

The Auditor-General
Audit Report No.30 2005–06
Performance Audit

The ATO's Strategies to Address the Cash Economy

Australian Taxation Office

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of Australia 2005

ISSN 1036–7632

ISBN 0 642 80890 2

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Canberra ACT
28 February 2006

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 *The ATO's Strategies to Address the Cash Economy*.

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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Contents

Abbreviations	7
Summary and Recommendations	9
Summary	11
Introduction (Chapter 1)	11
The ATO's Strategies (Chapter 2).....	13
Management Arrangements (Chapter 3)	14
Application of the Strategies (Chapter 4)	15
The ATO's Impact on the Cash Economy (Chapter 5)	16
Audit Conclusion	18
Recommendations	18
The ATO's Response	19
Recommendations.....	20
Audit Findings and Conclusions	23
1. Introduction.....	25
The Australian Taxation Office	25
The cash economy	25
The size and significance of the cash economy.....	26
The ATO's compliance task and the features of the New Tax System.....	28
The demographics.....	29
The ATO organisational arrangements for the cash economy	30
Previous ANAO report on the cash economy	31
Overseas jurisdictions	32
The audit.....	33
2. The ATO's Strategies	36
Introduction.....	36
Cash economy strategies and compliance principles	37
Cash Economy Task Force.....	38
Intelligence and risk management and ATO corporate level planning and reporting	39
Public statements of the ATO approach	41
3. Management Arrangements.....	43
Introduction.....	43
Responsibilities	43
ABN Integrity and Cash Economy Branch	44
Cash Economy Steering Committee	45
Management oversight of cash economy compliance projects	46
Management of GST Field teams	50

Staff turnover and capability.....	51
4. Application of the Strategies.....	53
Introduction.....	53
Targeting cases for the risk projects	53
Compliance measures by the cash economy project teams.....	56
Key compliance activities by other parts of the ATO supporting cash economy compliance	60
ATO external relationships	64
5. The ATO's Impact on the Cash Economy.....	69
Introduction.....	69
Existing measurement arrangements	70
Evaluation strategy.....	72
Compliance dividend	74
Appendices	77
Appendix 1: Agency response	79
Appendix 2: ANAO review of ATO action on the previous audit (Audit Report No.35 2001–2002)	84
Index.....	88
Series Titles.....	89
Better Practice Guides.....	92

Abbreviations

ABN	Australian Business Number
AICE	ABN Integrity and Cash Economy branch
ANAO	Australian National Audit Office
ATO	Australian Taxation Office
BAS	Business Activity Statement
CEI	Cash Economy Initiative
CESC	Cash Economy Steering Committee
CETF	Cash Economy Task Force
GST	Goods and Services Tax
HOTSA	Health of the System Assessment
IAWG	Inter Agency Cash Economy Working Group
JCPAA	Joint Committee of Public Accounts and Audit
SB	Small Business
SNCC	Serious Non Compliance Capability
SRM	Strategic Risk Management unit
TFN	Tax File Number

Summary and Recommendations

Summary

Introduction (Chapter 1)

1. The Australian Taxation Office (ATO) is the principal agency charged with administering Australian tax law. The ATO defines the 'cash economy' as 'all legal transactions which are not disclosed and result in evasion of tax'. The 'cash economy' is often synonymous with undisclosed or omitted income or supplies, but it also includes those operating outside the tax system. According to the ATO, the major tax risk arising from the cash economy is business income not being reported.

2. Since the cash economy is 'hidden' activity, it is difficult to quantify with any precision. Estimates prepared by different parties, applying various methodologies and assumptions, vary widely and are subject to debate. At the lower end of the range of estimates, in 2003 the Australian Bureau of Statistics estimated that the cash economy was highly unlikely to understate the level of Gross Domestic Product in 2000–01 by more than about 2 per cent. This translates into a value of \$13.4 billion in 2000–01. The Department of the Treasury considers that the Australian Bureau of Statistics' estimates, while at the lower bounds of estimates of the cash economy, come from a highly credible source and are calculated by reference to the maximum plausible extent to which industries and activities could be engaged in cash economy transactions.

3. The ATO does not attempt to estimate the size of the 'cash economy tax gap' (the gap attributed to the use of cash and not declaring income). The ATO reasons, having also considered overseas practice in measuring the tax gap, that accurate and defensible measures of the tax gap are impossible to achieve in a practical sense. It considers that the time, cost and the intrusive burden on taxpayers imposed by an exhaustive exercise rule out conducting such an estimate.

4. Regardless of uncertainty around its actual size, the cash economy is a significant issue because it results in lost tax revenue and the unfair shouldering of the tax burden between taxpayers. The ATO has identified the cash economy as a focus area for its compliance efforts over successive years. In addressing the cash economy, the ATO aims to optimise revenue and maintain community confidence. The ATO seeks to implement an effective compliance regime that avoids excessive costs on taxpayers.

ATO organisation for the cash economy

5. The profile of the cash economy in the ATO has changed over time. In more recent years, there have been the rejuvenated activities of the Commissioner of Taxation's advisory body, the Cash Economy Task Force, the expanded cash economy program of compliance activities in 2002–03, the development and refinement of strategies and lines of responsibility and the formulation of dedicated cash economy teams in 2003–04. These initiatives flow, in part, from legislative changes associated with the Government's tax reform initiatives of 1999–2000. These include introduction of the Australian Business Number, activity statements and withholding arrangements.

6. As to staffing directly related to cash economy matters, the ATO had approximately 600 full time equivalent staff assigned to cash economy projects in 2004–05. In addition to these dedicated staff, some 162 staff worked on cash economy risk issues and cash economy-related complex audit matters but were not specifically or wholly engaged in cash economy work. The ATO spent a total of \$53 million in 2004–05 (in direct costs) on dedicated cash economy projects. This compares to total ATO expenditure on compliance of over \$1.2 billion in the same period.

Previous audit

7. The Australian National Audit Office (ANAO) tabled Audit Report No.35 2001–02 *ATO Progress in Addressing the Cash Economy* in March 2002. The current audit found that the ATO had fully implemented four of the five recommendations of Audit Report No.35, but was still to fully implement an effective community education program, as recommended.

Overseas jurisdictions

8. The ANAO reviewed overseas practice to appreciate the wider context for the ATO's cash economy administration and to compare the approaches used in other jurisdictions (namely New Zealand, United Kingdom, United States and Canada). As might be expected, the ANAO found that the cash economy is a problem in other countries. The ANAO review also highlighted that the ATO's strategic approach is consistent with other jurisdictions, but unlike the United Kingdom and the United States, the ATO does not measure the tax gap in aggregate for the reasons outlined in paragraph 3, above.

Audit objectives and scope

9. The objective of the audit was to assess the ATO's strategies to address tax evasion in the cash economy, with emphasis on:

- the ATO's strategic focus;
- aspects of governance, management processes and compliance activities; and
- responses to the ANAO Report No.35 2001-02 *ATO Progress in Addressing the Cash Economy*.

10. The ANAO focussed on the work of the ATO's dedicated cash economy teams. In examining the application of the ATO's management processes, the ANAO considered a selection of the ATO's cash economy projects (namely hotels and licensed clubs; the adult industry; restaurants, cafes and takeaways; fishing; and low documentation loans). This selection of cash economy projects allowed the ANAO to review some of the practical features of projects of different scope, size and degrees of maturity. Our comments on the ATO's strategy, management and governance arrangements seeking to address the cash economy reflect this focus.

The ATO's Strategies (Chapter 2)

Strategic directions

11. The ANAO found that the ATO has appropriate strategies for its cash economy work, identifying that the ATO's vision is to secure taxpayer compliance and apply targeted compliance approaches where necessary. The guiding principles of compliance management underpin the ATO's strategies and cash economy work.

12. The principal longer-term influence on the ATO's cash economy strategy directions comes from the Commissioner of Taxation's advisory body, the Cash Economy Task Force.

13. Although the ATO's Compliance Plan sets out publicly the ATO's proposed areas of attention and activities, the ATO does not have a clearly-expressed, public statement of its approach or rationale in applying its cash economy strategies. Such a statement could help to improve public understanding of the issue and the ATO's resolve to address it. Feedback to the ANAO from tax and accounting professional association stakeholders was that

they would appreciate information on the ATO approach. The ANAO considers that the ATO should publicise such information.

Intelligence and risk

14. The ANAO found that the ATO's strategies and activities are informed by intelligence and risk management processes. These risk and intelligence management processes contributed to the ATO's planning and reporting processes and documents, at the corporate level, as intended.

Management Arrangements (Chapter 3)

The Cash Economy Steering Committee

15. The ATO has a matrix management approach to dealing with the cash economy, with responsibilities crossing ATO business line boundaries. The Cash Economy Steering Committee (CESC) is the ATO's key means for overseeing and coordinating its cash economy compliance activities.

16. The ANAO found that the ATO has not comprehensively documented the role or charter for the CESC. The ANAO considers that given the significance of the CESC as a management forum, the Committee's roles and responsibilities should be clearly set out.

Industry project management

17. At any one time the ATO has identified a number of distinct industry groupings to address as part of its cash economy work, with designated industry compliance teams addressing the different industries. These groupings include: property and construction; restaurants, cafes and takeaways; and the adult industry. The ANAO found that the ongoing management of individual industry projects occurs through a well-developed project management system.

Improved transparency in cash economy activity

18. The ATO's cash economy industry teams undertake a broad range of compliance work related to selected industries as part of their work on the cash economy. Work done by the cash economy industry teams resulted in revenue adjustments (not including penalties) of \$196 million in 2004–05.

19. However, the ANAO found that there is a risk that the ATO could overstate the resourcing and results attributed to cash economy work by the cash economy industry teams. This risk arises by the ATO not explicitly

recognising in the planning and reporting for cash economy industry teams that they will, by necessity, carry out certain work that is not cash economy (omitted income) compliance work.

20. The ATO advised that it has moved to improve the transparency and accuracy of cash economy planning and results reporting for 2005–06 and that the transparency of cash economy activity and results will be further enhanced from mid–2006 with the introduction of a new case management system. The system will allow for more detailed identification and monitoring of compliance activities and results.

Application of the Strategies (Chapter 4)

21. Applying the strategies, day to day, in the cash economy risk projects involves a large range of case selection and compliance activities. The case selection activities include profiling and analytical work using data matching, community information, project-based work and random selection of businesses. The compliance activities include advisory products and activities, review products and enforcement products. In 2004–05, staff in the designated cash economy risk projects undertook work on some 22 cash economy projects, involving 38 000 cases. The ANAO found that the range of case selection and compliance activities used by the cash economy teams is appropriate in applying the ATO's cash economy strategies.

Business-to-consumer transactions

22. The ANAO found that the emphasis in the risk projects' strategies, and the ATO's compliance approach more generally, tends to be on the 'business end' of industries. The ATO's approach, including its communication and education dimension, is less well-developed in dealing with the 'business-to-consumer' transactions.

23. The ATO accepted the Cash Economy Task Force's recommendations of 2003 that it develop its cash economy strategies with greater attention to cash dealings between businesses and consumers. The ATO conducts compliance treatments on business-to-consumer transactions and industries that deal directly with the general public. These include work as part of the adult industry; hotels and registered clubs; and the restaurants, cafes and takeaways industries projects. However, the ATO's 'community education' work is still in its developmental phases. The ATO has commissioned research on community and business perceptions and is testing communication products (such as posters and advertising) in selected industries. In addition,

the ATO intends to monitor community-focussed advertising activities conducted in overseas jurisdictions.

24. The ATO also advised that in 2005–06 its building and construction industry group is to undertake some specific compliance activities and interventions directed to consumers. This activity involves, for example, following up on consumers' renovations work by reviewing development applications to local councils and asking consumers about the value of work, payment and tax aspects of domestic construction work they have had done.

25. Given the significance of community attitudes in securing business-to-consumer compliance in the cash economy, the ANAO considers that it is important that the ATO expedites the formulation and implementation of a community education campaign.

Working with industry and professional bodies

26. The ATO has a wide span of relationships with industry parties. Industry and other representative bodies advised that overall, the relationship was productive and they appreciated the contacts they had with the ATO on industry, tax and cash economy matters and the occasions on which the ATO provided timely feedback on the matters on which they had been consulted.

27. Tax practitioners are a key leverage point between the ATO and taxpayers. Tax and accounting professional bodies consider that community engagement is an important influence on the success of the ATO's cash economy compliance work. The ANAO considers that there is merit in the ATO working with the tax and accounting bodies more extensively to promote cash economy compliance, including developing ideas on relevant cash economy compliance messages and ways to convey them through the professional associations' activities.

The ATO's Impact on the Cash Economy (Chapter 5)

Assessing the impact of the compliance activities

28. Since the cash economy is 'hidden' activity and it is difficult to quantify the revenue gap in aggregate, the ATO needs some mechanism to judge the impact of its cash economy compliance projects and activities. Assessing impact involves determining whether compliance work improves overall industry compliance in cash economy areas. The key impact requiring measurement is the effect occurring from particular compliance treatments on

the overall level of compliance and behaviour in specific cash economy industries, as demonstrated by tax revenue growth. Another impact that is useful for the ATO to measure is the effect on specific taxpayers who have been subject to compliance activity.

29. The ANAO found that the ATO's various cash economy activity reports do not allow the ATO to demonstrate reliably the impact of its activities in cash economy industries, over time.

30. Given the considerable attention and resources allocated by the ATO to cash economy compliance, the ANAO considers that the ATO should enhance the way it assesses its impact on the cash economy. The ANAO suggests that this could involve an evaluation strategy, building on its current approach. The evaluation strategy would: measure underlying movements in revenue collections in the cash economy industries that are being targeted (that is, abstracting from any external factors); measure changes in the attitudes of industry participants and consumers over a period of time (as reflected in changes in behaviour); and compare the tax payments of treated entities with those of non-treated entities (which the ATO already does).

Compliance dividend

31. In May 2000, before the introduction of the New Tax System, the ATO estimated that the compliance dividend it would obtain over the first three years of the operation of the New Tax System (2000–01 to 2002–03) would be \$3.4 billion and the estimated cash economy contribution towards this would be \$2.6 billion.

32. The Department of the Treasury incorporated the estimated compliance effect into the forward revenue projections for companies and 'other individuals' for 2000–01 to 2002–03. The ATO and the Treasury point out that actual collections in the relevant period exceed the projected estimates (incorporating the compliance dividend and parameter changes). However neither the ATO nor the Treasury have been able to assess the extent to which the estimated compliance revenue gains for this period were specifically achieved. The ATO advised the ANAO in September 2005 that it considers that the compliance dividend cannot be measured with any reasonable degree of accuracy.

Audit Conclusion

33. The cash economy is significant. Although it is difficult to quantify because the cash economy is hidden activity, it places billions of dollars of revenue at risk. Managing cash economy compliance is a challenging task for the ATO, particularly in finding effective compliance strategies that address community perceptions and avoiding excessive compliance costs on taxpayers. Overseas administrations face similar challenges. It is unlikely that there are strategies and a set of compliance activities that will entirely remove the cash economy.

34. The ATO has appropriate strategies to address targeted elements of the cash economy. Its strategic directions are risk-based, follow the expert advice of the Cash Economy Taskforce and are consistent with overseas approaches.

35. In its cash economy work, the ATO has sound governance arrangements with cross-line management arrangements and committee review structures for key functions. Governance can be enhanced by specifying more comprehensively the roles and responsibilities of the ATO's main cash economy management forum, the Cash Economy Steering Committee.

36. The ATO has well-developed management processes and diverse compliance activities to address the cash economy. This is characterised in the ATO's project management of cash economy risk projects operated by the dedicated cash economy teams and the targeted compliance measures applied by those teams and other parts of the ATO.

37. With regard to the ANAO Report No.35 2001–02 *ATO Progress in Addressing the Cash Economy*, the ATO has made good progress in implementing the Report's recommendations. Work still needs to be completed on the recommended community education program. This should include the significant issue of securing business-to-consumer compliance.

38. While recognising the challenges involved, the ATO does not have an effective evaluation approach to demonstrate the impact, over time, of the range of compliance activities it is undertaking in the cash economy industries that it has targeted.

Recommendations

39. The cash economy compliance management task is an ongoing one. The ANAO has made six recommendations to enhance the ATO's work addressing the cash economy.

The ATO's Response

40. The report acknowledges the ongoing challenge of addressing tax compliance within the cash economy, with generally positive reflection on the ATO's strategies and application of targeted compliance approaches.

41. The ATO welcomes the ANAO's recognition of the progress the ATO has made in meeting the previous recommendations of the *Progress in Addressing the Cash Economy* audit report of March 2002, as well as the finding that we follow the expert advice of the Cash Economy Task Force.

42. The report's recommendations give guidance with respect to improvement of strategies which are substantially agreed. Implementation of recommendations is proceeding, balancing requirements for validity, practicality and impact on taxpayers and tax agents.

43. The ATO agreed to all of the recommendations. The ATO's letter of response is at Appendix 1.

Recommendations

Set out below are the ANAO's recommendations aimed at improving the ATO's strategies to address the cash economy. 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 3, 4 and 6.

**Recommendation No.1
Para 2.23** To maximise the leverage that can be obtained through the tax and accounting professional associations and communication with the public more generally, the ANAO recommends that the ATO publish an explicit statement of its strategic approach to achieving cash economy compliance, and the underlying approach being applied, including the process of working with particular industries.

ATO Response: Agreed.

**Recommendation No.2
Para 3.15** Given the significance of the Cash Economy Steering Committee as a management forum, the ANAO recommends that the ATO set down a charter for the Committee, including its role and responsibilities, its membership, the responsibilities of the chair and members, and its relationships with other key committees.

ATO Response: Agreed.

**Recommendation No.3
Para 4.23** The ANAO recommends that for greater ATO emphasis on domestic cash dealings, the ATO establish a special focus on ATO compliance work directed at business-to-consumer transactions, with clear responsibilities within its management and reporting structure for overseeing such work and for reporting progress to the Cash Economy Steering Committee.

ATO Response: Agreed.

**Recommendation No.4
Para 4.33** The ANAO recommends that, given the significance of community attitudes in securing business-to-consumer compliance, the ATO develop and implement expeditiously a community education campaign focussing on business-to-consumer elements of cash economy compliance.

ATO Response: Agreed.

**Recommendation No.5
Para 4.52** The ANAO recommends that, in promoting the importance of cash economy compliance to the broader community, the ATO work with the tax and accounting bodies to develop ideas on relevant cash economy compliance messages and ways to convey them, including through the professional associations' activities.

ATO Response: Agreed.

**Recommendation No.6
Para 5.19** The ANAO recommends that the ATO review its evaluation approach in relation to its cash economy activity and establish mechanisms that would allow it to measure changes in underlying taxation revenue over time for particular industry sectors, and changes in the attitudes of industry participants and consumers in those sectors.

ATO Response: Agreed in principle.

Audit Findings and Conclusions

1. Introduction

This Chapter provides context for considering the ATO's strategies to address the cash economy. It outlines the concept of the 'cash economy', the ATO organisational context and the audit process.

The Australian Taxation Office

1.1 The Australian Taxation Office (ATO) is responsible for effectively managing and shaping the systems that support and fund services for Australians, and for giving effect to social and economic policy through the tax system. It is the principal agency charged with administering Australian tax law. In 2004–05, the ATO collected \$215 billion in tax, superannuation and excise revenue, and its operating expenses totalled \$2.5 billion. As at 30 June 2005 it employed 21 294 staff.

The cash economy

1.2 The ATO defines the 'cash economy' as 'all legal transactions which are not disclosed and result in evasion of tax'.¹ The Cash Economy Task Force (the Commissioner of Taxation's advisory body on the cash economy and associated compliance strategies) also excludes illicit transactions from the scope of the definition of the cash economy and defines the cash economy as:

...economic activity that is not brought to account through normal channels as required by the taxation and other regulatory systems.²

1.3 The use of cash is not illegal; what is illegal is the non-declaration of cash income or the misstatement of expenses for tax purposes that is facilitated by cash transactions without proper receipts and other documentation. Implicit in the term 'cash economy', therefore, is the notion that it refers to the use of cash³, or undertaking economic activity outside the tax system, for non-compliant purposes. The 'cash economy' is often synonymous with undisclosed or omitted income or supplies, but it also includes those operating

¹ The cash economy is also called the 'black economy' or the 'shadow economy'. The ATO's primary focus in the cash economy is on legal activities, with illegal activities being addressed via the ATO's fraud and special audit area (called the Serious Non Compliance CapabilitySNCC).

² Cash Economy Task Force Third Report, *The Cash Economy under the New Tax System*, September 2003, p1.

³ Or cheque, credit card, electronic transfer and barter.

outside the tax system. According to the ATO, the major tax risk arising from the cash economy is business income not being reported.⁴

1.4 Figure 1.1 illustrates the way in which the cash economy operates and provides an insight into the ATO's compliance work.

Figure 1.1

Case studies — The nature of the cash economy and looking for undisclosed income

Hotels and Licensed Clubs - In one pub, keg storage was found to be insufficient to hold the closing stock claimed for the period. A yield analysis showed that sales were greatly understated when yield was calculated on the kegs supplied. The owner later admitted to wholesaling a number of the kegs to small charity groups, pocketing the payments, and claiming all kegs purchased in the cost of goods sold for the main pub business.

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Restaurants, cafes and takeaways - The ATO audited a takeaway food shop reporting low income compared to similar-sized outlets. After reviewing the total meat purchased and using averages from the industry, the ATO worked out the number of takeaway meals that could be produced.

The ATO's analysis suggested a significant understatement of sales and reported income, estimated at \$225,600 in relation to the Business Activity Statement (BAS) periods for the year under review. The business owner agreed that he had not declared income of approximately \$395,000 in relation to the seven BAS periods since the inception of GST and had underpaid GST by approximately \$35,900. The ATO acted to collect the taxes due and also imposed penalties on the taxpayer.

Source: ATO

The size and significance of the cash economy

1.5 The ATO considers that the cash economy is a significant issue. It has identified the cash economy as a focus for compliance effort over successive years.⁵

1.6 Cash economy transactions may not be picked up in official statistics, such as the National Accounts, either because those statistics are based on taxation data or because transactions that go unreported for tax are also not disclosed in other government statistical surveys.

⁴ Business income may not be reported when entities:

- are completely outside the taxation system – they are not registered and they do not report activity;
- have engaged with the system sufficiently to become registered, but do not report revenue as required – they do not lodge activity statements or tax returns; or
- fulfil basic registration and lodgement requirements, but do not report all their revenue.

⁵ See references in the ATO's Compliance Program in 2003–04, 2004–05 and 2005–06.

1.7 Because the cash economy is ‘hidden’ activity, it is difficult to quantify with any precision. Estimates prepared by different parties, applying various methodologies and assumptions, vary widely and are subject to debate. In 2003, the Australian Bureau of Statistics estimated that the cash economy was highly unlikely to understate the level of Gross Domestic Product in 2000–01 by more than about 2 per cent. This translates into a value of \$13.4 billion in 2000–01.⁶ The Department of the Treasury considers that the Australian Bureau of Statistics’ estimates, while at the lower bounds of estimates of the cash economy, come from a highly credible source and are calculated by reference to the maximum plausible extent to which industries and activities could be engaged in cash economy transactions.

1.8 The ATO does not attempt to estimate the absolute size of the tax gap—or the ‘cash economy tax gap’ element of this (the gap attributed to undeclared cash transactions). The ATO reasons, having also considered overseas practice in measuring the tax gap, that accurate and defensible measures of the tax gap are impossible to achieve in a practical sense. It considers that the time, cost and the intrusive burden on taxpayers imposed by an exhaustive exercise, rule out conducting such an estimate.

1.9 Given the difficulties in quantifying the cash economy, it is not possible to assess definitively the extent to which the size of the economy has changed over time.

1.10 The significance of the cash economy is that it results in lost tax revenue and the unfair shouldering of the tax burden between taxpayers. The unfair burden is also manifest in industry competitiveness: when some industry participants reduce costs by avoiding their tax obligations, they have an unfair advantage relative to competitors who are compliant with the law. The cash economy can also be linked to employers avoiding other employment obligations such as the payment of workers compensation, superannuation or award wages. The cash economy also increases welfare costs as it affects, via some recipients’ understating their income, means tested social benefits and the child support system.

⁶ Other estimates of the size of the cash economy differ widely. For example, using survey data F Sneider, V Braithwaite and M Reinhart calculated the overall cash economy in 2000 to be valued between 4.8 per cent and 8.8 per cent of gross national income. See ‘Individual behaviour in Australia’s shadow economy: facts, empirical findings and some mysteries’, Centre for Tax System Integrity Working Paper No.19, September 2001.

Using a different methodology involving studying cash levels in the Australian economy, in 2003 C Bajada estimated the cash economy at 15 per cent of Gross Domestic Product. See C Bajada, *The tax mix and the underground economy*, Taxpayers Research Foundation, 2003.

1.11 Managing compliance in the cash economy is very important for community confidence in the tax system. This means the community's confidence that all people who should be paying tax, are paying the amount required and the tax system does not impose an undue administrative burden on compliant taxpayers.

The ATO's compliance task and the features of the New Tax System

1.12 In broad terms, the ATO's objective in devising and implementing strategies to address the cash economy is to manage taxpayer compliance so as to optimise revenue collections and maintain community confidence in the tax system. This translates into tasks for the ATO of implementing an effective compliance regime that avoids excessive costs on taxpayers, including by facilitating taxpayers' participation in the tax system, and identifying and dealing with those who do not participate as required by the law.

1.13 The New Tax System, implemented in mid 2000, introduced administrative and design features to improve tax compliance, including addressing the cash economy.⁷ According to the Commissioner of Taxation, in referring to these tax changes, 'We are better placed than ever before to detect and address evasion in the cash economy'.⁸

1.14 The ATO considers that the system's registration, tax invoicing and reporting requirements have enabled it to identify and pursue thousands of

⁷ Broadly, the system's design integrity features to improve tax compliance (especially relating to 'business-to-business' transactions) are:

- Australian Business Number (ABN) and GST registration - providing for the identification of businesses;
- Australian Business Register – allowing ABNs to be checked publicly;
- No-ABN withholding – businesses must have an ABN to deal with other businesses or have 48.5 per cent of any payments made to them withheld in withholding tax if no ABN is quoted;
- valid tax invoices are needed to claim GST input credits - providing a documentary trail;
- activity statements, including business activity statements – meaning that businesses must report on a regular and up-to-date basis;
- specified withholding – compulsory withholding for certain payments; and
- PAIVS (Payment, ABN and Identification Verification System) – a reporting regime for specified industries.

An example of a 'business-to-business' transaction is when a builder buys materials from a timber yard. 'Business-to-consumer' transactions (for example, when a builder builds a pergola or extension in a domestic situation in which the client is a private individual) are not so powerfully affected by the system's design control features.

See Chapter 2 of the Cash Economy Taskforce Third Report for a detailed outline of the New Tax System's features with respect to the cash economy.

⁸ See ATO Media Release 'ANAO Report on the Cash Economy Welcomed' 2002/17 11/3/02, and in similar terms Media Release 'Cash Economy Facing Increased Scrutiny' Nat 03/86 19/8/03.

businesses that were operating outside the tax system. The 'no-Australian Business Number withholding' and tax invoice requirements mean that businesses will generally not deal with another business if the latter does not have an Australian Business Number (ABN) and there are strong incentives to provide correct documentation in business-to-business transactions in order to claim input tax credits. The features also mean that the ATO has more real-time information; a better ability to cross-match the income tax and GST information it has been provided by taxpayers; and with its greater range of business information, to identify more easily businesses operating outside the norm.

The demographics

1.15 In assessing the ATO's strategies and approaches to managing the cash economy, it is important to appreciate the broad characteristics of the relevant taxpayer group.

1.16 For administrative purposes, the ATO scopes small businesses with a turnover up to \$10 million (excluding government, superannuation funds, not for profit organisations and passive investors), as potentially exposed to the cash economy.⁹ In the main, businesses omitting income from their tax liability reporting would fall within the small business grouping and the ATO places its main administrative focus on that particular segment of the taxpayer population.¹⁰

1.17 Key features of the small business grouping are that participants are relatively large in number but have business turnovers which are relatively small. There were 2.2 million participants in the relevant small business grouping operating in 2004, paying net tax of \$26.7 billion. ATO research showed that 80 per cent of this grouping in 2004 had turnover below \$250 000, with less than 1 per cent having turnover greater than \$5 million.

⁹ Passive investors/businesses represent beneficiaries of trust or partnership income which has previously been classified within trusts or partnerships without other business income.

¹⁰ The ATO classifies as 'micro business' those with an annual turnover of less than \$2 million. The micro-business segment is of particular interest to the ATO in connection with the cash economy. The ATO acknowledges that cash economy non-compliance can occur in businesses with turnovers exceeding \$10 million. The ATO deals with non-compliance in these businesses where it is apparent, by staff other than the dedicated cash economy teams.

The ATO organisational arrangements for the cash economy

Approach and organisation

1.18 The profile in the ATO of the issue of the cash economy has changed over time. In more recent years, there have been the rejuvenated activities of the Cash Economy Task Force (CETF) in 2001, the expanded cash economy program of compliance activities in 2002–03, the development and refinement of strategies and lines of responsibility and the formulation of dedicated cash economy teams in 2003–04. Since 2003–04 the ATO has identified the cash economy as a ‘focus area’ for its compliance effort.¹¹

1.19 The cash economy can come into play in various revenue streams (particularly income tax and Goods and Services Tax (GST), but also Fringe Benefits Tax, superannuation and excise). The cash economy compliance issue, in embracing issues of lodgement and non-disclosure of income or revenue, relates to the activities of many parts of the ATO that deal with compliance, lodgment and support matters such as relationship management, communication and education.

1.20 Although a number of areas within the ATO undertake work related to the cash economy as part of their functions, the ATO has established a focussed compliance capability to address cash economy concerns.

1.21 Responsibility for management oversight of cash economy work rests with the ABN Integrity and Cash Economy Branch (AICE) in the Small Business (SB) line. Responsibility for compliance delivery largely rests with the GST line. Field staff in GST General Compliance in the GST line, as the ATO’s field capability, undertake the bulk of the compliance fieldwork in the segment of very small businesses, addressing a range of tax obligations, including GST, income tax, Pay As You Go and Fringe Benefits Tax.

1.22 The ATO’s administrative arrangements involve links with other agencies. This is because the cash economy often has flow-on consequences for other areas of government activities (for example, understated income may result in inappropriate entitlements to government benefits such as Centrelink benefits or understated liability for child support payments). The ATO has formal, cross-agency consultative arrangements with several other

¹¹ See the ATO Compliance Programs for 2003–04, 2004–05 and 2005–06. In 2005–06, the ATO identifies the cash economy as one of the principal compliance risks in the micro segment.

Commonwealth agencies and operational links with the Child Support Agency and law enforcement and regulatory agencies in the States and Territories.

Cash economy resourcing

1.23 The ATO does not calculate the total resources it devotes to cash economy work. In part, this is because many areas in the ATO, although undertaking work relevant to the cash economy, only perform that as part of their work, and the ATO does not attribute costs and activities to this degree of detail.

1.24 In terms of the ATO's dedicated cash economy resources, the ATO had approximately 600 full time equivalent staff in the GST and SB lines assigned to cash economy compliance project activities in 2004–05. In addition, the ATO had some 162 staff working on cash economy risk issues and cash economy-related complex audit matters,¹² however these people were not specifically or wholly engaged in cash economy work.¹³ The ATO spent a total of \$53 million in 2004–05 (in direct costs) on dedicated cash economy projects. This compares to total ATO expenditure on compliance of over \$1.2 billion in the same period.

Previous ANAO report on the cash economy

1.25 In March 2002, the Australian National Audit Office (ANAO) tabled Audit Report No.35 2001–02 *ATO Progress in Addressing the Cash Economy*. The report was supportive of the ATO's progress in addressing the cash economy, and recommended action to improve aspects of management in five key areas (namely project management disciplines, knowledge sharing, working with industry, community education and use of AUSTRAC data).

1.26 The ANAO reviewed the ATO's responses to the report's recommendations and key findings. The results show that the ATO has made good progress. The ANAO found that the ATO had fully implemented four of the report's five recommendations, and its approaches to the cash economy had evolved and developed. The ANAO considers that the ATO is still to implement an effective community education program, as recommended. The theme of community education and ways the ATO might better support behavioural change in the community, are outlined in Chapter 4.

¹² For 2005–06, in addition to identifying the work and results of the dedicated GST line cash economy project teams as it does now, the ATO will also separately identify and report the work of the GST complex audit capability relating to cash economy matters.

¹³ As well as these staff directly related to cash economy matters, the ATO has some 2400 general field staff addressing cash economy issues as they arise in their other day to day compliance activities.

1.27 The results of our review of ATO action on the previous audit report are summarised at Appendix 2.

Overseas jurisdictions

1.28 The cash economy is not a tax compliance problem unique to Australia. Much work has been done internationally in the government¹⁴ sector to examine its causes, its nature, and ways to try to manage the problem. The ANAO was interested in international experience to appreciate the wider context for the ATO's administrative challenges and to compare the approaches used in other jurisdictions (United Kingdom (UK), New Zealand (NZ), United States (US) and Canada).¹⁵ The ANAO was also interested in the ways the ATO sought to learn from the experience of other jurisdictions. We deal with the latter point in Chapter 2.

1.29 The ANAO identified some broad similarities in the compliance management approaches used in NZ, UK, US, Canada, and Australia.¹⁶ This is illustrated, for example, in NZ's emphasis on industry partnerships to improve the relationship with the business community, particularly small business, and to address the cash economy. Similarities of approach were also evident in some areas in the UK. These included the multifaceted compliance approach of the then Inland Revenue (with measures to encourage compliance and measures to enforce compliance) and the establishment of specific teams to target the cash economy.

¹⁴ See for example, *Measuring the non-observed economy, A Handbook OECD and Measuring the non-observed economy*, OECD Statistics Brief No 5. November 2002.

¹⁵ Information on approaches used in NZ, UK, Canada and the US are on the agencies' websites. See www.ird.govt.nz, www.inlandrevenue.gov.uk, www.cra-arc.gc.ca, www.irs.gov, respectively. In the UK, the 2004 Budget announced that HM Customs and Excise and HM Inland Revenue would be integrated to form a single department, HM Revenue and Customs. See www.hmrc.gov.uk for information on the new department.

¹⁶ Although there are broad similarities in jurisdictions' compliance management approaches, their approaches to measuring the tax gap differ. HM Customs and Excise has conducted several exercises to measure Value Added Tax losses, using a 'top-down' method that compares total consumption (the theoretical tax liability) with tax paid and a 'bottom-up' method that uses targeted surveys and other data to estimate tax losses. See HM Customs and Excise, *Measuring indirect tax losses November 2002*, and *Measuring and Tacking Indirect Tax Losses—2004*.

In the US, the Internal Revenue Service estimated the income tax gap based on extensive audits of taxpayers.

As noted earlier, the ATO does not seek to estimate the absolute tax gap. The ATO advises that it in its opinion, the cost of inconveniencing compliant taxpayers through a program of rigorous, large scale, random audits is not commensurate with the benefits of the comparative, raw information obtained from these audits. The cost is further compounded by consuming resources that would otherwise be targeted at substantive compliance risks.

1.30 Regarding the US, ANAO research identified that the measures to identify unreported income used by the Internal Revenue Service were similar in a number of respects to those in Australia (for example, data matching, joint work and data sharing with other government agencies and tools to identify tax returns likely to contain unreported income).

1.31 The Canadian Customs and Revenue Authority also has a range of strategies to address the cash economy. Many features of the strategies are similar to Australia's,¹⁷ for example industry partnerships and arrangements with other government agencies to advance exchange of information. Canada's 'Get it in Writing!' campaign with consumers is being considered by the ATO. See Chapter 4 for discussion of the scheme.

1.32 The ANAO's review of comparative practice in other tax jurisdictions indicates that the ATO's strategic compliance approach is consistent with other jurisdictions (although approaches to measuring the tax gap differ), and overseas experience suggests that it is unlikely to be feasible to eliminate completely tax evasion in the cash economy.

The audit

Audit objective and scope

1.33 The objective of the audit was to assess the ATO's strategies to address evasion in the cash economy with emphasis on: the ATO's strategic focus; governance and management processes (that is planning and deploying resources; implementing treatments; working with other bodies; monitoring performance and assessing impact); and activities in response to ANAO Report No.35 2001–02 *ATO Progress in Addressing the Cash Economy*.

1.34 The ANAO focussed on the work of the ATO's dedicated cash economy teams in the GST line and ABN Integrity and Cash Economy Branch in the SB line that assists in the management of these teams. Other areas of the ATO, such as the Lodgment Compliance line and Serious Non Compliance Capability, also have implications for cash economy compliance in as much as

¹⁷ ANAO research also revealed that in 1999 the Canadian Auditor General identified areas for improvement in the Canadian revenue agency dealing with the cash economy. These observations (for example, regarding the increased attention and resourcing for cash economy work in Canada and the need for: general public awareness activities and supporting research; increased use of external data sources to detect unreported income; better ways to differentiate the success of the Canadian Underground Economy Initiative, from other enforcement activities) are broadly similar to themes the ANAO identifies in this audit with respect to the ATO. See *1999 Report of the Auditor General of Canada April* - Chapter 2 Revenue Canada Underground Economy Initiative. <www.oag-bvg.gc.ca>

they are also directed to specific aspects of tax compliance. The audit sought to understand how these areas broadly relate to cash economy compliance, but it did not examine these areas in detail.

1.35 In examining the application of the ATO's management processes, the ANAO considered a selection of the ATO's cash economy projects (namely hotels and licensed clubs; the adult industry; restaurants, cafes and takeaways; fishing; and low documentation loans). This selection of cash economy projects allowed the ANAO to review some of the practical features of, and approaches applied in, projects of different scope, size and degrees of maturity.¹⁸ The ANAO also looked at key features of the functions the ATO uses to support those projects (such as intelligence gathering and assessment, data matching and relationship management and education activities with industry and the public at large).

1.36 The ANAO had regard to the recommendations on cash economy management in the previous ANAO performance audit and the strategic advice provided to the ATO by its Cash Economy Task Force (CETF).

1.37 In reviewing the ATO's dedicated cash economy compliance capability, the ANAO looked to see whether the ATO's stated cash economy strategies, management support mechanisms, practical application of the strategies, and processes to assess impact were soundly-based and took account of relevant experience and information.

Audit methodology and cost

1.38 The ANAO conducted fieldwork between March and September 2005. In addition to document reviews, the ANAO interviewed staff at the ATO's national office in Canberra and offices in Sydney, Melbourne, Adelaide, Perth and Wollongong. A range of other parties with an interest in tax compliance measures, including with regard to the cash economy, were also interviewed.

¹⁸ The larger and more mature projects being: hotels and licensed clubs; and restaurants, cafes and takeaways, the smaller projects being the adult industry and fishing. The ANAO chose the low documentation loans project as an example of a project to scope risk, and one directed to exploring a potential risk issue, rather than an industry, as such.

They included:

- staff from the Office of the Taxation Ombudsman, Centrelink, the Child Support Agency and the Department of the Treasury and the former Department of Immigration Multicultural and Indigenous Affairs;
- representatives of some professional accounting and tax associations and a tax advocacy group (CPA Australia, the Tax Institute of Australia and Taxpayers' Australia);
- industry and representative bodies (National Farmers' Federation, Western Australian Fisheries Industry Council, Australian Hotels Association, Legal Adult Sex Industry, Restaurant and Catering Australia, the Construction Forestry Mining and Electrical Union, a small business operator and a tax practitioner who is a member of the CETF).

1.39 The audit was conducted in accordance with ANAO auditing standards, at a cost of \$377 000.

Audit report

1.40 The report's structure follows a sequence in themes. The audit report proceeds from the more general, to the more specific, aspects of strategies and steps in implementation. The report structure is:

- Introduction – Chapter 1
- The ATO's Strategies - Chapter 2;
- Management Arrangements - Chapter 3;
- Application of the Strategies - Chapter 4; and
- The ATO's Impact on the Cash Economy - Chapter 5.

Acknowledgements

1.41 The ANAO recognises, and appreciates, the contribution of staff of the ATO, industry and representative bodies, and other Commonwealth organisations, who assisted in the conduct of this audit.

2. The ATO's Strategies

This Chapter reviews the way the ATO develops and expresses its strategies for addressing the cash economy. The Chapter covers the work of the ATO with the Cash Economy Task Force and the planning, intelligence and risk assessment approaches that are key elements of the ATO's development of the strategies.

Introduction

2.1 Ensuring cash economy compliance is not an easy task and one contributing factor is that the community may show some tolerance of non-compliance in this area. A qualitative research report on the cash economy prepared for the ATO indicated that the key issues related to community norms and personal behaviour were:

- people do not think a great deal about the cash economy;
- when they do spontaneously think about it, they are generally positively disposed towards it; and
- any negatives are typically associated with a minority who overuse and abuse it, to the detriment of other individuals and society in general.¹⁹

2.2 In these circumstances the ATO's strategies must embrace a different mix of compliance approaches from the one it would apply when the general community is more accepting that tax compliance should occur. In the ANAO's view, the ATO's cash economy compliance task requires both creativity and persistence and the strategies must support that.

2.3 In examining the development and expression of the ATO's high level strategies for the cash economy, the ANAO expected to see that:

- the ATO had formulated high-level strategies, that apply the ATO's guiding principles of compliance management;²⁰
- the strategies are consistent with the strategic directions advocated by the Commissioner of Taxation's cash economy advisory body, the CETF, where these have been accepted by the ATO;
- the strategies draw on the experience of other countries as appropriate;

¹⁹ ATO: Cash Economy Community Research, May 2004 (blue moon research + planning pty ltd).

²⁰ The ATO compliance model requires the ATO to understand why people do not comply and develop an appropriate mix of strategies to address these causes. It is based on the principles of supporting taxpayers to comply with the law and responding appropriately to taxpayer behaviour, when they do not.

- the strategies are informed by intelligence and risk management work and are reflected in appropriate documentation at the corporate level; and
- there is a clearly-expressed public statement of the ATO's approach.

Cash economy strategies and compliance principles

2.4 The ATO's cash economy strategies are essentially strategies to secure taxpayer compliance. The ATO expresses its vision and longer-term strategic directions for its cash economy work in the internal document *Cash Economy Initiative - Directions and Strategies for the 2004–05 year and beyond* (the CEI strategies document). The CEI strategies document states that the vision for the initiative is that 'players in the cash economy sector understand, and are able to comply with, their tax obligations, and those that cannot or do not are effectively managed through well-developed and targeted compliance approaches....'. The outcomes sought from the initiative are that 'revenue flows are protected, compliance across targeted industries is improved and community confidence is at least maintained, and ideally improved'.

2.5 The CEI document outlines three streams of 'strategies' (activities) for the ATO, namely: research and understand; innovate and design; and optimise today. The CEI strategies document also outlines the intermediate strategies that the ATO pursues in relation to the cash economy. These intermediate strategies include working with others to identify opportunities for greater capture of the ABN and industry projects to include a focus on business-to-consumer dealings.

2.6 The ANAO found that the guiding principles of compliance management underpin the ATO's strategies and cash economy work.²¹ This is apparent in the CEI strategies document and studies (such as the research highlighted above) with their emphasis on undertaking research and seeking to understand the taxpayer population and their compliance issues. The application of the compliance model is also apparent in the nature and range of activities the ATO undertakes (see Chapter 4).

²¹ Indeed the CETF was a formative influence in the ATO formulating the compliance model and this model has been adopted as a cornerstone of the ATO's practice, corporately. See Cash Economy Task Force Report *Improving Tax Compliance in the Cash Economy* ATO April 1998.

The ATO's approach in applying its strategies

2.7 The ATO does not have a single, clearly-expressed statement of its approach in applying its cash economy strategies. The ANAO has devised a basic explanation of the ATO's approach, drawing on material obtained during the audit. The ANAO's statement and explanation of the ATO's approach to addressing the cash economy is that:

- sources of intelligence are used to inform the strategies taken with the cash economy, and the data matching that is being undertaken to improve targeting of its compliance effort;
- testing is undertaken before compliance activity is commenced;
- compliance activity is largely industry-focused, and compliance treatments are determined based on the most cost-effective means to address particular risks in an industry;
- compliance activity is directed to a particular industry with a view to reducing the level of non-compliance in that industry, and then moving resources on to address cash economy risks in other industries;
- industries that have been a focus of compliance work are monitored when the specific treatments have been completed (to detect whether improved compliance behaviours are maintained);
- other strategies such as ABN expansion (which seeks to have the ABN included as a compulsory element in state registration regimes for particular industries) and lodgement compliance work are also applied, to contribute to improving compliance in the cash economy; and
- marketing and education initiatives related to the cash economy are also being considered and applied in specific areas.

Cash Economy Task Force

2.8 The principal longer-term influence on the ATO's cash economy strategic directions comes from the CETF reports.²² Building on its previous reports, the 2003 CETF Report, *The Cash Economy under the New Tax System* supports the ways the ATO has approached the cash economy compliance task.²³ In keeping with the ATO's broad approach and established compliance

²² Members of the CETF are drawn from the ATO, industry, the community and academia.

²³ This is the Task Force's latest report. See www.ato.gov.au for the report and the Commissioner's response of 10 June 2004, accepting all of the CETF recommendations. Earlier reports entitled *Improving Tax Compliance in the Cash Economy* were completed in May 1997 and April 1998.

management principles, the CETF advocates a mix of measures to encourage and enforce compliance.

2.9 The ANAO found that the observations and recommendations of the 2003 CETF Report are consistent with the ATO's strategies and approaches.²⁴ An example of the consistency of CETF strategy and ATO approach are the CETF's recommendations encouraging or enforcing compliance through expanding the use of the Australian Business Register and extending data matching based on the ABN. These and other compliance measures are outlined in Chapter 4.

2.10 The CETF Report also focuses on the key area of transactions between businesses and consumers in the cash economy context. The Report recommends the ATO:

- consider a 'Get it in writing' campaign designed to educate and influence consumers. This is part of the approach taken in Canada;
- review with consumers, details about transactions they have undertaken with businesses; and
- make greater and more systematic use of data provided by third parties.

2.11 The Report's recommendations regarding business-to-consumer transactions guide the ATO's strategic directions, although the extent of the ATO's progress in some areas is variable (see Chapter 4). The ANAO found that the ATO's strategic directions follow those advocated by the CETF. The ANAO also found that the strategies draw on the experience of other countries, and especially Canada for some initiatives (see references in Chapters 1 and 4).

Intelligence and risk management and ATO corporate level planning and reporting

2.12 The application of intelligence and risk management processes are crucial in managing cash economy compliance. In part, this is because of the number of entities potentially involved and because of the nature of the issues themselves. Together, these factors mean that the nature of the compliance response must be driven by the intelligence on 'hidden' activity, and risk

²⁴ The CETF report made 38 recommendations, some with several parts. The ATO's April 2005 internal report on status indicated that most of the recommended outcomes had been fully or very largely implemented. Evidence from the ANAO fieldwork is consistent with this assessment.

assessment of the numbers of taxpayers involved and the significance of the matter.

