

Compliance Effectiveness Methodology

Australian Taxation Office

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Canberra ACT
12 June 2014

Dear Mr President
Dear Madam Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Australian Taxation Office titled *Compliance Effectiveness Methodology*. The audit was conducted 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 to the Parliament.

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

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee', is positioned above the printed name and title.

Ian McPhee
Auditor-General

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

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Contents

Abbreviations and Glossary	8
Summary and Recommendations	9
Summary	11
Introduction	11
Audit objective and criteria	13
Overall conclusion	14
Key findings by chapter	17
Summary of agency response	22
Recommendations	23
Audit Findings	25
1. Background and Context	27
Introduction	27
Measuring compliance effectiveness	30
Previous audits and reviews	35
Approaches of other revenue agencies to measuring compliance effectiveness	37
Audit objective, criteria and methodology	38
Structure of the report	39
2. Developing and Implementing the Compliance Effectiveness Methodology	40
Developing the methodology	40
Business as usual management arrangements	46
CEM resources and capability	49
Conclusion	53
3. Conduct of Compliance Effectiveness Methodology Evaluations	55
Introduction	55
Selection of risks subject to compliance effectiveness evaluations	56
Analysis of all risks evaluated	58
Analysis of 16 completed CEM evaluations	60
Conclusion	76
4. Outcomes of Compliance Effectiveness Methodology Evaluations	78
Introduction	78
Soundness of the 16 CEM evaluation conclusions	78
Use of CEM outcomes to achieve program objectives	84
Conclusion	95

5. Embedding Effectiveness Thinking in the Australian Taxation Office	97
Introduction	97
The project and work program	98
Embedding the methodology in non-Compliance business and service lines	104
Conclusion	106
Appendices	109
Appendix 1: Agency response	111
Appendix 2: Resource allocation by Business and Service Line for Compliance Effectiveness Methodology Activities, 2013–14	112
Index	114
Series Titles	115
Better Practice Guides	120

Tables

Table 1.1: ATO active compliance activities, 2009–10 to 2012–13	29
Table 1.2: Four phases of the Compliance Effectiveness Methodology	33
Table 1.3: Methods of other revenue agencies to calculate uncollected revenue	38
Table 1.4: Structure of the report	39
Table 2.1: Steps taken by the ATO to develop the CEM	41
Table 2.2: Desired project outcomes and success measures for the Compliance Effectiveness Implementation Project	44
Table 2.3: Centre of Expertise staffing, 2006 to 2013	50
Table 3.1: Number of risks evaluated by BSL	57
Table 3.2: CEM evaluations selected for ANAO review	60
Table 3.3: ANAO sample—meeting key requirements for Phase 1: articulate risk	61
Table 3.4: ANAO sample—meeting key requirements for Phase 2: define outcomes	62
Table 3.5: ANAO sample—meeting key requirements for Phase 3: design indicators	64
Table 3.6: Criteria for assessing indicators	65
Table 3.7: Relevance and reliability of indicators	66
Table 3.8: Completeness of indicators	68
Table 3.9: ANAO sample—meeting key requirements for Phase 4: prepare report	74
Table 4.1: ANAO assessment of CEM evaluation conclusions	79
Table 4.2: Evaluation of sustainability, ripple effect, and unintended consequences	83
Table 4.3: Reporting of CEM evaluations in Commissioner of Taxation annual reports from 2010–11 to 2012–13	91

Table 4.4:	Effectiveness stories on the ATO website.....	92
Table 5.1:	Steps taken by the ATO to implement the project and work program	98
Table 5.2:	ATO effectiveness work program status	103
Table 5.3:	The ATO's five core effectiveness questions	105

Figures

Figure 1.1:	ATO Compliance Model	28
Figure 2.1:	CEM administrative arrangements	47
Figure 3.1:	Evidence of conduct of key elements of the CEM, 2008 to 2013.....	59
Figure 3.2	Examples of complete sets of indicators	70
Figure 4.1:	Alignment of ATO risk management process and the CEM.....	87

Abbreviations and Glossary

BAU	Business as usual (that is, normal ongoing ATO operations)
BSL	Business and Service Line
CELF	Compliance Effectiveness Leadership Forum
CEM	Compliance Effectiveness Methodology
CoE	Centre of Expertise (for CEM)
ERMF	Enterprise Risk Management Framework
FTE	Full time equivalent staff member. A measure of the total level of staff resources used.
HoTSA	Health of the System Assessment
HWI	High Wealth Individual
ITX	Indirect Tax Business Line
JCPAA	Joint Committee of Public Accounts and Audit
KPI	Key Performance Indicator
OECD	Organisation for Economic Cooperation and Development
PG&I	Public Groups and International Business Line
SNC	Serious Non-Compliance Business Line
TPALS	Tax Practitioner and Lodgment Strategy Business Line

Summary and Recommendations

Summary

Introduction

1. The Australian Taxation Office (ATO) is responsible for administering Australia's taxation and superannuation systems. It seeks to build confidence in its administration through helping people understand their rights and obligations, improving ease of compliance and access to benefits, and managing non-compliance with the law. In 2012–13, the ATO collected \$311.7 billion in net cash from taxpayers, incurred operating expenses of \$3.5 billion, and had around 25 000 staff.¹
2. As an Australian Government agency, the ATO is expected to use its resources in an efficient and effective manner and to demonstrate to the Parliament and Australian community that its activities are promoting taxpayer compliance and dealing with non-compliance. As the Organisation for Economic Co-operation and Development (OECD) has observed, it is a key requirement that revenue agencies responsible for tax compliance 'are able to understand the impacts achieved and effectiveness of their risk treatment strategies.'² However, measuring the impacts of compliance activities is not straightforward, and revenue agencies around the world grapple with this issue, described by the ATO as 'challenging and evolving'.³
3. Over many decades, parliamentarians and parliamentary committees have been interested in how the ATO measures the effectiveness of its compliance activities and the related calculations of the 'tax gap'—the difference between the tax that is actually paid and the tax that should be paid if all taxpayers complied with their legal obligations. The ATO calculates the tax gap for the Goods and Services Tax and the luxury car tax, but not for any other taxes. In February 2014, the ATO advised the House of Representatives Standing Committee on Tax and Revenue that it was researching international

1 Commissioner of Taxation, *Annual Report 2012–13*, pp. i–vi.

2 OECD Forum on Tax Administration, *Evaluating the effectiveness of compliance risk treatment strategies*, p. 5, available from <<http://www.oecd.org/tax/administration/46274278.pdf>> [accessed 25 March 2014].

3 Commissioner of Taxation Michael D'Ascenzo, Speech to CEDA Trustees Roundtable, *Measure for measure: The four pillars of compliance*, 25 February 2011, available from <<https://www.ato.gov.au/Media-centre/Speeches/Measure-for-Measure--The-Four-Pillars-of-Compliance/>> [accessed 28 May 2014].

practice and consulting with the private sector with a view to developing a position on a suitable approach to tax gaps. At that meeting, the ATO also noted the use of ‘participation indicators’ as a high-level measure of tax compliance.⁴

4. The challenge of better measuring the effectiveness of compliance strategies is longstanding. In late 2006 the ATO established a project to research, design and implement a methodology to measure the effectiveness of the ATO’s compliance activities.⁵ This approach, known as the Compliance Effectiveness Methodology (CEM), aimed to support the ATO’s business intent of optimising voluntary compliance. The methodology was seen to be an invaluable tool for improving compliance and risk mitigation strategies, resource allocation, and accountability to government and the community.⁶

5. The CEM is based on two key elements: identification of measurable compliance objectives; and articulation and treatment of the risks to achieving them. The CEM involves four phases:

- Phase 1—articulate the risk and align it to the ATO’s business intent of optimising voluntary compliance, making payments under the law and building community confidence;
- Phase 2—define successful outcomes and develop compliance strategies to achieve these outcomes;
- Phase 3—identify and test indicators of success to be used during the compliance strategies; and
- Phase 4—use these indicators to evaluate and report on the extent of the effectiveness of the compliance strategies in the short, medium and long term.

4 House of Representatives Standing Committee on Tax and Revenue, *2013 Annual Report of the Australian Taxation Office, First Report*, March 2014. Participation in the system is seen as a good indicator of the level of compliance with tax obligations generally, and the participation indicators are linked to the OECD’s four pillars of compliance—correct registration; on-time lodgment; complete and accurate reporting; and on-time payment of tax.

5 The *Compliance Effectiveness Project Business Case* noted that while the ATO performs well against key performance measures and indicators, ‘it is acknowledged that these are largely activity based and efficiency focused, rather than indicators of effectiveness that gauge the impact our compliance activities have on compliance behavior’.

6 ATO, *Measuring Compliance Effectiveness—Our Methodology*, p. 3. Available from <<http://www.ato.gov.au/About-ATO/About-us/In-detail/Key-documents/Measuring-compliance-effectiveness---our-methodology/>> [accessed 13 January 2014].

6. The ATO conducted two pilot projects before deciding in July 2007 to implement the CEM within the Compliance Group, and other Groups were requested to consider developing better effectiveness measures relevant to their activities.⁷ From 1 July 2009, the CEM became part of 'business as usual' within the Compliance Group.

7. The ATO has taken a devolved approach to implementing the CEM, with Compliance business and service lines (BSLs) being responsible for applying the methodology to their priority compliance risks. As a result, the BSLs have adopted differing approaches to resourcing and implementing the CEM. As at February 2014, the CEM had been applied to 80 identified compliance risks across the eight Compliance BSLs. Under established procedures, risk owners provide direction, context and sign-off as appropriate in relation to the risks under their control. Risk managers are predominantly tasked with conducting the CEM process. The ATO has established a number of advisory groups to provide assistance to BSLs undertaking CEM evaluations. These include the Centre of Expertise, the Community of Practice and the Compliance Effectiveness Leadership Forum.

8. The ATO initiated an internal review of the CEM process in November 2011. This review found that the CEM had not been fully implemented by the Compliance Group and that little progress had been made in evaluating effectiveness across the ATO. To address these concerns, in January 2012, the ATO initiated an *Evaluating Compliance Effectiveness* project. Also, in November 2012, the ATO commenced an *Embedding Effectiveness Thinking* work program, to integrate effectiveness thinking across the agency (at all levels) and to enable it to assess, demonstrate and improve its effectiveness. This work is ongoing.⁸

Audit objective and criteria

9. The objective of the audit was to examine the application of the ATO's Compliance Effectiveness Methodology in evaluating the effectiveness of key compliance activities and shaping the development of strategies to promote voluntary compliance.

7 At the time, Compliance was one of five sub-plans within the ATO. Since 2012, the ATO has changed to a three-group structure: Compliance; People, Systems and Services; and Law Design and Practice.

8 For convenience, the 'Evaluating Compliance Effectiveness' project and the 'Embedding Effectiveness Thinking' work program are referred to collectively in this report as Embedding Effectiveness Thinking.

10. To form an opinion against this audit objective, the ANAO adopted the following high level criteria:

- sound management arrangements were in place to support the development and implementation of the CEM;
- CEM evaluations were conducted effectively;
- the results of CEM evaluations were used to shape future compliance strategies; and
- the Evaluating Compliance Effectiveness project and the Embedding Effectiveness Thinking work program were implemented effectively.

Overall conclusion

11. In 2006, the ATO developed and implemented the Compliance Effectiveness Methodology (CEM) to better measure the effectiveness of its compliance activities undertaken to improve voluntary compliance by Australian taxpayers and to build community confidence in the administration of the tax system. The intent was to evaluate the effectiveness of tax compliance strategies in order to improve compliance strategies, treatments, resource allocation and external accountability. At the time, the ATO also hoped to extend the lessons of, and thinking behind, effectiveness evaluations to the whole office. The CEM is a 'bottom-up' approach—evaluating discrete, priority compliance risks—with the results of these evaluations being considered in conjunction with higher-level approaches such as tax gap analysis and indicators of participation in the tax system, to provide an overall picture of the ATO's compliance effectiveness. As at February 2014, the CEM had been applied to 80 compliance risks across all Compliance BSLs.

12. The CEM is a sound evaluation methodology for assessing the effectiveness of the ATO's compliance activities, and has been recognised by the OECD as an innovative approach that provides practical methods for systematically evaluating the impacts of compliance risk treatment strategies.⁹ The four phases provide for the specification of compliance risks and strategies, design and validation of indicators, and reporting of evaluation findings and proposed outcomes.

9 OECD Forum on Tax Administration, *Evaluating the effectiveness of compliance risk treatment strategies*, pp. 5 and 9, available from <<http://www.oecd.org/tax/administration/46274278.pdf>> [accessed 25 March 2014].

13. The ATO applied generally sound project management practices and administrative frameworks in developing the CEM and preparing for its implementation within the eight BSLs of the Compliance Group. However, in implementing the CEM as an ongoing business process from 1 July 2009, there has been a lack of strategic focus and direction on its application and outcomes, and on fully embedding the methodology into the ATO's core processes, including risk management. As a consequence, the full benefits to be gained from the CEM as a means of improving the ATO's compliance strategies and treatments, resource allocation and external accountability have not been realised. Realising these benefits will require a reenergised approach by the ATO to assessing the effectiveness of its compliance activities.

14. There has always been an intention to apply the CEM to high priority compliance risks. However, without a common understanding across the Compliance Group BSLs of which risks are high priority, the methodology has been applied to a large number of risks of varying nature.¹⁰ The conduct of compliance evaluations¹¹ has also been inconsistent across the Compliance BSLs, particularly during the latter phases of the CEM (Phases 3 and 4) when there is a requirement to design indicators and report evaluation findings. The more thorough evaluations examined by the ANAO¹² (Project Wickenby, Lodgment and Transfer Pricing) had indicators that were clearly linked to specific success goals, desired outcomes and compliance strategies. The reports for these evaluations also contained a clear conclusion about compliance effectiveness that was defensible on the basis of documented evidence and analysis.

15. A significant proportion of the CEM evaluations examined in detail by the ANAO were either incomplete (particularly in their coverage of the non-compliant population¹³), had insufficient data to support conclusions, or made little reference to ATO compliance activities. Also, nearly all the

10 Under the ATO's risk management guidance, there are four levels of risk: strategic risks are linked to the ATO's strategic planning and priorities; enterprise risks relate to a core or enabling business function or process; operational risks are a component or a part of an enterprise risk; and tactical risks are usually associated with localised events or activities such as transactions, incidents and cases.

11 Compliance evaluations refer to the application of the CEM to compliance risks.

12 The ANAO examined 80 CEM evaluations at a high level and 16 CEM evaluations from the eight Compliance BSLs in more detail.

13 For any compliance risk, there will be a segment of the taxpayer population, generally small, likely to be non-compliant. It is important that evaluations attempt to understand the nature and key characteristics of this population, and if possible estimate its size in terms of number of taxpayers and revenue at risk.

evaluations resulted in a positive conclusion, and had little influence in encouraging the development of strategies to further promote voluntary compliance. Only four of the 16 evaluations examined in detail had suggested changes to compliance strategies and treatments.¹⁴ These results indicate that the ATO has missed opportunities to use the CEM to substantially strengthen existing risk management processes, and consequently it has not achieved an important element of the overall intent of the program—improved compliance strategies and treatments.

16. More broadly, the CEM program has also not notably improved reporting to the Parliament and Australian community about the effectiveness of the ATO's compliance strategies. External reporting has mainly involved presenting effectiveness case studies on the ATO website, or similar coverage in annual reports and compliance program reports, rather than presenting a comprehensive picture based on completed compliance effectiveness evaluations. To this end, there would be merit in the ATO taking a more strategic approach to selecting high priority risks for evaluation, and aggregating the results of the CEM evaluations of these risks. Aggregation of CEM results could then be considered in conjunction with a more systematic approach to measuring the tax gap, which the ATO has advised the Standing Committee on Tax and Revenue that it will be considering over 2014.

17. Since 2012, the ATO has sought to extend the focus on effectiveness beyond the Compliance Group to the other two Groups. This work is still in its early stages, and the ATO recognises that further work is required to embed the new effectiveness methodology throughout the organisation. In this regard, it is important that the ATO applies the lessons learnt from developing and implementing the CEM. These lessons include: providing centralised direction and oversight of evaluations; reaching clear conclusions about effectiveness and proposing improved strategies and treatments where appropriate; monitoring the outcomes being achieved; and aggregating results to enable an integrated view of the ATO's effectiveness.

18. The ANAO has made two recommendations with the aim of the ATO taking a more strategic approach to selecting the compliance risks to be evaluated; and improving the conduct of compliance effectiveness evaluations and reporting of their results.

14 There was also little documentation to indicate whether these strategies had been implemented, and their impact, in subsequent compliance evaluations.

Key findings by chapter

Developing and Implementing the Compliance Effectiveness Methodology (Chapter 2)

19. The ATO put in place a sound process to develop the CEM in 2006 and 2007, involving a dedicated project team, extensive literature review, two pilot projects and a business case to transition to business as usual. Implementation arrangements were extensive and also generally sound, based on an action plan arising from the business case. A project closure report was produced in June 2009, which concluded that all major project deliverables, such as the establishment of the Effectiveness Centre of Expertise, had been delivered. However, the report did not evaluate whether the project outcomes had been achieved. Also, no processes were established to monitor emerging risks over the course of the program.

20. Despite establishing an extensive administrative framework, there were some shortcomings in managing the CEM as business as usual in the Compliance Group from 1 July 2009, particularly in providing strategic direction in the use of the methodology and achieving the intent of the program. In November 2011, an internal review identified that the implementation of the CEM had been inconsistent. To promote greater consistency, the ATO advised in April 2014 that the existing Effectiveness Centre of Expertise would provide central direction and oversight of the CEM. These roles are intended to ensure that the CEM will: be applied to appropriate risks; be conducted consistently; and achieve its overall objectives.

21. As the CEM is not budgeted or costed, and with devolution of responsibility to the BSLs for staffing and resourcing, the levels of CEM resourcing between BSLs vary depending on availability of funding and local management decisions. This has contributed to some BSLs implementing and integrating the methodology more effectively than others.¹⁵ It has also led to a lack of understanding of the cost of undertaking CEM activity, which has limited the capacity of the ATO to manage the CEM consistently.

22. Training of staff in the CEM is left to the discretion of individual risk managers. CEM training is done through an *iLearn* package, knowledge-sharing

15 Based on information provided by BSLs, the ANAO estimated that the total direct employee costs captured across the Compliance Group for CEM-related activities in 2013–14 was around \$1.8 million.

and on-the-job training at the BSL level. As it has been around five years since the original CEM training was provided, and the ATO has identified possible skill and knowledge gaps, there would be merit in the ATO reviewing the adequacy of current training and support for staff applying the methodology, including with respect to statistical and evaluation techniques.

Conduct of Compliance Effectiveness Methodology Evaluations (Chapter 3)

23. Considerable guidance material is available to Compliance BSLs to support staff in conducting CEM evaluations. Nevertheless, the BSLs have taken differing approaches to conducting these evaluations, many of which have recast or extended prevailing risk assessments.

24. Rather than being high priority as envisaged in the CEM guidance, many of the risks originally selected for compliance effectiveness evaluation were of a varying nature. The decisions to select risks were often made by BSLs' risk management committees or executives, in the absence of clear guidance on determining which risks were high priorities to evaluate, and with the concept of priority not being clearly specified within existing risk management processes.¹⁶ Since the introduction of the Enterprise Risk Management Framework¹⁷ in 2012, the ATO has revised its compliance risks, with a number being downgraded, removed or consolidated with other risks. Accordingly, many operational and tactical risks have been incorporated into higher-level risks for CEM evaluations.

25. The ANAO's analysis of the 80 compliance risks that have been subject to a CEM evaluation found that BSLs have not systematically either applied or documented key elements of the methodology outlined in key guidance documents—namely, that workshops were undertaken, indicators developed and evaluations completed. Of the 80 risks, in 62 cases at least one of these three key aspects of the methodology (workshops) was not undertaken or documented. The analysis highlighted considerable problems with record

16 While the ATO's annual Health of the System Assessment process asks BSLs to identify and rate their compliance risks and develop strategies to mitigate those risks, the process does not have an agreed understanding of what is a high priority risk.

17 The ATO uses the Enterprise Risk Management Framework as a foundation for managing risks across the office. It uses the Framework to record, categorise and manage all 'enterprise risks'. The ATO Corporate business line has overall responsibility for the Framework.

keeping, as many BSLs were unable to provide CEM documentation for important phases, such as workshops.

26. In-depth analysis of 16 CEM evaluations from the eight Compliance BSLs found that Phases 1 and 2 (to articulate risks and define outcomes) were generally conducted in line with guidance. In contrast, a number of key aspects of Phases 3 and 4 (to design indicators and report results) were not always conducted in line with procedures or effectively overall. The ATO considered that separately conducting Phases 1 and 2 has been useful in encouraging evaluators, who were often drawn from risk teams, to focus on the effectiveness of the compliance strategy rather than deliverables (such as compliance revenue targets) as they had done in the past. However, a number of BSL staff advised that completing the required CEM documentation was burdensome, such as workbook templates that could run to 100 pages when completed. The Compliance Group could now draw more explicitly on existing risk processes for these two phases, with major additional work conducted on an exceptions basis.

27. The ATO has provided direction to its staff on designing indicators¹⁸ in a number of guides, which include extensive discussion of the theory and application of indicator design. Consistent with this guidance, 15 of the 16 evaluations proposed indicators for each success goal.¹⁹ However, only five of the evaluations had incorporated testing of the indicators against the SMART criteria. The lack of indicator analysis reduces the level of assurance that the indicators will measure the outcome of the success goals.

28. All 16 evaluations included indicators that were relevant and reliable²⁰, with more than 93 per cent of the 197 specific indicators satisfying each of the four specific characteristics for these two criteria—that they are focused, understandable, measureable and free from bias. However, six of the 16 evaluations had an incomplete set of indicators, mainly because they did

18 The methodology requires the development of a suite of indicators to paint a defensible picture of effectiveness and also advocates use of the SMART (Specific, Measurable, Achievable, Relevant and Timed) criteria in formulating and validating indicators.

19 Success goals are linked to positive, sustainable changes in behavior and/or community confidence. An example of a success goal is sustained improvement in the population of late lodgers (that is, those that do not lodge their returns by the due date).

