

The Auditor-General  
Audit Report No.40 2002-03  
Performance Audit

## **R&D Tax Concession**

**Department of Industry, Tourism and Resources,  
the Industry Research and Development Board  
and the Australian Taxation Office**

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of Australia 2003

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Canberra ACT  
22 April 2003

Dear Mr President  
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Department of Industry, Tourism and Resources, the Industry Research and Development Board and the Australian Taxation Office in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *R&D Tax Concession*.

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

Yours sincerely

A handwritten signature in black ink, appearing to read 'P. J. Barrett'.

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

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## Abbreviations/Glossary

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ABS	Australian Bureau of Statistics
ANZSIC	Australian and New Zealand Standard Industrial Classification
ATO	Australian Taxation Office
BERD	Business Expenditure on Research & Development
CSM	Customer Service Manager
Customer	A company that has registered for the R&D Tax Concession
DITR	Department of Industry, Tourism and Resources
JCPAA	Joint Committee of Public Accounts and Audit
KPIs	Key Performance Indicators
LB&I	Large Business and International (ATO business line)
LCM	Large Case Monitoring
MOU	Memorandum of Understanding
OECD	Organisation for Economic Co-operation and Development
R&D	Research and Development
TaxRED	R&D Tax Concession Regional Delivery Strategy
TCC	Tax Concession Committee





# **Summary, Key Findings and Recommendations**



# Summary

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1. In industrialised countries such as Australia, innovation is a key source of economic growth.<sup>1</sup> Research is a key driver of technological innovation and involves the process of systematic investigation and/or experimentation to discover new knowledge. The Government's industry innovation policy supports a business focus on Research and Development (R&D) through a range of programs, one of which is the R&D Tax Concession.

## The R&D Tax Concession program

2. The R&D Tax Concession was introduced in 1985. It is an uncapped program which provides a 125 per cent concessional deduction for eligible R&D expenditure, claimed against assessable income. Many other countries provide additional tax incentives of this nature to encourage investment in R&D.

3. The objectives of the R&D Tax Concession program are to:

...provide a tax incentive, in the form of a deduction, to make eligible companies more internationally competitive by:

- a) encouraging the development by eligible companies of innovative products, processes and services;
- b) increasing investment by eligible companies in defined research and development activities;
- c) promoting the technological advancement of eligible companies through a focus on innovation or high technical risk in defined research and development activities;
- d) encouraging the use by eligible companies of strategic research and development planning; and
- e) creating an environment that is conducive to increased commercialisation of new processes and product technologies developed by eligible companies.

The benefits of the tax incentive are targeted by being limited to particular expenditure on certain defined activities.<sup>2</sup>

4. Responsibility for the administration of the Concession is shared between the Industry Research & Development Board (the Board) and the Australian Taxation Office (ATO) under provisions of the *Industry Research and Development Act 1986*<sup>3</sup> and the *Income Tax Assessment Act 1936*.<sup>4</sup>

<sup>1</sup> *Investing for Growth*, Commonwealth of Australia, 1997, p. 28.

<sup>2</sup> *Income Tax Assessment Act 1936*, section 73B, 1AAA.

<sup>3</sup> Sections 39A to 39V of the Act establish the framework for registering companies and assessing whether particular activities meet the definition of eligible R&D activity.

<sup>4</sup> Including equivalent provisions in the *Income Tax Assessment Act 1997*. Sections 73B to 73G of the Act which establish the framework for determining the accuracy of deductions claimed under the Concession and define eligible R&D activity.

5. Broadly, the Board and its Tax Concession Committee<sup>5</sup> (TCC) are responsible for registration of companies seeking to claim the Concession, and for assessment of the eligibility of R&D activities. AusIndustry, a division of the Department of Industry, Tourism and Resources (DITR) provides administrative support to the Board and the Committee.

6. In order to claim the Concession, an 'eligible company'<sup>6</sup> must first be registered by the Board. Registration is required for each year of income in which the R&D expenditure is incurred. Companies then claim the Concession against assessable income by completing a single line entry on their tax return.

7. The amount of tax expenditure incurred by the Commonwealth in 2001–02 for the Concession is estimated by the Treasury to be \$420 million.<sup>7</sup>

## The audit

8. The objective of this audit was to assess the Commonwealth's administration of the R&D Tax Concession Program. The audit criteria involved the examination of:

- key governance arrangements;
- program performance and targets;
- customer service and information processes;
- process for registration of eligible R&D activity; and
- management of tax expenditure claims.

9. The audit methodology included analysis of a random sample of applications for registration, and review of documentation and management information systems. The audit also included interviews with industry stakeholders, customers and officers of AusIndustry, DITR and the ATO.

## Audit conclusion

10. The ANAO concluded that the R&D Tax Concession is well managed by each individual agency. However, aspects of joint governance and performance management for the program as a whole could be strengthened for better results.

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<sup>5</sup> Members of the Tax Concession Committee are appointed by the Minister for Industry, Tourism and Resources.

<sup>6</sup> A body corporate incorporated under a law of the Commonwealth or a State or Territory. Partnerships or trusts are not eligible to claim the R&D Tax Concession.

<sup>7</sup> Including Premium Tax Concession for additional R&D expenditure, *Tax Expenditures Statement 2002*.

11. The key governance arrangements for the R&D Tax Concession are well established and, on the whole, implemented in a sound manner. The roles and responsibilities of the Industry Research and Development Board, AusIndustry and the ATO are clear, well understood, and consistent with legislative responsibilities. They are supported by a Memorandum of Understanding (MOU) between the parties. However, overall administration of the program would benefit from incorporating measurement criteria in the MOU to require reporting on the provisions of the MOU for performance and cooperation between agencies, and by addressing systematic joint consideration of the overall risks associated with the program.
12. The Board, supported by DITR, monitors and publishes a range of performance indicators for the Concession. However, there are few targets associated with the indicators. These indicators have a focus on information supplied at registration, since there are currently limitations in the reliability of information on claims of the Concession as a tax expense.
13. Current performance indicators focus on inputs and outputs rather than providing assessment of the effect of the Concession in increasing investment by eligible companies in defined R&D, a key objective of the program. It would be desirable for DITR to establish some means of assessing this latter effect in its performance management framework. DITR has advised that it is devising performance indicators for all innovation programs, including the Tax Concession, in the context of reporting on outcomes from the *Backing Australia's Ability*<sup>8</sup> process.
14. Customer service and information processes are well managed. There is good information provision, with customers generally satisfied with the quality of information available. Customer service is also supported by AusIndustry's R&D Tax Concession Regional Delivery Strategy (TaxRED). Customers who have received a TaxRED visit have higher overall satisfaction with the program.
15. Registration of companies' R&D activities with the Board, which is a legal prerequisite for claiming the Concession, is administered in a timely manner. Registration has required companies to provide a substantial amount of information on R&D activities, some of which has not been used for performance reporting or compliance monitoring activities. The ANAO concluded that there would be benefit both in confirming what data is needed for program administration, and considering alternative and less DITR effort and customer-costly means of obtaining information required to manage the program.

