

The Auditor-General

Audit Report No.36 1998-99

Performance Audit

**Pay-As-You-Earn Taxation
—Administration of
Employer Responsibilities**

Australian Taxation Office

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ISSN 1036-7632
ISBN 0 644 38858 7

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Canberra ACT
28 April 1999

Dear Madam President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit of the Australian Taxation Office in accordance with the authority contained in the *Auditor-General Act 1997*. I present this report of this audit, and the accompanying brochure, to the Parliament. The report is titled *Pay As You Earn Taxation—Administration of Employer Responsibilities*.

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

Yours sincerely



P. J. Barrett
Auditor-General

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

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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

telephone (02) 6203 7505
fax (02) 6203 7798

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Audit Team

Lindsay Roe
Mark Rogala
Peter White

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Abbreviations/Glossary

ANAO	Australian National Audit Office
ATO	Australian Taxation Office
CaMRA	Case Management Reports Analysis system
CICADA	Case Information and Control for Advising, Disputes and Appeals
CISCO	Community Information, Storage, Communication and Observation system
DNL	Detect Non-Lodger
DNL MRS	Detect Non-Lodger Management Review System
EALA	Estimated Annual Liability Amount
FBT	Fringe Benefits Tax
PAYE	Pay-As-You-Earn
PAYG	Pay-As-You-Go
PPS	Prescribed Payments System
RPS	Reportable Payments System
STAC	Storage and Access of electronic returns
TLAB	Tax Law Amendment Bill
WHT	Withholding and Indirect Taxes Business Line

Summary and Recommendations

Summary

1. During 1997–98, the Australian Taxation Office (ATO) collected revenue through the Pay-As-You-Earn (PAYE) system totalling \$66 billion. This represented almost 60 per cent of a total of \$110.3 billion in ATO revenue collections for the year.

2. PAYE, introduced in 1941, is the ATO's most extensive collection system covering 85 per cent of the Australian work force. International research¹ has shown that a withholding tax arrangement such as PAYE is the most effective means of encouraging compliance. As well, the cost of compliance is lower than for other tax collection methods.

3. Employers play a key role in the effective operation of the PAYE system. They are responsible for withholding prescribed amounts from salary and wages and remitting those deductions directly to the ATO. The Withholding and Indirect Taxes² (WHT) business line within the ATO administers the PAYE provisions of the *Income Tax Assessment Act 1936*.

The audit approach

4. The objective of the performance audit was to assess key aspects of the ATO's administration of the PAYE system in relation to employers' remittances and to identify opportunities for improvement.

5. To achieve this objective, the audit focused primarily on the following four areas of PAYE administration:

- remittance monitoring, especially managing late remittances;
- follow-up action for end of year reconciliation, including discrepancies;
- handling compliance intelligence gained from the public; and
- ATO compliance projects

Overall conclusion

6. The ATO's administration of the PAYE system in relation to employers' remittances is generally sound. It ensures most employers

¹ US GAO Testimony, Taxpayer compliance: Analysing the nature of the income tax gap, January 1997

² On 1 March 1999, the Withholding and Indirect Taxes business line ceased to exist and the administration of PAYE was placed in the newly created Small Business line. This organisational change came into effect during the final reporting phase of the audit. This report comments on the administrative arrangements which were current during the audit process.

comply with their responsibilities for remitting tax withheld from employees' salaries.

7. The ANAO found that there is scope for improvement in the ATO's administration of PAYE. The audit revealed a risk to revenue arising from the ATO's lack of timeliness in actioning late PAYE remittances and reconciliation discrepancies. Improvements in data integrity of support systems, coupled with implementation of client risk profiling, would lead to better targeting and timeliness of compliance activity and therefore better outcomes.

8. A number of tax reform issues are currently being considered by the Parliament. Although these reforms have the potential to result in significant change in the administration of the tax system, an at-source withholding tax arrangement such as PAYE is expected to remain a core mechanism for supporting a reformed taxation system. As part of the current reform agenda, the Government proposes introducing a Pay-As-You-Go (PAYG) scheme which builds on the principles of operation of the current PAYE system. While recommendations made in this report are aimed at improving key aspects of PAYE administration, they will retain their relevance in an enhanced PAYG scheme.

Key Findings

Monitoring of PAYE remittances (Chapter 2)

9. In the context of a largely compliant client base, the ANAO found that the ATO's lack of timely action on overdue remittances represents a risk to tax revenue. There is a backlog of overdue PAYE remittances requiring follow-up action. Our analysis found that more timely follow-up would have improved revenue collection results. We also found client risk profiling would better target debt requiring timely action. This is particularly the case for small remitters who are the majority of ATO clients.

10. There is scope for the ATO to investigate the use of alternative forms of client notification where clients fail to remit as expected, taking into account client remittance patterns and behaviour.

11. We found better analysis of available system based information could improve remittance monitoring. We also found the majority of system generated indicators of late remittance were invalid. Items representing a debt owed reflected debt estimates which were often inaccurate. In addition to our recommendation to improve data accuracy, ATO initiatives such as introducing a 'running balance account' system could also lead to desirable improvements.

End of year reconciliation discrepancies (Chapter 3)

12. Most self assessed reconciliation statements of PAYE remittances successfully balance, reflecting a high level of compliance by employers. There is scope, however, for more timely ATO follow-up action of discrepancies. The current discrepancies backlog exceeds the system's retention capacity and reduces the likelihood of recovering debts. Improvements in error correction would reduce the number of invalid discrepancies occurring. This, coupled with improved targeting of debt, should more effectively resolve the problem of discrepancy items.

13. We also found credit and debit discrepancies could be treated more equitably. We consider that the ATO should provide clearer instructions on the reconciliation form to advise the potential for refunds. There is also scope for the ATO to educate new clients about the requirements of providing annual reconciliation returns. These changes would help improve client relations and encourage compliance.

Managing compliance intelligence (Chapter 4)

14. The ATO often receives information from the public which it uses in its compliance investigations. It refers to such compliance intelligence advice as ‘tip-offs’. The ANAO concluded that the ATO requires a nationally based system to manage tip-off information effectively and allow analysis of taxpayer non-compliance. Establishing appropriate performance indicators would assist WHT in monitoring such information follow-up. We also found the ATO does not effectively monitor how resources are allocated to ensure all tip-offs that reflect a high risk to revenue are actioned in a timely manner.

ATO compliance projects (Chapter 5)

15. As part of its work to improve taxpayer compliance, the ATO undertakes compliance projects designed to identify emerging issues and/or risk areas. We reviewed two key ATO compliance projects relevant to PAYE administration. One related to PAYE erosion and the other to reconciliation of employer remittances with group certificate information.

16. We found that ATO analysis and field work on its PAYE Erosion Project suggest that the majority of employing organisations are complying with PAYE provisions. Although ATO research indicated the movement of employees to contractor status is increasing, there was no indication of when this or other identified factors would have a significant impact on revenue.

17. Based on our review of the ATO’s PAYE Reconciliation Project, we found that the ATO had not undertaken a soundly based risk assessment of the potential revenue loss through Group Employers failing to remit PAYE Group Tax deductions. Also, attempts to date have focused on identifying those taxpayers who have registered with the ATO as Group Employers and who are not remitting PAYE tax instalment deductions withheld. The ATO would also benefit from identifying those Group Employers who are ‘outside the net’, that is Group Employers who are not registered with the ATO. This could be achieved to some extent by taking into account information provided on the employee’s copy of the Group Certificate, rather than relying on the employer’s copy only.

18. The ANAO recognises that any resource allocation to undertake such future reconciliation activity needs to be cost-effective. Consequently, targeting certain industries or high risk clients may prove more cost-effective than trying to reconcile the entire population of PAYE employers.

Recommendations

Set out below are the ANAO's recommendations aimed at improving the ATO's administration of key aspects of PAYE. Report paragraph references and abbreviated ATO comments are also included. More detailed responses are shown in the body of the report. The ANAO considers that the ATO should give priority to Recommendations 2, 4, 5, 6 and 8.

Recommendation No.1
Para. 2.19 The ANAO recommends that, to increase the accuracy and reliability of its information system, the ATO investigates methods for updating estimated employer PAYE liability and employment cycle information for Micro and Small Segment clients on a more timely basis.

ATO Response: Agreed

Recommendation No.2
Para. 2.30 The ANAO recommends that, to improve targeting of likely debt, the ATO further develops its use of client risk profiling for all remitter types and provides guidance to client teams using the Detect Non Lodger (DNL) Management Reporting System in prioritising DNL items for actioning.

ATO Response: Agreed

Recommendation No.3
Para. 2.47 The ANAO recommends that the ATO investigate the effectiveness of Final Notices in confirming PAYE debt. As part of any investigation, the ATO should consider how alternative forms of client notification will aid timely confirmation and collection of outstanding PAYE remittances.

ATO Response: Agreed

Recommendation No.4
Para. 2.56 The ANAO recommends that the ATO takes action to improve the timeliness of debt establishment and refines its performance indicators to assist in improving the ongoing management of its PAYE debt establishment performance.

ATO Response: Agreed

- Recommendation No.5
Para. 3.18** The ANAO recommends that:
- the ATO improves the timeliness of actioning self-assessed reconciliation discrepancies to clear the backlog, within the constraints of cost and risk;
 - reconciliation data entry keying errors be corrected at the bulk processing centre as part of the data capture process;
 - the ATO improves its system to prioritise discrepancy items on the basis of risk profiling;
 - both credit and debit discrepancies be actioned equitably and established credit refunds issued within the Taxpayer Charter specified time-frame;
 - advice on the Reconciliation Statement should be equitable in its treatment of both debit and credit discrepancies; and
 - proactive advice be automatically sent to new clients as timely assistance in handling their first end of year reconciliation.

ATO response: Agreed

- Recommendation No.6
Para. 4.14** The ANAO recommends that the ATO implements a nationally based tip-off information management system with consistent procedures for collecting, recording, and reporting tip-off information.

ATO Response: Agreed

- Recommendation No.7
Para. 4.23** The ANAO recommends that the Withholding and Indirect Taxes business line (WHT) implements performance indicators and monitors the timely allocation of tip-off information for investigation by WHT field teams.

ATO Response: Agreed

Recommendation No.8
Para. 4.32 The ANAO recommends that the ATO adopts a consistent approach to assessing the risk to compliance associated with tip-off information and that appropriate training is provided to WHT field teams in determining and interpreting the risk to compliance associated with tip-off information.

ATO Response: Agreed

Recommendation No.9
Para. 4.38 The ANAO recommends the ATO gives WHT field teams appropriate instructions and training in generating tip-off information management system reports to enhance ATO information management.

ATO Response: Agreed

Recommendation No.10
Para. 5.11 The ANAO recommends that the ATO, in relation to its analysis of PAYE erosion, should:

- analyse the downward trend in the proportion of revenue from PAYE to establish causes and project likely outcomes for the medium to longer term;
- analyse the trend by large employers towards outsourcing complete business units or functions to determine its impact on PAYE and overall revenue; and
- conduct a suitable sensitivity analysis to determine when identified effects on PAYE revenue will become significant so that timely action can be taken.

