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Performance Audit

# **Administration of Petroleum Excise Collections**

**Australian Taxation Office**

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Canberra ACT  
26 October 2001

Dear Madam President  
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Australian Taxation Office in accordance with the authority contained in the *Auditor-General Act 1997*. I present this report of this audit, and the accompanying brochure, to the Parliament. The report is titled *Administration of Petroleum Excise Collections*

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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# Summary and Recommendations



# Summary

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## Background

1. Excise is a tax that is imposed on certain goods, 'excisable goods,'<sup>1</sup> that have been produced domestically. This can be contrasted with customs duties, that are imposed on imported goods. Excise (and customs) duties are only imposed on goods consumed within Australia. Excise duty is not payable on any exports, including the fuel used in ships and international aircraft departing from Australia.<sup>2</sup>

2. Excise duties imposed and the particular rates that are to apply to the various excisable goods are set out in the Schedule to the *Excise Tariff Act 1921*, that is, the 'Excise Tariff.' Excisable goods identified in the Excise Tariff include:

- petroleum products, including aviation fuel, heating oil, kerosene, automotive diesel, gasoline (petrol), other refined or partly refined products, petroleum-based oils and lubricants not for use as fuel, and crude oil;
- tobacco products including cigarettes, cigars, tobacco and snuff; and
- alcoholic beverages including beer, brandy, whisky, rum and other spirits, and liqueurs, but not including wine.

3. The *Excise Act 1901* (the Excise Act) and the *Customs Act 1901* (the Customs Act) were administered together from 1901. In October 1998, the Government's Administrative Arrangements Order (AAO) transferred responsibility for the administration of the excise scheme from the Australian Customs Service (Customs) to the Australian Taxation Office (ATO). Implementation of this decision commenced from February 1999.

4. In 2000–01 excise collections (\$19.329 billion) constituted some 12 per cent of total Commonwealth tax revenue collected by the ATO. Excise from petroleum products is by far the largest component of excise revenue collected by the Commonwealth. In 2000–01, \$12.170 billion related to petroleum excise, accounting for 63 per cent of total excise collections.

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<sup>1</sup> Section 4 (1) of the Excise Act 1901 defines excisable goods as:  
*goods in respect of which excise duty is imposed by the Parliament...*

<sup>2</sup> Source: James, D. 1996, 'Beer and Cigs Up! A Recent History of Excise in Australia', *Background Paper 5 1995–96*, Department of the Parliamentary Library, p. 3.

5. Four large refiner-marketer companies (BP, Caltex, Mobil and Shell) dominate the Australian petroleum industry. In 2000–01, these companies paid over 95 per cent of the excise collected from the petroleum industry. This industry structure has influenced the ATO's strategic management and planning of resource allocations. The ATO's cost to collect petroleum excise is approximately one per cent of total petroleum collections.

## **Audit objective**

6. The objective of the audit was to assess, and report to Parliament on, the ATO's administration of petroleum excise collections. The audit examined whether the ATO had implemented effectively administrative arrangements for the collection of petroleum excise since the transfer of the function from Customs in 1999. In doing so, the ANAO examined the following areas relating to administration of petroleum excise:

- governance arrangements;
- licensing arrangements;
- compliance management;
- investigations; and
- revenue management.

7. The audit also reviewed the role of Customs in performing functions directly related to petroleum excise collections and key elements of the management relationship between the ATO and Customs in this area.

8. In providing feedback to the ANAO on its 2000–01 annual audit work program, the Joint Committee of Public Accounts and Audit (JCPAA) requested that the ANAO assign this audit high priority. The audit was also supported by the ATO, in recognition of the management and cultural challenges involved in integrating the excise function (which had been the responsibility of the one agency, Customs, for almost a century) within those of the ATO. The ATO considered that an audit at this early stage of the transfer of function could assist in its ongoing management of the excise scheme.

## **Overall conclusion**

9. The change of responsibility for the excise function from Customs to the ATO is a major historical shift, which has entailed the separation of previously closely linked arrangements for 'customs' and 'excise'. This transition also occurred at a time of significant focus by the ATO on

implementing the *New Tax System*. Overall, we concluded that the ATO is implementing effective administrative arrangements for the collection of petroleum excise. The ATO has implemented several management initiatives to strengthen the administration of the excise function.

**10.** The ANAO also found that there was scope for the ATO to further improve its administration of petroleum excise collections. We observed a number of gaps in strategic management and identified areas for improvement in operational management. Particular areas identified were:

- a less than comprehensive and considered approach to risk management for petroleum excise collections;
- incomplete partnership arrangements with Customs as an agency continuing to perform relevant functions both under the ATO's and Customs' legislative responsibilities;
- inefficiencies in the operation of the petroleum licensing systems and associated processes;
- insufficient integration of compliance and investigations functions into the overall governance of petroleum excise collections; and
- inadequate assessment of the ATO's continuing exposure to fuel substitution activities that impact on petroleum excise revenue collections.

## Recommendations

**11.** The ANAO has made 12 recommendations to enhance the administrative effectiveness of the petroleum excise function.

## Agency response

**12.** The ATO has welcomed the report and has agreed to all 12 recommendations.

**13.** One recommendation was directed to both the ATO and Customs in light of Customs' continuing role in performing functions directly related to petroleum excise collections. The recommendation related to finalisation of a Memorandum of Understanding between the ATO and Customs to establish an effective partnership between the two agencies on mutual interests and responsibilities in excise administration. Customs has also agreed to the recommendation.

# Key Findings

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## Governance arrangements (Chapter 2)

### Strategic planning and risk management

**14.** The Excise business line (EBL) was created in the ATO in 1999 and is responsible for administering the excise revenue and transfer payment systems. In order to implement its component of ATO-level strategies, the EBL has developed a Strategic Statement 2000–03.

**15.** While the content of the EBL Strategic Statement follows the structure and direction introduced by the ATO Strategic Statement, the EBL's outcomes as presently constituted do not meet fully the ATO's aim of continually improving business performance and client service levels. The ANAO also considers that when the EBL seeks to update its Strategic Statement and the associated planning documents, it should improve the specification, clarity and measurability of its outcome, outputs and performance measures and assessments. Guidance on these issues is provided in the ANAO's recent report on *ATO Performance Reporting*.<sup>3</sup>

**16.** In relation to risk management processes, the EBL has developed a Strategic Risk Profile for 2000–01 which identifies and rates strategic risks relevant to the EBL, and a National Excise Compliance Plan (NECP) which identifies a list of intended compliance activities to be undertaken through a risk assessment process. However, in the ANAO's view, the EBL's ability to meet and treat risks identified through its risk assessment processes is reduced through the absence of an excise risk management plan. Risk management plans are an integral element of a sound strategic framework, and are a precursor for comprehensive business planning of operational activities such as compliance management. Development of a risk management plan would also assist the EBL in carrying out its responsibilities in relation to the ATO Risk Register.<sup>4</sup>

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<sup>3</sup> ANAO 2001, *ATO Performance Reporting under the Outcomes and Outputs Framework*, Audit Report No.46 2000–01.

<sup>4</sup> The ATO Risk Register is the risk database developed to store intelligence information, that can be easily accessed when needed.

17. The ATO advised that it does not intend to implement a separate Excise Risk Management Plan. Rather, it proposes to address risks in Excise in the context of the overall new ATO approach to compliance management. This approach involves the development of a total ATO plan made up of four component plans, of which Compliance is one. Through this Plan the ATO proposes to manage compliance across all business lines and heads of revenue. Further, the ATO advised that its Risk Register is used actively in its planning processes. This approach addresses the primary issue raised by the ANAO provided the risks to petroleum excise collections are comprehensively considered and treated in the context of the ATO's new approach to compliance management.

18. The ANAO found that a number of petroleum excise entries on the ATO Risk Register would benefit from the conduct of a rigorous review to ensure their completeness, accuracy and relevance. There would be benefit also in applying appropriate risk management procedures, particularly, where relevant, in assessing the extent of revenue at risk.

### **Strategic partnership with Customs**

19. Development of an effective strategic partnership enables greater exchanges of ideas and information, and allows partners to gain access to the knowledge and resources of the other agency. With the move towards an output/outcomes framework for managing resources and measuring performance, these ongoing relationships help achieve the outputs and outcomes for both agencies.

20. The new model for excise administration adopted in 1999 envisages a continuing role for Customs in certain functions. Accordingly, the ATO relationship with Customs is a critical element in the efficient and effective administration of excise revenue collections.

21. In February 2000, Customs proposed a draft administrative agreement (Administrative Arrangement between the Australian Taxation Office and the Australian Customs Service Relating to Mutual Cooperation in the Provision of Services), referred to as 'the MOU' (Memorandum of Understanding).

22. The MOU aimed to formalise arrangements between the ATO and Customs in relation to a number of matters, such as the continuing provision by Customs of excise licensing and revenue collection services for the ATO and handling of excise equivalent goods (EEGs) related functions. The draft MOU notes that Customs would seek to recover certain costs from the ATO for services provided. The MOU has not been finalised due to several differences between the two agencies.

**23.** In particular there remains an issue in relation to certain imported goods, referred to as EEGs<sup>5</sup>, that would be excisable if they were locally produced. EEGs are subject to customs duty at the same rate as the excise duty that would be imposed if the goods were domestically produced. Currently Customs is responsible for administering and for collecting customs duty on EEGs. In 2000–01 customs duty collections on EEGs was \$1.5 billion. However, both the ATO and Customs note that the issue of EEGs is not as significant in relation to petroleum as it is to other excisable products because almost all petroleum products are managed by the ATO under the excise scheme.<sup>6</sup>

**24.** The ATO is of the view that a fundamental change to institute one taxing regime for both EEGs and excisable goods, to be administered by the ATO, is a desirable outcome. Further the ATO believes that, in the interest of good public administration, a system is required in which the legislation and administration, as well as policy, for taxing EEGs, is unified with excise arrangements.

**25.** However, Customs considers that there are benefits in maintaining a single legislative regime dealing with all imported goods, as is recognised by current legislation that gives Customs control over and makes it accountable for all aspects of the goods which cross the border. A major concern for Customs is that the ATO-desired approach is likely to impact adversely on Customs' ability to perform regulatory and law enforcement functions contained in the Customs Act and associated legislation concerning imports and exports. Customs notes further that a range of international conventions concerning the movement of goods across the border influences its operations.

**26.** The ATO has advised that, given the present situation, its view is that further development of the single regime concept is not productive at present and therefore stronger administrative processes need to be put in place. Both agencies have agreed to formulate ongoing coordination arrangements that ensure policies and procedures in relation to the administration of EEGs are consistent with those that apply to excisable goods, in such areas as exports, duty-free businesses and compliance issues generally, including investigation of offences. The ANAO considers that finalisation of the MOU is a necessary step in accomplishing this

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<sup>5</sup> In the initial stages of discussions between the ATO and Customs on this issue, the term 'like customable goods' was used widely to describe the goods at issue, ie the imported equivalents of any goods which fall within the *Excise Tariff Act 1921*. However, since this term has a defined meaning within the Customs Act (ie section 69: goods subject to weekly settlement), which does not entirely reflect all of the relevant goods, the term 'excise equivalent goods' has been adopted by the ATO. Customs continues to use the term 'like customable goods'.

<sup>6</sup> Customs duty on petroleum products in 2000–01 contributed around \$45 million. (Source: Fuel Taxation Inquiry 2001, *Issues Paper*, 18 August, p. 20).

aim. Further, the finalisation of the MOU between the ATO and Customs will also serve to establish an effective strategic partnership between the two agencies on mutual interests and responsibilities in excise administration.

## **Strategic management**

**27.** Strategic management involves effective integration of functions within a cohesive framework in order to achieve the output and outcome performance required to fulfil organisational goals and objectives. The ATO has implemented several management initiatives to strengthen the administration of the petroleum excise function. These initiatives have been taken over a relatively limited period of time and have included legislative and administrative measures, to strengthen aspects of the excise licensing, compliance and investigations operations.

**28.** The ANAO notes that these initiatives contribute to the effectiveness of the petroleum excise collection function. However, the ANAO found that there was considerable scope to adopt a more strategic focus in administering the petroleum excise function at various levels within the EBL. Some of the areas identified were covered in paragraphs 14 to 26 above such as:

- ensuring that the risks to petroleum excise collections are comprehensively considered and treated in the context of the ATO's new approach to compliance management;
- maintaining complete, accurate and relevant entries on the ATO risk register in relation to petroleum excise; and
- finalising the ATO/Customs MOU on mutual interests and responsibilities in excise administration.

**29.** Other strategic areas identified by the ANAO for improvement related to:

- implementing an efficient and effective excise licensing system and associated management processes;
- ensuring an appropriate strategic contribution by the compliance and investigations functions to the EBL's overall planning, risk management and business intelligence, so that experience in the field feeds back into planning for improved effectiveness;
- providing the necessary assurance on the integrity and effectiveness of the excise revenue collection function through effective management of services provided by Customs currently and through timely and effective implementation of the proposed ATO excise collections system; and
- undertaking systematic assessments of possible exposure to fuel substitution activities.

**30.** The ANAO considers that addressing these strategic management issues would be a desirable forward step in establishing a sound forward-looking and integrated approach to administration of the petroleum excise function.

## **Licensing arrangements (Chapter 3)**

**31.** Petroleum excise licensing arrangements have been in place for a number of years. Under Commonwealth legislation licences and permissions are required to manufacture and store or transport excisable goods on which excise duty has been deferred in certain circumstances. The licensing process also:

- enables the monitoring and regulation of manufacturers of excisable goods;
- promotes a controlled environment; and
- facilitates compliance with the Excise Act.

**32.** The ATO has taken several measures to strengthen the role and concept of licensing in relation to other areas of activity that are regulated for the purposes of the Excise Act, thus ensuring that the licensing provisions contribute to the compliance framework.

**33.** However, more progress is required to be made to enhance the efficiency and effectiveness of petroleum excise licensing arrangements. Areas that require particular attention are:

- the development of a comprehensive petroleum excise licensing policy and procedures manual that provides operational guidance, within the necessary strategic context, for administering the licensing function;
- establishing accountability arrangements for licensing decisions including consultation mechanisms between relevant areas to achieve optimum and value-added handling of licensing applications; and
- addressing the weaknesses of the current licensing systems and processes to achieve efficiencies and an increased client focus, both within and outside the ATO.

**34.** In responding to the ANAO's proposed report, the ATO advised that it has acted to address the concerns regarding existing licensing arrangements. The ATO recently completed an extensive review of the existing licensing system. The review focussed on the ability to use licensing provisions to address: identified risks; inherent weaknesses; and process inefficiencies within the current arrangements.

## Aspects of compliance management—Field Services (Chapter 4)

**35.** The self-assessment nature of the excise collection scheme places the onus of understanding and applying relevant excise legislation on clients making excise payments. Any self-assessment scheme requires, nevertheless, an effective and credible compliance component to provide assurance of revenue integrity, within the context of risk management.

### Excise compliance strategy

**36.** Excise compliance is conducted in accordance with the ATO Compliance Model,<sup>7</sup> which provides a framework for the approach to be taken towards compliance at both strategic and operational levels.<sup>8</sup>

**37.** The National Excise Compliance Plan (NECP) is developed each year, based on EBL risk assessment processes, and provides a sound basis to meet the conflicting priorities of the EBL in the area of compliance activities, particularly audits. It also aims to set a direction and impart coherence to compliance activities.

**38.** The ANAO considers that the NECP, in its current format, is more of a compliance activity statement than it is a compliance strategic plan. Within the context of risk management, effective compliance planning should address at least the following variables:

- the level of risk to be addressed by the compliance risk treatment strategy;
- who is responsible for achieving the desired result of the risk treatment; and,
- how success in achieving the plan is to be measured.

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<sup>7</sup> The ATO has adopted a structured approach to improving taxpayer compliance, known as the ATO Compliance Model. This Model is applied to all functions that the ATO administers.

<sup>8</sup> Within the ATO, the term 'compliance' is used in the broadest sense, that is, in managing compliance the ATO not only considers risks to revenue but also risks to community confidence, cost of compliance, and client capability and understanding. The ATO employs a range of compliance strategies, embracing activities as diverse as policy development, law design and change, delivering help and education products and services, analysing information and foreseeing market trends, etc, as well as operational field and investigation activities.

## **Operational management**

**39.** The approach adopted by the EBL to compliance management at the operational level involves excise compliance teams providing a range of compliance services to the Petroleum Excise Industry Group (PEIG)<sup>9</sup> within the EBL with a view to addressing the type and level of risk identified in the NECP. The PEIG plays a pivotal role in controlling the pattern and direction of compliance operations.

**40.** The ANAO found that the excise compliance teams had undertaken compliance cases proficiently. Compliance activities carried out by the excise compliance teams were adequately aligned with the requirements set down by the PEIG and the management and reporting of audit results was in accordance with the documented policy and procedures.

## **Management and reporting frameworks**

**41.** Sound management and reporting frameworks provide a basis for informed decision making, assisting in improving performance and accountability. They are also an early warning system enabling managers to undertake timely preventative action.

**42.** The ANAO identified a number of instances where the management, coordination and reporting of compliance action could be improved. There are different excise compliance management and reporting systems, databases and monitoring spreadsheets in use at national, regional, site and team levels leading to inconsistent provision and update of information. This diversity of arrangements creates difficulties for managers in the oversight and direction of compliance activities, as well as in the consolidation of information for management reporting.

**43.** This lack of consistent and coordinated information has been one of the primary factors that have contributed to difficulties in the EBL's ability to undertake an ongoing assessment of progress against compliance plans.

**44.** The ANAO identified also areas for improvement in compliance management reporting processes. Without adopting a strategic focus, the ability of the compliance function to contribute positively to the EBL's overall planning, risk management and business intelligence activities is lessened.

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<sup>9</sup> The PEIG within the EBL is responsible for undertaking a range of functions relating to administration of petroleum excise collections.

## Investigations (Chapter 5)

**45.** The Excise Investigations Unit within the EBL undertakes fraud<sup>10</sup> investigations either independently or in conjunction with other ATO business lines, other Government agencies and law enforcement agencies. The Unit is responsible for investigating instances of external fraud (that is fraud committed outside the ATO) involving possible breaches of Commonwealth legislation in relation to all excisable products/industries.

**46.** The ANAO found that the skills, experience and training of excise investigations staff were of a high standard, as well as being appropriate to the cases being undertaken.

**47.** However, the ANAO also identified scope for improvement in excise investigations case planning and management processes. The absence of initial case planning impacted adversely on the ability of the Investigations staff to conduct particular petroleum investigations efficiently and effectively.

**48.** Adoption of an effective case management framework incorporating clearly defined and articulated procedures and processes for case referral, selection, prioritising, planning, recording, monitoring and reviewing would enhance the efficiency and effectiveness of the excise investigations function.

## Revenue management (Chapters 6 and 7)

**49.** Key components of a revenue management process are revenue estimation, revenue collection, revenue monitoring and analysis (including regularly determining the extent of revenue foregone<sup>11</sup> as a result of exemptions/ concessions) and monitoring the exposure to revenue leakage activities. The extent to which planned revenue outcomes are achieved is linked to the accuracy of the revenue estimation process. Further, as excise duty is self-assessed, strong and effective monitoring mechanisms are required if budgeted excise revenue estimates are to be achieved.

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<sup>10</sup> The *Fraud Control Policy of the Commonwealth* defines fraud as:

*inducing a course of action by deceit or other dishonest conduct, involving acts or omissions or the making of false statements, orally or in writing, with the object of obtaining money or other benefit from, or of evading a liability to, the Commonwealth.*

(Commonwealth Law Enforcement Board 1994, *Best Practice for Fraud Control—Fraud Control Policy of the Commonwealth*, AGPS, Canberra, p. 3)

<sup>11</sup> The ATO uses the term 'revenue foregone' when referring to products that are cleared duty free, that is those products that, effectively, attract a zero rate of excise.

## **Revenue estimation**

50. The Department of the Treasury (Treasury) is responsible for formulating revenue estimates. Revenue outcomes are published by the ATO, and by Treasury and the Department of Finance and Administration. Detailed estimates are initially presented in the Budget Outlook, and are reviewed and revised as necessary as part of the Mid-Year Economic and Fiscal Outlook (MYEFO) and the next year's Budget Outlook processes. The outcomes are reported in the Final Budget Outcome (FBO). The Treasury relies on ATO processes and information in arriving at excise revenue estimates.

51. The petroleum excise revenue estimates for 2000–01 were revised downwards significantly in May 2001 (by \$800m or 6 per cent from the original budget estimates and by almost \$600m or 5 per cent from the MYEFO estimates).

52. The ATO and the Treasury attributed the significant downward revision to a number of factors including overly optimistic economic growth assumptions. Treasury advised that forecasts of economic activity are also subject to forecasting error. Forecasting uncertainties have been exacerbated by significant reform of the tax system. Treasury recognises that taking account of factors that have been important in the past may no longer be a valid approach.

53. The ANAO acknowledges the complexity of the revenue estimates process. There was adequate evidence to indicate that the formulation of 2000–01 excise revenue estimates was a consultative process, involving relevant areas of the ATO. Treasury's commitment to reviewing its revenue forecasting methods in a systematic and ongoing basis should ultimately improve the rigour and accuracy of the revenue estimates process.

## **Revenue collection, monitoring and analysis**

54. Under the arrangements in place between the ATO and Customs at the present time, the ATO is accountable for the revenue collection function, with Customs performing the role of a service provider in collecting the excise revenue. In 2000–01 petroleum excise revenue in the order of \$12.1 billion was collected by Customs on behalf of the ATO. Nevertheless, the onus is on the ATO to ensure that it can provide the necessary assurance on the integrity and effectiveness of the excise revenue collection function. However, the delays in finalising the MOU between the two agencies and the temporary nature of the current arrangements have led to some revenue collection controls not being implemented to provide this assurance.

55. The ANAO found that petroleum excise collection is currently monitored by the ATO. In 2000–01, due to the downward trend in petroleum excise revenue collections against estimates, substantial data analysis was undertaken in various ways to identify the factors contributing to the downward trend. However, the ANAO found that the ATO did not quantify the impact on collections of these factors which would be expected for performance assessment purposes.

56. The PEIG monitors and reports (on a quarterly basis) on revenue collection patterns. While the reports were comprehensive in providing an insight into the activities of the PEIG, and had a strong compliance focus, they could be further improved by exploring in more detail reasons for significant variations in the revenue pattern by the petroleum products and clients.

### **Revenue leakage—fuel substitution**

57. Fuel substitution involves products, which attract a nil excise rate or a concessional rate, being added to petrol or diesel. Petrol and diesel attract an excise rate currently around 38 cents a litre. Fuel substitution is regarded in the petroleum industry as one of the primary factors contributing to petroleum excise revenue leakage. The ANAO examined fuel substitution because it not only results in loss of excise revenue but also may damage the vehicle engines of unsuspecting motorists and distort the petrol/diesel market.

58. The ANAO found that the ATO has taken a number of legislative and administrative measures to address fuel substitution. The ATO presently rates fuel substitution as second only to illegal tobacco among its revenue risks in excise collections. The ATO recognises also that there is a continuing risk that parties involved in this activity will continue to look for other ways to avoid excise.

59. However, the ANAO considers that the ATO has not systematically quantified its exposure to fuel substitution activities nor identified its strategic objective in countering fuel substitution. The ATO has advised, that as with the size of the ‘black economy’, the quantum of revenue lost through fuel substitution is not amenable to precise estimation. Estimates of revenue loss vary considerably but indicatively could be \$30m per annum or higher.

60. The ANAO acknowledges that revenue lost through fuel substitution is not amenable to precise estimation. Nevertheless, the ANAO considers that the ATO should systematically assess, on an ongoing basis, its exposure to fuel substitution activities. This would require it to determine the extent of the problem, to undertake cost-benefit analyses of different revenue loss targets, and to formulate strategies to address the issue.

**61.** The ANAO found that there was also scope for the ATO to supplement its compliance and investigations activities in relation to fuel substitution, with measures which include:

- specifying detailed client compliance requirements to assist in assessing compliance and enabling appropriate and timely remedial action; and
- updating and finalising the draft fuel testing procedures to ensure maximum leverage from its fuel testing activities.

**62.** The ANAO considers that there may be opportunities to improve arrangements with the Department of Environment and Heritage (Environment Australia [EA]) on implementation of fuel quality standards, to enable both agencies to maximise their benefits from fuel testing initiatives.

# Recommendations

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*Set out below are the ANAO's recommendations aimed at improving the effectiveness of the EBL's administration of petroleum excise collections. Report paragraph references are included here. The ANAO considers that the ATO should give priority to Recommendations 1 and 2, 8, 9, and 11.*

**Recommendation No. 1**  
**Para 2.26** The ANAO recommends that the ATO conduct a rigorous review for completeness, accuracy and relevance of the Excise business line's petroleum entries on the ATO Risk Register.

**Response:** Agreed

**Recommendation No. 2**  
**Para 2.57** The ANAO recommends that, to effectively administer the excise collection function and to maintain a cooperative and effective working relationship, the ATO and Customs should finalise a memorandum of understanding on mutual interests and responsibilities in excise administration.

**Response:** ATO and Customs: Agreed

**Recommendation No. 3**  
**Para 3.9** The ANAO recommends that the ATO develop a comprehensive petroleum excise licensing policy and procedures manual that provides operational guidance, within the necessary strategic management context, for administering the licensing function.

**Response:** Agreed

**Recommendation No. 4**  
**Para 3.30** The ANAO recommends that the ATO review its petroleum excise licensing systems and processes. Specific areas that would benefit from this review are:

- establishing improved accountability arrangements and consultation mechanisms between the Petroleum Excise Industry Group and the Licensing Group, to achieve the optimum and value-added handling of licensing applications; and
- addressing the weaknesses of the current licensing systems and processes to achieve efficiencies and an increased client focus, both within and outside the ATO.

**Response:** Agreed

**Recommendation No. 5**  
**Para 4.51** The ANAO recommends that, to implement effective compliance management and reporting arrangements, the ATO take steps to establish a case management system to consolidate and rationalise the recording, updating, management and reporting of information relating to compliance activities.

**Response:** Agreed

**Recommendation No. 6**  
**Para 5.23** The ANAO recommends that the ATO:

- implement and maintain an effective case management framework within the Excise Investigations unit including in the conduct of initial case planning and resource allocation, ongoing management and review of case progress and decisions to terminate cases; and
- consider implementation of an automated case management system within the Excise Investigations unit.

**Response:** Agreed

**Recommendation No. 7**  
**Para 5.35**

The ANAO recommends that the ATO implement comprehensive and regular reporting on progress with investigation cases and on strategic and operational issues of importance, between the Excise Investigations unit, Field Services Branch management and the Petroleum Excise Industry Group.

**Response:** Agreed

**Recommendation No. 8**  
**Para 6.32**

The ANAO recommends that, in order to provide the necessary assurance on the integrity and effectiveness of the excise revenue collection function, the ATO should strengthen existing controls relating to excise revenue collection arrangements with Customs.

**Response:** Agreed

**Recommendation No. 9**  
**Para 6.51**

The ANAO recommends that, in monitoring and analysing petroleum revenue collection trends, the ATO should quantify, where possible, the impact of factors contributing to significant variations in revenue trends. This could result in a better understanding of the extent of impact associated with each factor, and would aid in improving future excise revenue estimates.

**Response:** Agreed

**Recommendation No. 10**  
**Para 7.31**

The ANAO recommends that, as part of its fuel substitution strategy, the ATO should supplement its compliance and investigation activities with measures such as:

- specifying detailed client compliance requirements to assist in assessing compliance and enabling appropriate and timely remedial action by the Petroleum Excise Industry Group; and
- updating and finalising the draft fuel testing procedures to ensure maximum leverage for the Excise Business Line from its fuel testing activities.

**Response:** Agreed

**Recommendation No. 11**  
**Para 7.42**

The ANAO recommends that, to consolidate its fuel substitution strategy, the ATO should systematically assess its exposure to fuel substitution activities with a view to fully determining the extent of the problem and formulating appropriate strategies to address the issue. This would include:

- identifying all the possible substitutes for diesel and petroleum;
- determining the possible revenue implications or potential exposure to revenue loss if any of the identified substitutes are used; and
- reviewing existing strategies or developing new strategies to limit exposure to revenue loss.

**Response:** Agreed in principle

**Recommendation No. 12**  
**Para 7.61**

The ANAO recommends that the ATO formalise its arrangements with Environment Australia on the implementation of fuel quality standards, to enable both agencies to maximise their benefits from fuel testing initiatives.

**Response:** Agreed

# Audit Findings and Conclusions



# 1. Background and Context

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*This chapter introduces the concept of excise, outlines the operation of the excise system in Australia and discusses relevant issues about the petroleum industry in Australia and the application of excise duties to petroleum products. This chapter also outlines the objective and methodology of this performance audit.*

## Excise in Australia

### What is excise?

**1.1** Excise is a tax that is imposed on certain goods, ‘excisable goods,’<sup>12</sup> that have been produced domestically. This can be contrasted with customs duties, that are imposed on imported goods. Excise (and customs) duties are only imposed on goods consumed within Australia. Excise duty is not payable on any exports, including the fuel used in ships and international aircraft departing from Australia.<sup>13</sup>

**1.2** Excise has been applied to a range of goods over time, most commonly to alcohol, tobacco and petroleum products.

### Excisable products

**1.3** Section 4 (1) of the *Excise Act 1901* defines excisable goods as follows:

*Excisable goods means goods in respect of which excise duty is imposed by the Parliament, and includes goods the subject of an Excise Tariff or Excise Tariff alteration proposed in the Parliament.*

**1.4** Excise duties are imposed by section 5 of the *Excise Tariff Act 1921*, that is, the ‘Excise Tariff.’ The particular rates that are to apply to the various excisable goods are set out in the Schedule to the Act. Excisable goods identified in the Excise Tariff include:

- petroleum products, including aviation fuel, heating oil, kerosene, automotive diesel, gasoline (petrol), other refined or partly refined products, petroleum-based oils and lubricants not for use as fuel, and crude oil;

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<sup>12</sup> Section 4 (1) of the Excise Act 1901 defines excisable goods as:

*goods in respect of which excise duty is imposed by the Parliament...*

<sup>13</sup> James, D., op. cit., p. 3.

- tobacco products including cigarettes, cigars, tobacco and snuff; and
- alcoholic beverages including beer, brandy, whisky, rum and other spirits, and liqueurs, but not including wine.<sup>14</sup>

**1.5** Excise is applied on a per unit basis:

- \$/litre of alcohol (spirits, beer, liqueurs);
- \$/litre of product (petroleum, diesel, other petroleum products);
- \$/stick (cigarettes, cigars); and
- \$/kilogram (pipe tobacco, roll your own, snuff).

## **Excise administration**

**1.6** In October 1998, the Government's Administrative Arrangements Order (AAO) transferred responsibility for the administration of the excise scheme from the Australian Customs Service (Customs) to the Australian Taxation Office (ATO). Implementation of the decision commenced in February 1999.

**1.7** The ATO is the Commonwealth's principal revenue collection agency, responsible for collecting a range of different taxes. In 2000–01, excise revenue of \$19.329 billion represented 11.7 per cent of total collections of \$165.408 billion.