20 The ANAO examined whether the indicators used were relevant, reliable and complete, using an approach developed for assessing Australian Government key performance indicators. This approach is applicable to CEM indicators, which also need to be relevant, reliable and complete in order to build a defensible argument regarding compliance effectiveness.

not cover the extent of non-compliant behaviour, or to a lesser extent, the results of active compliance activities. Measuring the extent of non-compliance requires information to indicate the magnitude of the non-compliant taxpayer population and the revenue at risk. Also, the results need to be attributed to the ATO's activities. CEM guidance provides examples of statistical methods that can be used to attribute observed results to compliance activities, such as randomised control trials which exclude other variables.²¹ In the 16 sets of indicators analysed, no such methods were applied through the CEM process.

Outcomes of Compliance Effectiveness Methodology Evaluations (Chapter 4)

29. Based on ANAO analysis, nine of the 16 evaluations reached defensible conclusions. That is, there was sufficient evidence of detailed analysis and sound judgements to support the ATO's conclusions about the effectiveness of compliance strategies. Of the seven that did not reach defensible conclusions, five had incomplete sets of indicators (largely because they did not adequately address the non-compliant population), and two did not have sufficient evidence of the analysis undertaken to reach the conclusion. As identified in the ATO's November 2011 review of the CEM, the conduct of these evaluations could be improved by strengthening the evaluation capability, and encouraging risk managers and evaluators to address identified deficiencies, such as data inadequacies, attribution of results to the ATO compliance activities and covering the non-compliant population.

30. According to CEM guidance, the final report is an important means of communicating the outcomes of the CEM so that continuous improvement can occur based on an improved understanding of the risk.²² The ATO was only able to provide evidence of a final report for 53 of the 80 completed compliance evaluations. Of those, 50 had recorded a conclusion, of which 46 were positive, one was neutral, and three were negative—that is, concluding that the existing compliance strategies were not effectively addressing compliance risks. This

21 In a randomised control trial, taxpayers are randomly selected from the population and separated into a target group and a control group. In the example in the CEM guidance, the target group is used to test the effectiveness of an advisory letter on their compliance behavior. The control group is isolated from the treatment. The difference in behavior between the groups is then used as an indicator of the effectiveness of the strategy.

22 ATO, *Measuring compliance effectiveness—Evaluating effectiveness*, p. 25, available from <http://www.ato.gov.au/uploadedFiles/Content/ATP/downloads/COR25789n73580.pdf> [accessed 17 April 2014].

high level of positive conclusions can partly explain the relatively small proportion of proposals to significantly change compliance strategies and treatments. A notable exception was the fringe benefits tax (FBT) evaluation completed in 2011. This evaluation influenced the Government's decision to make a law change to the FBT living away from home allowance, effective from 1 July 2012, which limited access to the tax exemption and strengthened the substantiation requirements.

31. While the ATO has published a number of case studies in its recent annual reports and compliance programs, there has been no meaningful aggregation of the results of evaluations to help provide an integrated view of the ATO's effectiveness. Accordingly, it is not evident that the ATO has achieved its program objectives for the CEM, particularly to improve compliance strategies and treatments, and external reporting of effectiveness.

Embedding Effectiveness Thinking in the Australian Taxation Office (Chapter 5)

32. The ATO's 2011 internal review identified scope to better integrate the CEM—both into key corporate processes, and throughout the ATO—and provided the impetus for developing the Evaluating Compliance Effectiveness project in January 2012 and a comprehensive blueprint and roadmap for the Embedding Effectiveness Thinking work program in November 2012. A number of deliverables of the blueprint had been achieved as at April 2014, although progress was slow in some areas, such as integrating the CEM into the ATO's Health of the System Assessments (HoTSAs)²³ and other key corporate processes.

33. The ATO has developed simplified approaches for ATO staff in support areas to consider when evaluating the effectiveness of their activities. Staff undertaking effectiveness work outside the Compliance Group can choose from a suite of support tools, depending on the complexity of work being undertaken, while work is continuing on a modified version of the compliance effectiveness methodology for use in non-compliance work. It is too early to assess the success of the project to embed effectiveness thinking, particularly outside the Compliance Group.

23 Annually, each BSL is required to prepare a HoTSA that addresses its major areas of risk, establish plans to manage those risks within anticipated funding levels and justify how these positions were reached. Resources are allocated according to these risk assessments. The Superannuation BSL has integrated the CEM into its 2013 HoTSA.

34. The ATO has identified barriers to achieving its objective of making effectiveness an integral part of its work, both within the Compliance Group and across the agency. Some of the identified barriers are significant, such as the need to develop the ATO's evaluation capability. Other barriers not explicitly identified by the ATO relate to addressing some of the key lessons learned from implementing the CEM process. Addressing these issues will support the ATO to better integrate effectiveness thinking into the ATO's decision making processes and demonstrate its effectiveness to the Parliament and Australian community.

Summary of agency response

35. The ATO provided the following summary comment to the audit report:

The ATO welcomes this audit and the recognition by the ANAO that our Compliance Effectiveness Methodology is a sound evaluation method for assessing the effectiveness of the ATO's compliance activities. The ATO continues to pursue approaches to understanding and demonstrating the impact of our activities.

The ATO recognises the opportunities highlighted by this audit to strengthen and further develop our capacity to undertake strategic evaluations, including the need to better aggregate the results of evaluations to help provide an integrated view of the ATO's effectiveness.

Over recent years the ATO has increased the publication of case studies and results based on compliance effectiveness evaluations in the Commissioner's annual reports and compliance program publications. We have also published improved performance information aggregated by tax product, market segment and key compliance obligations. We will continue to build a comprehensive picture of our effectiveness in our performance reporting to the Parliament and the community.

36. The ATO's full response is included at Appendix 1.

Recommendations

Recommendation No. 1

Paragraph 3.61

To improve the conduct and usefulness of compliance effectiveness evaluations, the ANAO recommends that the ATO institutes a more strategic approach to selecting the compliance risks to be evaluated, and reaffirms to evaluators the importance of undertaking and recording key elements of the methodology, particularly testing and validating effectiveness indicators.

ATO response: *Agreed.*

Recommendation No. 2

Paragraph 4.56

To improve the conduct of compliance effectiveness evaluations and their use in enhancing compliance strategies, treatments and external reporting, the ANAO recommends that the ATO:

- (a) strengthens the overall standard and completeness of evaluations;
- (b) uses the evaluations more extensively to improve compliance strategies and resource decisions; and
- (c) considers how to consolidate the results of these evaluations in reporting to the Parliament and community about the effectiveness of the ATO's compliance approaches.

ATO response: *Agreed.*

Audit Findings

1. Background and Context

This chapter provides the background and context for the audit, including details of the Australian Taxation Office's Compliance Effectiveness Methodology. It also outlines the audit objective and approach.

Introduction

1.1 The Australian Taxation Office (ATO) is Australia's principal revenue collection agency. In 2012–13, the ATO collected \$311.7 billion in net tax from taxpayers, had operating expenses of \$3.5 billion and employed over 25 000 staff.²⁴ Its desired outcome is to achieve confidence in the administration of Australia's taxation and superannuation systems by helping people understand their rights and obligations, improving ease of compliance and access to benefits, and managing non-compliance with the law.²⁵

1.2 The ATO is organised into three main groups: Compliance; People, Systems and Services; and Law Design and Practice. The groups are then divided into business and service lines (BSLs) that are responsible for the delivery of group priorities. The Compliance Group is responsible for ensuring maximum levels of voluntary compliance by taxpayers and its BSLs are structured according to the type of taxpayer or market covered (such as Small Business/Individual Taxpayers and Aggressive Tax Planning).²⁶

ATO risk management framework and compliance model

1.3 The ATO has a risk management framework that provides a structured approach to identifying and prioritising compliance risks. Risks are identified and rated for their likely occurrence and the potential threat to the ATO's mission, which is to contribute to the economic and social wellbeing of Australians by fostering willing participation in Australia's tax and

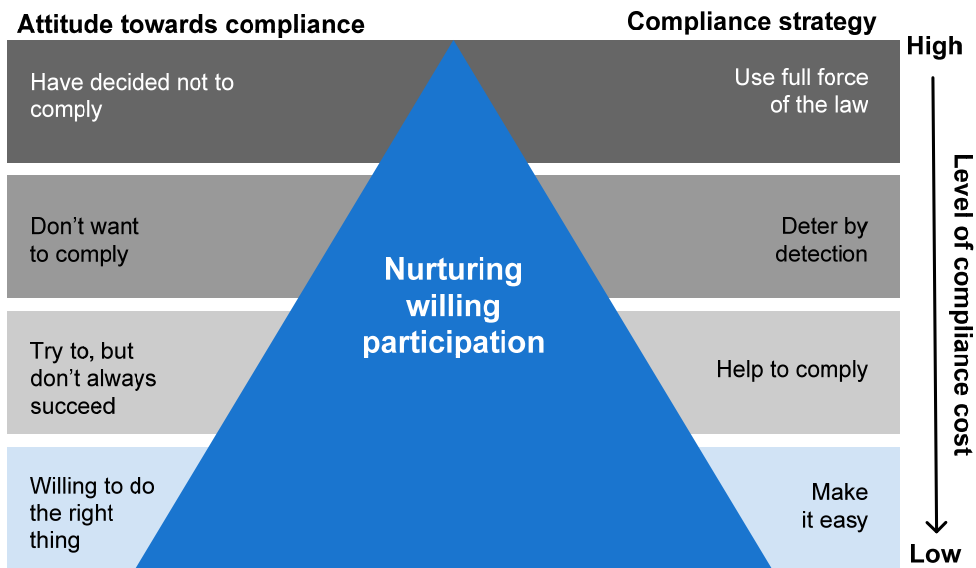
24 Commissioner of Taxation, *Annual Report 2012–13*, pp. vi and 2.

25 ATO, *How we do things*, available from <<http://www.ato.gov.au/About-ATO/About-us/How-we-do-things/>> [accessed 17 December 2013].

26 ATO organisational and senior executive structure, available from <<http://www.ato.gov.au/About-ATO/About-us/Who-we-are/Our-Executive/Organisational-chart/>> [accessed 17 December 2013]. Prior to 2012, the Compliance Group was known as the Compliance sub-plan. For ease of reading, this report uses the term 'Compliance Group' in all references to this element of the ATO's organisational structure.

superannuation systems.²⁷ The ATO publishes a compliance program annually (known in 2013–14 as *Compliance in focus*) outlining the compliance actions it intends undertaking in the next financial year to ‘deter, detect, and deal with’ those not meeting their tax and superannuation responsibilities. This program is based on the ATO Compliance Model, illustrated in Figure 1.1.

Figure 1.1: ATO Compliance Model



Source: ATO, *Compliance in focus 2013–14*, p. 3.

1.4 The Compliance Model aligns compliance strategies with taxpayers' attitudes to compliance, by²⁸:

- making it easy—providing advice and information through its website and in print, and receiving online lodgment applications such as e-tax;
- helping people comply—clarifying the law and communicating ATO views through public and private rulings, checklists, fact sheets, practice statements;
- deterring by detection—intensive action including compliance reviews and audits, issuing final notices and imposing penalties; and
- using the full force of law—prosecutions.

27 ATO, *Our strategic direction*, March 2014, available from https://www.ato.gov.au/uploadedFiles/Content/CR/downloads/js31949%20Corporate%20Plan%20Strategic%20Intent_w.pdf [accessed 29 April 2014].

28 ATO, *Compliance in focus 2013–14*, pp. 3–4.

1.5 As part of its strategy to ‘deter with detection’, the ATO conducted, on average, approximately 850 000 active compliance activities annually (including targeted campaigns²⁹, reviews³⁰ and audits³¹) between 2009–10 and 2012–13. The tax liability raised through these compliance activities was \$42.1 billion, with over \$25 billion in additional revenue being collected (as shown in Table 1.1). Differences between liabilities raised and cash collected arise where the debt is disputed and may not be collected, or where it is collectable but has not yet been paid.

Table 1.1: ATO active compliance activities, 2009–10 to 2012–13

	2009–10	2010–11	2011–12	2012–13	Total
Reviews, audits and compliance checks	798 401	887 408	981 098	749 053	3 415 960
Liabilities raised (\$ billion)	9.1	10.1	10.8	12.1	42.1
Estimated cash collected (\$ billion)	5.1	5.9	6.3	7.9	25.2

Source: ATO *Compliance Program 2012–13* and ATO *Compliance in focus 2013–14*.

1.6 In addition to its funding for administering the tax system, the ATO frequently receives additional funding for specific compliance initiatives. Over the last five years, additional funding has totalled \$2.2 billion. For example, in the 2010–11 Budget, the Government provided \$107.9 million to the ATO to collect \$492 million over four years by targeting the cash economy, and \$337.5 million over four years to fund additional activities that promote voluntary Goods and Services Tax (GST) compliance, with the aim of raising an additional \$2.7 billion in revenue over four years.³²

ATO Management and Accountability Framework

1.7 The compliance program is one element of the ATO’s Management and Accountability Framework, which operates to support the Australian Government Outcomes and Programs framework. The Outcomes and

29 Campaigns are aimed at delivering compliance education, gathering intelligence and as early intervention activities.

30 Risk reviews help the ATO understand a taxpayer’s business activities, tax affairs and risk profile to determine whether further review or audit is warranted.

31 Audits are specific or wide-ranging ATO investigations to confirm that the correct amount of tax has been paid.

32 Australian Government, *Budget 2010–11, Budget Paper No. 2, Part 1: Revenue Measures*, available from <http://www.budget.gov.au/2010–11/content/bp2/html/bp2_revenue–06.htm> [accessed 13 January 2014].

Programs framework requires agencies to measure the intended results, impacts or consequences of government actions on the Australian community. Agencies are required to develop and report against specified outcomes, program objectives, deliverables (outputs) and key performance indicators which are set out in their Portfolio Budget Statements (PBS). Achievements are set out in annual reports.

1.8 The ATO's Management and Accountability Framework outlines internal governance reporting processes, aimed at supporting the external reporting of the performance of its programs, as well as risk management, corporate planning and project management arrangements. A central element of the ATO's reporting of the performance of its programs is the effectiveness of its compliance program and related activities.

Measuring compliance effectiveness

1.9 Measuring the impacts of compliance activities is not straightforward, and revenue agencies around the world grapple with this issue, which is described by the ATO as 'challenging and evolving'.³³

1.10 Over many decades, parliamentarians and parliamentary committees have been interested in how the ATO measures the effectiveness of its compliance activities and the related calculations of the tax gap—the difference between tax that is actually paid and that expected if every citizen fully complied with their legal obligations. For example, in 1994 a Senate Estimates Committee questioned the ATO about the action it was taking to assess the tax gap. One reason for calculating the tax gap is that it can be used to monitor the performance of revenue agencies in maintaining tax system integrity.³⁴ The ATO advised the Committee that it was working on the ability to measure the effectiveness of its compliance activities. In 2003, a Senate Estimates Committee again asked the ATO about its ability to provide a tax gap figure.³⁵ The ATO replied that there were issues with tax gap calculations including resource usage, sampling methodologies and the timeliness of results.

33 Commissioner of Taxation Michael D'Ascenzo, Speech to CEDA Trustees Roundtable, *Measure for measure: The four pillars of compliance*, Melbourne, 25 February 2011, p. 2.

34 McManus J and Warren N, *The case for measuring tax gap*, eJournal of Tax Research (2006) vol.4 no.1, p. 68, available from <[http://darp.lse.ac.uk/papersdb/McManus-Warren_\(eJTR06\).pdf](http://darp.lse.ac.uk/papersdb/McManus-Warren_(eJTR06).pdf)> [accessed 13 December 2013].

35 Official Committee Hansard, Senate Economics Legislation Committee Estimates, Tuesday 3 June 2003, Canberra, pp. E263–E264.

1.11 The Joint Committee of Public Accounts and Audit (JCPAA) has also shown interest in the capacity of the ATO to measure its revenue collection effectiveness. Most recently, the JCPAA raised the issue at its 2012 hearing with the Commissioner of Taxation, and subsequently recommended that the ATO publicly release its report relating to the tax gap for GST and luxury car tax, and recommended work on methodologies to measure the tax gap and cash economy.³⁶ In November 2012, the ATO released tax gap estimates for the GST and luxury car tax.³⁷

1.12 In relation to measuring tax gaps for other major taxes and the overall tax gap, the ATO has previously advised that it has contemplated measuring the income tax gap, but considers no equivalent reliable benchmark is available. Also, it has regarded the conduct of random audits of taxpayers, which may be required for calculating the income tax gap and overall tax gap, as a diversion of resources from current compliance programs.³⁸ The then Commissioner of Taxation stated at the 2012 JCPAA hearing that ‘if you talk about the tax gap you are really talking about the effectiveness of the system, which is the way we prefer to approach it’.³⁹ The ATO has recently advised the Standing Committee on Tax and Revenue that it is exploring various methodological issues around tax gaps, and that it has been researching international practice and consulting with the private sector. It plans to develop a position on its proposed approach to measuring tax gaps later in 2014. The ATO also noted the use of ‘participation indicators’ as a high-level measure of tax compliance.⁴⁰

36 JCPAA, *Report 434: Annual Public Hearing with the Commissioner of Taxation—2012*, available from <http://www.aph.gov.au/parliamentary_business/committees/house_of_representatives_committees?url=jcpaa/taxationannual0812/report.htm> [accessed 13 January 2014].

37 ATO, *Measuring tax gaps in Australia for the GST and the LCT*, ATO, November 2012; available from <[http://www.ato.gov.au/Business/Bus/Measuring-tax-gaps-in-Australia-for-the-goods-and-services-tax-\(GST\)-and-the-luxury-car-tax-\(LCT\)/](http://www.ato.gov.au/Business/Bus/Measuring-tax-gaps-in-Australia-for-the-goods-and-services-tax-(GST)-and-the-luxury-car-tax-(LCT)/)> [accessed 19 February 2014]. In 2012–13, the ATO also said the trend in the GST gap provides reassurance that compliance levels have remained constant and there has been no significant increase in non-compliance. *Commissioner of Taxation Annual Report 2012–13*, p. 50.

38 ATO, Commissioner Committee briefing, June 2013, *Tax gap measurement—ATO approach*.

39 Hansard, JCPAA Annual hearing with Commissioner of Taxation, 14 September 2012, p. 21.

40 House of Representatives Standing Committee on Tax and Revenue, *2013 Annual Report of the Australian Taxation Office, First Report*, March 2014. Participation in the system is seen as a good indicator of the level of compliance with tax obligations generally, and the participation indicators are linked to the OECD’s four pillars of compliance—correct registration; on-time lodgment; complete and accurate reporting; and on-time payment of tax.

Compliance Effectiveness Measures Project

1.13 Recognising the Parliament's interest in measuring compliance effectiveness, in late 2006 the ATO established a Compliance Effectiveness Measures Project Team. Its purpose was to research, design and implement a methodology to measure the ATO's compliance effectiveness. Following the completion of two pilot studies (covering high wealth individuals and tax havens), the ATO Executive decided to expand the project across the Compliance Group and agreed to implement a corporate approach to measuring compliance effectiveness, including developing compliance effectiveness methodology training. According to the ATO's business case, the intended outcome of the Compliance Effectiveness Measures Project was that:

Compliance risk owners⁴¹ and others develop strategies that are effective in addressing their risk and evaluate their effectiveness in optimising voluntary compliance and building community confidence.

1.14 The project continued until June 2009, when the use of the Compliance Effectiveness Methodology (CEM) became business as usual, and ownership was transferred to the Compliance BSLs. The ATO's *Measuring Compliance Effectiveness—Our Methodology* (released publicly) described the methodology as an invaluable tool for improving the ATO's 'decision making, accountability to government and the community; planning; resource allocation; and choice of treatment strategies'.⁴²

Compliance Effectiveness Methodology

1.15 The CEM is an iterative process based on two key elements: identification of measurable compliance objectives; and articulation and treatment of the risks to achieving them. These key elements are reflected in the four phases to the CEM, which are shown in Table 1.2.

41 Risk owners, who are generally SES officers in the relevant BSLs, are responsible for managing and reporting on treatment strategies until the desired risk mitigation level has been achieved.

42 ATO, *Measuring Compliance Effectiveness—Our Methodology*, available from <<http://www.ato.gov.au/About-ATO/About-us/In-detail/Key-documents/Measuring-compliance-effectiveness—our-methodology/>> [accessed 13 January 2014].

Table 1.2: Four phases of the Compliance Effectiveness Methodology

Phase	Key elements
One	Articulate the risk and align it to the ATO's business intent of optimising voluntary compliance, making payments under the law and building community confidence. Prior to commencing this phase, risks need to be identified, quantified and prioritised, based on the ATO's Risk Management Framework.
Two	Define successful outcomes and develop compliance strategies to achieve these outcomes, including the use of educational information, stakeholder engagement, and compliance activities such as letters, telephone calls, reviews and audits.
Three	Identify and test indicators of success to be used during the compliance strategies.
Four	Use these indicators to evaluate and report on the extent of the effectiveness of the compliance strategies in the short, medium and long term.

Source: ATO, *Measuring Compliance Effectiveness—Our Methodology*.

1.16 The CEM relies on the evidence collected being defensible, not definitive. The indicators are not limited to taxpayer behaviour or tax revenue figures but also include community confidence that the tax system is administered effectively. The methodology accepts that a large number of indicators will not be directly attributable to particular ATO programs or activities. Therefore, a requirement of the methodology is documentation of discussions relating to each indicator decision, to help ensure the indicator is meeting its original intent. Methodology guidelines also require an evaluation report at the conclusion of Phase 4, although occasionally only a summary report has been prepared.

1.17 The CEM is regarded as a sound methodology by the Organisation for Economic Co-operation and Development (OECD) Forum on Tax Administration, which described it as an innovative approach that provides practical methods for systematically evaluating the impacts of compliance risk treatment strategies.⁴³ In 2011, the CEM received a Comcover Award for Excellence in Risk Management.⁴⁴

43 OECD Forum on Tax Administration, *Evaluating the effectiveness of compliance risk treatment strategies*, pp. 5 and 9, available from <<http://www.oecd.org/tax/administration/46274278.pdf>> [accessed 25 March 2014].

44 Department of Finance, *Comcover Awards for Excellence in Risk Management 2011*, <<http://www.finance.gov.au/comcover/awards/awards-2011.html>> [accessed 4 April 2014].

