicators that provide a meaningful measure of performance against, and compliance with, those terms and conditions.

ATO Response: Agreed.

**Recommendation
No.6
Para 3.40**

The ANAO recommends that, to provide adequate assurance that the Surcharge assessment run operates efficiently and effectively, the ATO:

- compile a comprehensive set of procedural documentation for the Surcharge assessment run; and
- introduce a robust system of controls to manage this documentation, including:
 - the storage of this documentation in a secure central location; and
 - controls to provide assurance that SCS system procedural documentation is current and complete.

ATO Response: Agreed.

**Recommendation
No.7**

Para 3.52

The ANAO recommends that, to provide adequate assurance that the SCS system is operating efficiently and effectively, the ATO:

- compile a complete set of baseline specifications for the SCS system; and
- introduce a robust system of controls to maintain the currency and completeness of the SCS system baseline and change specifications.

ATO Response: Agreed.

**Recommendation
No.8**

Para 3.64

The ANAO recommends that, to provide assurance that changes to the Surcharge processing systems are appropriately analysed, authorised and implemented, the ATO:

- clearly define the roles, responsibilities and accountabilities of business and IT staff regarding the operation of Surcharge processing systems; and
- as part of its change management framework, develop controls to provide assurance that appropriate IT and business managers review and approve changes to Surcharge processing systems.

ATO Response: Agreed.

**Recommendation
No.9**

Para 3.72

The ANAO recommends that, to provide assurance that system errors are managed efficiently and effectively, the ATO develop and implement a consistent approach to identifying, recording, and prioritising changes to Surcharge processing systems.

ATO Response: Agreed.

**Recommendation
No.10
Para 3.81**

The ANAO recommends that, to provide assurance that emergency changes to the SCS system are appropriately classified, controlled and approved, the ATO:

- develop, document and implement controls to provide assurance that emergency fixes are used appropriately and in accordance with ATO emergency fix procedures; and
- monitor and report on the number of emergency fixes as a measure of overall Surcharge system performance, and to assist in the assessment of Surcharge systems' risk; and
- review regularly the impact of emergency fixes on the operation of Surcharge systems.

ATO Response: Agreed.

**Recommendation
No.11
Para 3.93**

The ANAO recommends that, to achieve the required level of security, and to promote consistency in access approval processes to Surcharge processing systems, the ATO:

- introduce a robust suite of procedures and controls to provide assurance that all Firecall access relating to Surcharge processing systems is legitimate;
- as part of a comprehensive approach to the Certificate of Compliance process, review all Surcharge related Firecall access regularly to provide assurance that it is legitimate; and
- as part of its internal reporting framework, report the results of Firecall access reviews.

ATO Response: Agreed.

**Recommendation
No.12
Para 4.39**

The ANAO recommends that, to provide a coordinated and comprehensive approach to managing future identity-matching exceptions in accordance with the Surcharge legislation, the ATO:

- develop and enforce a policy for the timely issue of Surcharge letters and default assessments, as specified under the Superannuation Contributions Tax Imposition Act 1997; and
- actively monitor and report to ATO corporate management the number of identity-matching exceptions, and the number of Surcharge letters and default assessments issued.

ATO Response: Agreed.

**Recommendation
No.13
Para 4.63**

The ANAO recommends that, to improve its management of SCS exceptions, the ATO:

- develop and document procedures to resolve all SCS exceptions in accordance with relevant Surcharge legislation; and
- provide relevant staff with the training necessary to resolve SCS exceptions.

ATO Response: Agreed.

**Recommendation
No.14
Para 5.21**

The ANAO recommends that, in order to assess the risk applicable to the non-lodgement of member contribution statements by registered superannuation funds, and to determine the completeness of member contribution statement lodgements, the ATO:

- analyse and report on significant variations between the number of registered superannuation funds, and the number of funds lodging member contribution statements;
- with assistance from APRA, introduce a systematic and co-ordinated approach to share and analyse relevant registered superannuation fund data; and
- use the results of this analysis to support ATO Surcharge compliance activities.

ATO Response: Agreed.

**Recommendation
No.15
Para 5.36**

The ANAO recommends that, to manage Surcharge compliance effectively, the ATO develop a logical, well structured, and comprehensive Surcharge compliance framework which incorporates the following:

- a policy for issuing contravention notices for holders of contributions that do not comply with their Surcharge lodgement obligations;
- a risk assessment process to identify, assess and rank Surcharge compliance risks as part of a Surcharge compliance strategy;
- a methodology based on the ATO Compliance Model to identify potential strategies to mitigate Surcharge compliance risks, as part of a Surcharge compliance strategy;
- a regular reporting process to monitor and report on compliance risks and risk mitigation strategies; and
- a coordinated approach to reporting Surcharge compliance within the Superannuation Business Line, to ATO corporate management and publicly.

ATO Response: Agreed.

**Recommendation
No.16
Para 5.78**

The ANAO recommends, that, in order provide assurance that holders of superannuation contributions comply with their obligation to lodge Surcharge information of high quality, the ATO:

- as part of a Surcharge compliance strategy, establish compliance mechanisms or procedures to identify the lodgement of inaccurate or low quality Surcharge information; and
- undertake regularly compliance enforcement activity.

ATO Response: Agreed.

**Recommendation
No.17**

Para 5.86

The ANAO recommends that, to improve Surcharge compliance, the ATO:

- articulate clearly, cross-Business Line dependencies between the Superannuation Business Line and other relevant ATO Business Lines; and
- establish and document procedures between the Superannuation Business Line and other relevant Business Lines for joint 'business-as-usual' compliance activity.

ATO Response: Agreed.

Audit Findings and Conclusions

1. Background and Context

This chapter establishes the background to the audit, provides contextual information relevant to the ATO's administration of the Superannuation Contributions Surcharge, and outlines the audit's objective and methodology.

Background

The Australian Taxation Office

1.1 The Australian Taxation Office (ATO) is responsible for effectively managing and shaping systems that support and fund services for Australians, and give effect to social and economic policy through the tax system. It is the principal agency charged with the administration of Australian tax law, including applicable superannuation law.

1.2 In 2003–04, the ATO collected almost \$199 billion¹⁰ in tax, superannuation and excise revenue, and received an appropriation of \$2.3 billion. As at 30 June 2004 it employed 21 009 staff.¹¹

Superannuation

1.3 Superannuation is a large and complex area of taxation administration. As at 30 June 2004, the ATO's superannuation activity covered approximately:

- 10 million Australian employees;
- 900 000 employers;
- 27 million member accounts;
- \$20 billion in member contributions per annum;
- \$38 billion employer contributions per annum;
- 300 000 superannuation funds; and
- \$625 billion assets under management.¹²

1.4 The ATO's superannuation administrative responsibilities impact on a diverse range of clients, ranging from individual employees through to large superannuation companies. Although the ATO provides a wide range of services to these clients, the focus of ATO superannuation activity is on four

¹⁰ Commissioner of Taxation 2004, *Annual Report 2003–04*, p.33.

¹¹ *ibid.*, p.240.

¹² ATO Health Of The System Assessment (HOTSA) November 2004.

main areas: Superannuation Guarantee¹³, Superannuation Co-contributions¹⁴, Self Managed Superannuation Funds (SMSFs)¹⁵ and Superannuation Contributions Surcharge (the Surcharge). Responsibility for the administration of these four areas rests with the ATO's Superannuation Business Line.

Superannuation Contributions Surcharge

1.5 In 2003–04, the ATO collected \$1.05 billion in Surcharge revenue, which is equivalent to 0.5 per cent¹⁶ of the total revenue collected by the ATO in that year. As at 30 June 2004, 152 full time equivalent staff undertook Surcharge related activities at a total cost of \$22 million.

1.6 As part of the 1996–97 Budget, the Government introduced a series of budget measures to '...make superannuation arrangements fairer, more flexible and better suited to the needs of the modern workforce'.¹⁷ A key focus of those measures was the disparity between the tax concessions for superannuation contributions received by high-income earners¹⁸, compared to low and middle-income earners.

1.7 One measure (the Surcharge) sought to address this disparity, by imposing an additional amount payable on certain superannuation contributions relating to high-income earners. The Treasurer noted that the introduction of the Surcharge '...greatly improves the equity of the superannuation system'.¹⁹

Calculation of the Surcharge

1.8 The calculation of the Surcharge depends on a number of factors, including the superannuation fund type and the particular income tax arrangements a superannuation fund member has. In simple terms, the

¹³ The Superannuation Guarantee scheme was introduced on 1 July 1992 to ensure that most Australian employees receive employer superannuation support. This product was reviewed by the ANAO in *Audit Report No. 16 1999–2000 Superannuation Guarantee*.

¹⁴ Under the Super Co-contribution scheme, the Government will match applicable members contributions, up to certain limits.

¹⁵ The ATO took over responsibility for the regulation of these funds from the Australian Prudential Regulation Authority (APRA) in 1999.

¹⁶ *ibid*, p. 73.

¹⁷ Treasurer, Press Release 20 August 1996, 'Superannuation Reform'.

¹⁸ The ATO notes that there is not a single, standard definition for a 'high income earner'. We note that for the purposes of the Surcharge, in 2004–05, a high-income earner is considered to be a taxpayer with an adjusted taxable income equal to or greater than \$99 710. In comparison, for income tax purposes high income earners are considered to be those taxpayers that are subject to the top marginal income tax rate, which commences at a top taxable income threshold of \$70 000.

¹⁹ Treasurer, 'ibid'.

Surcharge is levied on the surchargeable contributions of a member²⁰ whose Adjusted Taxable Income (ATI) exceeds the minimum Surcharge threshold in a given income year. The ATO determines a member's ATI and calculates a member's Surcharge liability by matching and combining data from an individual's income tax return²¹, with the member contribution data the ATO receives via a Member Contribution Statement (MCS).²² The holder of the surchargeable contributions (the holder)²³ provides this statement to the ATO. The steps involved in the calculation of the Surcharge, as well as a more comprehensive explanation of terms specific to the Surcharge (see underlined words above), are provided in Appendix 2.

Surcharge legislation

1.9 Although there are several pieces of legislation that are applicable to the operation of the Surcharge, there are two main Acts that impose the Surcharge and provide for its administration. These are the:

- *Superannuation Contributions Tax Imposition Act 1997* (the Imposition Act). The object of this Act was to impose the Surcharge on a member's surchargeable contributions; and
- *Superannuation Contributions Tax (Assessment and Collection) Act 1997* (the Assessment and Collection Act). The object of this Act was to provide for the assessment of the superannuation contributions Surcharge payable on surchargeable contributions for high-income earners. This includes the establishment of the Surcharge 'collection mechanism' (see Appendix 3).

1.10 There are features of these Acts that impact on how the ATO administers the Surcharge. These features include:

- *the calculation of the Surcharge is reliant on the lodgement of income tax returns by members and the lodgement of MCSs by superannuation holders. If*

²⁰ A 'member' means a member of a superannuation fund or of an Approved Deposit Fund (ADF), the holder of a Retirement Savings Amount (RSA), or the purchaser of an annuity from a life assurance company or from a registered organisation.

²¹ This will generally be the taxable income detail for the member, along with any reportable fringe benefit information and deducted personal superannuation contributions.

²² A Member Contributions Statement (MCS) is an ATO approved form that indicates the value of a member's superannuation contributions. In addition to the value of a member's contributions, the MCS should also contain the member's Tax File Number (TFN), which the ATO uses to match the MCS to other taxation information to calculate the Surcharge.

²³ In most cases (except those where the contributed amounts have started to be paid out to the member) this will be the relevant superannuation fund that has control of the member's contributed amounts.

an MCS or an income tax return is not lodged with the ATO, the Surcharge cannot be calculated²⁴;

- *the Commissioner of Taxation (the Commissioner) must make an assessment of Surcharge for every member for whom there are superannuation contributions for each financial year.*²⁵ Under this provision, the Commissioner has a duty to ensure holders comply with their obligation to lodge MCSs and members lodge income tax returns. However, this duty is not absolute, as there are limited circumstances in which the Commissioner may lawfully decide not to make an assessment²⁶; and
- *members need to provide their Tax File Number (TFN) to the holder of their contributions to avoid being issued a default assessment.*²⁷ Although there is no legal requirement for a member to quote a TFN to the holder of their superannuation contributions, the ATO can issue members with default assessments if they do not provide their TFN to the holder of their contributions. As discussed in Appendix 2, the ATO is heavily reliant on TFNs to match the information provided on MCSs to income tax returns. Without members' TFNs, the ATO's ability to calculate members' Surcharge assessments is reduced significantly.

1.11 In practice, we found that these features of the Surcharge legislation provide a number of challenges for the ATO regarding the effective and equitable administration of the Surcharge. The implications for the ATO of these features, are discussed in more detail in Chapters 2, 3, 4 and 5 of this report.

Surcharge implementation

1.12 At the time the Surcharge was introduced, the ATO rated it as one of the most difficult administrative challenges it had ever faced. This was evidenced by an October 1997 letter from the then Assistant Treasurer to the then Minister for Finance, which stated that:

Implementing the Surcharge involves the single largest data load over the shortest period that the ATO has ever undertaken. Specifically, some 150 000

²⁴ See Chapter 5.

²⁵ Section 15(1) of the *Assessment and Collection Act*.

²⁶ During the audit, the ATO in consultation with ANAO, sought a legal opinion from the Australian Government Solicitor (AGS) on this matter. The dot-point above reflects the legal opinion provided by the AGS. The Commissioner's obligation to assess all members for the Surcharge is discussed in more detail in Chapter 4.

²⁷ Subject to the Commissioner taking all reasonable steps to determine a member's identity and writing to the member twice to advise them of their obligation to provide their TFN, a default assessment, which applies the Surcharge at the maximum Surcharge rate can be issued on a members super contributions.

superannuation funds will report 50 mandatory data items for 16.8 million member accounts (per recent ISC advice) to the ATO on 15 December 1997.²⁸

1.13 Since 1998–99, the challenge of administering the Surcharge has become more difficult, with increases in the number of member accounts processed by Surcharge systems²⁹, and ongoing changes to Surcharge legislation that have increased the complexity of Surcharge calculations.³⁰

1.14 The collection of data from members and holders, the amount of data processed, and the complexity of the calculations needed to issue Surcharge assessments, required the development of a large and complex Information Technology (IT) system. Due to these factors, the Superannuation Contributions Surcharge (SCS)³¹ system is one of the largest IT systems operated by the ATO.³² The ANAO recognises that the introduction of the SCS system by the ATO in a short period of time, and with a limited budget, was a commendable achievement.

1.15 Although among the ATO's largest IT systems, the SCS system is used to collect significantly less revenue than other ATO IT systems of a comparative size. For example, the Pay As You Go Withholding (PAYGW) system was used to collect \$90 billion in revenue in 2003–04. In comparison, the SCS system was used to collect \$1 billion in Surcharge revenue.

1.16 In addition to the implementation of its Surcharge systems, the ATO faced a number of other challenges prior to, and immediately following the introduction of Surcharge legislation. Appendices 4 and 5 provide an overview of the history and difficulties associated with the introduction and ongoing administration of the Surcharge.

Surcharge administration costs

1.17 The cost to implement and maintain a large and complex Surcharge system has been substantial for the ATO. As part of the 1996–97 Budget, the ATO received ongoing departmental funding of \$3.3 million to implement Surcharge systems. The ATO advised that the total cost of administering the Surcharge in 2003–04 was \$22 million. Aspects of ATO Surcharge funding are discussed further in Chapter 2.

²⁸ Letter sent from the then Assistant Treasurer, Senator the Hon. Rod Kemp, to the then Minister for Finance and Administration, the Hon. John Fahey MP, 22 October 1997.

²⁹ See paragraph 1.23.

³⁰ See Appendix 4.

³¹ This system is discussed in Chapter 3.

³² This is based on the amount of data processed by the system.

1.18 The costs for holders to comply with their obligations under the Surcharge have also been significant. These costs include:

- changes to IT systems to collect and provide member superannuation contributions information to the ATO;
- additional administration associated with the provision of member contributions information to the ATO;
- additional legal and actuarial advice regarding the Surcharge; and
- provision of advice to members regarding the introduction of the Surcharge.

1.19 In August and September 1998, the Association of Superannuation Funds of Australia Limited (ASFA) and the Investment and Financial Services Association Limited (IFSA) undertook a survey of 105 holders who represented over 1 000 superannuation funds, regarding their Surcharge compliance obligations. The survey found that Surcharge implementation costs for holders were approximately \$190 million.³³ This compares with the \$120 million estimate calculated by the ATO prior to the implementation of the Surcharge.

Context

1.20 To obtain an understanding of the current Surcharge environment, and the effect the Surcharge had on taxpayers and revenue, the ANAO assessed the data contained in the SCS system. Although we raise some concerns about the quality of the data contained on the SCS system in Chapters 3, 4 and 5, we consider that our analysis of this data provides a reasonable basis for assessing the ATO's performance in administering the Surcharge.

Current Surcharge environment

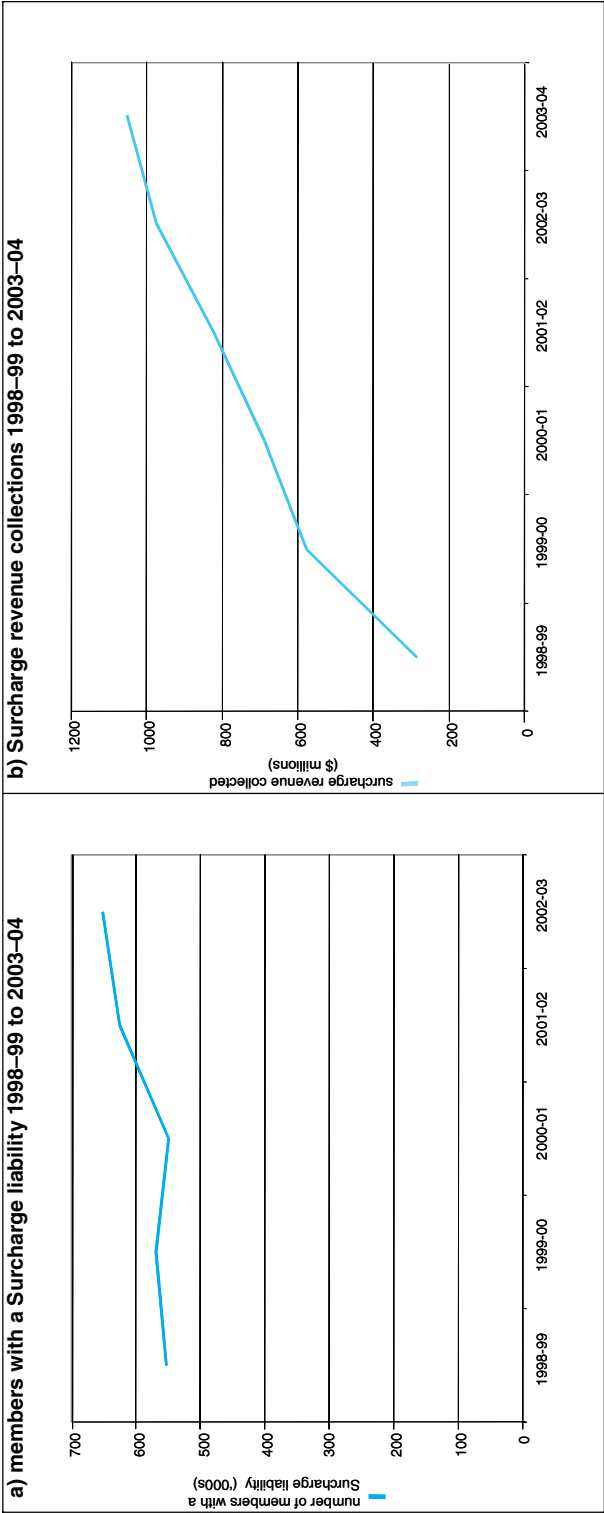
1.21 At the time the Surcharge was introduced to Parliament in 1996–97, the Government estimated that approximately 355 000 taxpayers would be affected, and that the estimated revenue collected from the Surcharge would be \$434 million in 1997–98, \$500 million on 1998–99, and \$526 million in 1999–2000.

1.22 Although estimates were close initially, there have been increases in the amount of Surcharge revenue collected since 1998–99, and a steady growth in the number of members paying the Surcharge. The following figures illustrate the growth in Surcharge revenue, as well as the related growth in the number of members paying the Surcharge.

³³ The Association of Australian Superannuation Funds of Australia Limited and the Investment and Financial Services Association Limited, *The Surcharge: Survey of Costs and Implementation Issues*, October 1998.

Figure 1.1

Number of members with a Surcharge liability and Surcharge revenue collections between 1998–99 and 2003–04



Source: ANAO analysis of ATO SCS and Treasury data³⁴

³⁴ The number of members with a Surcharge liability reflects the actual number of distinct members processed by the ATO during the financial year. The Surcharge revenue collection relates to the actual Surcharge revenue (cash) collected by the ATO during the financial year.

1.23 During the introduction of the Surcharge (1997–98) there were a number of compliance, systems and legislative issues that had not been resolved, which impacted on Surcharge revenue collections.³⁵ For this reason we have excluded the 1997–98 financial year from our analysis of the Surcharge environment. Analysis of Surcharge liability and revenue data shows the following:

- between 1998–99 and 2003–04 the number of members affected by the Surcharge increased from 552 000 to 640 000 (a 16 per cent increase). This indicates a steady, but moderate growth in the number of members affected by the Surcharge during this time; and
- Surcharge revenue collections increased from \$286 million in 1998–99 to \$1050 million in 2003–04 (or a 267 per cent increase). This indicates there has been a significantly greater proportionate increase in Surcharge revenue between 1998–99 and 2003–04, in comparison to the number of members paying the Surcharge.

1.24 This analysis indicates that although ‘bracket creep’³⁶ is a factor in the growth in Surcharge revenue, growth has also resulted from existing members contributing higher amounts of Surcharge each year. This is supported by the analysis contained in Appendix 6.

Stakeholder comment on the current Surcharge environment

1.25 Prior to the introduction of the Surcharge in 1996–97, the majority of superannuation industry representatives voiced strong opposition to the mechanism the Government proposed to collect the Surcharge.³⁷ This mechanism placed significant obligations on holders to collect and provide large amounts of contribution information to the ATO.³⁸ Alternative collection mechanisms examined prior to the introduction of the Surcharge imposed additional administrative costs on employers. This did not accord with the Government’s policy objectives described in Appendix 4.

1.26 During the audit, we interviewed 11 stakeholders, concerning their views on the Surcharge, including the ATO’s current Surcharge administrative practice.³⁹ We note that the majority of those interviewed were accepting of the intent of the Surcharge policy, but remained critical of the Surcharge collection mechanism (see Appendix 5).

³⁵ These issues are discussed in Appendix 4.

³⁶ That is, each year, member’s ATIs are increasing at a faster rate than the indexation of the ATI limits, putting a larger proportion of members above the lowest Surcharge threshold.

³⁷ Stakeholder reaction to the introduction of the Surcharge is discussed in greater detail in Appendix 5.

³⁸ The Surcharge collection mechanism is depicted in Appendix 3.

³⁹ The stakeholders consulted as part of this audit are listed and discussed further in paragraph 1.34.

New Surcharge environment

1.27 In recent years, the ATO's administration of the Surcharge has undergone significant change. This change included a large amount of additional funding from the 2004–05 Budget, as well as a corporate restructure of the Superannuation Business Line. The impact of these changes on Surcharge administration is discussed below.

Additional Surcharge funding from 2004–05 Budget

1.28 As part of the 2004–05 Budget, the ATO received additional departmental expense funding of \$326.4 million over four years for taxation and Superannuation compliance activities. Of this funding, \$52.8 million related to Superannuation activities. There are three areas related to the Surcharge that will benefit from this funding. These are:

- processing Surcharge exceptions.⁴⁰ This is discussed in Chapter 4;
- the issuing of Please Quote TFN letters. This is discussed in Chapter 4; and
- Self Managed Superannuation Fund (SMSF) compliance. This is discussed further in Chapter 5.

1.29 As part of this expense measure, the ATO has undertaken to collect an additional \$125 million in additional Surcharge revenue over four years. To date, the ATO has raised additional Surcharge assessments to the value of \$67 million. Also, as part of the 2004–05 Budget, there was an adjustment to the maximum Surcharge rate. This rate change is explained fully in Appendix 2.

The ATO and Superannuation Business Line organisational structure

1.30 Up to and during the audit, the ATO was restructuring the Superannuation Business Line to enable the more efficient and effective administration of the Surcharge and other Superannuation activity. A key initiative resulting from the changes included the creation of three new Senior Executive positions, two in Active Compliance, and one in Client Services. The ANAO notes that the changes within the Superannuation Business Line have impacted on other aspects of governance (for example planning and reporting). These aspects of governance are discussed further in Chapter 2.

⁴⁰ An exception is broadly defined as an event that interrupts workflow through a process or system that requires correction by manual or electronic intervention.

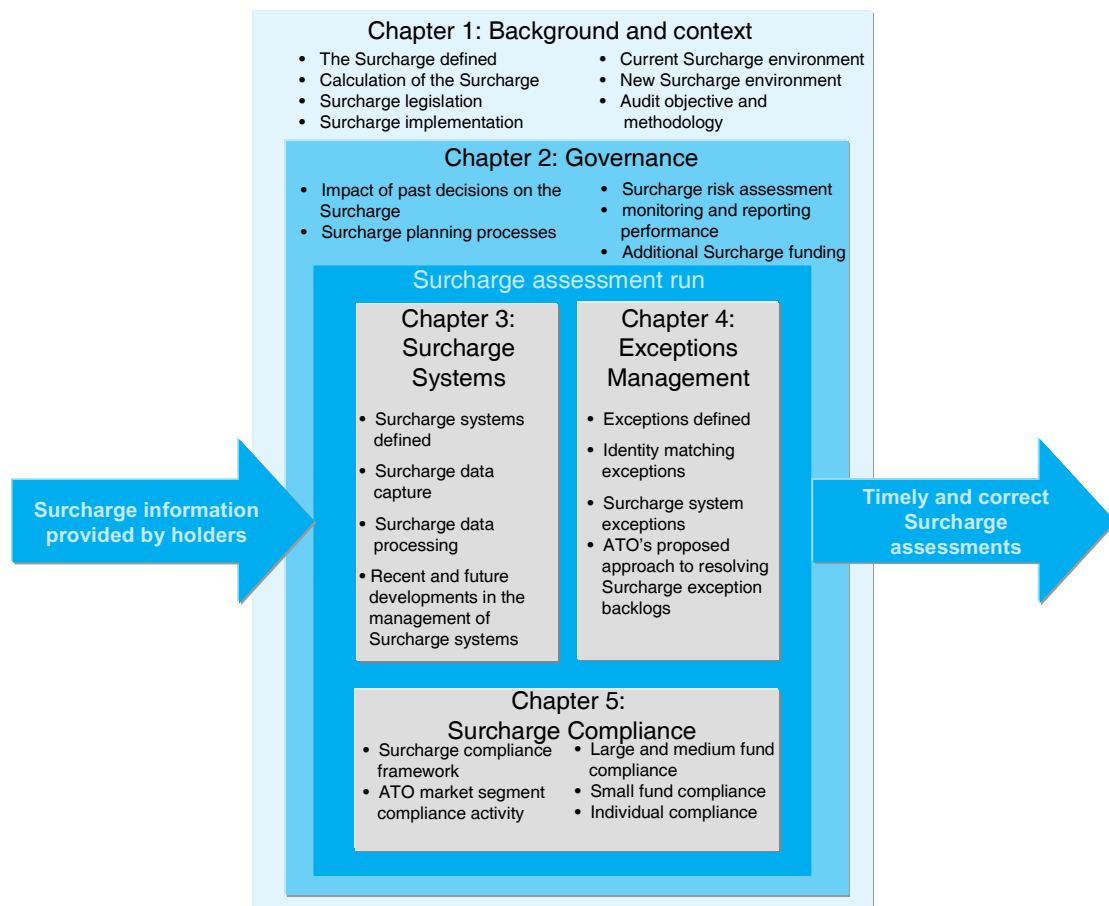
Audit Objective and Methodology

Audit Objective

1.31 The objective of the audit was to assess the ATO's administration of the Superannuation Contributions Surcharge. Specifically, the audit sought to:

- report on the environment into which the Surcharge was introduced, including the legislative intent behind the Surcharge, and the current Surcharge environment;
- examine and report on aspects of Surcharge governance;
- assess the systems, processes and controls the ATO uses to:
 - match MCS data with income tax return data using TFNs;
 - process Surcharge information; and
 - issue Surcharge liability assessments.
- assess the mechanisms the ATO uses to assess, classify, manage and rectify existing Surcharge exceptions, and prevent future exceptions from occurring; and
- examine the mechanisms and strategies the ATO uses to provide assurance that members and holders of contributions are complying with their Surcharge obligations.

1.32 We have reported separately against each of these areas. Figure 1.2 depicts the structure of the chapters.

Figure 1.2**Structure of the chapters****Audit Methodology**

1.33 The bulk of the audit fieldwork was conducted from June 2004 to August 2004. In addition to the review of relevant superannuation documentation, we undertook qualitative and quantitative analysis of the systems, processes and controls used in the administration of the Surcharge. Interviews with key ATO staff from the Personal Tax and Superannuation Business Lines were also conducted, as well as with ex-superannuation staff responsible for the introduction of the Surcharge.

1.34 Interviews were conducted with stakeholders from the superannuation industry⁴¹, representatives from accounting professional bodies⁴², and relevant Commonwealth organisations⁴³, on the operation of the Surcharge and aspects of the ATO's administration. Stakeholder views are discussed in paragraphs 1.25 and 1.26, as well as Appendix 5.

1.35 We also undertook testing of the ATO main superannuation system (SCS system). Testing involved the review and analysis of systems documentation, change control, and systems testing procedures.

1.36 The audit was conducted in accordance with auditing standards at a cost of \$516 000.

Acknowledgements

1.37 The ANAO recognises, and appreciates, the contribution of ATO officers, superannuation industry representatives, accounting professional organisations, and other relevant Commonwealth organisations, who assisted in the conduct of this audit.

⁴¹ Superannuation industry representatives interviewed included: Association of Superannuation Funds of Australia Limited (ASFA); Investment Financial Services Australia Limited (IFSA); Bravura Solutions Limited; AMP; Colonial First State; Mercer HR Consulting; Self Managed Super Funds Professional Advisors Association (SPAA); and Australian Administration Services (AAS).

⁴² The accounting professional associations interviewed were CPA Australia, and the Institute of Chartered Accountants Australia (ICAA).

⁴³ The Commonwealth agencies interviewed as part of the audit were: The Commonwealth Ombudsman; The Department of the Treasury; and ComSuper.

2. Governance

This chapter addresses aspects of the ATO's Surcharge governance framework. In particular we focus on key decisions made by the ATO following the implementation of the Surcharge, as well as aspects of its planning, risk management, and reporting.

Introduction

2.1 The Surcharge is a complex area of Superannuation legislation affecting a wide range, and large number, of members and holders. To provide assurance that all Surcharge activities are effectively planned, coordinated and reported, it is important that the Surcharge is managed within a robust, well-coordinated ATO governance framework.

2.2 For the purposes of this report, effective public sector governance comprises a number of generally accepted principles, which include:

- **accountability**—being answerable for decisions and having meaningful mechanisms to ensure adherence to all applicable standards;
- **transparency**—clear roles and responsibilities and clear procedures for decision-making and the exercise of power;
- **integrity**—acting impartially, ethically and in the interests of the organisation, and not misusing information acquired through a position of trust;
- **stewardship**—using every opportunity to enhance the value of the public assets and institutions that have been entrusted to care;
- **efficiency**—the best use of resources to further the aims of the organisation with a commitment to evidence-based strategies for improvement; and
- **leadership**—leadership from the top is critical to achieving an organisation-wide commitment to good governance.⁴⁴

2.3 Effective governance is also about achieving results while taking account of risk. This makes a structured approach to risk management an essential component of sound governance and management practice.

⁴⁴ ANAO Better Practice Guide, *Public Sector Governance and the Individual Officer—Guidance Paper No.1*, July 2003.

2.4 This chapter focuses on the higher-level strategies, controls and reporting arrangements the ATO uses to manage its Surcharge administrative obligations, and addresses, in particular:

- the impact of past ATO decisions on present Surcharge management arrangements;
- effective Surcharge planning processes;
- effective Surcharge risk assessment processes;
- a structured approach to monitor and report Surcharge performance; and
- additional Surcharge funding provided in the 2004–05 Budget Process.

The impact of past ATO decisions on the current management of the Surcharge

2.5 Following the implementation of the Surcharge in 1997, the ATO made critical decisions that continue to affect the way the Surcharge is administered. Although some of these decisions have had an adverse impact on Surcharge administration, they should be considered within the superannuation environment that existed at the time. Several factors that influenced the Surcharge environment between 1990–91 to 2000–01 were:

- Surcharge funding. As discussed in Appendix 4, the ATO made several requests to Government for funding to cover costs applicable to a number of separate pieces of superannuation legislation (including the Surcharge) from 1990–91 to 1996–97. The ATO was asked by Government to absorb the majority of these costs.
- Surcharge revenue. Surcharge revenue collections were significantly higher than estimates, from 2001–02. For example, in 2001–02 the ATO collected 24 per cent more Surcharge revenue than estimated.⁴⁵ This was accomplished despite funding cuts.
- A New Tax System (ANTS).⁴⁶ From 1999 to 2001, the main focus of ATO activity was on the implementation of ANTS. During that time, ATO funding requests centred on ANTS-related activities. Also, staff from a number of Business Lines within the ATO, were reassigned to work on ANTS-related projects, particularly the implementation of the Goods and Services Tax.

⁴⁵ source: Treasury Surcharge estimates (cash).

⁴⁶ A package of A New Tax System (ANTS) legislation was presented to Parliament in May 1999, which enacted, amongst other things, the Goods and Services Tax (GST).

- safeguarding ATO IT systems against the 'year 2000 problem'.⁴⁷ The ATO advised that adequately protecting its systems (including the Superannuation Contributions Surcharge (SCS) system) against the year 2000 problem was costly and resource intensive. The ATO advised that this issue had a major impact on Superannuation Business Line (and Surcharge) resources.

2.6 Although there is no documentary evidence to show the impact these factors had on the ATO's approach to Surcharge administration, the Surcharge was not a high priority area for the ATO. Within this environment, the ATO made three key decisions regarding its administration of the Surcharge for the immediate future. These were:

- not to undertake any further development of the SCS system, to make it a fully functional system (this is discussed further in Chapter 3);
- to significantly reduce the number of assessments issued for Member Contribution Statements (MCSs) that resulted in Surcharge exceptions after 1999; and
- to cease issuing Please Quote Tax File Number (PQTFN) letters and default assessments after 2001.⁴⁸

2.7 The ATO's approach to managing Surcharge exceptions and PQTFN letters, is examined in detail in Chapter 4.

Development of the SCS system

2.8 After funding cuts to the Superannuation Business Line in 1997–98, a draft business case was developed by the ATO, to determine whether additional resources were required to provide for the assessment and collection of the Surcharge. The draft business case noted that:

- as at August 1999, an estimated 70 per cent of the core functionality of the SCS system had been constructed. This was equivalent to approximately 55 per cent of the total work effort needed to complete the Surcharge system;

⁴⁷ The 'year 2000 problem' refers to the inability of some computer programs and micro processors to recognise or perform calculations using either a four digit year date or a two digit year date where the year 2000 is represented as '00'. This may result in the program failing to operate correctly, either by shutting down or producing erroneous results.

⁴⁸ The ATO advised that this decision was taken as a result of the closure of the Bankstown tax office and subsequent loss of interactive voice recognition technology. The ATO advised further that, at this time, it was focussing its attention and resources on the critical and important priorities associated with Tax Reform and the implementation of the Goods and Services Tax.

- given that the current Surcharge system was not completed and did not meet a number of legislative requirements, ceasing further work on the SCS system, was not considered a viable option;
- failure to complete this work would expose the ATO to significant criticism; and
- approximately \$48.5 million in capital and expense funding over four years would be required to make the SCS system fully functional.

2.9 We were advised by the ATO that ATO corporate management was aware of the issues raised in the business case, and the possible implications of not fully funding the SCS system. Although the ANAO was unable to obtain documentary evidence concerning the ATO's decision not to fund the completion of the SCS, we note that the system is still not fully functional. The full impact of this decision is discussed in detail in Chapter 3.

Reduction in the number of assessments issued in relation to Surcharge exceptions

2.10 An exception is broadly defined as an event that interrupts workflow through a process or system that requires correction by manual or electronic intervention. For the Surcharge, the ATO divides exceptions into two categories. In simple terms, these are:

- SCS exceptions. These arise when an event occurring during processing (within the SCS system) prevents the Commissioner from making an assessment, or indicates that the Commissioner should review an assessment at a later time. This usually involves the SCS system not being able to interpret a member's MCS or Income Tax Return (ITR) record; and
- identity matching exceptions. These arise when an MCS cannot be matched to a member's ITR before it is processed by the SCS (see Chapter 3 Figure 3.1), to allow the Commissioner to make a Surcharge assessment. Such circumstances may arise when a member does not provide correct or complete information to their holder, or alternatively the holder does not forward correct information to the ATO.

2.11 Both types of exceptions are explained, analysed and discussed in more detail in Chapter 4 but are covered in this chapter as well, given their impact on the ATO's ability to manage the Surcharge effectively.

SCS exceptions

2.12 The ANAO was advised by the ATO that in 1999, the ATO undertook a review of SCS exceptions to determine whether they should be resolved. Although the ATO was unable to provide a copy of the review or its results, we were advised the review found there would be a limited impact on Surcharge revenue if SCS exceptions were not resolved.

2.13 This apparent finding, in conjunction with pressures on Surcharge resources, a focus on ANTS, and the year 2000 problem, led to a decision by ATO corporate management not to resolve Surcharge exceptions. This decision had two significant consequences:

- the Commissioner would not issue Surcharge assessments for the majority of members whose records resulted in SCS exceptions; and
- large numbers of SCS exceptions (824 000) were unresolved as at August 2004. Many of these exceptions will be difficult to resolve as they date back to 1997–98.

2.14 The ATO identified SCS exceptions as a key corporate risk in 2003 and successfully went forward for additional funding during the 2003–04 Budget process. During the audit, the ATO had made progress to resolve the SCS exceptions backlog. The ATO's policy and actions regarding the resolution of SCS backlog cases is discussed in detail in Chapter 4.

2001 decision not to issue Please Quote Tax File Number (PQTFN) letters and default assessments

2.15 As discussed in Chapter 1 (paragraph 1.10), the ATO needs a member's TFN to match MCS's data to their ITR for the purpose of calculating the Surcharge. If a member does not provide a TFN⁴⁹, the ATO can issue a default assessment (i.e. impose the maximum Surcharge rate on a member's superannuation contributions for that Surcharge period). However, to do this, the ATO must issue two letters (PQTFN letters)⁵⁰, as specified under the Surcharge legislation.⁵¹

⁴⁹ And the ATO has been unable to obtain a TFN for the member from existing tax records.

⁵⁰ PQTFN letters request that a member supplies their TFN to the ATO. It also specifies that, by not doing so, the member will be subject to a default assessment. This aspect of Surcharge law is discussed in more detail in Chapter 4.

⁵¹ s.5(3) *Superannuation Contributions Tax Imposition Act 1997*.