**1.8** Figure 1.1 illustrates the extent of excise revenue collections from 1989–90 to 2000–01.

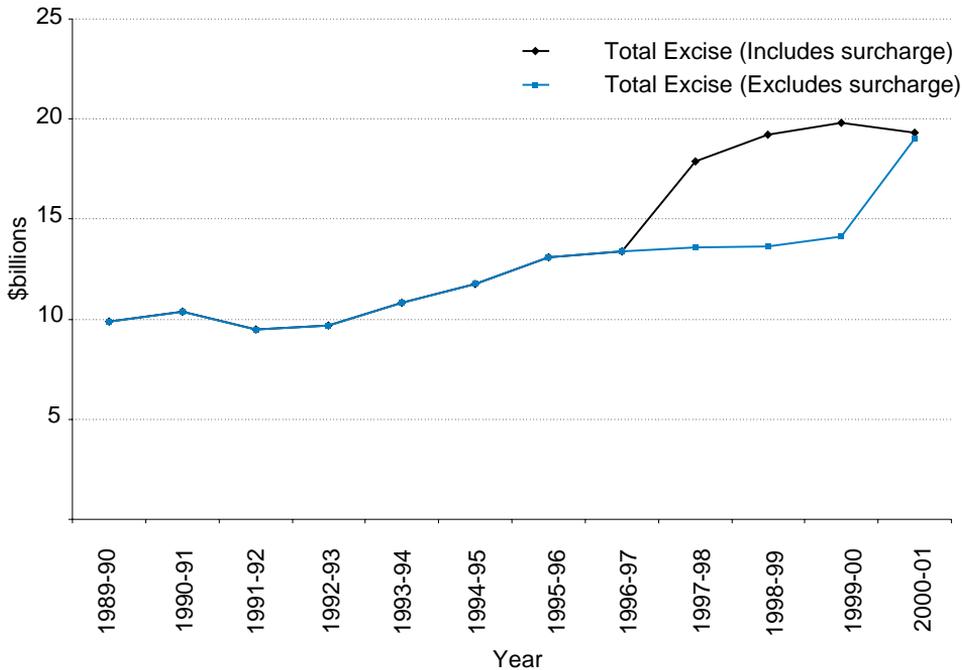
### **Significant features of the excise collection scheme**

**1.9** The requirement to pay excise duty is imposed at a specific step in the production or distribution of goods before the goods reach the hands of consumers. This step where excise is payable is known as 'entry into home consumption'. This is taken to occur when the product has reached the end of the manufacturing process and has been released by the manufacturer into the market, for example to a wholesale distributor of the product. It is at this stage that excise becomes payable, before the goods reach the consumer.<sup>15</sup>

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<sup>14</sup> Wine is subject to the Wine Equalisation Tax (WET), replacing the Wholesale Sales Tax on wine (abolished with introduction of the GST)

<sup>15</sup> Note that major producers holding Weekly Settlement Permissions (discussed in Chapter 6), are required to make such excise payments on a weekly basis only.

**Figure 1.1****Total excise collections—all commodities 1989–90 to 2000–01**

\* In August 1997 the High Court decided that business franchise fees that had been imposed by some States and Territories (on tobacco and petroleum products) were unconstitutional. From 1997 to 1999–2000 the Commonwealth Government collected surcharge excise duty on petroleum and tobacco products on behalf of those States and Territories that had imposed business franchise fees. The Commonwealth reimbursed surcharge amounts to the States under agreed 'safety net' repayment schemes until the introduction of the GST from 1 July 2000 (minor amounts of surcharge revenue were collected in July and August 2000).

Source: ATO data

### 1.10 The significant features of the excise collection scheme are:

- a system for aligning excise taxes (on domestically produced goods) with customs duties (on imported goods or 'excise equivalent' goods), to achieve equitable tax treatment;
- establishment of varying excise rates, depending on the use made of the excisable products at the consumer level;
- a licensing system for excise payers, with excise tax obligations conferred at the wholesale not retail level;
- use of a system of permission limits<sup>16</sup> (given the varying excise rates related to the end-use of products) on amounts of excisable products able to be delivered, applicable to licence holders;

<sup>16</sup> The system of permissions imposes limits on the entry of product into home consumption

- a weekly collection system based on self-assessment by excise payers complemented by monitoring, compliance management<sup>17</sup> and investigations activities conducted by the ATO; and
- systems for excise tax concessions or ‘excise exemptions’ (and incentive payments) provided in certain circumstances.

## **Legislative framework**

**1.11** The *Excise Act 1901* (the Excise Act) and the *Customs Act 1901* (the Customs Act) were administered together from 1901 until 1998. The Customs Act imposes duty on imported goods as described in the Customs Tariff, while the Excise Act imposes duty on locally manufactured goods as described in the Excise Tariff.<sup>18</sup>

**1.12** The Excise Act provides the overarching legislative framework. However, there are other pieces of legislation that support the Excise Act and that are relevant to the administration of the excise function for the various excisable goods. These include the *Excise Amendment (Compliance Improvement) Act 2000*, the *Fuel (Penalty Surcharges) Administration Act 1997* and the *Petroleum Excise Amendment (Measures to Address Evasion) Act 2000*.

**1.13** Following passage of responsibility for excise matters from Customs to the ATO, legislative action was required to give effect to the new arrangements. During the audit, relevant legislation was passed by the Parliament (the *Taxation Laws Amendment (Excise Arrangements) Act 2001*). Among other things, this Act transfers responsibility for the general administration of excise legislation from the Chief Executive Officer (CEO) of Customs to the Commissioner of Taxation, and incorporates in the Excise Act the powers of officers that were previously conferred by the Customs Act for excise purposes.

## **Accountability arrangements**

**1.14** As mentioned in paragraph 1.6 the ATO is responsible for the excise collection scheme. However, administration of this scheme involves

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<sup>17</sup> Within the ATO, the term ‘compliance’ is used in the broadest sense, that is, in managing compliance the ATO not only considers risks to revenue but also risks to community confidence, cost of compliance, and client capability and understanding. The ATO employs a range of compliance strategies, embracing activities as diverse as policy development, law design and change, delivering help and education products and services, analysing information and foreseeing market trends, etc, as well as operational field and investigation activities.

<sup>18</sup> Section 55 of the Constitution requires that ‘laws imposing duties of customs shall deal with duties of customs only, and laws imposing duties of excise shall deal with duties of excise only’.

a number of inter-agency accountabilities. Those relevant to petroleum excise collection arrangements include:

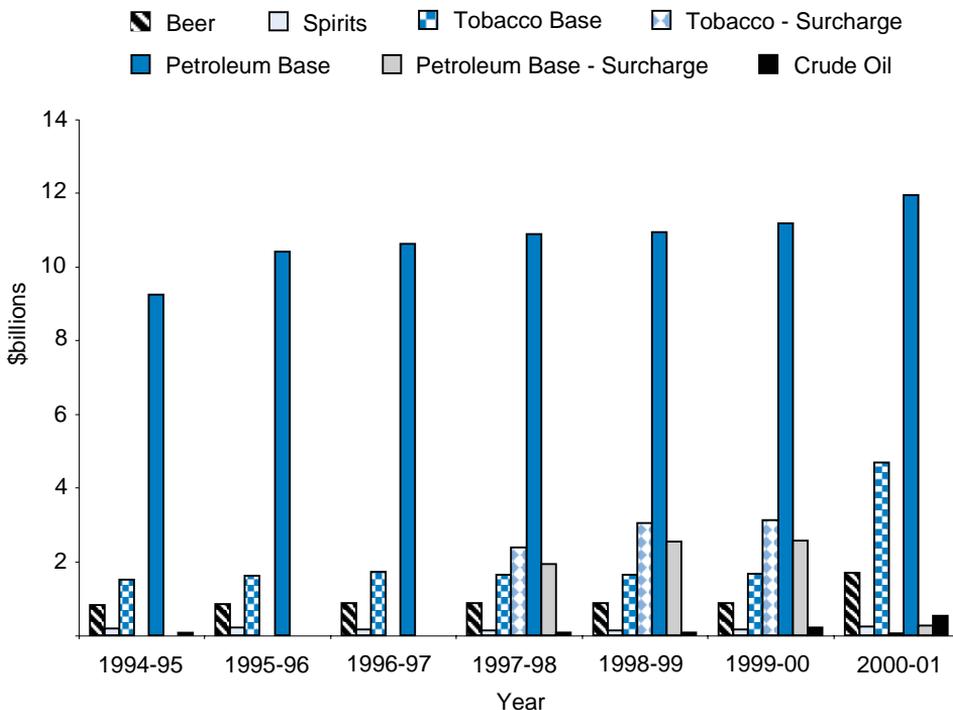
- the Treasury, which is responsible for formulating revenue estimates and publishing revenue outcomes;
- Customs, which is directly responsible for collection of duty payable on imported goods that would be excisable if locally produced. Also Customs has a continuing role as a service provider to the ATO in respect of excise revenue collection and licensing function at the operational level; and
- Environment Australia, which is responsible for administration of the *Fuel Quality Standards Act 2000*.

## Petroleum

**1.15** Excise from petroleum products is by far the largest component of excise revenue collected by the Commonwealth. In 2000–01, \$12.170 billion was collected in petroleum excise, accounting for 63 per cent of total excise collections. Figure 1.2 shows total excise collected from all petroleum products in the last seven years compared to total excise collected from all other excisable products.

**Figure 1.2**

### Excise collections by product



Source: ANAO depiction of ATO data

## **Petroleum refining**

**1.16** Four large refiner-marketer companies (BP, Caltex, Mobil and Shell) dominate the Australian petroleum industry. In 2000–01, these companies paid over 95 per cent of the excise collected from the petroleum industry. This industry structure has influenced the ATO’s strategic management and planning of resource allocations. The ATO’s cost to collect petroleum excise is approximately one per cent of total petroleum collections. The four large refiner-marketer companies currently operate eight major refineries spread around Australia. In addition to the major refineries, there are eight smaller or mini refineries located around Australia.

**1.17** The function of a refinery is to produce petroleum products from refinery feedstocks.<sup>19</sup> Appendix 1 provides an illustration of the elements of a typical refinery and of the range of refinery outputs (which can be subject to excise), together with a description of the main refinery processes.

## **Distribution of petroleum products**

**1.18** Given the geographic spread of major petroleum markets in Australia, the cost of shipping petroleum products has the potential to add significant costs to the supply of products to the consumer, which would need to be passed on. As a consequence, ‘refinery exchanges’ have been developed between the major refiners. The basic principle of such arrangements is that one company makes product available to another company from its refinery or terminal, in exchange for product of equivalent volume and quality in another part of Australia. Such arrangements reduce the need for long-distance haulage of product, thereby reducing costs.

**1.19** Links in the chain of distribution of petroleum products from producer to consumer are represented graphically in Appendix 2.

## **Petrol prices**

**1.20** Since the deregulation of petrol pricing on 1 August 1998, the Australian Competition and Consumer Commission (ACCC) has monitored petrol prices, with a particular focus on non-metropolitan

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<sup>19</sup> Feedstocks comprise crude oil or other hydrocarbons that are the basic materials for a refining or manufacturing process.

prices. In its recent Discussion Paper *Reducing Fuel Price Variability* the ACCC notes that:

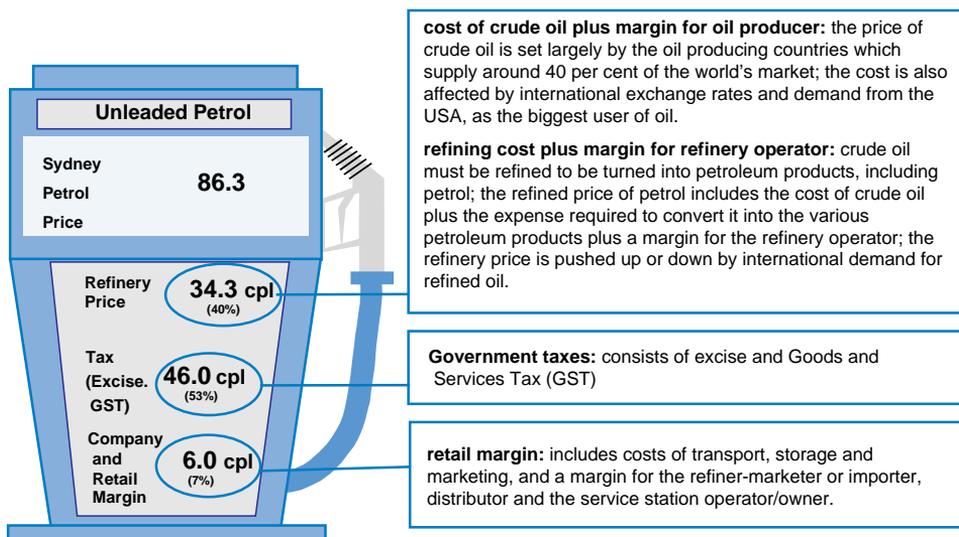
*Retail fuel prices are determined by a combination of international and local factors. The international factors include the prices of crude oil and refined petroleum products, and the Australian/US dollar exchange rate. The local factors include the level of Federal and State excise and taxes, ad hoc local supply and demand factors (such as shortages arising out of refinery maintenance and additional demand on public holidays) and local price cycles.<sup>20</sup>*

**1.21** Figure 1.3 illustrates price components for the price of unleaded petrol in Sydney on 10 October 2001.

**1.22** The price of petrol in Australia has been considered to be low when compared to the prices recorded for other countries in the Organisation for Economic Cooperation and Development (OECD). Appendix 3 provides an overview of the analysis undertaken by the International Energy Agency showing the tax and non-tax components, and the total price of a litre of unleaded petrol in 27 OECD countries.

**Figure 1.3**

**Components of petrol price (as at 10 October 2001)**



Note: cpl = cents per litre

Source: ANAO depiction of information provided at [www.shell.com.au/petrolpricing/home.asp](http://www.shell.com.au/petrolpricing/home.asp) (accessed 10-10-01)

<sup>20</sup> ACCC 2001, *Reducing Fuel Price Variability*, Discussion Paper, June, p. 5.

## Imports and export of petroleum products

**1.23** In 1999–2000, Australia produced 93 per cent of its net liquid petroleum needs (the balance between imports of crude oil and other feedstocks for its refineries and the export of the same or similar products) and all of its gas needs.<sup>21</sup>

**1.24** Australian refineries presently supply around 95 per cent of total finished petroleum products required by the Australian retail market. The remaining 5 per cent of finished product, largely automotive gasoline and diesel, is imported, particularly from Singapore, and is purchased by a growing number of independent retailers. In 1999–2000, imports of petroleum products increased by 14 per cent over 1998–99.<sup>22</sup>

**1.25** Australian refineries also export a range of finished petroleum products, particularly to customers located throughout the South Pacific, including New Zealand.

## Audit objective and methodology

**1.26** The objective of the audit was to assess, and report to Parliament on, the ATO's administration of petroleum excise collections. The audit examined whether the ATO had implemented effectively administrative arrangements for the collection of petroleum excise since the transfer of the function from Customs in 1999. In doing so, the ANAO examined the following areas relating to administration of petroleum excise:

- governance arrangements;
- licensing;
- compliance management;
- investigations; and
- revenue management.

**1.27** The audit also reviewed the role of Customs in performing functions directly related to petroleum excise collections and key elements of the management relationship between the ATO and Customs.

**1.28** In providing feedback to the ANAO on its 2000–01 annual audit work program, the Joint Committee of Public Accounts and Audit (JCPAA) requested that the ANAO assign this audit high priority. The audit was also supported by the ATO, in recognition of the management and cultural challenges involved in integrating the excise function (which had been the responsibility of the one agency [Customs] for almost a century) within those of the ATO. The ATO considered that an audit at this early stage

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<sup>21</sup> Department of Industry, Science and Resources (DISR) 2000, *Australian Petroleum Statistics*, Issue No.47, June, p. 3.

<sup>22</sup> *ibid.*, p. 3.

of the transfer of function could assist in its ongoing management of the excise scheme.

**1.29** In reviewing petroleum excise arrangements the audit did not cover the ATO's administration of crude oil excise<sup>23</sup>, fuel excise rebate and payment schemes<sup>24</sup> and the Petroleum Resources Rent Tax (PRRT).<sup>25</sup> The administration arrangements for these components vary considerably from the features relevant to the petroleum excise collection function including as set out in paragraph 1.10.

### **Audit methodology**

**1.30** Audit fieldwork was conducted from February 2001. In addition to document and file review, interviews with key ATO staff were undertaken at ATO National Office in Canberra, and at ATO offices located in Melbourne, Sydney and Brisbane. The principal purpose of such visits was to gain information on excise corporate governance, licensing, revenue management, compliance management and investigations functions relevant to the subject matter of the audit.

**1.31** The ANAO held discussions with, and reviewed the work of, a range of Customs officers responsible for performing revenue collection function on behalf of the ATO, and in managing the ongoing relationship with the ATO on excise matters. The ANAO consulted with representatives of the Treasury and the Department of the Environment and Heritage (Environment Australia [EA]) in view of the inter-agency accountabilities noted in paragraph 1.14.

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<sup>23</sup> Crude oil excise is imposed by section 6B of the *Excise Tariff Act 1921*. Crude oil excise is collected from two sources: offshore fields in the North West Shelf production licence areas that are not subject to PRRT (see below), and onshore fields and coastal waters. Crude oil excise is the only excise not to be levied on a per unit basis. Instead, the excise rate applied to crude oil is based on both the quantity of crude oil sold (with the first 30 million barrels exempt) and the sale price, as well as on the discovery and development dates of the oil fields involved.

<sup>24</sup> At the time of the audit these comprised:

- Diesel Fuel Rebate Scheme (off-road), extended to marine and rail transport from 1 July 2000;
- Diesel and Alternative Fuel Grants Scheme (on-road);
- Fuel Sales Grants Scheme;
- Goods and Services Tax Special Petroleum Credit;
- Product Stewardship (Oil) scheme.

<sup>25</sup> PRRT is levied under the *Resource Rent Tax Assessment Act 1987* and applies to offshore areas other than the North West Shelf production and associated exploration areas, which are subject to crude oil excise and royalty arrangements.

**1.32** The ANAO also contacted the Office of the Commonwealth Ombudsman to discuss any complaints that were relevant to the subject of the audit. Advice at the time of the audit was that in 2000–01 the only complaint received about the ATO’s management of excise concerned a fuel excise matter that was not relevant to the scope of the audit.<sup>26</sup>

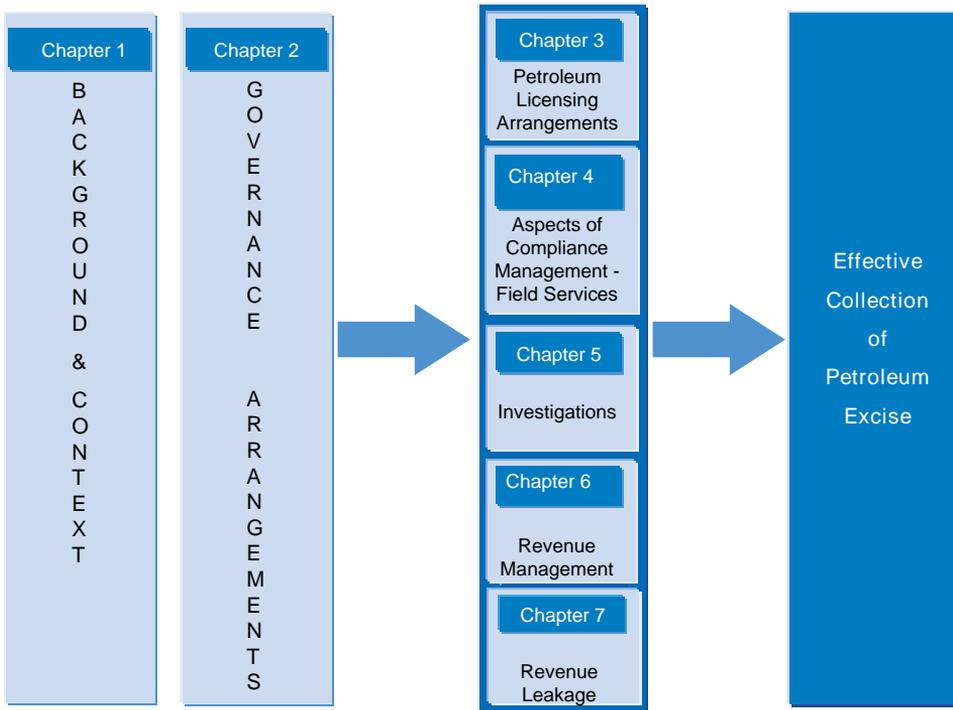
**1.33** The ANAO took account of the views expressed by a number of external stakeholders<sup>27</sup> in discussions or other contact with the audit team.

**1.34** The audit was conducted in accordance with ANAO auditing standards at a cost of \$325 000.

## Report structure

**1.35** Figure 1.4 illustrates the framework that the ANAO used to assess the ATO’s administration of petroleum excise. This framework formed the basis for the structure of the performance audit report.

**Figure 1.4**  
**Structure of ANAO report**



<sup>26</sup> The ANAO was advised that the only complaint related to a fuel rebate payment.

<sup>27</sup> The Australian Institute of Petroleum, the four major refiner-marketer petroleum companies in Australia, one medium petroleum company and one small petroleum company.

## Acknowledgments

**1.36** The ANAO wishes to express its appreciation for the time, effort and expertise contributed by officers representing the ATO and other Commonwealth public sector agencies, particularly Customs and the Department of the Treasury, during the audit and in the preparation of the report. The ANAO thanks also the staff of all stakeholder organisations that were consulted during the conduct of the audit.

## 2. Governance Arrangements

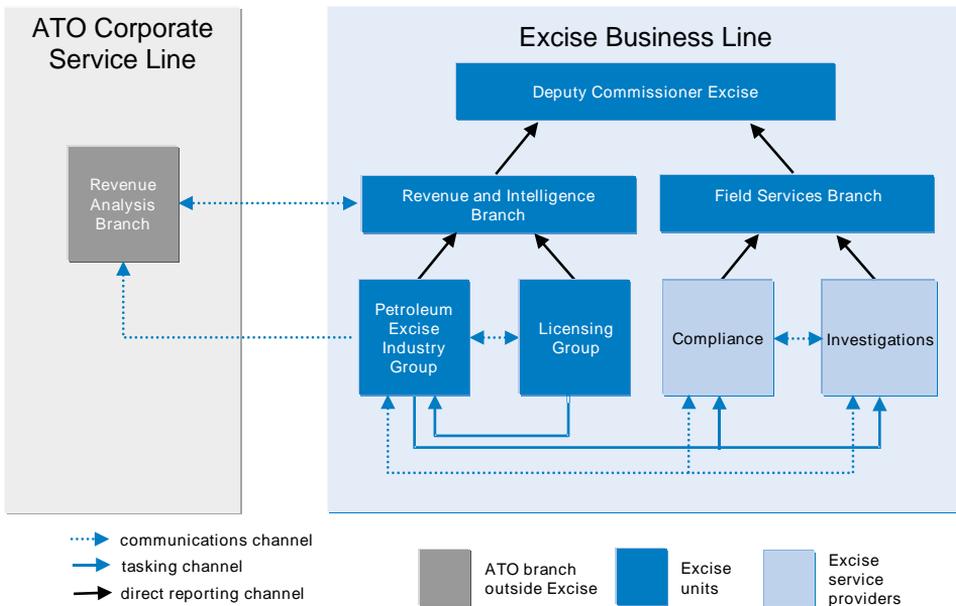
*This chapter discusses a range of strategic management issues relating to the administration of the petroleum excise function within the ATO. The ANAO also discusses relevant aspects of the strategic relationship between the ATO and Customs.*

### Excise management arrangements

**2.1** Following the transfer of the excise function from Customs to the ATO, the Excise business line (EBL) was created in 1999. The EBL is responsible for administering the excise revenue and transfer payment systems. The current structure of the EBL is shown at Appendix 4. Figure 2.1 outlines the ATO's internal management and accountability arrangements for petroleum excise collections.

**Figure 2.1**

#### Petroleum excise internal accountability arrangements



Source: ANAO depiction of ATO information

**2.2** As at 30 June 2001, the EBL had 782 staff. Most of the staff were allocated to administration of business payments (as described earlier at paragraph 1.29) of some \$3 billion to 350 000 clients in a range of fuel schemes and to field services functions (compliance and investigations).

**2.3** In reviewing the petroleum excise arrangements, the ANAO covered the relevant operations of the EBL's Revenue and Intelligence and Field Services Branches. Within the Revenue and Intelligence Branch (RIB), a major focus of ANAO work was on the operations of the Petroleum Excise Industry Group<sup>28</sup> (PEIG),<sup>29</sup> because the audit focused on the administration of petroleum excise collections.

**2.4** The PEIG is responsible primarily for administering and managing all aspects of petroleum excise collections. Key responsibilities include:

- monitoring petroleum excise revenue receipts;
- identifying risks and the required compliance and investigations coverage to treat risks; and
- monitoring and liaising with the petroleum industry particularly in identifying emerging trends.

**2.5** The ANAO also examined the relevant roles and responsibilities of the Licensing Group (see Chapter 3) and of the excise compliance and investigation functions (see Chapters 4 and 5 respectively).

**2.6** In assessing the petroleum excise governance arrangements the ANAO had particular regard to:

- strategic planning and risk management processes;
- performance and reporting arrangements;
- partnership arrangements with Customs; and
- strategic management issues.

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<sup>28</sup> There are four Excise Industry Groups covering the administration of excisable goods: tobacco, alcohol, diesel fuel (payments) and petroleum.

<sup>29</sup> For 2000–01 the PEIG had a staff allocation of 19 and funding of \$2.025 million.

## Strategic planning and risk management

### Strategic and business planning

**2.7** In order to implement its component of ATO-level strategies, the EBL has developed a Strategic Statement 2000–03.<sup>30</sup> This document takes account of ATO priorities as outlined in the ATO Strategic Statement, the Commissioners’ HOTSA,<sup>31</sup> the deliberations of the Compliance Management Integration Forum (CMIF)<sup>32</sup> and the EBL’s own risk assessment and strategic and business planning processes. The Statement covers such issues as the EBL’s:

- required outcomes, for example: ‘minimising Excise clients’ compliance costs’;
- purpose and vision (including the value that EBL adds);
- opportunities, risks and key strategies;
- required future key capabilities; and,
- performance measures to be used as indicators of success, such as ‘collection of revenue against estimates’.

**2.8** The ANAO’s view is that the content of the EBL Strategic Statement follows the structure and direction introduced by the ATO Strategic Statement. However, the EBL’s outcomes, as presently constituted, do not meet fully the ATO’s aim of continually improving business performance and client service levels. The ANAO considers also that, when next the EBL seeks to update its Strategic Statement and the associated planning documents, it looks to improve the specification, clarity and measurability of its outcome, outputs and performance

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<sup>30</sup> The ATO Strategic Statement 2000–2003 sets the present strategic direction for the ATO as a whole, including stating the outcomes that the ATO is seeking to achieve, the key strategies for achieving them and the indicators of success against which achievements are to be measured.

<sup>31</sup> The ATO introduced a risk management process in 1994–95, known as the Health of the System Assessment (HOTSA). The HOTSA process was designed to form the basis of a continuing assessment of the risks involved in the collection of tax, and was implemented within all ATO business lines. This process requires each of the ATO business lines to identify and assess their major areas of risk, to establish plans to manage those risks within available resources and to justify how conclusions on risk areas, management plans and resourcing are reached. The ANAO understands that the term HOTSA is no longer in use and ATO risk reviews will be conducted in another format from 2001–02.

<sup>32</sup> CMIF operates under the direction of a Second Commissioner of Taxation, and comprises Senior Executive Service (SES) level compliance management representatives from all ATO business lines, the heads of Strategic Intelligence Analysis (LB&I) and Revenue Analysis Branch, and representatives of various business tax reform projects. CMIF’s role includes developing a corporate risk identification and assessment process that would enable a consistent examination and escalation of identified risks across the ATO.

measures and assessments. Guidance on these issues is provided in the ANAO's recent report on *ATO Performance Reporting*.<sup>33</sup>

**2.9** The required outcomes set out in the EBL's Strategic Statement, together with the associated Resource Plan for 2000–01, are reflected in strategic and operational planning at the Branch and group/unit levels within the EBL. For example:

- the RIB Plan 2000–01 establishes its role as: 'manages excise revenue collection in addition to developing industry and other intelligence to improve policy, compliance and identifying opportunities for the future,' notes that individual Group Plans (including for the PEIG) support the RIB Plan, lists strategies to support the Excise Strategic Statement and details associated success indicators; and
- the FSB Plan 2000–01 sets out its role as: 'provide skilled and efficient compliance and investigatory services which support Excise business outcomes,' and, similarly to the RIB Plan, notes that individual Group/unit Plans (and also region and team) support the FSB Plan and lists strategies to support the Excise Strategic Statement and associated success indicators.

**2.10** In our examination of the EBL strategic and business planning hierarchy, the ANAO found appropriate planning links between the ATO Strategic Statement and EBL strategies. EBL planning outputs were well structured and consistent in terms of their content. The ANAO recognised that strategic planning documents had taken account also of the EBL's assessment of its environment and the risks arising from dealing with the excise payer segment of the Australian community.

## **Risk management within EBL**

**2.11** Risk management within the ATO, and the EBL, is based on Australia-New Zealand Risk Management Standard (AS/NZS 4360) and MAB/MIAC Guidelines.<sup>34</sup>

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<sup>33</sup> ANAO 2001, *ATO Performance Reporting under the Outcomes and Outputs Framework*, Audit Report No.46 2000–01.

<sup>34</sup> Management Advisory Board/Management Improvement Advisory Committee 1996, *Guidelines for Managing Risk in the Australian Public Service*, Report No.22, October.

**2.12** As in other ATO business lines, the EBL risk management process is required to be a key part of the annual planning and budgeting cycle. Risk assessments<sup>35</sup> provide the basis for identification of priorities and subsequent resource allocations. This process requires identification and assessment of major areas of risk, establishment of plans to manage those risks within available resources and justification on how conclusions on risk areas, management plans and resourcing are reached.

**2.13** The EBL is required to conduct risk assessment practices as part of the compliance strategy implemented throughout the ATO.<sup>36</sup> In formulating a compliance framework for petroleum excise, the EBL has been sensitive to its clients' needs and ways of dealing with them. In particular, the EBL recognises that the major excise payers contribute approximately 95 per cent of total excise revenue while making up a much smaller proportion of the excise client population. For example, in the March 2001 quarter the four major petroleum companies paid 95.1 per cent of petroleum excise revenue, while 30 non-major clients paid the remaining 4.9 per cent.

**2.14** While major clients may not represent a high risk in terms of their attitude towards paying, because of the size of the revenue at risk, they may still be subject to a range of risk treatments such as audit of varying levels of intensity and coverage. On the other hand, the EBL conducts compliance audits of smaller clients where the amount of revenue at risk is relatively low but where, for some, the attitude towards paying may be less than desirable.

**2.15** The EBL developed a Strategic Risk Profile (SRP) for 2000–01 that identified six key strategic risks. The SRP contributes to the Excise business planning process and provides a foundation for the development of the National Excise Compliance Plan (NECP). The NECP covers each of the four excise industries and comprises a listing of compliance activities to be conducted during the year. The NECP is discussed further in Chapter 4.

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<sup>35</sup> Risk assessment requires application of a series of steps to establish the type and level of risk and to determine the risk treatment strategies needed to address the risk. These are:

- establish the context;
- identify key risks, that is: what can happen and when, where, how and why each risk can occur;
- analyse risks against a likelihood/consequences matrix;
- assess and prioritise risks;
- develop and implement compliance treatment strategies on a cost-benefit basis; and
- monitor and review risk assessments and treatment strategies progressively and report against accountability requirements.

<sup>36</sup> As part of its risk management approach the ATO has adopted a structured approach to improving taxpayer compliance, known as the ATO Compliance Model. The Compliance Model is applied to all functions that the ATO administers and is used at both the strategic and operational levels.

**2.16** The ANAO noted the content and intended purpose of the EBL SRP, and the links that it established to the NECP. The ANAO is of the view that the NECP could be seen more as a list of intended activities than as a compliance plan. That is, for example, it provides no detail on the level of risk to be addressed, who will be responsible for achieving the desired result of the risk treatment to be used and how success in achieving the Plan is to be measured.

**2.17** The ANAO considers that there is a need for a management planning facility between the quite strategic approach of the EBL SRP and the purely operational, activity-level content of the NECP.

**2.18** The ANAO suggests that the EBL's ability to meet and treat risks identified in the risk assessment process that is coordinated by RIB officers is reduced through the absence of a formal risk management plan.

**2.19** Risk management plans are an integral element of a sound strategic framework, and are a precursor for comprehensive business planning of operational activities such as compliance field services.<sup>37</sup> Risk management plans should outline the nature of the risks identified, assess the degree of risk arising for the organisational unit and function/activity and outline the approach to be taken to mitigate each risk to an acceptable level of tolerance. The risks identified should include both compliance risks, such as 'risk to revenue,' including those arising from external fraud, and business risks, such as 'failure to retain staff'.

**2.20** The ANAO is of the view that the creation of a risk management plan would assist the EBL in carrying out its responsibilities in relation to the ATO Risk Register, as discussed in the next section of this chapter.

