

The Auditor-General  
Audit Report No.13 2005-06  
Performance Audit

**Administration of Goods and Services Tax  
Compliance in the Large Business Market Segment**

**Australian Taxation Office**

Australian National Audit Office

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of Australia 2005

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Canberra ACT  
18 October 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*. I present the report of this audit and the accompanying brochure to the Parliament. The report is titled *Administration of Goods and Services Tax Compliance in the Large Business Market Segment*.

Following its tabling in Parliament, 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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# Abbreviations

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ABN	Australian Business Number
ANAO	Australian National Audit Office
ATO	Australian Taxation Office
BAS	Business Activity Statement
BMG	Business Management Group
CAP North	Client Assurance Program North
CAP South	Client Assurance Program South
CCAA	Cooperative Compliance Advance Agreement
CCM	Cooperative Compliance Model
CoE	Centre of Expertise
CRM	Client Relationship Manager
FS&I	Financial Supplies and Insurance Assurance Program
FTE	Full Time Equivalent
GIC	General Interest Charge
GST	Goods and Services Tax
GST Performance Agreement	<i>Goods and Services Tax Administration Performance Agreement between the Australian Taxation Office and States and Territories</i>
HOTSA	Health of the System Assessment
ILEC	Interpretation and Large Enterprise Compliance
LB&I	Large Business and International

LCCP	Large Corporate Compliance Program
OECD	Organisation for Economic Co-operation and Development
PBR	Private Binding Ruling
Prop. And Cons	Property and Construction Assurance Program
Res. And Energy	Resources and Energy Assurance Program
RMT	Risk Management Team
RRE	Risk Rating Engine
SME	Small to Medium Enterprise
SRS	Strategic Reporting System
TICE	Technology, Information, Communication and Events Assurance Program
TQR	Technical Quality Review

# Summary and Recommendations



# Summary

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## Background and Context (Chapter 1)

1. The Goods and Services Tax (GST) came into effect in Australia on 1 July 2000. The GST is an indirect, broad-based, consumption tax of 10 per cent, levied on most goods and services in Australia. The GST is governed by the *A New Tax System (Goods and Services Tax) Act 1999*.
2. The Australian Taxation Office (ATO) is responsible for the collection of GST. Administration of the GST is outlined in the *GST Administration Performance Agreement between the Australian Taxation Office and the States and Territories* (GST Performance Agreement). The outcome to be achieved under the GST Performance Agreement is *to collect GST revenue effectively through maintaining compliance and a cost-effective GST administration*.<sup>1</sup> The ATO's GST Line is the primary provider of services for this outcome. Within the GST Line, the Interpretation and Large Enterprise Compliance Business Unit (ILEC) is responsible for managing GST compliance in the large business market segment.<sup>2</sup>

### Large business market segment

3. The ATO defines the large business market segment as consisting of businesses with a turnover of \$100 million or more. The GST large business market segment consists of approximately 1 000 large economic groups. These represent a total of approximately 18 000 business entities and 6 000 Business Activity Statement (BAS) lodgers. The large business market segment makes a major contribution to Australia's revenue through the tax system.
4. Between 2002–2003 and 2004–2005 large business GST revenue collections were approximately \$56.9 billion. This accounted for more than half of the GST collected. Figure 1 depicts total GST revenue collected by the ATO between 2002–2003 and 2004–2005 and the GST large business market segments' contribution. In 2004–2005, the ATO also raised approximately

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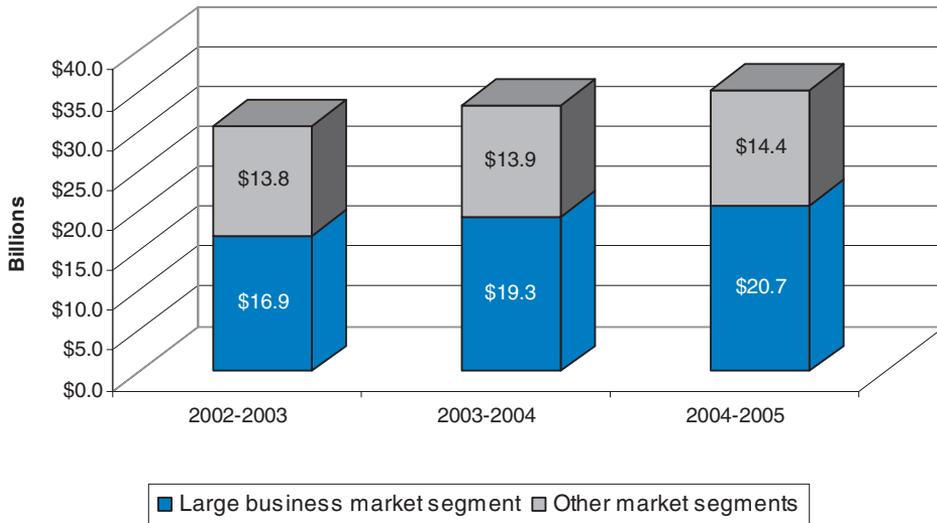
<sup>1</sup> *GST Administration Performance Agreement between the Australian Taxation Office and the States and Territories*, Part 3, clause 10.

<sup>2</sup> The Large Business and International, Business Line (LB&I) is responsible for managing income taxation compliance in the large market segment. LB&I has a similar client base to ILEC, however, differences occur in respect of the grouping and structural arrangement of business entities for GST and income taxation purposes. Different consolidation rules apply to businesses for GST and income taxation purposes.

\$425 million in additional GST and related penalties from large businesses. The additional GST is attributed to the ATO's active compliance, audit and verification activities. This result represented a 25 per cent increase in the value of GST adjustments made in 2003–2004.

**Figure 1**

**GST revenue collections 2002–2003 to 2004–2005**



Source: Australian Taxation Office (data based on per cent market share of total GST cash collections)

### Interpretation and Large Enterprise Compliance Business Unit

5. To support the administration of GST compliance in the large business market segment, ILEC has been divided into five assurance programs. Each of the assurance programs is responsible for a range of clients grouped by industry, geographic location, or risk profile. In late 2004–2005 ILEC revised its assurance program structure.<sup>3</sup>

6. In addition to managing GST compliance in the large business market segment, ILEC also has a shared responsibility for managing aspects of GST compliance in the small to medium enterprise and micro markets. For example, the Aggressive Tax Planning, and Financial Supplies and Insurance assurance programs reside within ILEC, but have a whole of GST, cross-market scope.

<sup>3</sup> ILEC's assurance programs as outlined in its 2005–2006 Business Plan are: Financial Supplies and Insurance; Aggressive Tax Planning; Client Assurance Program North/Technology, Information, Communication, and Events; Client Assurance Program South/Resources and Energy; and Property and Construction.

## Recent reviews and initiatives

7. Aspects of the ATO's administration of GST compliance in the large business market segment have been considered in the conduct of several recent reviews. These have included reviews by the Inspector-General of Taxation and the ATO's review of its GST Large Corporate Compliance Program (LCCP Review).

## Audit objective and scope

8. The objective of the audit was to assess the administrative effectiveness of the ATO's management of GST compliance in the large business market segment. In conducting the audit the ANAO examined three key areas:

- governance – ILEC's corporate planning and reporting arrangements relevant to the management of GST compliance in the large business market segment;
- assessing and identifying compliance risks – how ILEC collects information relating to the large business market segment and how it uses this information to support risk identification and assessment; and
- managing compliance – compliance planning and the products and processes used by ILEC to manage GST compliance in the large business market segment and evaluating compliance outcomes to support future compliance planning and the targeting of GST compliance risks.

In undertaking the audit, the ANAO took account of the findings of previous reviews, in particular the LCCP Review.

## Aspects of Governance (Chapter 2)

9. Good governance includes a broad range of activities that assist an organisation achieve its corporate and business goals. As part of this audit the ANAO examined whether ILEC's governance arrangements support the management of GST compliance in the large business market segment. In carrying out this examination, the ANAO reviewed ILEC's planning framework and the monitoring and reporting of its performance.

## Planning framework

10. The ANAO found that ILEC's plans are generally aligned with the ATO's higher level planning documents.<sup>4</sup> However, including the GST Performance Agreement outcome measures in the ILEC Business Plan for 2005–2006 and future years would assist the ILEC Executive in assessing the Business Unit's overall performance. The ANAO considers that ILEC should more clearly specify its output targets including the number of audits to be completed, the number of industry partnership meetings expected to be held and direct client contact made by client relationship managers.

11. The ANAO observed that ILEC's 2005–2006 Business Plan clearly documents identified GST compliance risks in the large business market segment, outlines proposed mitigation strategies (the mix and number of compliance activities to be completed) and performance measures. The performance measures include the GST Performance Agreement outcome measures. The ANAO found that ILEC's 2005–2006 Business Plan provides clear direction to the Assurance Programs, which are responsible for completing audits and other compliance activities.

## Monitoring and reporting performance

12. The ANAO found that overall, the monitoring and reporting of ILEC's performance was sound. Reporting on ILEC's performance occurs at various levels. To support more informed management decision-making and resource allocation, the ANAO considers that the content of some of the reports could be better aligned with ILEC's planned outputs. The monitoring and reporting of ILEC's performance would be enhanced if ILEC:

- reviewed its existing performance measures and developed a standard set of measures to be applied across the Business Unit. These measures should focus on assessing a combination of activity, revenue and the effectiveness of ILEC's compliance strategies in treating potential GST compliance risks in the large business market segment;
- assessed its performance consistently across the Business Unit, by applying a sub-set of aligned performance measures at the assurance program level; and

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<sup>4</sup> As part of the audit the ANAO reviewed ATO planning documents relating to 2004–2005.

- streamlined current reporting arrangements with a view to providing relevant, accurate and timely information to the ILEC Executive.
13. ILEC advised the ANAO that as part of its business planning process for 2005–2006, it has aligned its risks and risk mitigation strategies with its outputs. ILEC also advised that a new set of management reports is being developed. These reports will support monthly reporting on each of its outputs to the ILEC Executive. The assurance programs' business plans are also to articulate the same performance measures as the ILEC Business Plan.

### Compliance Risk (Chapter 3)

14. The ATO's Business Model states that it uses a risk management approach to verify tax compliance. The ATO aims to optimise revenue collections through responding to changing circumstances and managing compliance risks. In doing so the ATO aims to make informed choices about how it uses its resources.

15. Compliance risk management is *a structured process for the systematic identification, assessment, ranking and treatment of tax compliance risks*.<sup>5</sup> Compliance risk management in the ATO takes place within the context of ATO-wide risk management. The ANAO reviewed the ATO's broader framework for managing compliance risks, including recent developments in this area. In particular, the ANAO reviewed the first four processes in the ATO's compliance risk management model. These processes are: establishing the operating context, identifying compliance risks, assessing and prioritising compliance risks and analysing compliance behaviour.

16. Compliance risk management within the ATO is an evolving process. The ANAO found that both the ATO as an organisation and ILEC as a Business Unit, are continually improving their risk management activities. In response to the LCCP Review recommendations, the GST Line has implemented a GST Risk Management Framework. ILEC advised that the GST Risk Management Framework replaced the existing risk management structure and processes within ILEC and focuses on risk from a whole of GST perspective. The ANAO did not audit the GST Risk Management Framework, as it was implemented from July 2005.

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<sup>5</sup> Organisation for Economic Co-Operation and Development, 2004. *Compliance Risk Management: Managing and Improving Tax Compliance*. Centre for Tax Policy and Administration Guidance Note. p. 8.

## **Establishing the operating context**

17. The ANAO observed that the ATO uses segmentation to understand its operating environment and facilitate management of compliance risks. Segmentation sorts businesses into different groups and sub groups with similar features in order to better understand common behaviours. The ATO's segmentation at a high level includes market segments, tax issues<sup>6</sup> and industries, while lower level segmentation relates to economic groups, business entities and transactions. The OECD recommends the use of segmentation as good practice.

18. The ANAO found that several business areas within the ATO have profiled large business market segment clients and undertaken environmental scanning for the large business market segment. Environmental scanning supports the identification of changes in the large market segment that may impact on tax compliance.

19. To support a more coordinated approach and the systematic sharing of information and intelligence, the ANAO considered that the responsibilities and timeframes for undertaking large business profiling and environmental scanning could be more clearly defined. To achieve this, the ATO should determine who is responsible for completing these activities, the frequency with which risk information should be formally reported and to whom this information should be reported. ILEC advised that implementation of the GST Risk Management Framework should provide further clarity on the sharing of risks and intelligence across the whole of GST and with other ATO business and service lines.

## **Compliance risk identification**

20. The ANAO found that at the time of undertaking fieldwork, ILEC had focused on identifying operational level risks, as opposed to systematically identifying GST compliance risks across the large business market segment. The LCCP Review outlined similar findings.

21. The ANAO considers that to improve risk identification, ILEC should establish a clear structure for categorising compliance risks and document the requirements for undertaking risk identification activities at each segmentation level. Developing standard tools or techniques for systematically identifying

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<sup>6</sup> Tax issues are specific tax matters that may relate to a cross section of a market segment, for example, GST aggressive tax planning.

GST compliance risks would also be a sound initiative. The ANAO further considers that ILEC should periodically review the risks that have previously been recorded. This is to ensure that all relevant GST compliance risks in the large business market segment have been recorded and that the information recorded is up to date and complete. The ANAO notes that this issue is expected to be addressed as part of the GST Risk Management Framework.

### **Assessing and prioritising compliance risks**

22. During audit fieldwork, the ANAO found that ILEC did not have adequate processes in place for prioritising and/or ranking compliance risks within or across the assurance programs. However, ILEC has subsequently initiated processes for assessing, prioritising and ranking GST compliance risks across the large business market segment.

23. The ANAO noted that a number of the GST compliance risks identified as part of ILEC's business planning process are articulated in the ATO's published Compliance Program for 2005–2006. The Compliance Program states that the ATO's major GST compliance focus in the large market for 2005–2006, relates to the following focus areas: margin scheme property valuations, GST aggressive tax planning, Division 129 transactions, securitisation, GST international issues, the motor vehicle industry, security deposits, GST consolidations and the integrity of business systems.<sup>7</sup>

24. The ANAO considers that in addition to implementing an annual process for risk analysis at the large business market segment level, ILEC should also ensure it has processes in place for analysing and prioritising emerging risks. This analysis and prioritisation should occur both within the assurance programs and at the whole of large business market segment level. The ANAO was advised in June 2005 that the Business Management Group<sup>8</sup> has implemented a process for reviewing and analysing emerging risks. These risks are to be rated using the ATO Risk Matrix, from a GST large business market segment perspective.

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<sup>7</sup> Paragraph 3.37 outlines in more detail the GST large market focus areas identified in the ATO's Compliance Program for 2005–2006.

<sup>8</sup> The Business Management Group (BMG) is an operational decision making body whose primary role is to support the ILEC Executive by focusing on the management of operational issues that affect ILEC.

## Analysis of compliance behaviour

25. The analysis of compliance behaviour supports the development of appropriate compliance risk treatment strategies. The ANAO noted that ILEC uses the BISEPS<sup>9</sup> model to understand drivers of compliance behaviour. The LCCP Review found that this model is underutilised by ILEC. The ANAO supports the Review sub recommendation that ILEC *fully adopt the BISEPS principles* when analysing behaviour that creates compliance risks.

## Managing Compliance (Chapter 4)

26. Australia's GST system relies on self-assessment, where taxpayers are required to assess their liabilities under the law and pay the correct amount of taxation. The system of self-assessment has inherent risks, which the ATO aims to manage through its compliance program of education and enforcement activities. As part of this audit, the ANAO examined ILEC's approach to managing GST compliance in the large business market segment.

### ILEC's compliance planning

27. The ANAO found that ILEC, through its business planning process, aims to identify compliance risks and determine the mix of activities required to treat identified risks. As noted earlier, the ANAO also found ILEC had focused on identifying GST compliance risks at the economic group, entity and transactions levels. This limited ILEC's ability to methodically plan for the treatment of its highest-level GST compliance risks through its business planning processes. The ANAO considers that by more closely integrating risk management and compliance planning processes, ILEC could better target its highest-level compliance risks. ILEC advised that for 2005–2006 it has implemented a revised planning framework through which it has identified, assessed and ranked its highest-level compliance risks.

