

The Auditor-General
Audit Report No.55 2001-02
Performance Audit

Administration of Tobacco Excise

Australian Taxation Office

© Commonwealth
of Australia 2002

ISSN 1036-7632

ISBN 0 642 80643 8

COPYRIGHT INFORMATION

This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth, available from AusInfo. Requests and inquiries concerning reproduction and rights should be addressed to:

The Manager,
Legislative Services,
AusInfo
GPO Box 1920
Canberra ACT 2601

or by email:
Cwealthcopyright@finance.gov.au

Canberra ACT
7 June 2002

Dear Madam President
Dear Mr Speaker

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

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.

Auditor-General reports are available from Government Info Shops. Recent titles are shown at the back of this report.

For further information contact:
The Publications Manager
Australian National Audit Office
GPO Box 707
Canberra ACT 2601

Telephone: (02) 6203 7505
Fax: (02) 6203 7519
Email: webmaster@anao.gov.au

ANAO audit reports and information about the ANAO are available at our internet address:

<http://www.anao.gov.au>

Audit Team

Medha Kelshiker
Jonathan Hansen
Christian Anderson
Peter White

Contents

Summary and Recommendations	7
Summary	9
Background	9
Audit objective	11
Overall conclusion	11
Recommendations	12
Key Findings	13
Tobacco excise governance arrangements—Chapter 2	13
Intelligence—Chapter 3	17
Field Services' Compliance and Investigations Activities—Chapter 4	20
Recommendations	22
Audit Findings and Conclusions	25
1. Background and Context	27
Introduction	27
Australian Taxation Office	28
The tobacco industry in Australia	28
Overview and history of tobacco excise	29
The Audit	37
2. Tobacco Excise Governance Arrangements	39
Tobacco excise management arrangements	39
Strategic and business planning	41
Risk management	45
Performance management and reporting	53
Conclusion	55
3. Intelligence	57
Introduction	57
The tobacco excise intelligence framework	59
Coordination of <i>chop-chop</i> intelligence within the Excise Business Line	60
Intelligence gathering and analysis skills of the excise staff	62
Information technology (IT) infrastructure to support the collection and analysis of intelligence	64
Coordination of <i>chop-chop</i> intelligence between the Excise Business Line and external stakeholders	68
Conclusion	75
4. Field Services' Compliance and Investigations Activities	76
Introduction	76
Field services' compliance	77
ATO/Customs joint approach to compliance	80
Tobacco excise investigations	81
Conclusion	87

Appendices	89
Appendix 1: Overview of the Australian Tobacco Industry	91
Appendix 2: Comparison of Australian and a range of international cigarette tax rates	98
Appendix 3: Recommendations from Audit Report No. 17 2001–2002, <i>Administration of Petroleum Excise Collections</i> – Australian Taxation Office –Tabled 26 October 2001	99
Appendix 4: Excise Organisational Framework	112
Appendix 5: Tobacco Industry Group Structure	113
Appendix 6: Aggressive Tobacco Project	114
Appendix 7: Analysis of revenue leakage associated with <i>chop-chop</i>	116
Appendix 8: Customs’ Intelligence Cycle	118
Appendix 9: Status of Tobacco Excise Compliance activities	119
Glossary/Abbreviations	120
Index	123
Series Titles	125
Better Practice Guides	129

Summary and Recommendations

Summary

Background

1. Excise duties are levied on excisable goods¹ that have been produced domestically and intended for consumption in Australia. Excise duties are not payable on goods exported from Australia. Customs duties are imposed on imported goods. The three main categories of goods subject to excise duties² are:

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

2. This audit focused on the Australian Taxation Office's (ATO) administration of **tobacco** excise duties and is designed to complement a previous Australian National Audit Office (ANAO) audit into the ATO's administration of petroleum excise duties (the Petroleum Excise Audit).³ The Petroleum Excise Audit examined whether the ATO had implemented effective administrative arrangements for the collection of petroleum excise.

3. The ATO's Excise Business Line (EBL) is responsible for managing commodity-based revenue and business payment (transfer) systems. The EBL collected excise revenue of \$19.3 billion in 2000–01, which accounted for 11.6 per cent of the total tax revenue collected by the ATO for that year.⁴ Revenue attributable to tobacco products collected by the EBL in 2000–01 totalled \$4.7 billion, which accounted for 24 per cent of total excise collections in that year.⁵

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

² Excisable goods and applicable excise duty rates are set out in the Schedule to the *Excise Tariff Act 1921*.

³ ANAO Audit Report No.17, 2001–2002 *Administration of Petroleum Excise Collections*, Australian Taxation Office.

⁴ In 2001–02 the EBL estimates it will collect \$19.5 billion in excise revenue.

⁵ Excise revenue attributable to tobacco products in 2001-02 is estimated to total \$4.8 billion.

4. The Australian tobacco industry is comparatively small, representing only 0.2 per cent of the world's tobacco production. It comprises growers, dealers, manufacturers and retailers. The deregulation of the tobacco industry,⁶ the introduction of a uniform taxation regime⁷ on excisable products, and the introduction of the 'per-stick' method⁸ for calculating excise have all contributed towards a changing tobacco industry in Australia. There has been a fall in the quantity of tobacco product cleared under excise by the ATO, although tobacco excise collections have steadily increased each year (except in 2000–01).

5. There are four key factors that have affected the demand for licit Australian tobacco. These are:

- manufacturers are not required to use Australian tobacco in the production of their tobacco products;
- Government 'anti-smoking' education programs;
- the higher cost of tobacco products resulting from the imposition of Government excises and taxes; and
- the growth in the trade of illicit tobacco product.⁹

6. An area of significant risk to tobacco excise revenue, and therefore a key focus of this audit, was *chop-chop*,¹⁰ the excisable product that is the subject of illicit tobacco trade, in Australia.

⁶ In January 1995, the Federal Government deregulated tobacco production in Australia and abolished the minimum tobacco leaf quota (manufacturers were provided import tariff concessions if a specified proportion of local tobacco leaf was used in the production of tobacco products), thereby reducing the tariff on imported tobacco leaf products to zero.

⁷ Until 1997, most States and Territories applied varying business franchise fees in addition to the excise duties levied at the Federal level. In August 1997, the High Court ruled the State business franchise fees to be unconstitutional. As a result, from 1997 to 1999–2000, the Commonwealth Government collected an increased rate of excise duty on tobacco products and reimbursed surcharge amounts to the States under agreed 'safety net' repayment schemes until the introduction of the Goods and Services Tax (GST) from 1 July 2000 (minor amounts of surcharge revenue were collected in July and August 2002).

⁸ Prior to 1999, tobacco excise was calculated on the weight of tobacco products produced by the manufacturers. Taxing on a weight basis encouraged the production and consumption of lighter weight cigarettes. In November 1999, there was a change in the method of calculating excise on tobacco products. Tobacco excise is now measured on a per stick basis, thereby encouraging the production and consumption of fewer cigarettes with heavier weight.

⁹ Illicit tobacco trade in Australia includes: smuggling of tobacco product into Australian domestic markets; smuggling of counterfeit tobacco product into Australian domestic markets; diversion of Australian-produced underbond stock for export into domestic market; and production and sale of Australian-grown tobacco (*chop-chop*) on which excise has not been paid.

¹⁰ Generally refers to Australian-grown and manufactured tobacco that is sold illicitly in a chopped-up form to Australian consumers, and upon which excise has not been paid. However, there have recently been cases of imported leaf being smuggled for the *chop-chop* market.

Audit objective

7. The objective of the audit was to assess the ATO's administration of tobacco excise. The ANAO considered three key areas in addressing the audit objective:

- tobacco excise governance arrangements, including planning, risk management and performance management and reporting;
- collection and analysis of intelligence, including an assessment of intelligence capabilities relevant to the detection and prevention of trade in illicit Australian-grown tobacco; and
- tobacco-related field services compliance and investigations activities, including assessing the extent to which these activities were aligned with the tobacco risk management strategies and plans.

8. Although the audit examined these broader aspects of the ATO's administration of tobacco excise, we placed particular emphasis on the strategies used by the ATO to address the proliferation of *chop-chop* in Australian markets as a major risk to revenue.

Overall conclusion

9. The ANAO concluded that the ATO has arrangements in place for the effective administration of tobacco excise. We found that the ATO has also implemented appropriate governance arrangements to manage tobacco excise administration. To address the risk of *chop-chop* to tobacco excise revenue, the ATO has established an intelligence framework to collect, analyse and store suitable intelligence, particularly with regard to *chop-chop*. Further, the ATO is working to better align its field services compliance and investigations activities with its tobacco risk management strategies and plans.

10. That said, the ANAO found that the ATO could improve its administration of tobacco excise in a number of areas, including:

- articulating clearly appropriate strategies and measures aimed at achieving the objectives identified in the tobacco excise business planning documents and assessing agency performance against these objectives;
- developing partnerships with appropriate stakeholders to more accurately quantify revenue leakage associated with *chop-chop* (indicatively, excise loss attributed to the *chop-chop* market is currently estimated to range between \$99 million and \$450 million per annum) and to develop more informed risk assessments;
- establishing a tobacco intelligence capability that can effectively contribute to the ATO's compliance outcomes and support tobacco-related strategic, operational and tactical levels of decision-making;

- establishing suitable liaison arrangements with authorities capable of providing relevant intelligence relating to *chop-chop*; and
- improving aspects of its internal and external relationship management, including sharing of information and intelligence within the ATO.

Recommendations

11. The ANAO has made eight recommendations to strengthen key areas in tobacco excise administration. The ATO agreed to the recommendations, two with qualification, and advised that the report will be helpful in further developing its tobacco excise program.

Key Findings

Tobacco excise governance arrangements—Chapter 2

12. The Excise Business Line (EBL) is responsible for administering the excise function. Its Revenue and Intelligence Branch is responsible for managing excise revenue collection and developing industry and other intelligence to improve policy and compliance for the three Excise Industry Groups.¹¹ The Field Services Branch is responsible for providing compliance and investigations services to the Excise Industry Groups.

13. The Tobacco Excise Industry Group (TIG) is responsible for the collection of revenue, the development of tobacco excise policy, and monitoring compliance within the tobacco industry (growers, dealers and manufacturers).

Strategic and business planning

14. In May 2001, the ATO introduced revised planning arrangements with a view to improving the existing arrangements. The revised arrangements aim to clarify the ATO's priorities by adopting a more system-based view of their work, building stronger collaboration across the ATO and ensuring the most appropriate deployment of its resources. A key element of the revised planning arrangements is the development of a suite of ATO plans for 2001–02 consisting of a Strategic Statement and four plans (Compliance Plan, Operational Plan, Information Technology Plan and a People Plan). These four Plans comprise the ATO Plan for 2001–02.

15. In order to achieve its component of the ATO plan, the EBL has developed a Delivery Plan for 2001–02 through which it is accountable for achieving activities in the higher-level ATO Plans. The Delivery Plan includes a series of compliance strategies relating to managing risks and compliance. In addition, the TIG and Field Services have developed separate (*but linked*) Business Plans for 2001–02. These are their logistical or tactical delivery plans for the EBL with regard to tobacco excise and compliance and investigations services respectively.

16. Overall, the ANAO considers that the TIG and Field Services Branch's approach to developing their individual Business Plans was sound and reflects a commitment to achieving objectives stated in the higher-level ATO Plans (e.g. the ATO Compliance Plan). However, the ANAO notes that there is scope to strengthen certain aspects of the TIG Business Plan. The ANAO considers

¹¹ The Excise Industry Groups covering the administration of excisable goods are: tobacco; alcohol; and petroleum.

that the strategies and performance measures relating to areas of secondary focus were not adequately developed. The ATO advises that the strategies in question (intelligence and internal capability)¹² are being addressed and it is working on implementing them.

17. The ANAO considers that this approach will enable the ATO to fully realise the leverage and resources it has at its disposal to minimise revenue loss. Further, the magnitude of the revenue lost each year due to the *chop-chop* industry, the involvement of organised crime¹³ and the steady growth of this market in recent years, warrants the need for effective systems and processes as part of an integrated approach to redressing the problem of *chop-chop*. This would be congruent with the new ATO approach to risk management that emphasises the achievement of corporate alignment and integration of risk analysis and treatment activities.

Risk management

18. The ATO has adopted a strategic approach to assessing and managing tobacco excise risks, in particular, illicit tobacco (including *chop-chop* and diversion of duty-free products). In managing these risks, the TIG has implemented a number of initiatives as part of an overall tobacco strategy.¹⁴ These include: making legislative changes; holding meetings and education seminars with the tobacco cooperatives on the legislative changes; and developing a field compliance audit program to monitor tobacco growers, manufacturers and duty-free operators' compliance with excise legislation.

19. In further addressing the risks relating to tobacco growers, the TIG has recently developed, and is implementing, a targeted project, *Aggressive Tobacco Project 2001–02* to address the problem of *chop-chop* at the point of supply. However, the ANAO noted the following areas require further consideration:

- tobacco retailers/tobacco sellers;
- strategic partnerships with stakeholders; and
- quantification of revenue leakage from *chop-chop*.

¹² Refers to the staff and systems required to support an intelligence capability.

¹³ Commonwealth law enforcement authorities have evidence to link organised crime groups to the trade in *chop-chop*.

¹⁴ In assessing the risks related to *chop-chop*, the Illicit Tobacco Strategy was developed by the ATO in May 1999. In 2001, the Illicit Tobacco Strategy was re-assessed to determine the extent to which it was implemented. The 2001–03 Tobacco Strategy (Tobacco Strategy) was the outcome of this process and identifies target client groups, strategies to manage risks in relation to each of the client groups and a time-frame within which to implement these strategies.

Tobacco Retailers/Tobacco Sellers

20. There are currently 48 000 tobacco retailers operating in Australia. The ATO's strategies in managing the risks at the retail end have largely related to enforcement rather than client education and awareness. The ANAO acknowledges that it is appropriate to curtail the problem of *chop-chop* at the point of supply. However, complementary preventative initiatives through education and awareness strategies of retailers are also likely to make an important contribution to minimising the illegal trade of *chop-chop* and provide useful intelligence.

21. The ATO advised the focus on retailers was assigned a low priority, as there is greater leverage with intervention further up the supply chain. However, the ATO acknowledges also that education/targeting of retailers during 2002 remains a component of the overall strategy to mitigate risks. The ANAO notes that, as part of a recent staffing restructure within the TIG, staff have now been specifically assigned to liaise with the tobacco retail sector to increase client education and awareness.

Strategic partnerships with stakeholders

22. Strategic partnerships with stakeholder organisations are a key component of tobacco excise administration and the management of risks relating to *chop-chop*. These stakeholder partnerships (with law enforcement authorities, Department of Health and Ageing [Health], Department of Agriculture, Fisheries and Forestry - Australia [AFFA] and tobacco industry) may provide valuable intelligence relating to law enforcement and social issues. As well, they may help to establish a viable network for the exchange of information and ongoing communication.

23. The TIG has invited Health and AFFA to participate in regular industry liaison meetings. However, it has not explored opportunities to develop formal partnerships with these stakeholders. The TIG's partnerships with law enforcement authorities is discussed in sections relating to intelligence. An ongoing responsibility of Health is to conduct household surveys¹⁵ to determine the prevalence of smoking in Australia. The ANAO considers that the data from the surveys could be useful to the TIG to help estimate the impact of *chop-chop* on the Australian tobacco market. The TIG could also provide formal input into survey questions on *chop-chop*.¹⁶

¹⁵ Health, in cooperation with AIHW has conducted several National Drug Strategy Household Surveys since 1985. These surveys cover attitudes, beliefs and behaviours of households to alcohol, tobacco, illicit drugs, etc. The 2001 Survey covers questions on roll-your-own tobacco and *chop-chop*. In conjunction with this survey, Health has conducted National Tobacco Campaign Surveys (referred to as Tracking Surveys) since November 1997 as a regular feature of its Campaign evaluation strategy.

¹⁶ The ATO advised that input was provided into the 2001 Tracking Survey, albeit on an informal basis.

24. Similarly, AFFA maintains contact with the tobacco industry to remain informed of significant developments and thus provide appropriate advice and briefings to Government as required. Therefore, the TIG could benefit from sharing information with AFFA.

Quantification of revenue leakage

25. The ANAO acknowledges that it is not easy to precisely estimate revenue loss attributed to the *chop-chop* market. However, it is important to do so because:

- it helps contribute to the accuracy of the revenue estimation process;
- strategies developed to manage risks to tobacco excise revenue need to be commensurate with the magnitude of the problem to be effective; and
- when an approach to systematically quantify revenue leakage is established, comparative assessments can be made to determine the effectiveness of the risk management strategies over time.

26. At this stage, the ATO has not been able to fully quantify the revenue loss that can be attributed to the *chop-chop* market. Industry estimates that \$450 million per annum in excise loss (equivalent to almost 10 per cent of the total tobacco excise revenue collected annually) can be attributed to the *chop-chop* market.

27. To obtain another perspective on tobacco excise revenue leakage, the ANAO worked with Health and the Australian Institute of Health and Welfare (AIHW) to analyse the tobacco-related information collected through its surveys (see paragraph 23). The survey data indicated that the revenue loss from *chop-chop* ranged between \$99 million and \$220 million per annum. The ANAO notes that the survey accounts for 86 per cent of tobacco cleared by the ATO and Customs for domestic consumption. The difference (14 per cent) in the cigarette consumption as reported through the survey, compared to the ATO and Customs¹⁷ cigarette clearance statistics, could possibly be due to smokers understating their cigarette consumption. This could partially explain the gap in the revenue loss estimated by the industry and the revenue loss estimated from the household surveys.

28. The ATO considers it is difficult to get an accurate estimate. However, it accepts *chop-chop* is a problem which is being addressed through an active compliance strategy. The ANAO considers that the information collected through these surveys (on use of *chop-chop* and smoking prevalence rates) could help the ATO gain an alternative perspective in understanding the magnitude of the *chop-chop* market in Australia.

¹⁷ As mentioned in the Petroleum Excise Audit, Customs is responsible for collection of duty payable on tobacco products imported into Australia for domestic consumption.

Performance management and reporting

29. Reporting on the administration of tobacco excise reflected the revised ATO planning arrangements for 2001–02. The quarterly governance report prepared by the EBL includes sufficient information for the ATO Executive to assess the Business Line’s achievements in relation to the administration of tobacco excise. Similarly, the EBL’s internal performance reports also include information on a number of aspects relating to tobacco excise administration, thus effectively contributing to the corporate governance reporting process.

Intelligence—Chapter 3

30. Sound intelligence is a necessary element of informed decision-making about the strategic direction, planning, and allocation of resources within an agency. In this context, an effective intelligence framework is essential to the ATO’s administration of tobacco excise, given its exposure to the *chop-chop* market and the nature of the legislation it administers.

31. The intelligence requirements of the EBL in relation to the *chop-chop* market differ significantly from the intelligence requirements of other ATO activities, particularly with regard to timeliness and accuracy of intelligence. Without accurate and timely intelligence, excise officers could be placed in a quite disadvantageous position, possibly involving physical danger, given the involvement of organised crime in this industry.

Coordination of chop-chop intelligence within the Excise Business Line

32. The EBL has established an intelligence framework to collect, analyse and store intelligence particularly with regard to *chop-chop*. Nevertheless, the responsibility, with regard to the collection and analysis of strategic, operational and tactical tobacco-related intelligence, is not articulated clearly in the EBL’s planning and other documentation.

33. Current arrangements have resulted in duplication of activities and have inhibited the sharing of tobacco-related intelligence. For example, each area has developed its own intelligence methodologies and systems to gather and analyse tobacco-related information. Neither the methodologies, nor the systems developed, are compatible.

Intelligence gathering and analysis skills of the excise staff

34. The intelligence gathering and analysis skills of excise staff vary considerably between individual teams in both the Revenue and Intelligence

Branch and the Field Services Branch. For example, the Investigations Unit within the Field Services Branch, which has many staff with experience in law enforcement authorities such as the Australian Federal Police (AFP) and Customs, has a good knowledge base on intelligence methodology and practice.

35. However, within the TIG and elsewhere within the EBL, staff in key intelligence positions have not undertaken specialised strategic, operational and tactical intelligence training. In some cases, they may not have the necessary background, experience and knowledge to undertake this function. The ANAO notes that specialised strategic intelligence training is important to those officers who currently develop intelligence policy, as well as taskings for both the Compliance and Investigations Units.

36. The ANAO considers it is essential that relevant TIG and Investigations officers are appropriately trained to effectively gather and analyse strategic, operational and tactical intelligence, depending on their specific roles and responsibilities. The ATO acknowledges that it needs to address this issue.

Information technology (IT) infrastructure to support collection and analysis of intelligence

37. An essential component of a modern effective intelligence framework is a well structured, reliable and secure IT intelligence system. An effective IT intelligence system is capable of storing, sorting, interrogating and analysing large amounts of intelligence so that it can be accessed by, or disseminated to, appropriate staff in a timely way.

38. The EBL currently uses numerous stand-alone databases to record information from investigations and compliance activities and information received by the TIG. These databases are maintained separately and access is limited to relevant staff in that area. As a result, the information contained in these databases cannot be analysed in total by excise intelligence officers. This information, when analysed in total, would provide a more comprehensive understanding of the *chop-chop* market.

39. The ANAO considers that the EBL needs to assess its IT intelligence system requirements with respect to information (which is sometimes duplicated) stored in the different stand-alone databases.

40. The ANAO notes also that the EBL did not have a sufficient number of licences¹⁸ (at the time of the audit)¹⁹ to make effective use of the intelligence

¹⁸ Licence gives the user limited (or unlimited) authority to use software applications simultaneously.

¹⁹ At the time of the audit, the ATO had 37 licences for the use of two intelligence analysis tools (iBase and Analyst's Notebook). Of the 37 licences for these tools, the EBL held two licences. The ATO advised that two additional licences have recently been provided to cover major sites and future needs will be reviewed as part of the development of the EBL intelligence framework.

analysis tools that are available to the intelligence analysts. It is essential that, given the number of internal and external databases potentially available to EBL intelligence analysts, they are used effectively to collate and analyse information to strengthen the administration of tobacco excise. Further, staff currently using these tools needs to be provided formal training in their use.

Coordination of *chop-chop* intelligence between the Excise Business Line and external stakeholders

41. The ANAO notes that the EBL has made considerable efforts to develop intelligence sharing arrangements with the tobacco growing and manufacturing industries. The involvement of the tobacco manufacturers in the TIG's strategic planning processes, and their ongoing liaison arrangements, has enhanced the strategic planning and intelligence gathering capability of the TIG. The TIG has recently established formal liaison arrangements with some tobacco retailers' associations.

42. Currently, the EBL and Customs have established an intelligence sharing arrangement by holding monthly meetings to discuss issues relating to tobacco products and duty-free liaison. However, the ANAO notes that, due to legislative constraints, the EBL and Customs cannot freely exchange information relevant to excise and customs' issues, including on *chop-chop*. The ANAO considers that the exchange of information and intelligence between the two agencies could be included in the Memorandum of Understanding, which is currently being finalised.²⁰

43. Although the EBL and the police forces have strong liaison arrangements in some areas, these could be enhanced by establishing and maintaining formal intelligence sharing arrangements. The ANAO also considers that maintaining regular contact with State Road Traffic Authorities²¹ would create stronger communication channels, which would promote intelligence sharing.

²⁰ As discussed in the Petroleum Excise Audit, the ATO and Customs are in the process of finalising a Memorandum of Understanding to establish an effective partnership between the two agencies on mutual interests and responsibilities.

²¹ State Road Traffic Authorities can collect valuable information relating to the movement and content of vehicles suspected of carrying chop-chop.

Field Services' Compliance and Investigations Activities—Chapter 4

Field services' compliance

44. The Field Services Compliance Unit is responsible for undertaking a range of activities (audit and other risk treatment activities) to improve compliance, as requested by the Industry Groups, based on tailored compliance kits prepared by the Industry Groups. It is responsible also for providing feedback to the Industry Groups on compliance tasks conducted and assisting with information gathering.

45. In accordance with the Tobacco Strategy and the risks identified in the TIG's Business Plan, the tobacco excise compliance activities reflect the areas of risk identified by the TIG, in particular, ensuring growers' compliance with excise legislation.

46. The ATO has also advised that the current arrangements between the TIG and Field Compliance have seen an improvement in planning and management of compliance tasks leading to a more systematic and organised approach.

ATO/Customs joint approach to compliance

47. In May 2001, both the ATO and Customs agreed to adopt a joint compliance approach to clients who would need to deal with the ATO and Customs regularly as part of their normal business.²²

48. Although both agencies have agreed to undertake such an approach to minimise the administrative burden and compliance costs for their clients, the ANAO found joint compliance activities were rare. Both the ATO and Customs advised that, while opportunities for joint compliance activities were limited, they have actively been working together to review and formalise the approach to joint compliance. The ATO advised that it has been working with Customs on joint compliance activities relating to duty-free stores. However, it was acknowledged that the joint approach has had some difficulties, as both agencies adjust to working under the changed administrative and legislative arrangements that have separated excise and customs. The lessons learned from experience gained from these changes is expected to be incorporated into the Memorandum of Understanding currently being developed between the ATO and Customs.

²² Relevant to the three tobacco manufacturers and duty-free stores (duty-free stores are licensed under then *Customs Act 1901*, since duty-free sales to relevant travellers are linked to the act of importation with respect to inwards duty-free stores and exportation for outwards duty-free. These entities also gain access to excisable products through the holding of storage licences and permission granted under the Excise Act).

Tobacco excise investigations

49. The Excise Investigations Unit (Unit) is responsible for investigating instances of external fraud (fraud committed outside the ATO) involving possible breaches of Commonwealth legislation in relation to all excisable products/industries. The operations of the Unit (including case planning, case management, case reporting and liaison arrangements) were previously reported in the Petroleum Excise Audit.

50. In recognition of the risk of *chop-chop* to Commonwealth revenue, almost 75 per cent of the Unit's resources were dedicated to tobacco-related activity in 2000–01. The Unit originally planned to deploy slightly fewer resources (60 per cent) in 2001–02.²³ In the event, resources have remained at about the 75 per cent level, because of the EBL's ongoing assessment of changes in relative risks across commodities.

51. The ANAO notes that the Excise Investigations Unit uses a sound methodology in undertaking tobacco-related investigations. It has experienced success in detecting *chop-chop* and apprehending those offenders breaching the excise legislation. However, the ANAO identified a number of working arrangement matters that need to be addressed between the TIG and the Investigations Unit to achieve improved operational effectiveness and to maximise investigations outcomes. The ANAO considers that: to eliminate duplication of information and analysis effort; to have an effective intelligence capability; and to better achieve its tobacco excise investigations outcomes, the EBL could more clearly define the roles and responsibilities of the TIG and the Investigations Unit. This would, to some extent, contribute to more effective workflow arrangements. The better sharing of relevant information and intelligence between the two areas is also to be encouraged.

²³ This is in addition to the investigations resources deployed on the *Aggressive Tobacco Project* (see paragraph 19).

Recommendations

Set out below are the ANAO's recommendations, with report paragraph references, aimed at improving the effectiveness of the ATO's administration of tobacco excise. The ANAO considers that the ATO should give priority to Recommendations 3, 4, 5, 6 and 8.

**Recommendation
No. 1
Paragraph 2.20**

The ANAO recommends that, as part of a continuous improvement process, when developing the Business Plan for 2002–03, the Tobacco Excise Industry Group articulate clearly appropriate strategies and measures aimed at achieving the objectives identified in the Business Plan and assess its performance against those objectives.