**2.21** The ATO advised that it does not intend to implement a separate Excise Risk Management Plan. Rather, it proposes to address risks in Excise in the context of the overall new ATO approach to compliance management. This approach involves the development of a total ATO plan made up of four component plans, of which Compliance is one. Through this Plan the ATO proposes to manage compliance across all business lines and heads of revenue. Further the ATO advised that its Risk Register is used actively in its planning processes. This approach addresses the primary issue raised by the ANAO provided the risks to petroleum excise collections are comprehensively considered and treated in the context of the ATO's new approach to compliance management.

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<sup>37</sup> The application of risk management at the operational level, concerning management of compliance measures to address identified risks, is discussed further in Chapter 4.

## **ATO Risk Register**

**2.22** The ANAO noted that RIB is responsible also for developing and maintaining EBL components of the ATO Risk Register. The ATO Risk Register is a risk database developed to store decisions/judgments made on the basis of intelligence information, to be accessed across the ATO when needed. Individual business lines are required to assess risks against certain criteria<sup>38</sup> and to record them in the register. This allows the capture of qualitative information from many sources of compliance risk across the ATO and includes multiple views such as market segment, policy and client perspectives. This data is then assessed by a Business Line Reference Group (BLRG).<sup>39</sup> The ANAO was advised that the ATO Risk Register will be reviewed on a six-monthly basis by the CMIF.<sup>40</sup>

**2.23** At the time of the audit, members of the RIB, including those in the PEIG, were taking steps to complete the entries on the Register that relate to the EBL's identified risks.

**2.24** The ANAO examined a number of petroleum entries, in relation to petroleum excise, that the EBL is responsible for on the ATO Risk Register. The ANAO noted that some of the Register's contents in this area were incomplete. In particular, the entry in relation to 'Blending/Substitution of Petroleum', requires updating and re-assessment of the extent of revenue at risk from substitution/blending of the various petroleum products. The significance of the risk of revenue leakage from fuel substitution activities and the need for quantification is discussed further from paragraph 7.33.

**2.25** The ANAO considers that a number of other petroleum entries would benefit from the conduct of a rigorous review to ensure their completeness and accuracy. There would be benefit also in applying appropriate risk management procedures, particularly, where relevant, in assessing the extent of revenue at risk.

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<sup>38</sup> Criteria to be entered on the Risk Register includes: risk description; legislative impact; segments, focus areas, industry groups, political; external and internal capability; core process stages; risk analysis; risk owners; risk status, treatments, and drivers; management and reporting; and related risks.

<sup>39</sup> The BLRG is a forum comprising representatives from all ATO business lines and is responsible for the effective cross-line management of ATO risks through a process of risk registration, analysis and treatment to achieve realistic risk reduction within operational constraints. The BLRG prepares a monthly report for the CMIF prioritising ATO compliance risks.

<sup>40</sup> The role and makeup of the CMIF is described at footnote 32.

## Recommendation No. 1

**2.26** The ANAO recommends that the ATO conduct a rigorous review for completeness, accuracy and relevance of the Excise business line's petroleum entries on the ATO Risk Register.

### *ATO response*

**2.27** Agreed. The ATO has implemented the terms of this recommendation, as the ATO's risk register is always subject to review. The Risk Register feeds into the overall ATO approach to managing risk.

### *ANAO comment*

**2.28** As referred to in paragraph 2.24, in conducting the audit the ANAO found some of the Register's contents in this area were incomplete.

## Performance management and reporting

**2.29** The ANAO considers that sound performance reporting is required to enable executive management to assess progress against goals, to make informed decisions, and where necessary to take remedial or preventative action. As with the other ATO business lines, the EBL is required to meet the requirements of the ATO Commissioners for line performance and governance reporting. Reporting components include:

- the relevant monthly business line performance report to provide an ongoing aggregate picture of EBL performance; and
- bi-annual governance reports to provide assurance on the EBL's operations.

**2.30** The ANAO examined the EBL's most recent reporting against bi-annual and monthly accountability requirements, particularly in connection with petroleum excise functions. The reports cover revenue performance in relation to petroleum excise matters and the EBL's performance on a number of corporate governance requirements including achievements against Taxpayers' Charter standards.

**2.31** The ANAO considers that the reports provide sufficient information in an acceptable format for ATO management to be able to assess the business achievements of the EBL, including on compliance and other activities relating to petroleum excise matters. They also provide adequate information on petroleum issues to bring significant matters to the attention of ATO management in a timely fashion.

**2.32** However, the reports do not provide a consistent and ongoing assessment of the EBL's progress in addressing risks identified through its risk assessment processes described earlier. The ANAO considers that the absence of an EBL Risk Management Plan contributes to what we regard as a gap in EBL's performance reporting framework.

**2.33** The ANAO noted that, in the case of petroleum revenue performance in particular, the RIB monthly reports were supported by comprehensive three-monthly Monitoring Reports prepared by the PEIG. These reports bring to notice key issues arising in the period between reports, report on revenue performance (excise payments) and provide analysis of revenue outcomes by, for example, the major and non-major excise payers. These aspects are covered in more detail in Chapter 6.

**2.34** Further, the ANAO is aware that in 2000 the EBL had prepared a report entitled *Compliance Activity for 1999–2000*. This report presented an overview of compliance activities undertaken during the 1999–2000 year, including those conducted in relation to petroleum matters. The ANAO found this report to be a useful summary of overall compliance activities within the EBL, and would encourage its preparation in the future, including for the 2000–01 year. The ANAO's comments relating to compliance and investigations management reporting are discussed in Chapters 4 and 5.

**2.35** While noting the deficiency in EBL's reporting on its management of risks as discussed in paragraphs 2.25 and 2.32, the ANAO considers that EBL's governance reports adequately serve to inform the ATO Executive on EBL's internal performance management.

## **Partnership arrangements with Customs**

**2.36** Development of an effective strategic partnership between agencies enables greater exchanges of ideas and information, and allows partners to gain access to the knowledge and resources of the other agency. With the move towards an output/outcomes framework for managing resources and measuring performance, these ongoing relationships help achieve the outputs and outcomes for both agencies.

**2.37** The new model for excise administration adopted in 1999 foresees a continuing role for Customs in certain functions. Accordingly, the ATO relationship with Customs is a critical element in the efficient and effective administration of excise revenue collections.

**2.38** The continuing use of the Customs' licensing system and revenue collection systems and facilities is discussed in Chapter 3 and Chapter 6 respectively. In this section we discuss the responsibility of Customs in relation to imported goods which would be excisable if they were domestically produced and the ATO's management of this aspect of its relationship with Customs.

## Background

**2.39** As noted earlier, the AAO transfer to the Treasury portfolio of responsibility for the administration (by the ATO) of excise functions separated responsibility for the *Excise Act 1901* (administered by the ATO) from the *Customs Act 1901* (administered by Customs).

**2.40** The ATO advised that, in the transfer of the excise function from Customs to the ATO, a range of obstacles had to be overcome. Further the ATO is of the view that many of these obstacles have since been removed successfully through the maintenance of cooperative working relationships between the two agencies, particularly at the operational levels. Nonetheless, some residual problems remain due to the agencies having different policy priorities, and by virtue of the operation by the agencies under two sets of laws (namely excise and customs) that were originally designed to have application by one agency.

**2.41** Following the transfer of agreed excise functions, and legislative responsibility, from Customs to the ATO, there remains an issue in relation to certain imported goods referred to as excise equivalent goods (EEGs),<sup>41</sup> that would be excisable if they were locally produced. EEGs are subject to customs duty at the same rate as the excise duty that would be imposed if the goods were domestically produced. This matter is important as most of the major excise business clients deal also in EEGs.

**2.42** Currently, Customs is responsible for administering and for collecting customs duty on EEGs. In 2000–01 customs duty collections on EEGs was \$1.5 billion. While in certain instances equivalent imported goods can be treated as excisable goods,<sup>42</sup> for the most part the regime for EEGs continues to be separate to that for excisable product. The ATO considers that this has led to inconsistencies in the legislative and administrative treatment of similar domestically produced and imported products, reflecting differences between the Excise Act and the Customs Act. However, Customs considers that the current arrangements are effective, having streamlined procedures and coordination arrangements between the two agencies.

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<sup>41</sup> In the initial stages of discussions between the ATO and Customs on this issue, the term 'like customable goods' was used widely to describe the goods at issue, ie the imported equivalents of any goods which fall within the *Excise Tariff Act 1921*. However, since the term has a defined meaning within the Customs Act (ie section 69: goods subject to weekly settlement), which does not entirely reflect all of the relevant goods, the term 'excise equivalent goods' has been adopted by the ATO. Customs continues to use the term 'like customable goods'.

<sup>42</sup> Customs collects customs duty revenue on finished imported goods or those requiring minimal processing such as reducing or packaging. However, a significant amount of imported goods, such as petroleum products for blending with domestic products, are released by Customs under the *Customs Tariff Act 1995* for excise manufacture. As well, raw materials such as petroleum feedstocks and unmanufactured tobacco leaf are imported and cleared from Customs control into the excise manufacturing process. For petroleum, this means that the bulk of revenue collected on imported goods is collected by the ATO as excise revenue.

**2.43** Nevertheless, the ANAO notes that there has been ongoing discussions between ATO and Customs officers regarding the issue of responsibility for EEGs. The focus of these discussions has been on issues around client service arrangements, imported substitutable goods (such as toluene)<sup>43</sup> and ongoing administrative arrangements between the agencies. Both the ATO and Customs note that the issue of EEGs is not as significant in relation to petroleum as it is to other excisable products because almost all petroleum products are managed by the ATO under the excise scheme.<sup>44</sup>

### **Client-based split in administration functions**

**2.44** With the transfer of excise functions an interim shared client arrangement was put in place for entities dealing in EEGs. Under these arrangements the ATO administers entities whose excise liability is greater than their duty liability on EEGs, and vice versa for Customs. Client sharing arrangements extended to compliance, licensing, movement permissions and general information provision.

**2.45** The split of clients was designed to achieve a single point of contact 'one stop shop' for clients, in order to minimise the number of agencies that clients had to deal with on similar issues. Although this arrangement was reached to facilitate client relationships, the ANAO noted that both ATO and Customs agree that it is not working to the satisfaction of the various players involved. As well, industry stakeholders consulted by the ANAO during the course of the audit indicated that, invariably, they are required to deal with both ATO and Customs, thus causing confusion and delays before a particular matter is resolved. It was indicated to us strongly that clients' preference is to deal with one Commonwealth agency on all excise and excise equivalent matters.

**2.46** In responding to ongoing difficulties in the client-based split, the ATO and Customs have agreed that from May 2001 each agency would resume responsibility for administration of all aspects of its own legislation. However, where a client deals in both excisable and EEGs a joint compliance<sup>45</sup> approach would be adopted.

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<sup>43</sup> In Chapter 7 the ANAO discusses the fuel substitution situation arising from imports of toluene, and the administrative delays in addressing this issue.

<sup>44</sup> Customs duty on petroleum products in 2000–01 contributed around \$45 million. (Source: Fuel Taxation Inquiry 2001, *Issues Paper*, 18 August, p. 20).

<sup>45</sup> Joint compliance action would range from sharing information on the outcomes of compliance activity undertaken to joint audits and investigations.

**2.47** The ANAO notes that, in order for the current client servicing arrangement to be effective, each agency will participate in the compliance planning of the other agency to ensure that activities on common issues can be aligned or complemented wherever possible. Customs advises that the joint compliance model has been a contributing factor to improve levels of cooperation and the identification of areas of mutual interest.

### **Administrative arrangements**

**2.48** In February 2000 Customs proposed a draft administrative agreement (*Administrative Arrangement between the Australian Taxation Office and the Australian Customs Service Relating to Mutual Cooperation in the Provision of Services*), referred to as 'the MOU' (Memorandum of Understanding).

**2.49** The MOU aimed to formalise arrangements between the ATO and Customs in relation to a number of matters, such as the continuing provision by Customs of licensing and revenue collection services for the ATO (discussed in Chapters 3 and 6 respectively) and handling of EEG related functions. The draft MOU notes that Customs would seek to recover certain costs from the ATO for services provided.

**2.50** The MOU has not been finalised due to several differences between the two agencies, particularly in relation to the administration of EEGs. Action to resolve the EEG matter has involved consideration of issues and proposals at staff working party, SES, CEO/Commissioner and Ministerial levels.

**2.51** The ATO is of the view that a fundamental change to institute one taxing regime for both EEGs and excisable goods, to be administered by the ATO is a desirable outcome. Moreover, that, in the interest of good public administration, a system is required in which the legislation and administration, as well as policy, for taxing EEGs, is unified with excise arrangements.

**2.52** However, Customs considers that there are benefits in maintaining a single legislative regime dealing with all imported goods, as is recognised by current legislation that gives Customs control over and makes it accountable for all aspects of the goods which cross the border. A major concern for Customs is that the ATO-desired approach is likely to impact adversely on Customs' ability to perform regulatory and law enforcement functions contained in the Customs Act and associated legislation concerning imports and exports. Customs notes further that a range of international conventions concerning the movement of goods across the border influences its operations.

**2.53** While cooperation between the agencies has been forthcoming in a number of avenues such as the joint compliance model mentioned at paragraph 2.46 above, the long-running issue of the administrative handling of EEGs has impacted on the achievement of a full strategic partnership between Customs and the ATO. This includes the finalisation of the MOU.

**2.54** The delay in finalising the MOU has impacted on the maintenance of an effective revenue collection and accountability process (as discussed in paragraph 6.24). Further, continuing delays may impact on the ongoing effectiveness of the joint compliance arrangement.

**2.55** The ATO has advised that, given the present situation, its view is that further development of the single regime concept is not productive at present and therefore stronger administrative processes need to be in place. Both agencies have agreed to formulate ongoing coordination arrangements that ensure policies and procedures in relation to the administration of EEGs are consistent with those that apply to excisable goods, in such areas as exports, duty-free businesses and compliance issues generally, including investigation of offences. The ANAO considers that finalisation of the MOU is a necessary step in accomplishing this aim. Further, the finalisation of the MOU between the ATO and Customs will also serve to establish an effective strategic partnership between the two agencies on mutual interests and responsibilities in excise administration.

**2.56** The ATO has advised that it is in the process of incorporating excise issues as part of a revised ATO agreement being negotiated with Customs on GST services. While the ANAO notes this development, our view remains that in order for the ATO to effectively administer the excise collection function, the issues contained in the draft MOU require resolution. This could be achieved through either incorporation in a wider agreement or as a stand-alone agreement.

## **Recommendation No. 2**

**2.57** The ANAO recommends that, to effectively administer the excise collection function and to maintain a cooperative and effective working relationship, the ATO and Customs should finalise a memorandum of understanding on mutual interests and responsibilities in excise administration.

### *ATO response*

**2.58** Agreed. Discussions on a proposed memorandum of understanding are continuing at the highest level between the ATO and

Customs. While there are areas where agreement has not yet been reached, both agencies are working to resolve outstanding issues and reach agreement as soon as possible.

### *Customs response*

**2.59** Agreed.

## Strategic management issues

**2.60** Strategic management involves effective integration of functions within a cohesive framework in order to achieve the output and outcome performance required to fulfil organisational goals and objectives. Effective strategic management requires, firstly, the adoption of sound corporate governance principles and practices and, secondly, the coordination and interaction of functional units and activities such that the organisation's responsibilities and objectives are addressed in a strategic, as well as an operational manner.

**2.61** The ANAO notes that the EBL has conducted its corporate governance responsibilities in accordance with the ATO's requirements. At the same time, the EBL has implemented also a number of management initiatives to strengthen the administration of the petroleum excise function. These actions have been taken over a relatively limited period of time, since the excise function was transferred in 1999, and are outlined below:

- several legislative and administrative measures were implemented to more closely link the concepts of licensing and compliance with a view to limiting avenues available for fuel substitution (see Chapter 3);
- a separate Field Services Branch was established in 2000 to provide a greater strategic focus and overall direction to excise compliance and investigations activities (see Chapters 4 and 5);
- legislative and administrative measures were adopted to provide greater powers for the ATO to take action against petroleum excise evasion (see Chapter 7); and
- an Excise Intelligence Network (EIN)<sup>46</sup> was established in 2001, to take responsibility for analysis and reporting of business intelligence and to manage the creation of the Excise Intelligence module of the ATO Intelligence Database.<sup>47</sup>

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<sup>46</sup> The EIN comprises EBL staff with significant operational expertise, drawn particularly from the Excise Industry Groups.

<sup>47</sup> This is an ATO corporate-level capability to obtain and share strategic business information and intelligence between ATO business lines.

**2.62** On the latter point, the ANAO notes that the establishment of a business intelligence capability within the EBL is only in its initial stages. Therefore we were unable to assess its effectiveness. The ANAO supports moves by the EBL to enhance its business intelligence capabilities, as a way of addressing emerging risks within the EBL risk management framework.

**2.63** The ANAO considers that the initiatives listed in paragraph 2.61 have contributed to the effectiveness of the petroleum excise collection function. However, during our assessment of the administration of the petroleum excise collection function, the ANAO established that there was considerable scope to adopt a more strategic focus in administering the petroleum excise function at various levels within the EBL. The ANAO's discussion on these issues is covered throughout the report and the areas that require particular attention are summarised below. These relate to:

- ensuring that the risks to petroleum excise collection are comprehensively considered and treated in the context of the ATO's new approach to compliance management; (see paragraph 2.17);
- maintaining complete, accurate and relevant entries on the ATO risk register in relation to petroleum excise (see paragraph 2.25);
- finalising the ATO/Customs MOU on mutual interests and responsibilities in excise administration (see paragraph 2.55);
- implementing an efficient and effective excise licensing system and associated management processes (see Chapter 3);
- improving compliance and investigations management and reporting frameworks and ensuring that these functions make a strategic contribution to the EBL's overall planning, risk management and business intelligence activities (see Chapters 4 and 5);
- providing the necessary assurance on the integrity and effectiveness of the excise revenue collection function through effective management of services provided by Customs currently and through timely and effective implementation of the proposed ATO excise collections system (see Chapter 6); and
- undertaking systematic assessments of possible exposure to fuel substitution activities (see Chapter 7).

**2.64** The ANAO considers that addressing these issues would be a desirable forward step in establishing a sound forward-looking and integrated approach to administration of the petroleum excise function.

## 3. Petroleum Licensing Arrangements

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*This chapter discusses the petroleum excise licensing system and the use of licences and permissions to monitor compliance with the excise legislation. The ANAO identifies a number of areas that would benefit from the ATO's attention.*

### Introduction

**3.1** Excise licensing arrangements were introduced in 1969. Under Commonwealth legislation licences and permissions are required to manufacture and store or transport excisable goods on which excise duty has been deferred in certain circumstances. The licensing process:

- enables the monitoring and regulation of manufacturers of excisable goods;
- promotes a controlled environment; and
- facilitates compliance with the Excise Act.

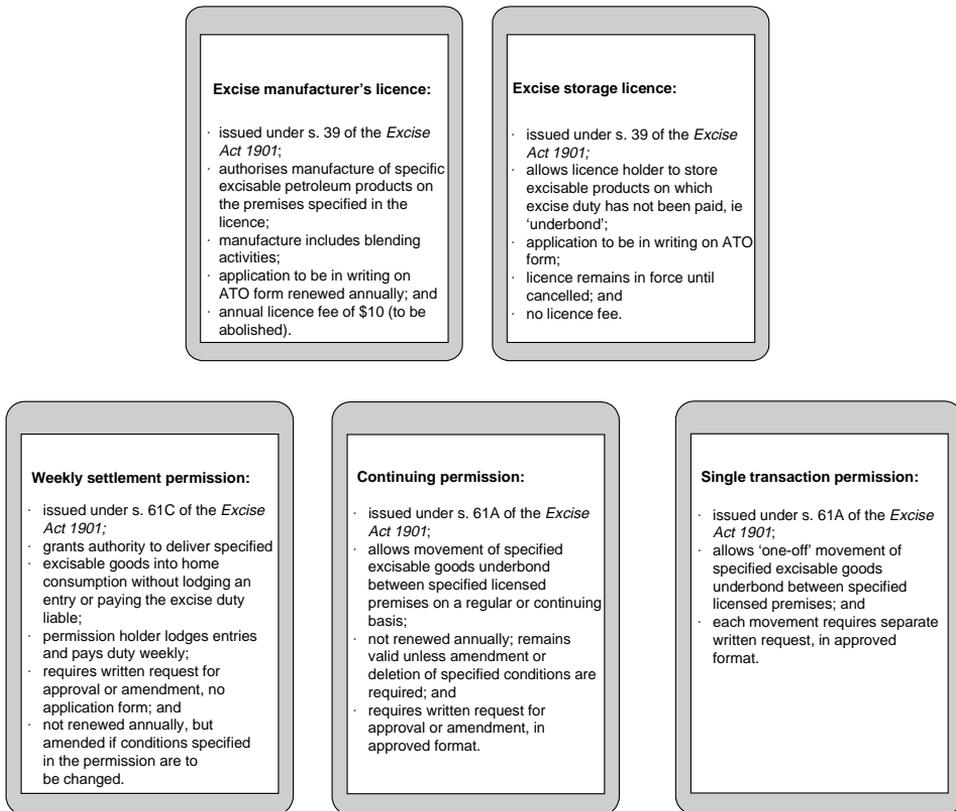
**3.2** Broad details of the types of licences and permissions that are relevant to petroleum excise licensing arrangements are shown in figure 3.1. These are described in further detail at Appendix 5.

**3.3** The Excise Licensing Group is responsible for managing on a national basis the licensing and permissions regime of the EBL. The Petroleum Licensing team within the Licensing Group is responsible for processing all licence applications, Weekly Settlement Permission (WSP) requests, Single Transaction Permission (STP) and Continuing Permission (CP) applications relating to excisable petroleum products.<sup>48</sup> The team is responsible for the maintenance and update of licences and permissions issued. Figure 2.1 in Chapter 2 shows the relationship between the Licensing Group and the PEIG.

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<sup>48</sup> These products include diesel, solvents, products under the Product Stewardship Oil scheme (recycled petroleum products and lubricant base oils), crude oil and condensate.

**Figure 3.1**  
**Excise Licences and Permissions**



Source: ANAO depiction of ATO information.

**3.4** The ANAO examined the petroleum licensing arrangements to establish whether:

- policy and procedural guidance was available on petroleum licensing arrangements, to document the role and responsibilities of the parties involved and provide guidance on aspects such as licence approval and refusal ;
- appropriate processes existed to provide assurance on consistency of licensing decisions;
- mechanisms existed to ensure licensing arrangements contribute to the compliance framework relevant to petroleum excise collections; and
- the current petroleum licensing arrangements were responsive to clients' needs.

## Licensing policy and procedures manual

**3.5** Policies and procedures manuals provide a framework for operational activities and promote consistency in decision making. There is, however, no consolidated documentation covering the petroleum licensing function. The Licensing Group has been using a table of standard operating procedures, which outlines the licensing and permissions approval process. However, these are out of date and do not reflect a number of recent changes to the licensing legislation, policy and procedures.

**3.6** The ANAO noted that the EBL at National Office level is in the process of developing an Excise Revenue and Intelligence Industry Policy and Procedures Manual, which includes a chapter on petroleum licensing. However, as currently drafted (March 2001 was the last update) the Manual does not address a number of key aspects relating to petroleum licensing, such as:

- the objective of the licensing function and its associated business processes;
- how the petroleum licences and permissions contribute to the excise regulatory and compliance framework;
- the relevant sections of the Excise Act which govern the licensing processes, for example for cancellation, amendment, refusal; and
- the recent amendments in September 2000 to the licensing provisions of the Excise Act (the Manual continues to refer to the old licensing provisions of the Excise Act).

**3.7** The ANAO acknowledges the EBL's attempts to develop a consolidated Excise Industry Group Manual, to address all aspects of Excise administration. However, if the Manual is to be the primary source of reference for licensing operations, it should:

- contain contextual information to provide an understanding of the licensing function;
- accurately reflect the current licensing policies and procedures;
- include broad interpretations of the excise legislation relating to licensing requirements; and
- be made user friendly for ease of reference.

**3.8** The lack of a consolidated and up-to-date licensing policy and procedures manual has negative consequences and contributes to:

- a lack of strategic focus in administering the licensing function;

- significant reliance of the licensing staff on the PEIG for initial assessment and advice on the application (further discussed in paragraphs 3.14 to 3.16); and
- licensing staff using the Excise Regulations and the Excise Act as a sole source of reference on operational matters, making the process inefficient and open to personal interpretation.

## Recommendation No. 3

**3.9** The ANAO recommends that the ATO develop a comprehensive petroleum excise licensing policy and procedures manual that provides operational guidance, within the necessary strategic management context, for administering the licensing function.

### *ATO response*

**3.10** Agreed. The ATO recently completed an extensive review of the existing licensing system. Consistent with the new arrangements, specific licensing requirements for petroleum will be drawn up and included in the Petroleum Manual.

## Licensing management systems

**3.11** In reviewing the efficiency and effectiveness of the licensing management systems the ANAO considered recent ATO initiatives to strengthen the consistency of licensing decisions, the relationship between the Licensing Group and the PEIG in arriving at licensing decisions and the use of licensing systems to process and manage the flow of licensing information.

### Centralisation

**3.12** When the excise function was formerly with Customs, licence administration was Region-based and operated on a decentralised basis. In July 1999, the ATO centralised its excise licensing operations at Sydney by establishing the Licensing Group within the Revenue and Intelligence Branch of the EBL.<sup>49</sup> Centralising the licensing function in 1999 has strengthened the consistency of decision making and has enabled a standard approach to be delivered on a national basis.

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<sup>49</sup> The licensing function was centralised as a result of an ATO internal review of its licensing and permits operations. In April 1999, the Licensing and Concessional Spirit Approvals Task Force (the Task Force) was set up to review this area. The Task Force made a number of recommendations, the primary one related to a need to centralise processing of all licences and permissions. Centralising the function was to achieve uniformity of practice, one point of contact for the client, better utilisation of staff and information technology (IT) resources, concentration of expertise and efficiencies of scale.

**3.13** The ANAO also found that the ATO has taken a number of other initiatives to provide assurance on consistency of its licensing decisions. These include:

- in November 1999, as a result of changes to petroleum provisions in the *Excise Tariff Act 1921*, all permissions were revoked, and were re-issued centrally using a consistent procedure and approach. Licensees were provided with consistent and detailed advice on the reasons for this administrative measure;
- a standard process was followed in renewing all petroleum manufacturer licences in 2001;
- the ATO developed standard application forms for storage and excise manufacturer licences and CPs. This facilitated lodgment and processing and provided assurance that relevant information was being consistently collected and taken account of when processing an application; and
- our review of a number of licences and permissions processed in 2000–01 found that the PEIG was closely involved in assessing new licence applications or amending existing permissions. The Petroleum Licensing Team was the central point of contact for all petroleum licensing queries and liaised closely with the PEIG’s key client managers in assessing all petroleum licence/permission applications.

### **Reliance on PEIG**

**3.14** The Manager Licensing within the Licensing Group is ultimately responsible for making all licensing decisions. The ANAO was advised that, although the Licensing Group takes advice from the PEIG, it considers itself to be independent from the PEIG. On matters of consistency and/or legislative interpretation, the Licensing Group is willing to challenge any recommendation from the PEIG if it considers that it may not be consistent with the legislation the ATO administers, particularly the Excise Act. Prior to all licences and permissions being issued to the client, these are forwarded to the Manager Licensing for review and approval.

**3.15** The ANAO noted that in processing or amending all new/existing licences and permissions the Licensing Group forwards the application for PEIG’s assessment and recommendation. The current draft of the Excise Industry Procedures Manual specifies that the Petroleum Licensing Team should initially assess the application and prepare a report on its assessment, emailing it to the PEIG. There was insufficient evidence to indicate whether the Petroleum Licensing Team prepared an initial assessment report prior to the application being forwarded to PEIG.

Similarly the existing business processes revealed complete reliance on licensing advice from the PEIG. The ANAO found that the current operational arrangement has certain drawbacks:

- the accountability arrangements for licensing decisions are not clear and the licensing process ceases to operate as an arm's length transaction providing assurance on the independence of the process. It becomes another processing function without adding any value to the process; and
- there is considerable duplication and unnecessary handling of information.

**3.16** The ANAO acknowledges that PEIG staff have a good understanding of the industry and its operations and are therefore well placed to recommend on licensing decisions. However, the current reliance on PEIG staff for application assessment and recommendation makes the licensing process inefficient and the function redundant. There would be considerable benefit in the ATO reviewing the current arrangements to achieve the optimum handling of licensing applications. As part of undertaking the review there would be value, for example in determining the purpose for establishing the licensing function independent from the Industry Groups, establishing the accountability arrangements for licensing decisions and exploring alternatives to seeking Excise Industry Group input without being completely reliant on their advice.

**3.17** In responding to the ANAO's proposed report, the ATO advised that it had recently completed an extensive review of the existing licensing system. Following this review a decision was made to decentralise the licensing function to the Excise Industry Groups, within the Revenue and Intelligence Branch. The ATO was now in the process of effecting the new arrangements.

### **Licensing fee**

**3.18** Section 39(2)(f) of the *Excise Amendment (Compliance Improvement) Act 2000* specifies that 'in relation to an application for a manufacturer's licence, an application be accompanied by the prescribed fee (if any)'. Excise Regulation 246 authorises a licensing fee, which is currently prescribed at \$10 for each manufacturer's licence. As mentioned in Appendix 5, excise manufacturer's licences are renewed at the beginning of each calendar year. The \$10 fee does not cover the cost of collection (the licensing fees collected in 2000-01 totalled \$7540 and the cost to collect them was approximately \$20 500).

**3.19** The ANAO considers that the licensing fee arrangements current at the time of the audit were not cost-effective. In responding to the ANAO's proposed report the ATO advised that it had received policy approval to amend the Excise Regulations to provide for the fee for licences to be zero.

### **Licensing and Permissions System (LAPS)**

**3.20** Although the responsibility for excise licensing was transferred from Customs to the ATO, applications for licences are processed using Customs' Licensing and Permissions Systems. The LAPS was introduced in 1992 to deal with problems of inconsistent application of policy, given that Customs maintained staff resources and licensing expertise in each Region and applications were processed in each site. LAPS is a centralised database package that maintains historical and current records of all licensing/approval transactions, except for STPs. Information relating to these is maintained on a separate Microsoft Access database. LAPS utilises a suite of licences and attendant conditions which as a general rule cannot be over-ridden.

**3.21** The ANAO understands that the ATO proposes to implement its own licensing functionality as part of the new Excise Collections System to be implemented from July 2002. The ANAO noted that the staff from the Licensing Group were consulted on the new system requirements, and that their input was being sought in reviewing the current documents and processes with a view to streamlining the new licensing system.

**3.22** However, the ANAO found no evidence to indicate that the ATO had systematically analysed the problems and/or deficiencies of current licensing systems and processes to ensure these could be addressed in developing the new licensing system. There was also no documentation on the objective of the new licensing system and its business imperatives. In using the current system the ANAO identified a number of weaknesses. For example:

- the LAPS-generated licence renewal notices give instructions for licence payments to be made to Customs offices in each region instead of centrally to ATO in Sydney. Therefore, in renewing manufacturing licences, renewal notices have to be manually amended (776 renewal notices were generated for 2001) to remove reference to a Customs return address;
- there is inadequate provision in LAPS to generate licensing statistical reports;

- since the 1997 High Court decision,<sup>50</sup> LAPS-generated WSPs applicable to the major petroleum clients are incorrectly worded. Therefore, a manual version is being utilised; and
- the current licensing processes are largely paper-based although LAPS is used to undertake some of the processing functions. The ANAO understands that there will always be a need to maintain certain minimal documentation on file, for example manufacturing site plans and storage plans. However, a significant amount of information can be electronically stored, improving access to data and reducing storage costs.

**3.23** The ANAO considers that in developing the new licensing functionality as part of the new Revenue Collections System (discussed in Chapter 6), the ATO should ensure, within the context of cost-benefit, that all weaknesses and process inefficiency issues of the current system are addressed. The ATO has advised that the objective and business imperatives of the new licensing system are established by the need to align with the ATO Compliance Model and the Excise Business Principles. Both documents outline clear objectives for future interaction with clients and this intent is incorporated within the new licensing system. Further, the ATO advised that the identified weaknesses in the existing licensing system will be addressed as part of the Excise Collections Project (discussed in Chapter 6) deliverables.

## Licensing and compliance

**3.24** The concept of ‘licensing’ is applied, in the Excise context, to the manufacture, storage and movement of excisable goods. However, since the transfer of the function to the ATO a series of measures have been taken to strengthen the role and concept of licensing in relation to other areas of activity that are regulated for the purposes of the Excise Act.

**3.25** In November 1999, the Government announced changes to the petroleum provisions of the *Excise Tariff Act 1921* that took effect on and from 15 November 1999, as a systematic attempt to combat fuel

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<sup>50</sup> On 5 August 1997 the High Court found that business franchise fees levied on tobacco wholesalers by the New South Wales Government were unconstitutional. The Commonwealth Government, at the request of States and Territories, agreed to implement a temporary ‘safety net’ package to protect their revenue formerly dependent on these fees. The additional revenue on these goods collected under the ‘safety net’ was referred to as surcharge duty. The Commonwealth Government collected on behalf of the States the surcharge and reimbursed it to the States under agreed repayment schemes. The surcharge was collected on a monthly basis while excise was collected on a weekly basis. The LAPS generated WSPs reflected these arrangements.

substitution. The licensing provisions are now being used to regulate the quantity of petroleum products entered for home consumption, especially those products that attract a lower rate of excise duty.

**3.26** As a result of the recently legislated *Excise Amendment (Compliance Improvement) Act 2000*, increased penalties apply for the manufacture of excisable goods without a licence. Similarly, increased penalties apply for non-compliance with licence conditions and permissions.

**3.27** Despite some difficulties in re-establishing the licensing function, the ANAO notes that the ATO has undertaken a number of initiatives to ensure that licensing arrangements contribute to and strengthen the compliance framework. The ATO has advised that the revised licensing arrangements (noted at paragraph 3.17) will provide opportunities for the use of licensing as a compliance management tool.

## Client perspective

**3.28** Overall, the ANAO found that key petroleum excise clients considered centralisation of the licensing function to be a positive initiative, however they identified a number of areas in which the current process could be made considerably more efficient. These mainly related to the:

- duplicate handling of licence applications by the Petroleum Licensing Team and the PEIG (referred to in paragraph 3.15);
- frequency of information requested on names and credentials of management staff each time there was a change in staff involved in managing the licensed sites results in unnecessary work; and
- inefficient licence issuing process which often involved the actual licences being sent to the licensed site (which could be at a remote location) and not sent (nor a copy) to the applicant.<sup>51</sup> The petroleum clients' preference is for all documentation to be received centrally by the applicant as specified in the application.

**3.29** The ANAO acknowledges that the ATO has undertaken a number of initiatives to improve client service with respect to its licensing function. These were discussed earlier, for example, in centralising the function and developing standardised application forms. However, as part of a continuous improvement process, the issues raised in the previous paragraph also need to be addressed.

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<sup>51</sup> As an illustration, in a recent case the licence was sent to a railway siding and two fuel tanks. It was evident from the maps submitted that the licensed site was unmanned. The client had to go to considerable effort to track down the actual licence.

## Recommendation No. 4

**3.30** The ANAO recommends that the ATO review its petroleum excise licensing systems and processes. Specific areas that would benefit from this review are:

- establishing improved accountability arrangements and consultation mechanisms between the Petroleum Excise Industry Group and the Licensing Group, to achieve the optimum and value-added handling of licensing applications; and
- addressing the weaknesses of the current licensing systems and processes to achieve efficiencies and an increased client focus, both within and outside the ATO.

### *ATO response*

**3.31** Agreed. The ATO has acted to address the concerns regarding existing licensing arrangements. The recommended review has been undertaken and improved licensing arrangements for excise are in the process of being implemented. The review focussed on the ability to use licensing provisions to address: identified risks; inherent weaknesses; and process inefficiencies within the current arrangements.

## Conclusion

**3.32** Since the transfer of the petroleum licensing function, the ATO has taken a number of initiatives to promote a consistent approach to processing licences. These initiatives have been well received by its petroleum excise clients. Also, the ATO has taken several measures to strengthen the role and concept of licensing in relation to other areas of activity that are regulated for the purposes of the Excise Act, thus ensuring that the licensing provisions contribute to the compliance framework.

**3.33** However, more progress is required to be made to enhance the efficiency and effectiveness of the petroleum licensing arrangements.

**3.34** In responding to the ANAO's proposed report, the ATO advised that it is implementing revised excise licensing arrangements to enhance their efficiency and effectiveness.

## 4. Aspects of Compliance Management—Field Services

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*This chapter discusses the excise compliance management function, performed at the time of the audit within the Field Services Branch (FSB) of the Excise business line (EBL). It introduces the excise investigations function, which is discussed in more detail in Chapter 5.*

### Introduction

**4.1** As is the case for other taxes administered by the ATO, the excise collection scheme is based on excise payers cooperating with the ATO and complying voluntarily with their obligations under relevant provisions of legislation dealing with the requirements to pay excise at certain rates on certain excisable products. The self-assessment nature of excise collection places the onus of understanding and applying relevant excise legislation on clients making excise payments. Any self-assessment excise scheme requires, nevertheless, an effective and credible compliance component to provide assurance of revenue integrity, within the context of risk management.

**4.2** Excise compliance is conducted in accordance with the ATO Compliance Model that provides a framework for the approach to be taken towards compliance at both strategic and operational levels.<sup>52</sup> Excise compliance strategy aims to ensure compliance and to detect and deal with non-compliance<sup>53</sup> on the part of excise payers.

**4.3** Compliance activities<sup>54</sup> can be distinguished from those conducted by staff of the Excise Investigations unit, which handles cases involving fraud (the Investigations function is discussed in Chapter 5). Essentially, fraud encompasses matters that are dealt with through investigation and prosecution action, rather than by application of compliance activities such as audits.

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<sup>52</sup> Within the ATO, the term 'compliance' is used in the broadest sense, that is, in managing compliance the ATO not only considers risks to revenue but also risks to community confidence, cost of compliance, and client capability and understanding. The ATO employs a range of compliance strategies, embracing activities as diverse as policy development, law design and change, delivering help and education products and services, analysing information and foreseeing market trends, etc, as well as operational field and investigation activities.

<sup>53</sup> Non-compliance relates to matters such as failure to comply with provisions contained in the various Taxation Acts.

<sup>54</sup> In this chapter we discuss operational compliance functions conducted by the Excise Compliance Teams, within the Field Services Branch of the EBL.

**4.4** The excise compliance function operates in an integrated fashion with compliance resources shared across all excisable products, and also the excise payment schemes.

### **Administration structure**

**4.5** The ATO upgraded its administration and management structures to implement its compliance and investigation functions more effectively by creating a new Field Services Branch (FSB) within the EBL in late 2000.<sup>55</sup> The FSB is headed by an officer at the Assistant Commissioner level, with responsibilities for the overall direction and management of compliance and investigations activities within the EBL. In carrying out its compliance and investigation activities, the FSB functions as a service provider to Excise Industry Groups, including the PEIG.

**4.6** As shown in Figure 2.1 elements within the FSB and especially Branch management require close contact and exchange of information with the PEIG within the RIB on petroleum excise compliance and investigation matters.

### **Excise compliance process**

**4.7** The PEIG plays a pivotal role in controlling the pattern and direction of compliance operations. The PEIG is ultimately responsible for prioritising the petroleum excise risks and for determining the spread and frequency of compliance risk treatments (discussed further in paragraph 4.15).

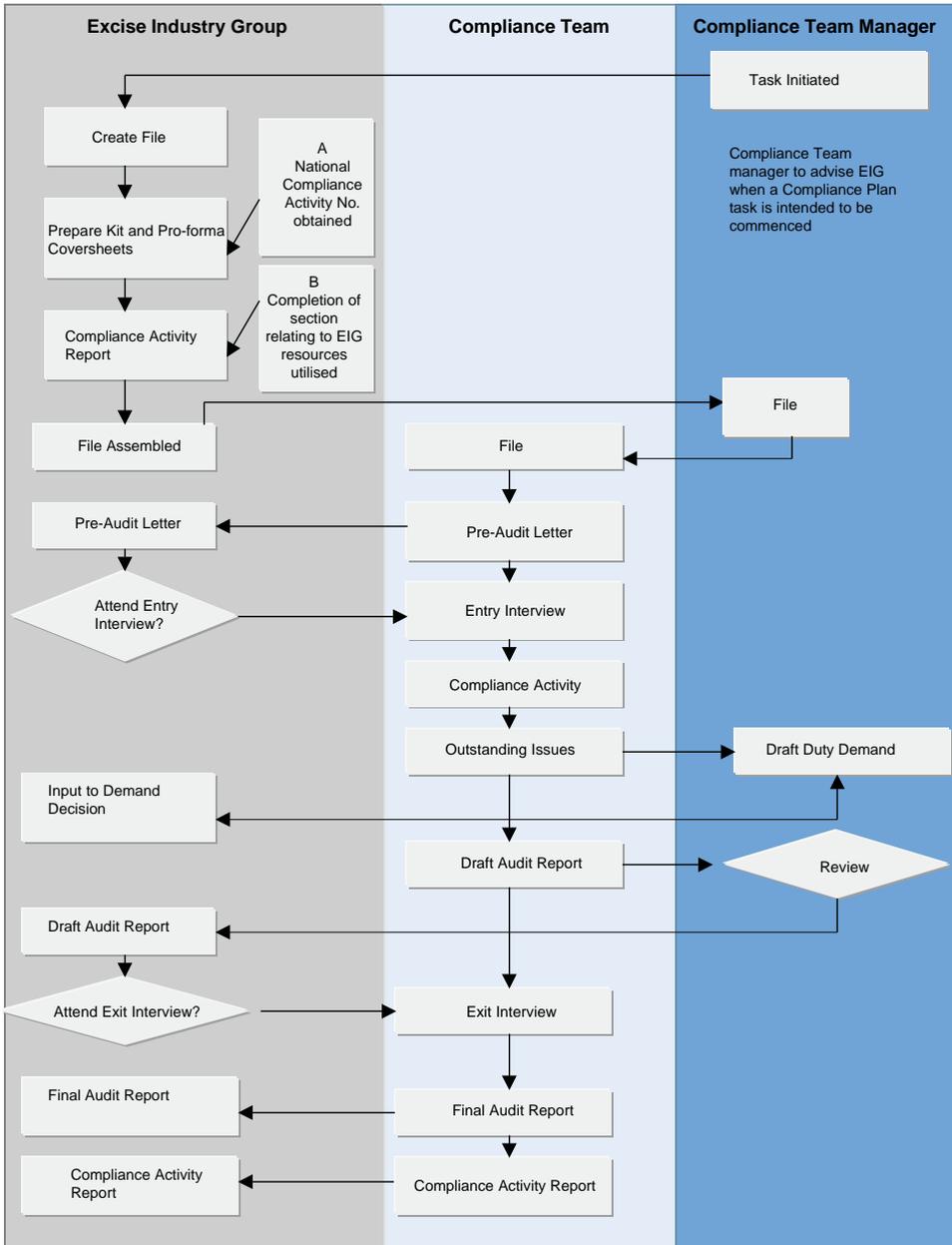
**4.8** At the operational level the compliance function is carried out by Excise Compliance Teams (ECTs) located throughout Australia. The ECTs are managed by two Directors, Field Compliance (North and South). The ECTs:

- perform audit and other risk treatment activities, as requested by the Industry Groups, based on tailored compliance kits (referred to from paragraph 4.23) prepared by the Industry Groups;
- provide feedback through the Directors Field Compliance to the relevant Industry Groups on the compliance taskings that the Team has been responsible for; and
- assist with information gathering for the Industry Groups (for example information supplied by ECTs assists the Industry Groups in their monitoring of clients' compliance with conditions set on excise licences; licensing issues are discussed in Chapter 3).

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<sup>55</sup> In 2000–01, the FSB was allocated 314 staff, and financial resources of \$31.5 million.

**Figure 4.1**  
**Excise field compliance audit process**



Source: ANAO depiction of ATO information.

**4.9** The flow-chart at Figure 4.1, drawn from the Excise Compliance Manual, illustrates the excise compliance process from the planned notification of a compliance activity through to the preparation of a Compliance Activity Report (CAR).<sup>56</sup>

**4.10** The ANAO examined excise compliance management arrangements to establish:

- whether compliance assessments were within a strategic framework in which risks to revenue were subjected to effective prioritisation;
- their operational effectiveness which included:
  - adequacy of documentation of procedures to ensure consistency with compliance policy and activity across compliance teams;
  - effective implementation of compliance activities;
  - effective implementation of compliance strategy; and
- the effectiveness of compliance management and reporting frameworks within which compliance activity was conducted.

## Excise Compliance Strategy

**4.11** The ATO's compliance philosophy (referred to in paragraph 4.2), combined with the behaviours set out in the ATO's Taxpayers' Charter and implementation of risk management processes, forms the basis for a National Excise Compliance Strategy designed to deliver required outputs in accordance with the EBL's business planning. Further information on the ATO Compliance Model, risk management and planning is to be found in Chapter 2.

**4.12** The National Excise Compliance Plan (NECP) is developed as a result of the risk assessment processes described in Chapter 2.

### The National Excise Compliance Plan

**4.13** The ANAO reviewed the 2000–01 NECP. The EBL convened two national forums to facilitate the development of the 2000–01 NECP. These forums allowed all stakeholders in the national compliance strategy to have input to the content of the NECP and to allow for the linking of risks to resources. Once the content and resource requirements of the NECP were agreed, the tasks arising from it were available for allocation to ECTs, at the instigation of the respective Excise Industry Groups.

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<sup>56</sup> CARs are designed to advise that the compliance activity (identified by activity number) allocated to ECTs has been completed. CARs require the ECTs to report on, among other things, resource usage, time taken, revenue or other compliance results and to raise other issues that are relevant to the audit action taken and/or to the role of the Industry Groups in their monitoring of the four excise industries.

**4.14** The 2000–01 NECP comprised a listing of compliance activities to be conducted during the year. Activity numbers were assigned to planned and unplanned<sup>57</sup> tasks for which a compliance team site had been identified to carry them out, the excise client if known, and the risk treatment to be carried out.

**4.15** The Excise compliance strategy acknowledges that selection of risk treatment depends on the type and level of risk identified. The EBL uses one of a number of risk treatment types in its compliance activities, depending on the differing objectives and subject matter of the compliance action. The details of the risk treatment types available are set out in Appendix 6.

**4.16** Of the risk treatments available, treatment types as shown in Table 4.1 were proposed by the PEIG in respect of petroleum clients in the 2000–01 NECP.

**4.17** The NECP aims to set a direction and impart coherence to compliance activities. The ANAO considers that the NECP provides a sound basis for the EBL to meet the conflicting priorities of the four Excise Industry Groups in the area of compliance activities, particularly audits.

**4.18** However, the NECP, in its current format, is more of a compliance activity statement than it is a compliance strategic plan. Within the context of risk management, effective compliance planning should address at least the following variables:

- the level of risk to be addressed by the compliance risk treatment strategy;
- who is responsible for achieving the desired result of the risk treatment; and,
- how success in achieving the plan is to be measured.

**4.19** As discussed in Chapter 2, the ANAO considers also that the EBL should develop and implement a Risk Management Plan for 2001–02. Such an action would impact positively on the content and purpose of a future NECP provided that the sense of strategic risk management is also reflected in the NECP.

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<sup>57</sup> In the NECP unplanned activities are anticipated that will be allocated against various clients as they are identified throughout the year. Unplanned activities are included also so that compliance matters arising during the year can be addressed within allocated resources. In 2000–01 some allowance was made for some 370 unplanned tasks. For example in 2000–01 it was anticipated that there would be a number of changes in the petroleum industry that would require application of various compliance risk treatments, but which had not been decided specifically when the NECP was finalised.

**Table 4.1**

**Excise risk treatment types proposed by PEIG in 2000–01 for petroleum clients**

<i>Description</i>
<p><b>National audit:</b> a comprehensive coordinated audit of a company covering all of its relevant operations Australia-wide;</p> <p><b>Comprehensive audit:</b> an audit of all of the relevant activities of a company within a particular State or throughout Australia;</p> <p><b>Focussed audit:</b> a one-off examination of a specific activity or transaction in a company;</p> <p><b>Monitoring by visitation/liaison:</b> could involve visiting a premise to ensure that the systems are still in place, that new legislation or regulations are explained, or previous audit recommendations are followed up;</p> <p><b>Examination and verification:</b> involves detailed physical inspection and the establishment and documentation of truth, through focussed inspection and/or compliance and substantive testing; and</p> <p><b>Client Education:</b> in accordance with the ATO objective of self-assessment on the part of clients, aimed at assisting excise payers to understand relevant laws and regulations and hence comply; utilises information campaigns, seminars, field visits, ATO publications; articles in professional and industry publications and media releases.</p>

Source: ANAO depiction of ATO information

## Operational management

### Excise Compliance Manual

**4.20** The conduct of compliance activities within the EBL is carried out with the benefit of comprehensive, specific procedures detailed in the Excise Compliance Manual. This manual, which is in three parts is located on the EBL's Intranet for the information and direction of compliance staff (and is also available in printed format), and includes guidance on:

- the strategic framework for compliance assessments;
- excise audit methodology including audit standards, policies and legislation; and
- use of standard audit working papers for compliance reporting, complaints and quality assurance checklists.

**4.21** The ANAO reviewed the Excise Compliance Manual and noted that it had some content that reflected the background of compliance functions within Customs. However, efforts had been made to incorporate relevant ATO procedures and processes such as acknowledging, for example, that excise compliance activities are to be conducted within the context of the ATO Compliance Model, the Taxpayers' Charter and so on. The Manual is in the process of being

updated further to take account of reorganisation of the compliance function (referred to in paragraph 4.5). As it stands the Manual is a useful guide for EBL staff engaged in compliance activities.

### **Implementation of compliance activities**

**4.22** In assessing the effective implementation of petroleum excise compliance activities, the ANAO examined a sample of compliance kits prepared by the PEIG and a sample of compliance case work relating to petroleum excise clients.

#### ***Compliance activity kits***

**4.23** Excise Industry Groups provide information and direction to ECTs on required compliance action through Compliance Activity Kits.<sup>58</sup>

**4.24** As service providers to the Excise Industry Groups, ECTs depend on development of effective and comprehensive compliance kits. For example, the inclusion of background information such as company structures in sufficient detail, assist the ECTs in determining how to meet the Industry Groups' requirements in the compliance activities requested.

**4.25** The ANAO examined some 25 compliance kits provided by the PEIG to ECTs since 1999 when the excise function transferred from Customs to the ATO. The compliance activities covered in the sample of kits reviewed by the ANAO ranged from focussed audits of aspects of the activities of the four major oil companies to audits of the end-use of concessional petroleum products by Remission Certificate<sup>59</sup> holders (as discussed in Chapter 7).

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<sup>58</sup> Depending on individual circumstances, such kits may include information on:

- an activity number to identify the compliance activity within the context of the NECP;
- the excise client to be examined, including company details;
- the compliance activity to be undertaken, including a summary of the risk treatment to be applied, and the period of the audit (if audit action is the compliance risk treatment being requested);
- the required focus and expected outcome of the audit/examination;
- the reasons why the activity is being applied to the client;
- potential difficulties;
- legislation involved in what is being examined;
- potential policy considerations; and
- details of any research and analysis conducted by the Excise Industry Group in support of the activity.

<sup>59</sup> Remission Certificates are issued by the PEIG to firms that can demonstrate a need for access to unmarked fuel for use as a solvent. The Certificates allow for purchase of unmarked solvent for the applicant's own use at the concessional (free) rate of duty.

**4.26** Overall, the ANAO concluded that the use of compliance kits to specify and direct the conduct of compliance activities is appropriate and forms a critical part of the compliance management process. The production of kits assists in the PEIG maintaining consistency of coverage in the compliance activities that it authorises.

**4.27** The ANAO considered that the value-added content of the compliance kits issued by the PEIG had become more comprehensive over time. The later kits were seen as arguably inherently more useful to the compliance staff members who would be carrying out the activity, although further improvements needed to be made to Remission Certificate kits.<sup>60</sup>

**4.28** The ANAO noted some difficulties in the management of activity numbers and compliance reporting, that to an extent concern the distribution and follow-up of compliance kits, and these are discussed later in this Chapter.

### ***Compliance audits***

**4.29** The ANAO examined audit documentation relating to some 30 compliance cases, mostly focussed audits, that had been conducted relevant to the petroleum excise subject matter of this audit since 1999. Once again our selection process, drawing from the documentation held within the PEIG on completed and ongoing compliance cases, meant that the compliance coverage in these cases ranged from examination of particular aspects of operations of the major oil companies to one-off examination of small companies' use of Remission Certificates. The ANAO's examination covered compliance activities conducted in the Melbourne, Sydney and Brisbane compliance sites.

**4.30** The ANAO's assessment of the particular cases selected is that EBL compliance teams and managers had managed compliance cases proficiently, showing the application of professional audit techniques and of acquired skills, experience and knowledge of the petroleum industry and, in some cases, of the company involved. In each case the audit objectives set by the PEIG had been followed in the audit process applied by the ECT.

**4.31** Moreover, the range of resulting audit reports examined by the audit team showed that the ECT had covered the required subject matter effectively. In each case the outcomes and conclusions reached had been arrived at in logical, arguable steps, and audit recommendations and

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<sup>60</sup> In the areas of provision of company information and on the need to review the use of Remission Certificates by the particular holder.

outcomes flowed from the findings and supporting facts. Based on our examination of this sample of compliance case work, the ANAO considers that the results of compliance activity would prove useful to the PEIG in its oversight of petroleum excise clients.

### *TeamMate*

**4.32** The ANAO noted that some ECT staff undertaking audit processes have access to an automated audit working papers system known as 'TeamMate'.<sup>61</sup> TeamMate was used in two of the three compliance sites that our case examination covered. In Sydney paper records continued to be used as audit documentation.

**4.33** The ANAO considers TeamMate to be a functional system for the storage and retrieval of audit documentation. The ANAO noted particular documents such as CARs and final audit reports that are forwarded to the PEIG are still printed and retained on files relevant to each case. The PEIG does not have on-line access to TeamMate.

**4.34** The ANAO supports the continued use of the TeamMate system or similar, and suggests that it be introduced throughout all excise compliance sites. The ANAO sees benefits also in the TeamMate application being networked between all EBL compliance sites. Amongst other things, this would allow for enhanced oversight of team performance by the Directors, Field Compliance (North and South). In view of the PEIG's requirement to review the outcomes of and gain assurance on the conduct of compliance activities, the ANAO suggests that the ATO consider extending networked access to TeamMate records to the PEIG.

## **Achievement against NECP**

**4.35** The ANAO found that the 2000–01 NECP was being followed in the conduct of petroleum excise compliance activities.

**4.36** However, as discussed in paragraph 4.18, the NECP comprises a listing of intended activities rather than a plan against which performance can be measured. Therefore while the ANAO can report that a number of activities that were listed on the NECP have been completed, it is not possible to ascertain, from recording of progress against the NECP itself, the level of performance reached as no targets or desired levels of execution have been provided.

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<sup>61</sup> This is a stand alone system, with access restricted to staff within each compliance site. The system allows the compliance team member to record audit documentation and processes electronically, with links to electronic files containing documentation relevant to each of the steps in the audit process. TeamMate provides for information to be updated on-line and for documentation to be scanned by managers, particularly in the audit quality assurance process.

**4.37** The table at Appendix 7 shows, as at October 2001, the status of achievements against the compliance activities tasked by PEIG for the 1999–2000 and 2000–01 years. The ANAO notes some 1999–2000 tasks were not completed until 2000–01.

**4.38** Some delay can be expected while the PEIG issues kits and while compliance teams are identified and allocated to conduct the compliance activity as planned. However, the ANAO considers that the NECP should reflect the compliance activities, in this case in the petroleum excise area, that can and will be carried out in the year indicated. Thus the 2001–02 NECP should not only include those activities formally deferred from 2000–01 but also those that had not been completed at the end of the 2000–01 year. In this way the NECP would always be current against the realistic program of compliance activities, while still allowing for a measure of unplanned activities to be conducted as issues may arise during the year.

**4.39** The ANAO found that the ‘unplanned’ activities that had been included in the NECP had been and were being used to meet requirements that have arisen throughout the year. Alternatively, they were being used for activities for which the PEIG had determined, since the NECP was formulated, the details of the particular client or type of compliance activity that would be carried out. The ANAO found that around half-way through the 2000–01 year, some 35 per cent of petroleum compliance activities that had been undertaken were unplanned. However, the contents of the NECP were not varied to acknowledge this. The NECP as it is managed at present, is a static document.

**4.40** The ANAO notes that the provision of unplanned compliance activities provides flexibility in addressing previously unknown, or changing, circumstances during the period of the plan. However, by their nature, the provision of unplanned activities within the NECP has a number of less than desirable effects:

- they impact on the ability of FSB compliance management down to the team manager level to take a forward looking approach in resource planning, most clearly in the provision of compliance teams of an appropriate make-up at appropriate sites and periods to meet industry groups’ compliance requirements, including those of the PEIG;
- they lead to difficulties in accurately monitoring and reporting on progress against the NECP as their extent and make-up are not known until some time after the planning period has taken place; and
- further, because targets or performance indicators are not set while planning, unplanned activities can seemingly be set to accomplish performance levels or standards that will be met rather than the levels that should be met.

**4.41** The ANAO suggests that the extent of unplanned compliance activities continue to be kept under notice within the EBL. There would be merit in identifying as is feasible in the compliance planning process, the types of compliance treatments and the particular clients to which they will be applied. This will provide added certainty to the operations of the ECTs, and assist them in providing effective compliance services to the industry groups throughout each year.

## Management and reporting frameworks

**4.42** Sound management and reporting frameworks provide a basis for informed decision making, assisting in improving performance and accountability. They are also an early warning system enabling managers to undertake timely preventative action.

**4.43** Compliance performance management and reporting<sup>62</sup> within the EBL is conducted at various levels, and involves a number of different processes, examples of which are shown below:

- the PEIG maintains database and paper (file) records of what compliance activity kits have been issued to the ECTs;
- Compliance Team Managers at each compliance site prepare a Compliance Activity Monthly Report to cover achievements during the month, based on maintaining extensive records on status of compliance activities that have been assigned to the site, including information on the team allocated, timing of various stages of the compliance activity, resource usage; and
- the FSB prepares monthly reports on the compliance work completed and in progress for each Industry Group. The reports are based on records<sup>63</sup> maintained on finalised and non-finalised activities by site, by type of risk treatment, by Excise Industry Group.

**4.44** The ANAO notes that:

- there are other reports at higher levels than these, for example an FSB monthly report to the Excise Leadership Team (ELT); comment on such reports is covered in Chapter 2;
- a report entitled Compliance Activity for 1999/2000 presents a useful overview of compliance activities undertaken during that year; the ANAO suggests that a similar report be prepared for the Assistant Commissioner FSB, the heads of each of the Excise Industry Groups and the ELT to cover 2000–01 activities.

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<sup>62</sup> That is, reporting on the management of the compliance process, not the actual audit reports—see paragraphs 4.30 and 4.31 for comment on audit reports examined by the ANAO.

<sup>63</sup> A number of spreadsheets are used to maintain this record.

**4.45** However, the ANAO found that the reports mentioned above did not provide a strategic view on compliance activities relevant to the responsibilities of the PEIG. Without the compliance function adopting a strategic focus, the ability of this function to contribute positively to the EBL's overall planning, risk management and business intelligence activities is lessened.

**4.46** Further, due to the different recording systems maintained, the compliance management function does not have coordinated and integrated data on its performance that can be accessed on a timely basis to assess the effectiveness of the function. That is, the compliance management function does not have access to an electronic case management system.

### ***Case management system***

**4.47** Within the ATO, electronic case management systems (CMSs) have a range of features that may include:

- on-line access, depending on user access level, to case details contained in a range of data fields such as case identification number, case subject or type of case, specifics of the team handling the case, ATO region and unit involved, costs of case, case history, case status, case contact details, priority level, case timing, etc.;
- an ability to perform specific searches, using combinations of information filters and parameters that limit the field of potential cases, to identify a specific case or specific classes of cases;
- on-line updating of entries relating to case costs, case status and history, team details, etc.;
- reporting facilities that provide for automated and one-off reports on any or all of the data fields contained in the CMS; and
- recording of case outcomes, such as revenue gained through compliance case work.

**4.48** The ANAO observed that the absence of a CMS in excise compliance management has resulted in a number of management and administrative deficiencies. Examples are:

- there are different compliance management and reporting systems, databases, monitoring spreadsheets, etc in use by FSB at national, regional, site and team levels; this provides for inconsistent information provision and updating; from the ANAO's observation this causes difficulties for managers in maintaining oversight and direction of compliance activities, and in conducting ongoing assessment of progress against compliance plans, as well as in the consolidation of information for management reporting;

- there have been some omissions and inconsistencies in providing feedback to Excise Industry Groups, including the PEIG, on status of compliance activities, including in those cases where some follow-up action is recommended; this situation causes difficulties in the PEIG updating its own records of compliance activity against the compliance activity kits that it has issued and also in conducting any follow-up action considered necessary by the ECTs; and
- because it has not updated its records consistently at the conclusion of each audit, the PEIG has not provided timely feedback to FSB on the quality and utility of compliance activities undertaken; as well the PEIG has not consistently conducted a follow-up audit (this point is discussed in Chapter 7).

**4.49** The ANAO sees the need to resolve such problems. Further, the FSB needs to manage excise compliance activities effectively, in its role as a service provider to Industry Groups, including the PEIG. The ANAO suggests the implementation of a CMS to be used for recording, maintaining, providing access to and reporting on the current state of compliance activities within the EBL. The ANAO is aware that the EBL's lack of a CMS for its compliance function has been noted by the ATO's Integrated Field Work Project in its report on 'ATO Performance Measures for Field Work.'

**4.50** The ANAO was informed that restrictions have been placed on the implementation of new CMSs due to the proliferation of such systems. However, the need for such a system within the EBL compliance function is such that adaptation of a system already in place elsewhere within the ATO should be pursued. Of course, any CMS would need to be implemented with different levels of access depending on the user, but the ANAO would suggest, for example, that the PEIG have access to the records of its own compliance cases so that its management of compliance kits could be enhanced. The ANAO understands that the FSB is currently seeking to establish a trial of an existing system, and the ANAO supports such a move.

## **Recommendation No. 5**

**4.51** The ANAO recommends that, to implement effective compliance management and reporting arrangements, the ATO take steps to establish a case management system to consolidate and rationalise the recording, updating, management and reporting of information relating to compliance activities.

### *ATO response*

**4.52** Agreed. Improved short-term case management arrangements are currently being implemented. Work has been commissioned to develop a more integrated medium to long-term case management capability.

## **Conclusion**

**4.53** The NECP sets a direction and imparts coherence in the conduct of compliance activities. It provides a sound basis to meet the conflicting priorities of the four Excise Industry Groups in the area of compliance activities, particularly audits.

**4.54** However, the ANAO suggests that the NECP, in its current format, does not provide a strategic framework for compliance activities. In the context of our recommendation set out in Chapter 2 concerning creation of an Excise Risk Management plan, the ANAO sees the need for the NECP in future years to become more of a strategic and results-oriented compliance planning document.

**4.55** The ANAO concluded that the operational aspects of compliance management within the EBL were carried out effectively. However, the ANAO identified a number of instances where the management, coordination and reporting of compliance action could be improved.

## 5. Investigations

*This chapter discusses the operations of the excise investigations function within the Excise business line (EBL), with a particular focus on petroleum excise investigations.*

### Introduction

**5.1** The Excise Investigations Unit within the EBL undertakes fraud<sup>64</sup> investigations<sup>65</sup> either independently or in conjunction with other ATO business lines, other Government agencies and law enforcement agencies. The Unit is responsible for investigating instances of external fraud (that is fraud committed outside the ATO) involving possible breaches of Commonwealth legislation in relation to all excisable products/industries.

**5.2** Excise investigators are responsible for detecting and identifying possible offences, investigating such offences and collecting and presenting the necessary evidence to support prosecution and administrative outcomes. When an investigation is completed, a brief of evidence is prepared and forwarded to the Director of Public Prosecutions (DPP) for consideration of criminal prosecution action or to the Australian Government Solicitor (AGS) for civil action. Investigators may also be required to present evidence and testimony in court and to support legal advocacy of prosecution action.

**5.3** Similar to the compliance function, the EBL has an integrated approach to managing investigation cases relating to tobacco, petroleum, alcohol and excise payment schemes.

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<sup>64</sup> The *Fraud Control Policy of the Commonwealth* defines fraud as:

*inducing a course of action by deceit or other dishonest conduct, involving acts or omissions or the making of false statements, orally or in writing, with the object of obtaining money or other benefit from, or of evading a liability to, the Commonwealth.*

(Commonwealth Law Enforcement Board 1994, *Best Practice for Fraud Control—Fraud Control Policy of the Commonwealth*, AGPS, Canberra, p. 3)

<sup>65</sup> The *Fraud Control Policy of the Commonwealth* requires the Australian Federal Police (AFP) to conduct investigations directed toward prosecution under the *Crimes Act 1914*, subject to three exceptions:

- agencies that prosecute fraud cases under their own legislation, such as the ATO, should continue to investigate matters where the Crimes Act is considered more appropriate and the DPP is satisfied that the prosecution brief does not require AFP involvement;
- agencies that can satisfy both the AFP and DPP that they have the capacity and capability to investigate criminal cases; and
- matters involving multi-jurisdictional organised crime, which are referred to the National Crime Authority.

**5.4** Since the transfer of the excise investigations function from Customs,<sup>66</sup> the ATO has significantly expanded the size of the Excise Investigations unit by undertaking a major recruitment campaign to recruit investigators.<sup>67</sup> For 2000–01 the Excise Investigations unit’s total resource allocation was \$9.345 million. The expansion was in recognition of the challenges to address emerging issues concerning evasion of excise (particularly involving distribution of ‘chop chop’ tobacco and fuel substitution).

**5.5** The ANAO considers that key aspects of an effective Excise Investigations Unit are its ability to undertake and manage investigations effectively with a view to providing timely responses to issues as they arise. The Unit would also need to work closely with the Excise Industry Groups. In this context the ANAO examined the Excise Investigations unit’s:

- referral processes;
- case management framework including case planning, management and recording of excise investigations; and,
- case reporting and liaison arrangements.

## Investigation referrals

**5.6** The initiation of Excise Investigations casework may arise through the provision of referrals, information and intelligence from:

- the various Excise Industry Groups, including the PEIG;
- Excise compliance (field audit) staff ;
- public ‘tip-offs’ or ‘dob-ins’ from industry groups, individuals or companies with knowledge of suspect activities, including through the ATO’s Community Information, Storage, Communication and Observation (CISCO) system<sup>68</sup> (in the case of petroleum cases, these would generally be referred to the Investigations unit through the PEIG); and

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<sup>66</sup> Most excise functions were transferred from Customs to the ATO on 4 February 1999. At that time, Customs and the ATO agreed that investigations and prosecutions on excise and fuel substitution offences would for a period of six months, continue to be conducted and managed by Customs under a temporary purchaser-provider arrangements. In May 1999, the ATO decided to assume responsibility for excise investigations and prosecutions as from 12 July 1999.

<sup>67</sup> In 2000–01 the Excise Investigations Unit had expanded from 26 staff transferred from Customs in 1999 to 91 staff across Australia.

<sup>68</sup> The CISCO system records information received by the ATO from members of the community (‘dob-ins’) and disseminates advice, particularly on major issues raised by community informants, to appropriate areas within the ATO for action.

- Commonwealth or State law enforcement or other agencies with information on possible illegal or suspect matters that are the responsibility of the EBL.

**5.7** The ANAO noted that the majority of referrals (other than referrals from the PEIG in respect to fuel testing) are received from external contacts, particularly law enforcement sources. The Excise Investigations unit is keen to maintain a network of such sources, and has successfully used these resources during the conduct of its activities.

**5.8** During the audit the ANAO noted that the Investigations unit had a large backlog in referrals forwarded from the PEIG covering fuel testing matters to be carried out in various locations.<sup>69</sup> That is, there had been significant delays between the receipt of fuel testing referrals from the PEIG, and the fuel tests being carried out. (Chapter 7 discusses the conduct and results of fuel testing undertaken by the Investigations unit over 1999–2000 and 2000–01).

**5.9** The ANAO was informed that the backlog had arisen due to difficulties in dealing immediately with fuel testing requests that required some analytical and preparatory work. The ANAO noted that before the transfer of the investigations function from Customs, an intelligence and analysis component had been part of Customs investigations unit. This facility, among other things, had provided support to investigations staff in the preparation of background analysis relevant to implementation of plans for dealing with referrals. However, this facility was not available within the ATO.

**5.10** The ANAO was informed that the Investigations unit is reallocating its resources to establish some analyst positions. The ANAO endorses the initiative to provide support to excise investigators in analysis and intelligence functions. Such a facility could:

- contribute to timely handling of investigations referrals;
- provide analysis and intelligence assistance to investigators in planning the conduct of cases;
- enable analysis to be conducted into patterns and trends in excise referrals; and
- research potential excise fraud risks and contribute to the development of an excise investigations strategy.

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<sup>69</sup> The ANAO notes in Chapter 7 that major resources were committed subsequently to fuel testing at a number of sites thus addressing the backlog of referrals from the PEIG.

## Case management framework

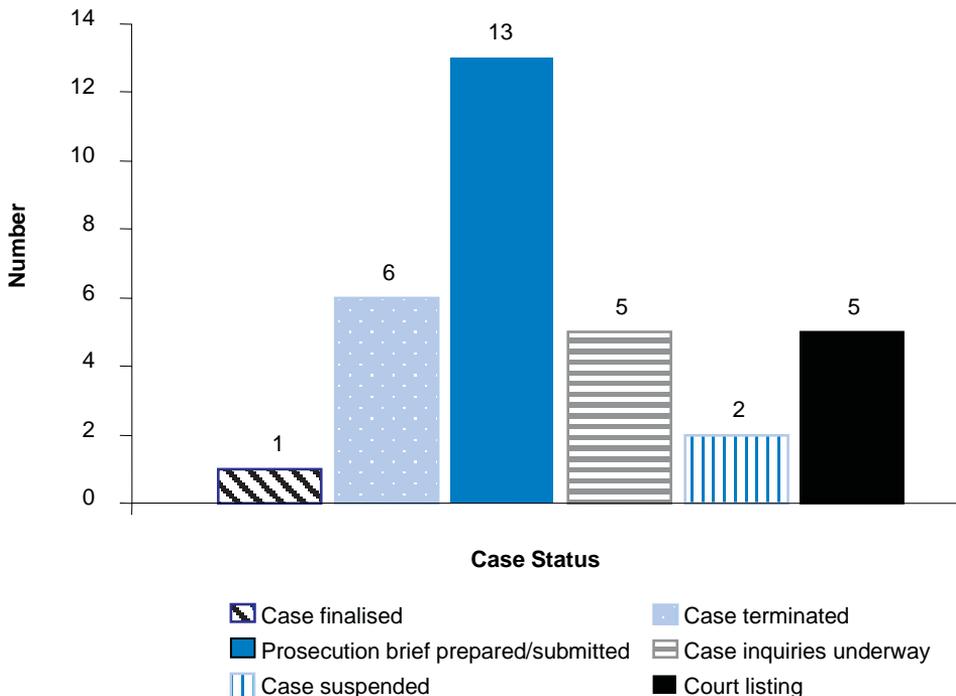
### Case planning and management

**5.11** Effective case planning and management ensures a certainty of process that all major steps in investigation are logically determined, all possible alternatives considered and that decisions are transparent and documented. Management review processes will provide further assurance that a case has been properly investigated.

**5.12** The ANAO undertook a review of the conduct of a sample of 32 investigations<sup>70</sup> cases relating to petroleum excise that had been concluded since the investigations function had been transferred from Customs to the ATO or that were under way at the time of the audit. A summary of case status at the time of the audit is shown in Figure 5.1.

**Figure 5.1**

**Petroleum investigation cases examined by the ANAO**



Source: ANAO depiction of ATO data

<sup>70</sup> These are major investigation cases, that is they exclude those cases involving covert sampling of fuel; we comment on fuel testing in Chapter 7 and earlier in this chapter.

### 5.13 Overall the ANAO found that:

- the Investigations unit had exhibited considerable professional expertise in applying investigation techniques while pursuing cases and in gathering and preparing comprehensive documentation;
- where a decision had been made or was to be made to terminate the matter,<sup>71</sup> the rationale for doing so, had been documented adequately;
- necessary security had been maintained within the Investigations unit<sup>72</sup> over information obtained in the course of investigations cases, for example in protecting informants and in being able to pursue searches and seizures without leaks to suspects; this reflects the fact that investigations matters are considered to be very sensitive, therefore security provisions are strictly enforced in terms of access to information and progress re ongoing cases;
- in the majority of cases investigations staff had performed their roles in accordance with the provisions of the Excise Investigations Procedure Manual,<sup>73</sup> which provides comprehensive, explicit guidelines and instructions for the handling of excise investigations matters, and with relevant Instructions issued by the National Director Investigation Excise;
- excise investigations staff demonstrated their possession of both requisite experience<sup>74</sup> and mandatory comprehensive and effective training<sup>75</sup> in carrying out required legal and other processes to be followed during investigations cases; and
- effective use was made of liaison arrangements between excise investigations staff and Commonwealth and/or State law enforcement and other agencies in exchanging information and in arranging for assistance at particular stages in the process of investigations cases.

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<sup>71</sup> Once a case has been commenced, a broad range of circumstances can lead to a decision to take no further action on a case. These can include missing or insufficient evidence, uncooperative case witnesses, a finding that no offence has been committed, or time delays during the investigation.

<sup>72</sup> The ANAO was informed that Investigation staff are security cleared to at least the 'Protected' level, while Investigation management staff are cleared to at least 'Highly Protected'.

<sup>73</sup> The cases where this had not happened are discussed in paragraph 5.15.

<sup>74</sup> Many excise investigations staff have backgrounds that include experience in other Commonwealth and State law enforcement agencies such as Customs, the AFP and State police forces.

<sup>75</sup> Prior to undertaking fraud investigations, investigators must complete the Certificate IV in Government (Fraud Control - Investigations) training course.

**5.14** However, our examination of cases revealed instances of:

- a lack of documentation to establish evidence of effective planning having been conducted at the initiation of cases;
- a lack of documentation of decisions to select a case for action or to not investigate a case;
- some inconsistencies or gaps in the recording of evidence collected, which had, in some of the cases examined, resulted in case termination as a result of advice from the DPP about insufficient, inappropriate or incomplete evidence required under Excise legislation and/or the timeliness of taking the case before a court;
- a lack of evidence of ongoing participation of team leaders or of Investigation unit management in monitoring and managing the overall progress of cases through regular case reviews; and
- significant problems with timeliness in pursuing petroleum cases; 17 of the 32 petroleum investigation cases at the time of the audit had commenced within Customs<sup>76</sup> before the transfer of the excise function to the ATO.

**5.15** The ANAO considers that clearly defined parameters should be implemented without exception against which possible cases can be tested and documented as to whether they will proceed or not. In this way justification would remain available for review covering those instances where an investigation will not be carried out.

**5.16** The ANAO appreciates that the duration of an investigation case will vary depending on a number of factors such as:

- the relative complexity of the issue;
- the evidence required to establish an effective, supportable case for prosecution;
- timing delays imposed by Courts at various levels; and
- legal or administrative appeals conducted on behalf of the individual or company being pursued in the case.

**5.17** Despite the complexities of petroleum investigations cases, and the possibilities for process delays that are out of the control of the ATO or its officers,<sup>77</sup> the ANAO considers that measures are required to be put in place to achieve more timely investigation processes.

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<sup>76</sup> Note: carriage of prosecution actions commenced in Customs before transfer of the excise investigations function remained with Customs.

<sup>77</sup> The ANAO noted advice from Investigations unit management that due to the time sensitive nature and public visibility of cases involving seizure of illicit tobacco and prosecution of offenders involved in tobacco excise evasion, resources have not been devoted consistently to the necessarily longer term petroleum cases.

**5.18** The ANAO is of the view that the initiation and management of petroleum excise investigation cases could be improved by adopting a more integrated and comprehensive case management framework. The ANAO would see this action as encompassing documentation of:

- the initial decision-making involved in initiating or not proceeding with investigation cases;
- case planning aspects that include estimating the resourcing requirements and timeframes for progressing the case through various stages of the investigations process (establishing analyst positions referred to in paragraph 5.10 is expected to contribute to effective case planning);
- case action review and oversight; and
- management reporting of progress and outcomes.

### **Case management system**

**5.19** The Excise Investigations unit does not have access to an electronic case management system (CMS).<sup>78</sup> Chapter 4 reports on a similar deficiency in relation to the excise compliance functions.

**5.20** Currently the unit maintains a manual record of cases on hand (at the time of the audit this totalled some 219 cases across all excise products). The ANAO noted that such a system:

- does not provide for ready identification of the current status of cases under way;
- is difficult to access by officers other than those who operate it;
- requires manual updating and manipulation of information;
- does not have effective management reporting functionality.

**5.21** As noted in Chapter 4, there are currently restrictions imposed by ATO senior management on the implementation of new CMSs because of the proliferation of such systems, mostly tailored to individual requirements, within the ATO. Nevertheless, the ANAO suggests that consideration be given to the Excise Investigations unit having access to an effective CMS. The absence of such a system detracts from the ability of investigations management, including the Assistant Commissioner FSB:

- to oversight and direct the excise investigations function;
- to establish the current state of individual investigations cases; and
- to review aspects of performance management at the unit and individual staff member levels.

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<sup>78</sup> Access to Customs' electronic CMS, used by the investigations function within Customs, was not continued when the excise investigation function transferred to the ATO in 1999.

**5.22** In other areas of the ATO such systems provide for centralised recording of information on individual cases, and include a range of search and report generating functions for case monitoring and workflow management purposes. The ANAO believes that an efficient outcome would be for the Excise Investigations unit to adopt a CMS that is already in use elsewhere within the ATO and that would meet case management requirements for the EBL with relatively minor adaptation. The ANAO notes that implementation of a CMS for the excise investigations function would need to take account of the ATO's current examination of the investigations infrastructure required to support the ATO's investigatory capability as a whole.

## **Recommendation No. 6**

**5.23** The ANAO recommends that the ATO:

- implement and maintain an effective case management framework within the Excise Investigations unit including in the conduct of initial case planning and resource allocation, ongoing management and review of case progress and decisions to terminate cases; and
- consider implementation of an automated case management system within the Excise Investigations unit.

### *ATO response*

**5.24** Agreed. The ATO will be implementing appropriate corporate case planning and managing products and tools developed by the ATO Integrated Field Work Project. The ATO is also looking at using one of its existing automated Case Management Systems, in use in other areas of the ATO, for its excise investigation work.

## **Investigations reporting and liaison arrangements**

**5.25** The Assistant Commissioner FSB has responsibility for, among other things, the overall direction and management of compliance and investigations activities within the EBL (see figure 2.1). The occupant of this position is part of, and reports on such activities to, the Excise Leadership Team (ELT). Allocated responsibilities include acting as an advocate for the Field Services Branch when resourcing, risk management and strategic planning decisions are being considered at the ELT level.

**5.26** The ANAO considers that, without current and comprehensive briefings and reports to the SES level within the EBL on current investigations activities, including coverage of individual cases, the ongoing management direction of the FSB is weakened. Similarly to the compliance function, unless reporting by the Investigations unit through

the Assistant Commissioner Field Services adopts a strategic focus, the investigations function will be unable to contribute to the EBL's overall planning, risk management and business intelligence activities.

**5.27** The ANAO found that, while ongoing reports on case progress and any issues arising from them were provided to the head of the Investigations unit, they were not provided to the Assistant Commissioner, FSB. The ANAO noted that the Investigations unit is not required to provide any written reports to the Assistant Commissioner, FSB (other operational units within FSB do so). Rather, the head of the Investigations unit holds regular discussions with the Assistant Commissioner covering progress of cases on hand.

**5.28** Further, the ANAO considers that a vital role of the FSB's investigations unit, as it also is for the compliance management function, is to provide a service to the PEIG. The ANAO sees the necessity for these areas to assist the PEIG in its roles of monitoring the conduct of the petroleum industry in relation to fuel excise matters and providing strategic advice on current or prospective issues in the industry that may need to be addressed. Advice from the investigations function may include, for example, possible legislative or administrative (such as revised licensing limitations on particular companies) variations to address deficiencies identified during the conduct of investigation cases.

**5.29** To perform such roles the PEIG requires regular, specific feedback of a strategic nature from the Investigations unit. This includes:

- a considered viewpoint on any matters arising from investigations case work or analysis that should be addressed by the PEIG or of which it should be aware; and
- information on the progress of any cases or issues that the PEIG has referred to the investigations unit.

**5.30** The ANAO found that such feedback is not provided currently as a matter of course, perhaps because of the perceived sensitivity of ongoing investigations and/or through lack of an adequate administrative mechanism to provide for such a flow of information.

**5.31** In order to enhance the effectiveness of the PEIG in carrying out its roles within the RIB the ANAO considers that the provision of information from the investigations unit to the PEIG should be performed on a regular basis in a comprehensive report.

**5.32** The ANAO recognises that there is a need to maintain security regarding intelligence or investigation information. This could be achieved by establishing a reporting feedback arrangement using 'need to know' provisions involving different levels of access to information as happens elsewhere within the ATO.

**5.33** A corollary of this, of course, is the need for the PEIG to provide feedback to the Investigations unit on:

- its requirements and priorities for the conduct of petroleum excise cases;
- any necessary input or assistance on the current and prospective investigation cases that relate to petroleum;
- issues that come to notice within the PEIG, perhaps through industry contacts or through issues raised in the compliance field teams' audit reports to the PEIG, that impact on the work of the Investigations unit or that may lead to the instigation of cases by investigations management.

**5.34** The ANAO considers that the two-way flow of information between the PEIG and the Investigations unit envisaged above would contribute to the more effective management of excise arrangements in the petroleum industry.

## **Recommendation No. 7**

**5.35** The ANAO recommends that the ATO implement comprehensive and regular reporting on progress with investigation cases and on strategic and operational issues of importance, between the Excise Investigations unit, Field Services Branch management and the Petroleum Excise Industry Group.

### *ATO response*

**5.36** Agreed. A comprehensive review of reporting requirements has been undertaken with a short-term solution being developed and a longer-term solution being investigated.

## **Conclusion**

**5.37** The ANAO considers that the Excise Investigations unit has undertaken its investigation functions in relation to petroleum excise in a professional manner. The ANAO notes and endorses the ATO's intention to provide an additional staffing capacity to provide analytical and intelligence services within the Investigations unit.

**5.38** The ANAO noted that the skills, experience and training of excise investigations staff were of a high standard, as well as being appropriate to the cases being undertaken. All staff have access to policy and procedural guidance on investigations relevant to petroleum excise collections, albeit that the ANAO considers that a more effectively structured case management framework is desirable. Moreover, all investigations staff showed a commitment to the achievement of successful outcomes in the cases with which they were involved.

**5.39** However, the ANAO also identified scope for improvement in excise investigations case planning and management processes. The absence of initial case planning impacted adversely on the ability of the Investigations staff to conduct particular petroleum investigations efficiently and effectively. The ANAO has identified a number of areas to enhance the effectiveness and efficiency of investigations work on petroleum cases. These include:

- adopting a strategic focus in investigations reporting processes involving the Assistant Commissioner, FSB and the PEIG;
- adopting an effective case management framework which incorporates clearly defined and articulated procedures and processes for case referral, selection, prioritising, planning, recording, monitoring and reviewing investigations cases; and
- giving consideration to implementing an automated case management system that has a capacity to provide relevant management and performance reports.

## 6 Revenue Management

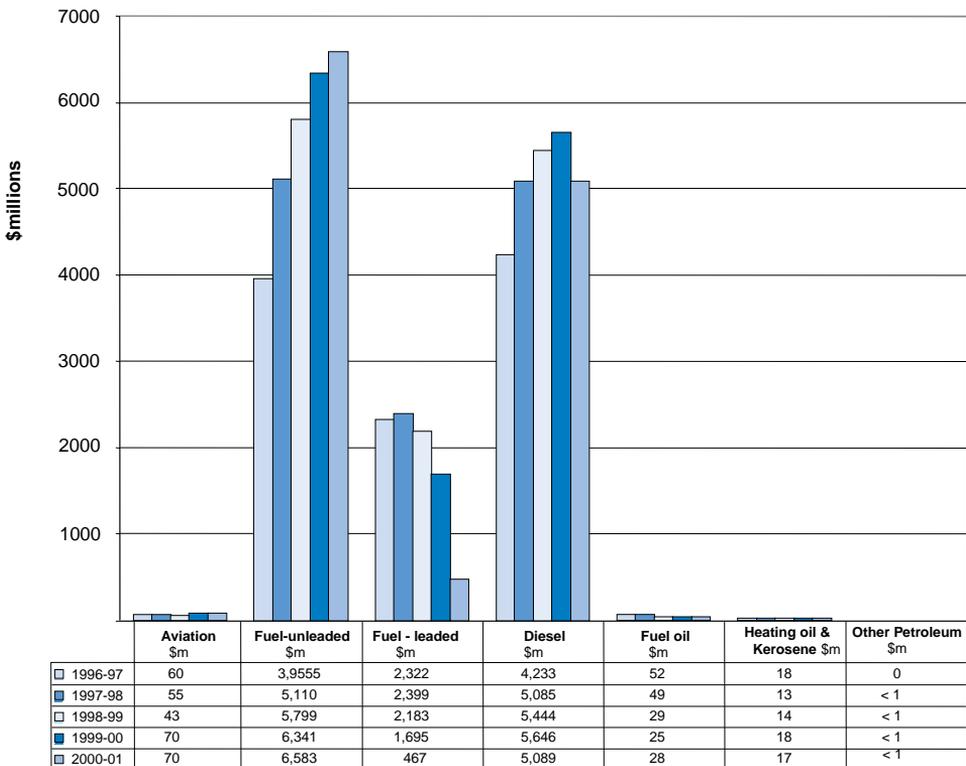
*This chapter examines key aspects of the petroleum excise revenue management process, which includes revenue estimation, collection, monitoring and analysis arrangements.*

### Introduction

**6.1** As indicated in paragraph 1.15, excise from petroleum products comprises by far the largest component of the total excise revenue collected by the Commonwealth. Figure 6.1 shows comparative trends for the major petroleum products for the last five years. The figure shows excise collected from unleaded petrol as the largest component, followed by diesel fuel and leaded petrol.

**Figure 6.1**

*Excise Collections by petroleum products<sup>79</sup>*



Source: ANAO depiction of ATO data

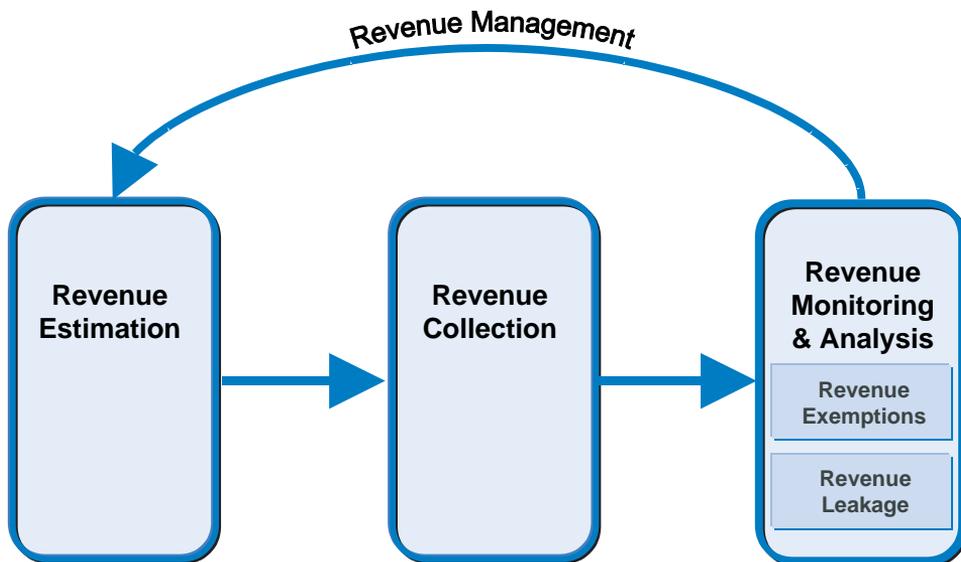
<sup>79</sup> Data includes excise revenue collected on behalf of the States and Territories (known as surcharge or revenue replacement payments). Data does not include crude oil excise.

**6.2** Key components of a revenue management process are shown in Figure 6.2. The ANAO examined each one of these in order to establish whether:

- mechanisms exist to ensure the petroleum excise revenue estimates process was robust, consultative and made use of (monitored and analysed) historical data (see our comments from paragraph 6.3 below);
- appropriate and sufficient controls, systems and practices exist, relating to revenue collection, to ensure all petroleum excise revenue due is collected (see comments from paragraph 6.20);
- mechanisms exist to provide assurance that petroleum excise revenue collection trends are monitored and analysed on a regular basis and variations appropriately followed up (see comments from paragraph 6.38) ;
- quantitative analysis was regularly undertaken to determine the extent of revenue foregone as a result of exemptions/ concessions (see comments from paragraph 6.53); and
- monitoring is in place to determine the ATO's exposure to petroleum revenue leakage activities (see Chapter 7).

**Figure 6.2**

**Key components of a revenue management process**



Source: ANAO

## Revenue estimation

**6.3** The extent to which planned revenue outcomes are achieved is linked to the accuracy of the revenue estimation process. The Department of the Treasury (Treasury) is responsible for formulating revenue estimates. Revenue outcomes are published by the ATO, and by Treasury and the Department of Finance and Administration. Detailed estimates are initially presented in the Budget Outlook, reviewed and revised as necessary as part of the Mid-Year Economic and Fiscal Outlook (MYEFO) and next year's Budget Outlook processes. The outcomes are reported in the Final Budget Outcome (FBO). The Treasury relies on ATO processes and information, in arriving at the excise revenue estimates.

**6.4** The ANAO aimed to understand the excise revenue estimates process, and the role of Treasury and the ATO in this process. We have also reviewed and commented on the progress of excise collections against budgeted revenue estimates, including disclosure issues relating to petroleum excise in the Budget papers and the ATO's Annual Report.

### Role of Treasury

**6.5** Treasury acknowledges that although responsible for preparing the excise revenue estimates, these are developed in consultation with the ATO's Revenue Analysis Branch (RAB). Treasury advised that the excise revenue estimates are based on historical excise collections data, historical consumption quantities/clearance data, and certain economic assumptions<sup>80</sup> which are the major Treasury inputs to the process. Prior to the excise function being transferred to the ATO, similar arrangements were in place with Customs.

### Role of ATO

**6.6** The ATO stated that Treasury consulted it in developing petroleum excise revenue estimates for 2000–01. The estimates were initially computed independently by both Treasury and RAB, although from a common data-base, and then the parties liaised with each other to reconcile the two estimates. There was adequate evidence to indicate that RAB agreed to the excise revenue estimates for 2000–01. As shown in figure 2.1, the RAB liaises with the EBL in arriving at the ATO estimates.

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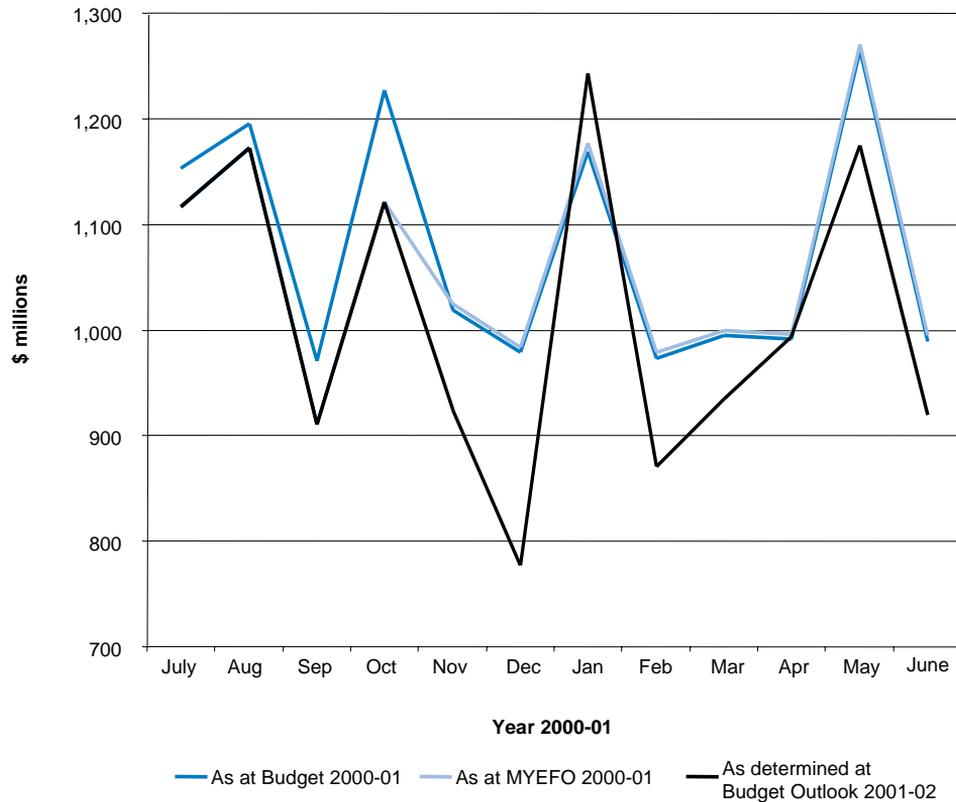
<sup>80</sup> The major economic parameter assumptions are disclosed in Budget Papers.

## Revenue outcomes against estimates

**6.7** Figure 6.3 shows petroleum excise revenue estimates for 2000–01 as at Budget 2000–01, and as revised at MYEFO, and as part of next year's (2001–02) Budget Outlook process.

**Figure 6.3**

### Petroleum excise revenue estimates for 2000–01

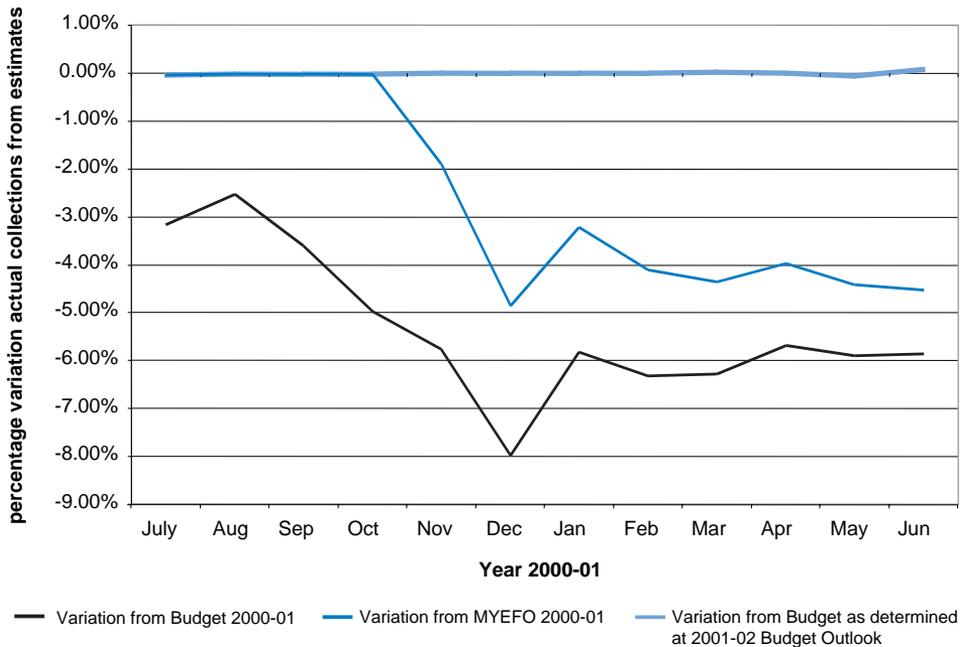


Source: ANAO depiction of ATO and Budget-related data

**6.8** Figure 6.4 shows the percentage variation of actual petroleum excise revenue collections from the estimates as at Budget 2000–01, and as revised at MYEFO, and as part of next year's (2001–02) Budget Outlook process.

**Figure 6.4<sup>81</sup>**

**Actual 2000–01 petroleum collections against estimates**



Source: ANAO depiction of ATO data

**6.9** Figure 6.4 shows that the actual petroleum excise revenue collections were significantly below the original estimates. As a result, estimates were adjusted at MYEFO but actual collections continued to be below these revised estimates. Subsequently the petroleum excise revenue estimates for 2000–01 were revised downwards significantly as part of the 2001–02 Budget Outlook process (by \$800m or 6 per cent from the original budget estimates and by almost \$600m or 5 per cent from the MYEFO estimates).

**6.10** Both Treasury and the ATO have attributed the significant downward revision to factors including:

- the original budget estimate assumptions being too optimistic, particularly in relation to the expectation of a continuation of long-term demand growth;
- the impact of the lower than expected clearance<sup>82</sup> outcome for 1999–2000;

<sup>81</sup> Actual collections exclude excise revenue collected on behalf of the States and Territories (known as surcharge or revenue replacement collections) which ceased in August 2000.

<sup>82</sup> Refers to quantities cleared for consumption into the home market.

- a number of developments after MYEFO which include the 1.5 cents per litre cut on fuel excise rates on 1 March 2001 for diesel, unleaded petrol and leaded petrol (for other petroleum products, excise rates fell by a proportionate amount);
- the accelerated phase-out of leaded petrol; and
- the abolition of future excise indexation adjustments on petroleum products.

**6.11** Treasury further advised that while it is true that forecasts are generally developed by increasing the previous year's outcome by an assumed rate of growth (based on economic fundamentals, such as growth in petrol consumption and movements in CPI), there are a number of major uncertainties in the forecasting process. It is difficult to attribute revenue outcomes to particular influences. Forecasts of economic activity are also subject to forecasting error.

**6.12** Treasury acknowledged that these uncertainties have been exacerbated by significant reform of the tax system with the introduction of the *New Tax System*. Treasury has indicated that taking account of factors that have been important in the past may no longer be a valid approach.

**6.13** The ANAO understands that Treasury, when liaising with RAB on the 2000–01 MYEFO estimates, acknowledged the need to explore more sophisticated quantitative techniques to forecast petrol clearances. Similarly, the ANAO noted that RAB was also reviewing its approach to developing the estimates for the excise revenue. This included taking account of dependent variables (such as, excise collections data) and independent variables (such as, consumption expenditure on operation of motor vehicles from Australian Bureau of Statistics national accounts) when forecasting excise revenue.

**6.14** The ANAO considers that Treasury's and the ATO's commitment to reviewing their revenue forecasting methods on a systematic and ongoing basis should ultimately improve the rigour and accuracy of the petroleum excise revenue estimates process.

### **Disclosure of petroleum excise revenue estimates and outcome in Budget papers and ATO Annual Report**

**6.15** The ANAO noted that excise revenue estimates in Budget documentation (Budget Strategy and Outlook) relating to petroleum products are presented by four major categories (unleaded petrol, leaded petrol, diesel and other which comprises aviation gasoline, aviation turbine fuel, fuel oil, heating oil and kerosene). Estimated excise revenue from crude oil is shown as a separate line item.

**6.16** However, the Treasury practice has been to present the petroleum excise revenue outcome information in the Final Budget Outcome Report as a single line item referred to as ‘petroleum products’. This includes all petroleum products and crude oil.

**6.17** The ANAO acknowledges that the Final Budget Outcome Report attempts to provide an overview. However, in a given year if there is a significant variation in either petroleum base revenue or crude oil revenue (as was the case in 2000–01), the disclosure in budget documentation could be regarded as insufficient.

**6.18** Treasury advised that until recently the crude oil collections comprised an insignificant proportion (some 1 to 2 per cent) of petroleum excise revenue. Given the level of 2000–01 crude oil collections (at more than \$526 million, crude oil revenue represents 4.33 per cent of petroleum excise revenue) Treasury has indicated that it proposed that petroleum excise be separately identified from crude oil in the 2000–01 Final Budget Outcome Report.

**6.19** The ATO’s Annual Report also presents the total excise collections data only. That is, it does not report publicly on actual excise collections compared to estimates, nor does it separately identify petroleum excise collections that comprise 63 per cent of the total excise collected. The ANAO considers there would be merit in reporting publicly on such information, to enhance the ATO’s performance reporting.

## Revenue collection arrangements—current

**6.20** As noted in Chapter 2, Customs continues to collect all excise revenue on behalf of the ATO since the function was transferred in February 1999. Each week, excise revenue in the order of \$200 to \$250 million is received by the Commonwealth in respect of petroleum products delivered into the market for home consumption.<sup>83</sup>

**6.21** In February 2000, Customs proposed a draft MOU (referred to in paragraph 2.47) to formalise the arrangements between the ATO and Customs in relation to mutual cooperation in the provision of excise related services. Although the MOU was not signed, some of the proposed arrangements have been in place since the excise function was

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<sup>83</sup> The Weekly Settlement Permission (WSP) process enables the permission holder to deliver goods into home consumption for a period of seven days without having to lodge an entry or pay the duty liable.

transferred. In relation to excise revenue collections the draft MOU provides that:

- the processing functions relating to excise entries and lodgment of returns<sup>84</sup> will be undertaken by Customs until such time as alternative arrangements are in place;
- to assure that weekly settlement entries are correctly matched to a corresponding payment, a weekly report will be provided by Customs. The report will be in the agreed format; and
- Customs will be responsible for ensuring that the amount on each return lodged equals the amount paid. Where amounts are not equal, Customs will contact the relevant Excise Industry Group for follow-up action. Any other problems associated with the reconciliation of weekly settlement payments will be discussed with the relevant Excise Business Group.

**6.22** At the time of the audit, Customs continued to undertake responsibility for collecting all excise revenue and processing all returns on behalf of the ATO. The Customs' revenue collection process is shown in Appendix 8. The key controls that provide assurance on the integrity and effectiveness of the revenue collection function would be:

- the lodgment of the 'Nature 40' return by the company paying the excise;
- bank reconciliations undertaken by Customs staff to ensure amount shown as deposited in the Bank Statement of Account reconciles to the amount shown as paid on the company return; and
- reconciliations undertaken by ATO staff to ensure banking information as reported in the ATO's financial system reconciles to the return information as entered into the Customs system.

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<sup>84</sup> Each week a WSP holder is expected to lodge a return (referred to as a 'Nature 40 Entry') and pay the duty in respect of goods delivered for the previous week.

## **ANAO findings**

**6.23** The current excise revenue collection arrangements provide general assurance that petroleum excise revenue self-assessed by clients is being collected. This is largely because, as mentioned in paragraph 1.16, in 2000–01 the four major refiner-marketer companies paid over 95 per cent of the excise collected from the petroleum industry. Overall, we found weekly payments were received by Customs on time (although there was no facility to provide an exception report on the default rate, by client). Moreover, there was evidence to indicate that where payments were not received on time, the ATO's PEIG was immediately contacted for appropriate follow-up action.

**6.24** However, the ANAO identified weaknesses in the current revenue collection arrangements that increase the ATO's exposure to loss of revenue and inaccuracies in the excise collections, specifically:

- the ANAO visited one of Customs' Regional Offices and found evidence to indicate that Customs staff were reviewing the Bank Statement of Account and comparing the transactions to the returns lodged to ensure these matched. However, there was no evidence to indicate when and whether the reconciliations were occurring. There was no reconciliation statement/summary prepared on a weekly basis and/or forwarded to the ATO's PEIG to provide ongoing assurance that all revenue as shown on returns lodged by the companies reconciled to the amounts banked as shown in the Bank Statement of Account; and
- there was no agreement on the structure of the weekly report to be prepared by Customs for the ATO (referred to in paragraph 6.21) to provide assurance that weekly settlement entries are correctly matched to a corresponding payment. Further, there was no evidence to indicate that such an arrangement was in place.

**6.25** The ANAO found also there were no procedures in place to undertake any system reconciliations, despite the manual entry of data at several stages in the process. Discussions with the ATO indicated that there were several instances where excise items were incorrectly coded in the QSP<sup>85</sup> system. There were also instances identified where customs duty payments were incorrectly entered as excise duty payments.

**6.26** The ATO relies on the revenue collections data when monitoring revenue collections and its accuracy is important in providing assurance on the excise collection function.

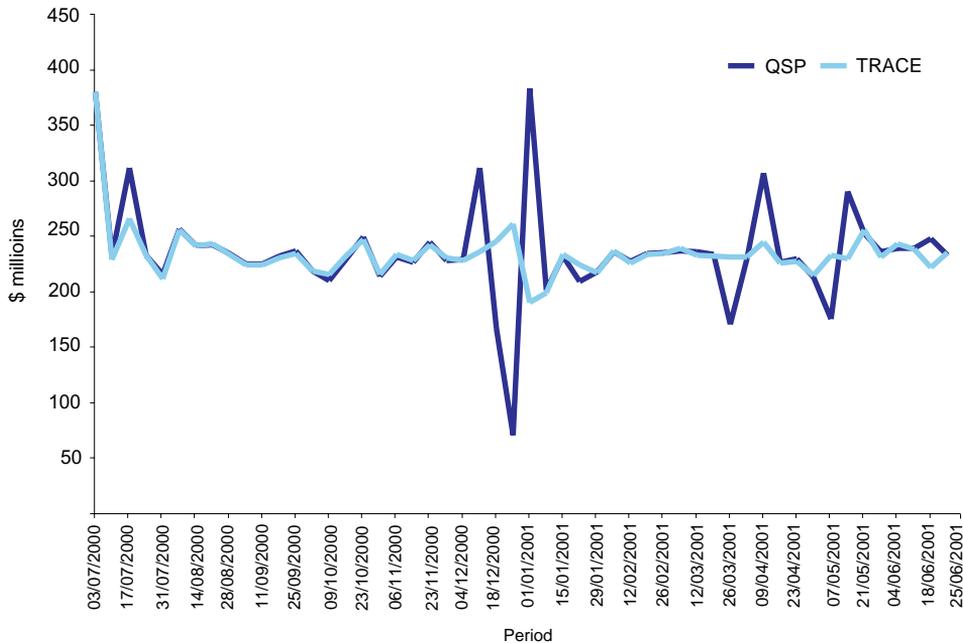
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<sup>85</sup> Custom's corporate accounting system which is where all revenue is receipted.

**6.27** The ANAO analysed the variations between the QSP and TRACE<sup>86</sup> data in year 2000–01. Figure 6.5 shows significant variations between the data in a number of weeks.

**Figure 6.5**

**Variations between QSP and TRACE petroleum excise revenue collections data**



**6.28** The ATO advised that while some of these variations are caused due to timing differences,<sup>87</sup> a number of these variations can be attributed to incorrect entries in Customs' TRACE and/or QSP systems (referred to in paragraph 6.25). While these errors largely have impact on the integrity of data rather than on revenue, it requires a significant investment of time and effort to rectify these errors. The ATO has acknowledged that only significant variations are followed up with Customs (i.e. those approximately \$10 million or above). Therefore, without the added assurance of manual and system reconciliations there is a greater exposure to smaller discrepancies remaining undetected.

<sup>86</sup> Custom's reporting system which holds all information entered from the Nature 40 returns.

<sup>87</sup> A timing difference occurs when a Nature 40 return is lodged on the 30<sup>th</sup> or 31<sup>st</sup> of a given month and the QSP is updated in the following month.

**6.29** The ANAO notes that the ATO is accountable for the revenue collection function, with Customs currently assuming the role of a service provider. Nevertheless, the onus is on the ATO to ensure it can provide complete assurance on the integrity of the excise revenue collection processes and on the effectiveness of the revenue collection function. However, the delays in finalising the MOU (discussed in Chapter 2) between the two agencies and the temporary nature of the current arrangements have led to some revenue collection controls (referred to in paragraph 6.22) not being implemented to provide this assurance.

**6.30** The ATO is in the process of developing its new Excise Revenue Collection System (discussed in the following section) and recognises the weaknesses in the current revenue collection process. However, in the meantime, it is important that the ATO ensures that it can provide the necessary assurance on both the integrity and effectiveness of the excise revenue collection function.

**6.31** Customs has advised that in response to the concern over procedural consistency for reconciliations of excise collections, it will issue a direction to its cashier staff to ensure nationally consistent application of published reconciliation procedures associated with excise collections.

## **Recommendation No. 8**

**6.32** The ANAO recommends that, in order to provide the necessary assurance on the integrity and effectiveness of the excise revenue collection function, the ATO should strengthen existing controls relating to excise revenue collection arrangements with Customs.

### *ATO response*

**6.33** Agreed. The ATO has taken steps to strengthen revenue collection arrangements with Customs, including development of stronger administrative processes to minimise the inherent risk.

## **Revenue collection arrangements—future**

**6.34** In August 2000 the ATO initiated its Excise Collections System (ECS) Project (to build an excise revenue collection system) with a view to implementing the new system from 1 July 2001. The ATO advised that the implementation timetable has taken a setback, due to use of new technology and the need to take account of ATO wide issues in development of the new systems. The initial proposal to integrate the project with the Excise Equivalent Goods Project (discussed in Chapter 2) was also a factor that has contributed to the delay. The new system is currently scheduled to commence from 1 July 2002.

**6.35** The ATO identified a number of imperatives in developing its own system to support excise collections and identified a series of benefits to clients, itself and the Government. These are listed at Appendix 9.

**6.36** A broad review of the Project documentation indicates that the ATO has in place a sound 'system under development' approach and methodology. Discussions with the PEIG have indicated regular consultation to ascertain industry group requirements. The ANAO also noted that the weaknesses in the revenue collection process identified by the ECS Project Team in reviewing the current system, were similar to those identified by the ANAO (in paragraph 6.24). The ECS Project team also identified a number of inefficiencies in the process, which it proposes to address in the new system. The ATO has estimated that the ECS Project is to be implemented at a cost of \$2.711 million.

**6.37** The ANAO supports the ATO's ECS Project and considers that given the business imperatives and prospective benefits, all efforts should be made to ensure that the revised timetable is adhered to.

## Revenue monitoring and analysis

**6.38** As excise duty is self-assessed, strong and effective monitoring mechanisms are required if budgeted excise revenue estimates are to be achieved.

**6.39** Similarly, timely analysis of revenue trends will:

- identify the reasons for any variations from estimated revenue;
- assist in determining strategies to address those reasons that are within the ATO's control; and
- contribute also to the revenue estimation process.

**6.40** Petroleum excise revenue is currently monitored by the ATO on a number of fronts. The Revenue Analysis Branch (RAB) monitors all ATO revenue collected against the overall Budget or MYEFO estimates. In addition the Revenue and Intelligence Branch within the EBL monitors and analyses petroleum excise collections on a regular basis, as part of its overall responsibility to administer excise collections. The specific role of these two areas is discussed separately below.

### Revenue Analysis Branch (RAB)

**6.41** RAB plays a significant role in analysing and monitoring revenue collections against budget estimates. It prepares a monthly report, which analyses all revenue collections to date. The report is classified as a PROTECTED document and is prepared for the ATO Executive, with copies also forwarded to Treasury.

**6.42** In its March 2001 monthly report, RAB prepared a detailed attachment analysing the petroleum base, (and tobacco collections) to the end of February 2001. This is because the petroleum base collections to end of February 2001 were substantially below the Budget (\$588m [7%]) and MYEFO profile (\$349 million).

**6.43** The report undertook substantial data analysis from various aspects such as:

- weekly clearances of petrol and diesel by financial year for the last three years;
- petrol clearances vs. bowser prices rate and crude oil prices, attributing the increase in bowser prices to change in world crude oil prices and the fall of the Australian dollar; and
- the effect of the Olympics and the airline price war, and industry comments on petroleum demand.

**6.44** However, the report does not quantify the impact of these factors which would be expected for performance assessment purposes. The ATO has argued that quantification of variations is always an implicit part of the estimates' process. While such a model can be useful in quantifying reasons for divergence from estimates 'after the event', unanticipated drivers of changes in demand may still occur. The ATO has acknowledged that it did not anticipate the size of the consumer response during 2000–01 to price rises in what had previously been seen as an inelastic demand for petroleum products.

**6.45** The ANAO considers that the analysis undertaken by RAB was sufficiently detailed to support the development of the 2001–02 Budget estimates. Quantifying, where possible, the relative impact of factors contributing to a change in trend patterns would aid in improving future excise revenue estimates.

## **Revenue and Intelligence Branch—EBL**

**6.46** Within the EBL petroleum excise collections are monitored on weekly,<sup>88</sup> monthly, and quarterly bases. The Revenue and Intelligence Branch liaises closely with RAB in providing advice to EBL Executive on reasons for significant variations from estimates. Based on its analyses of monthly excise data, the Branch contributes to the EBL's monthly performance reports that form part of the ATO's governance arrangements (referred to in Chapter 2).

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<sup>88</sup> Excise Collections are monitored also by senior ATO Executive through the ATO's Revenue Reporting System (alternatively referred to as the Commissioner's Daily Cash System). The system is maintained within RAB and access to the system is limited to senior ATO Executive. The system maintains on a daily basis summary data by head of revenue (in case of excise the revenue information would be updated on a weekly basis in accordance with the excise collection pattern). The system also includes monthly target information.

**6.47** Within the Branch, the PEIG is primarily tasked with ensuring budgeted petroleum excise revenue is collected and researching reasons for any shortfalls. PEIG monitors revenue collection patterns by:

- individual petroleum products to assess the domestic clearance trends and determine any trends emerging in imported petroleum products;
- clients (large, medium and small) to compare their clearance levels to their individual permission limits; and
- consumption pattern of all petroleum products in all three categories (that is, full excise rate, concessional and duty free), to determine whether duty free or concessional product is being unlawfully diverted to be used in an internal combustion engine.

**6.48** Based on its monitoring activity, the PEIG prepares quarterly monitoring reports for the EBL Excise Leadership Team (ELT). The ANAO noted that these reports had been prepared for a number of years even prior to the transfer of function from Customs.

**6.49** The ANAO noted that the reports have a broader focus than progress against revenue estimates. They were comprehensive in providing an insight into the activities of the PEIG, and had a strong compliance focus. The PEIG plans its compliance activity based on the quarterly monitoring process.

**6.50** The ANAO considers that PEIG reporting can be further improved to explore in more detail reasons for any significant variations in the revenue pattern by the petroleum products and clients. The reports include a number of charts and statistics. They, however, are not adequately analysed and possible factors contributing to these trends are not identified.

## Recommendation No. 9

**6.51** The ANAO recommends that, in monitoring and analysing revenue collection trends, the ATO should quantify, where possible, the impact of factors contributing to significant variations in revenue trends. This could result in a better understanding of the extent of impact associated with each factor, and would aid in improving future excise revenue estimates.

### *ATO response*

**6.52** Agreed. While the ATO does monitor and analyse petroleum revenue collection trends there is scope for further improvement.

## Excise exemption

**6.53** Remission and refunds are the two main circumstances under which excise duty is exempted.

**6.54** Products are cleared excise duty free or at a concessional rate (\$0.07 cents per litre) under certain circumstances referred to as remission. Remission Certificates are issued by the PEIG to those 'end-users' who can demonstrate to the ATO their legitimate need for unmarked<sup>89</sup> fuel 'for other use', that is, not as fuel in an internal combustion engine.

**6.55** Currently, end-users are required to apply for a remission certificate on company letterhead and required to include a number of details.<sup>90</sup> During client consultations the ANAO was informed that companies would prefer if the ATO developed standard application forms for Remission Certificates (similar to licensing forms). This would enable the companies to provide their prospective clients (who were seeking to purchase a duty free petroleum product from them) with the standard application forms, thus making the process more efficient.

**6.56** A refund means that excise duty that has been paid is returned to the owner. Refunds are paid pursuant to section 78 of the *Excise Act 1901*.<sup>91</sup> Most refunds fall into the following categories:

- where fuel is used to manufacture explosives;
- bunker levels which cover vessels entering and leaving Australia, as well as private use fuel for which excise is paid but the fuel is used outside Australia;
- manifest error (that is, a company may have over-paid); and
- refunds relating to vapour recovery units.<sup>92</sup>

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<sup>89</sup> Following the implementation of the marking regime in 1998, a number of organisations approached the Government claiming that they required access to petroleum solvent not containing the marker. Therefore, industry groups such as the pharmaceutical, veterinary, food stuffs, paint etc were granted Remission Certificates.

<sup>90</sup> Details required to be submitted when applying for a remission certificate include: the Australian Business Number of the applicant; the name of the product; whether remission is sought on bulk or drummed petroleum products; the price per litre; the frequency of deliveries; the intended end-use; the quantity needed per annum; the flash-point of the product; and the name and address of the supplier.

<sup>91</sup> The *Excise Act 1901* (at section 79) provides also for drawback of excise duty paid. A drawback applies to excisable goods that have been entered into home consumption and that are subsequently exported without being altered. The goods may be combined with other goods but must retain their essential form

<sup>92</sup> Petroleum products such as gasoline, and to a lesser extent diesel, are very volatile and give off large amounts of vapour. When liquid hydrocarbons are unloaded into a storage tank at a service station, the displaced vapour from the underground tank is collected in the empty barrel of the road tanker. The vapour must be captured as it is illegal in most states of Australia to release them into the atmosphere. When the empty road tanker returns to the terminal to refill, the vapour captured in the barrel is vented to the Vapour Recovery Unit (VRU). A VRU reconstitutes the hydrocarbon back into a liquid form. As the reconstituted petroleum product is returned to an underbond tank and is a derivative of a duty-paid product; upon return to a warehouse, it is deemed to be eligible for a refund of the excise duty previously paid.

**6.57** Remission and refund circumstances are prescribed in Excise Regulation 50(1). There are currently 46 different excise refund/remission circumstances.<sup>93</sup> Remissions and refunds are both processed by the PEIG.

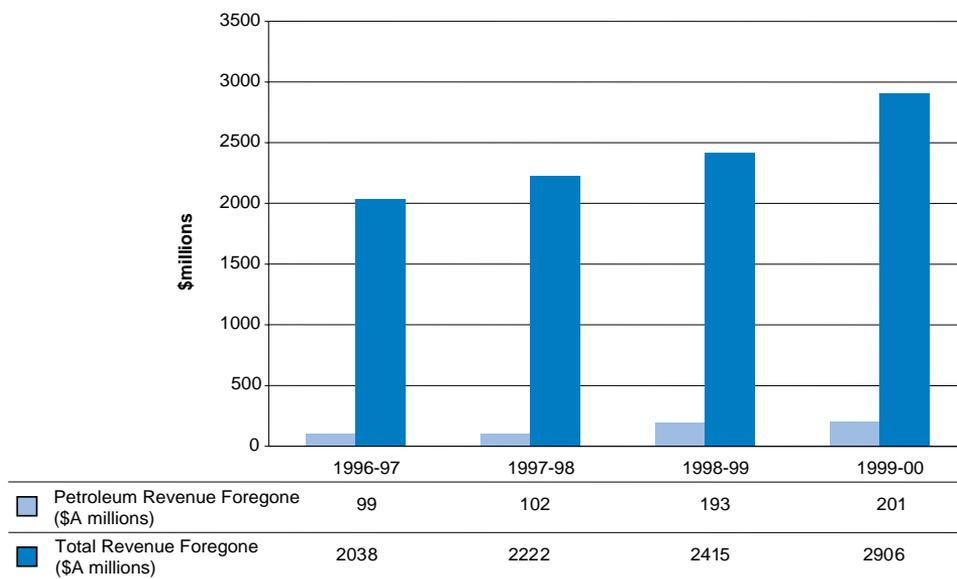
**6.58** The ATO uses the term ‘revenue foregone’ when referring to products that are cleared duty free, that is those products that, effectively, attract a zero rate of excise. The ATO calculates revenue foregone by multiplying quantity of product cleared free of duty by the full duty rate for the product. Monitoring revenue foregone through remissions and refunds is an integral aspect of the excise revenue management process.

**6.59** Figure 6.6 shows revenue foregone for petroleum products as a proportion of total revenue foregone for all excise products. It shows that petroleum products comprise a small proportion of the total revenue foregone (4–8 per cent) in the last five years.

**6.60** The ANAO found that the PEIG is effectively administering the system of refunds and remissions. The Excise Industry Procedures Manual details the procedures to be followed and the PEIG regularly monitors the remissions and refunds statistics. The ANAO was advised that a small customer-base for refunds enables the PEIG to adequately monitor this area. The PEIG also schedules ongoing compliance activity to ensure compliance with the remission conditions (discussed in Chapter 7).

**Figure 6.6**

**Petroleum revenue foregone compared to total revenue foregone<sup>94</sup>**



Source: ANAO depiction of ATO data

<sup>93</sup> A number of refunds/remissions have sunset clauses in relation to the period they operate with 5 of these circumstances requiring a lodgment of the claim within a 12-month period. The remaining circumstances are open-ended and are not subject to any time limit other than a statute of limitation.

<sup>94</sup> Revenue foregone figures for 2000-01 were not available within the ATO as at October 2001.

## Conclusion

**6.61** The ANAO acknowledges the complexity of the revenue estimates process and considers that there was adequate evidence to indicate that the formulation of 2000–01 excise revenue estimates was a consultative process, involving relevant areas of the ATO. Treasury’s and the ATO’s commitment to reviewing their revenue forecasting methods in a systematic and ongoing basis should improve the rigour and accuracy of the revenue estimates process.

**6.62** The ANAO notes that the ATO is accountable for the revenue collection function, with Customs performing the role of a service provider. Nevertheless, the onus is on the ATO to ensure it can provide the necessary assurance on the integrity and effectiveness of the excise revenue collection function. However, the delays in finalising the MOU between the two agencies and the temporary nature of the current arrangements has led to some revenue collection controls not being implemented to provide this assurance.

**6.63** The ANAO notes that petroleum excise revenue is currently monitored by the ATO on a number of fronts. In 2000–01 due to the downward trend in petroleum excise revenue collections, the ATO’s Revenue Analysis Branch played a significant role in monitoring and analysing petroleum excise revenue collections against estimates. While substantial analysis was undertaken from various aspects to identify factors contributing to the downward trend, quantifying where possible, the impact of these factors, would provide a better understanding of the extent of their impact.

**6.64** Similarly there is further scope to improve the level of analysis undertaken in the quarterly reports prepared by the PEIG. The reports include a number of charts and statistics, but these are not adequately analysed and possible factors contributing to trends are not identified.

**6.65** The ANAO considers that the ATO is effectively managing the system for petroleum excise remissions and refunds.

# 7 Revenue Leakage

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*This chapter examines the issue of fuel substitution, as one of the primary factors contributing to revenue leakage. The ATO's initiatives to address fuel substitution are also discussed.*

## Introduction

**7.1** Excise on petroleum products has been levied historically at different rates depending on the intended end use of the product, and this is still the case. Products intended for use as transport fuels in an internal combustion engine, for example unleaded petrol, attract an excise rate currently around 38 cents a litre. Heating oil, by contrast, attracts an excise rate of around seven cents per litre (when it is intended to be used as a fuel other than in an internal combustion engine), while toluene,<sup>95</sup> if used in the paint industry, effectively attracts a zero rate of excise.

**7.2** The concessional rates mechanisms also tempts some manufacturers/dealers to exploit it by making false or misleading claims about their use of a petroleum product. The principal form of excise evasion is entry into home consumption of concessional products with subsequent use of those products in higher taxed applications. Because they result in revenue leakage, these practices impact on revenue collection.

## Fuel substitution

**7.3** With retail fuel sales being extremely competitive and margins for resellers narrow, there is an enormous incentive for operators to seek to evade excise. Fuel substitution is a primary means of evading excise. It involves some operators adding products, which attract a nil excise rate or a concessional rate, to petrol or diesel, thus increasing their profit margins. Fuel substitution is a type of fraud that not only results in a loss of excise revenue but also may damage the vehicle engines of unsuspecting motorists and distort the petrol/diesel market.

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<sup>95</sup> Toluene is a petrochemical that is used as a solvent in paints, adhesives, ink and cleaning agents. However, some 92 per cent of toluene used in Australia is added to petrol by manufacturers legitimately in order to improve the petrol's octane rating.

7.4 In 1997, Customs initiated legislative changes (*the Fuel (Penalty Surcharges) Administration Act 1997*) by establishing the marking system whereby concessional products were generally available only if a chemical marker was added. The manufacturer must be licensed for excise purposes to manufacture fuels attracting a concessional rate. The use of the marker was to enhance detection in instances where fuels, which attracted little or no excise, were blended with or substituted for higher excise petrol or diesel. The legislation also set out record-keeping requirements and created a new penalty and offence regime.

7.5 This regime was successful for a short period,<sup>96</sup> but fuel substitution soon began to increase again. The method of enforcing the use of the marker did not prove to be very successful.<sup>97</sup> There were technical issues in the drafting of the *Fuel (Penalty Surcharges) Administration Act 1997*. As a result Customs found that it was extremely difficult to mount successful prosecutions.<sup>98</sup>

7.6 The ANAO analysed initiatives taken by the ATO to address this problem and assessed the current magnitude of this problem. The industry perspective and initiatives currently under way by stakeholder organisations with regard to fuel quality were also analysed.

## ATO measures

7.7 The ANAO found that the ATO has implemented a number of legislative measures to address fuel substitution. These measure have included:

- introducing a new tariff structure in February 2000 (*Excise Tariff Amendment Act [No. 1] 2000* and the *Customs Tariff Amendment Act [No. 1] 2000*) to eliminate the excise-free status of marked petrol and diesel products that were being substituted for or blended with full rate products.<sup>99</sup> All petrol and diesel products (other than recycled products) are now subject to the same rate of excise as that which applies to fuel used in internal combustion engines in motor vehicles;

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<sup>96</sup> In June 1998, these measures were described by the Government as 'very successful ..[resulting in increased revenue of] of around \$10 million a month (Excise Tariff Amendment Bill (No. 1) 2000 (Bills Digest 123 1999-2000), p. 3.)

<sup>97</sup> see: Senate Economics Legislation Committee *Report*, Petroleum Excise Amendment (Measures to Address Evasion) Bill 2000, August 2000.

<sup>98</sup> There were problems with the definition of 'fuel' as specified in the legislation.

<sup>99</sup> The Excise Tariff was amended to remove sub-items for marked gasoline and diesel, as well as gasoline and diesel in containers of less than 210 litres for uses other than fuel. It was alleged that substantial quantities of diesel and petrol were being declared into home consumption by certain licensed excise manufacturers as drummed product for use other than as a fuel at a free rate of duty and then being decanted back into bulk for sale as transport fuel. In addition the quantity of petrol and diesel containing the chemical marker and hence declared into home consumption duty free was far above any reasonable explanation.

- further amending the *Petroleum Excise Amendment (Measures to Address Evasion) Act 2000* in September 2000 to minimise excise evasion; and
- further amending the blending provisions<sup>100</sup> in the *Excise Tariff Act 1921* and Excise Regulations. The amendment revoked the exempt blend status of any clean petroleum product with methanol.

**7.8** To complement the legislative measures, the ATO has also undertaken a series of administrative measures. These are briefly discussed below.

### **Establishing permission limits**

**7.9** When *Excise Tariff Amendment Act (No. 1) 2000* was passed to address the revenue evasion problem, additional administrative measures were introduced to limit fuel substitution. The ATO revoked and reissued Weekly Settlement Permissions granted under section 61C of the Excise Act. The new permission allows the sale of duty free diesel, however, the company is required to meet certain conditions.<sup>101</sup>

**7.10** As a result of these arrangements, a company is liable to pay excise duty, if it supplies duty free diesel to a customer that does not have the appropriate remission certificate. The ANAO noted that when introducing the new administration arrangements, the companies were advised that to enter the product correctly for a concessional purpose they are required to have a 'reasonable understanding' of the end use of the product.<sup>102</sup>

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<sup>100</sup> In 1993, blending provisions were inserted into Excise legislation, that made blending of petroleum products with other products a process of manufacture. Accordingly the process was subject to both licensing under the *Excise Act 1901* and to payment of further excise duty on components of the blend on which the appropriate duty has not already been paid. At the same time certain blends of petroleum products were exempted from the blending arrangements so those producing such blends would not require licensing as excise manufacturers or payment of further excise upon production.

<sup>101</sup> The new continuing permissions are designed to protect the revenue by:

- providing details of products covered by the permission;
- providing the amount of product which may be delivered; and
- providing that entries of unmarked duty free diesel and low flash point (gasoline and other petroleum or shale spirit have a flash point of less than 0 degrees Celsius and are referred to as low flash point products) solvent must be on-sold to remission certificate holders only.

<sup>102</sup> The ATO wrote to all companies who entered products for use as a fuel other than in internal combustion engine. The companies were advised that with the introduction of new tariff provisions, the ATO anticipated that products such as marked heating oil and kerosene would be targeted as potential sources of excise evasion. Therefore, additional requests for these products were to be scrutinised to determine what the customer intended to use the product for.

## **Monitoring and analysis of permission limits**

**7.11** The PEIG continually analyses the limits imposed on the entry of product into home consumption through its system of permissions. This includes:

- examining the volume limits for legitimate clients and increasing these when it is satisfied that the supply to legitimate clients has been restricted<sup>103</sup>;
- monitoring clearances of high risk products through its quarterly reporting process; and
- requesting companies to provide an explanation of their understanding of the customers' end use of the particular product.

**7.12** As a result of this monitoring activity the PEIG may initiate a compliance audit to assess the validity of sales made to certain customers. This is discussed in the following section.

## **Compliance activities**

**7.13** The ANAO noted that the PEIG programmed a number of compliance audits in 1999–2000 and 2000–01 to assess compliance with the legislative and administrative measures. The compliance audits targeted the following areas in relation to fuel substitution:

- validity of remission certificate holders to check end-use; or
- analysis of records of companies dealing with concessional products to assess compliance with permissions, which included underbond movement of goods; or
- validity of sales made to certain customers.

**7.14** The ANAO noted that, if the ATO found that a company sale through a distributor to a third party could not be properly accounted for, in terms of end-use of the product, the ATO could not directly pursue recovery of lost excise revenue from the company that entered the product. In these circumstances the ATO had to pursue the excise duty liability directly with the party involved. Companies have claimed that where deliveries have been made to recognised distributors and retailers of petroleum products and not the end users of the product, it is not possible for them to obtain information about the end use of the product. The following example illustrates this issue.

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<sup>103</sup> The ATO advised that examination of increasing volume limits takes place before existing volume limits are reached so that clients do not lose business, while awaiting approval.

**7.15** In June 2000, the ATO found that in the period December 1999 to March 2000, sales of heating oil by Company A to Company B were particularly high. This was identified as a result of a compliance assessment of sales of heating oil made by Company A (who declared the product to the ATO). The ATO requested the customer details from Company A and on following-up the matter found that Company B's sales to Company C failed to comply with the Excise requirements and the sales could not be satisfactorily accounted for. Company C advised that a total of 1.2 million litres of heating oil was sold on a cash basis to an unidentified man. Therefore, pursuant to section 161 of the Excise Act 1901, ATO issued a demand for payment to Company A, on the basis that the goods were entered for home consumption without entry under a permission.

**7.16** Company A disputed the demand for payment on a number of grounds:

- it had no control over what its customers actually do with the heating oil they acquire, especially if the customer is a third party;
- the excise legislation does not give any guidance on the requirement a person must fulfil prior to being satisfied that goods have entered for home consumption;
- it received no directions from the ATO on the documentary evidence necessary to support home consumption entry; and
- the ATO has not specified its requirements with regard to supporting evidence that needs to be retained or requested from customers.

**7.17** In August 2000, the ATO advised Company A that it would pursue the excise duty liability through other avenues. The ANAO was advised that the case was referred to Excise Investigations in June 2001, some 10 months since the issue was identified.

**7.18** Monitoring clients' compliance with permissions is clearly necessary. However, the ATO should ensure that it is supplemented with detailed specifications of compliance requirements, such as, necessary documentary evidence that is to be retained by companies to provide relevant assurances. As well, where compliance activity identifies a breach, it is important that there is no delay in undertaking the necessary follow-up action if the ATO is to maximise the potential to recover excise duty lost. Chapters 4 and 5 commented on the excise compliance audit and investigation processes.

## Fuel testing

**7.19** The ATO is also addressing the issue of fuel substitution through targeted investigations activity, which largely relates to undertaking fuel testing. *The Petroleum Excise Amendment (Measures to Address Evasion) Act 2000* took effect on 26 October 2000 and provides a better legislative framework than under the Customs regime for prosecuting excise evaders involved with fuel substitution.

**7.20** The fuel testing conducted by the Excise Investigations unit uses five capital city-based purpose-equipped vehicles that were transferred from Customs with the excise function in 1999. These vehicles (see Figure 7.1) are supplied with chemical reagent kits and other relevant equipment. These facilities provide for 'roadside' testing of fuel samples drawn covertly to ascertain if the samples contain marked fuel.<sup>104</sup>

**Figure 7.1**

**Fuel testing truck**



Source: ATO

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<sup>104</sup> If the covert sampling and testing returns a positive sample, that is, that the sample reacts with the chemical reagent to indicate that a marked product is present in the sample, then overt action is taken such as:

- seeking and executing a search warrant;
- requesting a full professional analysis of additional fuel samples obtained overtly; and
- advising the retailer "that it is an offence to further blend marked fuel with other fuel, that such fuel cannot be sold for use in internal combustion engine and that any sale of marked fuel must be invoiced with appropriate end-use provisions clearly indicated."

**7.21** The ATO has developed draft investigations operational guidelines relating to fuel substitution. The guidelines include details on the fuel sampling and testing process; the vehicles to be used in undertaking these tests; the evidence handling process and the investigation and audit powers available to ATO officers. However, the guidelines are out of date and do not reflect recent legislative changes (October 2000) and do not contain an investigation strategy or a risk management approach to address fuel substitution matters.

**7.22** Nevertheless, there were interim National Director's (Investigations) instructions issued on '*Procedures Re Taking of, Analysis, Movement and Storage of Fuel samples*'. As well, Excise Investigations staff conducting fuel testing have received training in fuel sampling procedures and in Occupational Health and Safety requirements for the handling of fuel.

**7.23** At the present time, the tests conducted by the ATO concentrate on testing samples of diesel fuel as the marked concessional fuels—heating oil and kerosene—can be used as blends with diesel.

**7.24** Currently, no regular testing is being conducted on unleaded or lead replacement petrol, which attract the highest rate of excise. However, tests can be conducted on such products (for example, to test for methanol<sup>105</sup> in petrol which constitutes an offence under sections 117(1) and/or 117(B) of the Excise Act, or for the presence of ethanol in petrol; testing procedures and facilities are also available to test for such products as canola oil in diesel).

**7.25** In March 2001, as a one-off initiative, the ATO visited four sites and took samples of unleaded petrol from each site. These tests were undertaken to check the presence of methanol, but results were inconclusive. The ANAO noted that the EBL is seeking to develop further its fuel testing techniques in order to identify clearly whether methanol is present in test samples.

**7.26** At the time of the ANAO's audit field work, from the date of effect of the *Petroleum Excise Amendment (Measures to Address Evasion) Act 2000* the Investigations unit had conducted 101 tests nationally which had revealed 4 cases of a product containing the chemical marker being found in diesel. In these cases prosecution was being considered. The ANAO notes that the first successful prosecution relating to misuse of marked fuel (under the Crimes Act) concluded on 17 April 2000.

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<sup>105</sup> Until 28 July 2000, methanol could be blended with petrol without attracting excise on the methanol component. An amendment to the *Excise Regulations* effective from 29 July 2000 removed the excise-free status of blended methanol making excise payable on the full volume of the blended product.

**7.27** The ANAO notes also that the ATO excise investigations unit subsequently had conducted a major fuel testing program between April and June 2001 (the ATO tested 702 ‘high risk’ sites, with nine positive results). Amongst other things, this addressed the large number of referrals that had been forwarded to Investigations by the PEIG. The table in Appendix 10 illustrates the extent of fuel testing conducted within the ATO since the transfer from Customs of the Excise Investigations unit, and the fuel testing trucks, in July 1999.

**7.28** The ANAO understands that the ATO is keen to adopt a systematic approach to fuel substitution and that it does not necessarily consider fuel testing to be an appropriate long-term strategy. The ATO advised that based on 2000–01 fuel testing results the ATO is assessing whether it should attribute resources to a strategy that makes a negligible impact on the risk.

**7.29** The ANAO supports the development of a systematic approach but considers that a field presence, which includes fuel testing initiatives, should be an inherent element of this approach and would contribute to maintaining the risk at a ‘negligible’ level.

**7.30** Subsequent to the audit fieldwork the ANAO was informed that the EBL has decided to transfer the responsibility for conducting fuel testing to the Excise Compliance Teams. The ANAO is not in a position to report on the effectiveness of this move, as implementation had not occurred before the conclusion of our audit fieldwork. However, unless additional authorisations or delegations are made for compliance team members to exercise powers associated with such matters as warrants, the involvement of investigations staff, who hold such powers already, will be mandatory at particular stages of the testing process.<sup>106</sup>

## **Recommendation No. 10**

**7.31** The ANAO recommends that, as part of its fuel substitution strategy, the ATO should supplement its compliance and investigation activities with measures such as:

- specifying detailed client compliance requirements to assist in assessing compliance and enabling appropriate and timely remedial action by the Petroleum Excise Industry Group; and
- updating and finalising the draft fuel testing procedures to ensure maximum leverage for the Excise Business Line from its fuel testing activities.

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<sup>106</sup> That is, in particular, if a positive test result is obtained on a sample drawn by compliance staff, and warrant action is required.

### *ATO response*

**7.32** Agreed. The PEIG spends considerable resources ensuring its clients are aware of their compliance obligations and often embarks on re-education programs when the major clients have staffing changes. The ATO intends to be more visible in its testing procedures, ensuring community confidence and tracing the source of the blending offence. The draft fuel testing procedures have been updated and finalised.

## Quantification of revenue leakage

**7.33** The ANAO noted that in December 1996 when Customs was proposing to implement the *Fuel (Penalty Surcharges) Administration Act 1997*, it undertook a strategic assessment of diesel fuel substitution. Customs quantified the maximum potential loss of revenue due to diesel fuel substitution to be at \$46.6 million in 1995–96. Customs acknowledged that this figure was based on conservative assumptions about fuel use and industry trends.<sup>107</sup> Substitution was then considered to be confined to concessional heating oil, concessional fuel oil, duty free heating oil, duty free kerosene and duty free diesel. After the marking regime was introduced in 1998, Customs claimed that it had noted an increase in petroleum excise revenue in the order of \$10 million each month, which is equivalent to \$120 million per annum.

**7.34** In November 1999, the ATO estimated revenue lost through fuel substitution activities. The estimate was undertaken to determine the impact of the measures undertaken in November 1999 in relation to changes in the excise Tariff. Based on its analysis, the ATO acknowledged that while it was difficult to estimate, up to \$100 million may have been lost in the 12 month period prior to 15 November 1999. It therefore estimated the gain from the new tariff measures to be in the order of \$100 million. The revenue estimate was based on the assumption that fuel substitution activities would be eliminated after the date of implementation of *the Excise Tariff Amendment Act (No. 1) 2000*.

**7.35** The ATO presently rates fuel substitution as second only to illegal tobacco among its revenue risks in excise collections. It recognises that there is a continuing risk that parties involved in this activity will continue to look for other ways to avoid excise. When one avenue is closed or made economically unattractive, excise avoiders and excise evaders turn to other sources of product. However, since November 1999, the ATO has not undertaken an exercise to quantify its exposure to fuel substitution activities.

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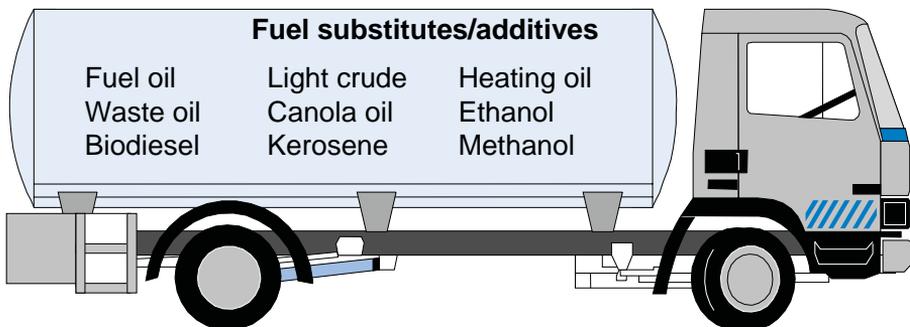
<sup>107</sup> Customs used data from Australian Bureau of Statistics, Australian Bureau of Agriculture and Resource Economics reports and Bureau of Transport and Communication reports.

**7.36** The ANAO noted that the ATO has reviewed on an ad hoc basis some exempt blend products.<sup>108</sup> For example, PEIG has initiated a review of methanol and ethanol and of possible fuel substitutes, such as canola oil. However, the ATO had not undertaken any initiative to quantify its exposure to fuel substitution activities or to identify its strategic objective in countering fuel substitution. The ATO has advised, that as with the size of the ‘black economy,’ the quantum of revenue lost through fuel substitution is not amenable to precise estimation. The ATO further considered that the task of producing an estimate is exacerbated by the separation between the ATO and the Customs of control over imported versus locally manufactured product. Estimates of revenue loss vary considerably but indicatively could be \$30 million per annum or higher.

**7.37** The ANAO acknowledges that revenue lost through fuel substitution is not amenable to precise estimation. However, the ANAO considers that the ATO should systematically assess, on an ongoing basis, its exposure to fuel substitution activities. This would require it to determine the extent of the problem, to undertake cost-benefit analyses of different revenue loss targets, and to formulate strategies to address this issue.

**7.38** As noted in Chapter 6 the actual petroleum excise revenue collection for 2000–01 was \$539 million below 2000–01 Budget revenue estimates. While the ANAO recognises, as noted in paragraph 6.10, that the variation can be attributed to a number of factors, the ATO does not attribute any variation to fuel substitution activity. The ANAO considers that the ATO should systematically analyse its exposure to fuel substitution activity as a possible factor contributing to the downward variation in revenue collection. Figure 7.2 lists examples of the range of possible fuel substitutes/additives that were brought to the ANAO’s attention during the course of the audit.

**Figure 7.2**  
Possible fuel substitutes/additives



Source: ANAO depiction of ATO information.

<sup>108</sup> When that proportion of product blended with clean petroleum product is not excisable.

**7.39** The ANAO notes that ethanol<sup>109</sup> (ethyl alcohol<sup>110</sup>) is currently considered as a potential excise revenue risk. A blend of ethanol and petroleum products is prescribed in the Excise Regulations as an exempt blend. Such blends of petroleum products are only subject to excise that has already been paid on the petroleum product and not on the whole blend. The nature of ethanol is such that it is normally blended with gasoline (petrol).

**7.40** Currently, there are no specifications in the legislation to restrict the proportion of ethanol in fuel blends.<sup>111</sup> Some companies have indicated to the ATO that they are currently blending up to 10 per cent of ethanol with petroleum. While the ATO is monitoring this area and the production of fuel ethanol which has significantly increased (by 51% between 1995–96 and 1998–99 and by 94% between 1998–99 and 1999–2000) in the last few years, it has not quantified its exposure to revenue loss or assessed the revenue implications.

**7.41** The ANAO therefore considers that it is important for the ATO to utilise its business intelligence processes (referred to in Chapter 2) to consolidate its fuel substitution strategy.

## Recommendation No. 11

**7.42** The ANAO recommends that to consolidate its fuel substitution strategy the ATO should systematically assess its exposure to fuel substitution activities with a view to fully determining the extent of the problem and formulating appropriate strategies to address the issue. This would include:

- identifying all the possible substitutes for diesel and petroleum;
- determining the possible revenue implications or potential exposure to revenue loss if any of the identified substitutes are used; and
- reviewing existing strategies or developing new strategies to limit exposure to revenue loss.

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<sup>109</sup> Ethanol (ethyl alcohol) is produced largely from fermentation of sugars or starches from, eg, grain or wood products. Currently there are two major producers of ethanol within Australia.

<sup>110</sup> Ethyl alcohol is the constituent in alcoholic drinks and is excisable; however, when denatured (denatured ethyl alcohol contains a poisonous substance, such as methyl alcohol or benzene, which makes it unfit for human consumption) it is used as a fuel, or as a solvent, reagent, etc.

<sup>111</sup> The petroleum industry does not have a uniform position on the excise treatment of ethanol. A number of other industry bodies (Australian Biofuels Association) strongly support the continuing excise exempt status of ethanol blends.

## *ATO response*

**7.43** Agreed in principle. The ATO agrees with the intent of this recommendation. It is continually working to improve its strategies for dealing with the fuel substitution issue and for limiting exposure to revenue loss. The ATO will do what it can to quantify the revenue risk in this area. The ATO considers that its strategies are aimed at curtailing fuel substitution with revenue loss being a very minor consideration, with risk to public safety being at the fore.

## **Industry perspective**

**7.44** Key industry stakeholders hold the view that fuel substitution continues to be a primary component of widespread evasion of excise. The industry recognises that the ATO has undertaken a number of initiatives to address this issue, however, it considers that it is still widely prevalent. The increasing prices of fuel are providing an increased incentive for evasion.

**7.45** The industry considers that to fully address this problem all concessional excise rates should be removed, thus removing any advantage or incentive to illegally sell excise-free product. The Australian Institute of Petroleum<sup>112</sup> (AIP) made this recommendation to a Parliamentary Committee on behalf of its member companies in a submission titled *Supplementary Paper on Excise Matters* in April 1999, and has since then canvassed this view through a number of forums.<sup>113</sup> The AIP is proposing that all relevant petroleum products should pay excise at the standard rate with an expanded refund/rebate system put in place to protect legitimate users. This mechanism would make the marking scheme (still prevalent for heating oil and kerosene) redundant.

**7.46** The ANAO understands that a sub-committee of the Petroleum Liaison Committee (a consultative body chaired by the Treasury that includes Commonwealth Departments and agencies and petroleum industry stakeholders) formed in May 2000, continues to examine this option.

**7.47** If such a strategy is being considered the recommendation referred to in paragraph 7.42 would directly contribute to the above exercise in providing a cost/benefit perspective.

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<sup>112</sup> Representing largely the four major petroleum refiner-marketer companies.

<sup>113</sup> For example, AIP's submission on *Technical Implementation Issues relating to A New Tax System (Goods and Services Tax) Bill 1998*.

## Liaison with stakeholder organisations

**7.48** As discussed above, the ATO is consulting the industry on a strategic solution to fuel substitution issues. Other government organisations that have a role to play in this area are Customs (due to its continuing responsibility for excise equivalent goods) and Environment Australia (responsible for implementing the fuel standards legislation). The ATO's liaison arrangements with these two agencies are discussed below.

### Customs

**7.49** Chapter 2 discusses the nature of the ATO's strategic partnership with Customs. When implementing the new excise tariff changes in November 1999, both the ATO and Customs were aware that entities that were then engaged in fuel substitution may seek to exploit new legislation by importing the fuel used for substitution activities. The ATO and Customs liaised for a number of months to make appropriate administrative arrangements in relation to imported toluene (as a result of excise tariff changes in November 1999, toluene manufactured locally was excisable, however, it could be imported duty free under the Customs legislation).

**7.50** In March 2000 changes were made to the *Customs Tariff Act 1995* to combat illicit fuel blending activities, involving toluene. In a media release then, the ATO stated that 'even if all toluene imported in the last three and half months were used in fuel substitution—and clearly it has not been—the total amount of excise evaded involved would be less than \$10 million.

**7.51** Subsequent to the toluene issue, Customs acknowledged the need to establish a small Working Group to work through options and identify solutions to overcome fuel substitution. A Working Group was established in March 2000 to address a series of issues in relation to risks of revenue evasion and avoidance, which included resolving ATO concerns surrounding the importation of potential substitutes.

**7.52** Due to differences between the two agencies on the handling of excise equivalent goods (EEGs, discussed in Chapter 2), the Working Group made limited progress on its terms of reference and was disbanded in March 2001. However, as mentioned in paragraph 2.46, the two agencies have agreed on Joint ATO/Customs compliance arrangements for excisable goods and EEGs.

**7.53** For this model to be implemented, there are a number of issues yet to be resolved. These relate to administration of licensing and duty free stores.<sup>114</sup>

**7.54** Customs further advised that subsequent to the toluene issue, the Petroleum Centre of Expertise (COE) was also established within Customs. The COE works closely with the PEIG in the ATO. Customs now maintains profiles<sup>115</sup> against imported potentially substitutable goods. The COE liaises with the ATO prior to passing entries that hit these profiles. The COE reports on its activities on a monthly basis to Customs Central Office. Customs advised that the reports have indicated minimal importations of substitutable product by 'at risk' importers for some time.

**7.55** Customs is therefore of a view that the current arrangements are effective. Customs has also streamlined procedures and coordination arrangements between the agencies in relation to the implementation and administration of the two tariffs.<sup>116</sup>

**7.56** The ANAO acknowledges these initiatives, nevertheless, there are implications of possible revenue leakage, if the import policies and procedures relating to EEGs are not consistent with excisable goods. Therefore, it is important that the ATO and Customs finalise the joint compliance strategy in relation to excisable and EEGs to ensure a coordinated approach to fuel substitution problem. This strategy, once finalised, should form an explicit element of the Memorandum of Understanding to be finalised between the two agencies (see Recommendation No.2 in Chapter 2).

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<sup>114</sup> The ATO places limitations on issuance of licences whereas Customs legislation does not parallel some of the limitations. Provisions exist for duty free stores in both Customs and Excise legislation.

<sup>115</sup> Under current arrangements, products included in a Customs' profile are 'red lined' and the ATO is contacted and advised that the shipment has arrived and whether any further action should be taken prior to giving authority to deal. The profiling arrangements were put into place in November 1999.

<sup>116</sup> Customs advised that unlike the Excise Tariff the classification of goods to the *Customs Tariff Act 1995* is made in accordance with the Harmonised System. The Harmonised System is an international agreement on the classification of imported goods. The System imposes a range of rules on the way goods are classified according to their characteristics at the time of importation, not end use. The ATO is not bound by such rules for goods manufactured under the excise legislation as this occurs within the Australian jurisdiction. Where goods are potentially substitutable, a delicate balance needs to be maintained between protecting the revenue and the interest of legitimate users. Where on balance the interests of the legitimate users outweigh the revenue risks an EEG rate is not applied to those tariff items. However, these tariff items are closely monitored in liaison with the ATO through the profiles mentioned in paragraph 7.54 to ensure that potential revenue leakage is minimised.

## Environment Australia

**7.57** As part of a uniform approach to regulate standards for fuel and fuel additives for related purposes, the *Fuel Quality Standards Act 2000* (the Fuel Act) was passed on 21 December 2000 and proclaimed to commence fully from 1 January 2002. Mandatory national fuel quality standards for petrol and diesel will come into effect from that date. The Department of Environment and Heritage (Environment Australia [EA]) is responsible for administering the Fuel Act.

**7.58** EA advised that it will assume responsibility for coordinating fuel testing arrangements under the Act, by instituting service level agreements with the States and Territories. EA will undertake fuel testing from 1 January 2002, with a voluntary pilot project to commence outside the Fuel Act in late 2001.

**7.59** The ANAO considers that both the ATO and EA can benefit from each other's fuel testing activities and should formalise its existing arrangements to enable both agencies to maximise their benefits from fuel testing initiatives.

**7.60** EA agrees with the ANAO that both the ATO and EA can benefit from each other's fuel testing, as well as from their other monitoring, compliance and enforcement activities. EA, however, understands that legislative amendments are necessary to enable the ATO to cooperate with EA in this regard. EA further states that it would welcome the early introduction of the necessary amendments to the relevant legislation administered by the ATO.

## Recommendation No. 12

**7.61** The ANAO recommends that the ATO formalise its arrangements with Environment Australia on the implementation of fuel quality standards, to enable both agencies to maximise their benefits from fuel testing initiatives.

### *ATO response*

**7.62** Agreed. The ATO considers that some fuel substitution that is an offence under the excise legislation, has little or no impact on fuel quality, for example diversion of heating oils into the diesel market. Conversely, activities which are perfectly lawful under the excise arrangements may cause concerns for fuel quality, for example high concentration ethanol blends.

**7.63** Further, the excise legislation provides no head of power for the ATO to pursue fuel quality issues. The ATO testing regime in place is directed under the legislation to detection of marked fuels.

**7.64** In the longer term the ATO is not convinced of the value of a routine testing program for marked fuels. The ATO believes that the administrative actions already taken to restrict access to marked fuels have had much greater impact on fuel substitution than the testing program. Further, the ATO is currently developing proposals that would make the marker regime, and consequently its testing program, redundant.

**7.65** However, the ATO notes that the program being developed by EA may produce information which is relevant to excise compliance. Consequently the ATO will be seeking to develop formal arrangements for information exchange as appropriate.

## Conclusion

**7.66** The ATO has taken a number of legislative and administrative measures to address fuel substitution. The ATO presently rates fuel substitution as second only to illegal tobacco among its revenue risks in excise collection. The ATO acknowledges that parties involved in this activity continue to look for ways to avoid excise. This suggests a continuing level of risk, which requires active managing.

**7.67** However, the ATO has not systematically quantified its exposure to fuel substitution activities nor identified its strategic objective in countering fuel substitution. The ATO has advised, that as with the size of the 'black economy,' the quantum of revenue lost through fuel substitution is not amenable to precise estimation. The ANAO recognises that revenue lost through fuel substitution is not amenable to precise estimation. However, the ANAO considers that the ATO should systematically assess its exposure to fuel substitution activities with a view to determining the extent of the problem and formulate appropriate strategies to address the issue.

**7.68** There is also scope for the ATO to supplement its compliance and investigation activities with measures such as:

- specifying detailed client compliance requirements in assessing compliance and enabling appropriate and timely remedial action by the PEIG; and
- updating and finalising the draft the fuel testing procedures to ensure maximum leverage for the EBL from its fuel testing activities.

**7.69** The ATO could also benefit from formalising its arrangements with other stakeholder organisations such as Environment Australia in its involvement in implementing fuel quality standards.

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A handwritten signature in black ink, appearing to read 'Ian McPhee', written in a cursive style.

Canberra ACT  
26 October 2001

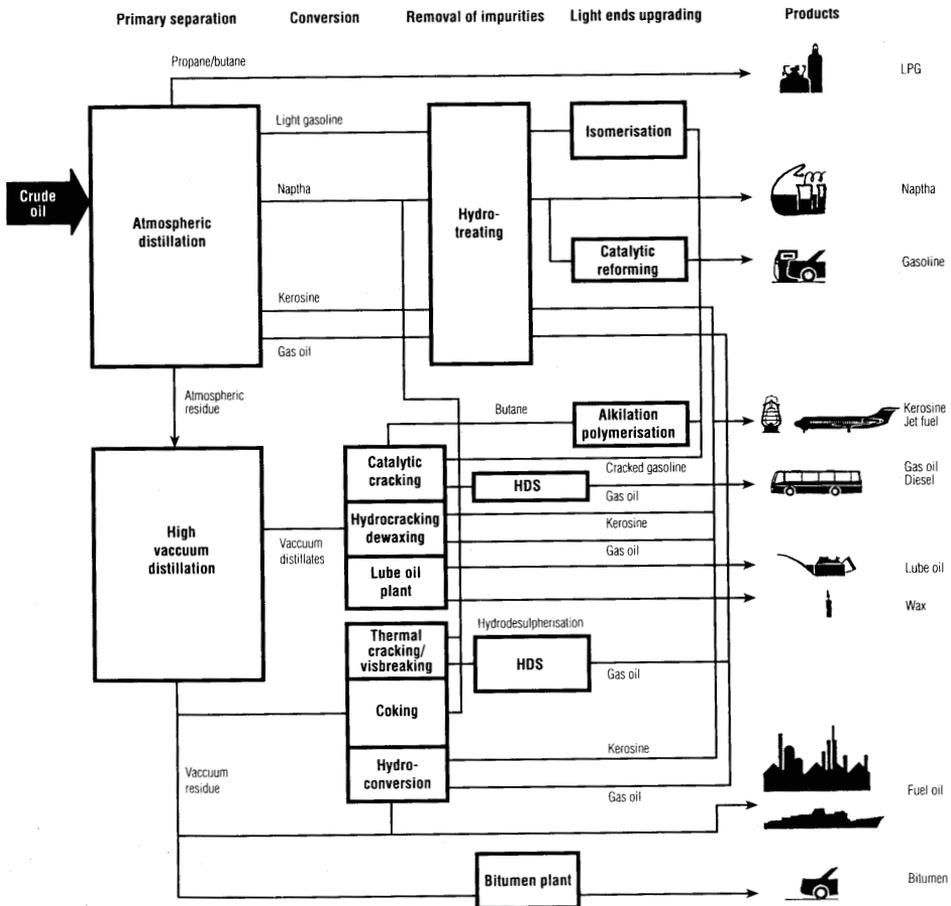
IanMcPhee  
Acting Auditor-General



# Appendices



# Appendix 1: Elements of a typical refinery



Source: Australian institute of Petroleum 1997, *Australia's Oil Industry*, AIP Melbourne, Figure 3.1, p. 16.

## Refinery processes

<i>Refinery Process</i>	<i>Description</i>
<b>Distillation</b>	In this process, the different boiling points of individual crude oil components are utilised to separate light and heavy components ('fractions').
<b>Catalytic cracking</b>	In catalytic cracking, a catalyst of the silica/alumina type is used to break down large hydrocarbon molecules to yield a high proportion of gasoline. The feedstock for these units is usually residues, from other parts of the refining process, or, rarely, a naturally occurring heavy petroleum feedstock.
<b>Catalytic reforming</b>	Catalytic reforming is a hydrogenation and aromatisation process used to produce high octane gasoline from naphtha. <sup>117</sup> Catalytic reforming is also a source of aromatics for use as solvents or as intermediates in chemical manufacture.
<b>Alkylation</b>	Alkylation is the process of chemically combining two gases such as butylene and isobutane to form high octane gasoline.
<b>Treating</b>	Treating removes sulphur and other contaminants from the various product streams.
<b>Blending</b>	Individual products from the processing units are blended to produce finished products.

Source: Australian Institute of Petroleum 1997, *Australia's Oil Industry*, AIP Melbourne, p. 17.

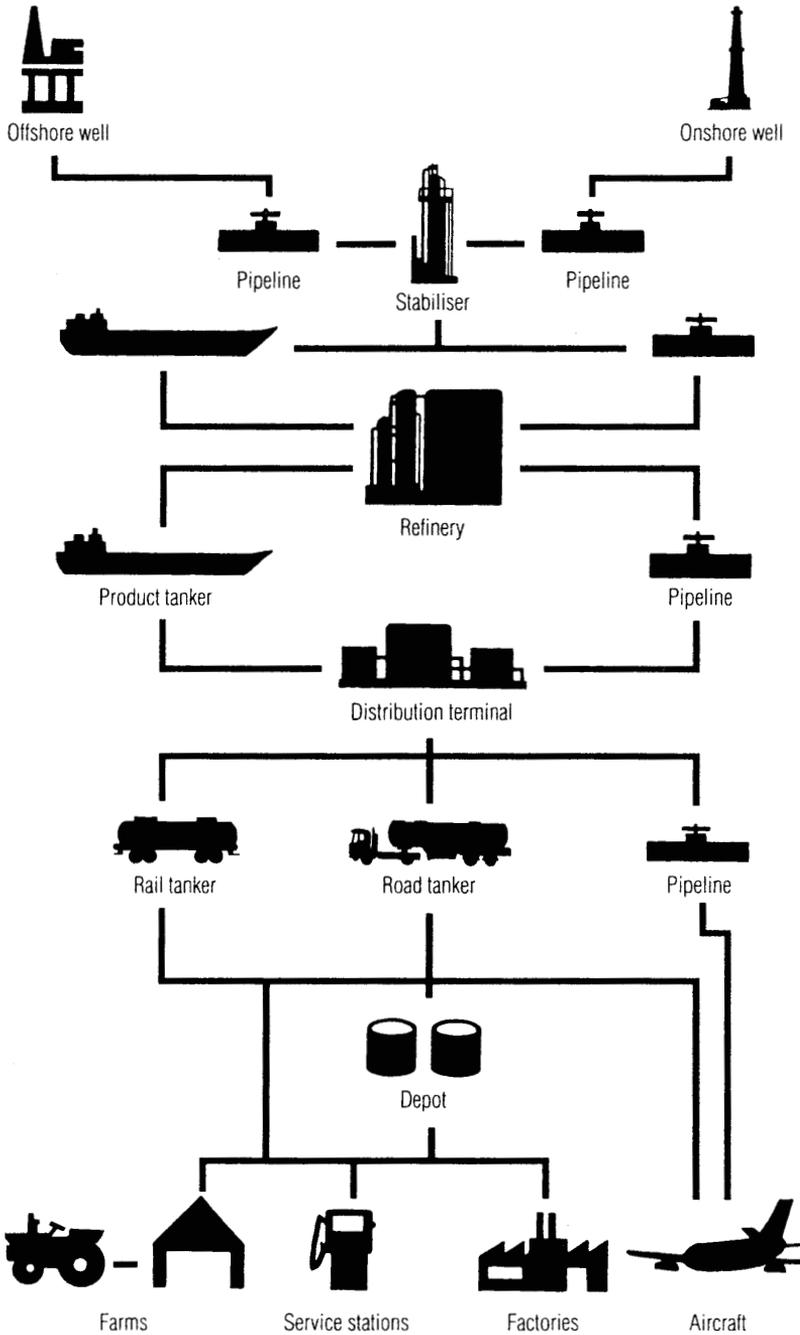
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<sup>117</sup> A volatile, colourless liquid obtained from petroleum distillation; used as a solvent in the manufacture of paint, as dry-cleaning fluid, and for blending in producing gasoline.

**Appendix 2:**

**Distribution network of petroleum products**

**Petroleum products: distribution network from producer to consumer**



Source: Australian Institute of Petroleum 1997, *Australia's Oil Industry*, AIP Melbourne, Figure 4.3, p. 24.

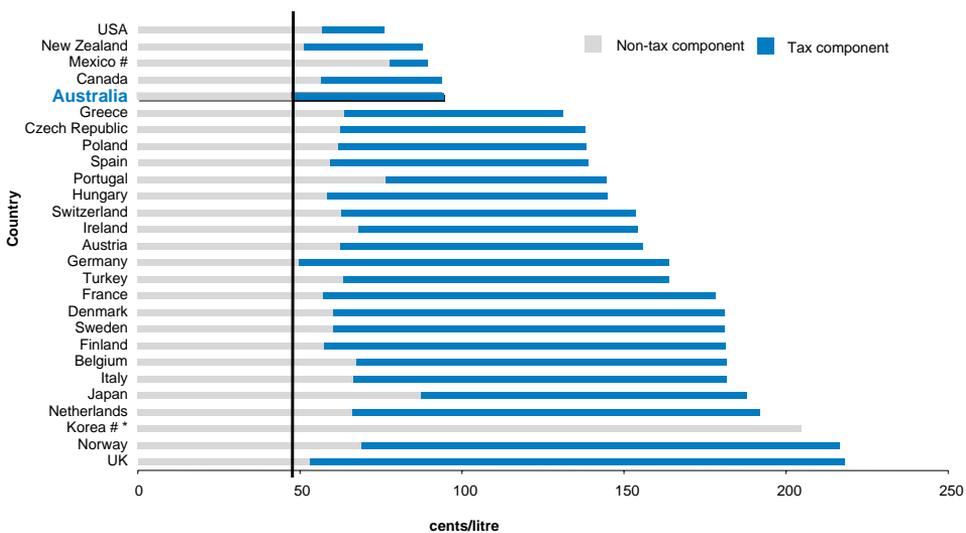
### Appendix 3:

## Comparison of international petrol prices

1. The data that the International Energy Agency has used to create the comparison of petrol prices and taxes shown in the figure below reveals that Australia had the lowest ex-tax<sup>118</sup> price for its petrol in the OECD during the December Quarter 2000 (47.7 cents per litre), as shown by the vertical line in the Figure, against an average cost of the product less tax for all of the 27 countries of 61.8 cents per litre.

2. Further, on the basis of the data relating to these OECD countries, the average tax rate applied to petrol in these 27 OECD countries in the December Quarter 2000 was 46.9 per cent of the selling price (49.5 per cent in Australia).

### Comparison of international petrol prices (as at December Quarter 2000)



# Previous quarter

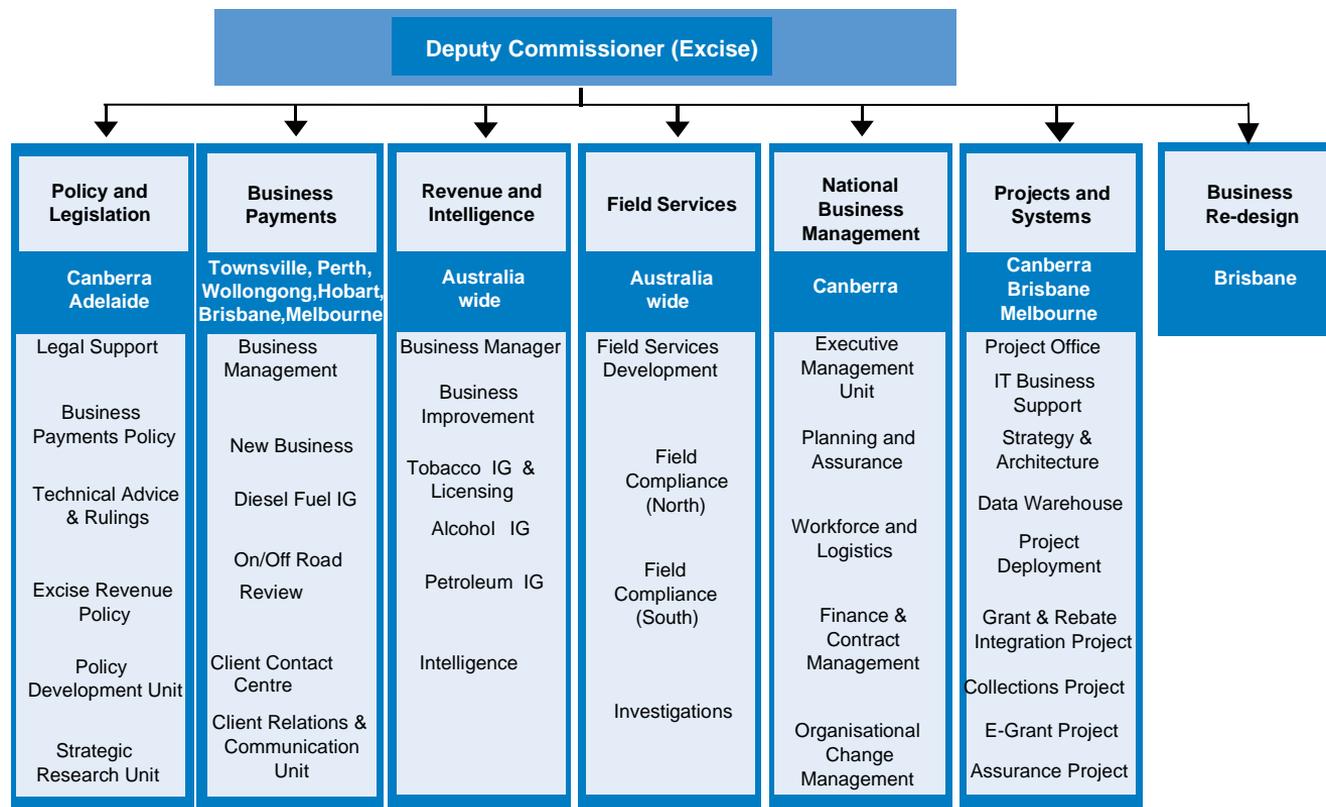
\* Tax component not available

Source: ANAO depiction of information supplied in DISR 2001, *Australian Petroleum Statistics*, Issue No. 56, March, Table 8A and Chart 8A, pp. 24–25

<sup>118</sup> The price of a product when the tax component of the selling price is not included.

## Appendix 4:

### Excise Business Line—Organisation Structure



IG: Industry Group

Source: ANAO depiction of ATO information

## Appendix 5:

### Excise licences and permissions

1. There are two types of licences and three types of permissions that are relevant to petroleum excise licensing arrangement. These are separately described below.

#### Excise manufacturer's licence

2. This licence is issued under section 39 of the *Excise Act 1901* and authorises a licence holder to manufacture specific excisable petroleum products in the premises specified on the licence. In 1993, the requirement to hold a manufacturer's licence was extended to blending activities. That is, all refineries, service stations and other businesses that blend petroleum and oil products were required to be licensed and to pay duty on the blended substances at either the diesel or the petrol excise rate.<sup>119</sup>

3. In 1998, further legislative changes relating to marking<sup>120</sup> provisions in the fuel substitution legislation [*Fuel (Penalty Surcharges) Administration Act 1997*] resulted in an increase in other companies requiring licences. Solvent distributors have traditionally supplied product to the paint and similar industries that require unmarked product. They may also blend thinners using products such as toluene, white spirit and mineral turpentine. As blending is considered to be manufacture, companies involved are required to be licensed under section 25 of the *Excise Amendment (Compliance Improvement) Act 2000*.<sup>121</sup> Similarly, paint manufacturers also manufacture thinners for both the trade and retail market and have been granted licences.

4. At the time of the audit, an excise manufacturer's licence was required to be renewed on an annual basis, requiring payment of a nominal annual licence fee of \$10. In responding to the ANAO's proposed report, the ATO advised that it had received policy approval to amend the Excise Regulations to provide for the fee for licences to be zero.

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<sup>119</sup> *Excise Tariff Amendment Bill (No. 1)2000* (Bill Digest 123 1999-2000), p. 3 of 6.

<sup>120</sup> In 1998, as part of its initiative to combat fuel substitution the Government introduced fuel substitution legislation which requires the addition of a chemical marker, Mortrace MP, to 'concessional fuel' (that is fuel such as heating oil and kerosene which attracts a lower rate of excise duty, or solvents which attract no duty). The process of adding the prescribed marker to concessional products occurs before the products enter the distribution system. Fuel for internal combustion engines, such as fuels sold at service stations, should never contain the marker.

<sup>121</sup> ATO Petroleum Seminar 2000, p. 3.2

## Excise storage licence

5. This licence is issued under section 39 of the *Excise Act 1901* and allows a licence holder to store in the premises specified on the licence specific excisable products that are the property of the licence holder or of another person/company and on which duty has not been paid.

6. Major oil companies have a network of sites around Australia where products from refineries are moved underbond.<sup>122</sup> The major oil companies also supply duty paid fuel to distributors to ensure their products are accessible in most locations. Distributors do not have section 39 licences and therefore they cannot store underbond product.<sup>123</sup>

7. An excise storage licence does not require annual renewal and is exempt from any fee.

## Statistics

8. The following table shows the number of storage and manufacturer's licences currently issued. The ANAO requested licensing statistics on storage and manufacturer's licence for the last four years, but was advised that the current licensing system was difficult to manipulate and the data would have to be compiled manually which would be very resource intensive.

### *Excise storage and manufacturer licences (number)*

Type of Licence	2000–01
Storage	159
Manufacturers	196

## Weekly Settlement Permission (WSP)

9. This term applies to a permission holder that has been granted authority under section 61C of the *Excise Act* to deliver certain goods, as specified on the WSP, into home consumption for a period of seven days without having to lodge an entry or pay the excise duty liable.

<sup>122</sup> 'Underbond' means that the excise duty has not been paid on these goods and they remain the responsibility of the licensee. Underbond goods can be moved between licensed premises (bonds). The duty liability of these goods transfers to the receiving bond once the goods are received and written into the records of the bond. Therefore, whilst the goods are in transit between bonds, the transferring owner remains liable for their safekeeping.

<sup>123</sup> Petroleum Seminar, op. cit., p. 3.2

**10.** All the petroleum companies pay duty under the weekly settlement scheme. Under this scheme the permission holder may deliver into home consumption any goods covered by their permission. The main advantage of this scheme to industry is that it allows the owners of the goods to receive up to a week's credit by deferring the duty payment. A further advantage to the industry and the ATO is that a week's deliveries can be summarised on a single document.<sup>124</sup>

**11.** Clients who wish to avail themselves of this facility, must submit a written request for a WSP to the ATO. There is no application form. Most WSP requests are made at the same time as a licence application. Requests for WSPs are to be processed within seven days of receipt, in accordance with the ATO's client service standards.<sup>125</sup>

**12.** These permissions are not required to be renewed on an annual basis, but require amendment when there is a change in the conditions specified in the permission.

#### Single Transaction Permission (STP)

**13.** An STP issued under section 61A of the Excise Act allows the 'one-off' movement of underbond excisable goods from one licensed premise to another licensed premise as specified on the permission. Each time goods are moved underbond an STP application form is required to be lodged with the ATO. Decisions on STPs are to be made within one day of receipt of a correctly completed application.<sup>126</sup> While goods are moved underbond they remain the responsibility of the licensee. The duty liability for these goods transfers to the receiving bond once the goods are received and written into the records of that bond.

#### Continuing Permission (CP)

**14.** This permission is also issued under section 61A of the Excise Act. It allows the movement of goods underbond on a regular or continuing basis between licensed premises as specified on a schedule to the CP without the need to approach the ATO for individual authority in each case.

**15.** A CP does not require an annual renewal. Once approved it remains valid unless any amendment or deletions on the schedule are required. Clients who wish to amend their CPs are required to lodge the application in writing. Requests for CPs are to be processed within seven days of receipt in accordance with the ATO service standards.<sup>127</sup>

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<sup>124</sup> *ibid.*, p. 3.4

<sup>125</sup> *Excise Industry Procedures Manual*, Petroleum Licensing Issue and Maintenance of Licences, pp. 3,4 of 6.

<sup>126</sup> *ibid.*, p. 4 of 6.

<sup>127</sup> *ibid.*, p. 5 of 6.

## Appendix 6:

### Excise risk treatment types

Risk Treatment No.	Description
1	<b>National audit:</b> a comprehensive coordinated audit of a company covering all of its relevant operations Australia-wide.
2	<b>Comprehensive audit:</b> an audit of all of the relevant activities of a company within a particular State or throughout Australia.
3	<b>Focussed audit:</b> a one-off examination of a specific activity or transaction in a company.
4	<b>Monitoring by performance indicators:</b> a method of monitoring compliance through analysing actual company and industry data against expected data and identifying reasons for any discrepancies.
5	<b>Monitoring by visitation/liaison:</b> could involve visiting a premise to ensure that the systems are still in place, that new legislation or regulations are explained, or previous audit recommendations are followed up.
6	<b>Monitoring by profiling:</b> involves intercepting real time transactions to ensure compliance: under current processing arrangements, requires liaison with Customs; profiles can require actions ranging from simple collection of information to the withholding of goods from processing, pending resolution of any ATO concerns.
7	<b>Examination and verification:</b> involves detailed physical inspection and the establishment and documentation of truth, through focussed inspection and/or compliance and substantive testing.
8	<b>Leverage exercises:</b> encourages clients to check compliance independently of audit, through use of press releases, advertising campaigns, mail-outs, issue of leaflets or surveys; monitoring of industry trends prior to and post the leverage exercise provides an indication of its effectiveness and may identify areas or targets for alternative risk treatments.
9	<b>Analytical research/intelligence gathering:</b> utilises any information that is relevant and normally available from within the EBL, from other business lines or external sources; can involve the collection, assessment, manipulation and analysis of intelligence information; used in audit planning, monitoring and identifying risk areas where audit can be focussed.
10	<b>Client Education:</b> in accordance with the ATO objective of self-assessment on the part of clients, aimed at assisting excise payers to understand relevant laws and regulations and hence comply; utilises information campaigns, seminars, field visits, ATO publications; articles in professional and industry publications and media releases.
11	<b>Policy, procedural and legislative change:</b> changes can be introduced when benefits to clients and/or to compliance would result.

## Appendix 7:

### Status of petroleum compliance activities

#### Status of petroleum compliance activities 1999–2000 and 2000–01 (to 10 October 2001)

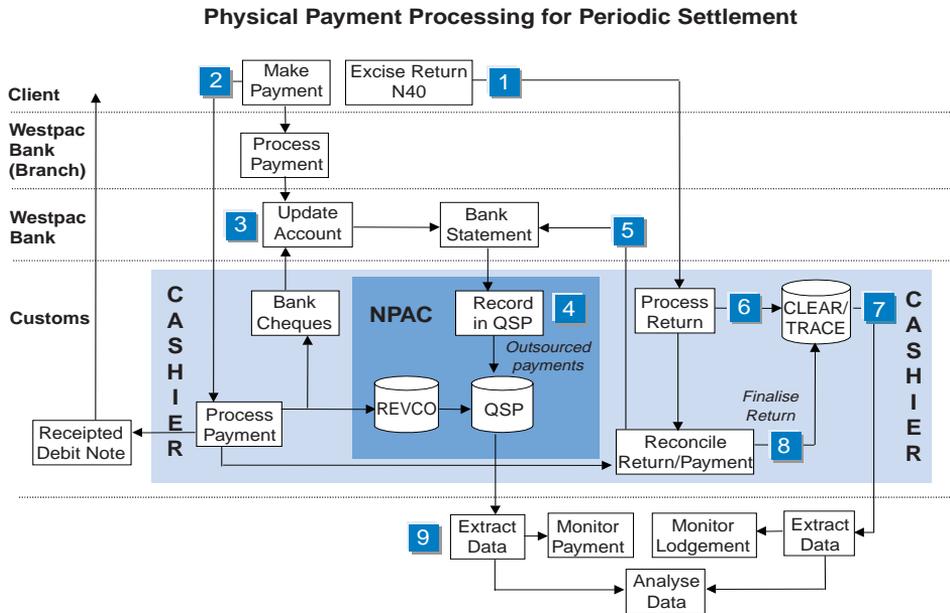
Risk Treatment Type	1999-2000					2000-01				
	No. of Compliance Kits* Issued by the PEIG	Completed No.	Outstanding No.	Completed %	Outstanding %	Number of Compliance Kits Issued	Completed No.	Outstanding No.	Completed %	Outstanding %
<b>Comprehensive Audit</b>	6	2	4	33.3	66.7	2	2	0	100	0.0
<b>Focussed Audit</b>	180	175	5	97.2	2.8	49	34	15	69.4	30.6
<b>Monitoring by Visitation/ Liaison</b>	6	5	1	83.3	16.7	6	4	2	66.7	33.3
<b>Examination/ Verification</b>	22	20	2	90.9	9.1	13	11	2	84.6	15.4
<b>Education</b>	2	2	0	100.0	0.0	1	1	0	100.0	0.0
<b>Total Activities</b>	<b>216</b>	<b>204</b>	<b>12</b>	<b>94.4</b>	<b>5.6</b>	<b>71</b>	<b>52</b>	<b>19</b>	<b>73.2</b>	<b>26.8</b>

\* Compliance kits are described from paragraphs 4.23 to 4.28 of the report.

Source: ANAO depiction of ATO data

## Appendix 8:

# Excise revenue collection process



**1** All major excise clients who have an excise liability are required to lodge their ‘Nature 40 Entry’ return with Customs each week. This form details the deliveries of excisable goods into home consumption and the amount of excise duty that is payable.

**2** The amount of excise self-assessed by the company is paid into Customs’ Excise Settlement Account<sup>128</sup> via an electronic funds transfer (EFT) (by the majority of clients). Where payments are made via cheques, these are received by a Customs cashier into the REVCO<sup>129</sup> system and banked into the relevant Customs account.

**3** The Bank updates Customs’ Excise Account overnight with all EFT payments and these payment transactions are recorded on a Statement of Account.

<sup>128</sup> Prior to 1 February 2001, excise payments were directly transferred to Customs’ excise account in the Reserve Bank. However, Customs has recently changed its banking arrangements and the payment is initially transferred to Customs’ Excise Settlement Accounts with the Westpac Bank (at the State Level), and overnight Westpac sweeps all deposits into the Commonwealth’s Official Public Account with the Reserve Bank.

<sup>129</sup> This is Customs’ commercial system into which payments are entered by all Customs cashiers.

**4** The following morning Customs' National Payment Account Centre (NPAC) accesses the Bank's Statement of Account on-line and prints it out. Details of this print are manually entered into Customs' QSP system.<sup>130</sup> Customs extract data from QSP on a weekly and monthly basis on behalf of the ATO's Information Management Group (Excise Canberra).<sup>131</sup>

**5** A copy of the Bank Statement of Account is faxed to the Cashier section of Customs in each region.

**6** The Cashier's section receives the Nature 40 from the client and enters details on to the 'Weekly Settlement and Cash Log'. This data is then manually entered into Customs' CLEAR<sup>132</sup> system.

**7** To ensure details entered are correct the Cashier's section reconciles the entry to the Bank Statement of Account received from NPAC.

**8** If the reconciliation is successful the Nature 40 entries are finalised in CLEAR and the data is automatically transferred to the TRACE system.<sup>133</sup> Customs' staff follow up any discrepancies that relate to calculation with the respective client.

**9** Customs liaises directly with the client in relation to any under/over payments (where a client has paid less or more than the amount entered on the Nature 40). The relevant Excise Industry Group within the ATO is informed if the amounts are significant or the discrepancies cannot be resolved with the client. The return is then finalised. The ATO staff are required to reconcile the TRACE data to the QSP data and resolve any discrepancies that may arise due to timing differences or incorrect processing of return.

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<sup>130</sup> This is Customs' corporate accounting system which is where all revenue is receipted.

<sup>131</sup> The Information Management Group also requests ad hoc QSP reports from Customs and combines this with information extracted directly from the TRACE system.

<sup>132</sup> This is a Customs commercial system into which all excise entries are entered. The CLEAR system conducts a validation of the input line information to detect any computation errors.

<sup>133</sup> This is Customs' reporting system. Some ATO excise staff are allowed access to this system to extract reports for payment monitoring purposes.

## Appendix 9:

### Benefits of the new Excise Collections System

#### ***Benefits associated with adopting a new Excise Collections System (ECS)***

1. The ATO considers the benefits to fall into three major categories:

- Benefits to clients;
- Benefits to the ATO; and
- Whole of Government benefits.

#### ***Benefits to clients***

2. It will provide improved case of client interaction. This will include:

- a web-based entry point that will not only provide a lodgement facility, but also a calculator to assist with providing the right answer;
- for clients with systems that can support business to government (B2G) information flows, there will be an ability to communicate directly with ATO systems—this should lead to long term cost benefits for the client;
- for all clients for whom direct credit payments are not economically viable, there will be an increased number of payment options;
- for both web and B2G lodgement the validation process will prevent the client lodging incomplete returns and reduce the need to return forms for correction; and
- links to registration will reduce the need for clients to input name and address data each time they lodge, as it will be completed automatically based on the Australian Business Number (ABN).

#### ***Benefits to the ATO***

3. These are varied, and will include:

- improving information management—the client information will be collected and stored in a more accessible format;
- automating some of the processes that will see a move away from low value-adding checking towards activities aimed at improving compliance and analysis of all aspects of Excise;
- providing the ATO with the ability to trial new technological options in a low-risk to collections environment;

- contributing to a wider ATO picture of the client (through the information collected), both in terms of the financial details recorded on the ATO's information systems, and more industry-specific details captured by the ECS;
- reducing the number of errors generated by the client completing returns by hand, and also errors resulting from incorrect manual input of data;
- enabling Excise to position itself to attract more business in the collections field; and
- ensuring that the ATO is complying with the Government directive that it provides clients with the option of interacting with Commonwealth agencies electronically.

### ***Whole of Government benefits***

4. These will be reflected in lower operating costs, and include:
- migrating excise collections information to enable Customs to shut down legacy systems that are nearly obsolete;
  - improving collection processes;
  - reducing the overall cost of collecting a dollar of Excise as direct credit is retained for large payers, and the ATO moves away from counter lodgement and payment for small to medium clients;
  - giving effect to the Government's intentions when transferring the responsibility for Excise from the Customs to the ATO; and
  - amalgamating fully Excise collections into an ATO legislative, human and systems environment—to help provide an ATO 'look and feel'.

## Appendix 10:

### Fuel testing

#### *Fuel testing—referrals, results and outcomes (to end June 2001)*

<i>Fuel Testing Action</i>	<i>1999–2000</i>	<i>2000–01</i>
<b>No. of Sites Referred</b>	Nil *	521 (from PEIG)
<b>No. of Sites Tested</b>	42	702
<b>No. of Positive Fuel Test Results</b>	8	9
<b>Action after Positive Fuel Test Results</b>	<ul style="list-style-type: none"> <li>• 1 finalised; 12 months imprisonment (3 charges);</li> <li>• 1 terminated on DPP advice;</li> <li>• 1 subject to further investigation on DPP advice;</li> <li>• 3 briefs being prepared, subject to further investigation; and</li> <li>• 2 briefs submitted, currently before the courts.</li> </ul>	<p>10 search warrants resulting in 11 investigations of:</p> <ul style="list-style-type: none"> <li>• 8 retailers</li> <li>• 3 distributors</li> </ul> <p><u>Progress:</u></p> <ul style="list-style-type: none"> <li>• 1 brief of evidence sent to DPP recommending prosecution;</li> <li>• 2 briefs of evidence to go to DPP recommending prosecution;</li> <li>• 2 terminated; and</li> <li>• 6 continuing investigations.</li> </ul>

\* The *Petroleum Excise Amendment (Measures to Address Evasion) Act 2000* took effect in September 2000; fuel testing referrals didn't commence until 2000–01.

Source: ANAO depiction of ATO data

# Abbreviations/Glossary

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AAO	Administrative Arrangements Order
AIP	Australian Institute of Petroleum
ANAO	Australian National Audit Office
ATO	Australian Taxation Office
barrel	a measure used by the oil industry for crude oil and oil products; equivalent to 42 U.S. gallons, 35 imperial gallons or 158.987 litres
canola oil	the oil extracted from canola, a variety of rapeseed.
CAR	Compliance Activity Report
CEO	Chief Executive Officer
CMIF	Compliance Management Integration Forum
CMS	case management system
concessional fuels	(non-transport fuel products) fuels that attracts a lower than full rate of excise duty, or that attract no duty
concessional rate	a lower rate of excise that is applied to particular commodities used for purposes other than the fully taxed use of such products
CP	Continuing Permission
crude oil	a mixture of hydrocarbons produced from an oil well as a liquid from natural underground reservoirs
crude oil excise	levied on production from all areas other than offshore areas subject to PRRT and Barrow Island; the excise rate applied to crude oil is based on both the quantity of crude oil sold (with the first 30 million barrels exempt) and the sale price, as well as on the discovery and development dates of the oil fields involved
Customs	Australian Customs Service
customs duties	duties that are imposed on imported goods
diesel	(diesoleum, diesel fuel, diesel oil, distillate, gas oil, ADO [Automotive Diesel Oil]); a petroleum fuel used in compression ignition engines including transport, industrial and marine applications

DISR	Department of Industry, Science and Resources
DPP	Director of Public Prosecutions
EA	Environment Australia (Department of Environment and Heritage)
EBL	Excise Business Line
ECS	Excise Collections System
ECT	Excise Compliance Team
EEGs	excise equivalent goods
EFT	electronic funds transfer
EIN	Excise Intelligence Network
ELT	Excise Leadership Team
entry into home consumption	in excise terms, occurs when a product has reached the end of the manufacturing process and has been released by the manufacturer into the market
ethanol	(ethyl alcohol, alcohol, fuel alcohol); a colourless, inflammable liquid produced from the fermentation of sugars or starches (obtained from, eg, grain or wood products) or by petrochemical processes; used as the constituent in alcoholic drinks and, when denatured, as a reagent or solvent or as a fuel, particularly in a blend with gasoline
excisable goods	goods on which Parliament has imposed excise duty
excise	a tax or duty that is imposed on certain goods that have been produced domestically
Excise Tariff	the rates of excise for excisable products as set out in the Schedule to the <i>Excise Tariff Act 1921</i>
exempt blend	that proportion of product blended with clean petroleum product that is not excisable
feedstocks	crude oil or other hydrocarbons that are the basic materials for a refining or manufacturing process; includes a chemical refined and manufactured from hydrocarbons and used to produce petrochemicals
FSB	Field Services Branch
fuel oil	heavy distillates, residues or blends of these, used as fuel for the production of heat or power; heavy boiler fuel

fuel substitution	involves the use of non-transport petroleum products, such as heating oils, kerosene, solvents, light crude oils and condensates, as transport fuels (gasoline and, most commonly, diesel). Substitution can involve the blending of the non-transport products with transport fuels, blending of a number of non-transport products or the direct use of a non-transport product as a transport fuel. These products are then sold fraudulently as genuine transport fuels in order to evade excise payment.
gasoline	(petrol, motor spirit, benzine); a refined petroleum distillate suitable for use as a fuel in spark-ignition internal combustion engines
GST	Goods and Services Tax
heating oil	a petroleum product used in domestic heating installations, having characteristics between kerosene and Automotive Diesel Oil; a substitute for diesel fuel
HOTSA	Health of the System Assessment
hydrocarbons	organic chemical compounds of hydrogen and carbon atoms
kerosene	a refined petroleum distillate used for lighting and heating and as a fuel for certain types of internal combustion and jet-turbine engines
LAPS	Licensing and Permissions System
LCGs	like customable goods
MAB/MIAC	Management Advisory Board/Management Improvement Advisory Committee
marker	a chemical added to concessional fuel; the chemical marker proscribed is Mortrace MP
methanol	(methyl alcohol); a colourless, flammable, poisonous liquid manufactured from a variety of carbon-based feedstocks such as natural gas or coal and renewable resources including agricultural and wood waste and biomass crops; used as a fuel or solvent
MOU	Memorandum of Understanding
MYEFO	Mid-Year Economic and Fiscal Outlook
natural gas	gaseous form of petroleum consisting of mixtures of hydrocarbon gases and vapours; produced from a gas well or in association with the extraction of crude oil from an oil well

'Nature 40'	Customs form detailing the delivery of excisable goods into home consumption and the amount of excise duty payable
NECP	National Excise Compliance Plan
non-transport fuels	(concessional petroleum products) products entered for home consumption at rates of excise duty less than the rate applied to transport fuels
OECD	Organisation for Economic Cooperation and Development
PEIG	Petroleum Excise Industry Group
permission limits	limits imposed by the ATO on volumes of excisable goods that may be entered for home consumption
petrol	(gasoline, motor spirit, benzine); a refined petroleum distillate suitable for use as a fuel in spark-ignition internal combustion engines
petroleum	a generic term for hydrocarbons, including crude oil, natural gas liquids, natural gas, and their products
profiles	border controls imposed by Customs on the passage of imported goods, until entry of the goods is authorised by the ATO
RAB	Revenue Analysis Branch
refiner-	a company having an integrated petroleum supply chain from refining through distribution to marketing of petroleum products to consumers
refinery marketer	a facility where crude oil is separated into various petroleum products including fuels, lubricants and chemicals
refund	repayment of excise duty paid
remission	entry of products for home consumption at an excise duty free rate
Remission Certificate	authorisation issued by the ATO to allow purchase of petroleum products not containing the chemical marker at an excise duty free rate for use other than in an internal combustion engine
revenue foregone	a measure of (excise) revenue not collected due to remission or refund of excise duties on excisable products

RIB	Revenue Intelligence Branch
SRP	Strategic Risk Profile
STP	Single Transaction Permission
Taxpayers' Charter	a service treaty that sets out taxpayers' rights and obligations in relation to the ATO
TeamMate	an electronic working papers system for compliance activities
toluene	a petrochemical used as a solvent in paints, adhesives, ink and cleaning agents, and as a mixture added to petrol to improve the octane rating
transport fuels	fuels described in the Excise Tariff and Customs Tariff as fuels for use in an internal combustion engine
underbond	where excise duty has not been paid on goods and they remain the responsibility of the excise licensee
WSP	Weekly Settlement Permission

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