### Compliance products and processes

28. The ANAO considers that overall, ILEC's compliance products and processes for managing GST compliance in the large business market segment are sound. The ANAO found that ILEC had developed and implemented a range of compliance products and processes. These include education and

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<sup>9</sup> The BISEPS model is defined as: (B) business, (I) industry, (S) sociology, (E) economy, (P) psychology and (S) systems. These are considered to be broad areas, which reflect the fact that taxpayer compliance decisions are affected by a wide set of related factors.

advice products, such as GST fact sheets and GST public rulings, through to active compliance audit products. Application of these products was outlined in the ATO's Compliance Program and ILEC's Business Plan. ILEC's compliance program covered a broad range of activities, but largely focused on active compliance (audit and verification) activities. These are activities that would generally result in an adjustment to the GST payable. Table 1 outlines the outcomes of the ATO's GST active compliance program in the large business market segment between 2002–2003 and 2004–2005. The total value of GST adjustments from all active compliance activities in the large business market segment is also detailed.

**Table 1**

**Details of completed GST audit and verification activities in the large business market segment 2002–2003 to 2004–2005**

Details	2002–2003 <sup>1</sup>	2003–2004	2004–2005
Audits planned (ATO's Compliance Program) <sup>2</sup>	1 023	1 430	1 200
Audits completed <sup>2</sup>	934	1 314	1 203
Net value of adjustments arising from audits <sup>2</sup>	\$239 million	\$315 million	\$381 million
Number of cases completed by ILEC	-	3 231	2 330
Net value of adjustments made by ILEC	-	\$279 million	\$343 million
Total number of cases completed <sup>2</sup>	-	8 462	6 158
Net value of adjustments and penalties <sup>2</sup>	-	\$320 million	\$425 million

Note 1: The data for 2002–2003 relates to all audits activities completed by ILEC, data was not available for the large business market segment.

Note 2: Although ILEC is the area of the ATO responsible for managing GST compliance in the large business market segment, some compliance activities are undertaken by other areas of the ATO.<sup>10</sup> ILEC completes approximately 95 per cent of GST audits in the large market.

Source: Interpretation and Large Enterprise Compliance Business Unit

## Private sector stakeholder consultation

29. During the audit the ANAO consulted with a range of large business representatives and professional associations about the ATO's management of GST compliance in the large business market segment. Generally stakeholders indicated support for the ATO's approach to GST compliance in the large business market segment. Notwithstanding, the consultation process identified a number of issues including the:

<sup>10</sup> For example, General Compliance is responsible for undertaking the review of deferred GST for all clients including those in the large market.

- number of ATO audit staff participating in industry partnership meetings and perceptions that ILEC uses information from these meetings to select clients for review and/or in conducting audits;
- timeliness of private binding rulings and the limited opportunity to liaise directly with the ATO's interpretations' staff in resolving complex technical issues;
- time taken to complete audits; and
- work associated with entering into a Cooperative Compliance Advance Agreement with the ATO.<sup>11</sup>

The ANAO noted that the ATO received similar feedback as part of the LCCP Review and is working towards resolving these issues. ILEC advised that the aim of the industry partnerships is to provide senior industry representatives and the ATO with a forum to discuss relevant aspects in the administration of the tax system, consult on any issues of concern or interest and where possible resolve such issues. ILEC further advised that the ATO does not use the industry partnership forums as a means of selecting clients for audit.

### **Analysing compliance outcomes**

30. The ANAO considers that recording and assessing compliance outcomes is important to inform future compliance planning and the targeting of compliance risks. In reviewing ILEC's management of GST compliance in the large business market segment the ANAO considered that ILEC inconsistently used compliance case results to inform future compliance planning and case selection. High-level information such as return on investment has been used to assess the effectiveness of audit products. However, compliance outcome data was not consistently used to assess the effectiveness of compliance risk treatments.

31. The ANAO also considers that ILEC's outcome measures should extend beyond revenue assessment as not all compliance activities result in a direct revenue return. The ability to assess the outcomes of non-audit activities is important in demonstrating the effectiveness of these approaches in managing GST compliance risks.

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<sup>11</sup> Cooperative Compliance Advance Agreements are directed at delivering greater certainty, reduced costs and improved administration for both the ATO and the large businesses in their GST dealings. The agreements involve the ATO assessing the integrity of a client's systems for managing GST. If satisfied with the systems' controls the ATO commits to reduced audit activity. For further information refer to paragraphs 4.33 and 4.34.

## Audit conclusion

32. The ANAO found that the ATO has developed and implemented governance and risk management processes that support the management of GST compliance in the large business market segment. The ANAO also found that the ATO has implemented a compliance program to treat identified GST compliance risks. Over the three-year period 2002–2003 to 2004–2005, GST cash collections and adjustments resulting from the ATO's compliance activities, have exceeded estimated revenue targets in the large business market segment.

33. During the audit, the ATO commenced a number of initiatives to improve its systems and processes that support the management of GST compliance. Measures have also been put in place to resolve issues raised by stakeholders. The ANAO considers that collectively these initiatives will enhance the ATO's administrative effectiveness in managing GST compliance in the large business market segment. The ANAO also identified several areas where the ATO's systems and processes for managing GST compliance in the large business market segment could be strengthened. These include the ATO's Interpretation and Large Enterprise Compliance Business Unit:

- enhancing its performance monitoring and reporting by developing and defining a set of standard performance measures, consistently assessing performance across the Business Unit and streamlining reporting arrangements;
- further developing its risk management framework, to support the coordinated and systematic identification, recording and assessment of GST compliance risks in the large business market segment;
- developing stronger linkages between compliance planning and risk management, in order to demonstrate that the highest-level GST compliance risks in the large business market segment are being effectively targeted; and
- systematically analysing its compliance results and using this information to inform future compliance planning and case selection.

## Recommendations

34. The ANAO has made four recommendations to improve the administrative effectiveness of the ATO's management of GST compliance in the large business market segment. The recommendations are intended to complement the ATO's initiatives commenced in response to the ATO's review of its GST large corporate compliance program.

## ATO's response

35. The ATO recognise the important role played by large businesses in the operation of the GST system and the impact that their compliance behaviour can have on industry, revenue and community confidence. This segment contributes around 59 per cent of all GST collected. We acknowledge the generally good compliance record of large businesses, but also note that our GST compliance activities in the large business market segment resulted in liabilities of \$425 million plus collections of \$381 million in 2004–2005. Consequently it is of critical importance that we continue to build our capability in administering GST compliance of this segment.

36. In September 2004 the Tax Office commissioned a review of the GST Large Corporate Compliance Program (LCCP). One of the major initiatives implemented as a result of this review, is a new GST Risk Management Framework. The ANAO performance audit has recognised the LCCP review, and we are pleased that the ANAO report recommendations complement the initiatives that have commenced.

37. The Tax Office supports the recommendations contained in your report and will proactively work towards delivering on them as we implement the improvements flowing from the LCCP review.

38. The ATO's letter of response is at Appendix 1.

# Recommendations

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Set out below are the ANAO's recommendations aimed at improving the ATO's administration of GST compliance in the large business market segment. Report paragraph references and abbreviated ATO responses are included. More detailed responses are shown in the body of the report. The ANAO considers that the ATO should give priority to Recommendations 1 and 4.

**Recommendation No.1**  
**Para. 2.33**

The ANAO recommends that to strengthen the monitoring and reporting of its performance, the Interpretation and Large Enterprise Business Unit reviews its existing performance measures and develops a standard set of measures to be applied across the Business Unit.

*ATO response: Agreed.*

**Recommendation No.2**  
**Para. 3.20**

The ANAO recommends that to support the systematic and coordinated analysis of GST compliance risks in the large business market segment, the Interpretation and Large Enterprise Compliance Business Unit documents who is responsible for and the frequency with which, profiles and environment scans are created, updated and distributed.

*ATO response: Agreed.*

**Recommendation No.3**  
**Para. 3.30**

To support informed management decision making about the prioritisation and treatment of compliance risks, the ANAO recommends that the Interpretation and Large Enterprise Compliance Business Unit strengthen its processes for recording identified GST compliance risks through:

- (a) recording all relevant GST compliance risks for the large business market segment in a timely manner and in accordance with ATO Policy; and
- (b) periodically reviewing and updating all recorded risk information.

*ATO response: Agreed.*

**Recommendation No.4 Para. 4.43** The ANAO recommends that to inform future compliance planning and case selection, the Interpretation and Large Enterprise Compliance Business Unit:

- (a) identifies and documents its expected compliance outcomes, including changes in compliance behaviour over time, as part of its compliance planning; and
- (b) routinely evaluates the outcomes and effectiveness of its compliance program and activities, including the effect of its non-audit compliance products.

*ATO response: Agreed.*

# **Audit Findings and Conclusions**



# 1. Background and Context

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*This chapter provides an introduction to the Goods and Services Tax and the Australian Taxation Office's role in managing compliance with this tax in the large business market segment. The audit objective, scope and methodology are also outlined.*

## Introduction

**1.1** The Goods and Services Tax (GST) came into effect in Australia on 1 July 2000. The GST is an indirect, broad-based, consumption tax of 10 per cent, levied on most goods and services in Australia. The GST is governed by the *A New Tax System (Goods and Services Tax) Act 1999*.<sup>12</sup>

**1.2** As a consumption tax, it is the final consumer that pays the GST. The GST is charged at each step in the supply chain and businesses are entitled to claim credits, from the Australian Taxation Office (ATO), for the GST they have paid.<sup>13</sup> Businesses claim input tax credits and account for the GST payable, through a Business Activity Statement (BAS), which must be lodged at the end of each tax-reporting period.<sup>14</sup>

## Administrative arrangements for management of the GST

**1.3** The ATO is responsible for the collection of the GST. Administration of the GST is outlined in the *GST Administration Performance Agreement between the Australian Taxation Office and the States and Territories (GST Performance Agreement)*.<sup>15</sup> The GST Performance Agreement states that

The parties [the ATO, and States and Territories] agree that the outcome to be achieved by the ATO's GST administration is to collect GST revenue effectively through maintaining compliance and a cost-effective GST administration.<sup>16</sup>

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<sup>12</sup> CCH Australia Limited, 2005, *Australian Master Tax Guide 2005*, McPherson's Printing Group, Australia, 2005, p. 1549.

<sup>13</sup> Businesses are only entitled to claim input tax credits from the ATO if: the business has an Australian Business Number (ABN); the business is registered for GST; the supplier is registered for GST; the supplier quotes its ABN on tax invoices; and the acquisition was for a creditable purpose.

<sup>14</sup> GST tax-reporting periods vary between businesses based on their annual turnover. The reporting periods are monthly, quarterly and annually. For further information refer to the ATO's website <<http://www.ato.gov.au>>.

<sup>15</sup> In accordance with the GST Performance Agreement, the ANAO conducts an annual special purpose audit of GST costs and the systems for control of GST costs. The ANAO reports its findings to the Commissioner of Taxation. In 2003–2004, the audit opinion was unqualified.

<sup>16</sup> *GST Administration Performance Agreement between the Australian Taxation Office and the States and Territories*, Part 3, clause 10.

The ATO's GST Line is the primary provider of services for this outcome. The GST Line is managed by the GST Board, which is chaired by the GST Line Deputy Commissioner. The GST Line also reports to the GST Revenue Product Strategic Management Committee. The ATO's Large Market Committee also influences the management of GST in the large business market segment.<sup>17</sup>

**1.4** The three Business Units within the GST Line that manage GST compliance are:

- General Compliance – responsible for GST compliance in the small to medium enterprise (SME) and micro markets;
- Government and Community Sector – responsible for GST compliance in the government and not-for profits sectors; and
- Interpretation and Large Enterprise Compliance (ILEC) – responsible for managing GST compliance in the large business market segment.<sup>18</sup>

The GST Risk Management Committee, GST Intelligence and Risk Assessment Unit, the Planning and Reporting team; and the Issues Management and External Relations unit also support the three GST Business Units.

## **Managing GST compliance in the large business market segment**

**1.5** This audit focused on ILEC's management of GST compliance in the large business market segment. The ATO defines the large business market segment as consisting of businesses with a turnover of \$100 million or more. The large business market segment consists of approximately 1 000 large economic groups. These represent a total of approximately 18 000 business entities and 6 000 BAS lodgers. The large business market segment makes a major contribution to Australia's revenue through the tax system.

**1.6** Between 2002–2003 and 2004–2005 large business GST revenue collections were approximately \$56.9 billion. This accounted for more than half of the GST collected. Figure 1.1 depicts total GST revenue collected by the ATO

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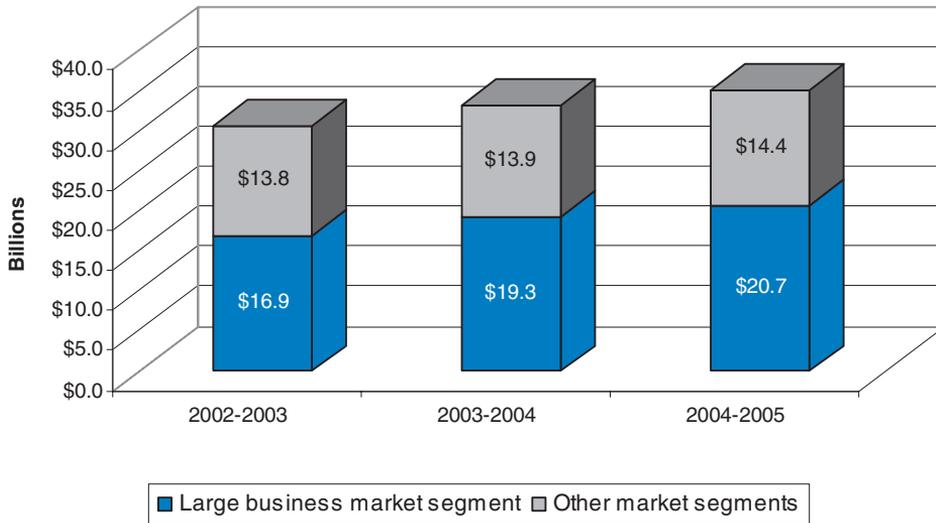
<sup>17</sup> The ATO's Large Market Committee's role is to enable the ATO to develop an integrated approach to the administration of the tax system within the large market and set the strategic directions for the sector.

<sup>18</sup> The Large Business and International Line (LB&I) is responsible for managing income taxation compliance in the large market segment. LB&I has a similar client base to ILEC, however, differences occur in respect of the grouping and structural arrangement of business entities for GST and income taxation purposes. Different consolidation rules apply to businesses for GST and income taxation purposes.

between 2002–2003 and 2004–2005 and the large business market segments' contribution. In 2004–2005, the ATO also raised approximately \$425 million in additional GST and related penalties from large businesses. The additional GST is attributed to the ATO's active compliance, audit and verification activities. This result represented a 25 per cent increase in the value of GST adjustments made in 2003–2004.

