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Goods and Services Tax Administration by Commonwealth Organisations

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Australian National
Audit Office

Canberra ACT
29 May 2002

Dear Madam President
Dear Mr Speaker

The Australian National Audit Office has undertaken an Assurance and Control Assessment audit across agencies 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 *Goods and Services Tax Administration by Commonwealth Organisations.*

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

Yours sincerely

P. J. Barrett
Auditor-General

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

AUDITING FOR AUSTRALIA

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

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Abbreviations/Glossary

ABS	Australian Bureau of Statistics
ACA	Assurance and Control Assessment
Acquisition	Acquisition is a very broad term. It includes all goods, services and rights purchased for the business or enterprise.
ABN	Australian Business Number. The number is used by businesses for dealing with the ATO and other organisations.
ANAO	Australian National Audit Office
A New Tax System	The Government announced its plans for tax reform, 'A New Tax System' in August 1998. The reforms comprise wide-ranging changes over a number of years, including from 1 July 2000 the replacement of sales tax with the Goods and Services Tax. The reforms also include reductions in personal and company tax.
ATO	Australian Taxation Office
BAS	Business Activity Statement. Businesses registered for GST use this single form to report their business tax entitlements and obligations, including GST and fringe benefit tax instalments. Businesses offset tax payable against tax credits to arrive at a net amount payable/refund due.
CAC Act	*Commonwealth Authorities and Companies Act 1997*
Financial error	For the purposes of the audit, financial errors represent transactions where there has been an error in the amount of GST paid or input tax credits claimed. Further explanation is provided at Table A1.2 of Appendix 1.
FMIS	Financial Management Information System
FMA Act	*Financial Management and Accountability Act 1997*
GIC	General Interest Charge. The GIC is the penalty for late payment of all outstanding ATO-related debts. The GIC is a commercially linked interest rate that compounds daily and varies every quarter with changes in the money market.
Grandfathered	A 'grandfathered' agreement is an agreement which was entered into prior to 8 July 1999 (or in some cases 2 December 1998) under which there is no opportunity

	to increase the consideration to enable GST to be charged. Supplies made under a 'grandfathered agreement' are treated as GST-free prior to 1 July 2005, or until a review opportunity actually arises.
GST	Goods and Services Tax. The GST is a broad-based tax of 10 per cent on most supplies of goods and services consumed in Australia. On 1 July 2000, the GST replaced wholesale sales tax, which had applied at varying rates to a range of products.
GST code	The code is used in an organisation's FMIS to define the GST treatment of transactions. Examples include: taxable supply; transaction with no GST effect; and GST-free acquisition.
GST-free supplies	No GST is payable on a GST-free supply, but the supplier is still entitled to an input tax credit for the GST charged to it on any acquisitions that relate to making that supply. Supplies that are GST-free include exports, food, health and medical care, and education and child-care.
Input tax credits	Registered entities are entitled to an input tax credit for the GST included in the price paid for an acquisition or the GST paid on an importation if it is acquired for carrying out the entity's enterprise, but not to the extent that the acquisition or importation is used to make input-taxed supplies. A tax invoice is necessary to claim an input tax credit (except for purchases with a GST-inclusive value of $55 or less).
Input-taxed supplies	No GST is payable on an input-taxed supply, and the supplier cannot normally claim input tax credits for the GST charged to it on any acquisitions that relate to making that supply. Supplies that are input-taxed include financial supplies and residential leases.
Non-financial error	For the purposes of the audit, non-financial errors do not have a dollar impact but represent errors in processing that require correction. Further explanation is provided at Table A1.2 of Appendix 1.
Out-of-scope (or non-taxable) supplies	A number of different supplies are outside the scope of the GST legislation. No GST is payable in respect of such supplies. Out-of-scope supplies include supplies made before 1 July 2000, supplies made by any persons that are not required to be registered for GST, and supplies that are not connected with Australia. They also include Government appropriations.

Recipient created tax invoice	This is a tax invoice issued by the recipient rather than the supplier in circumstances where it is more convenient for the recipient to issue the documentation. Recipient created tax invoices can only be issued when the recipient meets certain criteria or a Determination has been issued that approves their use for that type of supply. In addition, a recipient created tax invoice can only be issued pursuant to a written recipient created tax invoice agreement between the supplier and the recipient.
Supply	'Supply' is extremely broadly defined, and includes: the supply of goods and services; the provision of advice or information; the granting, assignment and surrender of rights; and entry into, and release from, an obligation.
Tax code	See GST code above.
Tax invoice	A tax invoice is a document generally issued by the supplier. It shows the price of a supply, indicating whether it includes GST, and may show the amount of GST. It must show other information, including the ABN of the supplier. It is necessary to hold a compliant tax invoice at the time of claiming an input tax credit on the BAS, except for purchases of $55 or less including GST.
Taxable supplies	GST is payable on a taxable supply. A supply is not a taxable supply if it is GST-free or input taxed.

Summary and Recommendations

Summary

Background

1. On 1 July 2000, legislation to establish a new tax system[1] came into effect. A major element of the new tax system was a 10 per cent Goods and Services Tax (GST) on the supply of most goods and services consumed in Australia.[2] Businesses and other entities registered for the GST may be entitled to claim input tax credits for the GST included in the price paid for goods and services and are required to remit to the Australian Taxation Office (ATO) the GST on their sales and other taxable supplies.

2. While Commonwealth entities are not liable to pay the GST, '…it is the Parliament's intention that the Commonwealth and Commonwealth entities should be notionally liable to pay GST payable under this Act and be notionally entitled to input tax credits arising under this Act…'[3]. Accordingly, the *Finance Minister's (A New Tax System) Directions 2000*[4] requires each organisation, subject to the *Financial Management and Accountability Act 1997* (FMA Act) and the *Commonwealth Authorities and Companies Act 1997* (CAC Act), to manage its affairs as though it is subject to the GST.

3. For many Commonwealth organisations, the GST represents the first occasion they have had to manage significant indirect tax obligations as part of their normal reporting, revenue and expenditure cycles.

4. Organisations that have not implemented adequate processes to ensure timely compliance face a number of risks including overpayment and/or underpayment of tax, and potential cash flow issues. In this context, as in other areas of public administration, Commonwealth organisations are expected to be exemplars of good practice in complying with their GST obligations.

Audit objective and coverage

5. The audit objective was to determine whether organisations had implemented adequate control frameworks and processes to mitigate the risks associated with GST obligations and transactions. The audit was conducted at six Commonwealth organisations.

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1 The new tax system comprised a number of reforms including: the replacement of sales tax with the Goods and Services Tax and with a reduction in personal and company income tax rates; the introduction of the pay as you go arrangements; and changes in Commonwealth-State financial relations.

2 The GST is governed principally by *A New Tax System (Goods and Services Tax) Act 1999*. The main Act is supported by various other Acts.

3 *A New Tax System (Goods and Services Tax) Act 1999*, subsection 177-1 (1).

4 The *Finance Minister's (A New Tax System) Directions 2000*, 27 June 2000.

Audit conclusion

6. During the GST implementation phase, most of the six organisations audited had established an environment that continues to provide a control framework to effectively support most GST transactions and Business Activity Statement (BAS) reporting. Nevertheless, at least three organisations need to make immediate improvements to their control frameworks, with less pressing improvements warranted in the remaining organisations. The key areas warranting improvement included:

- consideration of the benefits of using formal process level risk assessment to design the organisations' overall approach and management of GST;
- assigning ownership and accountability for GST management;
- implementing on-going training;
- completing and documenting procedures that include BAS preparation guidelines, templates and checklists;
- implementing processes that ensure compliance with the legislation—for example, adequate communication with technical specialists and documentation of tax positions;
- more active management of the cash flow impacts associated with GST; and,
- the use of in-built testing programs and error logs as continuous improvement tools.

7. Audit testing, which was directed to assessing whether transactions were processed accurately and in accordance with legislative and procedural requirements, identified error rates of between approximately three and 17 per cent by volume in samples of 160 GST transactions at each of the organisations audited. Further, based on the samples of transactions, the lowest estimated true population error rate ranged between 0.4 and 5.8 per cent, whilst the highest estimated true population error rate ranged between 11.1 and 22.7 per cent.

8. More than half the errors were financial and affected the amount of GST paid or input tax credits claimed.[5] The remaining non-financial errors may impact on the integrity of BAS reporting to the ATO; and there is no minimum level of error that the ATO will necessarily ignore.

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5 Although errors were classified as either financial or non-financial in their effect, the nature of the sampling methodology used (known as attributes sampling) does not indicate the amount of dollar error likely to exist in all transactions. Instead, as the sample testing was undertaken to support control framework observations, the results indicate the rate of occurrence or frequency of GST process control errors.

Sound and better practices

9. The audit identified examples of sound and better practices in several organisations. A summary of these practices is provided at Table 1.

Table 1

Sound and better practices in GST processes

Control framework component	Sound and better practice
Risk assessment	• Risk assessment processes incorporated into GST implementation planning and activity. • Documented GST process level risk assessments linking risks with controls.
Control environment	• Formal assignment of GST management responsibility to a competent manager. • Central management and processing of BAS reporting. • Documented implementation activity including system modification and updating of procedures. • On-going training activity designed to meet knowledge gaps.
Control activities	• Analytical review of monthly transactions. • BAS preparation process that uses system generated reports as its principal source of data. • Logical and complete storage of documentation to support transactions. • Use of a tax invoice compliance checklist by processing staff. • System GST calculations based on defined GST codes. • Independent review of the BAS prior to submission.
Information and communication	• Use of external technical tax advice to establish tax positions and design processes. • Use of intranet to communicate updates to processes following changes in legislation.
Monitoring and review	• Internal audit reviews of GST processing. • Periodic substantive testing of GST transactions.