ATO Response: Agreed.

**Recommendation
No. 2
Paragraph 2.33**

The ANAO recommends that the ATO review its strategy to manage risks relating to illicit tobacco and to include contact with Australian tobacco retailers as an integral part of ensuring compliance with excise legislation.

ATO Response: Agreed.

**Recommendation
No. 3
Paragraph 2.50**

The ANAO recommends that, to develop better informed risk assessments and to more accurately quantify the revenue leakage resulting from the trade of *chop-chop* in Australia, the ATO should consider developing effective working relationships with the Department of Health and Ageing and other appropriate Commonwealth agencies. This would provide added information relevant to ascertaining the nature and size of the *chop-chop* market.

ATO Response: Agreed.

**Recommendation
No. 4
Paragraph 3.25**

The ANAO recommends that the ATO evaluate its tobacco excise intelligence capability to ensure that staff have the skills necessary to effectively gather and analyse strategic, operational and tactical intelligence.

ATO Response: Agreed.

**Recommendation
No. 5
Paragraph 3.37**

The ANAO recommends that the Excise Business Line, in reviewing its intelligence information technology requirements, ensure that these are directed at meeting its business needs by:

- developing access to intelligence information; and
- effectively using intelligence analysis tools to collate and analyse information to strengthen the administration of tobacco excise.

ATO Response: Agreed.

**Recommendation
No. 6
Paragraph 3.67**

The ANAO recommends that, to develop a more effective tobacco intelligence capability, the Excise Business Line consider establishing and maintaining formal intelligence sharing arrangements with:

- tobacco retailers;
- Customs;
- Australian Federal Police and State police forces; and
- State Road Traffic Authorities.

ATO Response: Agreed with qualification.

**Recommendation
No. 7
Paragraph 4.21**

The ANAO recommends that, to help develop an efficient and effective approach to joint compliance and to minimise compliance costs for the tobacco industry, the ATO and Customs agree on the joint compliance working arrangements for tobacco audits, and incorporate them into the Memorandum of Understanding currently being developed between the ATO and Customs.

ATO and Customs Response: Agreed.

**Recommendation
No. 8
Paragraph 4.39**

The ANAO recommends that, to better achieve its tobacco excise investigation outcomes, the Excise Business Line clarify the role of the Tobacco Industry Group and the Excise Investigations Unit in:

- planning and prioritising investigations activities; and
- sharing relevant information and intelligence.

ATO Response: Agreed with qualification.

Audit Findings and Conclusions

1. Background and Context

This chapter discusses the concept and application of excise to tobacco products, provides an overview and history of the tobacco industry in Australia, and an outline of the chop-chop problem. The chapter also outlines the objective and methodology of this performance audit.

Introduction

1.1 Excise duties are levied on excisable goods²⁴ that have been produced domestically and intended for consumption in Australia. Excise duties are not payable on goods exported from Australia. Customs duties are imposed on imported goods. The three main categories of goods subject to excise duties²⁵ are:

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

1.2 While, until 1998, both customs and excise duties were administered together, in October 1998 the Government decided to transfer responsibility for the administration of excise duties from the Australian Customs Service (Customs) to the Australian Taxation Office (ATO). Full implementation of this decision commenced from February 1999.

1.3 This audit focused on the ATO's administration of **tobacco** excise duties and is designed to complement a previous Australian National Audit Office (ANAO) audit into the ATO's administration of petroleum excise duties (Petroleum Excise Audit).²⁶ The Petroleum Excise Audit examined whether the ATO had implemented effective administrative arrangements for the collection of petroleum excise.

²⁴ Section 4(1) of the *Excise Act 1901* defines excisable goods as: goods in respect of which excise duty is imposed by Parliament...

²⁵ Excisable goods and applicable excise duty rates are set out in the Schedule to the *Excise Tariff Act 1921*.

²⁶ Audit Report No.17, 2001–2002, *Administration of Petroleum Excise Collections*, Australian Taxation Office.

1.4 A more detailed history of excise duty in general and its transfer from Customs to the ATO can be found in the Petroleum Excise Audit report. Also, many of the systems and procedures used by the ATO to collect and report excise revenue (which are similar for both tobacco and petroleum excise duties), while relevant to tobacco excise, are explained in the Petroleum Excise Audit and are not covered in detail in this report.

Australian Taxation Office

1.5 The ATO is the Commonwealth's primary revenue collection agency and responsible for collecting \$165 billion in 2000–2001, which accounted for approximately 83 per cent of all Commonwealth revenue collected in 2000–2001.

1.6 The ATO's Excise Business Line (EBL) is responsible for managing commodity-based revenue and business payment (transfer) systems.²⁷ The EBL collected \$19.3 billion in 2000–01, which accounted for 11.6 per cent of the total tax revenue collected by the ATO for that year. Revenue attributable to tobacco products collected by the EBL in 2000–01 totalled \$4.7 billion, which accounted for 24 per cent of total excise collections in that year.²⁸

1.7 For a more specific description of the roles of the EBL regarding the collection of tobacco excise, see Chapter 2.

The tobacco industry in Australia

1.8 The Australian tobacco industry is comparatively small, representing only 0.2 per cent of the world's tobacco production. It comprises:

- growers and dealers: there are 324 tobacco growers in Australia. These growers are represented by cooperatives, who act as dealers to the manufacturers, in three major regions;²⁹
- manufacturers / distributors: there are two major tobacco manufacturers³⁰ and one major tobacco distributor in Australia³¹ whose products account for approximately 95 per cent of tobacco sales in Australia;³² and

²⁷ The structure of the Excise Business Line can be found at Appendix 4. The Petroleum Excise Audit contains a detailed explanation of the roles and functions of the Excise Business Line.

²⁸ In 2001–02, the EBL estimates it will collect \$19.5 billion in excise revenue, with \$4.8 billion attributed to tobacco excise.

²⁹ The growing regions and their cooperatives are: North Queensland - Queensland Tobacco Marketing Cooperative Association Limited; Victoria - Tobacco Cooperative of Victoria Limited; and Southern Queensland - South Queensland Tobacco Growers Cooperative Association Limited.

³⁰ The two companies that manufacture tobacco in Australia are: Phillip Morris Limited (manufacturer/distributor); British American Tobacco Australasia Limited (manufacturer/distributor).

³¹ Imperial Tobacco Australia Limited is a distributor of Australian tobacco products.

³² For the purpose of this audit, this ATO client group will be referred to as 'manufacturers'.

- retailers: there are approximately 48 000 tobacco retailers in Australia, ranging from supermarkets and convenience stores to newsagencies and petrol stations. These retailers conduct trade in tobacco products under State laws and regulations. Commonwealth excise laws have no specific provisions on retail trade. Any person, including retailers, who deals in tobacco products on which excise has not been paid may commit various offences under excise legislation.

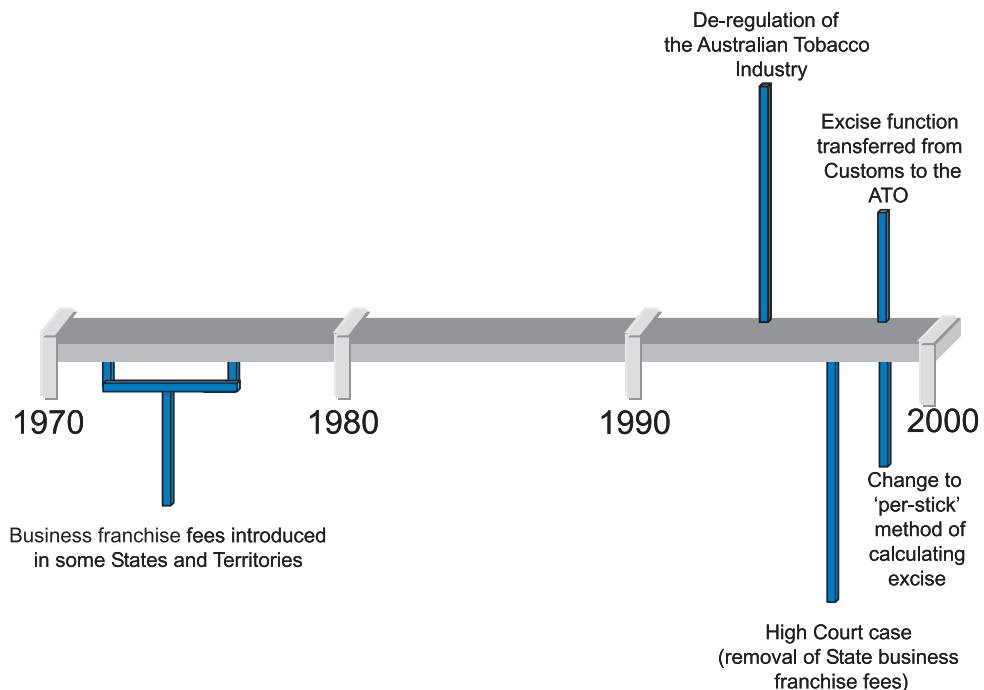
1.9 More detailed information on the Australian tobacco industry can be found in Appendix 1.

Overview and history of tobacco excise

1.10 Tobacco has been grown and manufactured in Australia since the early 1820s. Excise became a sole Commonwealth responsibility in 1901 with the introduction of the *Excise Act 1901* (Excise Act). In more recent times, there have been some significant events that have influenced the growing, manufacturing and retailing of tobacco in Australia. The figure below illustrates major events that have significantly affected the industry.

Figure 1.1

Major events affecting the Australian tobacco industry



Source: ANAO analysis

Regulation of the tobacco industry

1.11 From the 1960s to the 1990s, the Australian tobacco market was regulated heavily by the Government. This regulation included, amongst other controls, the provision of tariff concessions on imported tobacco for manufacturers who used Australian-grown tobacco in their products.

1.12 On 1 January 1995, the Government de-regulated tobacco production in Australia and reduced the protective tariff on imported tobacco leaf products to zero. This reduced the incentive for manufacturers to purchase Australian tobacco, and had the effect that many growers moved out of the tobacco industry.³³

Clarification of tobacco excise collection arrangements

1.13 In August 1997, the High Court determined that business franchise fees that had been imposed by some States and Territories on tobacco products were unconstitutional. From 1997 to 1999–2000, the Government collected an increased rate of excise duty on tobacco products and reimbursed surcharge amounts to the States under agreed ‘safety net’ repayment schemes until the introduction of the Goods and Services Tax (GST) from 1 July 2000 (minor amounts of surcharge revenue were collected in July and August 2000).

1.14 Prior to the High Court decision and the Government’s introduction of new rates of excise, the illicit tobacco trade was focussed on mechanisms to avoid paying business franchise fees. It was shortly after the introduction of the new arrangements that law enforcement authorities noticed a significant increase in the amount and availability of illicitly manufactured Australian tobacco, known as ‘chop-chop.’ This issue is discussed further in paragraph 1.27.

Other factors/events that impacted upon tobacco excise

1.15 In 1999, the Government introduced a number of health initiatives to reduce smoking. One of these initiatives, which had a significant influence on the price of tobacco products, involved changing the way that manufacturers calculated the amount of excise paid on their products.

1.16 Prior to 1999, tobacco excise was calculated on the weight of tobacco products produced by the manufacturers. Taxing on a weight-basis encouraged the production and consumption of more, lighter weight cigarettes.³⁴ However, in November 1999, a change in Government health policy meant that tobacco

³³ After deregulation, the legal NSW tobacco industry ceased to exist with NSW growers agreeing to a State Government ‘buy-out’.

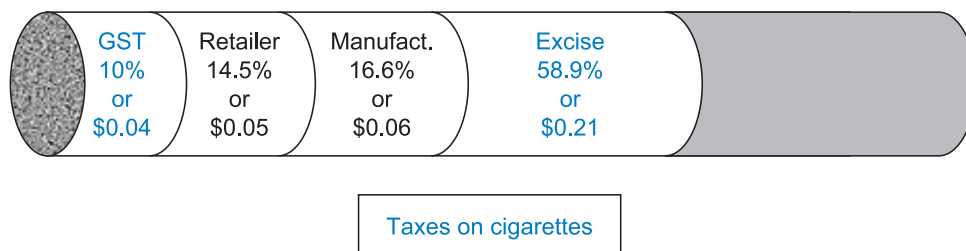
³⁴ One method manufacturers used to reduce the weight of their cigarettes was ‘dry ice expanded tobacco’ (DIET). This method of producing cigarettes increased the size of the cigarette whilst reducing its weight.

excise was calculated per-stick.³⁵ A per-stick method of calculating tobacco excise encourages the production and consumption of fewer cigarettes with higher tobacco weight, which has a reduced health impact than a larger number of lighter weight cigarettes.³⁶

1.17 The following figure is indicative of the amount of excise paid per-stick following the introduction of the per-stick method of calculating tobacco excise.³⁷

Figure 1.2

Breakdown of retail cost of a cigarette



Source: ATO data

1.18 Taxes on cigarettes (i.e. excise and GST) account for approximately 68.9 per cent of the total cost of cigarettes in Australia. It is this high proportion of tax that provides generous margins to illicit dealers. A comparison of Australian and a range of international tobacco product prices, including government taxes, can be found at Appendix 2.

Current tobacco excise environment

1.19 The deregulation of the tobacco industry, the introduction of uniform excise legislation for the manufacture of Australian tobacco products, and the introduction of the 'per-stick' method of calculating excise have all contributed towards a changing tobacco industry in Australia. These changes have manifested themselves in a fall in the quantity of tobacco product cleared³⁸ under excise by the ATO and a rise in the amount of excise revenue collected on that tobacco product each year (except in 2000–01). The following figures illustrate this point.

³⁵ Based on the number of cigarettes per packet. The current per stick rate is 20.893 cents per cigarette up to a weight of 0.8 grams of tobacco. Cigarettes over 0.8 grams of tobacco and all loose tobacco and cigars are taxed at a rate of \$261.16 per kilogram of tobacco.

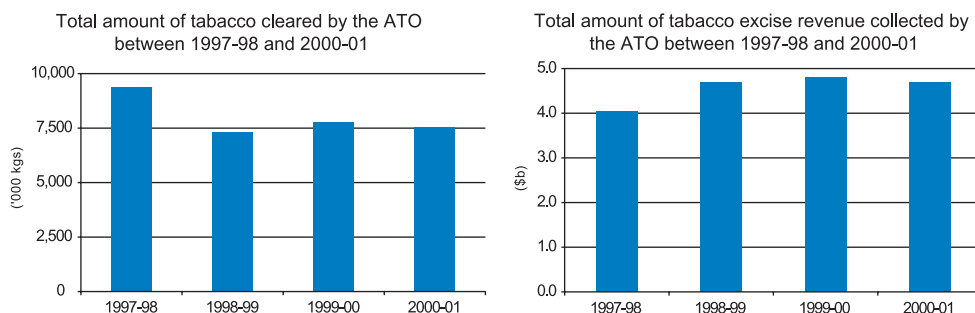
³⁶ *Tax Reform: Not a New Tax, A New Tax System*, Commonwealth of Australia, August 1998.

³⁷ Example is taken from a packet of Winfield 25s cigarettes, which retail at \$9.10 as at 03/04/02.

³⁸ Cleared refers to the quantity of tobacco products entered (that is, subject to excise duties) into domestic market for consumption.

Figure 1.3

Tobacco clearance and revenue collection trends 1997–98 to 2000–01



Source: ATO data

1.20 Although there are many factors that could impact upon the decrease in demand for locally manufactured tobacco product, there are four key factors that have affected the demand for licit Australian tobacco. These are:

- manufacturers are not required to use Australian tobacco in the production of their tobacco products;³⁹
- Government 'anti-smoking' education programs;
- the higher cost of tobacco products resulting from the imposition of Government excises and taxes; and
- the growth in the trade of illicit tobacco product.

1.21 The illicit tobacco trade began in Australia when people sought to avoid business franchise fees (see Figure 1.1) imposed by some States and Territories on tobacco products.⁴⁰ Since then, the factors noted in paragraph 1.20 have changed the extent and nature of the illicit tobacco trade significantly and include:

- increased smuggling of tobacco product into Australian domestic markets;
- increased smuggling of counterfeit⁴¹ tobacco product into Australian domestic markets;
- increased diversion of Australian-produced underbond⁴² stock for export into domestic markets (eg. diversion of duty-free tobacco product); and

³⁹ In 2000–01, almost double the amount of tobacco leaf purchased from Australian tobacco growers was imported as unmanufactured tobacco into Australia (14 million kilograms).

⁴⁰ Illicit trade (at the time of business franchise fees) concerned mainly the unauthorised transportation of tobacco product between States. For example, tobacco product was transported illegally between New South Wales and Queensland, as Queensland's business franchise fees were lower than those in New South Wales.

⁴¹ Counterfeiters undercut legitimate manufacturers' production costs with inferior materials and by breaching employment and other regulatory standards. Cigarette counterfeiting can be highly lucrative when a destination market has high duties.

⁴² Underbond stock refers to tobacco product upon which excises, duties, fees, taxes etc. have not been paid.

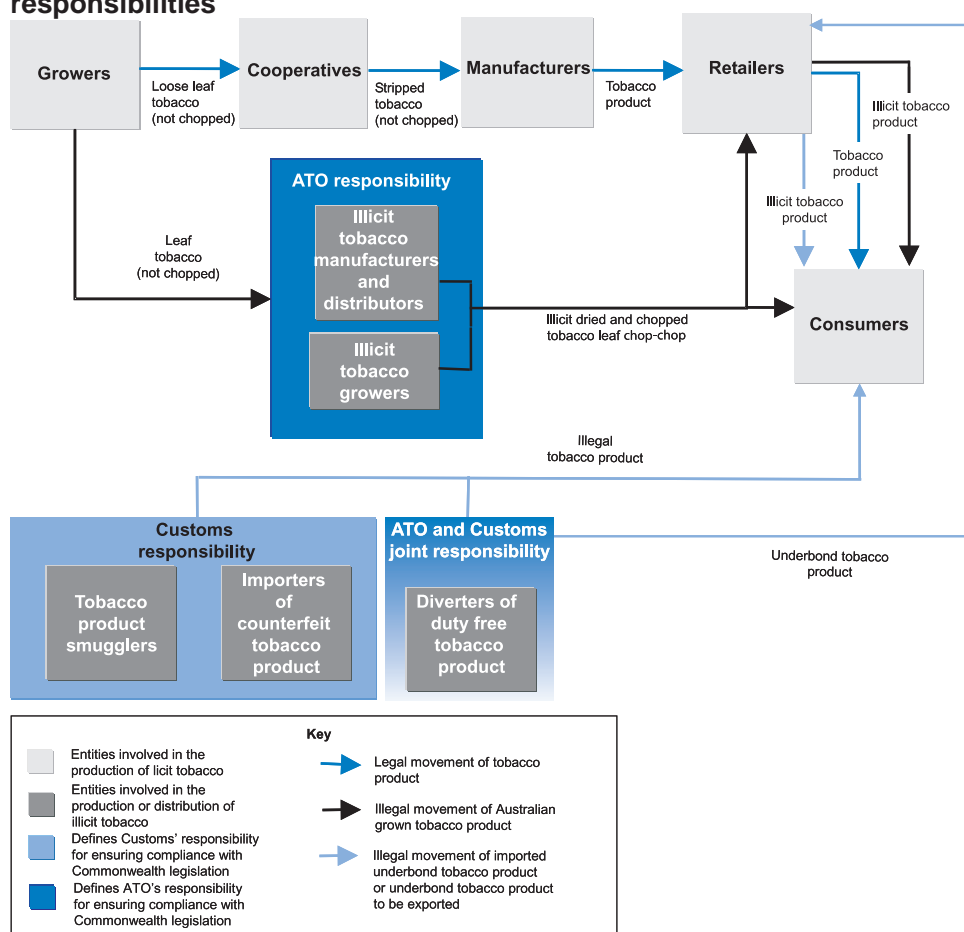
- the increased production and sale of Australian-produced tobacco, upon which excise has not been paid.

1.22 Figure 1.4 illustrates the types of illicit tobacco trade, the means used to avoid paying excise and the different but interacting responsibilities of the two Commonwealth agencies, Customs and the ATO.⁴³

1.23 A more detailed overview of the tobacco production process, and the role the ATO plays in the administration and regulation of tobacco excise can be found in Appendix 1.

Figure 1.4

Types of illicit tobacco trade—An overview of ATO and Customs' responsibilities



Source: ANAO analysis

⁴³ Customs is responsible for the collection of duties on imported tobacco product under the *Customs Tariff Act 1995* and the ATO is responsible for the collection of tobacco excise on product manufactured in Australia and ensuring compliance with the Excise Act. ATO and Customs are jointly responsible to address the diversion of duty-free tobacco products (discussed in paragraph 1.26).

1.24 This report covers the measures the ATO uses to monitor and prevent the proliferation of illicit tobacco in Australia, which occurs through either:

- the diversion of underbond tobacco product from duty-free stores (see paragraph 1.26); and
- the manufacture and sale of *chop-chop* (see paragraph 1.27 to 1.35).

1.25 An area of significant risk to tobacco excise revenue, and therefore a key focus of this audit, was *chop-chop*,⁴⁴ the excisable product that is the subject of illicit tobacco trade in Australia. The audit examined three perspectives of the *chop-chop* trade: what the *chop-chop* market comprises, the size of the *chop-chop* market and how much excise revenue the Commonwealth is losing as a result of the *chop-chop* trade. This enabled the audit to view both the present situation and the underlying dynamics of this taxation field.

Diversion of tobacco product from duty-free stores

1.26 The legislation governing the operation of duty-free stores is complex and contained in both the *Customs Act 1901* (Customs Act) and Excise Act. Prior to May 2001, under the client sharing arrangement in place between Customs and the ATO, Customs had sole responsibility for ensuring that the owners of duty-free stores complied with legislation regarding the sale of underbond products to relevant travellers. These products included alcoholic beverages and locally-produced tobacco products. From May 2001, the ATO assumed responsibility for decision-making about the access by businesses licensed as duty-free stores to underbond excisable products. The legislation governing disposal of alcoholic beverages and tobacco products remains in the Customs Act and accordingly a Customs responsibility. The joint programs the ATO and Customs have undertaken to address the diversion of duty-free tobacco products are discussed in Chapter 2.

Chop-chop tobacco

1.27 *Chop-chop* is generally sold in a 'loose tobacco' form,⁴⁵ however it can also be sold as tailor-made cigarettes. Most *chop-chop* is identified easily, as it is usually sold in cheap packaging (for example, clear plastic bags) and does not have health warnings or other labelling. However, in recent times, it has also been

⁴⁴ Refers to Australian-grown and manufactured tobacco that is sold illicitly in a chopped-up form to Australian consumers, and upon which excise has not been paid. It also refers to the illegal trade in un-chopped tobacco leaf (see Figure 1.4).

⁴⁵ *Chop-chop* in a loose leaf form can be consumed in the same way as other, legal, roll-your-own tobacco products. A common method of consuming chop-chop is using tailor made cigarettes. These are made using cigarette tubes, which are empty paper tubes with an attached cigarette filter. Cigarette tubes are sold legally in Australia and are discussed further in Chapter 2.

sold in counterfeit packaging of legitimate manufacturers. It is generally sold in bulk, in half-kilogram and one-kilogram lots.

Where does chop-chop come from?

1.28 As illustrated in Figure 1.4, *chop-chop* comes from two major sources: some licensed growers,⁴⁶ who, the ATO considers, are the principal source for the majority of *chop-chop*⁴⁷ and unlicensed growers.

1.29 The ATO considers there are a number of factors that have influenced some licensed growers' decisions to divert tobacco into the illicit industry. These include:

- a decline in demand for Australian tobacco leaf by manufacturers resulting in an oversupply of Australian tobacco leaf. Recent decisions by the manufacturers not to purchase tobacco leaf from some Australian-licensed tobacco growers following the conclusion of the 2002 growing season has meant that the number of licensed growers able to produce tobacco, but not able to sell their product (because the opportunity for Australian growers to export their product is limited'—see dot point 3), has increased significantly;
- the market price for *chop-chop* is up to 10 times the market rate paid by manufacturers;
- exporting Australian tobacco leaf is generally not a commercial proposition. The international market price for tobacco is significantly cheaper than the price Australian growers are willing to accept for their tobacco (average international price for tobacco is around \$A3.70 per kilogram, whereas the Australian market price is between \$A5.00–\$A6.00);
- the evasion of taxes, particularly GST and income tax; and
- the application of pressure by organised crime.

1.30 The tobacco manufacturers estimate that the trade in *chop-chop* accounts for approximately 1 to 1.2 million kilograms of tobacco traded per year. This is equivalent to approximately five per cent of the total Australian tobacco market. The ANAO discusses the associated revenue implications for excise in Chapter 2.

⁴⁶ There are 324 registered growers in Australia, and approximately 700 persons involved in growing tobacco in Australia. See Appendix 1 for a more detailed description of the growers and the growing process.

⁴⁷ Based on the *chop-chop* seized by the ATO, it is estimated that licensed growers produce up to 90 per cent of all *chop-chop*.

Manufacture and distribution of chop-chop

1.31 Prior to 1997, the manufacture and distribution of *chop-chop* was not systematic. However, since that time, there is evidence to indicate that the manufacture and distribution of *chop-chop* is becoming more systematic. This is supported by an increase in the seizures of *chop-chop* (refer to Table 4.1 in Chapter 4) and sophisticated equipment used to produce *chop-chop* and manufacture cigarettes on a large scale, by the ATO. The ANAO also confirmed that Commonwealth law enforcement authorities have evidence to link organised crime groups to the trade in *chop-chop*.

1.32 The ATO has noted that the distribution networks used by those manufacturing *chop-chop* are well organised. They often use trucking firms and long haul coaches to transport large quantities of their illicit product.

Sale of chop-chop

1.33 The sale of *chop-chop* occurs through a number of different sources. These include licensed tobacconists, markets, hairdressers, newsagents and milk bars. Often, retailers of *chop-chop* trade it openly and several investigations undertaken by the ATO has shown that until recently it has not been difficult for consumers to purchase *chop-chop* in particular States. However, recently the ATO's investigators report that it is becoming more difficult to buy *chop-chop* and retailers are becoming more wary. While *chop-chop* was available to consumers at a price in the region of \$45 to \$60 per kilogram through 2000–01, recent ATO intelligence indicates that in 2002, the general market price has risen to between \$80 and \$100 per kilogram. In comparison, 50 grams of legal roll-your-own tobacco costs around \$16 (i.e. \$320 per kilogram).

The risk of *chop-chop* to tobacco excise

1.34 As part of its corporate planning, the ATO noted that it would continue its focus on key risk areas. One of these risk areas was tobacco excise. The ANAO notes that based on its corporate risk assessment process, the ATO has allocated additional resources to the EBL to address the *chop-chop* problem. These resources have been directed towards the EBL's *Aggressive Tobacco Project* (see Chapter 2).