**Figure 1.1**

**GST revenue collections 2002–2003 to 2004–2005**



Source: Australian Taxation Office (data based on per cent market share of total GST cash collections)

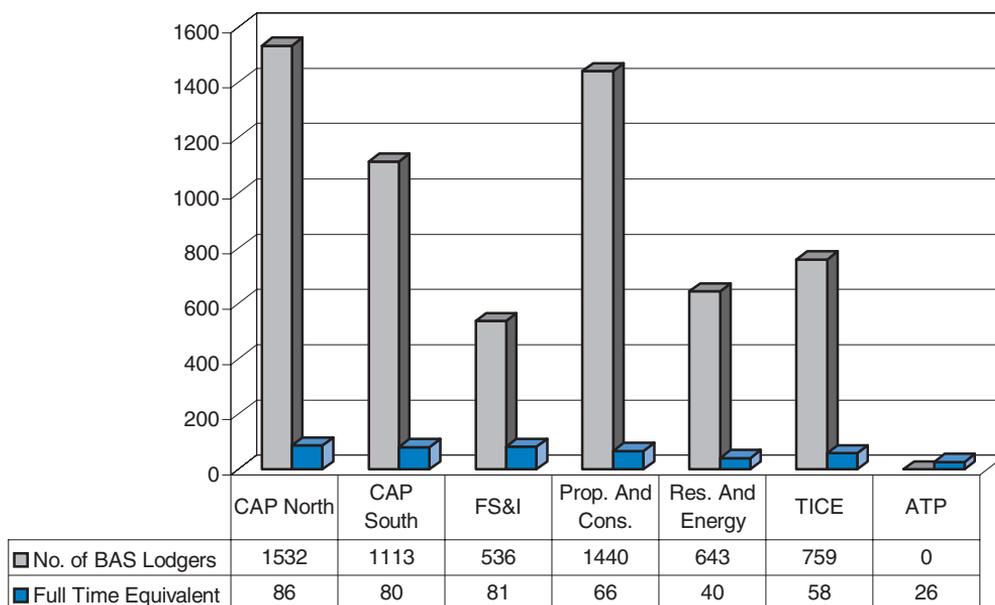
**1.7** ILEC advised that generally large businesses have been complying with their GST obligations. However, ILEC also advised that it is starting to see the emergence of GST aggressive tax planning and more aggressive interpretative behaviour by some clients. The ATO has publicised that it is moving to a firmer approach with respect to the application of penalties. During 2004–2005 ILEC completed 1 203 GST audits in the large business market segment. In this segment the ATO completed a total 6 158 specific enquiries, including 2 258 GST activity statement refund checks. The large business market segment has a population of around 6 000 BAS lodgers.

## Interpretation and Large Enterprise Compliance Business Unit

1.8 To support the administration of GST compliance in the large business market segment, ILEC has been divided into five assurance programs. Each of the assurance programs is responsible for a range of clients grouped by industry, geographic location, or risk profile. In late 2004–2005 ILEC revised its assurance program structure.<sup>19</sup> Figure 1.2 details the number of BAS lodgers managed by each assurance program and the full time equivalent (FTE) staff allocation to each assurance program. Other teams within ILEC that support the assurance programs are National Support; GST Risk Management; Case Leadership; and Planning, Reporting and Quality.

**Figure 1.2**

**Number of BAS lodgers and FTE staff allocation, by assurance program**



Source: Interpretation and Large Enterprise Compliance Business Unit (information as at September 2005)

<sup>19</sup> ILEC's assurance programs as outlined in its 2005–2006 Business Plan are: Financial Supplies and Insurance; Aggressive Tax Planning; Client Assurance Program North/Technology, Information Communication and Events; Client Assurance Program South/and Resources and Energy; and Property and Construction.

**1.9** In addition to managing GST compliance in the large business market segment, ILEC also has a shared responsibility for managing aspects of GST compliance in the SME and micro markets. For example, the Aggressive Tax Planning and Financial Supplies assurance programs reside within ILEC, but have a whole of GST, cross-market scope.

## **Cooperative Compliance Model**

**1.10** The ATO promotes a cooperative approach to compliance across all market segments. To support compliance in the large business market segment, the ATO has implemented the Cooperative Compliance Model (CCM). The CCM is an adaptation of the ATO's Compliance Model and promotes the use of tailored responses to different taxpayers based on their compliance risk profile and compliance history. The CCM was developed in 2000.

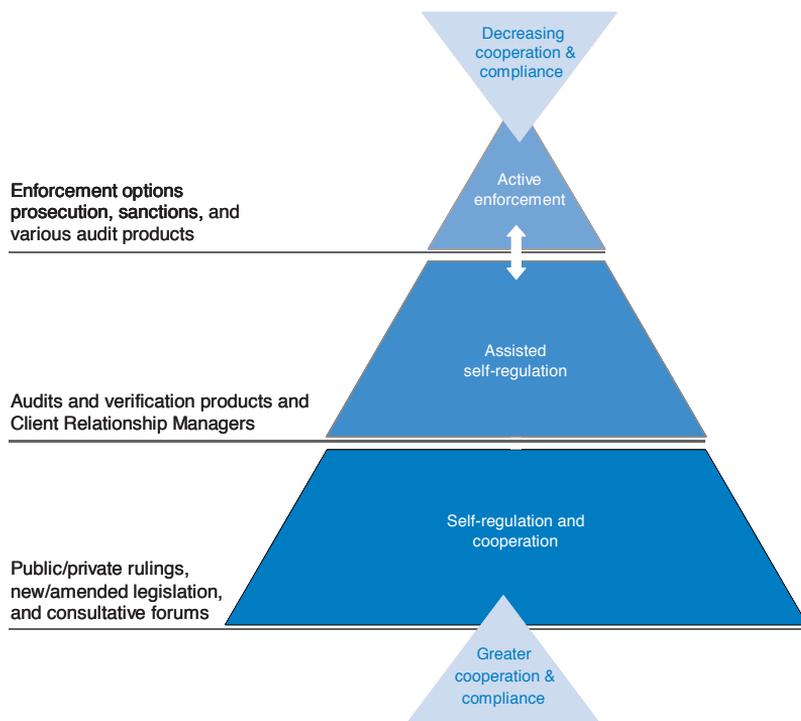
**1.11** The CCM encompasses a range of approaches to ensure that large businesses comply with their GST obligations. These include products aimed at facilitating and supporting self-regulation; cooperative approaches to solving problems; audit activity; and prosecution action in the case of serious non-compliance. The CCM hierarchy and ILEC's products used in managing GST compliance in the large business market are depicted in Figure 1.3.<sup>20</sup>

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<sup>20</sup> For further information about the Cooperative Compliance Model, refer to *Cooperative Compliance—Working With Large Business in the New Tax System*, available from the ATO's website, <<http://www.ato.gov.au>>.

**Figure 1.3**

**CCM compliance hierarchy and ILEC products used to ensure compliance**



Source: Interpretation and Large Enterprise Compliance Business Unit

## Recent reviews and initiatives

**1.12** Aspects of the ATO’s administration of GST compliance in the large business market segment have been considered in the conduct of several recent reviews. These have included reviews by the Inspector-General of Taxation and the ATO’s review of its GST Large Corporate Compliance Program (LCCP Review).

### Reviews by the Inspector-General of Taxation

*Review of Tax Office administration of GST refunds resulting from the lodgement of credit BASs*

**1.13** The Inspector-General of Taxation’s report on the administration of GST refunds was released publicly on 24 May 2005. The review investigated the ATO’s administration of GST refunds arising from the lodgment of BASs. It

evaluated the balance between protecting the revenue from mistaken or fraudulent refund claims and the necessity of maintaining cash flows for businesses and other entities by expeditiously issuing refunds.<sup>21</sup>

**1.14** The report made two key recommendations, requiring the ATO to:

- improve its systems to better match risk issues associated with paying GST refunds, through better balancing paying refunds in a timely manner and preventing fraudulent or incorrect refunds from being paid; and
- establish 'whole of office' systems which measure the elapsed time for the payment of GST refunds.<sup>22</sup>

**1.15** Ten subsidiary recommendations relating to a range of client service and client education issues were also made. These recommendations were aimed at improving the time taken by the ATO to process GST refunds. The ATO agreed with all recommendations.

### *Review into Aspects of the Australian Taxation Office's Business Active Compliance Activities*

**1.16** The Inspector-General of Taxation has also reviewed aspects of the ATO's business active compliance activities. These include whether the application of penalties and interest to businesses during active compliance activities is consistent and whether the length of time taken to complete the ATO's active compliance activities directed at businesses is reasonable.<sup>23</sup>

## **GST Large Corporate Compliance Program Review**

**1.17** In September 2004, the ATO announced that it would conduct an internal review of its GST large corporate compliance program (LCCP). The ATO commissioned an external consulting company to lead this review. The value of the contract as reported on the ATO's website was \$499 990. The

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<sup>21</sup> Inspector-General of Taxation, March 2004, *Review Into The Tax Administration of GST Refunds Arising From The Lodgement of Business Activity Statements—Terms of Reference and Consultation Plan*.

<sup>22</sup> Inspector-General of Taxation, January 2005, *Review of Tax Office administration of GST refunds resulting from the lodgement of credit BASs—A report to the Minister for Revenue and Assistant Treasurer*, p. 5.

<sup>23</sup> Inspector-General of Taxation, November 2004, *Review into Aspects of the Australian Taxation Office's Business Active Compliance Activities—Terms of Reference and Consultation Plan*. The Inspector-General of Taxation has submitted two reports to the Minister, these include the *Review into the Length of Time to Complete Tax Office Active Compliance Activities* - 19 July 2005 and *Review into the Tax Office's Administration of Penalties and Interest Arising from Active Compliance Activities* - 18 May 2005.

review sought to identify opportunities for the ATO to enhance its internal capabilities and business processes, to ensure that its GST LCCP was prepared to face future challenges. The final review report was presented to ILEC on 23 March 2005.

**1.18** The LCCP Review made eight recommendations relating to key areas of ILEC's administration. The eight recommendations are as follows:

- risk – ILEC enhance GST LCCP risk identification and risk management;
- structure – the ILEC organisation structure be designed to provide for improved identification and treatment of risk on an ILEC wide basis;
- process – the GST LCCP process be enhanced;
- workforce capability – ILEC defines and monitors workforce capability maturity levels, to meet current and future needs of the GST LCCP;
- Client Relationship Management (CRM) role – the CRM role be clearly defined and consistently delivered across assurance programs;
- performance – ILEC review its performance reporting;
- knowledge management – ILEC knowledge management is aligned with the ATO strategy and focus on knowledge sharing; and
- leadership accountability – the ILEC leadership accountability and role is defined.<sup>24</sup>

The GST Board, endorsed with some qualification the LCCP Review's recommendations, in May 2005. The LCCP Steering Committee signed off on the ATO's response to the LCCP Review on 5 September 2005.

## The audit

### Audit objective and scope

**1.19** The objective of the audit was to assess the administrative effectiveness of the ATO's management of GST compliance in the large business market segment. In conducting the audit the Australian National Audit Office (ANAO) examined three key areas:

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<sup>24</sup> *Final Report Review of the GST Large Corporate Compliance Program*, March 2005, p. 8.

- governance – ILEC’s corporate planning and reporting arrangements relevant to the management of GST compliance in the large business market segment;
- assessing and identifying compliance risks – how ILEC collects information relating to the large business market segment and how it uses this information to support risk identification and assessment; and
- managing compliance – compliance planning and the products and processes used by ILEC to manage GST compliance in the large business market segment and evaluating compliance outcomes to support future compliance planning and the targeting of GST compliance risks.

**1.20** Two areas that the ANAO reviewed at a high level, but did not audit, were ILEC’s provision of written advice capability and operation of the ATO’s Risk Rating Engine (RRE).<sup>25</sup> The ANAO reviewed the ATO’s management of tax rulings, including the provision of written advice, in two previous audits.<sup>26</sup> The ANAO is examining operation of the RRE and the verification of large business activity statement refunds as part of its performance audit of activity statement high-risk refunds.

## Audit methodology

**1.21** In undertaking the audit, the ANAO took account of the findings of previous reviews, in particular the ATO’s review of its GST Large Corporate Compliance Program. The ANAO’s audit findings and conclusions are based around the work completed during audit fieldwork. The main component of audit fieldwork was conducted between February and April 2005.

**1.22** The audit included a combination of interviews with ATO staff and key private sector stakeholders and an examination of the ATO’s systems and processes supporting the management of GST compliance in the large business market segment. To enhance the ANAO’s understanding two case study reviews were completed. The case studies focused on the ATO’s management of GST compliance from a client perspective and GST compliance in a

<sup>25</sup> The RRE is a system designed to assess BASs at the time of lodgement. The system compares the BAS data to a range of criteria to identify potential non-compliance in a real time environment. Where a BAS does not meet the prescribed criteria, it is referred for further review. Payment may be delayed until the BAS has been reviewed.

<sup>26</sup> For details about the ATO’s management of the taxation rulings, refer to Audit Report No. 7 of 2004–2005, *Administration of Taxation Rulings Follow-up Audit*, and Audit Report No. 3 of 2001–2002, *The Australian Taxation Office’s Administration of Taxation Rulings*.

higher-risk industry. Given that the LCCP Review examined a sample of completed audit cases, the ANAO did not duplicate this aspect of work.

1.23 The audit was conducted in accordance with ANAO auditing standards at a cost of \$399 900.

## Acknowledgement

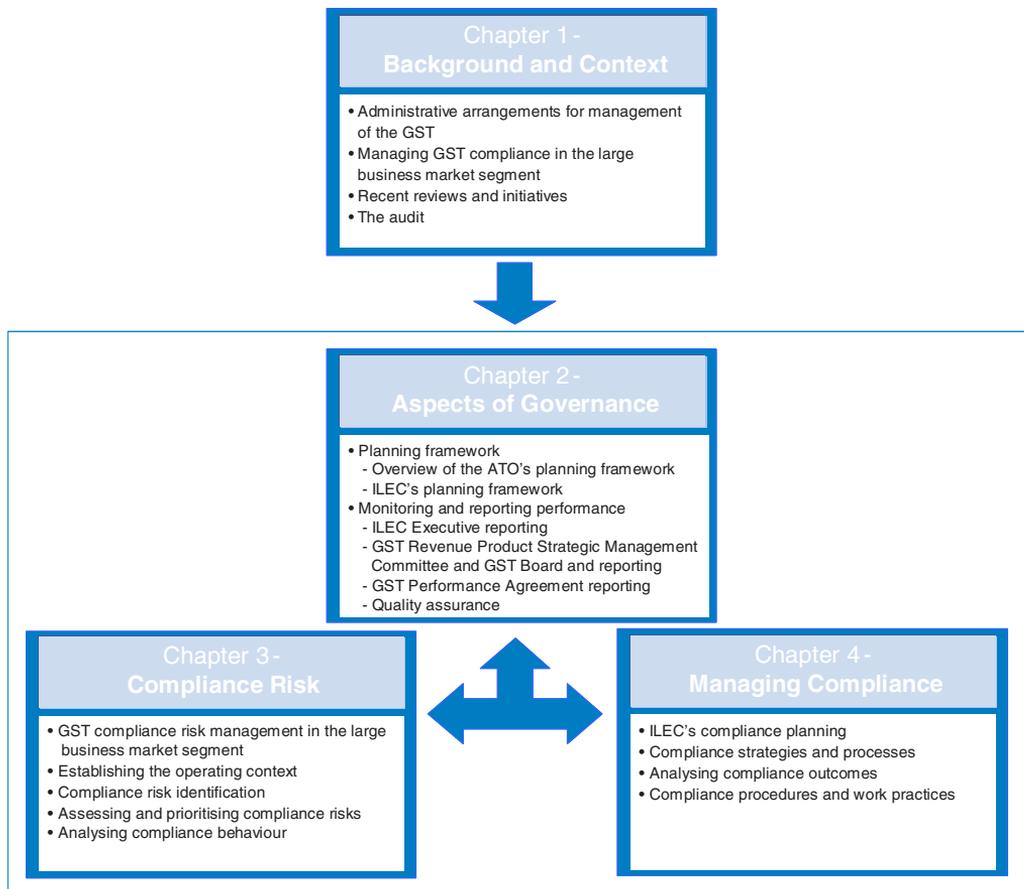
1.24 The ANAO would like to express its appreciation to the ATO’s management and staff for their assistance in the conduct of this audit. The ANAO would also like to thank the private sector stakeholders consulted during the audit.

## Structure of the audit report

1.25 Figure 1.4 depicts the structure and content of the audit report.

**Figure 1.4**

### Audit report structure



## 2. Aspects of Governance

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This chapter discusses whether the ATO has implemented a governance framework that supports the management of GST compliance in the large business market segment.