ATO Response: Agreed

Recommendation No.11
Para. 5.26 The ANAO recommends that the ATO undertakes a soundly based risk analysis to determine the likely revenue at risk from registered and unregistered Group Employers failing to remit PAYE Group Tax deductions to the ATO.

ATO Response: Agreed

Audit Findings and Conclusions

1. Introduction

Background

1.1 PAYE is the Australian Taxation Office's largest revenue collection system, contributing just over \$66 billion in Commonwealth revenue during 1997–98. Employees are required to pay tax on their salary or wage income progressively as they earn it. It is paid through tax instalment deductions made by employers under the Pay-As-You-Earn (PAYE) system.

1.2 Under the *Income Tax Assessment Act 1936*, employers are required to deduct (s221C) tax instalments at prescribed rates from each payment of salary or wages to an employee and remit (s221F) these amounts to the ATO within specified time-frames. An employer who refuses, or fails, to comply with the PAYE provisions commits an offence and may be prosecuted.

1.3 The PAYE system is based on self assessment without the safety net of tax administrators validating the liability of every Group Employer. Employers are required to assess their own PAYE liability in relation to their employees in order to deduct and remit the correct amount of tax. The ATO considers that PAYE law is not complex in its application compared to other taxes.

1.4 The Withholding and Indirect Taxes business line (WHT) is responsible for managing, among other things, the PAYE system. Client teams help employers meet their responsibilities. In October 1997, WHT reorganised existing client segments within its business line into Large, Small and Micro Segments. Each client segment comprises teams (of 10 to 20 people) which administer a number of WHT roles including PAYE, Prescribed Payments System and Sales Tax. The profile of WHT client segments is shown in Table 1.

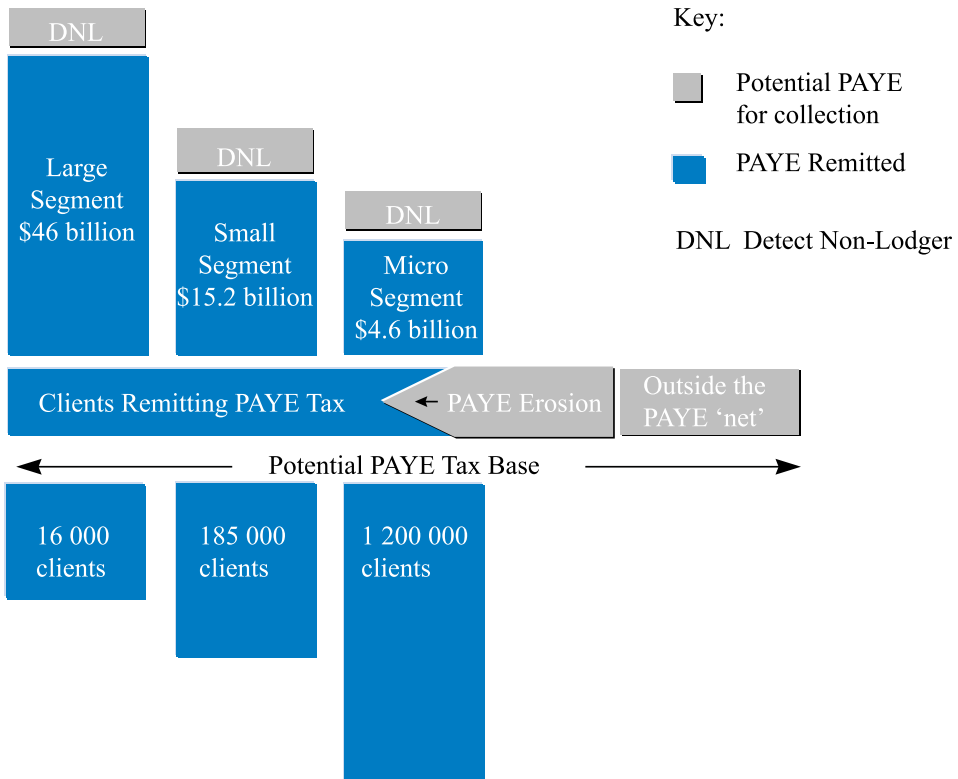
1.5 Although large segment clients make up less than 2 per cent of group employers, they contribute 70 per cent of PAYE revenue. Approximately half of all PAYE revenue comes from the top one thousand large segment clients.

Table 1
WHT structure by client segment

	<i>Large Segment</i>	<i>Small Segment</i>	<i>Micro Segment</i>
ATO Criteria (WHT liability includes PAYE, PPS, RPS and Sales Tax)	Annual WHT liability > \$1 million or business turnover > \$10 million	Annual WHT liability > \$25,000 and < \$1 million	Annual WHT liability < \$25,000
Approximate No. of clients	16,000	185,000	1.2 million
ATO Staff No.	142	695 ^a	923 ^b
No. of ATO client teams	10	50	56
No. of active PAYE roles ^c	9,136	184,940	634,319
1997–98 PAYE receipts	\$46.136 billion	\$15.159 billion	\$4.614 billion
% of PAYE receipts	70%	23%	7%

- Notes
- a. Includes staff employed in 31 field (audit) teams.
 - b. Includes staff employed in 13 Business Registration Services Teams
 - c. As a client may have separate responsibilities for more than one group of employees, the ATO defines each responsibility as a unique 'role'.

Figure 1
Model of potential PAYE population



Note: A detect non-lodger (DNL) indicator warns of potential non-remittance of PAYE tax and is used by client teams to investigate and encourage compliance. The DNL indicator is a key control of the remittance system. DNLs are examined in Chapter 2.

Budget changes to payment methods

1.6 Under the *Income Tax Assessment Act 1936*, Group Employers are required to remit tax instalment deductions to the ATO in accordance with prescribed remittance cycles. These remittance cycles changed from 1 July 1998. As part of the 1997–98 Budget, the Government announced changes to the Reportable Payments System (RPS), PAYE and Prescribed Payments System (PPS) withholding arrangements to rationalise the remittance obligations of withholders under the three systems. ATO clients are classified as either Small, Medium or Large remitters depending on their combined remittance level for PAYE, PPS and RPS. The remittance cycles are shown in Table 2.

Table 2
Client remitter profile

<i>Remitter type</i>	<i>Remittance level</i>	<i>Remittance cycle (due date)</i>
Large	> \$1 000 000	Average time for remittance is 7 days from time of withholding. Remittances must be made electronically.
Medium	\$25 000 to \$1 000 000	Monthly—7 th of each month
Small	\$25 000 or less	Quarterly—7 th of October, January, April and July

1.7 The ATO has implemented several strategies to smooth the transition of Group Employers remitting PAYE Tax Instalment Deductions (TID) to the new remittance cycles. Specifically, the ATO tasked a team to provide information and advice to both ATO clients and staff concerning these new cycles. The strategies the ATO used to achieve these objectives focused on large remitters—the segment most affected—and included:

- letters advising of the new remittance arrangements;
- seminars for ATO clients and staff;
- an internal newsletter;
- advertising in the press;
- providing advice on the ATO Internet site; and
- providing information by 'A Fax From Tax'.

Indications are that the ATO has been successful, in that approximately 96 per cent of large segment clients are now remitting electronically.

1.8 The WHT allocation of clients to its segment structure, shown earlier in Table 1, also takes into account a taxpayer's Sales Tax remittances (where applicable) whereas the definition of remittance type does not

take Sales Tax remittances into account. For example, a client paying large amounts of Sales Tax and smaller amounts of PAYE Group Tax may be classified as a large segment client and a medium remitter.

Costs of compliance

1.9 A report into Taxpayer Cost of Compliance³ by the Australian Taxation Studies Program, University of NSW, in November 1997, found that:

- PAYE is by far the most compliance-cost-efficient tax collection mechanism; and
- as a proportion of turnover, small business taxpayers face total compliance costs (which include PAYE responsibilities) 25 times greater than for medium sized business. Large business actually gains through economies of scale and short term use of money withheld (approximately \$25 per \$1000 turnover vs \$1 per \$1000 and -\$0.60 per \$1000 respectively). PAYE costs are in line with the average for all businesses in terms of relative compliance burden.

1.10 During the audit, small business representatives also expressed concern that the regressive cost of taxation law compliance in Australia imposed a greater burden on small business. PAYE compliance costs, however, are lower than for all other forms of tax collection. The effects of remittance cycle changes, introduced from 1 July 1998 (in part to address such costing differences) have yet to be determined.

1.11 A range of employer groups held generally positive views of how PAYE was administered. A common issue was uncertainty over defining 'employee' and 'contractor' status. The ATO expects tax reform initiatives to allay these concerns as the proposed pay as you go (PAYG) scheme is much broader and will not depend on a definition of 'employee'. Under the proposed PAYG scheme, a mechanism will be introduced so payments for work can be specified as subject to withholding.

ATO Risk Assessment of PAYE

1.12 The 1998 WHT Health Of The System Assessment (HOTSA)⁴ recognises the importance of maintaining an effective collection system identifying among other things that:

- the collection system, which provides the bulk of Government revenue, supports client compliance;

³ Evans C, Ritchie K, Tran-Nam B, Walpole M, A report into taxpayer costs of compliance, AGPS, November 1997

⁴ ATO's formal risk management process is entitled Health of the System Assessment or HOTSA

- the quality of the data in the revenue collection system, and system adaptability to changes in environment, determine ATO success; and
- the primary asset WHT manages is the collection system.

Overall, the ATO considers that PAYE is a sound and increasing revenue line.

Current taxation environment

1.13 Parliament is currently considering tax reform issues⁵. Although the outcome could significantly change overall tax system administration, an at-source withholding tax arrangement is expected to underpin a reformed taxation system.

Audit objective and approach

1.14 The objective of the performance audit was to assess key aspects of the ATO's administration of the PAYE system in relation to employers' remittances and to identify opportunities for improvement.

1.15 To achieve this objective, the audit focused primarily on the following four areas of PAYE administration:

- remittance monitoring, especially managing late remittances;
- follow-up action for end of year reconciliation, including discrepancies;
- handling compliance intelligence gained from the public; and
- ATO compliance projects

1.16 Audit work was conducted within WHT covering ten regional offices in Canberra, Brisbane, Sydney and Melbourne and in National Office. This was supported by the use of a survey questionnaire on remittance monitoring covering approximately 40 client teams across all States. The cost of the audit as at the time of tabling was approximately \$298 000. The audit was conducted in accordance with ANAO Auditing Standards.

Report Structure

1.17 The report is structured around the four focus areas noted above which were identified as being of key importance to the effective administration of PAYE employer remittances.

1.18 The monitoring of remittances is an important activity to ensure employers meet their taxation obligations. Chapter Two examines the

⁵ A series of Bills for Tax reform were introduced to the Parliament by the Treasurer on 2 December 1998

ATO's monitoring of PAYE remittances including system accuracy, actioning of potential PAYE debt, timeliness of PAYE debt confirmation, automated generation of PAYE client notices and performance management.