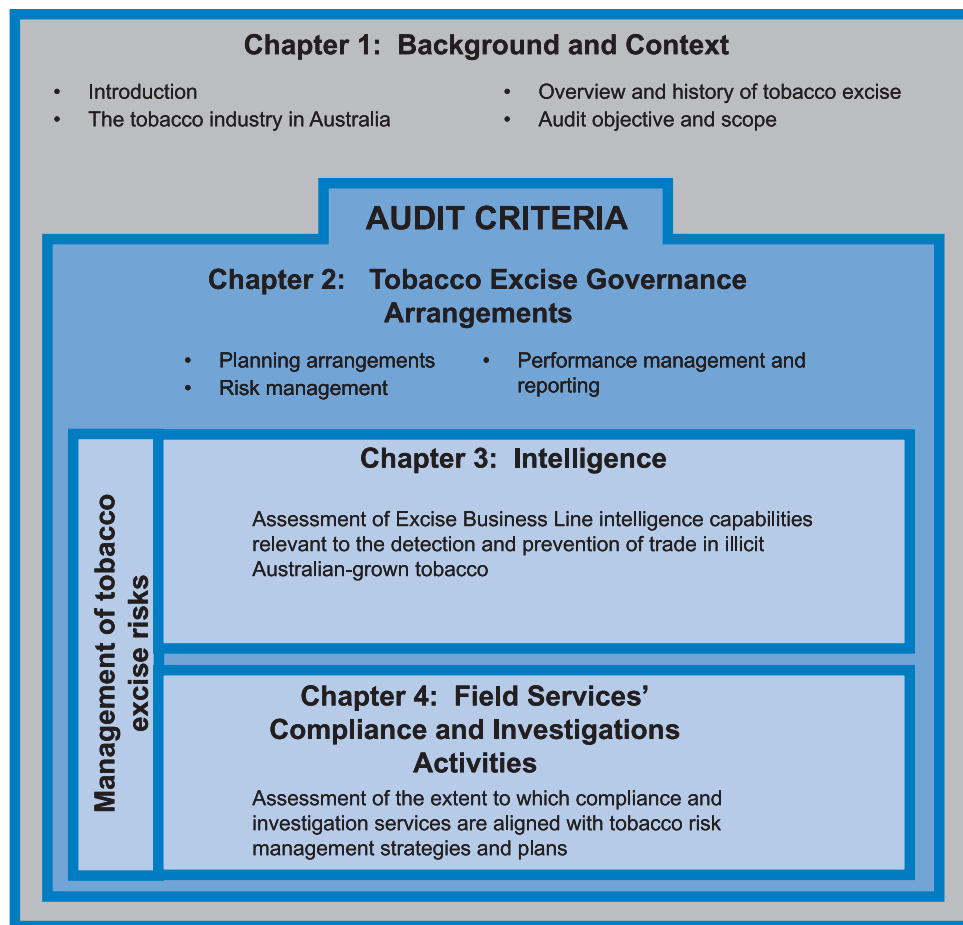
The Audit

Audit objective and scope

1.35 The objective of the audit was to assess the ATO's administration of tobacco excise. The ANAO considered three key areas in addressing the audit objective. These key areas formed the basis of the audit report, depicted in Figure 1.5.

Figure 1.5

ANAO report structure



Source: ANAO analysis

1.36 Although the audit examined these broader aspects of the ATO's administration of tobacco excise, we placed particular emphasis on the strategies used by the ATO to address the proliferation of *chop-chop* in Australian markets, as it is an area of major risk to tobacco excise revenue.

1.37 We note that some recommendations made in the Petroleum Excise Audit are relevant to tobacco excise duties. The ANAO also used this audit as an opportunity to assess and report back to the Parliament on the implementation status of the recommendations from the Petroleum Excise Audit (see Appendix 3).

Audit methodology

1.38 Audit fieldwork was conducted from September 2001 to March 2002. In addition to document and file reviews, interviews with relevant ATO staff were conducted at the ATO's National Office in Canberra. Interviews were also conducted with ATO staff located in Sydney, Melbourne and Brisbane. The purpose of the visits and interviews was to gain an understanding of the risk assessment and management of tobacco excise, the tobacco excise intelligence capability, and compliance and investigations' activities.

1.39 The ANAO also held discussions with Customs on their relationship with the ATO on information exchange and joint compliance arrangements. In addition, the ANAO held discussions with the following stakeholders:

- participants in the tobacco industry (including the major manufacturers / distributors, the Victorian and North Queensland grower cooperatives and the NSW Retail Tobacco Traders Association);
- the Department of Health and Ageing (Health);
- the Department of Agriculture, Fisheries and Forestry Australia (AFFA);
- the Australian Institute of Health and Welfare (AIHW);
- the Australian Federal Police (AFP); and
- the Australian Bureau of Criminal Intelligence (ABCI).

Audit cost

1.40 The audit was conducted in conformance with the ANAO auditing standards at a total cost of \$258 000.

Acknowledgments

1.41 The ANAO would like to thank the ATO officers who assisted in the conduct of the audit and particularly the officers of the Excise Business Line for their time, effort and expertise. We also appreciate the cooperation of the other Commonwealth agency stakeholders, the tobacco manufacturers / distributors and the tobacco cooperatives consulted during the audit.

2. Tobacco Excise Governance Arrangements

In discussing tobacco excise governance, this chapter covers issues relating to strategic and business planning processes, risk management and performance management and reporting arrangements. The ANAO found that in managing risks relating to tobacco excise, the Excise Business Line has placed considerable emphasis on adopting a strategic and structured approach to risk management.

Tobacco excise management arrangements

2.1 The *Taxation Laws Amendment (Excise Arrangements) Act 2001* transferred responsibility for the administration of excise legislation from the Chief Executive Officer of Customs to the Commissioner of Taxation. The responsibilities under this *Act* involve administering all aspects of tobacco excise legislation as defined in the Excise Act.

2.2 The area within the ATO responsible for administering tobacco excise is the Excise Business Line (EBL). The current structure of the EBL and its position within the ATO corporate structure is illustrated at Appendix 4. Figure 2.1 shows the EBL's internal management and accountability arrangements in relation to the administration of tobacco excise.

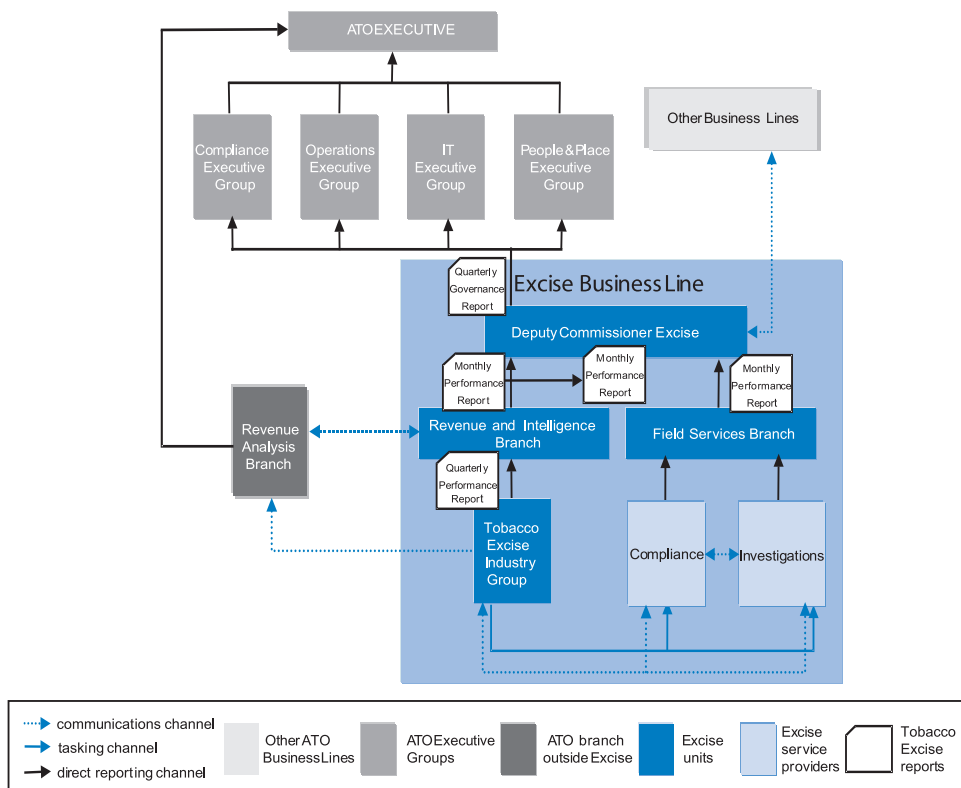
2.3 In reviewing tobacco excise arrangements, the ANAO covered the relevant operations of the Revenue and Intelligence and Field Services Branches. The Revenue and Intelligence Branch is responsible for managing excise revenue collection and developing industry and other intelligence to improve policy and compliance for the three Excise Industry Groups.⁴⁸ The Field Services Branch is responsible for providing compliance and investigations services to the Excise Industry Groups.

2.4 The Tobacco Excise Industry Group (TIG) is the unit within the EBL that has dedicated responsibility for revenue collection, developing tobacco excise policy and monitoring compliance of the tobacco industry (growers, dealers and manufacturers) with the excise legislation. As shown in Figure 2.1, the TIG's relationship with the Field Services Branch is critical to the effective administration of tobacco excise and is further explored in Chapters 3 and 4.

⁴⁸ There are three Excise Industry Groups covering the administration of excisable goods: tobacco; alcohol; and petroleum.

Figure 2.1

Tobacco excise internal accountability and reporting arrangements



Source: ANAO depiction of ATO information

2.5 The TIG is currently located in Sydney and has 21 staff with an annual budget allocation of approximately \$1.4 million (including indirect costs).⁴⁹ Appendix 5 details the structure of the TIG (which was revised recently in January 2002) and provides a broad overview of its functional responsibilities. Since May 2001, the TIG assumed responsibility also for administering all tobacco-related excisable products stored and sold by duty-free shops.⁵⁰ The broader aspects of the EBL's governance arrangements can be found in the Petroleum Excise Audit.

⁴⁹ This does not include the recent allocation of funds to implement the *Aggressive Tobacco Project* referred to in paragraph 2.25 and the funds allocated to Field Services Branch to undertake tobacco-related compliance and investigations activity.

⁵⁰ Until May 2001, duty-free shops were administered by Customs under the transitional approach to managing clients who dealt with both imported goods and excisable goods. From May 2001, authority to store excisable goods in a duty-free shop licensed by Customs has to be obtained from the ATO (as a result of the *Excise Amendment (Compliance Improvement) Act 2000*, a comprehensive licensing system was introduced for the manufacturing and storage of all excisable goods). Similarly, duty-free shops now have to apply to the ATO for permission authorising excisable goods to be sold in the shop to be delivered to relevant travellers for export with the traveller without an export entry.

2.6 In reviewing tobacco excise governance arrangements, the ANAO had particular regard to:

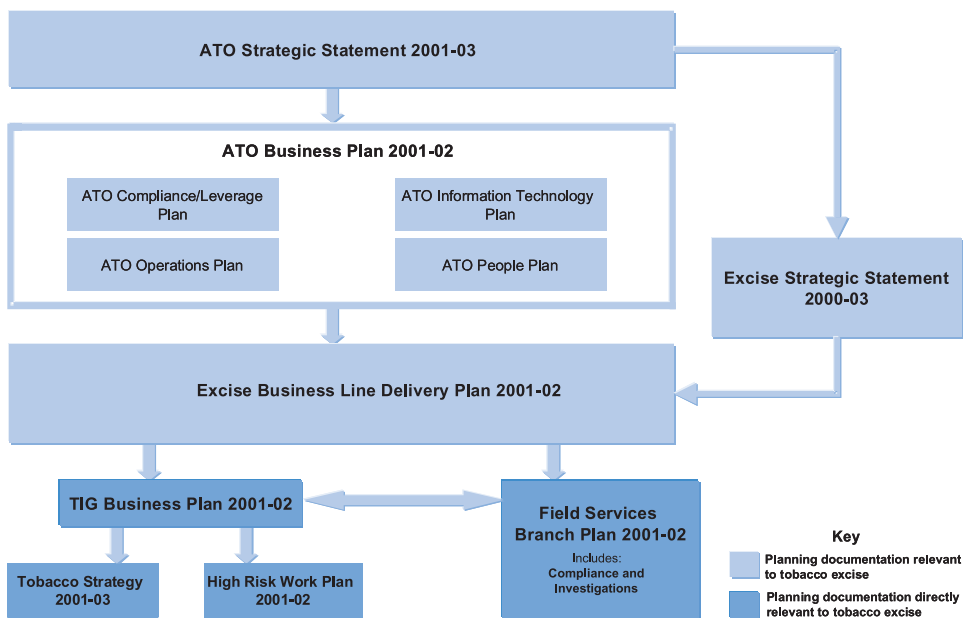
- strategic and business planning processes within the TIG and Field Services;
- assessment and management of tobacco excise risks; and
- performance management and reporting arrangements.

Strategic and business planning

2.7 In May 2001, the ATO introduced revised planning arrangements with a view to improving the existing arrangements. The revised arrangements aim to clarify the ATO's priorities by adopting a more system-based view of their work, building stronger collaboration across the ATO and ensuring the most appropriate deployment of its resources. The following figure illustrates the revised planning arrangements as they relate to tobacco excise.

Figure 2.2

Tobacco excise planning hierarchy



Source: ANAO analysis

2.8 As shown in the Figure 2.2, the suite of ATO plans for 2001–02 consists of a Strategic Statement and four plans (Compliance Plan, Operational Plan, Information Technology Plan and a People Plan)⁵¹ that comprise the ATO Plan for 2001–02. These plans articulate risks in terms of the health of the tax system and list mitigation strategies. The Petroleum Excise Audit referred to the revised ATO approach to risk management through its ATO-wide Compliance Risk Policy and Compliance Risk Program.⁵² In order to achieve its component of the ATO-level objectives and outcomes, each business line is required to develop a Delivery Plan that is linked to the ATO plans. Similarly, within the business line, each area is required to develop a logistical or tactical delivery plan for its activities, as well as develop a risk management plan to address the relevant risks identified in the ATO plans.

2.9 The ANAO notes that the EBL has developed a Delivery Plan for 2001–02 through which it is accountable for achieving activities in the higher-level ATO Plans. The EBL Delivery Plan includes a series of compliance strategies relating to managing risks and compliance. In addition, the TIG and Field Services Branch have developed separate (*but linked*) Business Plans for 2001–02, which are their logistical or tactical delivery plans for the EBL with regard to tobacco excise and compliance and investigations services respectively.

2.10 Work undertaken by the TIG with regard to tobacco excise risks is discussed separately in paragraphs 2.22 to 2.49. In the following sections, we comment on the TIG and Field Services Business Plans.

TIG Business Plan 2001–02

2.11 The 2001–02 TIG Business Plan (Business Plan) was an outcome of a consultative effort within the TIG and takes account of the current operating environment and the risks associated in dealing with different segments of the tobacco industry.

2.12 The Business Plan provides an overview of the TIG’s approach and strategy to administering tobacco excise collections. The Business Plan identifies the key business risks and strategies to mitigate these risks as well as measures to determine the effectiveness of these strategies. Through its Business Plan, the

⁵¹ The four plans cover all activities of the ATO, apart from the Australian Valuation Office, including budget allocation.

⁵² The ATO Compliance Risk Policy and Compliance Risk Program are based on a number of aspects that are recognised by international agencies. In particular: the Standards Australia booklets entitled ‘Guidelines for Managing Risks in the Australian and NZ Public Sector’ and the ‘Australian/New Zealand Standards for Risk Management’; the Forum on Strategic Management Knowledge Exchange by the OECD; the ATO Compliance Model and the ATO’s risk profiling systems (eg. the ATO Risk Register and the GST Risk Rating Engine). The new approach emphasises the achievement of corporate alignment and integration of risk analysis and treatment activities.

TIG has also identified the outcomes it seeks to achieve in managing its human and information technology resources. The Business Plan also identifies the accountabilities and responsibilities of staff within the Group.

2.13 The ANAO considers that the TIG's approach to developing its Business Plan was sound and reflects its commitment to achieving objectives stated in the higher-level ATO Plans (e.g. the ATO Compliance Plan). However, the ANAO notes that there was scope to strengthen certain aspects of its Business Plan, particularly with respect to the strategies and measures identified to achieve and assess the Business Plan objectives. For example, the Business Plan states that a whole-of-system⁵³ approach is to be adopted to managing the problem of *chop-chop*. However, the strategies articulated in the Business Plan to address the problem of *chop-chop* do not support this approach.

2.14 While the Plan outlines how the TIG intends to address the first part of its objective (specifically targeting tobacco growers), it does not identify strategies to achieve the second part (that is, to liaise closely with other government agencies etc.).

2.15 The ANAO considers there is potential for better exchange of information with Health⁵⁴ and AFFA,⁵⁵ on illicit tobacco issues (the TIG's contact with Health and AFFA has mainly related to the development of the 2001–03 Tobacco Strategy discussed in paragraph 2.23). The ANAO views partnerships with these stakeholders as an integral element of the TIG's strategies in administering the tobacco excise function and developing an understanding of the *chop-chop* market. This issue is discussed further in paragraphs 2.35 to 2.39 under 'Strategic partnerships with stakeholders.'

2.16 Further, the TIG Business Plan in prioritising its activities identifies intelligence and internal capability as an area of secondary focus. However, the ANAO considers that the strategies and performance measures relating to areas of secondary focus were not adequately developed in the TIG Business Plan to reflect the approach outlined in the ATO Compliance Plan. The ATO advised that the strategies in question (intelligence and internal capability)⁵⁶ are being addressed and it is working on implementing them.

⁵³ Refers to including all parties involved in the tobacco industry.

⁵⁴ The Department of Health and Ageing is assigned the task of coordinating a whole-of Government approach to tobacco control, through the Framework Convention on Tobacco Control (FCTC). The FCTC guidelines cover issues relating to illicit tobacco trade.

⁵⁵ The Field Crops policy area within AFFA is responsible for developing and communicating policy on matters relating to industry structures, supply chain competitiveness, structural adjustment and support for all its industries, including tobacco. In July 2001, AFFA consulted the TIG in developing its response to a submission by the tobacco growers for financial assistance by way of a buy-out.

⁵⁶ Refers to the staff and systems required to support an intelligence capability.

2.17 The ANAO considers that this approach will enable the ATO to fully realise the leverage and resources it has at its disposal to minimise revenue loss. The magnitude of the revenue lost each year due to the *chop-chop* industry, the involvement of organised crime and the steady growth of this market in recent years, warrants the need for effective systems and processes, as part of an integrated approach to redressing the problem of *chop-chop*. This would be congruent with the revised ATO approach to risk management referred to in paragraph 2.8 (that emphasises the achievement of corporate alignment and integration of risk analysis and treatment activities).

2001–2002 Field Services Plan

2.18 The Field Services Branch Business Plan for 2001–2002 has a service delivery focus and identifies the Field Services Branch’s vision, purpose, its guiding principles and key stakeholders.⁵⁷ The Field Services Branch Plan outlines the outcomes to be achieved, strategies to achieve these outcomes and lists the key success indicators to measure the achievement of these outcomes. The Field Services Branch Plan also includes: an activity statement that identifies the areas/positions within the Field Services Branch that are responsible for implementing the various activities in the Plan; and details on deployment of its resources to address the risks identified by the Excise Industry Groups.

2.19 Overall, the ANAO considers that the Field Services Branch Plan is comprehensive and aligns itself appropriately with the TIG’s Business Plan, thereby making it more likely that it will provide effective compliance and investigations services to the TIG. The Plan also includes a range of qualitative and quantitative key success indicators, which provide a useful measure to assess the achievement of its outcomes. However, the ANAO notes the need to:

- clarify the roles and responsibilities of the TIG and Investigations staff particularly with regard to the collection and handling of intelligence (discussed in Chapters 3 and 4); and
- reconcile the two distinct accountability patterns (as shown in Figure 2.1) emerging from the Field Services Branch’s service provider relationship to the TIG and its direct reporting relationship to the Deputy Commissioner Excise. This aspect is further discussed in Chapter 4.

⁵⁷ Field Services Branch’s key stakeholders are the Revenue and Intelligence Branch, which includes the Excise Industry Groups, Policy and Legislation, Business Payments, Projects and Systems, ATO Field Custodian and Serious Non-Compliance.

Recommendation No. 1

2.20 The ANAO recommends that, as part of a continuous improvement process, when developing the Business Plan for 2002–03, the Tobacco Excise Industry Group articulate clearly appropriate strategies and measures aimed at achieving the objectives identified in the Business Plan and assess its performance against those objectives.

ATO response

2.21 The ATO agrees with this recommendation and notes it reflects well-established ATO current practices as implemented in the Excise Business Line.

Risk management

2.22 As mentioned in Chapter 1, the ATO has identified *chop-chop* as a risk to tobacco excise revenue. In assessing the risks related to *chop-chop*, the Illicit Tobacco Strategy was first developed by the ATO in May 1999,⁵⁸ soon after it assumed responsibility for the excise function. The strategy was developed with the following aims: illicit activity is minimised so that it does not erode Government revenue; the legitimate tobacco industry is not disadvantaged; and the community is safeguarded.⁵⁹

2.23 In 2001, further risk assessments were undertaken by the TIG and the status of the 1999 Illicit Tobacco Strategy was re-assessed to determine the extent to which it was implemented. The 2001–2003 Tobacco Strategy (as shown in Figure 2.2) was the outcome of this process. The risk assessments relating to illicit tobacco are documented in the 2001–2003 Tobacco Strategy, which identifies the target client groups,⁶⁰ strategies to manage risks in relation to each of the client groups and a time frame within which to implement these strategies.

⁵⁸ The ATO widely consulted the tobacco growers, manufacturers, retailers, importers and Customs.

⁵⁹ ATO's draft Illicit Tobacco Strategy, 18 June 1999.

⁶⁰ The Tobacco Strategy identifies its primary client group as: the growers, illegal manufacturers, distributors and growers, retailers/sellers of illicit tobacco, duty-free shops and licensed manufacturers.

TIG initiatives

2.24 The ANAO notes that, in managing the illicit tobacco risks, the TIG has implemented a number of initiatives from both the 1999 Illicit Tobacco Strategy and the 2001–2003 Tobacco Strategy. These include:

- making legislative changes (*Excise Amendment (Compliance Improvement) Act 2000*) to strengthen the pecuniary penalties attached to relevant sections of the Excise Act⁶¹ and to provide the Excise Investigations Unit with stronger powers to pursue *chop-chop*;
- holding meetings and education seminars with members of the Victorian, North and South Queensland Tobacco Cooperatives on the legislative changes;
- licensing all tobacco growers and dealers under the Excise Act;
- risk-rating all licensed tobacco growers against a list of indicators to determine the level of risk treatment under the ATO Compliance model;⁶²
- using licensing as a compliance tool rather than a ‘rubber stamp’ process;⁶³
- developing a field compliance audit program to monitor tobacco growers and manufacturers’ compliance with excise legislation (further discussed in Chapter 4); and
- advising all duty-free shops that were dealing in excisable tobacco products of the changes to excise storage licence and associated permission requirements.⁶⁴

2.25 The ANAO notes also that a High Risk Work Plan was developed for 2001–02, which details the risk treatments for the risks identified in the 2001–03 Tobacco Strategy. This includes estimating and costing resources required and an implementation timetable. As mentioned in Chapter 1, in further addressing the risks relating to tobacco growers, the TIG has recently developed, and is implementing, a targeted project, the *Aggressive Tobacco Project 2001–02*, to address

⁶¹ The *Excise Amendment (Compliance Improvement) Act 2000* was passed in September 2000 and introduced the capacity for ATO officers to stop and search vehicles for excisable goods at any place and put in place increased and new penalties including imprisonment and penalty notices.

⁶² The ATO Compliance Model provides a framework for the approach to be taken towards compliance at both strategic and operational levels.

⁶³ The ATO has imposed conditions on individual licences to limit growing, movement, storing, dealing, sales and disposal actions that can occur with tobacco products.

⁶⁴ Duty-free shops were asked to complete questionnaires which required them to provide details of all sales of excisable goods, including sales to relevant travellers, diplomats, duty-free concessions and other disposals made during 2000–2001. The information collected from these questionnaires will be used to risk-rate the duty-free licensees and determine the appropriate compliance strategy to be applied to manage the related risks.

the problem of *chop-chop* at the point of supply. The *Aggressive Tobacco Project* is an 18-month trial program based on:⁶⁵

- a visible presence in the main tobacco growing regions;
- more planned activity (fewer ad hoc responses);
- a collaborative approach to sharing of intelligence with appropriate systems to support data collection and sharing of information;
- resolution to tobacco-related legislative and policy issues; and
- targeted projects with the AFP, National Crime Authority, State Road Transport Authorities and local police in the two main tobacco-growing regions.

2.26 The *Aggressive Tobacco Project* was endorsed by the EBL Executive in December 2001 and involves an investment of \$2.5 million. Appendix 6 provides further details on the project and the desired outcomes.

2.27 The ANAO notes that the project's focus is largely on maintaining a permanent presence in the main tobacco growing regions. The approach to addressing other areas within the scope of the project such as developing a collaborative approach to gathering and sharing intelligence and developing targeted projects with the National Crime Authority and State Road Transport Authorities is yet to be formulated. This issue is discussed further in Chapter 3.

2.28 The ANAO considers that the *Aggressive Tobacco Project*, if implemented effectively in its entirety, has the potential to play a pivotal role in addressing the problem of *chop-chop* and thereby reduce the ATO's level of exposure to revenue loss. The ATO expects the results of this project to be visible after October 2002 through prosecutions, cancellation of licences and increased street value of loose tobacco.

2.29 The ANAO considers that the TIG has adopted a strategic approach to assessing and managing tobacco excise risks. An ongoing review to evaluate the effectiveness of the strategies in light of shifting risk priorities will contribute to maximising the desired outcomes. However, in managing the tobacco excise risks, the ANAO noted the following areas require further consideration:

- tobacco retailers / tobacco sellers;
- strategic partnerships with stakeholders; and
- quantification of revenue leakage from *chop-chop*.

2.30 Each of these areas is separately discussed below.

⁶⁵ Source: Australian Taxation Office, *Aggressive Tobacco Strategy*, 30 November 2001.

Tobacco retailers/Tobacco sellers

2.31 The ANAO considers that further work needs to be undertaken in relation to retailers/sellers of tobacco. For an overview of the retail tobacco market see Appendix 1. The ATO's strategy in managing the risks at the retail end has largely related to enforcement⁶⁶ rather than client education and awareness. The ANAO acknowledges that it is appropriate to curtail the problem of *chop-chop* at the point of supply. However, complementary preventative initiatives through education and awareness strategies of retailers are also likely to make an important contribution to minimising the trade of *chop-chop* and provide useful intelligence (see Chapter 3). The ATO advised that the focus on retailers was assigned a low priority, as there is greater leverage with intervention further up the supply chain. However, the ATO acknowledges also that education/targeting of retailers during 2002 remains a component of the overall strategy to mitigate risks. The ANAO noted that as part of a recent staffing restructure within the TIG, staff have now been specifically assigned to liaise with the tobacco retail sector.

2.32 As the number of growers, dealers and manufacturers are far fewer than retailers, the EBL's Tobacco Strategy focuses largely on the tobacco growers and manufacturers. Furthermore, these entities are licensed and regulated under the Excise Act, whereas the tobacco retailers operate under State legislation. However, the ATO has an obligation to enforce compliance, including by relevant retailers, with excise legislation. The tobacco manufacturers see the tobacco retailers to be very much involved in the *chop-chop* trade. When one retailer sells cheaper product, others are forced to follow to remain competitive. There is a view among the tobacco manufacturers that a federal system for licensing retailers could be a solution to regulating the tobacco retail industry. The ATO advises that it strongly disagrees with this view on constitutional and practical grounds. The ANAO notes that the guidelines developed by the World Health Organisation on the Framework Convention on Tobacco Control (discussed in paragraph 2.15) also refers to the need to work with tobacco retailers in controlling the problem of illicit tobacco.