Intelligence gathering

2.13 The key area responsible for gathering intelligence related to the cash economy is located in the Strategic Risk Management unit (SRM) within the GST line.²⁵ The ATO has a range of substantial internal sources of intelligence, including material available from risk work and national risk processes (for both income tax and GST). One of the external sources of intelligence and information is the work by relevant taxation administrations overseas. The ATO has fostered close relations with a number of taxation administrations, particularly Canada and New Zealand.

Risk management

2.14 Risk management activities such as collecting and assessing information on cash economy risks occur in several areas in the ATO. The main ones relevant in this audit are SRM and the cash economy risk industry groups in the GST line.

2.15 The cash economy risk industry groups provide information on particular risks, whereas SRM's Industry Tax Performance Indicators reports take more of an industry focus, and support general risk analysis.

2.16 The Cash Economy Steering Committee (CESC) uses such risk information to make resourcing decisions and to determine the compliance products that would be most appropriate to apply for particular risks.²⁶

2.17 One of the key formal risk management and corporate planning mechanisms in the ATO is the Health of the System Assessment (HOTSA). HOTSAs are important in managing a variety of ongoing risks within the ATO. These assessments and associated reports are designed to provide information on particular revenue products, focus areas and market segments and to feed into the ATO's Corporate Plan.²⁷ The ANAO observed that risks

²⁵ The SRM 2004–05 Delivery Plan assigns over 30 full time equivalent staff (some 72 per cent of its staff resources) to the cash economy and the micro segment. Key elements are business intelligence and analysis, research and evaluation, risk management, profiling and risk quantification.

²⁶ See Chapter 3 for information on this body.

²⁷ The ATO Corporate Plan comprises five Sub Plans, namely the Compliance, the IT, the People and Place, the Operations and the Easier Cheaper More Personalised Sub Plans. The Sub Plan most relevant to the ATO's cash economy compliance strategy is the Compliance Sub Plan.

relevant to the cash economy and its management were reflected in relevant HOTSAs.²⁸

2.18 The ANAO noted that, as per the intended corporate approach linking risk identification, HOTSAs, plans and reports, these risks feed into the ATO's Compliance Sub Plan. The ANAO found that the ATO's high level strategies for the cash economy are reflected in the Compliance Sub Plan.

Public statements of the ATO approach

2.19 The highest level planning document in the public domain that contains specific material relating to the cash economy is the Compliance Program 2005–06. The Program outlines the high-risk cash economy industries that are being examined, and indicates the number of particular compliance products that are to be applied in compliance activities relating to the cash economy. The Program indicates the broad areas where the ATO will be applying its resources related to cash economy compliance.²⁹

2.20 The Commissioner of Taxation Annual Report 2004–05 also includes considerable information regarding the work that the ATO is doing on the cash economy. It highlights the work being done: within selected industries; on ABN integrity activities; with stakeholders; and on communication. In addition, media reports from time to time refer to particular initiatives being undertaken in a specific industry (such as the removalist and horse racing industries).

2.21 Representatives of professional tax and accounting associations indicated to the ANAO that they would appreciate receiving more explicit information related to the ATO strategies on the cash economy, particularly the compliance aspects. This information could provide a more comprehensive picture of the approach that is being applied to improving compliance in the cash economy rather than just listing industries being addressed and the numbers of particular actions to be undertaken, as tends to be done currently.

²⁸ Relevant to the ATO's strategies to address the cash economy are the Cash Economy HOTSAs, the Micro segment HOTSAs and the Income Tax HOTSAs.

²⁹ For example in the micro business sector 2005–06 to: undertake 11 000 registration check visits (unannounced); send letters to 37 000 businesses asking them to check their reported activity statement information because that information departs from the industry norm; and audit 9 200 businesses, including ones in the high-cash industries, to determine the extent of any omitted income.

2.22 The ANAO considers there would be benefit in the ATO outlining the rationale and underlying approach it has to addressing cash economy activities. If the ATO provided more comprehensive information to tax and accounting professional associations, the associations would be in a better position to influence the role that their members play. Having regularly updated information regarding the cash economy strategies, that is accessible by those in the profession with an interest, could also help make sure that the ATO's strategies are appropriate and transparent. Such a statement would also help to reinforce the message that the cash economy is a serious compliance issue for the ATO and the ATO is working on it in a deliberate and systematic manner. The ANAO's outline of the ATO's approach, set out earlier in this Chapter, could be a starting point for the ATO's work in this regard.

Recommendation No.1

2.23 To maximise the leverage that can be obtained through the tax and accounting professional associations and communication with the public more generally, the ANAO recommends that the ATO publish an explicit statement of its strategic approach to achieving cash economy compliance, and the underlying approach being applied, including the process of working with particular industries.

ATO response

2.24 Agreed. The ATO's primary communication of its strategies for improving compliance in the community is directed at market segments. We do this so that we bring together all the relevant messages relating to a business' taxation obligations rather than fragmenting these messages into different topics which are not communicated together. Nevertheless, we will review this and look to develop a complementary way of explaining our cash economy concerns and strategies to the community. As the ATO's response to the cash economy continues to target industries and segments it is important to engage tax professionals and industry bodies in a mutual understanding of the strategic approach within which the segment responses are nested.

3. Management Arrangements

This Chapter examines the management arrangements that the ATO uses to direct and oversee the resources applied to compliance activities related to the cash economy. These include the Cash Economy Steering Committee, the ABN Integrity and Cash Economy Branch, resourcing processes and arrangements with GST General Compliance.

Introduction

3.1 Given the ATO's matrix management approach, with cash economy work occurring across the office, a coordination framework is essential for good management. In examining how the ATO delivered its strategies, the ANAO expected to see that:

- responsibilities of key individuals and committees are clearly set out;
- appropriate and integrated management oversight arrangements, including planning and reporting processes, are in place; and
- staffing resources are appropriate to the task.

Responsibilities

3.2 The principal responsibility for cash economy work lies with the Deputy Commissioner, SB line. The Deputy Commissioner has devolved the day-to-day oversight of cash economy work to the Assistant Commissioner ABN Integrity and Cash Economy Branch (AICE) in the SB line. The key means by which the Assistant Commissioner exercises this oversight role is through the CESC.

3.3 The Assistant Commissioner directly controls work areas in AICE, accounting for approximately 28 staff, comprising the core group helping to direct the cash economy strategies and supporting the Assistant Commissioner in this role.³⁰

3.4 In 2004–05 there were approximately 580 full time equivalent staff specifically working on cash economy matters within GST General Compliance. The 580 staff specifically carrying out cash economy compliance work are organised into relatively small teams that focus on particular cash

³⁰ They are the Cash Economy Project Team, Micro Risk Management, ABN Integrity, and Practices and Procedures.

economy industries (for example, restaurants, cafes and takeaways, licensed hotels and registered clubs, tourism and hospitality, fishing, motor vehicle retailing and barter).³¹ The teams are geographically dispersed across the country.

3.5 The Assistant Commissioner AICE does not have direct responsibility for these staff; they are part of the GST line. However the CESC includes the GST Senior Assistant Deputy Commissioner and all the GST General Compliance Assistant Commissioners, so that there is a close working relationship between the GST and SB lines in relation to delivering the cash economy initiative.

3.6 The ATO has not formulated an explicit statement of the responsibilities of the Deputy Commissioner, SB line and the Assistant Commissioner AICE in relation to cash economy work. The ANAO considers that it would be useful for the ATO to do so, given that the risk significance of the issue and the multifaceted nature of the compliance task.

ABN Integrity and Cash Economy Branch

3.7 AICE does not undertake direct compliance activities with taxpayers. However, its functions support these activities. These functions include promoting the use of ABN by other bodies, such as State industry regulation bodies; enhancing tax integrity via codes of conduct for particular industries; and developing new record keeping review tools. The AICE group also coordinates the reports to the CESC and the work responding to the recommendations of the CETF.

Cash Economy Initiative (CEI) – Directions and strategies

3.8 As noted in Chapter 2, the ATO produced a document that outlines cash economy directions and strategies for 2004–05.³²

3.9 The ATO intermittently³³ prepares a cash economy activity report, containing information on the status of activities, such as marketing and education, active compliance and risk identification by the AICE team and

³¹ See Table 3.1 for indicative staffing numbers for the larger cash economy project teams.

³² *Cash Economy Initiative Directions and Strategies for the 2004–05 Year and beyond* (the CEI strategies document), prepared by AICE.

³³ The activity report, the 'CEI Monthly Scorecard' was introduced in July 2004. In the period to September 2005, the ATO has produced only one other edition of this report (for the August–October 2004 period), the ATO attributing the hiatus to staffing and workload pressures.

others in the ATO. However, the activity reports do not provide sufficient measures of progress in meeting the ATO's various intermediate strategies (such as opportunities to increase capture of the ABN and industry projects including a focus on business-to-consumer dealings).

3.10 It would assist executive decision-making, overall accountability and the CESC's ability to track progress against the planned strategies if the ATO regularly prepared a report outlining progress on the various strategies and activities specified in the CEI strategies document.

Cash Economy Steering Committee

3.11 The CESC is the ATO's chief means to oversight the resources deployed on cash economy compliance measures.³⁴ The Committee meets monthly and considers matters such as:

- proposals and evaluation reports from individual cash economy projects and the allocation of resources to treatments compared to levels proposed in the Compliance Program;
- information on emerging cash economy risks;
- planning for future resourcing of cash economy teams; and
- matters relating to the CETF, including progress in implementing the CETF's recommendations.

3.12 The Committee is chaired jointly by the Assistant Commissioner AICE and a senior manager of the GST line. The Committee is attended by particular officers of the GST, SB, Serious Non Compliance and Lodgement Compliance lines. If matters relating to GST delivery are not able to be resolved at the CESC, they are considered at the GST Compliance Executive Meetings, as appropriate.

3.13 As the CESC is a key management forum in regard to the cash economy, with a number of responsibilities that cross business line boundaries, it is important that the role of the committee is clearly set out. Responsibility for the cash economy strategies lies primarily with SB officers, and delivery of the compliance function related to many of these strategies is largely the responsibility of a separate business line, GST. It is important that all participants have a clear understanding of their responsibilities, and how the

³⁴ The GST and SB lines make decisions regarding the allocation of resources jointly. See later section of this Chapter.

CESC role relates to other ATO committees, such as the SB Executive and the GST Compliance Executive.

3.14 The ANAO found that the ATO has not comprehensively documented the role or charter for the CESC. The CESC adopted a statement of objectives during the audit, in August 2005, with the undertaking to develop and document the Committee's roles and responsibilities more comprehensively. Having the role and responsibilities clearly set out and understood, would help reinforce the key elements of the cash economy management framework.

Recommendation No.2

3.15 Given the significance of the Cash Economy Steering Committee as a management forum, the ANAO recommends that the ATO set down a charter for the Committee, including its role and responsibilities, its membership, the responsibilities of the chair and members, and its relationships with other key committees.

ATO response

3.16 Agreed. Whilst the Cash Economy Steering Committee has now established a descriptive role statement, it is recognised that the significance of the cash economy issue requires further development of its charter and organisation chart.

Management oversight of cash economy compliance projects

Resource Planning

3.17 Project resource allocations for the bulk of the resources directed to cash economy compliance activities takes place as part of the GST field planning process.³⁵ The cash economy resources are allocated to particular industry teams and regions throughout Australia, after an iterative process of planning and comment. The process involves the CESC and the responsible Assistant Commissioners in the GST line to whom the industry teams are responsible. Table 3.1 sets out staffing levels for 2004–05 and 2005–06.

³⁵ As noted earlier, AICE has less than 30 staff, whereas GST field resources in the cash economy industry teams number approximately 580.

Table 3.1**Staffing allocation for Cash Economy projects within GST General Compliance**

Project	Planned 2004-05 FTE ¹	Actual 2004-05 FTE ¹	Planned 2005-06 FTE ¹
Property (Building) and Construction	130	176	91 ²
Restaurants, Cafes and Takeaways	102	121	108
Licensed Hotels and Registered Clubs	49	66	65
Other projects	356	215	299
Total	637	578	563 ³

- Note:
1. Full Time Equivalents
 2. Resourcing for building and construction work in the project only. In 2005–06, resources associated with property issues are resourced outside of the cash economy resources. In 2004–05, building and construction accounted for 141 FTE of the total 176 FTE.
 3. In addition to the 563 GST General Compliance staffing allocated to cash economy projects, in 2005–06, the ATO plans to allocate some 102 FTE GST Complex Audit staff to cash economy work.

Source: ATO

3.18 The ATO did not deploy all the planned resources to the cash economy project teams in 2004–05, in part because of the inability to recruit appropriate staff in a timely manner. Resources are planned in the light of experience regarding risks, including emerging risks, and revenue returns being obtained from particular compliance activity. The ATO recognises, in light of the CETF’s recommendations, that it must focus on business-to-consumer transactions to improve cash economy compliance. Given this focus, it will be important in 2005–06 that resources are available to undertake the ATO’s intended business-to-consumer compliance activities in key industries such as building and construction.

Project management approach

3.19 The ongoing management of individual industry projects that are delivered by GST General Compliance occurs through a well-developed project management system that classifies projects within phases, according to the maturity and compliance risk features of the project.

3.20 Commencement of a project requires the approval by the CESC. Having been approved, monthly project status reports are provided to the CESC by each of the industry project teams. For a project to move from one phase to another, the CESC must consider a relevant report on the project.

Activity reporting

3.21 As part of its oversight of the work on cash economy projects, the CESC reviews results of the fieldwork carried out by the various cash economy industry teams. Table 3.2 includes examples of the data considered by the CESC.

Table 3.2

Cases and Revenue Adjustments from Cash Economy Projects 2004–05

Project	Number of cases finalised	Revenue Adjustment ¹ (\$m)		
		GST	OHR ²	Total ³
Licensed Hotels and Registered Clubs	5 234	14.1	13.0	27.0
Property (Building) & Construction	13 714	27.7	14.8	42.5
Restaurants, Cafes & Takeaways	10 303	24.9	17.7	42.6
Property Issues (in the Micro and Not for profit industry segments)	781	25.9	4.0	29.9
Other projects	9 332	27.7	25.9	53.8
Total	39 364	120.3	75.4	195.8

Notes: 1. Refers to revenue 'raised' (not collections) and does not include penalties
 2. Other heads of revenue (such as income tax, fringe benefits tax).
 3. Amounts may not add due to rounding.

Source: ATO

3.22 Table 3.2 shows that there is considerable compliance activity by the ATO in the identified high-risk industries. Revenue adjustments made during 2004–05 from work done by cash economy industry teams was \$195 million, compared to planned revenue adjustments by the ATO of \$203 million for the year.³⁶

Practical issues with activity reporting

3.23 As noted earlier, at any one time the ATO has identified a number of distinct industry groupings to address as part of its cash economy work, with designated industry compliance teams allocated to them.

³⁶ Planned revenue adjustments were revised down from \$224 million to \$203 million because the full time equivalent staffing achieved for 2004–05 was lower than planned. See Table 3.1.

3.24 The ATO's cash economy industry teams undertake a broad range of compliance work, ranging from 'straightforward' non-compliance by entities operating in the particular cash economy industry groupings, to specific cash economy 'omitted income' matters. The ANAO considers that having teams operating in this way is a practical means of dealing with the variety of compliance issues that arise in the case of very small enterprises. However management and transparency would be enhanced through an explicit recognition in the planning and reporting for 'cash economy' industry teams that they will, by necessity, carry out certain work that is not cash economy (omitted income) compliance work.

3.25 In the absence of this explicit recognition, there is the risk that the extent of compliance activity that is attributed by the ATO's industry teams to the cash economy is overstated.³⁷

3.26 Currently ATO case management systems do not support the separation of omitted income results and other compliance impacts in respect of particular compliance cases. However the ATO proposes to address this by improving issue-based reporting and recording of the nature of adjustments made. These improvements are being incorporated in a new case management system starting to be implemented from mid-2006 as part of the ATO change program.