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<sup>8</sup> *Backing Australia's Ability: real results, real jobs: the Government's innovation report 2001–02*, 2001.

16. Since then there has been a review of data needs, and the Board has approved a new registration application form for 2003. This form will reduce data requirements compared with previous years including removing the requirement of the more detailed schedule for larger applicants. DITR advised that further work is under way to streamline and harmonise data collection for the 2004 year, working with the ATO and the Australian Bureau of Statistics

17. AusIndustry has a sound approach to compliance monitoring, supported by detailed standard operating procedures, which are well documented and implemented. Some 90 per cent of companies reviewed are not subject to further action. There may therefore be merit in reviewing the need for the current level of compliance activity, and its targeting, on risk management grounds.

18. R&D Tax Concession expenditure claims are managed by the ATO as part of its management of company income tax self assessment. This includes private rulings, which are generally well managed and timely. The ATO has a structured approach to establishing that legal requirements for registration have been fulfilled prior to claiming the Concession, through data matching with AusIndustry.

## **Recommendations and DITR and ATO response**

19. The ANAO made four recommendations aimed at strengthening the R&D Tax Concession administration, including incorporating whole of government approaches to costing, administration and management of objectives. Both DITR and the ATO agreed with the recommendations addressed to them.

# Key Findings

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## Key Governance Arrangements (Chapter 2)

### Roles, responsibilities & accountabilities

20. Administration of the R&D Tax Concession is shared between the Industry Research and Development Board (the Board), AusIndustry and the Australian Taxation Office (ATO) in accordance with their legislative responsibilities.

21. Broadly, the Board, which reports directly to the Minister, is responsible for registration and assessing eligibility of companies seeking to claim the Concession. It is assisted by its Tax Concession Committee (TCC), with administrative support from AusIndustry. The ATO is responsible for ensuring compliance with the Concession provisions of the *Income Tax Assessment Act 1936*.

22. The ANAO found the roles and responsibilities of these parties are clear, well understood, and consistent with legislative responsibilities. The processes in place to manage the delegated powers of the Board are sound.<sup>9</sup>

23. To assist in carrying out their joint and individual administrative responsibilities for the Concession, the Department of Industry, Tourism and Resources (DITR), the ATO & the Board have established a written Memorandum of Understanding (MOU). The ANAO found that the MOU establishes a clear working framework for the arrangement between the parties. The agreement reflects a 'facilitative' approach under which the agencies cooperate well and comply with the provisions of the MOU.

24. However, the MOU would benefit from incorporating measurement criteria to require reporting on the provisions of the MOU for performance and cooperation between agencies, to assist in the overall administration of the program. The criteria might include assessing key matters addressed in the MOU, such as timeliness and quality of information exchange.

### Risk management

25. The Concession has been identified by DITR as a high risk program due, in part, to its relative size and the self assessment nature of the Concession. A detailed strategy for risk management has been developed. Risk mitigation measures are reviewed and updated and include, for example, better definitions of terms, information campaigns, review of the registration process, and

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<sup>9</sup> Management of ATO delegated authority has been addressed in previous audits. These are: ANAO Audit Report No.23, *The Management of Tax Debt Collection, 1999–2000*, p. 58; and ANAO Audit Report No.31, *Administration of Tax Penalties 1999–2000*, p. 34.

increased training and development of program guidelines. This risk management approach is supported by an R&D Tax Concession Compliance Framework. Overall, this approach is in line with DITR's high risk rating of the program.

26. The ATO considers the risk attached to the R&D expense allocation to be low. The tax expenditure is a relatively small part of the revenue base and a previous study<sup>10</sup> supported a low rating. Consequently, the ATO has not undertaken a specific risk assessment for the program. Instead, risk management for the Concession forms part of the overall ATO risk management approach.

27. While both agencies manage the Concession's risk consistent with their individual risk management approaches, there is no means for systematic joint consideration of the overall risks associated with the program. In the absence of such joint consideration, assessment of risks and resulting management actions may be uneven across a program with shared management responsibilities. Accordingly, the ANAO considers that risk management would be strengthened by adopting procedures to jointly consider the risks of the program as a whole.

## **Managing perceived conflict of interest**

28. The Board and the TCC membership are drawn largely from the private sector. This provides the relevant commercial and technical expertise necessary in making decisions as to eligibility of R&D activity under the *Industry Research and Development Act 1986*. Inevitably, this means that many of these members have links to industry, and so there will often be the risk of perceived or actual conflicts of interest arising that need to be managed. The ANAO found that procedures for managing perceived conflict of interest for the Board are implemented systematically. AusIndustry has also implemented conflict of interest procedures for its employees.

## **Consultation with industry stakeholders**

29. The value of consultation with stakeholders is recognised through a number of consultative mechanisms. However, until recently, consultation on administrative issues was ad-hoc. To address this concern, the ATO and AusIndustry have established an R&D Tax Concession Administration Consultative Group. The Group meets in Sydney and Melbourne. It would be consistent with whole of government trends for enhanced Regional access to examine the potential to hold meetings in areas other than metropolitan Sydney and Melbourne. AusIndustry is considering this approach.

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<sup>10</sup> A 1997 field work project testing expenditure claims from a sample of 10 companies with R&D claims under \$500 000 concluded that the compliance risk was 'minimal'.



## Information exchange between agencies

30. One of the key matters addressed by the MOU is the need for information to be exchanged between DITR and the ATO at officer level. This is a key aspect of the joint administration of the program, and is necessary for both agencies to carry out their responsibilities effectively.

31. The ANAO found that some of the processes for data exchange were undocumented. Better practice in the exchange of data between databases includes mechanisms to provide assurance that the data loaded into the receiving database matches the data initially extracted. Strengthening data transfer procedures would provide greater assurance of the integrity of the data transferred. AusIndustry, in response to the draft audit report, indicated that progress is being made in this area.

32. The Concession data provided by AusIndustry is stored on a shared network drive at the ATO. As noted in a previous ANAO audit,<sup>11</sup> the ATO's IT security policies do not adequately address the sharing of data on the wide area network. At the time of this audit, Concession data stored at the ATO was not subject to application level access controls, nor was it password protected. The ATO is developing revised IT security policies and procedures to address storage of data outside of its mainframe environment.

## Program Performance (Chapter 3)

### DITR performance measurement outputs/outcomes

33. The performance indicators associated with the Concession are trends in the number of registrants, value of registrations and in Business Expenditure on R&D (BERD); timeliness of key processes; customer satisfaction; and cost of service delivery. These measures are regularly reported to senior management in relevant performance reporting, and to the Parliament through annual reporting.