⁶⁶ For example, issuing infringement notices and prosecuting repeat offenders.

Recommendation No. 2

2.33 The ANAO recommends that, the ATO review its strategy to manage risks relating to illicit tobacco and to include contact with Australian tobacco retailers as an integral part of ensuring compliance with excise legislation.

ATO response

2.34 The ATO agrees with this recommendation and notes that it has established liaison with retailer representative organisations through regular industry meetings. Additionally the ATO worked closely with a major tobacco manufacturer on its recent media campaign targeting retailers and consumers.

Strategic partnerships with stakeholders

2.35 The ANAO views strategic partnerships with stakeholder organisations as a key component of tobacco excise administration and management of risks relating to *chop-chop*. These stakeholder partnerships (with law enforcement authorities, Health, AFFA and the tobacco industry) may provide valuable intelligence relating to law enforcement and social issues. As well, they may help to establish a viable network for the exchange of information and ongoing communication (within legislative restrictions). The TIG's partnership with law enforcement authorities and tobacco industry stakeholders is discussed in the following chapters, which relate to intelligence and field services. In this chapter, we examine the ATO's relationship with agencies such as Health and AFFA. Information from these agencies may provide useful insight into the potential effects of excise legislative and policy decisions on the tobacco social and industry environment and thus assist in monitoring the effectiveness of the excise collection system.

2.36 The TIG has advised that stakeholders such as Health and AFFA have been invited to participate in regular industry liaison meetings (referred to in paragraph 3.46). As noted in paragraph 2.15, there is potential for better exchange of information through developing formal partnerships with stakeholders such as Health and AFFA. An ongoing responsibility of Health is to conduct household surveys⁶⁷ to determine the prevalence of smoking in Australia. The ANAO considers that the data from the surveys could be useful to the TIG to help estimate the impact of *chop-chop* on the Australian tobacco market. The TIG could

⁶⁷ Health in cooperation with the Australian Institute of Health and Welfare (AIHW) has conducted several National Drug Strategy Household Surveys since 1985. These surveys cover attitudes, beliefs and behaviours of households to alcohol, tobacco, illicit drugs, etc. The 2001 Survey covers questions on roll-your-own tobacco and *chop-chop*. In conjunction with this survey, Health has conducted National Tobacco Campaign Surveys (referred to as Tracking Surveys) since November 1997 as a regular feature of its Campaign evaluation strategy.

also provide formal input into survey questions on *chop-chop*.⁶⁸ This information could also be useful to undertake risk assessments on tobacco excise.

2.37 Similarly, AFFA maintains contact with the tobacco industry to remain informed of significant developments and thus provide appropriate advice and briefings to Government as required. Therefore, the TIG could benefit from sharing information with AFFA.

2.38 The ANAO considers that the TIG should seek to establish a forum involving relevant stakeholders such as Health and AFFA to provide a basis for communication and the exchange of information on matters relating to tobacco.

2.39 Health has indicated that it is willing to share household survey data with the ATO and welcomes input from the TIG regarding additional survey questions on the use of *chop-chop*.

Quantification of revenue leakage associated with *chop-chop*

2.40 The ANAO notes that in Budget 2001–02, the tobacco excise revenue estimates⁶⁹ were revised down by in excess of \$500 million relative to Budget 2000–01. The 2001–02 Budget papers stated that some of the factors that have contributed to the downward revision include a possible consumer demand response to higher tobacco prices since the introduction of the GST and the increased use of the anti-smoking drug Zyban.⁷⁰ In addition, the Budget papers suggest that ‘higher tobacco prices may have contributed to the growing illicit tobacco market (known as *chop-chop*).’

2.41 Given this revision, the ANAO sought to establish whether the ATO had assessed the size of the *chop-chop* market and its impact on Commonwealth revenue.⁷¹

⁶⁸ The ATO advised that input was provided into the 2001 Tracking Survey, albeit on an informal basis.

⁶⁹ The Department of Treasury is responsible for formulating tobacco excise revenue estimates. The Petroleum Excise Audit covers in detail the revenue estimates process.

⁷⁰ The ANAO noted that the TIG’s research and analysis section has also undertaken some preliminary work to determine the use of the anti-smoking drug Zyban as a factor impacting on excise revenue. However, the TIG acknowledges that given Zyban became available as a prescribed drug on the Pharmaceutical Benefits Scheme in February 2001, it was too early to draw any conclusions.

⁷¹ In 1998, Customs assessed the Commonwealth’s exposure to revenue loss due to evasion of tobacco excise and customs duty, to be in the order of \$60 million per annum. The estimated revenue lost was attributed to the illegal manufacture of Australian grown tobacco leaf, that is, *chop-chop*. (Source: *Tobacco Revenue Avoidance and Evasion Paper*, November 1998, Australian Customs Service, Intelligence Branch).

2.42 The ANAO acknowledges that it is not easy to precisely estimate this revenue loss, however it is important to do so because:

- it helps contribute to the accuracy of the revenue estimation process;
- strategies developed to manage risks to tobacco excise revenue need to be commensurate with the magnitude of the problem to be effective; and
- when an approach to systematically quantify revenue leakage is established, comparative assessments can be made to determine the effectiveness of the risk management strategies over time.

ATO estimates

2.43 At this stage, the ATO has not been able to fully quantify the revenue loss that can be attributed to *chop-chop*. The ATO's recent attempts to quantify the revenue loss has been based largely on an assumption that the increasing trends in the importation of cigarette tube and cigarette paper into the country since 1997 can be attributed to the increasing use of *chop-chop*.⁷² The ATO acknowledges that several of its assumptions remain to be tested,⁷³ and the gaps in the current information prevent it from obtaining an accurate estimate of the size and value of the *chop-chop* market. The ATO accepts *chop-chop* is a problem and considers it is being addressed through an active compliance strategy. The ATO advised that it is also continuing to work on the quantification issues⁷⁴ to enable a more accurate assessment of the impact of its risk management strategies.

2.44 Industry estimates⁷⁵ that \$450 million per annum in excise loss (equivalent to almost 10 per cent of the total tobacco excise revenue collected annually) can be attributed to the *chop-chop* market.

⁷² Cigarette filter tubes are imported into Australia predominantly from Europe and South East Asia, and sold by the majority of tobacconists and grocery outlets. Cigarette paper is imported for roll-your-own tobacco, which is sold by the manufacturing companies. The tobacco manufacturing companies have alleged for a number of years that cigarette filter tubes are being used for *chop-chop*. There has been an unprecedented increase (approximately 280 per cent) in importation of tubes and paper from 244 million units in 1997 to 924 million units in 2000.

⁷³ The ANAO notes that the problem with statistical codes was identified by the TIG in its May 1999 Illicit Tobacco Strategy. However, this issue remains to be resolved. The EBL advised that it has held discussions on this matter with the Australian Bureau of Statistics (ABS) and the importers of cigarette tubes.

⁷⁴ The ATO advised that due to the limited number of importers importing cigarette tubes, introducing separate tariff item codes for cigarette papers and cigarette tubes would identify the importers and the quantities they are importing. Therefore, the ATO had to seek their approval before canvassing this option with the ABS.

⁷⁵ In light of difficulties in accurately estimating excise revenue loss attributed to *chop-chop*, the ATO has used this estimate in developing its compliance strategy.

ANAO estimates

2.45 To obtain another perspective on the tobacco excise revenue leakage, the ANAO worked with Health and the AIHW to explore the possibility of using information collected through its surveys (referred to in paragraph 2.36) to gain an insight on:

- the smoking prevalence rates;
- the extent of the problem of *chop-chop*; and
- the consumption figures as reported in the Health and AIHW surveys compared to the actual cigarette quantities cleared by the ATO and Customs⁷⁶ for domestic consumption.

2.46 The data from these surveys indicate (see table at Appendix 7) that:

- since 1998, the smoking prevalence rate has declined (between 1.9 and 2.5 per cent); and
- the revenue loss from *chop-chop* ranged from \$99 million to \$220 million per annum.⁷⁷

2.47 The ANAO notes that the survey accounts for 86 per cent of tobacco cleared by the ATO and Customs for domestic consumption. The difference (14 per cent) in the cigarette consumption, as reported through the survey, compared to the ATO and Customs' cigarette clearance statistics, could possibly be due to smokers understating their cigarette consumption. This could partially explain the gap in the revenue loss estimated by the industry and the revenue loss estimated from the household surveys.

2.48 Nevertheless, the ANAO considers that the information collected through these surveys on use of *chop-chop* and smoking prevalence rates could help the ATO:

- improve the accuracy of the tobacco excise revenue estimates process; and
- gain an alternative perspective in understanding the magnitude of the *chop-chop* problem.⁷⁸

⁷⁶ As mentioned in the Petroleum Excise Audit, Customs is responsible for the collection of duty payable on imported goods that would be excisable if locally produced. In this case, all imported tobacco products are cleared by Customs.

⁷⁷ Calculated as a proportion of licit tobacco consumption as reported through the survey.

⁷⁸ The ANAO notes that the assessment of revenue lost due to evasion of tobacco excise and customs duty (as referred to in footnote 71) used data from surveys on smoking habits of Australians conducted by various health authorities other than the AIHW.

2.49 In addition, the ANAO considers that the approach undertaken by Customs in 1998 (referred to in footnote 71) to quantify the magnitude of tobacco excise revenue leakage was reasonable. Consideration of this approach could also contribute to the ATO's initiatives when addressing these quantification issues. In addition, a better intelligence capability would increase the TIG's capacity to assess and manage these risks. This issue is discussed in the following chapter.

Recommendation No. 3

2.50 The ANAO recommends that, to develop better informed risk assessments and to more accurately quantify the revenue leakage resulting from the trade of *chop-chop* in Australia, the ATO should consider developing effective working relationships with the Department of Health and Ageing and other appropriate Commonwealth agencies. This would provide added information relevant to ascertaining the nature and size of the *chop-chop* market.

ATO response

2.51 The ATO agrees with this recommendation and will further develop existing relationships with other relevant government agencies and stakeholders. It is currently enhancing the role of its established industry liaison meetings, in informing the continuing development of its illicit tobacco strategy. The ATO is concerned that some of the methodologies used to estimate market size are very sensitive to the assumptions made and this is reflected in the wide variation in estimates. The ATO considers that it may not be possible to develop a sufficiently accurate estimate of an illegal market of this nature that is useful for program management purposes. In addition to further efforts to estimate the market size, the ATO will continue to develop other appropriate indicators e.g. monitoring retail price of *chop-chop*.

Performance management and reporting

2.52 The introduction of revised planning arrangements within the ATO (as mentioned in paragraph 2.7) has led to changes in reporting, monitoring, governance and accountability arrangements. As part of the ATO's revised corporate governance reporting requirement, the EBL is to prepare a quarterly governance report that includes information relating to its business outcomes, expenditure against budget, new/changing risks and major improvement opportunities. The information from these reports (from all ATO business lines) is used in the preparation of the four Sub-Plan Reports that relate to the four ATO Plans (see Figure 2.2 on page 41, which outlines the ATO planning hierarchy).

In addition to the quarterly governance report, each business line is also required to prepare exception reports⁷⁹ for the ATO executive on a monthly basis.

2.53 The corporate governance reports are supported by operational reporting requirements within each business line. The EBL prepares a monthly performance report for the Excise Executive, which provides an ongoing aggregate picture of EBL performance. The ANAO notes that this report is being constantly reviewed and revised to improve the quality of the information presented. In addition, the following reports provide information on tobacco excise administration:

- the Revenue and Intelligence Branch Monthly Report includes revenue and payment information relating to the various excisable products and transfer schemes;
- the Field Services Branch Monthly Report covers compliance and investigations activities relating to all excisable products and payment schemes; and
- the TIG Quarterly Report for Revenue and Intelligence Branch management includes aspects relating to tobacco excise administration, such as initiatives in managing tobacco excise risks.

2.54 Figure 2.1 on page 40, reflects the tobacco excise performance management and reporting hierarchy. The ANAO considers that the reporting on the administration of tobacco excise was effectively aligned with revised planning arrangements for 2001–02. The ANAO notes that the quarterly governance report includes sufficient information for the ATO Executive to assess the EBL’s business achievements in relation to the administration of tobacco excise. The report provides an update on the Tobacco Strategy and the EBL’s progress in addressing the problem of *chop-chop*.

2.55 Similarly, the EBL performance reports (referred to in paragraph 2.53) also include information on a number of aspects relating to tobacco excise administration, thus contributing to the corporate governance reporting process. The Field Services Branch Monthly Report was found to provide a clear overview of the Branch’s business achievements. This could partly be due to the clarity in the key success indicators developed and identified in the Field Services Branch Business Plan.

2.56 However, the ANAO notes that the Revenue and Intelligence Branch Monthly Report, while providing information relating to tobacco excise revenue performance, lacks requisite information on its tobacco-related intelligence

⁷⁹ The exception report is to be prepared if a business line in a particular month does not expect to meet its commitment identified in any of the four higher-level ATO plans.

activities. This could be partly attributed to the gap in the TIG's reporting in this area, which reflects an absence of strategies and measures relating to intelligence and internal capability, developed in the TIG's Business Plan, as mentioned in paragraph 2.16.

Conclusion

2.57 *Chop-chop* has been identified as a risk to tobacco excise revenue. Commensurate with this risk, we found that the ATO has in place governance arrangements to manage strategic and operational aspects of tobacco excise administration.

2.58 Both the TIG and Field Services Branch have developed individual Business Plans for 2001–02 that seek to achieve the deliverables identified in the EBL Delivery Plan. Overall, their approach to planning was sound, however, further work is needed to strengthen certain aspects of the TIG's Business Plan. This would be congruent with the revised ATO approach to risk management referred to in paragraph 2.8 (that emphasises the achievement of corporate alignment and integration of risk analysis and treatment activities).

2.59 The ATO has adopted also a strategic approach to assessing and managing tobacco excise risks. Since assuming responsibility for this function, the ATO has implemented a number of initiatives to manage the illicit tobacco risks.

2.60 The ATO's strategy in managing risks at the retail end has largely related to enforcement rather than client education and awareness. The ATO advised that focus on retailers was assigned a low priority, as there is greater leverage with intervention further up the supply chain. However, the ATO acknowledges that the education/targeting of retailers during 2002 remains a component of the overall strategy to mitigate these risks. The ANAO notes that as part of a recent staffing restructure within the TIG, staff have now been specifically assigned to liaise with the tobacco retail sector to increase client education and awareness.

2.61 The ANAO considers also that there is further scope to undertake more informed risk assessments and more accurately quantify the revenue leakage resulting from the trade of *chop-chop* in Australia. Such action would enable developed ATO reporting on the impact and performance of its programs. This could be achieved through developing effective working relationships with stakeholders such as the Department of Health and Ageing and other Commonwealth agencies.

2.62 Reporting on the administration of tobacco excise reflected the revised ATO planning arrangements for 2001–02. The ANAO notes that the EBL is

constantly seeking to review and revise the quality of the information presented in its various performance reports and its quarterly governance report includes sufficient information for the ATO Executive to assess the Business Line's achievements in relation to the administration of tobacco excise. Similarly, the EBL's internal performance reports also include information on a number of aspects relating to tobacco excise administration, thus effectively contributing to the corporate governance reporting process.

3. Intelligence

This chapter discusses the importance of a robust intelligence framework to identify breaches of excise legislation and to minimise the impact of chop-chop on the Australian market. The coordination of intelligence within the Excise Business Line using skilled intelligence staff; robust information technology systems and analysis tools; and liaison arrangements with external agencies capable of providing relevant information is also discussed.

Introduction

3.1 Sound intelligence is a necessary element of informed decision-making about the strategic direction, planning and allocation of resources within an agency. In this context, an effective intelligence framework is essential to the ATO's administration of tobacco excise, given its exposure to the *chop-chop* market and the nature of the legislation it administers (see Chapter 1).

3.2 Intelligence is the product that results from the collection, evaluation (and continued re-evaluation), collation and analysis of information. It becomes meaningful when it is controlled, focussed, secure, timely, accurate and distributed to appropriate consumers (for a description of an intelligence model, refer to Appendix 8). Intelligence that does not meet these criteria is likely to hinder, rather than advantage the operations of an agency.⁸⁰

3.3 It is widely accepted by the Australian law enforcement community that there are three main types of intelligence product.⁸¹ These are:

- **strategic intelligence**—an intelligence product that provides insight or understanding, contributing to decisions on broad strategies, policies and resources, directed to achieving long-term organisational objectives;
- **operational intelligence**—an intelligence product which supports managers in planning activity and deploying resources to achieve operational objectives; and
- **tactical intelligence**—an intelligence product, which supports line areas and other operational areas in taking case-specific action to achieve compliance or enforcement objectives.⁸²

⁸⁰ ANAO Audit Report No.38, 1999–2000, *Coastwatch*, Australian Customs Service, p. 79.

⁸¹ An intelligence product provides insight or understanding on the nature and/or extent of a current or future threat, developed through the careful analysis of available information that provides direction for future action. *Strategic Crime Intelligence Explained*. National Crime Authority. p. 6.

⁸² *Intelligence Doctrine*. Australian Customs Service, April 2000, pp. 5–6.

3.4 The distinction between the three different intelligence products is less obvious in practice, with tactical and operational issues in particular often overlapping each other. However, the skills and knowledge required by officers for each intelligence product differs significantly, particularly those skills relating to strategic intelligence products compared to operational and tactical intelligence products.

Chop-chop intelligence environment

3.5 The intelligence requirements of the EBL in relation to the *chop-chop* market differ significantly from the intelligence requirements of other ATO activities. These differences relate to the:

- **timeliness of intelligence.** Unlike other areas of the ATO, to apprehend people involved in the *chop-chop* market, a more traditional law enforcement approach is required.⁸³ That is, the onus is on the EBL to apprehend people ‘in the act’⁸⁴ of breaking excise law. Generally, those people involved in the *chop-chop* market do not keep records, which could be used by the EBL to gain a successful conviction under other taxation law. Consequently, the intelligence required by excise officers is time critical, as evidence needs to be obtained while the excise law is being broken; and
- **accuracy of intelligence.** As noted in Chapter 1, there is evidence that organised crime groups are involved in the manufacture and distribution of *chop-chop*. For this reason, excise investigators and field officers need to be sure that the intelligence they receive about the location, and people they are investigating is accurate and timely.

3.6 Without accurate and timely intelligence, excise officers could be placed in a quite disadvantageous position, possibly involving physical danger, as those involved in the manufacture and distribution of *chop-chop* may become violent if approached by an excise officer without appropriate law enforcement support.

⁸³ Law enforcement authorities are responsible primarily for the detection and investigation of offences and the acquisition of evidence (proof) to enable relevant authorities to bring charges. In the case of *chop-chop*, the intelligence to be gathered relates to a physical commodity, rather than other ATO activities that relate to paper-based transactions involving taxation issues.

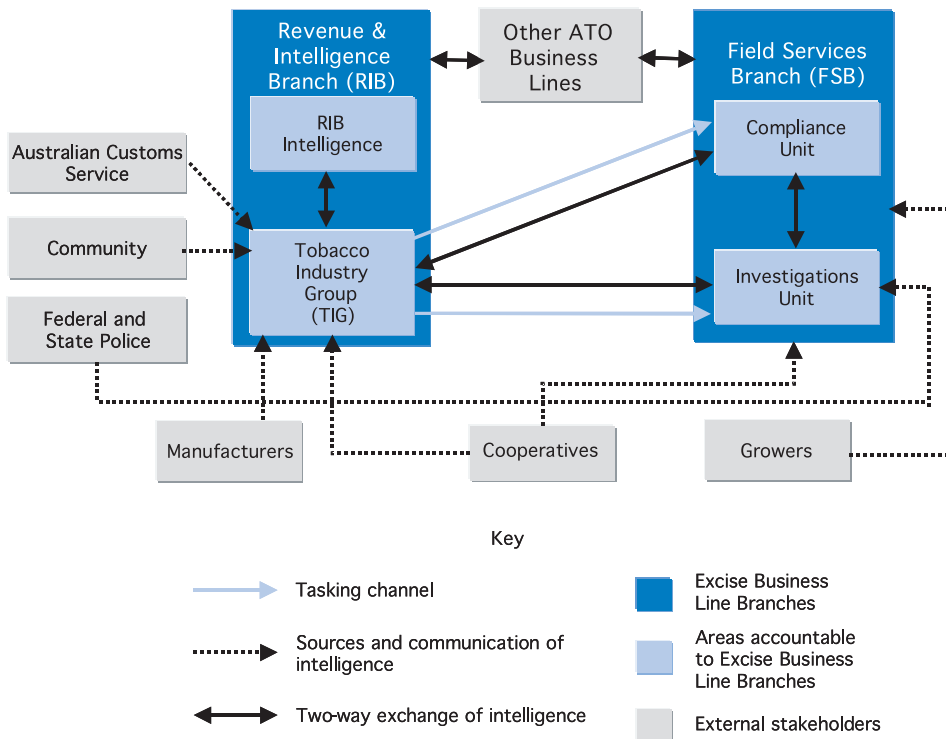
⁸⁴ That is, to obtain a successful conviction, ATO officers must obtain strong evidence on an event (for example the illegal transportation of *chop-chop*) as it occurs.

The tobacco excise intelligence framework

3.7 The EBL has an intelligence framework to collect, analyse and store suitable intelligence particularly with regard to *chop-chop*. The figure below illustrates the current arrangements in place between the two main areas responsible for the collection and analysis of intelligence (the Revenue and Intelligence Branch and the Field Services Branch) within the EBL.

Figure 3.1

Excise Business Line tobacco intelligence framework



Source: ANAO's depiction of the ATO's tobacco intelligence framework

3.8 The Revenue and Intelligence Branch, in addition to managing excise revenue collection (as referred to in Chapter 2), is also responsible for managing intelligence (including industry and other intelligence) to improve policy, compliance and identifying opportunities for the future. The Intelligence area within the Revenue and Intelligence Branch (see Figure 2.1), in particular, is responsible for developing the EBL's intelligence infrastructure to capture and manage strategic intelligence.

3.9 The TIG is responsible for implementing (amongst other activities) tobacco intelligence policy, as well as administering operational and tactical intelligence

in relation to the *chop-chop* market. It is also responsible for the preparation of taskings to engage Field Services Branch resources for investigations/compliance activities.

3.10 The responsibility for the collection of tactical and operational intelligence rests with the Field Services Branch and in particular, its Compliance and Investigations Units.⁸⁵ The Compliance Unit provides intelligence to the Industry Groups through its audits and other risk treatment activities. The Investigations Unit provides intelligence to the Industry Groups through its investigations of external fraud involving possible breaches of Commonwealth legislation in relation to all excisable products/industries.

3.11 As mentioned in Chapter 2, the coordination between the relevant areas of the Revenue and Intelligence Branch and the Field Services Branch is a critical aspect of an efficient and effective EBL intelligence framework. Any breakdown in the coordination and communication between these two branches would significantly inhibit the collection and analysis of tobacco-related intelligence and consequently, effective decision-making at both the strategic and operational/tactical levels. In reviewing the EBL's existing intelligence framework (as outlined above), the ANAO focussed on four areas impacting upon its success. These were the:

- coordination of *chop-chop* intelligence within the EBL;
- intelligence gathering and analysis skills of excise staff;
- information technology infrastructure to support the collection and analysis of intelligence; and
- coordination of *chop-chop* intelligence between the EBL and external stakeholders.

Coordination of *chop-chop* intelligence within the Excise Business Line

3.12 Although the Revenue and Intelligence Branch and the Field Services Branch have specified their roles and functions in annual planning and other documentation⁸⁶ (see Chapter 2), this documentation does not articulate their responsibility with regard to the collection and analysis of strategic, operational and tactical tobacco-related intelligence.

⁸⁵ The Field Services Branch is also responsible for providing compliance and investigations services to the Transfers and Payment Group.

⁸⁶ Field Services Plan 2001–02 and Revenue and Intelligence Branch PowerPoint Presentation, *Partners in Excise*, October 2000.

Coordination of strategic intelligence

3.13 As noted previously, the Intelligence area within the Revenue and Intelligence Branch (see Figure 2.1) is responsible for, amongst other activities, managing excise strategic intelligence. The TIG has also been responsible for aspects of strategic intelligence management, through its analysis of strategic tobacco-related intelligence. The ANAO noted that there was no documentation outlining the roles of the respective areas in relation to the overall management of strategic tobacco-related intelligence and the development of tobacco excise intelligence policy.

3.14 Clearly defined and documented strategic intelligence roles and responsibilities would help to ensure clear lines of responsibility between the Intelligence area within the Revenue and Intelligence Branch and the TIG with regard to the gathering and analysis of strategic intelligence, and development of tobacco-related intelligence policy. It would also assist EBL management in allocating staff with the skills necessary to undertake specific strategic intelligence activities, and effectively identifying staff who require additional skills in this area (see paragraph 3.19).

Coordination of operational and tactical intelligence

3.15 As shown in Figure 2.1, the TIG is responsible for tasking both the Compliance and Investigations Units of the Field Services Branch to undertake compliance audits of tobacco industry stakeholders and to conduct investigations of potential breaches of excise legislation. The information collected from these activities forms a basis for operational and tactical tobacco-related intelligence. As a result, the effectiveness of the tasking process impacts heavily on the relevance and quality of the tobacco intelligence gathered by the TIG.

3.16 The ANAO noted that the tasking process was not streamlined, as the Investigations Unit primarily acted on information received from external sources. The Unit undertook investigation action without necessarily advising the TIG (discussed in more detail in Chapter 4).⁸⁷ Further, there was no delineation of roles between the TIG and the Investigations Unit regarding the gathering and analysis of tactical and operational intelligence.

3.17 An efficient and effective intelligence framework clearly identifies the area(s) responsible for gathering and analysing operational and tactical tobacco-

⁸⁷ The ANAO noted that the majority of the Compliance Unit's audits were based on taskings or other information provided by the TIG. Also, the information collected by the Compliance Unit was communicated to the TIG in detailed audit reports. We consider that the communication channels that exist between the Compliance Unit and the TIG allow an uninhibited flow of information between the two areas. For this reason, the focus of this Chapter is on the TIG's tasking of the Investigations Unit, and the exchange of information between the two areas.

related intelligence. In 2000–2001, the EBL made progress in defining the operational and tactical intelligence responsibilities of the TIG and the Investigations Unit.⁸⁸ This included the circulation of a detailed research paper on the tobacco-related intelligence requirements of the EBL, and meetings to discuss closer liaison arrangements. In late 2001, both the TIG and the Investigations Unit developed a ‘roles and relationships’ paper to better define their responsibilities in relation to intelligence. This paper specified that:

Investigations will be responsible for, in conjunction with the TIG, the gathering, collating and the manipulation of information to form an intelligence capability...⁸⁹

3.18 Although the EBL has introduced steps to improve the coordination between the TIG and the Investigations Unit, clarity between the operational and tactical intelligence roles of each area remains an issue. We note that the current arrangements have resulted in a duplication of activities and have inhibited the sharing of tobacco-related intelligence. For example, each area has developed its own intelligence methodologies and systems to gather and analyse tobacco-related information. The methodologies and systems developed by the Investigations Unit and the TIG are incompatible also (see Chapter 4 for further detail on the information sharing arrangements between the TIG and the Investigations Unit).