Key findings

Risk management

10. Prior to the audit, most organisations expressed confidence in the way they managed GST. In general, GST was perceived as a low risk administrative task, and managers expected low error rates in audit testing. While the Australian National Audit Office (ANAO) recognises that GST risks are less significant than some other risks facing Commonwealth organisations, the level of errors detected in the audit indicates that organisations generally need to improve GST control frameworks.

11. The execution of a risk management plan provides an organisation with a useful tool to design its GST control framework. Only one organisation was able to support its confidence in GST management with a formal plan that linked GST risks to specific controls. This organisation had by far the lowest error rate in audit testing.

Control environment

GST management

12. The clear assignment of GST responsibility to an individual or group is important for effective GST management. If there is no ownership and accountability, the organisation is unlikely to implement on-going monitoring or process improvement.

13. Most organisations had assigned responsibility to an appropriately qualified individual with varying levels of effectiveness. One organisation, that had not adequately identified a process owner until recently, had a significant and unresolved technical matter outstanding with the ATO, as well as on-going Financial Management Information System (FMIS) and process weaknesses that should have been actively addressed during the GST implementation phase.

14. Those organisations that had clearly defined responsibilities to an individual were more likely to have benefited from continuous improvement mechanisms, such as, training, accessing complete technical advice, and in-built testing of transactions.

Training programs

15. While most organisations trained staff and managers in GST processing and compliance matters during implementation, only one had recently carried out formal on-going training.

16. Most errors identified in audit testing can be readily addressed through training. Common areas requiring attention include: the identification of compliant tax invoices and processes for dealing with non-compliance; correct coding of transactions; and overriding system-based controls to force system data to match hard copy source data.

17. Error rates should be monitored through the use of error logs, which could form the basis of designing training programs for those staff involved with the management and processing of the GST.

Procedures, templates and checklists

18. Formal, standard procedures are the basis for the proper processing of transactions. All organisations had updated policies and procedures during the GST implementation phase, and these continue to provide guidance that ensures most transactions are processed properly. However, most organisations can improve procedures by ensuring they are complete and documented.

19. Organisations often lacked procedures for the following: identifying and dealing with non-compliant tax invoices; BAS preparation that includes adequate authorisation and checking controls; and preparing and maintaining documentation to support technical decisions on high-value or significant transactions.

20. Managers should check that procedures include templates that comply with the GST legislation. Most organisations would benefit from including standard checklists in normal procedures—for example, a tax invoice compliance checklist and a BAS authorisation checklist. Any changes to standard procedures should be incorporated into training.

Control activities

21. Most organisations are able to use FMIS generated data with limited manual input to properly complete BAS reporting. However, organisations would benefit from expanding and formalising this preparation process to include additional checking controls. The audit noted some use of reviews of the reasonableness of the data but there was limited evidence of exception reporting. Organisations would benefit from combining these types of management controls into a standard BAS preparation checklist that could be used by both preparer and authoriser.

Information and communication

Getting GST technical matters right

22. While the focus of the audit was on GST processes rather than technical tax treatments, the ANAO noted two organisations had significant unresolved technical tax issues. Further, most organisations had embodied some form of non-compliance with the legislation into procedures or work place practices.

23. It was unclear whether technical non-compliance is the result of not accessing adequate technical advice or failure to implement an appropriate mechanism for communicating and implementing this advice. The key message is that Commonwealth organisations should make sure they have sufficient information and communication processes to ensure the correct GST treatment of transactions.

Cash flow management

24. Five organisations reported a significant regular net GST refund position to the ATO. However, there was limited monitoring of the impact of GST on cash flow. As well, most organisations had not implemented mechanisms to leverage any possible cash flow advantage. For example, most had not considered how to time: the claiming of input tax credits; the reporting of output tax; and the BAS submission—in order to create a cash flow advantage.

25. The ANAO considers that organisations should actively seek opportunities to manage cash flow and identify any related opportunities for short or long-term banking investments.

Monitoring and review

26. Organisations had not focused on the continuous improvement of GST processing. Most do not undertake formal testing of transactions and only two had used Internal Audit to examine aspects of GST. None maintained formal error logs.

Recommendations

The recommendations are based on the findings made in the organisations audited but should have relevance to all Commonwealth organisations, and have been framed accordingly.

Recommendation No. 1 Para 3.9

The ANAO *recommends* that organisations undertake process level risk assessments of GST in order to define the full range of risks, related controls and treatment plans. Assessment should include the application of cost-benefit analysis to the GST risk and control environment.

Recommendation No. 2 Para 4.14

The ANAO *recommends* that organisations ensure responsibility and accountability for management of GST is clearly assigned to an appropriate key person in the organisation.

Recommendation No. 3 Para 4.22

The ANAO *recommends* that organisations provide focussed on-going training to staff involved in GST processing.

Recommendation No. 4 Para 4.34

The ANAO *recommends* that organisations ensure the control framework is supported by appropriate and complete policies and procedures (including checklists) that are compliant with legislation.

Recommendation No. 5 Para 5.12

The ANAO *recommends* that organisations strengthen controls surrounding the BAS preparation and reporting process through:

- regular management review of appropriate exception reports;
- management authorisation of the BAS using a checklist to ensure all appropriate review activity has been completed prior to submission; and
- segregation of duties between BAS preparation and authorisation.

Recommendation No. 6 Para 6.13	The ANAO *recommends* that organisations: • obtain appropriate technical advice for GST impacted transactions; and • ensure that technical positions adopted are formally recorded, and included in GST procedural documentation and training programs.
Recommendation No. 7 Para 6.19	The ANAO *recommends* that organisations implement formal monthly cash flow management that considers the impact of timing of transactions with significant GST implications.
Recommendation No. 8 Para 7.8	The ANAO *recommends* that organisations increase continuous improvement activity associated with GST processes through, amongst other things: regular periodic testing of transactions; the establishment of error logs that can be used to design training, controls and future testing; and the use of periodic independent audits.

27. All of the audited organisations responded positively to the recommendations. The ANAO also provided an individual report to each of the audited organisations, which included similar recommendations tailored to the organisation's specific control environment.

Audit Findings and Conclusions

1. Introduction

Background

1.1 On 1 July 2000, legislation to establish a new tax system[6] came into effect. A major element of the new tax system was a 10 per cent Goods and Services Tax (GST) on the supply of most goods and services consumed in Australia[7]. Businesses and other entities registered for the GST may be entitled to claim input tax credits for the GST included in the price paid for goods and services and are required to remit to the Australian Taxation Office (ATO) the GST on their sales and other taxable supplies.

1.2 In 2000–01, net GST revenue collected by the ATO totalled $27.5 billion.[8] Most Commonwealth organisations are in a regular net refund position from the ATO because most of their revenue comes from appropriations, which are not subject to GST, and because they can claim input tax credits on their acquisitions.

1.3 While Commonwealth entities are not liable to pay the GST, '…it is the Parliament's intention that the Commonwealth and Commonwealth entities should be notionally liable to pay GST payable under this Act and be notionally entitled to input tax credits arising under this Act…'.[9] Accordingly, the *Finance Minister's (A New Tax System) Directions 2000*[10] requires each organisation, subject to the *Financial Management and Accountability Act 1997* (FMA Act) and the *Commonwealth Authorities and Companies Act 1997* (CAC Act), to manage its affairs as though it is subject to the GST. This includes: registering for the GST; paying the GST on taxable supplies and taxable importations; claiming input tax credits where appropriate; and remitting the GST on taxable supplies of goods and services.

1.4 For many Commonwealth organisations, the GST represents the first occasion they have had to manage significant indirect tax obligations as part of their normal reporting, revenue and expenditure cycles. To be ready by 1 July 2000, Commonwealth organisations had to: register for the GST; address transitional issues such as the treatment of contracts and work in progress; address the question of cost savings under the new tax system; update accounting and record-keeping systems and processes; train staff; and address budgetary and cash management issues.

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6 The new tax system comprised a number of reforms including: the replacement of sales tax with the Goods and Services Tax and with a reduction in personal and company income tax rates; the introduction of the pay as you go arrangements; and changes in Commonwealth-State financial relations.

7 The GST is governed principally by *A New Tax System (Goods and Services Tax) Act 1999*. The main Act is supported by various other Acts.

8 Commissioner of Taxation Annual Report, 2000-01, Financial Statements, Note 19B, p. 190.

9 *A New Tax System (Goods and Services Tax) Act 1999*, subsection 177-1 (1).

10 The *Finance Minister's (A New Tax System) Directions 2000*, 27 June 2000.

1.5 Organisations that have not implemented adequate processes to ensure timely compliance face a number of risks including overpayment and/or underpayment of tax, and potential cash flow issues. In this context, as in other areas of public administration, Commonwealth organisations are expected to be exemplars of good practice in complying with their GST obligations.

Audit objectives, coverage and scope

1.6 The audit objective was to determine whether organisations had implemented adequate control frameworks and processes to mitigate the risks associated with GST obligations and transactions. The audit was undertaken in six Commonwealth organisations, as follows:

- Australian Federal Police;
- Department of Communications, Information Technology and the Arts;
- Department of the Treasury;
- National Gallery of Australia;
- Royal Australian Mint; and
- Special Broadcasting Service Corporation.

1.7 There is no relationship between the order of the organisations listed at paragraph 1.6 and the order of the identifying numbers allocated to organisations in the various tables and figures in the report.