34. The AusIndustry Customer Service Charter sets a target of 30 days for decisions to be made on registration of applications. AusIndustry performance data indicates that, in 2001–02, prima facie, 85 per cent of applications met the target. However, the 15 per cent that apparently failed to meet the target include applications that were incomplete. The ANAO estimates that 5 to 10 per cent of properly completed applications did not meet the target of 30 days.

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<sup>11</sup> ANAO Audit Report No.16, *Australian Taxation Office Internal Fraud Control Arrangements*, 2000–01, pp. 78–79 and Recommendation No.6.

35. AusIndustry, which is the main interface with customers of the Concession, has assessed customer satisfaction through a customer survey. This indicates an overall satisfaction rate for AusIndustry management of the program of 60 per cent; 32 per cent were neither satisfied nor dissatisfied. Eight per cent were dissatisfied. Further analysis by AusIndustry suggested that key drivers in satisfaction were professionalism in dealing with customers, knowledge of the program, and adequacy of information supplied about requirements and about other relevant services.

36. The AusIndustry customer satisfaction survey also sought to identify where improvement in delivery processes was required. Following the survey, AusIndustry developed an action plan to identify specific actions to deal with the issues raised by customers. The ANAO found that AusIndustry has effectively implemented the action plan. As a result, substantial progress has been made to improve customer service delivery.

37. AusIndustry has advised that it intended to repeat the survey annually. However, this had not occurred due to a lack of resources. AusIndustry advised, in response to the draft audit report, that it was undertaking a new survey in March 2003.

38. The total cost of administration of the program by AusIndustry and the ATO is estimated at \$10.2 million, with AusIndustry accounting for approximately three-quarters of the cost. AusIndustry has recently introduced time-based costing. This is expected to produce a more reliable cost estimate in future.

## **Characteristics of Concession claimants**

39. The Concession is accessed by companies across a wide range of industries. The mining, machinery and equipment manufacturing, and property and business services sectors accounted for over 50 per cent of registrants in 2001–02.

40. Sixty four per cent of companies registering for the Concession advised that R&D expenditure would be less than \$500 000 (representing 8 per cent of the total expected R&D expenditure). Three per cent indicated expenditure over \$10 million (representing 51 per cent of the total expected R&D expenditure).

## **ATO performance framework**

41. Published performance measures for the Concession are based on DITR's registration data. The ATO Annual Report does not have specific performance indicators for the Concession. However, the ATO's Innovation Segment,<sup>12</sup> which has primary responsibility for the Concession in the ATO, does report its activities

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<sup>12</sup> The Innovation Segment forms part of the Large Business and International (LB&I) business line.

in an internal management report. The accuracy of ATO data on the program is discussed at paragraph 78 below.

### **Strengthening performance measurement**

42. The Joint Committee of Public Accounts and Audit has recommended that a lead agency should be identified where agencies have a shared outcome. Effectively, the Board, supported by DITR, has this lead role as it undertakes performance reporting for the program.

43. DITR conducted an evaluation of the Program in 2000, which included a survey of companies that were registered, or had been registered, for the Concession.<sup>13</sup> The survey found that the Concession is an important influence on R&D activity for a large number of firms, but was unable to quantify the extent to which the Concession acted as an inducement to increased investment in R&D. The ANAO suggests that, in future, there would be merit in such analysis also addressing the characteristics of companies for which the Concession is highly influential.

44. The ANAO notes that performance indicators primarily focus on inputs and outputs, rather than providing direct assessment of the effect of the Concession in increasing investment by eligible companies in defined R&D, a key objective of the program. It would be desirable for DITR to include in its key performance indicators some means of assessing the impact of the Concession. DITR has advised that it is drafting new departmental performance indicators, as part of the *Backing Australia's Ability*<sup>14</sup> statement, to enhance assessment of their innovation programs, including the Concession. The department further advised, in response to the draft audit report, that the higher order objective of inducing additional R&D as a result of the program will be measured through a survey of industry.

## **Informing Customers About Eligibility Criteria (Chapter 4)**

### **Promoting the R&D Tax Concession**

45. AusIndustry is responsible for marketing the Concession, along with approximately 30 other business assistance products and services of the department. AusIndustry's market research has found that the target audience for its products and services is diverse. Consequently, AusIndustry products are not marketed individually. Rather, the products are grouped to target industry

<sup>13</sup> Total survey target was 2700. There was a 30 per cent response to this survey.

<sup>14</sup> *Backing Australia's Ability: real results, real jobs : the Government's innovation report 2001–02, 2001.*

sectors and business needs. The Concession has been promoted using a variety of media, as part of the innovation group of products.

46. However, the 2001 AusIndustry customer satisfaction survey found that, while the majority of customers were satisfied with the level of promotion of the Concession, 10 per cent were dissatisfied. In response to these findings, a new Marketing Plan was implemented in 2001–02, to better target and promote the Concession.

### **Informing customers about eligibility criteria**

47. AusIndustry and the ATO have developed a number of tools to communicate to potential customers information about the Concession, eligibility requirements and processes to claim the Concession. These include a joint AusIndustry and ATO publication, *The Guide to the R&D Tax Concession*, which provides comprehensive information about the program, including the definition of R&D, eligibility issues and monitoring of the program. The AusIndustry website is also a key source of information. AusIndustry and the ATO also jointly run seminars on the Concession for companies and their consultants.

48. The AusIndustry customer satisfaction survey showed that 90 per cent of respondents considered that information about the program was readily available. Customers were generally satisfied with the quality of information available. Stakeholders consulted by the ANAO reported that they found the information disseminated by AusIndustry valuable. However, some were not aware of the extent of the availability of information.

### **TaxRED**

49. Another key means by which customers are informed of the requirements of the Concession is the R&D Tax Concession Regional Delivery Strategy (TaxRED). TaxRED has two key purposes: providing information to customers and improving compliance. Once a customer has registered for the Concession, the customer may be identified for a TaxRED visit or desk review by a Customer Service Manager from a Regional office of AusIndustry.<sup>15</sup>

50. Customers who had received a TaxRED visit had higher overall satisfaction with the program, suggesting that direct customer contact was beneficial in improving service delivery. Industry stakeholders advised that AusIndustry has made a concerted effort to improve customer service and has adopted a constructive approach to industry, without compromising the integrity of the program.

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<sup>15</sup> The compliance monitoring aspect of TaxRED is discussed in Chapter 5.

## Registration and Self-assessment of R&D Activity (Chapter 5)

### Purpose of registration and information collection

51. Registration of R&D activities with the Board is a legal prerequisite for companies intending to claim the Concession. The formal stated purpose of enabling the Board to register or not register companies for the Concession is 'to reduce the incidence of companies being required to reimburse tax benefits subsequent to a tax audit'. Notwithstanding this statement, AusIndustry and the Board do not verify each activity.