### Introduction

**2.1** Governance refers to the processes by which organisations are directed, controlled and held to account. Good governance includes a broad range of activities that assist an organisation achieve its corporate and business goals. The concept of public sector governance is discussed in detail in the ANAO's Better Practice Guide, *Public Sector Governance*.<sup>27</sup> As part of this audit the ANAO examined whether ILEC's governance arrangements support the management of GST compliance in the large business market segment. In carrying out this examination, the ANAO reviewed ILEC's planning framework and the monitoring and reporting of its performance.

**2.2** As outlined in chapter one, *Background and Context*, ILEC is the area responsible for the administration of GST compliance in the large business market segment. ILEC's role, as stated in the *GST Interpretation and Large Enterprise Compliance 2004–2005 Draft Business Plan*,<sup>28</sup> later referred to as the ILEC Business Plan, is two fold. First, it is *to work with the knowledge of the large business sector to achieve the highest levels of GST compliance* and second, *to provide GST technical leadership and expertise to clients and the Tax Office*.<sup>29</sup>

### Planning framework

**2.3** An essential element of a robust governance framework is an effective corporate and business planning process. This process should ensure that all corporate objectives and planning documents are aligned and mutually supportive. Key elements of the ATO's planning framework are presented in Figure 2.1, which has been adapted to highlight ILEC's administration of GST compliance in the large business market segment, within this framework.

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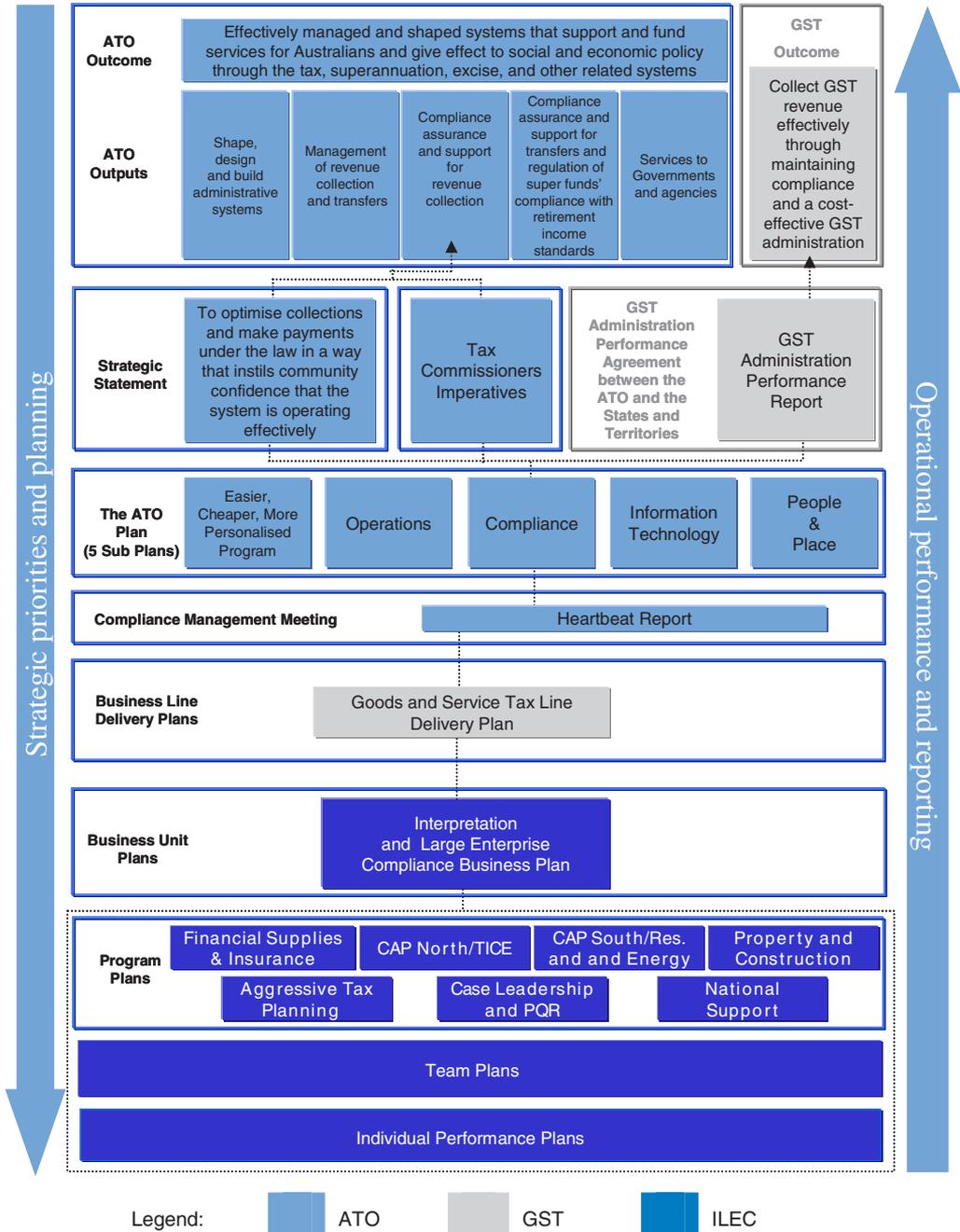
<sup>27</sup> The Better Practice Guide is available at: <http://www.anao.gov.au/WebSite.nsf/Publications/5A8717E993DEB3484A256D730015D4F4>. For further information about public sector governance also refer to: <http://www.apsc.gov.au/foundations/index.html>.

<sup>28</sup> ILEC advised that its 2004–2005 Business Plan was not signed off, as at the time of its preparation, there was uncertainty regarding its final budget allocation. ILEC further advised that all other aspects of the Plan were considered finalised.

<sup>29</sup> *GST Interpretation and Large Enterprise Compliance 2004–2005 Draft Business Plan*, p. 6.

**Figure 2.1**

**Elements of the ATO's planning framework**



Source: ANAO adaptation of Australian Taxation Office information – reflects the Interpretation and Large Enterprise Compliance Business Unit organisational structure as at September 2005

## Overview of the ATO's planning framework

2.4 The ATO's planning framework provides the structure within which the various elements of the ATO can articulate, in a consistent and coordinated way, their strategies, risks, priorities and performance measures. The ATO's planning framework also incorporates four views across the organisation: market segments, revenue products, special focus areas and corporate capabilities. Information from these four views form an input into the ATO's planning processes. This includes information about risks, organisational priorities and strategies.

2.5 The ATO's high-level planning documents relevant to management of GST compliance in the large business market segment are the:

- ATO's Outcome and Outputs Framework – the framework establishes the ATO's corporate direction and specifies the products and services it has undertaken to deliver to the community;
- ATO's Strategic Statement – this document aims to provide a clear sense of direction and a framework for the ATO's activities over the three year period, 2003–2005. The ATO's business intent as outlined in its strategic statement, is *To optimise collections and make payments under the law in a way that instils community confidence that the system is operating effectively*,<sup>30</sup>
- ATO Plan – collectively, the ATO's five sub-plans form the ATO Plan. The sub-plans articulate the strategies, priorities, risks and performance measures that the ATO uses to manage its performance against its outcome and outputs;
- GST Performance Agreement – the ATO's approach to managing GST compliance across all market segments is guided by its agreement with the States and Territories. The GST Performance Agreement outlines accountability, performance and reporting requirements; and
- GST Line Delivery Plan – this plan identifies those strategies and activities from the ATO's sub-plans that the GST Line needs to deliver. It translates the high-level strategic objectives outlined in the sub-plans into high-level risks and strategies. Within the GST Line, each Business Unit then develops its own business plan. The GST Business Units' plans are

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<sup>30</sup> Australian Taxation Office, *Strategic Statement 2003–05*, p. 1

designed to show how they contribute to the achievement of the outcomes of the GST Line Delivery Plan.

**2.6** Activities associated with the management of GST compliance in the large business market segment are largely funded under the ATO's Compliance Sub-Plan.

## **ILEC's planning framework**

**2.7** The ANAO noted that the ATO has developed a Practice Statement relating to corporate planning. The Practice Statement applies to all levels of ATO plans and outlines the ATO's design criteria. The ILEC Business Unit's planning documents relevant to the management of GST compliance in the large business market segment are the:

- ILEC Business Plan;
- Strategic Reporting System (SRS) Reports – these identify strategic risks and emerging trends and propose risk mitigation strategies;<sup>31</sup>
- assurance programs' business plans;
- segment and team plans; and
- individual performance plans.

**2.8** The ANAO found that ILEC has designed its planning framework to be consistent with the ATO's approach to corporate planning. In examining ILEC's Business Plan and the assurance programs' business plans, the ANAO noted an alignment with the ATO's higher-level planning documents. This alignment was achieved by ILEC duplicating the information contained in the GST Line Delivery Plan and ILEC Business Plan, respectively. The ANAO also noted that the ILEC Business Plan outlined the overall direction for the Business Unit and summarised the number and type of clients managed.

**2.9** ILEC's Business Plan and the assurance programs' business plans documented at a high level a range of performance measures. These measures included the number of audits planned and the results of quality assurance reviews. However, the plans did not clearly document how ILEC planned to

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<sup>31</sup> This includes the GST Large Market SRS Report and assurance programs SRS Reports. The SRS process is similar to the ATO's Health of the Systems Assessment (HOTSA). ILEC's SRS and the ATO's Compliance Sub-Plan HOTSA are designed to assess potential risks across eleven core aspects of management. These are referred to as compliance pillars or key success factors. These key success factors range from the level of revenue collected through to system design and sustainability issues.

allocate and use its staff to complete its compliance activities. The plans also did not clearly document what compliance risks were to be treated during the financial year.

**2.10** The ANAO also found that ILEC's plans at the next level (segment and team plans) generally aligned with the assurance programs' business plans. However, the expected outcomes of the individual teams (number of audits planned to be completed etc) were not always clearly documented. Planning at this level focused on activity, which is to be expected, but did not show how these activities would contribute to ILEC's outcomes or the treatment of identified compliance risks. The ANAO did not examine individual staff performance agreements as part of the audit.

#### *Integration of risk and business planning*

**2.11** At the time of fieldwork for the audit, the ANAO found that ILEC had not clearly documented its identified strategic compliance risks in its business plans. The ANAO observed that for 2005–2006, ILEC has implemented a revised risk management and planning process. In implementing this process, ILEC has identified and ranked its business and compliance risks and allocated its resources based on their proposed treatment. The ANAO considers that this has supported ILEC in allocating its resources to its highest-level risks.

#### *Integration of GST Performance Agreement outcomes into ILEC's Business Plan*

**2.12** The GST Performance Agreement includes a number of key outcome performance measures. The ANAO considers that these outcome measures, in part, should guide the strategic management of GST compliance in the large business market segment.

**2.13** The ANAO found that the GST Performance Agreement outcome measures were not clearly stated in ILEC's Business Plan. The ANAO considers that including these measures in ILEC's Business Plan for 2005–2006 and future years, would allow ILEC to more clearly demonstrate that it is achieving these outcomes. The ANAO noted that the GST Performance Agreement measures have been included in ILEC's Business Plan for 2005–2006.

## **Conclusion**

**2.14** The ANAO found that ILEC's plans are generally aligned with the ATO's higher level planning documents. However, including the GST

Performance Agreement outcome measures in the ILEC Business Plan, for 2005–2006 and future years would assist the ILEC Executive in assessing the Business Unit’s overall performance. The ANAO considers that ILEC should more clearly specify its output targets including the number of audits to be completed, the number of industry partnership meetings expected to be held and direct client contact made by Client Relationship Managers.

**2.15** The ANAO observed that ILEC’s 2005–2006 Business Plan clearly documents identified GST compliance risks in the large business market segment, outlines proposed mitigation strategies (the mix and number of compliance activities to be completed), and performance measures. The performance measures include the GST Performance Agreement outcome measures. The ANAO found that ILEC’s Business Plan for 2005–2006 provides clear direction to the assurance programs, which are responsible for completing audits and other compliance activities.

## Monitoring and reporting performance

**2.16** Performance monitoring and reporting are important aspects of ILEC’s governance. Without the timely collection and analysis of performance information, fully informed decisions about the management of GST compliance in the large business market segment cannot be made.

**2.17** The ANAO noted that ILEC is subject to the corporate governance reporting requirements that are common to the whole of the ATO. These include:

- annual reporting such as the Health of the System Assessment process (HOTSAs). The HOTSAs process focuses on assessing potential risks across eleven core areas. ILEC has input into several HOTSAs including the large market and Compliance Sub-Plan; and
- quarterly and monthly governance reporting. These reports include a range of information by market segment, liabilities, collections and work type. The reported information relates to both audit related and non-audit related activities, such as the provision of written advice. Information is generally reported at the market segment or product level. Various groups and forums within the ATO receive these reports. Some of these are the market committees, capability leaders, plenary governance forum, and the ATO Executive.

The ANAO also noted that ILEC reports progress monthly, against the GST large market commitments in the ATO's Compliance Program.

**2.18** At the ILEC Business Unit level, the ANAO also reviewed reporting:

- to the ILEC Executive;
- to the GST Revenue Product Strategic Management Committee and GST Board;
- against the GST Performance Agreement outcomes; and
- of quality assurance outcomes.

### **ILEC Executive reporting**

**2.19** The ILEC Executive receives a range of management reports monthly, quarterly and annually. The ANAO considers that information routinely reported to the ILEC Executive should align with ILEC's performance measures as outlined in its Business Plan. The ANAO observed that ILEC's performance measures largely focused on revenue. Information routinely reported to the ILEC Executive included the value of GST adjustments, return on investment, large business market segment coverage and priority technical issues.<sup>32</sup> These measures related to ILEC's active compliance (audit and verification) program. These were also some of the performance outcome measures of the GST Performance Agreement. Other information relating to risks and the age of audit and provision of advice cases was also reported.

**2.20** The ANAO considers that the ILEC Executive should also measure and report on the effectiveness of its broader compliance strategies, such as marketing and education and provision of advice and assistance. To achieve improvement a number of additional performance measures may need to be developed.<sup>33</sup> ILEC advised that it currently measures the effectiveness of its audit program through the review of client feedback questionnaires, professionalism surveys and informal feedback provided by clients to senior

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<sup>32</sup> Priority technical issues are tax technical legal interpretative issues that are associated with high-level risks. Priority technical issues may be resolved through the public rulings process and are prioritised based on how important resolving the technical issue is to reducing the risk.

<sup>33</sup> Additional performance measures could include: the number and severity of emerging risks, revenue at risk, the community and large businesses perceptions' about the integrity of the GST system and compliance with GST public rulings and determinations.

officers. The Business Management Group<sup>34</sup> in the future will also monitor emerging risks. Emerging risks are to be escalated to the GST Risk Management Committee where appropriate.<sup>35</sup> ILEC further advised that it is considering several approaches to assess the effectiveness of its compliance program and activities. This may include assessing the impact of GST public rulings post issue and monitoring changes in revenue or other key client indicators following the completion of GST audits.

**2.21** The ANAO identified variances in the performance measures detailed in and between, the assurance programs' business plans. Some of the performance measures detailed did not directly align with ILEC's performance measures as outlined in its Business Plan. The ANAO considers that this may lead to inconsistent reporting of performance across ILEC. The ANAO suggests that ILEC review and clearly define its performance measures. These should be a sub-set of measures that are consistently applied across the Business Unit and collectively allow ILEC to report on its performance and against its stated role. Sound management practice suggests that ILEC's performance measures should be both quantitative and qualitative and focus on measuring activity and effectiveness.

**2.22** ILEC advised that the assurance programs' plans for 2005–2006 will use the same format as the ILEC Business Plan, to ensure consistency in the information provided at this level. In respect of management reporting, ILEC also advised that it is reviewing its reporting framework and developing a set of standard management reports. The ANAO supports this initiative.