1.19 The annual reconciliation process is a key control in an environment of self assessment. Chapter Three reviews the end of year reconciliation of the total amount claimed to be remitted to the ATO with the total amount of instalment deductions received by the ATO. The chapter focuses on the actioning of reconciliation discrepancies and using the results of reconciliation as a tool to educate employers.

1.20 Effective compliance intelligence management allows the ATO to target compliance activities better. Chapter Four considers how the ATO manages compliance intelligence from the public about the activities of individuals and entities. Coverage includes consideration of the system support, information usage, performance management, the ATO's method for following up intelligence gathered, resourcing and public relations and advertising.

1.21 Compliance project work is a useful monitoring tool to alert the ATO to trends in client behaviour, allowing the ATO to address any significant risk areas. Chapter Five reviews two such ATO compliance projects. The first examined erosion of the PAYE revenue base and the second performed a reconciliation of all group certificates issued by employers with the remittances received from employers.

Acknowledgments

1.22 The ANAO wishes to express its appreciation of the time, effort and expertise contributed by ATO officers during the course of the audit.

2. ATO Monitoring of PAYE (Group) Remittances

Background

2.1 The ATO monitors the remittance of PAYE tax instalment deductions (TID) by employers using the automated ATO Integrated System (AIS). Employers who register as clients with the ATO provide an estimate of their expected annual TID liability. Based on this estimate, the ATO determines the client's remittance cycle as described in Chapter 1. Subsequent year liabilities are calculated on the client's actual amount remitted for the previous year.

2.2 In order to identify outstanding remittances in a timely manner, a remittance monitoring system must detect and respond automatically to potential breaches.

2.3 If a client fails to remit as expected, the AIS automatically generates a Detect Non Lodger (DNL) item. A DNL is a critical factor in monitoring compliance as it alerts an ATO client team of the need for investigative action. The AIS performs a range of DNL related actions as shown in Table 3.

Table 3

AIS actioning of remittance default

	<i>Small Remitter</i>	<i>Medium Remitter</i>	<i>Large Remitter</i>
<i>AIS records a DNL item the next working day after the due date</i>	Yes	Yes	Yes
<i>AIS generates a Final Notice to the client</i>	No	Yes	No
<i>AIS automatically generates an item for actioning by a client team</i>	No	Yes	Yes

2.4 A Final Notice advises that employers are required to advise and pay the ATO the amount of Tax Instalments deducted from the salary and wages of their employees. Final Notices are generated on the first weekend, nine days after the due date.

2.5 Final Notices are not generated for defaulting large remitters because large client teams have a higher officer to client ratio than other ATO client teams. This provides them with a better opportunity to understand the risk profile of their clients.

2.6 In the case of defaulting small remitters where a Final Notice is not generated, client team leaders are required to investigate DNLs in the first instance. The provision of guidance to client team leaders in this regard is discussed further under *Actioning of potential PAYE debt* from paragraph 2.23.

2.7 In the case of medium and large remitters, DNL items are also automatically reported to client teams for investigation as appropriate using the Action Queuing System (AQS), a subset of the AIS.

2.8 The ANAO noted that DNL items for small remitters are not automatically reported as AQS items to client teams for follow-up action. Instead, the ATO is implementing the DNL Management Review System (DNL MRS) requiring client team leaders to:

- interrogate the DNL MRS to identify DNL items for investigation; and
- select those DNL items to be actioned and refer these to client team members for follow-up action.

The DNL item survey

2.9 The ANAO sought to test AIS accuracy in monitoring PAYE remittances against recognised better practice in receivables management. The ANAO developed a DNL survey to sample approximately 40 ATO client teams in all States. The ANAO surveyed action on 611 DNLs of which 482 were finalised within the survey time-frame.

System Accuracy

2.10 System accuracy is important in giving correct priority to outstanding PAYE remittances for follow-up action.

2.11 Not all DNL items generated by the AIS represent a debt owed to the Commonwealth. Client teams investigate DNL items to establish whether a debt exists. A DNL item that does not result in a debt being established with a client is referred to as an invalid DNL item.

2.12 There are a number of reasons why invalid DNL items are generated by the AIS. For example, a DNL item will be generated if an employer inadvertently submits the wrong payment slip (from the PAYE Payment Book) together with their payment, because the payment will be posted to a period other than the period to which the payment related. As invalid DNLs could reduce the effectiveness of ATO compliance monitoring, the ANAO sought to determine the number and value of invalid DNL items in a sample captured by the DNL survey. The results are shown in Table 4.

Table 4**Number and value of invalid DNL survey items—as at September 1998**

	<i>Micro Segment</i>	<i>Small Segment</i>	<i>Large Segment</i>	<i>Total</i>
Total estimated PAYE debt associated with DNLs for all surveys actioned	\$1 297 041	\$2 832 970	\$101 923 426	\$106 053 437
% of invalid DNLs	69.8%	53.6%	95.4%	
Estimated PAYE debt associated with invalid DNLs	\$946 927	\$759 587	\$101 540 022	\$103 246 536
% of estimated PAYE debt associated with invalid DNLs	73.0%	26.8%	99.6%	97.4%
Estimated PAYE debt associated with valid DNLs	\$350 114	\$2 073 383	\$383 404	\$2 806 901
% of estimated PAYE debt associated with valid DNLs	27.0%	73.2%	0.4%	2.6%

2.13 Our survey indicated that the majority of DNL items actioned by ATO client teams are invalid. Consequently, significant resources are diverted from actioning those DNL items which do represent actual PAYE debt for collection. There is also the risk that client teams may be actioning invalid DNL items instead of undertaking other tasks that would have a higher risk associated with them.

2.14 WHT has stated in their 1998 Health Of The System Assessment (HOTSAs), that all WHT resources are allocated on the basis of risk. This requires sound information to assess the level of risk and any subsequent allocation of resources to treat the risk, otherwise client teams will expend significant amounts of time actioning invalid DNL items instead of DNL items representing debt. Client risk profiling would help client teams prioritise DNL items according to risk and thereby increase the likelihood of client teams actioning DNL items that represent debt rather than invalid DNL items. Client risk profiling is discussed further under *Actioning of potential PAYE debt* from paragraph 2.23.

2.15 The ATO is aware that invalid DNL items are a problem in the current system where remittances are recorded against a specific time period. The ATO expects the introduction of a 'running balance account' system to reduce the number of invalid DNL items. This system will compare total remittances due with total remittances received irrespective of time periods and is scheduled for implementation from July 1999.

2.16 The ANAO sought to quantify the potential benefit of a running balance account system by testing this approach against DNL survey sample results. The ANAO found that of the invalid DNL survey items identified, approximately 20 per cent would be resolved with the

introduction of a running balance account system, while 45 per cent would not be resolved and 35 per cent were inconclusive.⁶ Given the continuing large number of invalid DNL items, the ANAO suggests that the ATO continues investigating options for reducing these DNL items, including the use of client risk profiling.

2.17 The ANAO also found that where a DNL item did represent an outstanding remittance, there was a significant difference between the ATO’s estimate of the debt outstanding and the actual debt outstanding. The DNL survey sample results are provided in Table 5.

Table 5

Comparison of AIS debt value versus confirmed debt value where DNL items represent debt

	<i>Micro Segment</i>	<i>Small Segment</i>	<i>Large Segment</i>	<i>Total</i>
AIS estimated PAYE debt value	\$350 114	\$2 073 383	\$383 404	\$2 638 946
Actual debt value confirmed with client	\$436 201	\$1 394 522	\$400 126	\$1 982 852
Difference	(\$86 087)	\$678 861	(\$16 722)	\$656 094
% Difference	(25%)	33%	(4%)	25%

Note: Percentages shown in brackets indicate that the ATO has underestimated outstanding PAYE remittances.

2.18 The survey sample indicates there is a risk that the ATO may be underestimating the PAYE debt associated with micro segment clients while overestimating the debt associated with small segment clients. The likely cause for inaccurate estimates of potential PAYE debt is out-of-date client information. The ANAO recognises that the employment patterns of businesses may vary greatly over time, which in turn may affect the accuracy of PAYE data held on the AIS. There is scope to improve the ATO’s estimation of potential debt. This factor is important for assigning follow-up action priorities to recover potential debt.

Recommendation No.1

2.19 The ANAO recommends that, to increase the accuracy and reliability of its information system, the ATO investigates methods for updating estimated employer PAYE liability and employment cycle information for Micro and Small Segment clients on a more timely basis.

⁶ Some ATO survey responses were not clear or did not contain sufficient information to allow appropriate categorisation.

ATO response

2.20 The ATO agrees with this recommendation. In respect of estimating employer PAYE liability, one of the shortcomings with the current PAYE legislation which impacts on the ATO ability to identify the amount of debt outstanding is that there is no requirement to notify the ATO of a liability only a requirement to pay the amount. Under Tax Law Amendment Bill (TLAB) (No. 5) 1998, which was reintroduced to the Parliament in December 1998, there will be a requirement for employers to notify the ATO of the amount of the liability as well as remitting that liability. This change will assist in debt establishment for PAYE.

2.21 In addition to the above Bill, a Business Activity Statement has been incorporated into the government's tax reform proposals (including PAYG – Pay as you go) for July 2000. This statement, which is proposed to be monthly or quarterly, could provide a range of information about a business which may help to develop client profiles.

2.22 More frequent updating of Estimated Annual Liability Amount (EALA) based on more current information stemming from recent remittance receipts may provide more reliable information for estimating potential liability outstanding. This would, however, require modification of AIS. The ATO's ability to implement this change would depend upon the relative benefits of this change in the context of the overall reform "change" agenda. Implementing innovative changes, such as running balance accounting, which should deliver more significant outcomes, including earlier payment of debt and reduced debt case workloads in the longer term, have a higher priority at this point in time. Additionally, the EALA may be less reliable in relation to clients who have not remitted where there is no data to reliably update the EALA.

Actioning of Potential PAYE Debt

2.23 Prioritising DNL items for action by client teams needs to be based on the risks associated with the potential debt, as this affects the likelihood of collection. The ANAO found that DNL items that are reported as AQS items (for large and medium remitters) are given priority for client team action by using an algorithm which takes into account the dollar amount of the outstanding remittance and the number of remittance periods outstanding. In essence, the larger the dollar amount and number of periods outstanding, the higher the priority attached to the DNL item for actioning.

2.24 This approach focuses on the risk characteristics of the potential debt but gives no weight to the risk characteristics of the potential debtor including:

- financial capacity;
- compliance history; and
- related demographics, such as the type of industry involved.

2.25 Although the AIS does not take into account the risk characteristics of the potential debtor in prioritising DNL items as such, the ANAO noted that the ATO has established some ‘high risk’ teams to manage those clients with a history of poor compliance. There is scope to develop further the ATO’s approach in relation to client risk profiling, to assist in appropriately prioritising DNL items for action.

2.26 The ANAO also found that, although the AIS prioritises AQS items for action by client teams, staff are not required to action AQS items accordingly. Consequently, ATO staff may select AQS items which have a lower risk profile than other available AQS items. Not actioning higher risk cases in a timely manner may affect the likelihood of the ATO collecting potential debt. The ANAO found that client teams were not given appropriate policy advice requiring them to action AQS items according to the AIS priority ranking. The ANAO recognises that a degree of flexibility in actioning AQS items is desirable. However, general guidance to client teams would increase the effective management of ATO clients.

2.27 The DNL MRS is a relatively new system specifically developed to monitor clients required to remit quarterly. With the introduction of the new remittance cycles, the majority of the ATO’s 800 000 PAYE clients are now classified as quarterly remitters (approximately 650 000). The DNL MRS does not utilise the AQS to automatically report DNL items. Also, the DNL MRS does not automatically prioritise DNL items for action. Instead, client team leaders are responsible for prioritising DNL items for action by client managers. The ANAO found that there has been no policy advice issued to client teams as to how they should prioritise DNL MRS items. The ANAO considers that there is a risk of inconsistent prioritisation of DNL items by client teams which would adversely affect the likelihood of PAYE debt collection where the appropriate priority has not been established.

2.28 As the DNL MRS does not automatically generate a Final Notice for quarterly non-remitters failing to remit, we also consider that it is important that client teams appropriately prioritise these DNL items for timely follow-up action.

2.29 In summary, the ANAO considers that the ATO could take more effective action to ensure that DNL items for all remitter types are appropriately prioritised for actioning by client teams.

Recommendation No.2

2.30 The ANAO recommends that, to improve targeting of likely debt, the ATO further develops its use of client risk profiling for all remitter types and provides guidance to client teams using the Detect Non Lodger (DNL) Management Reporting System in prioritising DNL items for actioning.

ATO response

2.31 The ATO agrees with this recommendation. It is acknowledged that the ATO needs to better target likely debts and provide clear directions to staff regarding criteria they use when operating the DNL MRS program. The ATO is undertaking risk scoring profiling of clients based on previous compliance history.

2.32 Work is currently being undertaken to develop risk profiling capabilities as part of the ATO Receivables Management Re-engineering process. We anticipate that profiling will allow the better development of appropriate debt collection responses to particular taxpayer/debt categories. In addition, the use of call centres and automated action will assist in the prioritisation of debt. New accounting systems are scheduled and these will provide overall improvements to the ATO's ability to action cases.

2.33 Client risk profiling is an integral part of the re-design of receivables management. Action is under way to implement a client risk profiling tool and a replacement receivables management system. In the interim we are using DNL MRS and OLAP (On-line analytical programming) tools to assist with the identification of priority DNL work. Team Leaders have access to DNL MRS and have received training in use of the tool. DNL MRS has enabled us to identify cases which previously were not referred by AQS (Action Queue Service).

Timeliness of PAYE debt confirmation

2.34 Better practice in receivables management recognises that potential debt should be actioned in a timely manner to increase the likelihood of collection. The ANAO examined the ATO's timeliness in confirming potential PAYE debt with clients by conducting an age analysis of AIS data as at August 1998. The ANAO analysed:

- the number of outstanding DNL items (remittance periods) as shown in Figures 2 to 4; and
- the potential value of collectable PAYE debt associated with outstanding DNL items as shown in Appendix 1.

Figure 2

Outstanding DNL items (remittance periods) for Large Segment

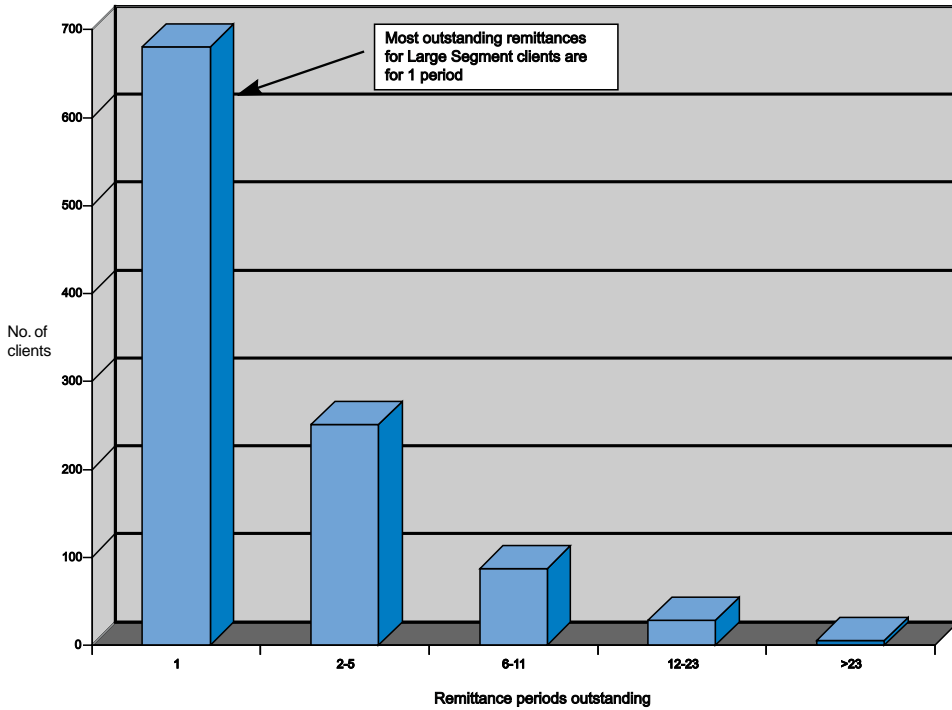


Figure 3

Outstanding DNL items (remittance periods) for Small Segment

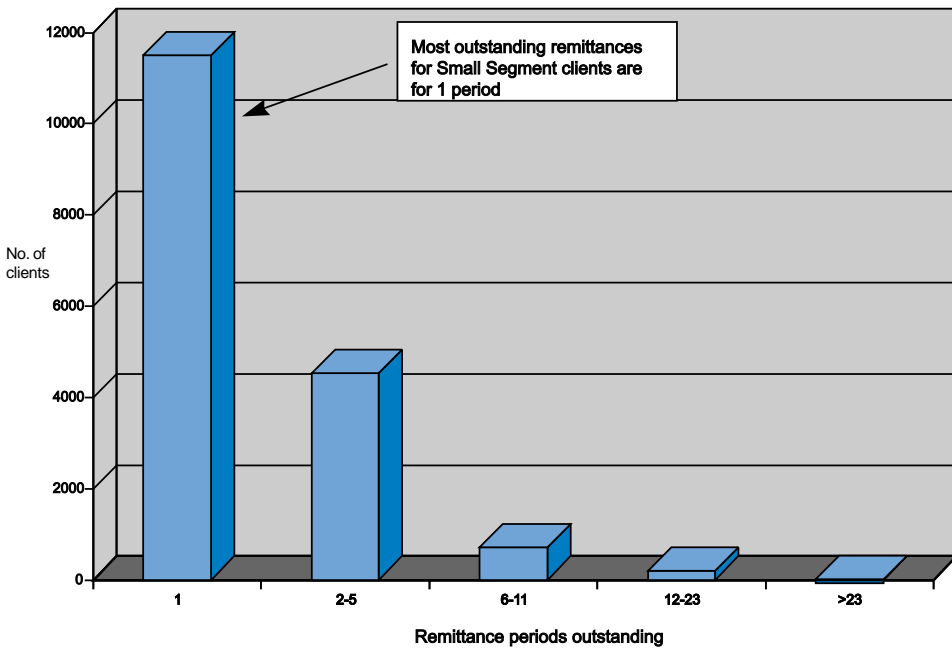
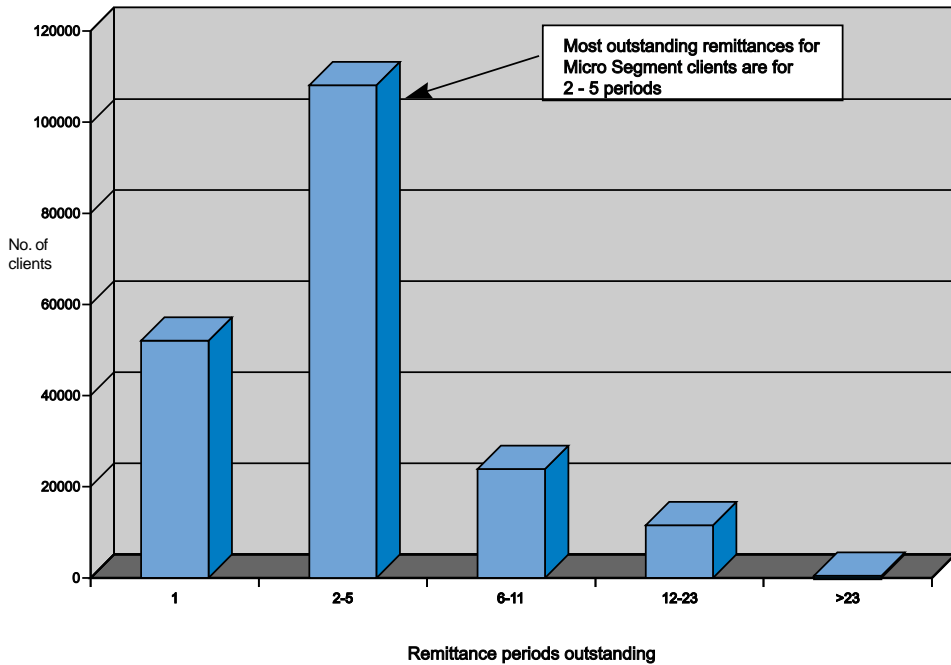


Figure 4**Outstanding DNL items (remittance periods) for Micro Segment**

2.35 Although the AIS data analysed represents a 'snapshot' only of outstanding remittance periods, Figures 2 to 4 demonstrate that there is a backlog of PAYE DNL items to be actioned. Most DNL items for large and small segment clients represent one outstanding remittance period, whereas most DNL items for micro segment clients represent two to five outstanding remittance periods. This difference is most likely owing to the large number of clients to be managed within the micro segment and the small value associated with each individual DNL.

2.36 The ATO recognises the backlog of DNL items to be actioned is a significant problem. In December 1997, an ATO report indicated that for the micro segment there were 1.7 million outstanding periods representing over \$1.4 billion in potential debt. The ATO has initiated a culling process based on criteria of low client risk to reduce invalid data.

2.37 The ANAO recognises the benefits of ensuring that client accounts reflect accurate information. However, the ATO will need to be sure that any culling of DNL items is based on sound criteria to avoid removing DNL items that in fact represent debt owed. Reliance on 'after the event' culling, to identify those DNL items that are likely to represent debt, reduces the likelihood of the ATO collecting potential debt from micro clients owing to the elapsed time before culling activity is undertaken.

2.38 The ANAO suggests that in addition to using client risk profiling to prioritise DNL items for actioning, the ATO could also use client risk profiling to flag DNL items for potential culling. The criteria in this regard could be continually updated in response to the effectiveness of any culling activity undertaken. This approach would help the ATO ensure that only DNL items associated with low risk clients were the subject of any culling activity. Also, where DNL items have been culled on the basis of client risk profiling, this information could also be taken into account in prioritising future DNL items for actioning by client teams.

Age analysis of DNL items

2.39 The ATO has not estimated the value of debt associated with outstanding DNL items that are likely to be valid or the value of revenue that could be collected taking into account the age of these valid DNL items.

2.40 In the absence of this information, the ANAO sought to calculate an indicative value by performing an age analysis of DNL items which are likely to be valid. The ANAO applied the results of the DNL survey sample to estimate the value associated with outstanding DNL items that are likely to be valid. The value of this debt was then multiplied by a collection factor to determine the value of debt that was likely to be collectable. Appendix 1 shows the results of this analysis.

2.41 Our analysis found that more timely follow-up of outstanding remittances would result in improved revenue collection. The analysis indicates that even if those PAYE DNL items aged more than one month could be followed-up immediately, approximately \$108 million of PAYE debt may not be collected owing to the age of the debt. This indicative analysis demonstrates there is a risk to tax revenue where PAYE DNL items are not actioned in a timely manner. The issue of performance management in relation to PAYE debt establishment is discussed later in this Chapter.

Automated generation of PAYE client notices

2.42 The *Background* section of this Chapter referred to the issuing of Final Notices to non-remitters. As a risk based approach the ATO has chosen not to issue a Final Notice where a large remitter defaults. The AIS does however, issue a Final Notice where a medium remitter fails to remit as expected.

2.43 Small remitters are monitored using the DNL MRS. The DNL MRS does not automatically issue Final Notices where clients default. This is due to the large number of clients in this category and the nature of their remittance patterns. Small remitters are more irregular in their

payment patterns than larger remitters. Consequently, it is not always appropriate to issue automatically a Final Notice when a small remitter fails to remit. Currently, employers are not legally required to advise the ATO of a nil return. However, the ATO has advised that, under the tax reform initiative:

. . . all quarterly payment and remittance dates—including income tax instalment payments, withholding remittances and Fringe Benefits Tax (FBT) payments—will be aligned with the new quarterly GST and PAYG payment dates . . . Most businesses will, therefore, be able to complete a single compliance statement once a quarter, and make one quarterly payment.⁷

2.44 This approach will help the ATO determine whether clients have an outstanding liability.

2.45 The ANAO recognises that client notices are not the ATO's only communication tool. The ATO advised that teams communicate extensively by telephone with clients who fail to respond to client notices. Where the ATO does issue client notices, client notice design should generate the best response possible in debt confirmation and collection. Given the number of periods outstanding in relation to DNL items (shown in Figure 4), there must at least be some uncertainty as to Final Notice effectiveness in prompting clients' compliance. Ineffective client notices reduce the likelihood the ATO will collect PAYE debt.

2.46 The ANAO noted that an ATO Branch has tested the effectiveness of an alternative client notice in following up 191 cases of potential PAYE debt. The notice adopts a different approach to confirming PAYE debt compared with that taken in the Final Notice. Test results show an improved success rate with the letter in confirming and/or collecting the debt.

Recommendation No.3

2.47 The ANAO recommends that the ATO investigate the effectiveness of Final Notices in confirming PAYE debt. As part of any investigation, the ATO should consider how alternative forms of client notification will aid timely confirmation and collection of outstanding PAYE remittances.

ATO response

2.48 The ATO agrees with this recommendation. As part of the Receivables Management Re-engineering process the ATO will be

⁷ *Tax Reform not a new tax a new tax system, The Howard Government's Plan for a New Tax System*, circulated by The Honourable Peter Costello, M.P., Treasurer of the Commonwealth of Australia, August 1998

examining and evaluating the most effective and efficient procedures for confirming debt. The use of risk profiling and telephone projects are alternative approaches that will be examined by receivables management.

2.49 Alternative forms of client notification are being considered as part of the Receivables Management Redesign Project in line with a graded approach based on risk. With the advent of more sophisticated and on-line client profiling, clients will be streamed to receive the most appropriate interaction with the ATO based on their compliance profiles. The range of interactions will be expanded. The interactions may extend from telephone contact either before and after due date depending upon the client’s compliance history, together with a greater variety of notices such as those with a softer tone for those who have generally complied and notices with a stronger message for those with a poorer compliance history.

2.50 In the interim other forms of notices can be generated. However, as the generation of these notices is not automatic, there is a significant resource commitment. Accordingly we need to apply these approaches sparingly to higher risk cases, such as new clients.

Performance management

2.51 Sound corporate governance requires, among other things, establishing and monitoring appropriate performance indicators to facilitate performance feedback and improvement. The ANAO found that the ATO monitors its debt establishment performance by segment at Region and Branch Office level, reporting against the following criteria:

- the percentage of defaulting employers out of total employers; and
- the percentage of outstanding periods per defaulting employer.

2.52 Desirably, both indicators will show a reducing trend. A summary of ATO monthly reports on these criteria for client segments for the financial year 1997–98 are shown in Table 6.

Table 6

ATO reporting of debt establishment performance for 1997–98

	<i>Micro Segment</i>	<i>Small Segment</i>	<i>Large Segment</i>	<i>Trend (Reducing/ Increasing)</i>
% Defaulting PAYE employers as % of total employers (for each month)	Between 7%—11%	Between 5%—8%	Between 4%—5%	No discernible trend
Average no. of periods outstanding per defaulting role (for each month)	Between 3 and 4 periods	Between 2 and 3 periods	Between 2 and 3 periods	No discernible trend

2.53 The ANAO considers that measurement of the number of defaulting employers is an indication of taxpayer compliance rather than of debt establishment performance.

2.54 The results of ATO monitoring of the average number of periods outstanding per defaulting employer for the 1997–98 financial year demonstrate that there is no reducing trend to indicate improved performance in this area.

2.55 The ANAO notes that calculating the average number of periods outstanding per defaulting employer provides a high level analysis of limited value. Alternatively, the ATO could profile the number of outstanding periods to better assist in identifying potential problem areas and assist in the appropriate allocation of resources. Figures 2 to 4 provide an example of the type of profiling the ATO could perform based on information currently available. The ANAO considers that the ATO would benefit from refining its performance indicators to provide a more indicative reflection of its debt establishment performance.

Recommendation No.4

2.56 The ANAO recommends that the ATO takes action to improve the timeliness of debt establishment and refines its performance indicators to assist in improving the ongoing management of its PAYE debt establishment performance.

ATO response

2.57 The ATO agrees with this recommendation. As previously mentioned, proposed changes to the legislation announced in TLAB (No. 5) 1998 will assist in the establishment of debt. In addition, the running balance account system will help overcome posting and other accounting errors. The development of risk profiling of clients, which has already commenced through co-operative work with Legal Collections in WHT and the Micro segment in WHT will lead to more refined performance indicators. The WHT Small Segment has undertaken extensive work in profiling its high risk clients.

2.58 The ATO is seeking to improve debt establishment processes by forming the new Small Business Line, Receivables Management Stream. With this new structure, systems and the adoption of best practices, a more dedicated and professional approach to receivables management in the ATO is planned. More effective performance indicators with appropriate system reporting capability will be considered as part of the Receivables Management Redesign Project. Consideration of suitable performance indicators has formed part of our planning processes. The

difficulty at present is the limited ability of our current systems to provide measures of success in terms of the performance indicators.

Conclusion

2.59 In the context of a largely compliant client base, the ANAO found that the ATO's lack of timely action on overdue remittances represents a risk to tax revenue. There is a backlog of overdue PAYE remittances requiring follow-up action. Our analysis found that more timely follow-up would have improved revenue collection results. We also found client risk profiling would better target debt requiring timely action. This is particularly the case for small remitters who are the majority of ATO clients.

2.60 There is scope for the ATO to investigate the use of alternative forms of client notification where clients fail to remit as expected, taking into account client remittance patterns and behaviour.

2.61 We found that improvements to remittance monitoring could be achieved by better analysis of available system based information. We also found that the majority of system generated indicators of late remittance are invalid. Where such items represent a debt owed, the estimates of debt are often inaccurate. In addition to our recommendation for improving data accuracy, ATO initiatives such as the introduction of a 'running balance account' system could also be expected to lead to desirable improvements.

3. End-of-year reconciliation discrepancies

Annual reconciliations

3.1 Group employers are required to forward annually to the ATO original group certificates together with a reconciliation statement. This statement is used to reconcile the total amount claimed as remitted to the ATO during the income year with the total amount of instalment deductions shown in the group certificates issued to all employees.

3.2 Under a self-assessment regime such as that operating in Australia, annual reconciliation provides a key control. Discrepancies arising from the end of year reconciliation process represent potential debt to the ATO or refunds owed employers.

Debt establishment

3.3 As with non-lodgement of remittances, establishing early where debt arises from a debit discrepancy is a critical factor in successfully collecting that debt. In terms of equity, it is equally important that overpayments, indicated by a credit discrepancy, are refunded to the employer in a timely fashion.

3.4 Processing of the reconciliation statements leads to approximately a 4.1 per cent rate of self-assessed discrepancies, fairly evenly divided between debits and credits. Discrepancies may result from a number of causes: keying error, client error, account errors or actual discrepancies. A valid self-assessed debit discrepancy is, in effect, a notification of debt by the employer and should therefore be actioned as soon as possible. A valid self-assessed credit discrepancy is, on the other hand, a notification of over payment and under the Taxpayers' Charter should be refunded within the stated time-frame.

Results of sampling discrepancies

3.5 A sample of discrepancy items was examined as part of the audit. Results indicate that 38 per cent of the sample were valid discrepancies, 27 per cent were keying errors, 25 per cent were client error, 3 per cent were accounting error and 7 per cent could not be finalised in the survey time-frame. In terms of dollar value represented by the sample, 2.9 per cent of the discrepancy total was valid.

3.6 The larger discrepancy values were more likely to be invalid, with the largest valid discrepancy being just under \$20 000 and the bulk being

under \$10 000. Developing client risk profiling, proposed by the ATO to improve compliance activities, would also help client teams select the discrepancies most likely to be valid.

3.7 AIS provides on-line lists of discrepancy items to WHT client teams for follow-up action. There is a backlog of these discrepancy items as shown in Table 7. Although these appear to represent potential debt of \$2.35 billion and potential refunds of \$3.09 billion (as at 31 October 1998), prompt follow-up action by the ATO is necessary. This will establish whether the discrepancy is valid or the result of keying error, client error, ATO accounting error or lack of up to date client information. On the basis of the sample of discrepancy items referred to in paragraph 3.5, the actual discrepancy figure is likely to be significantly less.

Table 7

Self assessed reconciliation status as at 31 October 1998

Year	No. of reconciliation statements lodged	Discrepancies (Dr)		Discrepancies (Cr)	
		No.	Value \$	No.	Value \$
1996*	764 128	3 379	169 million	9 456	340 million
1997	762 276	5 626	315 million	10 890	1.2 billion
1998	581 742	10 754	1.87 billion	13 240	1.55 billion

* 1996 results were last reported on ATO systems as at 1 August 1998

Resolving discrepancies

3.8 A key issue is that timely resolution of discrepancies is not occurring. There are still discrepancies outstanding from the 1996 reconciliation (1.7 per cent of that year’s reconciliations lodged as at 1 August 1998 or over 40 per cent of the number of discrepancies for that year). The problem is exacerbated in that 1996 items are no longer displayed on the client teams’ automated action lists as two years of action items only are available. This represents \$169m of potential debt and \$340m of potential refund which are no longer being actioned. Although ATO experience and our analysis indicate very few of these discrepancies represent actual debt or credit, timely resolution of these discrepancies is required.

3.9 Also at issue is whether the Taxpayers’ Charter is being adhered to in terms of providing timely refunds. Credit discrepancies receive low priority. We found that some staff understood that the only credit discrepancies to be actioned were those where a refund had been specifically requested. Although the ATO policy on credits and refunds requires a request in writing, in this instance where the client has provided a reconciliation statement, the low priority for credit discrepancy refunds

appears contrary to the principle of fair treatment in the Taxpayers' Charter.

3.10 The Group Employer's Reconciliation Statement form is very definite about a debit discrepancy, describing it as a short-remittance and advising employers that they must pay the shortfall. No such clarity is provided for a credit discrepancy nor is there an indication that a refund is possible. This does not appear to be even-handed treatment.

Correcting keying errors

3.11 An initiative which would remove the keying errors and therefore present client teams with discrepancies which require follow up action is to have the bulk processing centre check all potential discrepancies as part of their daily batch processing error checking. It would be more efficient and timely having corrections performed at source. The client team use of discrepancy value as an indicator of priority would then be more reasonable than it currently is because the high value discrepancies are mainly keying errors.

Educating new clients

3.12 An ATO initiative for encouraging compliance is for new clients to be allocated to teams specifically established to emphasise an education role in their first year of operation. System indicators of failure to comply form an opportunity for the ATO to explain to the client their obligations and to assist them in fulfilling those obligations effectively. The first Reconciliation Statement presents such an opportunity.

3.13 The ANAO noted comparatively high rates of reconciliation stationery outstanding reported for the Micro segment 'new' teams. Although it might be expected that more new clients may have difficulty in furnishing details for annual reconciliation, it seems that the opportunity to inculcate compliant behaviour as early as possible is being lost.

3.14 A proactive approach where advice is automatically sent to new clients a month in advance of the due date for submitting reconciliation statements may have multiple benefits. It may encourage timely compliance by those who just needed a reminder. Those who need assistance would have an impetus to contact their client team and, for those whose business has failed, it allows for timely amendment of AIS records. Improved client relations with the ATO and better compliance are likely outcomes.

Use of full reconciliation facility

3.15 Full reconciliation is a term used to describe the ATO's process which captures Group Certificate information provided electronically by the employer and attempts to reconcile the total instalment deductions claimed against the total of remittances recorded throughout the year.

3.16 The ATO success rate for full reconciliations is quite low at less than 8 per cent. Client team staff in general do not have confidence in a 'fail' indicator (debit or credit discrepancy) on full reconciliations as their experience has shown that the high rate of discrepancies are mainly caused by client error in providing information electronically. In addition, only a small proportion of the employer population furnishes the information in this way. The sample survey of discrepancies conducted as part of the audit confirmed the basis for this lack of confidence. Although the sample size was small, all full reconciliation discrepancies examined proved to be invalid.

3.17 At issue is whether the full reconciliation process is or will ever be viable. It is not presently supporting the ATO in either collecting revenue or improving compliance.

Recommendation No.5

3.18 The ANAO recommends that:

- the ATO improves the timeliness of actioning self assessed reconciliation discrepancies to clear the backlog, within the constraints of cost and risk;
- reconciliation data entry keying errors be corrected at the bulk processing centre as part of the data capture process;
- the ATO improves its system to prioritise discrepancy items on the basis of risk profiling;
- both credit and debit discrepancies be actioned equitably and established credit refunds issued within the Taxpayer Charter specified time-frame;
- advice on the Reconciliation statement should be equitable in its treatment of both debit and credit discrepancies; and
- proactive advice be automatically sent to new clients as timely assistance in handling their first end of year reconciliation.

ATO response

3.19 First point—The ATO agrees with this recommendation. The use of the whole of client approach will allow a better identification of

genuine debit and credit discrepancies. The utilisation of emerging technology involving the Data Warehouse will allow the distribution of the data to the relevant work sites. The ATO does action self-assessed discrepancies. However, the priority of this workload has to be considered in the context of overall risks. We note ANAO comments that the vast bulk of these cases involve small amounts of revenue, so we need to ensure that excessive resources are not redirected from higher risk to action these cases. Systems support is also required for measurement of this performance standard.

3.20 Second point—The ATO agrees that the issue of data entry keying errors should be examined. Implementation of the recommendation would require a number of system changes. Further examination of the recommendation would need to be carried out to determine on a cost benefit basis whether this is the most appropriate course of action, as alternative solutions may be available. Keying errors that can be identified early should be corrected by the Bulk Processing centres.

3.21 Third point—The ATO agrees with this recommendation. The ATO has already commenced developing risk profiles which encapsulate not only discrepancy items, but other client account factors drawn from AIS, NTS (National Taxpayer System) and the STAC (Storage and Access of electronic returns) systems. We anticipate this profiling will allow the development of appropriate strategies for actioning potential debt cases based on the level of risk posed. DNL MRS already is being used to prioritise DNLs based on compliance history (debt and number of periods outstanding).

3.22 Fourth point—The ATO agrees with this recommendation. The ATO has a clear policy regarding prompt actioning of credits on taxpayers' accounts. The existence of credit balance items on AQS, the Weekly Credit Balance Reports and the Monthly AIS Refund Certificate attest to the importance the ATO places on the correct and equitable treatment of account credits. It should be noted that a credit discrepancy on a reconciliation statement does not raise a credit on the taxpayers' AIS account. The credit discrepancy needs to be reconciled and only rarely results in a credit to the client. The comments in relation to equitable treatment of credit and debit discrepancies are noted, particularly within the framework of the Taxpayers' Charter. However it is still our preference within the constraints of our existing systems to encourage clients to offset credits against their next remittance.

3.23 Fifth point—The ATO agrees with this recommendation. The ATO is currently reviewing the wording on the PAYE Reconciliation Statement. The reconciliation statement allows the client to notify the ATO of both

underpayment or overpayment. It is acknowledged that debit discrepancies are treated as a higher priority than credit discrepancies as historically credit discrepancies have not resulted in refunds to roles. The ATO has an EDI Project working on Electronic Data Interchange. Once this facility is available and provided employers use the facility we will be able to more easily identify credit discrepancies within 28 days both for electronic users and for the residual paper users (provided electronic usage is high).

3.24 Sixth point—The ATO agrees with this recommendation, which should be addressed with Tax Reform proposals. Further analysis of new client behaviour also needs to be undertaken so that the most appropriate strategies can be implemented.

Conclusion

3.25 Most self assessed reconciliation statements of PAYE remittances successfully balance, reflecting a high level of compliance by employers. There is scope, however, for more timely ATO follow-up action on discrepancies. The current backlog of discrepancies exceeds the system's retention capacity and reduces the likelihood of debt recovery. Improvements in error correction would reduce invalid discrepancies occurring. This, coupled with improved debt targeting, should more effectively resolve the problem of discrepancy items.

3.26 The treatment of credit and debit discrepancies could be more equitable. We consider that the ATO should provide clearer instructions on the reconciliation form to advise the potential for refunds. There is also scope for the ATO to educate new clients about the requirements of providing annual reconciliation returns. This would help improve client relations and encourage compliance.

4. Managing Compliance Intelligence

Planning and coordination of tip-off information collection

4.1 The ATO often receives information from the public which it uses in compliance investigations. It refers to such compliance intelligence advice as 'tip-offs'. Tip-offs are received by the ATO through a number of avenues including:

- telephone calls;
- letters direct to operational areas;
- information by phone direct to auditors or enquiry officers; and
- information provided directly to field officers both through associations with their case work and because they are accessible in the field.

4.2 Tip-offs are a significant source of market intelligence for the ATO with approximately 20 000 tip-offs expected this financial year, of which approximately 6000 will be referred to WHT. The majority of WHT tip-offs relate to PAYE (approximately 60%). The ATO recognises the importance of tip-off information in contributing to improved taxpayer compliance. In the 1998–2001 Corporate Plan, the Commissioner stated in relation to the ATO's approach to compliance, that the ATO will:

*. . . increasingly build our understanding of compliance risks and trends through knowledge derived from processing, other client interactions and a wide range of other sources . . .*⁸

4.3 Effectively managing tip-off information is important in helping the ATO target compliance activities. Timely tip-off information follow up is also important to avoid a loss in public confidence concerning the ATO's response to information provided by the public.

ATO system support for tip-off information

4.4 To obtain maximum benefit from its tip-offs, the ATO requires a nationally based system to provide a complete picture of the information received. WHT currently utilises CaMRA, a locally based system, to assist in managing tip-off information received from the public.

⁸ Supporting the Community 1998 to 2001 Plan, ATO, 1 July 1998, page 4

4.5 In February 1998, the ATO conducted an internal workshop to discuss the way in which tip-offs are managed within the ATO. The workshop made a number of preliminary findings, including that a key aspect of effective use of tip-off information is the development of a nationally accessible information management tool or database. This database would provide a standard format for the collection of data and provide a focal point for the supply of tip-off information to ATO staff.

4.6 In relation to the ATO's use of technology the Commissioner has stated in the ATO Corporate Plan 1998–2001 that the ATO will:

. . . use a common infrastructure across the ATO, varying from that only where there is good, sustainable, business reason for doing so.

4.7 The ATO has progressed its management of tip-off information by establishing new procedures which came into effect from 1 July 1998. The ATO now has a call centre operating to receive information offered to the ATO by telephone and other media. The ATO has also developed the Community Information, Storage, Communication and Observation system (CISCO) to help manage tip-offs. Information received by the call centre is recorded on CISCO for referral to the relevant ATO business line.

4.8 The ANAO found that the ATO's system for handling tip-off information is currently designed so that WHT-related information received by the call centre is referred to WHT officers with access to CISCO. As discussed, WHT uses CaMRA rather than CISCO to manage tip-off information. The ANAO noted that CISCO and CaMRA cannot exchange information automatically. Consequently, WHT staff with tip-off information already keyed into CISCO, must re-key the same information into CaMRA. Likewise, in order for the ATO to have a truly national analysis of its tip-off information available, CISCO would need manual updates of WHT tip-off investigation outcomes. The result of this approach is that the ATO is operating a largely labour intensive method of managing its tip-off information using two systems which inhibits its ability to access timely tip-off information.

4.9 The ANAO found that the interface between CaMRA and CISCO was not operating effectively. Tip-off information updated in CaMRA is not always subsequently re-keyed into CISCO. The majority of WHT field teams had not had any tip-offs referred to them from the new call centre.

4.10 Wherever interfaces are introduced between information systems there is a risk that the integrity of information moving through the interface may be compromised or that information may be lost. The most effective way of treating this risk is to reduce where possible, the

number of interfaces between information systems or eliminate them entirely.

4.11 The ANAO considers that CaMRA does not provide effective national support for managing WHT tip-off information. CaMRA is supported by a local server in each ATO Branch and there is no simple means of obtaining a national picture automatically. Further, there is no apparent business reason why WHT requires a separate tip-off information system to the rest of the ATO.

WHT use of tip-off information

4.12 To maximise the benefits available from collecting public information, tip-off information received should not be investigated in isolation from other enforcement activities. For example, where a field team is engaged in performing audit work on a specific project, any related information received from the community needs to be passed effectively and efficiently to the project team for their consideration.

4.13 During ANAO field work, WHT field teams advised that tip-off information was taken into account when performing field work. However, without access to a national system for managing tip-off information, it is not possible for ATO field teams to take into account all public information when prioritising and actioning field work. This further highlights the need for the ATO to develop a nationally based system for the management of tip-off information.

Recommendation No. 6

4.14 The ANAO recommends that the ATO implements a nationally based tip-off information management system with consistent procedures for collecting, recording, and reporting tip-off information.

ATO response

4.15 The ATO agrees with this recommendation. The ATO has implemented a nationally based tip-off information system known as CISCO. This will now be used to record tip-offs for PAYE. It is acknowledged consistent and improved procedures are required to ensure that the best quality data as possible is gathered, to assist in our planning and risk assessment processes.

4.16 Consistent and improved procedures are required to ensure that the best quality data possible is gathered. The receiver of any information must be trained to ensure the best information possible is extracted from the person providing the tip-off. Letters that are received, and tip-offs verbally communicated direct to WHT staff will be included in the CISCO database.

4.17 The ATO (WHT) is currently examining proposals to improve the interface between CISCO and CaMRA so that WHT officers using CaMRA have the relevant data within CaMRA to manage cases involving tip-offs. This will be done through upgrades to the CaMRA system.

4.18 The ATO agrees, subject to resource constraints, that the interface between CISCO and CaMRA and other ATO systems such as AIS needs improvement so that the relevant data is automatically transferred from CISCO to CaMRA without the need for manual intervention. It is noted that the risk rating mechanisms within both CISCO and CaMRA are not as effective as possible due to:

- not automatically drawing upon data found on other ATO databases to expand the client’s profile; and
- the poor quality of information supplied by informants.

ANAO Comment

4.19 It is doubtful that the use of two separate systems to manage tip-off information can be justified. For example, the duplication of risk rating and some data entry procedures represents a risk to efficient and accurate information management and follow-up action.

Performance management

4.20 ATO strategic planning at the segment level has identified that, in relation to knowing and understanding its clients, one method to identify those people outside the system is by actioning anonymous information. The ATO workshop conducted in February 1998 also found that the ATO needs to be able to measure its performance in managing tip-off information. They proposed that these indicators be built into the database developed so as to provide automated reporting.

4.21 In relation to actioning tip-off information, the ANAO found that most tip-offs referred to WHT on CISCO were not subsequently allocated to WHT field team staff for investigation. CISCO records (1 July 1998 to 17 September 1998) revealed that approximately 70 per cent of tip-offs referred to WHT were not allocated to WHT field team members, as shown in Table 8.

Table 8
Allocation of tip-offs

	<i>Cases Completed</i>	<i>NFA</i>	<i>Not Allocated</i>	<i>Pending Action</i>	<i>Researching</i>	<i>Total</i>
WHT BSL	33	69	581	1	123	807

Note: Tip-off information has not been risk-rated at this stage. Therefore tip-offs representing a high risk to compliance may be unallocated to WHT field teams.

4.22 This effectively means that potentially valuable tip-off information is not reaching the appropriate ATO staff for follow-up and that the ATO is failing to reap the benefits available from this intelligence source. The lack of progress in this regard suggests that WHT's performance in actioning tip-offs is not closely monitored.

Recommendation No. 7

4.23 The ANAO recommends that WHT implements performance indicators and monitors the timely allocation of tip-off information for investigation by WHT field teams.

ATO response

4.24 The ATO agrees with the recommendation and is currently examining appropriate performance indicators. Indicators being considered include recording the information in a timely manner, acknowledging the information in a timely manner, and acting upon the information in a timely manner. It is noted that acknowledging the information may often be difficult as a substantial volume is received anonymously.

4.25 Initially, ATO efforts have been directed to developing systems to record and manage tip-off information. As a result CISCO and CaMRA systems have now been developed. Whilst CaMRA is being utilised nationally, it still has to be placed on a national systems platform to obtain the overall national picture in relation to management of tip off cases. The CaMRA system is currently being upgraded so that the CaMRA and CICADA (Case Information and Control for Advisings, Disputes and Appeals) databases can be managed together. It is also proposed to use a revised IT program to enable CaMRA to become a national application.

4.26 It is agreed that indicators are required in relation to:

- recording tip off information in a timely manner;
- acknowledging to the informant of the receipt of the information in a timely manner (where possible);
- risk assessing the information in a timely fashion; and
- acting upon the information which has been identified as higher risk in a timely manner.

4.27 Where an informant provides sufficient contact information and requests an acknowledgment, the performance standard is that an acknowledgment be issued within 7 days. The benefits of acknowledgment include:

- recognition of community confidence is an important issue;
- prevention of possible duplication of tip off information where the informant has not received a response; and
- alerting the informant that the ATO will not be able to keep them informed of developments due to privacy considerations.

Methodology for following-up intelligence gathered

4.28 Tip-off information received by the ATO varies in type, quality and significance. Accordingly, to ensure the optimal use of ATO resources, tip-off information should be prioritised based on the potential risk to the tax revenue base.

4.29 CaMRA's risk rating system differs significantly from the previous form-based system used by WHT field teams. The ANAO found that the CaMRA risk rating system was poorly understood by WHT field teams. WHT field teams had not received training on how to use or interpret the risk rating system. Similarly, field teams had not received any communication describing how the new risk rating system worked. Consequently, they were unsure of the risk associated with a tip-off based on the score allocated by the risk rating system. A further consequence is that WHT field teams may fail to recognise the degree of risk associated with tip-off information received and may not respond in an appropriate manner to manage the risk at hand.

4.30 The ANAO also found that some field teams did not use the CaMRA risk rating facility as the basis for prioritising tip-offs for action. These teams preferred to continue using the form predating the CaMRA risk rating system, as they understood this method better. Further, where WHT field teams continued with the form, they used different versions which meant that certain tip-off information would be risk rated differently depending on which version was applied to the information.

4.31 WHT field teams are not adopting a consistent approach to prioritising tip-off information for action. As a result, a particular tip-off could receive a different risk rating depending on which WHT field team was rating the information. Consequently, WHT field team resources may not be appropriately allocated according to the real risk that tip-offs represent to taxpayer compliance.

Recommendation No. 8

4.32 The ANAO recommends that the ATO adopts a consistent approach to assessing the risk to compliance associated with tip-off information and that appropriate training is provided to WHT field teams in determining and interpreting the risk to compliance associated with tip-off information.

ATO response

4.33 The ATO agrees that field staff require a good understanding of the risk process and trends. Part of the development process in this area has been the delivery of the ATO Compliance Model workshops, with an emphasis on risk management and the tailoring of appropriate strategies and tools to obtain compliance. Further training programs will be assessed and developed.

4.34 Training has been delivered in relation to CaMRA. However further training in relation to the manipulation of data may be required together with more detailed skilling in relation to CISCO.

Reporting

4.35 The ANAO found most field teams were not aware of all the reports CaMRA could generate. They had no training in using CaMRA report functions. The ANAO also found some field teams generated management reports for tip-off information using systems other than CaMRA.

4.36 Some field teams consider that CaMRA is not providing the management reporting functionality required although ATO senior management has advised that CaMRA does possess the required reporting functionality. For those field teams that perceive CaMRA to be lacking in reporting functionality there is a risk that they will:

- under utilise CaMRA as a resource;
- duplicate already available management tools by creating their own management reports;
- manage tip-off information in an inconsistent way; and
- do without relevant management information needed to manage taxpayer compliance effectively.

4.37 The ANAO considers that WHT field teams have not received adequate instruction and training in the use of CaMRA management reports.

Recommendation No. 9

4.38 The ANAO recommends the ATO gives WHT field teams appropriate instructions and training in generating tip-off information management system reports to enhance ATO information management.

ATO response

4.39 The ATO agrees with this recommendation. Appropriate ATO staff will be trained in report generation and extraction of relevant

information from CISCO and CaMRA as part of management reporting activities.

Tip-off resourcing

4.40 The ANAO found evidence that where the ATO had been previously utilising the form based system, not all tip-offs identified as being high risk were actioned. There is a risk that tip-off information may not be actioned in a timely manner, potentially leading to some loss of public confidence in the taxation system.

4.41 The number of tip-offs representing a high risk to taxpayer compliance may vary from year to year. It is not clear at this time whether the identified resource allocation will be sufficient to action all high risk tip-offs. The ANAO suggests the ATO closely monitors how appropriate this level of resource allocation is in ensuring tip-offs are consistently actioned in a timely manner.

Public relations and advertising

4.42 The ATO has advised the majority of WHT tip-offs received are from sources seeking to remain anonymous. However, where this is not the case, WHT does not currently reply to individuals providing tip-off information to acknowledge their contribution towards ATO compliance monitoring. If WHT adopted such an approach it could better assure the public that their efforts to assist are appreciated and are being acted upon. We recognise that the ATO would need to be mindful of the provisions of the *Privacy Act 1988* in implementing any form of recognition scheme.

4.43 The ATO has identified the benefits that advertising can bring in relation to encouraging the public to provide information concerning taxpayer non-compliance. The ATO intends to implement a targeted advertising campaign advising the Call Centre contact telephone number when the recently established Call Centre has reached a viable capacity.

Conclusion

4.44 The ANAO concluded that the ATO requires a nationally based system to manage tip-off information effectively and analyse taxpayer non-compliance. We consider establishing appropriate performance indicators will help WHT in monitoring tip-off information follow-up. We also found the ATO does not effectively monitor how resources are allocated to ensure all tip-offs that reflect a high risk to revenue are actioned in a timely manner.

5. ATO compliance projects

Introduction

5.1 As part of its work to improve taxpayer compliance, the ATO undertakes projects designed to identify emerging issues or risk areas. We reviewed two key ATO compliance projects relevant to the administration of PAYE:

- erosion of the PAYE revenue base; and
- reconciliation of employer remittances.

ATO work on PAYE erosion

History

5.2 The ATO has identified risks to revenue from taxpayers leaving the PAYE system. Causes and effects have been investigated since 1992 with a dual focus of measuring what was happening and encouraging compliance. Two separate external studies were commissioned, in 1993 and 1994, to help measure and analyse the issues. Also, legal judgements on test cases have cast doubt on the validity of specific aspects of ATO compliance efforts. These judgements centred on the definition of the employer-employee relationship.

5.3 In considering proposals to address the issues identified, the Government asked the ATO to use the existing tax legislation to minimise avoidance and analyse more fully the various impacts of erosion.

The enhancement project

5.4 The PAYE Enhancement project, which commenced in November 1996, had as its objectives:

- to determine and state publicly the ATO view on the reach of the present PAYE provisions;
- to research labour market changes and determine their effect on PAYE; and
- to ensure those within the reach of the provisions are subjected to the provisions.