Identity matching exceptions

2.16 In February 2001, following consideration of other competing priorities, the ATO made a decision to stop issuing PQTFN letters. As a consequence, it was also unable to issue default assessments. This decision contributed to a backlog of approximately 10.5 million identity matching exceptions (as at August 2004). This backlog was growing at a rate of approximately 1 million exceptions per year.

2.17 As is the case with SCS exceptions, the ATO decision not to issue PQTFN letters and default assessments potentially creates inequitable results for members, as all identity-matching exceptions are not being resolved, and members who are potentially surchargeable have not received a Surcharge assessment. The ATO's approach to resolve identity matching exceptions, and whether this approach is consistent with Surcharge legislation, is discussed further in Chapter 4.

Conclusion

2.18 In reviewing the decision-making process used with regard to the three key decisions (see paragraph 2.6), we sought to determine whether a systematic approach, which considered relevant risks, had been followed, and whether the information upon which the decisions were based was reliable.

2.19 The ANAO was advised by the ATO that ATO corporate management, through well-established executive committees, discussed the three key decisions, and based these decisions using sound risk assessment processes.⁵² This was done within the demanding and complex taxation environment that existed at the time. That said, the ATO was unable to provide documentary evidence regarding:

- what decisions were made;
- who made the decisions; and
- on what basis (information/intelligence) the decisions were made.

2.20 Not documenting the final decision, or clearly articulating the decision-making process, does not meet acceptable levels of accountability or better practice records management standards.⁵³ Furthermore, clearly documenting important administrative decisions has a positive impact on:

⁵² The ATO noted that balancing the revenue perspective, costs of administration, compliance costs for members and holders, and the impact on the community, were all considered when making important administrative decisions regarding its administration of the Surcharge.

⁵³ See AS ISO 15489.1-2002 *Australian Standard, Records Management Part 1: General*, 9.1.

- the ability of management to review those decisions at a later time;
- future management decision-making;
- staff certainty regarding their roles and responsibilities; and
- planning, risk assessment and reporting processes.

2.21 As will be discussed in Chapters 3 and 4, the impact of these difficult decisions at a time of significant change in the Australian taxation system has been costly for the ATO, both in terms of the additional resources that will be needed to rectify these problems⁵⁴, as well as the potential damage to the community's confidence in the ATO's administration of the Surcharge.

Recommendation No.1

2.22 The ANAO recommends that the ATO, in accordance with the Australian Standards on record management, and as part of an all-inclusive Surcharge governance framework, implement mechanisms to provide assurance that all major decisions affecting the Surcharge are fully recorded.

ATO response

2.23 Agreed. New governance and management arrangements for the administration of Surcharge were introduced in 2004. Surcharge risk and mitigation strategies are developed through the ATO corporate risk management framework; using corporate market committees and sub-plan management forums for consideration in the wider compliance environment. The new arrangements also provide for structured decision making processes and proper recording of significant decisions.

Effective Surcharge planning processes

2.24 An essential element of a robust governance framework is effective corporate and business planning processes, which provide assurance that all corporate objectives and planning documentation are aligned and mutually supportive. Ideally, planning should cascade from an agency's intended purpose (as expressed in its outputs and outcomes) through to specific team plans. This reduces the possibility for confusion, particularly over objectives, or lack of clarity in performance planning and monitoring.

⁵⁴ The ATO identified the potential risks applicable to SCS exceptions in 2003 and received additional funding as part of the 2003–04 budget process to mitigate these risks. This funding is being used to resolve the backlog of Surcharge exceptions and is discussed further in paragraph 4.57.

Preface to the ANAO's assessment of the ATO's planning, risk management and reporting processes relevant to the Surcharge

2.25 As discussed in Chapter 1 the Superannuation Business Line was subject to significant change in 2003–04. This restructure resulted in changes to the way the Superannuation Business Line is managed, and, in particular, the methodology it uses to plan, manage risks and report on its performance.

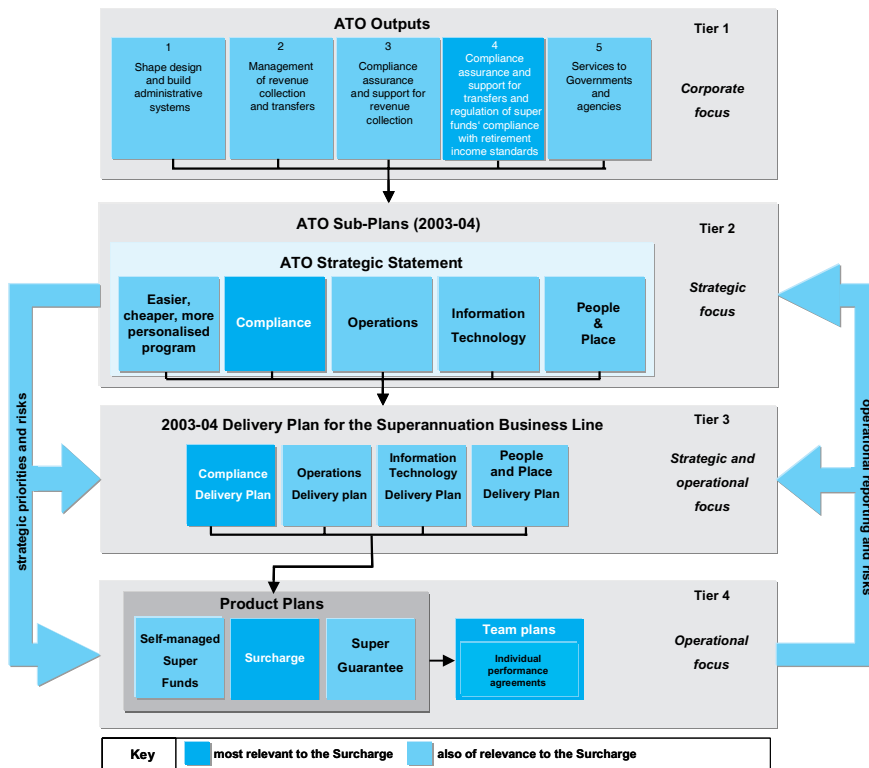
2.26 That said, the ANAO assessed the ATO's planning, risk management and reporting methodology under the Superannuation Business Line's corporate structure as at August 2004. Although the structure of the Superannuation Business Line may change, some of the underlying (corporate) methodology and processes the ATO used to produce planning and reporting documentation relevant to the Surcharge, will have ongoing relevance.

Current Surcharge planning processes

2.27 The ATO is a large and complex organisation, administering the revenue system and a range of new payment systems, including the senior Australian tax offset, family tax benefit, diesel and alternative fuels grants scheme, diesel fuel rebate, private health insurance rebate, and refunds of excess imputation credits. Consequently, the ATO's planning and governance framework is also necessarily complex to reflect the diverse range of activities undertaken. The ATO's approach to planning is designed to provide assurance that:

- ATO sub-outputs are delivered in an integrated way between Business Lines;
- there is accountability across the ATO for the delivery of products and services; and
- ATO corporate management forums are provided with the information they need to make informed decisions about the ATO and the wider tax system.

2.28 This approach is represented in Figure 2.1.

Figure 2.1**Aspects of the ATO's planning and governance framework relevant to the administration of the Surcharge**

Source: ANAO analysis of ATO information.

2.29 A key element of this framework is that there are clear links between each tier, which include integrating objectives, ensuring a consistent approach to assessing risk, and monitoring and reporting performance. Each tier, and its relevance to the administration of the Surcharge, is discussed below.

ATO outputs and strategic statement (Tier 1)

2.30 The ATO's outputs establish its corporate direction, and specify the sub-outputs it undertakes to deliver to the community. For administrative purposes (such as the ATO's 2002-05 Output Pricing Agreement (OPA)), most superannuation activity (including the Surcharge) is located and reported under Output 4.

ATO sub-plans 2003–04 (Tier 2)

2.31 The ATO sub-plans articulate the strategies, priorities, risks and performance measures the ATO uses to manage its performance, and report against its outcome⁵⁵ and outputs. Aspects of each sub-plan provide the strategic direction for the administration of the Surcharge. Business and service line resourcing is also determined at this level by ATO corporate management. We focused particularly on the Compliance Sub-Plan, as the majority of performance targets and strategies specific to the Surcharge are found in this plan.

Superannuation Delivery Plans (Tier 3)

2.32 Superannuation Delivery Plans are used by the Superannuation Business Line to translate the strategic priorities, and other directives contained in the sub-plans, into tangible and measurable priorities at an operational level. The delivery plan is also used to allocate resources within the Superannuation Business Line.

2.33 Although the ANAO reviewed all Superannuation delivery plans, we focused particularly on the compliance delivery plan, as it addresses key issues applicable to the audit.

Superannuation Product Plans (Tier 4)

2.34 Superannuation Product Plans provide a greater level of detail regarding the practical implementation of the priorities documented in the delivery plans for particular superannuation products. Although there are some linkages between the various product plans (for example, between Self Managed Super Funds and the Surcharge), we focused mainly on the Surcharge Product Plan.

2.35 There are several teams located within the capability areas (for example, the Superannuation Contact Centre within Client Services), and within other product areas (such as Self Managed Superannuation Funds), that undertake Surcharge related activities. The ANAO reviewed applicable team plans to determine whether the objectives outlined in these plans supported the objectives specified in other higher-level Business Line plans.

⁵⁵ The ATO's outcome is *effectively managed and shaped systems that support and fund services for Australians and give effect to social and economic policy through the tax, superannuation, excise and other related systems*.

ANAO comment on the ATO's Surcharge planning framework

2.36 In addition to reviewing the plans mentioned above, we also reviewed the links between each tier, to gain assurance that a consistent and comprehensive approach was taken to Surcharge planning. We found the following positive features about the Surcharge planning framework:

- the 2003–04 ATO Compliance sub-plan was aligned with the ATO outcome-outputs framework, with compliance capabilities linked directly to Outputs and Sub-Outputs;
- the 2003–04 Superannuation delivery plans aligned directly with four of the five ATO sub-plans.⁵⁶ We also found that compliance performance targets and deliverables were consistent between the Compliance sub-plan and the Superannuation delivery plan; and
- Surcharge planning processes were being refined and strengthened throughout the audit.

2.37 Although the comprehensiveness of, and links between, higher level strategic documentation was adequate, there were aspects of the ATO's Surcharge planning at the operational level that could be improved. In particular:

- it was not apparent how all Surcharge performance measures, and compliance mitigation strategies, specified in the Superannuation Business Line plans (and in particular the delivery plans) were determined; and the extent to which they provided an accurate measure of Surcharge performance over time. It was also unclear how the achievement of all performance targets, and implementation of all strategies, would improve the administration of the Surcharge, and, member and holder compliance with their Surcharge obligations⁵⁷;
- although the current planning framework (Figure 2.1) was introduced in 2003–04, the ATO was unable to provide a Surcharge product plan for this year. Similarly, for 2003–04 there were no specific references in team plans to performance targets and performance mitigation strategies specified in the delivery plans; and

⁵⁶ One sub-plan, the Easier, Cheaper, More Personalised Program does not have a corresponding Superannuation Delivery Plan. We recognise that aspects of this plan, including the ATO change program, may not have been relevant in the past. However, for consistency, and to provide assurance that there are clear linkages between superannuation delivery plans and the sub-plans, the Superannuation Business Line could consider developing an Easier, Cheaper, More Personalised delivery plan.

⁵⁷ This issue is discussed further in Chapter 5.

- there was not a consistent approach to the development or comprehensiveness of, team plans or strategies. We noted that some team plans did: identify risks; define performance targets and deliverables; and establish links to the Superannuation delivery plans. However, other team plans did not.

2.38 The ANAO concluded that, the Superannuation Business Line's Surcharge planning would be made more consistent and comprehensive with improvements to planning methodology and documentation at the operational level.

Recommendation No.2

2.39 The ANAO recommends that, to improve its approach to Surcharge planning, the ATO's Superannuation Business Line:

- develop and implement a planning methodology at the operational level, which clearly links to the priorities, outcomes and risks identified in strategic level plans;
- implement, monitor and report on integrated, quantitative and qualitative performance measures that will provide a consistent and meaningful measure of Surcharge performance over time; and
- monitor and report against plans at the operational level.

ATO response

2.40 Agreed. Superannuation Business Line management arrangements introduced in 2003–04 provide a strong focus on the strategic management of the Surcharge. The operational aspects are now administered through the Operations and Information and Communications Technology (ICT) Business Lines to draw on their experience and expertise in dealing with these aspects of our superannuation operation. The Superannuation Business Line will work with both the Operations and ICT Lines to develop operational plans, integrated performance indicators, and protocols to monitor and report performance.

Effective Surcharge risk assessment processes

2.41 The process of identifying, prioritising, monitoring and reporting risks is an essential element of providing management with the information necessary to make informed business decisions in an uncertain environment. For the management of the Surcharge in particular, sound risk management should be an integral part of planning, management and reporting; particularly, given the size and complexity of Surcharge processing, finite

Surcharge resourcing, and the impact key decisions had on Surcharge administration in the past.

2.42 The ATO's approach to Surcharge risk management for specific activities (for example compliance) is discussed in detail in Chapters 3, 4 and 5. This chapter examines the Superannuation Business Line's risk management strategy in relation to the Surcharge, as an integral component of an effective governance framework.

The Superannuation Business Line's approach to risk management

2.43 When assessing the framework the ATO uses to manage Surcharge risks, we examined a range of ATO risk documentation. This documentation included:

- risk assessments applicable to Surcharge planning and reporting at the operational and strategic levels (see tiers 3 and 4 of Figure 2.1);
- Certificate of Compliance Process; and
- relevant aspects of the ATO fraud control plan.

2.44 An integrated approach to Surcharge risk assessment requires appropriate links between the risks identified in the above documentation.⁵⁸ This issue of linkage, as well as the comprehensiveness of the above risk documentation are addressed below.

Risk assessments applicable to Surcharge planning and reporting.

2.45 The ANAO examined Surcharge risk documentation dating back to 1997–98, as part of our examination of key Surcharge decisions (see paragraph 2.6). Although initial documentation was comprehensive⁵⁹, the quality and comprehensiveness of Surcharge risk documentation declined noticeably during the period of tax reform and the introduction of the Goods and Services Tax (2000–01 to 2002–03). During this busy period, ATO corporate management determined that certain areas of superannuation administration, such as exceptions, were a lesser risk than other areas of taxation administration. As a result, the Surcharge was not monitored and reported regularly and comprehensively during this period. Also, the Surcharge risk information provided to ATO corporate management was not sufficient to make informed decision about the management of the Surcharge.

⁵⁸ For example, if a key Surcharge risk was identified in the ATO fraud control plan, that risk should be considered when assessing the risks for planning and reporting purposes.

⁵⁹ For example, in August 1999, the Superannuation Business Line completed a comprehensive risk assessment as part of its Surcharge Compliance Strategy.

2.46 In assessing current Surcharge risk management practice, the ANAO examined the risk methodology used, and risk documentation applicable to 2003–04: team plans; superannuation product plans; and ATO sub-plans. We also examined the risk assessment methodology and documentation applicable to key Surcharge reports (see paragraphs 2.68–2.74) for 2003–04. Our analysis showed that:

- the methodology/methodologies used to identify Surcharge risks and appropriate mitigation strategies were unclear, did not appear to be consistent, and were not documented;
- Surcharge risks identified in planning and reporting documentation were not based on sound, documented analysis⁶⁰;
- in many instances risks were not described clearly, or in a sufficient level of detail, to provide management with meaningful information upon which to base decisions;
- the Surcharge quantitative data used as a justification for some risks was not current or correct in all instances⁶¹;
- the priority (ranking), potential impact, or consequences, of Surcharge risks were not clearly analysed or articulated;
- risk assessment documentation was not completed for all relevant superannuation plans⁶²;
- there were inconsistencies between the various plans and reports regarding the key Surcharge risks (i.e. planning and reporting documentation was not linked or consistent)⁶³;

⁶⁰ The ATO has conducted a significant amount of analysis with regard to Self Managed Superannuation Funds (SMSFs) as part of a Compliance Review Benchmarking Project completed in August 2003 (see Chapter 5 paragraph 5.70). We consider that documentation, which incorporates the results of this project, would provide a sound basis for the assessment of SMSF Surcharge risks. However, this is only one area of risk relevant to the Surcharge.

⁶¹ For example, in the 2004–05 Surcharge product plan, 643 000 exceptions were identified. However, other planning and reporting documentation developed at the same time identifies between 800 000 to 900 000 exceptions. Similarly the product plan identifies that there was potentially \$15 million in uncollected Surcharge revenue associated with identity matching exceptions. This figure was noticeably different to the estimates provided to the ANAO as part of the financial statements audit process, and the estimates (based on ATO data) compiled for this audit.

⁶² Risk assessment documentation for particular team plans (Superannuation Contact Centre excluded), and the 2003–04 Surcharge Product Plan was either incomplete or did not exist.

⁶³ For example, risks were not consistently reported between the Surcharge Compliance Strategy, the Superannuation Compliance Delivery Plan, the Surcharge Product Plan, product reports and capability reports.

- risks identified in past reports did not appear to be adequately monitored and the effectiveness of corresponding mitigation strategies, reported; and
- apparent risk areas, such as identity matching exceptions (see Chapter 4), were not identified as a risk, and monitored consistently.

2.47 The ANAO concluded that the current risk management framework used by the Superannuation Business Line is less than adequate to identify, prioritise, monitor, and report Surcharge risks. Linked with this, the current risk framework also does not appear to comply with aspects of the ATO's corporate risk management policy.⁶⁴

2.48 We are aware that severe Surcharge risks, such as Surcharge exceptions (Chapter 4), and SMSF compliance (Chapter 5), were identified and reported to ATO corporate management for the first time in 2003–04. Although this is a positive sign, these risks did not appear to be identified as part of the established superannuation risk management framework.

Certificate of compliance process

2.49 The *Certificate of Compliance for the Payment of Public Money (through Client Account Management)* process assures the ATO's Chief Finance Officer that all payments of public monies by the ATO are correct, following processing by ATO business systems (for example, the SCS system). Assurance is provided through the identification of key controls using a risk assessment process. Once identified, controls are continually assessed by ATO operational staff, and reported on a monthly basis to ATO national managers. A number of the controls monitored as part of the certificate of compliance process are found in the SCS system.

2.50 The risk assessment process associated with the Certificate of Compliance includes an assessment of controls that are critical to the effective operation of the SCS system (and as a consequence, the effective administration of the Surcharge). We consider it crucial that a comprehensive and well-documented Certificate of Compliance risk assessment process is conducted regularly, given the amount of change the SCS system undergoes annually (see Chapter 3). The risks identified as part of the Certificate of Compliance process should also be included as part of other Surcharge risk assessment processes.

⁶⁴ For example, the methodology specified in *ATO Practice Statements PS CM 2003/01* and *PS CM 2003/02* to rank and prioritise risks, was not used, or was not used consistently for all Surcharge related plans.

2.51 In assessing the aspects of the Certificate of Compliance risk assessment process relevant to the Surcharge, the ANAO found that:

- a risk assessment to identify Surcharge controls applicable to the Certificate of Compliance process, was last carried out in mid-2000. We note that since that time, the SCS has undergone significant changes. This means that the current Surcharge controls monitored and reported as part of the Certificate of Compliance process may need updating; and
- aspects of the Certificate of Compliance risk assessment process relevant to the Surcharge were not considered as part of other risk assessment processes, including the development of operational plans and reports (see Figure 2.1 tiers 3 and 4).

2.52 As examined in Chapter 3, aspects of the SCS system, and associated controls, could be improved to provide assurance that the system operates efficiently, and to specifications. A robust Certificate of Compliance risk assessment process would significantly improve the quality of risk information provided to management regarding the Surcharge IT systems (see, for example, paragraph 3.91, regarding the use of Firecall to access and change Surcharge systems). A sound/rigorous Certificate of Compliance risk assessment process would also improve the level of assurance that systems are operating to specification. The results of such an assessment should also be included as part of any other Surcharge risk assessments.

2.53 The absence of recent Certificate of Compliance risk assessment processes and the failings of the Certificate of Compliance process with regard to IT systems, have contributed to an ineffective Certificate of Compliance process for the Surcharge.

ATO Fraud Control Plan

2.54 The ATO's Fraud Control Plan is a specific requirement of both the Commonwealth Fraud Control Policy and the *Financial Management and Accountability Act* (FMA Act). The Fraud Control Plan is a mechanism to outline an agency's overall approach to fraud control and should:

- reflect the risks identified in a fraud risk assessment;
- present strategies to rectify shortcomings identified in the risk assessment;
- provide a timetable for implementation of the strategies; and

- nominate action areas responsible for implementing each strategy.⁶⁵

2.55 As part of a comprehensive approach to fraud control planning within the ATO, a separate fraud control plan was developed for the Superannuation Business Line in July 2003. The ANAO reviewed this plan and observed that:

- there were few specific references in the plan to the Surcharge, or to Surcharge related IT systems; and
- despite the plan stating that it covers IT platforms specific to the Superannuation Business Line, the SCS system did not appear to be assessed for potential fraud risks.

2.56 In Chapter 3, we review the IT systems and controls relevant to the administration of the Surcharge. In that chapter we find that some controls relating to IT system change control processes could be improved significantly. Without effective IT change management controls in place, the potential for fraud to occur increases significantly. This issue is discussed further in Chapter 3.

2.57 Also, a key control identified as part of the Certificate of Compliance process was that the '*...Fraud Control Plan is effectively in place to manage internal and external fraud*'. Although identified as a key control, the operational staff responsible for ensuring that the fraud control plan is operating effectively do not have access to it (or relevant extracts of it).

2.58 Similarly, operational staff responsible for the development of other related Surcharge risk management plans⁶⁶, should be aware of the fraud risks associated with their areas of responsibility. We found no evidence that the risks contained in the fraud control plan were considered when other Surcharge risk assessment processes were undertaken.

Conclusion against Surcharge risk management practice

2.59 As part of its December 2003 *Superannuation Product Health of the System Assessment (HOTSA)* report (see paragraph 2.70), the ATO noted that superannuation risk management processes are in 'seriously poor health' and that:

...we [the ATO] do not systematically follow corporate risk processes and document the end-to-end process.

⁶⁵ The ATO's fraud control plans are examined in detail in Commonwealth Auditor-General Report No.16, 2000–01, *Australian Taxation Office Internal Fraud Control Arrangements*, November 2000, and Commonwealth Auditor-General Report No.55, 2002–03, *Australian Taxation Office Goods and Services Tax Fraud Prevention and Control*, June 2003.

⁶⁶ See paragraph 2.45.

2.60 We are aware that since this finding, the ATO has taken some steps to improve its Surcharge risk management processes, and that this work continues. However, as noted above, the methodology used to identify, monitor and report on potential Surcharge fraud risks was not adequate to manage potential Surcharge risks at the time of the audit.

Recommendation No.3

2.61 The ANAO recommends that, to improve Surcharge risk management, the ATO:

- develop and apply a consistent Surcharge risk management methodology at the operational level, based on sound analysis and information, which clearly links to the risks identified in strategic level plans and is consistent with ATO corporate risk management policy;
- as part of the ATO Certificate of Compliance process, undertake regularly an assessment of Surcharge system risks, to identify key Surcharge controls; and
- undertake an assessment of fraud control risks for Surcharge information technology systems, and ensure that ATO staff responsible for implementing applicable risk mitigation strategies are aware of, and report regularly against, these risks.

ATO response

2.62 Agreed. The ATO corporate risk management framework is now used to develop strategic and operational plans for managing Surcharge risks. In October 2004 the Superannuation Business Line commenced reviewing Certificates of Compliance with ATO Resource Management. As processing work has now been transferred to the Operations Business Line that business line is developing arrangements for the regular maintenance of Certificates of Compliance. The Superannuation Business Line is working with the ATO's internal audit area to review fraud control risks for all superannuation systems.

A structured approach to monitor and report Surcharge performance

2.63 Performance monitoring and reporting are important aspects of Surcharge administration. Without the timely collection and analysis of Surcharge performance information, fully informed decisions about the management of the Surcharge cannot be made. Using a consistent reporting methodology, and correct source data, are two elements crucial to sound performance reporting. This is because:

- quantitative Surcharge information can be obtained from a number of systems;
- Surcharge systems produce large numbers of exceptions, and they are reliant on manual processes; and
- there is a large number of Surcharge reports (see paragraphs 2.68 and 2.70), examining different aspects of Surcharge performance, which are targeted at both the operational and strategic levels.

2.64 As discussed above in paragraph 2.31, the majority of Surcharge planning (and hence reporting) relates to the Compliance Sub-plan. Our focus was, therefore, mainly on reporting compliance. Surcharge compliance reporting is also discussed in Chapter 5.

2.65 In assessing the ATO's Surcharge reporting framework, the ANAO examined internal and external reporting processes. These areas are discussed below.

ATO internal Surcharge reporting processes

2.66 The ATO uses a multi level compliance-reporting framework to monitor and report on its performance. This framework is structured around three 'compliance views'.⁶⁷

- market segments: designed to allow the ATO to better understand the community and help it to see how particular revenue products (see below) are working in the community. A more detailed explanation of market segments, and their impact on the management of the Surcharge, is in Chapter 5;
- revenue products (products): allows the ATO to understand whether its products are working as intended by delivering outcomes for the Government. As shown in Appendix 7, Superannuation is a key ATO product. Within Superannuation, the Surcharge is also viewed as a distinct product; and
- capabilities: designed to assist the ATO to understand aspects of the efficiency and effectiveness in the delivery of its products and services, to identify improvement opportunities and to implement these with economies of scale.

2.67 Each of these compliance views is managed through a number of market segment and revenue product committees, which comprise ATO senior

⁶⁷ A more comprehensive overview of market segments, revenue products and capabilities is contained in Appendix 7.

executive staff. The information obtained by these committees is then reported to ATO corporate management.

Internal Surcharge reports

2.68 For 2003–04, the Superannuation Business Line commenced reporting against the compliance views described above, at the operational level (Figure 2.1, tiers 3 and 4, page 53). Each month, the Superannuation Business Line produces two main reports, which comment on Surcharge performance at the operational level. These are:

- Product Reports; and
- Capability Reports.

2.69 Although not producing a separate ‘market report’, the Superannuation Business Line comments on market performance as part of these reports.

2.70 At the strategic level, information is provided to ATO corporate management (or relevant ATO committees) through a number of different reports. These reports are used to provide performance information on ATO wide issues with a compliance focus, and can be used to highlight Surcharge issues of significance.⁶⁸ These are:

- Health of the System Assessment (HOTSA) reports (annual). These reports provide the ATO compliance executive with an ATO wide view of compliance;
- Exceptions reports (monthly). These reports are used to alert ATO corporate management to unexpected or serious issues or risks; and
- Heartbeat reports (monthly). These reports are used by ATO corporate management to review year to date performance against compliance commitments.

2.71 The ANAO reviewed the reports relevant to the Surcharge, noted in paragraphs 2.68 and 2.70, for the 2003–04 financial year, to assess whether Surcharge performance reporting was adequate.

ANAO comment on the ATO’s internal Surcharge reporting framework

2.72 As discussed above, Surcharge risks, and a broader range of measures to reflect overall performance, were not identified, monitored and reported accurately in the past. However, during 2003–04 the ATO made progress in implementing a more comprehensive approach to governance in the

⁶⁸ The compliance strategic reporting framework, and a brief description of relevant reports, is in Appendix 8.

Superannuation Business Line. Although still being developed fully, we note the following positive aspects of this approach with respect to reporting:

- a clear and consistent reporting framework, with an articulated methodology, has been developed at the strategic level;
- most critical strategic Surcharge risks are being monitored, and are being reported regularly to ATO corporate management⁶⁹; and
- reporting at the operational level was being refined and strengthened.

2.73 That said, a critical element of a robust reporting framework is that effective planning and risk management processes underpin it. As noted above, aspects of the ATO Surcharge risk management and planning processes could be improved, and require further development, particularly at the operational levels (see Figure 2.1 tiers 3 and 4, page 53). Our analysis of Surcharge reporting processes showed that:

- a consistent and comprehensive approach to monitoring and reporting Surcharge performance at the team level was not evident⁷⁰;
- links between information reported at the team (operational level), and that reported at the strategic level, were not clear⁷¹;
- statistical information relating to critical Surcharge risks was sometimes incomplete, inconsistent between reports (and also planning documentation), or was out of date;
- a set methodology, and set parameters, was not used to compile statistical Surcharge information for reporting; and
- statistical information for reporting purposes was sourced from ATO IT systems that may not provide clear and accurate results.⁷²

2.74 In the past, internal reporting practices did not provide ATO corporate management with the information they needed to make informed decisions regarding the Surcharge. In 2003–04, the ATO improved its reporting processes and methodology. However, these processes still require strengthening. We

⁶⁹ As discussed in paragraph 2.46, the ATO has not recognised identity matching exceptions as a key risk. The ANAO considers this to be a significant omission.

⁷⁰ Although some relevant teams did regularly report and monitor performance, for example the Superannuation Contact Centre, others did not.

⁷¹ We note however, reporting links for the Surcharge were clear with regard to the Superannuation Contact Centre.

⁷² For reporting purposes, the ATO uses its Data Warehouse (a central repository for storage of tax information for statistical analysis) to compile statistical information on the Surcharge. As part of our analysis for Chapter 3, we found that there were anomalies in Surcharge information recorded in the data warehouse prior to 1999. For this reason, we consider that, where possible, statistical information for reporting purposes should be sourced from production systems.

are aware that the ATO is undertaking significant work in this area to further improve its reporting practices.

Recommendation No.4

2.75 The ANAO recommends that, to provide a comprehensive, consistent and integrated approach to Surcharge internal reporting, the ATO develop and implement a robust Surcharge reporting framework, underpinned by sound planning and risk management processes, which clearly link to other relevant ATO strategic level plans.

ATO response

2.76 Agreed. The ATO corporate risk management framework, managed through the ATO's Sub-plans and its market, product and capability committees, is now used to develop the strategic and operational plans for managing Surcharge risks. This process identifies Surcharge risks and mitigation strategies across all ATO activities and Business Lines. The process also incorporates robust planning and reporting arrangements.

ATO external Surcharge reporting processes

2.77 The ATO uses a number of publications to report on its administration of the Surcharge. These publications include: ATO Annual Report; Taxation Statistics and its Compliance Program. The ANAO examined these documents when examining the quality and quantity of Surcharge information reported publicly.

2.78 Although these documents focus on a wide range of issues concerning ATO administration, before 2003–04 there were only small amounts of information on the Surcharge. Of particular note was that until 2003–04, the ATO did not comply with its legislated reporting obligations under section 30 of the *Superannuation Contributions Surcharge Tax (Assessment and Collection) Act 1997*, which states that:

After the end of each financial year, the Commissioner must give the Treasurer a report on the working of this Act during the year for presentation to the Parliament.

2.79 During the audit, the ATO took steps to improve the amount and quality of its Surcharge information as part of its 2003–04 annual report. The ATO considers that its obligations under the Assessment and Collection Act have now been satisfied. However, the consistency and comprehensiveness of Surcharge information in other relevant external ATO reports, such as Taxation Statistics and the Compliance Program, could be improved significantly.

Additional Surcharge funding provided in the 2004–05 Budget process

2.80 As noted in Chapter 1, as part of the 2004–05 Budget, the ATO received expense funding of \$326.4 million over four years for superannuation and other taxation compliance activities. The ATO indicated that \$52.8 million of this funding was to address serious issues associated with superannuation administration, as well as the changing superannuation client profile.

2.81 The ATO advised that in 2004–05 it received approximately \$9.1 million of the new expense funding for Superannuation Business Line activities, with approximately \$2.2 million to be used to resolve Surcharge exceptions. It also noted that it had re-allocated an additional \$4.8 million from other ATO programs and activities for work on Surcharge exceptions.

2.82 As part of this expense measure, the ATO has undertaken to collect an additional \$1.1 billion in additional revenue over four years (\$251.0 million in 2004–05), of which \$125 million relates to the Surcharge. To date, the ATO has raised additional Surcharge assessments to the value of \$67 million.

3. Surcharge Systems

This chapter addresses the information technology (IT) systems and manual mechanisms the ATO uses to process the Surcharge. Specifically, we focus on the systems, processes and controls the ATO uses to capture and process data relevant to the Surcharge. In assessing these areas, we examined the ATO's main Surcharge processing system—the Superannuation Contributions Surcharge (SCS) system.

Introduction

3.1 It is essential that Surcharge information technology (IT) processing systems and controls are capable of collecting, matching and processing Surcharge contributions data⁷³ quickly and accurately, given the large amounts of Surcharge data processed by the ATO. IT systems that malfunction or are inefficient, not only increase the risk that high numbers of incorrect Surcharge assessments are issued, but may also produce large numbers of exceptions⁷⁴ requiring manual rectification, which is potentially very costly and time consuming.⁷⁵

3.2 For Surcharge IT systems to be fully effective and secure, the roles and responsibilities of business managers⁷⁶, and IT staff⁷⁷, must be clearly defined, and accountabilities clearly articulated. Without a clear separation between the 'business' and IT roles, and without input from business managers into the design and operation of Surcharge IT systems, there are increased risks that Surcharge IT systems will not operate:

- as intended;

⁷³ As noted in footnote 22 of Chapter 1, the main source of Surcharge contributions data is the Member Contributions Statement (MCS). However, in addition to the MCS, the ATO also receives Surcharge contributions data through Assessment Variation Advice (AVA) forms (which are submitted by holders to amend original Surcharge assessments). Member Exit Statements (MES) are another source of Surcharge contributions data, submitted for members of Constitutionally Protected Funds. In this chapter, we refer primarily to MCSs, however, in the main, AVAs and MESs are processed in a similar way.

⁷⁴ Exceptions are defined and examined in Chapter 4.

⁷⁵ Although manual intervention is required to process the Surcharge, manual processing increases the risk that the Surcharge may be incorrectly calculated.

⁷⁶ Relevant business managers are appropriately responsible for specifying IT system requirements, as these managers should have an in depth knowledge of legislation, ATO policy and practice, and operational priorities. For the purposes of this chapter, the term 'business managers' refers to management staff within the Superannuation Contributions Surcharge product area within the Superannuation Business Line.

⁷⁷ IT staff are responsible for implementing and maintaining IT systems. Implementation should be done in consultation with relevant business managers, who are responsible for specifying what they require from the system.

- in accordance with ATO policy and practice; and
- in accordance with relevant legislation.

3.3 In addition to clearly defined roles, there must also be strong lines of communication between business and IT staff.⁷⁸

3.4 For the purposes of the audit, we refer to the collection, matching and processing of Surcharge contributions data by ATO IT systems as the 'Surcharge assessment process.' This process is defined below.

Surcharge assessment process defined

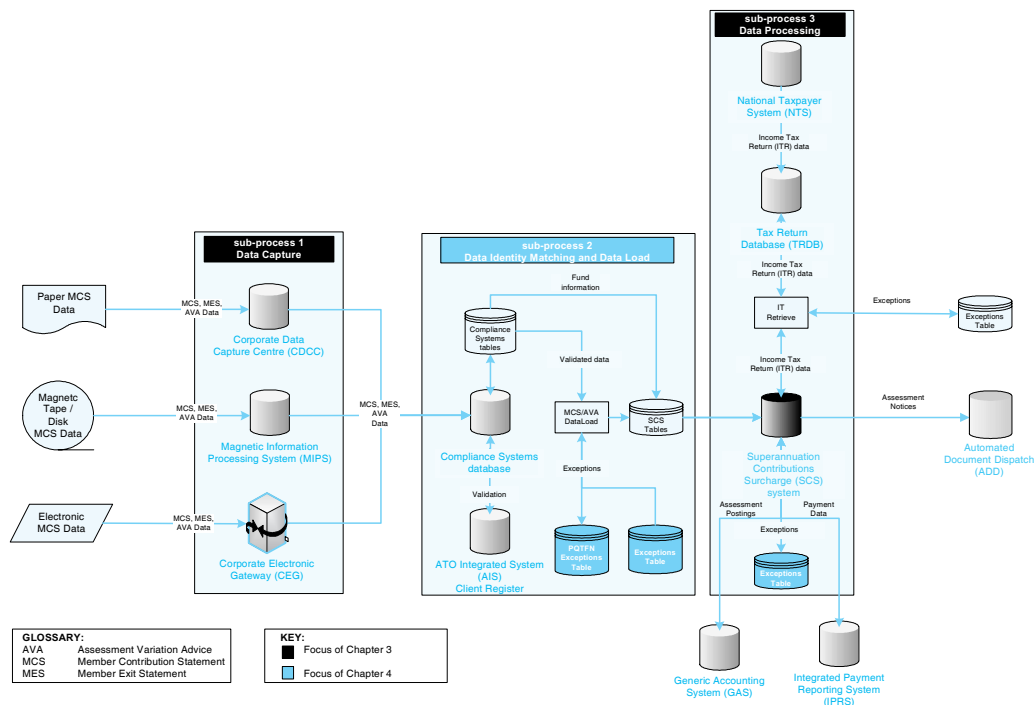
3.5 The ATO's Surcharge assessment process is managed by three ATO business and service lines⁷⁹, and uses a number of distinct IT systems that are supported by manual processes and controls. Figure 3.1 provides a high level overview of the Surcharge assessment process, including relevant IT systems, processes and controls. In addition to representing the process, the figure also provides a map indicating in which chapters the topic is discussed. For a detailed description of the Surcharge assessment process, see Appendices 9 and 10.

⁷⁸ Audit Guidelines, CobiT, 3rd Ed., July 2000, IT Process P04: 'Define the Information Technology Organisation and Relationships'.

⁷⁹ The Operations Service Line is responsible for data capture. The Personal Tax, and Superannuation Business Lines are responsible for data identity matching and data load. The Superannuation Business Line is responsible for data processing including document dispatch.

Figure 3.1

The Surcharge assessment process



Source: ANAO analysis of ATO information

3.6 The Surcharge assessment process is based on the lodgement of Surcharge contributions data through a range of data capture mechanisms (sub-process 1). A series of data validation and identity matching processes are applied to the member's contribution data (sub-process 2), before it is loaded onto the Superannuation Contributions Surcharge (SCS) system. The SCS system is the principal IT system used to assess the Surcharge for all members. It does this by comparing the 'scrubbed and matched' Surcharge contributions data provided by holders, with data from members' Income Tax Returns (ITR). ITR information is retrieved from the ATO's Tax Return Database (TRDB) (sub-process 3). Once the Surcharge has been assessed, and a Surcharge liability has resulted, notices of assessment are sent to relevant members, and holders are advised of the Surcharge liability.

3.7 Figure 3.1 shows there are three sub-processes comprising the Surcharge assessment process. In this chapter, we examine:

- data capture (sub-process 1); and

- data processing (sub-process 3).⁸⁰

Data capture (sub-process 1)

3.8 The accurate capture of Surcharge contributions data is critical to the efficient and effective processing of the Surcharge. If this data is not captured accurately in the first instance, additional downstream work can be generated, with exceptions more likely to occur (see Chapter 4). A detailed explanation of the data capture process is in Appendix 9.

3.9 Surcharge data capture refers to the process the ATO uses to accurately capture the Surcharge contributions data submitted by holders, in a standard format, that can be matched to ITR data and processed by ATO IT processing systems. To encourage the timely and accurate provision of high quality Surcharge information from holders, the ATO maintains several lodgement options. These are:

- paper lodgement;
- magnetic media⁸¹ lodgement; and
- electronic lodgement.