52. In practice, one of the main purposes of registration is to provide AusIndustry with its main source of statistical information. This information is then used for its compliance activity and is the basis for program performance information. Companies have been required to supply a considerable amount of information, with larger registrants required to provide an additional schedule of more detailed information on R&D activities.

53. In practice, AusIndustry has made little use of the registrants' application information to determine whether or not compliance activities will be undertaken. The information supplied is used once the company has been selected for compliance review. Some registration information is used for performance information purposes. However, only a small part of it is actually used for this purpose.

54. The ANAO concluded that there would be benefit both in confirming what data is needed for program administration, and considering alternative and less DITR effort and customer-costly means of obtaining information required to manage the program.

55. In response to the draft audit report, DITR advised that registration is considered to be important, inter alia, to maintain the integrity of the Tax Concession and as a mechanism for drawing companies' attention to the requirements of the Tax Concession in a self assessment environment, to reduce the possibility of erroneous claims. However, there has been action since the audit to reduce the cost burden of information provision at registration.

56. DITR has advised that, following a review of data needs, the Board has approved a new registration application form for 2003. This form will reduce data requirements compared with previous years, including removing the requirement of the more detailed schedule for larger applicants. DITR advised that further work is under way to streamline data collection for the 2004 year. AusIndustry is working with the ATO and the Australian Bureau of Statistics to look at harmonising data collection under the Tax Concession. A joint working group will examine the feasibility of reducing data collected.

## Data entry accuracy

57. The ANAO examined a sample of companies seeking registration for the 1999–2000 year. The ANAO found that some two thirds of the total sample of registrations had some form of data entry error. Some 40 per cent of the errors included incorrectly entered schedule data, incorrect addresses and errors in company turnover.

58. These error rates reduce the value of these elements for compliance and performance reporting purposes. AusIndustry advised the ANAO that there were some particular circumstances that led to an unusually high level of errors at that time. Procedural improvements for data entry have since been undertaken, including a formal, documented data integrity checking process, to address this issue.

## Compliance activities

59. AusIndustry's compliance monitoring for the Concession comprises TaxRED monitoring (see paragraph 49), which addresses companies claiming up to \$2.5 million R&D expenditure per year; and Large Case Monitoring (LCM), which addresses those companies claiming over \$2.5 million R&D expenditure. In addition, there is a joint compliance monitoring approach in conjunction with the ATO for the Top 30 groups of companies.<sup>16</sup> The rigour of monitoring increases across the spectrum. Thus, LCM monitoring is more in depth than for TaxRED. Likewise, Top 30 monitoring is more rigorous than for LCM.

60. The ANAO found that AusIndustry has a sound basis for conducting its monitoring activities. This is supported by detailed procedures and associated training. AusIndustry staff were largely following procedures. However, there was some variation in adherence to formal documented procedures. This suggests that either efforts to ensure adherence to procedural requirements are required, or that the requirements should be revised if activities are no longer necessary.

61. Some 90 per cent of companies reviewed are not subject to further action. There may therefore be merit in reviewing the need for the current level of compliance activity—some 25 per cent of all companies—and its targeting, on risk management grounds (including consideration of any deterrent effect).

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<sup>16</sup> The number of the group of companies included in the program can vary as companies may drop out due to mergers, acquisitions, wind ups etc. The actual number may be up to 35. Companies are grouped, as separate entities may come under one large umbrella parent company. There may be up to 200 companies covered by the Top 30 groups.

## Legislative assessments

62. Legislative assessments of the eligibility of R&D activity are conducted if a company is rated high risk as a result of compliance monitoring. This involves an assessment by AusIndustry (under section 39L of the *Industry Research and Development Act 1986*), with a final decision by the TCC. Customers dissatisfied with the decision may request, under section 39S of the Act, a review of the assessment by the Board.

63. The ANAO found that the process for legislative assessment is robust and well documented. It is supported by substantial quality assurance mechanisms. The TCC and the Board review assessments.

64. Most projects assessed have ultimately been found to be allowable. Only 17 per cent of projects (25 per cent of value) initially subject to legislative assessment were ultimately not allowed. However, the number of these assessments has declined recently as a result of TaxRED and other compliance monitoring activity. These activities provide 'front end' management of compliance, filtering out unproductive assessment on a risk managed basis. While it is too early to determine the extent to which this has reduced the less productive assessment, the evidence to date suggests that the new arrangements have increased the rates of disallowment.

## Supporting information systems

65. The ANAO found that the departmental information systems which support administration of the Concession function well and meet operational needs. However, there were weaknesses in some aspects of IT procedures, in particular in documentation of operational/maintenance procedures, use of security auditing, and disaster recovery. These matters warrant attention to increase assurance of the security of Concession data and the capacity of the department to respond appropriately to a major systems failure.

## Expenditure Claims (Chapter 6)

66. After registering with AusIndustry, companies are eligible to claim the Concession through the company tax return. It is one claimable item on a multi-faceted annual company tax return.

67. The Concession is relatively small in the context of company income tax revenues. The ATO collected company revenue of \$27 billion in 2001–02,<sup>17</sup> compared to projected tax expenditure for the Concession of \$420 million<sup>18</sup> (1.56 per cent of company income tax).

<sup>17</sup> ATO *Annual Report 2002* (Output 1.1.2—Provide Revenue).

<sup>18</sup> Includes the Premium Tax Concession for additional R&D expenditure. Source: *Tax Expenditure Statement 2002*.



## Compliance management

68. Risk management for the Concession takes place within the ATO's overall approach to risk management and compliance. Because the risks attached to R&D expense allocation, through self assessment, have been assessed as low, risk related activities in relation to the Concession are limited to those areas of highest assessed risk within the program.

## Taxation rulings

69. An important element of the ATO's administration of taxation law is the provision of interpretative advice on taxation issues to taxpayers. A key mechanism used to disseminate the Commissioner of Taxation's interpretative advice on the Australian taxation law is taxation rulings.

70. The ANAO has previously audited the ATO's administration of taxation rulings,<sup>19</sup> concluding that, '... the administrative processes for **private** rulings have operated poorly in many respects'. The volume of rulings for the Concession is relatively small, averaging 10 per year.<sup>20</sup> Most rulings are private rulings; public rulings are rare.

71. The ANAO found that rulings were being prepared in accordance with ATO guidelines, and were complying with corporate standards. The timeliness service standard of 28 days was met in 88 per cent of private rulings. Industry stakeholders consulted by the ANAO indicated that they were generally satisfied with the outcomes of the processes for the public ruling on plant expenditure.

## Assisted self regulation

72. The Top 30 program is the only systematic risk assessment activity by the ATO specifically focussed on the Concession. It targets the largest groups of companies and accounts for 40 per cent of the annual total expenditure claims for the Concession. Broadly, six company groups are examined in any one year. For 2001, most projects had been found to have no significant issues.

73. The ATO also conducts industry customer risk reviews as part of a standardised Large Customer Program. These target company groups with turnover greater than \$100 million per annum. Results of the reviews confirm the ATO view that the Concession is relatively low risk.

74. The ATO also receives compliance referrals resulting from AusIndustry compliance activities such as TaxRED. The ATO advised that this is an efficient

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<sup>19</sup> ANAO Audit Report No.3, *The Australian Taxation Office's Administration of Taxation Rulings*, 2001-02.

<sup>20</sup> Half are syndication related (years 1999-2002).



means of capturing risk information about the smaller end of the Concession market. Only one such referral, so far, has been identified as high risk.

75. The ANAO found that the various risk assessment activities described above had not been well coordinated or integrated. This has been recognised by the ATO. Consequently, it is developing a business line wide risk and treatment framework for technical compliance risks.

76. In addition to the above activities, the ATO has adopted a structured approach to establishing that legal requirements for registration with the Board have been fulfilled prior to claiming the Concession. It has been undertaking data matching with AusIndustry registration information since 1997. This matching initially found that substantial numbers of Concession claimants had not been registered prior to claiming the Concession, as required by law. However, the number of claimants requiring an adjustment has declined as companies have become more aware of registration requirements. To date, this data matching has found that projects totalling \$68 million had been incorrectly claimed, resulting in tax savings of \$12.8 million.

## **Enforcement**

77. Under the ATO's Cooperative Compliance Model, it is intended that active enforcement activity, such as audits and litigation, should constitute the final, and least frequently used, aspect of compliance activity. This is the case for the Concession, consistent with its assessment as a relatively low risk expense. Accordingly, the Innovation Segment has not been conducting audits of current Concession claims.

## **Accuracy of expenditure claim data**

78. On registration with AusIndustry, companies record the intended R&D expenditure but are not required to subsequently report actual expenditures claimed in their taxation return. Thus, the ATO is the only source of information on actual claims of the Concession as a tax expense. The estimation of tax expenditure on the Concession is carried out by Treasury based on data provided by the ATO.

79. There have been, however, a number of limitations in the reliability of these data. These limitations flow from taxpayer behaviour in completing the form, and from limitations in ATO information systems. For example, the number of claimants identified in the ATO information system was, on average, 28 per cent less than registrants with AusIndustry. This is caused mostly by companies using an incorrect label on the tax return form or by companies

claiming the Concession by amendment.<sup>21</sup> Although this does not affect self assessed tax liability, these two effects lead to under-recording on the ATO information systems. It also means that these companies are not identified as claimants in risk assessment and audit activity in relation to the Concession.

**80.** The companies affected by these underestimations tend to be smaller companies and represented less than 10 per cent of the value of concessions claimed.

**81.** The ANAO also found that some companies mis-complete their tax return form with respect to the amount of the claimed R&D expenditure entered at label L on the return. This was identified as a substantial problem in the previous audit.<sup>22</sup> Companies incorrectly enter 125 per cent, rather than 25 per cent<sup>23</sup>. In contrast to the effect of the other errors/system limitations described above, this has the effect of overstating the amount of the Concession on ATO information systems.

**82.** The overall impact on estimates, of all these errors, may therefore be less than 10 per cent. However, in the absence of more reliable information, this cannot be established more reliably without further work by the ATO and AusIndustry.

**83.** A new schedule was introduced at the beginning of the tax year 2002 to assist in capturing further data related to the Concession. The ATO envisages that the new schedule will largely resolve the problems of companies completing the wrong label or recording the wrong amount of expenditure, including significant improvements for capturing whether a company is registered. There is also a requirement for an R&D schedule to be lodged for an amendment that includes changes to a company's R&D claim. The ATO advised, in response to the draft audit report, that it will extend data matching with AusIndustry to support correct tax return preparation.

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<sup>21</sup> A claim by amendment would occur, for example, when a company submits a tax return for particular year with no R&D claim, and subsequently amends their tax return to include an amount at the R&D Concession label.

<sup>22</sup> ANAO Audit Report No.12, *Administration of the 150% Taxation Incentive for Industry Research and Development*, 1993–94, p. 20.

<sup>23</sup> Sample study undertaken of ATO data.

# Recommendations

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Set out below are the ANAO's recommendations with report paragraph references. Recommendations 1-3 relate to the joint administration of the program, recommendation 4 relates to DITR only. The ANAO considers that all recommendations warrant the same priority.

**Recommendation  
No. 1  
Para. 2.20**

**Memorandum of  
Understanding**

The ANAO recommends that the MOU between the IR&D Board, DITR and the ATO incorporate measurement criteria to enable reporting on the level of achievement of the objectives identified in the MOU, to better assist in the overall administration of the program.

*DITR Response:* Agreed.

*ATO Response:* Agreed.

**Recommendation  
No. 2  
Para. 2.36**

**Risk Management**

The ANAO recommends that the ATO and DITR adopt procedures to jointly identify and address risks to the program as a whole. This process should be reflected in the MOU.

*DITR Response:* Agreed.

*ATO Response:* Agreed.

**Recommendation  
No. 3  
Para. 2.53**

**Data Exchange**

The ANAO recommends that data exchange processes between AusIndustry and the ATO be agreed, documented and tested and include processes that confirm the integrity of the data transferred (e.g: batch control totals).

*DITR Response:* Agreed.

*ATO Response:* Agreed.

**Recommendation  
No. 4  
Para. 5.53**

**Security and Integrity  
of Company Data**

The ANAO recommends that DITR strengthen the integrity and security of R&D Tax Concession information systems by documenting processes for security, backup and recovery of R&D Tax Concession data.

*DITR Response:* Agreed.



# **Audit Findings and Conclusions**



# 1. Introduction

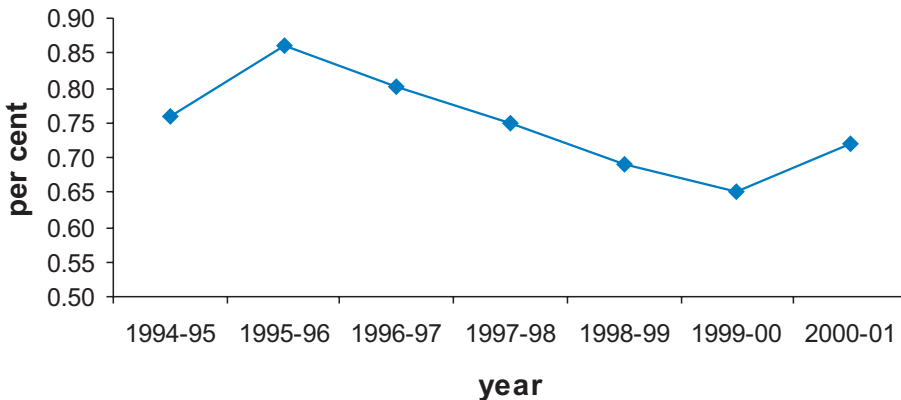
This chapter provides background to the administration of the Research & Development (R&D) Tax Concession and outlines the purpose of this audit.

## Background

1.1 In industrialised countries such as Australia, innovation is a key source of economic growth.<sup>24</sup> Research is a key driver of technological innovation and involves the process of systematic investigation or experimentation to discover new knowledge. The business sector is an essential component of Australia's national innovation system, funding, performing and using research.<sup>25</sup>

1.2 Figure 1.1 shows business expenditure on Research and Development (BERD) in Australia as a percentage of Gross Domestic Product (GDP) over time. On this measure, Australia's business R&D performance declined from 1995–96 to 1999–2000.<sup>26</sup> All major industry sectors recorded an increase in R&D expenditure in 2000–01.<sup>27</sup>

**Figure 1.1**  
**Australia's BERD as a percentage of GDP**



Source: ABS data

<sup>24</sup> *Investing for Growth*, Commonwealth of Australia, 1997, p. 28.

<sup>25</sup> *Business Commitment to R&D in Australia*, A submission to the House of Representatives Science and Innovation Committee by CSIRO, August 2002.

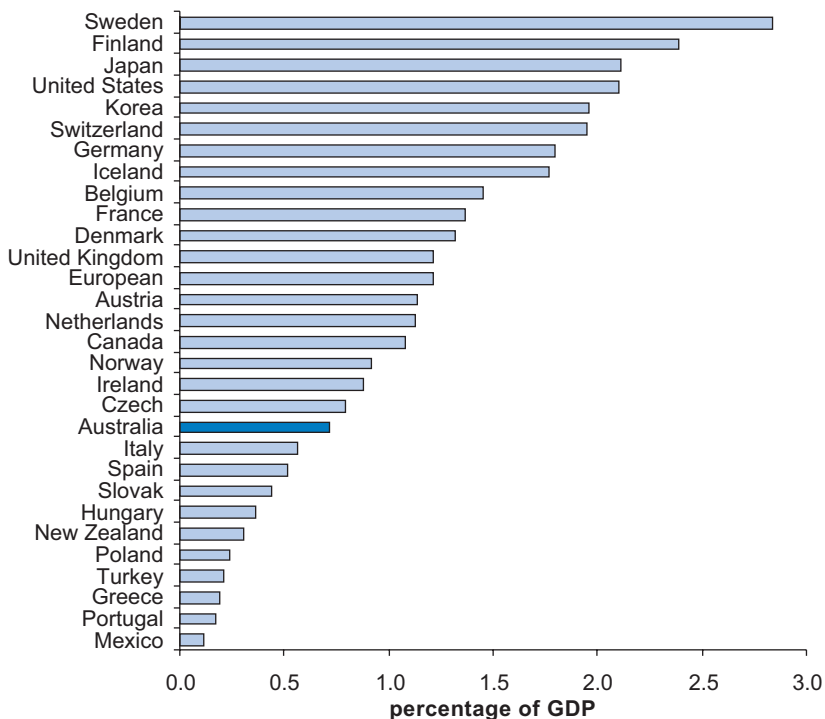
<sup>26</sup> The fall in BERD was largely attributable to the termination, in 1996, of the syndication component of the R&D Tax Concession and a fall in investment in the mining sector. *Submission to the House of Representatives, Committee on Innovation and Science, Inquiry into Business commitment to R&D in Australia, 2002*, Department of Industry, Tourism and Resources.

<sup>27</sup> 2000–01 is the most recent year for which data is available.

1.3 In the international context, Australia's BERD as a proportion of GDP is somewhat below the median of that of other Organisation for Economic Co-operation and Development (OECD) countries (see Figure 1.2).

**Figure 1.2**

**BERD expenditure as a percentage GDP 2001**



Source: OECD<sup>28</sup>

1.4 Sixteen OECD countries, including Australia, provide additional tax incentives to business in the form of R&D tax credits and allowances to encourage investment in R&D. Overseas studies have shown that R&D tax incentives are an important method of stimulating R&D activity.<sup>29</sup>

<sup>28</sup> OECD *Main Science and Technology Indicators*, Volume 2002/2.

<sup>29</sup> Warda, J., *Measuring the value of R&D tax provisions*, OECD, 1996, Paris.



## The R&D Tax Concession

**1.5** The Australian Government's industry innovation policy supports a business focus on R&D through a range of programs, which provide support for basic R&D, commercialisation and technology diffusion (see Appendix 1).

**1.6** The R&D Tax Concession Program, which is uncapped, is the largest such support program, both in terms of value and the number of businesses assisted. It enables concessional deductions to be claimed against assessable income for eligible expenditure on R&D activities.<sup>30</sup>

**1.7** The objectives of the R&D Tax Concession program are to:

...provide a tax incentive, in the form of a deduction, to make eligible companies more internationally competitive by:

- a) encouraging the development by eligible companies of innovative products, processes and services;
- b) increasing investment by eligible companies in defined research and development activities;
- c) promoting the technological advancement of eligible companies through a focus on innovation or high technical risk in defined research and development activities;
- d) encouraging the use by eligible companies of strategic research and development planning; and
- e) creating an environment that is conducive to increased commercialisation of new processes and product technologies developed by eligible companies.

The benefits of the tax incentive are targeted by being limited to particular expenditure on certain defined activities.<sup>31</sup>

**1.8** The Concession was introduced in 1985 and provided a 150 per cent deduction for eligible R&D expenditure. The August 1996 Budget reduced the concessional rate from 150 per cent to 125 per cent. At the same time, registration of new syndicates<sup>32</sup> was terminated.

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<sup>30</sup> For the purposes of the Concession, R&D activities must be systematic, investigative and experimental activities which involve innovation or high levels of technical risk and are carried on for the purpose of acquiring new knowledge or creating new or improved materials, products, devices, processes or services.

<sup>31</sup> *Income Tax Assessment Act 1936*, section 73B, 1AAA.

<sup>32</sup> Syndication provided for more than one company to share the financial risk of large R&D projects. Syndication was terminated in 1996 following concerns that the program was subject to abuse.

## Recent changes to the R&D Tax Concession

1.9 Following the government's *Backing Australia's Ability*<sup>33</sup> initiative, a requirement for companies to prepare R&D plans was introduced. This plan is not submitted with registration, but is a requirement of being an 'eligible company' and claiming the Concession.

1.10 In addition, new measures were introduced, designed to encourage Australian companies to increase the level of R&D activities undertaken and to support the development of innovative, small companies. The measures widen the Concession in some circumstances, as outlined in Table 1.1.

**Table 1.1**

### Recent changes to the R&D Tax Concession

<b>R&amp;D Tax Offset</b>	Available for small companies (turnover under \$5 million) and aggregated expenditure of up to \$1 million per year on research and development. It is of benefit to companies in tax loss, where a rebate can be offset against other tax liabilities. The tax offset applies to expenditure incurred in income years commencing after 30 June 2001.
<b>175% Premium (Incremental)</b>	Available for additional investment in R&D. To be eligible, companies must increase their R&D expenditure during the year above a base level determined by their average expenditure over the previous three years. Applies to expenditure incurred in income years commencing after 30 June 2001.
<b>R&amp;D Plant</b>	Companies will be able to claim the full value of R&D plant consumed in or associated with R&D activities. All plant will now be eligible for effective life depreciation deduction at 125 per cent for the period that the plant is used in R&D activities. This provision is effective from 12.00pm AEST 29 January 2001.

Source: Taxation Laws Amendment (research and development) Bill 2001, Explanatory Memorandum.

## Legislative and administrative framework

1.11 The Concession contributes to Outcome 2 of the Department of Industry, Tourism and Resources (DITR), that is, 'enhanced economic and social benefits through a strengthened national system of innovation', through Output 2.3 covering 'science and innovation program design and implementation'.<sup>34</sup>

1.12 Responsibility for the administration of the Concession is shared between the Industry Research & Development Board (the Board) and the Australian Taxation Office (ATO) under provisions of the *Industry Research and Development*

<sup>33</sup> *Backing Australia's Ability: real results, real jobs : the Government's innovation report 2001–02*, 2001.

<sup>34</sup> The output structure has changed from 2002–03, (see *Portfolio Budget Statements 2002–03*). Under the new structure, the R&D Tax Concession will come under output 2.1: *Program management services*.

Act 1986<sup>35</sup> and the *Income Tax Assessment Act 1936* and equivalent provisions in the *Income Tax Assessment Act 1997*.<sup>36</sup> AusIndustry, a division of DITR, provides administrative support to the Board and its Tax Concession Committee.

**1.13** The ATO's role is to ensure compliance with the Concession provisions of the *Income Tax Assessment Act 1936*, including determining the accuracy of deductions claimed under the deduction.

**1.14** The Concession is a self assessed entitlement. In order to claim the Concession, an 'eligible company'<sup>37</sup> must first be registered by the Board<sup>38</sup> under section 39J of the *Industry Research & Development Act 1986* (IR&D Act). Registration is required for each year of income in which the R&D expenditure is incurred. Companies then claim the Concession against their assessable income by completing a single line entry on their tax return.

## Cost of the program

**1.15** The amount of tax expenditure by the Commonwealth in 2001–02 for the R&D Tax Concession is estimated by the Treasury to be approximately \$420 million.<sup>39</sup>

**1.16** The costs of administering the Concession for 2001–02 were approximately \$7.5 million for DITR/AusIndustry and approximately \$2.75 million for the ATO.

## Previous audit coverage and review

**1.17** The Concession has been the subject of two previous ANAO performance audits, in 1989<sup>40</sup> and 1993.<sup>41</sup> Both audits identified scope to improve administrative processes and enhance accountability for the program. The extent to which matters raised in the earlier audits remain pertinent are addressed in this report.

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<sup>35</sup> Sections 39A to 39V of the Act, inter alia, establish the framework for registering companies and assessing whether particular activities meet the definition of eligible R&D activity.

<sup>36</sup> Sections 73B to 73G of the Act, inter alia, establish the framework for determining the accuracy of deductions claimed under the Concession, and define eligible R&D activity.

<sup>37</sup> A body corporate incorporated under a law of the Commonwealth or a State or Territory. Partnerships or trusts are not eligible to claim the R&D Tax Concession.

<sup>38</sup> The Board is responsible to the Minister for Industry, Tourism and Resources.

<sup>39</sup> This includes \$40 million for the Premium Tax Concession (i.e. 175 per cent). *Tax Expenditures Statement 2002*.

<sup>40</sup> The Auditor-General Efficiency Audit Report, *Taxation concessions and grants for industry research and development schemes*, May 1989

<sup>41</sup> The Auditor-General, Audit Report No.12, Efficiency Audit, *Administration of the 150 per cent Taxation Incentive for Industry Research and Development*, 1993–94.

**1.18** The Standing Committee on Industry, Science and Resources held an inquiry into the effects on R&D of public policy reform in September 1999, which led to the National Innovation Summit in February 2000. The report of the Summit, *Innovation—Unlocking the Future* (August 2000), along with the Chief Scientist’s Report, *Chance to Change* (August 2000), recommended that a cash-out option be created for small to medium business and an incremental R&D Tax Concession rate for R&D over and above a company’s current level of expenditure. These two provisions have since been implemented (see Table 1.1).

**1.19** The House of Representatives Standing Committee on Science and Innovation is currently undertaking an inquiry into business commitment to R&D in Australia, which is due to report mid-2003.<sup>42</sup>

## This audit

### Audit objective and criteria

**1.20** The objective of this audit was to assess the Commonwealth’s administration of the R&D Tax Concession Program. The administration of the new provisions (paragraph 1.9–1.10) was not included in the scope of this audit, as they commenced on 1 July 2002.<sup>43</sup>

**1.21** The audit criteria involved the examination of:

- key governance arrangements;
- program performance and targets;
- customer service and information processes;
- processes for registration of eligible R&D activity; and
- management of tax expenditure claims.

### Audit methodology

**1.22** Audit fieldwork was undertaken in AusIndustry in Canberra, Melbourne and Adelaide, as well as in the ATO in Canberra and Adelaide. The ANAO interviewed officers of both agencies, reviewed files, documentation and management information processes to exchange information between AusIndustry and the ATO. The security and operating environment of the relevant information systems were also assessed.

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<sup>42</sup> House of Representatives Standing Committee on Science and Innovation: *Inquiry into Business Commitment to Research and Development in Australia*. The Standing Committee’s terms of Reference are outlined in Appendix 2.

<sup>43</sup> The new provisions apply to expenditure incurred in income years commencing after 30 June 2001.

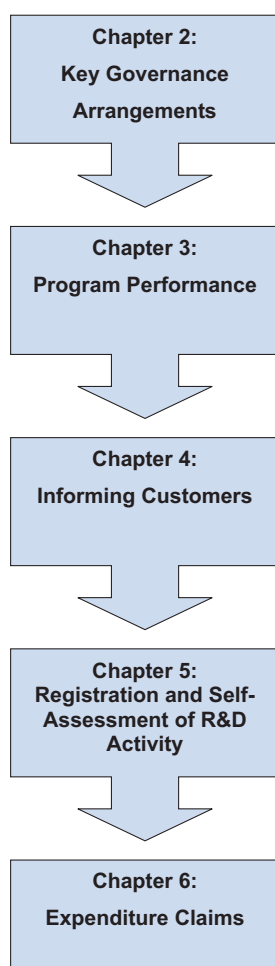
**1.23** A random sample of applications from the 1999–2000<sup>44</sup> year of registration was examined for integrity of registration processes, compliance monitoring and expenditure claims. Interviews were also conducted with industry stakeholders and customers.

**1.24** The audit was conducted in accordance with ANAO auditing standards at a cost of \$423 000.

## Report structure

**1.25** The audit findings are reported in five further chapters, as illustrated in Figure 1.3.

**Figure 1.3**



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<sup>44</sup> At the time the fieldwork was conducted, the 1999–2000 year was the most recent complete year of data available.

## 2. Key Governance Arrangements

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*This chapter assesses key program governance arrangements for agencies involved with the administration of the R&D Tax Concession.*

### Introduction

#### Program objectives

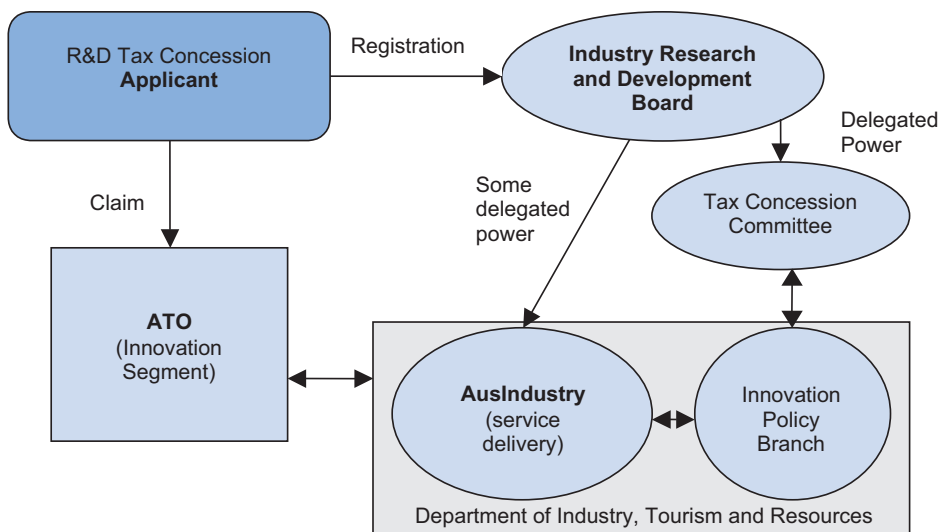
2.1 As discussed at paragraph 1.12, administration of the R&D Tax Concession is shared between the Industry Research and Development Board (the Board) and the Australian Tax Office (ATO) in accordance with their legislative responsibilities. This Chapter addresses the main governance arrangements for delivering the program, particularly in respect of:

- roles, responsibilities and accountabilities;
- strategic relationship management amongst the parties administering the Concession;
- risk management;
- managing perceived conflicts of interest;
- consultation with industry stakeholders; and
- exchange of information between AusIndustry and the ATO.

2.2 Performance management and outcomes are addressed in Chapter Three.

#### Roles, responsibilities & accountabilities

2.3 Clear roles, responsibilities and accountabilities are an important aspect of corporate governance, particularly where administrative arrangements are complex. The key administrative bodies, their responsibilities and relationship with Concession claimants are summarised in Figure 2.1.

**Figure 2.1****R&D Tax Concession administrative framework**

Source: ANAO from DITR information

**2.4 The Industry Research & Development Board (the Board)** is established under the *Industry Research and Development Act 1986*. The Board has 12 members appointed by the Governor-General. Board members are industry and research experts, most of whom are independent of Department of Industry, Tourism and Resources (DITR). As part of its responsibilities, the Board aims to promote the development of Australian industry and to improve the commercial success of research and development outcomes.

**2.5** The Board, which reports directly to the Minister, is responsible for registration of companies seeking to claim the Concession and assessment of the eligibility of R&D. The Board gives effect to these responsibilities by issuing guidelines covering the administration of the Concession. These guidelines outline the roles and responsibilities for the Board, the Tax Concession Committee and DITR.

**2.6** The **Tax Concession Committee<sup>44</sup> (TCC)** assists with the administration of the Concession under delegation from the Board.<sup>45</sup> Its delegated responsibilities include registration of companies wishing to claim the Concession, and assessment of the eligibility of R&D. The TCC also provides advice to the Commissioner of Taxation concerning the eligibility of activities for which the Concession is claimed.

<sup>44</sup> Members of the Tax Concession Committee are appointed by the Minister for Industry, Tourism and Resources.

<sup>45</sup> Under section 21 of the *Industry Research and Development Act 1986*.

**2.7 AusIndustry** is a division of DITR. It provides a single entry point for businesses seeking assistance to improve their competitiveness. AusIndustry provides the secretariat for both the Board and the TCC. In this capacity, it provides administrative support for the Concession, including customer information, service management of registrations and risk management. It also ensures conflict of interest guidelines are followed, and prepares reports for the Board.

**2.8 The Innovation and Industry Policy Division** of DITR is responsible for providing policy advice to Government. In this role it seeks the Board's views on policy matters.

**2.9** The relationship between AusIndustry and the Innovation and Industry Policy Division is managed through a Business Partnership Agreement. The Agreement contains performance expectations and measures for the Concession, consistent with the division of responsibility between program policy and program delivery.

**2.10** The **Australian Taxation Office (ATO)** is responsible for ensuring compliance with the Concession provisions of the *Income Tax Assessment Act 1936*. This includes determining the accuracy of deductions claimed under the Concession. Within the ATO, primary responsibility for administering the Concession rests with the Innovation Segment, which is part of the Large Business and International (LB&I) business line. Other segments within LB&I and the Small Business lines are also involved in the program's administration.

**2.11** The ANAO found that the above roles and responsibilities are clear and consistent with legislative responsibilities. The Board guidelines for administration of the Concession outline the policies and practices to be adopted by the Board, the TCC and AusIndustry. They provide a clear articulation of, and framework for, the roles and responsibilities for program administration. The ANAO also found that roles were well understood by the relevant parties, and that the department, the Board and the ATO acted consistently within their responsibilities.

## **Managing delegations**

**2.12** The Board has delegated many of its administrative powers under the *Industry Research and Development Act 1986* to its TCC and to AusIndustry officers (for example, the power to register a company for the Concession). The delegation of powers is revised at approximately six-monthly intervals, via a delegation instrument issued by the Chair of the Board.

**2.13** The ANAO found that, in general, the processes in place to manage the exercise of delegated powers were sound. There were some weaknesses—in particular some delegations were out of date and there were limitations in documentation of registration approvals. However, these have since been rectified.



**2.14** ATO delegations with respect to the Concession are managed as part of its overall process for managing ATO delegated authority. These delegations have been addressed in recent ANAO audits.<sup>47</sup> Broadly the audits found that the ATO has implemented nationally consistent delegations and authorisations and that the ATO has firm, centrally managed, guidelines and online information on its system of delegations.

## