

The Auditor-General
Audit Report No.27 1999–2000
Performance Audit

Risk Management of Individual Taxpayer Refunds

Australian Taxation Office

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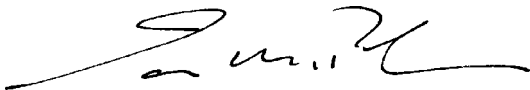
Canberra ACT
27 January 2000

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 *Risk Management of Individual Taxpayer Refunds*.

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



Ian McPhee
Acting Auditor-General

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

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Abbreviations/Glossary

ADD	Automatic Document Dispatch system
AIS	ATO Integrated System
ANAO	Australian National Audit Office
ATO	Australian Taxation Office
BANCOM	Business Advisory Network Compliance Management
CSA	Child Support Agency
DDE	Direct Data Entry system
ELS	Electronic Lodgement System
FBT	Fringe Benefits Tax
GST	Goods and Services Tax
HOTSA	Health Of The System Assessment
HRR	High Risk Refund
INB	Individuals non-Business line
LB&I	Large Business and International business line
NTS	National Taxpayer System
PAYE	Pay-As-You-Earn
PPS	Prescribed Payments System
RDCC	Return Data Capture Centre
SB	Small Business line
TFN	Tax File Number

Summary and Recommendations

Summary

1. In 1998-99, the Australian Taxation Office (ATO) collected taxation receipts of \$143.8 billion.¹ In the same year, some \$13.4 billion was distributed as refunds. Approximately \$9.9 billion of these refunds went to individual taxpayers.
2. Refunds occur as a result of the ATO's processing of information provided by a taxpayer, for example, an income tax return. The issuing of refunds is an important part of the ATO's functions, and is also a highly visible part of their role.
3. Refunds are issued to taxpayers who, for a variety of reasons, pay too much tax. The most common form of refunds paid by the ATO relates to income tax. Refunds to individual taxpayers average around 80 percent of the total amount refunded each year.
4. Two business lines in the ATO share responsibility for processing individual taxpayer refunds, Individuals Non-Business (INB) and Small Business (SB). For the period covered by this report, returns for high wealth individuals and all business returns were processed by SB with all other individual returns processed by INB. In exercising this responsibility, the ATO undertakes a number of activities designed to encourage compliance with tax law. These include automated checking for accuracy and consistency, as well as examination of returns selected on the basis of compliance analysis.
5. One series of checks included in the range of compliance activities relates to examining individual taxpayer refunds that trigger predetermined exception criteria. Reviewing refunds that meet these risk based exception criteria is a small but important part of the ATO's administration of tax returns. Such reviews are in addition to INB's major compliance management strategy of risk based analysis of individual items in a return.
6. In undertaking the audit, the ANAO recognised that the ATO has consciously adopted a risk management methodology and has combined it with a compliance model framework within which it manages all client relations. In addition, the taxpayers' charter, an initiative designed to make the ATO more accountable to the community for its operations, specifies performance standards for staff.

¹ ATO Annual Report 1998-99, Financial Statements for the year ended 30 June 1999, page 164. The accrued taxation revenues for 1998-99, shown on page 143, total \$135.3 billion.

7. The ANAO was also conscious that the Government has instituted a series of changes to the way in which the tax law will operate in future. Responsibility for implementing such changes falls in large measure on the ATO. However, until these changes come into operation, the ATO must obviously collect tax in accordance with the law in operation at the time. The attention of the ATO, particularly at very senior levels, is directed both at meeting the demands of the Government's tax reform timetable and the statutory obligation to implement the tax law as it stands.

The audit approach

8. The objective of the performance audit was to assess the effectiveness and consistency of risk management processes undertaken by the ATO in administering individual taxpayer refunds.

9. The focus of the audit was on those refunds that met specific ATO criteria of risk. The ATO has defined two risk categories that require intervention, namely high risk and large refunds. Audit investigation centred on INB risk management and compliance with procedures dealing with those two categories of individual taxpayer refunds.

10. In carrying out its review, the ANAO:

- visited all sites within the ATO where these refunds were processed;
- held discussions with officers at various levels within the organisation;
- collected and examined relevant documents;
- reviewed the available performance data; and
- conducted a statistical analysis of compliance practice.

Overall conclusion

11. The ANAO found that there is scope for improvement in high risk and large refund exception handling processes. There have been inconsistencies in the way that these refund exceptions have been investigated. Neither the high risk nor large refund exception categories have been subject to regular risk assessment to determine the validity of their criteria.

12. The ATO could achieve improvements in effectiveness and consistency by better integrating its risk management process for high risk and large refunds into the overall risk management framework for individual returns. Analysis of the results would then enable INB to establish whether processes for handling high risk and large refunds are fully effective.

13. INB was examining its returns processing procedures, including refunds, during the time of the audit. Recent initiatives, such as the consolidation of high risk refund processing into two sites and new procedures for large refunds, should lead to more effective practice in terms of consistent application of investigative procedures and input into ongoing risk assessment.

Key Findings

Risk management (Chapter 2)

14. Examining refund exceptions is only a part of the ATO's approach to managing compliance in individual taxpayer returns. All items on a return, which are designated by labels, are assessed for risk of non-compliance. Projects that examine a label are then resourced on the basis of that risk. The ATO sees this as the most important part of its compliance strategy because it targets those areas of a return that are most likely to indicate failure to pay tax properly due. In contrast, refund checking does not receive the same risk management treatment. The ANAO considers that refund checking should be treated as complementary to the other compliance processes and be integrated formally into the ATO's risk management framework.

15. In particular, the ANAO concluded that the risk management approach adopted by INB could be improved by increasing the attention given to the refund exception review process. Monitoring and reassessment of the criteria for exception reporting would enable their timely adjustment leading to better targeting of resources and hence, greater efficiency. A review of the high risk and large refund categories would assist by validating the categories along with other approaches in use and by maintaining the currency of information by which resource allocation decisions can be made. The extension of that review to include the application of the high risk criteria to all individual returns would add to its value.

Compliance management (Chapter 3)

16. At the time of the audit, procedural instructions for high risk and large refunds were not up to date. In addition, the practices for the review of refunds were not applied consistently.

17. With the assistance of the Australian Bureau of Statistics, the ANAO undertook statistical sampling of both large and high risk refunds at all processing sites. We sought to identify whether the observed inconsistencies in processing had any measurable effect on the outcome of refund examinations, that is, whether these returns were adjusted more frequently in some sites. We found a significant difference in outcome between two sites only. However, the ANAO concluded that there was no significant difference between the sixteen individual sites and the estimated national average in terms of their likelihood to make adjustments to refunds that have been identified as high risk.

18. The ANAO also concluded that, once a refund was identified as anomalous, there was little likelihood that it would be investigated. Cases were not consistently referred to audit teams because experience showed those teams were largely focused on other projects. The outcome of referrals was not communicated back to the referring officer. This resulted in a gap in the information on which risk management assessments were based, some indeterminate level of non-compliance and some staff dissatisfaction with the processes.

19. A more coordinated, nationally-managed approach to address training needs is required to ensure that officers undertaking the high risk refund assessments and reviews of large refund exceptions receive the necessary training to undertake their role efficiently, to ensure consistency and improve cost-effectiveness.

20. In addition, there would be a benefit, in terms of consistency of operation, maintenance of staff competence and intelligence gathering processes if a form of formal networking were to be implemented for staff undertaking the review of refunds. The ANAO notes the opportunities for this initiative that are available within the new organisational arrangements.

21. The ATO has addressed many of these deficiencies in preparing for the latest year of returns processing. INB has now consolidated the examination of high risk refund exceptions into two sites. The ATO advised that an updated manual and guidance have been provided to the two new teams. The new procedures encourage officers to consult technical expertise in pursuing a case and allow for regular updates of procedures on a continuous improvement basis.

22. Although new business line arrangements have the potential to improve coordination, the ATO may find some benefits from reviewing its coordination arrangements further. In particular, the ANAO considers that improved coordination would result in better information flows between the experienced operators, the development of up-to-date risk assessment profiles and improved consistency of interpretation of the legislation.

Recommendations

Set out below are the ANAO's recommendations aimed at improving the ATO's administration of key aspects of refunds. 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 1, 2, and 5.

Recommendation The ANAO recommends that the ATO:

No.1

Para. 2.23

- review the rationale for its high risk and large refund exception processes, including a risk assessment of the criteria for these exceptions to determine their accuracy and validity; and
- consider the extension of the high risk criteria to all individual returns.

ATO Response: Agreed

Recommendation The ANAO recommends that, to promote consistency in processing refund exceptions, the ATO provide staff with relevant training and maintain up-to-date procedure manuals.

No.2

Para. 3.38

ATO Response: Agreed

Recommendation The ANAO recommends that, to provide better support to staff performing the refund exception function, the ATO should establish formal networks to share information about findings and techniques to gather data. In support of such networks, the ATO should establish contact lists for specific issues requiring technical advice.

No.3

Para. 3.46

ATO Response: Agreed

Recommendation The ANAO recommends that the ATO take steps to improve the consistency of its refund exception processes and to improve collation of risk data.

No.4

Para. 3.55

ATO Response: Agreed

Recommendation No.5
Para. 3.62 The ANAO recommends that the ATO develop specific arrangements to subject refund exception cases identified as requiring further action to full investigation. Options include either equipping the high risk teams with the skills to pursue such cases to finality or ensuring that audit teams investigate such referrals promptly.

ATO response: Agreed

Audit Findings and Conclusions

1. Introduction

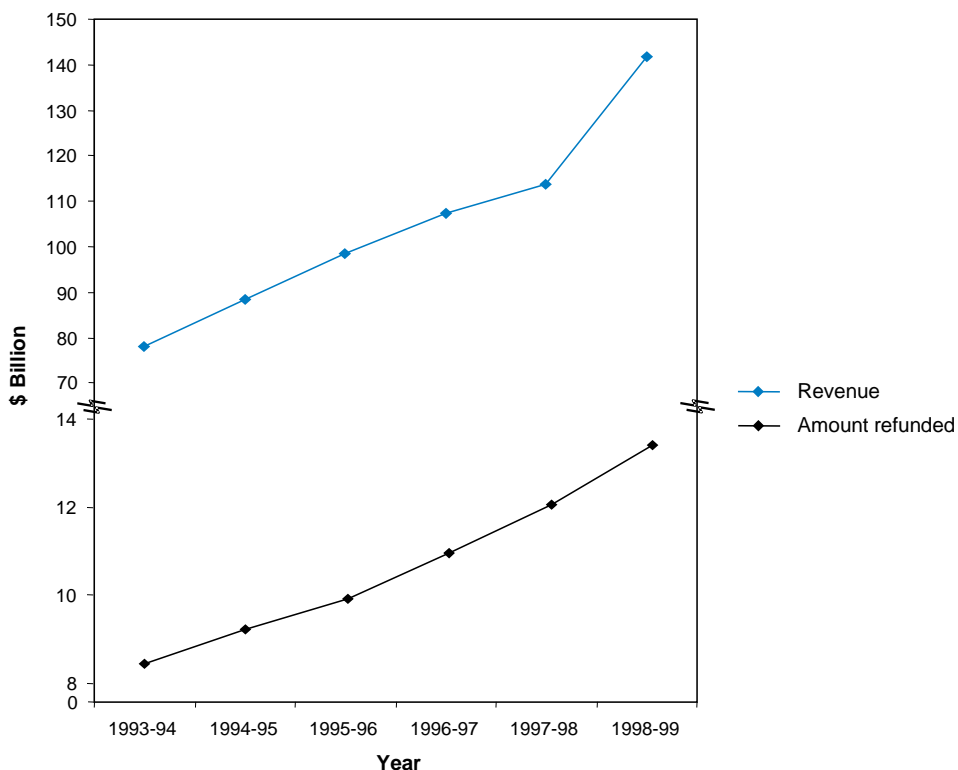
This Chapter provides an overview of the ATO's operating environment for refunds and the way it handles them as well as the background to, and structure of, the report.

Background

1.1 The Australian Taxation Office (ATO) is the Commonwealth's principal revenue collection agency. In 1998-99, the ATO collected taxation receipts of \$143.8 billion. In the same year some \$13.4 billion was distributed as refunds. Of this approximately \$9.9 billion related to individual taxpayers. The value of refunds has been growing steadily since 1993-94. As shown in Figure 1, the increase is generally in proportion to the growth in revenue.

Figure 1

Revenue collection and the amount refunded



Source: ATO. The figures are calculated on a cash basis.

1.2 Although refunds are simply a result of a number of processes undertaken by the ATO, they are, for taxpayers especially, very important. The activities of the ATO generally, and refunds specifically, are of interest to the majority of taxpayers, as well as to the Parliament, the media, professional bodies and the business community.

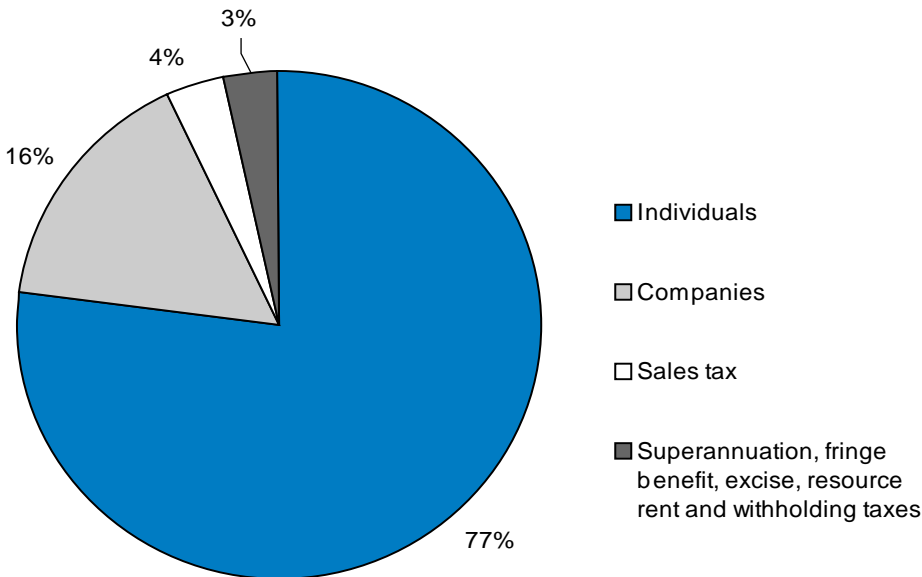
1.3 In deciding to undertake this audit the ANAO took these factors into consideration.

What is a refund?

1.4 Refunds are issued to taxpayers who, for a variety of reasons, pay too much tax. The most common form of refund paid by the ATO relates to income tax (for individuals, companies and superannuation funds). Refunds can also be paid in relation to prescribed payments system (PPS) credits, Tax file number (TFN) withholding tax credits, Pay-as-you-earn (PAYE) remittances, resource rent tax, fringe benefits tax, excise, sales tax and, in the future, Goods and Services Tax (GST) credits. Refunds issued to individuals average around 80 per cent of the total amount refunded each year. Figure 2 shows the relative proportion of refunds for different tax types in 1998-99.

Figure 2

Amount refunded for different tax types 1998-99



Source: ATO

Calculating a refund

1.5 Income tax liability is calculated by first determining the assessable income. Assessable income is reduced by allowable deductions to arrive at taxable income. This figure is used to calculate tax payable. Any rebates are then deducted to determine the final tax payable. This figure is compared with the tax instalments already paid. Tax may have been paid by company tax instalments, PAYE tax instalment deductions, PPS deductions, provisional tax paid or any other credits. If there is a difference between the tax paid and the tax payable it gives rise a tax debt or, where too much tax has been paid, a refund.

How refunds are managed

1.6 All returns are handled electronically. Once a return is received, the details are entered into the ATO's computer through one of several input systems. The key input systems for income tax returns are the Return Data Capture Centre (RDCC) and Direct Data Entry (DDE) for paper returns and the Electronic Lodgement System (ELS) for electronically lodged returns. For sales tax and PAYE, the input system is the ATO Integrated System (AIS). The input systems contain a variety of validation checks.

1.7 The return then passes to the relevant business system for processing. On the basis of the details provided in the return the business systems (including AIS and the National Taxpayer System (NTS)) calculate the tax payable by the taxpayer and compare it to the tax already paid.

1.8 The system then produces the details of the Notice of Assessment, which is the ATO's formal statement of account for the taxpayer. If the taxpayer has paid too much tax, the system calculates the refund that is due.

1.9 The business systems transmit details of the Notice of Assessment (including details of any refund cheques that might be necessary) to the Automatic Document Dispatch (ADD) system. The ADD system produces and dispatches Notices of Assessment, including refund cheques and debit notices where appropriate.

1.10 Returns are lodged under the self-assessment system. This means that, where a taxpayer claims a refund and the amount is within an allowable tolerance when compared to the actual credit of tax on file, no action is taken to verify that calculations and technical decisions made by taxpayers are correct. An automatic refund normally issues unless certain circumstances are present. However, the ATO has validation checks in place, based on its research into risks of non-compliance, to satisfy itself that the data that has been presented is correct.

ATO's framework for the administration of refunds

1.11 The ATO is structured around groups of clients, into business lines and service lines. Each business line has responsibility for one major market segment. The ATO business lines are: Individuals, Non Business (INB); Small Business (SB); Large Business and International (LB&I); GST; Superannuation; Legislative Services; the Tax Counsel; and the Valuation Office.

1.12 Responsibility for income tax refunds is spread across two business lines, INB and SB. Where the responsibility for each taxpayer lies varies depending upon taxpayer type. For example, all individual returns, including those with business income and deductions, are processed by INB. For the period examined during audit field work, SB processed returns for high-wealth individuals and all company, trust and partnership returns, including those for LB&I clients. This function was transferred to INB from 1 July 1999.

1.13 SB have responsibility for the review of certain refunds in relation to individual taxpayers with business income or deductions, while INB review refunds for individuals without business related income or deductions.

Controls in place

1.14 As mentioned above, the processing of refunds under the self-assessment regime is largely automatic. However INB, the business line responsible for processing returns, performs edit and error corrections designed to find and correct mistakes in data input. It also carries out other checks designed to uncover anomalies in the return. When these are detected, the system produces an exception code that identifies the kind of anomaly that has occurred.

1.15 There are two kinds of exception report associated with refunds:

- 'informative' where the issue of the refund is delayed for a period of two days to allow examination and, if necessary, corrective action. If no action is taken, the system will resume processing the return and the assessment together with the refund cheque will be sent; and
- 'fatal' where the processing is halted and intervention is required to complete the assessment. The fatal exceptions must be actioned, otherwise the assessment will not issue.

1.16 There are two sets of circumstances in which an exception report will be generated:

- large refunds. Large refunds are those with a value above a predetermined threshold. Large refunds normally generate an 'informative' exception; and
- high risk refunds. High risk refunds relate to a series of risk factors that have been developed through the ATO's risk analysis processes. Depending on the nature of the risk involved, they may generate either an 'informative' or a 'fatal' exception.

1.17 When a high risk exception is detected it is referred to a High Risk Refund (HRR) officer. HRR officers are located in both the SB and INB lines. Their role is to verify the accuracy of the assessment for those cases reporting as fatal errors.

Systems for managing debt cases (including Child Support obligations)

1.18 Checking against other tax debts (for example tax owing from previous years or sales tax debts) is not automatic unless a composite debt indicator is on the file. This indicator must be put on manually, either by the debt collection section or by the teams responsible for sales tax, PAYE and PPS. HRR officers check against debts on other heads of revenue only if the refund triggers the test for this indicator and generates the appropriate error code.

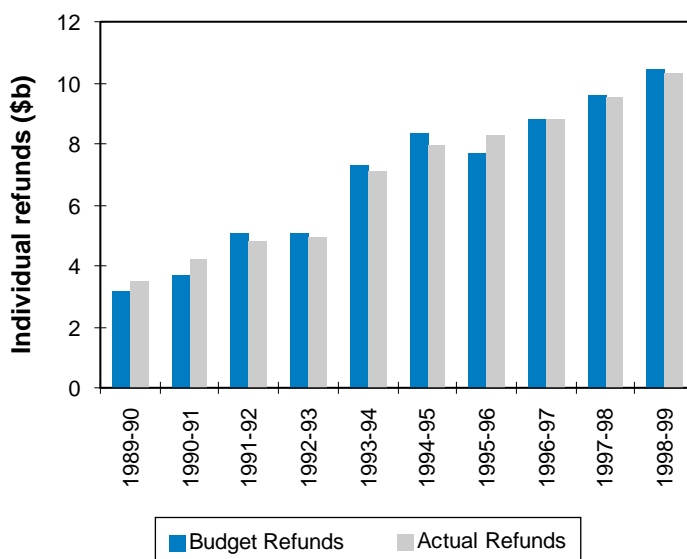
1.19 In relation to Child Support Agency (CSA) obligations, the CSA registers any outstanding debt on NTS. An indicator is placed on the file, which is checked automatically. Once the refund has been calculated, the funds are transferred to the CSA in payment or partial payment of the debt. The assessment is then sent to the taxpayer (with no cheque or a balance owed cheque). The ATO does not advise that the refund was garnished for the CSA. That is CSA's responsibility.

Estimating refund activity

1.20 Refunds have a significant impact on the cash management for the Commonwealth. It is important, therefore, that the ATO provide accurate estimates of value of refunds. The ATO estimates refunds explicitly only for refunds to individual taxpayers. The other heads of revenue and other individual groups are less predictable and are a relatively small proportion of refunds. Refunds to individual taxpayers average around 80 percent of total refunds. Estimates of other refunds can be derived from the net head of revenue. As illustrated in Figure 3, the ATO's forecasting of individual refunds is reasonably accurate.

Figure 3

Individual refunds - budget and actual



Source: ATO. Figures are calculated on a cash basis

ATO environment

1.21 In carrying out the audit the ANAO was conscious of a range of factors that had a significant impact on the way the ATO carries out its responsibilities. Key factors include:

- the implementation of the Government's tax reform agenda;
- the risk management framework adopted by the ATO;
- the compliance strategies adopted by the ATO to ensure that it collects all tax properly payable; and
- the taxpayers' charter.

The Government's Tax reform agenda

1.22 The Government has instituted a series of changes to the way in which the tax law will operate in future. These changes include, most notably, the introduction of the Goods and Services Tax, the abolition of provisional tax, revised tax scales for individual taxpayers, the abolition of sales tax, and a new business tax regime. These changes are fundamental to the way tax is collected and are due to come into operation progressively. Responsibility for implementing these changes falls in large measure on the ATO.

1.23 Many of the changes will take effect from the beginning of the 2000-2001 financial year. Until they come into operation, however, the ATO must collect tax in accordance with the law in operation at the time. As far as this audit is concerned, the ATO operations under examination relate to tax collected under arrangements prior to the tax reform changes. We recognise that the attention of the ATO, particularly at very senior levels, is directed both at meeting the demands of the Government's tax reform timetable and the statutory obligation to implement the tax law as it stands.

Risk management

1.24 The ATO has consciously adopted a risk management methodology. The ATO's Health of the System Assessment (HOTSA) forms the basis of a continuing assessment of the risks involved in the collection of tax. The HOTSA is a key input into the ATO's strategic planning framework. Risk assessments, which are the foundation of the HOTSA, lead to definition of priorities and resource allocation. In the case of tax returns, on the basis of risk assessment, the ATO targets particular labels for more intensive examination through the year. It involves the systematic evaluation of the risks attaching to each of the items or labels of the tax return. It does this individually and in various combinations (for example: are members of a particular industry more or less likely to have problems complying with particular aspects of the tax law). The assumption is that if the inputs to the system are corrected, the automatic assessments that flow from the self-assessment process will be generally acceptable.

1.25 The risk assessments derived from the HOTSA flow into the compliance strategy of the ATO.

The compliance model

1.26 The ATO has made use of social science research that shows there are many different factors that determine a client's behaviour. The ANAO recognises that the ATO needs to understand these factors and tailor a response that is appropriate to the particular taxpayer's circumstances and suitable for the protection of Commonwealth revenue.

1.27 Income tax is self-assessed. Placing the onus of understanding and applying the legislation on taxpayers has inherent risks. Under self-assessment, non-compliance is likely if taxpayers are unaware that they have a liability, unsure of their obligations or believe that the enforcement activity of the ATO is unlikely to identify them if they do not comply.

1.28 The ATO has developed a framework within which it manages all taxpayer relations. This is known as the compliance model. The compliance model recognises that the majority of taxpayers comply voluntarily with no need for ATO intervention. Others comply but need some assistance or prompting. Others will not comply in the first instance but will if prompted further. A small number will not comply and may need enforcement action.

1.29 The ATO has developed its compliance model as part of its risk management approach. The model sets out a graduated series of responses to the general kinds of problems associated with ensuring that all taxpayers pay all and only the tax properly payable. The main components of the compliance model are:

- Education – this is aimed to make sure that all taxpayers know what their obligations are. It includes, for example, seminars, web sites, telephone hot-lines, the tax pack. It assumes that most people will comply with the tax law if they know what it is and that a significant proportion of non-compliance derives from ignorance. The ATO also seeks to keep its presence before the public as an incentive for people to comply.
- Real time business examinations and record keeping reviews – These are aimed at ensuring that taxpayers have the appropriate systems so that they can comply with the law. That is, they have records that will satisfy the ATO's requirements. In general, these examinations and reviews are targeted at high-risk groups within the taxpaying community and are intended to remedy defects in business systems before stronger action is required. Again, part of the strategy is to maintain a presence amongst taxpayers so that compliance is more likely.
- Audit, with or without penalty – taxpayers are selected for audit according to certain criteria, which include risk assessments derived from an examination of various items of the tax return.
- Prosecution – where non-compliance is persistent or significant, the ATO is prepared to take legal action to collect tax payable and impose penalties. This also serves as an incentive for others to comply.

1.30 The ATO considers that combined with the risk assessment processes of the HOTSA, the compliance model provides a comprehensive risk management approach to the collection of tax revenue.

Taxpayers' Charter

1.31 As Commonwealth public servants, ATO officers are required by law to provide reasonable assistance to members of the public and help them to understand their entitlements and any requirements with which they are obliged to comply. The taxpayers' charter is an initiative designed to make the ATO accountable to the community for its operations. In it the ATO outlines a desired relationship with the community based on mutual trust and respect. It details taxpayers' rights, obligations and standards of service delivery.

1.32 The charter sets out in general terms:

- the respective responsibilities of the ATO and the taxpayer;
- performance standards for various ATO operations. For example, it undertakes to process paper returns within 54 days and electronic returns within 14 days;
- the way in which the ATO will deal with taxpayers; and
- review and appeal procedures for taxpayers who believe they have not been dealt with fairly.

Audit objective and approach

1.33 The objective of the performance audit was to assess the effectiveness and consistency of risk management processes undertaken by the ATO in administering individual taxpayer refunds.

1.34 The focus of the audit was on those refunds that met specific ATO criteria of risk. The ATO has defined two risk categories that required intervention, namely high risk and large refunds. Audit investigation centred on INB risk management and compliance with procedures dealing with those two categories of individual taxpayer refunds. The approach by SB was reviewed to establish a picture of comparative practice.

1.35 In carrying out its review, the ANAO:

- visited all sites within the ATO where refunds were processed;
- held discussions with officers at various levels within the organisation;
- collected and examined relevant documents;
- reviewed the available performance data; and
- conducted a statistical analysis of compliance practice.

1.36 The cost of the audit was \$247 000. The audit was conducted in accordance with ANAO Auditing Standards.

Related reports

1.37 This audit forms part of a series of audits that have examined aspects of the ATO's risk management approach. Audit Report No.37 1996-97, *Risk Management, Australian Taxation Office* examined the ATO's overall approach to risk management. Audit Report No.19 1997-98, *Risk Management in ATO Small Business Income* looked at how the principles of risk management were being applied within a significant business line of the organisation. Audit Report No.16 1999-2000, *Superannuation Guarantee* reviewed this particular function from a risk management framework.

Structure of the report

1.38 Apart from this introduction that describes the background to the refund process and the audit, this report has two substantive chapters that deal with the main issues:

- Chapter 2, *Risk management framework for refunds*, discusses how refunds fit into the ATO compliance arrangements, how, in the view of the ANAO the attendant risks should be managed and states an opinion on how well the ATO satisfies these requirements; and
- Chapter 3, *Compliance with procedures*, looks at how the ATO carries out its procedures related to exception handling. It examines the consistency of procedures and the relevance of guidance material including manuals. Organisational support for the function, which covered areas such as training, use of staff networks and coordination, was also examined.

1.39 In both chapters the ANAO makes recommendations to improve the ATO's risk management in relation to refunds.

Acknowledgments

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

2. Risk Management Framework for Refunds

This Chapter examines how refunds fit into the ATO compliance arrangements, how, in the view of the ANAO the attendant risks should be managed and states an opinion on how well the ATO satisfies these requirements.

ATO risk management approach

2.1 The ATO was among the first agencies in the Australian Public Service to introduce a formal risk management process as part of its strategic planning framework. This process, called the HOTSA, is described in paragraph 1.24 and has been undertaken on an annual basis across all ATO business and service lines since 1994-95.