3.10 The electronic lodgement option is preferable for the ATO for a number of reasons. These include:

- improved data quality. Unlike Surcharge contributions data that is lodged using the paper and magnetic media options, the ATO is able to maintain control over the electronic Surcharge contributions data it receives from holders. That is, through the Corporate Electronic Gateway (see Figure 3.1), and through the use of designated electronic lodgement software⁸², all electronic Surcharge contributions data is subjected to an initial layer of controls known as validation rules. If these rules are not met, the holder cannot lodge Surcharge contributions with the ATO. For this reason, data lodged through the gateways is generally of higher quality than other Surcharge contributions data lodgement options; and
- consistently formatted data. The validation rules contained in electronic lodgement software also provide assurance that the Surcharge

⁸⁰ As noted in Figure 3.1, there are a number of exceptions generated during the data processing phase of the Surcharge assessment process. These are known as SCS exceptions. SCS exceptions are discussed in more detail in Chapter 4.

⁸¹ Magnetic media refers to a range of different mediums, including DAT tapes, cartridges, floppy disks and CD-ROMs.

⁸² See paragraph 3.11.

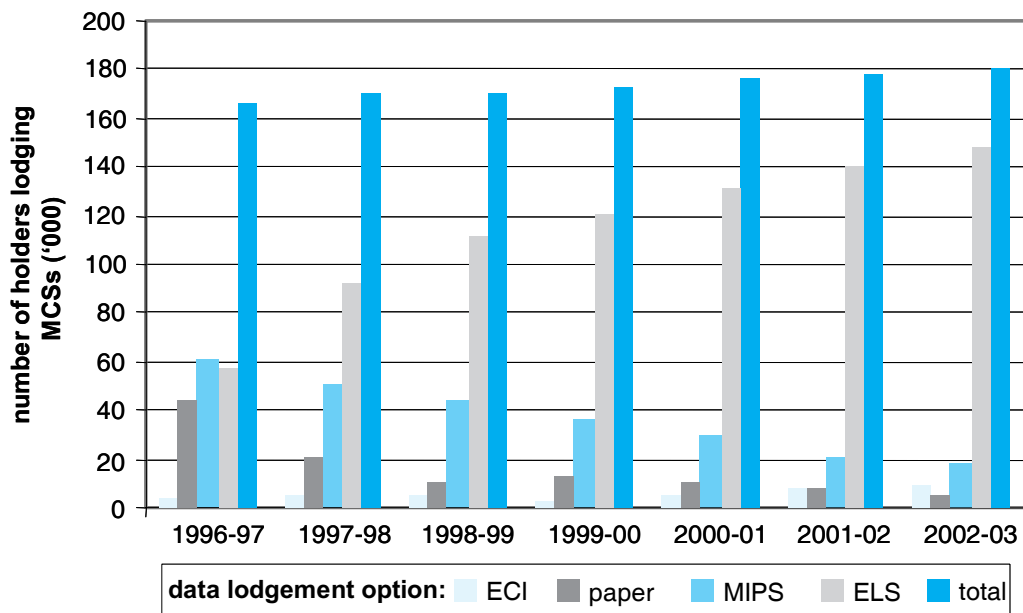
contributions data is in a format that is suitable for matching to ITR data. It also provides assurance that it is in the correct form for processing by the SCS system.

3.11 The ATO offers two options for holders to lodge Surcharge contributions data electronically. These are the Electronic Lodgement Service (ELS)⁸³ and the Electronic Commerce Interface (ECI).⁸⁴

3.12 As part of the audit, the ANAO examined how holders lodge MCSs to determine whether holders were using the more costly and potentially less accurate paper and magnetic media lodgement options, or if they were using electronic lodgement. Figure 3.2 shows lodgement options used by holders.⁸⁵

Figure 3.2

Number of holders lodging accepted Member Contribution Statements by data lodgement option from 1996–97—2002–03.



Source: ANAO analysis of ATO information

⁸³ Electronic Lodgement Service (ELS) allows the secure exchange of electronic transactions between registered tax practitioners and the ATO.

⁸⁴ Electronic Commerce Interface (ECI) provides for the secure exchange of digitally signed and encrypted files and messages between the ATO and its clients.

⁸⁵ Note that Figure 3.2 excludes Member Contribution Statements that did not pass electronic validation rules, or were sent back holders because of data quality problems (in the case of paper or magnetic media lodgements).

3.13 The ATO has invested significant resources to encourage holders to lodge electronically. As Figure 3.2 shows, the ATO's commitment to electronic lodgement has been successful, and has resulted in the majority of holders preferring to lodge MCSs electronically (that is, the majority of holders use ECI or ELS). In 1997, approximately 37 per cent of all holders utilised electronic Surcharge contributions data form lodgement options (i.e. ELS and ECI). In 2003, this had risen significantly, to 87 per cent.

3.14 Despite the majority of holders lodging electronically, approximately 10 per cent lodge using magnetic media. Although only a comparatively small number of holders lodge this way, some of those holders are large, and represent millions of member accounts.⁸⁶ For this reason, we specifically examined the methodology used by the ATO to capture magnetic media lodgements.

The efficient collection and extraction of magnetic media Surcharge contributions data

3.15 The Operations Service Line manages the collection, extraction and secure storage of all magnetic media lodgements for the ATO, through its Magnetic Information Processing System (MIPS) team. Although the MIPS team is responsible for collecting and extracting Surcharge contributions data onto ATO systems for processing, the majority of its work relates to other taxation information, such as Pay As You Go (PAYG) data.

3.16 Unlike electronically lodged Surcharge contributions data which requires little, if any, manual intervention, the MIPS team is responsible for manually extracting and reviewing Surcharge contributions data contained on magnetic media. The MIPS team advised that, approximately 10 per cent of this data cannot be loaded properly, and must be sent back to the holder for re-submission, or correction. This can delay the timely processing of this data.

Timely loading of Surcharge data by MIPS

3.17 Superannuation Business Line managers advised that, on occasion, there has been some frustration regarding the MIPS team's timely and efficient extraction of large amounts of Surcharge contributions data. These concerns relate, in particular, to:

- slow MIPS processing times;
- lack of resourcing in the MIPS team;

⁸⁶ The ATO advised that up to 40 per cent of all member accounts are lodged using magnetic media. As shown in Figure 5.3 of Chapter 5, although large and medium holders only account for approximately one per cent of the total number of holders, they represent 98 per cent of the total number of member accounts.

- the formation of Surcharge contributions data backlogs; and
- Surcharge contributions data being lost.⁸⁷

3.18 We were unable to obtain documentary evidence showing that performance information relating to the extraction of Surcharge contributions data was collected, analysed and reported regularly to the Operations Service Line Executive and the Superannuation Business Line Executive. This type of information is important in assessing the overall performance of Surcharge processing, and to identify potential improvements.

3.19 To manage Surcharge data collection more effectively, the Operations Service Line and the Superannuation Business Line should identify, and agree on, the conditions and terms for the effective extraction of Surcharge contributions data provided on magnetic media, and the loading of this data onto relevant ATO systems for processing. Information on the performance of this task should also be collected by the Operations Service Line, and reported regularly to Superannuation Business Line management, as part of a comprehensive reporting framework.⁸⁸

Recommendation No.5

3.20 The ANAO recommends that, to provide assurance that Surcharge contributions data is captured in a timely and efficient manner, and to improve accountability, the ATO's Superannuation Business Line and the Operations Service Line:

- develop, agree and document the terms and conditions for the extraction of Surcharge contributions data provided on magnetic media, and the placement of these data onto relevant ATO IT systems for processing; and
- develop and report against performance indicators that provide a meaningful measure of performance against, and compliance with, those terms and conditions.

ATO response

3.21 Agreed. The Information & Communications Technology Line, the Operations Business Line and Superannuation Business Line are establishing a Service Level Agreement (SLA) for uploading magnetic media onto core systems for processing. The SLA will be specific to the treatment of

⁸⁷ We note that, although this point was made mainly with regard to paper Surcharge contributions data forms processing, it did not exclude Surcharge contributions data forms contained on magnetic media.

⁸⁸ The Surcharge reporting framework is discussed in Chapter 2.

Superannuation data and is expected to be ratified and in place by mid May 2005. Conformance to the SLA will be overseen by the Production Change Management Branch of the Operations Business Line and the Production Systems Support Branch of the Information & Communications Technology Line. Conformance reports will be provided to the Superannuation Product Committee as part of the formal ATO Governance cycle.

Data processing (sub-process 3)

3.22 Accurate and timely Surcharge data processing is the most critical aspect of the Surcharge assessment process. The failure of Surcharge processing systems and associated controls to detect errors or anomalies in data relevant to the calculation of the Surcharge increases the risk that the ATO will issue incorrect Surcharge assessments.

3.23 Similarly, Surcharge IT systems that malfunction, do not apply business rules⁸⁹ as intended, or apply ill-considered or undeveloped business rules, may generate incorrect Surcharge assessments.

Surcharge data processing defined

3.24 Data processing refers to the manual and electronic processes and controls used by the ATO to determine whether members are surchargeable, and to calculate Surcharge liabilities for members who are surchargeable. Unlike some other large ATO systems, Surcharge data processing does not occur continuously. During the audit we found that, to assess the Surcharge, matched Surcharge contributions data was collected and stored for up to three months, and then processed in batches at the end of a three-month period. This can mean that if a holder submits Surcharge contributions data during, or shortly following the completion of this batch processing, some data may not be processed for up to three months. The processing of batch information is known as the Surcharge assessment run, and it is described further in Appendix 10.

3.25 Although, as shown in Figure 3.1, information relevant to the assessment of the Surcharge must be collected from a number of large ATO IT systems, the SCS system is the principal IT system used to drive the Surcharge assessment run. Therefore the focus of this part of the report is on the operation of the SCS system.

⁸⁹ A business rule is a rule with its basis in ATO policy or legislation, that is applied to data provided by clients, or data generated or retained by the ATO to establish the integrity of that information, or for calculation purposes.

History of Surcharge processing and the Superannuation Contributions Surcharge (SCS) system

3.26 The SCS system was introduced in 1996–97 as the principal system to process the Surcharge. As mentioned in Chapters 1 and 2, the ATO had a short time-frame and limited resources to develop and implement the SCS system. In 1999, the ATO estimated that the SCS was only able to deliver 70 per cent of the functionality required to process the Surcharge effectively. Although some improvements have been made to the SCS system since that time⁹⁰, a large proportion of intended functionality remains undelivered. For example, as at March 2004, the SCS system was not able to effectively:

- manage the wind up of holders (superannuation funds). This can impact on the ATO's ability to collect outstanding Surcharge debt;
- manage exceptions. The management of exceptions (and in particular SCS exceptions) is examined in detail in Chapter 4. Other undelivered functionality (for example, the wind up of holders) has generated significant numbers of exceptions; and
- issue and track Please Quote Tax File Number (PQTFN) letters and default Surcharge assessments. PQTFN letters and default assessments are key mechanisms designed to provide assurance that all members are fairly assessed for the Surcharge. This issue is discussed in detail in Chapter 4.

3.27 To address these shortfalls in functionality, the ATO implemented manual processes and work-arounds⁹¹ as temporary processing measures. Since that time, however, these temporary measures have become permanent, as major SCS system redevelopment had not occurred. Although manual processes and work-arounds allow the ATO to process the majority of Surcharge data successfully, there is a higher risk that errors or exceptions will occur with manual processing, when compared with a fully effective automated process.

3.28 Manual processes and work-arounds extend the time taken to process the Surcharge considerably, when compared to a fully functional automated process. Up until November 2004, each Surcharge assessment run lasted approximately six weeks. Of this time, approximately 15 days was spent undertaking manual checks. That is, each year the total time taken to process the Surcharge was 24 weeks (as there are four assessment runs annually, see

⁹⁰ For example, in 1999, the SCS was unable to assess members who transferred between funds during that year. However, since that time, the ATO has included this functionality in the SCS system.

⁹¹ A work-around is a temporary manual or IT procedure that is put in place to facilitate the operation of an IT system, until such time that a permanent system change can be formulated and implemented.

Appendix 10). Of this time, approximately nine weeks was used to undertake manual checks and processes.

3.29 The disadvantage of having long assessment runs is that the assessment run prevents other Surcharge pre-processing activity⁹² in that time. That is, any Surcharge data submitted by holders during the assessment run cannot be processed until after the assessment run has been completed. This places additional pressure on Surcharge systems, as backlogs of Surcharge contributions data submitted during the assessment run must be processed in conjunction with data submitted after the run.

3.30 For the reasons outlined above, current Surcharge processing arrangements, which rely heavily on manual processes, are not efficient, are unwieldy, prone to error, and produce large numbers of exceptions. We recognise that a significant redevelopment of the SCS system to provide in full its intended functionality will be costly, and may duplicate work being completed as part of the ATO Change Program. That said, there is considerable merit in the ATO examining ways of increasing the efficiency and accuracy of Surcharge processing systems.

3.31 During the audit the ATO commenced a number of reviews (see paragraphs 3.101- 3.102) into Superannuation IT systems (including the SCS system) that focused on improving the efficiency of the assessment run process and the SCS system. The ATO advised that from these reviews, new measures have been introduced to reduce overall time required to perform the Surcharge assessment run. We were also advised that a more automated approach to Surcharge processing is being used to reduce the amount of manual checking that occurs during the assessment run. These are positive initiatives to improve Surcharge processing.

SCS system controls

3.32 Given the ATO's reliance on manual processes and work-arounds to process the Surcharge, and the limitations of the SCS system (as discussed in paragraph 3.26), a robust and comprehensive control framework is required to provide assurance regarding the timely and equitable calculation of the Surcharge for all members. To assess the control framework the ATO uses to manage the Surcharge, we examined the SCS system using a traditional

⁹² For example the retrieval of relevant ITR information, see Figure 3.1 (IT retrieve process).

Systems Development Life Cycle (SDLC) approach.⁹³ This examination highlighted four areas of interest, namely:

- the documentation of Surcharge processing systems;
- change management;
- Surcharge systems testing; and
- Surcharge fraud control arrangements.

The documentation of Surcharge processing systems

3.33 Comprehensive and accurate documentation for the Surcharge assessment run is needed to properly understand how Surcharge processing works, and whether Surcharge processing systems (such as the SCS) are operating as intended. Although there are no definitive guidelines to specify the format and contents of Surcharge processing documentation, this documentation should:

- cover the whole system life cycle (see SDLC above);
- be managed effectively;
- be appropriate to its readership; and
- have identifiable standards that are used consistently throughout the ATO.⁹⁴

3.34 For processing systems that rely heavily on manual processes and work-arounds, such as the SCS, it is particularly important that manual procedures are documented, so that staff responsible for these processes use a consistent approach. For this reason we examined two aspects of systems documentation. These were:

- Systems procedures documentation; and
- IT technical documentation.

⁹³ Although there is no one common definition for the SDLC, a traditional 'waterfall' approach to SDLC is most commonly divided into the following stages: project planning/feasibility study; systems analysis/requirements definition; systems design; implementation; integration and testing; acceptance, installation and deployment; and maintenance.

⁹⁴ These points were derived from *Australian Standard AS 3897-1991, Information Processing—Guidelines for the management of software documentation*.

SCS systems procedures documentation

3.35 An organisation's SDLC methodology should require that adequate user procedures manuals be prepared and refreshed as part of every information system development, implementation or modification project.⁹⁵

3.36 As discussed above, the Surcharge assessment run relies heavily on manual processes and work-arounds to process the Surcharge. This reliance increases the risk that errors and exceptions will occur. A key mechanism to mitigate this risk is the development of comprehensive procedures and user manuals, so that IT and other ATO staff understand fully, their roles and responsibilities with regard to Surcharge processing.

3.37 The ANAO examined the ATO's Surcharge procedures documentation, as part of our examination of the Surcharge assessment run process. We found the procedures documentation:

- lacked consistency and standardisation;
- was not located in a central repository;
- was not always complete; and
- did not always reflect current practice.

3.38 Under current arrangements, if key IT staff were to leave the ATO, it is unlikely that the assessment run would be completed without error, and within the required timeframes. The current documentation practices are, therefore, a significant risk to the ongoing viability of the assessment run process.

3.39 For the reasons outlined above, it is important that the ATO develop and maintain a complete set of Surcharge systems procedures documentation applicable to the Surcharge assessment run.

⁹⁵ Audit Guidelines, CobiT, 3rd Ed., July 2000, IT Process AI4: 'Develop and Maintain Procedures' (Acquisition and Implementation).

Recommendation No.6

3.40 The ANAO recommends that, to provide adequate assurance that the Surcharge assessment run operates efficiently and effectively, the ATO:

- compile a comprehensive set of procedural documentation for the Surcharge assessment run; and
- introduce a robust system of controls to manage this documentation, including:
 - the storage of this documentation in a secure central location; and
 - controls to provide assurance that SCS system procedural documentation is current and complete.

ATO response

3.41 Agreed. Responsibility for the production support of the Surcharge Assessment run will be transferred to the Production System Support team within the Information & Communications Technology Line at the completion of the February Assessment run. All procedural documentation is being updated as part of this transfer and is expected to be finalised by the end of May. All documentation supporting the management of the assessment run will conform to Information & Communications Technology Line document management protocols.

IT technical documentation

3.42 A critical aspect of managing ATO IT systems effectively, is the creation and maintenance of IT technical documentation which:

‘...includes an up to date description of all aspects of the system, including hardware, software, and data. It is essential that it is constantly updated during the system life cycle’.⁹⁶

3.43 If IT technical documentation is not created and kept up-to-date, the ATO cannot be certain of how its IT systems are operating. Important dimensions of this knowledge include whether its IT systems apply business rules as intended, and whether these business rules comply with applicable legislation and with ATO policy. Also, not having IT technical documentation makes it difficult to identify and rectify systems problems when they occur, as well as to predict the results of any changes made to IT systems.

3.44 Although the ATO does not have a universal methodology for the development and maintenance of IT technical documentation, there are

⁹⁶ Australian Standard 3876 – 1991, *Information Processing—Guidelines for the documentation of computer-based application systems*, p.5.

underlying systems documentation conventions that are used for the majority of ATO IT systems. In simple terms, the ATO has two main types of IT technical documentation, namely:

- **baseline specifications.** These specifications provide an up-to-date description, and the history, of all aspects of ATO IT systems; and
- **change specifications.** Although it is ideal to maintain a single set of baseline specifications for a system, it is often not practical to do so because of the number of changes to a system (many made simultaneously), and the complexity of a system. Where there is much systems change, it is common to have changes being documented in separate change specifications. Ideally, change specifications are then used to update the baseline specifications at a later point in time.

3.45 If many change specifications are generated for a particular system before baseline specifications can be updated, then a well-managed and documented change control process is critical to maintain control over the operation of systems. The SCS change control process is discussed further in paragraph 3.54.

SCS systems baseline and change specifications

3.46 The ANAO requested a complete set of baseline specifications for the SCS system to assess Surcharge system documentation practices. When the SCS system was first implemented in 1996–97, the ATO did not develop baseline specifications, and it has not developed them since that time. This was due in part, to the short timeframes for implementing the SCS system, and the large number of legislative changes made up to, and immediately following, the implementation of the SCS system (see Appendix 4).⁹⁷

3.47 Similarly, we could not find any evidence that the ATO had implemented a systematic approach to documenting all changes (through change specifications) to the SCS system. We found that the majority of changes that were documented, did not have appropriate sign-offs from business managers and other relevant ATO staff (this issue is discussed further in paragraphs 3.57–3.63).⁹⁸

⁹⁷ That is, if amended legislation affects the operation of the Surcharge (for example the changes made regarding the constitutionally protected funds), then changes will need to be made to the way Surcharge IT systems operate.

⁹⁸ As part of the audit, we reviewed 59 change specifications, for comprehensiveness, consistency and management approval. We found that all specifications did not have any formal management sign-off. Although there were 'distribution lists' on some change specifications, we consider that these do not constitute formal approvals.

3.48 The absence of vital SCS system documentation is a serious risk for the ATO.⁹⁹ Without this documentation, the ATO is not able to provide definitive assurance that it understands how the SCS IT system is processing the Surcharge, and whether the SCS system processes Surcharge information in accordance with the ATO's policy and procedures, and Surcharge legislation.

3.49 Without adequate systems documentation, knowledge of the Surcharge assessment run, and the operation of the SCS system, resides with a small number of key SCS system IT staff. This also poses a risk to effective Surcharge processing, because if these staff were to leave, the ATO's ability to process the Surcharge effectively would diminish.

Conclusion against SCS systems documentation

3.50 The ATO should develop, from source computer code, a complete set of baseline specifications to document the SCS system; and to assess whether the SCS is operating as expected and in accordance with Surcharge legislation. This is essential if the ATO is to redevelop and enhance the SCS system in the future, and if it is to provide assurance that the SCS system is operating efficiently and effectively.

3.51 The ATO should also develop effective procedures to record and document all changes made to the SCS system. The SCS system change methodology is discussed further below.

Recommendation No.7

3.52 The ANAO recommends that, to provide adequate assurance that the SCS system is operating efficiently and effectively, the ATO:

- compile a complete set of baseline specifications for the SCS system; and
- introduce a robust system of controls to maintain the currency and completeness of the SCS system baseline and change specifications.

ATO response

3.53 Agreed. A complete set of baseline specifications will be developed by the Information & Communications Technology Line. This work will be undertaken in parallel with enhancements to the Surcharge Assessment System required for the November 2005 Assessment run. All system documentation will conform with Information & Communications Technology document management protocols.

⁹⁹ The ATO did not identify the absence of key systems documentation as a risk to the Surcharge in its planning, risk assessment and reporting documentation. We consider that this illustrates a weakness in Surcharge risk management practices, and reaffirms the merit of Recommendation 3.

Change management

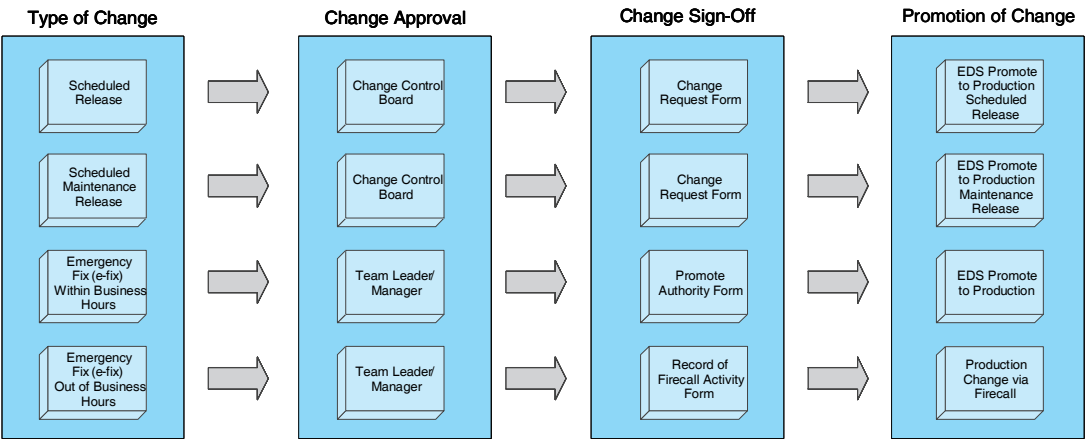
3.54 An essential aspect of maintaining effective control over Surcharge processing is a robust and effective change management control framework. This is particularly important for Surcharge systems (and in particular the SCS system). This is because these systems are not fully functional, are supported by manual processes and work-arounds, and produce large numbers of errors. Ideally, such a framework should seek to minimise ‘...the likelihood of disruption, unauthorised alterations, and errors’,¹⁰⁰ to Surcharge processing systems. In particular, this framework should provide for:

- the identification of changes;
- the categorisation and prioritisation of emergency procedures;
- impact assessment; and
- change authorisation.¹⁰¹

3.55 Although the ATO’s Information and Communications Technology (ICT) division has developed and implemented a corporate change management control framework for the majority of the ATO’s larger systems, during the audit we found that the Superannuation Business Line used a different change management framework for Surcharge processing systems. This framework is illustrated in Figure 3.3.

Figure 3.3

Superannuation Business Line system change management framework



Source: ANAO analysis of ATO information¹⁰²

¹⁰⁰ Audit Guidelines, CobiT, 3rd Ed., July 2000, IT Process AI6: ‘Manage Changes’ (Acquisition and Implementation).

¹⁰¹ *ibid.*

3.56 The Surcharge change management framework is based around a scheduled release program¹⁰³ for all major system changes. This is supported by a scheduled maintenance release program¹⁰⁴, which is used to correct system errors that occur after each Surcharge assessment run. Small systems errors¹⁰⁵ that require immediate rectification are managed through an emergency fix (or e-fix) process.

3.57 Several aspects of the current Surcharge change management framework do not support the effective management of changes to Surcharge systems, or provide assurance that Surcharge systems are operating effectively overall. These aspects include:

- systems documentation. Current change specifications are not adequately documented (this issue has been discussed in paragraphs 3.46-3.51).
- accountability for changes made to Surcharge systems. Business managers are not fully aware of how Surcharge systems operate, and do not have input into the change management process;
- corporate change management systems to manage Surcharge system changes. The Superannuation Business Line currently does not use the SOLVE system consistently to prioritise and action Surcharge system changes; and
- effective management of emergency fixes (e-fixes). The ATO does not have procedures in place to record and rectify e-fixes.

3.58 These points (with the exclusion of point 1) are discussed below.

¹⁰² See Appendix 11 for a detailed description of the Surcharge change management process.

¹⁰³ Although there is no set timetable for the Surcharge scheduled release program, past records indicate that there are up to two annually. This program is used to implement major systems changes stemming from a number of reasons, including major system errors or legislative amendments that require changes to Surcharge systems.

¹⁰⁴ The scheduled maintenance release program occurs four times a year, after each assessment run. Maintenance releases are typically used to correct major errors that have occurred. However, we note that by scheduling maintenance releases in advance, the Superannuation Business Line is anticipating that major errors will occur after each assessment run. The ANAO considers that this is an indication that Surcharge systems are not as stable as they desirably should be.

¹⁰⁵ Systems errors are divided into two categories: production errors—which are errors that occur when a system does not deliver expected results according to a system specification; and production changes—which are changes to a program where the system delivers according to a system specification but does not meet business needs.

Accountability for Surcharge system changes made outside the scheduled release program

3.59 To manage Surcharge processing systems effectively, it is important that business managers have an understanding of Surcharge legislation and policy and know how these systems operate. In particular, business managers should know how business rules are applied to Surcharge data, including how processing systems calculate the Surcharge. If business managers do not have this knowledge, there is an increased risk that the ATO would not be able to detect when Surcharge systems did not operate in accordance with legislation or ATO policy.

3.60 The ICT division's comprehensive change management policies, for other large ATO systems, are usually enforced through a committee or board comprising senior ATO IT and business staff. These groups are responsible for approving all major systems changes. They also perform a number of associated tasks including: the prioritisation of changes; the allocation of resources to change projects; and the approval of change projects. Approval of change projects requires relevant committee or board members to sign-off¹⁰⁶ on change projects.

3.61 As shown in Figure 3.3, all proposed changes to Surcharge systems that are considered as part of the scheduled release program, go to a change control board¹⁰⁷ for approval. This board's membership comprises mainly IT staff, and does not include any business managers. Similarly, Surcharge business managers are not required to sign-off on Surcharge system changes.¹⁰⁸

3.62 The ANAO found that there was little, if any, input by Surcharge business managers into the changes made to Surcharge processing systems. Also, there was little evidence to support that business managers had a comprehensive understanding of the operation of Surcharge systems or business rules. We note that this understanding would be inhibited by the absence of key systems documentation, such as baseline specifications.

3.63 It is essential that, as part of a robust change control management framework, and to provide assurance that Surcharge systems operate in accordance with Surcharge legislation and ATO policy, the ATO provide assurance that relevant Surcharge business managers have input into change

¹⁰⁶ Committee or board sign-off usually means a board member supplies an e-mail or handwritten note agreeing to the change project.

¹⁰⁷ The change control board consists of a change control manager, as well as other ATO IT staff.

¹⁰⁸ We note that the board sends out invitations to Surcharge business managers advising that they will be making changes to Surcharge systems and that they can attend board meetings to discuss the changes. Representatives of the board stated that business response to these invitations has been poor.

processes and are aware of, and are accountable for, changes made to Surcharge processing systems.

Recommendation No.8

3.64 The ANAO recommends that, to provide assurance that changes to the Surcharge processing systems are appropriately analysed, authorised and implemented, the ATO:

- clearly define the roles, responsibilities and accountabilities of business and IT staff regarding the operation of Surcharge processing systems; and
- as part of its change management framework, develop controls to provide assurance that appropriate IT and business managers review and approve changes to Surcharge processing systems.

ATO response

3.65 Agreed. Information & Communications Technology Line, and the Operations and Superannuation Business Lines are progressing the establishment of clearly defined roles and responsibilities relating to the ongoing support and development of the Surcharge processing system. The Surcharge processing system is now subject to established Incident, Problem and Change Management procedures that are co-sponsored by the Information and Communications Technology Line and the Operations Business Line. Superannuation Business Line support teams are being integrated into these processes.

3.66 The ANAO considers that a side-effect of not having business input into changes made to Surcharge processing systems, is that the accountability of IT staff responsible for implementing those changes is diminished. Ensuring business managers examine and sign-off Surcharge processing system changes, increases the level of scrutiny placed on major Surcharge system changes, supports IT staff in making technical changes and decreases the potential for fraud. This issue is discussed further in paragraphs 3.98 to 3.100.

Corporate change management systems to manage Surcharge processing systems changes

3.67 A consistent approach to identifying, prioritising and rectifying systems changes is an essential aspect of managing system changes effectively. It is particularly important for Surcharge systems, which produce large numbers of systems errors. If a consistent approach to managing Surcharge system changes is not used, there is an increased risk that:

- critical system errors may not be identified;

- system errors may not be prioritised (risk rated) correctly. As a result, IT resources may not be directed to the most important and time-critical systems errors;
- system errors are not documented properly; and
- system errors may become lost or left uncorrected.

3.68 An efficient and reliable change management IT system is central to a consistent approach to managing system changes. SOLVE is a key IT tool for reporting system errors. It is commonly used by ATO IT areas responsible for the development and maintenance of IT systems. It is used, amongst many other functions, for tracking system errors that arise in ATO IT systems, as well as errors that arise during system testing (discussed below). Importantly it is:

- a corporately approved system to prioritise (risk assess) system errors, so that ATO IT resources are directed to the highest priority errors; and
- ATO policy that any change to ATO IT production systems must be recorded in one or more SOLVE records.

3.69 As part of the audit, the ANAO examined 791 change requests¹⁰⁹ relevant to Surcharge processing systems. We reviewed whether these system errors were recorded on SOLVE, and whether they were documented consistently. Our analysis of these changes showed that:

- SOLVE was not used to record 25 per cent of cases;
- the detail contained in each SOLVE record was inconsistent;
- there was not a clear audit trail from the change requests to the associated SOLVE record in all cases.

3.70 The results of this analysis indicate that the ATO did not use SOLVE consistently to record Surcharge system changes. We also found that the ATO has not developed, or adhered to, a consistent approach to prioritise Surcharge system changes.

3.71 ATO IT staff advised that SOLVE did not provide the functionality required to effectively record and prioritise all Surcharge system errors. For this reason, and because of the other issues noted above, there is a pressing need for the ATO to develop an effective and consistent approach to analysing, recording and prioritising Surcharge system changes.

¹⁰⁹ A change request is a form requesting a change to a production system. These forms are used to initiate the rectification of system errors, and can also be used to address user requests and other requests for increased system functionality.

Recommendation No.9

3.72 The ANAO recommends that, to provide assurance that system errors are managed efficiently and effectively, the ATO develop and implement a consistent approach to identifying, recording, and prioritising changes to Surcharge processing systems.

ATO response

3.73 Agreed. The Surcharge processing system is now subject to established Incident, Problem and Change Management procedures that are co-sponsored by the Information & Communications Technology Line and the Operations Business Line. Superannuation Business Line support teams are being integrated into these processes.

3.74 The ANAO considers that not using a systematic and comprehensive approach to record system changes, increases the risk that unauthorised changes will be made to Surcharge processing systems. In addition, not having a complete set of baseline and change specifications, significantly decreases the ATO's ability to detect unauthorised system changes. We consider that the current, deficient arrangements increase the fraud risks applicable to Surcharge processing systems. This issue is discussed further in paragraph 3.98.

Effective management of emergency fixes (e-fixes)

3.75 Emergency fixes (e-fixes) are an essential aspect of managing Surcharge processing systems effectively, particularly given the large number of exceptions and systems errors that continue to occur. Current ATO procedures state that an e-fix:

‘... is used to repair errors found in the production system that cannot wait for the next enhancement release.¹¹⁰ It is a collective term used to describe error fixes that are true emergencies, as well as fixes that would normally be implemented as essential maintenance. It is also collective in terms of including fixes for all production processing platforms’.¹¹¹

3.76 E-fixes generally pose a higher level of risk to Surcharge systems than other types of system changes, as they are not subject to the same degree of management scrutiny and approval before they are implemented. They are also not subject to the same amount of system testing as other system changes. As a result, there is an increased risk that they may not operate as intended, and have an adverse impact on processing activity. For an overview of the

¹¹⁰ See scheduled release in Figure 3.3.

¹¹¹ *ATO Emergency Fix Procedures*, November 2002.

Surcharge e-fix process, see Figure 3.3. Good management practice suggests that e-fixes should be:

- comprehensively documented;
- approved by IT management prior to implementation; and
- reviewed at a later point in time to determine whether the e-fixes had any unintended consequences or results.

3.77 Between 1997 and 2004, the ATO recorded 414 e-fixes in the SOLVE system relevant to Surcharge processing systems. However, the ATO advised that the actual number of e-fixes (or system changes) may be significantly higher than this, as some have not been recorded on the SOLVE system (see paragraph 3.69).

3.78 To assess the ATO's use and management of e-fixes for the Surcharge system, the ANAO examined a sample of 105 of the e-fixes recorded on the SOLVE system. This analysis revealed:

- 68 e-fixes (65 per cent) did not have the required management sign-off; and
- 65 e-fixes (62 per cent) did not have documentation specifying why the e-fix was required and what system changes resulted from the system fix.

3.79 The analysis suggests that e-fixes might be used by staff to bypass formal change approval processes and controls (such as those under the scheduled release program - see Figure 3.3). We note, however, that the use of e-fixes may be a consequence of the number of system changes that IT staff need to make, the time frames they have to make them, and the comparatively¹¹² small number of IT staff currently administering Surcharge processing systems.

3.80 Based on the above analysis, the ATO should develop, document and implement, controls to provide assurance that e-fixes comply with ATO emergency fix procedures policy¹¹³ and procedures for the use, approval and review, of e-fixes relevant to the Surcharge system. As part of a comprehensive reporting and performance framework (see Chapter 2), the ATO would benefit by regularly monitoring and reporting on the use of e-fixes. This process would provide a measure of overall system performance and would assist in the assessment of system risk.

¹¹² Compared with other, similarly-sized ATO systems.

¹¹³ *ATO Emergency Fix Procedures*, November 2002.

Recommendation No.10

3.81 The ANAO recommends that, to provide assurance that emergency changes to the SCS system are appropriately classified, controlled and approved, the ATO:

- develop, document and implement controls to provide assurance that emergency fixes are used appropriately and in accordance with ATO emergency fix procedures; and
- monitor and report on the number of emergency fixes as a measure of overall Surcharge system performance, and to assist in the assessment of Surcharge systems' risk; and
- review regularly the impact of emergency fixes on the operation of Surcharge systems.

ATO response

3.82 Agreed. The Surcharge processing system is now subject to established Incident, Problem and Change Management procedures that are co-sponsored by the Information & Communications Technology Line and the Operations Business Line. Superannuation Business Line support teams are being integrated into these processes. These processes include e-fix activity.

3.83 The ANAO considers that a reliance on e-fixes also increases fraud risk, as change controls are bypassed to rectify Surcharge problems that require immediate rectification. This issue is discussed further in paragraph 3.98. We also note that e-fixes created using the ATO's 'firecall' utility, further increase the fraud risk profile of e-fixes. Firecall is discussed below.

Firecall

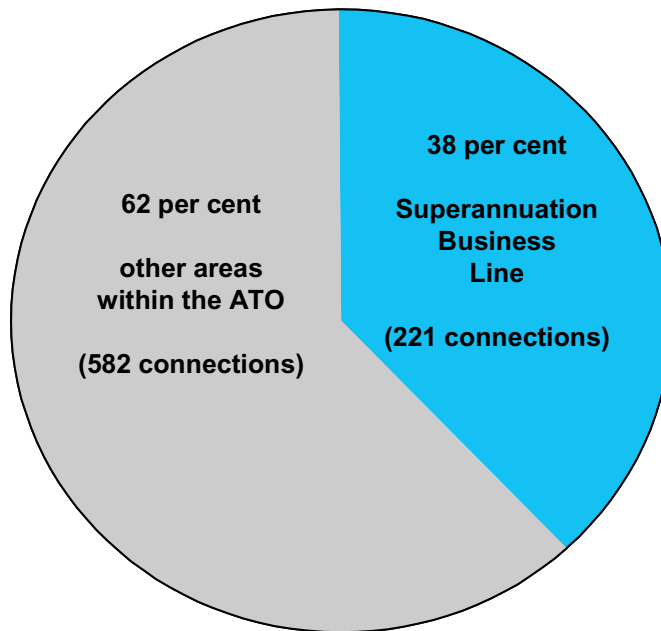
3.84 To facilitate the smooth operation of ATO IT systems, it is necessary at times for ATO IT systems staff to make direct changes to the Surcharge processing systems to correct system errors. To enable staff to perform these 'quick fixes' and to gain the necessary direct access to production data (for example Surcharge contributions data) in the ATO mainframe environment, the ATO has a special access authority, known as Firecall, to bypass regular security controls.

3.85 ATO staff requiring Firecall access must obtain management and/or user approval, as it bypasses all normal system change procedures and access controls. For this reason, its use should be kept to a minimum and each use of the Firecall utility should be carefully reviewed.

3.86 As part of the audit we analysed the Superannuation Business Line's use of Firecall between August 2003 and August 2004. Figure 3.4 and Figure 3.5 provide the results.