1.8 Table 1.1 provides an overview of the financial impact of GST on each of the audited organisations in 2000–01.

Table 1.1 Audited organisations' GST activity: 2000–01

Organisation	GST Payable to the ATO[11] ($'000)	Input Tax Credits[12] ($'000)	Approximate number of transactions per annum[13]
1	2 307	10 495	145 000
2	3 182	2 812	112 500
3	182	6 322	24 000
4	1 700	11 046	65 000
5	1 766	97 436	23 000
6	1 202	28 495	23 000

Source: Advice from audited organisations

[11] This is the GST payable on taxable supplies made by the organisation, as reported in Box 1A of the BAS.

[12] This is the total input tax credits claimed by the organisation on acquisitions made by it, as per Box 1B of the BAS.

[13] Almost all FMIS transactions require a GST decision, including revenue and expenditure cycle transactions as well as internal journal entries.

Audit evaluation criteria

1.9 The audit is one in a series of Assurance and Control Assessment (ACA) audits looking at business and financial processes in the Commonwealth[14]. The audit criteria for ACA audits are based on the internal control framework detailed in the ANAO's 1997 Better Practice Guide *Control Structures in the Commonwealth Public Sector: Controlling Performance and Outcomes,* and consist of:

- risk assessment;
- control environment;
- control activities;
- information and communication; and
- monitoring and review.

1.10 The internal control framework can be described as follows:

> The control environment is the foundation for the effectiveness of all the other components. It reflects management's commitment and attitude to establishing an effective control structure. It is sometimes referred to as the 'tone at the top' and is dependent on firm leadership and clarity of direction from the governing body.
>
> Risk assessment and control activities include identification, analysis and assessment of risks to achieving objectives and the design of control policies and procedures to manage those risks, focussing on those that have potential for more significant exposures and are critical to the business.
>
> Regular and relevant information needs to be collected and communicated to enable performance to be monitored and reviewed. The effectiveness of the control structure also requires on-going monitoring and review.[15]

Detailed audit criteria

1.11 The above audit criteria have been adapted and expanded to take account of the diverse risks and operating requirements presented by the GST. Development of the criteria also considered better practice in private and public sector GST processing.

1.12 Table 1.2 shows the evaluation criteria mapped against the components of the internal control framework. Each organisation's management of GST processing was assessed against the criteria.

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[14] ACA audits are undertaken under the general performance audit provisions of the *Auditor-General Act 1997.* The audits examine common business activities and processes that are not specifically covered by financial statement or other performance audits.

[15] ANAO, Better Practice Guide, *Control Structures in the Commonwealth Public Sector: Controlling Performance and Outcomes,* Canberra, 1997.

Table 1.2
Audit criteria

Risk assessment	
Management effectively uses risk assessment to identify, assess and manage GST risks.	
Control environment	
Management's pro-active approach and leadership ensure a robust control environment for GST transactions.	
Structure	Responsibility for managing and processing GST is structured in a way that efficiently meets the needs of the organisation allowing for clear responsibilities and accountabilities.
Process	There are complete policies and procedures that reflect the organisation's responsibilities.
People	Key personnel possess an appropriate level of competence and are aware of their responsibilities through training and communication.
Technology	Information system design and functionality effectively and efficiently support GST processing and obligations.
Control activities	
Management has established specific control activities relating to BAS processes and the GST requirements of the expenditure and revenue cycles. These activities mitigate risks, prevent and detect irregularities, safeguard assets and ensure completeness and accuracy of data.	
Management Controls	Management implement detective controls through supervision and review.
Organisational Controls	The GST function is effectively organised to ensure registration compliance, maintenance of documentation and segregation of duties.
Authorisation Controls	GST related transactions are appropriately authorised.
Operational Controls	There are effective preventative and detective controls that ensure the completeness, accuracy and timeliness of GST transactions.
Computing Controls	There are effective and complete system controls that protect the integrity of GST data because: • FMIS master file controls protect the integrity of GST data; and • systems and data are subject to physical and logical controls.
Information and communication	
The right information about GST and its impacts is communicated to the right people at the right time.	
Monitoring and review	
There is evidence of a continuous improvement approach to GST processing in that the organisation makes effective use of in-built and/or periodic monitoring and review mechanisms.	

Audit methodology

1.13 The audit methodology comprised an examination of the GST processing controls currently in place at each organisation as well as substantive testing of a statistical sample of transactions selected from the first year of GST implementation (1 July 2000 to 30 June 2001).[16] The Australian Bureau of Statistics (ABS) approved the statistical methodology used in the audit.

1.14 The audit process involved interviews with selected officers, the examination of files and records supporting GST processing activity, general observation and inspection, and testing of key controls.

1.15 The audit was undertaken for the ANAO by Andersen on a contract-managed basis in accordance with ANAO auditing standards. The audit cost approximately $450 000.

Structure of the remainder of the audit report

1.16 Chapter 2 discusses the results of the testing of the sample of transactions processed within each organisation's Financial Management Information System.

1.17 Chapters 3–7 discuss the findings and recommendations of the audit against each component of the internal control framework. The ANAO's observations are presented in two distinct categories:

- *Audit findings* which detail control weaknesses contributing to a breakdown in both efficiency and effectiveness of the internal control framework; and
- *Sound and better practices* which relate to business practices, which, if adopted, would strengthen the internal control framework and lead to improved effectiveness and efficiency of outputs and outcomes.

[16] For details of statistical sampling methodology, see Appendix 1.

2. Testing of GST Transactions

Introduction

2.1 The audit methodology included testing a statistical sample of transactions processed within each organisation's FMIS. The testing was directed to assessing whether transactions were processed accurately and in accordance with legislative and procedural requirements. The testing was also used to support the ANAO's observations of the effectiveness of the each organisation's control framework.

2.2 In each audited organisation, a sample of 160 transactions was drawn from the population of all GST transactions in the first financial year of GST, that is, 1 July 2000 to 30 June 2001.[17]

Results of testing

Types of errors

2.3 The types of errors identified during the testing were classified into four categories, as follows:

- **Invalid tax invoices.** Invalid tax invoices occur where the organisation does not have adequate evidence to claim an input tax credit. These errors include: the acceptance and payment of non-compliant tax invoices and subsequent input tax credit claiming; non-compliance with recipient created tax invoice requirements; and non-compliant adjustment notes issued and received. All but one of the audited organisations had errors of this type. These errors have a financial impact on the organisation because it is not entitled to claim an input tax credit unless it holds a valid tax invoice at the time it lodges the BAS with the ATO.[18] The organisation is liable to repay the ATO for amounts representing input tax credits previously claimed but not supported by a valid tax invoice.
- **Coding errors.** Coding errors involve the incorrect classification of transactions. All of the organisations had coding errors, the most common of which was a misclassification of transactions between 'GST-free'[19] and

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17 The Australian Bureau of Statistics (ABS) approved the audit's statistical methodology for the sample selection and estimation techniques implemented in this testing. Appendix 1 describes the justification for the statistical audit testing approach and the basis upon which confidence level statements and audit conclusions are made.

18 *A New Tax System (Goods and Services Tax) Act 1999*, subsection 29-10(3).

19 No GST is payable on a GST-free supply, but the supplier is still entitled to an input tax credit for the GST charged to it on any acquisitions that relate to making that supply. Supplies that are GST-free include exports, food, health and medical care, and education.

'Out-of-scope' supplies.[20] These coding errors are important because they affect the accuracy of information reported by code on the organisations' BAS.[21] In several cases, miscodings also have an effect on the integrity of GST amounts processed and reported—for example, in the case of a revenue transaction that is coded GST-free when it should be taxable, or applying the same GST code to mixed supplies so that an input tax credit was claimed for an acquisition with no GST in the price.

- **Inadequate documentation.** Inadequate documentation is where insufficient evidence was available to verify whether GST was correctly treated. In these circumstances, without a standard process to support all transactions with adequate documented evidence at the time of processing, there is a risk that the organisation will be unable to substantiate GST treatments in the event of an ATO audit. Three of the organisations had errors of this type.
- **Data entry errors.** Although data entry errors had minimal financial impact on the organisations, they are of concern because they indicate there are differences between hard copy source data and the processing of system entries. Three organisations had data entry errors.

Number of errors

2.4 The number of errors identified out of the sample of 160 transactions at each organisation ranged from five to 27 (see Figure 2.1), representing error rates of between approximately three and 17 per cent by volume.[22]

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[20] A number of different supplies are outside the scope of the GST legislation. No GST is payable in respect of such supplies. Out-of-scope supplies include supplies made before 1 July 2000, supplies made by people who are not required to be registered for GST, and supplies that are not connected with Australia.

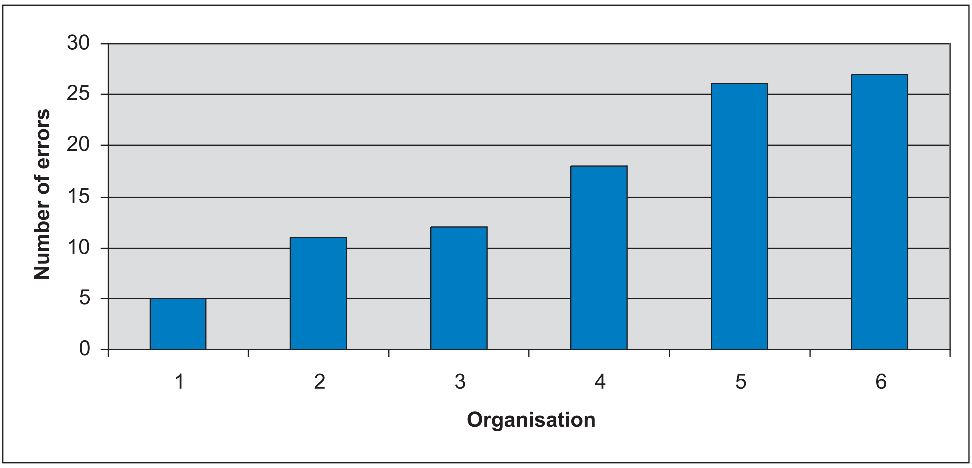
[21] GST-free supplies are included in the BAS whereas out-of-scope supplies are not recorded on the BAS.

[22] As is the case for any statistical sample, care should be taken with the interpretation of results. In relation to this sample, the following should be considered:

- each organisation's population of transactions was different and so, therefore, were the random samples, audit results and error causes;
- the ANAO relied on the integrity of data provided by the organisations to select the samples; and
- the concept of a GST error in relation to significance and occurrence is, in some instances, a matter on which opinions differ. Clarification on the ANAO's approach in classifying GST errors is therefore discussed further in Appendix 1.

Figure 2.1

Number of errors from the sample of 160 transactions tested in each organisation



Source: ANAO analysis.

2.5 Because the sample of transactions was statistically based, the ANAO was able to estimate with a certain degree of confidence the likely level of error in the population of each organisation's transactions, according to various confidence intervals.[23]

2.6 Table 2.1 shows, given a 95 per cent confidence interval, the likely transaction error rate in each organisation audited.[24]

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[23] A confidence interval is the range of values, at a specified level of confidence, within which the true population value lies. For example, a 95 per cent confidence interval expresses that the true population value has a 95 per cent chance of being within the specified range of values. From the statistical tests conducted in these audits, confidence bounds have been calculated based on the error rates from the sample of transactions. The confidence bound surrounding the lowest error rate of approximately 3 per cent is between 0.4 and 5.8 per cent. The confidence bound surrounding the highest error rate of approximately 17 per cent is between 11.1 and 22.7 per cent. Therefore, the lower 95 per cent confidence bound for the true population error rate, across all organisations in the sample, lies between 0.4 and 11.1 per cent. The upper 95 per cent confidence bound for the true population error rate, across all organisations in the sample, lies between 5.8 and 22.7 per cent.

[24] Other confidence levels and intervals for selected error rates that can be used for general application are shown at Table A1.1 in Appendix 1.

Table 2.1

Sample and population transaction error rates

Organisation	Number of errors in sample*	Errors in the sample* (%)	Number of transactions in population (rounded to nearest 500)	95% Confidence Interval for the true population error rate (%)		95% Confidence Interval for the true population error rate (numbers)	
				Lower bound	Upper bound	Lower bound	Upper bound
1	5	3.1	145 000	0.4	5.8	580	8 410
2	11	6.9	112 500	3.0	10.8	3 375	12 150
3	12	7.5	24 000	3.4	11.6	816	2 784
4	18	11.3	65 000	6.4	16.2	4 160	10 530
5	26	16.3	23 000	10.6	22.0	2 438	5 060
6	27	16.9	23 000	11.1	22.7	2 553	5 221
* 160 transactions in each organisation							

Source: ANAO and ABS analysis

2.7 This means, for example, that in the first organisation based on the sample of transactions, it can be concluded that in the population of transactions there was a 95 per cent chance of the true error rate being between 0.4 and 5.8 per cent. Put another way, there is a 95 per cent chance that the true number of errors was between 580 and 8410 out of a population of 145 000 transactions.

Financial and non-financial errors

2.8 The audit also classified each error as either a 'financial' or 'non-financial' error.[25] Financial errors represent transactions where there has been an error in the amount of GST paid or input tax credits claimed. Non-financial errors do not have a dollar impact but represent errors in processing that require correction. Non-financial errors may also impact on the integrity of BAS reporting to the ATO.

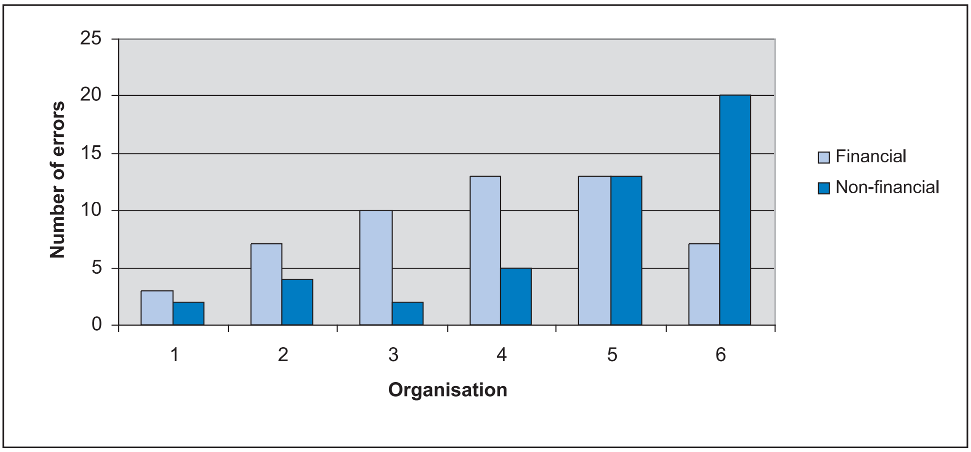
2.9 Figure 2.2 shows the number of financial and non-financial errors at each organisation. In this context, processing of non-compliant tax invoices was found to be the error most likely to lead to financial errors.

[25] Appendix 1 to this report provides further details on how each of the error types (invalid tax invoice, miscoding, inadequate documentation and data entry) was classified as either a financial or non-financial error.

2.10 Although errors were classified as either financial or non-financial in their effect, the nature of the sampling methodology used (known as attributes sampling) is not a precise indicator of the amount of dollar error likely to exist in a population of transactions. However, the sample testing methodology is highly appropriate to support control framework observations and the results indicate the rate of occurrence or frequency of GST process control errors.

Figure 2.2

Number of financial and non-financial errors from the sample of 160 transactions tested in each organisation



Source: ANAO analysis

Conclusion

2.11 Audit testing identified error rates of between approximately three and 17 percent by volume in the samples of 160 GST transactions at each of the organisations audited. More than half of the errors affected the amount of GST paid or input tax credits claimed. Further, based on the sample of transactions, the lower 95 per cent confidence bound for the true population error rate, across all organisations in the sample, lies between 0.4 and 11.1 per cent. The upper 95 per cent confidence bound for the true population error rate, across all organisations in the sample, lies between 5.8 and 22.7 per cent. While organisations may decide to accept a level of GST error in the light of cost-benefit analysis, this does not mean they should not strive to improve control frameworks and the accuracy of processing.

2.12 It should also be recognised that: non-financial errors may affect the integrity of BAS reporting to the ATO; and there is no minimum level of error that the ATO will necessarily ignore.

3. Risk Assessment

Background

3.1 Risk assessment is the starting point for evaluating the control framework because, through a formal systematic process, it provides the necessary information to properly design controls that are both appropriate and cost effective.

3.2 Risk assessment in the context of GST processes has two key elements:

- **Organisational level risk assessment**. This is the assessment of GST processing risk at the organisational level within the context of other risks facing the organisation, in terms of the risk's relative impact on the organisation's ability to achieve its outcomes and outputs efficiently and effectively. The management of the GST may be assessed as lower in significance and likelihood than other identified risks, and, therefore, not merit a specific treatment plan.
- **Process level risk assessment**.
    - — Process level risk assessment refers to the risks related to the day-to-day processing and reporting of GST transactions as part of statutory obligations. This level of risk assessment may be used if management considers that GST processing poses a significant risk. To be effective, a process level GST risk assessment should include a complete set of risks.
    - — Process level risk assessment provides managers with confidence that all risks associated with GST have been addressed and can be managed on an on-going basis. When completed, a process level risk assessment provides management with a tool for cost effective and robust control design and on-going monitoring.
    - — Some examples of the risks involved with GST processing are shown in Table 3.1.

Table 3.1

Examples of GST process risks

Risk category	Risk
Compliance	Inability to meet ATO BAS reporting deadlines.
Completeness and Accuracy	Incorrect transposition of GST purchase-related data into FMIS leading to over-claiming of input tax credits and on-going exposure or under-claiming of input tax credits and on-going financial loss.
Contracts	Records of GST-free 'grandfathered' contracts[26] are incomplete leading to incorrect GST coding of related invoices.
Reputation	The damage to an organisation's or the Commonwealth's reputation due to incorrect GST treatments, or a misstatement in BAS reporting to the ATO.
Information for Decision-Making	Management lacks adequate information on the impact of GST on cash flow to make decisions about cash management.
Human Resource	Staff involved in GST processing do not possess the required level of skills to accurately process GST

Audit findings and comment

3.3 All organisations used some form of organisational risk assessment to manage operational risks. In this context, GST risk was perceived by the audited organisations as low likelihood and low significance. As a result, most organisations did not use risk assessment at the GST process level.

3.4 The main audit findings in relation to risk assessment are summarised in Table 3.2.

[26] A 'grandfathered' contract is a contract which was entered into prior to 8 July 1999 (or in some cases 2 December 1998) under which there is no opportunity to increase the consideration to enable GST to be charged. Supplies made under a 'grandfathered agreement' are treated as GST-free prior to 1 July 2005, or until a review opportunity actually arises.

Table 3.2
Risk assessment audit findings

Principle	Management effectively uses risk assessment to identify, assess and manage GST risks.
Audit evaluation criteria	• Management is aware of, assesses, analyses and mitigates GST processes risks that impact upon an organisation's goals and objectives. • Management considers risk assessments at the organisational level and process level. • Management has documented a plan for treating the risks associated with GST processing.
Audit findings	Of the six organisations reviewed, the audit found: • all organisations had implemented some form of organisational risk assessment but, for most, GST risk was not considered to be material in relation to the other risks facing the organisation; and • three organisations performed monthly substantive testing of a sample of high value (high risk) GST transactions to ensure they had been accurately coded and captured for BAS reporting purposes.
Sound and better practices	The audit noted the following in at least one of the organisations examined: • use of formal risk assessment during GST implementation; and • documentation of a formal GST process level risk assessment linking GST risks with control activities.

Process level risk assessment

3.5 The audit found that most organisations have adopted a pro-active approach to risk assessment activities focusing on a formally documented framework that identifies, analyses and assesses the key risks to the organisation. Some organisations have provided training on risk assessment methodology to finance managers. However, most organisations have not undertaken process level risk assessments related to GST processes. In general, this was because most organisations did not consider that GST processing was a significant risk in the context of the organisation's operating environment.

3.6 Since GST decisions are required on most (if not all) transactions processed by the organisations, GST processing presents a number of risks that require assessment and management. A more complete understanding of risk leads to, and encourages, a more complete understanding of control issues. In this context, the audit noted that the organisation that had used formal GST process level risk assessment had the lowest error rate in statistical sampling. This organisation developed a GST risk assessment as part of the implementation project, defining possible causes and consequences. A subsequent controls and risk assessment planning document linked more than 20 process level GST risks with existing controls and planned activity. These process level risk assessments provided management with additional confidence in the control framework and a basis for continuous improvement.

Conclusion

3.7 Prior to the audit, most organisatons expressed confidence in the way they managed GST. In general, GST was perceived as a low risk administrative task, and managers expected low error rates in audit testing. While the ANAO recognises that GST risks are less significant than some other risks facing Commonwealth organisations, the level of errors detected in the audit indicates that organisations generally need to improve GST control frameworks.

3.8 The execution of a risk management plan provides an organisation with a useful tool to design its GST control framework. Only one organisation was able to support its confidence in GST management with a formal plan that linked GST risks to specific controls. This organisation had by far the lowest error rate in audit testing.

Recommendation No. 1

3.9 The ANAO *recommends* that organisations undertake process level risk assessments of GST in order to define the full range of risks, related controls and treatment plans. Assessment should include the application of cost-benefit analysis to the GST risk and control environment.

4. Control Environment

Background

4.1 A critical component of an effective control environment is management's attitude and commitment to the implementation and maintenance of an effective internal control framework. The level of positive support by management strongly influences the design and operation of control policies and procedures. Without an effective control environment, managers will be unable to ensure the adequacy of the GST processing control framework.

4.2 Organisations should establish a control environment that clearly sets out GST management and processing responsibilities and promotes sound principles of pro-active management, including continuous improvement and cost-effective processing.

4.3 Comprehensive and up-to-date policies and procedures, and on-going training programs to promote staff awareness of the requirements, as well as an FMIS that effectively supports BAS generation, are *fundamental* to achieving such an environment. Balanced alignment of people, process, technology and structure is required.

Audit findings and comment

4.4 Prior to 1 July 2000, most organisations undertook significant GST implementation activity that included FMIS modification, designing standard processes and training. While in most organisations these activities established control environments that effectively support most GST transactions and timely BAS reporting, the ANAO considers that improvements are now required, particularly in relation to ensuring ownership and accountability for GST, training, and procedural frameworks.

4.5 The main audit findings in relation to the GST processing control environment are summarised in Table 4.1.

Table 4.1

Control environment audit findings

Principle	Management's pro-active approach and leadership ensure a robust control environment for GST transactions.
Audit evaluation criteria	• Responsibility for managing and processing GST is structured in a way that efficiently and effectively meets the needs of the organisation allowing for clear responsibilities and accountabilities. • There are complete policies and procedures that reflect the organisation's responsibilities. • Key personnel possess an appropriate level of competence and are aware of their responsibilities through training and communication. • Information system design and functionality effectively and efficiently support GST processing and obligations.
Audit findings	Of the six organisations reviewed, the audit found: • two organisations had not adequately assigned accountability and responsibility for GST management to an appropriate and competent individual in the finance function; • policy and procedure documentation was not always complete or up-to-date; • one organisation could not rely on data produced by its FMIS to compile BAS reporting; and • only one organisation had performed specific GST follow-up training since GST implementation.
Sound and better practices	The audit noted the following in at least one of the organisations examined: • formal, documented assignment of responsibility for GST management to a competent manager; • formal hand over from the GST implementation team to the key GST manager via a documented outstanding issue list; • central management and processing of BAS reporting to the ATO; • communication of policy and procedure documents via Intranet facilities; • use of a training program to educate staff during implementation; • FMIS design to prevent processing of transactions without an allocated GST code; and • performance of a review of the types of transactions processed and alignment with an appropriate GST treatment through system GST code activation and mapping.

GST management

4.6 During GST implementation, most organisations assigned responsibility for GST planning to a project team or steering committee with representatives from financial, legal and operational functions. The ANAO noted evidence of a significant level of implementation activity in five organisations.

4.7 Once the GST was introduced, four organisations clearly assigned responsibility for the on-going management of GST to an appropriately qualified individual within the finance function. This individual is responsible for the coordination of GST management, including, but not limited to, procedural instructions, preparation of the BAS, reporting of the BAS, and evaluating and communicating GST legislative changes impacting on the organisation.

4.8 Two organisations, however, had either not clearly assigned responsibility and accountability for GST or had assigned responsibility to an individual at an inappropriate level within the organisation.

4.9 Inadequate or inappropriate allocation of responsibility for GST means:

- formal process level risk assessment may not be initiated;
- the impact of legislative changes may not be appropriately assessed and acted upon;
- staff are unclear as to who they should contact for advice on technical GST issues;
- inappropriate decisions relating to GST technical issues may be implemented;
- policies and procedures may not be updated on a timely basis; and
- there is no focus for the continuous improvement of GST processes.

4.10 Some organisations had documented responsibilities and task descriptions for both managers and GST processing staff; however, most organisations had not.

Conclusion—GST management

4.11 The clear assignment of GST responsibility to an individual or group is important for effective GST management. If there is no ownership and accountability, the organisation is unlikely to implement on-going monitoring or process improvement.

4.12 Most organisations had assigned responsibility to an appropriately qualified individual with varying levels of effectiveness. One organisation, that had not adequately identified a process owner until recently, had a significant and unresolved technical matter outstanding with the ATO, as well as on-going FMIS and process weaknesses that should have been actively addressed during the GST implementation phase.

4.13 Those organisations that had clearly defined responsibilities to an individual were more likely to have benefited from continuous improvement mechanisms, such as training, accessing complete technical advice, and in-built testing of transactions.

Recommendation No. 2

4.14 The ANAO *recommends* that organisations ensure responsibility and accountability for management of GST is clearly assigned to an appropriate key person in the organisation.

Implementing the recommendation

4.15 The role of this key person should include overall management of the GST compliance function including technical matters, risk management, defining GST roles and responsibilities of personnel, establishment of testing and training processes, creation and maintenance of adequate levels of documentation, and process improvement.

Training programs

4.16 While all organisations provided GST training to relevant staff prior to GST implementation, only one organisation had implemented a formal on-going training program. Management of this organisation's finance section had responded to staff turnover in other sections, where coding decisions take place, by implementing personal training programs. The organisation had also adapted the standard ATO template for GST training to meet operational and system requirements and had the least number of errors in the testing of sample transactions.

4.17 The audit observed instances where employees were unaware of policy and procedure, indicating the need for improved training and communication. In addition, at many of the organisations, the errors noted during the audit testing of transactions, indicate a need for further training of those involved in GST processing. While some errors related to transactions that were not straightforward in terms of the GST coding to be applied, the most common problems were relatively simple errors in processing, as the following indicate:

- Processing staff not being able to recognise whether a tax invoice is compliant and not knowing the standard processes for dealing with non-compliant documents.

- Not using standard coding required by the organisation's procedures.
- Processing staff overriding system coding controls to force system transactions to reflect hard copy data. This was normally because the processing staff did not understand the correct method of processing.
- Documentation not being retained in a systematic, logical manner to support GST treatments.

4.18 The ANAO considers that organisations should record and analyse processing errors, identified through normal checking or periodic testing, by using an error log. This information would then form a useful basis for designing training, the effectiveness of which could be monitored through subsequent testing and analysis.

Conclusion—training programs

4.19 While most organisations trained staff and managers in GST processing and compliance matters during implementation, only one had recently carried out formal on-going training.

4.20 Most errors identified in audit testing can be readily addressed through training. Common areas requiring attention include: the identification of compliant tax invoices and processes for dealing with non-compliance; correct coding of transactions; and overriding system-based controls to force system data to match hard copy source data.

4.21 Error rates should be monitored through the use of error logs, which could form the basis for designing training programs for those staff involved with the management and processing of the GST.

Recommendation No. 3

4.22 The ANAO *recommends* that organisations provide focussed on-going training to staff involved in GST processing.

Implementing the recommendation

4.23 Training should address identified processing errors, and be kept up-to-date to ensure legislative changes and other changes relating to GST processes are communicated on a timely basis.

Procedures, templates and checklists

4.24 The existence of up-to-date policies and procedures is a key element for developing guidance for GST transaction processing and reporting. Policy and procedure documentation is also a useful training tool for new employees and helps prevent control breakdowns should, for example, the organisation experience high turnover in personnel.

