

The Auditor-General
Audit Report No.12 2007-08
Performance Audit

Administration of High Risk Income Tax Refunds in the Individuals and Micro Enterprises Market Segments

Australian Taxation Office

© Commonwealth
of Australia 2007

ISSN 1036-7632

ISBN 0 642 80988 7

COPYRIGHT INFORMATION

This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth.

Requests and inquiries concerning reproduction and rights should be addressed to the Commonwealth Copyright Administration, Attorney-General's Department, Robert Garran Offices, National Circuit Barton ACT 2600

<http://www.ag.gov.au/cca>



Canberra ACT
1 November 2007

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Australian Taxation Office in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *Administration of High Risk Income Tax Refunds in the Individuals and Micro Enterprises Market Segments*.

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

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee'.

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.

For further information contact:

The Publications Manager
Australian National Audit Office
GPO Box 707
Canberra ACT 2601

Telephone: (02) 6203 7505
Fax: (02) 6203 7519
Email: webmaster@anao.gov.au

ANAO audit reports and information about the ANAO are available at our internet address:

<http://www.anao.gov.au>

Audit Team

David Crossley
Andrew Huey
Lesla Creswell
Brenda Canning

Contents

Abbreviations.....	7
Glossary	8
Summary and Recommendations	9
Summary	11
Audit objective and scope	13
Overall conclusion.....	13
Key audit findings.....	15
Recommendations	20
Summary of agency response	20
Recommendations	21
Audit Findings and Conclusions	23
1. Background and Context	25
Introduction	25
Previous reviews of high risk refund processing.....	30
Audit objective, scope and methodology	31
Structure of the report	32
2. Management Arrangements	33
Management issues examined as part of the audit	33
Organisational arrangements for administering high risk income tax refunds.....	33
Funding arrangements- <i>Compliance Challenges</i>	40
Planning processes relating to high risk income tax refunds.....	42
Performance monitoring and reporting	43
3. Identifying and Assessing High Risk Income Tax Refunds	47
Introduction	47
Identifying and assessing high risk income tax refunds.....	47
Risk based approach to administering high risk income tax refunds.....	52
High risk income tax refund business support processes.....	53
Tax Office's approach to managing aged high risk income tax refund cases	56
Private sector stakeholder feedback.....	57
4. Information Technology Systems, Processes and Controls	59
Introduction	59
Overview of the information technology environment.....	59
Change management and systems development	60
Information technology system user access and security	63
Business continuity management	65

Appendix	69
Appendix 1: Agency Response	71
Index.....	79
Series Titles.....	80
Current Better Practice Guides	81

Tables

Table 1.1	Relevant Taxpayers' Charter Service Standards and recent performance	30
Table 2.1	High risk income tax refund case outcomes.....	41
Table 3.1	NTS income tax return processing and high risk income tax refund test outcomes	49
Table 3.2	High risk income tax refunds reviewed by RAP Tools and case outcomes	51
Table 3.3	Incorrectly paid income tax refunds in the individuals and micro enterprises market segments	55
Table 3.4	High risk income tax refund cases on hand	57

Figures

Figure 1.1	Conceptual overview of the high risk income tax refund process— individuals and micro enterprises market segments	29
Figure 1.2	Report structure	32
Figure 2.1	Abridged Tax Office organisational structure highlighting areas administering high risk income tax refunds	35
Figure 3.1	High risk income tax refund process	48

Abbreviations

ANAO	Australian National Audit Office
CRISC	Credit Refund Integrity Steering Committee
ELS	Electronic Lodgement Service
NTS	National Taxpayer System
RAP Tools	Risk Assessment Profiling Tools
Tax Office	Australian Taxation Office

Glossary

ACSI 33	Australian Government Information and Communications Technology Security Manual, ACSI 33, released by the Defence Signals Directorate on 29 September 2006.
Coverage	Coverage relates to the planned and/or actual number of high risk income tax refund reviews completed by the Tax Office.
Data dictionary	A data dictionary is a collection of information relevant to individual data items that make up an information technology system. One benefit of a well-prepared data dictionary is a consistency between data items across different tables. For example, several tables may hold telephone numbers; using a data dictionary the format of this telephone number field will be consistent.
High risk income tax refund	The Tax Office defines a high risk income tax refund as a potentially incorrect refund claimed through an income tax return, that could result in a significant risk to revenue, or that could undermine the community's confidence.
RAP Tools	The RAP Tools are information technology systems designed to assist with identifying possible fraudulent activity and incorrect information reported in income tax returns. The Systems automate several of the manual processes associated with the review of high risk income tax refunds and identify lesser risk refunds for release to taxpayers.
Visual Basic	Visual Basic is a programming environment in which a programmer uses a graphical user interface to choose and modify pre-selected sections of code written in the BASIC programming language. Since Visual Basic is easy to learn and fast to write code with, it is sometimes used to prototype an application that will later be written in another programming language.

Summary and Recommendations

Summary

1. Income tax in 2005–06 accounted for 74 per cent of total revenue collected by the Australian Taxation Office (Tax Office). Income tax includes personal tax, company tax, capital gains tax and taxation of superannuation funds, including the superannuation contribution surcharge
2. Australia’s taxation system of self assessment places a responsibility on taxpayers to declare all of their assessable income and claim only deductions and/or offsets to which they are entitled. In administering the taxation system, the Tax Office has to balance the underlying principles of self assessment with the need to protect Commonwealth revenue.
3. The Tax Office uses information supplied by taxpayers to calculate the net amount of income tax payable or refundable. In 2005–06 the Tax Office processed around 8.3 million income tax refunds for individuals. The refund amount paid (\$13.4 billion) exceeded Budget estimates by \$307 million or 2.3 per cent. In the same period, around 1.5 million micro enterprises received income tax refunds amounting to some \$5.5 billion.
4. Over the last ten years, total annual income tax refunds paid to individual taxpayers have increased from \$8.8 billion to \$17.2 billion.¹ Growth in income tax refunds, over the 10 years, has exceeded relative growth in income tax collections by 2.7 per cent.² During recent periods, the Tax Office has reported an escalation in the amounts being claimed as work related expenses and rental income expenses. The non-disclosure of income and benefits is also a compliance risk for the Tax Office.

High risk income tax refunds

5. The Tax Office began to increase its focus on high risk income tax refunds in 2002 when it created the Refund Integrity Steering Committee, now known as the Credit Refund Integrity Steering Committee (CRISC), and the position of Tax Office Refund Integrity Custodian. The Tax Office defines a high risk income tax refund as a ‘potentially incorrect refund claimed through an income tax return, that could result in a significant risk to revenue, or that

¹ Commissioner of Taxation 2006, *Commissioner of Taxation Annual Report 2005–06*, Canberra, p. 84.

² Including the impact of the Family Tax Benefit, Baby Bonus and Private Health Insurance Rebate, growth in income tax refunds has exceeded growth in income tax collections by 20.3 per cent.

could undermine the community's confidence'³. In practice, where an income tax refund is tested and meets certain risk based criteria, the Tax Office classes the refund as high risk. These criteria are coded in the Tax Office's return processing system, the National Taxpayer System (NTS).

6. Historically, each year the Tax Office had reviewed around 6700 high risk income tax refunds payable to individual taxpayers. In the 2004–05 Budget the Tax Office received additional funding to, in part, increase its coverage of high risk personal income tax refunds. Over the four years of the funding, the Tax Office committed to undertake reviews of an additional 34 100 high risk income tax refunds. The Tax Office expected the additional reviews to result in income tax refund adjustments of \$44.2 million.

7. Changes made to the Tax Office's NTS high risk income tax refund test criteria resulted in a significantly larger number of income tax refunds being identified as potentially high risk. The Tax Office subjects all income tax refunds classified as high risk to additional verification procedures, either manual review by a high risk refund case officer or a combination of system-based and manual review processes. During 2005–06, due to the significant increase in the number of high risk income tax refunds, the Micro Enterprises and Individuals Business Line reviewed 31 560 high risk income tax refunds payable to individual taxpayers, and made revenue adjustments of around \$41 million.⁴ In the same period, the Client Account Services Business Line separately reviewed 52 240 income tax refunds relating to both individuals and other taxpayers and made adjustments in the order of \$50 million.⁵

The Tax Office's high risk income tax refund compliance approach

8. In administering income tax refunds, the Tax Office aims to pay the correct refund amount to the right taxpayer in a timely manner. The Tax Office's processes for administering high risk income tax refunds are designed to ensure the integrity of the refund process and mitigate associated risks. This includes potential fraud, errors in income tax return preparation and large or unusual refund claims.

³ Definition supplied by the Tax Office's Credit Refund Integrity Steering Committee in November 2006.

⁴ Commissioner of Taxation 2006, *Commissioner of Taxation Annual Report 2005–06*, Canberra, p. 139.

⁵ *ibid.*, p. 139.

9. The Tax Office's *2006–07 Compliance Program* states that it will check high risk income tax refunds against a set of criteria determined by intelligence from its compliance activities, prior to payment. The Tax Office may also match income tax return information with other data, and contact taxpayers or third parties to verify information included on income tax returns.

10. Although the Tax Office's high risk income tax refund strategy focuses on the pre-issue review of income tax refunds, related compliance risks are also managed through the Tax Office's broader compliance programs. These range from education and advice to active compliance and enforcement activities.⁶

Audit objective and scope

11. The objective of the audit was to assess the effectiveness of the Tax Office's compliance approach for high risk income tax refunds in the individuals and micro enterprises market segments. The audit examined three key areas:

- management and organisational arrangements relating to high risk income tax refund processes;
- processes and procedures for identifying high risk income tax refunds, and the processes and tools used to evaluate and verify taxpayers' entitlements to income tax refunds; and
- information technology systems, processes and controls supporting the processing of income tax returns and refunds.

Overall conclusion

12. In administering high risk income tax refund processes, the Tax Office seeks to balance client service against the need to maintain refund integrity and protect Commonwealth revenue. The Tax Office's governance framework supports the administration of high risk income tax refunds. The Credit Refund Integrity Steering Committee (CRISC), which oversees the income tax refund process, provides coordinated guidance and is involved in the ongoing administration of high risk income tax refunds. The Tax Office has also implemented risk-based frameworks to identify and assess high risk income tax refunds.

⁶ The Tax Office publishes a Compliance Program booklet each year that outlines risks to Australia's taxation system and how the Tax Office is proposing to use its resources to address those risks.

13. The Tax Office, in recent years, has identified as high risk and consequently reviewed prior to payment, income tax refund claims that are equal in total value to more than half of the value of all income tax refunds paid. The income tax refunds reviewed were payable to less than 2 per cent of taxpayers. However, following review or verification, the Tax Office has historically adjusted only 3 to 6 per cent of income tax refunds that it has classified as high risk.⁷ This indicates that prior to payment the Tax Office is withholding all higher value income tax refunds for review, as they potentially represent a significant risk to revenue and/or may be difficult to recover if paid. Nevertheless, due to the relatively low number of these refunds that are adjusted, there is considerable scope for the Tax Office to refine its high risk income tax refund tests to better target the underlying risks associated with the payment of high risk income tax refunds. This would have the dual benefit of better targeting Tax Office resources on income tax refunds that represent an actual risk to revenue, while reducing the average elapsed time for the processing of high risk income tax refunds.

14. The ANAO acknowledges that the Tax Office currently has limited ability to assess the effectiveness of its high risk income tax refund tests, due to technical limitations in its information technology systems. This impairs its capacity to complete sensitivity or other analysis to refine the scope of its high risk income tax refund tests.

15. The ANAO found that the Tax Office has focused on understanding the behaviour of taxpayers' whose income tax refunds have been identified as high risk. Consequently, there would be benefit in the Tax Office giving greater emphasis to understanding the changing environment and dynamics of taxpayer behaviour that may influence the broader population of taxpayers to make claims for large and/or unusual income tax refunds. Adopting such an approach would provide a more balanced strategy for addressing income tax refund risks across the individuals and micro enterprises market segments.

16. As part of the audit, the ANAO examined the information technology systems, processes and controls supporting the processing of income tax returns and refunds. The ANAO considers that the Tax Office needs to strengthen its information technology and security controls around the Risk Assessment

⁷ The adjustment rate has been calculated by dividing the number of high risk income tax refunds adjusted by the number of high risk income tax refunds identified by the NTS's high risk income tax refund tests. The Tax Office advised that it calculates strike rate by dividing the number of high risk income tax refunds adjusted by the number of high risk income tax refunds manually reviewed by high risk refund case officers. Calculating the strike rate in this way increases the ratio of cases adjusted to between 7 and 14 per cent.

Profiling Tools (RAP Tools).⁸ Related information technology and security control weaknesses have exposed the Tax Office to the risk of fraud and processing error. The Tax Office is progressively implementing strategies to mitigate the risks posed by operation of the RAP Tools.

17. The ANAO completed a performance audit of the Tax Office's administration of activity statement high risk refunds in March 2006.⁹ The ANAO made seven recommendations aimed at improving the Tax Office's administrative practices relating to its administration of activity statement refunds. The ANAO recognises that while the processing of activity statement and income tax refunds is administered by different business areas of the Tax Office, some common themes relating to risk management, systems based identification of high risk refunds, and information systems development have emerged in both audits. In implementing its new tax administration system and associated business processes, the Tax Office has the opportunity to address these issues from a whole of agency perspective.

Key audit findings

Management arrangements (Chapter 2)

18. Within the Tax Office the CRISC has been given the responsibility to mitigate risks associated with the credit and/or refund process. These risks include fraud, over claim of entitlement and error (either taxpayer or Tax Office). The CRISC's role has evolved over recent years with the committee extensively involved in ongoing administration of high risk income tax refunds. The CRISC provides:

- governance and leadership in managing credit and/or refund risks;
- maintains a risk methodology and framework; and
- assesses and endorses significant system or work practice changes, that may have an impact on the Tax Office's credit and/or refund controls.

19. The audit identified two areas where the Tax Office's management arrangements in relation to the administration of high risk income tax refunds could be enhanced. These relate to the Tax Office:

⁸ The RAP Tools are key information technology systems supporting high risk income tax refund processing.

⁹ Australian National Audit Office 2006, Audit Report No.35 2005–06, *The Australian Taxation Office's Administration of Activity Statement Refunds*, Canberra.

- improving its understanding of the risks associated with the administration of high risk income tax refunds and using this information to refine its high risk income tax refund controls; and
- enhancing its external reporting, in particular reporting to the Government through its *Compliance Challenges* reports and annual reports. Existing high risk income tax refunds information reported for individuals, only relates to cases actioned by the Micro Enterprises and Individuals Business Line and not cases actioned by the Client Account Services Business Line. Therefore, the information reported does not relate to total cases actioned for the individuals market segment.

Identifying and assessing high risk income tax refunds (Chapter 3)

20. The Tax Office focuses on managing income tax refunds identified as high risk as part of the income tax assessment process. The Tax Office classifies approximately 2 per cent of all income tax refund claims, as high risk. In 2005–06 high risk income tax refunds accounted by value, for more than half of all income tax refunds paid.

21. High risk income tax refunds once identified are subject to additional manual and/or system based verification procedures. The Tax Office has developed system-based RAP Tools to assist with the automated testing of high risk income tax refunds. Approximately 84 per cent of high risk income tax refund claims made in 2006–07 were reviewed by the RAP Tools with the remainder being manually reviewed by high risk refund case officers.¹⁰ Those high risk income tax refunds which fail the RAP Tools tests are similarly subject to manual review. High risk income tax refunds that have been assessed by the RAP Tools as lower risk are processed for release to taxpayers without further review and/or verification.

22. To maintain refund integrity in a dynamic environment it is important that the Tax Office collects, analyses and uses risk based information to support ongoing development of its information technology systems' controls. The ANAO found that the Tax Office has focused on managing only identified high risk income tax refunds. These are income tax refunds which are potentially payable to less than 2 per cent of taxpayers.

¹⁰ The RAP Tools are only applied to selected high risk income tax refunds that have failed one of a number of the NTS high risk income tax refund risk based tests.

23. To provide assurance that key underlying risks associated with the administration of high risk income tax refunds in the individuals and micro enterprises market segments are being identified, the ANAO has recommended that the Tax Office consider developing a specific post-issue income tax refund compliance strategy. This strategy would have regard to broader compliance risk issues and assess whether the Tax Office's existing pre-issue high risk income tax refund tests are effective in targeting non-compliance. The Tax Office could use the information and/or intelligence gained as an input into any broader Tax Office strategic risk assessments of income tax refund processing and the further development of its high risk income tax refund tests.

24. As a measure of the effectiveness of the Tax Office's controls supporting the processing of high risk income tax refunds, the ANAO reviewed the value and number of income tax refunds recorded by the Tax Office as having been incorrectly paid. The Tax Office advised that an 'incorrect refund register' was not fully implemented until May 2005. Between June 2005 and June 2007, the Tax Office recorded the incorrect payment of \$283 434 in high risk income tax refunds to individuals and micro enterprises. The Tax Office indicated that it had been able to recover approximately 80 per cent of the value of high risk income tax refunds incorrectly paid to individuals and micro enterprises.

25. The Tax Office has review processes to verify the accuracy of refunds where they have been identified as having been incorrectly paid. These processes are currently manual and only undertaken on a selected case-by-case basis. The Tax Office in reviewing incorrect refunds is well positioned to identify system or business process weaknesses. The ANAO considers that following the introduction of the Tax Office's new tax administration system, it should systematically analyse all incorrectly paid high risk income tax refunds, in order to identify and address system or business process weaknesses, and identify other potentially incorrectly paid high risk income tax refunds.

Information technology systems, processes and controls (Chapter 4)

26. The Tax Office's two main information technology systems used to identify and assess high risk income tax refunds are NTS and the RAP Tools. Both NTS and the RAP Tools are to be replaced in late 2007 when the Tax Office introduces its new tax administration system, as part of its *Easier, Cheaper and More Personalised Change Program*.

Change management and systems development

27. Sound management practice suggests that agencies should have in place change management processes that support development and modification of their information technology systems. Changes to, and maintenance of, the NTS is subject to the Tax Office's formal change management and systems development methodologies. The ANAO was advised that no changes have been made to the NTS's high risk income tax refund tests since Tax Time 2004.¹¹ The ANAO reviews the change processes associated with Tax Time each year as part of its audit of the Tax Office's financial statements.

28. The Refund Integrity Team developed the RAP Tools outside of the Tax Office's change management policies and procedures, including those procedures relating to system design and development. When the CRISC was requested to approve the current operation of the RAP Tools in late 2005, it identified that the documentation and governance supporting the RAP Tools was below standard. The Refund Integrity Team, who developed the RAP Tools, subsequently developed business requirements and other systems documentation in order to obtain CRISC sign-off of the system. Notwithstanding, due to the limited nature of the Tax Office's documentation around the RAP Tools, the ANAO is not able to confirm that all aspects of the RAP Tools have been adequately tested and/or align with user requirements.

User access and security

29. The regular and ongoing review of user access to the Tax Office's systems is an important control mechanism. This supports timely revocation of user access and maintenance of appropriate access levels for individual staff in the execution of their duties. A Tax Office review of Case Reporting System¹² user access in mid 2006, identified a large number of users who no longer required access to the System. In line with the Tax Office's national information technology security policy and ACSI 33¹³ guidelines, the Refund

¹¹ Tax Time is the Tax Office's annual information technology development process for maintenance of its key information technology systems. A well developed information technology governance process supports Tax Time.

¹² Access to the RAP Tools is controlled through the Tax Office's Case Reporting System. The Case Reporting System is also used to manage workflow, and record and monitor high risk income tax refund case outcomes including adjustments.

¹³ Australian Government Information and Communications Technology Security Manual, ACSI 33, released by the Defence Signals Directorate on 29 September 2006.

Integrity Team should periodically review all user access to the Case Reporting System.

30. The Refund Integrity Team controls administrator level access to the RAP Tools. The logging of user access and changes to the system is critical to provide an adequate audit trail of users' actions within the systems. The ANAO noted that the systems do not incorporate user access logging and consequently the Tax Office does not maintain an adequate audit trail of a users' actions within the systems.

31. Agencies should have clear and segregated levels of responsibility, particularly over information technology systems development, operation, technical support and security administration. The ANAO found that a single individual had been responsible for systems development, aspects of systems testing, release management, support and ongoing systems maintenance of the RAP Tools. The ANAO considers that the lack of segregation of duties in relation to the RAP Tools has exposed the Tax Office to a higher than acceptable level of fraud risk and processing error. The Tax Office advised that the systems developer moved to a new position in mid-July 2007 and that other members of the Refund Integrity Team are now providing support for the systems.

32. Information technology systems threat and risk assessments, generally consider internal and external threats largely from an information technology security perspective. The ANAO noted that no threat or risk assessment had been completed for the RAP Tools or Case Reporting System. Further, operation of the RAP Tools has not been reviewed from a fraud control perspective. The ANAO expected that the Tax Office would have considered operation of the RAP Tools in preparing its Micro Enterprises and Individuals Business Line Fraud Control Plan, finalised in mid 2007. The Tax Office advised that it will consider development and operation of the RAP Tools in preparing the Client Account Services Business Line Fraud Control Plan, as it is the business owner of the system.

33. The ANAO observed that the Tax Office has adopted a risk based approach where by it is implementing strategies to mitigate the risks associated with the continued operation of the RAP Tools and Case Reporting System. In this regard the Tax Office is aiming to balance client service and refund integrity.

Recommendations

34. The ANAO has made five recommendations. The first four recommendations focus on strengthening the Tax Office's management arrangements and risk identification process supporting the administration of high risk income tax refunds. The final recommendation in the audit relates to improving the Tax Office's information technology controls supporting the ongoing operation of the Tax Office's income tax refund RAP Tools which are key systems used to identify and assess high risk income tax refunds.

35. The Tax Office has agreed to the five recommendations made in this report.

Summary of agency response

36. The Tax Office welcomes the ANAO's recommendations in relation to the administration of high risk income tax refunds in the individuals and micro enterprises market segments and will adopt them in full (with the clarification at Recommendation 2).

37. The Tax Office accepts that many of the ANAO's recommendations are the result of the technical limitations of its existing information technology systems.

38. The introduction of an entirely new tax administration system, as part of the *Easier, Cheaper and More Personalised Change Program*, will provide the Tax Office with the opportunity to complement and build on existing manual processes for assessing risks, undertaking reviews and reporting on and/or analysing outcomes in relation to high risk income tax refunds.

39. It is encouraging to note that although the ANAO identified areas for improvement, it was supportive of the overall approach that the Tax Office has taken in administering high risk income tax refunds. That is, an approach that seeks to balance the delivery of timely refund processing in a self assessment environment with the need to maintain refund integrity and protect Commonwealth revenue.

Recommendations

Recommendation No. 1

Para. 2.18

The ANAO recommends that to systematically identify, assess and subsequently mitigate high risk income tax refund risks, including new and/or emerging risks, the Tax Office should:

- (a) undertake periodic strategic risk assessments of income tax refunds and the processes supporting their administration; and
- (b) establish mechanisms for the regular reporting of income tax refund risk information to the CRISC from relevant business areas, which can then be used to further refine the high risk income tax refund controls.

Tax Office response: Agreed.

Recommendation No. 2

Para. 2.26

To improve reporting to Government in relation to the *Compliance Challenges Budget* funding, the ANAO recommends that the Tax Office:

- (a) reports performance against the individual *Compliance Challenges* targets for each risk area for which the funding was provided; and
- (b) reports the total number of high risk income tax refunds reviewed and the total value of adjustments made for individuals' high risk income tax refunds actioned by the Micro Enterprises and Individuals Business Line.

Tax Office response: Agreed – with defined parameters.

Recommendation No. 3
Para. 3.17

The ANAO recommends that the Tax Office consider developing a specific post-issue income tax refund compliance strategy for the individuals and micro enterprises market segments, to provide assurance that it is identifying and targeting the key underlying risks associated with administering the income tax refund process.

Tax Office response: Agreed.

Recommendation No. 4
Para. 3.30

The ANAO recommends that following the introduction of the Tax Office's new tax administration system, the Tax Office should systematically analyse all incorrectly paid high risk income tax refunds, in order to identify and address system or business process weaknesses, and identify other potentially incorrectly paid high risk income tax refunds.

Tax Office response: Agreed.

Recommendation No. 5
Para. 4.33

The ANAO recommends that if the RAP Tools continue to be used as a primary review system in the processing of high risk income tax refunds in 2008, the Tax Office as a matter of priority, implement strategies to align operation of the RAP Tools with its corporate policies and procedures relating to information technology security and control.

Tax Office response: Agreed.

Audit Findings and Conclusions

1. Background and Context

This Chapter introduces the Australian Taxation Office's administration of high risk income tax refunds in the individuals and micro enterprises market segments. It also outlines the audit objective and methodology.

Introduction

1.1 The Australian Taxation Office (Tax Office) is Australia's principal revenue collection agency, collecting around 90 per cent of Commonwealth revenue. Income tax in 2005–06 accounted for 74 per cent of the total revenue collected by the Tax Office. Income tax includes personal tax, company tax, capital gains tax and taxation of superannuation funds, including the superannuation contribution surcharge.

Self assessment and calculation of income tax refunds

1.2 Australia's taxation system is based on self assessment. Self assessment places a responsibility on taxpayers to declare all of their assessable income and claim only deductions and/or offsets to which they are entitled. In administering the taxation system, the Tax Office has to balance the underlying principles of self assessment with the need to protect Commonwealth revenue.

1.3 The Tax Office uses information supplied by taxpayers to determine taxable income and to make income tax assessments. This involves the Tax Office reducing taxpayers' assessable income by any allowable deductions, rebates and/or offsets, to arrive at an amount of taxable income. Based on the level of taxable income the Tax Office assesses the amount of tax payable. This assessment may subsequently result in the Tax Office issuing an income tax refund. An income tax refund arises where the amount of income tax already paid exceeds the income tax payable.

1.4 In 2005–06 the Tax Office processed around 8.3 million income tax refunds for individuals. The refund amount paid (\$13.4 billion) exceeded Budget estimates by \$307 million or 2.3 per cent. In the same period around 1.5 million micro enterprises received income tax refunds amounting to some \$5.5 billion.

The Tax Office's individuals and micro enterprises market segments

1.5 This audit focused on the processing and payment of income tax refunds, in particular high risk income tax refunds, in the individuals and micro enterprises market segments. The individuals market segment, as at June 2006, was made up of around 9.2 million taxpayers, largely salary and wage earners or private investors. Tax agents prepare approximately 74 per cent of income tax returns lodged by individuals. The micro enterprises market segment as at June 2006 consisted of around 2.4 million micro businesses. Included in this total were 1.8 million individuals who received business income through either a partnership or trust. The Tax Office defines micro businesses as those businesses with a turnover of less than \$2 million per year. Micro businesses account, by number, for around 96 per cent of the total business market. Tax agents prepare about 93 per cent of micro businesses' income tax returns.

High risk income tax refunds

1.6 In administering income tax refunds, the Tax Office aims to pay the correct refund amount to the right taxpayer in a timely manner. Over the last ten years, total annual income tax refunds paid to individual taxpayers have increased from \$8.8 billion to \$17.2 billion.¹⁴ Growth in income tax refunds, over the 10 years, has exceeded relative growth in income tax collections by 2.7 per cent.¹⁵

1.7 The Tax Office defines a high risk income tax refund as a 'potentially incorrect refund claimed though an income tax return, that could result in a significant risk to revenue, or that could undermine the community's confidence'.¹⁶ In practice, where an income tax refund meets certain risk based criteria the Tax Office classes the refund as high risk. These criteria are coded in the Tax Office's return processing system, the National Taxpayer System (NTS).

1.8 The Tax Office began to increase its focus on high risk income tax refunds in 2002 when it created the Refund Integrity Steering Committee, now known as the Credit Refund Integrity Steering Committee (CRISC), and the

¹⁴ Commissioner of Taxation 2006, *Commissioner of Taxation Annual Report 2005–06*, p. 84.

¹⁵ Including the impact of the Family Tax Benefit, Baby Bonus and Private Health Insurance Rebate, growth in income tax refunds has exceeded growth in income tax collections by 20.3 per cent.

¹⁶ Definition supplied by the Tax Office's Credit Refund Integrity Steering Committee in November 2006.

position of Tax Office Refund Integrity Custodian. Subsequently, a review of refund processing was undertaken and enhancements were made to the Tax Office's information technology systems to better support identification of potentially high risk income tax refunds.¹⁷

1.9 In the 2004–05 Budget the Tax Office received additional funding to in part, increase its coverage of high risk personal income tax refunds. Over the four years of the funding, the Tax Office committed to undertake reviews of an additional 34 100 high risk income tax refunds. Historically, the Tax Office reviewed around 6700 high risk income tax refunds payable to individual taxpayers. The Tax Office expected the additional reviews to result in income tax refund adjustments of \$44.2 million. The Tax Office since receiving the additional funding has undertaken more high risk income tax refund reviews than planned and has exceeded its income tax refund adjustment targets.

1.10 Changes made to the Tax Office's information technology system's controls between 2002 and 2004 resulted in a significantly larger number of income tax refunds being identified as potentially high risk. As depicted in Figure 1.1, the Tax Office subjects all income tax refunds classified as high risk to additional verification procedures. During 2005–06 the Micro Enterprises and Individuals Business Line reviewed 31 560 high risk income tax refunds payable to individual taxpayers, and made revenue adjustments of around \$41 million.¹⁸ In the same period, the Client Account Services Business Line separately reviewed 52 240 income tax refunds relating to both individuals and other taxpayers and made adjustments in the order of \$50 million.

Administration of high risk income tax refunds for the individuals and micro enterprise market segments

1.11 The Tax Office's high risk income tax refund strategy focuses on reviewing selected income tax assessments and claims for credit and/or refunds prior to issue. All income tax assessments are processed through the Tax Office's NTS. The system has a series of inbuilt high risk income tax refund tests (risk criteria) against which all income tax returns are reviewed. The system channels assessments that fail any of the high risk income tax refund tests to the Tax Office's high risk income tax refund teams for consideration. The teams then review selected groups of high risk income tax refunds against

¹⁷ Several new NTS high risk income tax refund tests were introduced and modifications were made to a number of the existing tests.

¹⁸ Commissioner of Taxation 2006, *Commissioner of Taxation Annual Report 2005–06*, Canberra, p. 139.

a second set of risk criteria, with any assessed as a lesser risk automatically released for payment to the taxpayer.¹⁹ The Tax Office's *2006–07 Compliance Program* states that high risk income tax refunds will be checked against a set of criteria determined by intelligence from its compliance activities, prior to payment. The Tax Office may also match income tax return information with other data, and contact taxpayers or third parties to verify information included on income tax returns.

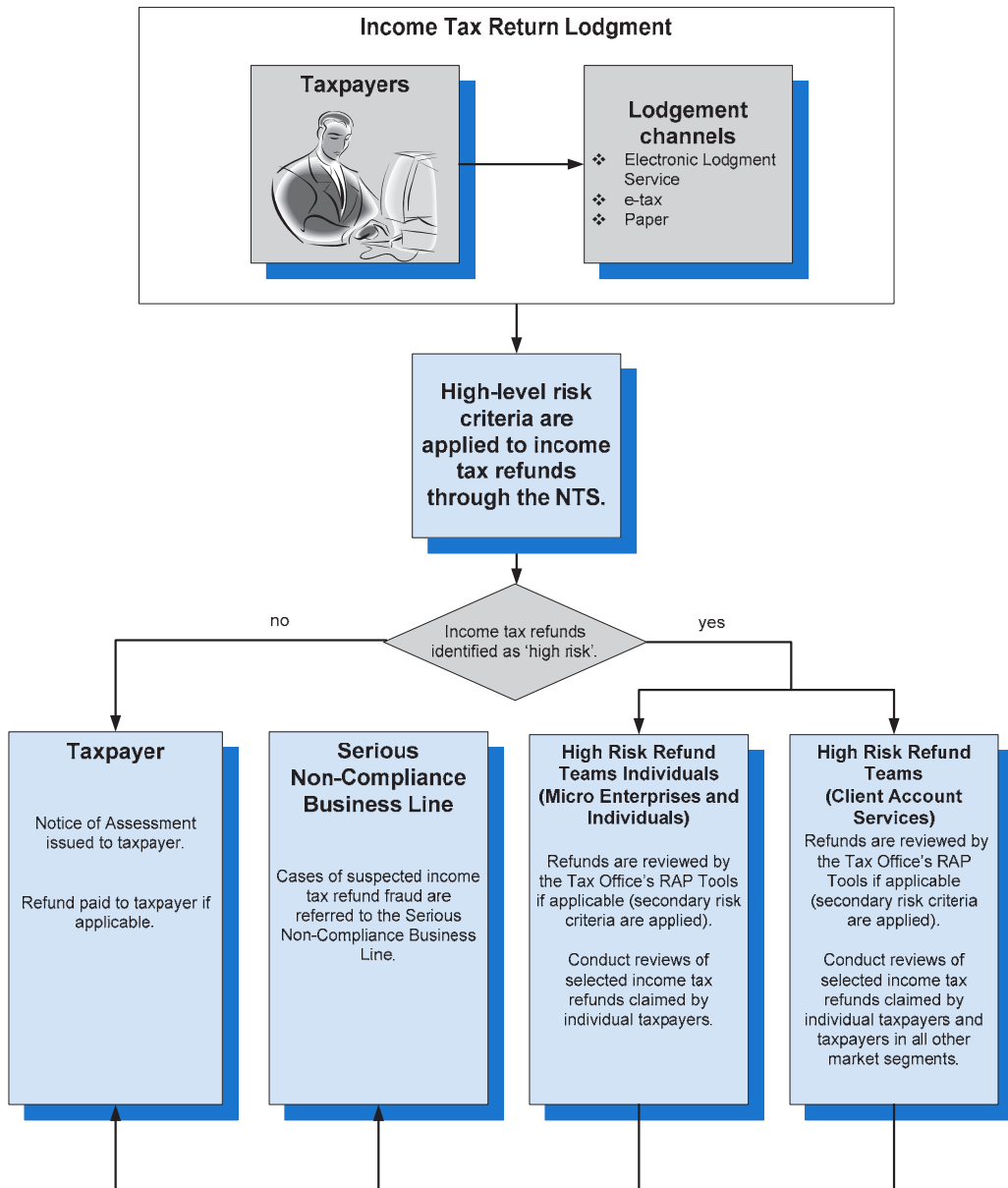
1.12 The Tax Office's processes for administering high risk income tax refunds are designed to ensure the integrity of the refund process and mitigate risks associated with payment of incorrect refunds. Figure 1.1 presents an end-to-end conceptual overview of the Tax Office's processing of high risk income tax refunds for taxpayers in the individuals and micro enterprises market segments. Although the Tax Office's high risk income tax refund strategy focuses on the pre-issue review of income tax refunds, related compliance risks are also managed through the Tax Office's broader compliance programs. These range from education and advice to active compliance and enforcement activities.²⁰

¹⁹ The Tax Office has developed several high risk refund risk assessment profiling systems (RAP Tools) which assist with the review of refunds prior to payment. The RAP Tools do not relate to all of the NTS high risk income tax refund tests and in 2005–06 approximately 78 per cent of high risk income tax refunds were reviewed by the RAP Tools.

²⁰ The Tax Office publishes a Compliance Program booklet each year that outlines risks to Australia's taxation system and how the Tax Office is proposing to use its resources to address those risks.

Figure 1.1

Conceptual overview of the high risk income tax refund process—individuals and micro enterprises market segments



Source: Australian National Audit Office analysis of Australian Taxation Office information.

Taxpayers' Charter Service Standards

1.13 Overall, the Tax Office's Taxpayers' Charter sets out how the Tax Office conducts its business and specifies its service and other standards. The payment of a refund of overpaid tax is generally subject to a taxpayer lodging a return. If a taxpayer lodges an income tax return, the Tax Office aims to process the return within 14 days if lodged electronically or 42 days if lodged on paper. Table 1.1 outlines the Tax Office's Taxpayers' Charter Service Standards for income tax lodgements, service standard benchmarks and recent performance.

Table 1.1

Relevant Taxpayers' Charter Service Standards and recent performance

Service	Standard	Benchmark	2004–05	2005–06	2006–07
Processing of electronically lodged tax returns	14 days	96%	96.8%	96.1%	95.8%
Processing of paper income tax returns	42 days	92%	96.6%	97.8%	92.1%

Source: Australian Taxation Office.

Previous reviews of high risk refund processing

1.14 The Australian National Audit Office (ANAO) completed an audit of the risk management of individual taxpayer refunds in 1999–2000.²¹ The audit report made five recommendations aimed at improving administration of key aspects of refunds. The ANAO also considered administration of activity statement high risk refunds in a previous audit.²² This audit made seven recommendations designed to improve the Tax Office's administration of activity statement high risk refunds. The findings of both reports have been considered in undertaking this audit.

²¹ ANAO 2000, Audit Report No.27 1999–2000, *Risk Management of Individual Taxpayer Refunds*, Canberra.

²² ANAO 2006, Audit Report No.35 2005–06, *The Australian Taxation Office's Administration of Activity Statement High Risk Refunds*, Canberra.

Audit objective, scope and methodology

Audit objective and scope

1.15 The objective of the audit was to assess the effectiveness of the Tax Office's compliance approach for high risk income tax refunds in the individuals and micro enterprises market segments. The audit examined three key areas:

- management and organisational arrangements relating to high risk income tax refund processes;
- processes and procedures for identifying high risk income tax refunds, and the processes and tools used to evaluate and verify taxpayers' entitlements to income tax refunds; and
- information technology systems, processes and controls supporting the processing of income tax returns and refunds.

Audit methodology

1.16 The audit included a combination of interviews with Tax Office business line staff and key private sector stakeholders, as well as an examination of the Tax Office's systems and controls supporting the processing of income tax refunds. The ANAO undertook fieldwork at Tax Offices in Adelaide, Albury, Canberra and Melbourne. Fieldwork involved consultation with staff from the Micro Enterprises and Individuals Business Line, Client Account Services Business Line, Serious Non-Compliance Business Line and the Information and Communications Technology Branch.

1.17 The ANAO's Information Technology Branch also undertook an application review of the information technology systems supporting the processing and payment of income tax refunds. This review has been combined with data analysis to understand the information technology controls environment supporting the processing of high risk income tax refunds and confirm operation of the Tax Office's system based high risk income tax refund controls.

1.18 The audit was undertaken in conformance with ANAO auditing standards and cost \$301 000.

Acknowledgements

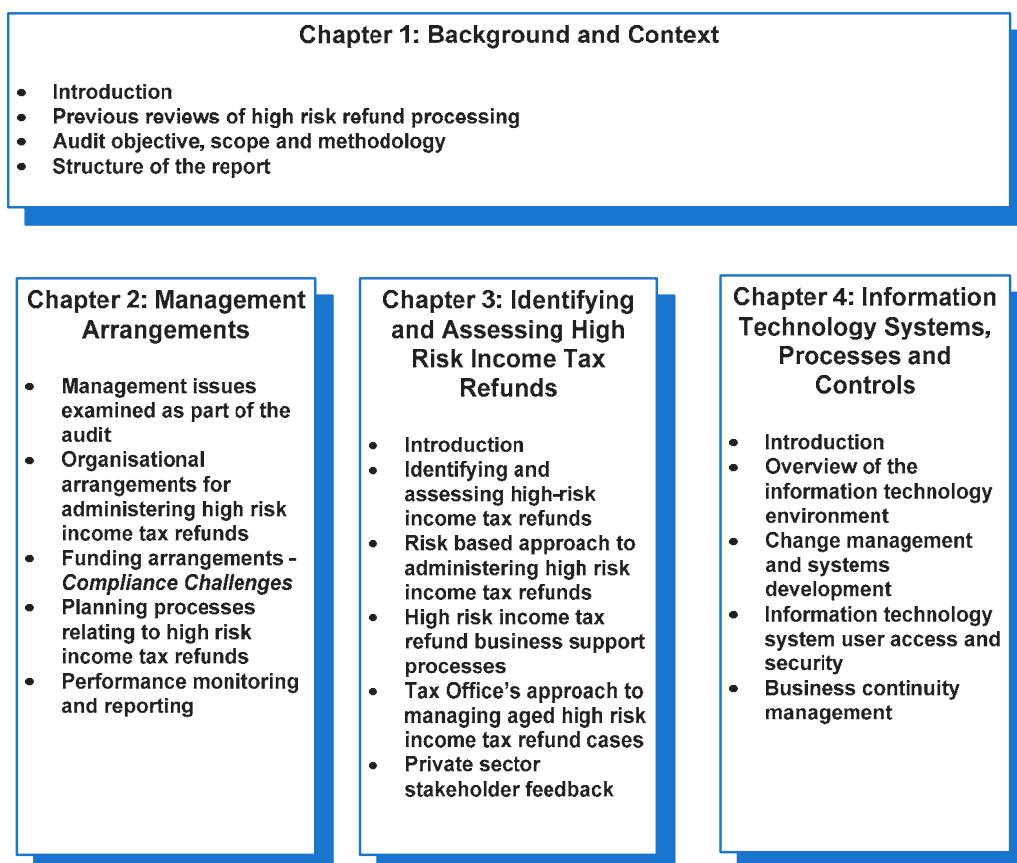
1.19 The ANAO would like to thank the Tax Office staff who assisted with the conduct of the audit, for their time, effort and expertise. The ANAO also appreciates the co-operation and assistance provided by private sector stakeholders consulted during the audit.

Structure of the report

1.20 Figure 1.2 depicts the structure of the Chapters of this report. The Chapters are structured around the three key areas examined as part of the audit.

Figure 1.2

Report structure



2. Management Arrangements

This Chapter discusses the Tax Office's management arrangements supporting administration of high risk income tax refunds in the individuals and micro enterprises market segments.

Management issues examined as part of the audit

2.1 Development and implementation of sound governance arrangements supports the effective management of agencies' programs and service delivery. The Tax Office administers high risk income tax refunds in the individuals and micro enterprises market segments within its broader governance and management frameworks. The principles of governance in the public sector are discussed in detail in the ANAO's better practice guide *Public Sector Governance*.²³

2.2 To assess the effectiveness of the Tax Office's management arrangements supporting administration of high risk income tax refunds in the individuals and micro enterprises market segments, the ANAO examined four key management issues:

- the organisational arrangements for administering high risk income tax refunds;
- funding arrangements-*Compliance Challenges*;
- planning processes; and
- performance monitoring and reporting.

Organisational arrangements for administering high risk income tax refunds

2.3 The Tax Office is a large organisation. To administer the taxation system and effectively address business and compliance risks, the Tax Office has adopted a matrix management model. The model combines the key elements of the Tax Office's management and planning frameworks. As part of its management framework the Tax Office uses market segments and special focus areas to assist with risk identification, and organisational and business planning. The business and service lines are responsible for achieving the

²³ ANAO 2003, *Public Sector Governance, Framework Processes and Practices*, Canberra.

Tax Office's output and outcome commitments to Government.²⁴ Responsibility for managing high risk income tax refunds is shared across several areas of the Tax Office. Figure 2.1 summarises the Tax Office's organisational framework relevant to the administration of high risk income tax refunds in the individuals and micro enterprises market segments. The roles of the key Tax Office areas administering high risk income tax refunds are examined in the following sections.

Role of the Credit Refund Integrity Steering Committee

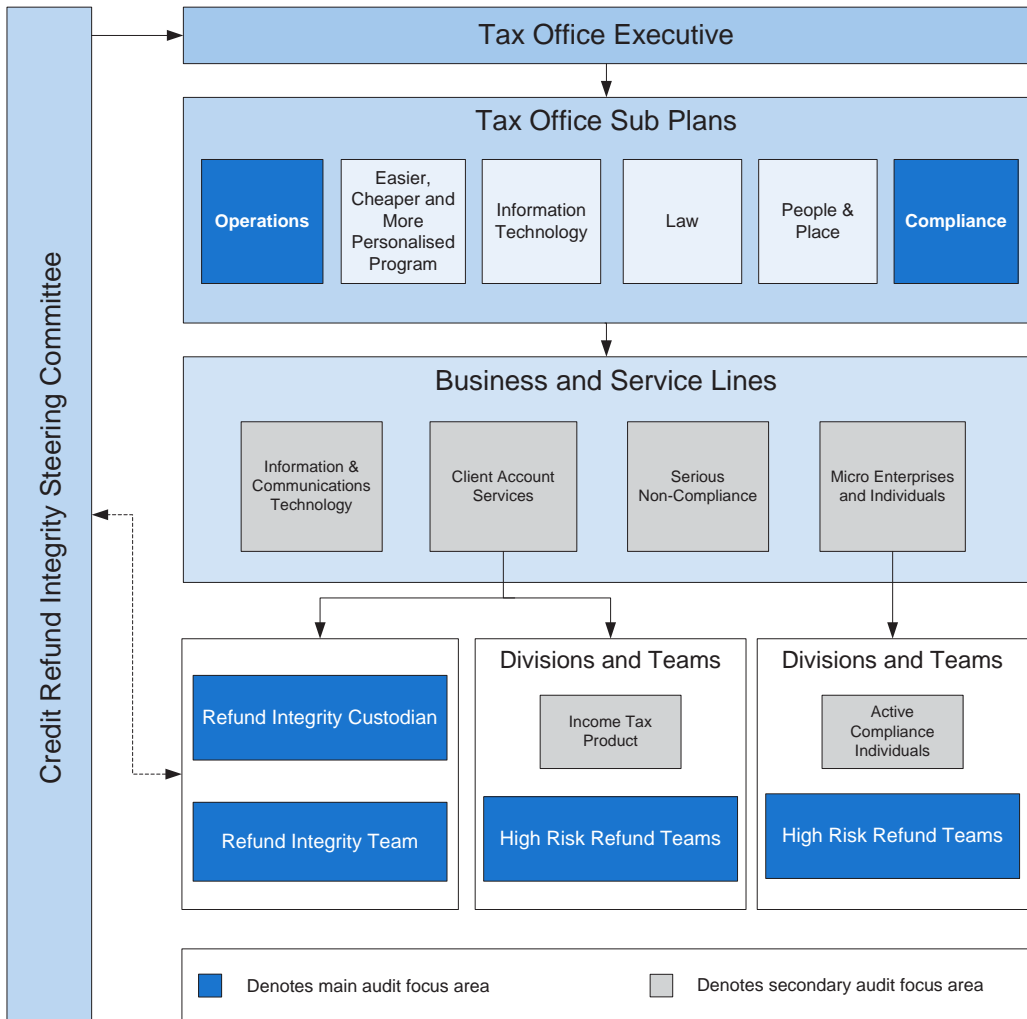
2.4 As previously noted, as part of its strategy for better managing high risk refunds, the Tax Office formed the Refund Integrity Steering Committee, which subsequently became known as the CRISC. The CRISC is made up of a number of senior Tax Office officers supported by the Refund Integrity Custodian.

2.5 Within the Tax Office the CRISC has been given responsibility to effectively mitigate risks associated with the credit and/or refund process. These risks include fraud, over claim of entitlement and error (either taxpayer or Tax Office). The CRISC also provides governance and leadership in managing credit and/or refund risks; maintains a risk methodology and framework; and assesses and endorses significant system or work practice changes that may have an impact on the integrity of the Tax Office's credit and/or refund controls.

²⁴ For further information about the Tax Office's outputs and outcomes and organisational structure refer to the *Commissioner of Taxation Annual Report 2005–06* available from the Tax Office's website <<http://www.ato.gov.au>>.

Figure 2.1

Abridged Tax Office organisational structure highlighting areas administering high risk income tax refunds



Source: Australian National Audit Office analysis of Australian Taxation Office information.

Providing governance and leadership in managing credit and refund risk

2.6 The Tax Office’s complex organisational structure and operating environment highlights the need for an oversight body to provide coordinated guidance in the administration of high risk income tax refunds. The CRISC’s role has evolved over recent years with it involved in the ongoing administration of high risk income tax refunds.

2.7 The ANAO was advised that the CRISC’s governance arrangements, in particular, its information technology governance arrangements have been

enhanced in recent periods. The ANAO observed that the CRISC previously endorsed the implementation of the Risk Assessment Profiling (RAP) Tools²⁵, key information technology systems supporting income tax refund integrity, without adequate consideration of the systems' development processes and associated security controls. As discussed in detail in Chapter 4: *Information Technology Systems, Processes and Controls*, the RAP Tools have inherent control weaknesses and their development did not align with the Tax Office's own policy and procedures for applications development, testing and release management.²⁶

Maintaining a high risk income tax refund risk methodology and framework

2.8 The Tax Office supports income tax refund integrity by identifying high risk income tax refund risks and mitigating these through its compliance activities. The Tax Office's high risk income tax refund controls identify approximately 2 per cent of all income tax refunds for further review and/or verification prior to issue. Annually, this equates to the Tax Office reviewing by value, in excess of half of all income tax refunds claimed by taxpayers.

2.9 The CRISC completed a risk assessment of high risk income tax refunds in 2002–03. This subsequently led to an enhancement of the high risk income tax refund controls incorporated in the NTS. The CRISC advised that in relation to the ongoing management of high risk income tax refund risks, it provides a focal point for senior Tax Office managers to identify, escalate and resolve cross-business service line delivery issues. The CRISC's aim is to complement the role of the revenue product committees (e.g. Income Tax Revenue Product Committee) that have responsibility for assessing, identifying and treating revenue product risks. The CRISC through its membership has access to compliance risk information from several areas of the Tax Office. The CRISC further advised that its actions have demonstrated that information flowing from those sources enables it to identify and respond to changes in the credit refund risk environment.

2.10 As previously noted, the Tax Office in recent years has classified as high risk, and subsequently reviewed prior to issue, income tax refund claims that are equal in total value to more than half of the value of all income tax

²⁵ The RAP Tools are information technology systems designed to assist with identifying possible fraudulent activity and incorrect information reported in income tax returns. The systems automate several of the manual processes associated with the review of high risk income tax refunds and identify lesser risk refunds for release to taxpayers.

²⁶ Tax Office policy documents: *Designing Change in the Tax Office PS CM 2006/11*, *Design and Program Management PS CM 2003/05* and *Applications Quality Assurance Processes PS CM 2004/11*.

refunds paid. However, these income tax refunds relate to only 2 per cent of the taxpayer population. The ANAO noted that in excess of 50 per cent of identified high risk income tax refunds are automatically released to taxpayers following assessment by the Tax Office's RAP Tools. The ANAO further noted that the Tax Office is only adjusting 3 to 6 per cent of high risk income tax refunds which are withheld for either automated system or manual review and/or verification.²⁷ This indicates that prior to payment the Tax Office is withholding all higher value income tax refunds for review, as they potentially represent a significant risk to revenue and/or may be difficult to recover if paid.

2.11 In 2006 the CRISC commissioned an external consultant to conduct a risk assessment of the Tax Office's major revenue products²⁸ to determine better practice controls that would help mitigate risks across the Tax Office's systems and processes. The ANAO reviewed the risk assessment and found that although income tax as a revenue product had been considered, the processing of income tax refunds was not specifically covered in the risk assessment.

2.12 The ANAO considers that if the CRISC implemented strategies to improve its understanding of the risks associated with administering the income tax refund process, including high risk income tax refunds, it would be better positioned to:

- assess if the high risk income tax refund tests are targeting income tax refund claims that present as a actual risk to revenue;
- target resources on income tax refunds that represent an actual risk to revenue, while reducing the average elapsed time for the processing of high risk income tax refunds; and
- develop an enhanced set of high risk income tax refund tests to be integrated into the Tax Office's new tax administration system.

2.13 The Tax Office is expecting that administration of high risk income tax refunds will be transferred to its new tax administration system in early 2008.

²⁷ The adjustment rate has been calculated by dividing the number of high risk income tax refunds adjusted by the number of high risk income tax refunds identified by the NTS's high risk income tax refund tests. The Tax Office advised that it calculates strike rate by dividing the number of high risk income tax refunds adjusted by the number of high risk income tax refunds manually reviewed by high risk refund case officers. Calculating the strike rate in this way increases the ratio of cases adjusted to between 7 and 14 per cent.

²⁸ The Tax Office's revenue products include Income Tax, Goods and Services Tax, Pay As You Go Withholding, Pay As You Go Income, Excise, Fringe Benefits Tax and Superannuation.

The new information technology system offers greater flexibility in assessing income tax returns and in identifying high risk income tax refunds. The Tax Office will, in this new environment, be able to apply a more comprehensive range of high risk income tax refund tests to identified income tax returns.

Assessing, prioritising and endorsing significant changes to refund controls

2.14 Ongoing review and revision of the Tax Office's high risk income tax refund controls is essential in identifying high risk income tax refunds prior to payment. The Tax Office's high risk income tax refund controls incorporated in its RAP Tools are continually being reviewed and refined. The RAP Tools are applied to selected groups of high risk income tax refunds and assist with identifying lesser-risk income tax refunds from those groups.²⁹ These are refunds that can be automatically released to taxpayers providing certain additional criteria are met. The CRISC, in line with its role of endorsing significant changes to refund controls that have an impact on integrity, has authorised changes to the RAP Tools and embedded risk criteria.

Role of Refund Integrity Custodian and Refund Integrity Team

2.15 The Refund Integrity Custodian has operational responsibility for managing the payment of high risk income tax refunds, and reports to the CRISC on the effectiveness of the Tax Office's refund controls. A small group of Tax Officers, referred to as the Refund Integrity Team, supports and reports to the Refund Integrity Custodian.

2.16 The Refund Integrity Team is responsible for identifying high risk income tax refund risks and mitigating these through improvements to the refund process. The Refund Integrity Team has established informal relationships with a number of areas of the Tax Office, which supports the sharing of information and identification of potential high risk income tax refund risks. Formalising these relationships, could promote the more systematic and coordinated sharing of information and may assist in identifying new and/or emerging risks. The Refund Integrity Custodian could then report this information to the CRISC. This would assist the CRISC in better understanding the broader risk environment and further developing and refining its high risk income tax refund controls.

²⁹ The RAP Tools are applied to high risk income tax refunds which have failed any one of the several NTS high risk income tax refund risk based tests. The RAP Tools do not relate to all of the NTS high risk income tax refund tests and in 2005–06 approximately 78 per cent of high risk income tax refunds were reviewed by the RAP Tools.

Role of the high risk income tax refund teams

2.17 The Tax Office's Micro Enterprises and Individuals Business Line is responsible for managing tax compliance risks and dealing with individuals' and micro businesses' tax affairs. Responsibility for the review of high risk income tax refunds in the individuals and micro enterprises' market segments is split between the Micro Enterprises and Individuals high risk refund teams and the Client Account Services-Income Tax Product-high risk refund teams. The Micro Enterprises and Individuals high risk refund teams review selected high risk income tax refunds payable to individual taxpayers prior to release. The Client Account Services-Income Tax Product-high risk refund teams action complementary high risk income tax refund cases for the remainder of the individuals market segment and taxpayers in the Tax Office's other market segments.

Recommendation No.1

2.18 The ANAO recommends that to systematically identify, assess and subsequently mitigate high risk income tax refund risks, including new and/or emerging risks, the Tax Office should:

- (a) undertake periodic strategic risk assessments of income tax refunds and the processes supporting their administration; and
- (b) establish mechanisms for the regular reporting of income tax refund risk information to the CRISC from relevant business areas, which can then be used to further refine the high risk income tax refund controls.

Agency response

2.19 Agreed.

2.20 The Tax Office through the membership of the Credit Refund Integrity Steering Committee has current access to compliance risk information from relevant business areas in addition to the Income Tax Product Committee and its annual Health Of The System Analysis assessments.

2.21 Relevant information relating to specific refund incidents and broader trends in refund risks does form part of the current consideration of the Credit Refund Integrity steering Committee. The committee recognises that this could be further enhanced by implementing more formal mechanisms that directly influence the maintenance and refinement of the Tax Office's high risk income tax refund controls.

Funding arrangements-*Compliance Challenges*

2.22 As noted earlier, the Tax Office received additional funding in the 2004–05 Budget to assist with the treatment of compliance related risks. This funding is referred to as *Compliance Challenges* and was conditional on the Tax Office reporting annually to the Expenditure Review Committee. The Tax Office has reported to Government three times on the outcomes of its compliance activities funded by the *Compliance Challenges* Budget allocation. The ANAO noted that the Tax Office has exceeded its liabilities raised³⁰ and coverage targets³¹ in the recent reporting periods.

2.23 In reporting to Government, the Tax Office has not consistently distinguished between the different categories of risk³² for which funding was provided. There is scope for the Tax Office to report segregated information to Government, about each risk area for which additional funding was provided, in order to demonstrate its progress in mitigating the specific compliance risks. The Tax Office advised that Government has only requested aggregated results to be reported and that further information is available and could be reported to the Government on request.

2.24 For the purpose of reporting to Government, the Tax Office has previously recorded adjustments arising from the review of high risk income tax refunds as either *Compliance Challenges* or business as usual. High risk income tax refund cases, where an adjustment is made to reduce the value of the refund, have previously been recorded largely against *Compliance Challenges*. Other cases, including no further action cases, have been recorded as business as usual. The ANAO acknowledges that the Tax Office has difficulty in differentiating high risk income tax refund *Compliance Challenges* and business as usual cases, as the additional funding has been used to enhance an existing Tax Office function.

2.25 The ANAO found that high risk income tax refund information previously reported to Government related only to cases actioned by the Micro Enterprises and Individuals Business Line. Individuals' high risk income tax refunds may be reviewed by Tax Office staff from either the Micro Enterprises

³⁰ Liabilities raised are the net value of adjustments made to income tax refunds payable.

³¹ Coverage relates to the planned and/or actual number of high risk income tax refund reviews completed by the Tax Office.

³² *Compliance Challenges* funding was provided to the Tax Office to mitigate risks in the individuals market. The underlying risks were associated with capital gains tax, rental expenses and high risk income tax refunds.

and Individuals Business Line or the Client Account Services Business Line. Further information in relation to the outcomes of high risk income tax refund reviews is presented in Table 2.1.

Table 2.1

High risk income tax refund case outcomes

Details/Business Line	2004–05	2005–06	2006–07
High risk income tax refund reviews completed (Micro Enterprises and Individuals)	36 286	31 560	27 193
Actual value of adjustments (Micro Enterprises and Individuals)	\$16.1 m	\$41.2 m	\$27.4 m
High risk income tax refund reviews completed (Client Account Services)	58 673	52 240	55 966
Actual value of adjustments (Client Account Services)	\$320.5 m ¹	\$47.89 m	\$48.69 m
<i>Compliance Challenges</i> targets (additional reviews—individuals market segment)	6200	9300	9300
<i>Compliance Challenges</i> (outcomes reported—individuals market segment as actioned by Micro Enterprises and Individuals)	17 050	9312	16 756
<i>Compliance Challenges</i> targets (liabilities raised—individuals market segment as actioned by Micro Enterprises and Individuals)	\$7.5 m	\$11.7 m	\$16.9 m

Note 1: This figure reflects the revised figure reported in an erratum to the *Commissioner of Taxation 2004–05 Annual Report*, following an internal review and subsequent broad re-classification of results for that year. The figure is not comparable with subsequent years' results as those later years reflect the full implementation of the Tax Office's revised classification of active compliance results.

Source: Australian Taxation Office.

Recommendation No.2

2.26 To improve reporting to Government in relation to the *Compliance Challenges* Budget funding, the ANAO recommends that the Tax Office:

- (a) reports performance against the individual *Compliance Challenges* targets for each risk area for which the funding was provided; and
- (b) reports the total number of high risk income tax refunds reviewed and the total value of adjustments made for individuals' high risk income tax refunds actioned by the Micro Enterprises and Individuals Business Line.

Agency response

2.27 Agreed- with defined parameters

2.28 The Tax Office will report against targets for each risk area and provide aggregated results for high risk income tax refunds actioned by the Micro Enterprises and Individuals Business Line. This will be included in the final Expenditure Review Committee Report for *Compliance Challenge* activities undertaken in 2007–2008

2.29 It is noted that the implementation of this report will require a finer level of detail and will be a once only report for the end of year report to the Expenditure Committee. This will be the final report to the Committee in relation to the *Compliance Challenges*. Such detailed reporting will not be required nor continue beyond this one report.

Planning processes relating to high risk income tax refunds

2.30 A sound organisational planning framework is an essential element of effective management and governance. The Tax Office's high level planning documents, such as the sub-plans and strategic statement, set the overall direction for the organisation. High risk income tax refunds are administered as part of the Tax Office's Compliance Sub-Plan.

2.31 A risk assessment model, referred to as the Health of the System Assessment, supports the Tax Office's planning framework. Health of the System Assessments consider risks from both a Tax Office product (income tax) and market segment (individuals and micro enterprises) perspective. Through the Health of the System Assessment process, the Tax Office aims to identify and rate its compliance risks and develop strategies to mitigate these risks. The Tax Office has identified high risk income tax refunds as a risk area.

2.32 To determine if the Tax Office has an integrated approach to planning for high risk income tax refunds, the ANAO examined the links between the Compliance Sub-Plan and lower level business line and team planning documents. The ANAO found that the Tax Office's planning documents reflect the risks associated with high risk income tax refunds and are clearly linked. The business lines' delivery plans identify the number of high risk income tax refund reviews to be completed, while the team plans reflect their overall responsibilities and areas for improved performance.

High risk income tax refunds fraud control planning

2.33 Another aspect of the Tax Office's administration of high risk income tax refunds is fraud control planning. The Tax Office, as part of its approach to managing fraud, has prepared a series of Fraud Control Plans. The Micro Enterprises and Individuals Business Line Fraud Control Plan identifies several high risk income tax refund fraud risks and associated fraud control mechanisms to mitigate the risks.

2.34 The ANAO found that the Micro Enterprises and Individuals Business Line Fraud Control Plan does not cover operation of the RAP Tools. The RAP Tools are critical Tax Office systems used in administering high risk income tax refunds. The ANAO expected that the Tax Office would have considered operation of the RAP Tools in preparing its Micro Enterprises and Individuals Business Line Fraud Control Plan. The Tax Office advised that it will consider the development and operation of the RAP Tools within the Client Account Services Business Line Fraud Control Plan, as it is the business owner of the system.

Performance monitoring and reporting

2.35 Performance management underpins sound management and governance. Ongoing and regular monitoring and reporting of performance supports agencies in managing their programs and in meeting their external accountabilities to the Government and to the Parliament.

External reporting of performance in relation to high risk income tax refund integrity

2.36 The Tax Office reports externally to the Parliament and the community through its annual reports. The Tax Office's 2005–06 Annual Report outlines the overall outcomes of its high risk income tax refund compliance activities. Also outlined in the Annual Report are historical trends in income tax refunds paid and income tax received by the Tax Office.

2.37 High risk income tax refunds in the individuals and micro enterprises market segments are administered by two different business lines. This requires the Tax Office to consolidate information to report by market segment. Internal Tax Office planning is largely completed by business line, with the Tax Office publishing annually, a compliance program with planned activities and results presented by market segment.

2.38 High risk income tax refund information in relation to the individuals market segment reported in the *2006–07 Compliance Program* and *Commissioner of Taxation Annual Report 2005–06*, only relates to cases actioned by the Micro Enterprises and Individuals Business Line and excludes cases actioned by the Client Account Services Business Line. To support the accurate reporting of high risk income tax refund case outcomes, in future years, the Tax Office should either consolidate the two business lines' activities or qualify the information reported as appropriate. The Tax Office's *Easier, Cheaper and More Personalised Program* is expected to deliver improvements to reporting capability, which will support the more comprehensive reporting of compliance results in future years.

Taxpayers' Charter Service Standards

2.39 As discussed in Chapter 1: *Background and Context*, the Tax Office's Taxpayers' Charter Service Standards indicate that when a taxpayer lodges an income tax return it will generally be processed within 14 days if lodged electronically or 42 days if lodged on paper. When the Tax Office withholds an income tax refund payable and pays it outside the Service Standards the taxpayer may be entitled to receive interest.

2.40 In 2006–07 the Tax Office reported processing approximately 96 per cent of income tax returns in accordance with the Service Standards. Although the Tax Office is achieving its Service Standards for payment of refunds on an annual basis, it acknowledges that in some instances during peak periods it is not meeting the Service Standards. More specifically, income tax returns where a high risk income tax refund is payable may take longer to process than the prescribed Taxpayers' Charter Service Standards. In 2004–05 and 2005–06 the Tax Office processed within the Service Standards, approximately 60 per cent of individual and micro enterprise income tax returns, where a high risk income tax refund was potentially payable. The Service Standards state that the Tax Office may take longer to process the income tax return, where information recorded requires checking, is incomplete or incorrect.

2.41 The Tax Office is reviewing the reporting of its performance in relation to the processing of income tax returns. To assist with managing taxpayers' expectations around the timeliness of income tax return processing and improve external accountability, the Tax Office could regularly report at a more detailed level its performance against the relevant Taxpayers' Charter

Service Standards. In particular, the average time taken to review high risk income tax refunds.

Internal performance monitoring and reporting

2.42 The Tax Office reports internally on the administration of high risk income tax refunds at several levels. Internal reporting is comprehensive and focuses on reporting largely by business line with some high risk income tax refund information also reported by market segment.

2.43 The ANAO found that while internal Tax Office reporting is comprehensive, it is not possible to accurately compare high risk income tax refund information captured at different points in the income tax assessment process. For example, it is not possible to accurately compare the high risk income tax refund value calculated by the Tax Office to other income tax refund data.³³ This limits the assessment of the effectiveness of the Tax Office's administration of high risk income tax refunds.

2.44 The ANAO found that while internal Tax Office reporting is comprehensive, it is not possible to accurately compare high risk income tax refund information captured at different points in the income tax assessment process. For example, it is not possible to accurately compare the high risk income tax refund value calculated by the Tax Office to other income tax refund data. This limits the Tax Office's ability to assess trends in high risk income tax refund claims within and across financial years. Access to further high risk income tax refunds data would allow the Tax Office's to assess over time, the effect of changes to the its high risk income tax refund test criteria and better support the targeting of the underlying compliance risks.

Certificate of Compliance

2.45 The *Financial Management and Accountability Act 1997* provides a legislative framework for the proper use and management of public money. The Commissioner of Taxation has a responsibility for the proper management of public money, in particular, matters relating to the handling, spending and accounting for public monies.

2.46 The Tax Office's Certificate of Compliance process relating to the Payment of Public Money is designed to provide assurance that payments made, for example, income tax refunds, are correct. The Certificate of

³³ The Tax Office calculates the high risk income tax refund value as part of the income tax assessment process. Where a taxpayer has submitted multiple returns in one year, the high risk income tax refund value can be overstated as it is an accumulated value calculated across multiple financial years.

Compliance process is supported by underlying Certificates of Evidence. Certificates of Evidence for the income tax refund process are completed by the Refund Integrity Custodian and other senior tax officers from the business lines responsible for administering high risk income tax refunds.

2.47 Assurance is provided through the identification of key controls and their ongoing assessment. The ANAO found that the Certificate of Evidence process has inherent weaknesses associated with questionnaire-based methodologies. As an example, the RAP Tools, key systems in the processing of high risk income tax refunds, have been reported as being compliant with Tax Office standards. The Certificates of Evidence reflect that ‘all controls are in place and there is insignificant risk to the payment process’³⁴. However, information technology security and controls weaknesses were evident in the development and operation of the RAP Tools. These issues are discussed in detail in Chapter 4: *Information Technology Systems, Processes and Controls*.

Performance measures

2.48 Sound management practice indicates that the Tax Office should be measuring the outputs and the outcomes of its high risk income tax refund compliance activities. The Tax Office’s key performance measure for high risk income tax refund administration is the number of refunds reviewed. Additional information is included in Tax Office management reports but this information is not reflected in its planning documents. The Tax Office could improve its approach to measuring high risk income tax refund compliance outcomes if it expanded and better aligned its performance measures with information currently reported to management.

³⁴ Australian Taxation Office—*Certificate of Evidence, Refund Control*, dated November 2006.

3. Identifying and Assessing High Risk Income Tax Refunds

This Chapter discusses the systems and processes the Tax Office uses to identify and assess high risk income tax refunds prior to payment.

Introduction

3.1 The Tax Office processed around 12.8 million individual and micro enterprise income tax returns in 2005–06. Approximately 77 per cent of these income tax returns resulted in the payment of a refund. Due to the volume of income tax returns processed, resource constraints and the nature of Australia’s self assessment taxation system, the Tax Office reviews income tax refund claims it considers high risk.

3.2 The ANAO has examined how the Tax Office has approached identifying and assessing high risk income tax refunds, using risk based methodologies. The ANAO reviewed the flow of income tax refund claims through the Tax Office’s information technology systems. The ANAO has also considered the Tax Office’s automated and manual processes for review and/or verification of income tax refunds. Figure 3.1 represents, at an aggregated level, the systems and processes the Tax Office uses in administering high risk income tax refunds.

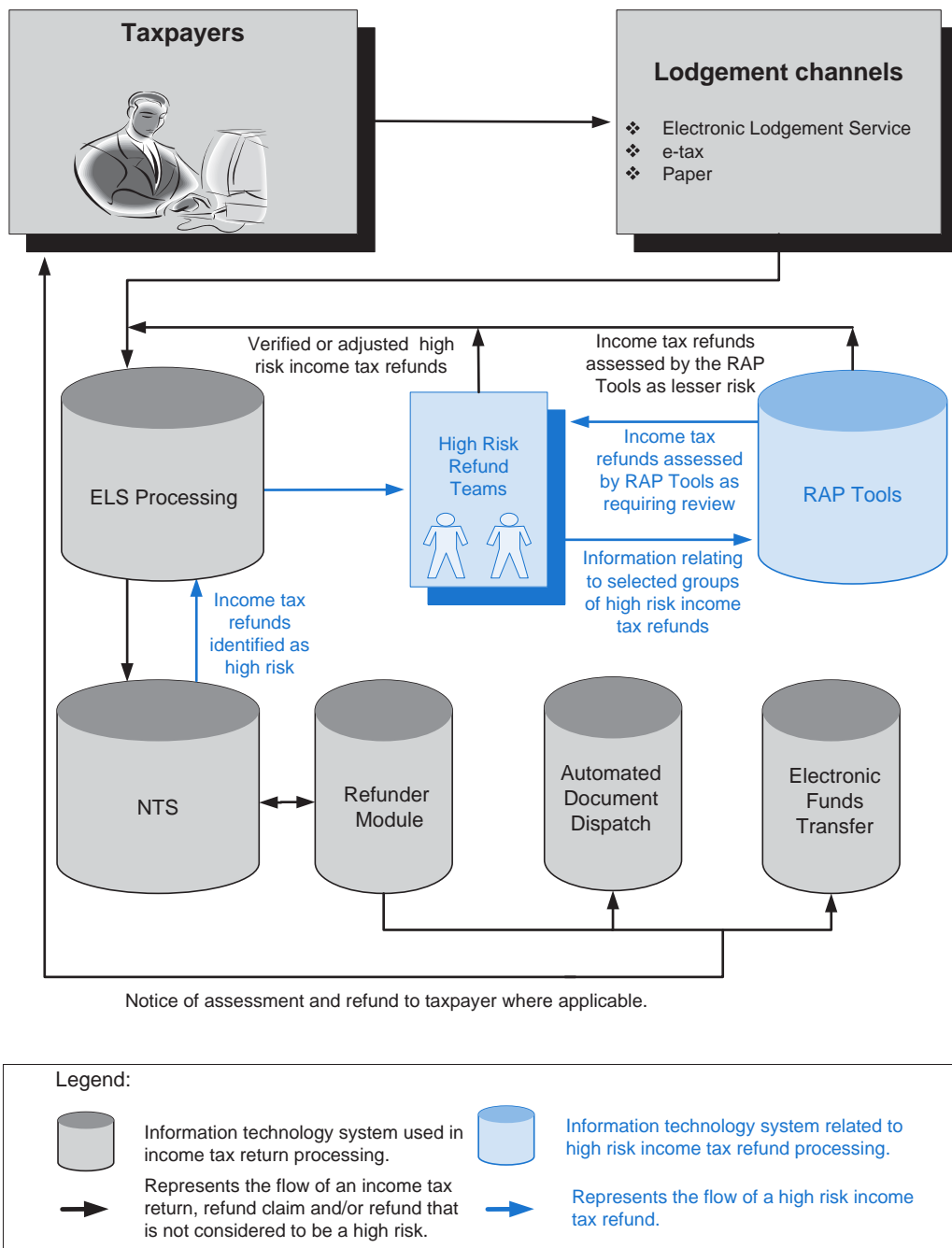
Identifying and assessing high risk income tax refunds

The NTS’s high risk income tax refund tests

3.3 Following lodgement, the Tax Office processes all income tax returns through its NTS. The NTS includes multiple high risk income tax refund tests relevant to individuals and micro enterprises. The high risk income tax refund tests relate to various groupings of taxpayers and use dollar value thresholds, various ratios and other parameters to classify income tax refunds as high risk. The high risk income tax refund tests are designed to help the Tax Office identify potential fraud, errors in income tax return preparation and large or unusual refund claims. Table 3.1 outlines the number of high risk income tax refunds the Tax Office’s NTS identified for the period 2004–05 to 2006–07.

Figure 3.1

High risk income tax refund process



Source: Australian National Audit Office analysis of Australian Taxation Office information.

Table 3.1**NTS income tax return processing and high risk income tax refund test outcomes**

Details	2004–05	2005–06	2006–07
Income tax lodgements	12.6 m	12.9 m	14.4 m
Income tax refunds paid	9.6 m	9.8 m	10 m
Value of income tax refunds paid	\$21.9 bn	\$25.2 bn	\$26.4 bn
Income tax refunds classified as high risk	188 434	200 015	202 705
Per cent of income tax refunds classified as high risk	1.9%	2%	2%

Source: Australian Taxation Office.

3.4 As part of the audit, the ANAO reviewed operation of the NTS's high risk income tax refund tests. In examining the high risk income tax refund tests the ANAO aimed to identify if the tests are operating in accordance with their design principles. As previously discussed, the volume of income tax refunds identified by the NTS as high risk is relatively low at around 2 per cent of all refunds payable. However, high risk income tax refunds equalled in total value, more than half of the value of income tax refunds paid in 2005–06.

3.5 The ANAO found that the Tax Office has limited ability to assess the effectiveness of its NTS high risk income tax refund tests. While the Tax Office can determine which high risk income tax refund tests are generating cases, it does not have the ability to complete sensitivity or other similar analysis to refine the scope of its high risk income tax refund tests. Due to the technical limitations of its current information technology systems the Tax Office cannot download significant numbers of past transactions, which would support this type of analysis. These limitations have resulted in the ANAO only being able to manually review 1485 income tax lodgement or lodgement amendment transactions relating to 955 taxpayers. From this analysis, the ANAO did not identify any anomalies in how the NTS high risk income tax refund tests are operating.

3.6 As a consequence of the ANAO's inability to undertake substantive testing of the NTS high risk income tax refund tests, a high degree of reliance has been placed on the Tax Office's own review of high risk income tax refund tests as part of its Tax Time systems development processes.³⁵ To provide

³⁵ Tax Time is the Tax Office's annual information technology development process for maintenance of its key information technology systems. Well developed information technology system development and governance processes support Tax Time.

further assurance as to integrity of the NTS high risk income tax refund tests, the ANAO completed a high level review of the system's programming code and examined the Tax Office's Tax Time testing documentation relating to the NTS high risk income tax refund tests.

3.7 The scope of the high risk income tax refund tests and the Tax Office's ability to amend the tests, is also limited by the functionality of system. Any proposed changes must be accommodated within the Tax Time annual update process for the NTS. This includes the end-to-end process that starts with the development of a business case for the system changes. The Tax Office advised that changes to the NTS have a long lead time of up to 18 months. The Tax Office previously acknowledged that there was a need for ongoing review of high risk income tax refund controls and that in moving forward it needs to find a better way to assess high risk income tax refund risks.

3.8 As noted in Chapter 2: *Management Arrangements*, the Tax Office is expecting to transfer income tax return processing to its new tax administration system in early 2008. The Tax Office expects the new information technology system to provide greater flexibility in identifying and assessing high risk income tax refunds.

Operation of the RAP Tools

3.9 High risk income tax refunds relating to individuals and micro enterprises are distributed pre-issue through the Electronic Lodgement Service (ELS) Processing System, to the high risk refund teams. High risk income tax refunds once identified are subject to additional manual and/or system based verification procedures.

3.10 The Tax Office has developed system-based RAP Tools to assist with the automated testing of high risk income tax refunds. Approximately 84 per cent of high risk income tax refund claims made in 2006–07 were reviewed by the RAP Tools with the remainder being manually reviewed by high risk refund case officers.³⁶ Those high risk income tax refunds which fail the RAP Tools tests are similarly subject to manual review. High risk income tax refunds that have been assessed by the RAP Tools as lower risk are processed for release to taxpayers without further review and/or verification. Table 3.2 outlines the number of high risk income tax refunds that have been assessed by the RAP Tools since 2004–05 and the outcomes of those cases.

³⁶ The RAP Tools are only applied to selected high risk income tax refunds that have failed one of a number of the NTS high risk income tax refund risk based tests.

Table 3.2**High risk income tax refunds reviewed by RAP Tools and case outcomes**

Details	2004–05	2005–06	2006–07
High risk income tax refunds subject to review and/or verification	188 434	200 015	202 705
High risk income tax refunds reviewed by the RAP Tools	136 651	156 446	169 295
Per cent of high risk income tax refunds reviewed by the RAP Tools	72.5%	78.2%	83.5%
High risk income tax refunds that passed the RAP Tools tests	98 249	127 903	131 748
Per cent of high risk income tax refunds that passed RAP Tools tests	71.9%	81.8%	77.8%
High risk income tax refunds adjusted following review and/or verification (individuals)	2926	4074	4698
High risk income tax refunds adjusted following review and/or verification (micro enterprises)	3363	6218	6457
Per cent of high risk income tax refunds adjusted following review and/or verification	3.34%	5.15%	5.5%
Value of high risk income tax refund adjustments following review and/or verification (individuals)	\$16.1 m	\$41.2 m	\$27.4 m
Value of high risk income tax refund adjustments following review and/or verification (micro enterprises)	\$320.5 m ¹	\$47.89 m	\$48.69 m

Note 1: This figure reflects the revised figure reported in an erratum to the *Commissioner of Taxation 2004–05 Annual Report*, following an internal review and subsequent broad re-classification of results for that year. The figure is not comparable with subsequent years results as those later years reflect the full implementation of the Tax Office's revised classification/definition of active compliance results. This had the effect of reducing the value of 'accounting adjustments' recorded, as active compliance. The Tax Office has determined that 'where an internal system could or should, be able to identify a particular issue – and where the client calculates the tax correctly – then any adjustments should not be classified as active compliance'.³⁷

Source: Australian National Audit Office analysis of Australian Taxation Office data.

Developing the Risk Assessment Profiling Tool

3.11 To maintain refund integrity in a dynamic environment it is important that the Tax Office collects, analyses and uses risk based information to support ongoing development of its information technology systems. While the Refund Integrity Team does not have a formal process for routinely identifying, monitoring and reporting risks relevant to the administration of high risk income tax refunds; it conducted a number of information gathering

³⁷ Australian Taxation Office – Active Compliance Steering Committee Submission Paper dated 22 August 2006, Operations – High Risk Refunds.

workshops in 2005. These workshops drew together key internal stakeholders and focused on how best to manage high risk income tax refunds within the Tax Office's information technology environment. The Refund Integrity Team considered information from these workshops when refining the RAP Tools. The Refund Integrity Team also receives requests from other Tax Office staff for enhancement to, or notification of anomalies in, how the RAP Tools are operating. This information is used to rectify errors and further develop the RAP Tools.

3.12 The Refund Integrity Team in consultation with the Tax Office's Data Analytics capability has also implemented a number of enhanced high risk income tax refund and data analytics business rules. The business rules are based on comprehensive data analysis and complex predictive modelling of high risk income tax refunds, and have resulted in improved case selection and a reduced workload for the high risk refund teams. The ANAO considers that the Tax Office's use of data analytics modelling is a sound initiative aimed at improving its administration of high risk income tax refunds.

Risk based approach to administering high risk income tax refunds

3.13 The Tax Office focuses on managing income tax refunds identified as high risk as part of the income tax assessment process. In 2006–07 the Tax Office classified 202 705 income tax refunds payable to individuals and micro enterprises as high risk. These high risk refunds had a combined value in excess of half of the value of all income tax refunds paid.

3.14 The ANAO observed that the Tax Office has focused on understanding the behaviour of taxpayers' whose income tax refunds have been identified as high risk. Consequently, there would be benefit in the Tax Office giving greater emphasis to understanding the changing environment and dynamics of taxpayer behaviour that may influence the broader population of taxpayers to make claims for large and/or unusual income tax refunds. For example, the Tax Office could systematically monitor income tax refund trends, to identify changes in taxpayer behaviour and enhance its high risk income tax refund tests. Adopting such an approach would provide a more balanced strategy for addressing income tax refund risks across the individuals and micro enterprises market segments.

3.15 As previously noted, the Tax Office has used data analytical modelling to inform development of the RAP Tools. Although this data analytical

modelling is extensive, the Tax Office has only used the income tax return information relating to high risk income tax refunds. As a result, the data analytical modelling has focused on understanding the behaviour of taxpayers' whose income tax refunds have been already identified as high risk. The Tax Office classifies approximately 2 per cent of all income tax refund claims, as high risk.

3.16 To help provide assurance that it is correctly identifying the key underlying risks associated with the administration of high risk income tax refunds in the individuals and micro enterprises market segments, the ANAO has recommended that the Tax Office consider developing a specific post-issue income tax refund compliance strategy. This strategy would have regard to broader compliance risk issues and assess whether the Tax Office's existing pre-issue high risk income tax refund tests are effective in targeting non-compliance. The Tax Office could use the information and/or intelligence gained as an input into any broader Tax Office strategic risk assessments of income tax refund processing and the further development of its high risk income tax refund tests.

Recommendation No.3

3.17 The ANAO recommends that the Tax Office consider developing a specific post-issue income tax refund compliance strategy for the individuals and micro enterprises market segments, to provide assurance that it is identifying and targeting the key underlying risks associated with administering the income tax refund process.

Agency response

3.18 Agreed.

3.19 The Tax Office has already commenced a post-issue income tax refund compliance strategy for taxpayers in the micro enterprises market segment. A similar strategy for taxpayers in the individuals market segment will be implemented in 2008–09.

High risk income tax refund business support processes

3.20 The Tax Office's high risk refund teams review selected high risk income tax refunds on a pre-issue basis. These high risk income tax refunds are those that have not passed the automated RAP Tools or those to which the RAP Tools cannot be applied. To assess the adequacy of the manual controls in place to administer high risk income tax refunds, the ANAO reviewed the

Tax Office's procedural documentation, staff training and quality assurance processes. The ANAO also reviewed the recording of incorrect refunds and trends in their payment as a measure of the effectiveness of the Tax Office's controls.

Documented procedures

3.21 Comprehensive documented procedures provide a policy framework for Tax Office case officers reviewing high risk income tax refunds and aid with consistency in decision making. The ANAO found that the Tax Office maintains sound procedural documentation relating to the manual processing of high risk income tax refunds. The Tax Office has periodically updated its documented procedures to reflect changes in policy.

Staff training

3.22 Staff training ensures that Tax Office case officers have the necessary skills to undertake their work. The ANAO found that both the Micro Enterprises and Individuals, and Client Account Services Business Lines have established training programs for their staff. Training is both formal and informal. On-the-job training and mentoring is a significant part of the Tax Office's approach to delivering training. The Tax Office's high risk income tax refunds training and support processes are providing case officers with the skills required to process high risk income tax refunds.

Quality assurance

3.23 Quality assurance processes are an integral tool in assessing performance and developing sound management practices. The Tax Office's high risk income tax refund processing is subject to quality assurance review as part of the Tax Office's corporate Technical Quality Review process. Technical Quality Reviews are conducted twice a year and focus on the quality of the Tax Office's written work and compliance with the Tax Office procedures and policy.

3.24 The Micro Enterprises and Individuals, and Client Account Services Business Lines also complete quarterly quality reviews of high risk income tax refund cases. The quality reviews consider both technical and procedural issues. This is a combination of whether the Tax Office officer managing the refund case has made the correct decision regarding payment or adjustment of the refund, and whether the case has been managed in accordance with the Tax Office's high risk income tax refund policies and procedures.

3.25 Quality reviews undertaken in late 2006 indicated that the high risk income tax refund teams were not consistently meeting the quality assurance benchmark standards. The ANAO noted that the quality review teams have made recommendations to improve case management and outcomes. The business lines have reported that are they implementing the quality review recommendations.

3.26 The ANAO considers that the Tax Office's framework for the manual review of high risk income tax refunds is sound. The Tax Office's procedures combined with skilling and quality assurance strategies are providing an overall level of assurance that high risk income tax refunds are being administered consistently across the Tax Office.

Incorrectly paid income tax refunds

3.27 As a measure of the effectiveness of the Tax Office's controls supporting the processing of high risk income tax refunds, the ANAO reviewed the value and number of income tax refunds recorded by the Tax Office as having been incorrectly paid. The incorrect payment of income tax refunds is a significant reputation risk for the Tax Office and could undermine the community's confidence in its administration of the taxation system. Where the Tax Office identifies and recovers incorrect refunds any adverse impact can be minimised.

3.28 The Tax Office advised that an 'incorrect refund register' was not fully implemented until May 2005. Between June 2005 and June 2007, the Tax Office recorded in its Incorrect Refund Register the incorrect payment of \$283 433 in high risk income tax refunds to individuals and micro enterprises. The Tax Office indicated that it had been able to recover approximately 80 per cent of the value of high risk income tax refunds incorrectly paid to individuals and micro enterprises. Table 3.3 presents data relating to high risk income tax refunds incorrectly paid between 2004–05 and 2006–07.

Table 3.3

Incorrectly paid income tax refunds in the individuals and micro enterprises market segments

Details	2004–05	2005–06	2006–07
Number of incorrectly paid refunds	10	12	12
Combined incorrect refund amount	\$386 224	\$181 389	\$102 044
Amount indicated by the Tax Office as recovered	\$350 246	\$ 139 652	\$91 546

Source: Australian National Audit Office analysis of Australian Taxation Office information.

3.29 The Tax Office has now established formal reporting procedures for incorrectly paid income tax refunds with detailed reports provided to the Refund Integrity Team. The Tax Office has review processes to verify the accuracy of refunds where they have been identified as having been incorrectly paid. These processes are currently manual and only undertaken on a selected case-by-case basis. The Tax Office in reviewing incorrect refunds is well positioned to identify system or business process weaknesses.

Recommendation No.4

3.30 The ANAO recommends that following the introduction of the Tax Office's new tax administration system, the Tax Office should systematically analyse all incorrectly paid high risk income tax refunds, in order to identify and address system or business process weaknesses, and identify other potentially incorrectly paid high risk income tax refunds.

Agency response

3.31 Agreed.

3.32 The Tax Office currently reviews and analyses reported incidents of incorrect refunds in order to identify any underlying systemic issues of weakness in its administrative systems.

3.33 Information technology advancements expected to be introduced into the Tax Office next year will enable incorrect refund analysis processes to be conducted more efficiently. This will provide more comprehensive assurance of the correct operation of the office's administrative systems.

Tax Office's approach to managing aged high risk income tax refund cases

3.34 The Tax Office's timely processing of high risk income tax refunds supports the principles outlined in the Tax Office's Taxpayers' Charter and helps to maintain the communities' confidence in the Tax Office's administration of the taxation system. The ANAO noted that the Tax Office has experienced ongoing timeliness issues with the processing of high risk income tax refunds. In late 2006 the Tax Office allocated additional resources to the Micro Enterprises and Individuals Business Line to help reduce the number of high risk income tax refund cases on hand.

3.35 Table 3.4 compares high risk income tax refund cases on hand at the beginning of December 2006 with cases on hand at the end of March 2007. The

Tax Office has reduced high risk income tax refund case holdings over 28 days in the Micro Enterprises and Individuals Business Line by 47 per cent. In comparison, during the same period high risk income tax refund case holdings over 28 days in the Client Account Services Business Line reduced by 17 per cent. Although the Tax Office has a significant number of cases aged over 91 days, its ability to finalise these cases is limited. The reasons for the delays in finalising these cases include that the Tax Office is waiting on information from the taxpayers or their tax agents, the Tax Office is waiting on lodgement of an outstanding income tax return, and the return has been referred to another area.

Table 3.4

High risk income tax refund cases on hand

Period	<14 days	15–28 days	29–60 days	61–90 days	>91 days	Total
Micro Enterprises and Individuals Business Line December 2006	569 15%	894 23%	1511 39%	348 9%	548 14%	3870 100%
Micro Enterprises and Individuals Business Line March 2007	441 22%	326 16%	468 22%	124 6%	688 34%	2047 100%
Client Account Services Business Lines December 2006	1384 30%	1157 25%	1363 30%	291 6%	429 9%	4624 100%
Client Account Services Business Lines March 2007	1124 31%	733 21%	929 26%	290 8%	503 14%	3579 100%

Source: Australian Taxation Office.

Private sector stakeholder feedback

3.36 During the audit the ANAO consulted with a number of private sector stakeholders about the Tax Office's administration of high risk income tax refunds in the individuals and micro enterprises market segments. The consultation process identified several issues including the need for the Tax Office to:

- better manage taxpayers' expectations as to timely processing of income tax returns and refunds, in particular refunds that have been withheld for review;

- notify tax agents when income tax refunds have been withheld for review, this would help tax agents manage their clients' expectations about the processing of income tax returns; and
- review the timeliness of income tax return processing where income tax refunds are payable.

3.37 The Tax Office has a number of consultative forums that include participation from the professional accounting and taxation representative bodies. The Tax Office is addressing some of the issues raised about processing of income tax refunds through these forums. The Tax Office also has formal escalation and complaints processes available to taxpayers and tax agents.

4. Information Technology Systems, Processes and Controls

This Chapter discusses the information technology environment supporting the administration of high risk income tax refunds and related security controls.

Introduction

4.1 The Tax Office, in processing income tax returns for individuals and micro enterprises, relies on several information technology systems. It is important for the Tax Office to develop and maintain security and assurance mechanisms around its information technology systems in line with better practice principles to minimise its exposure to risk. A failure of one of the Tax Office's key information technology systems or associated security controls could result in the incorrect payment of income tax refunds or delay their processing.

4.2 During the audit, the ANAO examined the information technology systems supporting the processing of income tax returns and the identification and assessment of high risk income tax refunds. The specific areas of focus were:

- an overview of the Tax Office's information technology environment supporting the processing of high risk income tax refunds;
- change management and systems development;
- information technology systems user access and security; and
- business continuity management.

Overview of the information technology environment

4.3 The Tax Office's two main information technology systems used to identify and assess high risk income tax refunds are NTS and RAP Tools. The flow of an income tax return and processing of high risk income tax refunds through the Tax Office's information technology systems is presented in Figure 3.1 in Chapter 3: *Identifying and Assessing High Risk Income Tax Refunds*.

4.4 The NTS and the RAP Tools have been developed and are maintained by different business areas of the Tax Office. The NTS is the responsibility of the Tax Office's main information technology business area—Information and

Communications Technology—while the Refund Integrity Team has responsibility for the RAP Tools.

4.5 As previously discussed, both the NTS and RAP Tools are expected to be replaced in late December 2007 when the Tax Office introduces its new tax administration system, as part of its *Easier, Cheaper and More Personalised Change Program*. Accordingly, the ANAO has made only one recommendation relating to the Tax Office’s administration of its legacy information technology systems used in identifying and assessing high risk income tax refunds.

Change management and systems development

4.6 Sound management practice suggests that agencies should have in place change management processes that support development and modification of their information technology systems. Change management relates to the processes associated with managing changes to an information technology system during its life. This includes identification of the requirement for change or development; detailed business requirements definition; systems design, development, testing and implementation; and documenting the system. The Tax Office has formalised processes and procedures relating to change management, systems development and release management.

Change management

National Taxpayer System

4.7 Changes to, and maintenance of, the NTS is subject to the Tax Office’s formal change management and systems development methodologies. The ANAO was advised that no changes have been made to the NTS’s high risk income tax refund tests since Tax Time 2004. The ANAO reviews the change processes associated with Tax Time each year as part of its audit of the Tax Office’s financial statements. Consequently, the ANAO has not examined ongoing maintenance of the NTS as part of this performance audit.

RAP Tools

4.8 The Refund Integrity Team has developed a change management framework for the RAP Tools that is largely aligned with Tax Office policy. Requests for significant changes to the functionality of the RAP Tools are recorded on a change request form with the details also recorded in a change request register maintained by the Refund Integrity Team. Other than significant changes to the functionality of the RAP Tools, the Refund Integrity

Team has not formally recorded changes made to the system. The systems developer completed regular maintenance of the RAP Tools in response to user feedback.

4.9 The Tax Office has identified that the RAP Tools have been developed outside of Tax Office change management policies and procedures. The Refund Integrity Team advised that with the pending implementation of the Tax Office's new tax administration system, no further changes to the functionality of the RAP Tools are planned.

RAP Tools design and development

4.10 The Refund Integrity Team initially developed the RAP Tools as a spreadsheet calculator with the aim of automating several of the manual checking processes associated with the review and/or verification of high risk income tax refunds. Subsequently, the Refund Integrity Team redeveloped the RAP Tools using Visual Basic.³⁸

4.11 In reviewing the development and testing of the Tax Office's RAP Tools the ANAO examined internal Tax Office policy documents and considered the system development lifecycle methodology applied. The business requirements for any information technology system should be determined prior to systems development commencing. A clear definition of user requirements assists in the development of systems which meet users' needs.

4.12 The Refund Integrity Team, in developing the RAP Tools, failed to comply with the Tax Office's own policy and procedures relating to system design and development. The business requirements and business case for the RAP Tools were prepared after the system had been developed. Similarly, the functional specifications for the RAP Tools were prepared post development.

4.13 The CRISC was requested to approve the current operation of the RAP Tools in late 2005. The committee identified that the documentation and governance supporting the RAP Tools was below standard. The Refund Integrity Team subsequently developed business requirements and other systems documentation in order to obtain CRISC sign-off of the system.

4.14 The Refund Integrity Team advised that they consulted extensively with the high risk refund teams in developing the RAP Tools. Anecdotal

³⁸ Visual Basic is a programming environment in which a programmer uses a graphical user interface to choose and modify pre-selected sections of code written in the BASIC programming language. Since Visual Basic is easy to learn and fast to write code with, it is sometimes used to prototype an application that will later be written in another programming language.

evidence suggests that users are satisfied with the operation of the RAP Tools. Notwithstanding, the CRISC who have ultimate responsibility for income tax refund integrity should have been consulted and approved the development of the RAP Tools.

Information technology systems testing

4.15 Information technology systems testing is an important aspect of information technology development. It is used to provide assurance that a system is operating as specified in relevant documentation, including business requirements, and that the system has no unexpected impacts, including any adverse impacts on the operation of other systems.

4.16 The Tax Office advised that both the systems developer and users completed testing of the RAP Tools. The ANAO noted that limited post-implementation reviews of the RAP Tools have also been completed through the use of control cases. This provides a degree of assurance as to the correct operation of aspects of the RAP Tools. However, due to the limited nature of the Tax Office's documentation around the RAP Tools, the ANAO is not able to confirm that all aspects of the RAP Tools have been adequately tested and/or align with user requirements.

Complete and accurate documentation

4.17 Complete and accurate information technology systems documentation is essential in supporting the effective ongoing management of applications and systems. The documentation should be comprehensive and describe all aspects of the systems. The available documentation should include business requirements; functional and technical specifications; test plans and results; and approvals by relevant stakeholders. In the absence of complete systems documentation, it is difficult for the Tax Office to determine if its information technology systems are operating in accordance with their business requirements, design principles and its related policies. Inadequate information technology systems documentation can also adversely affect business continuity and ongoing maintenance of the system.

4.18 As noted earlier, the CRISC when it was requested to approve the current operation of the RAP Tools in late 2005, identified that development of the RAP Tools was not documented. The Refund Integrity Team subsequently developed a business case and systems documentation³⁹ in order to obtain

³⁹ These included documents titled: Overview of the Development Process, Functional Specification and draft Quality Assurance Process.

approval for the RAP Tools by the CRISC. The CRISC approved operation of the first of three RAP Tools in early 2006. The CRISC subsequently approved operation of the other RAP Tools. The ANAO reviewed the RAP Tools documentation, including systems testing documentation, and found that it was below the standard expected for such critical information technology systems.

Information technology system user access and security

4.19 Case officers processing high risk income tax refunds need access to a number of Tax Office systems. The main system is ELS Processing through which high risk income tax refund cases are channelled. When an income tax return fails an NTS high risk income tax refund test an exception is created in ELS Processing. These high risk income tax refund exceptions are then either profiled by the RAP Tools or manually reviewed by a case officer. Access to the RAP Tools is controlled through the Tax Office's Case Reporting System. The Case Reporting System is also used to manage workflow and record and monitor high risk income tax refund case outcomes including adjustments.

Administration of user access

4.20 The Micro Enterprises and Individuals and Client Account Services Business Lines control assignment of user access rights to high risk income tax refund cases stored within ELS Processing. Access to the relevant high risk income tax refund module of ELS Processing needs to be authorised by a high risk refund team leader, with access subsequently granted to the user by the Tax Office's local workplace system administrators.

4.21 The Refund Integrity Team has implemented a devolved model of user access for the Case Reporting System. High risk income tax refund team leaders also act as Case Reporting System user administrators. The high risk refund team leaders can grant and revoke access for users up to specified levels within the system.

4.22 The regular and ongoing review of user access to the Case Reporting System is an important control mechanism. This supports timely revocation of user access and maintenance of appropriate access levels for individual staff in the execution of their duties. The ANAO noted that the Refund Integrity Team undertook a review of Case Reporting System user access in mid 2006. This review identified a large number of users who had left the work area and no longer required access to the Case Reporting System. Under the Tax Office's devolved model of user administration, responsibility for revoking user access

rests with the user administrators located in each high risk refund team. In line with the Tax Office's national information technology security policy and ACSI 33 guidelines the Refund Integrity Team should periodically review all user access to the Case Reporting System.

Administrator level access

4.23 The Refund Integrity Team controls administrator level access to the RAP Tools. Up to five members of the team can have this level of access. The logging of user access and changes to the system is critical to provide an adequate audit trail of a user's actions within the systems. This is a key information technology systems control. The ANAO noted that the systems do not incorporate user access logging and consequently the Tax Office does not maintain an adequate audit trail of a user's actions within the systems.

Information technology threat and risk assessments

4.24 The Tax Office completes threat and risk assessments of its information technology systems. These assessments generally consider internal and external threats, largely from an information technology security perspective. The ANAO noted that no threat or risk assessment had been completed for the RAP Tools or Case Reporting System. Further, as discussed in Chapter 2: *Management Arrangements*, operation of the RAP Tools has not been reviewed from a fraud control perspective. These control weaknesses may be exposing the Tax Office to a higher than acceptable level of risk and could potentially diminish the integrity of the Tax Office's high risk income tax refund processes. The Tax Office has advised that the RAP Tools will be considered in developing the next Client Account Services Business Line Fraud Control Plan, as it is the business owner of the system.

Segregation of duties—RAP Tools development and testing

4.25 Segregation of information technology systems duties is fundamental to sound management practice. Agencies should have clear and segregated levels of responsibility, particularly over information technology systems development, operation, technical support and security administration.

4.26 The ANAO found that a single individual (the systems developer) had been responsible for systems development, aspects of systems testing, release management, support and ongoing systems maintenance for the RAP Tools. The systems developer is the only person within the Tax Office with a well

developed working knowledge of the systems and previously held administrator level access.

4.27 The ANAO noted that the RAP Tools do not have an inbuilt audit trail and that their design does not align with contemporary practice. The absence of a data dictionary and technical specifications further limits the Refund Integrity Team's ability to support the systems in the absence of the systems developer.

4.28 The ANAO considers that the lack of segregation of duties in relation to the RAP Tools was a significant control weakness which exposed the Tax Office to a higher than acceptable level of fraud risk and processing error. The absence of an audit trail and systems documentation, which supports independent verification of the operation of the systems, is a further significant control weakness that significantly limits income tax refund integrity. The Tax Office has advised that the systems developer moved to a new position as of mid-July 2007 and that other members of the Refund Integrity Team now provide support for the systems.

Business continuity management

4.29 The disaster recovery component of information technology business continuity management focuses on minimising disruption to key business systems needed to support critical business activities. In relation to the RAP Tools, the Tax Office is exposed to a high business continuity risk. Internal Tax Office users have become heavily reliant on the RAP Tools. The unavailability of these systems could have an adverse impact on the timeliness of processing of high risk income tax refunds and income tax refund integrity.

4.30 As previously discussed the RAP Tools and Case Reporting System have been developed in house. The systems are not supported by adequate documentation such as data dictionaries⁴⁰ and technical specifications. The Tax Office has advised that up to mid 2007, the systems developer was also responsible for the ongoing maintenance of the RAP Tools and Case Reporting System. Consequently, the Tax Office had a 'key man' risk as it was heavily reliant on one member of the Refund Integrity Team to maintain these systems.

⁴⁰ A data dictionary is a collection of information relevant to individual data items that make up an information technology system. One benefit of a well-prepared data dictionary is a consistency between data items across different tables. For example, several tables may hold telephone numbers; using a data dictionary the format of this telephone number field will be consistent.

4.31 The ANAO was advised that the Refund Integrity team consulted with the Information and Communications Technology (ICT) business area about transferring support for the RAP Tools and Case Reporting System. Information and Communications Technology undertook a review of the systems. The Tax Office has advised that the review report is not a public document nor an official report. However, the internal review identified a number of weaknesses in the systems and their supporting information technology controls. In summary, the review concluded that

It would seem inappropriate for ICT to take responsibility for an application that doesn't have production approval for the database design, isn't running on a production server and the application has not been subjected to normal release processes.⁴¹

4.32 The ANAO noted that a considerable amount of work is required for the Tax Office to address the weaknesses in the RAP Tools and associated information technology controls. The risks posed by past operation of the RAP Tools cannot be easily mitigated, however, the Tax Office has adopted a risk based approach where by it is now implementing strategies to mitigate the risks associated with their continued operation. The Tax Office advised in August 2007 that it is undertaking an assessment of its risk exposure and may implement interim safeguards if significant controls weaknesses are identified. The ANAO acknowledges that the Tax Office is aiming to balance client service and refund integrity. The RAP Tools are expected to be replaced in late December 2007 to coincide with the introduction of the Tax Office's new tax administration system.

Recommendation No.5

4.33 The ANAO recommends that if the RAP Tools continue to be used as a primary review system in the processing of high risk income tax refunds in 2008, the Tax Office as a matter of priority, implement strategies to align operation of the RAP Tools with its corporate policies and procedures relating to information technology security and control.

Agency response

4.34 Agreed.

⁴¹ Undated Tax Office Minute relating to the relocation of support for the High Risk Refund Assessment Profiling Tool (RAPT) from the Refund Integrity Team in Operations to Information and Communications Technology, Production Systems Support (PSS).

4.35 The Tax Office has undertaken an assessment of its risk exposure in relation to the continued operation of the Risk Assessment Profiling Tools and will implement interim safeguards to address identified control weaknesses.



Ian McPhee
Auditor-General

Canberra ACT
1 November 2007

Appendix

Appendix 1: Agency Response

PO Box 9990
Canberra ACT 2601



Australian Government
Australian Taxation Office

Mr David Crossley
Executive Director
Performance Audit Services Group
Australian National Audit Office
GPO Box 707
CANBERRA ACT 2601

Contact Officer: Judy O'Connell
Telephone: (03) 9275 2718
Facsimile: (03) 9275 2032
Issue Date: 12th October 2007

Dear Mr Crossley

Australian National Audit Office Performance Audit of the Australian Taxation Office's (Tax Office) Administration of High Risk Income Tax Refunds

On the 14th of September 2007, the Australian National Audit Office (ANAO) provided the Tax Office with the proposed audit report on the administration of high risk income tax refunds in the individuals and micro enterprises market segments.

I am writing to you to provide comments on the report, pursuant to section 19 of the *Auditor-General Act 1997*.

I would like to thank the ANAO audit team, in particular Andrew Huey, for the cooperative and professional manner in which the audit was undertaken and I look forward to continuing the good working relationship developed in this performance audit.

As requested, the Tax Office has provided:

- **Annex 1:** Comments on the final report;
- **Annex 2:** Responses to each of the recommendations;
- **Annex 3:** A summary of comments to be used in the report brochure;
- **Annex 4:** Updated tables including 2006-07 financial year results.

If you require further information on this matter, please contact Judy O'Connell, Assistant Commissioner, Micro Enterprises and Individuals business line, on phone (03) 9275 2718.

Yours sincerely

Erin Holland
Deputy Commissioner
Micro Enterprises and Individuals
Australian Taxation Office

Cc: Mr Andrew Huey Australian National Audit Office

ANNEX 1

The Tax Office offers the following comments regarding the ANAO report:

The Tax Office welcomes the ANAO's report into its administration of high risk income tax refunds in the individuals and micro enterprises market segments, and the conclusion that it seeks to balance client service against the need to maintain refund integrity and protect Government revenue.

This conclusion reflects the considerable effort and investment that the Tax Office has made to ensure that appropriate resources, procedures, skilling and governance frameworks are in place to effectively administer high risk income tax refunds.

This is supported by the results from the high risk income tax refunds reviewed. In 2006–2007, in excess of 83,000 high risk income tax refunds were subject to manual review, resulting in revenue adjustments of approximately \$77.5 million.

The Tax Office accepts the five recommendations made by the ANAO and has already made progress towards their implementation.

The Tax Office understands that many of the ANAO's recommendations for improvement have arisen due to the technical limitations of its existing information technology systems.

The introduction of an entirely new tax administration technology system, as part of the *Easier, Cheaper and More Personalised Change Program*, will provide the Tax Office with the opportunity to complement and build on existing manual processes for assessing risks, undertaking reviews and reporting and/or analysing outcomes in relation to high risk income tax refunds.

The ANAO report suggests refinements to the high risk refund tests to better target the risk to revenue and reduce the average elapsed time for their processing. The Tax Office accepts this suggestion but it is important to put the current number of reviews undertaken in the context of the overall population and the processing environment.

In 2006–2007, a total of 202,705 income tax refunds were classified as high risk. This represents only 2% of the total income tax refund population. Furthermore, 83.5% or 169,295 of these refunds were subject to an automated review process via the Risk Assessment Profiling Tools) and this generally resulted in their timely release.

The ANAO report also identified a number of control risks for the Risk Assessment Profiling Tools. The ANAO did acknowledge that the Tax Office was progressively implementing strategies to mitigate the risk posed by the continued operation of these tools. It is also important to recognise that the Risk Assessment Profiling Tools were implemented as an interim measure to assist with the delivery of timely processing of high risk income tax refunds in a self assessment environment. It was the clear intention of the Tax Office to decommission these tools following the introduction of the new tax administration technology system.

ANNEX 2

	Recommendations	Tax Office Response
1	<p>The ANAO recommends that to systematically identify, assess and subsequently mitigate high risk income tax refunds risks, including new and/or emerging risks, the Tax Office should:</p> <ol style="list-style-type: none"> undertake periodic strategic risk assessments of income tax refunds and the processes supporting their administration; and establish mechanisms for the regular reporting of income tax refund risk information to the CRISC from relevant business areas, which can then be used to further refine the high risk income tax refund controls. 	<p>Agreed.</p> <p>The Tax Office through the membership of the Credit Refund Integrity Steering Committee has current access to compliance risk information from relevant business areas in addition to the Income Tax Product Committee and its annual Health Of The System Analysis assessments.</p> <p>Relevant information relating to specific refund incidents and broader trends in refund risks does form part of the current consideration of the Credit Refund Integrity steering Committee. The committee recognises that this could be further enhanced by implementing more formal mechanisms that directly influence the maintenance and refinement of the Tax Office's high risk income tax refund controls.</p>
2	<p>To improve reporting to Government in relation to the <i>Compliance Challenges</i> Budget funding, the ANAO recommends that the Tax Office:</p> <ol style="list-style-type: none"> reports performance against the individual <i>Compliance Challenges</i> targets for each risk area for which the funding was provided; and reports the total number of high risk income tax refunds reviewed and the total value of adjustments made for individuals' high risk income tax refunds actioned by the Micro Enterprises and Individuals Business Line. 	<p>Agreed- with defined parameters</p> <p>The Tax Office will report against targets for each risk area and provide aggregated results for high risk income tax refunds actioned by the Micro Enterprises and Individuals Business Line. This will be included in the final Expenditure Review Committee Report for <i>Compliance Challenge</i> activities undertaken in</p>

		<p>2007–2008</p> <p>It is noted that the implementation of this report will require a finer level of detail and will be a once only report for the end of year report to the Expenditure Committee. This will be the final report to the Committee in relation to the Compliance Challenges. Such detailed reporting will not be required nor continue beyond this one report.</p>
3	<p>The ANAO recommends that the Tax Office consider developing a specific post-issue income tax refund compliance strategy for the individuals and micro enterprises market segments, to provide assurance that it is identifying and targeting the key underlying risks associated with administering the income tax refund process.</p>	<p>Agreed.</p> <p>The Tax Office has already commenced a post-issue income tax refund compliance strategy for taxpayers in the micro enterprises market segment. A similar strategy for taxpayers in the individuals market segment will be implemented in 2008-09.</p>
4	<p>The ANAO recommends that following the introduction of the Tax Office's new tax administration system, the Tax Office should systematically analyse all incorrectly paid high risk income tax refunds, in order to identify and address system or business process weaknesses, and identify other potentially incorrectly paid high risk income tax refunds.</p>	<p>Agreed.</p> <p>The Tax Office currently reviews and analyses reported incidents of incorrect refunds in order to identify any underlying systemic issues of weakness in its administrative systems.</p> <p>Information technology advancements expected to be introduced into the Tax Office next year will enable incorrect refund analysis processes to be conducted more efficiently. This will provide more comprehensive assurance of the correct operation of</p>

		the office's administrative systems.
5	The ANAO recommends that if the RAP Tools continue to be used as a primary review system in the processing of high risk income tax refunds in 2008, the Tax Office as a matter of priority, implement strategies to align operation of the RAP Tools with its corporate policies and procedures relating to information technology security and control.	Agreed. The Tax Office has undertaken an assessment of its risk exposure in relation to the continued operation of the Risk Assessment Profiling Tools and will implement interim safeguards to address identified control weaknesses.

ANNEX 3

The Tax Office offers the following summary of our comments:

The Tax Office welcomes the ANAO's recommendations in relation to the administration of high risk income tax refunds in the individuals and micro enterprises market segments and will adopt them in full (with the clarification at Recommendation 2).

The Tax Office accepts that many of the ANAO's recommendations are the result of the technical limitations of its existing information technology systems.

The introduction of an entirely new tax administration system, as part of the *Easier, Cheaper and More Personalised Change Program*, will provide the Tax Office with the opportunity to complement and build on existing manual processes for assessing risks, undertaking reviews and reporting on and/or analysing outcomes in relation to high risk income tax refunds.

It is encouraging to note that although the ANAO identified areas for improvement, it was supportive of the overall approach that the Tax Office has taken in administering high risk income tax refunds. That is, an approach that seeks to balance the delivery of timely refund processing in a self assessment environment with the need to maintain refund integrity and protect Commonwealth revenue.

ANNEX 4

Table 1.1
Relevant Taxpayer Charter Service Standards and recent performance

Service standard	Standards	Benchmark	2004–05	2005–06	2006–07
Processing of electronically lodged tax returns	14 days	96%	96.8%	96.1%	95.8%
Processing of paper income tax returns	42 days	92%	96.6%	97.8%	92.1%

Table 2.1
High risk income tax refund case outcomes

Details/Business Line	2004–05	2005–06	2006–07
High risk income tax refund reviews completed (Micro Enterprises and Individuals)	36 286	31 560	27 193
Actual value of adjustments (Micro Enterprises and Individuals)	\$16.1 million	\$41.2 million	\$27.4 million
High risk income tax refund reviews completed (Client Account Services)	58 673	52 240	55 966
Actual value of adjustments (Client Account Services)	\$320.5 m ¹	\$47.89 million	\$48.69 million
Compliance Challenges targets (additional reviews – individuals market segment)	6 200	9 300	9 300
Compliance Challenges (outcomes reported – individuals market segment as actioned by Micro Enterprises and Individuals)	17 050	9 312	16 756
Compliance Challenges targets (liabilities raised – individuals market segment as actioned by Micro Enterprises and Individuals)	\$7.5 million	\$11.7 million	\$16.9 million

Note 1: This figure reflects the revised figure reported in an erratum to the *Commissioner of Taxation 2004–05 Annual Report*, following an internal review and subsequent broad re-classification of results for that year. The figure is not comparable with subsequent years' results as those later years reflect the full implementation of the Tax Office's revised classification of active compliance results.

Note 2: The Tax Office has advised that it is now reporting combined business as usual and *Compliance Challenges* information.

Source: Australian Taxation Office

Table 3.1
NTS income tax return processing and high risk income tax refund test outcomes

Details	2004–05	2005–06	2006–07
Income tax lodgements	12.6 million	12.9 million	14.4 million
Income tax refunds paid	9.6 million	9.8 million	10 million
Value of income tax refunds paid	\$21.9 billion	\$25.2 billion	\$26.4 billion
Income tax refunds classified as high risk	188 434	200 015	202 705
Per cent of income tax refunds classified as high risk	1.9 per cent	2 per cent	2 per cent

Source: Australian Taxation Office

Table 3.2
High risk income tax refunds reviewed by RAP Tools and case outcomes

Details	2004–05	2005–06	2006–07
High risk income tax refunds subject to review and/or verification	188 434	200 015	202 705
High risk income tax refunds reviewed by the RAP Tools	136 651	156 446	169 295
Percentage of high risk income tax refund reviewed by the RAP Tools	72.5%	78.2%	83.5%
High risk income tax refunds that passed the RAP Tools tests	98 249	127 903	131 748
Percentage of high risk income tax refunds that passed RAP Tools tests	71.9%	81.8%	77.8%
High risk income tax refunds adjusted following review and/or verification (individuals)	2 926	4 074	4 698
High risk income tax refunds adjusted following review and/or verification (micro enterprises)	3 363	6 218	6 457
Percentage of high risk income tax refunds adjusted following review and/or verification	3.34%	5.15%	5.5%
Value of high risk income tax refund adjustments following review and/or verification (individuals)	\$16.1 m	\$41.2 m	\$27.4 m
Value of high risk income tax refund adjustments following review and/or verification (micro enterprises)	\$320.5 m ¹	\$47.89 m	\$48.69 m

Note 1: This figure reflects the revised figure reported in an erratum to the *Commissioner of Taxation 2004–05 Annual Report*, following an internal review and subsequent broad re-classification of results for that year. The figure is not comparable with subsequent years results as those later years reflect the full implementation of the Tax Office's revised classification/definition of active compliance results. This has had the effect of reducing the value of 'accounting adjustments' recorded, as active compliance. The Tax Office has determined that 'where an internal system could or should, be able to identify a particular issue – and where the client calculates tax correctly – then any adjustments should not be classified as active compliance'.

Source: ANAO analysis of Australian Taxation Office data.

Index

C

Certificate of Compliance, 45
Compliance Challenges, 5, 16, 21, 33, 40–42, 73, 76
Credit Refund Integrity Steering Committee (CRISC), 7, 11, 13, 15, 18, 21, 26, 34–39, 61–62, 73

F

Fraud control, 19, 43, 64
Fraud risk, 19, 43, 65

I

Information technology change management, 5, 18, 59–61
Information technology controls, 5, 36, 46, 59

N

National Taxpayer System (NTS), 6–7, 12, 14, 16–18, 26–28, 36–38, 47, 49–50, 59–60, 63, 77

P

Performance monitoring and/or reporting, 5, 33, 43, 45

R

Refund Integrity, 13, 16, 19–20, 36, 43, 51, 62, 65–66, 72, 75
Refund Integrity Team, 18–19, 38, 51–52, 56, 60–66
Risk assessment, 17, 19, 21, 28, 36–37, 39, 42, 53, 64, 73
Risk Assessment Profiling Tools (RAP Tools), 6–8, 15–20, 22, 28, 36–38, 43, 46, 50–53, 59–66, 74, 77

S

Segregation, 19, 40, 64, 65
Self assessment, 11, 20, 25, 47, 72, 75

T

Taxpayer behaviour, 14, 52–53

U

User access, 5, 18–19, 59, 63–64

Series Titles

Audit Report No.1 2007–08
Acquisition of the ABRAMS Main Battle Tank
Department of Defence
Defence Materiel Organisation

Audit Report No.2 2007–08
Electronic Travel Authority Follow-up Audit
Department of Immigration and Citizenship

Audit Report No.3 2007–08
Australian Technical Colleges Programme
Department of Education, Science and Training

Audit Report No.4 2007–08
Container Examination Facilities Follow-up
Australian Customs Service

Audit Report No.5 2007–08
National Cervical Screening Program Follow-up
Department of Health and Ageing

Audit Report No.6 2007–08
Australia's Preparedness for a Human Influenza Pandemic
Department of Health and Ageing
Department of Agriculture, Fisheries and Forestry

Audit Report No.7 2007–08
The Senate Order for Departmental and Agency Contracts (Calendar Year 2006 Compliance)

Audit Report No.8 2007–08
Proof of Identity for Accessing Centrelink Payments
Centrelink
Department of Human Services

Audit Report No.9 2007–08
Australian Apprenticeships
Department of Education, Science Training

Audit Report No.10 2007–08
Whole of Government Indigenous Service Delivery Arrangements

Audit Report No.11 2007–08
Management of the FFG Capability Upgrade
Department of Defence
Defence Materiel Organisation

ANAO Audit Report No.12 2007–08
Administration of High Risk Income Tax Refunds in the Individuals and Micro Enterprises Market Segments

Current Better Practice Guides

The following Better Practice Guides are available on the Australian National Audit Office Website.

Public Sector Internal Audit	
An Investment in Assurance and Business Improvement	Sep 2007
Fairness and Transparency in Purchasing Decisions	
Probity in Australian Government Procurement	Aug 2007
Administering Regulation	Mar 2007
Developing and Managing Contracts	
Getting the Right Outcome, Paying the Right Price	Feb 2007
Implementation of Programme and Policy Initiatives:	
Making implementation matter	Oct 2006
Legal Services Arrangements in Australian Government Agencies	Aug 2006
Preparation of Financial Statements by Public Sector Entities	Apr 2006
Administration of Fringe Benefits Tax	Feb 2006
User-Friendly Forms	
Key Principles and Practices to Effectively Design and Communicate Australian Government Forms	Jan 2006
Public Sector Audit Committees	Feb 2005
Fraud Control in Australian Government Agencies	Aug 2004
Security and Control Update for SAP R/3	June 2004
Better Practice in Annual Performance Reporting	Apr 2004
Management of Scientific Research and Development Projects in Commonwealth Agencies	Dec 2003
Public Sector Governance	July 2003
Goods and Services Tax (GST) Administration	May 2003
Managing Parliamentary Workflow	Apr 2003
Building Capability—A framework for managing learning and development in the APS	Apr 2003
Internal Budgeting	Feb 2003
Administration of Grants	May 2002

Performance Information in Portfolio Budget Statements	May 2002
Some Better Practice Principles for Developing Policy Advice	Nov 2001
Rehabilitation: Managing Return to Work	June 2001
Business Continuity Management	Jan 2000
Building a Better Financial Management Framework	Nov 1999
Building Better Financial Management Support	Nov 1999
Commonwealth Agency Energy Management	June 1999
Security and Control for SAP R/3	Oct 1998
New Directions in Internal Audit	July 1998
Controlling Performance and Outcomes	Dec 1997
Protective Security Principles (in Audit Report No.21 1997–98)	Dec 1997