Figure 3.4

Percentage of Firecall usage by the Superannuation Business Line compared to the rest of the ATO 31 August 2003–31 August 2004

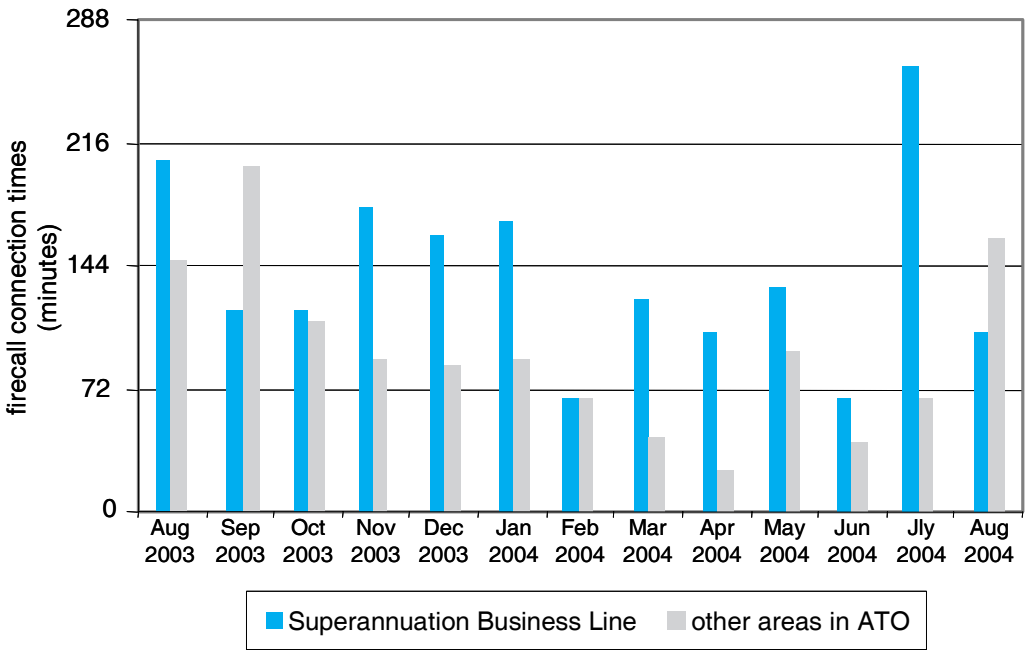


Source: ANAO analysis of data provided by the ATO's Trusted Access group

3.87 Between August 2003 and August 2004, Superannuation Business Line IT staff were significant users of Firecall, indeed these staff were the largest users of Firecall of any specific area within the ATO. The ATO advised that a significant proportion of this access related to changes made to Surcharge processing systems, and in particular changes to Surcharge production data (for example, the information contained on MCSs). We were also advised that the use of Firecall had become a regular part of correcting Surcharge contributions data and correcting system errors.

Figure 3.5

Average Firecall connection times for the Superannuation Business Line and other areas in the ATO from 31 August 2003 to 31 August 2004



Source: ANAO analysis of data provided by the ATO's Trusted Access group

3.88 Figure 3.5 shows that, in the majority of cases in the review period, the average connection times for the Superannuation Business Line were significantly longer than for all other areas within the ATO. Between 20 August 2003 and 30 August 2004, the average Firecall connection time was 139 minutes compared to 93 minutes for the remainder of the ATO.

3.89 Our analysis reveals that the Superannuation Business Line's IT staff are the highest users of Firecall within the ATO, both in terms of the number of Firecall connections and the duration of those connections. ATO policy states that 'Firecall use is the exception not the rule'.¹¹⁴ Based on the number and length of Firecall connections, the Superannuation Business Line appears to use Firecall to access superannuation processing systems to carry out 'business-as-usual' maintenance work on Surcharge and other superannuation systems and member data.

¹¹⁴ ATO Trusted Access National IT Security Guidelines for Tax Office Staff Using the Firecall Utility, June 2004.

3.90 As mentioned in paragraph 3.85, all Firecall access should be carefully reviewed to provide assurance that Firecall is used for legitimate purposes. This is done by the ATO's Trusted Access area, which reviews whether correct protocols, authorisations and procedures have been followed by staff accessing Firecall. However, Trusted Access does not examine whether the work performed using Firecall was legitimate, or consistent with the written explanation provided by the user who made the Firecall request.

3.91 As discussed in Chapter 2, the ATO's Certificate of Compliance process is designed to provide management with assurance that key system controls are operating effectively. One of the key controls regarding the operation of Surcharge systems is that *'Firecall usage is reviewed on a regular basis'*. This control requirement should include an assessment of the legitimacy of the reasons for access, as well as a review of the changes that were made. Although this key control has been signed-off by the Superannuation Business Line (as part of the Certificate of Compliance), there was no evidence to show that a review of Firecall usage regarding Surcharge systems had ever occurred.

3.92 We concluded that, based on the issues discussed above, the use of Firecall to access and change Surcharge systems is a significant fraud risk for the ATO, as many critical IT security controls are bypassed, and access is not reviewed. This issue is discussed further in paragraph 3.98.

Recommendation No.11

3.93 The ANAO recommends that, to achieve the required level of security, and to promote consistency in access approval processes to Surcharge processing systems, the ATO:

- introduce a robust suite of procedures and controls to provide assurance that all Firecall access relating to Surcharge processing systems is legitimate;
- as part of a comprehensive approach to the Certificate of Compliance process, review all Surcharge-related Firecall access regularly to provide assurance that it is legitimate; and
- as part of its internal reporting framework, report the results of Firecall access reviews.

ATO response

3.94 Agreed. The Surcharge processing system is now subject to established Incident, Problem and Change Management procedures that are co-sponsored by the Information & Communications Technology Line and the Operations Business Line. Superannuation Business Line support teams are being integrated into these processes. These processes include firecall access and

monitoring. The Certificate of Compliance process is undertaken monthly with conformance and integrity checks applied to the review and authenticity of firecall requests. These checks are performed by the Productions Systems Support area of the Information & Communications Technology Line. All firecall activity is reported as part of the line performance against the monthly corporate integrity indicators process.

Surcharge systems testing

3.95 System testing provides an independent quality assurance control for all IT projects. It is used to provide assurance that a system change operates as intended, and does not have any unexpected impacts on the overall operation of the system. The Surcharge SDLC methodology should provide standards covering test requirements, verification, documentation and retention for:

- testing individual software units and aggregated programs created as part of every information system development or modification project¹¹⁵; and
- testing the total system as a part of every information system development or modification project.¹¹⁶

3.96 As part of the audit, the ANAO reviewed the work undertaken by the Superannuation Business Line's systems testing team, which is responsible for testing all changes made to Surcharge processing systems. Our analysis showed that:

- testing procedures were well documented and, where testing was undertaken and documented, procedures were adhered to;
- testing documentation standards were maintained through the use of standard templates; and
- all testing, once completed, was signed-off and approved by ATO staff with relevant authority.

3.97 Although, the methodology used to test changes¹¹⁷ to Surcharge systems was sound, the ATO has disposed of large amounts of testing data, including relevant sign-offs for completed testing. As a result, the ANAO was unable to form a definitive conclusion on Surcharge testing processes. The disposal of this information is unfortunate, as it would have provided some

¹¹⁵ Audit Guidelines, CobiT, 3rd Ed., July 2000, IT Process PO: 'Manage Quality: Programme Testing Standards' (Planning and Organisation).

¹¹⁶ *ibid.*

¹¹⁷ The Surcharge system testing discussed above refers only to the scheduled release and Scheduled Maintenance Release Program (referred to in Figure 3.3)

assurance that aspects of Surcharge systems were operating correctly, particularly given the absence of key baseline and change specifications.

Surcharge Fraud Control Arrangements

3.98 The prevention and detection of internal fraud is founded on the education of key staff, a robust corporate structure (which separates key job functions), a comprehensive framework of controls, and quality assurance and review processes. The issues raised in Chapters 2 and 3, suggest that several potentially significant risks exist within the SCS system that impact the ATO's ability to detect and prevent internal fraud:

- Superannuation Business Line Fraud Control Plan (see Chapter 2). This plan does not assess the fraud risks associated with Surcharge IT systems. Based on our analysis, unmitigated fraud risks exist within Surcharge systems;
- Input from Surcharge business managers into changes to Surcharge IT systems. Under current Surcharge change control methodology, Surcharge business managers are not required to review systems changes made by a small number of IT staff. Review of changes to systems by ATO staff outside the Surcharge IT area could significantly decrease fraud risks;
- Not consistently and comprehensively recording changes to Surcharge systems. By not recording system changes, the ATO's ability to identify unauthorised (and potentially fraudulent) changes, is reduced significantly;
- Using e-fixes regularly to make system changes. The e-fix process bypasses the normal review process associated with changes made using the Scheduled Release Program. This program provides much greater scrutiny of, and provides for high levels of accountability for, system changes; and
- Excessive use of Firecall. The Firecall utility bypasses many security controls built into ATO systems to prevent unauthorised access to, and alteration of, ATO systems and taxpayer/member data.

3.99 Because of the issues noted above, the ATO should modify their approach to fraud control with regard to the Superannuation Contributions Surcharge systems. This is addressed in Recommendation 7.

3.100 IT staff responsible for the management of Surcharge IT systems, appear to have adopted their current approach in order to cope with large workloads, systems that do not have full functionality and large volumes of exceptions. ATO Management taking action to make Surcharge systems more robust would provide Superannuation IT staff with the measures of support they need to undertake their work effectively and without compromise.

Recent and future developments in the management of Surcharge systems

3.101 Since the audit commenced in April 2004, the Superannuation Business Line has undertaken work to improve its administration of the Surcharge and, in particular, the operation of its Surcharge IT systems and supporting manual processes. This is evidenced by the following:

- Review of the Superannuation Surcharge System. This review focused on improving the Surcharge assessment run, and provides possible solutions to minimise the number of exceptions generated by Surcharge systems.
- Review of Superannuation IT systems by IBM. The ATO initiated an external review of Superannuation IT systems to be undertaken by IBM. We were informed that this review involved an examination of the programming code of the SCS system (as well as other Superannuation IT systems).
- Relocation of the Superannuation Business Lines' IT area into the ATO's Information, Communication and Technology area. We were advised in August 2004 that the ATO was undertaking this relocation to improve the Superannuation procedures and controls for IT, and to align Superannuation IT practices with the rest of the ATO.

3.102 The ATO also advised that it recognises that some redevelopment of Surcharge IT systems (and the SCS system in particular) needs to occur. For this reason, at the time of the audit, the ATO was considering including the redevelopment of Superannuation systems as part of its redevelopment of all major ATO IT systems (known as the Change Program). This is a practical approach to solving the long-term problems associated with Surcharge systems, but 2007 will be the earliest time that this can occur.

4. Exceptions Management

This chapter addresses the ATO's management of instances that prevent the Commissioner making Surcharge assessments for particular members. These instances are known as Surcharge exceptions. In particular, we focused on the issues applicable to Surcharge exception backlogs and the processes and controls the ATO uses to manage Surcharge exceptions.

Introduction

4.1 Exceptions will occur within any large or complex processing system as part of business-as-usual activity. The design and robustness of the system, as well as the quality of the data processed by the system, will affect the number and type of exceptions generated. Not managing Surcharge exceptions effectively can result in large backlogs of incomplete work, as well as poor performance against intended objectives.

4.2 One of the most effective strategies to manage exceptions is prevention. That is, utilising an effective combination of automated controls and compliance initiatives, to automatically correct exceptions without manual intervention, and to encourage relevant external parties to provide high quality data, in the first instance, that does not require rectification.

4.3 As discussed in Chapter 1, Surcharge legislation specifies that the Commissioner has a general duty to assess the Surcharge for every member for whom there are superannuation contributions, for each financial year.¹¹⁸ This means that the ATO must use an equitable, logical and well-documented methodology to address all exceptions. If exceptions are not corrected using a sound methodology, all members with Surcharge obligations may not be treated fairly.

Past Surcharge exceptions management practices

4.4 As discussed in paragraph 2.6 of Chapter 2, the ATO reassessed its priorities in 1999 and decided not to action Surcharge exceptions. These changes had an impact on the effectiveness of exceptions management within the Superannuation Business Line. This impact was acknowledged in April 2004, when the ATO's corporate management was informed by the Superannuation Business Line that:

- for many categories [of exceptions], we [the ATO] have no experience in dealing with the work;

¹¹⁸ Although it is recognised that there are limited circumstances in which the Commissioner may lawfully decide not to make an assessment.

- the error [exception] may not be clearly defined; and
- there are no procedures for correction, and the system may not support resolution.¹¹⁹

4.5 The ATO's re-prioritisation of work within the 2000–01 tax reform environment, coupled with incomplete Surcharge IT systems, and less than adequate system controls (see Chapter 3), has caused large and administratively burdensome Surcharge exception backlogs. As at August 2004, there were approximately 11.3 million Surcharge exceptions¹²⁰ requiring resolution. The ANAO estimates that these exceptions could account for a range of between \$360 million and \$750 million in uncollected Surcharge revenue.¹²¹

4.6 As discussed in Chapter 2, during 2003, the ATO identified the potential administrative difficulties associated with these large exception backlogs. As a remedy, it approached Government as part of the 2003–04 Budget and received additional funding to resolve Surcharge exceptions. During the audit it had made some progress in this regard. This progress is discussed below (see paragraph 4.57).

Surcharge exceptions defined and the ANAO views on Surcharge exceptions management

4.7 Although there is not a strict definition of what an 'exception' is, for the purpose of this chapter, we have divided Surcharge exceptions into two categories:

- identity matching exceptions. These arise when an MCS cannot be matched to a member's ITR before it is processed by the SCS system (see Chapter 3 Figure 3.1). Such circumstances may arise when a member does not provide correct or complete information to the fund, or the fund does not forward correct information to the ATO; and

¹¹⁹ Refer to the briefing to the Commissioners by the Assistant Deputy Commissioner of the Superannuation Business Line on 22 April 2004.

¹²⁰ This is made up of approximately 10.5 million identity matching exceptions (discussed further at paragraph 4.11 below) and approximately 826 000 Superannuation Contributions Surcharge (SCS) exceptions (discussed further at paragraph 4.45).

¹²¹ This is approximately made up of between \$298 million and \$600 million in relation to identity matching exceptions (discussed further at paragraph 4.12) and between \$69 million and \$149 million in relation to SCS exceptions (discussed further at paragraph 4.44).

For its 2003–04 financial statements, the ATO developed a methodology to estimate the Surcharge exception backlog. Using this methodology, it estimated the Surcharge exception backlog to be \$323 million. The ANAO reviewed the methodology used by the ATO's to estimate Surcharge exception revenue, and raised concerns regarding: the completeness and accuracy of data used in calculating the revenue estimates; and the assessment as to the ability to collect some of these amounts.

The ATO advised that Surcharge exceptions backlogs revenue is still a relatively small proportion of total Surcharge revenue. This is illustrated in Appendix 12 of this report.

- Superannuation Contributions Surcharge (SCS) exceptions. These arise when an event occurring during processing (within the SCS system) prevents the Commissioner from making an assessment, or indicates that the Commissioner should review an assessment at a later time. This usually involves the SCS system not being able to interpret a member's MCS or Income Tax Return (ITR) record.¹²²

4.8 As the ANAO's analysis of the ATO's management of exceptions is detailed, we have drawn together our overall views here.

4.9 We note that the ATO's management of both types of exceptions has been less than adequate in the past, with large exception backlogs accumulating for each category. Although there are many factors that have contributed to the size of these backlogs, large numbers of unresolved exceptions could have been prevented by:

- the effective utilisation of legislated tools, such as Please Quote Tax File Number (PQTFN) letters and default assessments (which are discussed below), could have reduced the number of identity matching exceptions; and
- the development and implementation of effective compliance initiatives¹²³ to enforce the lodgement of high quality MCS data by holders could have prevented large number of exceptions from being generated by the SCS system.

4.10 The impact of past ATO compliance strategies on each category of exception, and the detailed analysis underlying our views, are set out below. We end this chapter by describing the ATO's proposed approach to resolve a large proportion of the Surcharge exception backlogs.

Identity matching exceptions

4.11 As discussed in Chapters 1 and 2, Surcharge legislation specifies that members need to quote their TFN to their superannuation provider (holder) to avoid receiving a default assessment. Identity matching exceptions occur where a member fails to quote a TFN to their holder, and the Commissioner has not been able to derive a TFN for the member, despite taking 'all reasonable steps'.¹²⁴

¹²² Refer to Chapter 3 for an overview of the SCS system.

¹²³ The Surcharge compliance strategy is also discussed in Chapter 5.

¹²⁴ The 'reasonable steps' undertaken by the Commissioner, in accordance with the requirements of the Surcharge legislation, refer to the verification of MCS data via Compliance Systems identity matching engines, which allocate confidence levels to the identity of a member reported to the ATO (either by verifying the TFN quoted, or deriving one). Where an MCS record has not been verified to a sufficient level of confidence, it is classified as an identity matching exception and added to the please quote tax file number (PQTFN) table (see Figure 3.1).

4.12 As at August 2004, there was a backlog of approximately 10.5 million identity-matching exceptions, potentially accounting for between \$298 million¹²⁵ and \$600 million¹²⁶ in uncollected Surcharge revenue. In recent years, this backlog has been growing at a rate of approximately 1.5 million exceptions each year. Given the size of the backlog, the ANAO considers that the ATO cannot resolve identity-matching exceptions as part of 'business-as-usual' Surcharge processing.

4.13 As shown in Figure 3.1 of Chapter 3, an identity matching exception occurs before an MCS record enters the SCS system and is, therefore, excluded from the Surcharge assessment process. This means that once an identity matching exception has been resolved for a particular MCS record, that MCS record must still pass through the SCS system where further Surcharge exceptions (SCS exceptions) may occur.

4.14 As discussed above in paragraph 4.4, as part of the re-prioritisation process undertaken during the lead up to tax reform, the Superannuation Business Line made a decision in 1999 not to action identity matching exceptions. We found that, apart from affecting the level of Surcharge revenue collected by the ATO (as indicated above), this decision may also affect:

- members' willingness to provide their TFN to their holder;
- the ATO's ability to issue PQTFN letters; and
- the ATO's ability to issue default assessments.

4.15 Each of these impacts is discussed further below.

Members' willingness to provide their TFN to the holder of their contributions

4.16 Obtaining a member's TFN is critical to the calculation of the Surcharge.¹²⁷ Without a TFN, the ability of the ATO to match an MCS record to an applicable Income Tax Return (ITR) to calculate the Surcharge (see Appendix 2) is reduced considerably.

¹²⁵ This estimate is based on the number and dollar value of total contributions relevant to identity matching exceptions multiplied by the percentage of all Surcharge assessments with a Surcharge liability (see Appendix 5). We note, however, when the SCS system was designed, the PQTFN table was not originally designed to capture information on 'surchargeable contributions' for members, but rather total contributions. As such there is an even greater level of uncertainty associated with using the total contributions field stored on the PQTFN table.

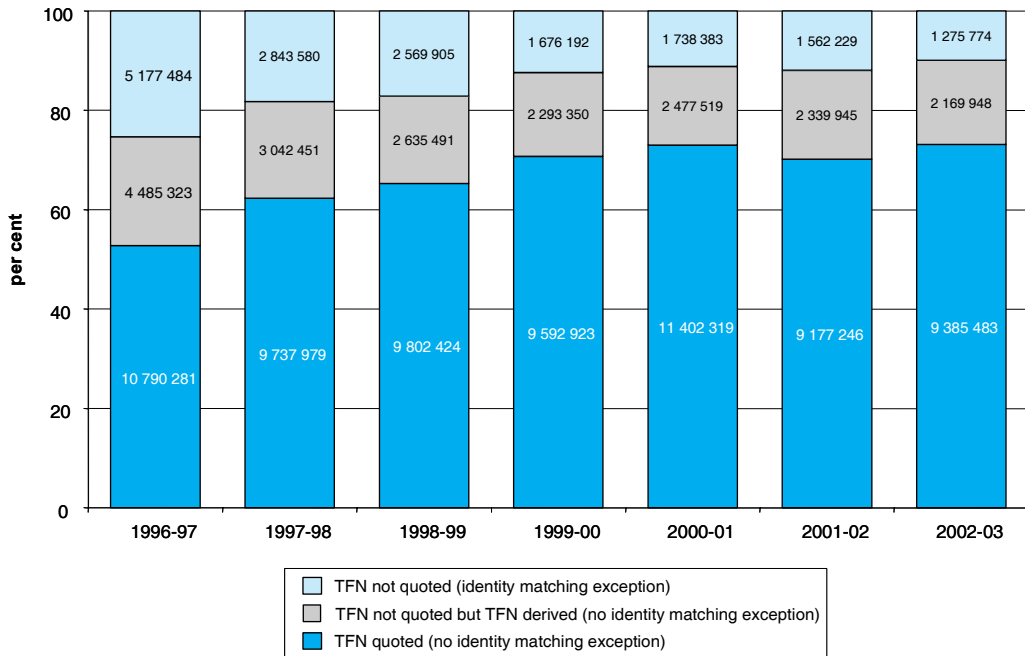
¹²⁶ This estimate is based on an extrapolation of the outcomes of previous default assessments (discussed in paragraph 4.33) and applied to the number of Surcharge exceptions as at August 2004.

¹²⁷ The ANAO notes that under Surcharge legislation, members are not obligated to quote tax file numbers to the holder of their superannuation contributions for Surcharge purposes. However, as described further in paragraph 4.21 below, where a TFN has not been quoted, the Surcharge legislation provides the ATO with a specific mechanism, the PQTFN letter, to request a members TFN to enable the assessment of the Surcharge.

4.17 To assess the impact of the ATO's approach to managing the quotation of TFNs by members, the ANAO examined Surcharge data to determine how many MCS records had a corresponding TFN supplied by members. The results of our analysis are in Figure 4.1.

Figure 4.1

Numbers of MCS records lodged with TFNs and lodged without TFNs between 1996–97 to 2002–03



Source: ANAO analysis of ATO SCS system data¹²⁸

4.18 Figure 4.1 shows that, although the quotation of TFNs for Surcharge purposes has increased overall, there are still large numbers of MCS records that cannot be matched to ITRs because a TFN has not been quoted. Specifically, Figure 4.1 shows that:

- the majority of identity matching exceptions occurred in the three years following the introduction of the Surcharge. This is to be expected of a new system that is large and complex. In 1996–97, 25 per cent (5.2 million) of all MCSs processed, resulted in identity matching exceptions. As a consequence, a large proportion of the identity

¹²⁸ The ANAO notes that there are some discrepancies between the data used for graphs throughout the report. These discrepancies may relate to timing differences (i.e. when the data was obtained from an ATO IT system), the system from which the data was extracted, and the method in which the data was extracted.

matching exceptions occurring in the first three years of the Surcharge have not been resolved;

- between 1999-00 and 2002-03, there has not been a significant change in the number of new identity matching exceptions. However, between 2000-01 and 2002-03, there has been a small proportionate decrease in TFN quotation by members;
- it is likely that the significant proportionate increases in TFN quotation between 1996-97 and 1999-00 occurred because the system was new and stakeholders (in particular, the holders of contributions) were still being made aware of obligations. The issuing of PQTFN letters and default assessments also had an impact on TFN quotation rates (PQTFN letters are discussed in paragraphs 4.21-4.31); and
- the number of MCSs with TFNs lodged by holders remained relatively constant from 1999-00 to 2002-03, despite steady increases in the total number of members making contributions (see Appendix 5). This could indicate that TFN quotation rates have improved since 1999-00. However, Figure 4.1 shows that proportionately high numbers of MCS continue to be remitted without TFNs.¹²⁹

4.19 The above analysis shows that, not only is the backlog of identity matching exceptions a risk for the ATO, but so is the constant rate at which new exceptions are occurring. We consider that the reason for this growth is the absence of an effective education and communication strategy to encourage members to lodge their TFNs. The main mechanisms available to the ATO regarding the lodgement of TFNs are:

- PQTFN letters; and
- default assessments.

4.20 The effectiveness, and the ATO's use, of these mechanisms are discussed further below.

Please Quote Tax File Number (PQTFN) letters

4.21 As advised in Chapter 1, if a member does not quote their TFN to their superannuation provider (holder), the ATO can issue that member with a default assessment.¹³⁰ However, before a default assessment can be issued, the

¹²⁹ This also coincided with the decision made by the ATO in 2000-01, not to issue PQTFN letters as part of 'business-as-usual' processes (see Appendix 4).

¹³⁰ A default assessment applies the Surcharge at the maximum Surcharge rate to a member's superannuation contributions. Although the ATO can issue a default assessment, it cannot 'force' a member to provide a TFN for Surcharge purposes.

Superannuation Contributions Tax Imposition Act 1997 specifies that the Commissioner must write a ‘first’ PQTFN letter to the member:

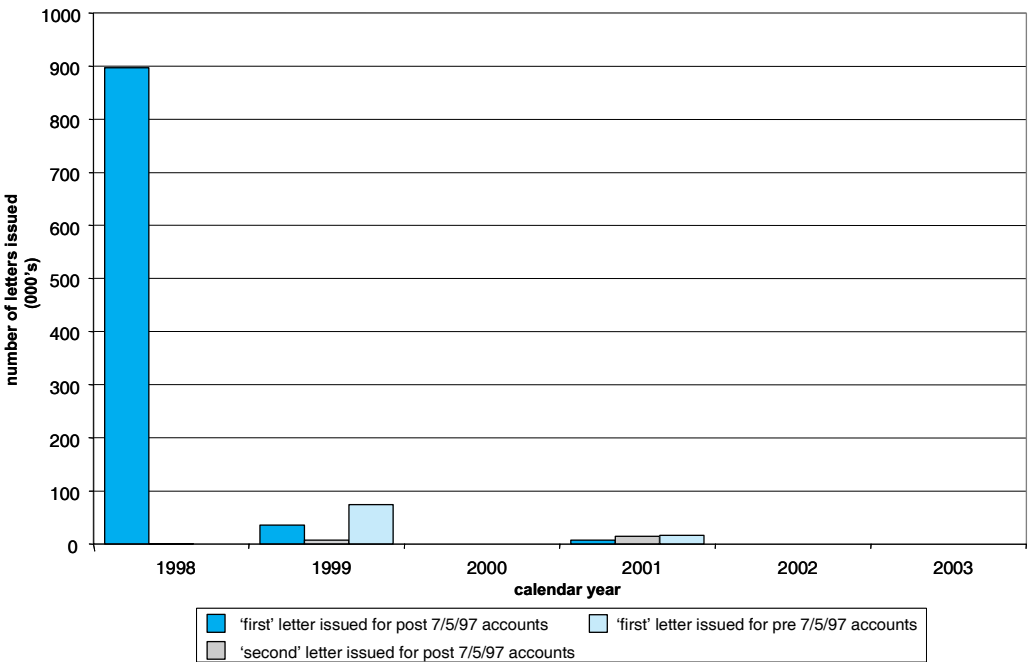
- requesting that the member quote his or her TFN to the ATO for Surcharge purposes; and
- stating that if the member does not quote his or her TFN, they may be issued with a default assessment.¹³¹

4.22 If the member does not quote their TFN within three months of the ‘first’ letter being sent, the ATO must issue a ‘second’ PQTFN letter written in the same terms as the first. If the member does not quote their TFN to the ATO following this letter, the maximum rate of Surcharge (currently 14.5 per cent) may be applied to the member in respect of all the contributions attached to the identity matching exception.

4.23 To determine how actively the ATO has used PQTFN letters to encourage members to provide their TFN, we reviewed the number of ‘first’ and ‘second’ PQTFN letters issued by the ATO. This analysis is depicted in Figure 4.2

Figure 4.2

PQTFN letters issued since the introduction of the Surcharge



Source: ANAO analysis of ATO information¹³²

¹³¹ S.5(3)(c) *Superannuation Contributions Tax Imposition Act 1997*.

4.24 Approximately 1.1 million ‘first’ and ‘second’ PQTFN letters have been issued by the ATO for all categories. Approximately 85 per cent (900 000) of these letters were issued in 1998. The ATO advised that, as a result of these letters, approximately 600 000 members (58 per cent of letter recipients) quoted their TFN to the ATO.¹³³ Based on these statistics, PQTFN letters would appear to be an effective mechanism in obtaining TFNs from members to enable the Commissioner to make a Surcharge assessment.

4.25 Figure 4.2 also shows that the ATO has not issued PQTFN letters regularly since 1999. This finding is consistent with an administrative policy decision made in 2000–01 not to issue PQTFN letters (see Chapter 1, Figure 1.2). The ANAO notes that this decision was taken despite the apparent success of PQTFN letters as an effective mechanism to obtain TFNs for Surcharge purposes, and the growing identity matching exception backlog.

2000–01 ATO decision not to issue PQTFN letters

4.26 The ATO advised that its 2000–01 decision not to issue PQTFN letters, was based on a number of factors including:

- Cost. The cost of issuing up to millions of ‘first’ and ‘second’ PQTFN letters was significant for the ATO.¹³⁴ Providing facilities for members to quote their TFNs (such as automated telephony systems¹³⁵ to allow members to quote their TFN over the telephone) was also costly.¹³⁶ As discussed in Chapter 1, the funding for the Surcharge was rated as a significant challenge for the ATO. We note that, in 1997, the ATO asked for additional funding for the PQTFN process. However, this funding request was rejected;
- Revenue. As discussed in Chapter 2 paragraph 2.18, the ATO advised that it had undertaken analysis of identity matching exceptions in 1999,

¹³² Under s.3(d) *Superannuation Contributions Tax Imposition Act 1997*, the Commissioner need only issue one PQTFN letter for contributions paid for or by the member to a superannuation provider on or before 7 May 1997, where those contributions exceed the surchargeable contributions threshold.

¹³³ At the time, the Superannuation Business Line had put in place an Interactive Voice Recognition (IVR) telephony system, which automated much of this process, by letting members provide their TFN details using a reference number generated by the SCS system. The Surcharge IVR was decommissioned in February 2001 following the decision by the Superannuation Business Line to cease issuing PQTFN letters.

¹³⁴ The costs associated with issuing PQTFN letters included: locating the member’s address (so a PQTFN letter could be sent to them); printing the letters; and dealing with enquiries made by members once they had received a PQTFN letter.

¹³⁵ See paragraph 4.29 for a brief description of the Surcharge telephony systems used by the ATO.

¹³⁶ The cost of the automated telephony service in 2001 was approximately \$6 500 per month to run (this does not include initial hardware and software costs). To implement a new service (not using existing ATO infrastructure, and including the issue of PQTFN letters) is estimated at \$528 000.

and determined that, potentially, these exceptions would result in the collection of comparatively small amounts of Surcharge revenue;

- A small proportion of identity matching exceptions will result in a Surcharge liability. The ATO advised that its 1999 analysis indicated that a very small number of exceptions would result in a Surcharge liability; and
- Superannuation industry. The ATO advised that it undertook extensive work and negotiations with the superannuation industry to find more efficient and effective ways to obtain TFNs. The outcome of this collaboration was that, in 2000, the industry undertook to actively collect TFNs from their members.

4.27 We were also advised that the decisions not to address identity-matching exceptions, and not to issue PQTFN letters, were only a temporary measure. Both of these activities recommenced in 2002. However, as shown in Figure 4.2, this did not occur.

4.28 Although we were also advised that the ATO corporate management was aware of the decisions not to issue PQTFN letters, we could find no evidence that these decisions had been clearly documented.¹³⁷ The implications of not documenting key administrative policy decisions are discussed in Chapter 2.

4.29 In addition to not issuing PQTFN letters, one of the ATO's most efficient mechanisms to allow members to quote their TFN, the Surcharge Interactive Voice Recognition (IVR) telephony system, was decommissioned in February 2001.¹³⁸ Without this system, members would find it difficult to quote their TFNs, and the ATO would not be able to efficiently process high volumes of TFNs if large numbers of members wanted to quote them.

Plans to re-introduce the PQTFN process

4.30 In addition to the ATO's collaboration with the superannuation industry to encourage members to provide their TFNs, in 2004, the Superannuation Business Line Executive gave approval to the re-introduction of the PQTFN letter process. The ATO advised that it intends to send out up to

¹³⁷ As discussed in Chapter 2, not documenting key decisions can impact decision-making at a later time, and management's ability to review those decisions. We note that, since 2002, there has been significant staff turnover at the executive level within the Superannuation Business Line. We also note that current ATO staff were unaware of the 1999 decision taken to recommence work to identify matching exceptions, or to commence issuing PQTFN letters.

¹³⁸ The Surcharge IVR telephony system is a fully automated system, which allows members to quote their TFN over the telephone by pushing the buttons on their telephone keypad. PQTFN letters specify that members should use this system to quote their TFNs.

80 000 PQTFN letters annually, and will use an IVR system to allow large numbers of members to quote their TFN.¹³⁹

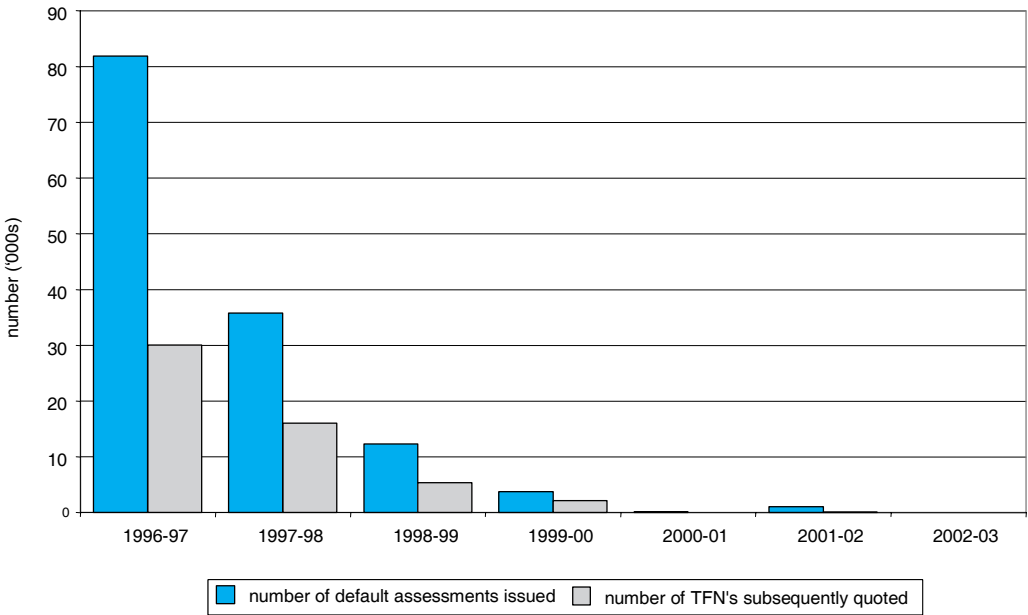
Conclusion on the ATO’s management of PQTFN letters

4.31 PQTFN letters are an important element of the overall Surcharge framework, and have proven to be effective in the past. The ATO’s decision to cease issuing PQTFN letters appears to have reflected the environment at the time (see Chapter 2). However, in hindsight, it has impacted on the size of the identity-matching exceptions backlog. It has also forced the ATO to implement strategies to resolve the existing backlog that may not be equitable to all members (this is discussed further below from paragraph 4.66).

Default assessments

4.32 As noted above, the ATO can issue a default assessment once it has issued two PQTFN letters. As part of the audit, we examined the number of default assessments issued by the ATO and whether issuing these assessments prompted members to quote their TFNs. This analysis is shown in Figure 4.3.

Figure 4.3
Default assessments issued since the introduction of the Surcharge



Source: ANAO analysis of ATO systems information

¹³⁹ As noted in footnote 133 above, the original IVR system used by the Superannuation Business Line was decommissioned in February 2001.

4.33 Our analysis indicates that default Surcharge assessments were an effective mechanism to obtain TFNs. Specifically, we found that:

- approximately 135 000 Surcharge default assessments have been issued since the introduction of the Surcharge;
- approximately 53 000 additional TFNs were quoted to the ATO as a result of members receiving a default assessment; and
- revenue collected from Surcharge default assessments was approximately \$60.2 million.¹⁴⁰

4.34 It also is apparent that, based on the above information, default Surcharge assessments are not only effective for the quotation of TFNs by members, but can also assist the collection of significant additional Surcharge revenue.¹⁴¹

Implications of not adopting a systematic approach to issuing default assessments and PQTFN letters

4.35 Figure 4.3 shows that the ATO's decisions not to resolve identity-matching exceptions, or issue PQTFN letters, had a direct impact on issuing default assessments. Specifically, less than 1 200 default assessments were issued after 1999-00. Not issuing the two required PQTFN letters, and consequently not issuing default assessments, has contributed to the size of the identity-matching backlog.

4.36 If the information from Figure 4.2 (PQTFN letters) is analysed in conjunction with Figure 4.3, it is evident that the ATO has not 'followed through' with a large part of the work that it undertook between 1996-97 and 1999-00. Although the ANAO is unable to determine from the ATO's data, which members were issued with 'first' or 'second' TFN letters, we note that approximately:

- 454 000 members failed to quote their TFN details to the ATO after receiving either a 'first' or 'second' PQTFN letter; and
- of those members, 318 000 members should either have been issued with a 'second' PQTFN letter, or a default assessment, but were not.

¹⁴⁰ The ATO originally recognised \$85.5 million in additional Surcharge revenue coming from default assessments. However, through members subsequently quoting their TFN, this revenue was reduced by \$25.3 million.

¹⁴¹ This is particularly the case for the 1996-97 and 1997-98 financial years, to which most of the \$60.2 million in default assessment revenue relates.

Conclusion on the ATO's management of Surcharge default assessments

4.37 A Surcharge default assessment is the final step available to the ATO under Surcharge legislation to obtain a TFN to enable the Commissioner to make a Surcharge assessment. In conjunction with PQTFN letters, it is an effective means to encourage members to quote their TFN, and can educe considerable additional Surcharge revenue, from those members not willing to quote their TFN.

4.38 That said, by issuing only a small number of default assessments inconsistently since 1999-00, and not 'following through' with activity started in 1996-97, the ATO has not taken a consistent and equitable approach to issuing default assessments. As noted above, this is largely a result of decisions taken to defer this type of activity due to the resource constraints imposed by tax reform. However, now that additional funding has been secured (see paragraph 2.80 of Chapter 2) the ATO is in a better position to implement a more comprehensive approach to managing future identity matching exceptions.¹⁴²

Recommendation No.12

4.39 The ANAO recommends that, to provide a coordinated and comprehensive approach to managing future identity-matching exceptions in accordance with the Surcharge legislation, the ATO:

- develop and enforce a policy for the timely issue of Surcharge letters and default assessments, as specified under the *Superannuation Contributions Tax Imposition Act 1997*; and
- actively monitor and report to ATO corporate management the number of identity-matching exceptions, and the number of Surcharge letters and default assessments issued.

ATO Response

4.40 Agreed. Each year the ATO receives 16.5 million Member Contribution Statements, 3 million do not have a TFN, although the ATO is able to match 2 million, leaving 1 million potentially requiring contact with the taxpayer. Policies for the timely issue of appropriate numbers of Surcharge letters in relation to identity matching exceptions, and the timely issue of default assessments are being developed. Arrangements are in place for regular monitoring and reporting to senior management of: the number of exceptions completed; work in progress; and the numbers on hand.

¹⁴² The ATO's chosen approach to deal with the existing backlog of identity matching exceptions is discussed in detail from paragraph 4.66.

SCS exceptions

4.41 It is to be expected that any IT system that processes large quantities of data from multiple sources (such as the SCS system), will generate exceptions as part of day-to-day processing activity. However, a well designed IT system, underpinned by sound manual processes and controls, will minimise the number of exceptions that occur, as well as provide an environment conducive to efficiently addressing unavoidable exceptions.

4.42 As discussed in Chapters 2 and 3, the ATO recognises that the SCS system does not have full functionality and, as our analysis has shown, some of the manual processes and controls underpinning the SCS system are less than effective. We consider that these factors have an impact on the large number and type of exceptions that the SCS system has produced, and that remain unresolved.

4.43 Although there is not a strict definition for an ‘SCS exception’, the ATO has defined them as occurring:

“...where [MCS] data does not meet specific parameters [tests] required by the [SCS] system, [and] it falls outside the scope of what the batch process can automatically process...”¹⁴³

4.44 As discussed above, in 1999, the ATO made a decision not to resolve Surcharge exceptions (which includes SCS exceptions).¹⁴⁴ This decision, in conjunction with an SCS system that is not fully functional, and some manual processes and controls that are less than adequate, has resulted in a backlog of approximately 826 000 SCS exceptions as at 9 August 2004. These exceptions have been growing at an average rate of approximately 100 000 exceptions each year since 1997–98. The ATO estimates the SCS exceptions backlog could account for between \$69 million and \$149 million in uncollected Surcharge revenue.