4.25 Most organisations had updated some of their existing policies and procedures for the impact of GST. However, the extent of completeness of this update differed substantially between organisations. Most documents provide instructions on how to process standard revenue and expenditure transactions but often lack clear guidance on significant but less common transactions. This means that GST processing staff lack the necessary information to process transactions in a way that meets the requirements of the legislation. The most user-friendly documents include descriptions of process as well as management techniques such as system screen prints, process flow charts and decision trees.

4.26 Only three organisations had documented policies and procedures relating to the preparation of the BAS. These included detailed guidance on how to run the reports required to prepare the BAS, and how to verify the data prior to preparation of the BAS including checking and reconciliations to be performed during the BAS preparation process. Most errors identified in audit testing could be detected through a more robust and formal documented procedure that required the BAS authoriser to sign off on a BAS authorisation checklist.

4.27 Three organisations had issued updates to policy via circulars or staff bulletins, but these updates had not been captured in comprehensive policy and procedure documentation. Many organisations use the Intranet to communicate policies and procedures. However, in general, the ANAO noted that staff use of the Intranet is limited, which could mean staff may be unaware of changes.

4.28 Processing of non-compliant tax invoices was a common error in audit testing and was also the most likely error to lead to over-claiming input tax credits. All organisations need to ensure GST processing staff use a checklist template as part of standard procedures to check all requirements for tax invoice compliance. Processing staff at most organisations did not know that the standard process for dealing with non-compliant tax invoices is to request the supplier to submit a compliant tax invoice before processing. These procedures require formalisation and need to be covered during training.

4.29 In the event of an ATO audit, organisations will need to provide documented support for the GST treatment of transactions. The quality of documentation to support complex decisions varied. Furthermore, some workplace procedures included instances of non-compliance—for example, the use of adjustment note and recipient created tax invoice templates that did not comply with the legislation.

4.30 Finally, the ANAO noted that procedures at three organisations provided allowances for travel as a 'per diem' where the employee is not required to produce tax invoices to substantiate the allowance. This means the organisation is unable to claim input tax credits for such payments and creates an opportunity cost of GST leakage. The ANAO acknowledges this issue is unlikely to be resolved in the short term (because travel allowances often form part of an organisation's certified agreement negotiated with staff periodically) but considers that each organisation should continue to research the best way to provide travel allowance that would allow the organisation to benefit from input tax credits that can be legitimately claimed.[27]

Conclusion—procedures, templates and checklists

4.31 Formal, standard procedures are the basis for the proper processing of transactions. All organisations had updated policies and procedures during the GST implementation phase and these continue to provide guidance that ensures most transactions are processed properly. However, most organisations can improve procedures by ensuring they are complete and documented.

4.32 Organisations often lacked procedures for the following: identifying and dealing with non-compliant tax invoices; BAS preparation that includes adequate authorisation and checking controls; and preparing and maintaining documentation to support technical decisions on high-value or significant transactions.

4.33 Managers should check that procedures include templates that comply with the GST legislation. Most organisations would benefit from including standard checklists in normal procedures—for example, a tax invoice compliance checklist and a BAS authorisation checklist. Any changes to standard procedures should be incorporated into training.

Recommendation No. 4

4.34 The ANAO *recommends* that organisations ensure the control framework is supported by appropriate and complete policies and procedures (including checklists) that are compliant with legislation.

[27] This issue has previously been raised by the ANAO in Audit Report No 19, 2000–2001 *Management of Public Sector Travel Arrangements—Follow up audit.*

5. Control Activities

Background

5.1 Control activities refer to that group of specific internal controls that, within an effective control environment, combine to mitigate unacceptable risks to assist the achievement of business objectives. They operate as the organisation's front line of defence in ensuring the existence of basic controls, such as the segregation of duties, authorisation, completeness, accuracy, timeliness and system security. They should also ensure the adequacy of documentation relating to the treatment of transactions in the event of an ATO audit.

5.2 An effective framework includes both preventative and detective controls that minimise the impact of risks and contribute to the efficient and effective delivery of quality program outcomes. Control activities ensure integrity, accuracy and completeness. Importantly, these controls also ensure system access integrity, upon which the integrity of GST reporting relies. In addition, properly designed control activities provide an important key to efficiency in processing. The effectiveness of specific internal controls is greatly enhanced by the surrounding pervasive controls, the control environment, and monitoring and reporting activities, but their failure can create wide-ranging risks, including non-compliance with GST legislation. For this reason, emphasis should be on preventative rather than detective controls.

Audit findings and comment

5.3 Most organisations have established a series of control activities that prevent GST errors. The ANAO noted a wide range of preventative controls including: up-to-date and complete registration with the ATO; logical and complete storage of documentation to support standard transactions; and standard system controls to capture and report GST data.

5.4 The ANAO considered that most organisations could improve detective controls through building additional authorisation and checking mechanisms into the BAS preparation process. The key audit findings are included in Table 5.1.

Table 5.1

Control activities audit findings

Principle	Management has established specific control activities relating to BAS processes and the GST requirements of the expenditure and revenue cycles. These activities mitigate risks, prevent and detect irregularities, safeguard assets, and ensure completeness and accuracy of data.
Audit evaluation criteria	• Management implements detective controls through supervision and review. • The GST function is effectively organised to ensure registration compliance, maintenance of documentation and segregation of duties. • GST related transactions are appropriately authorised. • There are effective preventative and detective controls that ensure the completeness, accuracy and timeliness of GST transactions. • There are effective and complete system controls that protect the integrity of GST data.
Audit findings	Of the six organisations reviewed, the audit found: • five organisations did not segregate the duties of BAS preparation and BAS authorisation; • management review of exception reports to highlight GST anomalies was limited; • at most organisations there was no evidence of GST processing staff using a control checklist to identify non-compliant tax invoices; • the need to improve controls surrounding processing of non-standard transactions; • the FMIS at most organisations is designed to prevent processing of transactions without a GST coding; and • some organisations did not document the reason for their GST treatment of significant transactions in a way that could easily be referenced in the event of an ATO audit.
Sound and better practices	The audit noted the following in at least one of the organisations examined: • performance of substantive checks of sample transactions selected using a defined materiality threshold to ensure they are correctly treated for GST purposes; • analytical review of amounts on the BAS to ensure they appear reasonable and appropriate prior to BAS submission;

Sound and better practices	• logical and complete documentation storage for transactions; • the use of GST control accounts which allow for reconciliation of GST sub-ledgers; • logical access controls to protect BAS submission to the ATO and the electronic funds transfer of GST related funds; and • management review of exception reports to identify errors.

Preparation of BAS

5.5 For most organisations, BAS preparation comprises a relatively straightforward process that starts with running specific BAS reports on the FMIS and ends with the electronic submission of a BAS to the ATO.

5.6 The ANAO noted that most organisations could improve controls surrounding the BAS reporting process, principally through formalising the process and including additional authorisation, checking and reconciliation. While most organisations rely on the integrity of FMIS reporting and provide limited manual input into the BAS, there are often manual adjustments that are not independently reviewed. For example, in some organisations, adjustments to record GST elements of salary packaging were not checked. Instead, these organisations relied on their third party service provider to provide the GST adjustment information, without verifying the accuracy of the data.

5.7 Four organisations did not require management review and authorisation of the BAS prior to submission to the ATO. In some organisations, there is no segregation of duties between the preparation and submission of the BAS, meaning that the same person processes and authorises BAS data without an opportunity for independent checking and review. None of the organisations made use of a checklist to ensure all appropriate procedures were followed prior to submission of the BAS. The absence of such a check increases the risk that anomalies may not be identified, and an inaccurate or incomplete BAS may be submitted to the ATO.

5.8 Five organisations did not review exception reports, for example, a report of all GST-free transactions or transactions where GST is not equal to $1/11^{th}$ of total amount.[28] Review of these reports on a regular basis should eliminate some of the errors, such as mis-coding errors, noted during the audit, and would strengthen controls surrounding the BAS preparation and reporting process.

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[28] For the majority of an organisation's transactions, GST will equal one eleventh of the GST inclusive price. For example, an item priced at $110 comprises $10 GST and $100 before GST was applied—thus GST represents one eleventh of the price.

5.9 Only one of the organisations relied on a largely manual process, including manipulation of spreadsheet data to compile BAS reporting, because of a lack of confidence in FMIS GST reporting. Clearly, any organisation with this kind of FMIS difficulty should resolve it as a matter of urgency.

5.10 Two organisations did not have a process to authorise journal entries. At these organisations, there was a risk that incorrect adjustments to GST accounts could be made and never identified. There was also a risk of miscoding.

Conclusion

5.11 Most organisations are able to use FMIS generated data with limited manual input to properly complete BAS reporting. However, organisations would benefit from expanding and formalising this preparation process to include additional checking controls. The audit noted some use of reviews of the reasonableness of the data but there was limited evidence of exception reporting. Organisations would benefit from combining these types of management controls into a standard BAS preparation checklist that could be used by both preparer and authoriser.

Recommendation No. 5

5.12 The ANAO *recommends* that organisations strengthen controls surrounding the BAS preparation and reporting process through:

- regular management review of appropriate exception reports;
- management authorisation of the BAS using a checklist to ensure all appropriate review activity has been completed prior to submission; and
- segregation of duties between BAS preparation and authorisation.

6. Information and Communication

Background

6.1 Effective information and communication help managers establish whether resources are being directed towards the achievement of desired outcomes in the most efficient, effective and ethical way. With specific reference to GST processes, organisations need to ensure effective lines of communication internally and externally.