2.2 In line with the ATO Compliance model described in Chapter 1, INB has developed its Compliance Management Strategy to deal with all individual taxpayer returns. Under its risk management approach, each label on a return is assessed for risk of non-compliance and resourced accordingly. By focusing on specific items of the tax return, INB is working to encourage assessment accuracy and validity and therefore, refund accuracy and validity.

2.3 Refunds are a by-product of other processes that are subject to compliance initiatives. As one of the actions aimed at minimising the risk of incorrect refunds being made, the ATO has instituted specific exception reports that are generated as returns are processed. The two types of exception have been labelled by the ATO as 'large' and 'high risk' refunds (see paragraph 1.16).

2.4 In 1998-99, of 9.67 million tax returns for which assessments were issued by the ATO, 7.35 million (or 76 per cent) resulted in refunds. Of these, 124 819 were reported for checking because of the large dollar value of the refund and 20 333 were reported for checking because they were regarded as a risk.

How the risk should be managed

2.5 A risk management approach should include the following key features:

- monitoring of existing risk areas;
- reassessment of existing risk areas;
- sampling and intelligence gathering to identify emerging risks; and
- developing strategies to deal with the identified risks.

INB performance

2.6 INB undertakes the following activities as part of its Compliance Management Strategy:

- monitoring of existing risk areas;
 - analysing information provided by the use of individual labels on the return;
 - selecting samples,
 - using proactive questionnaires;
- reassessment of existing risk areas;
 - auditing to ascertain the level of risk associated with individual labels;
- gathering intelligence on compliance and non-compliance; and
- developing strategies to encourage compliance.

2.7 Of particular importance, INB undertakes projects to identify and quantify other risks to compliance and devises strategies to encourage greater compliance. The Compliance Management Strategy team manages risk assessment projects. These projects are not limited to refunds but focus on particular labels on the tax return, for example, interest and dividend deductions or work related expenses.

2.8 The cross-business line initiative in obtaining real-time intelligence to address the growth in aggressive financial tax planning represents strategic action in response to the identification of a risk to revenue. It covers all individual returns with interest and dividend deductions over a threshold value, not just refunds resulting from such deductions. The new edit check designed for this initiative should provide a timely and comprehensive source of information on a real-time basis for analysis of the issue.

2.9 However, when examining the risk criteria for the refund exception reports, the ANAO was unable to identify a link between the intelligence gained from these projects and the modification of system checks to reflect changes in the risk profile. Nor was such intelligence distributed to the officers who processed the refund exceptions.

2.10 The ANAO sought to ascertain whether INB had conducted a risk assessment on the refund exception reporting and review process. Such an assessment would determine the accuracy of the high risk and large refund criteria for targeting refunds at risk and measure the effectiveness of the procedures for checking those codes. We were informed that it did neither. The introduction of such monitoring and reassessment of risk would strengthen the benefit of these procedures.

Using the results of refund reviews

2.11 The examination of returns that have met established risk criteria provides a useful source of intelligence that may contribute to identifying trends or changes to compliance practice. Review of individual labels of a return feeds into the assessment process. However, INB had not used the results of high risk or large refund processes as input into their intelligence gathering for risk assessment.

2.12 The ANAO identified the need for a mechanism to ensure that information is properly collated to determine the results of high risk assessments and provide data to assess the success of the function. The ATO subsequently advised that recently introduced procedures would now enable the collection and inclusion of intelligence gathered from the refund checking process.

Risk criteria

2.13 The criteria for generating the refund risk exception reports have not been changed except to introduce variability in the threshold value.

2.14 In the ANAO's opinion, what is required is a statistical analysis of the high risk and large refunds supported by audit examination of the cases selected. This would provide:

- a measure of the success of the current criteria; and
- identification of those factors which contribute to increased risk.

Better dissemination of the results of audit projects would help other staff appreciate the implications of the information they use in processing returns and lead to more consistent application of procedures.

2.15 Until such an analysis is completed, high-risk error codes should be treated as significant. When high-risk refund officers have referred cases to audit teams, those teams have accepted only those cases that fit their current project. Even then, there is no guarantee that such cases will be addressed. The other cases that are not compatible with existing projects are not addressed at all (see also paragraph 3.59). In other words, of the small number of refund cases identified as high-risk, even fewer that are considered suspicious are ever followed up. Given that the particular cases have already been assessed as high risk and there has been a cost in arriving at this assessment, it does not appear to be consistent with the principles of risk management to ignore them. In short, either the high-risk refund is a significant indicator and should be followed up or it is not significant and the cost of collection and assessment of the information could be saved. At present there is insufficient evidence to determine whether it is a reliable indicator of non-compliance or not.

2.16 In the ANAO's opinion, the project approach used by the ATO has its strengths and weaknesses, as indeed would any alternative approach. The ANAO acknowledges the advantages of the systematic investigation of particular indicators or labels especially its ability to use intelligence gathered in a range of different ways. The leverage to be gained in taxpayer awareness is also a useful outcome.

2.17 However, it is important to recognise the significance of the large and high-risk refund approach. The project approach is necessarily fragmented in that it examines only some items of the return. Other items may result in avoidance but not be subject to systematic review. The investigation of the whole return that results from the use of a refund based approach would complement the projects and pick up some of the avoidance that would otherwise not be targeted as well as give an added intelligence source. From an 'incentive' viewpoint, it would also serve as a useful addition to the ATO's deterrent options for non-compliance.

2.18 The ANAO recognises that refunds are just one possible outcome of a taxpayer's assessment. The risk-management principles underlying the proposed approach to refunds apply equally to all forms of outcome. Such a review should look at all deductions and not just those that result in a refund. This holistic approach to taxpayer returns would provide complementary coverage to the activity focused specifically on individual return items.

Coordination

2.19 Each Business Line is responsible for its own section of the HOTSA process. One of the inherent risks associated with the hierarchical design of the HOTSA process is that coordination between the inputs of the various business lines must be addressed by other mechanisms. International best practice favours an integrated approach to risk management especially when risk factors are common across functional and business lines.

2.20 High risk refund assessment is one activity in relation to which two business lines operate separate compliance assurance functions. The ANAO observed some interaction at the operational level. It looked for interaction at the strategic risk management level because a coordinated approach would improve effectiveness. However, there was little evidence that business lines looked across their boundaries to develop the HOTSA assessments. In the ANAO's view integration is crucial when management strives to achieve a shared corporate vision across the organisation. The ATO has advised the formation of the Compliance Management Information Forum to address the standardisation of the HOTSA process across business lines.

Conclusion

2.21 Examining refund exception cases is only a part of the ATO's approach to managing compliance in individual taxpayer returns. All labels on a return are assessed for risk of non-compliance and projects to examine a label are resourced on the basis of that risk.

2.22 The ANAO concluded that the risk management approach adopted by INB could be improved by increasing the attention given to the refund exception review process. Monitoring and reassessment of the criteria for exception reporting would enable their timely adjustment leading to better targeting of resources and so, greater efficiency. A review of the high risk and large refund categories would assist by validating them along with other approaches in use and maintaining the currency of information by which resource allocation decisions can be made. The extension of that review to include the application of the high risk criteria to all individual returns would add to its value.

Recommendation No.1

2.23 The ANAO recommends that the ATO:

- review the rationale for its high risk and large refund exception processes, including a risk assessment of the criteria for these exceptions to determine their accuracy and validity; and
- consider the extension of the high risk criteria to all individual returns.

ATO response

2.24 The ATO agrees with this recommendation. The ATO will carry out further research and analysis of high risk refund data as part of a reassessment of our exception processes. In doing so, the ATO will determine whether the current criteria detect the real risk.