Implementation of the Compliance Effectiveness Methodology

1.18 As at February 2014, the CEM had been applied to 80 identified compliance risks across eight Compliance BSLs. Each BSL manages the CEM process for its compliance risks. Risk owners have responsibility for applying the methodology in relation to their risks by providing direction, context and sign-off as appropriate; and the risk management forums⁴⁵ were to sign-off the results. Risk managers are predominantly tasked with conducting the evaluations.⁴⁶ The ATO has also established a number of groups to support the implementation of the CEM, of which the most important are the:

- Compliance Effectiveness Leadership Forum—a forum of senior officers responsible for providing overall leadership of compliance effectiveness across the Compliance Group⁴⁷;
- Evaluation Community of Practice—a forum of BSL representatives responsible for sharing knowledge through peer discussion to increase understanding of, and ATO capability in relation to, effectiveness; and
- Effectiveness Centre of Expertise (CoE)—a small team (around nine full time equivalent staff) that provides guidance and support to risk managers, evaluators and others who are seeking to apply effectiveness principles.

1.19 The ATO initiated an internal review of the CEM process in November 2011. This review found that the CEM had not been fully implemented by the Compliance Group and that little progress had been made in evaluating effectiveness across the ATO. To address these concerns, in January 2012, the ATO initiated an Evaluating Compliance Effectiveness project. Also, in November 2012, the ATO commenced an Embedding Effectiveness Thinking work program, to integrate effectiveness thinking across the agency (at all levels) and to enable it to assess, demonstrate and improve its effectiveness.

45 Risk management forums provide a strategic focus for the management of risks for a BSL. However, the ATO advised that the risk management forums for most BSLs had been disbanded in late 2013. Some BSLs advised that they will be managing effectiveness work through the BSL Executive and other forums.

46 Risk managers are appointed to oversee a particular risk considered to have a significant potential for impact, and are often Executive Level 2 officers.

47 The Compliance Effectiveness Leadership Forum consisted of: 10 Assistant Commissioners from each of the BSLs; representatives from the Economist Practice in Public Groups and International; and the Revenue Analysis Branch in Corporate Relations. It was supported by a dedicated secretariat.

This work is ongoing.⁴⁸ At the outset of the implementing the CEM in 2009, there was an expectation that the methodology would assist in embedding effectiveness thinking, not only in the Compliance Group, but also across the ATO.⁴⁹

Previous audits and reviews

ANAO audits

1.20 The ANAO has undertaken a number of audits where the CEM has been applied to the relevant compliance risks. These include:

- Audit Report No. 34 2008–09, *The Australian Taxation Office's Management of Serious Non-Compliance*;
- Audit Report No. 20 2010–11, *Administration of the Wine Equalisation Tax*; and
- Audit Report No. 16 2011–12, *The Management of Compliance in the Small to Medium Enterprise Market*.

1.21 The Serious Non-Compliance audit concluded that the indicators and measures being used by the Serious Non-Compliance BSL should be able to demonstrate whether community confidence in the tax system has been changed by its compliance activities. The Wine Equalisation Tax audit report concluded that, while there needed to be an ongoing process to revise the relevant effectiveness measures, the approach had been useful and was likely to provide valuable information over time about the effectiveness of wine tax administration. The Small to Medium Enterprises audit concluded that, while the use of the CEM was maturing within the BSL, it had the potential to provide evidence of the impact of compliance strategies on improving voluntary compliance. Of the three areas audited, only the Small to Medium Enterprises Business Line had attempted to summarise the overall effectiveness of its compliance activities.

48 For convenience, the *Evaluating the effectiveness of our compliance activities* project and the *Embedding Effectiveness Thinking* work program are referred to collectively in this report as Embedding Effectiveness Thinking.

49 ATO, *Measuring Compliance Effectiveness—Our Methodology*, Foreword.

ANAO key performance indicators pilot project

1.22 Following changes to the *Auditor-General Act 1997* giving the Auditor-General explicit authority to conduct audits of the appropriateness of entities' key performance indicators (KPIs) and the completeness and accuracy of their reporting, the ANAO conducted a pilot project. The pilot aimed to develop an audit approach and methodology for the audit of KPIs.⁵⁰

1.23 As part of this pilot project, the ANAO developed criteria for evaluating the appropriateness of Australian government entities' KPIs, and the completeness and accuracy of their reporting. These criteria, which have been accepted by the ATO, have been used to examine the indicators developed by the ATO during Phase 3 of the CEM evaluations.

ATO internal audit

1.24 The ATO's Internal Audit Unit has also examined the Compliance Effectiveness Measurement Process, reporting in June 2013. The scope of the audit was to provide assurance that the compliance effectiveness principles and methodology were fully and appropriately applied to priority risks.⁵¹

1.25 The audit found Phases 1 and 2 of the CEM were conducted well with compliance risks appropriately defined. However, it found that Phases 3 and 4 were conducted inconsistently between BSLs, and documentation supporting the underlying analysis of Phase 4 was often not completed.

1.26 The audit rated the enterprise risk of the CEM as high, and made three recommendations involving: greater emphasis on effectiveness in risk management documentation; improved guidance material to include record keeping and version control requirements; and the CoE to provide more guidance for risk managers. The ATO advised it has implemented two of the audit recommendations,⁵² and is seeking to implement the other, subject to the

50 ANAO Audit Report No.28 2012–13, *The Australian Government Measurement and Reporting Framework*; and ANAO Audit Report No.21 2013–14, *Pilot Project to Audit Key Performance Indicators*.

51 The audit reviewed a priority compliance risk from each of three BSLs: Superannuation (Self Managed Superannuation Funds Regulatory); Small and Medium Enterprises (Fringe Benefits Tax); and Tax Practitioner and Lodgment Strategy (Cash Economy Benchmark Strategy).

52 The two recommendations were that the ATO's Effectiveness Centre of Expertise: update the methodology and/or other guidance material; and provide further guidance on how risk managers can seek feedback.

outcome of a number of internal reviews and audits impacting on corporate policy and risk management procedures and guidance.

Capability Review of the ATO

1.27 In May 2013, the Australian Public Service Commission released its report on its Capability Review of the ATO. The Commission commented that, while the ATO had achieved some success in refining key performance indicators, it has not yet been able to ‘address some of the more challenging effectiveness questions, such as how to identify early gaps in revenue collection to thereby better influence tax design’.⁵³

1.28 In response, the ATO undertook to ‘continue to develop a consistent approach to measuring effectiveness and monitoring business as usual outcomes’. The deliverables were that the:

- effectiveness measurement approach would be broadened to support the governance system and provide an enterprise view of effectiveness; and
- measurement of enterprise effectiveness would be agreed and established for 2014–15 and beyond.

Approaches of other revenue agencies to measuring compliance effectiveness

1.29 Revenue agencies around the world have varying methods for attempting to measure compliance effectiveness or the extent of uncollected revenue. There also has been guidance from central organisations such as the OECD Forum on Tax Administration. Table 1.3 outlines the methods used in selected countries to calculate uncollected revenue.

53 APSC, Capability Review—Australian Taxation Office, p. 7, available from <http://www.apsc.gov.au/data/assets/pdf_file/0019/27514/Capability-review-ATO-accessible-ready.pdf> [accessed 17 December 2013].

Table 1.3: Methods of other revenue agencies to calculate uncollected revenue

Country	Method used
United Kingdom	Her Majesty's Revenue and Customs produces a tax gap estimate for a variety of taxes (such as value added tax, beer tax, income tax and tobacco excise).
Canada	Statistics Canada produces <i>Underground economy</i> , addressing the estimated results of the underground economy. The Canada Revenue Agency does not undertake tax gap estimates, citing a lack of recognised or reliable tax gap methodology. ⁵⁴
United States of America	The Internal Revenue Service conducts research into compliance behaviour. It also produces a tax gap estimate and Tax Gap Map.
Sweden	Sweden produces a Tax Gap Map for the amount of tax 'missing' from the system, along with a detailed description of the calculations involved.

Source: ANAO analysis.

1.30 The ANAO's scan of international practices in measuring tax compliance suggests that revenue agencies in OECD jurisdictions have focused on tax gap analysis rather than other evaluation methodologies such as the CEM.

Audit objective, criteria and methodology

Audit objective

1.31 The objective of the audit was to examine the application of the ATO's Compliance Effectiveness Methodology in evaluating the effectiveness of key compliance activities and shaping the development of strategies to promote voluntary compliance.

Audit criteria

1.32 To form an opinion on the audit objective, the ANAO adopted the following high level criteria:

- sound management arrangements were in place to support the development and implementation of the CEM;
- CEM activities were conducted effectively;

54 Canada Revenue Agency, *Re: PBO Information Request IR0099: Tax Gap Estimates*, <http://www.pbo-dpb.gc.ca/files/files/Response_IR0099_CRA_tax_gap_EN.pdf> [accessed 7 April 2014].

- the results of the activities were used to shape future compliance strategies; and
- the Evaluating Compliance Effectiveness project and the Embedding Effectiveness Thinking work program were implemented effectively.

Audit methodology

1.33 The ANAO conducted audit fieldwork in the ATO's offices in Canberra, Brisbane and Adelaide. Specifically, the audit team:

- examined policy documents, guidelines, procedures and operational documents;
- interviewed staff in the relevant business and service lines, and key stakeholders;
- reviewed relevant files, records and publications; and
- undertook testing of the 80 completed CEM evaluations and comprehensively tested 16 evaluations (two from each BSL).

1.34 The audit has been conducted in accordance with the ANAO's auditing standards at a cost of approximately \$469 000.

Structure of the report

1.35 Table 1.4 outlines the structure of the report.

Table 1.4: Structure of the report

Chapter	Chapter overview
2. Developing and Implementing the Compliance Effectiveness Methodology	Examines the development of the CEM, ongoing management and resourcing arrangements, and the guidance and training provided to staff conducting compliance effectiveness evaluations.
3. Conduct of Compliance Effectiveness Methodology Evaluations	Examines the conduct of CEM evaluations within ATO Compliance BSLs.
4. Outcomes of Compliance Effectiveness Methodology Evaluations	Examines the outcomes of CEM evaluations conducted in Compliance BSLs, including using the results to strengthen compliance strategies. External reporting of the CEM evaluations is also examined.
5. Embedding Effectiveness Thinking in the Australian Taxation Office	Examines the ATO's Evaluating Compliance Effectiveness project and Embedding Effectiveness Thinking work program.

2. Developing and Implementing the Compliance Effectiveness Methodology

This chapter examines the development of the CEM, ongoing management and resourcing arrangements, and the guidance and training provided to staff conducting compliance effectiveness evaluations.

2.1 As previously noted, the ATO commenced a Compliance Effectiveness Measures Project in 2006 in recognition that it did not have a structured process to assess the effectiveness of its compliance programs. When the Compliance Effectiveness Measures Project ceased in 2009, use of the CEM was moved to 'business as usual' (that is, normal ongoing operations) in the Compliance Group.

2.2 The ANAO assessed the ATO's development and implementation of the CEM, focusing on whether the ATO had effectively:

- developed the methodology through the Compliance Effectiveness Measures Project and in transition to business as usual;
- supported the application of the methodology in the business as usual phase through appropriate administrative arrangements; and
- resourced the program and provided training and guidance to support the conduct of sound compliance effectiveness evaluations.

Developing the methodology

Steps in developing the CEM

2.3 The main steps taken by the ATO to develop the CEM and to transition to business as usual are summarised in Table 2.1.

Table 2.1: Steps taken by the ATO to develop the CEM

Year	Step	Description
Initial development of the Compliance Effectiveness Methodology		
November 2006	Compliance Effectiveness Measures Project Team established	The Compliance Effectiveness Measures Project was established after the Compliance Executive identified a need for improved effectiveness measures. The project team undertook a thorough review of the Australian and international literature on measuring compliance effectiveness. The team noted that the proposed framework needed to be 'supported by a broader effectiveness measurement capability, embedded within the organisation's business model and its planning, reporting, risk management and intelligence processes'.
February 2007	Development of a methodology for measuring compliance effectiveness	The ATO Executive endorsed a conceptual framework for measuring the effectiveness of the ATO's compliance strategies and approved its progression to the next stage. This included further development of the effectiveness methodology and support tools (such as a guide to help compliance managers facilitate a workshop for designing indicators to measure compliance effectiveness) and pilot testing of the concept in two compliance projects.
July 2007	Completion of pilot studies	Two pilot studies involving the High Wealth Individuals Taskforce and the Tax Havens project were undertaken. These projects were chosen as they were relatively new, had a high profile and had obtained additional government funding. Workshops were held to gain an understanding of risks, drivers, strategies and potential effectiveness indicators.
Transitioning the methodology		
August 2007 to June 2009	Transition to 'business as usual'	<p>The ATO Executive endorsed a proposed work program to implement the methodology within the Compliance Group from 1 July 2009. It also agreed that use of the methodology should not be restricted to that Group and asked that a corporate approach be developed.</p> <p>The Project Team prepared a Concept Brief specifying a number of desired outcomes, including that the CEM would successfully integrate with relevant corporate processes, and that Compliance Group leaders, risk owners and risk managers would understand the methodology and apply it in planning and evaluating their compliance treatment interventions. To support the transition to 'business as usual', the ATO:</p> <ul style="list-style-type: none"> produced two corporate publications, <i>Our methodology</i> and <i>Applying our methodology</i>, in August 2008; and established a CEM Centre of Expertise (CoE).

Source: ANAO analysis of ATO data.

Assessment of the development of the CEM

Initial development of the methodology

2.4 To support the development and testing of the methodology, a project team was created. This was overseen by a Compliance Effectiveness Steering Committee. The project had high-level management support within the Compliance Group (sponsored by a Deputy Commissioner and a First Assistant Commissioner, overall management by an Assistant Commissioner and day-to-day management by a project manager).⁵⁵ In addition, a Compliance Effectiveness Reference Group was created in October 2007, so that core design team members could be directly involved in using the methodology and helping to ensure that it was built into BSL processes.⁵⁶

2.5 To conduct effective pilot studies, it was necessary to develop success indicators which were measurable. Also, the ATO needed to establish whether the CEM could be successfully replicated across the Compliance Group.

2.6 While not specifically addressing the pilot projects' success measures, including whether the CEM could be implemented across the ATO, the report on the High Wealth Individuals Taskforce noted that the pilot did not reach a definite conclusion on the effectiveness of high wealth individuals compliance treatments. However, it found that the exercise had been valuable because of its strategic focus, and noted that, for example, the pilot highlighted the importance of capital gains in assessing the tax performance of groups of high wealth individuals. It concluded that a more complete picture needed to be developed and that sufficient resources should be allocated for this purpose.

2.7 The tax havens pilot report, which made use of AUSTRAC data, concluded that the pilot had informed the future development of the Tax Havens strategy. It had also shown that the effectiveness methodology could be applied in a way that would deliver value to risk owners, risk managers and other related parties. In reaching this conclusion, the report could have more explicitly addressed the success measures and trends in the compliance behaviours of taxpayers.

55 The steering committee ceased to operate in May 2009, shortly before the conclusion of the project.

56 In June 2009, the Compliance Effectiveness Reference Group was merged into a newly created Compliance Effectiveness Leadership Forum. Other support arrangements included: the establishment in October 2008 of a cross-BSL core design team, comprising representatives from the eight Compliance Group BSLs, to help ensure a collaborative approach to the design of the integration work; and a design workshop in December 2008, involving participants from different BSLs.

2.8 As only one of the two pilot studies was able to report definitively on the effectiveness of the methodology, there would have been benefits in the ATO undertaking additional pilot studies to further test the methodology.

Management of the Compliance Effectiveness Measures Implementation Project

2.9 Following the pilot projects, in December 2007 the ATO prepared a business case for a Compliance Effectiveness Measures Implementation Project to implement the compliance effectiveness framework and methodology within the Compliance Group. The business case specified a number of project milestones to June 2009, when use of the CEM was expected to form part of the ATO's business as usual operations and the project was to conclude.⁵⁷ Progression of the project through its various stages was approved by the project sponsors⁵⁸ in a number of 'stage gate' decisions.⁵⁹ These decisions provided sign-off (without accompanying explanation) that the project was being implemented successfully. The arrangements put in place by the ATO provided effective oversight of the project during the design and rollout stages of the methodology.

Project outcomes and success measures

2.10 The business case specified a number of desired project outcomes and success measures, which are listed at Table 2.2.

57 The milestones included developing (and rolling out) training products, developing guidance material, establishing data analyst networks, developing a communication strategy, designing the transition to normal operations and preparing a project closure report. A post implementation review was proposed for November 2009.

58 These were the then Deputy Commissioners of Small and Medium Enterprises BSL and Compliance Support and Capability BSL.

59 Under a 'stage-gate' approach, projects are divided into stages or phases, separated by gates. At each gate, the continuation of the process is decided by a manager or a steering committee. The project team prepared decisions for the 'readiness' and 'operational acceptance' stage gates.

Table 2.2: Desired project outcomes and success measures for the Compliance Effectiveness Implementation Project

Component	Outcome or measure
Overall outcome	<ul style="list-style-type: none"> Compliance risk owners and others develop strategies that are effective in addressing their risk and evaluating their effectiveness in optimising voluntary compliance and building community confidence.
Other high level outcomes	<ul style="list-style-type: none"> Improved visibility of the ATO's effectiveness to both the compliant and non-compliant taxpayer communities. A greater level of assurance and confidence on the part of government. Greater visibility within the ATO, leading to informed compliance resourcing decisions and improved ATO compliance strategies.
Success criteria	<ul style="list-style-type: none"> Risk owners and others have the required capability to develop and report on their effectiveness. Effectiveness thinking becomes part of the culture of the Compliance Group and the effectiveness methodology is integrated into existing processes. Compliance Group strategies align with the ATO business intent. The CEM shapes strategic thinking within the Compliance Group.

Source: ATO, *Compliance Effectiveness Project Business Case*, 4 December 2007.

2.11 These outcomes were relevant and ambitious and, if achieved, would have demonstrated the benefits of implementing the methodology more widely in the Compliance Group. However, the prescribed methods for measuring success against these criteria were purely qualitative in nature, and not always easily understood or free from unbiased assessment. For example, the indicators included: 'risk management strategies/plans reflect the ATO business model and intent'; 'behavioural change from front line compliance staff (this could be measured using existing methods e.g. case level taxpayer questionnaire)'; and 'our risk management strategy is informed by our evaluation of strategy effectiveness'.

Transitional arrangements

2.12 The ATO produced a detailed action plan for integrating the CEM into business as usual by 30 June 2009.⁶⁰ This document included a self-assessment from each of the Compliance BSLs on their level of readiness to assume ownership of the CEM. It also noted some essential messages emerging from discussions between BSLs and the core design team, which suggested the need

⁶⁰ This included action plans for each of the eight Compliance BSLs, and involved a staged transfer of responsibility for the use and application of the methodology to BSLs during the 2008–09 financial year.

for ongoing support for the implementation of the methodology after it became part of BSLs' business as usual operations. The issues raised included:

- gaps in the capability (and resources) of some BSLs to apply the methodology;
- BSLs were seeking guidance on when and how to apply CEM;
- BSLs were seeking 'assurance' around the integration of the products;
- the enterprise risk management process contained some gaps in supporting products; and
- a need for a community of practice for compliance effectiveness.

2.13 The business case also included a section on risk management that identified a number of risks to the successful implementation of the program, together with mitigation strategies.⁶¹ While the risk management process was useful, it did not include a risk that was subsequently realised—that BSLs might devote differing levels of resourcing to the methodology and might apply it inconsistently once use of the CEM became business as usual (discussed further in Chapter 3). The ATO could have developed more effective strategies to address the risks of its highly devolved approach to implementing the CEM.

Project closure reporting and evaluation

2.14 A project closure report was prepared in June 2009. The report stated that all project deliverables had been delivered (with some minor exceptions). The major deliverables included the establishment of the CoE and the Community of Practice. However, the project closure report did not contain an assessment of the extent to which the project had achieved its intended outcomes and lessons that could be applied to improve the CEM in assessing the ATO's compliance strategies. While some issues were canvassed in the report on the action plan for integrating the CEM into business as usual, such an assessment would have been helpful.

2.15 A post-implementation review was not carried out, but a review of the CEM's operation under 'business as usual' was undertaken in 2011. The review found that the ATO had made significant progress, but that a number of issues

61 Among the identified risks were: the level of demand for project team assistance; uncontrolled usage of the methodology and products when insufficient knowledge and skills development has occurred; and resistance to cultural change.

needed to be addressed (including some of the matters identified in paragraph 2.12). The review made a number of recommendations to improve the application of the methodology, which were endorsed by the ATO Compliance Executive in November 2011.

Business as usual management arrangements

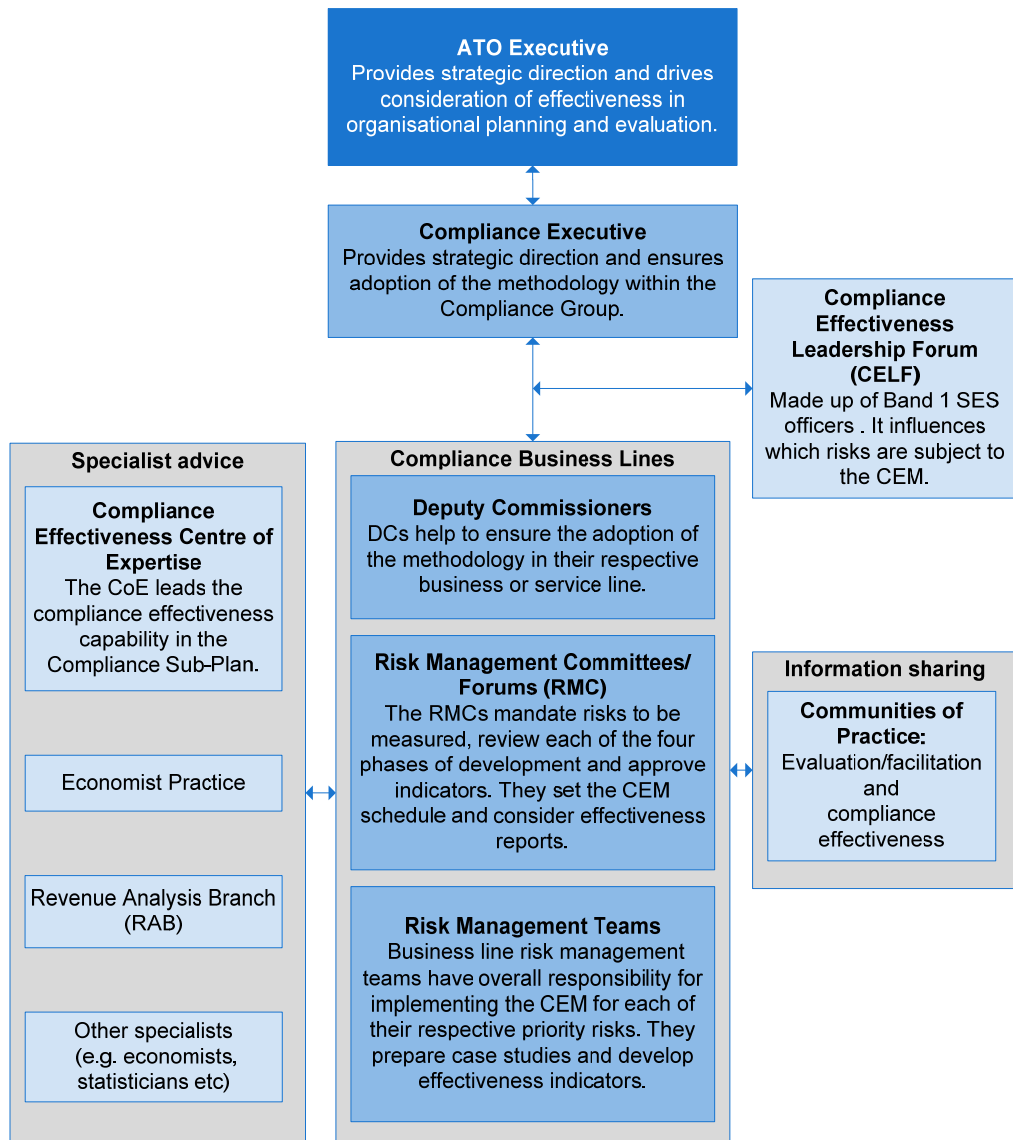
2.16 When use of the CEM became business as usual on 1 July 2009, BSLs assumed primary responsibility for determining when and how the methodology should be reflected in their business activities. Under business as usual, the Compliance BSLs are expected to apply the CEM as part of their normal operations within existing funding.

2.17 The CoE has a role in compiling the results of CEM activities for reporting purposes through its coordination of inputs into corporate documents such as Compliance in focus and the annual report. Noting this shared responsibility between the Compliance BSLs and the CoE, there have been divergent approaches and problems in aggregating the results of CEM activities in a meaningful way, as discussed in Chapter 4.

Administrative framework for the CEM

2.18 In planning and implementing the CEM in its business as usual phase within the Compliance Group, the ATO has used a number of organisational structures, such as committees, as set out in Figure 2.1. There are various arrangements for assigning responsibility for approving, overseeing, contributing to and reviewing the selection and conduct of CEM evaluations. There are also arrangements to help ensure the effective consideration of results from these activities in refining compliance strategies, and achieving the objectives of the CEM program. As part of a review of the ATO's internal committees, the ATO is currently assessing some of the committees responsible for CEM to determine whether they should be retained, modified, merged or abolished.

Figure 2.1: CEM administrative arrangements



Source: ANAO analysis of ATO data.

2.19 The ANAO's examination of the minutes of Compliance Executive meetings from 2009 to 2013 indicates that the Executive has been provided with regular updates on the operation of the CEM. Advice has also been provided on particular technical and methodological issues by the Compliance Effectiveness Leadership Forum and Community of Practice. However, there was little evidence that the Compliance Executive and Compliance Effectiveness Leadership Forum had regularly considered the Compliance

Group's priority risks for applying the methodology. There was also little evidence that the CEM results had been considered in subsequent risk processes, or that the ATO had assessed how the objectives of the CEM program were being achieved.

2.20 It is important to the overall success of the CEM that there is a greater strategic focus in respect of its application. This would help to ensure that appropriate priority risks are subject to CEM evaluations, and that subsequent evaluation results are sound and are being used to strengthen compliance strategies, treatments and resourcing. Such a focus should also include monitoring and reviewing the progress of the overall CEM program in meeting its stated objectives and outcomes. There would be benefits in the Compliance Executive taking a stronger leadership role in determining CEM priorities within the Compliance Group and appointing a single area within the ATO to manage the CEM.

2.21 In this light, and also to provide leadership for a broader ATO-wide effectiveness culture, in December 2012 the ATO established an 'Embedding ATO Effectiveness Steering Committee' to:

provide strategic leadership, direction and governance on embedding effectiveness across the ATO's management and accountability cycle, including coordinating integration with other projects impacting on our risk management, planning, reporting and governance systems that include effectiveness elements.⁶²

2.22 In the minutes of the May 2013 meeting, a Committee member emphasised the importance of a senior responsible officer managing an important change project:

While it could be difficult in the current environment, a dedicated SES would be preferable to ensure effectiveness received the required level of attention, rather than being added on to a larger role. The main reasons for this were that evaluating effectiveness involves specific skills, generating demand for evaluation, influencing significant behavioural change and managing the political landscape across the office.

2.23 However, the Committee was only established for a year and, following its October 2013 meeting, the Committee suggested that it be

62 ATO, *Embedding ATO Effectiveness Steering Committee Charter*, p. 6. The Committee was established to ensure that the ATO has effective arrangements in place to support embedding effectiveness across the agency—that is beyond the Compliance Group.

abolished and its functions absorbed into another, as yet unspecified, ATO governance group.

2.24 In April 2014, the ATO advised the ANAO that the existing CoE would provide central direction and oversight of the CEM. These roles are intended to ensure that the CEM will: be applied to appropriate risks; be conducted consistently; and achieve its overall objectives.

CEM resources and capability

2.25 Initial planning for implementing the CEM recognised the need to assist and enable risk managers, particularly those in the Compliance Group, to develop and evaluate strategies that were effective in optimising voluntary compliance, thus building community confidence. The focus was on enabling BSLs to integrate compliance effectiveness into their existing internal risk management processes rather than establishing a centralised unit to oversee the allocation of resources. This decentralised approach was considered more likely to be successful, on the basis that each BSL is able to allocate resources to better suit the nature of the relevant priority risks. However, there were significant challenges for some BSLs in implementing and integrating compliance effectiveness, notably:

- resourcing CEM work from existing budgets;
- aligning CEM with existing risk management processes and business policies; and
- training and supporting risk managers and evaluators, particularly as this was the first time many risk managers had measured the effectiveness of compliance activities.

2.26 While allowing individual BSLs to allocate and organise their CEM work as they saw fit, the ATO addressed these challenges in particular by: establishing the CoE and providing support through it and the other groups outlined in Figure 2.1; and training risk managers and evaluators.

Cost of the Compliance Effectiveness Measures Project

2.27 To support the efficient allocation of evaluation resources, it is important that the ATO has a good understanding of the cost of measuring compliance effectiveness.

2.28 The Compliance Effectiveness Measures Project was funded through the Compliance Group. The project completion report indicated that total project expenditure to 31 May 2009 was \$4.6 million.

2.29 To obtain a sound understanding of CEM costs, the ANAO requested information from the ATO on the total level of resourcing for compliance effectiveness, incorporating the CoE, business and service line investment and related evaluation resources. In response, the ATO noted that CEM costs and resourcing are not specifically captured in its systems or reports.

Centre of Expertise staffing

2.30 The CoE has had a major role in providing guidance and support for the CEM, and its staffing over time is set out in Table 2.3. The cost in 2013–14 of the 8.9 FTE staffing in the CoE was approximately \$830 000.

Table 2.3: Centre of Expertise staffing, 2006 to 2013

Period	Level of staffing
Initial project phases (2006–2008)	An average of 8 to 10 full time equivalent (FTE) staff were assigned to activities such as the literature review and other research, methodology design, product development and stakeholder engagement.
2009	The CoE was established with approximately five FTE, reflecting the move of the methodology into business as usual.
2011–12	The CoE's resources were increased as it fulfilled a leadership role in developing effectiveness information for reporting in the Commissioner's annual reports and compliance programs.
2012–13	The level of resourcing increased as the CoE took on the broader role of embedding effectiveness thinking throughout the ATO, to approximately 11 FTE in early 2013.
2013–14	As it transitioned to a corporate role incorporating the proposed establishment of an organisational evaluation capability, the CoE had 8.9 FTE.

Source: ANAO analysis of ATO data.

Business line staffing costs

2.31 As previously noted, for the transition to business as usual, the Compliance BSLs were not allocated additional resources for applying the CEM.⁶³ Compliance effectiveness is included in the BSLs' broader risk

⁶³ Some BSLs, such as Serious Non-Compliance, have been provided with additional specific Budget funding for certain risks such as Project Wickenby. Projects where the Compliance Group received specific Budget funding totalled \$117.192 million in 2009–10; \$314.49 million in 2010–11; \$465.769 million in 2011–12; \$598.767 million in 2012–13; and \$737.963 million in 2013–14. Some of this funding could have been applied to CEM-related projects.

management activities, and seen as a key function of risk managers, rather than as an additional role. The BSLs did not separately record the resources involved in CEM evaluations or contributing to the Compliance Effectiveness Leadership Forum and Community of Practice.

2.32 The levels of resourcing allocated to CEM activity between BSLs also vary depending on internal management resourcing decisions. In some BSLs, such as Tax Practitioner and Lodgment Strategy, the management and support of CEM activities has been centralised within a specialist team, whose sole responsibility is overseeing CEM related activities. Others, particularly smaller BSLs such as Resource Rent Tax, have limited resources and prioritise revenue-generating business as usual activities over the application of the CEM. As discussed further in Chapter 3, this has led to certain BSLs implementing and integrating the methodology more effectively than others.

2.33 As the ATO's systems do not specifically capture CEM costs and resourcing, for the purposes of the audit the ANAO estimated these costs for 2013–14 based on information provided by BSLs, as shown in Appendix 2.⁶⁴ This analysis indicates that costs differ widely between BSLs—from \$87 136 in Serious Non-Compliance to \$426 294 in Tax Practitioner and Lodgment Strategy. The total direct employee costs captured across the Compliance Group for CEM-related activities in 2013–14 were estimated at around \$1.8 million and total FTE staffing at around 14.

2.34 It would be helpful for the ATO to have a better understanding of the overall level of CEM resourcing, with a broad measure of costs being sufficient to inform ATO views and resource decisions.

Compliance effectiveness training and guidance

2.35 The ANAO examined whether there had been adequate training and guidance provided to staff to support the implementation of the CEM.

2.36 In the planning and implementation phase of the CEM Project, the project team was responsible for supporting BSLs in the management of priority risks, including skilling facilitators and providing evaluation support. As such, training was provided at an agency-wide level to help ensure that

64 The ANAO estimates are based on BSL advice of the approximate proportion of effort expended by each staff classification level on CEM-related activities in which they were involved. They include all direct employee costs in the relevant BSLs performing CEM-related activities in 2013–14. Indirect management and administration costs incurred within each of the relevant BSLs were excluded.

staff members in the facilitator role were familiar with the various phases of the CEM and how to apply these. Facilitators were then responsible for conducting two-day workshops to help risk managers: design compliance strategies that reflected the ATO's business intent; consider the desired compliance outcomes upfront; address the drivers of compliance behaviour; and, by using a range of indicators, measure compliance effectiveness.

2.37 A suite of products was also developed to provide workshop participants with further guidance and support. These included: a facilitator's guide; a measuring compliance effectiveness reference manual; and a compliance effectiveness indicators workbook. The project team also developed an *iLearn* package⁶⁵ and Compliance Effectiveness intranet page to introduce the methodology to risk managers.

2.38 Following the transition to business as usual, the CoE retained responsibility for the compliance effectiveness methodology, including learning and development related to the methodology. Other guidance material has been developed by the CoE during this later stage, including: a guidance product, *Measuring compliance effectiveness—Evaluating effectiveness* (which was also externally published); and a case study template in a one page format for presentation purposes.

2.39 The CoE has also incorporated effectiveness guidelines in corporate documents prepared for risk managers. These include: a suite of risk management templates; the ATO's corporate management practice statement and procedures; and an intermediate level training product, *Risk Management—Treat and Monitor*. It has also incorporated effectiveness content in project management templates.

2.40 The compliance effectiveness page on the ATO intranet contains links to guides and templates covering compliance effectiveness methodology, evaluation and strategy development. The CEM intranet material was substantially updated in 2013 to include a broader explanation of effectiveness in the ATO, reflecting the role of the CoE. There have also been relatively minor changes to the compliance effectiveness materials, including to implement the recommendations arising from the internal audit that was completed in 2013. To provide assurance that the ATO's training materials are

65 The *iLearn* package was designed to: provide an overview of the CEM and practical examples of how it is applied; explain the key features of compliance effectiveness; and identify some key roles and responsibilities for compliance effectiveness in the ATO.

effective in assisting risk managers and evaluators to apply the CEM, there would be merit in the ATO periodically evaluating the continued currency of the training material, in the light of experience with its use, and updating the material, as needed.

2.41 Training in compliance effectiveness is undertaken though the *iLearn* package, knowledge-sharing and on-the-job training at the BSL level. The Serious Non-Compliance BSL advised the ANAO that risk managers are expected to ‘drive the development of CEM’ and, as such, are viewed as being ‘aware of changes the Compliance Effectiveness Methodology may be indicating’. In this light, with the exception of the *iLearn* package and the intranet page, none of the BSLs delivered any additional formal training or guidance targeted at the roles and responsibilities of risk managers working on CEM. It is the view of some BSLs and risk managers that the methodology is best learnt on the job and that any further theoretical training is not necessary. The CoE has encouraged new starters to undertake the *iLearn* package and to consult the intranet page to gain a foundational understanding of CEM prior to commencing an evaluation. However this is not mandatory and is often left to the discretion of individual risk managers.

Monitoring training needs

2.42 Staff performance is managed in accordance with the ATO performance management system. Performance is formally reviewed bi-annually as part of performance development agreements, which include details of role statements and the ATO’s expectations of its staff. There would be merit in the ATO drawing together the results of these processes in relation to staff involved in the CEM, as inadequate skills has been identified as a potential barrier to the application of the CEM (see paragraph 5.10). This would assist the ATO to identify skills deficits in the use of the methodology and address these deficits.

Conclusion

2.43 Sound processes were in place to develop the CEM in 2006 and 2007, and arrangements to prepare for its implementation were also generally sound. In moving the CEM to business as usual from 1 July 2009, an extensive administrative framework was established, although there has been limited executive direction and management of the use of the effectiveness methodology.

2.44 The ATO adopted a decentralised approach to resourcing CEM activities. While this has allowed BSLs to allocate resources according to their requirements, the ATO has not recorded or monitored the level of resources devoted to CEM evaluations. Broadly measuring resources and costs would better inform CEM strategies and resource decisions.

2.45 In the initial business as usual phase, the ATO developed a comprehensive suite of training products and provided training to risk managers and facilitators. More recently CEM skills and knowledge have been mainly acquired through on-the-job training. In the light of identified evaluation skill shortages, there would be merit in the ATO assessing the effectiveness of its current support for CEM staff.

3. Conduct of Compliance Effectiveness Methodology Evaluations

This chapter examines the conduct of CEM evaluations within ATO Compliance business service lines.

Introduction

3.1 The CEM is designed to measure the effectiveness of ATO compliance activities in optimising voluntary compliance by taxpayers and building community confidence. Applying the methodology to conduct compliance effectiveness evaluations involves the ATO assessing the extent of positive and sustainable changes in the compliance behaviour of taxpayers, and evaluating whether these changes can be attributed to the ATO's compliance strategies.

Outline of the methodology and evaluation requirements

3.2 The CEM requires the completion of four phases by the eight Compliance BSLs.⁶⁶ Phases 1 and 2 require BSLs to reach agreement on the articulation of the risk, desired outcomes and proposed high-level strategies to improve voluntary compliance and/or community confidence. This agreement is generally obtained during a two-day workshop, including key internal stakeholders from within the BSLs and other areas of the ATO such as the Effectiveness CoE.

3.3 Phase 3 involves identifying success goals⁶⁷ and potential indicators and applying a series of business validation tests to ensure that they are viable. Potential indicators are approved by the risk owner. In Phase 4, the effectiveness of the compliance strategies in changing behaviour is evaluated. Until late 2013, this final phase was endorsed by the BSLs' risk management forum (or the BSL Executive), and presented for subsequent annual review.⁶⁸

66 The eight Compliance BSLs are: Aggressive Tax Planning; Private Groups and High Wealth Individuals; Public Groups and International; Serious Non-Compliance; Small Business/Individuals Taxpayers; Indirect Tax; Superannuation; and Tax Practitioners and Lodgment Strategy.

67 Success goals are linked to positive, sustainable changes in behavior and/or community confidence. An example of a success goal is sustained improvement in the population of late lodgers that lodge their returns by the due date.

68 In late 2013, risk management forums were abolished in most BSLs with their responsibilities transferring to BSL executives or steering committees.

3.4 Selected case studies and reports are presented at Compliance Executive meetings attended by Deputy Commissioners and the ATO's Second Commissioner for Compliance. As CEM reports are presented by risk managers to their BSLs' executives and risk management forums at different intervals during the CEM process, informal feedback on the reports is provided through these presentations and committees. CEM case summaries are also often provided to the Compliance Effectiveness Leadership Forum, which is also able to provide assurance and feedback.

3.5 Since 2008, the CEM has been applied to 80 compliance risks across the Compliance Group BSLs. The ANAO examined the:

- basis for selecting these risks for compliance effectiveness evaluations;
- key characteristics of the evaluations for each of these risks; and
- four phases of two completed CEM evaluations from each of the eight Compliance BSL in detail, to assess compliance with the ATO's documented policies and procedural guidelines.

Selection of risks subject to compliance effectiveness evaluations

3.6 The ATO's Enterprise Risk Management Framework defines risks by four levels:

- strategic risks are linked to the ATO's strategic planning and priorities;
- enterprise risks relate to a core or enabling business function or process;
- operational risks are a component or a part of an enterprise risk; and
- tactical risks are usually associated with localised events or activities such as transactions, incidents and cases.

3.7 As stated in CEM guidance, it is most appropriate to apply the CEM to high priority compliance risks, as changes in behaviour may take several years to take effect and monitor, and will require the commitment of resources over the immediate, intermediate and long terms to measure effectiveness.⁶⁹ The

69 The methodology can also be applied to other compliance risks to provide a higher degree of confidence that the ATO's interventions will be effective. ATO, *Measuring Compliance Effectiveness—Our Methodology*, p. 12.

ATO does not define the term 'priority' risk, although some priority risks have been set out in the annual compliance program.

3.8 In practice, the CEM has been applied to a large number of risks. As discussed earlier, since 2008 the CEM has been applied in varying degrees to 80 compliance risks across all the compliance BSLs through 114 different evaluations, as indicated in Table 3.1.

Table 3.1: Number of risks evaluated by BSL

BSL	No of risks	CEM evaluations by year					Total
		2008–09	2009–10	2010–11	2011–12	2012–13	
Aggressive Tax Planning	3	0	0	0	0	3	3
Indirect Tax	10	0	1	2	2	3	8
Private Groups and High Wealth Individuals	19	6	5	7	10	5	33
Public Groups and International	14	2	2	4	6	5	19
Small Business/ Individual Taxpayers	12	2	4	5	9	1	21
Serious Non-Compliance	4	0	1	1	3	0	5
Superannuation	8	2	2	2	7	5	18
Tax Practitioner and Lodgment Strategy	10	0	1	4	0	2	7
Total¹	80	12	16	25	37	24	114

Source: ANAO analysis of ATO information.

Note: 1. Some of these include lesser evaluations, such as updating figures in a previous report. Further, there are more evaluations than risks as some risks have been evaluated more than once.

3.9 The variation in the number of evaluations between BSLs can largely be attributed to the relative size of the BSL and the number of risks for which it is responsible.

3.10 Rather than being high priority, many of the risks originally selected for compliance effectiveness evaluation were at a lower level. The decisions to select risks were often made by BSLs' risk management committees or executives, in the absence of a clear strategy or guidance about the type of risks to be subject to CEM evaluations. Despite the lack of central guidance, to date

only three of the eight Compliance BSLs (Aggressive Tax Planning, Indirect Tax and Serious Non-Compliance) have provided their own guidance on how risks should be selected. Other BSLs, such as Private Groups and High Wealth Individuals, have acknowledged that past evaluation of minor risks was not an optimal use of resources and have subsequently revised the risks being evaluated.

3.11 Since the introduction of the Enterprise Risk Management Framework in 2012, the ATO's risks have been reassessed, with a number of risks being downgraded and removed, or being consolidated with other risks. Accordingly, many risks have been incorporated into higher-level risks for CEM evaluations. For example, Serious Non-Compliance has incorporated four of its risks into a single Tax Crime Risk. The ANAO considers this is a positive development as it means that more significant risks are being subject to CEM evaluations.

Frequency of CEM evaluations

3.12 There is no requirement for a BSL to conduct a CEM evaluation every year, or over any other specified period (such as every three years). It is a matter for the BSL to determine the frequency of evaluations based on its risk and strategy decisions. Consequently, the frequency of conducting compliance effectiveness evaluations has been variable.

3.13 The period between CEM evaluations for a particular risk may vary for a number of reasons, including changes in strategy, or availability of data. In the Private Groups and High Wealth Individuals BSL, CEM instructions for risk managers note there will be a lag between implementing new strategies and when the effects of those strategies will be realised. Because many factors can affect how quickly strategies will achieve results, evaluators need to have regard to these lags when developing indicators and evaluating the effectiveness of compliance strategies.

Analysis of all risks evaluated

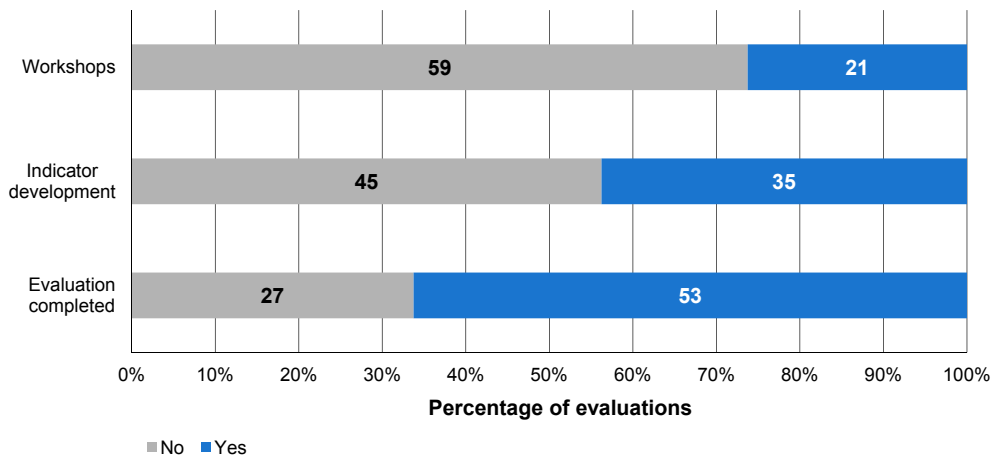
3.14 As identified in the ATO's project brief in February 2012, one of the risks to the successful implementation of the CEM is that major elements of the methodology will not be fully and consistently applied. In this context, the ANAO assessed the 80 risks subject to CEM evaluations for evidence of the following three major elements of the methodology: workshops had been

undertaken; indicators were developed; and evaluations completed.⁷⁰ These stages represent the major phases in a CEM evaluation:

- workshops—an important risk evaluation and alignment process that allow for input from others across the BSL and the ATO;
- indicator development—the design and validation of the indicators is integral to the successful evaluation of the effectiveness of the compliance strategies; and
- evaluation—CEM results are to be defensible and reported in sufficient detail and clarity to inform planning and strategy decisions.

3.15 Details of these elements and the results of the ANAO analysis are shown at Figure 3.1.

Figure 3.1: Evidence of conduct of key elements of the CEM, 2008 to 2013



Source: ANAO analysis.

3.16 The results of this analysis indicate that these key elements of the methodology were not always applied, particularly the workshopping component. The analysis also highlighted problems with record keeping, as some BSLs could provide only limited CEM documentation. The areas with centralised CEM units were more aware of the status of CEM work and had

⁷⁰ Each BSL was requested to provide documentation that indicated that these elements had been conducted, the analysis undertaken and the findings and recommendations of the evaluations. Where a risk had been evaluated more than once, the ANAO examined the most recent evaluation.

information available. The ATO advised that staff turnover and changing IT systems meant some documentation was hard to find or not available. The results also demonstrate the fragmented approach to CEM evaluations across BSLs and over time, with little central oversight.

3.17 It is important that the ATO retains documentation that is readily accessible to support the CEM evaluations. The results from CEM evaluations should inform ATO risk and compliance processes, and records of the methodology, analysis and results are critical to the conduct of subsequent evaluations of the same risks, to assess changes in compliance effectiveness over time.

Analysis of 16 completed CEM evaluations

3.18 The ANAO selected 16 CEM evaluations, two from each BSL, for further detailed examination. These are outlined in Table 3.2.

Table 3.2: CEM evaluations selected for ANAO review

BSL	CEM title	Date of evaluation ¹
Aggressive Tax Planning	Inflated donation scheme	2012
	Aggressive tax planning	2013
Indirect Tax	GST—working to improve voluntary compliance program	2013
	Wine equalisation tax	2009
Public Groups and International	Losses	2012
	Transfer pricing	2010
Small Business/Individual Taxpayers	Income tax return integrity	2012
	Internationals	2012
Private Groups and High Wealth Individuals	Capital gains tax	2012
	Fringe benefits tax	2012
Serious Non Compliance	Tax crime	2013
	Project Wickenby	2012
Superannuation	Super guarantee	2013
	Self managed super fund (SMSF) illegal early release schemes	2011
Tax Practitioner and Lodgment Strategy	Lodgment risk at the macro level	2013
	Small business benchmark project	2013

Source: ANAO analysis.

Note: 1. Date of the evaluation examined by the ANAO.

3.19 The selected evaluations had each completed all four phases of the methodology and were finalised between 2009 and 2013. Each evaluation was tested against key CEM requirements for the four phases: risk articulation;

defining outcomes and strategies; developing success goals and indicators; and evaluation and reporting of results.

Phase 1: Articulate risk

3.20 Phase 1 of the methodology is to understand and articulate the compliance risk, making sure it aligns with the ATO's intent to 'optimise voluntary compliance and make payments under the law in a way that builds community confidence.' This phase commences after the risk has been identified, quantified and prioritised through the corporate risk management framework. Phase 1 can be conducted concurrently with the risk assessment in the Enterprise Risk Management Framework (ERMF). The outputs of Phase 1 should be included in the ERMF risk assessment documentation. While many risks may have the same definition in the ERMF and CEM, separate exercises are expected to be conducted.

3.21 The ANAO examined whether each of the 16 evaluations had documented the response to key articulations required during this phase. As shown in Table 3.3, most evaluations had addressed the key aspects of the methodology for Phase 1.

Table 3.3: ANAO sample—meeting key requirements for Phase 1: articulate risk

Key criteria	Met criteria	
	Number	(%)
The ATO Outcome in the <i>Strategic Statement 2010–15</i> is translated into the risk context.	13	81
The compliance risk to achieving the intent is identified.	14	87
The risk population is defined.	16	100
The behaviours and drivers of the risk are identified.	15	94

Source: ANAO analysis of 16 completed compliance effectiveness evaluations from eight BSLs.

3.22 For several evaluations, the ATO could not provide documentation to support the workshops and discussions conducted in completing Phase 1. In those cases where the CEM documentation had been completed, the report could be up to 100 pages. ATO staff advised the ANAO that this was a deterrent to completing the template, as was the lack of mandatory requirements for its use. Accordingly, there would be merit in the ATO streamlining the documentation for evaluators and mandating the use of templates. Streamlining could involve referencing the risk identification

activities conducted under the ERMF, to avoid duplication of existing knowledge and clearly identifying where the CEM processes have improved the articulation of risks.⁷¹

Phase 2: Define outcomes and develop strategies

3.23 The intent of Phase 2 is to express the expected outcomes from addressing the risk in measureable terms, and identify an appropriate mix of strategies to treat the drivers of the non-compliance, and not just the observed behaviours. The ANAO examined final reports for evidence of consideration of the key elements of this phase—expected outcomes, defined success goals, identified target groups and treatment strategies. Table 3.4 summarises the results of the ANAO’s analysis.

Table 3.4: ANAO sample—meeting key requirements for Phase 2: define outcomes

Key criteria	Met criteria	
	Number	(%)
Outcomes to be achieved by addressing the risk are articulated.	16	100
Success goals are defined.	16	100
The target groups, and what drives their behaviours, are related to the strategies used to achieve the success goals.	16	100
Potential unintended consequences have been identified and/or planned for.	13	81

Source: ANAO analysis of 16 completed compliance effectiveness evaluations from eight BSLs.

3.24 In each of the 16 evaluations analysed, there was evidence of discussions to articulate the desired outcomes, define success goals and relate the strategies to achieve the success goals to the outcomes. However, in three evaluations there was no record of the evaluators considering potential unintended consequences.

3.25 Under the CEM guidelines, strategies can be evaluated retrospectively or prospectively. That is, evaluations can either measure the effectiveness of existing compliance strategies or determine new strategies—and measure them after sufficient time has elapsed to assess the impacts on compliance

71 In discussions with ATO evaluators from different BSLs, it was evident that some entered into extensive discussion in workshops to articulate risks while others had a much briefer assessment of whether the risk defined in the ERMF was appropriate.

behaviours and outcomes. Of the 16 evaluations, all focussed on the effectiveness of strategies already in place to mitigate the risk articulated, rather than attempting to develop new strategies, as provided for in the CEM guidance. In this light, CEM guidance could suggest that the development of strategies in Phase 2 is required only on an exceptions basis, where it is evident that existing strategies are ineffective.⁷²

Phase 3: Design indicators

3.26 Phase 3 involves designing and testing the viability of indicators to measure the extent of effectiveness. Indicators are to be aligned to success goals. The ATO considers that conclusions as to the extent of effectiveness will not be definitive, because it is difficult to reach a conclusive statement about causal relationships between compliance activities and the results produced. Accordingly, the methodology uses a suite of indicators which is intended to ‘paint a defensible picture’ of effectiveness.⁷³

3.27 Initially, a range of potential indicators are to be designed without considering whether or how they can be measured. The list is then narrowed to those indicators that together can paint a defensible picture. The ATO applies the SMART (Specific, Measurable, Achievable, Relevant and Timed) test in formulating and validating indicators.

3.28 The ATO has provided guidance to its staff on designing indicators in a number of guides, including through practical examples. The ANAO assessed key aspects of the indicators that are emphasised in the CEM guidance for developing indicators (Table 3.5).

72 The ATO advised that it usually discourages retrospective application of the CEM.

73 ATO, *Measuring Compliance Effectiveness, Our Methodology*, p. 15.

Table 3.5: ANAO sample—meeting key requirements for Phase 3: design indicators

Key criteria	Met criteria	
	Number	(%)
Indicators are proposed for each success goal.	15	94
Indicator wordings are as per guideline.	15	94
SMART test has been applied to each indicator.	5	30
Time period has been articulated for the indicators.	5	30
Indicator strength analysed (whether the indicator was strong or weak).	7	44

Source: ANAO analysis of 16 completed compliance effectiveness evaluations from eight BSLs.

3.29 While indicators were proposed for each success goal, a relatively small proportion of the evaluations had analysed the indicators using the SMART test, determined the strength of the indicators, or articulated a time period as required by the CEM guidelines.

3.30 CEM guidance further advises that once a set of potential indicators has been identified, it is necessary to test each indicator to validate whether it will provide the information that is expected.⁷⁴ The lack of indicator analysis by evaluators identified in the ANAO sample reduces the level of assurance that the indicators will provide the expected information.⁷⁵ There would be merit in the ATO reaffirming to evaluators the need to test and validate indicators in future CEM evaluations.

Assessing if indicators are relevant, reliable and complete

3.31 The ANAO analysed indicators developed for the selected CEM evaluations based on the criteria developed for an ANAO pilot project to evaluate key performance indicators (KPIs).⁷⁶ These criteria assess whether each individual indicator is relevant and reliable, and an overall assessment of the extent to which the set of indicators is complete.

⁷⁴ ATO, *Measuring compliance effectiveness, evaluating effectiveness*, p. 9.

⁷⁵ Many of the indicators are longstanding, accepted benchmarks within the ATO (for example, rates of on-time lodgment of a defined population such as small and medium enterprises, monitored and reported by the Tax Practitioner and Lodgment Strategy BSL over a number of years).

⁷⁶ ANAO Audit Report No.28 2012–13, *The Australian Government Measurement and Reporting Framework*; and ANAO Audit Report No.21 2013–14, *Pilot Project to Audit Key Performance Indicators*.

3.32 While these assessment criteria (outlined in Table 3.6) were developed specifically for assessing key performance indicators under the Australian Government Outcomes and Programs Framework, they are also applicable to the CEM indicators. This methodology shares many characteristics of the SMART criteria, and represents an equivalent analysis for the purpose of assessing the accuracy and completeness of CEM indicators. Previous ANAO analysis of performance indicators was based on the SMART criteria, but this approach was modified in the KPI pilot project to promote consistency with existing auditing and assurance standards and the experiences of other jurisdictions (such as the United Kingdom, Canada, New Zealand and Western Australia).

Table 3.6: Criteria for assessing indicators

	Criteria	Characteristics	Explanation
Individual Assessment	Relevant Relevant indicators contribute to conclusions that assist users' decision making.	Focused The indicators should address a significant aspect of the compliance strategies in effectively addressing the identified risks.	The indicators should assist significantly in informing whether the compliance strategies are effectively addressing the identified risks.
		Understandable The indicators should provide sufficient information in a clear and concise manner.	The indicators should be stated in plain English and signal the impacts of compliance activities to inform users.
	Reliable Reliable indicators allow for reasonably consistent assessment of a program.	Measurable The indicators should be quantified (allowing for results to show trends when measured over time).	The indicators should be capable of being measured to demonstrate the effectiveness of the compliance strategies.
		Free from bias The indicators should be free from bias, and where possible, benchmarked against similar activities.	The indicators should allow for clear interpretation of results.
Overall Assessment	Complete A set of indicators that allow for the overall assessment of a program to inform users' decision making.	Balanced The set of indicators should provide a balanced examination of the overall performance story, both quantitatively and qualitatively.	The set of indicators should provide an overall picture of the impact of the compliance strategies in addressing the identified risks.
		Collective The set of indicators should be representative of the desired outcomes.	The set of indicators should demonstrate the extent of achievement in addressing the identified compliance risks.

Source: ANAO Audit Report No.21 2013–14, *Pilot Project to Audit Key Performance Indicators*, p. 41.

3.33 The results of the ANAO's analysis of the sampled evaluations are set out in Table 3.7. While each set of indicators was assessed as being relevant and reliable, many of the individual indicators did not meet some of the characteristics of these criteria.

Table 3.7: Relevance and reliability of indicators

	Relevant				Reliable			
	Focused		Understandable		Measurable		Free from bias	
CEM title	✓ ⁽¹⁾	✗	✓	✗	✓	✗	✓	✗
Inflated donation scheme	8	–	7	1	8	–	8	–
Aggressive tax planning	12	1	12	1	13	–	12	1
GST—working to improve voluntary compliance program	12	2	13	1	14	–	12	2
Wine equalisation tax	8	–	8	–	8	–	8	–
Losses	9	4	13	–	13	–	12	1
Transfer pricing	12	1	12	1	13	–	12	1
Income tax return integrity project	5	–	5	–	5	–	5	–
Internationals	14	1	15	–	15	–	13	2
Capital gains tax	12	–	12	–	12	–	12	–
Fringe benefits tax	9	1	10	–	9	1	9	1
Tax crime	7	1	8	–	6	2	6	2
Project Wickenby	23	3	26	–	24	2	23	3
Super guarantee	7	3	10	–	10	–	10	–
SMSF illegal early release schemes	8	–	8	–	8	–	8	–
Lodgment risk at the macro level	17	–	17	–	17	–	17	–
Small business benchmark project	17	–	16	1	17	–	17	–
Total	180	17	192	5	192	5	184	13

Source: ANAO analysis of 16 completed compliance effectiveness evaluations from eight BSLs.

Note: (1) ✓ = met, or met some, of the criteria; ✗ = did not meet the criteria.

Relevant

3.34 In assessing the indicators against the ‘relevant’ criterion, the ANAO considered whether they were appropriately focused on significant aspects of the program outcomes (relevant success goal) and easily understandable. Of the 197 indicators, 17 were assessed as not focussed and five as not understandable.⁷⁷ Of those assessed as not focussed, the ANAO found one evaluation where the three indicators were not linked to the success goal⁷⁸ and seven evaluations where the indicators were too broad to significantly inform the success goals.⁷⁹

Reliable

3.35 In assessing the indicators against the ‘reliable’ criterion, the ANAO considered whether they were measurable, and if the results reported against the KPIs could be consistently interpreted by users (free from bias). Of the 197 indicators, five were considered not measureable and 13 not free from bias.

3.36 Indicators should be capable of being measured in order to effectively demonstrate entity performance. Measurable indicators also allow data to clearly show trends when measured over time, for example ‘trend in the number of superannuation illegal early release’. Examples of indicators not meeting the measurable criterion included ‘changes in the operating environment’ and ‘change in protection of investor funds’. Further, in line with CEM guidance, the indicators were routinely worded with a neutral description such as ‘trend in’, even if the desired direction of the trend is clear, at least over the longer term, such as ‘decrease in the number of superannuation illegal early release’. While there will always be some exceptions, it would assist the consistent interpretation of results in the final evaluation if the indicators included an anticipated direction of a trend—generally either an increase or decrease. The ATO advised that, while the existing workbook could be clearer on this point, the supporting indicator documentation should include information about expected changes.

77 For example, the following two indicators were not considered understandable: ‘Trends in commercial realism and documentation ratings’; and ‘Change in recidivism for known treated participants’.

78 The Superannuation Guarantee indicators of community confidence that the ATO is monitoring and maintaining compliance with Superannuation (discussed in paragraph 3.42, second dot point).

79 Examples of indicators that were too broad include: ‘Level of engagement with external advisory bodies’; and ‘Assessment of the ATO’s understanding of the stock of tax losses carried forward’.

3.37 Some indicators were considered not to be free from bias because they relied on existing ATO qualitative assessments, anecdotal evidence or media information. Examples of such indicators were: ‘change in serious evasion risk management processes’ and ‘trend in the evidence of exploitation of grey areas of the law and the number of legislative amendments to clarify existing grey areas’.

Completeness

3.38 Indicators, viewed as a set, should enable an overall assessment of the effectiveness of strategies, demonstrating the characteristics of ‘balanced’ and ‘collective’. Completeness is demonstrated through a mixture of qualitative and quantitative measures to provide an overall performance story, and measures which are collectively representative of the desired outcomes. Completeness of the assessed evaluations are outlined in Table 3.8.

Table 3.8: Completeness of indicators

CEM title	Complete	
	Balanced	Collective
Inflated donation scheme	✓	✓
Aggressive tax planning	✓	✓
Wine equalisation tax	✓	✓
Transfer pricing	✓	✓
Income tax return integrity project	✓	✓
Capital gains tax	✓	✓
Tax crime	✓	✓
Project Wickenby	✓	✓
Lodgment risk at the macro level	✓	✓
Small business benchmark project	✓	✓
GST—working to improve voluntary compliance program	✗	✗
Internationals	✗	✗
Losses	✗	✗
Fringe benefits tax	✗	✗
SMSF illegal early release schemes	✗	✗
Super guarantee	✗	✗
Total assessed as complete set of indicators	10	10

Source: ANAO analysis of 16 completed compliance evaluations from eight BSLs.

Note: ✓ = met, or met some, of the criteria; ✗ = did not meet the criteria.

3.39 Of the 16 sets of indicators, the ANAO found that for 10 evaluations the set of indicators was complete and could be used to assess whether existing compliance strategies were effectively addressing the identified compliance risks.

3.40 The more complete sets of indicators were clearly linked to specific success goals, desired outcomes and compliance strategies, and typically covered:

- voluntary compliance, through indicators such as effective tax rates⁸⁰, levels of voluntary disclosures⁸¹ and compliance dividends⁸²;
- the extent of non-compliance, through indicators drawing on broader economic and / or financial data;
- implications for overall compliance of the results of risk identification processes and active compliance activities;
- measures of community satisfaction (through surveys); and
- relevant deliverables (or outputs), such as lodgment rates, liabilities raised and cash collected.

3.41 Three examples of sets of indicators that had many of these attributes of completeness are outlined in Figure 3.2 for Project Wickenby, Lodgment and Transfer Pricing.

80 The effective tax rate is the average rate at which an individual's earned income is taxed. It is calculated by dividing total tax expense by taxable income.

81 A voluntary disclosure is when a taxpayer informs the ATO about a false or misleading statement they have made or a change that increases their tax or reduces their credits—without prompting, persuasion or compulsion by the ATO.

82 The compliance dividend measures the change in tax return data for individual active compliance cases that have generated outcomes post audit, and compares these taxpayers to their peers to determine whether there has been a change in compliance behaviour.

Figure 3.2 Examples of complete sets of indicators

Examples: Project Wickenby, Lodgment and Transfer Pricing

Project Wickenby

The indicators covered most of the main categories outlined in paragraph 3.40. This included levels of voluntary disclosures, compliance dividends, results of community perceptions surveys, trends in detection, and output measures such as trends in convictions and the severity of judicial sentences. To measure non-compliance, there was an indicator of financial flows into and out of tax havens based on AUSTRAC data, and an indicator of voluntary disclosure rates for regions considered of higher risk of non-compliance.

Lodgment

Lodgment risk is the failure of taxpayers, tax professionals and the community to understand and meet their lodgment obligations leading to deterioration in the administration of the tax, superannuation, welfare and transfer systems. This risk was conducive to measuring effectiveness, as it was a 'closed system' in that the population of lodgers was known from registrations data, and accordingly extensive quantitative data was available. Of primary importance were the on-time lodgment rates of the major defined populations, with the data drawn from the ATO's data warehouse. There were also indicators relating to tax practitioner performance (a key group), and results from surveys about perceptions of lodgment requirements and performance. The indicator relating to changes in the risk rating of a tax agent subsequent to an ATO specific contact would be useful if evaluated independently/objectively and in sufficient detail to demonstrate the rationale for any change in rating.

The indicator development process followed all major requirements set out in the CEM guidelines, such as assessment of the indicators, including strength, setting a baseline year, and identification of data requirements.

Transfer Pricing

This is an area of considerable difficulty to estimate the extent of non-compliant behaviour. Nevertheless, considerable efforts were made to measure non-compliance with transfer pricing obligations, and the ATO's Economist Practice was involved in developing indicators to compare trends over time in economic, tax and financial performance of entities. Indicators also measured client engagement through seeking rulings and the like, entering into advance pricing agreements, and outcomes from transfer pricing court cases.

There was extensive discussion of indicators at a workshop, which were subsequently subject to the SMART test and analysis of strength. A baseline was set in the 2009 analysis for comparison in later years (2011 to date).

Source: ANAO analysis.

3.42 For the six evaluations assessed as incomplete:

- Self managed super fund (SMSF) Illegal Early Release—indicators were designed to measure the ATO's ability to detect and remove SMSFs that were established for the purpose of illegal early release. However there

were no indicators to assess the non-compliant population of SMSFs that were not detected by the current methods.

- Superannuation guarantee—indicators chosen to measure the success goal ‘community confidence that the ATO is monitoring and maintaining compliance with Superannuation Guarantee obligations’ instead related to trends in the case completion cycle, finalisation of complaint cases, debt raised, collected and transferred—and had little or no direct connection with the success goal.
- Fringe benefits tax—indicators covered taxpayers who had lodged a fringe benefits tax return, and so provided a picture of those taxpayers who were already compliant to some extent, but there was no attempt to define the non-compliant population.
- Aggressive tax planning—indicators were aligned to known avoidance arrangements and promoters and their compliance behaviour following treatment by the ATO. They were not complete as they did not include an examination of active compliance activities acted on by other BSLs in relation to scheme participants or attempt to define the non-compliant population.⁸³
- Losses—had a complete set of indicators to measure activities for the taxpayers who lodge, whether on time and/or accurately, but no indicators to measure the non-compliant population.
- GST—working to improve voluntary compliance program—indicators were not balanced as they did not examine whether the ATO had made it easier for taxpayers to comply, or why taxpayers were making mistakes in completing the program.
- Internationals (Small Business/Income Tax)—the ATO was unable to provide specific details of the indicators used in the CEM evaluation.

3.43 Overall, the main limitations to completeness of the indicators in the 16 evaluations were incorporating the level of non-compliant behaviour, and to a lesser extent the implications of active compliance activities for voluntary compliance.

83 The Aggressive Tax Planning BSL advised it will be aiming to include these in future evaluations.

3.44 Measuring the extent of non-compliance requires information to indicate the magnitude of the non-compliant taxpayer population and the revenue at risk. CEM guidance provides examples of indicators that can be developed for this purpose, such as randomised control trials.⁸⁴ In the 16 sets of indicators analysed, no such indicators were developed through the CEM process⁸⁵, which overwhelmingly relied on existing indicators, particularly those used for risk assessment and internal reporting purposes. Examples of these included the fringe benefits tax evaluation, which made use of lodgment indicators, and the income tax return integrity evaluation, which made use of strike rates and administrative penalties. To provide a complete picture of the level and pattern of non-compliance in the taxpayer population as a whole, it is important that future CEM evaluations include indicators addressing the non-compliant population and revenue at risk.

3.45 Results of active compliance activities can provide useful information about the effectiveness of compliance strategies and treatments, including risk identification and assessment and case selection outcomes, if analysed appropriately. Some 13 evaluations contained indicators relating to the success of active compliance activities, such as strike rates⁸⁶ and return on investment.⁸⁷ However, no evaluations included indicators of the distribution of results from active compliance activities.⁸⁸ To provide a complete picture of effectiveness, there would be merit in the evaluations including more indicators of active compliance results, with the subsequent analysis drawing out implications for risk identification, case selection and active compliance strategies.

84 In a randomised control trial, taxpayers are randomly selected from the population and separated into a target group and a control group. According to the example in the CEM guidance, the target group is used to test the effectiveness of an advisory letter on their compliance behavior. The control group is isolated from the treatment. The difference in behavior between the group is then used as an indicator of the effectiveness of the strategy.

85 One BSL had investigated the use of randomised control trials. Tax Practitioner and Lodgment Strategy examined this for the Small Business Benchmarks Project but rejected this approach because it was unable to quarantine control groups that were unaware of publicity regarding the project.

86 A 'strike' case is recorded where a financial outcome was reached from an active compliance activity (generally an audit). The strike rate is: total 'strike' audit cases divided by total audit cases.

87 Return on investment is generally obtained by dividing the total amount of liability raised (but not necessarily collected) through particular compliance work by the average salary of the compliance staff involved in that work.

88 For example, audits of a particular taxpayer population in a financial year may have moderate strike rates and return on investment, providing little useful information about compliance. However, further analysis of the distribution of results from these audits may indicate a large number of small financial outcomes and a small number of large outcomes, suggesting that most of the population is compliant but a need for better targeting of risk identification and case selection processes.

Phase 4: Prepare evaluation report

3.46 The final step in a CEM evaluation is the interpretation, documentation and reporting of the findings in a way that informs decision makers about the effectiveness of compliance activities in mitigating the risks of non-compliance. The presentation of a report is the main means of communicating the CEM outcome; accordingly, the report needs to present information in a way that is easy to understand. CEM guidance recommends a detailed report is prepared, along with an executive summary for conciseness.

3.47 The BSLs have generally used two methods for preparing the final report—a detailed final report with analysis of all indicators or a case summary. Of the 16 evaluations analysed: nine had a detailed final report; while seven only used a case summary format.

Detailed final report

3.48 The methodology requires the preparation of a detailed report to include evidence that supports the evaluator's conclusions. The report should include:

- analysis of results for each indicator;
- discussion of the evidence supporting the conclusion; and
- whether the suite of evidence demonstrates the extent of any claimed effectiveness.

3.49 The ANAO examined whether each of the 16 evaluations had documented the response to each criteria. For the purpose of its analysis, the ANAO treated the seven case summaries as final reports. As shown in Table 3.9, the evaluations varied on the detail and level of conclusions made.

Table 3.9: ANAO sample—meeting key requirements for Phase 4: prepare report

Key criteria	Met criteria	
	Number	(%)
Each success goal has been analysed.	14	88
For each success goal there is an analysis of each indicator, and evaluation of the suite of indicators.	13	81
The report addresses:		
• overall picture of effectiveness;	15	94
• sustainability of changes or strategies;	5	31
• analysis and articulation of attribution of effectiveness;	14	88
• evaluation of any unintended consequences; and	2	13
• lessons learnt.	13	81

Source: ANAO analysis of 16 completed compliance effectiveness evaluations from eight BSLs.

3.50 Those reports that addressed the key aspects of the evaluations included many of the summaries; although there was little evidence provided by the BSLs to support analysis and to demonstrate the extent to which these factors had been considered from those evaluations.

3.51 The actual evaluation conclusions reached—and whether they were based on sufficient evidence and drew reasonable conclusions—are discussed in Chapter 4.

Case summaries

3.52 Case summaries have become the normal method of reporting to the Compliance Executive Meeting, together with a presentation by the risk manager. The summaries provide an outline of the four phases of CEM and are presented in an A3 format. They are appropriate as a summary but do not provide the detail required for further validation and clarification of findings. Without such detail, readers are unable to question the data and come to their own conclusions.

3.53 Some BSLs have adapted the concept of case summaries but also include a more detailed, but not full, report. For example, Tax Practitioner and Lodgment Strategy (TPALS) now produces for ‘Lodgment risk’ a five page

case summary that provides more detail for each indicator.⁸⁹ Small Business/Individual Taxpayers has revised the case summary to focus more on the results of the evaluation (Phase 4 rather than the earlier phases). While these presentation formats are easy to read and provide a picture of the phases, they do not give sufficient detail to provide assurance or allow for independent verification.

Quality assurance

3.54 The CEM Guide for risk managers and evaluators recommends that, to increase the quality of conclusions, evaluators should involve the right people throughout the process. Then, as a final step, the claims of effectiveness should be independently verified to ensure the conclusions are soundly based.⁹⁰

3.55 There is no formal ATO-wide quality assurance process for CEM evaluations. In practice, the CoE provides assurance regarding the application of the methodology, while the Economist Practice and Revenue Analysis Branch provide technical assurance, for example in relation to measurement issues. The CoE developed a template to test CEM case summaries for alignment with the methodology and offered a voluntary quasi quality assurance process.⁹¹ The Compliance Effectiveness Leadership Forum is intended to review all CEM case studies prior to them being presented to the Compliance Executive, although this practice has not been universally followed. Additionally, there are informal links between risk managers and other staff working on CEM. The Community of Practice also plays a role in the sharing of CEM knowledge and some ATO staff said it was a useful forum because they could exchange ideas and experience with others doing the same work.

3.56 There would be merit in the ATO taking a more formal approach to CEM quality assurance. Such an approach would help to identify where implementation of the methodology could be improved and provide assurance that it is being applied according to approved procedures.

89 TPALS advised that the five page summary provides greater detail for third parties. It also prepares a full evaluation report for the risk manager, which is only further circulated if required.

90 ATO, *Measuring compliance effectiveness: Evaluating effectiveness*, p. 23.

91 The CoE developed the test sheet but there is some confusion among BSLs whether it was an official quality assurance process.

Conclusion

3.57 The ATO has developed and disseminated guidance to support the conduct of compliance effectiveness evaluations. It is the BSLs' responsibility to decide the particular approaches taken, and there have been substantial differences between BSLs in the extent to which they followed this guidance. Generally, the CEM evaluations have extended existing risk assessments, rather than developed new approaches to measuring the overall effectiveness of compliance strategies.

3.58 Many Compliance BSLs have recognised that evaluations have been applied to too many lower priority risks, and are now focusing on more significant risks. Of the 80 compliance risks that have been subject to a CEM evaluation, in 62 cases at least one key aspect of the methodology (workshops, indicator development or preparation of a final report) either was not undertaken or documented. Appropriately documenting the evaluations will inform future evaluations of the same or similar risks, enable trends to be analysed and aid in the overall evaluation of the CEM program.

3.59 Detailed analysis of 16 completed compliance effectiveness evaluations found that Phases 1 and 2 were generally conducted in line with the key requirements of the CEM guidance. The ATO considers this has significantly improved the articulation of compliance risks and their alignment to the ATO's strategic intent. However, it would be prudent for these two phases to draw on existing risk processes undertaken through the ERMF, with major additional work conducted on an exceptions basis, where risks have changed or compliance strategies in place are known to be ineffective. Reports prepared under Phase 4 contained most required elements, although there was little evidence of analysis supporting the findings where only a summary report was prepared.

3.60 In developing indicators, all 16 evaluations incorporated indicators that were relevant and reliable in painting a defensible picture of the effectiveness of existing compliance strategies. However, six of the evaluations were assessed as not being complete, mainly because they did not contain sets of indicators that adequately addressed the extent of non-compliance or the results of active compliance activities. Further, the validity of the indicators was not systematically tested in most of the evaluations, as required by the CEM guidelines.

Recommendation No.1

3.61 To improve the conduct and usefulness of compliance effectiveness evaluations, the ANAO recommends that the ATO institutes a more strategic approach to selecting the compliance risks to be evaluated, and reaffirms to evaluators the importance of undertaking and recording key elements of the methodology, particularly testing and validating effectiveness indicators.

ATO response: *Agreed.*

4. Outcomes of Compliance Effectiveness Methodology Evaluations

This chapter examines the outcomes of CEM evaluations conducted in Compliance BSLs, including using the results to strengthen compliance strategies. External reporting of the CEM evaluations is also examined.

Introduction

4.1 The ATO established the CEM to demonstrate that its compliance strategies are helping to optimise voluntary compliance in a way that builds community confidence in the administration of the taxation and superannuation systems. As stated in the ATO publication outlining the measurement of compliance effectiveness, the methodology was seen to be an invaluable tool for improving: compliance and treatment strategies; resource allocation; and accountability to government and the community.⁹²

4.2 The ANAO examined whether the CEM has met these objectives. In undertaking this analysis, the ANAO reviewed:

- a sample of 16 CEM evaluations conducted by the ATO, to determine if the conclusions reached were supported by adequate evidence and reasoning;⁹³ and
- the use of CEM evaluations, to determine if the results have been used to strengthen compliance strategies, treatment and resourcing arrangements, and reported externally.

Soundness of the 16 CEM evaluation conclusions

4.3 The goal of CEM evaluations is to assess the effectiveness of ATO strategies to address compliance risks, attributing any change in compliance behaviour between ATO activities and external factors. Effectiveness is the extent to which the actual outcomes of activities align with the desired

92 ATO, *Measuring Compliance Effectiveness—Our Methodology*, p. 3. Available from <<http://www.ato.gov.au/About-ATO/About-us/In-detail/Key-documents/Measuring-compliance-effectiveness—our-methodology/>> [accessed 13 January 2014].

93 The ANAO examined the conclusions of the 16 selected CEM evaluations discussed in Chapter 3 as the basis for this analysis.

outcomes. Conclusions of CEM evaluations are to be defensible rather than definitive, and so use a range of indicators.

4.4 The ANAO examined whether the conclusions of the 16 compliance effectiveness evaluations were defensible (Table 4.1).

Table 4.1: ANAO assessment of CEM evaluation conclusions

CEM title	ATO conclusion of effectiveness	ANAO assessment of whether the conclusion is defensible
Inflated donation scheme	Positive	Yes: For the one identified scheme, the indicators demonstrated that success goals were being met, and accordingly voluntary compliance was optimised.
Project Wickenby	Positive	Yes: The conclusion was based on sufficient evidence of having met the success goals, which comprised a complete set of indicators.
Tax crime	Positive	Yes: The conclusion was also based on sufficient evidence of having met a complete set of indicators.
Lodgment risk	Positive	Yes: Many quantitative indicators painted the picture that compliance strategies were effective for the defined population that lodge. However, there was no assessment on non-registrants.
Transfer pricing	Positive	Yes: The conclusion was that considerable effort had been made to estimate the level of non-compliance in a challenging environment, and there was no basis for not maintaining compliance strategies.
Small business benchmark project	Positive	Yes: The conclusion painted a defensible picture for the specific risk (whether small businesses may be avoiding paying tax on cash payments as indicated by ATO benchmarks).
Income tax return integrity	Positive	Yes: There was sound analysis of a comprehensive set of indicators, although there could have been stronger linkages to compliance behaviour changes.
Capital gains tax	Negative	Yes: The conclusion of ineffective strategies was based on evidence that identified compliance threats were not being mitigated.
Fringe benefits tax	Negative	Yes: The conclusion was based on identified compliance threats in the known population that were not being effectively addressed.
Super guarantee	Positive	No: The evidence provided in the final report did not clearly justify the conclusion of effective compliance strategies, partly because the indicators were incomplete.
Wine equalisation tax	Positive	No: The evidence provided in the final report did not clearly justify the conclusion of effective compliance strategies.

CEM title	ATO conclusion of effectiveness	ANAO assessment of whether the conclusion is defensible
GST—working to improve voluntary compliance program	Positive	No: The evaluation contained extensive quantitative data and analysis but there were insufficient linkages to the compliance strategies to justify the conclusion.
Aggressive tax planning	Positive	No: There was insufficient information from the indicators to form a defensible conclusion about the success goals, including that there were no links to the active compliance strategies employed.
Internationals	Positive	No: The conclusion was drawn in the absence of analysis of the results of active compliance strategies and activities.
Losses	Positive	No: While the conclusion supported the specified success goals, these did not adequately cover the non-compliant population.
SMSF illegal early release schemes	Positive	No: The conclusion also supported the specified success goals but there was insufficient analysis of potential non-compliance.

Source: ANAO analysis of 16 completed compliance effectiveness evaluations from eight BSLs.

4.5 Of the 16 evaluations, 14 had positive conclusions about the effectiveness of ATO strategies to address the particular compliance risks. The two evaluations with negative conclusions about effectiveness—capital gains tax and fringe benefits tax—clearly identified threats that were not being effectively addressed by the existing ATO strategies.

4.6 Overall, the ANAO assessed that nine of the 16 conclusions were defensible, as the picture of effectiveness (seven positive, two negative) was justified by the evidence collected, analysis undertaken and reasoning used. Of the seven that were assessed as not being defensible, the main reasons were:

- a lack of data or analysis to support the conclusions (super guarantee, wine equalisation tax);
- insufficient coverage of the non-compliant population (losses, SMSF illegal early release schemes); and
- minimal, or no, attribution of the results to the ATO compliance activities (GST—working to improve voluntary compliance program, aggressive tax planning, internationals).

Defensibility of conclusions

4.7 The ATO's guide for risk managers and evaluators emphasises the importance of the suite of indicators providing⁹⁴:

- sufficient evidence to justify conclusions regarding the extent of effectiveness; and
- a picture strong enough to withstand scrutiny and challenge.

Sufficiency of evidence

4.8 One of the two evaluations (super guarantee, as discussed in Chapter 3) that the ANAO assessed as lacking data to support the conclusions had incomplete sets of indicators.⁹⁵ This lack of data contributed to insufficient evidence being available for evaluators to form a defensible conclusion about the effectiveness of compliance strategies. The final report of the wine equalisation tax evaluation was presented in summary form, and contained limited evidence of the basis for reaching the conclusion that compliance strategies were effective.

4.9 There was a tendency of the evaluations examined to conclude that compliance strategies were effective, even where there was a reasonable degree of uncertainty about the completeness of the indicators used. However, a number of evaluations either acknowledged the difficulty in reaching a conclusion (income tax return integrity) or attempted to ascribe some order of magnitude to the measurement problems, and concluded accordingly (transfer pricing).

Insufficient coverage of the non-compliant population

4.10 The ANAO also identified four evaluations that did not sufficiently address the potential size, nature or characteristics of the non-compliant population. In three instances, this compromised the capacity to reach a defensible positive conclusion (losses, SMSF illegal early release schemes, and wine equalisation tax). However, the fringe benefits tax evaluation, which was based on the known population, concluded that existing compliance strategies were not effective. This was a defensible conclusion. These results highlight the

94 ATO, *Measuring compliance effectiveness: Evaluating effectiveness*, available from <<http://www.ato.gov.au/uploadedFiles/Content/ATP/downloads/COR25789n73580.pdf>> [accessed 19 March 2014].

95 In this evaluation, there was insufficient information to inform a success goal—'community confidence that the ATO is monitoring and maintaining employers' superannuation guarantee obligations'.

importance of analysing the non-compliant taxpayer population as part of compliance effectiveness evaluations.

Attributing results to ATO compliance activities

4.11 Attribution of changes in taxpayer behaviour or community confidence to the ATO's compliance activities is necessary; otherwise there can be no assurance that the ATO's activities have made any contribution to outcomes. As the ATO guide for risk managers and evaluators states: 'Identifying a change in compliance behaviour or community confidence does not necessarily mean that your compliance strategies caused that change.'⁹⁶ CEM guides for staff provide examples of methods for measuring indicators that can increase the ability to attribute changes to ATO activities. These include how to identify a change using baselines, and identifying and analysing trends with methods such as: pre and post studies; longitudinal studies; and measuring against standards.⁹⁷

4.12 Indirect Tax BSL uses these methods in its evaluations and has provided advice to other BSLs on the subject. For example, in the 'GST—working to improve voluntary compliance program' evaluation, Indirect Tax used the pre and post treatment method to assess the change in timeliness and lodgment of Business Activity Statements post treatment, finding:

... overall lodgment increased from 26.7% to 80.3% after the case is completed. But then the overall lodgment for this population then decreases over the next six months to around 55%.

4.13 While Indirect Tax has applied a number of the ATO's more detailed recommended methods of assessing effectiveness, its evaluation results still lack clear attribution to strategies employed. An example is the indicator 'change in the average number of Business Activity Statement periods adjusted per case, in refund fraud cases involving multiple activity statements'. Within the final report of the GST—working to improve voluntary compliance program evaluation, there is no consideration of reasons why compliance strategies caused the change in observed outcomes. Similarly, conclusions of the aggressive tax planning and internationals evaluations were drawn with

96 ATO, *Measuring compliance effectiveness: Evaluating effectiveness*, p. 14.

97 Pre and post studies assess changes as a result of an intervention. A longitudinal study involves repeated observations of a specific set of participants over a period of time. A standard is a reference point (for example, percentage of on-time lodgments) against which compliance behavior or community confidence can be measured. In these cases, there is no comparison with a control group.

minimal or no reference to the implications of active compliance strategies and activities.⁹⁸

Additional issues to consider in evaluations

4.14 According to CEM guidance, an important part of the design of potential indicators is the capacity to measure the sustainability of changes, ripple effect and unintended consequences.⁹⁹ The ATO's internal guide for risk managers proposes that these three components should be included in the evaluation and presented in the final report. There is little evidence of the 16 evaluations including these criteria as outlined in Table 4.2.

Table 4.2: Evaluation of sustainability, ripple effect, and unintended consequences

Criteria	Yes	(%)
Sustainability of changes or strategies	5	31
Evaluation of any ripple effect	0	0
Evaluation of any unintended consequences	2	13

Source: ANAO analysis.

4.15 Where any of these three components were mentioned in evaluations, they received cursory attention. Given the lack of meaningful analysis of sustainability of changes, the ripple effect and unintended consequences, there would be merit in the ATO reconsidering its expectations about these factors and providing appropriate guidance.

4.16 A November 2011 internal review of the CEM concluded that the inconsistent conduct of evaluations was partly due to dispersed evaluation capability across the BSLs and the lack of data analysts. Subsequently, the ATO has focused on ways to develop and support its evaluation capability, including bringing together the people, processes and systems required for

98 For example, the aggressive tax planning evaluation did not include an examination of active compliance activities acted on by other BSLs (as discussed in paragraph 3.42).

99 Ripple effects are the impacts of compliance strategies beyond the immediate target groups, and should be examined to provide a balanced evaluation of the impacts of a compliance activity. An example of an unintended consequence is a risk that shifts as a result of compliance strategies and affects other aspects of the target groups' compliance behaviour, or the compliance behaviour of taxpayers outside the target groups. Sustainable changes are those that will be ongoing over time: ATO, *Measuring compliance effectiveness: Applying our methodology*, August 2008, available from <https://www.ato.gov.au/Print-publications/Measuring-compliance-effectiveness---Applying-our-methodology/> [accessed 28 May 2014].

ATO program level evaluation. This work was intended to improve the quality and consistency of compliance effectiveness evaluations.

Conclusion

4.17 Nine of the 16 evaluations examined by the ANAO reached defensible conclusions. These conclusions typically had reliable, relevant and complete indicators, and the evaluation reports or other documentation provided evidence of detailed analysis and sound judgements when measuring the indicators against the success goals.

4.18 Of the 14 conclusions that were positive, seven were assessed as not defensible. Five of these evaluations had incomplete sets of indicators (largely because they did not adequately address the non-compliant population or active compliance results), and two did not have sufficient evidence of the analysis undertaken to reach the conclusion.

4.19 To reach conclusions that can withstand scrutiny and challenge, evaluators need to develop complete sets of indicators, undertake (and document) analysis of those indicators, and apply sound judgement. In many cases, this would involve addressing data inadequacies and/or ensuring attribution of the results to the ATO compliance activities. The ATO has recognised that evaluation capacity is thinly dispersed across BSLs and is taking steps to build a robust evaluation capability. In conjunction with this work, it is important that the ATO encourages risk managers and evaluators to address the deficiencies in applying the CEM.

Use of CEM outcomes to achieve program objectives

4.20 As previously noted, the CEM is designed as a tool to assist in compliance planning and to enable the ATO to demonstrate to government and the community that it is providing value for money in the administration of the taxation and superannuation systems. The ATO defines effective compliance strategies as those that enable it to optimise voluntary compliance and build community confidence in the administration of these systems.

4.21 As mentioned in paragraph 4.1, the CEM is intended to improve the ATO's compliance and treatment strategies, resource allocation and external accountability. These objectives were, in essence, outlined in the original CEM report released in 2008. While subsequent CEM documentation has not indicated that these goals have changed, they have been subject to little subsequent validation or reinforcement.

Compliance strategies and treatments

4.22 The use of CEM evaluations to improve compliance strategies and treatments depends on the extent to which they have identified scope to improve effectiveness and proposed new compliance strategies and treatments or modifications to existing arrangements. If proposals for improvement have been made, they need to be considered and acted upon as appropriate. This requires integrating the CEM into ATO corporate processes, particularly the ATO's Enterprise Risk Management Framework (ERMF), including product Health of the System Assessments (HoTSAs) and BSL risk processes, including risk management forums.

Proposed improvements to compliance strategies and treatments

4.23 The ANAO analysed the extent to which completed evaluations had found compliance strategies to be effective. As outlined in Figure 3.1, the ATO was able to provide evidence of a final report in 53 of the 80 completed evaluations of compliance risks. Of those, 50 had recorded a conclusion, of which 46 were positive, one was neutral, and three were negative—that is, concluding that the existing compliance strategies were not effectively addressing compliance risks. Overall, nearly all conclusions were that existing compliance strategies were effective, and accordingly there was no need for proposals to substantially change these strategies or treatments.

4.24 To examine proposals for improved compliance strategies and treatments in more detail, the ANAO examined the sample of 16 evaluations from the eight BSLs. Of these, only four had recorded suggested changes to compliance strategies and treatments, either as part of the final evaluation report or in associated documentation. The nature of the suggestions was mixed: from a quite substantial but broad proposal to 're-think our compliance strategy'; to more specific but narrower proposals to 'develop an education strategy' and target compliance activities at a particular type of taxpayer, to more moderate proposed changes to 'monitor those involved in this scheme'. A notable exception was the fringe benefits tax (FBT) evaluation completed in 2011. This evaluation influenced the Government's decision to amend the legislation applying to the FBT living away from home allowance, effective from 1 July 2012, to limit access to the tax exemption and strengthen the substantiation requirements. Overall, this analysis indicated that most evaluations did not propose changes to compliance strategies or treatments. Those that did propose changes were mixed, with most proposals being in response to negative findings against individual indicators.

4.25 Further, CEM guidance advocates that initial CEM evaluations establish baselines of performance for comparison with subsequent evaluations of the same risk. Part of the process is to determine whether the strategies proposed in the prior evaluations have more effectively addressed compliance risks. In this regard, there was no documented record in the 16 evaluations examined of the impact on compliance effectiveness of strategies proposed in prior evaluations. While this may be because of the lack of documentation supporting the evaluations, future evaluations would benefit from documenting the link in the current evaluations to past changes in strategies.

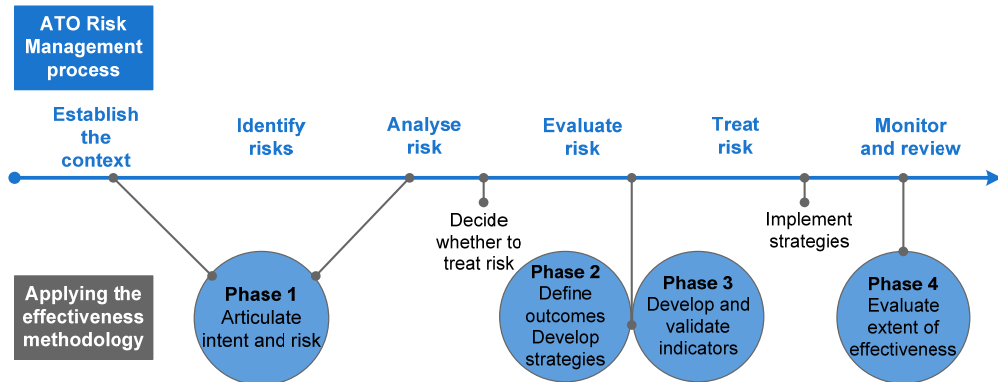
Integration of the CEM into ATO risk management processes

4.26 The ATO's current Enterprise Risk Management Framework (ERMF), introduced in 2012, provides a foundation for risk management in the ATO. It outlines the risks being faced by the ATO as a whole, rather than the risks being managed by individual BSLs, and encourages different areas of the organisation to work together to manage risks. This framework enables the ATO to prioritise compliance work by informing decisions about the appropriate tax compliance risks to address and the resource commitment required for each risk.¹⁰⁰

4.27 The alignment of the CEM phases with the ATO's risk management process (and particularly assessing and mitigating risks in the ERMF) is illustrated in Figure 4.1. However, as discussed earlier in this chapter and in Chapter 3, BSLs have different approaches to the conduct of CEM evaluations and consequent approach to risk management.

100 The framework identifies 22 different categories of risk. These categories focus on the following four key areas: tax and superannuation administration; stakeholder engagement; enabling capabilities; and other business.

Figure 4.1: Alignment of ATO risk management process and the CEM



Source: ANAO adaptation of the application of the CEM.

4.28 Effectively integrating the CEM into corporate risk management processes would have involved:

- establishing processes to record the risks being evaluated, and taking steps to monitor progress against them; and
- passing the outputs of CEM evaluations, particularly changes to compliance strategies and activities, through the BSLs' risk management forums to the BSLs' risk registers.

4.29 The Compliance Group has maintained a listing of risks under compliance effectiveness evaluation. In November 2011, the CoE, in collaboration with the Compliance Effectiveness Leadership Forum, prepared a three-year work program. In addition, either the CoE or an area within the Compliance Group could have maintained an agency-wide CEM risk register to monitor and review the risk mitigation strategies arising from the evaluations. This could have formed the basis for a consolidated view of risks, showing the assessment of risks through the CEM and supporting an aggregated view of compliance effectiveness throughout the agency and better practice risk management. However, no such register was created.

4.30 As noted in paragraph 4.24, the ANAO's examination of a sample of 16 evaluations found little evidence that CEM evaluations proposed changes to compliance strategies and activities. Further, an examination of BSL risk management forum minutes reveals little evidence that the forums have used

CEM outcomes to update the BSLs' risk registers, although this process may have occurred informally.¹⁰¹

Health of the System Assessments

4.31 Every year, each BSL is required to prepare a Health of the System Assessment (HoTSA) that addresses its major areas of risk, establishes plans to manage those risks within anticipated funding levels and justifies how these positions were reached. Resources are allocated according to these risk assessments. The quality of a HoTSA report depends largely on the information supplied by the management committees for each of the product lines, market sectors and specialist units within the Compliance Group.

4.32 The ANAO examined 12 HoTSA reports for 2013.¹⁰² Of these, eight reports were in a summarised, presentational style. While these reports focused on key issues, they did not make any reference to the CEM despite its important role in the ATO's risk and compliance framework. Of the four other reports¹⁰³, three made mention of the CEM (with Superannuation providing the most detailed treatment) and one did not. In some cases, there was a considerable amount of detail provided and it was evident that the CEM had been extensively used to help inform work regarding the product line.¹⁰⁴

BSL risk management arrangements

4.33 As discussed in Chapter 2, risk management arrangements in BSLs have generally involved risk management teams, led by a risk manager, working through risk management forums to the risk owner, who is an SES officer in the BSL. Until late 2013 when most were abolished, BSL risk management forums had an important role in the CEM process—to mandate risks to be measured, set the schedule of evaluation, review each of the four phases, approve indicators and consider effectiveness reports. Subsequently,

101 The ANAO asked the eight Compliance BSLs to identify and provide minutes of risk management forum meetings where the CEM was discussed.

102 The 2013 HoTSAs were GST Revenue Product, Wine Equalisation Tax, Income Tax, Internationals, Capital Gains Tax, Aggressive Tax Planning, Fringe Benefits Tax, Losses, Tax Practitioner and Lodgment Strategy, IT Tax Crime, Tax Practitioner and Lodgment Strategy Cash Economy, and Superannuation Revenue.

103 The Superannuation, Goods and Services Tax, and Excise product lines and the cash economy.

104 Eight HoTSAs for earlier years were also examined. These were: 2009 (Superannuation Revenue Product), 2009–10 (Small and Medium Enterprises Income Tax), 2010 (Trusts, Micro-enterprises Income Tax), 2011–12 (GST Revenue Product), 2012 (Micro-enterprises Market Segment); 2012–13 (GST Revenue Product); and 2013–14 (Excise Product). Of these, five made mention of the CEM and three did not, although these reports did include comments on compliance effectiveness.

this responsibility has generally been allocated directly to the risk owner—the BSL Executive.

4.34 Irrespective of the existence of risk forums, compliance effectiveness evaluations have been conducted by staff from risk management teams in most Compliance BSLs. These teams also have prime responsibility for developing compliance strategies and treatments. While it would be expected that risk managers (and centralised CEM teams where they exist) would have considered the findings of CEM evaluations in the development of compliance strategies and treatments, there was little documentation of this occurring.

Use of CEM results to inform compliance strategies and treatments

4.35 As mentioned in paragraph 4.30, the ANAO examined the risk management forum meeting minutes for the eight Compliance BSLs. These minutes did not reflect discussions regarding the 16 CEMs examined by the ATO.

4.36 While there may have been shortcomings in attributing revised strategies and treatments to CEM evaluations, most evaluations did not propose substantial changes to these arrangements, and those proposed would often have been identified through standard risk processes. Accordingly, there would have been a limited number of occasions where CEM results have led to notable changes to compliance strategies and treatments.

Resource allocations and decisions

4.37 The 2008 *Measuring Compliance Effectiveness—Our Methodology* publication stated that one of the objectives of the CEM is to improve the allocation of resources for compliance purposes.¹⁰⁵ As discussed in Chapter 2, the ATO does not monitor CEM resourcing at an organisational level and (apart from the CoE) charges BSLs with the responsibility to allocate and deploy resources for compliance purposes. Moreover, as discussed above, there is little evidence of the CEM evaluations being used to revise compliance strategies and treatments, let alone resourcing decisions.

4.38 In practice, in many BSLs, a great deal of reliance is placed on risk managers to assess their own effectiveness. While risk managers are

¹⁰⁵ ATO, *Measuring Compliance Effectiveness—Our Methodology*, p. 3. Available from <<http://www.ato.gov.au/About-ATO/About-us/In-detail/Key-documents/Measuring-compliance-effectiveness—our-methodology/>> [accessed 13 January 2014].

encouraged to seek outside input from specialists and from areas such as the Community of Practice, these specialist resources are not always available as they are subject to competing demands. Accordingly, there would be benefit in the ATO examining ways of providing additional external evaluation and technical (for example, statistical) resources to risk managers undertaking CEM exercises.¹⁰⁶ Also, the ATO should document resourcing decisions resulting from CEM evaluations so that it can assess whether the CEM is being used to help allocate resources efficiently.

External reporting of CEM results

4.39 The ATO has long recognised the need to report on the effectiveness of its activities, and at the outset of the CEM program envisaged that it would be an invaluable tool for improving accountability to government and the community.¹⁰⁷ Particularly since 2011–12, the ATO has undertaken external reporting of its compliance effectiveness—the main publications used have been the Commissioner of Taxation annual reports, ATO website, and Compliance Program (most recently titled *Compliance in focus*).

Annual reports

4.40 Each year the Commissioner of Taxation is required to prepare a report to be presented, through the Assistant Treasurer, to Parliament. Recent Commissioner of Taxation annual reports have made some mention of compliance effectiveness, as outlined in Table 4.3.

¹⁰⁶ The Indirect Tax BSL advised the ANAO it had already engaged externals to provide advice on specialised technical matters.

¹⁰⁷ ATO, *Measuring Compliance Effectiveness—Our Methodology*, p. 3. Available from <<http://www.ato.gov.au/About-ATO/About-us/In-detail/Key-documents/Measuring-compliance-effectiveness—our-methodology/>> [accessed 13 January 2014].

Table 4.3: Reporting of CEM evaluations in Commissioner of Taxation annual reports from 2010–11 to 2012–13

Year	Level of reporting on CEM
2010–11	Compliance effectiveness measures suggest that the indirect impacts of compliance were generally higher than the direct results.
2011–12	<p>A number of sections make reference to effectiveness work (CEM evaluations and tax gap analyses):</p> <ul style="list-style-type: none"> • Lodgment and registration—were ‘tracking reasonably well’; • Information matching—those who were sent a letter were more likely to be compliant next period; • Goods and Services Tax—gap estimation was conducted; • Goods and Services Tax—taxpayers who have had their activity statements amended subsequently report a higher level of net GST; • Luxury Car Tax—the ATO was refining its work on a gap analysis; and • Fringe Benefits Tax—the changes to the living away from home allowance legislation was identified during CEM.
2012–13	The Key Documents section directs the reader to visit ato.gov.au for more information on <i>Effectiveness Stories</i> .

Source: ANAO analysis of Commissioner of Taxation Annual Reports.

ATO website

4.41 In October 2013 the ATO published eight ‘stories’ in the ‘Our effectiveness’ section of the ATO website, www.ato.gov.au, in order to ‘show the public about the impacts of ATO activities toward improving voluntary compliance’.¹⁰⁸

4.42 These stories were the only public reporting of CEM evaluation results in 2013–14. The ANAO examined the five compliance effectiveness stories, assessing the extent to which results of CEM evaluations have been appropriately and accurately reported. The results are summarised in Table 4.4.

¹⁰⁸ The eight stories were: ABR: towards a better business future; Digital delivery: changing how we communicate; Dispute resolution pilot; GST audits lead to sustained compliance; Helping taxpayers to report correctly; Improving integrity of income tax refunds; Sustaining voluntary compliance with PAYG withholding; and Upholding integrity of GST refunds. The ANAO did not examine: ABR; Digital delivery; and Dispute resolution pilot because they were not explicitly compliance focused.

Table 4.4: Effectiveness stories on the ATO website

'Our effectiveness stories'	Evidence in CEM evaluations
GST audits lead to sustained compliance <i>To ensure sustained compliance behaviour by previously non-compliant taxpayers, it is important to understand the flow-on effects of audit activities.</i>	Consistent with CEM evaluation
Improving integrity of income tax refunds <i>We pay continual attention to the refinement of our risk-assessment strategies and in the past year, we have seen a decrease in the number of returns held for review and action.</i>	Consistent with CEM evaluation
Sustaining voluntary compliance with PAYG withholding <i>To help us measure our effectiveness, we monitor all audited employers and detect those who repeat non-compliance within two years of an audit.</i>	Consistent with CEM evaluation
Upholding integrity of GST refunds <i>Revenue collected from the GST helps fund services for the Australian community, which is why safeguarding the GST revenue base and ensuring the integrity of refunds is so important.</i>	No CEM evaluation, but figures updated
Helping taxpayers to report correctly <i>Experience tells us that assisting and encouraging taxpayers to comply with their tax obligations early is much more effective than enforcing compliance later.</i>	No CEM evaluation

Source: ANAO analysis of documents provided by ATO.

4.43 Three of the five effectiveness stories were of risks recently subject to compliance evaluations, and were reported consistent with the findings of those evaluations. The other two stories were based on information from other sources (and not examined by the ANAO). While there is no requirement for compliance effectiveness stories to be based on a CEM evaluation, these evaluations could provide a prime source of information for these stories as they would have been extensively documented and scrutinised.

Compliance in focus

4.44 Each year the ATO publishes a description of the areas of compliance focus for the next year. They are published to set out what the ATO is doing to manage the risks to, and maintain the integrity of, Australia's taxation and superannuation systems for the next 12 months.

4.45 The recent annual compliance publications contained coverage of compliance effectiveness, as follows:

- In 2011–12, the ATO included a description of the effectiveness of Project Wickenby in addressing the risk of tax secrecy jurisdictions.

While the ATO also included (as an appendix) a snapshot of its 2010–11 compliance activities, this was a summary of deliverables or outputs, rather than effectiveness measures.

- In 2012–13, the compliance program included detail of the effectiveness for each of the areas: registering in the system; lodging on time; reporting correctly; and superannuation. Many of the points covered results of compliance activities but there was also some commentary on effectiveness.
- The 2013–14 publication did not mention compliance effectiveness.

Participation indicators

4.46 Separately, in 2008 the ATO developed and began to collect data on a suite of indicators called ‘Participation in the System Indicators’. These indicators were developed on the proposition that the level of participation in the system is a good indicator of the level of compliance with tax obligations generally, and that the level of compliance is an obvious measure of the effectiveness of a revenue authority. These indicators use a combination of tax, economic and demographic data to measure participation levels in relation to the four ‘pillars of compliance’ of the OECD. These are: correctly registering in the system; lodging tax information on time; reporting complete and accurate information; and paying tax obligations on time.¹⁰⁹

Measurement against objectives

4.47 The ANAO has assessed whether the CEM has met the objectives indicated at the outset of the program, to improve: compliance strategies (decision making and planning); treatment strategies; resource allocation; and accountability to government. As the CEM evaluations have largely confirmed the effectiveness of existing strategies, they generally have not contributed to notable changes to compliance strategies, treatments and resourcing. Rather, there have been relatively minor proposals to change strategies, generally in response to the results of particular indicators. There was little documentation of whether these changes had been implemented, and their impact, in BSL risk processes or in subsequent compliance evaluations. The CEM program has

109 Commissioner of Taxation Michael D’Ascenzo, Speech to CEDA Trustees Roundtable, Measure for measure: The four pillars of compliance.

also not notably improved reporting to government and the community about the effectiveness of the ATO's compliance strategies.

4.48 In making this assessment, the ANAO has drawn on various reviews conducted by the ATO of the CEM program, particularly the November 2011 review and November 2012 blueprint for embedding effectiveness thinking (discussed in Chapter 5). While these reviews were useful in monitoring and reporting performance of measuring compliance in the ATO, and in planning changes to embed the CEM more broadly in ATO corporate processes and throughout the office, they did not explicitly evaluate the program against its objectives. This would have been expected of a program review, particularly of an effectiveness measurement program.

Aggregation of results

4.49 The CEM was established as a 'bottom-up' approach to measuring compliance effectiveness,¹¹⁰ based on the results of the evaluation of priority risks conducted by Compliance BSLs. This is in contrast to tax gap and other high-level analysis (such as participation indicators), which are top-down measures of the effectiveness of the ATO to collect the revenue payable if all taxpayers complied with all their tax obligations. Ideally, the two contrasting approaches should be used together in some way to form a high-level ATO view of its effectiveness.

4.50 One way that the CEM evaluations could have been used together with the 'top-down' approaches was if the evaluations were aggregated in a meaningful way to reflect the extent to which the office is effectively addressing all its priority compliance risks, and optimising voluntary compliance. The ATO has considered this intent for the CEM program, noting in an internal document that it was aiming to provide 'an integrated view of the effectiveness of its compliance strategies that tells a clear story of how the ATO is changing behaviour.'

4.51 However, the CEM has not been established in a way that would enable the ATO to readily aggregate CEM results. No process has been established to determine which risks should be evaluated and how they would be aggregated. Nor does the ATO have support systems in place, such as a

110 ATO, *Measuring Compliance Effectiveness—Our Methodology*, available from <http://www.ato.gov.au/About-ATO/About-us/In-detail/Key-documents/Measuring-compliance-effectiveness—our-methodology/> [accessed 13 January 2014].

centralised database of CEMs or a library of indicators, to enable a more integrated approach.¹¹¹ There would be merit in the ATO focusing on its high-priority risks and aggregating the results of CEM evaluations of these, and improving the compilation and storage of information required to aggregate results. Taking these steps would supplement the ATO's top down approach to CEM and could be considered by the ATO in conjunction with a more systematic approach to measuring tax gaps, which it has undertaken to consider by later this year.¹¹²

Conclusion

4.52 Nearly all CEM evaluations conducted by the ATO have concluded that compliance strategies in place were effectively addressing compliance risks. Accordingly, the evaluations have not been a prompt for the ATO to propose significant changes to compliance strategies and treatments. Instead, proposals were generally for minor changes to existing arrangements.

4.53 From detailed analysis of 14 positive CEM conclusions, the ANAO assessed that half were not defensible. This was largely because the indicators were not sufficiently complete and the analysis not extensive enough in considering the non-compliant population and attributing findings to compliance strategies, particularly active compliance interventions. Extending the indicators and analysis in these areas will improve the likelihood of the evaluations proposing notable changes to compliance strategies and treatments. Such proposals are likely to be considered for implementation by BSL risk teams and executives, as they are part of similar processes and often undertaken by the same staff. However, there is scope to better embed the CEM in higher level risk processes, particularly the HoTSA.

4.54 Further, before the ATO is able to assess whether there has been a change in compliance behaviour, it is necessary to establish baselines of performance for comparison with subsequent evaluations. As the establishment of baselines has not been documented, the CEM has not been able to measure the extent to which strategies developed since prior evaluations have more effectively addressed compliance risks.

111 The ATO advised there had been attempts to create a central repository but technology problems meant they were unworkable. The TPALS BSL advised it has developed an indicator repository database that could be adapted for ATO-wide use.

112 Hansard, House of Representatives Standing Committee on Tax and Revenue, *Australian Taxation Office Annual Report 2012–13*, 28 February 2014, p. 3.

4.55 The results of some CEM evaluations have been reported in key external publications such as the annual report and the ATO website as examples or case studies of ‘effectiveness stories’. However, these have not significantly improved the reporting of compliance effectiveness to the community or the government, which may help improve confidence in the ATO’s effectiveness, and there has been no meaningful aggregation of these evaluations. Such aggregation could be used together with more systematic use of top-down measures such as the tax-gap, which the ATO is currently considering.

Recommendation No.2

4.56 To improve the conduct of compliance effectiveness evaluations and their use in enhancing compliance strategies, treatments and external reporting, the ANAO recommends that the ATO:

- (a) strengthens the overall standard and completeness of evaluations,
- (b) uses the evaluations more extensively to improve compliance strategies and resource decisions, and
- (c) considers how to consolidate the results of these evaluations in reporting to the Parliament and community about the effectiveness of the ATO’s compliance approaches.

ATO response: *Agreed.*

5. Embedding Effectiveness Thinking in the Australian Taxation Office

This chapter examines the ATO's Evaluating Compliance Effectiveness project and Embedding Effectiveness Thinking work program.