6.2 External communication requirements include meeting reporting obligations to the ATO and for statutory financial statement reporting purposes. Internal communication requirements include ensuring managers and processing staff have up-to-date and complete GST information such as the relevance of legislative changes to the organisation. Internally, an organisation must also ensure managers have the right information to make decisions, for example, information on the GST impacts on organisation cash flow and/or the cost of GST processing.

Audit findings and comment

6.3 Five organisations had effectively met their statutory reporting requirements. All organisations could improve information and communication through making more complete use of technical advice and providing information on cash flow. The key audit findings are included in Table 6.1.

Table 6.1

Information and communication audit findings

Principle	The right information about GST and its impacts is communicated to the right people at the right time.
Audit evaluation criteria	• Management regularly communicates relevant information throughout the organisation to assist in the achievement of its objectives. • Management ensures relevant information is also reported externally on a timely basis. • Reporting of performance indicators is used to assess the efficiency and effectiveness of GST processes.

Audit findings	Of the six organisations reviewed, the audit found: • one organisation had not submitted BAS reporting to the ATO on a timely basis; • most organisations had access to external specialist tax advice to provide guidance on GST issues but had not always consulted these advisers on relevant technical matters; many organisations could improve their use of FMIS reporting; • most organisations did not formally monitor or assess the impact of GST on cash flow through regular cash flow forecasting; and • none of the organisations formally considered the effect of the timing of processing of transactions on the subsequent GST liability or GST input tax credit claim with the ATO.
Sound and better practices	The audit noted the following in at least one of the organisations examined: • updates to processes resulting from changes in GST legislation were communicated via the intranet; • total cost of GST implementation was monitored by the GST project team; and • regular cash flow forecasting considering the impact of GST was performed and reported.

Getting GST technical matters right

6.4 Since GST implementation, almost all transactions made by Commonwealth organisations have required a GST decision. Even internal transactions, such as journal entries, require the allocation of a GST code in the organisation's information systems. Commonwealth finance and administrative managers who previously had limited indirect taxation experience are now directly involved in indirect tax processing and reporting.

6.5 During the implementation phase, most organisations accessed specialist advice on their technical profile and other issues. This was supplemented with additional external technical training and professional organisation knowledge sharing.

6.6 However, post implementation, organisations need to ensure they are still treating all transactions in accordance with GST legislation. All organisations need mechanisms to ensure technical advice is accessed on the complete range of transactions and that this information is built into procedures. This is particularly so because of continual developments in the interpretation of the legislation as well as the on-going issuance of new rulings by the ATO.

6.7 Most organisations had not documented tax positions or policies on the range of transactions, which indicates that processing staff and managers lack adequate guidance. Documentation of the technical positions adopted would provide useful reference tools for relatively simple but common transactions—such as, the distinction between GST-free and 'out-of-scope' supplies—as well as the more complex treatments.

6.8 Two organisations, which faced technical tax matters of serious operational importance, consulted with specialist tax advisors on a periodic basis. However, the ANAO considers that the management and communication of this information could be improved. One organisation was in the process of disputing an ATO ruling on its core operational activity with fundamental impacts on all BAS reporting since 1 July 2000 as well as the possibility that large input tax credit claims might need to be reversed. The other organisation had insufficient documentation to justify the GST treatment of a major 2001 revenue stream.

6.9 While other examples identified in audit testing were less serious, most organisations had embodied, to varying degrees, some form of technical non-compliance in formal procedures or practices.[29] These included:

- generation and treatment of recipient created tax invoices that did not meet statutory requirements;
- incorrect GST treatment of foreign exchange transactions;
- incorrect standard GST treatment of a minor revenue stream;
- non-compliant template for adjustment notes;
- designing a process that allowed claiming of input tax credits on the basis of purchase orders rather than tax invoices;
- no formal tax position on a significant matter, dealing with the treatment of progressive, periodic supplies by the organisation; and
- treatment of supplies as GST-free under a high value 'grandfathered' contract[30], without adequate evidence that the contract was 'grandfathered' for GST purposes.

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29 The ANAO distinguished errors of technical non-compliance from errors relating to non-compliance with standard procedure.

30 A 'grandfathered' contract is a contract which was entered into prior to 8 July 1999 (or in some cases 2 December 1998) under which there is no opportunity to allow the consideration to be increased to enable GST to be charged. Supplies made under a 'grandfathered' agreement are treated as GST-free prior to 1 July 2005, or until an earlier review opportunity arises.

6.10 The audit also identified instances where organisations could have utilised more efficient processing mechanisms allowed by legislation; for example, by streamlining the processing of routine settlement rebates and progress payments on large invoices.

Conclusion—getting GST technical matters right

6.11 While the focus of the audit was on GST processes rather than technical tax treatments, the ANAO noted two organisations had significant unresolved technical tax issues. Further, most organisations had embodied some form of non-compliance with the legislation into procedures or work place practices.

6.12 It was unclear whether technical non-compliance is always the result of not accessing adequate technical advice or failure to implement an appropriate mechanism for communicating and implementing this advice. The key message is that Commonwealth organisations should make sure they have sufficient information and communication processes to ensure the correct GST treatment of transactions.

Recommendation No. 6

6.13 The ANAO *recommends* that organisations:

- obtain appropriate technical advice for GST impacted transactions; and
- ensure that technical positions adopted are formally recorded, and included in GST procedural documentation and training programs.

Cash flow management

6.14 Sound cash management by organisations is integral to the effective management of organisation resources and also assists management of the Commonwealth's overall borrowing activities. In this context, management should consider the GST impacts in terms of gaining maximum cash flow advantage.

6.15 Most of the organisations performed little cash forecasting. This was primarily because management of these organisations did not perceive cash flow as a significant risk to the organisation. Without more complete information, management is unable to make active and effective cash management decisions, for example, how much to invest and for how long.

6.16 While not all of the following may be suitable in the context of an organisation's operating environment, managers should consider the following practical steps to improve cash management:

- *BAS submission*: if an organisation is in a net GST refund position, it should submit BAS reporting as soon as possible after month-end, rather than waiting until the final compliance deadline. If the BAS is submitted earlier, the ATO will normally refund the organisation sooner and these funds will be available for investment for longer. The converse applies for any organisation in a net remittance position—in these cases, cash flow management better practice would be to remit funds on or close to the due date for submitting the BAS.
- *Claiming input tax credits*: for most organisations, using the accrual basis for BAS reporting, input tax credits recorded on the BAS are drawn directly from system records of invoices entered into the FMIS. All invoices, and all input tax credits will be included—for example, both invoices waiting for approval and invoices that have been paid will contribute to the amount of input tax credit in one month's BAS reporting. Organisations therefore have an additional reason to ensure invoices are entered into the system on a timely basis and minimise delays between organisation receipt and system entry. Such delays commonly arise when hard copy invoices must be sent to geographically dispersed divisions for approval; organisations are not affected by this process, where the approval of invoices is online.
- *Billing customers*: for most of the organisations in this audit, revenues from customers were far less significant than their appropriations from Government. However, organisations need to consider the timing of invoicing customers in relation to the timing of reporting—and paying—output tax to the ATO. For example, if an invoice is raised on the last day of a month, any related output tax will be due to the ATO in the next month's BAS. The organisation has limited time to collect the monies from the customer prior to BAS reporting and, in fact, may often report (and pay) tax to the ATO prior to receipt of funds from the customer. By contrast, for any bill raised on the first day of the month, the organisation has more than a month to collect the cash before including the transaction in that month's BAS. Clearly, in considering this aspect of cash management, managers also need to consider any overall cash flow disadvantage related to delaying billing.

Conclusion—cash flow management

6.17 Five organisations reported a significant regular net GST refund position to the ATO. However, there was limited monitoring of the impact of GST on cash flow. As well, most organisations had not implemented mechanisms to leverage any possible cash flow advantage. For example, most had not considered how to time: the claiming of input tax credits; the reporting of output tax; and the BAS submission—in order to create a cash flow advantage.

6.18 The ANAO considers that organisations should actively seek opportunities to manage cash flow and identify any related opportunities for short or long-term banking investments.

Recommendation No. 7

6.19 The ANAO *recommends* that organisations implement formal monthly cash flow management that considers the impact of timing of transactions with significant GST implications.

Implementing the recommendation

6.20 This should include designing processes that allow for maximising the benefit from managing the timing of transactions to ensure cash flow advantage is gained wherever possible.

7. Monitoring and Review

Background

7.1 Monitoring and review is the final component of an effective control framework. It is a key part of an organisation's continuous improvement process that ensures the organisation implements effective processes and tools to monitor and review relevant data. In relation to GST processes, the audit considered organisations' use of both periodic reviews, such as those undertaken by Internal Audit and external consultants, as well as in-built review mechanisms, such as control self-assessment.

7.2 Monitoring and review provide assurance and feedback on whether objectives are being achieved efficiently and effectively. They also provide an on-going check on the effectiveness of the control structure. Activity in this area significantly impacts continuous improvement. Periodic monitoring and review is often aligned with the sharing of ideas, both across the organisation and externally. This is associated with the benefits of sourcing independent and objective views. In-built monitoring and review mechanisms, such as control self-assessment, encourage ownership of controls and an enhanced control structure.

Audit findings and comment

7.3 The audit found limited evidence of a continuous improvement approach to GST processing. In general, organisations had undertaken limited activity since implementation, before and around July 2000.

7.4 While there was evidence of some in-built monitoring and review, more formal periodic and on-going testing of transactions could be undertaken. Several organisations used internal audit or specialist consultants to review their implementation activity around July 2000 but only two had used internal audit to assess GST processing during the following year. Table 7.1 outlines the key audit findings.