### *ILEC's forecasting model*

**2.23** In late 2003, ILEC implemented a forecasting model. The model is designed to assess whether ILEC could achieve its estimated revenue adjustments targets and assess the allocation of staff across the assurance programs. The model reports on audits in progress, audits expected to be finalised in the relevant period and the value of adjustments and penalties. The model is updated and reported to the ILEC Executive monthly. The ANAO considers that the concept of the forecasting model is a sound initiative.

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<sup>34</sup> The Business Management Group (BMG) is an operational decision making body whose primary role is to support the ILEC Executive by focusing on the management of operational issues that affect ILEC. Membership is made up of senior representatives (Executive Level 2 staff) from each of the assurance programs.

<sup>35</sup> ILEC advised that a GST Risk Management Committee was formed as part of the GST Risk Management Framework. The GST Risk Management Framework is discussed in chapter three, *Compliance Risk*.

### *Assurance program and team reporting*

**2.24** The ANAO noted that the assurance program executives' receive a range of reports on a monthly basis and have the ability to generate reports using the ATO's reporting system. The assurance programs also had local executive groups that examined risks, resource allocation and workload issues.

### **GST Revenue Product Strategic Management Committee and GST Board reporting**

**2.25** ILEC reports to the GST Revenue Product Strategic Management Committee as part of the ATO's governance reporting framework. The purpose of the Committee is to set the strategic direction for the GST revenue product. The Committee's primary objectives are to: ensure that the ATO meets its obligations under the GST Performance Agreement, create a strategic focus for the administration of the GST revenue product and create a shared accountability across all market segments and business lines that contribute to aspects of GST administration. Monthly reporting to the Committee is comprehensive. The information reported includes GST information by market segment, work type, liabilities and collections.

**2.26** The GST Board is an internal ATO group of senior GST Line managers. The GST Board meets twice monthly. Terms of Reference for the GST Board were drafted in late 2004–2005. The ANAO noted that the GST Board is the executive management forum for the GST Line. It is the main decision making body for the GST Line and provides leadership and strategic direction with the aim of administering the GST system and the GST Line as fairly and equitably as possible. The GST Board reviews the overall performance of the GST Line as part of its governance process. ILEC advised that it contributes to the internal management reports that are provided to the GST Board each month.

### **GST Performance Agreement reporting**

**2.27** The GST Performance Agreement requires that the ATO report to the States and Territories on its performance in administering the GST system. As part of the audit, the ANAO reviewed sections of the *GST Administration Full Year Performance Report 2003–2004* that related to the large market segment. Overall the ANAO considered that the sections reviewed were comprehensive. The reviewed sections reported on the ATO's performance against the outcome measures of the GST Performance Agreement. Detailed information was included about the ATO's performance across each of the market

segments, along with information about emerging risks and the ATO's compliance focus. The ANAO noted that ILEC's input into the report largely focused on management of GST compliance risks and the management of written technical advice.

## **Quality assurance**

**2.28** Quality assurance processes are an important tool in monitoring performance and developing sound management practice. The ATO has established a corporate quality assurance process referred to as Technical Quality Review (TQR). Through the TQR process, a random sample of cases is selected and reviewed for conformance with ATO policy and procedures, technical correctness and clarity. The results of the TQR process are reported to the ATO Executive and the relevant business and service lines. ILEC is subject to the TQR process.

**2.29** As cases are of the smaller number of cases completed by ILEC, when compared to GST General Compliance. As a result of the case selection process, ILEC is unable to make meaningful judgements about the quality of its work. In response, ILEC has implemented a Prudential Total Quality Review process. Case selection for this process is designed to achieve a representative cross section, including cases from all work types and assurance programs.<sup>36</sup> The ANAO considers that this is a sound approach. The results of the Prudential Total Quality Reviews are reported to the ILEC Executive. Table 2.1 sets out the results of ILEC's Prudential Total Quality Review process completed in May 2005. The ANAO observed that although ILEC's pass rate has increased in some areas, overall, it is still below the ATO's corporate benchmarks.<sup>37</sup>

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<sup>36</sup> Work types relates to the range of active compliance products used by ILEC to maintain GST compliance in the large business market segment. This includes, but is not limited to, the various verification and audits products used by ILEC and private binding rulings issued to ILEC clients.

<sup>37</sup> The benchmarks are an A grade pass rate of 83 per cent for active compliance and penalty cases and an A grade pass rate of 93 per cent for provision of written advice cases.

**Table 2.1****Results of ILEC Prudential Total Quality Review—May 2005**

Result	Active compliance cases	Penalty cases	Provision of written advice cases
Number A grade pass	32	14	26
Per cent A grade pass	71	64	87
Total number passed	40	21	29
Per cent passed	89	95	97
Number failed	5	1	1
Per cent failed	11	5	3

Source: Interpretation and Large Enterprise Compliance Business Unit

**2.30** ILEC advised that its quality review outcomes are used in reviewing its work practices and that it is also strengthening its linkages between the Planning, Reporting and Quality Team and Operations and Procedures Team. The ANAO was advised in June 2005 that the two teams have arranged to meet on a monthly basis to discuss issues of quality and work practices.

## Conclusion

**2.31** The ANAO found that overall the monitoring and reporting of ILEC's performance was sound. Reporting on ILEC's performance occurs at various levels, however, the ANAO considers that the content of some of the reports could be better aligned with ILEC's planned outputs. This would support more informed management decision-making and resource allocation. The monitoring and reporting of ILEC's performance would be enhanced if ILEC:

- reviewed its existing performance measures and developed a standard set of measures to be applied across the Business Unit. These measures should focus on assessing a combination of activity, revenue and the effectiveness of ILEC's compliance strategies in treating potential GST compliance risks in the large business market segment;
- assessed its performance consistently across the Business Unit, by applying a sub-set of aligned performance measures at the assurance program level; and
- streamlined current reporting arrangements with a view to providing relevant, accurate and timely information to the ILEC Executive.

**2.32** ILEC advised that as part of its business planning process for 2005–2006 it has aligned its risks and risk mitigation strategies with its outputs. ILEC also advised that a new set of management reports is being developed. These reports will support monthly reporting on each of its outputs to the ILEC Executive. The assurance programs' business plans are also to articulate the same performance measures as the ILEC Business Plan.

## **Recommendation No.1**

**2.33** The ANAO recommends that to strengthen the monitoring and reporting of its performance, the Interpretation and Large Enterprise Business Unit reviews its existing performance measures and develops a standard set of measures to be applied across the Business Unit.

### *ATO response*

**2.34** Agreed. Earlier this year, a small team was established with the role of centrally coordinating planning, quality and reporting functions for the ILEC business unit. A number of improvements to the previous processes have already been implemented as a result. This includes a structured, risk-based approach to preparing the 2005–2006 GST ILEC Business Plan. As part of this process, ILEC has now included the ATO and States and Territories performance measures in its 2005–2006 plan and is developing a set of reports that will provide regular feedback to senior management on performance against the range of measures articulated in the plan.

**2.35** Whilst we will continue to work on identifying and refining performance measures that are of most relevance to our work, a suite of measures that will be applied consistently across ILEC during 2005–2006 has been developed and implemented.

## 3. Compliance Risk

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*This chapter discusses the ATO's identification and assessment of GST compliance risks for the large business market segment. During the audit, the ATO advised that it implemented a whole of GST Risk Management Framework. This Framework replaced the existing risk management structure and processes within ILEC and focuses on risk from a whole of GST perspective.*

### Introduction

**3.1** The ATO's Business Model states that it uses a risk management approach to verify tax compliance. The ATO aims to optimise revenue collections through responding to changing circumstances and managing compliance risks. In doing so the ATO strives to make informed choices about how it uses its resources.

**3.2** Compliance risk management is *a structured process for the systematic identification, assessment, ranking and treatment of tax compliance risks*.<sup>38</sup> It is concerned with managing the risks affecting taxpayer compliance with registering, filing, reporting and remitting their tax obligations. This focus differentiates compliance risk management from 'organisation-wide' or 'corporate' risk management.

**3.3** Compliance risk management in the ATO takes place within the context of ATO-wide risk management. The model that underpins the ATO's compliance risk management process is presented in Figure 3.1, on the following page. This model is compatible with sound management practice in risk management.<sup>39</sup> The ATO's CCM, which guides the management of GST compliance in the large business market segment, also aligns with this model.<sup>40</sup>

**3.4** To understand ILEC's operating environment, the ANAO reviewed the ATO's broader framework for managing compliance risks, including recent developments in this area. In particular, the ANAO reviewed the first four

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<sup>38</sup> Organisation for Economic Co-Operation and Development, 2004. *Compliance Risk Management: Managing and Improving Tax Compliance*, Centre for Tax Policy and Administration Guidance Note, p. 8.

<sup>39</sup> The model is compatible with Standards Australia, risk management standard AS/NZ 4360:2004, and the Organisation for Economic Co-Operation and Development's (OECD's) Compliance Risk Management Model.

<sup>40</sup> Refer to chapter one, *Background and Context*, for a discussion of the CCM.

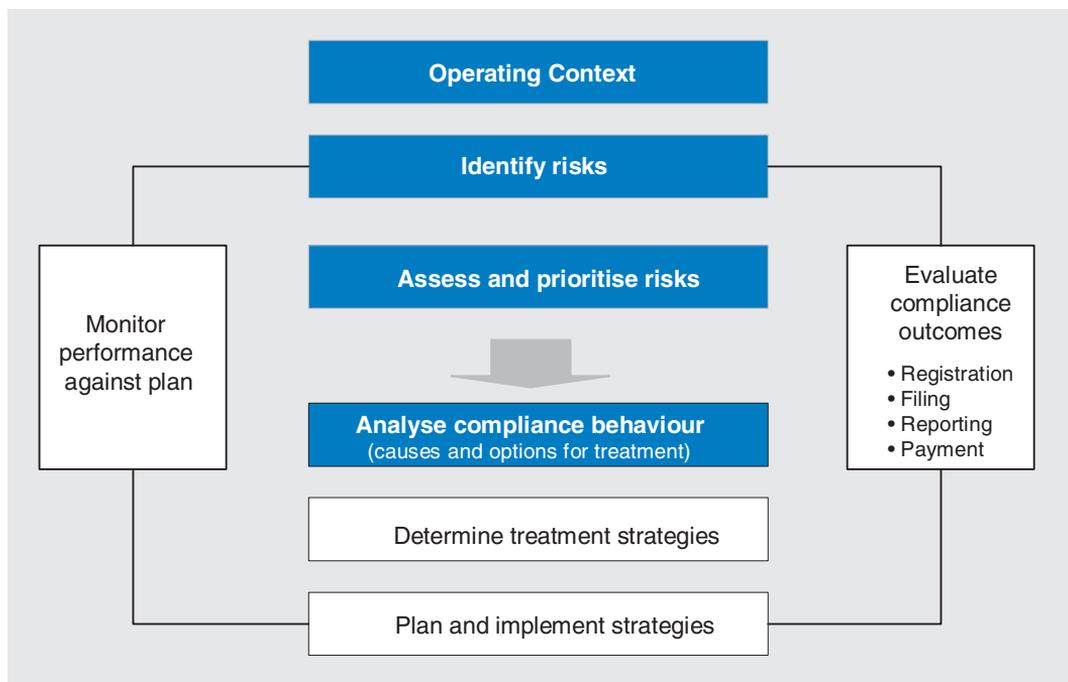
processes in the ATO's compliance risk management model (as depicted in Figure 3.1), to determine whether:

- ILEC had strategies in place to identify and assess GST compliance risks in the large business market segment; and
- GST compliance risk identification and assessment in the large business market segment is effectively integrated between ILEC and other areas within the ATO.

Other aspects of the model are discussed in chapter two, *Aspects of Governance* and chapter four, *Managing Compliance*.

**Figure 3.1**

**The ATO's compliance risk management model**



Source: ATO. Risk Management: Managing the Tax Office and Managing Compliance. p. 29.

## **GST compliance risk management in the large business market segment**

**3.5** Compliance risk management within the ATO is a constantly evolving process. The ANAO found that both the ATO as an organisation and ILEC as a Business Unit, are continually improving their risk management activities.

**3.6** The ANAO observed that at the time of fieldwork for the audit, the key areas responsible for managing GST compliance risks in ILEC were the:

- ILEC Executive – the ILEC Executive has a broad risk management role that includes reviewing and prioritising compliance risks and allocating resources to the treatment of these risks. The ILEC Executive has aimed to integrate risk management practices into the day-to-day operations of the Business Unit at all levels;
- Business Management Group – this group is a decision making body whose prime objective is to support the ILEC Executive by focusing on the management of operational issues. Its role in identifying and assessing compliance risks was not defined; and
- Risk Management Team (RMT) – the RMT described its role as managing intelligence from various sources and sharing intelligence through communication. It also produced ad-hoc risk management reports for the ILEC Executive.

**3.7** Sound management practice indicates that organisations should have documented risk management procedures and processes. This should include details of the roles and responsibilities of the various groups involved in managing risks. The ANAO found at the time of undertaking fieldwork, that ILEC could have better documented this aspect of its compliance risk management approach. In addition, the ANAO considers that ILEC should reinforce to its staff its overall approach to managing risks.

## **GST Large Corporate Compliance Program Review**

**3.8** The LCCP Review recommended that ILEC:

Enhance GST LCCP risk identification and risk management; [and]  
The ILEC organisation structure be designed to provide for improved identification and treatment of risk on an ILEC wide basis.<sup>41</sup>

The LCCP Review also made a number of sub-recommendations. These involved identifying and defining all outputs and sources of intelligence, forming a shared LB&I and ILEC risk management function and forming an independent Risk Management Committee. The ANAO was advised in late June 2005 that the GST Board accepted the LCCP Review recommendations relating to risk management, with some qualification.

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<sup>41</sup> *Final Report: Review of the GST Large Corporate Compliance Program*, 23 March 2005, p. 8.

## GST Risk Management Framework

3.9 In response to the LCCP Review recommendations, the ATO advised that the GST Line implemented a whole of GST Risk Management Framework. The GST Risk Management Framework replaced the existing risk management structure and processes within ILEC and focuses on risk from a whole of GST perspective. The ANAO did not audit the GST Risk Management Framework, as it was implemented from July 2005.

3.10 ILEC advised that the GST Risk Management Framework is designed to enable the GST Line to obtain a whole of GST and market view of risk. This is to provide a flexible mechanism to facilitate the end-to-end management of risks and issues. The GST Risk Management Framework was implemented across the GST Line, including ILEC. The framework was designed to be consistent with the ATO’s corporate approach to managing risks. The GST Risk Management Framework includes four areas, as detailed in Table 3.1.

**Table 3.1**

### GST Risk Management Framework

Area	Function
Risk Management Committee	Assess and review GST compliance risks. Prioritise risks and recommend resource allocation. Identify cross product risks for referral. Oversee the development and implementation of compliance risk treatment strategies. Monitor the impact of risk treatment strategies.
Intelligence and Risk Assessment Unit	Macro Analytic Capability Intelligence and Assessment Capability Evaluation and RRE Risk Pool Management and Modelling Capability
Planning and Reporting Team	Develop and analyse plans and reports to support the management of GST business.
Project Management Team	End to end management of risks and issues across whole of GST.

Source: ANAO interpretation of information relating to the GST Risk Management Framework, as supplied by the Interpretation and Large Enterprise Compliance Business Unit.

## Establishing the operating context

3.11 The first step in the ATO’s compliance risk management process is to *establish the operating context*. The ANAO noted that the ATO uses segmentation to facilitate the management of compliance risks. Segmentation sorts businesses into different groups and sub groups with similar features in

order to better understand common behaviours. The ATO's segmentation at a high level includes market segments, tax issues<sup>42</sup> and industries, while lower level segmentation relates to economic groups, business entities and transactions. The OECD recommends the use of segmentation as good practice.

### **The whole-of-market, tax issue and industry levels**

**3.12** The ANAO noted that several business areas within the ATO have a role in undertaking profiling and environmental scanning for the large business market segment.<sup>43</sup> These included ILEC's RMT, ILEC's assurance programs, the Aggressive Tax Planning Team, the GST Strategic Risk Management Unit,<sup>44</sup> and LB&I's Strategic Intelligence and Analysis Group.