Intelligence gathering and analysis skills of the excise staff

3.19 The ability to develop and adopt a structured, systematic approach to analysing information is the hallmark of an effective intelligence analyst. A structured and systematic approach to intelligence analysis requires adherence to accepted, fundamental principles and techniques, most of which are learned or assimilated over time.⁹⁰

3.20 Given (as mentioned above) the different set of skills required to perform particular analysis functions, it is imperative that intelligence officers receive specialised training for their particular role and function.

3.21 The intelligence gathering and analysis skills of excise staff vary considerably between individual teams in both the Revenue and Intelligence Branch and the Field Services Branch. For example, the Investigations Unit, which has many staff with experience in law enforcement authorities such as the AFP and Customs, has a good knowledge base in intelligence methodology and practice.

⁸⁸ This was facilitated through the Field Services & Revenue and Intelligence Workshop, held in October 2001.

⁸⁹ *Roles & Relationships*—Tobacco Industry Group & Field Services, ATO 2001.

⁹⁰ *Analytical Intelligence Training*, Marilyn B. Peterson and R. Glen Ridgeway, United States of America.

3.22 However, within the TIG and elsewhere within the EBL, staff in key intelligence positions have not undertaken specialised strategic, operational and tactical intelligence training. In some cases, they may not have the necessary background, experience and knowledge to undertake this function. The ATO acknowledges that it needs to build information management and analysis skills to address these areas.

3.23 The ANAO notes that specialised strategic intelligence training is important to those officers who currently develop intelligence policy, as well as taskings for both the Compliance and Investigations Units. We consider it essential that relevant TIG and Investigations officers are appropriately trained to effectively gather and analyse strategic, operational and tactical intelligence, depending on their specific roles and responsibilities. Intelligence training is offered through law enforcement authorities, such as the AFP and Customs, who have developed courses to satisfy their own requirements. Formal intelligence education can also be sought through tertiary-accredited diplomas.⁹¹

3.24 The Revenue and Intelligence Branch and the Field Services Branch have acknowledged that specific intelligence training is required for staff involved with the *Aggressive Tobacco Project* (see Chapter 2). We consider that it would be beneficial, in addition to these staff, if all staff involved with the gathering and analysis of tobacco-related intelligence undertook specialised intelligence training appropriate to their respective roles.

Recommendation No. 4

3.25 The ANAO recommends that the ATO evaluate its tobacco excise intelligence capability to help ensure that staff have the skills necessary to effectively gather and analyse strategic, operational and tactical intelligence.

ATO response

3.26 The ATO agrees with this recommendation. The EBL is currently developing an intelligence framework for the Business Line, including training requirements.

⁹¹ For example, the Diploma of Government (Fraud Control Investigations).

Information technology (IT) infrastructure to support the collection and analysis of intelligence

3.27 An essential component of a modern effective intelligence framework is a well structured, reliable and secure IT intelligence system. An effective IT intelligence system is capable of storing, sorting, interrogating and analysing large amounts of intelligence so that it can be accessed by, or disseminated to, appropriate staff in a timely way.

3.28 In examining current EBL intelligence systems, we consider that there are two essential components:

- the intelligence database/s (to enter and store intelligence); and
- IT intelligence analysis tools (used to interrogate and analyse the intelligence contained on the intelligence database and other external databases).

3.29 These two components, if fully integrated, will facilitate easy and timely access to relevant intelligence, that can be analysed effectively.

Excise intelligence database/s

3.30 The EBL currently uses numerous stand-alone databases to record information from investigations activities, compliance activities and information received by the TIG. These include:

- Investigations databases: These databases, which are maintained separately by each Investigations Unit team, can only be accessed by members of that team.⁹² Although the security of the information contained on these databases is essential, access to the information stored on these databases by intelligence officers (either by the Investigations Unit or by the TIG), could provide a greater understanding of tobacco-related investigation activities.⁹³

The ANAO notes that the EBL is examining the implementation of a single automated case management system within the Investigations Unit.⁹⁴ This system could be used to collect and analyse intelligence, as long as the

⁹² The databases are based on Microsoft Excel spreadsheets. The ANAO notes that although each spreadsheet is similar in design, not all data collected in the spreadsheets is easily comparable. During the audit, the major source of intelligence relating to the *chop-chop* market was stored on multiple, stand-alone investigations databases.

⁹³ In the case of the Investigations Unit, stand-alone systems provide additional security because only a small number of officers can gain access to that system. When systems are connected, the risk of a security breach increases.

⁹⁴ See Recommendation No. 6, the Petroleum Excise Audit, Appendix 3.

data on this system can be analysed in conjunction with the data contained on other ATO⁹⁵ and EBL (such as Compliance Unit and TIG) IT systems.

- Compliance databases: The Compliance Unit uses the 'TeamMate'⁹⁶ system to store its audit working papers and other audit-related documentation. This documentation, when examined in conjunction with intelligence gathered by other areas within the EBL and the ATO in general, could also improve intelligence capability particularly with regard to the *chop-chop* market.⁹⁷

Although the TeamMate system is used consistently in two Excise compliance sites,⁹⁸ access is restricted to staff within each compliance site. The ANAO notes that the EBL is in the process of developing a more integrated case management system for compliance activities. An integrated case management system could provide significant benefits to the EBL's intelligence capability if the data contained on the system can be analysed in conjunction with intelligence stored in other EBL and ATO systems.

- TIG databases: The ExcIntel database was designed to be the principal IT intelligence system for storing information on all EBL activity. In particular, it was to be used to store and analyse relevant information from a range of internal and external sources. To coordinate tobacco-related intelligence, the TIG uses the ExcIntel database to store and analyse intelligence gathered from a range of internal and external sources. It was also intended to provide strategic, operational and tactical intelligence to TIG officers upon which to base decisions concerning taskings for both the Compliance and Investigations Units.

The ANAO notes that although ExcIntel was being used consistently by the TIG, it was not being used by the Field Services Branch,⁹⁹ which collects the majority of tobacco-related intelligence for the EBL. To be effective, the security issues around ExcIntel must be resolved to gain acceptance from relevant staff of the Revenue and Intelligence Branch and the Investigations Unit.

⁹⁵ It is important that the EBL is able to analyse information on other ATO systems in conjunction with the information contained on their own systems. It is often the case that the people involved in the *chop-chop* market, are also avoiding their obligations under taxation legislation (such as GST, income tax etc.). Analysis of the information contained on both the EBL and other ATO systems could help detect other infringements of both tax and excise law.

⁹⁶ A more comprehensive overview of the 'TeamMate' system can be found in the Petroleum Excise Audit.

⁹⁷ The majority of Compliance Unit audits focus on tobacco growers and manufacturers. The information collected by the Compliance Unit on the tobacco growers, in particular, could provide further insight into the *chop-chop* market in Australia.

⁹⁸ TeamMate is used in Victoria and Queensland.

⁹⁹ The Excise Investigations Unit was reluctant to place intelligence on ExcIntel because of security and access control concerns. Investigations consider that the information they collect, as a result of their investigations, should be classified at the 'Protected' level. ExcIntel has a lower security classification of 'In-Confidence.' This matter has yet to be resolved by the TIG and the Investigations Unit.

3.31 The ANAO considers the EBL needs to assess its IT intelligence system requirements with respect to the information (which is sometimes duplicated) stored in each of the databases mentioned above. This information, when analysed in total, would provide a more comprehensive understanding of the *chop-chop* market, and would provide a more effective platform to assist in the targeting of EBL resources. The EBL can pursue either one of the following when assessing its IT intelligence system requirements:

- a single system, such as Exclntel, needs to be universally accepted by all parts of the EBL to be effective. The information contained on a single system must also be able to be analysed in conjunction with other ATO systems (see above); or
- a number of intelligence databases. If implemented, mechanisms need to be in place to allow intelligence analysts to access and analyse the information contained on these databases simultaneously, and in conjunction with other ATO systems.

3.32 The EBL advised the ANAO that the methodology and systems supporting intelligence gathering and analysis were being reviewed. In particular, its *Aggressive Tobacco Project* (see Chapter 2) identified a suitable IT infrastructure as a key element upon which the success of the project depends. The project recognised also that information technology, particularly for gathering and sharing intelligence, is an area that requires attention if it is to address effectively the problem of illicit tobacco.

Intelligence analysis tools

3.33 Intelligence analysis tools are computer software packages that rationalise and collate information from a diverse range of sources into a single, coherent structure. These tools also provide a facility to analyse information and extract meaningful intelligence. The use of these tools by intelligence analysts dealing with the *chop-chop* market is important if information is to be analysed from numerous EBL, ATO and other external databases (for example, AFP databases).

3.34 There are currently 37 licences issued across the ATO for the use of two intelligence analysis tools. These tools are:

- IBase—an investigative IT tool that allows the user to sort data from numerous data sources into a logical, structured, diagrammatic format; and
- Analyst's Notebook—an investigative analysis IT tool used to detect, interpret and display complex information in an easily understood format.¹⁰⁰

¹⁰⁰ It is linked to iBase.

3.35 However, the ANAO notes that the EBL did not have a sufficient number of licences (at the time of the audit, EBL held two licences) to make effective use of these tools. It is essential that, given the number of internal and external¹⁰¹ databases potentially available to EBL intelligence analysts, they are used effectively to collate and analyse information to strengthen the administration of tobacco excise. The ATO advised that two additional licences have recently been provided to cover major sites and future needs will be reviewed as part of the development of the EBL's intelligence framework.

3.36 We also note that staff currently using these tools have not undertaken any formal training in their use.

Recommendation No. 5

3.37 The ANAO recommends that the Excise Business Line, in reviewing its intelligence information technology requirements, ensure that these are directed at meeting its business needs by:

- developing intelligence systems that are user friendly, encourage a uniform approach and provide timely access to intelligence information; and
- effectively using intelligence analysis tools to collate and analyse information to strengthen the administration of tobacco excise.

ATO response

3.38 The ATO agrees with this recommendation. The ATO is taking steps to implement the details in this recommendation. A number of measures are in train to integrate the ATO's existing intelligence systems to streamline collection and access to data. The ATO has also begun to upgrade its supporting IT infrastructure to improve security and to facilitate the distribution of intelligence. The ATO has also obtained additional licences for key analytical tools so all major sites have access to these tools.

¹⁰¹ The databases used by law enforcement authorities such as the AFP, Customs, ABCI and various State police can be accessed and analysed using Analyst's Notebook and iBase. The ANAO notes that these law enforcement authorities use iBase and Analyst's Notebook to collate and analyse information to produce meaningful intelligence. Intelligence gathered by the ATO and law enforcement authorities using these tools would therefore be compatible.

Coordination of *chop-chop* intelligence between the Excise Business Line and external stakeholders

3.39 The EBL has identified two major groups capable of providing intelligence relating to the *chop-chop* market. These groups are:

- stakeholders involved in the tobacco industry; and
- Commonwealth and State law enforcement authorities.

3.40 Without intelligence coming from these groups, the EBL's ability to effectively enforce excise legislation in relation to tobacco would significantly diminish.

Stakeholders involved in the tobacco industry

3.41 As mentioned in Chapter 1, the tobacco industry in Australia comprises the tobacco growers (and their cooperatives), manufacturers and retailers. These stakeholders have first-hand knowledge of events taking place in the tobacco industry and are a valuable source of intelligence for the EBL.

Growers and their cooperatives

3.42 As outlined in Appendix 1, the growers' cooperative are responsible for distributing tobacco seed, as well as monitoring and accounting for the amount of tobacco grown by each grower within the cooperative. The cooperatives have an active interest in decreasing the production of illicit tobacco by growers within their cooperative because manufacturers are less likely to purchase local product if they are aware that growers within their cooperative are producing *chop-chop*. For this reason, the cooperatives can be a valuable source of intelligence for the EBL.

3.43 The ANAO notes that input from the cooperatives was sought when developing the 1999 and subsequent illicit tobacco strategies (see Chapter 2). Currently, the TIG has two officers dedicated to liaising with tobacco growers and their cooperatives in Victoria and North Queensland. There are also other points of contact within the EBL for the growers and their cooperatives (e.g. the Excise Investigations Unit). However, the communication and exchange of information (provided by the growers to the appropriate excise intelligence officers) within the EBL requires improvement. Ensuring well-defined arrangements to communicate this information would assist its effective use within the EBL (discussed above, and in Chapter 4).

3.44 The EBL stated that, as part of its *Aggressive Tobacco Project* (see Chapter 2), it was seeking to increase its contact with the growers by assigning excise officers to work in tobacco growing regions. This initiative should enhance significantly the intelligence gathering capability of the EBL.

Manufacturers

3.45 The major tobacco manufacturers (see Appendix 1) have an active interest in reducing the amount of *chop-chop*, because it directly impacts on their brand portfolios, volumes and overall profitability. Each manufacturer allocates resources to understanding the *chop-chop* market, and implementing measures (such as public awareness initiatives) to prevent the proliferation of *chop-chop*. The research on the *chop-chop* market undertaken by the manufacturers is also a source of intelligence for the EBL.

3.46 The ANAO notes that the TIG has taken measures to ensure that good liaison arrangements exist with the manufacturers.¹⁰² We consider that the involvement of the manufacturers in the TIG's strategic planning processes, and their ongoing liaison arrangements has enhanced the strategic planning and intelligence gathering capability of the TIG.

Retailers

3.47 Tobacco retailers can be a source of intelligence in relation to the distribution and sale of *chop-chop*. As mentioned in Chapter 2, tobacco retailers are not regulated under Commonwealth legislation. However, the EBL has a role in ensuring that these retailers comply with excise legislation regarding the sale of tobacco products.

3.48 As mentioned in Chapter 2, the TIG has recently established formal liaison arrangements with some tobacco retailers' associations. However, the ATO advises that although it is feasible to have formal relationships with representative tobacco retailer associations, there is no one association that covers all retailers and in many cases, these associations are State-based rather than national. Nevertheless, the ANAO considers there is potential for the TIG to improve its intelligence gathering capability through establishing and developing these formal liaison arrangements.

3.49 The ANAO notes also that, as mentioned in Chapter 4, a proportion of the EBL's investigations activity centres on ensuring that tobacco retailers comply with excise legislation regarding the sale of tobacco products. We consider that the information gathered from these investigation activities could be better used to gather intelligence about *chop-chop* retailing activities. Therefore, it is important that the Investigations Unit share the outcomes of investigation activities relating to tobacco retailers with relevant TIG officers.

¹⁰² The TIG included a representative of the manufacturers in the development of its 2001-02 Business Plan and included all manufacturers in the development of its 2001-03 Tobacco Strategy (see Chapter 2). The TIG also coordinated a tobacco industry liaison meeting, which included the manufacturers, in May 2001. This meeting provided an avenue for tobacco manufacturers to discuss the Excise Business Line's strategy to address the chop-chop market and other areas of concern. The TIG proposes to conduct these meetings on a six-monthly basis.

Commonwealth and State law enforcement authorities

3.50 Commonwealth and State law enforcement authorities have a direct role in enforcing excise legislation. These authorities, in addition to providing services to the EBL regarding the apprehension of those persons responsible for breaking the law, are also an important source of *chop-chop*-related intelligence.

3.51 The EBL has recognised the importance of establishing liaison arrangements with Commonwealth and State law enforcement authorities in its Tobacco Strategy 2001–03. Each of these authorities has developed, over a period of time, an extensive intelligence infrastructure that can be used effectively by the ATO. The ANAO considers that the EBL, in particular, should be seeking constantly to take advantage of the intelligence gathering and analysis methodologies employed by these authorities.

3.52 The EBL's relationship with the law enforcement authorities that have direct contact with the *chop-chop* market is discussed below.

Australian Customs Service (Customs)

3.53 As noted in Chapter 1, the ATO took over the administration of excise from Customs in 1999. As part of its border administration function, Customs continues to be responsible for legislation relating to the importation of illicit tobacco product into Australia (see Figure 1.4). As a result, many of the activities regarding the sale of illicit tobacco product in Australia require the participation of both the EBL and Customs, as often the same groups may be involved with both *chop-chop* and imported illicit tobacco product.

3.54 The ANAO considers that an intelligence sharing arrangement between the EBL and Customs is an important aspect of preventing the proliferation of both *chop-chop* and imported illicit tobacco product. The EBL, in particular, could benefit from an effective intelligence sharing arrangement, because Customs has invested significant time and resources into developing its intelligence infrastructure.

3.55 Currently, the EBL is involved in monthly meetings with Customs to discuss issues relating to tobacco products and duty-free liaison. The minutes of these meetings indicate that both agencies are willing to exchange information on current work plans, relevant audits / activities and intelligence derived from each other's investigations on illicit tobacco product. However, the ANAO notes that, due to legislative constraints,¹⁰³ the EBL cannot access freely Customs information relevant to *chop-chop*.¹⁰⁴

¹⁰³ The ATO can only access Customs' information under section 16 of the *Customs Administration Act 1985*.

¹⁰⁴ An example of the information collected by Customs that the ANAO considers to be useful to the ATO could include imported tobacco-related seizure statistics.

3.56 As discussed in the Petroleum Excise Audit, the ATO and Customs are in the process of finalising a Memorandum of Understanding (MoU) to establish an effective partnership between the two agencies on mutual interests and responsibilities in excise administration. The ANAO considers that the ATO and Customs could seek to include the exchange of information and intelligence between the two agencies in the MoU. This would formalise existing information exchange arrangements and provide clarity on the types of information that can be shared between the two agencies.

3.57 The ATO notes that there are ongoing issues arising from the control of tobacco products under both Excise and Customs Acts, and there needs to be ongoing work to resolve outstanding issues of overlap and gaps in the legislation.

Australian Federal Police (AFP) and State police

3.58 The AFP and the State police forces provide an essential service to the EBL regarding the enforcement of excise law. This extends to acting on warrants to search premises that may contain *chop-chop*, to arresting those suspected of breaching excise legislation. As part of these activities, the police forces are continuously in contact with the communities, in which the *chop-chop* market operates, and have an operational knowledge of the *chop-chop* market.

3.59 The EBL recognises that the information collected by the police forces is a valuable source of *chop-chop* intelligence. The police forces have access to a wide range of law enforcement information and intelligence contained on sophisticated intelligence databases. We note that the information contained on some of these databases is relevant to the *chop-chop* market.

3.60 The ANAO found that the EBL and the police forces do share intelligence regularly, and the EBL was involved in large joint operations with the AFP to investigate the extent of the *chop-chop* problem, and to enforce excise law. The following case study is an example of a successful joint investigation.

Case Study: Joint Operation involving the ATO and AFP

A joint ATO/ AFP taskforce was set-up in January 2001 to investigate a large-scale evasion of tobacco excise. The ATO's Excise Investigations Unit identified several persons, suspected of being involved in organised crime to defraud the Commonwealth. The nature of the criminal activities identified by the ATO included:

- the involvement of growers, organisers and retailers;
- the persons suspected being involved in the distribution of illegal tobacco in Victoria sourced from growers in Queensland and Victoria; and
- the criminal activities involving cash-based transactions, with sophisticated tobacco sourcing, transportation and distribution.

The progress of the joint operation was facilitated through regular meetings between the ATO and the AFP and the investigation was documented in the AFP's PROMIS database, with the ATO's seconded officers having access to the system.

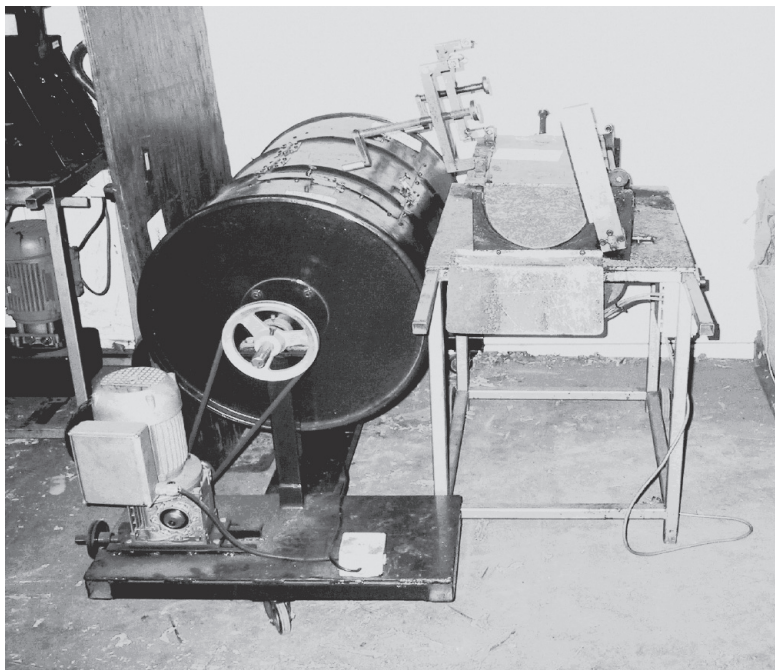
Both the ATO and AFP considered the joint operation to be of a high standard, timely and of great value to each other. The use of the AFP's PROMIS system and various other databases and analytical software tools were considered invaluable to the success of the operation by the ATO. A review of the joint operation recommended future cross-agency training should be conducted between the ATO and AFP.

The joint operation concluded at the end of May 2001. Between September 2000 and March 2001:

- in excess of \$118 000 in cash was seized; and
- approximately 81 full bales (or 8100 kilograms) of tobacco, including raw and manufactured tobacco, were seized.

Fifteen persons were charged with various offences relating to this joint operation. In addition to excise evasion (\$18 million), the suspected persons were also connected to criminal activity such as income tax fraud, social security fraud, drug usage and firearm offences.

3.61 In addition to specific operations undertaken by the EBL and the AFP, the EBL also has ongoing communication channels between individual Excise officers (who have previously worked in the police force) and officers in the police force. We note that these communication channels have not been formalised in all instances.



The picture above shows a machine used to press and chop tobacco leaf, which was seized by the ATO and the AFP.

3.62 The EBL does have formal arrangements with some police forces. In particular, it is a member of the NSW Police – Northern Region Intel Network,¹⁰⁵ and has a MoU with the Victoria Police¹⁰⁶ relating to organised crime investigations. This MoU details arrangements for sharing intelligence gathered and analysed during relevant police investigations.

3.63 Although the EBL and the police forces have strong liaison arrangements in some areas, these could be enhanced if the EBL established and maintained formal intelligence sharing arrangements with the AFP and State police forces. The ATO acknowledges that its informal communication network with the police forces need to be complemented with formal arrangements to maintain the integrity of the Excise intelligence framework.

¹⁰⁵ The network includes members from the NSW State Police, Customs, ABCI, AFP and the Department of Immigration and Multicultural and Indigenous Affairs. A recent Northern Region Intelligence Workshop was held, and the NSW Excise Investigations Unit presented a paper on the illicit tobacco industry and suggested measures to encourage the NSW Police to liaise and exchange information with the NSW Excise Investigations Unit.

¹⁰⁶ Includes AFP, Customs, National Crime Authority and Victoria Police.

State Road Traffic Authorities

3.64 As outlined in Chapter 1, and described further in Appendix 1, organised crime groups involved in the manufacture and sale of *chop-chop* have sophisticated distribution networks which use trucking firms and long haul coaches. The various State Road Traffic Authorities¹⁰⁷ can collect valuable information relating to the movement and contents of vehicles suspected of carrying *chop-chop*.

3.65 The EBL has conducted a client awareness program on the *chop-chop* market with the Victorian Road Traffic Authority (VicRoads). This awareness program provided information to VicRoads officers on how to identify *chop-chop* and who to contact in the EBL if *chop-chop* is discovered. However, similar programs have not been conducted with other State Road Traffic Authorities.

3.66 The ANAO considers that maintaining regular contact with the State Road Traffic Authorities would create stronger communication channels, which would promote increased intelligence sharing between the EBL and these authorities. The ANAO notes that the *Aggressive Tobacco Project* (see Chapter 2) identifies communication with the State Road Traffic Authorities as a compliance strategy to manage the proliferation of *chop-chop* in the Australian market.

Recommendation No. 6

3.67 The ANAO recommends that, to develop a more effective tobacco intelligence capability, the Excise Business Line consider establishing and maintaining formal intelligence sharing arrangements with:

- tobacco retailers;
- Customs;
- Australian Federal Police and State police forces; and
- State Road Traffic Authorities.

ATO response

3.68 The ATO agrees with this recommendation subject to restrictions imposed by legislation, relating to secrecy and privacy.

¹⁰⁷ These include VicRoads (Victoria), and the Road Traffic Authority (NSW).

Conclusion

3.69 The EBL has distinctive intelligence requirements compared to other areas within the ATO, and the effective use of intelligence is critical to the performance of the tobacco excise program. Gathering relevant information to produce meaningful and timely intelligence is an essential aspect of ensuring compliance with excise legislation and minimising the market for *chop-chop*. Without a robust intelligence framework, the risk of producing unusable, untimely or misleading intelligence is increased significantly.

3.70 The EBL has established an intelligence framework to collect, analyse and store suitable intelligence particularly with regard to *chop-chop*. However, there are a number of areas of this framework that need to be enhanced before it is operating at an optimal level. These areas include:

- the delineation of the roles and responsibilities between the Revenue and Intelligence Branch and the Field Services Branch and the conduct of relations between these two Branches regarding the collection and analysis of strategic, operational and tactical intelligence;
- staff trained in the collection and analysis of strategic, operational and tactical intelligence;
- the establishment and adoption of a robust information technology intelligence system and intelligence analysis tools; and
- robust liaison arrangements between the EBL and authorities capable of providing relevant intelligence relating to the *chop-chop* market.

4. Field Services' Compliance and Investigations Activities

This chapter discusses the range of tobacco-related compliance and investigations activities performed within the Field Services Branch of the Excise Business Line. Issues relating to the Excise Business Line's management of internal and external relationships are also discussed.

Introduction

4.1 The Field Services Branch is responsible for managing the Compliance and Investigations Units. In carrying out its compliance and investigations activities, the Units operate as service providers to the Excise Industry Groups, including the TIG (as shown in Figure 2.1). However, the Units directly report to and are accountable to the Assistant Commissioner, Field Services Branch, and not to the Industry Groups.

4.2 As noted in the Petroleum Excise Audit, excise compliance and investigations activities are undertaken across all excisable products and excise payment schemes (see Chapter 1). In the Petroleum Excise Audit, the ANAO examined:

- the role of Compliance and Investigations Units in undertaking excise compliance and investigations work;
- business processes including the development of the National Excise Compliance Plan (NECP); and
- the role of the Excise Compliance Teams.

4.3 The findings¹⁰⁸ of the Petroleum Excise Audit remain relevant to tobacco excise and are not revisited in this audit.

4.4 In this audit, our focus was on the nature and type of tobacco excise field compliance activities, the ATO/Customs joint approach to compliance and tobacco-related investigations activities. In reviewing these areas, the ANAO had regard to the extent to which these activities were aligned to address the risks identified in the Tobacco Strategy and higher-level ATO plans.

¹⁰⁸ Findings in the Petroleum Excise Audit which are pertinent to this audit include: the ANAO considered the NECP to be more of a compliance activity statement than a compliance strategic plan; the compliance activity kits issued by the TIG to Compliance were considered adequate in assisting the TIG in maintaining consistency of coverage in the compliance activities that it authorises; Compliance's use of 'TeamMate' (functional system for the storage and retrieval of audit documentation) as beneficial and which should be made available to all compliance users within the EBL; and the EBL compliance teams managed compliance cases proficiently, showing the application of professional audit techniques and the audit objectives set by the Industry Groups had been followed in the audit process applied by the EBL compliance team.

Field services' compliance

4.5 The Field Services Compliance Unit is responsible for undertaking a range of activities (audit and other risk treatment activities) to improve compliance, as requested by the Industry Groups, based on tailored compliance kits prepared by the Industry Groups. It is responsible also for providing feedback to the Industry Groups on compliance tasks conducted and assisting with information gathering. With regard to tobacco excise field compliance, the ANAO focussed on the:

- extent to which compliance activities were aligned to address the risks and strategies identified in higher-level plans (specifically the Tobacco Strategy, the TIG Business Plan and the ATO Compliance Plan);
- nature and type of tobacco excise compliance activities undertaken; and
- framework developed for the ATO/Customs approach to joint compliance audits.¹⁰⁹

Tobacco excise compliance planning

4.6 The NECP for 2001–02 has identified compliance activities that relate to tobacco growers, manufacturers and duty-free stores.¹¹⁰ These activities relate to: educating growers of the ATO's concern about *chop-chop*; risk-rating growers and duty-free operators; and conducting audits of manufacturers' systems to gain assurance that robust systems are in place to ensure that the correct amount of excise is being paid (see Appendix 1 for a brief description of the procedures used by the manufacturers to pay tobacco excise).

4.7 In accordance with the Tobacco Strategy and the risks identified in the TIG's Business Plan and the ATO Compliance Plan, the ANAO considers that the tobacco excise compliance activities reflect the areas of risk identified by the TIG, in particular, ensuring tobacco growers' compliance with excise legislation. The ANAO also noted that the TIG proposes to strengthen its planning processes for compliance activity in the future by adopting a more systematic approach to tobacco compliance activity, rather than respond with compliance action on an adhoc basis.¹¹¹

¹⁰⁹ As referred to in Chapter 2, the *Taxation Laws Amendment (Excise Arrangements) Act 2001* transferred the responsibility for administration of excise to the Commissioner of Taxation. As a result, from May 2001 both Customs and the ATO agreed that each agency would assume responsibility for administration of all aspects of its own legislation. However, both Customs and the ATO also agreed to adopt a joint compliance approach where a client deals in both excisable and excise equivalent goods.

¹¹⁰ The NECP identifies compliance activity relating to retailers/sellers, however, the TIG was not allocated resources to treat this risk.

¹¹¹ *Aggressive Tobacco Project 2002*.

Tobacco excise compliance activities

4.8 The types of compliance activities proposed during 2000–01 and 2001–02 were detailed in the Tobacco Strategy. Examples of compliance activity conducted by the Field Compliance Unit include:

- the education and registration of tobacco growers in the Victorian and Queensland regions in late 2000 on the amendments to the excise compliance legislation, as well as to develop a comprehensive listing of tobacco producers and register them under the Excise Act (referred to in Chapter 2);
- compliance staff and the TIG visiting a total of 143 licensed farms in North Queensland to: measure crops planted on licensed premises;¹¹² ensure correct record-keeping procedures were being followed; and identify the growers that were intending to plant for the next season.¹¹³ Similar exercises were conducted with the Victorian growers;
- reviewing manufacturing companies' refunds,¹¹⁴ remissions,¹¹⁵ drawback¹¹⁶ processes and supervision of tobacco destructions (see Appendix 1);¹¹⁷ and
- the TIG currently reviewing and re-issuing excise storage licences¹¹⁸ and continuing permissions of duty-free stores.¹¹⁹ This was achieved through a questionnaire forwarded to all duty-free stores (as discussed in Chapter 2). Based on the responses to the questionnaire, each duty-free store was risk-rated to determine its permission limits, that is, the amount of excisable product that a duty-free store can hold. The EBL has now commenced compliance audits of duty-free stores.

¹¹² This was to establish whether the subsequently reported yields were in accordance with the expected quotas. The TIG proposed to monitor the actual yield of each producer.

¹¹³ The number of growers for season 2001-02 was required to determine the level of crop that would be available for sale compared to the proportion of tobacco leaf that would be officially bought by the Australian manufacturers.

¹¹⁴ Refund is a repayment of excise or duty already paid. The principal source of tobacco refunds are a return of stale or damaged stock (excise paid) from customers to manufacturers.

¹¹⁵ Remissions are used to extinguish liability for underbond stock, that is, stock that has become stale or damaged in the manufacturer's bond store. It may also include returns from duty-free stores.

¹¹⁶ Drawbacks are similar to refunds but apply to exported excise/duty paid stock. Similar to refunds, drawback involves giving back monies paid.

¹¹⁷ Stock returned to manufacturer is usually destroyed. Manufacturers are obliged to seek approval from the EBL at least seven days prior to the intended destruction. Previously, the EBL (and Customs, when relevant) was required to attend every destruction involving domestically-produced tobacco. Recently, the EBL considered the viability of attending every destruction and decided to transfer the responsibility of compliance to the manufacturers. Currently, the EBL randomly visits destructions to monitor whether the manufacturers are complying with requirements or not.

¹¹⁸ The renewed excise storage licences include a number of conditions placing limitations on the types of excisable goods stored, with quantity restrictions on some or all.

¹¹⁹ Quantity limits have also been placed on movement of tobacco under this permission in support of the new excise storage licence conditions.

4.9 Appendix 9 provides an overview of tobacco excise compliance activity for 2000–01 and 2001–02.

Stakeholder views on field compliance activity

4.10 Discussions with the TIG indicated that it was satisfied with the work undertaken by the Compliance Unit. The TIG was also continuing its efforts to educate and train the Compliance Unit staff on tobacco-related compliance matters.

4.11 The ANAO's discussions with the North Queensland Tobacco Cooperative and Tobacco Cooperative of Victoria indicated that while there were no fundamental problems with the field compliance activity, they perceived that the compliance team generally lacked an understanding of the tobacco industry. To increase the effectiveness of field compliance activity, the cooperatives consider there would be value in having a permanent ATO presence in the tobacco growing regions. The ANAO considers that the implementation of the *Aggressive Tobacco Project* (discussed in Chapter 2) will address some of the existing gaps in the TIG's field compliance strategy relating to growers.¹²⁰

4.12 The tobacco manufacturers considered that the EBL had not undertaken sufficient audits in 2001 to provide assurance that the manufacturers' systems and internal controls were operating effectively in calculating the excise payable. The ANAO's discussions with manufacturers identified a range of issues. These mainly related to: duplication of work being undertaken due to time lags in commencing the audit activity (especially relevant to audit activity undertaken in 2001); and increasing compliance costs resulting from the functional split between the ATO and Customs (see paragraph 4.19).

4.13 The TIG indicated that staff shortages and ensuring compliance staff assigned to these audits had appropriate skills were the main reasons for these delays. The ANAO was advised that the current arrangements between the TIG and the Field Compliance Unit has seen an improvement in planning and management of compliance tasks leading to a more systematic and organised approach, with audits of the three tobacco manufacturers planned in 2001–02.

4.14 The extent of compliance activity involving tobacco retailers has largely related to education visits conducted by field compliance officers in one region. Although the TIG's High Risk Work Plan identifies education of tobacco retailers as a compliance strategy, it has not allocated any resources against this activity. However, as part of the recently revised staffing arrangements (referred to in Chapter 2), the TIG has dedicated staffing resources to undertake further work in this area.

¹²⁰ As part of this project, small teams of TIG staff will be stationed permanently in the two major tobacco growing regions: Mareeba in North Queensland and Myrtleford in Victoria. These teams will be responsible for the tasking, supervising and ongoing training of a mobile task force of 12 staff (with a mix of compliance, investigations and general auditing skills) to undertake targeted audit activities.

4.15 The ANAO considers that, for the EBL to be effective in achieving its compliance improvement outcomes, it is essential that all tobacco-related compliance activity is timely, targeted and is evaluated on an ongoing basis.

ATO/Customs joint approach to compliance

4.16 In May 2001, both the ATO and Customs agreed to adopt a joint compliance approach to clients who would need to deal with the ATO and Customs regularly as part of their normal business. Such an approach would be particularly relevant to undertaking audits of tobacco manufacturers (who manufacture and import tobacco products) and duty-free stores.¹²¹ The aim of the joint compliance approach was to jointly address risks to both agencies' compliance objectives.¹²²

4.17 The ANAO noted that although a joint ATO/Customs framework had been developed, the details of the framework were yet to be formulated.¹²³ The framework specified that a joint compliance program would be developed based on risk identification and assessment workshops and a joint compliance work plan. The ANAO found little evidence of progress in this area.

4.18 Discussions with Customs and the ATO on the joint approach to the audits (of the manufacturers) currently in progress indicates that both agencies will be conducting their own audit activity and exchanging relevant information with each other. Similarly, in the case of duty-free stores, the ATO initiated a project to review and re-issue excise storage licences and continuing permissions (see paragraph 4.8).¹²⁴

4.19 Although both agencies have agreed to undertake a joint compliance approach to audits of tobacco manufacturers and duty-free stores to minimise the administrative burden and compliance costs for their clients, the ANAO found joint compliance activities were rare. The ATO advised that it has been working with Customs on joint compliance activities relating to duty-free stores. However, it was acknowledged that opportunities for joint compliance activities were limited.

¹²¹ Duty-free stores are licensed under the *Customs Act 1901*, since duty-free sales to relevant travellers are linked to the act of importation with respect to inwards duty-free stores and exportation for outwards duty-free. These entities also gain access to excisable products through the holding of storage licences and permission granted under the Excise Act.

¹²² The ANAO noted that a joint ATO/Customs framework had been developed that sets out the general guiding principles that are to be followed; identifies the relevant parties within each agency that is responsible for the implementation and maintenance of the joint compliance program; and the processes to be followed in developing a joint compliance plan.

¹²³ Work needs to be done on the implementation of the joint compliance audits, particularly in terms of audit fieldwork and reporting, causing minimal disruption to the clients and not resulting in increasing compliance costs.

¹²⁴ Customs participated in this project.

4.20 The ANAO was advised that both the ATO and Customs have actively been working together to review and formalise the approach to joint compliance. It was acknowledged that the joint approach has had some difficulties as both agencies adjust to working under the changed administrative and legislative arrangements that have separated excise and customs. The lessons learned from experience gained from these changes is expected to be incorporated into the Memorandum of Understanding (MoU) currently being developed between the ATO and Customs.¹²⁵

Recommendation No. 7

4.21 The ANAO recommends that, to help develop an efficient and effective approach to joint compliance and to minimise compliance costs for the tobacco industry, the ATO and Customs agree on the joint compliance working arrangements for tobacco audits, and incorporate them into the Memorandum of Understanding currently being developed between the ATO and Customs.

ATO and Customs Response

4.22 The ATO and Customs agree with this recommendation.

Tobacco excise investigations

4.23 The Excise Investigations Unit (Unit) is responsible for investigating instances of external fraud (fraud committed outside the ATO) involving possible breaches of Commonwealth legislation in relation to all excisable products/industries. The operations of the Unit (including case planning, case management, case reporting and liaison arrangements) were previously covered in the Petroleum Excise Audit.

4.24 The ANAO was advised that, in recognition of the risk of *chop-chop* to Commonwealth revenue, almost 75 per cent of the Unit's resources were dedicated to tobacco-related activity in 2000–01. The Unit originally planned to deploy slightly fewer resources (60 per cent) in 2001–02.¹²⁶ In the event, resources have remained at about the 75 per cent level, because of the EBL's ongoing assessment of changes in relative risks across commodities. Table 4.1 provides an overview of the Unit's activities relating to *chop-chop* in 2000–01 and 2001–02.

¹²⁵ ANAO Audit Report No.17 2001-02, *Administration of Petroleum Excise Collections*, Recommendation No. 2.

¹²⁶ This is in addition to the investigations resources deployed on the *Aggressive Tobacco Project* referred to in Chapter 2.

4.25 In assessing the investigation activities in relation to *chop-chop*, the ANAO reviewed the Unit's approach to handling tobacco excise investigations and its management of internal and external relationships, with a view to maximising investigation outcomes. Each of these areas is discussed separately below.



Chop-chop bales seized during an ATO investigation. *Chop-chop* is generally sold to the public in smaller plastic bags (pictured above).

Tobacco excise investigations activities

4.26 The ANAO noted that the Unit has undertaken considerable work (as shown by the figures provided by the ATO in Table 4.1) in relation to tobacco excise matters. This has included: exercises involving several hundred tobacco retailers to assess the availability of unlawfully manufactured tobacco at tobacconists and other retail sites; and undertaking joint investigations with law enforcement authorities resulting in prosecution action. The investigations exercises involving the retailers has resulted in a number of penalty infringement notices¹²⁷ being issued as shown in Table 4.1.

¹²⁷ The *Excise Amendment (Compliance Improvement) Act 2000* introduced Penalty Infringement Notices (PIN) for selling or possessing tobacco on which excise was not paid. PINs are fines that can be issued on the spot to a value of up to \$2200. These are issued as an alternative to prosecutions, which are costly and time consuming.

4.27 The ANAO notes that compared to 2000–01, at this stage, less quantities of illicit tobacco have been seized in 2001–02. This could be attributed to factors including:

- a less than optimum tobacco excise intelligence framework (as discussed in Chapter 3); and/or
- a heightened awareness of the ATO's investigation activities.

4.28 The ATO advised that other factors contributing to less quantities of illicit tobacco seized may include a reduction in the amount of *chop-chop*, timing factors in relation to harvesting (see Appendix 1) and unusually large one-off seizures in 2000–01.

4.29 As discussed in Chapter 2, the ATO expects the results of the *Aggressive Tobacco Project* to be visible after October 2002.

Table 4.1

Tobacco Excise Investigations Activity in 2000–01 and 2001–02¹²⁸

	2000-01	2001-02
Cases finalised (No.)	69	58
Cases pending (No.)	36	70
Cases under investigation (No.)	112	105
Search Warrants (No.)	87	131
Seizure Warrants (No.)	102	95
Vehicles seized (No.)	15	10
Penalty Infringement Notices Issued (No.) (issued to retailers selling illicit tobacco)	60	50
Quantity of Cut Tobacco seized (kg)	5 140.52	2 885.1
Quantity of Tobacco Leaf seized (kg)	124 413.38	27 755.92
Excise value of tobacco seized (\$)	32.8 million	8 million
Value of Fines Imposed (\$)	243 219	115 352

Source: ATO

¹²⁸ Part year data only. Includes data for 2001-02 up to the end of April 2002.

4.30 In 2001, the ATO undertook a comprehensive quality assurance assessment of its Excise investigations files. This process was particularly important for the Investigations Unit because the information contained in these files can be used as evidence to obtain successful prosecution against offenders in breach of tobacco excise legislation.

4.31 The ATO used its *Judgment Model*¹²⁹ as a means of uniformly determining the quality of the EBL's investigation activities. The ANAO examined the 50 files that were subject to this quality assurance process and concluded that the methodology used to review the files was sound and the results a true representation of the quality of the files. The quality assurance process found that all files reviewed received a pass under the *Judgment Model*.¹³⁰

4.32 Based on the ATO's quality assurance process and the ANAO's examination of the files reviewed, the procedures used to record investigations information and results were sound.

Internal relationship management – the TIG and Excise Investigations

4.33 The Unit's relationship with the TIG is based on providing a service that requires it to investigate tasks as assigned by the TIG. Some of these tasks are referred to the Unit by the TIG. If the Unit receives referrals / information from external sources, it is required to complete an information report and forward it to the TIG. The Investigations Unit then uses its own decision-making processes, as required by the Commonwealth Fraud Control Policy (incorporating business line priorities), to determine the level of action and priority in respect of each referral.

4.34 The ANAO found that, although the Unit had undertaken considerable investigations activity in relation to tobacco excise matters (as noted in Table 4.1), a number of working arrangement matters (between the TIG and Investigations) need to be addressed to achieve improved operational effectiveness and to maximise investigations outcomes. The factors that have contributed to this include:

- a high proportion (90 per cent) of referrals received by the Unit from external sources (law enforcement authorities, contacts within the industry and State agencies). As a consequence, the Unit undertook investigative action without necessarily advising the TIG. We note that if the TIG was advised, it was generally during or after the investigation was completed. This has resulted in the TIG not being involved (or being involved on a

¹²⁹ See Audit Report No.3 2001-02, *The Australian Taxation Office's Administration of Taxation Rulings*- Australian Taxation Office.

¹³⁰ 82 per cent of files received an 'A' grade, 11 per cent a 'B' grade and eight per cent a 'C' grade.

limited basis) in determining the tobacco excise investigations priorities as they apply to individual cases;

- the limitations in the TIG's intelligence capability (refer to Chapter 3) resulting in inadequate sharing and exchanging of information; and
- the lack of clarity in the roles and responsibilities relating to intelligence gathering and management of information received from different sources to determine its relevance (as discussed in Chapter 3).

4.35 Both the Unit and the TIG are aware of the issues identified above and are addressing these through joint workshops (as mentioned in Chapter 3). For example, the EBL advised that it is developing treatment matrices for each excise commodity designed to establish appropriate treatments to be applied to investigation cases in particular circumstances. This is intended to achieve consistency in policy, improve resource allocation and reflects the Excise Industry Groups' role in establishing compliance priorities.

4.36 Further, a statement of roles and responsibilities has been developed to resolve the perceived relationship difficulties. However, the ANAO notes that the statement of roles and responsibilities was developed in March 2001 and the issues identified in paragraph 4.34 continue despite the existence of this document. As mentioned in paragraph 3.17, the statement of roles and responsibilities is ambiguous about the role of the Unit in a number of areas such as information gathering and adopting a collaborative approach with the TIG. The TIG has acknowledged that there is a need to revisit and review the statement of roles and responsibilities on an ongoing basis to ensure an effective approach to compliance management.

4.37 The ATO also advised that it continues to review the way investigations teams work. For example, improvements in work practices and reporting arrangements. The ATO considers the working arrangements have improved recently, with a number of workshops held to discuss management of information and strengthening of relationships both internally and externally. Operative staff were involved in these workshops to identify appropriate processes and systems to enable improvements to occur.

4.38 The ANAO considers that: to eliminate duplication of information and analysis effort; have an effective intelligence capability; and better achieve its tobacco excise investigations outcomes, the EBL could more clearly define the roles and responsibilities of the TIG and the Investigations Unit. This would to some extent, contribute to effective workflow arrangements.

Recommendation No. 8

4.39 The ANAO recommends that, to better achieve its tobacco excise investigation outcomes, the Excise Business Line clarify the role of the Tobacco Industry Group and the Excise Investigations Unit in:

- planning and prioritising investigations activities; and
- sharing relevant information and intelligence.

ATO response

4.40 The ATO agrees in principle with this recommendation. However, the ATO believes that the TIG need not be involved in decision-making on a case-by-case basis. The TIG's role is to set the broad strategic priorities and the policy for dealing with types of cases. The TIG needs to be kept informed, in a timely manner, on actions taken/contemplated by Investigations to enable it to continue to assess risks.

External relationship management - partnerships with law enforcement authorities

4.41 As mentioned in Chapter 3, the effective use of liaison arrangements with law enforcement authorities is critical for the EBL to establish intelligence links to the *chop-chop* trade. In particular, the ANAO identified the liaison arrangements made by the State-based Excise Investigations Units with State and Commonwealth law enforcement authorities. In the following section, the ANAO aimed to establish whether each of the Excise Investigations' Units has developed appropriate arrangements with law enforcement authorities to meet its investigation objectives.

4.42 The ANAO noted that the Excise Investigations Unit in Victoria operates under a formal agreement, a MoU, on the conduct of Joint Agency Organised Crime Investigations in the State of Victoria.¹³¹ The MoU, established in March 2001, is supported by a structured framework that provides guidelines to the standards and practices for a joint agency investigation into organised crime.¹³² Discussions with some of the representatives of the signatories (e.g. AFP) indicates that the current liaison arrangements incorporated in the MoU are working effectively and the Excise Investigations staff are highly regarded and their skills valued.

¹³¹ Signatories to the MoU include the AFP, Customs, National Crime Authority and Victoria Police.

¹³² Once an investigation commences, the relevant parties enter into a Joint Agency Investigation Agreement.

4.43 However, the ANAO noted that there are no similar liaison arrangements established in other States/Territories. Excise Investigations in Queensland have, on one occasion, entered into an individual MoU with the Queensland State Police when undertaking tobacco-related investigations. Otherwise, there was no ongoing agreement between the Excise Investigations Unit in Queensland and State law enforcement authorities regarding tobacco-related activity. Similarly, there are no formal liaison arrangements between Excise Investigations in New South Wales and relevant State and/or Commonwealth law enforcement authorities to conduct investigation activities.

4.44 The ANAO considers that the EBL would benefit from implementing liaison arrangements (similar to those used by Excise Investigations in Victoria) between State-based Excise Investigations and relevant State/Commonwealth law enforcement authorities in other States/Territories when conducting investigation activities. This could be facilitated by establishing a formal agreement that includes guidelines and procedures on how to conduct excise-related investigation activities. The ANAO considers that establishing a formal agreement with relevant law enforcement authorities in all States/Territories would ensure that the Excise Investigations Units adopt a consistent approach on a national basis and a universal approach to conducting excise-related activities. This arrangement would facilitate a timely and effective response to tobacco-related investigations, given the established links between *chop-chop* and organised crime and it represents better practice.

Conclusion

4.45 In accordance with the risks identified in the TIG's Business Plan, the field compliance activity has largely focussed on tobacco growers. However, the ANAO notes that the TIG has also undertaken, or plans to undertake in 2001–02, considerable compliance activity to gain assurance on the adequacy of the tobacco manufacturers' systems and processes, as well as on the operations of duty-free stores. The implementation of the *Aggressive Tobacco Project* will address some of the existing gaps in the TIG's field compliance strategy, particularly with regard to the tobacco growers.

4.46 A large proportion of the Investigations Unit's resources is currently dedicated to tobacco-related investigations. This is congruent with the level of risk attributed to tobacco excise by the ATO. The Unit uses a sound methodology in undertaking tobacco-related investigations and has experienced success in detecting *chop-chop* and apprehending those offenders breaching the excise legislation. However, the ANAO identified a number of working arrangement issues between the TIG and the Investigations Unit. This is impacting on the

administration of tobacco excise and impairing performance in some areas. Clarifying the roles and responsibilities of the TIG and the Investigations Unit will assist the EBL in better achieving its tobacco excise investigations outcomes. The better sharing of relevant information and intelligence between the two areas is also to be encouraged.

Canberra ACT
7 June 2002

A handwritten signature in black ink, appearing to read 'P. J. Barrett', with a stylized flourish at the end.

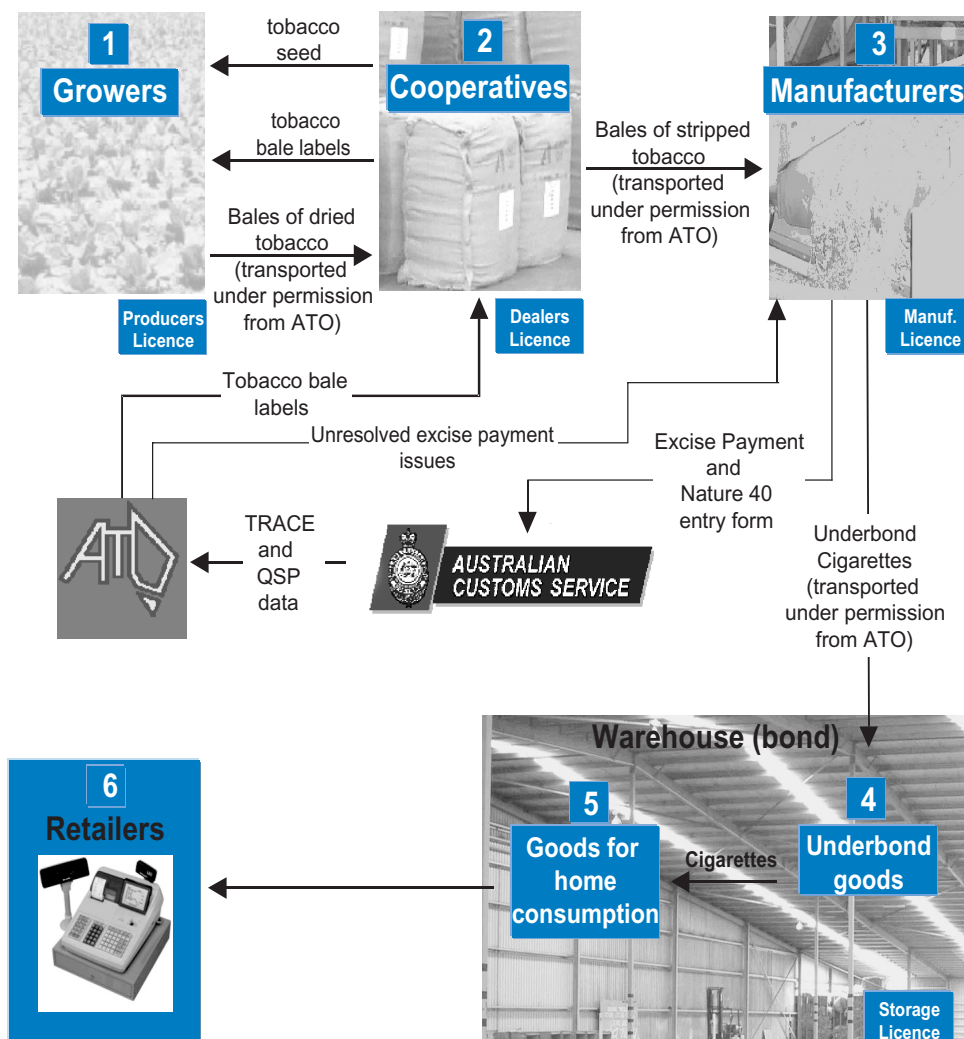
P. J. Barrett
Auditor-General

Appendices

Appendix 1

Overview of the Australian Tobacco Industry

1. This appendix provides an overview of the tobacco production process, and the excise licences required to produce and move tobacco product. It also describes part of the ATO administrative framework applicable to the collection of excise from manufacturers.
2. Throughout this appendix, reference will be made to the following diagram.



Source: ANAO analysis

3. Each number on the diagram shows a particular phase of the production process and corresponds to the particular number reference in this appendix.

1 GROWERS

4. There are approximately 324 licensed tobacco growers in Australia. These growers are found in three locations as shown in the map below.



Source: www.google.com

Producer's licence

5. To grow tobacco in Australia, a producer's licence must be obtained from the Australian Taxation Office. The criteria for the ATO granting a producers licence are found under s39A Excise Act.

Growing tobacco

6. The cooperatives are responsible for the regulation and distribution of tobacco seed (see [2](#)). Seed is distributed based on the desired production level of each farmer, which is based on the number of shares each grower has in the cooperative (see the section on Cooperatives).

7. The tobacco is grown and harvested between August and April in Victoria and throughout the year in Queensland. Once harvested, the tobacco is dried and packed into bales.

8. By agreement, the growers supply the cooperatives their allocated entitlement. The cooperatives have no control over an individual tobacco grower's production. Any Australian tobacco product not sold through the cooperatives will be unlawful.