In addition to case study investigations by tax officers, it relied in part on the 1993 and 1994 external studies with one of them (undertaken by the National Institute of Labour Studies) being updated in 1997 on the subject of self-employment.

5.5 The results still appear inconclusive. While the conclusion reached is that more people are leaving the PAYE system by entering contract arrangements, the ATO considers that it does not seem to have had a significant impact on revenue. Analysis of trends in the labour market showed that average PAYE tax per employee has a strong correlation to the increase in Average Weekly Earnings over the last thirteen years. It has proved extremely difficult for the ATO (and external studies) to identify what the potential PAYE population could be due to an inability to differentiate between categories of ‘contractors’ in labour force figures.

5.6 What could be determined was that PAYE still applies to most workers, that is, 7.1 million employees in the 1996–97 year. The ATO regards the consistent increase in PAYE revenue as masking the comparatively small numbers who are moving outside its provisions. In effect, the ATO considers the threat of PAYE erosion not to be as severe as they had estimated earlier.

5.7 The report identified a decrease in proportion of PAYE collections to total ATO revenue over the last four years although PAYE itself is increasing. What is missing is any attempt to analyse that movement in order to predict any trend over the medium to longer term. This may enable earlier detection of possible threats to the PAYE revenue stream.

5.8 A trend was identified within the large employer group of increased outsourcing of complete business units or functions and a resultant increase in the use of contractors. This change is expected to have a significant bearing on the PAYE collection system over time but neither the level of significance nor the likely timing of these effects has been analysed.

5.9 Eleven industry groupings the ATO considered ‘higher erosion risks’ were selected for review. Field work conducted during the project established that the overall level of compliance with the PAYE provisions, within the selected industries, was generally high.

5.10 A number of factors were identified which will affect either PAYE revenue or ATO costs of administration. The use of wage-alternative benefits, the increase in the number of owner-managers, part-time employment, the reduction in remittance levels from large employer groups and the increasing number of smaller remitters are expected to have varying impacts. What is not clear is whether there are threshold conditions which determine when the various effects become significant.

Recommendation No.10

5.11 The ANAO recommends that the ATO, in relation to its analysis of PAYE erosion, should:

- analyse the downward trend in the proportion of revenue from PAYE to establish causes and project likely outcomes for the medium to longer term;
- analyse the trend by large employers towards outsourcing of complete business units or functions to determine its impact on PAYE and overall revenue; and
- conduct a suitable sensitivity analysis to determine when identified effects on PAYE revenue will become significant so that timely action can be taken.

ATO response

5.12 The ATO agrees with this recommendation. Such analysis forms part of risk assessment processes.

The PAYE Reconciliation Project

5.13 Ensuring that those Group Employers who are not complying with the tax legislation are detected and brought to account promotes public confidence in the fairness and equity of the taxation system. The ATO undertakes a number of strategies to ensure Group Employer compliance including the full scale audit of selected Group Employers' business accounts. Another strategy available to the ATO is the reconciliation of tax instalment deduction credits from the duplicate copies of all group certificates issued by an employer, with the remittances received from the employer. Any discrepancies can then be investigated with the employer.

5.14 The above strategy differs from the annual reconciliation statements submitted by employers (discussed at Chapter 3) which facilitates the comparison of tax instalments remitted by employers with tax instalments received by the ATO.

5.15 Up until 1988, the ATO conducted reconciliation of all PAYE accounts. A 1988 review established that compliance was sufficient not to warrant allocating resources to this activity.

5.16 In 1993, WHT attempted to estimate the value of the gap between two dollar amounts: what Group Employers deducted as tax instalments

and what they remitted to the ATO. Two studies were conducted within the ATO. One estimated the risk to taxation revenue was potentially \$200 million without identifying the likely amount that could realistically be collected.

5.17 The other study also concluded that there was an estimated shortfall in PAYE revenue. Approximately 0.74 per cent of group tax deductions recorded on Group Certificates were not remitted to the ATO. This represented a risk to the tax revenue base of approximately \$300—\$400 million.

5.18 Prior to these two studies, ATO Internal Audit (Queensland) prepared a report on Group reconciliations in 1990. They estimated that there was a potential loss (based on the representative sample) of \$404 million (0.1% of the PAYE Group Employer population for 1989). However, their conclusion was that the risk to revenue was acceptable as there were several factors which reduced the potential revenue loss of \$404 million to a negligible amount. These factors were:

- further reconciliations revealed half the cases resulted in a nil discrepancy being verified; and
- the timely and accurate actioning of PAYE debit discrepancies.

5.19 In 1994, the Treasurer announced in the Budget statement that the ATO had identified a range of areas under existing laws where compliance could be improved through better procedures for the collection of outstanding taxes. These measures were expected to increase tax revenue by approximately \$300 million in 1994–95. One of these measures was the PAYE Reconciliation Strategy which was identified as contributing approximately \$200 million to the overall collection. WHT was also committed by the Agency Agreement to allocate 150 ASL for the PAYE Reconciliation Strategy.

5.20 In early 1994, the PAYE Reconciliation Project Management Team was established to capture Group Certificate information and reconcile it to remittances received by the ATO. It was estimated that the PAYE Reconciliation Project was to cost WHT approximately \$5 million.

5.21 The project found that:

- Group Employers who furnish Group Employer stationery had generally complied with their obligation to remit deductions; and
- there is a compliance risk associated with employers who failed to furnish Group Stationery.

5.22 An ATO review of the project reported that:

- the number of discrepancies that resulted in actual liability on the part of the employer was in the range of 15 to 45 per cent of the total number of discrepancies reported;
- large reported discrepancies generally resulted from some error, for example a keying error, and did not represent an actual liability;
- generally, verified liabilities were found to be small in value (\$3000—\$5000). The up front collection rate for established liabilities was 25 per cent; and
- the revenue target of an additional \$200 million in collection in the 1994–95 financial year was not achieved. Approximately \$20 million was collected for that year.

Lessons Learned

5.23 The ATO has identified a number of areas for improvement should the project be repeated: These include:

- sound methods are required to estimate the potential PAYE tax gap;
- consideration needs to be given to how much revenue could be collected and the time it would take to establish and collect the debt;
- there is a risk involved with implementing a project of this size when the ATO is also undertaking major workplace reform;
- records need to be kept of how the decision to implement a PAYE Reconciliation Project is reached; and
- criteria to measure the success in meeting objectives need to be developed during the decision making process.

5.24 Our review of the ATO's PAYE Reconciliation Project found the ATO had not undertaken a soundly based risk assessment of the potential revenue loss through Group Employers failing to remit PAYE Group Tax deductions to the ATO. Also, attempts to date have focused on identifying those taxpayers who have registered with the ATO as Group Employers and who are not remitting PAYE tax instalment deductions withheld. The ATO would also benefit from identifying those Group Employers who are 'outside the net', that is, Group Employers who are not registered with the ATO. This could be achieved to some extent by taking into account information provided on the employee's copy of the Group Certificate rather than relying on the employer's copy only.

5.25 The ANAO recognises that any allocation of resources to undertake future reconciliation activity of this type would need to be

cost-effective. Consequently, targeting certain industries or high risk clients may prove more cost-effective than attempting to reconcile the entire population of PAYE employers.

Recommendation No. 11

5.26 The ANAO recommends that the ATO undertakes a soundly based risk analysis to determine the likely revenue at risk from registered and unregistered Group Employers failing to remit PAYE Group Tax deductions to the ATO.

ATO response

5.27 The ATO agrees with this recommendation. The ATO is currently utilising Risk Analysis Teams to assist business units to assess risk to revenue posed by elements of the registered group employer client base. Furthermore, the resources in our WHT client teams and field teams are currently being deployed to test the hypotheses upon which the risk assessments have been made. It is anticipated through evaluation and further refinement of these processes that the revenue at risk will be more accurately determined. Adoption of the philosophies of the ATO Compliance Model should further ensure that appropriate compliance strategies will be implemented to attend to the identified risks. PAYE compliance activities are likewise focussed on identifying the risk posed by those group employers outside the PAYE system, though it is acknowledged that the ATO must continue to strive to improve risk processes.

Canberra ACT
28 April 1999



P.J. Barrett
Auditor-General

Appendices

Appendix 1

Age analysis of PAYE DNL items in August 1998

Segment	< 1 month	1 month	2 months	3 months	6 months	> 12 months	Total *
Collection factor	98.2%	93.8%	86.2%	73.6%	57.8%	26.6%	
Micro	\$233 706 868	\$1 088 346	\$773 636	\$110 094 663	\$203 522 221	\$269 043 658	\$584 522 524
Multiplied by % valid debt from survey—27%	\$63 100 854	\$293 853	\$208 882	\$29 725 559	\$54 951 000	\$72 641 788	\$157 821 081
Likely collectable	\$61 965 039	\$275 635	\$180 056	\$21 878 011	\$31 761 678	\$19 322 716	\$73 418 095
Likely uncollectable	\$1 135 815	\$18 219	\$28 826	\$7 847 548	\$23 189 322	\$53 319 072	\$84 402 986
Small	\$79 416 215	\$19 429 823	\$13 893 179	\$26 763 907	\$26 417 627	\$15 512 190	\$102 016 726
Multiplied by % valid debt from survey—73.2%	\$58 132 669	\$14 222 630	\$10 169 807	\$19 591 180	\$19 337 703	\$11 354 923	\$74 676 243
Likely collectable	\$57 086 281	\$13 340 827	\$8 766 374	\$14 419 108	\$11 177 192	\$3 020 410	\$50 723 911
Likely uncollectable	\$1 046 388	\$881 803	\$1 403 433	\$5 172 071	\$8 160 511	\$8 334 514	\$23 952 332
Large	\$83 146 733	\$29 243 256	\$18 308 219	\$47 120 642	\$12 631 822	\$21 044 448	\$128 348 387
Multiplied by % valid debt from survey 0.4%	\$332 587	\$116 973	\$73 233	\$188 483	\$50 527	\$84 178	\$513 394
Likely collectable	\$326 600	\$109 721	\$63 127	\$138 723	\$29 205	\$22 391	\$363 167
Likely uncollectable	\$5 987	\$7 252	\$10 106	\$49 759	\$21 323	\$61 786	\$150 227
Total All Segments	\$396 269 816	\$49 761 425	\$32 975 034	\$183 979 212	\$242 571 670	\$305 600 296	\$814 887 637
Total Potential debt	\$121 566 111	\$14 633 457	\$10 451 922	\$49 505 222	\$74 339 230	\$84 080 889	\$233 010 718
Total likely collectable	\$119 377 921	\$13 726 183	\$9 009 556	\$36 435 843	\$42 968 075	\$22 365 516	\$124 505 173
Total likely uncollectable	\$2 188 190	\$907 274	\$1 442 365	\$13 069 378	\$31 371 155	\$61 715 372	\$108 505 545

*Note: The Total column excludes potential debt less than one month old as it is considered to be within the appropriate timeframe for debt establishment action.

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