**3.13** To support a more coordinated approach and the systematic sharing of information and intelligence, the ANAO considers that the responsibilities and timeframes for undertaking large business client profiling and environment scanning could be more clearly defined. ILEC advised that it considers having each of the areas undertaking profiling or initiating environmental scans at different times and levels is quite appropriate. The LCCP Review made some observations in relation to the availability of centralised information and information sharing. In summary, the Review recommended that ILEC identify and define all outputs that are to be produced and identify and define all sources of data/intelligence that should be collected and maintained.<sup>45</sup>

**3.14** The ANAO considers that industry and GST large business market segment profiling are sound initiatives, which support the identification of potential GST compliance risks in the large business market segment. ILEC advised that the GST Line has contributed to the Large Market Environment Scan which is prepared periodically. The ANAO also considers that the use of industry profiles and other data, would be improved if the information were stored centrally and available to appropriately authorised staff. ILEC also advised the ANAO that industry profiles often contain sensitive and

<sup>42</sup> Tax issues are specific tax matters that may relate to a cross section of a market segment, for example, GST aggressive tax planning.

<sup>43</sup> Environmental scanning supports the identification of changes in the large market segment that may impact on tax compliance. In completing their large market environment scan for 2004, the ATO considered the impact of social, economic, political, technological, environmental, tax technical and tonal factors. The ATO also considered the views of external stakeholders.

<sup>44</sup> The Strategic Risk Management Unit was the area responsible for risk management in the General Compliance Business Unit, of the GST Line. The Strategic Risk Management Unit have provided one targeted profile to ILEC, dated 25 August 2003.

<sup>45</sup> *Final Report: Review of GST Large Corporate Compliance Program*, 23 March 2005, p. 9.

commercial-in-confidence information and that this information should only be accessed on a need to know basis. This issue is currently being considered as part of the GST Risk Management Framework.

### **The economic group, entity and transaction levels**

**3.15** The ANAO noted that when the GST was introduced, ILEC profiled all businesses in the large business market segment, to develop an understanding of the business and its operating environment. Profiling focused on the seven key risk areas identified in the CCM.<sup>46</sup> At the time of undertaking fieldwork for this audit, client profiles were being migrated to Healthcard2, which is a web based profiling tool developed in conjunction with LB&I. As it is important to ensure that the information contained in Healthcard2 is up to date, the ANAO considers that ILEC should reinforce to its staff the responsibilities and timeframes for creating Healthcard2 profiles for new businesses and regularly updating existing profiles.

**3.16** A significant risk area identified through ILEC's business profiling has been the integrity of large businesses systems' for recording and managing their GST obligations. As the GST is a transaction-based tax, ILEC has identified the importance of systems integrity to ensure that large business are correctly recording and accounting for the GST. Due to the high volume of transactions in some large businesses, a minor systems error can represent a significant risk to GST revenue. ILEC aims to manage this risk as part of its compliance program.

### **Sharing compliance risk information**

**3.17** As noted earlier, the sharing of compliance risk information between ILEC and other areas within the ATO occurs at the operational and strategic levels. However, the ANAO found that information sharing at the operational level can be informal, ad-hoc and at the discretion of the individuals concerned. The ANAO noted that there was an operational protocol<sup>47</sup> outlining the relationship between LB&I and ILEC. However, this was developed at the time of establishment of the GST Line in 2000. The ANAO considers that ILEC should review its processes for the sharing of information with other areas of

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<sup>46</sup> These risk areas are: business and transactions, globalisation, attitude, systems of compliance, perceptions of stakeholders, materiality and application of the law.

<sup>47</sup> Essentially the operational protocol was a informal Memorandum of Understanding.

the ATO, to ensure that it has access to and is sharing all relevant risk information.

**3.18** ILEC advised in June 2005, that it is rewriting the operational protocol between itself and LB&I. The proposed Memorandum of Understanding is to include protocols for the sharing of information. ILEC also advised that the GST Risk Management Framework will further facilitate the sharing of risk information.

## Conclusion

**3.19** The ANAO found that the ATO uses segmentation as a tool to assist in compliance risk management. However, in the ANAO's view, ILEC could implement a more coordinated approach to collecting and utilising risk information. To achieve this, the ATO should determine who is responsible for completing environmental scanning and client profiling activities, the frequency with which risk information should be formally reported and to whom this information should be reported. ILEC advised that the GST Risk Management Framework provides further clarity on the sharing of risks and intelligence across the whole of GST and with other ATO business and service lines.

## Recommendation No.2

**3.20** The ANAO recommends that to support the systematic and coordinated analysis of GST compliance risks in the large business market segment, the Interpretation and Large Enterprise Compliance Business Unit documents who is responsible for and the frequency with which, profiles and environment scans are created, updated and distributed.

### *ATO response*

**3.21** Agreed. Following the findings of the Review of GST's Large Corporate Compliance Program (LCCP), the GST Board commissioned work that will address this matter. The work includes:

- the GST Risk Management Framework which will enable both a whole of GST risk view, and a 'market' view of risk. Key elements of the framework include the Risk Management Committee (RMC) and the GST Intelligence and Risk Assessment Unit (GI&RAU). Intelligence and assessment functions performed by GI&RAU will provide a range of outputs including alerts, scans, assessments and scenarios which are

relevant to this recommendation, and consistent with the endorsed product suite of the ATO Corporate Intelligence Blueprint;

- developing and clarifying the Client Relationship Manager (CRM) role, including required competencies; and
- formalising an escalation process from the CRM to the next appropriate level of management.

These developments and the communication of these roles to staff will clarify the roles and responsibilities for the creation, updating and distribution of profiles and environmental scans.

## Compliance risk identification

**3.22** The second step in the ATO's compliance risk management process is to *identify risks*. Using a common framework to identify compliance risks increases the likelihood that all risks are considered and supports a shared understanding of risk identification processes. The importance of clearly defining and categorising risks was acknowledged by the RMT. However, the ANAO found that ILEC's frameworks for categorising compliance risks in the large business market segment were inconsistent. The ANAO considers that ILEC should establish a clear structure for categorising compliance risks. ILEC advised that its Business Plan and the GST Line Delivery Plan for 2005–2006 will provide details in relation to risk categories, consistent with ATO Policy.

### The whole-of-market, tax issue and industry level

**3.23** The ANAO noted that there were no standard processes, tools or techniques used for methodically identifying GST compliance risks at the whole-of-market, tax issue and industry levels within ILEC. The ANAO considers that this has limited ILEC's ability to realise the potential benefits of its segmentation. The ANAO also considers that care needs to be taken to ensure that the organisational structure of ILEC does not limit compliance risk identification and the subsequent analysis and treatment of risks, using other criteria.<sup>48</sup> The GST Risk Management Framework is planned to address the standardisation of risk identification processes and the identification of risk using various criteria.

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<sup>48</sup> For example, a possible alternate risk differentiator may be whether clients are net GST payers, versus clients who are entitled to a GST refund. Alternatively, risks may be identified according to whether they represent registration, filing, reporting, or paying compliance risks.

## The economic group, entity and transaction levels

**3.24** The ANAO observed that the identification of compliance risks at the economic group, entity and transaction level is conducted primarily at the assurance program level. This is achieved through BAS analysis, attending industry meetings, research and interactions with large businesses. Analysis of BAS data is the key method for identifying risks at the economic group, entity and transaction levels. BAS data for a particular business is examined to identify trends and exceptions.<sup>49</sup> BAS data is also subject to automated checking through the RRE.

### Risk escalation

**3.25** The ANAO found that ILEC has developed an electronic risk escalation form, which staff use for reporting identified compliance risks to the RMT. ILEC advised that the RMT receives about 300 risk forms annually. The LCCP Review observed that the electronic risk forms are generally completed at a time when the particular issue has already been resolved.<sup>50</sup> The ANAO noted that the electronic risk form is just one tool developed by the RMT for capturing risk information and that copies of the SRS Reports had been provided to the RMT for their information.

**3.26** The ANAO noted that the ATO has established a priority technical issues process for the prioritisation and management of complex technical matters. Within ILEC, when a significant compliance risk of a technical interpretive nature is identified, it is escalated as a priority technical issue to the ILEC Executive. ILEC has advised that potential priority technical issues will also be referred to the GST Risk Management Committee. The ANAO supports this proposal.

### Recording compliance risks

**3.27** Sound management practice in compliance risk management requires risks to be recorded in a risk register. ILEC advised that all relevant strategic GST large business market segment risks are recorded in the ATO Corporate Risk Register. At the operational level, compliance risk information may also be recorded in Healthcard2. The ANAO observed that not all GST compliance

<sup>49</sup> This analysis is conducted with the assistance of a BAS Analysis Spreadsheet and a BAS Ratio Analyser. The RMT assists assurance program staff undertaking compliance risk identification, by providing a range of reports on ILEC client BAS activity.

<sup>50</sup> *Final Report Appendix: Review of the GST Large Corporate Compliance Program*, 23 March 2005, p. 29.

risks had been recorded in a timely manner and where risks had been recorded, the information was in some instances incomplete.<sup>51</sup>

## Conclusion

**3.28** The ANAO found that at the time of undertaking fieldwork, ILEC had focused on identifying operational level risks as opposed to systematically identify GST compliance risks across the large business market segment. The ANAO also found that this had limited ILEC's ability to identify GST compliance risks at the tax issue and industry levels and to realise the potential benefits of its segmentation approach. The LCCP Review outlined similar findings.

**3.29** The ANAO considers that to improve risk identification, ILEC should establish a clear structure for categorising compliance risks and document the requirements for undertaking risk identification activities at each segmentation level. Developing standard tools or techniques for systematically identifying GST compliance risks would also be a sound initiative. The ANAO further considers that ILEC should periodically review the risks that have previously been recorded. This is to help ensure that all relevant GST compliance risks in the large business market segment have been recorded and that the information recorded is up to date and complete. The ANAO notes that this issue is expected to be addressed as part of the GST Risk Management Framework.

## Recommendation No.3

**3.30** To support informed management decision making about the prioritisation and treatment of compliance risks, the ANAO recommends that the Interpretation and Large Enterprise Compliance Business Unit strengthen its processes for recording identified GST compliance risks through:

- (a) recording all relevant GST compliance risks for the large business market segment in a timely manner and in accordance with ATO Policy; and
- (b) periodically reviewing and updating all recorded risk information.

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<sup>51</sup> In order to support informed management decision making, in recording its compliance risk, ILEC should ensure that the following information is recorded: risk categories/sub-categories; source; consequence; likelihood; risk rating; risk owner; existing controls; treatment strategies (when determined); risk status; and method of identification.

*ATO response*

**3.31** Agreed. At the GST level, ILEC's previous risk management role has been superseded through implementation of the GST Risk Management Framework. The new process will enable both a whole of GST risk view, and a 'market' view, enhancing GST's ability to identify and manage risks in an end to end manner for the whole product. The recently formed GST Risk Management Committee will play a key role in ensuring capabilities are maximised. In carrying out their role, the Committee will:

- assess and review compliance risks relating to the GST product with a view to prioritising risks and recommending appropriate resource allocation;
- identify specific cross product risks for referral (eg Capital Gains Tax matters, international issues);
- oversight the development and implementation of appropriate compliance risk treatment strategies which are commensurate with the nature and level of the identified risks;
- monitor on an ongoing basis the impact of risk treatment strategies on the level of risk; and
- provide a leading role in the development of GST Health of the System Assessments (HOTSAs) to enable high level analyses and a sufficient evidence base to contribute to their content.

**3.32** GST ILEC and GST large market segment issues will now be serviced by the GST Intelligence and Risk Assessment Unit (GI&RAU). ILEC will be working closely with this unit to develop the new processes and practices necessary to ensure that GST compliance risks in the large business market segment are appropriately identified, recorded and reviewed. At the corporate ATO level, the Chief Knowledge Officer (CKO) has responsibility for recording, reviewing and updating the most significant strategic compliance risks in accordance with ATO policy. The GST Risk Management Framework will appropriately link into wider corporate risk processes to ensure that GST risks escalate to the CKO level as necessary.

## Assessing and prioritising compliance risks

**3.33** The third step in the ATO's compliance risk management process is to *assess and prioritise risks*. Sound management practice requires the systematic analysis of all risks identified as part of the compliance risk identification process. The outcome of risk assessment should be a prioritised list of compliance risks, which ILEC plans to treat.

**3.34** ILEC's compliance risk identification has primarily focused on identifying economic group, entity and transaction level risks and there has been an emphasis on the analysis of risks at these levels. The ANAO noted that risk identification, assessment and the determination of treatment strategies may occur concurrently with audit case preparation and planning. The ANAO found that the assurance programs had not used a standard process to internally assess, prioritise and/or rank their GST compliance risks.

**3.35** The ATO's Risk Matrix defines the criteria to be used when determining the likelihood and consequences of a risk. At the time of fieldwork for the audit, the ANAO found that ILEC had not consistently used the ATO Risk Matrix to systematically analyse and prioritise compliance risks at the whole of market, tax type, or industry levels. The ANAO also found that ILEC had not used standard processes for prioritising and/or ranking compliance risks across assurance programs. This finding is consistent with the LCCP Review, which found that:

Although the individual risk prioritisation process followed by each assurance program is detailed, there is insufficient interaction between the assurance programs, and hence there is no clear integrated process for the prioritisation of identified compliance risks across the whole of ILEC.<sup>52</sup>

**3.36** In response to the LCCP Review and the Audit, the ILEC Executive initiated a *2005–2006 Planning Conference*, held on 17 and 18 March 2005. One outcome of this conference was a prioritised list of the compliance risks ILEC intends to treat in 2005–2006. The ANAO observed that these risks have been assessed using the ATO Risk Matrix. These risks have subsequently been included in the ILEC Business Plan for 2005–2006. ILEC advised that risk assessment is an integral part of the GST Risk Management Framework.

**3.37** The ANAO noted that a number of the GST compliance risks identified as part of ILEC's business planing process are articulated in the ATO's

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<sup>52</sup> *Final Report Appendix: Review of the GST Large Corporate Compliance Program*, 23 March 2005, p. 33.

published Compliance Program for 2005–2006. The Compliance Program states that the ATO’s major GST compliance focus for 2005–2006 relates to the following focus areas:

- margin scheme property valuations and the special rules which apply in these circumstances. The ATO is paying particular attention to margin scheme valuations for off-the-plan sales and partially completed premises;
- GST aggressive tax planning is an area of particular interest for the ATO. It includes tax avoidance arrangements in the property industry involving the sale of real property in order to avoid or reduce the GST payable and claims for input tax credits for second hand goods sold to associated entities;
- Division 129 transactions - these relate to changes in the extent of creditable purpose. The ANAO noted that the extent that an acquisition or importation is for a creditable purpose affects the value of the input tax credit;<sup>53</sup>
- securitisation - the ATO’s view of this aspect of the GST legislation is set out in GST Ruling GSTR 2004/4. The ATO is aiming to test large businesses awareness of the ATO’s view and it’s application;
- GST international issues - several international issues have been identified. The ATO is focusing on non-residents’ interaction with the GST, services purportedly supplied offshore, application of the GST in the international transport and international telecommunication industries and by foreign tour operators;
- motor vehicle industry - the ATO is aiming to ensure clarity in the law particularly around third-party payments and reconditioned parts;
- security deposits are a complex area of the GST that relates to the attribution of these deposits across financial years. Incorrect application of the GST legislation can lead do delays in the payment of GST;
- GST consolidations - the ATO is monitoring consolidations for any GST consequences and early indications of tax planning; and

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<sup>53</sup> Division 129 of the *A New Tax System (Goods And Services Tax) Act 1999* relates to the extent to which an acquisition or importation is for a creditable purpose and affects the amount of the resulting input tax credit. When the extent of creditable purpose is changed by later events, adjustments may need to be made.