ATO's management of SCS exceptions

4.45 When the SCS system was introduced in 1996–97, there were four categories of SCS exceptions. However, since that time, whenever a new or unusual circumstance arose that prevented the SCS system from processing an MCS record, the ATO would create a new exception category. As a result,

¹⁴³ Refer to page 14 of the Business Case for *Superannuation Surcharge exceptions—Clearance of backlogs* 9 June 2004.

¹⁴⁴ We are aware a number of exceptions have been resolved since 1999. However, action to resolve exceptions has not been planned or coordinated, and resulted from ATO staff initiatives, outside of ordinary work duties.

there are now around 30 exception codes used for SCS exceptions.¹⁴⁵ Adequate documentation describing each exception code was not created for each exception category. The ATO is currently working to understand these issues, determine policy and procedures, as well as actioning cases falling under all exception codes.¹⁴⁶

4.46 As discussed in paragraph 4.4, the ATO has recognised that many categories of exception were not well defined. Also, ATO staff did not have experience in dealing with the work, and there were no procedures for correcting exceptions for each exception category. These factors have contributed to the large SCS exception backlog.¹⁴⁷

4.47 In April 2004, the ATO commenced work to resolve SCS exceptions. For management purposes, and because it did not have a full understanding of existing exception codes, it classified SCS exceptions into three main categories. These were:

- fatal exceptions. These exceptions occur when a member's MCS record cannot be processed, and it prevents all future MCS records for that member being processed¹⁴⁸;
- semi-fatal exceptions. These occur where a member's MCS record cannot be processed, but does not prevent future MCS records for that member being processed; and
- informative exceptions. These occur where the exception does not prevent the ATO from issuing a Surcharge assessment, but generally identifies inconsistencies between the data reported on the MCS and the member's ITR. These inconsistencies are flagged for review at a later time, and could result in a revised Surcharge assessment.

4.48 As part of the audit, we analysed SCS exceptions using these three categories. The results of this analysis are shown in Figure 4.4 (a) and (b).

¹⁴⁵ Refer to Appendix 13 of this report for a description of each SCS exceptions code currently in use, as well as a separation between those SCS exceptions that prevent a Surcharge assessment from being raised, and those that do not.

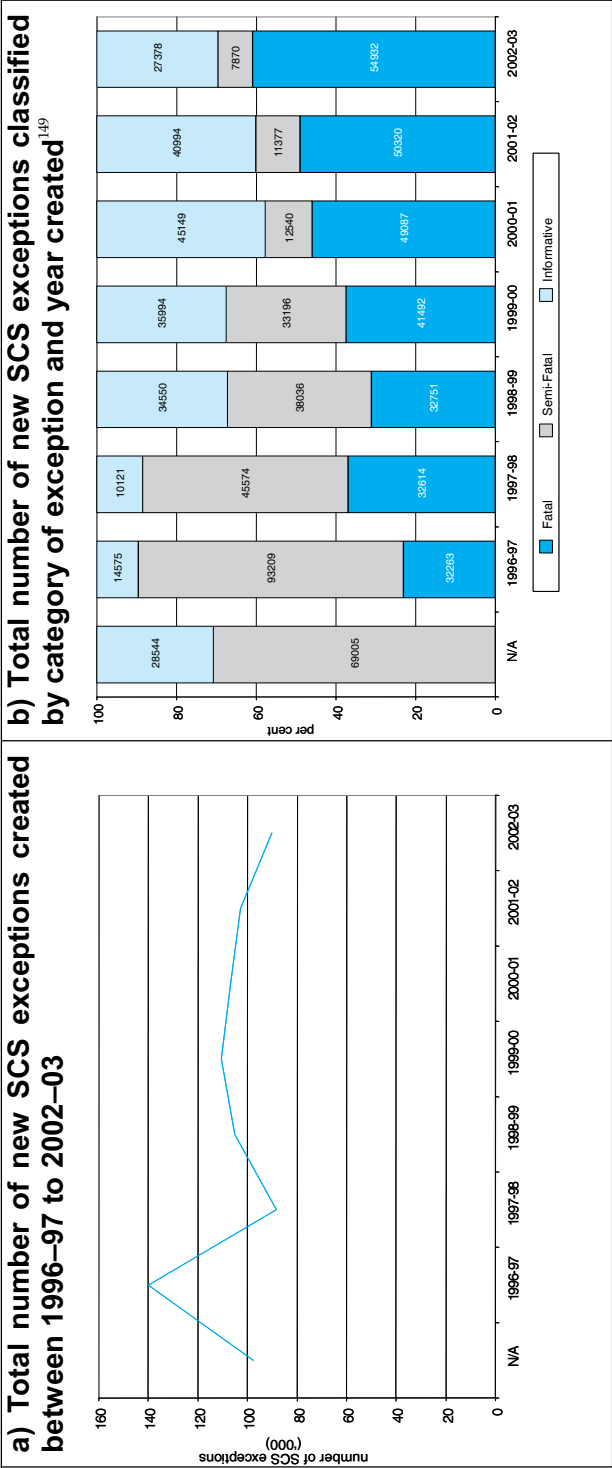
¹⁴⁶ Refer to paragraph 4.57 below.

¹⁴⁷ We do note, however, that the ATO has previously been successful in clearing certain categories of SCS exceptions. The ATO advised that there was an output pricing agreement (OPA) commitment that 50 000 exceptions be cleared each year for the 2002–03, 2003–04 and 2004–05 years. This commitment was met and exceeded in the 2002–03 with 104 514 exceptions cleared and 87 744 in 2003–04.

¹⁴⁸ An exception generated under this category is potentially the most serious for the ATO as, until it is resolved, a fatal exception will continue to generate future exceptions for that member.

Figure 4.4

SCS exceptions analysis



Source: ANAO analysis of ATO data¹⁵⁰

¹⁴⁹ Note that there is a difference of approximately 16 000 SCS exceptions between the number previously discussed in paragraph 4.5 (826 000 as at 9 August 2004) and the number that are depicted in figure 4.4 above (which was 842 000, the number of SCS exceptions as at 19 July 2004).

¹⁵⁰ The N/A column represents those SCS exceptions that could not be linked to a particular year. We note that the number of SCS exceptions occurring in 1996–97 was significantly higher than other years. We consider that this would not be unusual given that 1996–97 was the first year of operation of the SCS system.

4.49 Figure 4.4 (a) shows that, after 1997–98, the number of exceptions created by the SCS system has remained relatively constant from year to year, with between 90 000 and 110 000 exceptions created annually. This indicates that the ATO has either:

- not introduced any significant measures to reduce the number of new exceptions created by the SCS system; or
- has introduced measures that have not been effective in reducing the number of new exceptions.

Analysis of fatal and semi-fatal SCS exceptions

4.50 In 2002–03 approximately 70 per cent of SCS exceptions were classified as either fatal or semi-fatal. More specific analysis of the fatal and semi-fatal SCS exception information contained in Figure 4.4 (b) shows that:

- the number of fatal SCS exceptions has grown significantly from approximately 23 per cent of all SCS exceptions in 1996–97, to approximately 60 per cent of all SCS exceptions in 2002–03. As noted previously, unless fatal exceptions are resolved, additional SCS exceptions will be generated in all subsequent years;
- approximately 99 per cent of all fatal SCS exceptions have occurred because MCS information relating to a particular member is not consistent with MCS information already lodged and retained in ATO IT systems.¹⁵¹ An example is where MCSs lodged in consecutive years have different TFNs for a particular member. This kind of exception may indicate that there are problems with the quality of MCS data provided by particular holders;
- proportionately, the incidence of semi-fatal SCS exceptions has decreased from 67 per cent in 1996–97, to 9 per cent in 2002–03. This could be due to the strengthening of MCS reporting specifications in 2000–01¹⁵²; and
- approximately 10 per cent of all semi-fatal SCS exceptions arise when a member transfers his or her superannuation benefits from one holder to

¹⁵¹ See Appendix 14 for a full description of this type of exception under the heading of 'DBT'.

¹⁵² The tightening of MCS reporting requirements relates to the mandatory reporting of transfer details (that is, if a member transfers their superannuation benefits from one superannuation provider to another). In particular, the requirement to report the Australian Business Number (ABN) of the superannuation provider receiving the benefits has significantly improved the ATO's ability to process MCSs. Prior to the introduction of these additional reporting requirements, a large number of exceptions were generated because the ATO was not able to locate the superannuation provider to which benefits were being transferred. As an example of how effective these additional reporting requirements are, transfers of this type account for about 47 per cent of all current semi-fatal exceptions since 1996–97. Of these, over 95 per cent were generated prior to 30 June 2000.

another, and the ATO is unable to 'find' to which holder the benefits have been transferred.¹⁵³ That is, ATO IT systems have not recorded (or the ATO has not been advised) that benefits have been transferred from one holder to another.

4.51 This analysis indicates that the majority of fatal and semi-fatal exceptions have resulted from discrepancies between MCS information provided by holders annually, and the information already contained on ATO systems (including historical MCS and other client account information). This could indicate that some holders are providing poor quality or discrepant MCS data, which may be contributing to the high number of exceptions.

4.52 In the past, the ATO stated that it adopted a strategy to improve the collaborative relationship with funds, which assisted the strengthening of MCS reporting. It considered that this improved the quality of MCS data, and the number of exceptions decreased. Although more robust MCS reporting requirements are one way of increasing holder and member compliance with their MCS reporting obligations, we recognise that these obligations are potentially more onerous.

4.53 An alternative to strengthening holder-reporting requirements is a more rigorous approach to monitoring and acting on the lodgement of poor quality MCS data. We could find little evidence that the ATO has been consistently monitoring and analysing the quality of data provided by holders. Similarly, we could find little evidence that the ATO has adopted a consistent approach to ensuring holders comply with their reporting obligations, by providing only high quality MCS data.

4.54 Given the current backlog of SCS exceptions, and the rates at which they continue to grow, it is critical that the ATO put in place procedures to monitor, analyse and report on the quality of MCS data provided by holders. It is also important that the ATO establish mechanisms to provide assurance that holders comply with their MCS reporting obligations.¹⁵⁴ These initiatives should assist in reducing SCS exceptions in the future. This issue is covered in more detail, and should be considered as part of, Recommendation 16 in Chapter 5.

Analysis of informative SCS exceptions

4.55 In 2002–03, approximately 30 per cent of all SCS exceptions were classified as informative by the ATO. Our analysis of informative SCS exceptions showed that:

¹⁵³ See Appendix 14 for a full description of this type of exception under the heading of 'AVAQ'.

¹⁵⁴ Holder compliance, and the quality of MCS data is discussed further in Chapter 5.

- since 1996–97, 55 per cent of all informative SCS exceptions arose because Eligible Termination Payment (ETP) information reported as part of an MCS did not match with corresponding ETP information reported in corresponding members' ITR¹⁵⁵;
- a large proportion (32 per cent since 1996–97) of informative SCS exceptions were generated because there were significant differences between the personal deducted contributions claimed on a member's ITR, and the member's personal contributions reported on an applicable MCS record¹⁵⁶; and
- a number of informative SCS exceptions (11 per cent since 1996–97) arose because the ATO has been unable to properly apportion the interest it owes to a holder, following the amendment of a Surcharge assessment, which resulted in less Surcharge payable than was determined in the original assessment.¹⁵⁷

4.56 Like fatal and semi-fatal SCS exceptions, a high proportion of informative SCS exceptions may have resulted from holders providing MCS information that was not complete or accurate. Additional measures (such as those discussed in paragraph 4.54), could assist the ATO in reducing these exceptions.

The ATO Exceptions Taskforce

4.57 As discussed in Chapter 2, as part of the 2004–05 Budget the ATO received approximately \$72.1 million, over four years for compliance work across the ATO. The ATO has allocated \$8 million in 2004–05 to establish a Taskforce to resolve a range of exceptions, including the backlogs of Surcharge exceptions. In June 2004, the Taskforce commenced work on the Surcharge exception backlogs, with its main functions being to:

- bring the current backlog of SCS exceptions to within manageable levels; and
- ensure there is a sustainable superannuation exceptions handling capability into the future.

4.58 The ATO advised that, while originally planning to complete most of these functions by February 2005, further time would now be needed given

¹⁵⁵ The SCS system automatically updates the member's records to reflect the ETP information reported in the member's ITR for calculating the Surcharge. Consequently the ATO is able to issue a Surcharge assessment. However, the ATO should contact the member to determine why there was a discrepancy between ETP information provided in an MCS and the information contained in an ITR.

¹⁵⁶ See Appendix 14 for a full description of this type of exception under the heading of 'PDD'.

¹⁵⁷ *ibid.*, 'IOP'.

that there are only four Surcharge assessment runs per year.¹⁵⁸ We were also advised that to complete the project earlier, and to accomplish these complex and time consuming functions, would require significantly more resources than originally anticipated. We are aware that an additional 160 Average Staffing Equivalent (ASE) has been found from within the ATO to finalise the Taskforce's outcomes.

4.59 As a result of the additional funding granted for 2004-5, the Taskforce was progressively recruited from July 2004. The ATO advised that as at January 2005 it had:

- secured appropriate accommodation arrangements;
- identified exception case stock suitable for manual intervention and provided business specifications for categories of work that can be resolved through automated processes;
- created and progressively refined draft procedures and a quality checking methodology for the manual exceptions work that is currently being undertaken;
- allocated 176 228 backlog exceptions for manual resolution, with 102 414 of these having been finalised. In addition, 23 862 backlog cases were cleared using automated processes;
- manually resolved 28 991 exceptions generated on current year lodgements, with a further 16 298 such exceptions being resolved through automated processes; and
- issued Surcharge assessments to 30 658 members that had originally formed part of the SCS exceptions backlog.

4.60 The ANAO notes that the despite identity matching exceptions forming part of the scope for the Taskforce, its work to date has focussed on SCS exceptions.

Conclusion on the ATO's management of SCS exceptions

4.61 The number of unresolved SCS exceptions is large and cannot be rectified through business-as-usual processes. This led to the creation of a specific Taskforce charged with clearing all Surcharge exceptions that required a considerable internal shifting of resources.

4.62 Based on our analysis, the quality of MCS data provided by holders appears to be a significant factor affecting the large number of SCS exceptions. An effective compliance strategy should not only cover MCS lodgement, but should also address the quality of MCS data lodged by holders. This issue is discussed further in Chapter 5 and in Recommendation 15.

¹⁵⁸ The Surcharge assessment run is described in detail in Appendix 10.

Recommendation No.13

4.63 The ANAO recommends that, to improve its management of SCS exceptions, the ATO:

- develop and document procedures to resolve all SCS exceptions in accordance with relevant Surcharge legislation; and
- provide relevant staff with the training necessary to resolve SCS exceptions.

ATO Response

4.64 Agreed. Procedures to action the various types of Surcharge exceptions in accordance with relevant Surcharge legislation have been developed and implemented over the last nine months. These procedures are being used to resolve backlogs of exceptions. However, consistent with the advice from the Australian Government Solicitor, the ATO will not, for reasons of fairness, pursue exceptions where the person is either deceased, retired or the exception is greater than four years old. These procedures will enable the timely resolution of Surcharge exceptions in future processing. As the ATO gains experience and develops a better understanding of the nature of the exceptions, the procedures will be refined. A comprehensive training program has been place since August 2004.

4.65 During the audit the ANAO raised a number of questions regarding the Commissioner's legal obligation to issue Surcharge assessments for all members. As a result, the ATO approached the Australian Government Solicitor (AGS) to clarify its legal responsibilities concerning the Commissioner's obligations to issue Surcharge assessments, and his responsibility to resolve Surcharge exceptions. A summary of the ATO's proposed approach to resolving Surcharge exceptions and the AGS's legal advice is provided below.

The ATO's proposed approach to resolving the Surcharge exception backlogs

4.66 To improve the ATO's ability to clear the large exception backlogs, the Commissioner issued a policy in October 2004 to not make Surcharge assessments under certain circumstances. These circumstances are when the:

- member is deceased;
- member is aged 55 years and over and is in receipt of retirement income declared at labels in their ITR; and

- MCS for the exception was reported to the ATO for the 1997, 1998 or 1999 financial year.

4.67 In addition, the ATO advised that PQTFN letters will now be sent only for identity matching exceptions that it considers most likely to result in an actual Surcharge liability. This means that:

- PQTFN letters will not be issued to members in respect of MCSs received from holders for the 1997 to 1999 financial years, as no assessment will subsequently be raised;
- the ATO will prioritise the issue of PQTFN letters to members with initially the highest amount of contributions and not send letters where contributions reported by a holder for an individual member account are less than \$10 000; and
- letters will not be issued initially where the date of birth is provided¹⁵⁹ and the member is aged 60 years or over.

4.68 The ATO also advised the ANAO that IT system limitations prevent it from rectifying Surcharge exceptions. Specifically, the SCS system does not record whether exceptions relate to original Surcharge assessments or amended Surcharge assessments.¹⁶⁰ This is important because, under Surcharge legislation, there is no time limit for the Commissioner to issue an original assessment. However, there is a four-year time limit for issuing an amended assessment. As the ATO is unable to determine whether exceptions older than four years are original or amended assessments, there is a risk that if it did issue assessments for these exceptions, it would breach Surcharge legislation.

Australian Government Solicitor's opinion on the Commissioner's Surcharge assessment responsibilities

4.69 The advice provided by the AGS in December 2004 stated that the Commissioner has three broad areas of responsibility that need to be satisfied when issuing Surcharge assessments. These areas of responsibility are:

- The Commissioner must issue a Surcharge assessment for every member¹⁶¹;

¹⁵⁹ ANAO notes that under current MCS reporting specifications reporting a member's date of birth details to the ATO is optional.

¹⁶⁰ An amended Surcharge assessment occurs when a member has already received an original Surcharge assessment and their circumstances change, or an error is detected, requiring an alteration to that assessment.

¹⁶¹ As discussed in paragraph 1.10 the Commissioner's duty to make a Surcharge assessment is not absolute and there are limited circumstances in which he may lawfully decide not to make an assessment.

- The Commissioner may decide in a particular case not to make a Surcharge assessment in certain circumstances; and
- The Commissioner may decide not to assess a category of members where the category is defined by circumstances common to the people within it and those circumstances would support a decision not to assess in each person's case.

4.70 These areas of responsibility are complex and are discussed more fully below.

The Commissioner must issue a Surcharge assessment for every member

4.71 The AGS advised that as a general rule, the Commissioner has a duty to make an assessment of Surcharge for every member for whom there are superannuation contributions, for each financial year. However, this duty is not absolute. There are limited circumstances in which the Commissioner may lawfully decide not to make an assessment. These circumstances are discussed below.

The Commissioner may decide not to make a Surcharge assessment in certain circumstances

4.72 The AGS advised that the Commissioner can decide not to make an assessment in a particular case, if he considers that the circumstances of the case are such that it is not in the interests of the Commonwealth revenue to pursue assessment.

4.73 There is a range of factors that the Commissioner needs to consider and weigh in the particular case before reaching a decision not to assess. In the AGS's view, the relevant factors are:

- the likelihood of obtaining a net financial benefit for the Commonwealth if an assessment is made;
- as a related matter, the capacity of a member to pay on an assessment;
- the ATO resources which would be consumed by issuing the assessment;
- the effect of the decision on the public revenue in the short and long term;
- equity of treatment among taxpayers;
- whether negative consequences (especially financial and perhaps broader) outweigh any direct financial benefit; and
- the public confidence in the administration of the Surcharge system.

4.74 The AGS noted that the primary consideration for the Commissioner is the impact of his decision on the revenue. In considering that impact, it is both legitimate and appropriate for the Commissioner to consider the broader impacts of a decision in addition to the immediate financial impact.

The Commissioner may decide not to assess a category of members as a result of significant delays in processing the assessments

4.75 The AGS advised that a decision to *defer* the making of assessments is different from a decision *not* to make assessments. Systemic issues or processing limitations may justify a decision to defer making assessments in some circumstances.

4.76 They do not, however, justify a decision not to assess the Surcharge in relation to a category of members, which is defined by reference to a systemic issue, for example, difficulties with processing assessments where members do not disclose TFNs. By contrast, where the specific circumstances of a member would support a decision not to assess in the particular case (for example, because the amount of Surcharge is likely to be small, there is lack of capacity to pay, and so on), that decision could be extended to a class of members for which those circumstances are common.

4.77 In addition to the above three areas of responsibility, the AGS also noted that the Commissioner cannot decide not to assess a class of persons purely on the basis that the statutory scheme for assessment is not cost-effective. That is, the Commissioner cannot decide not to assess identity matching exceptions simply because the PQTFN letter and default assessment process is too costly. The Commissioner has a duty to apply the law except in limited circumstances. The law has expressly set out a process for situations where a TFN is not provided. If the default assessment process specifically contemplated by Parliament is expensive, this is a matter to be resolved through the legislative process.¹⁶²

ATO's proposed approach in light of the AGS advice

4.78 Having regard to the advice provided by the AGS, the ATO considers that its proposed strategy for resolving the Surcharge exception backlogs (as outlined in paragraph 4.66 - 4.67 above) complies with the AGS's advice for the following reasons:

- in its view, the factors cited by AGS in paragraph 4.73 as relevant to a decision not to assess have been met for each of the categories

¹⁶² The ANAO considers this is expressly the reason that the Surcharge legislation includes reference to the need for the Commissioner to report to the Treasurer on the *workings of the Act* (See paragraphs 2.77-2.79 of Chapter 2)

described in paragraph 4.66. This is particularly the case for deceased members;

- limitations with the SCS system prevent the ATO from being able to accurately compile member account data that may have been provided by a number of different holders. For this reason there is a possibility that resolving aged Surcharge exceptions may in fact be prohibited¹⁶³, as the Commissioner may have already issued a Surcharge assessment (including a 'nil assessment'¹⁶⁴);
- it has a finite amount of funding available to administer the Surcharge, and the amount of reverse workflow it would expect from raising assessments from old information, is not likely to raise a net financial benefit for the Commonwealth;
- the ATO's reputation would be damaged by issuing assessments now for information that it received some years ago. This would undermine the community confidence in the ATO's administration of the Surcharge system;
- there are approximately 10.5 million identity matching exceptions requiring resolution. Whatever the legal position may be, the ATO does not currently have sufficient resources available to send out the required number of PQTFN letters to all of the members and former members concerned without compromising its ability to perform other legal functions;
- it does not make economic sense to attempt to pursue every exception. Particularly given the quotation of a TFN in the vast majority of cases will mean that there is no Surcharge payable as the member's adjusted taxable income will be below the threshold; and
- where the TFN is not quoted and a default assessment is raised, the member has an unlimited amount of time to subsequently quote their TFN and have the assessment credit amended by applying the correct rate (possibly a nil rate). This further reduces the likelihood of a net

¹⁶³ Under existing taxation legislation, the Commissioner is generally restricted from issuing an amendment to increase liability to four years from the due date of the original assessment.

¹⁶⁴ A nil assessment is made when; having received member contribution information (as part of one or many member accounts submitted by a holder) for a member, the Commissioner has undertaken the calculation of the Surcharge and determined that there is no Surcharge payable. The ATO advised that the Surcharge system does not record whether a nil assessment has been made.

¹⁶⁵ The ANAO notes, however, that this reasoning is based on the assumption that all members that are currently tied up in the Surcharge exceptions backlog, have multiple superannuation memberships, and they have previously been assessed on one of these other memberships.

financial benefit for the Commonwealth by processing all of the identity matching exceptions.¹⁶⁶

4.79 As outlined above, there are a number of complex legal considerations associated with resolving the Surcharge exception backlogs. At the time of the audit the ATO was still in the process of refining its overall approach in consultation with the AGS. The ATO advised that, importantly, the Commissioner's proposed course of action is a one-off measure that relates only to the Surcharge exception backlogs. It also advised that this does not suggest that the same approach will be used on an on-going basis for the administration of the superannuation Surcharge in the future.

¹⁶⁶ The ANAO notes, however, as described in paragraph 4.33 above, the ATO have already secured a net amount of \$61.7 million as a result of the default assessment process.

5. Surcharge Compliance Management

This chapter addresses the ATO's approach to managing Surcharge compliance. It focuses on the ATO's overall Surcharge compliance framework as well as current holder and member lodgement practices for each market segment, (which includes key clients, large and medium funds, and small funds). We also focus on the methodology the ATO uses to assess and report Surcharge compliance.

Introduction

5.1 Compliance by members and holders with their obligations under Surcharge legislation, is critical for the effective administration of the Surcharge. Failure by members and holders to remit high quality Surcharge information to the ATO, significantly decreases the likelihood that the ATO will be able to issue correct and timely Surcharge assessments for all members.

5.2 To provide assurance that members and holders are complying with their Surcharge obligations, the ATO must have a logical, comprehensive and integrated compliance framework. By not fully implementing such a framework, the ATO will be unable to provide an appropriate level of assurance that all members have been correctly assessed. Community confidence in the ATO's ability to administer the Surcharge may also be affected, if non-compliance is not identified and addressed.

5.3 As noted in Chapters 3 and 4, Surcharge IT systems are not effectively processing Surcharge data. Part of the reason for this is that the ATO's systems are unable to process the poor quality, or inconsistently formatted, data provided by holders and members. A Surcharge compliance framework that encourages the provision of high quality and consistently formatted Surcharge data, could significantly improve the effectiveness of Surcharge processing systems.

What is Surcharge compliance?

5.4 Surcharge compliance refers to the provision of all information by holders and members, relevant to the calculation of the Surcharge. As discussed in Chapter 1, there are two ATO approved forms that contain all relevant Surcharge information. These are:

- Member Contribution Statements (MCS), which provide relevant information about a member's superannuation contributions. These are provided by holders; and

- Income Tax Returns (ITR), which provide information about a member's income, and are used in conjunction with MCSs to determine a member's adjusted taxable income. ITRs are provided by members.¹⁶⁷

5.5 Surcharge compliance not only involves the timely lodgement of MCSs and ITRs by members and holders, but is also concerned with gaining assurance that the information contained on these forms is correct. In assessing the ATO's approach to managing Surcharge compliance, the ANAO not only focused on the steps taken by the ATO to ensure that MCSs are lodged on time, but also how the ATO gains assurance that the data is of a high quality.

5.6 Although ITRs are essential to the correct calculation of the Surcharge, during the audit the ANAO focused predominantly on the collection and analysis of MCS information for which the Superannuation Business Line has full responsibility.

5.7 To assess the ATO's approach to managing Surcharge compliance, the ANAO focused on two main areas:

- the Surcharge compliance framework; and
- ATO market segment compliance activity.

Surcharge compliance framework

5.8 Since 1998, the ATO has adopted a structured approach to improving taxpayer compliance, the foundation of which is articulated in the ATO Compliance Model (see Appendix 16). A basic function of the compliance model is to assist the ATO in finding the correct balance between ATO compliance activities, which range from the less costly and less invasive (such as client education and support) though to the costly and invasive (such as audits and prosecution).

5.9 The effective application of the compliance model to the Surcharge relies on the ATO having a sound understanding of its clients (holders and members) and their behaviour. Without this understanding, the ATO will not be able to determine what compliance risks exist, and what compliance activity is required to address those risks.

¹⁶⁷ Refer to Appendix 2 for an explanation of the steps involved in the calculation of the Surcharge.

5.10 The ATO manages its Surcharge compliance risks through a suite of documents that are designed to provide a coordinated approach to compliance, by linking broad ATO-wide compliance strategies to the specific mechanisms and controls the ATO uses to enforce and monitor compliance for specific areas (such as the Surcharge). As part of the audit, we examined the following key documents as they relate to the Surcharge:

- Surcharge Compliance Policy; and
- Surcharge Compliance Strategy.

The Surcharge compliance policy

5.11 The ATO has developed a Surcharge compliance policy to articulate the roles and responsibilities of the ATO, holders and members with regard to the Surcharge. Specifically, the policy states that:

- holders of surchargeable contributions are to lodge statements (for example MCSs) with the ATO;
- the information provided by the holders is to be in a certain form as set out in a notice published in the *Commonwealth Gazette*;
- a member must give information about the holder of the member's contributions when requested to do so by the Commissioner; and
- holders must give information when a payment (i.e. transfer of benefits from one fund to another) is made, if requested to do so by the Commissioner.¹⁶⁸

5.12 The compliance policy also notes that holders and members are expected to give correct statements and information to the ATO by the time specified in the legislation (the notification date)¹⁶⁹, or to have made alternative arrangements (prior to the notification date) for late lodgement.

5.13 As part of the Surcharge Compliance Policy, the Commissioner states that he will:

- apply the most appropriate strategy, taking into consideration previous compliance history¹⁷⁰, that will most likely result in current and future compliance; and

¹⁶⁸ See NAT 5379, available from <<http://www.ato.gov.au/superprofessionals>>.

¹⁶⁹ The notification date is 31 October of the year following the financial year to which the MCS relates. We note that there are alternative arrangements for Self-Assessing Superannuation Providers (SASPs).

¹⁷⁰ This is consistent with the application of the principles underlying the ATO's Compliance Model, which directs that the ATO understand why people are not complying, and develop appropriate and proportionate responses. Refer to Appendix 15 to this report for further detail on the Compliance Model.

- undertake a full range of appropriate action to enforce compliance, which may include:
 - imposing an administrative penalty¹⁷¹ by way of a contravention notice where appropriate; or
 - instituting prosecution action where appropriate, or where an administrative penalty is not available.

5.14 As part of the audit, the ANAO analysed ATO and APRA data to determine: holder lodgement characteristics; whether the ATO has a comprehensive understanding of its client base; and whether the ATO has consistently applied non-compliance remedies such as administrative penalties.

Holder lodgement characteristics

5.15 In assessing holder lodgement, the ANAO examined two aspects of potential holder non-compliance with their Surcharge obligations. These were:

- non-lodgement of MCS; and
- late lodgement of MCS (holders not lodging MCS by the notification date).

Non-lodgement of MCS

5.16 To determine whether holders were not lodging their MCSs, the ANAO compared the registered superannuation fund data published by APRA¹⁷² with the number of holders (funds) lodging MCSs¹⁷³, since the inception of the Surcharge. Ideally the number of funds recorded should be similar. The results of our analysis are shown in Figure 5.1.

¹⁷¹ The administrative penalty for the non-lodgement of a MCS accrues from the notification date to which it relates and equates to:

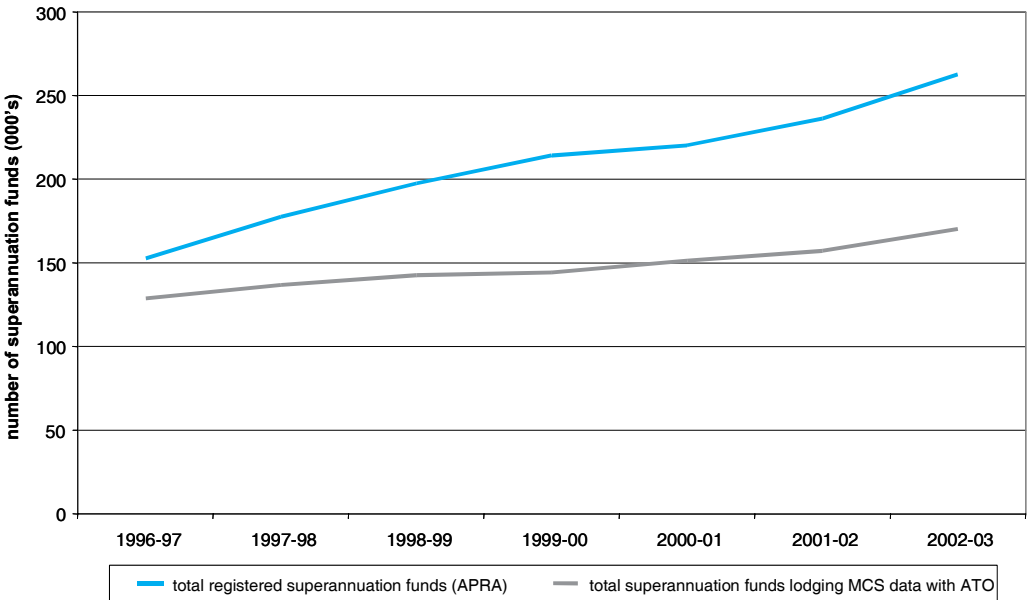
- \$550 per week for an individual trustee; and
- \$2750 per week for a corporate trustee.

¹⁷² APRA is the statutory government body responsible for prudential supervision within Australia. This includes being responsible for regulating all superannuation funds (except for SMSFs, see paragraph 5.62), to ensure compliance with the Superannuation Industry Supervision Act 1993 (SIS Act). As part of its regulatory role, APRA collects a range of relevant data, including the number of superannuation funds, fund members and their contributions. The superannuation data analysed by the ANAO was taken from page 24 of the *APRA Super Trends September 2004* publication, and all single member approved deposit funds were excluded from the total.

¹⁷³ As noted in Chapter 1, the vast majority of holders are superannuation funds.

Figure 5.1

Number of registered superannuation funds compared to the number of superannuation funds lodging MCS data with the ATO 1996–97 to 2002–03¹⁷⁴



Source: ATO and APRA data

5.17 As Figure 5.1 shows, in 2002–03, there was a variance of approximately 92 000 funds between the number of registered funds according to the APRA data, and the number lodging MCSs with the ATO. This may indicate that up to 92 000 funds may not have fulfilled their Surcharge obligations to lodge an MCS in the 2002–03 financial year. We note, however, that it is not possible to draw definitive conclusions about non-lodgement from this analysis, as the Commissioner has issued a determination, which exempts some holders from lodging. The determination states that:

If there are no contributed amounts and if no surchargeable amounts are transferred for a member or account holder during a financial year, there is no requirement for providers [holders] to give information in relation to those members or account holders for that year.¹⁷⁵

¹⁷⁴ As a large proportion of MCS lodgements for the 2003/04 financial year will not be processed until May 2005 (See Appendix 10), the most recent data available for analysis relates to the 2002/03 financial year.

¹⁷⁵ *Superannuation Contribution Determination 98/1*

5.18 As the majority of registered fund data (99 per cent) is collected by the ATO,¹⁷⁶ it is important that it determines why there is a large difference between registered fund data and MCS lodgements. This analysis will assist in targeting ATO compliance resources to where they will be most effective.

5.19 The ATO, with assistance from APRA, should also analyse the remaining one per cent of registered fund data (which relates to funds regulated by APRA) to determine the level of MCS lodgement compliance among these funds. Compliance by APRA regulated superannuation funds is particularly important given that approximately 98 per cent of all member accounts (see Figure 5.3) are managed by these funds.

5.20 Also, the ATO advised that although it receives registered fund data from APRA regularly, it is unable to match APRA data to its own because of differences in the type of data collected by each agency and the way that data is formatted.¹⁷⁷ The ATO, with assistance from APRA, should attempt to match APRA data with its own, to assess the non-lodgement risk associated with APRA regulated funds, as well to determine the completeness of MCS lodgements.¹⁷⁸

Recommendation No.14

5.21 The ANAO recommends that, in order to assess the risk applicable to the non-lodgement of member contribution statements by registered superannuation funds, and to determine the completeness of member contribution statement lodgements, the ATO:

- analyse and report on significant variations between the number of registered superannuation funds, and the number of funds lodging member contribution statements;
- with assistance from APRA, introduce a systematic and co-ordinated approach to share and analyse relevant registered superannuation fund data; and
- use the results of this analysis to support ATO Surcharge compliance activities.

¹⁷⁶ The ATO is responsible for the regulation of Self Managed Superannuation Funds (SMSFs) (see Appendix 4). These funds comprise approximately 99 per cent of all registered funds.

¹⁷⁷ For example, the ATO uses a different unique identifier for each registered fund, to APRA.

¹⁷⁸ The ANAO recognises that APRA already provides non-SMSF data to the ATO each month to update the Register of Complying Superannuation funds (RoCS) database. However, the ATO noted that it is unable to match this data (in its current form) to MCS lodgements.

ATO response

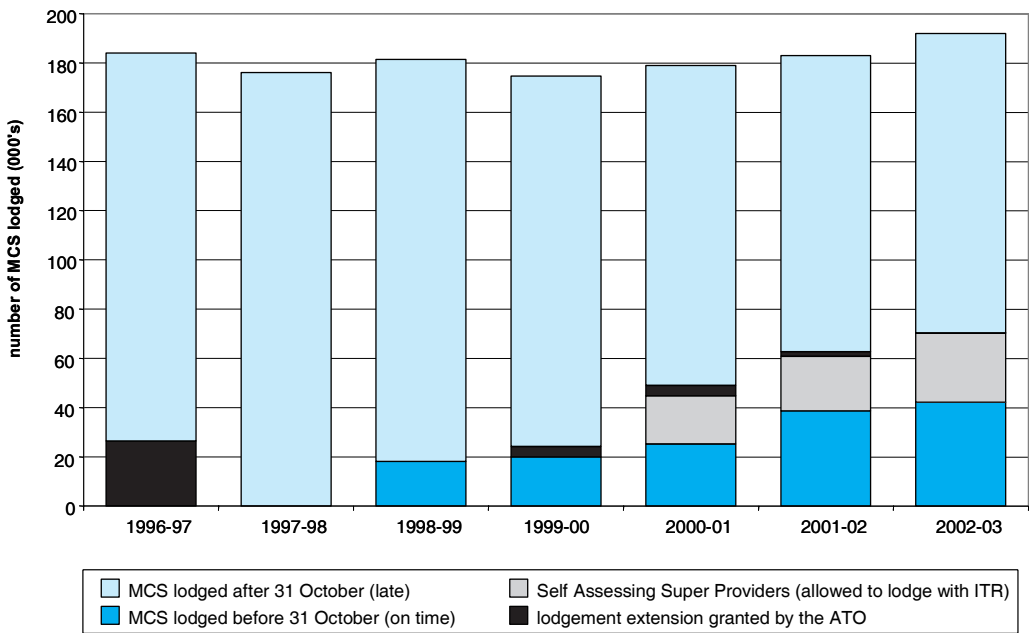
5.22 Agreed. A new business line has been established within the ATO management structure to focus on improving lodgement compliance across all taxation and superannuation obligations. Improved lodgement of member contribution statements by funds will be a specific area of focus for 2005-06 including helping and educating the community to understand their lodgement obligations and, when necessary, adopt appropriate enforcement activities. The ATO is also working closely with Australian Prudential Regulation Authority (APRA) to identify opportunities to share information and analyses, and to work cooperatively in improving Surcharge compliance.

Late-lodgement of MCS

5.23 As specified in the Surcharge Compliance Policy, holders of contributions are required to lodge MCS forms by the 31 October each year (the notification date). Figure 5.2 shows holder compliance with this lodgement date.

Figure 5.2

Holder MCS late lodgement statistics 1996–97 to 2002–03¹⁷⁹



Source: ANAO analysis of ATO data

¹⁷⁹ ANAO notes that, despite the 1997 year including an extension of time for the notification date to 15 December to assist holders in the first year of the Surcharge, nearly all lodgements were lodged after this time.