Table 7.1
Monitoring and review audit findings

Principle	There is evidence of a continuous improvement approach to GST processing.
Audit evaluation criteria	The organisation makes effective use of in-built and/or periodic monitoring and review mechanisms.
Audit findings	Of the six organisations reviewed, the audit found most organisations had undertaken an internal audit of GST implementation activity but only two had used Internal Audit to monitor GST activity during the first year of GST implementation.
Sound and better practices	The audit noted in at least one of the organisations examined that analytical and substantive testing of sample transactions during BAS preparation was being undertaken to ensure transactions had been treated correctly for GST purposes.

Continuous improvement

7.5 All of the organisations indicated their support for continuous improvement of GST processes. Four of the organisations used limited quality assurance processes in the preparation of the BAS. These included substantive checking of material transactions and a review of the amounts included on the BAS to ensure they appeared reasonable. However, none maintained an error log that could be used to record recurring errors and thus clarify the need for further training, as well as designing subsequent periodic testing. Many of the errors identified in the ANAO's audit testing could have been detected by an individual organisation's targeted testing program.

7.6 Several organisations commissioned independent reviews of GST implementation activity including the integrity of system design. All organisations had active internal audit functions and annual programs but most had not specifically considered GST. One organisation had considered and reported on GST as part of a financial function internal audit. Another internal audit function had undertaken limited substantive testing designed to ensure system coding controls were operating effectively.

Conclusion

7.7 Organisations had not focused on the continuous improvement of GST processing. Most do not undertake formal testing of transactions and only two had used Internal Audit to examine aspects of GST. None maintained formal error logs.

Recommendation No. 8

7.8 The ANAO *recommends* that organisations increase continuous improvement activity associated with GST processes through, amongst other things: regular periodic testing of transactions; the establishment of error logs that can be used to design training, controls and future testing; and the use of periodic independent audits.

Canberra ACT
29 May 2002

P. J. Barrett
Auditor-General

Appendices

Appendix 1

Statistical Testing Background

Summary

The ANAO consulted the Australian Bureau of Statistics (ABS) on the audit sampling approach to statistical testing. The ABS confirmed that:

- a sample size of 160 transactions allows the audit to support conclusions about estimates of the population at the level of accuracy as described in Table A1.1; and
- systematic sampling is a preferred methodology in the circumstances as it provides a random sample with reasonable coverage of transactions across all tax codes and dollar values. This allows the audit to make valid inferences about the population on the basis of the transactions selected.

Table A1.1 below provides a basis for making statements about the test results.

Sample size

The audit examined the question of sample size in the context of the following key factors:

- the ATO had no publicly available standards on sample sizes or confidence intervals for undertaking GST audits of organisations at the time the audit commenced. The ATO has subsequently released a paper titled *Auditing Statistical Sampling Guidelines* on the ATO assist website.[31]
- GST law allows the ATO to retrospectively assess any taxpayer for a period of up to four years. In addition, the ATO will apply a General Interest Charge (GIC) which is currently around 11.31 per cent compounding where GST is under-remitted. However, there is no legislative provision to impose this charge on Commonwealth Government organisations.
- There is no minimum level of error that the ATO will necessarily ignore.
- Prior to the audit, there was no basis to conclude in advance what the probable level of error would be in relation to GST processing by Commonwealth organisations. Small GST processing errors can add up to significant material amounts over a period of time due to the volume and value of taxable transactions being processed by organisations.

Accordingly, a sampling tool was used to calculate an appropriate sample size in populations with sizes between 10 000 and 10 000 000 transactions, using

[31] Refer http://atoassist/content.asp?doc=/content/Professionals/AuditStatistics.htm.

attributes sampling, an upper error limit of one per cent, a confidence level of 80 per cent and a negligible expected error rate. The tool suggested a sample of 160 on this basis.

The ANAO prepared Table A1.1 below to examine what the test results, based on a sample of 160, would mean once actual errors were discovered, that is if the initial assumption that organisations do not make GST processing errors was found to be incorrect.

The table examines possible test results and what they mean against three different confidence levels, on a two-sided confidence interval basis. The table was prepared for the purposes of giving an indication of the likely confidence intervals that would emerge following the sampling and does contain some approximations. While the initial presumption was that any GST processing error is unacceptable, the table was developed on the basis that it would be useful to understand the significance of the test results on a best and worst case basis, hence the use of a two-sided confidence interval.

Table A1.1

Statistical data for evaluating test results

Error rate found in sample (%)	Confidence Levels and Intervals		
	80%	90%	95%
50	44.9–55.1	43.5–56.5	42.3–57.7
40	35.0–45.0	33.6–46.4	32.4–47.6
30	25.4–34.6	24.1–35.9	22.9–37.1
27	22.5–31.5	21.2–32.8	20.1–33.9
25	20.6–29.4	19.4–30.6	18.3–31.7
20	16.0–24.0	14.8–25.2	13.8–26.2
18	14.1–21.9	13.0–23.0	12.1–23.9
16	12.3–19.7	11.2–20.8	10.3–21.7
14	10.5–17.5	9.5–18.5	8.6–19.4
12	8.7–15.3	7.8–16.2	7.0–17.0
10	7.0–13.0	6.1–13.9	5.4–14.6
9	6.1–11.9	5.3–12.7	4.6–13.4
8	5.3–10.7	4.5–11.5	3.8–12.2
7	4.4–9.6	3.7–10.3	3.1–10.9
6	3.6–8.4	2.9–9.1	2.3–9.7
5	2.8–7.2	2.2–7.8	1.6–8.4
4	2.0–6.0	1.4–6.6	0.9–7.1
3	1.3–4.7	0.8–5.2	0.3–5.7
2	0.6–3.4	0.2–3.8	0–4.2
1	0–2.0	0–2.3	0–2.5

Using the data in the table, if, for example, there was an error rate of 25 per cent in a sample of 160 transactions, it could be concluded using the table above with 80 per cent confidence that there was an error rate of between 20.6 and 29.4 per cent in the population of transactions.

Using the table, a sample size of 160 would support a level of accuracy sufficient for the organisation's requirements, based on any error rate achieved from the sample. Thus, the suggested sample size of 160 transactions was an appropriate basis for the audit.

Systematic sampling

The ANAO used a systematic sampling method to obtain the 160 transactions to be tested from the full population of each organisation's FMIS transactions in the fiscal year 2000–01, in a way that allows the commentary and analysis to be on the basis that the sample was random.

The purpose of systematic sampling was therefore to provide a random sample with reasonable coverage of transactions across all tax codes and dollar values. The population was also sorted by quarter to enable a reasonable spread of sample units across all quarters.

The sampling method included the following:

- complete listing of transactions from 1 July 2000 to 30 June 2001 sorted by tax code;
- sorting by quarter;
- sorting by ascending dollar values within each quarter and within each tax code;
- determination of interval selection from the total number of units in the population and the requirement for a sample of 160; and
- random number generation to determine the starting point of systematic sampling.

Testing criteria

Each transaction was allocated a pass or fail indicator based on the following:

- tax invoice compliance;
- withholding compliance where the supplier does not provide an ABN;
- under-claim or over-claim of GST;
- GST displayed on invoice compared to system entered data;

- accuracy of data entry from invoice to FMIS;
- accuracy of tax coding; and
- adequacy of supporting documentation.

Each transaction was audited against the above criteria. Given the complex nature of each organisation's operations and GST obligations, the compliance requirements for each transaction tested were not the same. In some cases, the audit used informed, but subjective, judgement to pass or fail a transaction. In considering whether a transaction passed or failed audit testing, the audit considered the concept of an error as:

- the absence of a process that meets the requirements of GST legislation;
- the absence of a process to mitigate potential ATO requirements in the event of an audit; and
- the absence of practical controls that meet normal, reasonable requirements of a Commonwealth organisation.

Financial and non-financial errors

The audit classified each error as either a 'financial' or 'non-financial' error using the criteria specified in Table A1.2. Financial errors represent transactions where there has been an error in dollar GST reporting, according to statutory requirements. Non-financial errors do not have a dollar impact but represent errors in processing that require correction.

Although errors were classified as either financial or non-financial in their effect, the nature of the sampling methodology used (known as attributes sampling) does not indicate the amount of dollar error likely to exist in all transactions. Instead, as the sample testing was undertaken to support control framework observations, the results indicate the rate of occurrence or frequency of GST process control errors.

Table A1.2

Financial / non-financial error types

Error type	Financial error	Non-Financial error
Invalid tax invoice/ adjustment note	No tax invoice available to support claim of input tax credits.	Incorrect documentation issued in respect of a supply made, eg: • invalid tax invoice issued; • duplicate tax invoices issued; • invalid adjustment note issued in respect of an increasing adjustment.
	Tax invoice missing one or more elements to be a valid tax invoice.	
	No adjustment note held or an invalid adjustment note held to support a decreasing adjustment.	
Inadequate documentation	Adequate documentation to support GST treatment not provided within a reasonable period.	Adequate documentation to support GST treatment not provided within a reasonable period but no financial impact e.g. lack of records to justify sources of tax data or basis for tax decisions.
Miscoding	Coding error resulting in over- or under-claim of input tax credits.	Miscoding between same GST rated items resulting in incorrect BAS disclosure, eg: • GST-free and out-of scope supplies; • capital acquisition (GST 10 per cent) and Non capital acquisition (GST 10 per cent).
	Coding error resulting in over- or under-payment of GST payable.	
Data entry	Data entry error resulting in over- or under-claim of input tax credits.	Data entry error where error impacts disclosure on the BAS but due to BAS compilation approach, does not result in an under- or over-payment of GST.
	Data entry error resulting in over- or under-payment of GST payable.	

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