- integrity of business systems - as the GST is a transaction based tax the ATO considers that it is important to check the integrity of large businesses' systems for recording transactions and complying with their GST obligations.<sup>54</sup>

## Conclusion

3.38 During audit fieldwork, the ANAO found that ILEC did not have adequate processes in place for prioritising and/or ranking compliance risks within or across the assurance programs. However, ILEC has subsequently initiated processes for assessing, prioritising and ranking its GST compliance risks across the large business market segment. ILEC advised that this prioritisation occurs both within the assurance programs and at the whole of large business market segment level. The ANAO was advised in June 2005 that the Business Management Group has implemented a process for reviewing and analysing emerging risks. These risks are to be rated using the ATO Risk Matrix, from a GST large business market segment perspective.

## Analysing compliance behaviour

3.39 The fourth process in the ATO's compliance risk model is *analyse compliance behaviour*. The ANAO noted that the BISEPS<sup>55</sup> concept was incorporated into ILEC's processes in order to identify strategic issues that may give rise to potential risks. This process facilitates the subsequent step of determining the appropriate treatment strategy for mitigating the risk.<sup>56</sup> ILEC in theory uses the BISEPS model to understand drivers of compliance behaviour. Application of the BISEPS model was not specifically reviewed as part of this audit. However, the LCCP Review found that this model had limited application by ILEC. Reference was made in the LCCP Review Report to one instance where the BISEPS model had been used. The ANAO supports the LCCP Review sub recommendation that ILEC *fully adopt the BISEPS principles* when analysing behaviour that creates compliance risks.

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<sup>54</sup> For further details about these GST compliance focus areas, refer to the ATO's Compliance Program for 2005–2006 available at: <http://www.ato.gov.au/corporate/content.asp?doc=/content/61826.htm>.

<sup>55</sup> The BISEPS model is defined as: (B) business, (I) industry, (S) sociology, (E) economy), (P) psychology and (S) systems. These are considered to be broad areas and reflect the fact that taxpayer compliance decisions are affected by a wide set of factors that are interrelated.

<sup>56</sup> Refer to chapter four, *Managing Compliance*, for a discussion of treatment strategies.

## 4. Managing Compliance

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*This chapter discusses the ATO's approach to managing GST compliance in the large business market segment.*

### Introduction

**4.1** Australia's GST system relies on self-assessment, where taxpayers are required to assess their liabilities under the law and pay the correct amount of taxation. The system of self-assessment has inherent risks, which the ATO aims to manage through its compliance program of education and enforcement activities.

**4.2** The ATO publishes annually its compliance program. As part of the audit we reviewed the ATO's 2004–2005 Compliance Program.<sup>57</sup> The Compliance Program outlined the ATO's overall approach to managing compliance, discussed the risks associated with Australia's taxation system and how the ATO proposed to treat them. The Compliance Program also outlined, at a high level, the activities the ATO planned to undertake in relation to GST compliance in the large business market segment.

**4.3** In examining ILEC's approach to managing GST compliance in the large business market segment, the ANAO sought to determine whether ILEC had:

- effective compliance planning processes that supported the treatment of identified GST compliance risks;
- developed a range of compliance strategies and used various compliance products and processes to treat identified GST compliance risks;
- analysed its compliance outcomes to inform future compliance planning; and
- documented its compliance procedures and work practices.

### ILEC's compliance planning

**4.4** A sound compliance management program assists organisations in treating potential compliance risks in a systematic manner. The ANAO found that through its business planning processes, ILEC identifies the number and

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<sup>57</sup> The ATO released its Compliance Program for 2005–2006 on 4 August 2005.

mix of compliance products to be delivered and the required resources. This occurs at the whole of ILEC and assurance program levels.

### **Strategic compliance planning (whole of ILEC level)**

4.5 The ATO's 2004–2005 Compliance Program documented several focus areas in the large business market segment for the GST Line. ILEC advised that the focus areas outlined in the Compliance Program were identified from a range of activities and risk assessment processes based on the previous year's compliance program.

4.6 The ANAO considers that the focus areas outlined in the Compliance Program for 2004–2005 could have been more clearly documented in ILEC's 2004–2005 Business Plan. The ILEC Business Plan did not clearly identify compliance risks or how ILEC was proposing to treat them. The ANAO found that ILEC's compliance planning, which is integrated into its business planning process, was output focused. The Business Plan documented at a high level the number of planned compliance activities, without linking these back to treatment of identified compliance risks.

4.7 As discussed in chapter three, *Compliance Risk*, ILEC's processes, prior to 2005–2006, for identifying and assessing compliance risks have largely focused on risks at the economic group, entity and transaction levels. The ANAO considers that this has limited ILEC's ability to methodically plan for the treatment of its highest-level compliance risks through its business planning process. Compliance risks in the large business market segment may be identified at the economic group, entity and transaction levels, but could have broader implications across the large business market segment. The ANAO noted that for 2005–2006, ILEC has implemented a revised planning framework through which it identified, assessed and ranked its highest-level compliance risks. This process is assisting ILEC in targeting its compliance risks and allocating its resources to the treatment of these risks. This approach is reflected in ILEC's 2005–2006 Business Plan.

### **Operational compliance planning (assurance program level)**

4.8 The ANAO found that compliance planning at the assurance program level was not well documented. The risks that the assurance programs were aiming to treat and how treating these risks addressed ILEC's priorities, was not detailed. Compliance activity at the assurance program level was largely driven by lower level risk identification and case selection activities. The

ANAO considers that ILEC could better document its compliance planning at the assurance program level. This would allow ILEC to clearly demonstrate that it is targeting its highest-level compliance risks, through its compliance activities.

## Conclusion

**4.9** The ANAO found that ILEC, through its business planning process, aims to identify compliance risks and determine the mix of activities required to treat identified risks. The ANAO also found that by more closely integrating risk management and compliance planning processes, ILEC could better target its highest-level compliance risks. As noted earlier, ILEC has implemented a revised business planning model for 2005–2006.

## Compliance products and processes

**4.10** The ANAO noted that ILEC uses several approaches to manage GST compliance in the large business market segment. These align with the ATO's Cooperative Compliance Model and include: marketing and education, client relationship management, provision of interpretative advice and active compliance audit and verification activities. Table 4.1 details compliance activities planned and completed by ILEC during 2004–2005.

**Table 4.1**

### ILEC planned and completed compliance activities - 2004–2005

Compliance Activity	Number of Planned Activities	Number Activities Completed
Marketing and education	122	85
Provision of interpretative advice		
- GST Public Rulings	6	4
- Private Binding Rulings	933	823
- Other advice and activities	777	727
Active compliance		
- GST audits	1 700	1 968
- Verification activities	1 029	2 384

Note: The number of compliance activities relates to all market segments. The ATO's Compliance Program for 2004–2005 detailed 1 200 planned audits for the large business market segment.

Source: Interpretation and Large Enterprise Compliance Business Unit

## Marketing and education

**4.11** The ANAO notes that marketing and education is a significant component of ILEC's compliance activity. The ILEC Business Plan for 2004–2005 outlined several activities relating to marketing and education. These included: industry partnerships, collaboration through consultative forums and client consultation.

**4.12** The ANAO found that the ATO has established relations with a range of large businesses through its GST industry partnerships and ATO forums, such as the Tax Practitioners Industry Forum and Corporate Consultative Committee. These groups and forums provide an opportunity for large businesses and industry to raise and discuss emerging GST issues. ILEC also uses these forums to inform industry and large business about issues effecting the management of GST, potential areas of higher-risk and its approach to managing these.

**4.13** The ANAO noted that the frequency of the industry partnership meetings has reduced over time in response to decreased need. The ANAO considers that this is to be expected following the introductory period for the GST system. In consulting with a range of large business representatives and professional associations, views about the effectiveness of the partnerships for large business was mixed. The ANAO noted concern about the number of ATO audit staff participating in industry partnership meetings. Large businesses advised that they felt reluctant to discuss openly certain issues, due to reservations about the information being used by ILEC to select clients for review and/or in conducting audits. ILEC advised that the ATO does not use the industry partnership as a means of selecting clients for audit.

**4.14** The ANAO considers that to manage client expectations, the ATO should clearly communicate to its clients the intended purpose of the industry partnership meetings. ILEC advised that the aim of the industry partnerships is to provide senior industry representatives and the ATO with a forum to discuss relevant aspects in the administration of the tax system, consult on any issues of concern or interest and where possible resolve such issues. The ANAO also considers that the ATO should review the mix of staff participating in these meetings to ensure a balanced representation between audit and interpretations staff. There may be need for additional staff with an interpretations background to participate in the industry partnership meetings.

## Client relationship management

**4.15** ILEC advised that each of its clients has a Client Relationship Manager (CRM). The CRM is responsible for routine contact with clients in the large business market segment. The ANAO noted that ATO Policy precludes the CRM from authorising the conduct of an audit for an allocated client, or signing-off an audit at its completion. This approach is sound management practice.

**4.16** The ANAO found that ILEC had not developed a role or duty statement for the CRM capability. The ANAO also found that large businesses consulted during the audit were not aware that they had a CRM. The ANAO noted that the LCCP Review recommended that in relation to the CRM role, ILEC defines the role and implements the CRM capability consistency across the assurance programs. The ANAO supports this recommendation.

**4.17** The ANAO considers that the CRM concept is a sound initiative, but suggests that ILEC communicates to its clients the contact details of their CRM and their role. This would provide ILEC's large business clients with a clear communication channel and a mechanism for raising and escalating issues. Stronger relationships between ILEC and its large business clients would also assist ILEC in maintaining its client profiles. ILEC advised that it is planning to define the CRM role, develop a role statement and identify the associated skills set. ILEC is also planning to communicate the CRM role to its staff and clients.

### *Measuring client contact and interaction*

**4.18** The ANAO found that client interaction is an important part of ILEC's overall compliance strategy. Notwithstanding, ILEC does not record direct or one on one client contact. The ANAO considers that ILEC should expand its existing performance measures to include measures relating to direct client contact.<sup>58</sup> The ANAO also considers that ILEC should regularly monitor and report on direct client contact. Regular contact between ILEC and its large business clients would assist it in maintaining good client relations and building large businesses' confidence in the GST system. Measuring direct client contact would also support ILEC in assessing the effectiveness of its CRM strategy. The ANAO has been advised that this will be considered as part of the ATO's response to the LCCP Review recommendation relating to the CRM role.

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<sup>58</sup> Refer to chapter two, *Aspects of Governance*, for a more detailed discussion of ILEC's performance monitoring and reporting.

## Provision of interpretative advice

**4.19** The provision of interpretative advice to taxpayers is an important part of the ATO's role. The ATO assists taxpayers to understand their obligations in Australia's self-assessment taxation system through the provision of interpretative advice. The onus is on taxpayers to apply the taxation law correctly to their circumstances.

**4.20** Interpretative advice may be provided to taxpayers on taxation issues either individually or collectively. This is generally achieved through the issuing of public taxation rulings, taxation determinations, private bindings rulings (PBR), fact sheets and other technical publications.

**4.21** As at 1 September 2005, the ATO had issued 108 GST public rulings that may apply to ILEC's clients. The selection of issues to be addressed as public rulings occurs through the ATO's priority technical issues process. This process aims to identify and manage technical issues that are associated with the ATO's highest-level risks. Priority technical issues are prioritised on the basis of how important resolving the technical issue is to reducing the risk. ILEC advised that potential priority technical issues are escalated internally through its senior managers to the ILEC Executive. As discussed in chapter three, *Compliance Risk*, ILEC has advised that potential priority technical issues will also be referred to the GST Risk Management Committee.

**4.22** The ANAO noted that the ATO issued 662 private rulings to ILEC clients in 2004–2005. A criticism from ILEC's clients consulted during the audit was the timeliness of PBRs. The ATO's Taxpayers' Charter outlines Service Standards for the provision of written advice, which includes PBRs.<sup>59</sup> ILEC's overall performance with respect to the Taxpayers' Charter timeliness standard for the provision of written advice is presented in Table 4.2.

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<sup>59</sup> The ATO's Taxpayers' Charter Service Standards state that the ATO will aim to provide a response within 28 days of receiving all the necessary information. If further information is needed to make a decision, the ATO aims to contact the client within 14 days to ask for the information. If the ATO finds that the request raises particularly complex matters that will take more than 28 days to resolve after receiving all the required information, it aims to contact the client within 14 days to negotiate an extended reply date. For further information refer to: <http://www.ato.gov.au/corporate/content.asp?doc=/content/25940.htm>.

**Table 4.2****ILEC's performance against the Taxpayers' Charter timeliness standard for the provision of written advice**

Details	2002–2003	2003–2004	2004–2005
Number of PBRs requests received	905	919	662
Number of PBRs finalised	1014	887	695
Per cent passed Taxpayers' Charter timeliness standard	78.49	86.01	86.85
Average elapsed time (days) <sup>60</sup>	74.01	42.08	55

Source: Interpretation and Large Enterprise Compliance Business Unit

**4.23** The ANAO noted that for particularly complex matters the ATO may request additional information and negotiate an extended reply date. Due to the complex nature of technical issues in the large business market segment, this would be expected to occur regularly. ILEC clients consulted during the audit advised the ANAO that additional information requests resulted in delays to PBRs being issued. However, in their view, the information requested did not always relate to the issue outlined in the request for a PBR. ILEC clients further advised that they would appreciate the opportunity to liaise directly with the ATO's interpretations' staff in resolving complex technical issues. This could involve large business clients or their representatives meeting with Centre of Expertise<sup>61</sup> staff to work through the details of the PBR request and existing business processes.

## Active compliance

**4.24** Activities undertaken as part of ILEC's active compliance program include verification of exceptions generated by the RRE through to a range of compliance audit activities. Table 4.3 details GST audits and verification activities planned and completed by ILEC in 2004–2005, and the number completed in the large business market segment.

<sup>60</sup> The average elapsed time relates to the time period between receipt of the PBR request and issuing of the PBR. A PBR may be issued within the Taxpayers Charter Standards, but the elapsed time may exceed the Standard, where the ATO has requested additional information from the taxpayer or negotiated an extended reply date.

<sup>61</sup> The ATO developed and implemented Centres of Expertise in order to ensure consistency in technical decision-making. All interpretative advice provided to taxpayers must rely on ATO precedential views. These are the settled ATO view of the tax law. Precedential views are published in such documents as public rulings, publicly issued draft public rulings and ATO interpretative decisions.

**Table 4.3****GST large business market segment audit and verification program for 2004–2005**

Details	Planned activities ILEC	ILEC completed all market segment	ILEC completed large market segment	GST Business Line completed large market segment
Comprehensive Audits	27	71	58	58
Issue Audits	1 069	1 016	762	822
BAS Integrity Audits	108	94	68	68
Refund Integrity Audits	496	787	255	255
Sub-total audit activities	1 700	1 968	1 143	1 203
Verification Activities	1 029	2 384	1 171	2 258
Total	2 729	4 352	2 314	3 461

Note 1: The 1 700 audits planned relates to all market segments, the ATO's Compliance Program for 2004–2005 detailed 1 200 planned audits for the large business market segment.

Source: Interpretation and Large Enterprise Compliance Business Unit

**Verification of RRE work items**

**4.25** As discussed earlier, the RRE forms part of the ATO's overall approach to managing GST compliance. The RRE is designed to monitor activity statement refunds against a range of risk characteristics (exception tests). The RRE generates a work item when an activity statement fails one or more exception tests. Work items that relate to ILEC clients are forwarded to the assurance programs for review.

**4.26** The Inspector-General of Taxation completed a *Review of Tax Office administration of GST refunds resulting from the lodgement of credit BAS*.<sup>62</sup> In response to issues raised during the review, ILEC revised its policy for managing BAS refunds. The changes aim to minimise the time between the lodgement of BASs and the issuing of refunds. The associated policy includes a range of administrative processes to ensure the integrity of refunds paid. Due to the timing of fieldwork for this audit, the ANAO did not examine ILEC's implementation of the policy. Implementation of the policy will be examined as part of the ANAO's performance audit of activity statement high-risk refunds.

<sup>62</sup> The Report was publicly released on 24 May 2005.

### Targeted active compliance activities

**4.27** The ANAO found that ILEC has implemented a GST compliance program that is designed to focus on refund and BAS integrity and areas of potential non-compliance. As presented in Table 4.3, the ATO uses a variety of audit products in undertaking its active compliance program. These products can be tailored to address specific risks. Table 4.4 outlines the outcomes of the ATO's GST active compliance program in the large business market segment between 2002–2003 and 2004–2005. The total value of GST adjustments from all active compliance activities in the large business market segment is also detailed.

**Table 4.4**

#### Details of completed GST audit and verification activities in the large business market segment 2002–2003 to 2004–2005

Details	2002–2003 <sup>1</sup>	2003–2004	2004–2005
Audits planned (ATO's Compliance Program) <sup>2</sup>	1 023	1 430	1 200
Audits completed <sup>2</sup>	934	1 314	1 203
Net value of adjustments arising from audits <sup>2</sup>	\$239 million	\$315 million	\$381 million
Number of cases completed by ILEC	-	3 231	2 330
Net value of adjustments made by ILEC	-	\$279 million	\$343 million
Total number of cases completed <sup>2</sup>	-	8 462	6 158
Net value of adjustments and penalties <sup>2</sup>	-	\$320 million	\$425 million

Note 1: The data for 2002–2003 relates to all audits activities completed by ILEC, data was not available for the large business market segment.

Note 2: Although ILEC is the area of the ATO responsible for managing GST compliance in the large business market segment, some compliance activities are undertaken by other areas of the ATO.<sup>63</sup> ILEC completes approximately 95 per cent of GST audits in the large market.

Source: Interpretation and Large Enterprise Compliance Business Unit

**4.28** The ANAO observed that in 2004–2005, a significant number of ILEC's audits occurred in response to potential risks identified at the economic group, entity or transaction levels. This may have limited ILEC's ability to target its highest-level and most severe risks through its compliance activities. This would include risks at the whole-of-market, tax issue and industry levels.

**4.29** The ANAO acknowledges that some areas of higher-risk have been addressed through industry based compliance activities. Notwithstanding,

<sup>63</sup> For example, General Compliance is responsible for undertaking the review of deferred GST for all clients including those in the large market.

case selection supporting these activities has occurred at the assurance program level. Case selection is largely based on local knowledge. The ANAO considers that a systematic assessment of potential risks is required to ascertain if the risks have an impact across the large business market segment. Informed management decisions can then be made about the treatment of the risk and allocation or reallocation of resources, if required. The ANAO observed that where strategic compliance risks are identified, ILEC has reallocated resources to the treatment of these. ILEC advised that it has developed mitigation strategies for high risks in the property and construction, resources and energy, financial supplies and motor vehicle industries.

**4.30** The ANAO noted that the ATO's Compliance Program for 2005–2006 highlights a number of areas where ILEC has been successful in raising significant GST adjustments. During 2004–2005 in the banking, financial supplies and insurance industries, 250 audits were completed. These audits focused on complex risks and GST refunds. From this compliance activity ILEC raised GST liabilities of \$54.5 million. Another risk area where ILEC undertook a number of audits was unusual or one-off transactions. Of the 73 audits completed in relation to this risk area, ILEC completed 43 cases relating to the disposal of assets. This generated additional GST revenue of \$1.6 million.

#### *Timing/age of active compliance cases*

**4.31** When the ANAO consulted with ILEC's clients, the time taken to complete audits was raised as an issue. In reviewing the timeliness of audits the ANAO noted that ILEC has established benchmark times for the completion of each type of audit product. These range from 40 days for a non-lodgement check through to 360 days for a comprehensive audit. The ILEC Executive and assurance programs regularly review the status of aged cases. The ANAO considers that this is indicative of good practice, but considers that the ILEC Executive should pay particular attention to resolving delayed cases. The timely completion of GST audits in the large business market segment:

- minimises compliance costs for large businesses where GST adjustments are being made. This is achieved through reducing the General Interest Charge Payable on the value of GST adjustments;<sup>64</sup>

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<sup>64</sup> The General Interest Charge (GIC) is a uniform interest charge imposed where there is a late payment of a tax debt. It is a common rate of interest that is applied across all liabilities administered by the ATO, including: liabilities arising from the lodgement of an activity statement, an ATO notified notional amount, or a penalty not paid by the due date. GIC accrues from the due date until the amount is paid in full.

- builds confidence in the ATO's administration of the GST system; and
- is indicative of sound management practice.

**4.32** Given client concerns regarding the duration of audits, the ANAO suggests that ILEC should maintain regular contact with its clients during the conduct of audits and advise them of any delays in the audit process. The ANAO noted that ILEC has established a case leadership function. This function is to provide whole of GST leadership and direction on the more difficult and complex aged cases, including building and developing staff capability. The ANAO was advised in June 2005 that the Business Management Group is now also monitoring aged cases and will look at strategies to resolve delayed cases. As noted in chapter one, the Inspector-General of Taxation has also reviewed this aspect of tax administration.

### **Cooperative compliance advance agreement**

**4.33** To support self-regulation,<sup>65</sup> ILEC has piloted a cooperative compliance advance agreement (CCAA) with one of its clients. The concept of the CCAA is directed at delivering greater certainty, reduced costs and improved administration for both the ATO and the large business, in their GST dealings. The agreement involves the ATO assessing the integrity of the client's systems for managing GST. If satisfied with the systems' controls and their application, the ATO commits to reduced audit activity. The client is required to report to the ATO changes to its GST systems. The ATO entered into its first CCAA in April 2003.

**4.34** ILEC's clients or their representatives, consulted during the audit, expressed mixed views about the CCAA concept. Overall, they felt that the ATO's requirements exceeded the expected benefits. ILEC advised that the CCAA program has been reviewed, with the GST Board recommending withdrawal of the relevant ATO policy document (Practice Statement Law Administration 2004/2). A new practice statement is to be developed to reflect alignment with the ATO's Forward Compliance Agreement (FCA) process.<sup>66</sup>

<sup>65</sup> Self-regulation relates to entities regulating their GST obligations in accordance with the GST legislation, without being subject to a high level of ongoing scrutiny by the ATO. This is achieved by the ATO committing to a lower level of audit activity than otherwise may be the case.

<sup>66</sup> The ANAO noted that the FCA model builds on the CCAA concept and similar arrangements relating to the management of international transfer pricing. The FCA concept includes all taxes. The ATO was piloting an FCA and was expecting to have formed views about product design by June 2005. The ATO had consulted with the Corporate Consultative Committee on the progress of the FCA pilot.

The ANAO considers that in order to manage client expectations, ILEC should communicate to its clients the ATO's position regarding the use of CCAAs and/or FCAs.

## **Aggressive tax planning**

**4.35** The ANAO noted that to mitigate the risk of GST aggressive tax planning, the ATO established the GST Aggressive Tax Planning Assurance Program. For administrative purposes the GST Aggressive Tax Planning Assurance Program is part of ILEC, but has a whole of GST focus. It has a broad support role that ranges from providing input into Treasury's legislative development process and GST public rulings through to the management of settlements and liaison with the area of the ATO responsible for the collection of debt. The ANAO considers that this demonstrates a sound approach to managing an identified class of GST compliance risks in a comprehensive and coordinated manner.

## **Conclusion**

**4.36** The ANAO considers that overall, ILEC's compliance products and processes for managing GST compliance in the large business market segment are sound. The ANAO found that ILEC had developed and implemented a range of compliance products and processes. These include education and advice products, such as GST fact sheets and GST public rulings, through to active compliance audit products. Application of these products is outlined in the ATO's Compliance Program and ILEC's Business Plan. While ILEC's compliance program covers a broad range of activities, the ANAO found that it largely focuses on active compliance (audit and verification) activities. These are activities that would generally result in an adjustment to the GST payable.

**4.37** During the audit the ANAO consulted with a range of large business representatives and professional associations about the ATO's management of GST compliance in the large business market segment. Generally stakeholders indicated a level of support for the ATO's approach. Notwithstanding, the consultation process identified a number of issues. The ANAO noted that the ATO received similar feedback as part of the LCCP Review and is working towards resolving these issues.

## Analysing compliance outcomes

**4.38** The ANAO considers that recording and assessing compliance outcomes is important to inform future compliance planning and the targeting of compliance risks. The ANAO identified that ILEC uses two main systems to manage audit cases. One system is used to record and manage workflow and case allocation, while the other system is used to record case results, client interactions and correspondence during an audit. The ANAO identified that the assurance programs also use a range of spreadsheets and local databases to record planned audits, audits in progress and audits finalised. These are used to support case management within the assurance programs. The ATO advised that it is implementing an organisation-wide case management system as part of its Easier, Cheaper, and More Personalised Program.

**4.39** In reviewing ILEC's management of GST compliance in the large business market segment the ANAO considered that ILEC inconsistently used compliance case results to inform future compliance planning and case selection. High-level information such as return on investment has been used in assessing the effectiveness of audit products. However, compliance outcome data was not consistently used to assess the effectiveness of compliance risk treatments.

**4.40** The ANAO considers that ILEC, in developing its compliance program, should identify its expected compliance outcomes and then evaluate the effectiveness of its compliance program in treating its identified compliance risks. Where growth in revenue is being used as a key indicator, the ANAO considers that these figures would need to be discounted for overall growth across the large business market segment and/or growth by industry sector. Growth in some industry sectors may exceed average economic growth or GDP.

**4.41** The ANAO further considers that ILEC's outcome measures should extend beyond revenue assessment as not all compliance activities result in a direct revenue return.<sup>67</sup> As part of this process ILEC could aim to identify changes in compliance behaviour over time. One approach would be for ILEC to undertake an analysis of key compliance indicators for an industry, or group of clients, prior to the commencement of compliance activities. This would establish a baseline, against which compliance behaviour could be assessed

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<sup>67</sup> ILEC's compliance strategies and processes include a broad range of activities, both audit and non-audit related.

one or two years on. The ANAO noted that in 2005–2006, ILEC intends to explore the use of analytics to extract outcomes from case data into its Healthcard2 system. ILEC is also planning to enhance its risk processes with a view of improving case selection. ILEC advised that it currently measures the outcome of its compliance activities through changes in revenue, the assessment of quality assurance outcomes, professionalism survey results and through the public rulings panel process.

## Conclusion

**4.42** The ANAO found that ILEC could more systematically assess its compliance results, including effectiveness, to inform future compliance planning, the targeting of compliance risks and effective case selection. The ANAO also considers that ILEC's ability to assess the outcomes of non-audit activities is important in demonstrating the effectiveness of these approaches in managing GST compliance risks.

## Recommendation No.4

**4.43** The ANAO recommends that to inform future compliance planning and case selection, the Interpretation and Large Enterprise Compliance Business Unit:

- (a) identifies and documents its expected compliance outcomes, including changes in compliance behaviour over time, as part of its compliance planning; and
- (b) routinely evaluates the outcomes and effectiveness of its compliance program and activities, including the effect of its non-audit compliance products.

### *ATO response*

**4.44** Agreed. The identification of compliance outcomes, evaluation of initiatives, actions and overall effectiveness are key areas of focus for all ATO elements operating under the ATO Compliance sub-plan. We acknowledge that this is a capability we need to further develop and work continues at the ATO level on improving our approaches to measuring the effectiveness of compliance activities. The GST business line will develop its capability in line with improvements to wider ATO processes.

- (a) ILEC is continuing to work on improving its compliance planning processes. The processes and plans have been significantly improved for 2005–06 in comparison to prior years. ATO Compliance approaches

planned are articulated in the ATO 'Compliance Program' booklet. The current booklet 'Compliance Program 2005–06' is the fourth publicly released compliance program. In addition to including a summary of prior year results at the front, this publication includes highlighted results by market segment. GST ILEC outcomes are included in the section devoted to Large Business.

- (b) At the corporate level, the ATO is developing a range of effectiveness indicators around compliance performance, with a view to publishing these in the 2006–2007 Compliance Program. In GST, as part of the GST Risk Management Framework, there will be a greater focus on measuring and evaluating the effectiveness of compliance strategies. Initially, we will be developing measures for assessing the effectiveness of the mitigation strategies aimed at treating our highest priority risks.

## Compliance procedures and work practices

**4.45** Well-documented procedures and reference material are important to support staff in undertaking active compliance activities. This provides staff with the information necessary to undertake these activities and make informed and consistent decisions. The ANAO noted that with the introduction of the GST, the ATO developed an on-line manual of policies and procedures and other documentation for all GST Line staff. ILEC specific active compliance procedures, processes and templates are stored on the system. The system is a structured reference source that is easily searchable. It is available to ILEC staff through a link on the ATO's Intranet.

**4.46** The ANAO found that ILEC has developed a number of supplementary communication products and processes to keep staff up to date with changes in policy and work practices. ILEC has also established user feedback processes to support ongoing development of its products.

**4.47** The ANAO observed that the LCCP Review assessed ILEC's active compliance audit products. The LCCP Review team examined a sample of 38 completed audit cases to validate its observations. In summary, the LCCP Review found that ILEC's audit processes were operating well and aligned with the practices of other jurisdictions. However, the review observed inconsistent application of the processes and made a recommendation that ILEC enhance its processes. The recommendation focused on two issues:

- project management of audits; and
- performance management of non-audit strategies and initiatives.

While the ANAO did not assess the effectiveness of individual audit products, the ANAO completed two case study reviews to enhance our understanding of ILEC's processes for completing GST audits. In respect of ILEC's audit process, the ANAO's case study results support the LCCP Review recommendation.

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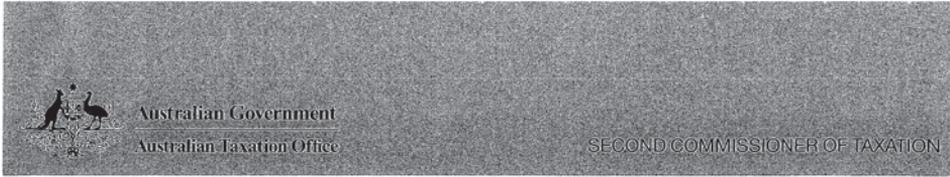
Ian McPhee  
Auditor-General

Canberra ACT  
18 October 2005

# Appendix



# Appendix 1: Agency response



Mr Peter White  
Executive Director  
Performance Audit Services Group  
Australian National Audit Office  
19 National Circuit  
Barton ACT

Dear Mr White

**Performance Audit – Australian Taxation Office – Administration of Goods and Services Tax Compliance in the Large Business Market Segment.**

Thank you for your letter of 22 August 2005 and the opportunity to provide comments on the proposed audit report on the ATO Administration of Goods and Services Tax in the Large Business Market Segment.

The Tax Office supports the recommendations contained in your report and has provided a response to each

We recognise the important role played by large businesses in the operation of the GST system and the impact that their compliance behaviour can have on industry, revenue and community confidence. During 2004/05 GST focussed considerable energy toward strengthening our approach to large market issues and identified gaps in our systems.

In September 2004 the Tax Office commissioned a review of the GST Large Corporate Compliance Program (LCCP). In addition to key findings which indicated that we have the hallmarks of a good indirect tax system, areas were identified that will help meet the challenges of a maturing GST system.

One of the major initiatives implemented as a result of this review, is a more sophisticated GST Risk Management Framework. We appreciate that the ANAO performance audit has recognised the LCCP review, and are pleased that the ANAO report recommendations complement the initiatives that have commenced.

Should you wish to discuss any of these matters, please contact Toni Balik on 03 9275 5073 or Deborah Pearce on 03 9275 4889.

Thank you for the collaborative and constructive approach your office has taken to this performance audit. In particular, we appreciate both the professionalism and thoroughness demonstrated by ANAO officers Andrew Huey and Kirsty Stuart in their dealings with ATO representatives.

Yours sincerely

Jennie Granger  
Second Commissioner of Taxation

16 September 2005

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