5.24 The above Figure illustrates that, since 1999, the number of holders lodging on time has been consistently low. We note that there were two factors that have a minor impact on these statistics. These factors are:

- since 2000 there will be some SMSFs that self-assess (self assessing superannuation providers) their Surcharge liability and are able to lodge their MCS at the same time as their applicable income tax return/s (up to February of the following year). For 2003–04 approximately 28 000 funds were in this category¹⁸⁰; and
- holders that apply for and are granted MCS lodgement extensions. However, as can be seen in Figure 5.2 above, this has had a marginal impact on the overall levels of late lodgement.

5.25 After taking these factors into consideration, we consider that lodgement of MCSs by holders has generally not been timely. For example, only 37 per cent of MCSs were lodged on time in 2002–03. The late-lodgement of MCSs also impacts on the ATO's administration of the Surcharge by:

- reducing the time the ATO has to accurately assess the Surcharge for approximately 10 million members¹⁸¹;
- reducing the amount of time the ATO has to rectify Surcharge exceptions¹⁸²;
- increasing the likelihood that holders may incorrectly report their MCS where a member may have transferred their contributions during the time between the end of the financial year and the lodgement date¹⁸³;
- reducing the amount of time the ATO has to provide assurance that the MCS data entered into the Surcharge system is of high quality; and
- potentially influencing on the amount of Surcharge revenue the ATO collects for a given financial year. That is, if a batch of MCSs is not processed within the last specified assessment run (see Chapter 3), Surcharge revenue may not be collected in the financial year in which it was due.

¹⁸⁰ ANAO notes that the SCS system was unable to record details concerning the number of SASPs for the 1999–2000 year. However, as can be seen in the figure above, overall, SASPs have only had a small impact on the total proportion of MCS received after the notification date during the past three years. Refer also to Appendix 16 for details on the number of member records attached to the above lodgements.

¹⁸¹ The difficulties associated with assessing the Surcharge are discussed in Chapter 3.

¹⁸² See Chapter 4 for the problems associated with Surcharge exceptions processing.

¹⁸³ This is discussed further in Chapter 4.

5.26 Our analysis indicates that many holders may not be lodging their MCSs, and that the majority of those who are lodging, are doing so after the specified notification date. Although there are a number of factors that may be contributing to these apparent high levels of non-compliance, how the ATO applies its lodgement enforcement powers under the Surcharge legislation may also have an influence on non-compliance levels.

Compliance enforcement activities

5.27 Despite evidence indicating that there are high levels of non-compliance in relation to the lodgement of MCSs, the ANAO could find no evidence that the ATO regularly monitors holder non-compliance, and regularly and consistently uses its lodgement enforcement mechanisms to enforce compliance.

5.28 As discussed in paragraph 5.13, the main lodgement enforcement mechanism the ATO has to enforce compliance is a 'contravention notice'. We found that the ATO has not used this mechanism regularly or consistently, as part of its compliance activity. That is, since the Surcharge was introduced, the ATO advised that it had only issued contravention notices on nine occasions. This issue is discussed in paragraphs 5.58 and 5.72, which note that although the ATO has identified instances where contravention notices could be issued, it is yet to issue them using a systematic approach for all holders. This lack of enforcement action may be a factor contributing to the potential high levels of lodgement non-compliance by holders, and shown in Figure 5.1 above.

Surcharge compliance strategy

5.29 The development of a robust Surcharge compliance strategy is an essential aspect of compliance. Without an effective strategy, there is the potential that compliance risks will not be identified correctly, compliance resources will not be targeted effectively, and non-compliance will go undetected or untreated.

5.30 As noted in paragraph 5.9, an essential aspect of identifying and treating Surcharge risks is having a comprehensive understanding of Surcharge clients (holders and members). We note that, based on our audit findings, the ATO's current overall understanding of its client base is less than adequate. Therefore, there will be shortcomings in any compliance strategy developed for the Surcharge.

Past Surcharge compliance strategies

5.31 In August 1999, the Superannuation Business Line developed a comprehensive Surcharge compliance strategy. The key features of this strategy included:

- a detailed Surcharge risk assessment. This risk assessment describes each risk and assigns a well explained risk rating; and
- a well defined list of mitigation strategies to address each risk.

5.32 Since 1999, the ATO has not produced a comprehensive, and integrated Surcharge compliance strategy. We note that the risks identified in the 1999 strategy do not appear to have been monitored, reassessed or reported against regularly. Also, all risk mitigation strategies described in the report do not appear to have been implemented or reviewed, nor their effectiveness evaluated. As well, we could find no evidence that the ATO had approved Surcharge compliance strategies in place between August 1999 and June 2003.

Current Surcharge compliance strategies

5.33 The ATO produced Surcharge compliance strategies for 2003–04 and 2004–05, which were very similar. However, these documents did not:

- include a sound risk assessment to identify and rate compliance risks;
- fully explain the risks identified in each strategy, the level of each risk, and the mitigation strategies belonging to each risk;
- identify the resources required to implement compliance risk mitigation strategies;
- identify what potential effect compliance risk management strategies will have on Surcharge compliance for each market segment; and
- specify how risks and risk mitigation strategies were going to be monitored and reported.

5.34 We also found that the 2003–04 and 2004–05 compliance strategies did not appear to cover all current Surcharge compliance risks. Many of these risks, which appear to remain relevant, were originally raised in 1999 and have not been reported against. These risks include the following:

- providers [holders] do not lodge and we [the ATO] have difficulty in determining exactly who our clients are;
- the ATO is unable to verify if providers (holders) re-lodged data where necessary; and
- individuals do not provide TFNs or do not authorise their use [as noted in Chapter 4, there are approximately 10.5 million Identity Matching exceptions]. Individuals do not respond to PQTFN letters.¹⁸⁴

¹⁸⁴ ATO Superannuation Business Line, *Surcharge Compliance Strategy—Risk Assessment and Recommended Strategies*, August 1999.

5.35 For the reasons noted above, the current Surcharge compliance strategy does not provide the ATO with a sound basis for determining Surcharge compliance risks, identifying risk mitigation strategies, or allocating compliance resources effectively. For these reasons, there is a high risk of members and holders not complying with their Surcharge obligations. This non-compliance is not being actioned by the ATO.

Recommendation No.15

5.36 The ANAO recommends that, to manage Surcharge compliance effectively, the ATO develop a logical, well structured, and comprehensive Surcharge compliance framework which incorporates the following:

- a policy for issuing contravention notices for holders of contributions that do not comply with their Surcharge lodgement obligations;
- a risk assessment process to identify, assess and rank Surcharge compliance risks as part of a Surcharge compliance strategy;
- a methodology based on the ATO Compliance Model to identify potential strategies to mitigate Surcharge compliance risks, as part of a Surcharge compliance strategy;
- a regular reporting process to monitor and report on compliance risks and risk mitigation strategies; and
- a coordinated approach to reporting Surcharge compliance within the Superannuation Business Line, to ATO corporate management and publicly.

ATO response

5.37 Agreed. The policy for issuing contravention notices is under consideration as part of a broader review of penalties and sanctions available to the ATO in regard to superannuation obligations. The ATO corporate risk management framework, managed through the ATO's Sub-plans and its market, product and capability committees, is now used to develop the strategic and operational plans for managing Surcharge risks. Improved governance processes are also in place to report on and monitor our Surcharge compliance activities.

ATO market segment compliance activity

5.38 Holders and members are classified for compliance purposes into the following superannuation market segments:

- key client funds;

- large/medium funds;
- small funds; and
- members.

5.39 Although, the ATO can make significant improvements to its Surcharge compliance framework, it has undertaken limited Surcharge compliance activity within each superannuation market segment. As the compliance approach taken by the ATO differs markedly between each market segment, the ANAO examined the Surcharge compliance activity within each segment and the effectiveness of that activity.

Key Client Group

5.40 The Key Client Group was established in 2002 to assist the largest holders (key clients) to comply with their superannuation obligations¹⁸⁵, including the lodgement of MCSs for the Surcharge. There is no set definition as to what constitutes a key client. The ATO advised that the key client group primarily look at the number of member accounts represented by the holder and, therefore, assets under management. It is for this reason that a large proportion of the key clients are fund administrators.

5.41 The Key Client Group is staffed by Client Relationship Managers (CRMs), who are required to develop specific knowledge about a defined number of key clients. This allows CRMs to provide a significantly higher level of specialist advice and support to key clients, than is available to other holders and members.

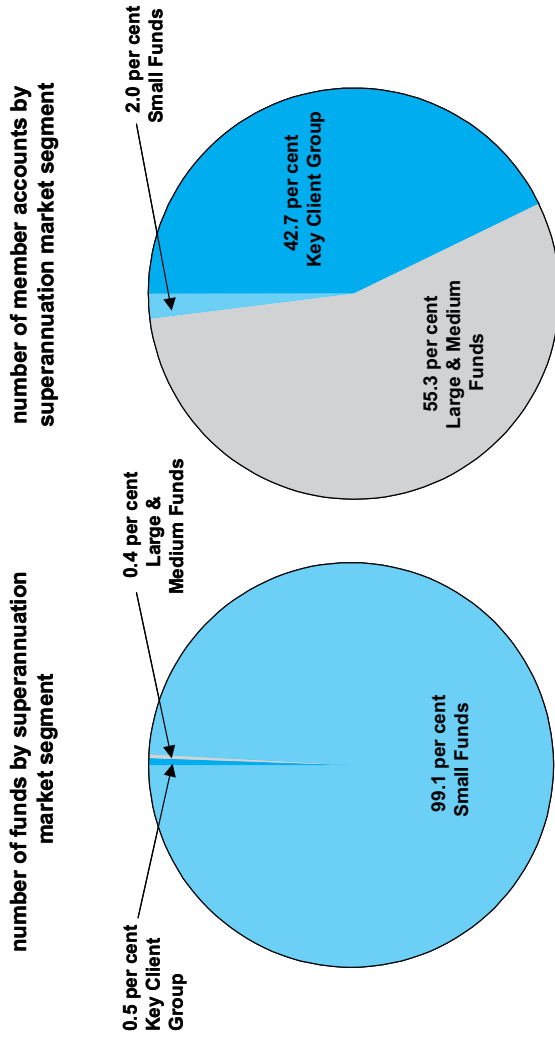
5.42 The ATO advised that the Key Client Group comprises 65 key clients, who are responsible for the administration of 1 372 superannuation funds. These funds are responsible for managing superannuation contributions for approximately 10 million member accounts.¹⁸⁶ The number of key clients and the number of member accounts they represent, in proportion to the rest of the superannuation industry, is represented in Figure 5.3.

¹⁸⁵ Others include Reasonable Benefits Limits (RBL), the Lost Members Register (LMR), Departing Australia Superannuation Payments (DASP) and the Co-Contributions.

¹⁸⁶ Member accounts refer to the distinct member data records submitted as part of the MCS for a specific holder to the ATO, and should not be confused with individual members (who may have many different member accounts).

Figure 5.3

The percentage of superannuation funds and member accounts belonging to each superannuation market segment as at 30 June 2003.



Source: ATO and APRA data¹⁸⁷

¹⁸⁷ We note that the ATO has not provided criteria for the segregation of the Large & Medium Fund group. Therefore we have assumed that APRA data provides the entire superannuation member population, and have subtracted ATO Key Clients and Small Funds data from this to determine the Large & Medium Fund population. We also note that a proportion of the Large & Medium Fund population will relate to non-contributing members that have not been reported to the ATO.

5.43 These graphs show that the Key Client Group, although comprising only 1 372 holders (or 0.5 per cent of the total number of registered superannuation funds), is responsible for almost 43 per cent of all superannuation member accounts.

5.44 We note, however, that APRA statistics show that over 98 per cent of all superannuation member accounts are managed by 2 290 holders.¹⁸⁸ This indicates that 917 holders (less than 0.4 per cent of the total number of registered superannuation funds) that are not part of the key client group, are responsible for managing over 55 per cent of the total number of member accounts. This could imply that some holders that are currently not part of the key client group, should be.¹⁸⁹

5.45 This analysis emphasises the need, as discussed in paragraph 5.40, for the ATO to establish sound criteria for each market segment. By not doing so, prospective key clients are potentially not receiving the level of support they require (see paragraph 5.42) and will not be subject to the appropriate level compliance activity.

MCS lodgement compliance by the Key Client Group

5.46 The ATO reported that, since the introduction of the Key Client Group in 2002, there has been almost 100 per cent compliance by key clients with their MCS lodgement obligations.¹⁹⁰ However, some of these clients may have been lodging their MCSs late (see Figure 5.2), and the ATO may not have categorised some large holders that could be considered to be key clients, in the Key Client Group. The number of member accounts not captured by the Key Client Group (see Figure 5.3 above) also suggests that many key clients may not be submitting MCS data for all of their member accounts. As noted in Recommendation 15, there may be benefit in the ATO comparing member account data attached to an MCS with that received by APRA as part of a large holder's annual regulatory return.

Key client compliance

5.47 The ANAO found that, on the whole, the ATO's strategy of using CRMs to liaise with and educate key clients is an effective mechanism to promote, encourage and enforce compliance within this market segment. This strategy is supported by two other compliance approaches. These are:

¹⁸⁸ These statistics do not include small funds (including SMSFs), which are discussed in paragraphs 5.62 to 5.77.

¹⁸⁹ The ANAO notes that there could be some variance between APRA and ATO data, as some funds do not need to report nil contributions to the ATO (see paragraph 5.17).

¹⁹⁰ Australian Taxation Office, *Compliance Program 2004–05*, August 2004.

- the Business Systems Working Group (BSWG), which meets quarterly to enable discussion of system design requirements, associated with, amongst other things, the provision of MCS data to the ATO. The BSWG was introduced in conjunction with the Surcharge; however, its scope has since widened to include the discussion of all changes within the Superannuation line that may impact on the system design requirements of key clients responsible for providing data to the ATO; and
- general workshops (focussing on RBL and Surcharge reporting) for members of the Key Client Group. These workshops were successfully introduced in 2003, and focussed on:
 - how to lodge information with a minimum number of errors;
 - how to interpret and action error reports; and
 - how to amend information that was previously reported incorrectly.

5.48 Feedback provided by key clients interviewed as part of the audit, about the ATO's superannuation compliance assistance mechanisms, was positive. The BSWG was seen as an effective mechanism for discussing and resolving operational issues for holders involved in meeting their Surcharge reporting requirements. In addition, the role performed by CRMs was seen as valuable and widely supported.

Quality of MCS data provided by the Key Client Group

5.49 Although MCS lodgement is a critical part of Surcharge compliance, of equal importance is the quality of the data lodged. Based on the number of exceptions generated by the SCS system (see paragraph 4.44 in Chapter 4), and the amount of MCS data rectification work undertaken as part of the Surcharge assessment run (see Appendix 10), the quality of some MCS lodgements submitted by holders may be less than adequate.

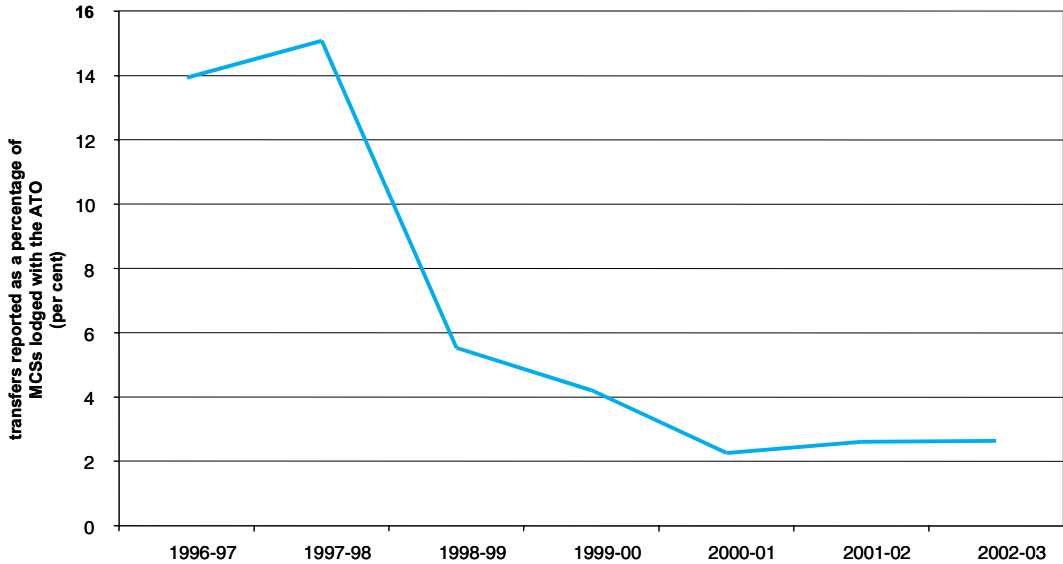
5.50 The notion that the ATO receives less than adequate MCS data from some holders is supported by analysis undertaken by the ANAO. Reporting requirements regarding the transfer of member superannuation contributions from one superannuation fund to another, were significantly strengthened in 2000.¹⁹¹ Transferring contributions from one holder to another delays Surcharge assessments from issuing and significantly increases the likelihood that a member will not be assessed at all, if the ATO cannot locate the holder receiving the contributions. We assessed the total number of transfers reported by holders

¹⁹¹ In 2000, the ATO made it mandatory for holders transferring members' superannuation contributions to another holder, to report the ABN of that holder on the MCS. Reporting the ABN of the holder receiving the contributions allows the ATO to track the contributions more easily, and minimises the chance that the contributions will become 'lost'.

as a proportion of the total number of MCSs processed. The results of this analysis are contained below.

Figure 5.4

Membership transfers as a percentage of the total number of MCSs lodged 1996–97 to 2002–03



Source: ANAO analysis of ATO data from SCS

5.51 Following 1996–97 and 1997–98, there were significant decreases in the number of reported transfers as a proportion of the total number of MCS lodged with the ATO. We note that some of these may have related to corrections being made to MCS data while the SCS system was being ‘bedded in’.

5.52 However, since this time, reported transfers as a proportion of total lodgements have remained consistently low (ranging from between 2 to 4 per cent) with the introduction of the new MCS reporting requirements. This may indicate that before 2000–01, the transfer of a member’s superannuation contributions between holders, may have been used by some holders to delay paying the Surcharge. This factor raises concern over the robustness of MCS information collected and processed by the ATO prior to 2000–01. As discussed in paragraph 5.46, we also note that some holders may not be reporting all member accounts as part of the MCS data submitted to the ATO.

5.53 Although not a risk identified in the Surcharge compliance strategy, the ATO recognises that there are potential problems with the quality of the data provided by large holders. As part of the Compliance Program, the ATO has

committed to undertake benchmark audits of a small number of large superannuation funds to test compliance with the Surcharge.¹⁹² Similarly, the ATO also plans to identify high-risk larger funds, by crosschecking MCS lodgements against fund income tax returns, to ensure that all contributions are reported.

5.54 Although the ANAO is supportive of ATO initiatives to obtain an understanding of the quality of MCS data lodged by key clients, we note that this kind of compliance activity should be undertaken as part of a coordinated approach to Surcharge compliance. We also note that vigilance in regularly monitoring the quality of Surcharge information provided by key clients will not only assist compliance, but also improve the timeliness, cost effectiveness and accuracy of Surcharge processing.

Large and Medium Fund Group

5.55 The Large and Medium Fund (LMF) Group was created within the Superannuation Business Line in April 2003 to assist holders who are not key clients, and are not considered 'small holders', to comply with their superannuation obligations. One of the tasks central to the establishment of the group was to define which holders belong to the LMF population.

5.56 At first, the ATO estimated that there were approximately 1 500 holders in the group.¹⁹³ However, following further refinements in data analysis, the ATO found that this estimate was closer to 2 000 funds. At the conclusion of the audit, the LMF Group was absorbed into a newly created Active Compliance area within the Superannuation Business Line. However the Active Compliance area had not completed its analysis of the size of the large and medium population.¹⁹⁴

MCS lodgement compliance

5.57 Unlike the Key Client Group, that has almost 100 per cent of its holders lodging MCSs (see paragraph 5.46), the ATO considers that MCS lodgement for the LMF Group is considerably lower. As a result, the ATO's focus has been to determine which holders have not lodged, and to undertake compliance enforcement activity accordingly.

¹⁹² This will be done in conjunction with Reasonable Benefits Limit (RBL) and Lost Members Register (LMR) reporting.

¹⁹³ Of these, 1000 funds would fall into the small to medium enterprise market segment, and 500 would be classified as micro-businesses.

¹⁹⁴ We also note that the estimated size of the LMF group advised by the ATO is substantially larger than that suggested by Figure 5.3, as part of our comparison between ATO and APRA data. This re-enforces the importance of Recommendation 15, in providing the ATO with a more informed compliance approach, based on a better understanding of the actual Superannuation holder population.

5.58 To enforce lodgement of MCSs, for the period 2000–01 to 2003–04, within the Large and Medium market segment, the ATO undertook a project to identify holders that had lodged their ITR, but did not have a corresponding MCS lodgement. This project identified significant non-compliance, and the ATO proceeded with action to enforce compliance, (including plans to issue contravention notices). The results of this project were that the ATO:

- targeted 433 large and medium holders for lodgement;
- secured the lodgement of 195 MCSs, resulting in additional Surcharge liabilities of \$6.7 million being issued to 102 holders, and for 6 572 members; and
- identified 158 holders to be issued with contravention notices.¹⁹⁵

5.59 As with the Key Client Group, while we are supportive of ATO initiatives to enforce lodgement of MCS data by LMFs, we consider that this type of compliance activity should be undertaken as part of a coordinated approach to Surcharge compliance.

Quality of MCS data provided by the Large and Medium Fund Group

5.60 Although the non-lodgement of MCSs is the area of most concern to the ATO for this market segment, the quality of Surcharge data provided by large and medium holders is also a compliance risk for the ATO. Although not conclusive, the LMF project (described above) identified a number of variances between the information reported on MCS, and the information contained in holders' ITRs. Although these findings are only indicative of the market segment as a whole, they should contribute to an overall assessment of risk, for the large and medium market segment.¹⁹⁶

5.61 The ATO advised that, based on the outcomes of this initial project work, there are plans to undertake similar projects as a regular feature of active compliance for the LMF Group. The ANAO considers that any future projects should accord with an overall Surcharge compliance strategy, as the results of these projects would also be highly relevant to other market segments (particularly the Key Client Group).

¹⁹⁵ As at 17 June 2004, 9 (7 corporate trustees, 2 individual trustees) holders had been issued with contravention notices with penalties accruing in accordance with the amounts specified at footnote 171.

¹⁹⁶ Refer to Recommendation 15 at paragraph 5.36.

Small Fund Group

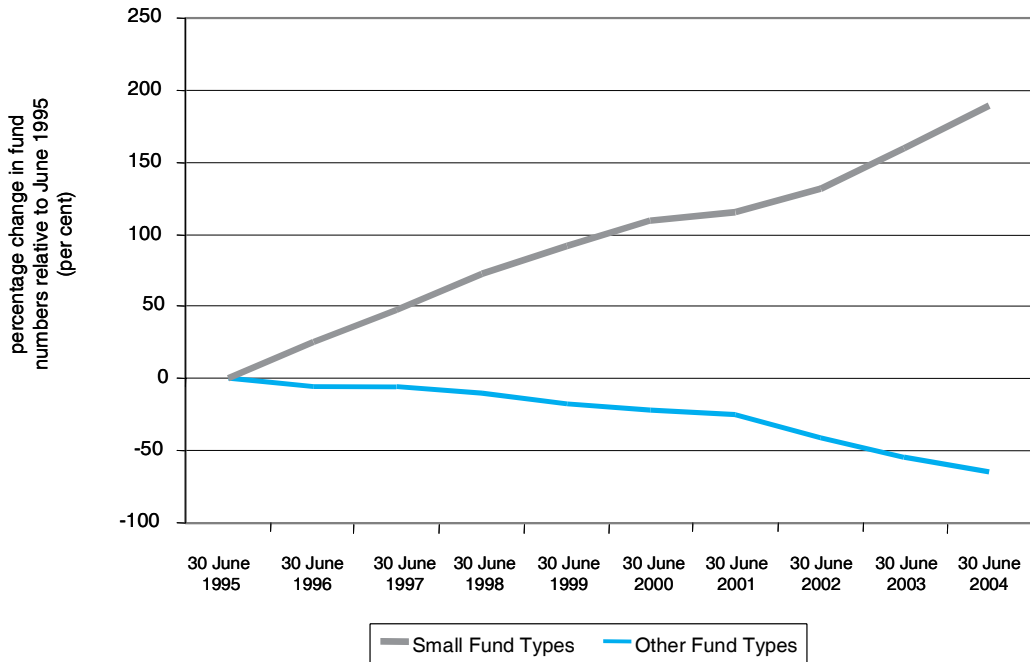
5.62 The Small Fund Group accounts for over 99 per cent of all superannuation funds in Australia (see Figure 5.3). As at 30 June 2004 it comprised approximately 7 843 small APRA regulated funds and 282 371 SMSFs for which the ATO has regulatory responsibility. Although the ATO's has a wide range of regulatory responsibilities for SMSFs, we focused predominantly on Surcharge compliance activities associated with SMSFs.

5.63 In 2003–04 the SMSFs population had the following characteristics:

- approximately \$125 billion (20 per cent overall) in assets under management as at 31 December 2003;
- a higher proportion of high-income earners compared to other fund types; and
- an average superannuation member account balance of approximately \$235 000.

5.64 As noted in Chapter 1, the ATO took over responsibility for the regulation of SMSFs in 1999 from APRA. However, the ATO only began to actively manage and report on the Surcharge compliance risks associated with this market segment in September 2002.

5.65 In 2003, the ATO rated SMSFs as a 'severe' compliance risk (discussed further below). A factor contributing to this risk rating has been the significant increase in the number of new small funds in comparison to other fund types, as shown in Figure 5.5.

Figure 5.5**Percentage growth in fund numbers from 30 June 1995 to 30 June 2004**

Source: APRA Super Trends, September 2004

5.66 The ATO advised that, in addition to the increases in the number of SMSFs that occurred in the past, the number of SMSFs is continuing to grow at a rate of 2 500 every month.¹⁹⁷

Small fund compliance

5.67 As there is a large, constantly changing number of SMSFs, the ATO needs to have a sound strategy, and appropriate education and liaison mechanisms in place for SMSFs.

5.68 The main mechanism the ATO uses to liaise with SMSFs is the Superannuation Industry Liaison Group (SILG). Membership of the SILG comprises a cross-section from the superannuation industry, with significant representation from representative bodies such as the Institute of Chartered Accountants in Australia (ICAA), Certified Practising Accountants (CPA) Australia and the SMSF Professionals' Association of Australia Ltd (SPAA).

5.69 Feedback from relevant SILG members interviewed during the audit was largely positive, with the majority considering it was an effective forum for

¹⁹⁷ Refer to Appendix 17 for detail on the growth in the number of SMSFs since the ATO became the SMSF regulator.

the ATO to disseminate information relevant to SMSFs, and for the ATO to receive feedback on its administrative practices.

MCS lodgement compliance

5.70 The Superannuation Business Line's current understanding of SMSF compliance has been shaped by the results of its Compliance Review Benchmarking Project (CRBP), completed in August 2003.¹⁹⁸ Although Surcharge compliance was only a small part of the overall scope of the project, the review revealed that up to 42 per cent of SMSFs are not fully compliant with their MCS lodgement obligations.

5.71 In addition, given over 96 per cent of all holders are SMSFs, our analysis of holder lodgement compliance in Figure 5.1 indicates that there is a significant discrepancy between the number of registered SMSFs (as advised by the ATO to APRA) and those lodging an MCS.

5.72 We found that the ATO's approach to SMSF Surcharge lodgement compliance has been less than adequate in the past, and is probably the least developed of all the market segments. However, the ATO advised that it was undertaking the following to improve compliance in this market segment:

- the introduction of a contravention notice strategy. This strategy is based on a combination of education¹⁹⁹, reminder and warning letters, and enforcement action (if voluntary compliance is unsuccessful). The ANAO notes that this is the first time contravention notices will be used to enforce compliance for outstanding MCS lodgements within the small funds group;
- making the CRBP a regular feature of the ATO's SMSF compliance approach; and

¹⁹⁸ The key output of the review was to gain a detailed measure of compliance with the SIS Act. Compliance with the Surcharge legislation was seen as a secondary output of the review (along with Income Tax and RBL legislation). The review was conducted using 2001 financial year data for a "statistically valid" sample of 781 SMSFs. The funds selected were reviewed by field or desk audit, involving a physical examination of the financial and source documents, of each SMSF.

Each fund was assigned with a weighted compliance rating for its overall compliance with each piece of relevant legislation, and demerit points were allocated to each non-compliant criterion (i.e. less compliant funds obtained a higher overall score). The criteria used were heavily weighted towards the SIS Act and to a lesser extent the Income Tax legislation. There was an even smaller focus given to Surcharge and RBL reporting.

¹⁹⁹ There have been a number of compliance assistance activities undertaken for SMSFs that have specifically made mention of MCS lodgement obligations. These include speeches by the Deputy Commissioner of Superannuation and a number of reminders as part of the ATO's *Super Update* monthly newsletter. In addition, the ATO has released a comprehensive booklet, titled *DIY Super, Its Your Money... But Not Yet!* (available from <www.ato.gov.au/super>), in July 2004. Designed to be a complement to the *Compliance Program*, it aims to assist SMSF trustees to be aware of the rules governing self managed super funds.

- developing a risk-rating database, which will assist in the identification of Surcharge and other relevant SMSF risks.

5.73 Also, during the 2004 financial year, the Superannuation line contacted 19 345 SMSFs to make sure they lodge income tax and regulatory returns. From this activity, 1 155 MCS were lodged. As part of the 2004–05 Compliance Program, there are plans to contact a further 30 000 SMSFs, to secure outstanding income tax and regulatory returns (a proportion of which will be MCS).

5.74 The initiatives noted above will go some way to address SMSF Surcharge lodgement compliance. However, to be fully effective, all Surcharge compliance activity must be well planned and integrated. We note that the current SMSF Surcharge compliance activity is not.

Quality of MCS data provided to the Small Fund group

5.75 The CRBP also noted that, of the small funds sampled, 32.3 per cent lodged MCSs with errors. This indicates that the quality of the data lodged by small funds is of low quality.

5.76 Although the ATO is becoming more proactive in providing small funds with the education material they need to provide high quality data, we note that the ATO has not undertaken much work in this area in the past. We were advised further, that the ATO's focus would be on identifying recalcitrant funds within the small fund population and enforcing compliance.

5.77 That said, a comprehensive and coordinated compliance strategy should consider and enforce the provision of good quality data by all holders.

Recommendation No.16

5.78 The ANAO recommends, that, in order provide assurance that holders of superannuation contributions comply with their obligation to lodge Surcharge information of high quality, the ATO:

- as part of a Surcharge compliance strategy, establish compliance mechanisms or procedures to identify the lodgement of inaccurate or low quality Surcharge information; and
- undertake regularly compliance enforcement activity .

ATO response

5.79 Agreed. Timely, complete and accurate lodgement of Surcharge information by holders of superannuation contributions is now a major focus of the ATO's superannuation compliance program. The ATO is working closely with Australian Prudential Regulation Authority and Australian Securities

Investment Commission to identify opportunities for cross-agency cooperation in improving this aspect of Surcharge compliance.

Individuals (members)

5.80 The Commissioner must have a member's Income Tax Return (ITR) and a corresponding MCS to make a Surcharge assessment. The key data derived from the ITR for Surcharge purposes includes taxable income and Reportable Fringe Benefits.²⁰⁰

5.81 Since the introduction of the Surcharge, there have been two specific ITR lodgement enforcement projects initiated for superannuation purposes. These were:

- a 2001 pilot project undertaken by the Superannuation Business Line. This project targeted the lodgement of ITRs based on unmatched MCS data for the 1998, 1999 and 2000 financial years. The project resulted in additional net revenue²⁰¹ of approximately \$7 million, the majority of which was Surcharge related; and
- a 2003–04 follow-up project undertaken by the Superannuation Business Line, Personal Tax (PTax) and Operations Service Line. This project focussed on the lodgement of ITRs for the 2001 financial year (as well as those that remained outstanding for 1999 and 2000). It resulted in a net revenue gain to the ATO of \$37.7 million²⁰², and enforced the lodgement of 87 999 ITRs. Some key findings from this project included:
 - recognition that the longer ITRs were outstanding, the less effective lodgement rates are, and the smaller the return to the ATO for its efforts;
 - confirmation that the majority of surchargeable taxpayers covered by the project would not normally be selected for lodgement enforcement by PTax as they will generally be in an income tax refundable position; and
 - support for the argument that a greater majority of high-income earners are likely to be members of an SMSF, with on average, SMSF members selected as part of the project having superannuation contributions of \$19 196 and a taxable income of \$124 631.

²⁰⁰ Further detail on the steps involved in calculating a liability to the Surcharge can be found in Appendix 2.

²⁰¹ All selected cases generally resulted in an income tax refund, however, the overall Surcharge liability resulting from enforcing the lodgement of the ITR was greater, resulting in a net revenue gain.

²⁰² This included income tax credits of approximately \$48.6 million and Surcharge liabilities raised of approximately \$85.9 million.

5.82 A finding from both projects was that, although there was considerable Surcharge revenue applicable to the non-lodged ITRs, there was comparatively little income and other tax revenue attached to those ITRs. This would indicate that PTax, which is responsible for income tax return lodgement compliance, would not concentrate its compliance activity on these ITRs, as their responsibility is to ensure income and other tax compliance, and not Surcharge compliance.

5.83 Both projects found that there is the potential for significant Surcharge revenue to be attached to members who do not lodge income tax returns. However, to effectively target compliance resources, the Surcharge should be factored into any assessment of risk (as part of business-as-usual practices) to determine what compliance action should be undertaken with respect to the non-lodgement of an ITR. For this to occur, there needs to be sound communication and well-defined processes between the Superannuation Business Line and other relevant Business Lines (for example Operations).

5.84 Although we recognise that communication between the Business Lines occurs at a high level (for example through market segment committees), communication at the working level also needs to occur, so that individual cases can be targeted and actioned.

5.85 During the audit we found no evidence that the Superannuation Business Line had articulated clearly its cross-line dependencies, and that agreements had been made between Business Lines to undertake joint compliance activity, as part of 'business-as-usual' compliance activity. That said, the ATO advised that:

- in the immediate future, the lodgement enforcement responsibility for ITRs will rest with the newly established Lodgement Enforcement Line;
- enforcement activities are initiated in respect of different types of risk including potential Surcharge liabilities;
- potential liability for Income Tax is based on factors including tax levels²⁰³, turnover, occupation and other tax roles (eg GST); and
- projects relating to the Surcharge are largely coordinated across Business Lines based on information provided by the Superannuation Business Line, and are driven by the income tax payable position of the taxpayer, rather than the likelihood of a potential liability for the Surcharge.

²⁰³ The tax level is determined by the most recent lodgement information held by the ATO and can broadly be separated between those taxpayers that are non-taxable (tax level 0), those that will be in an income tax payable position (tax levels 1–6, with level 6 covering the largest amount of tax payable of \$20 000 or above) and those that are in a tax refundable position (tax level 7).

Recommendation No.17

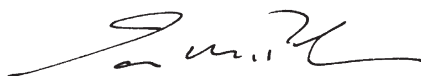
5.86 The ANAO recommends that, to improve Surcharge compliance, the ATO:

- articulate clearly, cross-Business Line dependencies between the Superannuation Business Line and other relevant ATO Business Lines; and
- establish and document procedures between the Superannuation Business Line and other relevant Business Lines for joint 'business-as-usual' compliance activity.

ATO response

5.87 Agreed. The ATO corporate risk management framework, managed through the ATO's Sub-plans and its market, product and capability committees, is now used to develop the strategic and operational plans for managing Surcharge risks. This process identifies Surcharge risks and mitigation strategies across all ATO activities and Business Lines.

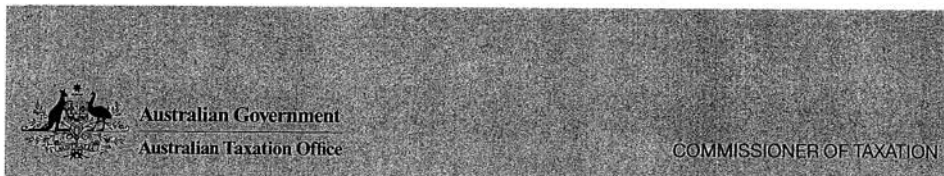
Canberra ACT
13 April 2005



Ian McPhee
Auditor-General

Appendices

Appendix 1: Agency response



Mr Pat Barrett
Auditor-General
Australian National Audit Office
19 National Circuit
Barton ACT

Dear Mr Barrett,

Thank you for your letter of 10 February 2005, from Executive Director Mr Peter White, and for the opportunity to provide comments on the proposed audit report on the Australian Taxation Office's administration of the Superannuation Surcharge System.

The ATO regards implementing the Surcharge as one of its most difficult challenges. This is not necessarily because of the measure itself, rather the environment in which it was introduced. At the time there were considerable pressures on the ATO, including numerous amendments to superannuation legislation and the introduction of a major tax reform program. Overall the Surcharge system has been implemented and is delivering, in aggregate, its projected outcomes; since its introduction revenue has increased by 267%.

At the same time we have not performed to the high standard I, and the community, expect. We are working hard to redress the shortcomings and have made significant progress in doing that.

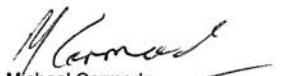
Whilst the ATO notes that the Australian National Audit Office concludes that the "ATO's administration of the Surcharge has not been managed well", I am pleased the ANAO has acknowledged the ATO's efforts in recent years to address particular areas of concern.

The ATO supports all recommendations and has provided a response to each.

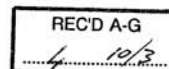
Should you wish to discuss this matter further please contact Denise English on (02) 6216 2532.

Thank you for the constructive and co-operative approach to this review. I would like to commend to you the work of your auditors, Jon Hansen and Ben Sladic who were most professional in their approach.

Yours sincerely


Michael Carmody
COMMISSIONER OF TAXATION

10 March 2005



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Summary of ATO's Response

Recommendation No.1
Para 2.22

The ANAO recommends that the ATO in accordance with the Australian Standards on record management, and as part of an all-inclusive Surcharge governance framework, implement mechanisms to provide assurance that all major decisions affecting the Surcharge be fully recorded.

ATO Response: Agreed. New governance and management arrangements for the administration of Surcharge were introduced in 2004. Surcharge risk and mitigation strategies are developed through the ATO corporate risk management framework; using corporate market committees and sub-plan management forums for consideration in the wider compliance environment. The new arrangements also provide for structured decision making processes and proper recording of significant decisions.

Recommendation No.2
Para 2.39

The ANAO recommends that, to improve its approach to Surcharge planning, the ATO's Superannuation Business Line:

- develop and implement a planning methodology at the operational level, which clearly links to the priorities, outcomes and risks identified in strategic level plans;
 - implement, monitor and report on integrated, quantitative and qualitative performance measures that will provide a consistent and meaningful measure of Surcharge performance over time; and
 - monitor and report against plans at the operational level.
- ATO Response: Agreed.** Superannuation Business Line management arrangements introduced in 2003–04 provide a strong focus on the strategic management of the surcharge. The operational aspects are now administered through the Operations and Information and Communications Technology (ICT) Business Lines to draw on their experience and expertise in dealing with these

aspects of our superannuation operation. The Superannuation Business Line will work with both the Operations and ICT Lines to develop operational plans, integrated performance indicators, and protocols to monitor and report performance.

**Recommendation
No.3**

Para 2.61

The ANAO recommends that, to improve Surcharge risk management, the ATO:

- develop and apply a consistent Surcharge risk management methodology at the operational level, based on sound analysis and information, which clearly links to the risks identified in strategic level plans and is consistent with ATO corporate risk management policy;
- as part of the ATO Certificate of Compliance process, undertake regularly an assessment of Surcharge system risks, to identify key Surcharge controls; and
- undertake an assessment of fraud control risks for Surcharge information technology systems, and ensure that ATO staff responsible for implementing applicable risk mitigation strategies are aware of, and report regularly against, these risks.

ATO Response: Agreed. The ATO corporate risk management framework is now used to develop strategic and operational plans for managing Surcharge risks. In October 2004 the Superannuation Business Line commenced reviewing Certificates of Compliance with ATO Resource Management. As processing work has now been transferred to the Operations Business Line that business line is developing arrangements for the regular maintenance of Certificates of Compliance. The Superannuation Business Line is working with the ATO's internal audit area to review fraud control risks for all superannuation systems.

**Recommendation
No.4
Para 2.75**

The ANAO recommends that, to provide a comprehensive, consistent and integrated approach to Surcharge internal reporting, the ATO develop and implement a robust Surcharge reporting framework, underpinned by sound planning and risk management processes, which clearly link to other relevant ATO strategic level plans.

- **ATO Response: Agreed.** The ATO corporate risk management framework, managed through the ATO's Sub-plans and its market, product and capability committees, is now used to develop the strategic and operational plans for managing Surcharge risks. This process identifies Surcharge risks and mitigation strategies across all ATO activities and Business Lines. The process also incorporates robust planning and reporting arrangements.

**Recommendation
No.5
Para 3.20**

The ANAO recommends that, to provide assurance that Surcharge contributions data is captured in a timely and efficient manner, and to improve accountability, the ATO's superannuation Business Line and the Operations Service Line:

- develop, agree and document the terms and conditions for the extraction of Surcharge contributions data provided on magnetic media, and the placement of these data onto relevant ATO IT systems for processing; and
- develop and report against performance indicators that provide a meaningful measure of performance against, and compliance with, those terms and conditions.

ATO Response: Agreed. The Information & Communications Technology Line, the Operations Business Line and Superannuation Business Line are establishing a Service Level Agreement (SLA) for uploading magnetic media onto core systems for processing. The SLA will be specific to the treatment of Superannuation data and is expected to be ratified and in place by mid May 2005. Conformance to the SLA will be overseen by the Production Change Management

Branch of the Operations Business Line and the Production Systems Support Branch of the Information & Communications Technology Line. Conformance reports will be provided to the Superannuation Product Committee as part of the formal ATO Governance cycle.

**Recommendation
No.6
Para 3.40**

The ANAO recommends that, to provide adequate assurance that the Surcharge assessment run operates efficiently and effectively, the ATO:

- compile a comprehensive set of procedural documentation for the Surcharge assessment run; and
- introduce a robust system of controls to manage this documentation, including:
 - the storage of this documentation in a secure central location; and
 - controls to provide assurance that SCS procedural documentation is current and complete.

ATO Response: Agreed. Responsibility for the production support of the Surcharge Assessment run will be transferred to the Production System Support team within the Information & Communications Technology Line at the completion of the February Assessment run. All procedural documentation is being updated as part of this transfer and is expected to be finalised by the end of May. All documentation supporting the management of the assessment run will conform to Information & Communications Technology Line document management protocols.

Recommendation No.7
Para 3.52

The ANAO recommends that, to provide adequate assurance that the Superannuation Contribution Surcharge (SCS) system is operating efficiently and effectively, the ATO:

- compile a complete set of baseline specifications for the SCS system; and
- introduce a robust system of controls to maintain the currency and completeness of the SCS system baseline and change specifications.

ATO Response: Agreed. A complete set of baseline specifications will be developed by the Information & Communications Technology Line. This work will be undertaken in parallel with enhancements to the Surcharge Assessment System required for the November 2005 Assessment run. All system documentation will conform with Information & Communications Technology document management protocols.

Recommendation No.8
Para 3.64

The ANAO recommends that, to provide assurance that changes to the Surcharge processing systems are appropriately analysed, authorised and implemented, the ATO:

- clearly define the roles, responsibilities and accountabilities of business and IT staff regarding the operation of Surcharge processing systems; and
- as part of its change management framework, develop controls to provide assurance that appropriate IT and business managers review and approve changes to Surcharge processing systems.

ATO Response: Agreed. Information & Communications Technology Line, and the Operations and Superannuation Business Lines are progressing the establishment of clearly defined roles and responsibilities relating to the ongoing support and development of the Surcharge processing system. The Surcharge processing system is now subject to

established Incident, Problem and Change Management procedures that are co-sponsored by the Information and Communications Technology Line and the Operations Business Line. Superannuation Business Line support teams are being integrated into these processes.

**Recommendation
No.9
Para 3.72**

The ANAO recommends that, to provide assurance that system errors are managed efficiently and effectively, the ATO develop and implement a consistent approach to identifying, recording, and prioritising changes to Surcharge processing systems.

ATO Response: Agreed. The Surcharge processing system is now subject to established Incident, Problem and Change Management procedures that are co-sponsored by the Information & Communications Technology Line and the Operations Business Line. Superannuation Business Line support teams are being integrated into these processes.

**Recommendation
No.10
Para 3.81**

The ANAO recommends that, to provide assurance that emergency changes to the Superannuation Contributions Surcharge system are appropriately classified, controlled and approved, the ATO:

- develop, document and implement controls to provide assurance that emergency fixes are used appropriately and in accordance with ATO emergency fix procedures; and
- monitor and report on the number of emergency fixes as a measure of overall Surcharge system performance, and to assist in the assessment of Surcharge systems' risk; and
- review regularly the impact of emergency fixes on the operation of Surcharge systems.

ATO Response: Agreed. The Surcharge processing system is now subject to established Incident, Problem and Change Management procedures that are co-sponsored by the Information & Communications Technology Line and the Operations Business Line. Superannuation Business Line support teams are being integrated into these processes. These processes include e-fix activity.

**Recommendation
No.11
Para 3.3**

The ANAO recommends that, to achieve the required level of security, and to promote consistency in access approval processes to Surcharge processing systems, the ATO:

- introduce a robust suite of procedures and controls to provide assurance that all Firecall access relating to Surcharge processing systems is legitimate;
- as part of a comprehensive approach to the Certificate of Compliance process, review all Surcharge related Firecall access regularly to provide assurance that it is legitimate; and
- as part of its internal reporting framework, report the results of Firecall access reviews.

ATO Response: Agreed. The Surcharge processing system is now subject to established Incident, Problem and Change Management procedures that are co-sponsored by the Information & Communications Technology Line and the Operations Business Line. Superannuation Business Line support teams are being integrated into these processes. These processes include firecall access and monitoring. The Certificate of Compliance process is undertaken monthly with conformance and integrity checks applied to the review and authenticity of firecall requests. These checks are performed by the Productions Systems Support area of the Information & Communications Technology Line. All firecall activity is reported as part of the line performance against the monthly corporate integrity indicators process.

**Recommendation
No.12
Para 4.39**

The ANAO recommends that, to provide a coordinated and comprehensive approach to managing future identity matching exceptions in accordance with the Surcharge legislation, the ATO:

- develop and enforce a policy for the timely issue of Surcharge letters and default assessments, as specified under the Superannuation Contributions Tax Imposition Act 1997; and
- actively monitor and report to ATO corporate management the number of identity-matching exceptions, and the number of Surcharge letters and default assessments issued.

ATO Response: Agreed. Each year the ATO receives 16.5 million Member Contribution Statements, 3 million do not have a TFN, although the ATO is able to match 2 million, leaving 1 million potentially requiring contact with the taxpayer. Policies for the timely issue of appropriate numbers of surcharge letters in relation to identity matching exceptions, and the timely issue of default assessments are being developed. Arrangements are in place for regular monitoring and reporting to senior management of: the number of exceptions completed; work in progress; and the numbers on hand.

**Recommendation
No.13
Para 4.63**

The ANAO recommends that, to improve its management of Superannuation Contributions Surcharge (SCS) system exceptions, the ATO:

- develop and document procedures to resolve all SCS exceptions in accordance with relevant Surcharge legislation; and
- provide relevant staff with the training necessary to resolve SCS exceptions.

ATO Response: Agreed. Procedures to action the various types of surcharge exceptions in accordance with relevant Surcharge legislation have been developed and implemented over the last nine months. These procedures are being used to resolve backlogs of exceptions. However, consistent with the advice from the Australian Government Solicitor, the ATO will not,

for reasons of fairness, pursue exceptions where the person is either deceased, retired or the exception is greater than four years old. These procedures will enable the timely resolution of surcharge exceptions in future processing. As the ATO gains experience and develops a better understanding of the nature of the exceptions, the procedures will be refined. A comprehensive training program has been place since August 2004.

Recommendation

No.14

Para 5.21

The ANAO recommends that, in order to assess the risk applicable to the non-lodgement of member contribution statements by registered superannuation funds, and to determine the completeness of members contribution statement lodgements, the ATO:

- analyse and report on significant variations between the number of registered superannuation funds, and the number of funds lodging member contribution statements;
- with assistance from APRA, introduce a systematic and co-ordinated approach to share and analyse relevant registered superannuation fund data; and
- use the results of this analysis to support ATO Surcharge compliance activities.

ATO Response: Agreed. A new business line has been established within the ATO management structure to focus on improving lodgement compliance across all taxation and superannuation obligations. Improved lodgement of member contribution statements by funds will be a specific area of focus for 2005-06 including helping and educating the community to understand their lodgement obligations and, when necessary, adopt appropriate enforcement activities. The ATO is also working closely with Australian Prudential Regulation Authority (APRA) to identify opportunities to share information and analyses, and to work cooperatively in improving Surcharge compliance.

**Recommendation
No.15
Para 5.36**

The ANAO recommends that, to manage Surcharge compliance effectively, the ATO develop a logical, well structured, and comprehensive Surcharge compliance framework which incorporates the following:

- a policy for issuing contravention notices for holders of contributions that do not comply with their Surcharge lodgement obligations;
- a risk assessment process to identify, assess and rank Surcharge compliance risks as part of a Surcharge compliance strategy;
- a methodology based on the ATO Compliance Model to identify potential strategies to mitigate Surcharge compliance risks, as part of a Surcharge compliance strategy;
- a regular reporting process to monitor and report on compliance risks and risk mitigation strategies; and
- a coordinated approach to reporting Surcharge compliance within the Superannuation Business Line, to ATO corporate management and publicly.

ATO Response: Agreed. The policy for issuing contravention notices is under consideration as part of a broader review of penalties and sanctions available to the ATO in regard to superannuation obligations. The ATO corporate risk management framework, managed through the ATO's Sub-plans and its market, product and capability committees, is now used to develop the strategic and operational plans for managing Surcharge risks. Improved governance processes are also in place to report on and monitor our Surcharge compliance activities.

Recommendation No.16 The ANAO recommends that, to improve Surcharge compliance, the ATO:

Para 5.78

- as part of a Surcharge compliance strategy, establish compliance mechanisms or procedures to identify the lodgement of inaccurate or low quality Surcharge information; and
- undertake regularly compliance enforcement activity.

ATO Response: Agreed. Timely, complete and accurate lodgement of Surcharge information by holders of superannuation contributions is now a major focus of the ATO's superannuation compliance program. The ATO is working closely with Australian Prudential Regulation Authority and Australian Securities Investment Commission to identify opportunities for cross-agency cooperation in improving this aspect of Surcharge compliance.

Recommendation No.17 The ANAO recommends that, to improve Surcharge compliance, the ATO:

Para 5.86

- articulate clearly, cross-business line dependencies between the Superannuation Business Line and other relevant ATO business lines; and
- establish and document procedures between the Superannuation Business Line and other relevant business lines for joint 'business-as-usual' compliance activity.

ATO Response: Agreed. The ATO corporate risk management framework, managed through the ATO's Sub-plans and its market, product and capability committees, is now used to develop the strategic and operational plans for managing Surcharge risks. This process identifies Surcharge risks and mitigation strategies across all ATO activities and Business Lines.

Appendix 2: Calculation of the Surcharge

The Superannuation Contributions Surcharge, which is assessed on information provided by superannuation providers and the member's income tax return, applies to superannuation contributions made by, or on behalf of, a member where those contributions are taxable contributions in the hands of a superannuation provider. In addition, the Surcharge is levied on most employer Eligible Termination Payments (ETPs) accrued after 20 August 1996²⁰⁴ and rolled over on or after 1 July 1997. The Surcharge also applies to amounts attributed to the account of members of defined benefit funds.

There are three steps to calculate the Surcharge.

Step 1—Determine "Adjusted Taxable Income"

The rate of the Surcharge is dependent upon the member's "Adjusted Taxable Income" (ATI). In most cases, a member's ATI is defined by the following formula²⁰⁵:

Adjusted Taxable Income (ATI) = the member's taxable income²⁰⁶ for the year
minus
certain super fund ETPs
minus
lump sum payments for unused long service leave and annual leave received because of a bona fide redundancy or invalidity, or under an approved early retirement scheme
plus
amounts that were exempt because family trust distribution tax was paid on them
plus
the member's reportable fringe benefits
plus
the member's 'surchargeable contributions'.

²⁰⁴ The Terminations Payments Surcharge applies to part of employer ETPs paid after 20 August 1996 that is taken as cash. These amounts are sometimes known as 'golden handshakes'.

²⁰⁵ A slightly different ATI formula applies to those members who receive an employer ETP below the maximum threshold.

²⁰⁶ That is, assessable income reduced by allowable deductions.

The calculation of surchargeable contributions will vary depending on whether the provider is an accumulated benefits fund²⁰⁷ (i.e. where the benefit a member receives is the contributions made plus net earnings on those contributions) or a defined benefits fund²⁰⁸ (i.e. a fund where the benefit a member receives is based on a formula).

In order to match a member's surchargeable contributions (which are provided by Superannuation providers via a member contribution statement (MCS)), to a member's taxable income (which is provided by the member using an income tax return), the Tax Office requires the member's TFN. When the provider lodges an MCS, the member's TFN can form part of the information contained in that MCS. This issue is discussed further in Chapter 4.

Step 2—Determine Surcharge Rate

If an employee's ATI is greater than the minimum Surcharge threshold (see below), an appropriate Surcharge rate is calculated and applied to the employee's 'surchargeable contributions.'

| Year | Minimum Threshold | Maximum Threshold | Denominator |
|---------|-------------------|-------------------|------------------------------|
| 2004/05 | \$99 710 | \$121 075 | \$1 709.20000 |
| 2003/04 | \$94 691 | \$114 981 | \$1 399.31034 ²⁰⁹ |
| 2002/03 | \$90 527 | \$109 924 | \$1 295 |
| 2001/02 | \$85 242 | \$103 507 | \$1 219 |

If the member's ATI is greater than the maximum threshold, the maximum Surcharge rate is applied. From 1 July 2003 the maximum rate was reduced to 14.5 per cent from 15 per cent in prior years. The maximum Surcharge rate was further reduced to 12.5 per cent from 1 July 2004, and following this, it will be reduced to 10 per cent from 1 July 2005.

²⁰⁷ For an accumulated benefits funds surchargeable contributions include employer contributions, member contributions for which a tax deduction has been claimed, certain parts of rolled-over employer ETPs, and allocated surplus amounts.

²⁰⁸ For a 'defined benefits fund' surchargeable contributions are the amounts that constitute the actuarial value of the benefits that accrued to, and the value of the administration expenses and risk benefits provided in respect of, the member for the financial year.

²⁰⁹ For the 2003/04 and future financial years, the ATO advised that the denominator is rounded to five decimal places.

If an employee's ATI is greater than the minimum threshold and less than the maximum threshold, the Surcharge rate is calculated using the following formula:

$$\text{Surcharge Rate} = \frac{\text{ATI} - \text{minimum Surcharge threshold}}{\text{Denominator}}$$

Step 3—Calculate Surcharge Liability

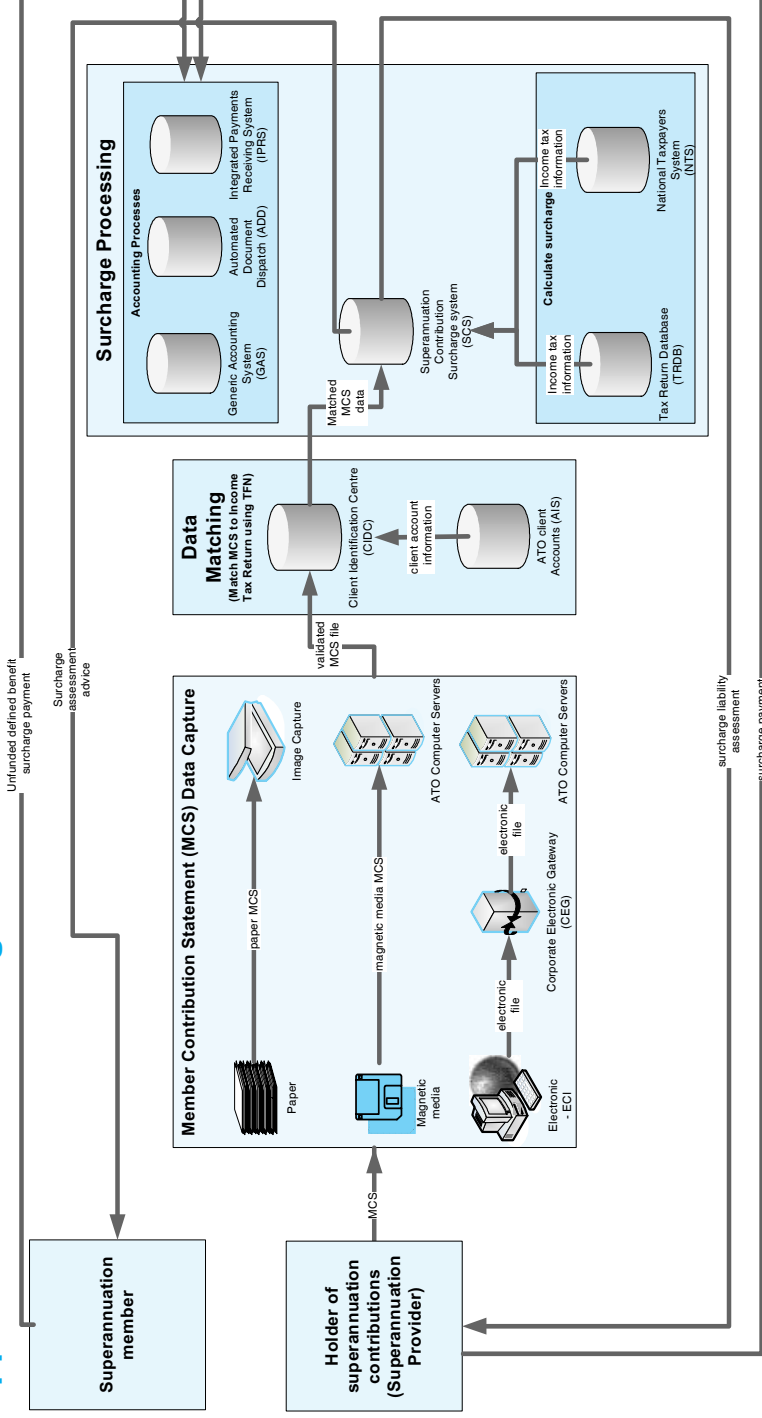
A member's Surcharge liability is calculated using the following formula:

$$\text{Surcharge Liability} = \text{Surcharge Rate} \times \text{Surchargeable Contributions}$$

The holder of surchargeable contributions is responsible for paying the assessed Surcharge one month after receiving a Surcharge assessment from the ATO.²¹⁰

²¹⁰ Except for members of unfunded defined benefit (UDB) funds and Constitutionally Protected funds, where the Surcharge is not payable until the member's benefits first become payable (e.g. on retirement). A UDB holder of contributions is responsible for maintaining a member's Surcharge debt account and must debit this account for interest owing on the debt, using the 10-year Treasury bond rate. The ATO is responsible for maintaining the debts accounts for all Constitutionally Protected funds.

Appendix 3: The Surcharge collection mechanism



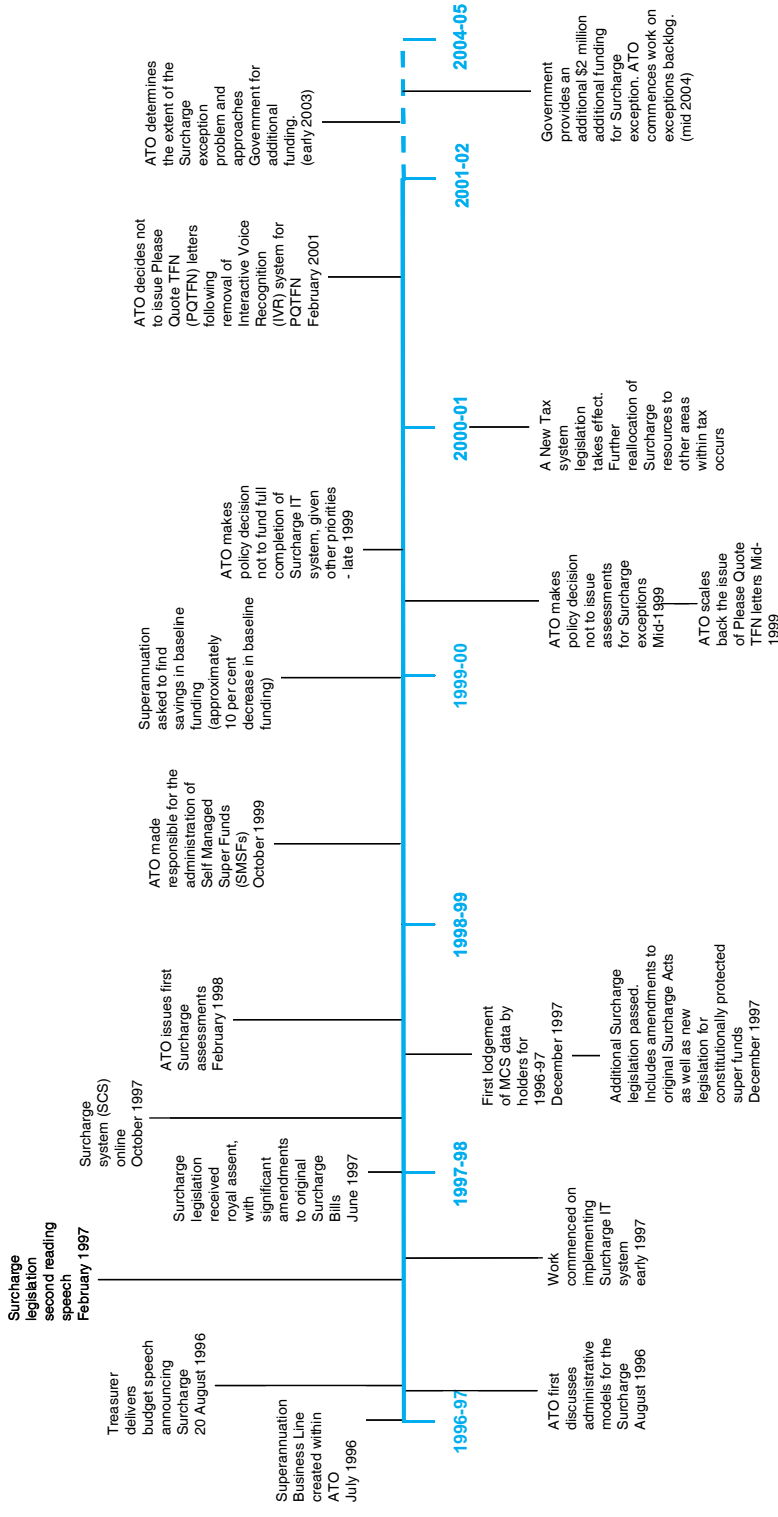
Source: ANAO analysis of ATO information

ANAO Audit Report No.39 2004–05
The Australian Taxation Office's Administration of the Superannuation Contributions Surcharge

Appendix 4: History and background relevant to the introduction and administration of the Surcharge

There are several events preceding and following the introduction of the Surcharge, which impacted on its administration. The following timeline provides an overview of the key events surrounding the implementation and maintenance of the Surcharge.

Timeline of Surcharge Events



Source: ANAO analysis of ATO information

ANAO Audit Report No.39 2004-05
The Australian Taxation Office's Administration of the Superannuation Contributions Surcharge

The impact of these events on the administration of the Surcharge is discussed further in Chapter 2 of this report.

The changing superannuation environment prior to Surcharge implementation

Between 1990–91 and 1996–97 there were substantial changes to the superannuation environment, which affected the ATO's administrative responsibilities. In particular, the ATO had new administrative responsibilities applicable to the following superannuation related initiatives:

- Superannuation Guarantee;
- Superannuation Holding Accounts Reserve (SHAR);
- Reasonable Benefits Limits (RBL); and
- Lost Members Register (LMR).

The ATO advised that it was asked to absorb a large proportion of the costs associated with these initiatives. It also advised that, while absorbing the costs of each initiative may be comparatively small, when combined, the costs are significant.

The ATO noted that it was also asked to absorb costs associated with the introduction and maintenance of the Surcharge. To manage the costs applicable to the Surcharge and the other superannuation initiatives identified above, the ATO centralised the management of superannuation into the Superannuation Business Line. Until that time, superannuation had been administered out of a number of business and service lines within the ATO.

Factors applicable to the implementation of the Surcharge

In August 1996, the Government approached the ATO to develop the Surcharge and advised that the new (Surcharge) policy had two parameters. These were that the new policy:

- could not be a tax; and
- could not be an imposition on employers.

These parameters placed considerable restrictions on the types of mechanisms the ATO could use to collect the Surcharge. This issue is discussed further below.

Short timeframes to implement the Surcharge system

As shown in the timeline above, the ATO commenced planning work on the development of the SCS system in early 1997. However, this work could not be completed until June 1997, at which time the final form of the Surcharge legislation was determined. From June 1997, the ATO had three months to

ensure the SCS system was implemented. Once implemented, the ATO collected and processed the first MCS lodgements within three months.

The short timeframes to implement the Surcharge system, had a profound impact on the ATO's capacity to implement an 'ideal' Surcharge system (this issue is discussed further in Chapter 3). Although there are many problems with current Surcharge IT systems (as discussed in Chapter 3 and 4), the ANAO recognises that to implement the current SCS system, within the specified timeframe and budget, was a commendable achievement.

Significant events following the introduction of the Surcharge

Following the introduction of the Surcharge, there were further amendments to Surcharge legislation. In addition, new legislation, affecting constitutionally protected funds, was also introduced. These changes required substantial alterations to Surcharge systems.

On 8 October 1999, the ATO acquired responsibility for the administration of Self Managed Superannuation Funds (SMSFs) from the Australian Prudential Regulation Authority (APRA). This placed additional pressure on Superannuation (and Surcharge) resources and the management of the Surcharge system. The ATO's management of SMSFs are discussed further in Chapter 5.

As part of the 1997–98 Additional Estimates process, there were significant savings (\$14.4 million) made within the Superannuation Business Line. Although these savings did not relate specifically to the Surcharge, the ATO noted that they did impact on Surcharge administration.

In 1999 and 2000, the ATO focussed its attention on tax reform and allocated its resources accordingly. As a result further pressure was placed on Surcharge resources during this period.

Between 1999 and 2002, several key decisions were made regarding the development of Surcharge IT systems, and the management of the 'exceptions' the existing system created. These are discussed in detail in Chapter 2.

Appendix 5: Stakeholder reaction to the introduction of the Surcharge

Following the Treasurer's second reading speech announcing the Surcharge in August 1996 (see the timeline in Appendix 4), the then Senate Select Committee on Superannuation (the Committee) examined the Bills applicable to the Surcharge.²¹¹ As part of this review, the Committee received in excess of 70 submissions from relevant stakeholders. The findings of the Committee, and the prevalent views of other relevant stakeholders are discussed below.

Findings of the Senate Select Committee on Superannuation

Although all Committee members recognised the need for greater equity within the superannuation system, there was disagreement between Government Senators and Senators from the other parties, over a number of areas including:

- the mechanism used to collect the Surcharge;
- the inclusion of unpaid leave and termination payments in Surcharge calculations; and
- other reform measures to improve equity within the superannuation system.

Prevalent stakeholder views on the Surcharge

Representatives from the superannuation industry, accounting professions, Judiciary, Defence forces and several State Governments were critical of the Surcharge in their submissions to the Committee. Among other concerns, some of the issues raised by these groups included:

- superannuation may not be as an attractive investment vehicle for retirement saving under the Surcharge, and some members may repackage their retirement savings to avoid it;
- many lower and middle income earners may be liable to pay the Surcharge if they do not quote their TFN to their superannuation fund); and
- many lower and middle income earners would bear some cost of the Surcharge, as superannuation funds would pass on administrative costs associated with the Surcharge to all members.²¹²

²¹¹ Parliament of the Commonwealth of Australia, 23rd Report of the Senate Select Committee - Superannuation Surcharge Legislation, March 1997.

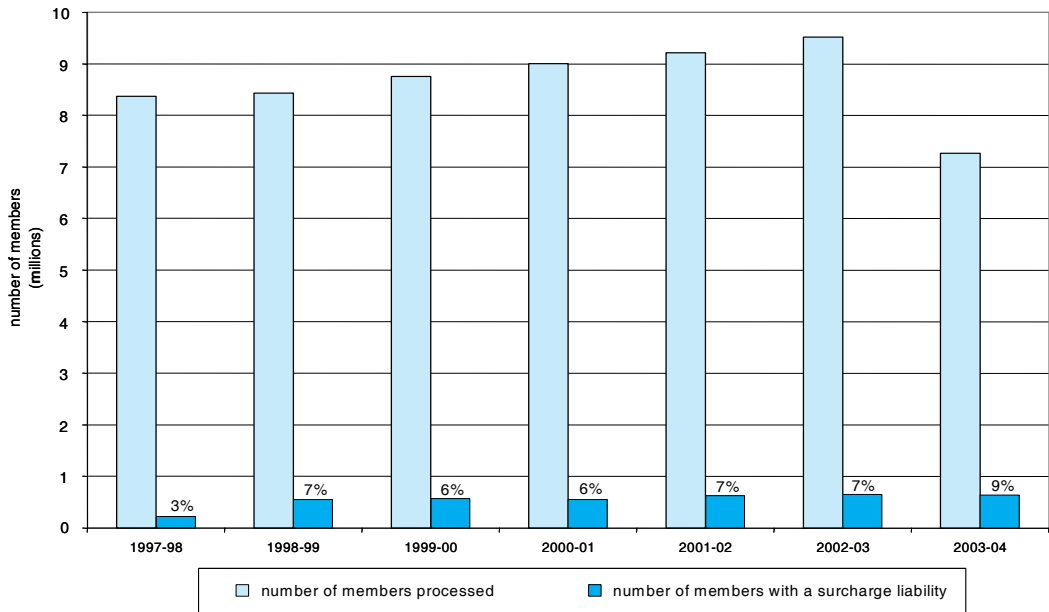
²¹² Parliament of the Commonwealth of Australia, 23rd Report of the Senate Select Committee - Superannuation Surcharge Legislation, March 1997 pp 3,4.

Stakeholder criticism of particular note, related to the Surcharge collection mechanism²¹³, which was seen as complex, cumbersome and costly. For example, a representative of Coopers and Lybrand advised the Committee that:

...we believe that this system as currently proposed is inefficient because of the requirement to match the data from 9 million taxpayers received separately via their tax returns to the... records of those 140 000 funds in order only to determine a Surcharge for some 350 000 people. It seems to be a sledgehammer cracking a nut, and it will have major cost implications.²¹⁴

ANAO analysis of SCS information shows that the ATO must assess a large number of members for the Surcharge, only a small proportion of who receive a Surcharge liability assessment. This is shown in the figure below.

Number of members assessed for the Surcharge compared to the number of members issued with a Surcharge liability 1997–98—2003–04



Source: ANAO analysis of SCS information²¹⁵

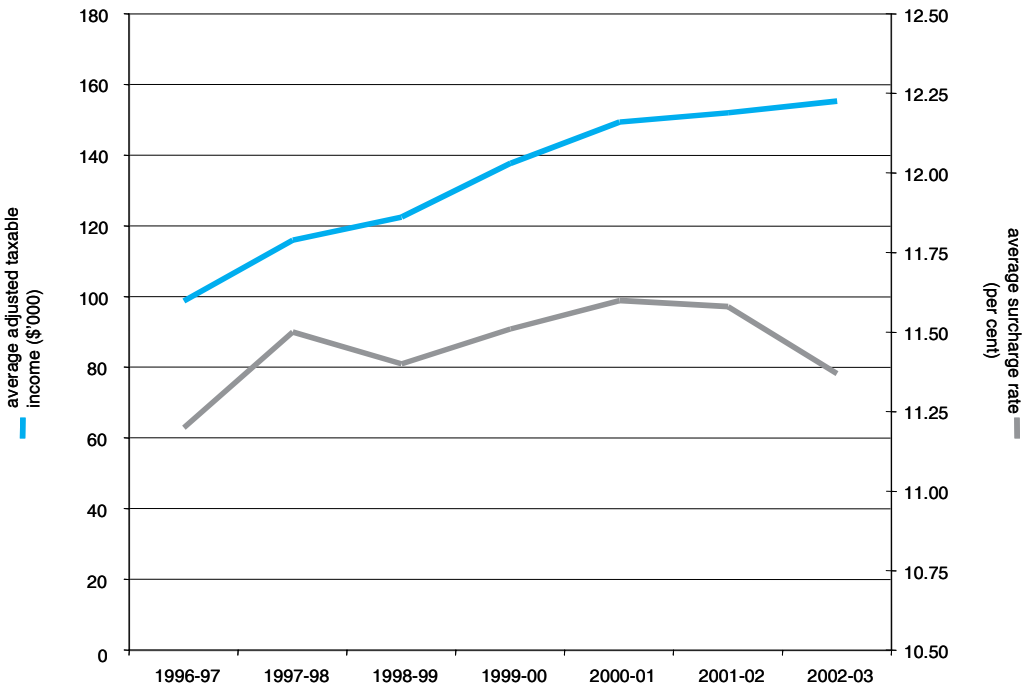
²¹³ The Surcharge collection mechanism is depicted in Appendix 3.

²¹⁴ Parliament of the Commonwealth of Australia, *23rd Report of the Senate Select Committee - Superannuation Surcharge Legislation*, March 1997 pp 32, 33. Evidence by Michael Forsdick—Coopers and Lybrand.

²¹⁵ The ATO advised the number of members processed in 2003–04 is lower than for other years, because not all 2003–04 MCSs had been lodged and processed when the data was compiled in February 2005. This situation may arise because: holders are granted extensions to lodge MCSs; the holder is a self-assessing superannuation provider (see paragraph 5.24); and some funds have not lodged on time. The ATO will obtain a more accurate figure following the May Surcharge assessment run (see Appendix 10).

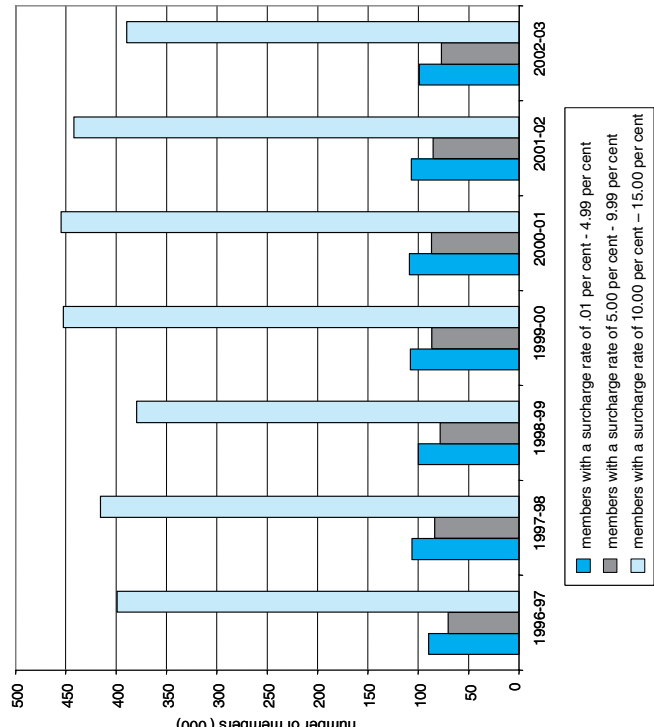
Appendix 6: ANAO analysis of Adjusted Taxable Income and Surcharge rate data

Diagram 1: average adjusted taxable income and average Surcharge rates 1996–97 - 2002–03



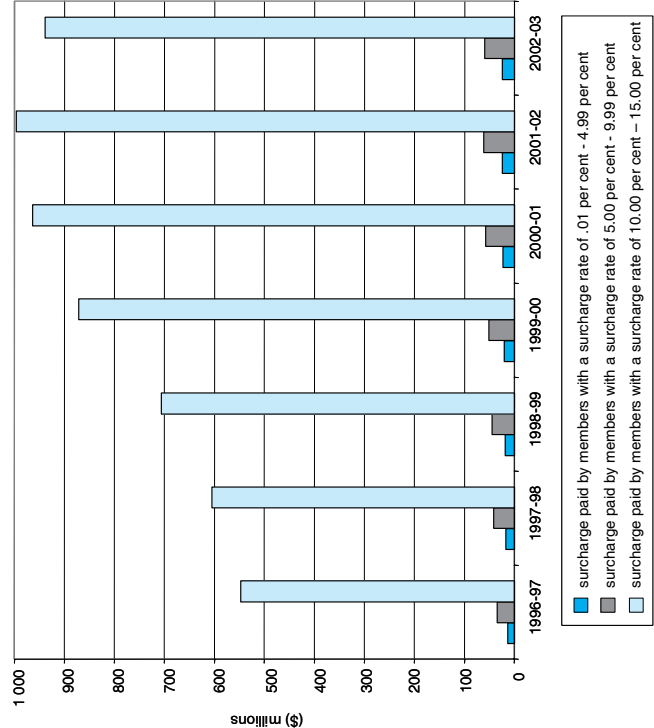
Source: ANAO analysis of SCS data

Diagram 2: stratification of members by Surcharge rate
1996-97—2002-03



Source: ANAO analysis of SCS data

Diagram 3: stratification of Surcharge amount by members' Surcharge rate 1996-97—2002-03



Source: ANAO analysis of SCS data

Analysis of the Figures above showed that:

- The average ATI of those subject to the Surcharge rose from \$98 846 to \$155 352 (57 per cent increase) between 1996–97 and 2002–03 (see Diagram 1).
- The average rate of Surcharge²¹⁶ applied to members in 2002–03 was 11.37 per cent. This indicates that the average member is being charged at close to the top Surcharge rate (15 per cent for 2002–03).²¹⁷ See Diagram 1.
- In 2002–03, 69 per cent of members were subject to a Surcharge rate of between 10 and 15 per cent. Ninety two per cent of Surcharge revenue is derived from these members. Conversely, members subject to a Surcharge rate of between 0.00001 and 4.99 per cent, account for only 18 per cent of the total surchargeable population. These members contribute 2 per cent of total Surcharge revenue. See Diagram 2 and Diagram 3.
- The proportion of members within each Surcharge rate category²¹⁸ has remained comparatively stable since 1996–97.

This analysis indicates that those members with the highest adjustable taxable income, have always contributed the highest proportion of Surcharge revenue (91 - 92 per cent). The analysis also indicates that the majority of the increase in Surcharge revenue has come from those members with the highest ATIs, and who are charged at close to the top Surcharge rate.

Eligible Termination Payments

A key concern of the Senate Select Committee on Superannuation (see Appendix 4) with regard to the Surcharge was the inclusion of eligible termination payments (ETPs) in Surcharge calculations. Non-Government Senators argued that the inclusion of ETPs in Surcharge calculations could potentially impact low and middle-income earners who receive a one off payment for leaving the workforce. Since that time there has been some criticism by stakeholders regarding the inclusion of all ETPs in Surcharge calculations.

²¹⁶ Which ranges between 0.00001 per cent and 15 per cent depending on the member's ATI.

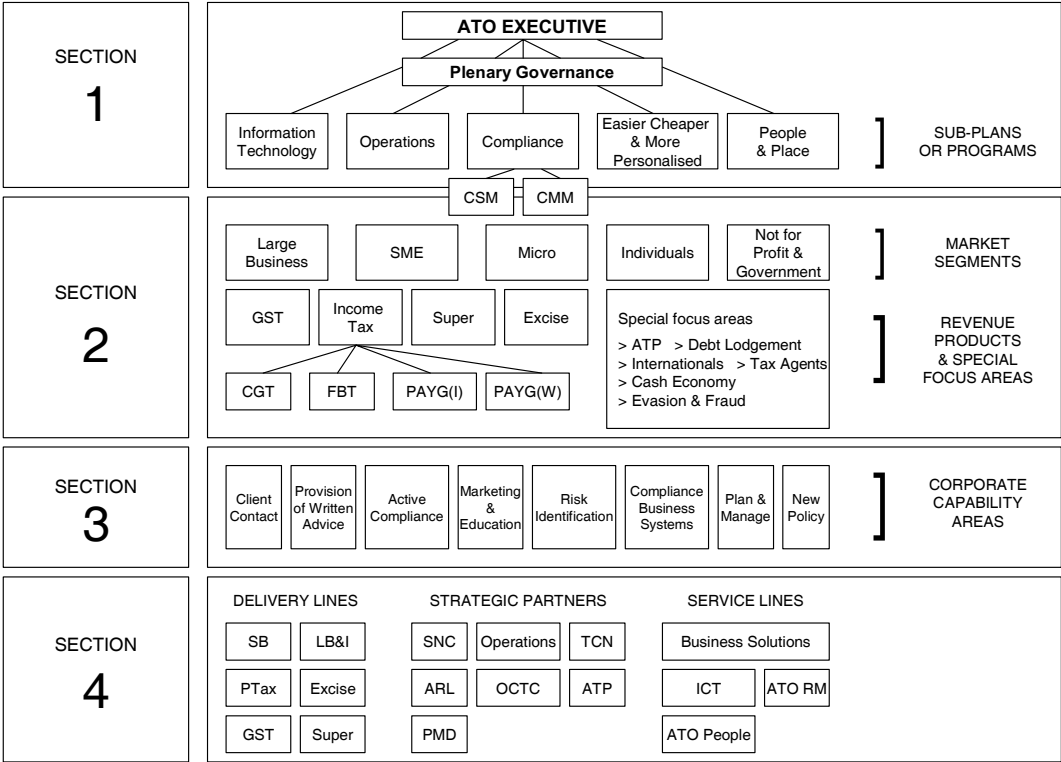
²¹⁷ The ANAO notes that under a 2004–05 Budget measure, in 2005–06, the top Surcharge rate will be 12.5 per cent. If Surcharge statistics remain stable, the average rate of Surcharge applied to applicable members will be the top rate. The Budget measure is discussed further in paragraph 1.28 and Chapter 2.

²¹⁸ The Surcharge rate categories are: 0.00001–4.99 per cent; 5–9.99 per cent; 10–15 per cent (for 1996–97 to 2002–03 only).

The ANAO analysed the information contained in ATO systems and found that between 1996–97 and 2003–04, approximately 115 000 members with ETPs were subject to the Surcharge. Of these members, approximately 54 000 (or 47 per cent) were not issued with a Surcharge liability assessment in the previous year.

This may indicate that up to 47 per cent of members receiving an ETP between 1996–97 and 2003–04, did not previously receive Surcharge liability assessments.

Appendix 7: ATO Governance arrangements



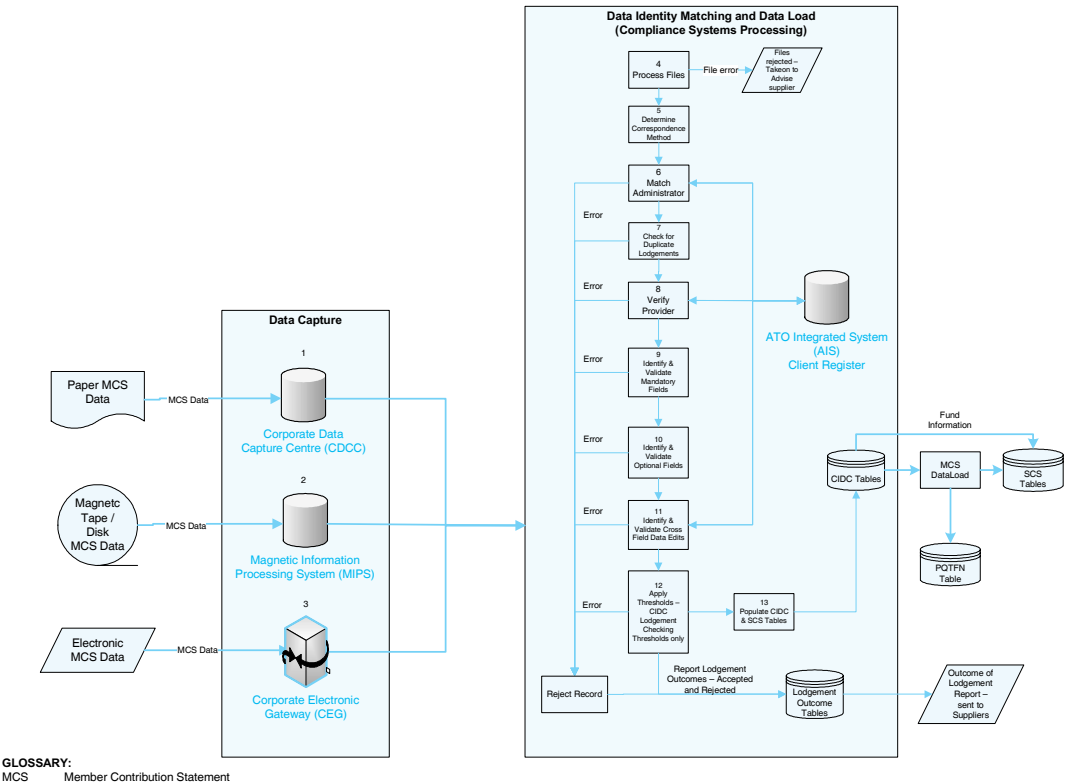
Source: ATO Superannuation Business Line

Appendix 8: ATO compliance reporting framework

| COMPLIANCE PLAN | A Strategy / Desired Outcomes | | | B Inputs & Outputs | | | |
|---------------------------|---|--|--|---|---|--|--|
| | <ul style="list-style-type: none">•Environment•Compliance Approach•Market Segments•Revenue Products•Focus Areas | | | <div>Capabilities / Sub-outputs</div> <ul style="list-style-type: none">•Resources•Measures•Workloads / Assumptions•Links with other plans | | | |
| REPORTS | Frequency | HOTSAs | Exceptions | Plenary | ERC | Annual | Heartbeat |
| | | Annually | Monthly | Quarterly | Annually | Annually | Monthly |
| | Reporting To | Market/Product/Focus Area Committees | BSLs | BSLs Capability Leaders | BSLs Market /Product/Focus Area Committees Capability Leaders | BSLs Market /Product/Focus Area Committees Capability Leaders | Capability Leaders SB |
| | Content | Report on the health Of the market Segment, revenue Product or focus areas Being reported on | Issue or risk that mean we may need to make a change to the Sub-Plan; Issues or risks that have cross line impacts and require BSL discussion; Performance against KPIs | Corporate Add-ons YTD performance against Sub plan One off reporting Integrity <i>Heartbeat report usually Used for plenary report</i> | Report against OPA with Outcomes / Outputs focus | ATO report to Government on Performance against Outcomes / Outputs | YTD performance against Compliance Capabilities: Marketing & Education Active Compliance Provision of Advice Client Contact Business Systems Plan & Manage YTD information on Operations: Debt Lodgement Refunds |
| | | | | | | | |
| | Input due to CPC | As per CSM program | Approx 15th month (confirmed at beginning of each month) | Approx 10 days before meeting | | | 2 weeks before meeting |
| Final Report due From CPC | | Wednesday before ATO Exec mtg | 1 week before meeting | | | 1 week before meeting | |
| BSL PLANS | A Strategy / Desired Outcomes | | | B Inputs & Outputs | | | |
| | <ul style="list-style-type: none">•Same as for Compliance plan but line level•Where an approach to a market or product is outlined in the plan the Relevant committee needs to endorse this part of the plan | | | <ul style="list-style-type: none">•Same as for Compliance plan but line level•Where an approach to a market or product is outlined in the plan the relevant committee needs to endorse this part of the plan | | | |

Source: ATO Superannuation Business Line

Appendix 9: Surcharge data capture and identity matching



GLOSSARY:
MCS Member Contribution Statement

Source: ANAO analysis of ATO information

Appendix 10: Surcharge assessment run (data processing)

The Surcharge assessment run (the assessment run) is a term used by the ATO to refer to a group of data processing functions, which are used to calculate a member's liability for the Surcharge. These data processing functions include the capture and processing of Surcharge contributions data, which are obtained from a number of relevant Surcharge forms (such as MCSs).

The Surcharge contributions data form contains all the information required to be reported by a provider for the financial year for which the report is being given, to enable the Commissioner to calculate the Surcharge liability of the holder of the contributions (the provider or the individual). Details provided in an Surcharge contributions data form include:

- who has supplied the contributions information;
- the superannuation provider where a member's contributions are held;
- members for whom contributions are being reported; and
- member contribution amounts.

The assessment run is a six-week process that occurs four times per calendar year on the following dates:

- 15th February;
- 15th May;
- 15th August; and
- 15th November.

The assessment run is highly complex, consisting of both manual and automated processes. Refer to the diagram below for an overview and description of the assessment run.

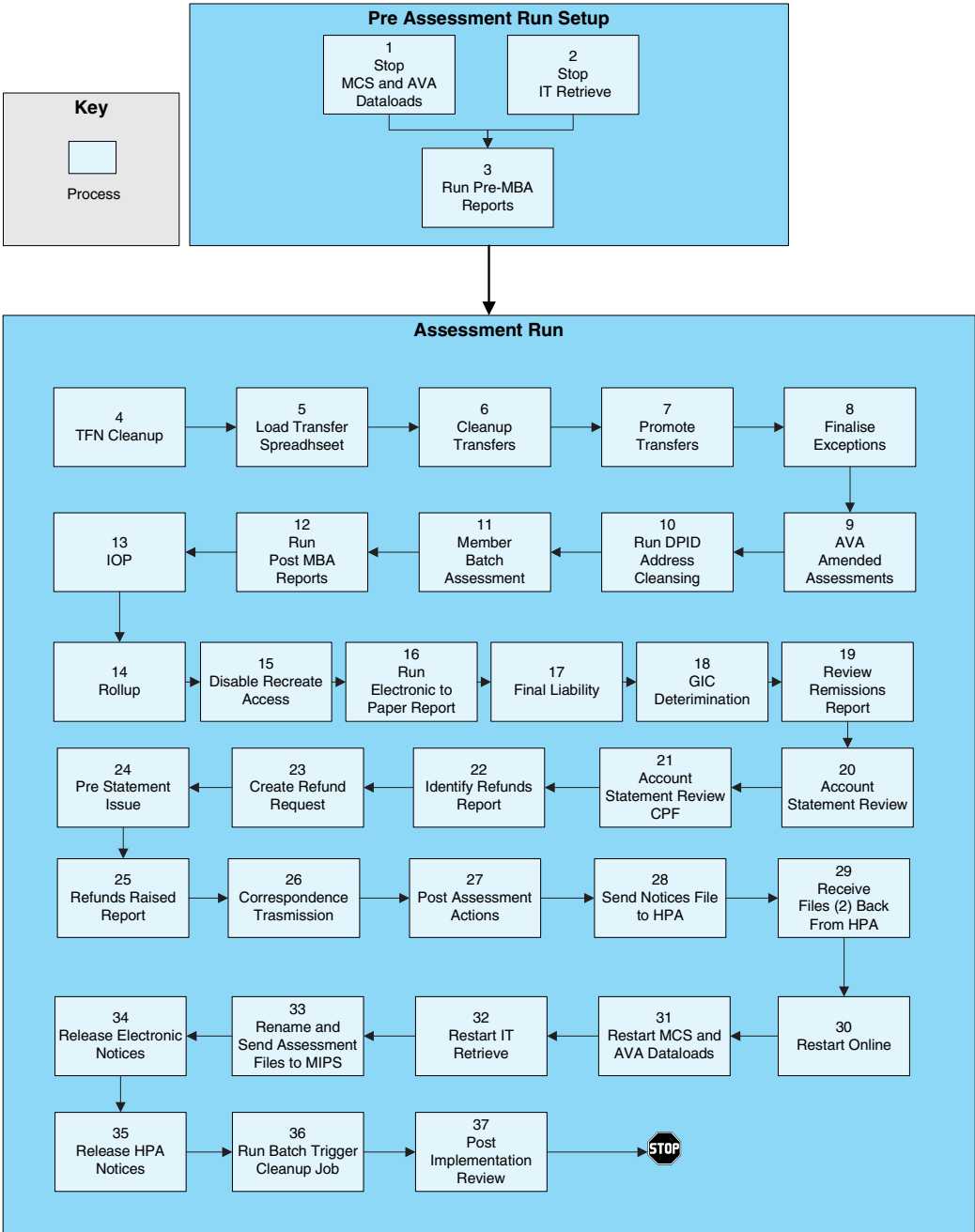
The complexity, duration and success of the assessment run is dependent upon, and often adversely affected by, the quality of the data provided in the Surcharge contributions data form.

The ATO was unable to provide the ANAO with a complete set of accurate procedural documentation outlining to staff how the assessment run functions at an operational level, and how to carry out the tasks, both manual and automated, required to complete the assessment run.

The ANAO found that the assessment run has developed into a process that is dependent upon the knowledge and management of the SCS IT systems section.

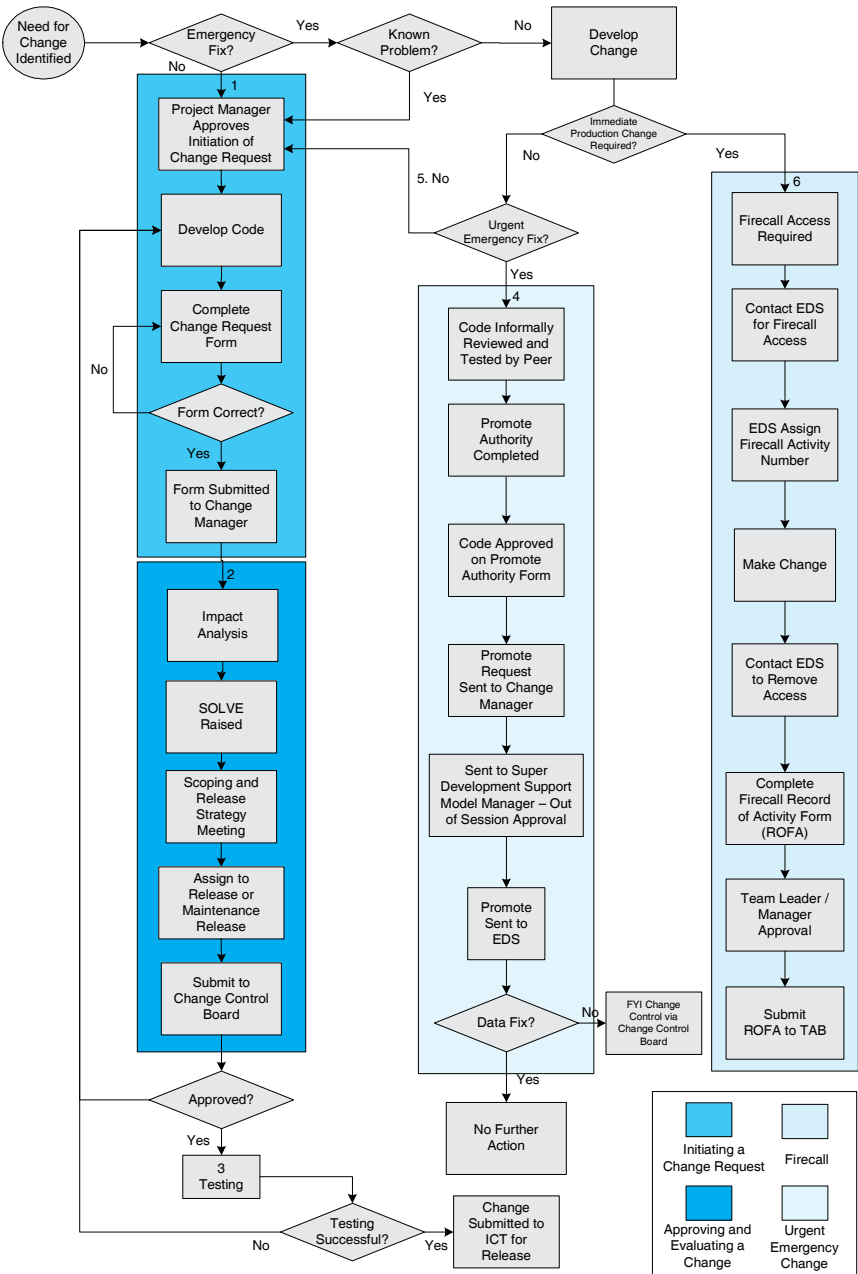
The ANAO concluded that, if key IT systems staff were to leave the ATO, the ATO would not be able easily to process Surcharge contributions data form data and assess members' liability for the Surcharge.

Surcharge assessment run



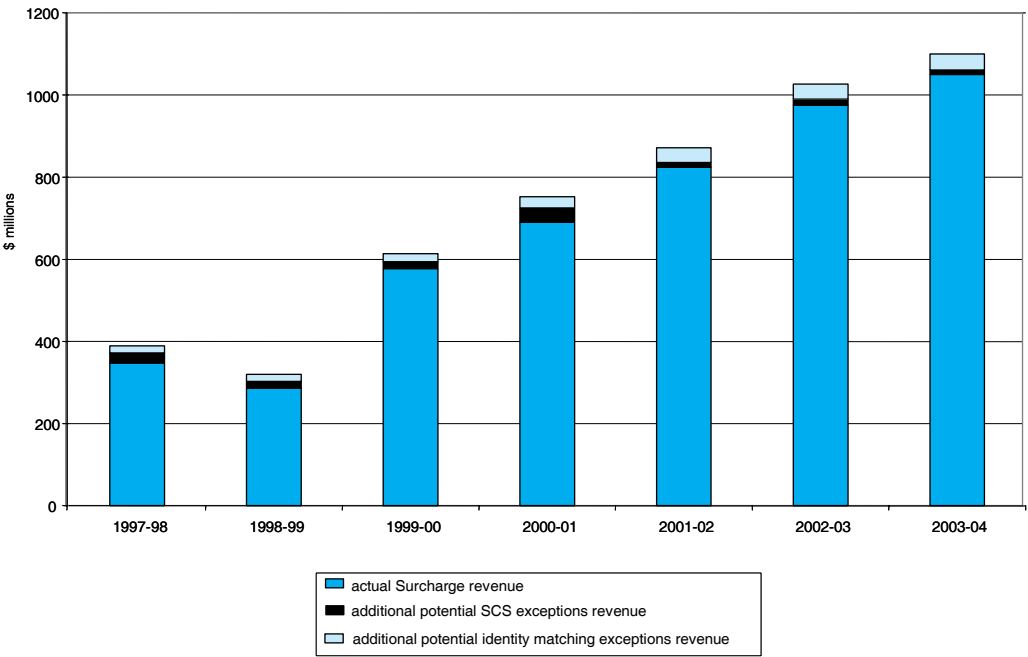
Source: ANAO analysis of ATO information

Appendix 11: Superannuation Contributions Surcharge system change management process



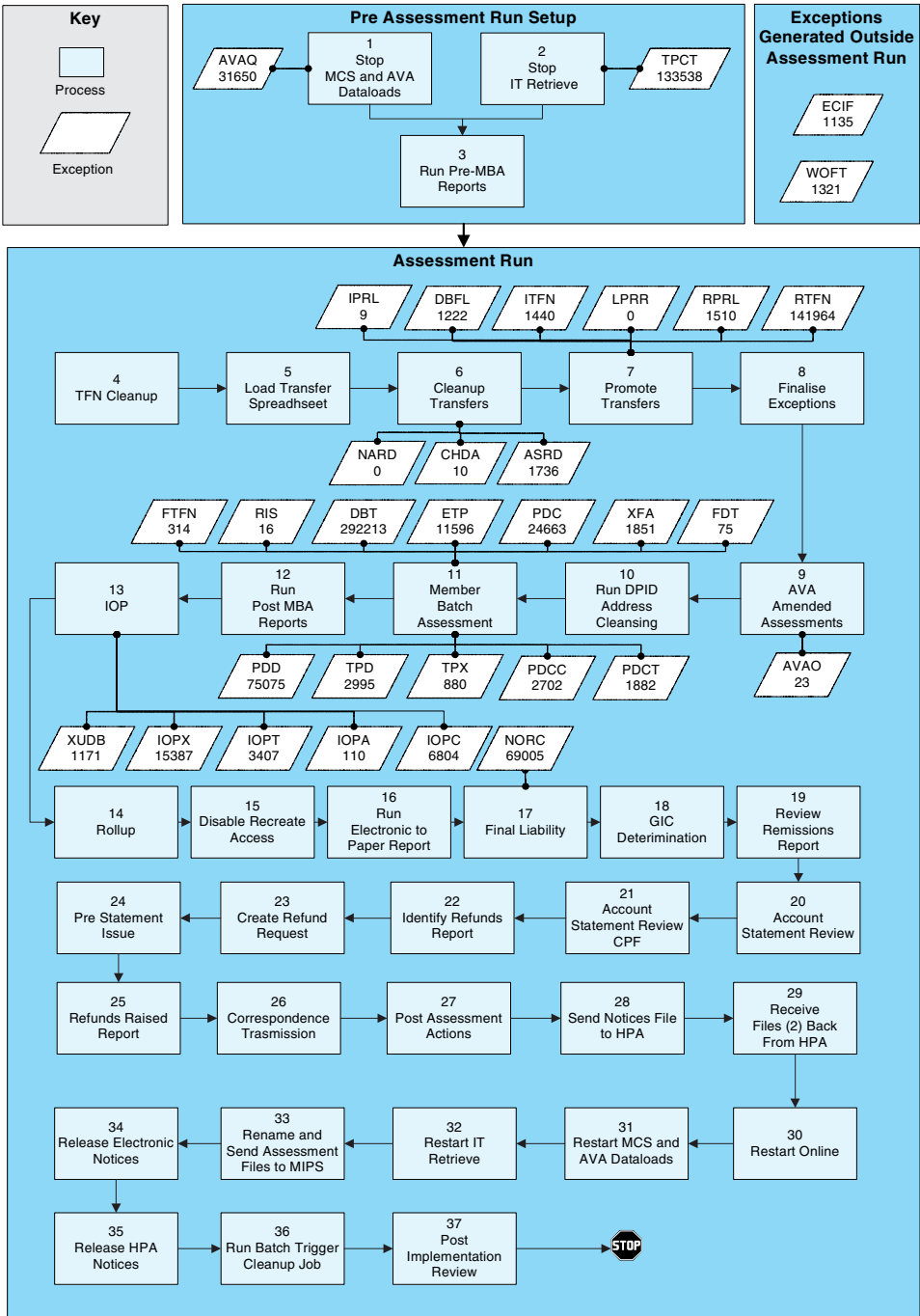
Source: ANAO analysis of ATO information

Appendix 12: ATO estimate of Surcharge exceptions revenue compared to Surcharge revenue collections



Source: ATO Superannuation Business Line

Appendix 13: SCS exception creation points



Source: ANAO analysis of ATO data (as at 9 August 2004)

For a description of the exceptions in the flow diagram above, see Appendix 13.

Appendix 14: SCS exception categories

Fatal / semi-fatal SCS exceptions (exceptions that prevent Surcharge assessments)

| ATO Classification | Exception Code | Description |
|--------------------|----------------|---|
| Fatal | DBT | The holders MCS contains inadequate details to match membership records to a high degree with existing member/membership information on the SCS system. This has resulted in the <i>Doubtful TFN</i> indicator for the member being turned on. As a result all future membership records received for the member cannot be processed by the SCS system. |
| | RIS | The member does not have a current Income Tax role. As a result the ATO cannot make a Surcharge assessment. |
| Semi-Fatal | ITFN | A transfer could not be promoted, as the member's TFN is not present. |
| | RPRL | A rollover-related transfer could not be promoted, as the payer role for the receiving holder's TFN is not present. |
| | RTFN | A rollover-related transfer could not be promoted, as the receiving holder's TFN is not present. |
| | AVAQ | Following reporting by Holder A that the member's contributions have been transferred to Holder B, Holder B has reported on an AVA that the member is unknown. |
| | DBFL | A transfer could not be promoted as the member's record has a Doubtful TFN indicator set to Y. This has resulted from MCS/AVA details failing to adequately match existing member/membership details on the SCS system. |
| | ETP | The member record has a Possible Employer ETP indicator of Y and the adjusted taxable income amount cannot be established due to the absence of payment dates. |
| | PDC | The personal deducted contributions claimed on the member's Income Tax Return cannot be apportioned to the member's memberships. |
| | XFA | The contributions amount reported by a holder as transferred out exceeds the amount of contributions the holder holds or held. |
| | FDT | Based on available information, the employment finish date relating to an ETP appears to be in the future. |
| | TDP | The member record has a Possible Employer ETP indicator of Y, an employer ETP type and pre and / or post July 83 service days and / or surchargeable amount and / or payment dates are missing. |
| | TPX | The member record has a Possible Employer ETP indicator of Y but the type of ETP has not been established. |

| ATO Classification | Exception Code | Description |
|--------------------|----------------|---|
| | PDCT | PDC amount on member's Income Tax Return cannot be apportioned to the Member's distributions. |
| | NORC | Final liability could not be calculated for the member as a Constitutionally Protected Fund has not previously reported any contributions information to the ATO. |
| | WOFT | Exception code created as a result of the Wind-up of Funds project |

Source: ATO Superannuation Business Line

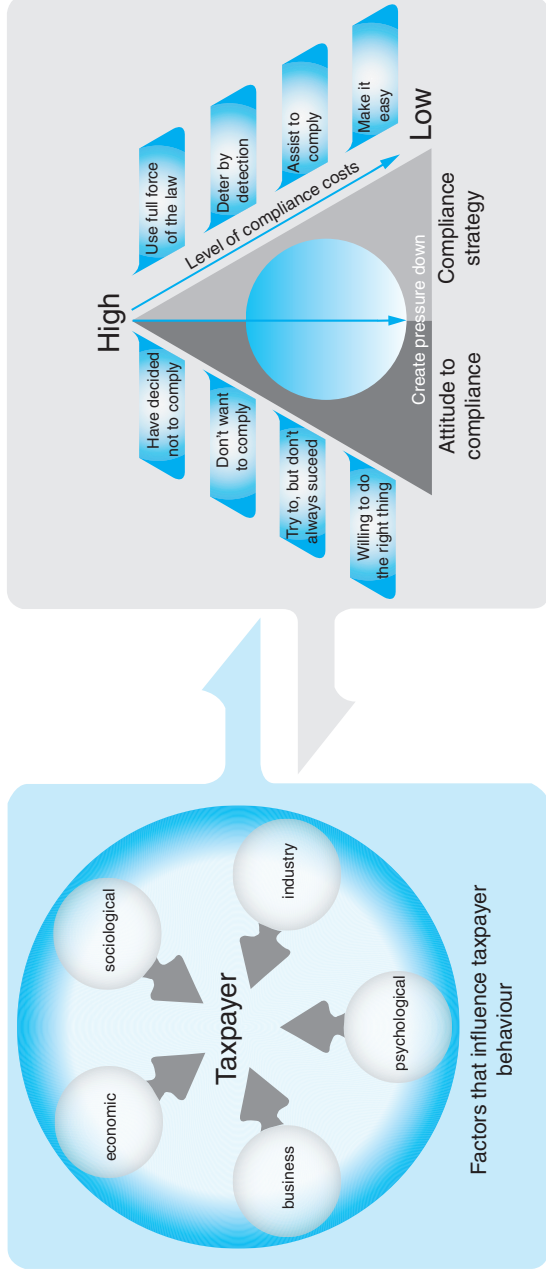
Informative SCS exceptions (exceptions that do not prevent Surcharge assessments)

| Exception Code | Description |
|----------------|---|
| ASRD | The creation of a zero contribution record on an assessed transfer membership caused the end dating of the distribution record. |
| ECIF | File not downloaded by client from ECI System. |
| FTFN | Assessment issued to source provider after full transfer and changed TFN. |
| PDCC | Exception generated due to compliance reasons. I.e. inconsistencies between what is on the MCS for the member and what is on their Income Tax Return. |
| PDD | The personal deducted contributions claimed on the member's Income Tax Return are over \$999 more than the sum of the member's personal contributions reported on their MCS. |
| AVAO | An AVA has been loaded for an assessment against which a subsequent amended assessment has already been issued. |
| CHDA | The creation of a new contribution record on a transfer membership caused the end dating of the distribution record. |
| TPCT | The TPCT is introduced to inform the user that an ETP type has been reported incorrectly and the Type has been altered in accordance with the data that was provided in the ETP. |
| XUDB | Interest could not automatically be calculated for a member due to a transfer of contributions from an Unfunded Defined Benefit (UDB) holder to a non-UDB holder. |
| IOPX | Following the re-issue of a credit amended Surcharge assessment, interest could not automatically be apportioned across previously issued original and amended debit Surcharge assessments (DR-DR-CR case). |
| IOPT | Due to one or more subsequent transfers of the same contributions, interest could not be automatically apportioned. |
| IOPA | Interest payment was made to a provider on an amended assessment after contributions had been transferred out. |
| IOPC | A credit assessment has been issued for a Constitutionally Protected Fund member. |

Source: ATO Superannuation Business Line

Appendix 15: ATO Compliance Model

The Compliance Model is a structured way of helping the ATO to understand the factors that influence different compliance behaviour. It enables the ATO to choose the most appropriate intervention for the circumstances.

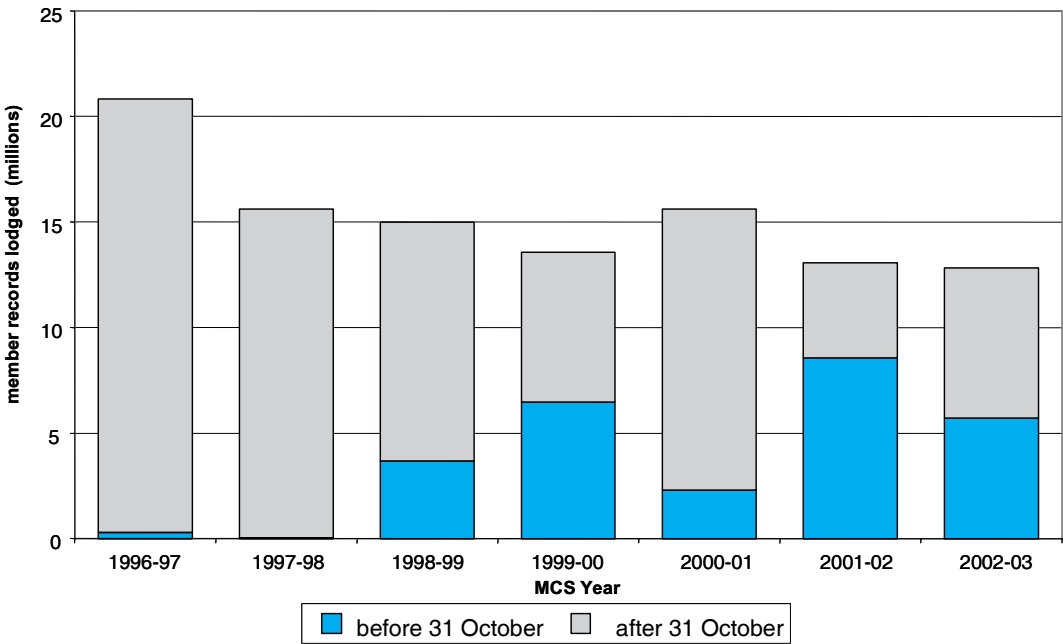


Source: ATO Compliance Program

The Compliance Model posits that the majority of taxpayers comply voluntarily with their tax obligations, with no need for ATO intervention. Others will not comply in the first instance but will, if prompted further. A smaller proportion will not comply voluntarily and may need enforcement action.

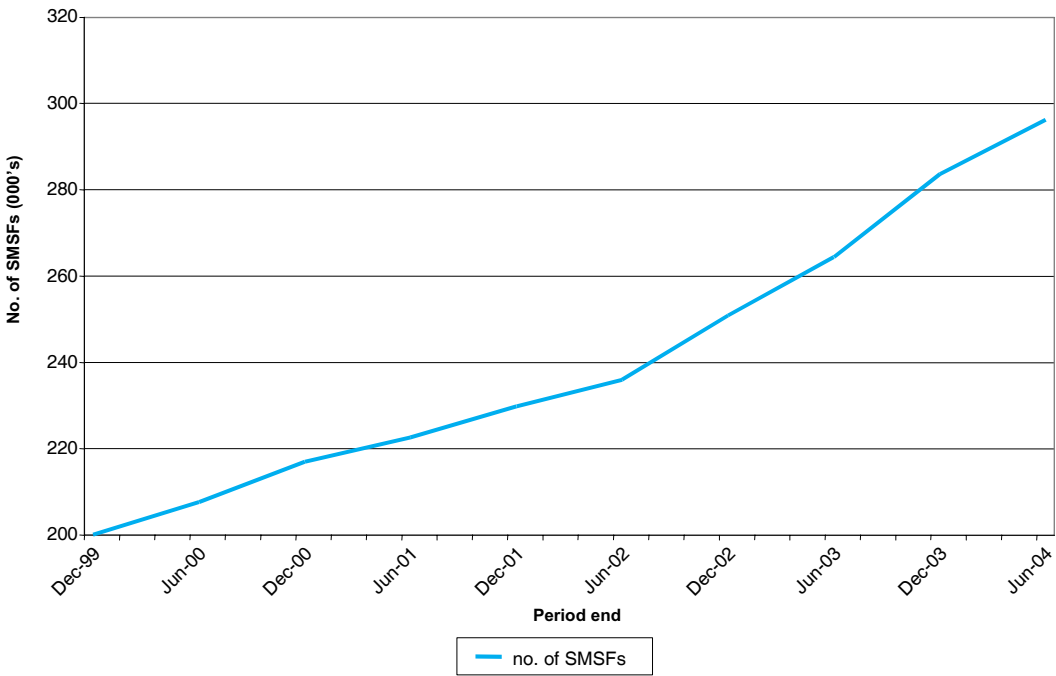
Appendix 16: MCS lodgement statistics for member records

MCS Lodgements—Member Records



Source: ANAO analysis of ATO information

Appendix 17: Growth in SMSFs since being regulated by the ATO



Source: ANAO analysis of ATO information

Index

A

adjusted taxable income, 7, 13, 34-35, 40, 120, 123, 161-163, 171, 173, 183
Australian Government Solicitor (AGS), 7, 20, 36, 116-119, 121
Australian Prudential Regulation Authority (APRA), 7, 19, 27, 34, 125-128, 134-135, 138, 140-143, 168

D

data quality, 71-72, 143
default assessment, 8-9, 17, 27, 36, 47, 49-50, 76, 99-100, 102-103, 106-108, 119-121

E

emergency information technology fixes, 84, 88-90, 95

F

firecall, 8, 17, 26, 60, 90-95

H

Holders of Superannuation Contributions (Holders), 8, 13, 19-20, 35-36, 48, 55, 71, 73, 75, 99-100, 102, 112-114, 117, 120, 122, 124-126, 128, 130, 133, 136, 138, 142, 163, 178, 183, 184

I

Identity matching exceptions, 8-9, 48, 50, 58-59, 65, 98-99, 100-105, 108, 115, 117, 119-121

K

Key Client Group, 122, 132-133, 135-136, 138-139

L

Large and Medium Fund Group, 138-139

M

Member Contributions Statement (MCS), 7-9, 13, 18, 35-36, 42, 48-49, 68, 98-102, 109-110, 112-115, 117, 122-129, 133, 135-139, 142-144, 162, 168, 183-184, 186

Members of Superannuation Provider (Members), 7-9, 13, 15, 19, 20, 27, 33-40, 47-49, 55, 68, 70, 72-73, 85, 92, 95, 97-100, 102-104, 108, 110, 112-114, 116-137, 140, 144, 161-163, 173, 178, 183-184, 186

P

Please Quote Tax File Number (PQTFN) letter, 9, 17, 47, 49-50, 76, 100, 102-108, 117, 119-120, 131

S

Self Managed Superannuation Fund (SMSF), 7, 34, 41, 58-59, 125, 127, 129, 135, 140-144, 168, 187

Senate Select Committee on Superannuation, 169, 173

Small Fund Group, 18, 122, 133, 135, 140, 142-143

Superannuation Business Line, 16-17,
22, 24, 28-29, 34, 41, 43, 47, 52,
54-57, 59, 61-62, 64, 67-69, 73, 74,
83-84, 86, 88, 90-100, 104-105, 106,
123, 130-132, 138, 142, 144-146,
167-168, 175-176, 181, 184

Superannuation Contributions

Surcharge (SCS) exceptions, 9, 18,
27, 48-51, 71, 76, 98, 100, 109-116,
183-184

Superannuation Contributions

Surcharge (SCS) system, 8-9, 15,
24-27, 37-38, 44, 47-48, 59-61, 70,
72, 75-77, 79-83, 90, 95-96, 98-101,
104, 109, 111-112, 114, 116-117,
120, 129, 136, 137, 167, 168, 180,
183

Surcharge assessment process, 69-71,
75, 100

Surcharge assessment run, 9, 24,
75-80, 82, 84, 96, 115, 136, 178-179

Surcharge compliance framework,
18-20, 28, 122-123, 132-133

Surcharge exceptions, 14-15, 17-18,
20, 41-42, 47-49, 51, 59, 67, 97-98,
100, 109, 114-117, 120, 129, 181

Surcharge Governance, 13, 15-16, 19,
22, 41-42, 45, 51-53, 57, 64, 75,
132, 175

surchargeable contributions, 8, 13, 35,
100, 104, 124, 162-163

system specifications, 16, 25, 81-82,
84-85, 88, 95

T

The Treasury, 39, 44, 46, 163

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