2.25 Consideration will also be given to extending the high risk criteria to all individual returns subject to an appropriate business case for any change.

3. Compliance with procedures

This Chapter examines how the ATO carries out its procedures related to exception handling. It examines the consistency of procedures and the relevance of guidance material including manuals. Organisational support for the function, which covers areas such as training, use of staff networks and coordination, is also examined.

Background to procedures

3.1 As discussed in Chapter 1, once a return is received by the ATO, details are entered onto an input system and then passed across to the relevant business system for processing. The key input systems for income tax returns are the Return Data Capture Centre (RDCC) for paper returns and the Electronic Lodgement System (ELS) for electronically lodged returns. The input systems contain a variety of validation checks. The business system for assessing individual returns (the National Taxpayer System (NTS)) calculates whether tax is owed by or to the taxpayer. If tax is owed to the taxpayer, a refund is issued.

3.2 Refunds are processed by NTS, which then passes details of the Notice of Assessment to the Automatic Document Dispatch (ADD) system. The ADD system produces and dispatches Notices of Assessment, including refund cheques and debit notices where appropriate.

3.3 In normal circumstances, because returns are lodged under the self-assessment system, no action is taken to verify that calculations and technical decisions made by taxpayers are correct. However, the ATO has validation checks in place to satisfy itself that the data being presented is correct.

3.4 After performing a series of edit and error checks that uncover matters such as the wrong tax file number or inconsistencies in the return, the system tests for a range of high risk refund factors as well as identifying all refunds that have a value above a predetermined threshold. Exceptions from these tests are reported as 'High Risk Refunds' (HRR) and 'Large Refunds' respectively.

3.5 If a particular return fails the HRR test the system reports this as an exception to either INB or SB. In this case, HRR officers, located in both the SB and INB lines, examine the report to ascertain what action should be taken. Their role is to verify the accuracy and reasonableness of every one of these exceptions. Only when they are satisfied that the return is reasonable can the operation proceed and the refund be issued.

3.6 On the other hand, if a return triggers the exception report for a Large Refund, officers have two days to check the return. If no action is taken, for whatever reason, the procedure resumes automatically and the refund is released.

How compliance should be managed

3.7 For any administrative function to be performed properly, especially by staff members across many sites, it is important that there should be procedures that are:

- well documented;
- up to date;
- applied consistently; and
- reviewed regularly to ensure relevance.

3.8 It is also important that staff should have all the skills necessary to carry out the procedures competently. This normally implies a systematic approach to the training of staff. To achieve consistency, an organisation needs to ensure that adequate training is provided so that officers undertaking the duties are knowledgeable, proficient and aware of the areas of risk. Systematic record-keeping is critical to facilitate performance measurement as well as provide a source of information for reassessment of risk and trends.

3.9 In addition to training, it is important that staff have adequate support, including:

- a supporting network of contacts within the ATO to ensure that experience gained in one place is available to others;
- availability of appropriate contacts for more specific technical advice;
- clear coordination procedures and a clearly identified focal coordinating point;
- a process of information feedback so that the experience gained in field activity is reflected in risk assessment criteria and guidelines; and
- a system that ensures that, where further action needs to be taken, it will happen quickly. As a result, those responsible can have an expectation that, where they make assessments or recommendations, it will result in a successful conclusion.

INB performance

3.10 The ANAO examined the procedures by which the high risk and large refund exceptions were examined. This examination focused on whether procedures are:

- documented, preferably in procedure manuals;
- up to date;
- applied consistently in every site;
- reviewed regularly to ensure their relevance; and
- supported by suitable computer systems

3.11 The ANAO examined the manuals and instructions available for those involved in the assessment of high-risk refunds. It found that, even where a manual was available, it was incomplete, out-of-date, considered not very useful and was largely ignored.

3.12 When the high risk refund function was moved between sections of the ATO in July 1998, in lieu of training, a quick walk-through of the procedures was provided for the new officers. In most sites, previous officers provided a copy of the manual that they used. However, in at least one site, the person performing the function received no assistance. One particular officer conducted his own research project to try to develop some contacts and gain some insights into how best to manage the function. From the results of the research, a manual was developed, with information about what data was available within the ATO and where to find it. It also incorporated a useful flow chart to assist in decision making in relation to processing the error code. Although this document provided the most up-to-date and accurate information about how the function was to be carried out, it has not been adopted generally. Only the site in which it was developed had access to the document. In cases such as this the ATO would have benefited from an established network to pass on the information. In the event this initiative was wasted as officers at other sites worked to out of date procedures or developed their own methods.

3.13 More comprehensive and up to date manuals and guidance would alleviate many of the problems experienced by the officers.

3.14 The procedures used for reviewing the refund and verifying the data prior to clearing the error message and releasing the refund varied. There are separate manuals for SB and INB. Both of them were quite dated, although both are in the process of being revised. Many of the procedures required in the manuals were not viable, due to the significant changes to systems and return forms since the high risk exception category was originally defined.

3.15 In general the ANAO found that:

- the procedures in place to undertake the assessment of large and high-risk refunds were inconsistent between INB sites;
- the procedures for the same tax return item were inconsistent between business lines; and
- HRR officers received information identifying new tasks in a very ad hoc fashion.

Inconsistency between sites

3.16 The practices between sites for dealing with high risk refund exceptions ranged from a cursory to a more comprehensive review. In the latter case, they included analysis of prior year activity, looking at current year information and a range of other checks.

3.17 The records kept (both paper and on the system in the form of electronic memo pad entries) also varied significantly between sites. In the ANAO's opinion it is important to record review results for all cases by an electronic memo pad entry on the computer system.

3.18 An example of a particular case illustrates what can happen if this is done properly. One officer had a case where the high risk refund assessment resulted in an adjustment. The taxpayer's agent then requested an amendment at another site. The form was lodged as an amendment request, not an objection. The amendment would have reversed the adjustments made by the high-risk refund officer. The officer processing the amendment referred it to the HRR officer, as there was a detailed memo on the adjustments made on the system. The HRR officer noted that the signature was different from the original return. When the HRR officer contacted the Tax Agent Board, it was already investigating this agent (the client was unaware of the amendment request), as were the AFP.

Inconsistent treatment of similar material

3.19 We observed HRR officers in the two business lines performing different levels of investigation. This was necessary in many cases for SB where the returns had the additional complexity of business related claims. The SB officers had greater experience in dealing with such complexity. There were, however, cases in INB that included some business related claims. These did not receive the same level of investigation, possibly due to the officers' different level of experience.

Identification of new tasks

3.20 As there was no procedure for updating the old procedure manual, no mechanism was in place to ensure that any changes to procedures or changes to supporting information were disseminated to all relevant staff. Officers in different sites relied on their informal contacts to maintain currency in their practices.

Related observations

3.21 A further observation, not just related to high risk refunds, concerns INB's own review of how all of its error and edit codes are processed. Actual practices varied greatly. In some cases certain errors were simply ignored. In others, fields would be adjusted to allow the return to be processed without affecting the assessment. The motivation was to achieve a more productive processing rate and meet Taxpayer Charter goals. The extent of these practices is uncertain, but clearly they would operate to circumvent the proper operation of the system. The ATO is currently modifying its system to focus on the best existing practice for handling the most common codes and adopt it as the basis of a consistent manner of processing. The intention is then to extend this continuous improvement process to all edit processing. As a complementary initiative, the ATO has introduced a quality assurance process. It is designed to reinforce better practice by regular checks that new procedures are in fact being complied with. This should result in a more consistent practice. At the time of the audit, it was too early to measure the benefits of this initiative.

Conclusion

3.22 At the time of the audit, procedural instructions were not up to date. In addition, the practices for the review of refunds were not applied consistently. The inconsistency arose from various factors, which are discussed later in this chapter.

3.23 The ATO has addressed many of these deficiencies in preparing for the latest year of returns processing. INB has now consolidated the examination of high risk refund exceptions into two sites. The ATO advised that an updated manual and guidance have been provided to the two new teams. The new procedures encourage officers to consult technical expertise in pursuing a case and allow for regular updates of procedures on a continuous improvement basis.

3.24 The new arrangements within INB are aimed at achieving a more consistent outcome. The ANAO notes that the decision to introduce the new procedures was made too late to have them ready for the new financial year. As a result, the procedures were provided late and required

substantial adjustments to be made in the first two weeks of their implementation. A more timely approach would have allowed new systems to be tested off-line before they were implemented.

3.25 There also need to be mechanisms to ensure consistency between the two new high risk teams. In addition, the systems need to ensure that, when examining the same items, SB and INB are conducting similar checks and applying the same tests and, where necessary, penalties to all taxpayers.

Statistical analysis

3.26 As part of the audit examination, with the assistance of the Australian Bureau of Statistics, the ANAO examined the processing results of a random sample of both high risk and large refunds reported in the 1998-99 financial year. The samples covered all INB processing sites. The aim was to ascertain whether or not the inconsistent practices observed in the various offices for examining high risk and large refund exceptions resulted in different outcomes, that is, whether these returns were adjusted more frequently in some offices.

High risk refunds

3.27 From the samples, we derived an estimate of the national population of refunds as well as an estimate of the adjustment at individual sites. For high risk refunds, the estimate of adjustments in individual offices varied from two to nine percent with a national estimate of five percent. A significant difference in outcome was identified between the Townsville and Box Hill sites only. However, no site differed significantly from the estimated national average for adjustments. Although there was wide variation between sites, the ANAO concluded that there was no significant difference between the sixteen individual sites in terms of their likelihood to make adjustments to refunds that have been identified as high risk.

3.28 The analysis included an attempt to identify whether certain factors were more likely to give rise to adjustments. In terms of reasons for the refund, there did not appear to be any factor that resulted in a higher rate of adjustment.

3.29 The following table shows, for each site and nationally, the estimates for the proportion of high risk forms adjusted. The table shows that the national estimate for the proportion of returns adjusted is 5 per cent. In summary there is a 95 per cent chance that the true proportion of forms adjusted is between 4 per cent and 6 per cent (that is, 5 per cent +/- 1 per cent).

Table 1
High risk refunds

Site	Sample size (number)	Number adjusted	Proportion adjusted (%)
<i>Canberra</i>	77	6	8
<i>Hurstville</i>	89	5	6
<i>Northbridge</i>	82	3	4
<i>Waymouth</i>	69	4	6
<i>Box Hill</i>	89	2	2
<i>Dandenong</i>	86	3	3
<i>Hobart</i>	35	3	9
<i>Parramatta</i>	67	3	4
<i>Sydney</i>	93	3	3
<i>Albury</i>	62	5	8
<i>Newcastle</i>	68	4	6
<i>Penrith</i>	56	3	5
<i>Brisbane</i>	78	2	3
<i>Chermside</i>	60	3	5
<i>Townsville</i>	34	3	9
<i>Upper Mt Gravatt</i>	65	3	5
Total	1110	55	5

Large refunds

3.30 For large refund cases, the wide variation in processing practice meant that a sample could not be collected from five of the sixteen sites. In these sites, evidence of processing action was not retained. From the other sites an estimated 1 per cent of forms were adjusted nationally (see Table 2 below). There is a 95 per cent chance that the true proportion of forms adjusted lies between 0.55 per cent and 1.45 per cent (that is, 1 per cent +/- 0.45 per cent). The low number of adjustments and a lack of information relating to reasons for the refund amount meant that no other analysis could be performed. The ANAO was therefore unable to determine whether the variation in practice between sites produced significantly different results.

3.31 The ANAO considers that this type of analysis should form part of the regular risk assessment of both high risk and large refunds referred to in Recommendation 1.

Table 2
Large refunds

Site	Sample size (number)	Number adjusted	Proportion adjusted (%)
<i>Canberra</i>	124	**0	0
<i>Hurstville</i>	117	1	1
<i>Northbridge</i>	*	*	*
<i>Waymouth</i>	63	**0	0
<i>Box Hill</i>	*	*	*
<i>Dandenong</i>	*	*	*
<i>Hobart</i>	94	**0	0
<i>Parramatta</i>	*	*	*
<i>Sydney</i>	*7	**0	0
<i>Albury</i>	99	**0	0
<i>Newcastle</i>	94	0	0
<i>Penrith</i>	50	0	0
<i>Brisbane</i>	121	2	2
<i>Chermside</i>	110	1	1
<i>Townsville</i>	105	0	0
<i>Upper Mt Gravatt</i>	99	2	2
Total	1076	6	1

Symbols: * - office not able to be sampled

** - value is either zero or incomplete data exists for this item.

Training

3.32 The range of systems - computerised and otherwise - used by officers examining both high risk and large refunds is extensive. Often, the office systems available and the way people use them reflect the hand over received from the previous occupant of the position, and the previous experience of the officer. We observed that officers gained access to data in NTS and AIS in different ways. Some methods were obviously more efficient than others. We also observed differences in the type of information that officers would access, reflecting their knowledge or experience. Much of this data is unused because staff are not completely familiar with what information is available to them on the various ATO systems or they do not have confidence in its accuracy, reliability or their ability to extract it. As a result, the effectiveness of staff is constrained.

3.33 Given the range of issues to be examined, the review of refunds requires a high level of technical skill and an extensive knowledge of the relevant ATO business systems. The normal ways an organisation acquires this skill base are through recruitment of people who already have the necessary skill and through training. In this particular area, both strategies are needed.

3.34 Training can be undertaken in many ways including:

- formal courses;
- on-the-job training; and
- self-paced training.

3.35 The ANAO examined the way in which staff acquired the skills they needed to carry out their duties. We looked at:

- how training was planned for and incorporated into the work program of the different business lines;
- how many staff actually received training; and
- whether training was in fact effective in providing the skills needed for the assessment and evaluation of high risk or large refunds.

3.36 Most training was provided on-the-job. Additional support was limited. Because the number of staff involved in the high risk refund process is relatively small, it is considered that on-the-job training is the most effective way of ensuring that all staff have the necessary skills. Even this training, however, has been limited to a brief walk through of the function when new staff are assigned. The fact that, in the past, the refund review function has been undertaken in all regions has contributed to a piecemeal training effort. The low level of training has not been effective in providing the skills necessary for the function. Recent organisation changes provide an opportunity to address the issue.

Conclusion

3.37 The ANAO concluded that a more coordinated, nationally-managed approach to address training needs is required to ensure that officers undertaking the high risk refund assessments and reviews of large refund exceptions receive the necessary training to undertake their role, to ensure consistency and improve cost-effectiveness.

Recommendation No. 2

3.38 The ANAO recommends that, to promote consistency in processing refund exceptions, the ATO provide staff with relevant training and maintain up-to-date procedure manuals.

ATO response

3.39 The ATO agrees with this recommendation. National procedures have been developed for both the HRR and large refunds. These procedures will be incorporated into appropriate manuals and training arrangements (including new electronic manuals available for processing staff). The procedures will now be maintained as part of our ongoing arrangements.

3.40 Further, the effectiveness of procedures and training will be regularly tested as part of quality assurance programs either in place or being developed.

Network of Contacts

3.41 In addition to training, staff can be encouraged to develop and follow consistent and up-to-date procedures by establishing formal networks for HRR officers in both INB and SB. Regular meetings to discuss current issues, methods for dealing with particular circumstances and any changes or adjustments necessary to the procedures would be invaluable. It would also provide staff with the opportunity to meet other officers performing the same function and give them some contacts to discuss particular cases.

3.42 From its observations and discussions with staff, the ANAO concluded that the level of mutual support across the nation was limited.

3.43 The move by INB to centralise the examination of high-risk refunds in two locations should provide an opportunity to address this problem. However, the ANAO suggests that it would probably be necessary to establish some formal forum for the interchange of ideas and experience to maximise the benefits of centralisation because:

- their existence does not rely on the initiative of the individual staff members who make it up. They will therefore continue to bring improvements in operation independently of staff changes; and
- provision for their operation can be made in the allocation of staff resources.

3.44 In several branches, an information sharing meeting called BANCOM (Business Advisory Network Compliance Management) is conducted. These meetings are held regularly with a representative from each INB team and representatives from the Schemes (SB) and Strategic Intelligence (LB&I) units. They gather information from team members on current issues and identified risks. Officers processing the returns are often the first to identify problem areas because they have the initial contact with the taxpayers. Conducting such meetings can deliver the dual benefits of procedural efficiency and intelligence sharing.

Conclusion

3.45 The ANAO concluded that there would be a benefit, in terms of consistency of operation, maintenance of staff competence and intelligence gathering processes if a form of formal networking were to be implemented for staff undertaking the review of refunds. The ANAO notes the opportunities for this initiative that are available within the new organisational arrangements.

Recommendation No. 3

3.46 The ANAO recommends that, to provide better support to staff performing the refund exception function, the ATO should establish formal networks to share information about findings and techniques to gather data. In support of such networks, the ATO should establish contact lists for specific issues requiring technical advice.

3.47 The ANAO notes that recent ATO changes reflect a move in the direction of this recommendation.

ATO response

3.48 The ATO agrees with this recommendation. Networks have been established to share information and intelligence on compliance findings and strategies. A national network has also been established to support staff processing large refunds. These arrangements will be examined to determine if further support is required and that staff have access to appropriate technical advice.

Coordination

3.49 The ANAO observed some other areas where coordination could be improved, particularly where cases are referred to other areas in the ATO.

3.50 In both business lines, where there is concern about the nature of a refund, there is the option to refer the case to the compliance teams. In the case of LB&I clients, they can be referred to LB&I for review. In certain cases they can be sent to the Superannuation business line for attention. However, there seemed to be limited use of this referral process. When cases were referred in this way, no systematic record was made of that fact. This reduces the ATO's ability to ensure action is completed in a timely fashion, to measure the effectiveness of these processes and to ensure consistency of treatment for taxpayers.

3.51 For particular issues, there are informal processes in place to notify other areas in the ATO of cases. For example, in cases where it is suspected that the taxpayer may be using certain questionable or illegal tax avoidance schemes, details of the taxpayer and the nature of the suspected scheme should be forwarded to the Schemes area. This practice did not appear to be occurring in all sites.

3.52 A single coordination point would help to ensure that staff who process high-risk refunds would have the appropriate range of options to deal with them as discussed elsewhere. The role of the coordinator would also include making sure that experience from the examination of refunds is fed back into the risk assessment process.

Conclusion

3.53 With regard to INB, the ANAO concluded that, although new business line arrangements have the potential to improve coordination, the ATO may find some benefits from reviewing its coordination arrangements further. In particular, improved coordination would result in better information flows between the experienced operators, the development of up-to-date risk assessment profiles and improved consistency of interpretation of the legislation.

Further coordination considerations

3.54 There was a lack of coordination of the high risk refund process within the ATO. There are two distinct areas undertaking the assessment process of high risk refunds. These two groups do not follow the same set of procedures (see paragraph 3.19). This means that for clients who may have similar circumstances, there is a danger of different treatment. This inconsistency could be overcome by having a single area responsible for all HRR assessments. Not only would this increase the likelihood of consistent treatment, but it would also enable information on trends and potential risk areas to be better and earlier identified.

Recommendation No. 4

3.55 The ANAO recommends that the ATO take steps to improve the consistency of its refund exception processes and to improve collation of risk data.

ATO response

3.56 The ATO agrees with this recommendation. Since June 1999, INB HRR exception processing for individuals has been amalgamated into two sites. National procedures for processing all exceptions have been developed and will be subject to on-going review.

3.57 HRR operatives also enter the results of their processes into a register designed specifically to collect risk data. The register information will be used to improve the collation of risk data and provide feedback to all stakeholders including the HRR operatives. Specific liaison arrangements have also been established between INB and SB HRR staff. We consider that these steps will improve both collation of data and consistency of approach.

Proper completion of processes

3.58 Staff reviewing refund exceptions reported that they do not consistently refer cases to other relevant areas of the ATO when they assess them as potentially fraudulent or requiring further action. They reported that it was their belief that no action would be taken. HRR officers should be able to satisfy themselves that the refund is valid before releasing it. In the instances reported, this is not the case. Staff that process high-risk refunds should be able to conduct more comprehensive reviews or audits of selected cases or refer such cases to a team with resources to handle these ad hoc referrals.

3.59 The staff we spoke to advised that the audit teams work on specific projects (both in Interpretation & Compliance in INB and in Compliance and Assurance in SB). When cases were referred to them, the audit teams often advised the HRR officers that they were working on a specific project and the matter didn't fall within the parameters for that project. They also claimed that they did not have sufficient resources to undertake more ad-hoc work. They were effectively restricted to the cases in their project.

3.60 In some situations, the HRR officer was unable to finalise the exception without receiving more specific information. If a matter related specifically to another area of the ATO, the HRR officer may have requested that area to review the case (for example alienation or residency cases). The HRR officer would send a memo with a copy of the return and wait for a response. How the matter was then addressed depended on its seriousness. If it was only a minor part of the return, it may have been deferred until after the refund was issued and reviewed more closely post-issue.

Conclusion

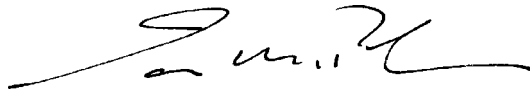
3.61 The ANAO concluded that once a refund was identified as anomalous, there was little likelihood that it would be investigated. This resulted in a gap in the information on which risk management assessments were based, some indeterminate level of non-compliance and some staff dissatisfaction with the processes.

Recommendation No. 5

3.62 The ANAO recommends that the ATO develop specific arrangements to subject refund exception cases identified as requiring further action to full investigation. Options include either equipping the high risk teams with the skills to pursue such cases to finality or ensuring that audit teams investigate such referrals promptly.

ATO response

3.63 The ATO agrees with this recommendation. Further steps to carry out this recommendation will be driven by the results of the review proposed in response to Recommendation 1. We anticipate, however, some adjustments to the refund exception criteria and some added investment in HRR audit activity to fully and promptly investigate any referrals.

A handwritten signature in black ink, appearing to read 'Ian McPhee', with a long horizontal stroke extending to the right.

Canberra ACT
27 January 2000

Ian McPhee
Acting Auditor-General

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