Introduction

5.1 In late 2011, the ATO conducted a review of the implementation of the CEM in the Compliance Group and found that, due to a number of factors, the methodology had not been fully implemented.¹¹³ In January 2012, the ATO commenced the Evaluating Compliance Effectiveness project. Subsequently, in November 2012 the ATO designed and started implementing a program of work—the Embedding Effectiveness Thinking work program—to extend the understanding and use of effectiveness concepts and techniques throughout the agency.¹¹⁴ At that time, the ATO Executive noted that the work being undertaken in relation to the CEM would help ‘to broaden our thinking around what we need to do to get better outcomes for government and the community’. This was consistent with the ATO’s decision in August 2007 that a corporate approach should be taken to the implementation of the CEM and that it should not be restricted to the Compliance Group.

5.2 The ANAO examined the ATO’s implementation of the Evaluating Compliance Effectiveness project and Embedding Effectiveness Thinking work program, and the follow-up action taken, to determine whether:

- the project and work program were being implemented effectively; and
- the extent to which effectiveness thinking has still to be embedded within the organisation.

113 The review found that the ATO had made significant progress, but also made a number of recommendations to improve the application of the methodology.

114 At the November 2012 meeting, the ATO Executive Committee described Embedding Effectiveness Thinking as a ‘program of work’, which implied that the initiative was to be implemented as business as usual.

The project and work program

Implementing the project and work program

5.3 The main steps taken by the ATO following the 2011 review of the CEM to develop strategies for improving effectiveness evaluation and embedding effectiveness thinking throughout the agency are summarised in Table 5.1.

Table 5.1: Steps taken by the ATO to implement the project and work program

Date	Step	Description
November 2011	Compliance Executive Meeting submission	The submission stated that while there were good effectiveness stories, the ATO did not always identify the full impact of compliance activities and its evaluations were not always carried through for the necessary period. The Compliance Executive Meeting endorsed a desired future state and forward work program.
January-February 2012	Concept and project briefs for 'Evaluating compliance effectiveness'	In January 2012, the ATO held a workshop and developed a concept brief. In February 2012 a project brief was developed. The project brief identified many of the key problems facing the CEM and noted that each BSL had some reservations about its implementation of the CEM.
February 2012	Engagement of national program managers	The Second Commissioner Compliance wrote to ATO national program managers seeking support for the work he was sponsoring to develop a more cohesive and holistic story on the extent to which the ATO's activities were changing compliance behaviour. The work was in two phases: Phase 1—developing a draft framework for approval by the Compliance Executive; then Phase 2—further development through a Corporate Design Forum in mid-2012.

Date	Step	Description
March-April 2012	'Evaluating compliance effectiveness' project registered and endorsed	<p><i>Evaluating the effectiveness of our compliance activities</i> was registered as a Tier 3 project (the minimum level of governance and control for an ATO project). The project outline stated that a key objective of the project was to enable the ATO to tell a compelling compliance effectiveness story, which it would deliver through the annual report and compliance program (known as <i>Compliance in focus</i> since 2013-14). It aimed to do this by:</p> <ul style="list-style-type: none"> designing and building the compliance effectiveness model; embedding the compliance effectiveness model within corporate planning, governance and risk management systems; delivering an integrated and holistic effectiveness story; and understanding current and required skills and developing a more sustainable evaluation and research capability. <p>The estimated total project cost was \$426 368. In April 2012, the project was formally endorsed by the project sponsor, Deputy Commissioner, Aggressive Tax Planning.</p>
August 2012	Corporate Design Forum held and blueprint work program developed	A Corporate Design Forum was held to discuss the intent for embedding effectiveness thinking into 'business as usual' operations. The Corporate Design Forum developed a draft high-level intent statement. This stated that effectiveness thinking needed to be embedded in the ATO's main corporate policies and frameworks.
September 2012	Core design team established	A core design team was established to develop the proposed design (blueprint) for delivering the agreed intent.
October 2012	Intent statement endorsed	The high-level intent statement was endorsed by the ATO Executive.
November 2012	Final blueprint	A final blueprint and roadmap was noted by the ATO Executive.
December 2012	Steering Committee established	The ATO established the Embedding ATO Effectiveness Steering Committee.

Source: ANAO analysis of ATO data.

Proposed project outcomes and deliverables

5.4 As part of its decision in November 2011, the Compliance Executive endorsed an approach to embed compliance effectiveness across the Group. Among the desired outcomes were that:

- principles of compliance effectiveness are integral (not stand alone) to the broader risk management framework, and are embedded into key frameworks, policies and products;
- stronger governance and assurance processes are in place that ensure CEM is being applied appropriately (for example, the right risks at the right level) and evaluation is carried through to the extent necessary and iterative across the Compliance Group (discussed in paragraph 2.21); and
- a clear picture exists of compliance effectiveness across the ATO including an integrated view of the effectiveness of the ATO's compliance strategies that tells a clear story of how the ATO is changing behaviour.

5.5 The deliverables included building a consolidated view of risks undergoing compliance effectiveness measurement to provide stakeholders with a comprehensive view of effectiveness across the ATO, and for high-level governance.¹¹⁵

5.6 The project brief contained an outcome and some success goals, which were to be measured by conducting a stock-take of risks, a review of case studies and publication of effectiveness stories in the annual report and other corporate documents. The brief contained one project risk, relating to succession planning for the project team. Neither the project brief nor the project outline referred to the consolidated view of risks that the Compliance Executive had endorsed in November 2011. This would have assisted in obtaining a whole-of-ATO view of effectiveness and delivering an integrated and holistic effectiveness story.

5.7 The project team did not consider and address some of the risks which materialised during the original implementation of the CEM, such as lack of

¹¹⁵ The project brief prepared in February 2012 stated: 'Whilst we broadly measure the areas of macro participation and community perception, we do not currently have a clear view that aggregates this information to provide an overall picture from which to evaluate and report on our effectiveness.'

high-level oversight and direction, and inconsistent application of the methodology. Nor did the team gain the views of external experts, such as the peak tax professional bodies, tax academics and evaluation specialists, despite an objective of the CEM being to communicate the ATO's effectiveness to persons outside the ATO.

5.8 The project closure report, prepared in December 2012, embodied the results of a post implementation review. The report reinforced the need to embed effectiveness broadly across the ATO, and not just within the Compliance Group. It noted some key highlights, including that, in 2012 the ATO had produced several effectiveness stories, and had also improved KPIs for inclusion in the 2013–14 Portfolio Budget Statements. It also noted some learnings, for example that it was unclear which BSLs were responsible for the 'registration' and 'correct reporting' elements of compliance, and that best practice was important in document version control. There would have been benefits to the ATO if the review had been more comprehensive and had considered, for example, whether the risks mentioned in paragraph 5.7 had been appropriately addressed and were now being managed.

Blueprint for embedding effectiveness thinking

5.9 As previously discussed, the blueprint was noted by the ATO Executive in November 2012. It assessed some sample outputs of the ATO's planning and reporting processes against effectiveness criteria and found that, in general, the ATO provided little effectiveness information, and minimal guidance on how to evaluate effectiveness.

5.10 The blueprint contained some hypotheses regarding key barriers to embedding effectiveness thinking in the ATO, including:

- lack of compelling external drivers—external perceptions of the ATO's effectiveness focus on revenue and output measures;
- corporate intent—a perception that the ATO does not value effectiveness thinking;
- no corporate requirement—there is no clearly articulated requirement to apply effectiveness thinking to risk management or other natural systems;
- organisational culture—staff not having the motivation to apply effectiveness thinking;

- no data—staff undertaking effectiveness work do not define data requirements and baselines up front and do not collect the data they need to evaluate effectiveness; and
- individual capability—staff not having the capability to apply effectiveness thinking (in this regard, the blueprint speculated that in addition to lacking knowledge/skills and access to expertise, staff do not have the software tools the ATO needs to measure effectiveness).

5.11 In relation to the blueprint's hypothesis regarding the level of individual capability of staff, the ATO advised that it has assessed foundation-level evaluation training and has undertaken to increase its evaluation and data analytics capacity. Nonetheless, as the CEM is implemented by officers at various levels, there would have been merit in the ATO evaluating its approach to training staff at all levels in the use of the CEM.

5.12 The blueprint set out some desired outcomes and possible success indicators, all of which were qualitative and difficult to measure. For example, one indicator was 'Extent to which learnings from evaluating effectiveness are used to improve operations'. The blueprint placed significant emphasis on changing staff behaviour—this led to the preparation of a 'Behavioural change plan for effectiveness' in May 2013. Finally, the blueprint set out implementation options for the period December 2013 to December 2015, and a work program. The objective of the work program was to embed effectiveness evaluation within the ATO's natural systems, and to enable it to cascade through the planning and governance processes.

5.13 The ATO planned the full implementation of the work program to occur over a three to five year period—2012 to 2016—in order to achieve the required organisational behavioural shift. The ATO's progress in implementing its work program as at December 2013 is summarised in Table 5.2.

Table 5.2: ATO effectiveness work program status

Key deliverable	Achieved
New suite of KPIs for the 2013–14 ATO Portfolio Budget Statements, intended to provide better information on the extent to which program objectives are being met and to embed 'participation in the system' indicators.	✓
Visual model designed to help staff at all levels think about their effectiveness, aligned to the Commissioner's intent statement.	✓
Effectiveness reporting framework, used at the start of each compliance project to understand the planned revenue impacts and provide an appropriate measurement method. Designed to help risk managers recognise and report on the contribution of their compliance actions to revenue and to demonstrate the relationship to the budget forecast.	✓
Integration of effectiveness into HoTSAs.	Only for Superannuation
Develop and implement an evaluation plan for embedding the evaluation of effectiveness.	Partially ¹
Online publication of effectiveness stories.	✓
Embedding effectiveness communication strategy including broader effectiveness material endorsed by senior leaders, that is, Commissioner's speeches, NewsExtra articles, the effectiveness intranet site and eWiki.	✓

Source: ANAO analysis of ATO data.

Note: 1. The ATO advised that the plan has been finalised, but it is yet to formally evaluate against it.

5.14 The ATO has put significant effort into developing effectiveness KPIs for the 2013–14 Portfolio Budget Statements and Annual Plan. These measures, based on the four pillars of compliance identified by the OECD, have been included in the Portfolio Budget Statements, as it is the highest level at which the ATO reports to the Parliament. The ATO will use these KPIs to report on performance in its 2013–14 Annual Report.

5.15 The ATO has included detailed CEM commentary in its 2013 Superannuation HoTSA. Also, the ATO advised the ANAO in February 2014 that it has altered its processes to ensure that effectiveness is embedded into the Income Tax HoTSA. A minute to SES contributors and stakeholders included a template asking for 'Key achievements and compliance effectiveness impacts'. Guidelines for contributors also reflected including effectiveness elements in responses. In addition, the Income Tax Steering Committee held a workshop that resulted in recommendations to ensure effectiveness is reflected within the questions asked of HoTSA contributors. However, these changes will only fully take effect in 2015. A full assessment of

these developments will not be possible until the 2014 and 2015 Income Tax HoTSAs are completed.¹¹⁶

5.16 Other complementary work has also occurred in some areas. In August 2013, for example, Public Groups and International (PG&I) BSL started developing a reporting framework that more clearly illustrates how it has influenced and driven compliance behaviour in the large market. The project outline for this work stated that this was expected not only to enable the effectiveness story to be told, but also to lead to more informed decision making concerning strategy and best practice compliance approaches. In March 2014, the ATO advised that this work was close to finalisation, and provided a prototype model.

Embedding the methodology in non-Compliance business and service lines

5.17 While the CEM remains an applicable methodology for high priority compliance risks, the ATO has recognised the need for simpler methods to help ATO staff in the other groups¹¹⁷ to consider and evaluate (in a less formal sense) the effectiveness of their activities. One response has been to develop a suite of support tools from which the evaluators can choose, depending on the complexity of work being undertaken (described in paragraphs 5.18 to 5.20). In addition, work is continuing on a modified version of the compliance effectiveness methodology to use in relation to non-compliance work.

5.18 As noted at paragraph 2.21, in December 2012 the ATO established an Embedding ATO Effectiveness Steering Committee at Deputy Commissioner level to oversee the approach necessary to change the ATO's evaluation of effectiveness as part of business as usual. The ANAO examined the minutes of this Steering Committee's meetings from December 2012 to October 2013 to determine its contribution to the broader embedding process. The minutes indicated that the Committee had focussed on matters such as: updating the ATO's KPIs for its Portfolio Budget Statements, especially in relation to

116 It is unclear what progress is being made in respect of HoTSAs for other revenue products (GST and excise) and market segments (such as individuals and large business). An income tax work program notes that work should be done to: share the income tax product HoTSA process with other product authors, and; encourage streamlining of processes within business lines for HoTSA preparers.

117 As of April 2014, the other two groups were: People Systems and Services; and Law Design and Practice.

compliance; noting the progress made on work program items, such as effectiveness stories; and development of the ATO effectiveness model.

5.19 The ATO advised that it has identified a need for a range of approaches to suit the work of a particular BSL depending on its nature (for example, compliance work or an enabling function) or level of complexity. At its simplest, the ATO uses a ‘five questions’ approach to enable staff at all levels to understand effectiveness and consider it in the context of their own work or their team’s work. The five questions are set out in Table 5.3.

Table 5.3: The ATO’s five core effectiveness questions

Question	Considerations
1. What was the situation, risk or opportunity?	Consider how this aligns with the ATO’s strategic direction.
2. What did you set out to achieve?	Consider your intended outcome, what you were aiming to accomplish and how you planned to achieve this.
3. What did you do?	What actions you undertook to address the situation and achieve your aim.
4. What was the outcome?	Describe the impact of your activities—this will be positive or negative.
5. What did you learn?	Describe the insights gained from the experience. Were planned outcomes met, if not why? Could things have been done better? Should we continue to do this or do something else?

Source: ATO.

5.20 At a more advanced level, the ATO uses an ‘ABCD’ model (a planning instrument that is useful for articulating desired outcomes and strategies).¹¹⁸ It also uses more formal evaluation tools, including: the compliance effectiveness method for compliance risks; a modified version of the compliance effectiveness method for other areas; and techniques such as outcomes mapping and benefits realisation for significant projects. The main tool that remains under development is a modified version of compliance effectiveness, which the CoE has been testing by working with areas in the ATO such as Integrated Tax Design and Learning and Development.

5.21 The ANAO examined the work done to February 2014 by BSLs outside the Compliance Group to embed effectiveness principles. Material was

¹¹⁸ The ABCD model used by the ATO asks: A – Where are we now?; B – Where do we want to be?; C – How will we get there?; D – What will we do to make it happen?

provided by Learning and Development, Integrated Tax Design and Service Delivery Support BSLs. The material provided by Learning and Development indicated that, while the BSL had identified the need for outcomes measures and performance indicators, and commenced working on these, it had not completed them as at the end of December 2013. In November 2013, Integrated Tax Design undertook a workshop to develop high-level effectiveness indicators, and has subsequently developed a number of qualitative and quantitative success indicators. Service Delivery and Support have made the most progress of the three BSLs, developing numerous KPIs and success measures, and having provided effectiveness stories for the 2012–13 annual report.

5.22 While the available evidence suggests that there has been some progress, it was too early to make a meaningful assessment of how well BSLs outside the Compliance Group have implemented effectiveness thinking and been able to demonstrate their effectiveness, where the ATO had used the methodology. The ATO, in establishing the Embedding Effectiveness Thinking work program and the Embedding ATO Effectiveness Steering Committee, recognises that considerable work still needs to be done to extend the use of the new effectiveness methodology throughout the organisation.

Conclusion

5.23 The ATO has taken steps to fill gaps in its guidance and capability to monitor revenue outcomes and assess the success of broader upstream compliance activity. The ATO has also made some improvements to monitoring outcomes and assessing success through improving KPIs for its Portfolio Budget Statements. However, the Evaluating Compliance Effectiveness project and the Embedding Effectiveness Thinking work program have not paid sufficient attention to: monitoring the outcomes being achieved; assessing success or otherwise; and rectifying the problems.

5.24 While acknowledging the competing demands on the ATO, a greater focus on high-level direction and feedback to promote consistency and quality would have led to better outcomes sooner. This emphasises the importance of the need for good governance processes, which was identified in the 2011 Compliance review of CEM. Given that the CEM is focusing on priority risks, high-level direction is essential, and would help address the finding of the Capability Review (outlined in paragraphs 1.27 to 1.28) that the ATO has yet to achieve serious monitoring of strategic outcomes.

5.25 Also, in some respects the ATO has not applied some of the key lessons from its earlier implementation of the CEM in the Compliance Group. These include the need to: aggregate CEM results so that the ATO has an integrated view of its compliance effectiveness; and integrate effectiveness into the ATO's key risk management systems, rather than effectiveness being separate or apart from those systems. For example, despite the ATO having identified integration into HoTSAs as a priority as early as 2008, there is still limited evidence that this has occurred.

5.26 Embedding effectiveness thinking is a difficult task involving significant cultural change and the ATO has acknowledged that more work is required to adopt the concept more broadly in the organisation. Nonetheless, there is now considerable evidence available on the issues that need to be addressed. Resolving these issues and embedding effectiveness thinking in the ATO will require strong leadership and direction and a commitment from senior management across the organisation if this is to occur.



Ian McPhee
Auditor-General

Canberra ACT
12 June 2014

Appendices

Appendix 1: Agency response

9.30
2 JUN 2014
GSD



Australian Government
Australian Taxation Office

Second Commissioner of Taxation

Ms Barbara Cass
Group Executive Director
Performance Audit Services Group
Australian National Audit Office
GPO Box 707
CANBERRA ACT 2601

Dear Ms Cass

RE: AUSTRALIAN NATIONAL AUDIT OFFICE PERFORMANCE AUDIT OF THE
COMPLIANCE EFFECTIVENESS METHODOLOGY

Thank you for your letter dated 6 May 2014 and for the opportunity to provide comments on the proposed report on the Compliance Effectiveness Methodology.

The ATO agrees with the two recommendations contained in the section 19 report.

Attached is the ATO response to the recommendations (Annexure 1) and a summary of our comments to be included in the report (Annexure 2).

I would like to thank the Australian National Audit Office audit team for the cooperative and professional manner they have adopted in working with us on this matter. I look forward to continuing the good working relationship developed in this performance audit.

If you require further information on this matter, please contact Mr John Becker, Assistant Commissioner, Information Management, on (08) 8208 1348.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Geoff Leeper'.

Geoff Leeper
Second Commissioner
Australian Taxation Office

30 May 2014

Appendix 2: Resource allocation by Business and Service Line for Compliance Effectiveness Methodology Activities, 2013–14

BSL	Resources allocated	Total estimated cost for CEM-related activities	Centralised teams or risk managers
Aggressive Tax Planning	EL1 (0.6) EL2.1 (0.2) EL2.2. (0.1) Total FTE: 0.9	\$123 799	ATP risk managers are responsible for conducting CEM evaluations, with support from lower levels where necessary.
Indirect Tax	EL1(1) EL2.1 (1) EL2.2 (0.2) Total FTE: 2.2	\$318 542	CEM-related activities are primarily the responsibility of the risk managers and risk owners.
Private Groups and High Wealth Individuals	Approximately 0.5 of 1 FTE in Risk Detection and Revenue Analysis team.	See Note	Phase 1–3 are the responsibility of the risk managers. Phase 4 is developed by the Risk Detection and Revenue Analysis team.
Public Groups and Internationals	APS5 (0.4) APS6 (0.1) EL1 (1.3) EL2.1 (0.4) EL2.2 (0.2) Total FTE: 2.4	\$306 200	Staff, working on CEM, are located in the Risk Intelligence and System Support area and the Economist Practice. Phase 1–3 are the responsibility of the risk managers. Phase 4 is developed by the Risk Management and Evaluation team.
Small Business and Individual Taxpayers	EL2.2 (FTE 0.05) EL2.1 (FTE 0.25) EL1 (FTE 0.50) APS6 (FTE 0.50) Total FTE: 1.3	\$161 395	CEM-related activities are primarily the responsibility of the risk managers/owner.
Serious Non-Compliance	EL1 (0.5) EL2.1 (0.1) EL2.2 (0.05) Total FTE: 0.65	\$87 136	CEM-related activities are primarily the responsibility of the risk managers/owner.

BSL	Resources allocated	Total estimated cost for CEM-related activities	Centralised teams or risk managers
Superannuation	APS6 (0.1) EL1 (1.12) EL2 (1.6) Total FTE: 2.82	\$407 846	CEM-related activities are primarily the responsibility of the risk managers/owner.
Tax Practitioner and Lodgment Strategy (TPALS)	APS5 (1) APS6 (0.45) EL1 (1.8) EL2.2 (0.4) Total FTE: 3.65	\$426 294	TPALS Effectiveness team works full time on CEM.

Source: ANAO analysis of information provided by the ATO.

Note: PG&H advised the ANAO that, given that there are no CEM codes for ATOUCA (the ATO's costing system) and no staff specifically assigned on CEM, it was unable to provide a breakdown of staff levels working on CEM-related activities.

Index

A

Aggressive Tax Planning BSL, 27, 58

C

Centre of Expertise (CoE), 34, 36, 46, 49, 50, 52–53, 75, 87, 105

Community of Practice, 34, 45, 47, 51, 75, 90

Compliance Effectiveness Leadership Forum (CELf), 34, 47, 51, 56, 75, 87

Compliance Effectiveness Measures project, 32, 40–41, 49–50

E

Embedding ATO Effectiveness Steering Committee, 48, 104, 106

Enterprise Risk Management, 56, 58, 61, 85, 86

F

Fringe Benefits Tax (FBT), 71, 72, 80, 81, 85

Funding, 29, 46, 88

G

Goods and Services Tax (GST), 29, 31, 80, 82, 91–92

H

Health of the System Assessments (HoTSA), 85, 88, 95, 103–4, 107

I

Indirect Tax BSL (ITX), 58, 82

K

Key Performance Indicators (KPI), 30, 36, 64–72, 101, 103, 106

O

Organisation for Economic Co-operation and Development (OECD), 33, 37, 38, 93, 103

R

Resourcing, 31, 42, 49–53, 88, 49–53

Risk management forums, 34, 55, 85, 87–89

S

Serious Non-Compliance BSL (SNC), 35, 51, 53, 58

Staff training, 17, 32, 40, 49, 51–53, 102

Superannuation, 67, 71, 88, 93, 103

T

Tax Practitioner and Lodgment Strategy BSL (TPALS), 51, 74–75

W

Wine Equalisation Tax, 35, 80, 81

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