Reports to monitor progress

3.27 As well as the Project Status Summary Report used for activity reporting, the CESC also reviews the quarterly Monitoring Report on the Cash Economy. The Monitoring Reports provide, among other things, information at the aggregate level on cash economy industries that the ATO is addressing, and also highlights changes in particular industries, such as licensed hotels and registered clubs, and restaurants, cafes and takeaways.³⁸

3.28 Using this information, the CESC is able to obtain a broad indication of whether there has been an improvement in collections as a result of compliance activity. However, external factors such as industry activity and profitability would affect movements in taxation payments in the particular industries.

³⁷ In late 2004–05, the ATO decided to refine its approach to cash economy project planning and results reporting for 2005–06, by excluding a category of work in the property sector whose results were not closely related to matters of omitted income. This refinement means that there will be a closer nexus between the cash economy teams and work on omitted income.

³⁸ The reports provide high-level business income and income tax data and activity statement data.

3.29 Figure 3.1 sets out a range of indicators of the ATO's activity in relation to the cash economy in recent years.

Figure 3.1

The ATO's indicators of its activity in the cash economy

Over the past three years the chances of businesses in cash economy industries being reviewed by the ATO has increased. The cash economy teams have contacted over 123 000 businesses where cash trading is prevalent and this has led to extra tax of over \$352 million being assessed. Many of these businesses were assisted to keep better records making it easier to meet their obligations.

The ATO's cash economy response has contacted over 36 000 building and construction businesses since 2002, helping many businesses improve their records and adapt to the new tax system, including raising over \$88 million in additional revenue.

Since the cash economy project on restaurants and cafes commenced in 2002, over \$83 million has been raised in additional revenue, with over 28 000 such businesses being contacted regarding their returns.

Clubs and pubs have been reviewed by the ATO cash economy teams using the same margin analysis that prudent businesses use to manage their day-to-day business. This has led to a further \$66 million in tax being assessed.

Anecdotal information to the ATO indicates that the introduction in 2000 of the New Tax System incorporating the Australian Business Number (ABN) has led to a dramatic reduction in business-to-business undeclared cash trade. The necessity to hold an invoice including correct ABN details in order to claim input tax credits has brought to account many transactions that may have been undeclared under the previous system.

Significant numbers of taxpayers have been drawn into the system under the New Tax System, with over 190 000 tax returns demanded raising some \$210 million in additional revenue.

Source: ATO

Management of GST Field teams

3.30 The ATO's cash economy delivery approach, with geographically dispersed field teams specialising in particular industries, means that there could be several cash economy teams operating in a particular region. The regional executive of the GST line has responsibility for day-to-day management of the cash economy field teams.³⁹ This management occurs alongside the management of the GST line's other field teams.

³⁹ Teams' fieldwork is monitored at the regional level with activity reports that report a wide range of operational matters. These include return on investment—planned versus actual, coverage (the specific number of compliance activities, such as walk-ins, required to be done in each region)—planned versus actual levels and the results of quality assurance reviews.

3.31 Revenue and coverage targets are key drivers for GST compliance field work. The ATO's planned average return on investment across all cash economy projects in 2004–05 was 2.5 to 1. The ATO Compliance Program 2004–05 set a coverage target to check income tax, GST and superannuation compliance in 9 per cent of micro-businesses in that year. Cash economy work may not always provide immediate revenue returns as generally required in this framework. A focus on achieving these revenue and coverage targets could tend to put pressure on resource allocations available for some of the more complex cash economy activities.⁴⁰

3.32 The ANAO considers that the ATO's regional management approach and monitoring provide good levels of management for field teams. However the focus on quantifiable targets and returns needs to be balanced with the need to undertake cash economy compliance work that may not generate rapid, or large, results in the short term.

Staff turnover and capability

3.33 An ATO review of staff capability completed in June 2004 found that capability had improved during 2003–04, with the formation of dedicated cash economy teams, the development and delivery of a broad cash economy skilling strategy and curriculum and accumulated experience.⁴¹

3.34 In discussions with field staff, the ANAO found that individual officers were quite knowledgeable in outlining approaches in compliance activities in their particular industry area.

3.35 The ANAO considers that the skill level of staff has also been enhanced by their completion of the Compliance Officers Advanced Audit and Accounting Program. Some 120 cash economy project team staff had completed the course at the time of the audit. The following case shows staff looking behind the figures to find an area in which income was not fully disclosed.

⁴⁰ In 2004–05, the ATO raised revenue of \$165.8 million across all cash economy projects, representing an average return on investment of 290 per cent, which is above its target. The ATO Compliance Program 2005–06 did not report performance against the coverage target for micro businesses. The ATO advised in January 2006 that it covered only 6.4 per cent of micro businesses in 2004–05, which is well below its target.

⁴¹ Reflected in an upward trend in revenue and return on investment obtained by cash economy teams and improved results in the internal quality assurance processes for cash economy cases.

Figure 3.2

Case study – looking behind the disclosed figures

Hotels and Licensed Clubs - A perusal of local newspapers by field officers revealed a pub was charging Friday and Saturday night door fees. When asked why the fees had not been disclosed, the client claimed they were coded as mixed drinks. A yield analysis, however, concluded that the yield on mixed drinks was exactly what would be expected if the door fees had not been coded to this category. The taxpayer eventually admitted to not declaring the fees. The pub had substantial GST adjustments made following the audit.

Source: ATO

3.36 ANAO fieldwork showed that staffing issues can bear heavily on the ATO's ability to deliver its cash economy strategies, with members of the ATO regional executive and industry team managers pointing out that it is important to have an appropriate blend of more experienced staff. In several locations, the ANAO noted that the teams had not been able to operate at their planned staffing level during the year due to a shortfall in available staff.

3.37 Although there are positive indications about the level of ATO staff capability, an internal review in the GST line in early 2005 highlighted that staff have concerns regarding their capability. In light of this staff perception, the ANAO considers that it will be important for initiatives designed to improve staff capability in identifying understated income continue to be pursued.

Cash economy and industry team communication

3.38 Effective staff communication is important in the ATO because the cash economy teams are specialised and dispersed. The ANAO found that the ATO uses appropriate ways to communicate cash economy matters across the ATO and within industry teams, including teams in remote locations.

4. Application of the Strategies

This Chapter considers the application of the ATO's strategies to address the cash economy, particularly case targeting work and treatments undertaken as part of the cash economy industry risk projects.

Introduction

4.1 The ANAO's main focus in this Chapter is on the practical activities (day to day) that the ATO's uses in its core focus area of the cash economy risk projects. These activities involve case selection and compliance measures. The ANAO also notes work done in other key parts of the ATO supporting cash economy compliance. The ATO's relationships with external parties, especially other government agencies and industry, are also discussed here.

4.2 In considering the ATO's application of the strategies, the ANAO expected to see that the ATO:

- had ways to identify and target cases of potential interest (supported by intelligence and risk assessment processes);
- had a range of tailored ways to treat non-compliance;
- supported staff with effective guidance and protocols and had ways to promote better practice; and
- worked with other agencies, industry and the general public, for compliance, consultation, education and advocacy.

Targeting cases for the risk projects

4.3 The ANAO found that the main methods the ATO uses to select cases for its cash economy projects are:

- profiling and analytical work drawing on internal and external data sources and using data matching work;
- community information – especially that received by the ATO's Tax Evasion Referral Centre;
- project-based work – for example projects undertaken by the industry groups, using a range of tools to analyse taxpayer data and to highlight potential risks; and

- random selection – for example spot-checks of aspects of the operations of the enterprise (a walk-in) by the cash economy industry team.

4.4 One of the functions of the GST's SRM area is to select cases for cash economy work. In broad terms, this involves SRM analysing data on GST risks and translating these risks into case selection parameters as the risks emerge. SRM selects cases applying these parameters to create a pool of cases on which the industry groups can draw.⁴²

4.5 The Tax Evasion Referral Centre (which is administered by the GST line) receives information from the community on behalf of all business lines about tax evasion, including cash economy matters. It then identifies and profiles the client who is the subject of the information and assesses the matter's risk to revenue. It allocates cases to the relevant areas of the ATO (including staff in cash economy projects) according to protocols negotiated with those areas.⁴³

4.6 The industry teams also undertake targeting work as part of their projects. The ANAO observed how pilot projects were used in the restaurants, cafes and takeaways group to focus on parts of the industry group considered to be potentially high risk.

4.7 Allowing teams to select some cases at the local level means that the ATO can harness local team knowledge and this work can be used to get a mix of cases for project management purposes. Walk-ins, for example, in which ATO staff select premises to attend unannounced to undertake registration checks and take an overview of operations, can fall into this category. Some taxpayers are selected for a walk-in on the basis of their risk characteristics, while others may be randomly selected.

4.8 Data matching plays a crucial role in cash economy case selection by SRM and the industry teams. The micro business sector has many participants, with diverse characteristics. Data matching facilitates analysis and

⁴² SRM is also one of the ATO's main bodies responsible for collecting and making sense of business and industry intelligence and assessing risks related to cash economy and the GST product, more generally. SRM also responds to ad hoc requests from industry groups to identify cases involving particular risk features or characteristics. SRM uploads cases onto the ATO's Automatic Work Allocation System for the industry group leader to allocate to the cash economy field staff.

⁴³ The Tax Evasion Referral Centre received 18 000 contacts relating to tax evasion in 2003–04 and 19 000 in 2004–05. Of these, less than 28 per cent were cash economy business referrals. In both periods, the top three cash economy industries reported were building and construction, retail trade and cafes and restaurants. These totalled over 3 400 reports in 2003–04 and 5 000 reports in 2004–05. In 2003–04, the top 250 Tax Evasion Referral Centre referred cases finalised by GST Field and cash economy teams resulted in additional revenue of approximately \$23.7 million. The top 500 cases completed in 2004–05 resulted in additional revenue of approximately \$29.7 million.

development of leverage opportunities (that is, compliance activities directed to many taxpayers at one time) that are operationally advantageous in these circumstances. The ANAO observed that the ATO uses data matching extensively, drawing on its own data sources, those of other agencies and the private sector.⁴⁴

4.9 Given the nature of the cash economy compliance issue (omitting income or operating outside the tax system), external data sources are more likely to be effective in identifying cases than only cross-checking information provided by taxpayers on activity statements and tax returns. The latter can be of more of limited value than external data matching processes because it predominantly involves a check on the internal consistency of the taxpayer's return form information.

4.10 The ANAO has found that data matching, with due regard to privacy considerations, is a cost-effective compliance tool. Previous ANAO reports have encouraged the ATO to continue to develop its data matching practices, including using third party data.⁴⁵ The ANAO supports the ATO's efforts to use and expand its external data sources. The ANAO encourages the ATO to continue to seek out opportunities with other regulatory bodies and organisations dealing with major sources and uses of funds.

4.11 The ANAO noted that the ATO has well-developed procedures and review infrastructures to manage the data matching process.⁴⁶ These protocols shape and guide the data matching work done by other parts of the ATO, including data matching work that supports the cash economy teams. This work is mentioned later in this Chapter.

⁴⁴ Internal data sources include tax investment income data. External sources include fishing data from State regulators, data on payments to parties in the horse racing industry from the NSW Racing Authority and building and construction data from a commercial database.

⁴⁵ See, for example, Audit Report No.35 2001–02 *ATO Progress in Addressing the Cash Economy* which refers to the ATO's use of AUSTRAC data in managing the cash economy, (pp 48-52). See also Audit Report No.48 2003–04 *The ATO's Management of Annual Investment Income Reports* and Audit Report No.47 2004–05 *Australian Taxation Office Tax File Number Integrity* which identify the need for the ATO to enhance data quality and progress data matching from other sources, such as AUSTRAC and financial institutions.

⁴⁶ For example guidelines for external data matching in Practice Statement *External Data Matching* PS CM 2004/17 (G) provide a checklist for project leaders undertaking external data matching, the appointment of an ATO Data Matching Gatekeeper and a Data Matching Steering Committee to coordinate and review processes. The procedures may also involve the Privacy Commissioner to ensure that the activities apply sound privacy practices. These corporate protocols are designed to help the ATO to control data acquisitions, record data streams, manage action and evaluate data streams.

Compliance measures by the cash economy project teams

4.12 The ANAO found that the ATO’s cash economy project teams have a wide variety of treatment methods at their disposal. These include: advisory products and activities; review products; and enforcement products. Table 4.1 lists the types of compliance measures employed by the cash economy teams.

Figure 4.1

Types of compliance measures applied by the cash economy project teams

Compliance measures
Data matching and analysis to identify and assess cases
Compliance tools such as the record keeping assessment tool to assess the quality of taxpayer record keeping; and the outlier tool to identify where taxpayers’ data depart markedly from industry norms ⁴⁷
Review, enforcement and compliance investigation work, such as walk-in checks (unannounced registration and lodgement integrity checks) and specific checks; Business Activity Statement (BAS) reviews; and comprehensive audits
Penalties for poor record keeping
Escalation to other areas of the ATO (eg to the GST line’s Complex Audit and to the SB line’s Micro Complex Compliance for complex cases and to Serious Non Compliance for investigation and prosecution for fraud cases)
Developing tools to promote self-regulation, eg codes of practice and codes of conduct for particular industries (eg the code of conduct for the scrap metal industry)
Tools to facilitate compliance eg a payment card to help industries to manage tax payments
Communication (eg leverage products such as bulk letters inviting taxpayers to review records and advise any adjustments and industry fact sheets on compliance issues)
Education, information and self-help. A major topic is that of record keeping. For instance, the ATO provides record keeping fact sheets, a record keeping practice statement outlining obligations and penalties and an automated record keeping evaluation tool so businesses can self-assess their standard of record keeping Another example of information provision is the ATO’s guidance to taxpayers and staff on legal interpretation in ATO Interpretative Decisions (eg regarding adult entertainment and adult services for GST purposes)
Presentations to stakeholders, visits to tax agents, articles in industry publications and attendance at trade shows

Key:

Active compliance
Facilitation and self-regulation
Communication and education

Source: ATO information

⁴⁷ The Business Activity Statement (BAS) outlier methodology identifies taxpayers whose reported BAS data depart significantly from the expected norm, for example in respect of the industry pattern of wages to sales or input tax credits to total business income.

4.13 A noteworthy aspect of compliance treatments is the ATO's work with industries to harmonise compliance requirements and industry administrative practices. Examples include the BAS payment card for the taxi industry and work to negotiate codes of practice and codes of conduct for the scrap metal and horticultural industries.⁴⁸ The ANAO considers these examples as very worthwhile initiatives by the ATO to encourage and support industry compliance in risk industries and implement a measure of industry self-regulation. By working with industry in developing its compliance approaches, the ATO is both streamlining its processes and containing taxpayers' costs of compliance, while seeking to embed good industry practices for sustainable compliance improvement. Guidance such as the ATO Interpretative Decisions mentioned in Figure 4.1 not only educate taxpayers, but also inform staff on compliance matters.

Field treatment types and focus

4.14 Field activity statistics of the industry groups show that the ATO undertakes many treatments. Within that total number, some types of treatments are more numerous than others. For example, the restaurants, cafes and takeaways project undertook over 3 300 treatments involving client contact, between 1 July 2004 and 25 March 2005. In this period, its most numerous treatment type was walk-ins (2020 cases) followed by non-lodgement compliance activity (530 cases).

4.15 Although the industry group largely met its target of 3 338 treatments, in aggregate terms, there were variations in the types of treatments from those planned. The ATO had undertaken more integrity treatments (especially many more walk-ins) than planned but fewer verification treatments.⁴⁹ The ANAO noted that the ATO undertook more checking activities than planned but fewer of the more penetrative treatments planned.

4.16 In 2004–05, staff in the designated cash economy risk projects undertook work on some 22 cash economy projects, involving 38 000 cases, spanning activities such as lodgement checks, registration integrity checks,

⁴⁸ The cash economy taxi project worked with the Australian Industry Association to develop and implement the card to make payments easier for taxi drivers. The ATO intends to use this as a prototype in expanding the payment card to other industries.

⁴⁹ The ATO planned 1 919 integrity checks (1 809 of these planned to be walk-ins) and did 2 051 (2 020 of these as walk-ins). As to verification activities, the ATO planned 943 activities, but did 736.

record keeping assessments and comprehensive reviews.⁵⁰ Of the total revenue adjustments from the cash economy projects in that period (\$195.8 million), 52 per cent of revenue was raised from lodgement reviews, 22 per cent from form reviews and 15 per cent from specific checks. Comprehensive reviews accounted for 15 per cent of revenue raised from the cash economy projects. However, in considering these activities and results, the ANAO's comments earlier in this Chapter concerning the attribution of activities to work by the cash economy industry teams apply.

Communications as a treatment

4.17 The ATO's management approach for cash economy risk industries requires teams to devise a communication framework for the particular industry. However, this requirement is often not applied, meaning that industry teams are forgoing the opportunity to bring attention to important, though perhaps more diffuse, communications aspects of compliance treatments.⁵¹ In the ANAO's view, the mix of activities specified in the communications plans (such as in the restaurants, cafes and takeaways project) involving communicating with tax agents, articles in industry publications, industry handouts and information on the ATO website, is appropriate. However, the ANAO notes that the emphasis in this communication strategy, and indeed in the ATO's compliance approach more generally, tends to be on the 'business end' of the industry. The ATO's compliance management approach, including its communication and education dimension, is less well-developed in dealing with the 'business-to-consumer' or 'domestic' transactions.⁵²

⁵⁰ A lodgement check involves the ATO confirming that the taxpayer has lodged all required tax returns (activity statements and income tax returns). A registration integrity check involves the ATO establishing that the taxpayer has an ABN and is registered for GST, as required. A record keeping assessment reviews the quality of the taxpayer's records and record keeping practices. A comprehensive review (or comprehensive audit) involves a more in-depth examination of the taxpayer's compliance.

⁵¹ Relevant ATO staff advised the CESC that many of the communication strategies have not been put in place and the approach in practice is ad hoc.

⁵² The Cash Economy HOTSA lists the 'business-to-consumer' aspects of compliance management as a future challenge. The CESC acknowledges that the ATO needs to enhance its communication strategies and adopt a more strategic focus, including with the involvement of external parties such as the industry and professional tax and accounting bodies and community associations, to change perceptions. In the latter part of 2005, the ATO was devising a cash economy communications strategy to guide relevant work over the next few years. The ATO advised that managing business-to-consumer transactions will be a key issue for the communications strategy.

Treatments directed to business-to-consumer transactions – a key area

4.18 In dealing with the difficult issue of domestic cash dealings, it is important that the ATO continues to implement active treatments and field activities focussed on business-to-consumer transactions and industries with strong links to the general public. Field activity needs to complement broader community education programs and other measures with a wider community focus.

4.19 The ATO conducts compliance treatments on business-to-consumer transactions and industries that deal directly with the general public. From discussions with project leaders and teams, the ANAO obtained anecdotal evidence of the ATO's work in a number of areas directed to business-to-consumer transactions.⁵³ The ANAO appreciates that field compliance activities in industries with business-to-consumer links or work on specific business-to-consumer transactions may not provide, in the short term, the return on investment results that the ATO strives to achieve.⁵⁴

4.20 In 2005–06 the ATO's building and construction industry group is to undertake some specific compliance activities and interventions directed to consumers. This activity involves, for example, following up on consumers' renovations work by reviewing development applications to local councils and asking consumers about the value of work, and the payment and tax aspects of their domestic construction work.

4.21 Such compliance activity helps to project an active ATO presence to relevant consumers and the community. It can also help to convey the message to consumers that their transactions with businesses have taxation implications (although not often direct tax implications on the consumer side) and are not beyond scrutiny. It is important because, as shown in the ATO's own research and popular media coverage of the cash economy, for many taxpayers such business-to-consumer transactions are the recognisable features of the cash economy.

⁵³ The ATO advised in September 2005, that all cash economy projects are now being asked to report specifically on the business-to-consumer aspects of their industry grouping, especially where there may be opportunities to affect consumer behaviour.

⁵⁴ The return on investment planned for 2004–05 for the adult industry was 2.5; restaurants, cafes and takeaways was 2.8; and pubs and clubs was 3.1. The returns on investment achieved for these industry groups in this period were 1.2, 2.8 and 3.3, respectively.

4.22 ATO progress may be expedited if an officer were made responsible for monitoring the compliance activities directed to business-to-consumer transactions and for reporting on progress to the CESC. This function could be incorporated into the Cash Economy Project Team which already has cash economy coordination, oversight and reporting responsibilities and strong links to relevant areas across the ATO.

Recommendation No.3

4.23 The ANAO recommends that for greater ATO emphasis on domestic cash dealings, the ATO establish a special focus on ATO compliance work directed at business-to-consumer transactions, with clear responsibilities within its management and reporting structure for overseeing such work and for reporting progress to the Cash Economy Steering Committee.

ATO response

4.24 Agreed. Strengthening our existing work from the Cash Economy Task Force, an officer has been appointed with specific oversight and responsibility for the business-to-consumer focus including specific monthly and governance reporting on the progress of initiatives.

4.25 Currently the ATO is piloting new business-to-consumer compliance techniques in several cash economy industries.

Key compliance activities by other parts of the ATO supporting cash economy compliance

4.26 Table 4.2 sets out key compliance measures undertaken by parts of the ATO other than the cash economy teams. Two of these compliance activities are discussed in more detail below because of their particular relevance in the application of the ATO's cash economy strategies.

Figure 4.2**Types of compliance activities by other areas of the ATO supporting cash economy**

Activities
Data matching - for example data matching by the area in the Lodgment Compliance line, called Those Outside the System and the SB line's ABN Integrity team. Using ATO data and third party data, these areas seek to identify unregistered taxpayers, those not meeting their lodgment responsibilities or to test the compliance of taxpayers in properly disclosing all income ⁵⁵
Compliance activities by GST General Field (other than staff in the cash economy industry field teams)
Office Audit capability in the GST line - contact by phone or letter with taxpayers in particular cash economy industries or on particular tax issues
Complex compliance cases undertaken by GST's Complex Audit and SB's Micro Complex Compliance areas and serious non compliance, fraud investigations and prosecution work by the Serious Non-Compliance Capability
Work to promote the use by other government and industry bodies of the ABN as a business identifier
Communication, education and information activities. Examples include: the ATO Compliance Program outlining the ATO's overall compliance directions, areas of emphasis and planned activities; items in the Tax Agent Newsletter; and material on the ATO website from the Tax Evasion Referral Centre providing information to the community on ATO cash economy activities. ⁵⁶ Other examples are: communication and marketing work by GST's Marketing and Education; the ATO Relations line; and the SB line's Alliances and Information area. Alliances and Information is responsible for help and education products and services, especially for taxpayers who are new to business. Working across the ATO and other government agencies, it also organises events and expos

Key:

Active compliance
Facilitation and self-regulation
Communication and education

Source: ATO information

⁵⁵ As well as undertaking some data matching work for particular cash economy risk projects (such as fishing and restaurants, cafes and takeaways), the Those Outside The System area also undertakes data matching exercises to identify other taxpayers who are not in the tax system. Data matching projects by the ABN Integrity Team (within the AICE Branch) have checked that grants and other receipts for a number of categories of taxpayer have been properly declared (eg Dairy Adjustment scheme beneficiaries).

⁵⁶ The ATO publicises the Tax Evasion Referral Centre's results in a fact sheet and promotional contact cards and it publicises results in a quarterly newsletter 'Tax evasion and the community – recent results' and on the ATO <website www.ato.gov.au>.

Business-to-consumer research and education campaign

4.27 As noted earlier, in 2003, the CETF recommended that the ATO develop its cash economy strategies with greater attention to cash dealings between businesses and consumers.⁵⁷

4.28 The ATO accepted the recommendations and has made progress in a number of areas. The ATO has commissioned research on community and business perceptions of the cash economy and industry-specific research on attitudes of businesses to the cash economy. The ATO conducted industry research on hotels and registered clubs, painting and plastering and restaurants and cafes. In addition, the ATO has undertaken advertising and communication to increase awareness of consumer rights and promote the reporting of tax evasion.

4.29 Since the 2003 CETF report, the ATO has been considering options and strategies for a communication campaign to promote business-to-consumer messages, as advocated by the Task Force. The ATO has decided to adopt a phased and targeted approach to the issue, preferring to test particular advertising and communication products (such as public posters and advertising on the day at motor vehicle auction houses) before considering any large-scale business-to-consumer advertising and communication campaign.

4.30 Coupled with this targeted approach to testing particular advertising and communication products, the ATO intends to monitor the experience of community-focussed advertising activities applied overseas, such as Canada's 'Get it in Writing!' campaign⁵⁸ designed to encourage consumers of services to ask for written quotes, contracts and receipts and to appreciate the consequences of not doing so.

4.31 The ANAO supports the ATO's work on these community-focussed measures. As in any area, and particularly the cash economy, the ATO cannot 'audit its way to community compliance'. Success can flow from securing the interest and support of the community,⁵⁹ raising the awareness of consumers as to the merits of compliance and highlighting the active presence of the ATO in the field.

⁵⁷ Cash Economy Task Force, *The Cash Economy under the New Tax System* September 2003, Chapter 5.

⁵⁸ The 'Get it in Writing Campaign' conducted by the Canadian Customs and Revenue Agency was found by that agency to be of some benefit in spreading to the community the message of good compliance.

⁵⁹ Academic commentators such as some in the Centre for Tax System Integrity support this view. For example, they observe that a mix of treatments is required, because although direct audits might produce the 'biggest results', treatments based on persuasion and citizen agreements are also needed because they are cheaper and help to develop trust between the government and the citizen.

4.32 Although the ATO accepted the CETF recommendation in 2003, the ATO's business-to-consumer community education strategy is still in its developmental phases. Given the significance of community attitudes in securing business-to-consumer compliance in the cash economy, the ANAO considers that it is important that the ATO expedites the formulation and implementation of a community education campaign.

Recommendation No.4

4.33 The ANAO recommends that, given the significance of community attitudes in securing business-to-consumer compliance, the ATO develop and implement expeditiously a community education campaign focussing on business-to-consumer elements of cash economy compliance.

ATO response

4.34 Agreed. A significant cash economy communication strategy paper is currently being completed with a major focus on business-to-consumer strategies. The strategy paper builds upon learnings from attitudinal and academic surveys, overseas experience and expert advice. In light of this research and our experience the ATO prefers a segmented and targeted approach over a broad based campaign. The ATO is unaware of any evidence that such broad based campaigns are effective in changing behaviour. The ATO is trialling a number of more targeted consumer campaigns within specific industries which will be fully evaluated before committing to major program expenditure. In addition it is important to make sufficient progress on compliance strategies (Recommendation 1) before major communication investment.

ABN expansion

4.35 The ABN (as a unique identifier for business taxpayers) provides the ATO with a much-improved ability to manage the cash economy. The ATO's ability to capitalise on the potential of this compliance mechanism through effective and broadly-scoped data matching is, in part, related to the extent to which agencies at the State and federal level also reliably capture business data, including identifiers such as the ABN.

4.36 The ATO has a structured program to promote the use of the ABN and to have the ABN incorporated into a wide range of registers in the government

and private sectors.⁶⁰ It has made considerable progress in these negotiations (especially with its increased attention to the matter since early 2003).⁶¹ The resulting data matching has been productive.⁶²

4.37 The ANAO supports these efforts and agrees with the ATO's stated future direction to seek to expand the use of the ABN into a broad range of external data sources that serve to indicate wealth, income and business activity. In the ANAO's view, the wider the circle of diverse, sources of quality data, the better will be the ATO's capacity to apply data matching effectively as a compliance treatment in managing the cash economy.⁶³

ATO external relationships

4.38 Productive external relationships are a crucially important element of effective strategies to address the cash economy. As noted in Chapter 1, cash economy transactions can have impacts across commercial, social welfare and labour market systems as well as the taxation system. The cash economy is therefore a 'whole of government' issue that requires a 'whole of government' response. This means that the ATO needs to work with other regulatory and service delivery bodies to share information, plan appropriate responses and to act with these bodies in a coordinated way.

4.39 The ATO also needs effective external relationships with industry parties and the wider community. These relationships can allow it to better target its compliance activities and to obtain greater leverage from its efforts by spreading the desired compliance messages more broadly than just to the non-compliant taxpayers directly concerned.

4.40 In assessing this aspect of the ATO's strategies and their application, the ANAO expected to see that the ATO collaborated with a range of other agencies across all levels of government. The ANAO also expected to see that the ATO sought to engage and consult with industry and tax and accounting professional representatives and the community about compliance issues relevant to their interests, and to use community and industry networks to convey ATO (and broader government) messages.

⁶⁰ An area of AICE has been assigned responsibility and there is a clearly-specified approach to planning and monitoring activities.

⁶¹ For example, as at April 2005, the security industry in New South Wales; business names registration in Victoria, South Australia and the Northern Territory; liquor licensing in Victoria, Tasmania, the Australian Capital Territory and Queensland; all State Revenue Offices except Victoria.

⁶² For example ATO data matching using data from Workcover SA highlighted employer non-compliance in lodgement, PAYGWithholding and superannuation responsibilities, and raised over \$8 million to February 2005.

⁶³ This theme is mentioned in several other audit reports on the ATO, as noted earlier.

Working with other government agencies

4.41 The ATO is a member of the Inter Agency Cash Economy Steering Group and a member of the Inter Agency Cash Economy Working Group (IAWG)⁶⁴, along with the Department of Employment and Workplace Relations, the former Department of Immigration, Multicultural and Indigenous Affairs, Centrelink and the former Department of Family and Community Services. The IAWG meets at least quarterly, to consider issues of mutual interest. A Memorandum of Understanding and procedural guidelines underpin the ATO's, the former Department of Immigration, Multicultural and Indigenous Affairs' and Centrelink's joint cash economy compliance activities. The Child Support Agency is not a member of the Steering Group or the Working Group.

4.42 The ANAO observed that child support information featured in reports to the Tax Evasion Referral Centre and found that Centrelink is seeking to develop closer working relationships with the Child Support Agency to better deal with fraud, particularly in relation to the cash economy.⁶⁵ Given the importance of the Child Support Agency in terms of the potential impact of the cash economy on its clients, the ANAO suggests that it also be invited to join the IAWG. The ANAO understands that the Child Support Agency attended the meeting of the Working Group in June 2005.

4.43 The ATO undertakes joint operations with other government bodies, for example Centrelink and the police. Examples of this are the joint agency work in Western Australia's Alhalbros Islands focussing on fishers and joint agency work in the adult industry project in Queensland. In both instances, agencies paid particular attention to cash economy, immigration and social welfare matters.

4.44 The ANAO found that joint work, particularly involving Centrelink, attracted considerable media attention, especially regarding the extent of the welfare payment savings that were identified.⁶⁶ The impacts from other agencies' involvement do not appear to be reported as frequently or in such

⁶⁴ The Steering Group is the strategy group, while the Working Group is responsible for developing and coordinating operations. Responsibility for chairing the Working Group and providing the venue and secretariat services, rotates after each meeting.

⁶⁵ The Child Support Agency has operational links with the Tax Evasion Referral Centre, supported by procedural instructions and the agency is developing a Memorandum of Understanding.

⁶⁶ For example, media reports of 'raids' on taxi drivers, vineyard labourers and meat packing workers.

specific terms. Currently there is no comprehensive reporting of the results of whole of government work.

4.45 The ANAO considers that the profile of the ATO's and other agencies' work, including joint work, on cash economy matters would be considerably enhanced if agencies reported the major results of cash economy-related compliance activities. Such cross-agency reports would highlight the fact that coordinated action was being undertaken and the effect of this monitored and reported publicly.

4.46 Figure 4.3 highlights ATO work with industry and government agencies.

Figure 4.3

Case study adult services industry compliance work – industry and other agencies

The dancing sector of the adult industry had a strong cash-in-hand business history. The sector's population throughout Australia exceeds 2 000 at any time and there is a strong turnover of dancers. Historically the adult dancer sector has a high number of people who are receiving welfare benefits inappropriately as well as a number of illegal workers.

The ATO instigated a strategy of engaging with the dancing clubs in the eastern states, discussing acceptable compliance behaviours and making public the ATO's planned compliance strategy for the adult industry.

Between May 2004 and August 2005 the ATO worked with other agencies to conduct unannounced visits to adult dance clubs in order to identify and register dancers into the taxation system via an ABN or Tax File Number where applicable. Typically a team involved three to four ATO officers and one to two Centrelink officers.

Over 50 clubs have been contacted as part of these activities, with a sample receiving unannounced visits. The ATO strategy has directly identified over 2 500 dancers in Sydney, Melbourne and Queensland for follow-up action for tax and Centrelink matters. All major adult dance clubs have now instituted more acceptable tax compliance strategies amongst their dancers, with the industry as a whole following this trend.

Source: ATO

Working with industry stakeholders and the professional bodies

4.47 The ATO has a wide span of relationships with industry. The cash economy risk industry groups have specific, and quite focussed, contacts with stakeholders relevant to the risk industry compliance programs. The ANAO found many examples of these, such as in the restaurants, cafes and takeaways, hotels and licensed clubs, and fishing industry projects. ANAO discussions with representatives in these industries and several other representative

bodies, highlighted that they appreciated the contacts they had with the ATO on industry, tax and cash economy matters. Industry stakeholders consider the relationship overall to be productive and positive.

4.48 Industry stakeholders support the way in which the ATO works with them and consults on tax matters. Industry appreciates it when the ATO provides feedback or status reports on the matters on which it has been consulted. However, ANAO consultations revealed that sometimes this is not done, or not done in a timely way. A protocol highlighting for staff the basic elements of sound operating practice could help the ATO to better manage the mechanics of industry relationships. Such a protocol could help the ATO to obtain consistency in better practice in maintaining productive relationships.

Tax and accounting professional bodies

4.49 The ATO promotes aspects of its cash economy compliance approach to the tax and accounting professional and tax advocacy bodies. This includes providing briefing to representatives at the peak tax consultative bodies such as the National Tax Liaison Group and the ATO Tax Practitioner Forum and addressing industry and tax practitioners with articles in the ATO's tax agents newsletter and briefings at tax time. ANAO consultations with some of the professional and advocacy bodies (namely, the Tax Institute of Australia, CPA Australia and Taxpayers Australia) show that they are supportive of the ATO's strategies and efforts to manage the cash economy, including via relationship management with the professional bodies. In their view, community engagement is an important influence on the degree to which the ATO's cash economy compliance work is successful.

4.50 As noted in Chapter 2, there is scope for the ATO to set out and promote publicly its cash economy strategies and approaches. Linked with this point, there is also scope for the ATO to work with the tax and accounting bodies more extensively to promote cash economy compliance. Certain compliance themes are relevant to tax practitioners and their clients, and these themes could be the basis of messages from the ATO. Among the themes for such tax 'industry-focussed' compliance messages are:

- the importance of the level playing field in commerce and how the cash economy upsets this;
- the value of the integrity of the tax system, commercially, administratively and socially; and

- the pragmatic, commercial advantages in industry being tax compliant and reducing the chance and cost of ATO intrusion in members' and their clients' affairs.

4.51 At this stage, the ATO relationship with the tax and accounting bodies regarding the merits of cash economy compliance appears to be one of information provision (although the tax practitioners may consider themselves to be much more directly engaged in the ATO's compliance activities). Tax practitioners are a key leverage point between the ATO and taxpayers. Given this, the relationship and the compliance strategy would be usefully developed by the ATO enlisting the help of the professional bodies for advocacy, to help it support attitude and behaviour change in the community.⁶⁷ For example, the tax and accounting bodies could present these messages within the context of their members' established professional development programs or could help distribute literature to members and their clients. This could be part of a broader community education campaign by the ATO in response to the CETF Report.⁶⁸

Recommendation No.5

4.52 The ANAO recommends that, in promoting the importance of cash economy compliance to the broader community, the ATO work with the tax and accounting bodies to develop ideas on relevant cash economy compliance messages and ways to convey them, including through the professional associations' activities.

ATO response

4.53 Agreed. The ATO has worked with tax agents through advisory bodies such as the National Tax Liaison Group and the ATO Tax Practitioner Forum as well as regularly communicating through tax agent newsletters and Sky Channel discussions. We are interested in engaging with professional bodies more and including their input into our risk and intelligence and strategic cash economy directions.

⁶⁷ According to the *ATO Compliance Program 2005–06*, nearly 26 000 registered tax agents lodge around 75 per cent of income tax returns for individuals and 97 per cent of business-related returns.

⁶⁸ In 2002–03 Centrelink ran a media campaign, entitled 'Support the system that supports you' to promote voluntary compliance by its clients. Although this campaign's specific focus was different from one that could be run by the ATO in the community to promote the merits of tax compliance, the underlying message could be apposite for the ATO.

5. The ATO's Impact on the Cash Economy

This Chapter examines how the ATO assesses that it is making a difference with its strategies for the cash economy. This includes ATO work assessing the impact that its compliance activity has on the level of compliance generally in cash economy industries and work to assess the achievement of the compliance dividend projected to accrue from the introduction of the New Tax System.

Introduction

5.1 The compliance work undertaken by the ATO results in a number of activity measures such as cases actioned and revenue adjustments raised. There are also indirect results from this activity such as improved industry disclosure, as well as improved lodgement rates and timing. This Chapter does not address the activity measures of compliance work, but whether the compliance work is having a broader influence (impact) on improving overall industry compliance in cash economy areas.

5.2 Directly measuring the size of the cash economy is very difficult. This poses problems for evaluating the effectiveness of compliance measures to address the cash economy. However given the significance of the cash economy issue and considerable resources the ATO applies to addressing it, it is important that the ATO develops measures to assist it in demonstrating the impact of ATO cash economy compliance activities. A key consideration is the impact of particular compliance treatments on the overall level of compliance and behaviour in specific cash economy industries, as demonstrated by tax revenue growth. Another useful way to determine impact is the effect or impact on specific taxpayers who have been subject to compliance activity. Without some form of evaluation it could be difficult over time for the ATO to demonstrate the sustainable benefits flowing from cash economy compliance efforts.

5.3 Evaluation measures should also be directed at detecting long-term changes in the behaviour of taxpayers and consumers within particular industries, because improving compliance in the cash economy in some of the more difficult business-to-consumer areas will involve long-term effort.

5.4 In examining how the ATO assesses the impact of its strategies, the ANAO expected to see that:

- the ATO has measures of revenue change linked to ATO initiatives for particular cash economy industries that are effective in showing the underlying movement in taxation revenue for those industries over time;
- the ATO has an explicit evaluation strategy that covers the means of tracking movements in revenue for selected industries, as well as changes in behaviour of industry and consumer participants; and
- given the ATO's undertaking to Government in 1998 that the New Tax System would result in a cash economy compliance dividend, that the ATO has processes to assess the compliance dividend obtained.

Existing measurement arrangements

5.5 Data related to the activities and impact of the ATO's cash economy strategies are included in a number of ATO internal reports. These reports have been developed to meet various reporting needs. They cover risk assessment, performance indicators related to cash economy work and the effectiveness of compliance activity on actioned entities.

5.6 These reports all play a useful part in the provision of risk assessment and performance monitoring information for the ATO in its work in cash economy industries.

5.7 However, the ANAO considers that these reports do not provide a sufficient basis for the ATO to be able to demonstrate reliably that it is making a concerted impact to improve compliance in cash economy industries.⁶⁹ While recognising that it is difficult to develop reliable performance measures of improved compliance in cash economy industries, there is scope for the ATO to better assess its compliance impact, as outlined in this and the next section. The ANAO considers that these efforts could allow the ATO to obtain improved insights into the cash economy and particular risk industries and improved insights into how to manage compliance.

Data on behaviour of industry and consumer participants

5.8 The ATO recognises the importance that community and business behaviour plays in regard to the operation of the cash economy. Community research commissioned by the ATO in early 2004 pointed out the difficulties that it confronted in improving compliance in cash economy industries. A key point that came from the research was that many in the community had a fairly benign view of cash economy activities. In addition, input from certain suppliers indicated that the cash economy was ‘a key part of their lives’.

5.9 The ANAO considers that changing these behaviours over time will be critical to improving compliance in relation to the cash economy. The ATO has commissioned a number of industry surveys since May 2004 that elicit views from industry participants (scrap metal, restaurants/catering, painting/decorating and plastering) related to cash economy matters.

⁶⁹ The reporting that covers the profile of the entire tax community is too broad to be useful for determining the impact on cash economy industries of the ATO compliance effort.

The *Industry Tax Performance Indicator* reporting provides information that mainly relates to risk matters, rather than performance or impact.

The *Monitoring Report Cash Economy* report provides trend taxation information from a number of viewpoints, including all cash economy industries, all actioned cash economy industries, ‘maintenance stage’ cash economy industries and non-actioned cash economy industries. Information is also provided on individual cash economy industries. The *Monitoring Report Cash Economy* report also compares movements in taxation revenue with movements in broad economic indicators such as Household Consumption Expenditure, Gross Domestic Product, and salary and wages. However, these indicators do not relate to specific cash economy industries.

The *Cash Economy Level 7 Evaluation* report seeks to determine the impact that the compliance activity has made on particular cash economy industries. This is done by comparing the tax payments of treated entities with those of a control group of non-treated entities. This can show whether particular treatment strategies are being effective. It is a useful measure of the impact of particular treatment strategies on specific taxpayers who have been subject to compliance activity. However, it does not show whether there have been underlying gains across a particular cash economy industry over time.

5.10 While the ATO proposes to collect this type of industry-related data from time to time to indicate the effectiveness of its marketing activity, the ANAO found that the ATO has not used such data in a systematic manner to demonstrate changes in industry participants' attitudes and behaviours over time.

5.11 An important part of demonstrating that compliance strategies are having an impact would be to show that there are impacts on the attitudes of consumers, as well as business, in the targeted industries. Matters other than marketing campaigns will affect these attitudes, and therefore data collection should not be limited to the conduct of marketing campaigns. Although the ANAO recognises that surveys have limitations in eliciting the underlying attitudes of taxpayers, the ANAO considers that the ATO will need to consider the best approach to undertaking a survey that would specifically measure changes in attitudes over time for both industry participants and consumers (that influence changes in behaviour).

Evaluation strategy

5.12 The ANAO considers that it is important that the ATO should have in place an evaluation strategy that would allow it to obtain better insights into cash economy industries and thereby ways to manage them. The strategy may also help to demonstrate the impact that the ATO's compliance activities have in relation to the cash economy, or parts of it. A more strategic approach to compliance management may be obtained by the ATO improving its model of impact analysis through undertaking more detailed analysis at the industry level. Without an effective evaluation strategy, the ATO does not know whether its compliance program in cash economy industries is positively affecting taxpayers in that industry grouping, other than those specific taxpayers who are contacted as part of the ATO's compliance activity. The information gained from an evaluation would also assist in determining which treatments are most appropriate for the ATO to apply.

5.13 The ANAO considers that the strategy could have a three-part approach. One part would be to measure underlying movements in revenue collections in the cash economy industries that are being targeted (that is, abstracting from any external factors). A second part would be to measure changes in the attitudes of industry participants and consumers over a period of time (as reflected in changes in behaviour). A third part would be to compare the tax payments of treated entities with those of non-treated entities (which is already done). This three dimensional approach would also assist the

ATO in measuring the impact that its initiatives were having on the potential participants in business-to-consumer cash transactions.

5.14 In the ANAO's view, the ATO's impact assessment would be enhanced by the ATO developing a descriptive model of key industries. The task would be to 'unpack' what is going on in an industry, in order to see, over time, what has been the ATO's underlying compliance impact. For example, the elements may include the ATO undertaking systemic and rigorous analysis of the industry, taking account of trends in activity and seeking to control for other industry or economic factors affecting revenue that are not related to ATO compliance activity.

Underlying movements in revenue collections

5.15 The principal report that currently shows movements in revenue is the Quarterly Monitoring Report. The ANAO observed in a number of documents, that the ATO relies on this material to demonstrate the impact of compliance activity on particular industries.

5.16 The ANAO questions whether the comparisons of changes in tax collections for specific industries with changes in economy-wide indicators such as Gross Domestic Product, as is done in the ATO's Quarterly Monitoring Report, are meaningful. This is because, as shown in Table 5.1, the levels of growth in particular industry sectors vary considerably over time, and vary substantially between sectors and from the economy-wide measures. As well as the level of growth in a particular industry affecting the level of tax paid, changes in factor inputs to a particular industry, changes in profitability levels, pricing changes and changes in wage rates would also have effects.

Table 5.1

Percentage changes in industry gross value added

Industry	2001-02 (%)	2002-03 (%)	2003-04 (%)
Construction	11.9	16.2	6.3
Accommodation, cafes and restaurants	-1.3	3.8	6.5
Gross domestic product	3.9	3.2	3.8

Source: Australian Bureau of Statistics, Australian National Accounts, 5204.0, 2003-04 (Table 10)

5.17 Using comparisons in the Quarterly Monitoring Report, which compare the movement in tax collections by industry with overall Gross Domestic Product movements, is unlikely to give a reliable measure of impact at the level of cash economy industry compliance interventions.

5.18 Although recognising that precise calculations are not possible, the ANAO considers that as part of an evaluation strategy, the ATO should consider the merits of drawing on economic expertise to develop the proposed descriptive model and method of analysis that would eliminate movements in tax collections that are not related to improved compliance by that industry. The ANAO considers that, if the ATO considered it feasible methodologically and in terms of resources, this analysis could be updated annually. In the interest of practicality, the work could focus on industries where it is recognised there exists a serious cash economy problem, such as building and construction.

Recommendation No.6

5.19 The ANAO recommends that the ATO review its evaluation approach in relation to its cash economy activity and establish mechanisms that would allow it to measure changes in underlying taxation revenue over time for particular industry sectors, and changes in the attitudes of industry participants and consumers in those sectors.

ATO response

5.20 Agreed in principle. The ATO believes that effective measurement techniques need to balance requirements for validity, practicality and impact on taxpayers and tax agents. While the ATO appreciates that devising reliable methods of measuring changes in underlying taxation revenue over time can be problematic, we do believe tracking effectiveness is important and will investigate better ways to do this. The ATO will also examine ways of monitoring long term behavioural changes of individuals and cash economy industries.

Compliance dividend

5.21 Conceptually, measurement of the cash economy compliance dividend involves comparing actual revenue figures against forecast revenue after making allowance for other impacts not related to the cash economy.

5.22 The ATO estimated in May 2000 that the compliance dividend it would obtain over the first three years of the operation of the New Tax System (2000–01 to 2002–03) would be \$3.4 billion and the estimated cash economy contribution towards this, would be \$2.6 billion.

5.23 The issue of measuring the compliance dividend was unresolved at the time of the previous audit report, Audit Report No.35 2001–02 *ATO Progress in Addressing the Cash Economy*, in early 2002. This is because the results depend on the processing of income tax returns and the final measurement for the effect over the three years could not be determined until after lodgment of the third year's returns were finalised in June 2004.⁷⁰

5.24 Given the discussion of the issue of the compliance dividend in Audit Report No.35, the ANAO requested specific information on the work that the ATO has done to assess the extent of the compliance dividend obtained from the first three years of the operation of the New Tax System.

5.25 The Department of the Treasury is responsible for preparing the forward estimates of revenue for Government, taking account of influencing factors such as Government new policy proposals, economic parameters and advice from the ATO regarding compliance trends and revenue estimates.

5.26 In relation to the estimated compliance effects of the New Tax System on revenue projections, the Treasury incorporated the estimated compliance effect into the forward revenue projections for companies and other individuals for 2000–01 to 2002–03. However neither the ATO nor the Treasury have been able to assess the extent to which the estimated compliance revenue gains for this period were specifically achieved. The ATO advised the ANAO in September 2005 that it considers that the compliance dividend cannot be measured with any reasonable degree of accuracy. This is because it is too difficult to distinguish the revenue effects of changes in compliance as a result of tax reform from tax reform's other effects⁷¹ and the impacts of other compliance measures at that time.⁷²

⁷⁰ ATO advice to their senior executive in the Micro segment Corporate Governance Report January 2001 reiterated this point.

⁷¹ Such as the impact that the GST had on consumption and investment and therefore business income and taxation revenue.

⁷² For example other compliance initiatives such as those relating to the alienation of income and non-commercial losses.

5.27 The ATO and Treasury point out that actual collections in the relevant revenue categories in the period exceed the estimates (that incorporate the compliance dividend effect and parameter changes) and they maintain this reassures both agencies that the Government's expectation of a compliance dividend of \$3.4 billion over three years was met.

5.28 The ANAO understands that there are practical difficulties for the ATO and Treasury in both estimating and reconciling the specific compliance effects of the New Tax System. Appreciation of these difficulties was not reflected in the agencies' advice to the ANAO in 2002 at the time of the previous audit and was only raised with the ANAO in mid 2005, some time after the expiry of the relevant three year period.

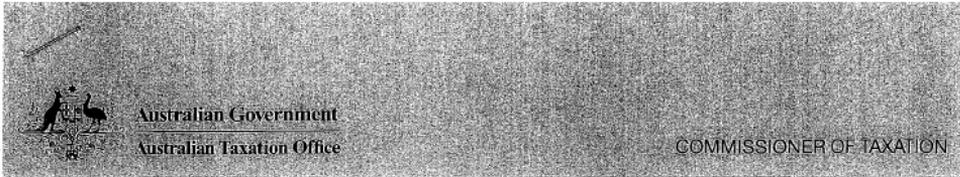


Ian McPhee
Auditor-General

Canberra ACT
28 February 2006

Appendices

Appendix 1: Agency response



Mr Peter White
Executive Director
Performance Audit Services Group
Australian National Audit Office
CANBERRA ACT 2600



25 January 2006

Dear Peter White 391

Proposed Report – Performance Audit – The ATO's strategies to address the Cash Economy

Thank you for providing a copy of the ANAO's proposed report on the ATO's work in managing cash economy compliance.

The ATO certainly agrees with the ANAO that managing cash economy compliance is a challenging task. We welcome the ANAO's findings that we have appropriate strategies for our cash economy work and that those strategies are risk-based and consistent with overseas approaches. The ATO also welcomes the ANAO's finding that we follow the expert advice of the Cash Economy Task Force and the recognition of the progress the ATO has made in implementing their recommendations.

We would like to thank the ANAO auditors for their professional approach and the considerable efforts they have made to understand and report on the cash economy issue. The ATO would also like to thank the ANAO for their constructive recommendations and we are pleased to be able to agree with all of them.

The ATO's formal response to the report is enclosed at attachment A in accordance with Sec 19 of the *Auditor-General Act 1997* and our comment for inclusion in the brochure accompanying the report is enclosed at attachment B.

If you or your staff have any questions regarding the response, please contact Ian Fargher on (02) 4223 2198 or Mark Shanahan on (02) 9374 5740.

Yours sincerely


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Attachment A
The ATO's Strategies to Address the Cash Economy - ATO Response to ANAO Recommendations

Reference	Recommendation	ATO Response
<p>Recommendation No. 1 Para 2.23</p>	<p>To maximise the leverage that can be obtained through the tax and accounting professional association and communication with the public more generally, the ANAO recommends that the ATO publish an explicit statement of its strategic approach to achieving cash economy compliance, and the underlying approach being applied, including the process of working with particular industries.</p>	<p>Agreed. The ATO's primary communication of its strategies for improving compliance in the community is directed at market segments. We do this so that we bring together all the relevant messages relating to a business' taxation obligations rather than fragmenting these messages into different topics which are not communicated together. Nevertheless, we will review this and look to develop a complementary way of explaining our cash economy concerns and strategies to the community. As the ATO's response to the cash economy continues to target industries and segments it is important to engage tax professionals and industry bodies in a mutual understanding of the strategic approach within which the segment responses are nested.</p>
<p>Recommendation No. 2 Para 3.15</p>	<p>Given the significance of the Cash Economy Steering Committee as a management forum, the ANAO recommends that the ATO set down a charter for the Committee, including its role and responsibilities, its membership, the responsibilities of the chair and members, and its relationships with other key committees.</p>	<p>Agreed. Whilst the Cash Economy Steering Committee has now established a descriptive role statement, it is recognised that the significance of the cash economy issue requires further development of its charter and organisation chart.</p>

Attachment A
The ATO's Strategies to Address the Cash Economy - ATO Response to ANAO Recommendations

Reference	Recommendation	ATO Response
<p>Recommendation No. 3 Para 4.23</p>	<p>The ANAO recommends that for greater ATO emphasis on domestic cash dealings, the ATO establish a special focus on ATO compliance work directed at business-to consumer transactions, with clear responsibilities within its management and reporting structure for overseeing such work and for reporting progress to the Cash Economy Steering Committee.</p>	<p>Agreed. Strengthening our existing work from the Cash Economy Task Force, an officer has been appointed with specific oversight and responsibility for the business-to-consumer focus including specific monthly and governance reporting on the progress of initiatives.</p> <p>Currently the ATO is piloting new business-to-consumer compliance techniques in several cash economy industries.</p>
<p>Recommendation No. 4 Para 4.32</p>	<p>The ANAO recommends that, given the significance of community attitudes in securing business-to-consumer compliance, the ATO develop and implement expeditiously a community education campaign focussing on business-to-consumer elements of cash economy compliance.</p>	<p>Agreed. A significant cash economy communication strategy paper is currently being completed with a major focus on business-to-consumer strategies. The strategy paper builds upon learnings from attitudinal and academic surveys, overseas experience and expert advice. In light of this research and our experience the ATO prefers a segmented and targeted approach over a broad based campaign. The ATO is unaware of any evidence that such broad based campaigns are effective in changing behaviour. The ATO is trialling a number of more targeted consumer campaigns within specific industries which will be fully evaluated before committing to major program expenditure. In addition it is important to make sufficient progress on compliance strategies (Recommendation 1) before major communication investment.</p>

Attachment A
The ATO's Strategies to Address the Cash Economy - ATO Response to ANAO Recommendations

Reference	Recommendation	ATO Response
<p>Recommendation No. 5 Para 4.51</p>	<p>The ANAO recommends that, in promoting the importance of cash economy compliance to the broader community, the ATO work with the tax and accounting bodies to develop ideas on relevant cash economy compliance messages and ways to convey them, including through the professional associations' activities.</p>	<p>Agreed. The ATO has worked with tax agents through advisory bodies such as the National Tax Liaison Group and the ATO Tax Practitioner Forum as well as regularly communicating through tax agent newsletters and Sky channel discussions. We are interested in engaging with professional bodies more and including their input into our risk and intelligence and strategic cash economy directions.</p>
<p>Recommendation No. 6 Para 5.18</p>	<p>The ANAO recommends that the ATO review its evaluation approach in relation to its cash economy activity and establish mechanisms that would allow it to measure changes in underlying taxation revenue over time for particular industry sectors, and changes in the attitudes of industry participants and consumers in those sectors.</p>	<p>Agreed in principle. The ATO believes that effective measurement techniques need to balance requirements for validity, practicality and impact on taxpayers and tax agents. While the ATO appreciates that devising reliable methods of measuring changes in underlying taxation revenue over time can be problematic, we do believe tracking effectiveness is important and will investigate better ways to do this. The ATO will also examine ways of monitoring long term behavioural changes of individuals and cash economy industries.</p>

Attachment B
The ATO's Strategies to Address the Cash Economy
Brief ATO response for release brochure

The report acknowledges the ongoing challenge of addressing tax compliance within the cash economy, with generally positive reflection on the ATO's strategies and application of targeted compliance approaches.

The ATO welcomes the ANAO's recognition of the progress the ATO has made in meeting the previous recommendations of the *Progress in Addressing the Cash Economy* audit report of March 2002, as well as the finding that we follow the expert advice of the Cash Economy Task Force.

The report recommendations give guidance with respect to improvement of strategies which are substantially agreed. Implementation of recommendations is proceeding, balancing requirements for validity, practicality and impact on taxpayers and tax agents.

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Appendix 2: ANAO review of ATO action on the previous audit (Audit Report No.35 2001–2002)

Fully Implemented	Partially Implemented
●	◐

Rec No	ANAO Recommendation	Agency Response to Audit Report No.35	Status	ANAO Assessment of Progress Against Recommendation
1	The cash economy team reviews its management framework to ensure its initiatives are supported effectively with clear planning, communication, priorities, monitoring processes and project deliverables.	Agreed. The cash economy team has significantly developed its management framework considerably since the time of the ANAO review. Strategic and operational plans are in place complemented by a regime of project initiation briefs, monitoring templates and evaluation criteria, which are in various stages of completion. A draft cash economy communication strategy has been prepared and will ensure staff are more aware of the management structure and project responsibilities. The cash economy team now has a key place in cross-segment and cross-business line compliance executives.	●	The ATO has fully implemented this recommendation. ATO approaches have evolved, with well-developed project management elements in the cash economy projects. The ATO's latest communication strategy was 2003, but as of September 2005, was working on a new one.

Rec No	ANAO Recommendation	Agency Response to Audit Report No.35	Status	ANAO Assessment of Progress Against Recommendation
2	<p>The cash economy team takes appropriate action to improve knowledge sharing by maintaining a formal system of records that is nationally accessible and regularly updated.</p>	<p>Agreed. Knowledge gathering and dissemination are key issues for the ATO's cash economy initiative. The cash economy team has already commenced building on the previously established cash economy National Office filing system by extending it nationally. Electronic share directories have also been established and are being expanded.</p>	●	<p>The ATO has fully implemented this recommendation. ATO approaches have evolved with electronic share directories for cash economy projects and the designated cash economy staff having personal networks for knowledge sharing, supported by the designated Industry Groups and Industry Group leaders. The Cash Economy Newsletter for ATO staff, more generally, also helps communication and knowledge sharing.</p>
3	<p>The ATO build and improve on its current industry partnerships, utilising a model of two-way interaction:</p> <ul style="list-style-type: none"> • with regular meetings to address industry and community concerns relating to the cash economy; and • promoting those meetings both as a forum for intelligence sharing and to gain industry-based support for the ATO's cash economy projects and activities 	<p>Agreed. A number of industry partnerships are already expanding beyond their initial focus relating to GST issues. Work is under way to better engage members on issues relating to planned activities and intelligence sharing, with more emphasis on two-way interaction. Contact has already been made with a number of more important partnerships to engage them in development and implementation of current and future cash economy strategies and activities. Not all industries are covered by the current industry partnership arrangements. The ATO's experience with the existing industry partnerships will be considered when creating new partnerships.</p>	●	<p>The ATO has fully implemented this recommendation. The vehicle of the industry partnerships appear not to be so potent now, post-introduction of the GST. However, the ATO engages industry representatives in its cash economy industry projects and there is some ATO engagement on the cash economy with the tax and accounting professionals' representative bodies – eg CPA Australia and the Tax Institute of Australia.</p>

Rec No	ANAO Recommendation	Agency Response to Audit Report No.35	Status	ANAO Assessment of Progress Against Recommendation
4	<p>The ATO take action to implement a coordinated education campaign to address community attitudes to the cash economy.</p>	<p>Agreed. The original Cash Economy Task Force developed and put in place a community education strategy that included a campaign to raise awareness in the general community and industry specific campaigns raising awareness about the cash economy and how the ATO was dealing with it. The CETF considered the development of a broader community education campaign aimed at changing attitudes toward tax evasion. However, it was concluded that further research was required. Further research has been conducted by the Centre for Tax System Integrity (CTSI) and is currently being analysed. This research will be considered further by the CETF in 2002. It is noted that any campaign aimed at changing community attitudes would require significant funding over time. This would need to be considered further by the ATO once the recommendation of the CETF is available.</p>		<p>The ATO has partially implemented this recommendation. The Centre for Tax System Integrity research and the ATO have undertaken surveys of community and industry perceptions of the cash economy and knowledge of ATO approach.</p> <p>However, the ATO is still to complete its action on the community education program as recommended by the CETF Report 2003. The ATO has approved some communication strategy options canvassed as a result of the CETF Report but is still developing its approaches and organising funding – over two years after the CETF Report was completed.</p> <p>In brief, while the ATO has acted on the recommendation, it still has a way to go.</p>

Rec No	ANAO Recommendation	Agency Response to Audit Report No.35	Status	ANAO Assessment of Progress Against Recommendation
5	<p>To enhance ATO cash economy intelligence, the ATO takes further action to use AUSTRAC data more strategically in its cash economy project teams by:</p> <ul style="list-style-type: none"> • ensuring that, in conjunction with AUSTRAC, the lines of communication are clarified and effective partnerships established; and • ensuring that appropriate ATO officers are fully trained in the use of AUSTRAC data for undertaking cash economy work 	<p>Agreed. In reference to the earlier ANAO performance audit The Auditor-General Audit Report No.7 2000–01 into the ATO's use of AUSTRAC data, the ATO agreed then with the recommendation to improve its strategic partnership with AUSTRAC. Senior executives from the ATO in strategic and risk management areas have commenced working with senior AUSTRAC officers to identify areas where AUSTRAC data can be of greater benefit. The Assistant Commissioner responsible for the cash economy is one of these officers. In relation to skilling, an on-going process has been put in place to identify and provide skilling to appropriate staff in the use of AUSTRAC data. The cash economy team has undertaken appropriate training since the audit has been completed. In addition, an ATO senior executive has been nominated to ensure AUSTRAC data is integrated into the ATO's information management capability.</p>	●	<p>The ATO has fully implemented this recommendation. ATO approaches have evolved, with AUSTRAC searches as part of the standard protocol for cash economy industry projects and other relevant parts of the ATO, such as the Strategic Risk Management unit, also using AUSTRAC data.</p>

Source: Audit Report No.35 2001-02 *ATO Progress in Addressing the Cash Economy* and ANAO analysis of audit information 2005

Index

A

Audit methodology and cost, 13, 35

B

Business-to-consumer research and education, 62

C

Cash Economy Initiative (CEI), 37, 44

Cash economy resourcing, 31, 47

Cash Economy Steering Committee (CESC), 14, 40, 43-49, 58, 60

Cash Economy Task Force (CETF), 12, 13, 15, 19, 25, 34, 36-38, 60, 62, 86

Compliance dividend, 17, 74

Compliance measures, 56, 61

D

Definition of the cash economy, 11, 25

E

Evaluation, 72

External relationships, 16, 21, 58, 64-68

G

'Get it in Writing' campaign, 33, 39, 62

O

Overseas practice, 11, 12, 27, 32

P

Previous audit report (Audit Report No.35 2001–2002), 12, 31, Appendix 2, 84-87

S

Size of the cash economy, 11, 26

Strategic Risk Management unit (SRM), 40, 87

T

Tax gap, 11, 12, 27, 32-33

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