9. Prior to transporting the tobacco bales to the cooperatives, growers are required to affix *tobacco bale labels*¹³³ to all tobacco bales. The labels are issued by the ATO and distributed by the cooperatives. The purpose of the label is twofold. Firstly, it enables baled tobacco, which is found on premises other than licensed premises to be identified to its source. This allows the ATO to verify the legitimacy of the movement of the tobacco. Secondly, it helps identify the illegitimate movement of tobacco bales, as the movement of tobacco bales off the grower's property without labels is unlawful.¹³⁴

10. Once all bales have been labelled, the growers either deliver the tobacco themselves, or arrange contractors to transport the bales to the cooperatives. The grower is required under s44 Excise Act to obtain permission from the ATO to transport the tobacco bales. The ATO can issue two types of permissions:

- Continuing Permission—grants the permission holder authority to move tobacco leaf between specified premises on a regular or continuing basis (used by the growers and manufacturers); and
- Single Transaction Permission—grants the permission holder authority for a “one-off” movement of tobacco leaf between specified premises (used by the growers and manufacturers).

2 COOPERATIVES

11. As a result of the deregulation of the tobacco growing industry in late 1994 and 1995 (see Chapter 1), the tobacco growers from each regional tobacco growing area formed cooperatives to represent their interests. The cooperatives are:

- Tobacco Cooperative of Victoria Limited - Victorian tobacco farmers;
- Queensland Tobacco Marketing Cooperative Association Limited - North Queensland tobacco farmers; and
- South Queensland Tobacco Growers Cooperative Association Limited - South Queensland tobacco farmers.

¹³³ Tobacco bale labels are forms identified by the Commissioner of Taxation as uniquely identifying a bale of tobacco leaf. s4(1) Excise Act.

¹³⁴ s117D of the Excise Act.

12. Amongst other activities, the cooperatives act on behalf of their growers in providing the following services:

- the purchase of seed and its distribution to growers;
- the marketing and sale of tobacco product to tobacco manufacturers; and
- liaison with the ATO and other government departments on administrative and compliance matters.

13. Ownership of the cooperatives is based on the number of shares each grower has in the cooperative. For example, the Tobacco Cooperative of Victoria has 3.2 million shares divided amongst its growers. The number of shares held by each grower determines how much tobacco they are entitled to provide to the cooperative to sell to the manufacturers.¹³⁵ The tobacco manufacturers will only purchase raw tobacco product through the cooperatives and there is not an attractive export market for Australian tobacco product at present. This means that any other tobacco grown in excess of the growers' share in the cooperative could be sold illicitly.

Dealer's licence

14. To buy and sell tobacco products in Australia, a dealer's licence must be obtained from the ATO. The conditions for dealing in tobacco product are outlined in s33 of the Excise Act. The criteria for obtaining a licence are found under s39 of the Excise Act.

Marketing and selling tobacco

15. Each cooperative has its own procedures for receiving, marketing and selling tobacco to the manufacturers. By way of an example, we have used the procedures used by the Tobacco Cooperative of Victoria.

16. Once the bales of tobacco are delivered to the Cooperative's storage shed, staff at the Cooperative grade the tobacco and negotiate a sale price with representatives from the manufacturers. Following the purchase of the tobacco by the manufacturers, the Cooperative is responsible for threshing,¹³⁶ under a separate contract with the manufacturers.

17. The manufacturers are then responsible for collecting and delivering the threshed tobacco to their manufacturing plants. The manufacturers use a contractor to transport the threshed tobacco to their manufacturing plants. In a similar manner to the growers, the manufacturer must obtain a *permission* from the ATO to transport the tobacco.

¹³⁵ In Victoria, for every one share owned by a grower, that grower is entitled to sell 1.259 kg of tobacco through the cooperative.

¹³⁶ Threshing is the process of separating the midrib (stem) from the lamina (leaf).

3 MANUFACTURERS

18. To manufacture tobacco product in Australia, manufacturers must obtain a manufacturer's licence from the ATO. The conditions for manufacturing tobacco are outlined in s25 of the Excise Act. The three companies that currently hold manufacturing licences in Australia are:

- Philip Morris Limited, which is based in Melbourne, Victoria;
- British American Tobacco Australia Limited (BATAL), which is based in Sydney, NSW; and
- Imperial Tobacco Australia Limited, which is based in Sydney, NSW.

19. Aside from tobacco leaf sourced in Australia, both Philip Morris and BATAL also purchase tobacco imported from overseas. Imperial Tobacco Australia Limited does not manufacture tobacco products, but does distribute locally manufactured and overseas products to retail stores and is therefore required to hold a manufacturers' licence under the Excise Act.¹³⁷ Together, the three companies outlined above account for over 95 per cent of all tobacco products sold in Australia. Two other companies, Swedish Match Australia Pty Ltd and Stuart Alexander & Co Pty Ltd account for the majority of the remaining market.

Manufacturing process

21. The manufacturing process involves turning the raw tobacco leaf into tobacco products such as cigarettes. The manufacturing of cigarettes essentially occurs in two stages:

Stage 1: the processing of tobacco leaf into cut tobacco. Broadly, this involves the storage, conditioning, blending, cutting and drying of raw tobacco leaf; and

Stage 2: the manufacture and packing of cigarettes. Broadly, this involves making the cigarettes by combining the cut tobacco (processed in Stage 1), paper and filter. It also involves packaging the cigarettes into shippers for sale.

22. All shippers of cigarettes produced are bar coded and counted automatically to ensure that tobacco products are accounted for. Cigarettes are then either placed into storage at the manufacturing plant (in BATAL's case) or sent directly into bond storage (Phillip Morris).

¹³⁷ Imperial Tobacco Australia Limited was formed after the merger of Rothmans Holdings Limited and W.D. & H.O. Wills Holdings Limited (the merged entity known as British American Tobacco Australasia Limited). The Australian Competition and Consumer Commission only approved the merger if the two entities divested some of their cigarette and tobacco brands. This led to the formation of Imperial Tobacco Australia Limited.

Compliance

23. To ensure that manufacturers account correctly for all the tobacco products they produce, the ATO conducts system audits on an intermittent basis. These audits examine whether the systems and controls manufacturers have in place ensure that the correct amount of excise is paid on all tobacco products manufactured. Chapter 4 examines this process in more detail.

4 and 5 DISTRIBUTION/WAREHOUSING

24. Manufacturers may store manufactured tobacco products, on which excise has not been paid, in a place approved by the ATO.

25. The three major tobacco manufacturers use a contractor to transport, store and distribute their tobacco products. The contractor uses a permission under s61A, obtained from the ATO, to transport tobacco product. They also hold a storage licence to operate bonds used by the manufacturers.

Payment of tobacco excise

26. Once the cigarettes have been delivered to a bond, they are physically placed into an underbond section of the warehouse (a section of the bond that designates that excise has not been paid on the goods within that section).

27. Under an arrangement with the ATO, known as the *Weekly Settlement Permission*¹³⁸ (clearances from Monday to Friday are paid the following Monday),¹³⁹ the manufacturers determine the quantity and excise amount payable for the total movement of tobacco products from underbond to “goods from home consumption” for that particular week. The manufacturers then lodge a return (via facsimile) in the form of a *Nature 40 Entry*¹⁴⁰ with the ATO’s Cashiers section on the Monday for the preceding week. The *Nature 40* form indicates the quantity of tobacco delivered into home consumption and the amount of excise payable on the tobacco products. The manufacturers (also on the Monday) deposit the amount stated on the *Nature 40* form into the ATO’s designated bank account. The ATO then provides the manufacturer with a receipt of the payment.

¹³⁸ Made under s61C of the Excise Act.

¹³⁹ A weekly settlement permission holder may deliver into home consumption any goods covered by their permission, throughout a seven-day period, without first having to pay the duty liable. On the first working day following the designated seven-day period, the owner will lodge a return for any goods delivered in that period and remit the duty payable.

¹⁴⁰ Nature 40 entries are authorities to move excisable goods from a bond into home consumption. There is an advantage for both the ATO and the manufacturers using a weekly settlement permission, as there is only one document needed to summarise the weekly payment of excise on goods. If this arrangement was not in place, a separate form would have to be lodged each time a manufacturer wished to sell its products.

6 RETAILERS

28. There are approximately 48 000 tobacco retailers in Australia, ranging from supermarkets and convenience stores to petrol stations that are licensed under State laws and regulations.

Transportation to retailers

29. Once the excise on the tobacco product has been paid the manufacturers, through transport companies, deliver their products to wholesalers. The wholesalers then distribute the tobacco products to individual retailers for sale to the public.

Offsets/Refunds

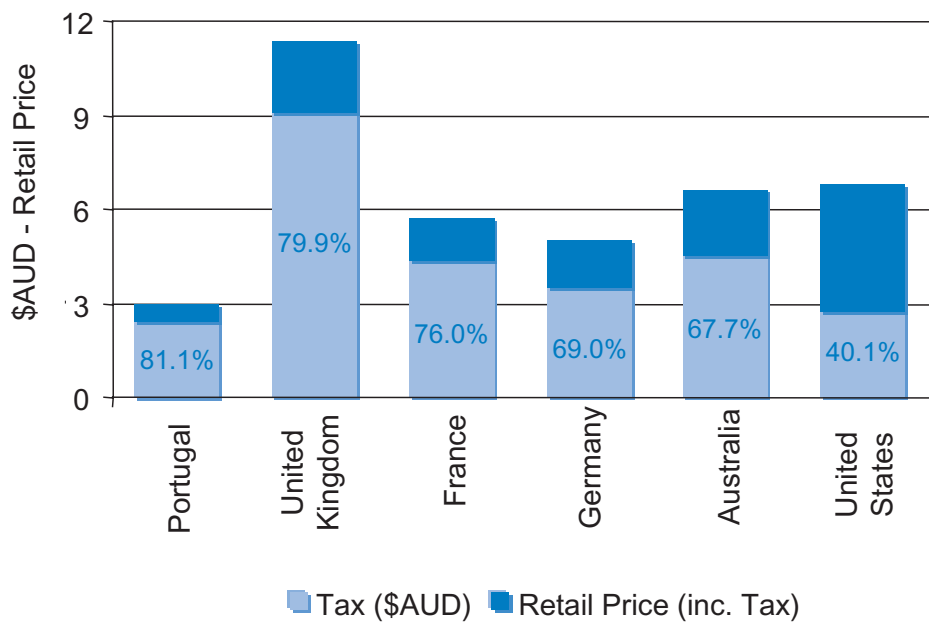
30. If tobacco products are damaged in transit, or the stock expires, the retailers can return the stock to the manufacturer and receive a refund. As the stock was not sold by the retailers, the manufacturers are entitled to recover the excise paid on the returned stock from the ATO. They can do this in two ways:

- a refund: which is a direct repayment of excise already paid; and
- a setoff: which is a reduction of liability to excise (in place of a refund).

31. Returned stock is usually destroyed by the manufacturer. The manufacturers are obliged to seek approval from the ATO at least seven days prior to the intended destruction. The ATO has the option of supervising the destruction to ensure that the manufacturers comply with approved destruction procedures. The ATO attends destructions on a risk-assessed basis.

Appendix 2

Comparison of Australian and a range of international cigarette tax rates



Source: *Cigarette Taxes and Retail Prices*, ATO

Appendix 3

Recommendations from Audit Report No.17 2001–02, Administration of Petroleum Excise Collections— Australian Taxation Office—Tabled 26 October 2001

Recommendation and ATO response	ATO advice on status of implementation
<p>Recommendation No.1: The ANAO recommends that the ATO conduct a rigorous review for completeness, accuracy and relevance of the Excise business line's petroleum entries on the ATO Risk Register.</p> <p>Response: Agreed</p>	<p>As part of the whole-of-Excise review of the Petroleum Excise Industry Group (PEIG) has engaged in a review of all risks on the register.</p> <p>An initial workshop was held with Field Services, Excise Policy and PEIG staff to develop a shared understanding of the nature of Petroleum Excise compliance risks and the current treatment strategies. The workshop examined the nature of the risk, how we have treated the risk and what we have learnt from past/present treatment strategies.</p> <p>The PEIG is regularly assessing the effectiveness of the treatment strategies and considering alternative approaches. The risk treatment strategies proposed for 2002–03 will be presented to the Excise Executive for endorsement in May 2002.</p> <p>The risks recorded on the ATO Risk Register have been amended in accordance with recent corporate directions however, with recent changes in reporting, the entries are incomplete and the PEIG is preparing more comprehensive supporting material to measure the effectiveness and cost of each treatment strategy.</p>

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

Response: ATO and Customs Agreed

The ATO and Customs signed a Memorandum of Understanding (MoU) in December 2001 however, the second schedule, which relates to Excise arrangements is yet to be finalised.

The MoU includes roles and responsibilities of both agencies, inter-agency liaison and dispute resolution, commencement, review and termination of the MoU, schedules to the MoU and authorisation. Schedule 2 sets out arrangements between the ATO and Customs for administering their respective Like Customable Goods (LCG) and Excise-related matters under the New Tax System. The schedule includes authorisations and delegations by the Commissioner, information sharing, consultation on rulings, determinations and legislation. The Schedule also includes compliance, licensing, entry processing functions, compliance activity of duty-free stores/ship stores, fuel substitution, importation of goods for Excise manufacture and the services to be provided by Customs.

There are a number of issues unresolved including the transfer of imported goods into excise warehousing for blending. These issues are expected to be resolved shortly and the Schedule finalised.

<p>Recommendation No.3: The ANAO recommends that the ATO develop a comprehensive petroleum excise licensing policy and procedures manual that provides operational guidance, within the necessary strategic management context, for administering the licensing function.</p> <p>Response: Agreed</p>	<p>The PEIG is currently reviewing draft procedures prepared by the Alcohol and Tobacco Excise Industry Groups. From the review the PEIG will prepare a licensing policy document that will provide operational guidance for PEIG licensing functions within the necessary strategic management context.</p> <p>The policy document will outline our ability to use licensing provisions to address identified and inherent risks in the Petroleum Excise Industry. More specifically the document will include details on the need for licensing, the licensing process, the roles and responsibilities of the parties involved, and how licences and permissions contribute to the regulatory and compliance framework. The document aims to reflect specific licensing requirements for petroleum clients, in line with current policies and procedures.</p>
---	---

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

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

Response: Agreed

Following an extensive review of the licensing function, a decision was made to decentralise the licensing function to the Excise Industry Groups. From November 2001, the newly established Licensing Group, within the PEIG, conducts all PEIG licensing matters.

To promote consistency in decision-making, there is now a direct consultative process within the PEIG. All licensing issues pertaining to PEIG clients are canvassed and resolved internally. As double-handling is no longer an issue, all processes result in a quicker turn-around time, and, to date, a 100 per cent completion rate against agreed Service Standards has been achieved. As each licence application is individually assessed by the Key Client Manager (KCM), and appropriately conditioned/ restricted to address individual situations, the risk is assessed/ managed directly within the PEIG. All licences are signed by the delegate, who is a PEIG member, thereby underpinning the direct management of these issues and improving accountability arrangements. These measures address the previous licensing operation inefficiencies, as identified by the ANAO.

The above processes are conducted via the Customs Licensing and Permissions System mainframe, whilst the Excise Collection System is being developed. Once released, the Excise Collection System will provide various benefits to clients including

	<p>an electronic lodgement facility, with inbuilt “assists” to minimise incorrect/incomplete returns, thereby reducing the need to return forms for correction. Larger clients will have the ability to communicate with other linked ATO systems while smaller clients will also have an increased number of manual payment options.</p> <p>ATO benefits (from the Excise Collection System) will include improved information management with more industry-specific detail available from a more accessible retrieval format. The Excise Collection System will ensure that the ATO complies with the Government directive that it provides clients with electronic interaction with Commonwealth agencies.</p>
--	--

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

Response: Agreed

In response, the Excise Field Services, Revenue and Intelligence (R&I) and Policy & Legislation (P&L) staff met in March to consider the details of issues in tobacco and petroleum prosecutions, and understand the prosecution process so that P&L can document the framework, decision-making arrangements and reporting.

A treatment matrix is also being developed to provide a basis for decision-making in specific situations. This will link back to broader compliance strategies for the various commodities. The treatment matrices will set out clear principles for deciding which treatment would be most appropriate in particular types of cases, for example a limit (either excise value or amount of goods) could be determined to decide when a penalty infringement notice is more appropriate than formal prosecution.

Once the treatment matrices and decision-making principles have been implemented we will establish key decision-making points in the process both for input to the decision-making and ensuring feedback. Business analysts have recently been commissioned to determine business needs and to evaluate internal and external systems with a view to recommending short and long-term solutions. This project is expected to be completed by the end of June 2002.

<p>Recommendation No.6: The ANAO recommends that the ATO:</p> <ul style="list-style-type: none"> • implement and maintain an effective case management framework within the Excise Investigations unit including in the conduct of initial case planning and resource allocation, ongoing management and review of case progress and decisions to terminate cases; and • consider implementation of an automated case management system within the Excise Investigations unit. <p>Response: Agreed</p>	<p>Investigations standards and procedures are currently in the process of being published on ATO Connect. These cover, amongst other things, planning, resource allocation, ongoing management, review of cases and decision points in each case including finalisation and termination of cases.</p> <p>Investigations has recently established a target development and client assessment group in Victoria, which is responsible for identifying potential cases, prioritisation and allocation of all cases. In other States, this process is carried out by the Team Leaders.</p> <p>Business analysts have recently been commissioned to determine business needs and to evaluate internal and external systems with a view to recommending short and long-term solutions. This project is expected to be completed by the end of June 2002.</p>
<p>Recommendation No.7: The ANAO recommends that the ATO implement comprehensive and regular reporting on progress with investigations cases and on strategic and operational issues of importance, between the Excise Investigations unit, Field Services Branch management and the Petroleum Excise Industry Group.</p> <p>Response: Agreed</p>	<p>A policy will be developed to ensure liaison between the PEIG and Investigations to ensure an integrated approach to recovery action or other risk treatments in conjunction with prosecution actions. Investigations and Excise Industry Groups have met to improve formal and informal processes for information management and to establish roles and responsibilities.</p>

<p>Recommendation No.8: The ANAO recommends that, in order to provide the necessary assurance on the integrity and effectiveness of the excise revenue collection function, the ATO should strengthen existing controls relating to excise revenue collection arrangements with Customs.</p> <p>Response: Agreed</p>	<p>There is a real time reporting system in place with five Customs' receiving points around Australia. However, Customs has not established a standard format for providing a reconciliation of 'Weekly Settlement Entries to Payments'. Excise has decided not to request changes to the reporting from Customs as the new Excise Collection System being developed by the ATO to receive Excise payments will eliminate the requirement for Customs to perform this function.</p> <p>The PEIG maintains a strategic partnership with counterparts in Customs and liaises on a regular basis to identify, assess and manage petroleum excise risks.</p>
<p>Recommendation No.9: The ANAO recommends that, in monitoring and analysing petroleum revenue collection trends, the ATO should quantify, where possible, the impact of factors contributing to significant variations in revenue trends. This could result in a better understanding of the extent of impact associated with each factor, and would aid in improving future excise revenue estimates.</p> <p>Response: Agreed</p>	<p>The PEIG is pursuing stronger partnerships with key stakeholders, especially the Australian Institute of Petroleum, as the Institute has previously produced very accurate demand patterns that are useful in forecasting collections.</p> <p>The PEIG also continues to research alternative fuels and is monitoring developments through key environmental and industry groups. The PEIG is aware that small shifts in demand to excise free alternative fuels will have a marginal impact on revenue collections and continues to explore methods to accurately assess this impact.</p>

	<p>The Australian demand for petroleum is a stable, mature market, displaying minimal opportunity for substitutes and slowness in the uptake of technological change. The average age of the Australian fleet is about 12 years indicating that any technological shift would be slow in displacing the demand for petroleum products. Notwithstanding, the PEIG is working on broadening its monitoring to include surveying the energy sector more generally. This input has not reached any reports to date as the database is still being built.</p> <p>Excise continues to contribute to the ATO Revenue Analysis Branch surveys by contacting clients directly and sourcing information relevant to changing economic conditions. Although the Revenue Analysis Branch is the ATO area responsible for producing information on estimates for Treasury, the Petroleum Excise Industry Group is consulted whenever forecasts are prepared and provide weekly commentary against estimates.</p>
--	---

<p>Recommendation No.10: The ANAO recommends that, as part of its fuel substitution strategy, the ATO should supplement its compliance and investigations activities with measures such as:</p> <ul style="list-style-type: none"> • specifying detailed client compliance requirements to assist in assessing compliance and enabling appropriate and timely remedial action by the Petroleum Excise Industry Group; and • updating and finalising the draft fuel testing procedures to ensure maximum leverage for the Excise Business Line from its fuel testing activities. <p>Response: Agreed</p>	<p>The PEIG is currently reviewing the fuel substitution strategy and has requested major oil companies to assess their current exposure to fuel substitution activities for comparison to the PEIG estimates.</p> <p>Administrative mechanisms are also being used to minimise the exposure with the review of permissions to supply and receive concessional product in January. Certificates were not issued to those entities that no longer had a legitimate use of concessional product and quantity restrictions specified in those permissions issued.</p> <p>Quantity restrictions are continually monitored and deliveries are compared to the limits. All new application and variations must be supported by a business case to ensure legitimate end-use.</p> <p>Environment Australia and the ATO will consider the need to implement more formal arrangements for the exchange of information and continuation of a fuel testing program. The ATO intends to make use of the Environment Australia fuel testing results and discontinue its testing program.</p>
---	---

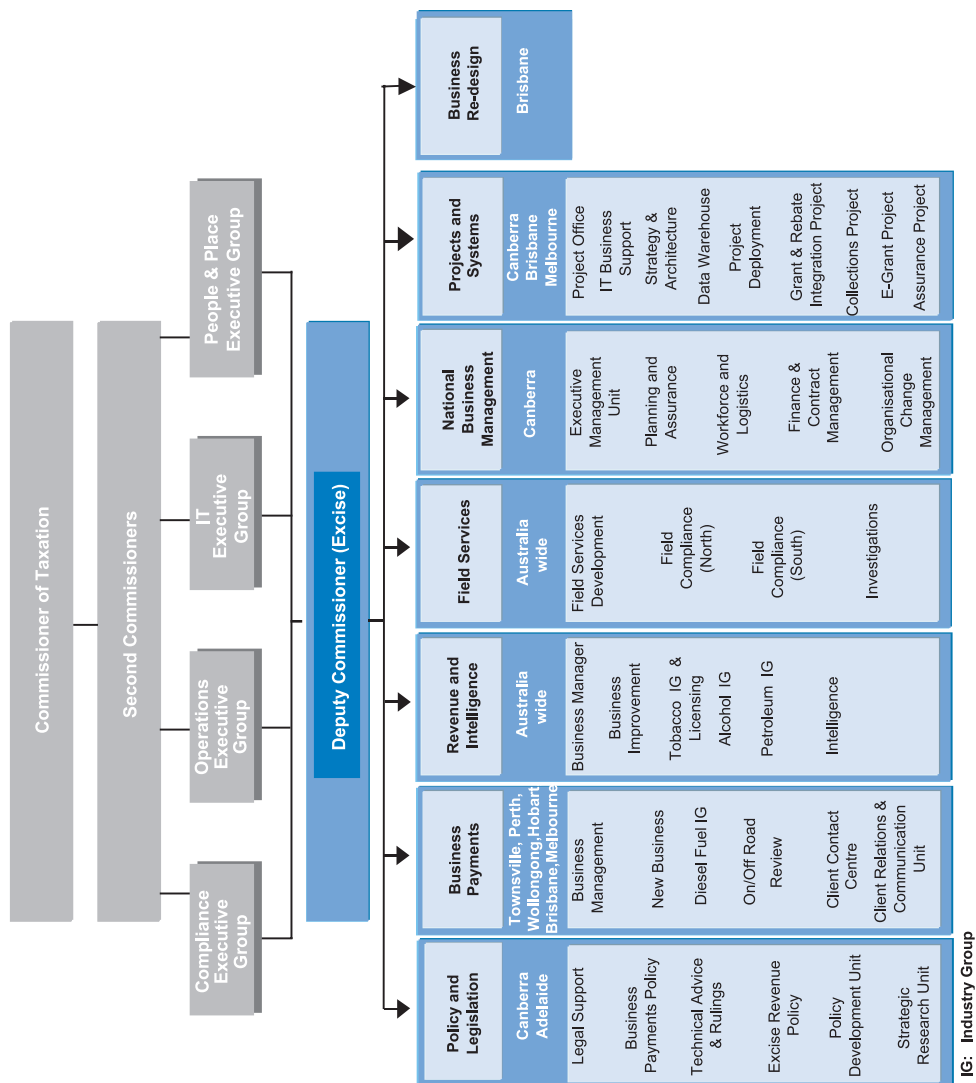
<p>Recommendation No.11: The ANAO recommends that, to consolidate its fuel substitution strategy, the ATO should systematically assess its exposure to fuel substitution activities with a view to fully determining the extent of the problem and formulating appropriate strategies to address the issue. This would include:</p> <ul style="list-style-type: none"> • identifying all the possible substitutes for diesel and petroleum; • determining the possible revenue implications or potential exposure to revenue loss if any of the identified substitutes are used; and • reviewing existing strategies or developing new strategies to limit exposure to revenue loss. <p>Response: Agreed in principle</p>	<p>The PEIG considers that it may not be possible to develop a sufficiently accurate estimate of the exposure to fuel substitution activities that is useful for compliance management purposes. The PEIG will continue to analyse other appropriate indicators e.g. monitoring retail prices, anti-competitive behaviour, consumer complaints, demand for fuel substitutes to estimate the extent of fuel substitution activities.</p> <p>In assessing the current exposure to fuel substitution activities and to formulate strategies to address the problem, the PEIG is liaising with representatives from the major oil companies. The PEIG is accessing industry information, which might provide a more strategic assessment of fuel substitution activities. Distribution networks and fuel quality assurance programs are also being reviewed by the PEIG to identify controls in place, which prevent diversion of products to the illicit market.</p> <p>Administrative mechanisms are also being used to minimise the exposure, with access to concessional product being restricted to remission certificate holders that can demonstrate a legitimate use of concessional product. Quantity restrictions have also been applied and continually monitored. Any variation must be supported by a business case to ensure legitimate end-use.</p>
--	--

	<p>In the absence of strategic intelligence, the results from the current fuel testing program, targeting 1000 retail sites, coupled with other 'dob-ins' has been a tool by which the ATO can attempt to establish the prevalence of fuel substitution within the marketplace.</p> <p>While the small number of suspect samples may indicate that the extent of fuel substitution within the marketplace is minimal, a number of other assumptions may be drawn. We are not testing for all fuel substitutes or the unsophisticated nature of ATO tests may prejudice the results.</p> <p>The PEIG has identified possible fuel substitutes and is continuing to monitor clearances of concessional product. Analysis indicates that the supply of concessional product is as expected based on historical data and trends. Recent anomalies have been investigated and found to be legitimate market variations.</p>
--	--

<p>Recommendation No.12: The ANAO recommends that the ATO formalise its arrangements with Environment Australia on the implementation of fuel quality standards, to enable both agencies to maximise their benefits from fuel testing initiatives.</p> <p>Response: Agreed</p>	<p>Since the ANAO review the ATO has taken the opportunity to address the duty rate differentials in the submission to the Fuel Tax Inquiry. A flat excise rate could apply to some high-risk fuel substitutes and limit exposure to revenue loss.</p> <p>The PEIG has met with Environment Australia (EA) on a number of occasions to develop a common understanding of the policy responsibilities of each in relation to excise and fuel quality and to examine opportunities to treat common risks.</p> <p>Relationships with EA has started very positively with the EA and the ATO fuel testing programs providing an avenue for the sharing of intelligence and facilitating the understanding of each agency's strategies.</p> <p>EA and the ATO will consider the need to implement more formal arrangements for the exchange of information and continuation of a fuel testing program. The ATO intends to make use of the EA fuel testing results and discontinue its testing program.</p>
--	---

Appendix 4

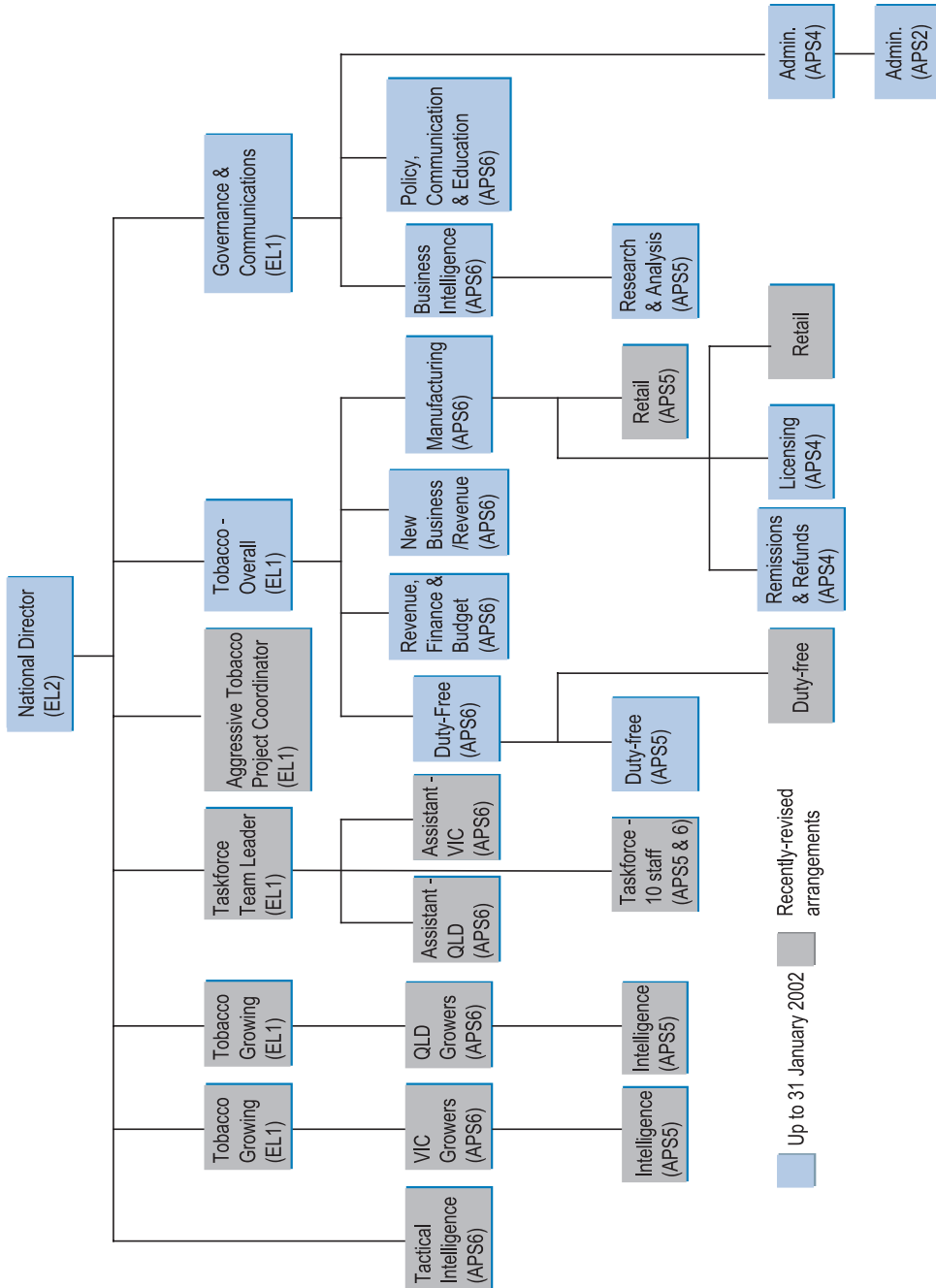
Excise Organisational Framework



Source: ATO

Appendix 5

Tobacco Industry Group Structure



Source: ATO

Appendix 6

Aggressive Tobacco Project

Overview

The ATO rates the illicit tobacco market as a high risk to revenue and community confidence. The opportunity for tobacco growers to sell their tobacco leaf within the legal market is diminishing, as manufacturers source and manufacture more product offshore. At the same time, the amount of tobacco grown by licensed producers is not decreasing, which results in more tobacco leaf being available for the illicit market.

As a result, the ATO intends to undertake a more aggressive approach to this issue, through an 18-month project called the *Aggressive Tobacco Project*.

Issues

The ATO believes the potential exists – through an aggressive audit/compliance program with licensed growers in North Queensland (Mareeba) and Victoria (Myrtleford) – to reduce the supply of tobacco to the illicit market. In addition, there would be a very positive impact to community confidence because the ATO would be seen to be active in an area that has raised concern at both government and community levels.

Approach

The ATO considers it essential that both tobacco-growing areas be targeted simultaneously to prevent a transferral of illegal activity from one area to another. The ATO also considers it important to target all licensed growers rather than to retain the current approach based on identifying and treating individuals deemed to be a high or severe risk.

Desired Outcomes

1. To prevent tobacco leaf grown on licensed farms entering the illicit market.
2. Heighten grower awareness of ATO concern about illicit tobacco.

Scope

The scope of the *Aggressive Tobacco Project* involves small teams of ATO officers based in each of the two major tobacco-growing regions. These officers would

be responsible for tasking, supervising and ongoing training of a mobile taskforce of 12 staff to undertake targeted audit activities. The ongoing presence of ATO officers would serve as a deterrent to illicit activity.

The permanently placed teams would also be responsible for education/liaison with the tobacco cooperatives, the Road Transport Authorities and State police on an ongoing basis. They are also responsible for referrals to the Excise Investigations Unit where the issues have broader application than within their region or have the potential to involve the AFP. The mobile taskforce would move strategically between both regions and would target their activities around critical stages of the growing and harvesting season.

Appendix 7

Analysis of revenue leakage associated with *chop-chop*

	Smoking prevalence rates ¹⁴¹	Amount of <i>chop-chop</i> smoked as a proportion of licit tobacco	Annual Excise evaded as a result of <i>chop-chop</i> smoked ¹⁴²
AIHW Household survey			
- 1998	23.6%	Not applicable*	Not applicable*
- 2001	21.1%	4.94%	\$220m
Health Tracking survey			
- 1998	21.7%	Not applicable*	Not applicable*
- 2001	19.8%	2.22%	\$99m

*The survey instrument did not include questions on *chop-chop*.

Source: ANAO depiction of AIHW analysis.

National Drug Strategy Household Survey Series

Commencing in 1985 under the then National Campaign Against Drug Abuse, this series of surveys has been conducted every two or three years, with the most recent survey undertaken in 2001. Questions on experience with illicit tobacco (*chop-chop*) were included only in the 2001 survey. The aim of the series of surveys is to estimate prevalence and consumption for licit and illicit drugs, and to gauge community attitudes, knowledge and beliefs regarding drug-related issues.

This survey is conducted using a number of collection methods, the most recent survey (2001) being a combination of computer-assisted telephone interviewing (CATI), personal (household) interview and drop-and-collect. Apart from CATI, questions on tobacco usage and illicit tobacco experience are answered in a confidential sealed section. The survey design is based on a national stratified multi-stage random sample of domestic households.¹⁴³

¹⁴¹ Based on smokers who smoke daily or most days.

¹⁴² Based on the rate of excise duty per cigarette containing equal to or less than 0.8 g of tobacco (or \$0.20893 per cigarette).

¹⁴³ Within household, one person aged 14 years or more is randomly selected. With CATI component, households without a telephone are necessarily excluded. All results are weighted to account for disproportionate sampling and to balance against population benchmarks.

The surveys are managed by the Australian Institute of Health and Welfare and are largely funded by the Commonwealth Department of Health and Ageing on behalf of the Inter-Governmental Committee on Drugs.

National Tobacco Campaign Tracking Survey Series

This series commenced with a benchmark survey in May 1997. This survey was followed by further surveys conducted in November each year. Questions on experience with illicit tobacco (*chop-chop*) were included in the 2000 and 2001 survey. This survey is conducted using CATI and its primary aim is to assess the impact of the national tobacco campaign on smokers' behaviours.

The sample design is a national stratified random sample of domestic telephone numbers.¹⁴⁴ Results reported from these surveys are *not* weighted to account for any disproportionate sampling amongst age groups.

The prevalence figures are calculated from the 'enumeration' component (in which the person answering the telephone reports on the smoking habits of each member of the household aged 16 years or more), whereas illicit tobacco experience is only asked of smokers and recent quitters (one respondent per household).

This survey is managed by the Research and Marketing Group of the Commonwealth Department of Health and Ageing.

Limitations of both survey programs

Certain population groups are excluded from the survey by the nature of the survey design,¹⁴⁵ notably the homeless, the institutionalised, and, for the non-CATI components, those living in very remote areas. There are also bottom limits on the age of the respondent.

Estimates of tobacco consumption do not include the consumption in the past year of recent quitters, and are based on 'usual' consumption.

There is an assumption in the analysis that reporting of illicit tobacco usage is included in a person's total reported tobacco consumption (overall consumption was asked in an earlier part of the survey to that about illicit tobacco consumption).

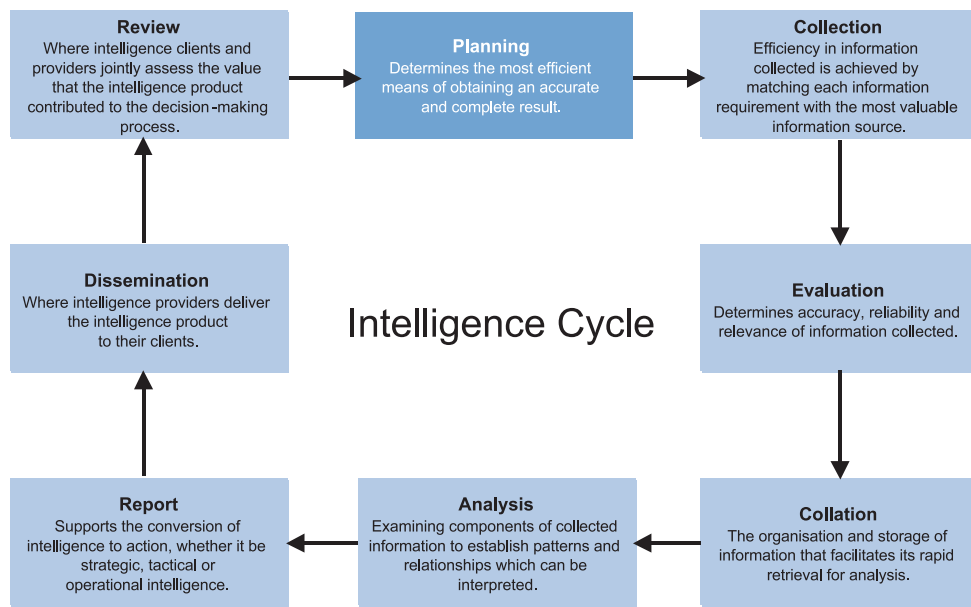
In general, household-based surveys suffer from a degree of under-reporting.

¹⁴⁴ Obvious exclusion from the scope of the survey are households without a telephone or with silent telephone numbers (less than two per cent in Australia).

¹⁴⁵ Electronic white pages were used as the sampling frame for the Campaign Tracking Survey as well as the CATI component of the Household Survey. That means anyone that has a silent number (i.e. not in the phone book) would have been excluded from the study.

Appendix 8

Customs' Intelligence Cycle



Source: *Intelligence Cycle*, Customs

Appendix 9 Status of Tobacco Excise Compliance activities

Status of tobacco compliance activities 2000–01 and July 2001 to April 2002

2000–2001						July 2001–April 2002				
Risk Treatment Type	No. of Compliance Kits issued by the TIG	Completed No.	Outstanding No.	Completed %	Outstanding %	No. of Compliance Kits issued by the TIG	Completed No.	Outstanding No.	Completed %	Outstanding %
Comprehensive Audit/National Audit	1	0	1	0	100%	1	1	0	100%	nil
Focussed Audit/Specific Issues Audit	21	18	3	85.7%	14.3%	222	200	22	90%	10%
Monitoring by Visitation/Liaison	16	13	3	81.3%	18.7%	292	8	284	3%	97%
Examination/Verification	181	89	92	49.2%	50.8%	67	59	8	88%	12%
Education	5	5	0	100%	0	14	2	12	14%	86%
Analytical Research/information gathering	6	0	6	0	100%	2	2	0	100%	nil

Source: ANAO depiction of ATO data

Glossary/Abbreviations

ABCI	Australian Bureau of Criminal Intelligence
ABS	Australian Bureau of Statistics
AFFA	Department of Agriculture, Fisheries and Forestry Australia
AFP	Australian Federal Police
<i>Aggressive Tobacco Project</i>	18-month project aimed to prevent tobacco leaf grown on licensed farms entering the illegal market and to heighten grower awareness of ATO concern about <i>chop-chop</i>
AIHW	Australian Institute of Health and Welfare
Analyst's Notebook	an investigative analysis IT tool used to detect, interpret and display complex information in an easily understood format
ANAO	Australian National Audit Office
ATO	Australian Taxation Office
BATAL	British American Tobacco Australasia Limited
business franchise fees	taxes imposed on retail and wholesale sale of tobacco
CEO	Chief Executive Officer
<i>chop-chop</i>	refers to Australian grown and manufactured tobacco that is sold illicitly in a chopped-up form to Australian consumers, and upon which, excise has not been paid. It also refers to the illegal trade in un-chopped tobacco leaf
continuing permission	grants the permission holder authority to move tobacco leaf between specified premises on a regular or continuing basis
counterfeit tobacco product	false reproduction of tobacco product intended to avoid Commonwealth duty payable
Customs	Australian Customs Service
customs duties	duties that are imposed on imported goods
drawback	similar to refunds but apply to exported excise/duty paid stock
duty-free store	licensed premises in which underbond goods are sold to passengers leaving the country

EBL	Excise Business Line
EEGs	excise-equivalent goods
ExcIntel	Excise database designed to store and analyse relevant information from a range of internal and external sources
excise duties	taxes imposed on excisable goods that have been produced domestically and are consumed within Australia
FCTC	Framework Convention on Tobacco Control
general bond	warehouse used for the storage of goods, which are the property of the general public
GST	Goods and Services Tax
Health	Department of Health and Ageing
iBase	an investigative IT tool that allows the user to sort data from numerous data sources into a logical, structured, diagrammatic format
intelligence	the product that results from the collection, evaluation (and continued re-evaluation), collation, and analysis of information
intelligence product	provides insight or understanding on the nature and / or extent of a current or future threat, developed through the careful analysis of available information that provides direction for future action
IT	Information Technology
MoU	Memorandum of Understanding
‘nature 40’	Customs form detailing the entry of excisable goods for consumption and the amount of excise duty payable
NECP	National Excise Compliance Plan
operational intelligence	supports managers in planning activity and deploying resources to achieve operational objectives
‘per-stick’ method	method of calculating tobacco excise based on the number of cigarettes per packet
PIN	Penalty Infringement Notice
private bond	warehouse used for the storage only of goods, which are the property of the licensee
PROMIS	AFP’s intelligence database

refund	repayment of excise duty paid
remission	entry of products for domestic consumption at an excise duty-free rate
revenue leakage	amount of revenue lost as a result of illegal activities
setoff	a reduction of liability to excise
single transaction permission	grants the permission holder authority for a “one-off” movement of tobacco leaf between specified premises
strategic intelligence	provides insight or understanding, contributing to decisions on broad strategies, policies and resources, directed to achieving long-term organisational objectives
tactical intelligence	supports line areas and other operational areas in taking case-specific action to achieve compliance or enforcement objectives
tariff concessions	duty applied to particular products used for purposes other than the fully taxed use of such products at a discounted rate
TeamMate	an electronic working papers system for compliance activities
threshing	process of separating the midrib (stem) from the lamina (leaf)
TIG	Tobacco Industry Group
tobacco bale labels	forms identified and attached to a bale of tobacco leaf
tobacco cooperatives	represents the interests of tobacco growers and act as dealers to the tobacco manufacturers
underbond goods	tobacco product upon which excises, duties, fees, taxes etc. have not been paid
Unit	Excise Investigations Unit
weekly settlement	deliver into home consumption any goods covered by this permission, throughout a seven-day period without first having to pay the duty liable. On the first working day following the designated seven-day period, the owner will lodge a return for any goods delivered in that period and remit the duty payable.

Index

A

Aggressive Tobacco Strategy Project

Audit

Objective and scope 37

Methodology 38

Fieldwork 38, 80

B

Business franchise fees 10, 30, 32, 120

C

Chop-chop

source 35, 64, 68, 69, 70, 71, 78

manufacture and distribution
36, 58

risk to tobacco excise revenue
10, 34, 37, 45, 55

revenue leakage 6, 11, 14, 16,
22, 47, 50, 51, 52, 53, 55, 116, 122

Compliance 5, 6, 11, 13, 14, 16, 18, 20,
22, 23, 33, 38, 39, 40, 42, 43, 44,
46, 48, 49, 51, 54, 57, 59, 60, 61,
63, 64, 65, 74, 75, 76, 77, 78, 79,
80, 81, 82, 83, 85, 87, 94, 96, 99,
100, 101, 104, 108, 109, 114, 119,
121, 122

Customs Intelligence Cycle 6, 118

Counterfeit tobacco product 10

F

Field Services

Business plan 13, 20, 22, 42, 43,
44, 45, 54, 55, 69, 77, 87

Compliance activities 6, 18, 20,
60, 64, 65, 76, 77, 78, 80, 122

Investigations activities 5, 11,
20, 23, 38, 54, 64, 76, 82, 86, 108

I

Illicit Tobacco Strategy 14, 45, 46, 51,
53

Illicit tobacco trade 10, 30, 32, 33, 34,
43

Intelligence

framework 5, 11, 17, 18, 57, 59,
60, 61, 63, 64, 67, 73, 75, 83

gathering and analysis 5, 17, 60,
62, 66, 70

information technology
infrastructure 60

coordination within Excise
Business Line

strategic 18, 57, 58, 59, 61, 63,
110, 122

tactical 18, 22, 57, 58, 59, 61, 62,
63, 65, 75, 122

operational 57, 60, 61, 121

Investigations

Tobacco excise activities

Internal relationship
management 84

External relationship
management 12, 86

P

Performance management and
reporting 5, 11, 17, 39, 41, 53,
54

Petroleum Excise Audit 9, 16, 19, 21,
27, 28, 38, 40, 42, 50, 52, 64, 65,
71, 76, 81

Q

Quantification of revenue leakage 14,
16, 47, 50

R

Risk management 5, 11, 14, 16, 39, 42,
44, 45, 51, 55

S

Strategic Partnerships 14, 15, 43, 47,
49

Strategic planning 19, 69

T

Tobacco

Industry in Australia 5, 10, 27,
28, 31, 68

Industry group structure 6, 113

Manufacturers 19, 20, 35, 38, 48,
69, 79, 80, 87, 94, 96, 122

Cooperatives 14, 38, 46, 115,
122

Retailers 14, 15, 19, 22, 23, 29,
47, 48, 49, 69, 74, 79, 82, 97

excise Revenue 10, 11, 16, 34,
37, 45, 50, 51, 52, 53, 54, 55

excise governance arrangements
5, 11, 13, 39, 41

Series Titles

Audit Report No.54 Performance Audit

Drug Detection in Air and Containerised Sea Cargo and Small Craft

Australian Customs Service

Audit Report No.53 Assurance and Control Assessment Audit

Goods and Services Tax Administration by Commonwealth Organisations

Audit Report No.52 Financial Control and Administration Audit

Internal Budgeting

Audit Report No.51 Performance Audit

Research Project Management

Commonwealth Scientific and Industrial Research Organisation (CSIRO)

Audit Report No.50

A Preliminary Examination into the Allocation of Grant Funding for the Co-Location of National General Practice Organisations

Audit Report No.49 Performance Audit

The Management of Commonwealth National Parks and Reserves

'Conserving our Country'

Department of the Environment and Heritage

Audit Report No.48 Performance Audit

Regional Assistance Programme

Department of Transport and Regional Services

Audit Report No.47 Performance Audit

Administration of the 30 Per Cent Private Health Insurance Rebate

Department of Health and Ageing, Health Insurance Commission, Australian Taxation Office, Department of Finance and Administration, Department of the Treasury

Audit Report No.46 Performance Audit

Management of an IT Outsourcing Contract

Department of Veterans' Affairs

Audit Report No.45 Assurance and Control Assessment Audit

Recordkeeping

Audit Report No.44 Performance Audit

Australian Defence Force Fuel Management

Department of Defence

Audit Report No.43 Performance Audit

Indigenous Education Strategies

Department of Education, Science and Training

Audit Report No.42 Performance Audit

Integrity of the Electoral Roll

Australian Electoral Commission

Audit Report No.41 Performance Audit
Transactional Banking Practices in Selected Agencies

Audit Report No.40 Performance Audit
Corporate Governance in the Australian Broadcasting Corporation
Australian Broadcasting Corporation

Audit Report No.39 Performance Audit
Management of the Provision of Information to Job Seekers
Department of Employment and Workplace Relations

Audit Report No.38 Performance Audit
Management of Australian Defence Force Deployments to East Timor
Department of Defence

Audit Report No.37 Performance Audit
Purchase of Hospital Services from State Governments—Follow Up Audit
Department of Veterans' Affairs

Audit Report No.36 Benchmarking Study
Benchmarking Implementation and Production Costs of Financial Management Information Systems

Audit Report No.35 Performance Audit
ATO Progress in Addressing the Cash Economy
Australian Taxation Office

Audit Report No.34 Assurance and Control Assessment Audit
Management of Travel—Use of Taxis

Audit Report No.33 Assurance and Control Assessment Audit
Senate Order of 20 June 2001 (February 2002)

Audit Report No.32 Performance Audit
Home and Community Care Follow-up Audit
Department of Health and Ageing

Audit Report No.31 Performance Audit
Audit Activity Report: July to December 2001
Summary of Outcomes

Audit Report No. 30 Performance Audit
Test and Evaluation of Major Defence Equipment Acquisitions
Department of Defence

Audit Report No.29 Financial Statement Audit
Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2001

Audit Report No.28 Information Support Services
An Analysis of the Chief Financial Officer Function in Commonwealth Organisations
Benchmark Study

Audit Report No.27 Assurance and Control Assessment Audit
Agency Management of Software Licensing

Audit Report No.26 Performance Audit
Management of Fraud and Incorrect Payment in Centrelink

Audit Report No.25 Assurance and Control Assessment Audit
Accounts Receivable

Audit Report No.24 Performance Audit
Status Reporting of Major Defence Acquisition Projects
Department of Defence

Audit Report No.23 Performance Audit
Broadcasting Planning and Licensing
The Australian Broadcasting Authority

Audit Report No.22 Protective Security Audit
Personnel Security—Management of Security Clearances

Audit Report No.21 Performance Audit
Developing Policy Advice
Department of Education, Training and Youth Affairs, Department of Employment,
Workplace Relations and Small Business, Department of Family and Community Services

Audit Report No.20 Performance Audit
*Fraud Control Arrangements in the Department of Agriculture, Fisheries and Forestry—
Australia (AFFA)*
Department of Agriculture, Fisheries and Forestry—Australia

Audit Report No.19 Assurance and Control Assessment Audit
Payroll Management

Audit Report No.18 Performance Audit
Performance Information in Portfolio Budget Statements

Audit Report No.17 Performance Audit
Administration of Petroleum Excise Collections
Australian Taxation Office

Audit Report No.16 Performance Audit
Defence Reform Program Management and Outcomes
Department of Defence

Audit Report No.15 Performance Audit
Agencies' Oversight of Works Australia Client Advances

Audit Report No.14 Performance Audit
Client Service Initiatives Follow-up Audit
Australian Trade Commission (Austrade)

Audit Report No.13 Performance Audit
Internet Security within Commonwealth Government Agencies

Audit Report No.12 Financial Control and Administration Audit
*Selection, Implementation and Management of Financial Management Information
Systems in Commonwealth Agencies*

Audit Report No.11 Performance Audit
Administration of the Federation Fund Programme

Audit Report No.10 Assurance and Control Assessment Audit
Management of Bank Accounts by Agencies

Audit Report No.9 Performance Audit
*Learning for Skills and Knowledge—Customer Service Officers
Centrelink*

Audit Report No.8 Assurance and Control Assessment Audit
Disposal of Infrastructure, Plant and Equipment

Audit Report No.7 Audit Activity Report
*Audit Activity Report: January to June 2001
Summary of Outcomes*

Audit Report No.6 Performance Audit
*Commonwealth Fisheries Management: Follow-up Audit
Australian Fisheries Management Authority*

Audit Report No.5 Performance Audit
Parliamentarians' Entitlements: 1999–2000

Audit Report No.4 Performance Audit
*Commonwealth Estate Property Sales
Department of Finance and Administration*

Audit Report No.3 Performance Audit
*The Australian Taxation Office's Administration of Taxation Rulings
Australian Taxation Office*

Audit Report No.2 Performance Audit
*Examination of Allegations Relating to Sales Tax Fraud
Australian Taxation Office*

Audit Report No.1 Financial Statement Audit
*Control Structures as part of the Audits of the Financial Statements of Major
Commonwealth Entities for the Year Ended 30 June 2001*

Better Practice Guides

Administration of Grants	May 2002
Performance Information in Portfolio Budget Statements	May 2002
Life-Cycle Costing	Dec 2001
Some Better Practice Principles for Developing Policy Advice	Nov 2001
Rehabilitation: Managing Return to Work	Jun 2001
Internet Delivery Decisions	Apr 2001
Planning for the Workforce of the Future	Mar 2001
Contract Management	Feb 2001
AMODEL Illustrative Financial Statements 2001	May 2001
Business Continuity Management	Jan 2000
Building a Better Financial Management Framework	Nov 1999
Building Better Financial Management Support	Nov 1999
Managing APS Staff Reductions (in Audit Report No.49 1998–99)	Jun 1999
Commonwealth Agency Energy Management	Jun 1999
Corporate Governance in Commonwealth Authorities and Companies–Principles and Better Practices	Jun 1999
Managing Parliamentary Workflow	Jun 1999
Cash Management	Mar 1999
Management of Occupational Stress in Commonwealth Agencies	Dec 1998
Security and Control for SAP R/3	Oct 1998
Selecting Suppliers: Managing the Risk	Oct 1998
New Directions in Internal Audit	Jul 1998
Controlling Performance and Outcomes	Dec 1997
Management of Accounts Receivable	Dec 1997
Protective Security Principles (in Audit Report No.21 1997–98)	Dec 1997
Public Sector Travel	Dec 1997

Audit Committees	Jul 1997
Core Public Sector Corporate Governance (includes Applying Principles and Practice of Corporate Governance in Budget Funded Agencies)	Jun 1997
Administration of Grants	May 1997
Management of Corporate Sponsorship	Apr 1997
Telephone Call Centres	Dec 1996
Telephone Call Centres Handbook	Dec 1996
Paying Accounts	Nov 1996
Performance Information Principles	Nov 1996
Asset Management	Jun 1996
Asset Management Handbook	Jun 1996
Managing APS Staff Reductions	Jun 1996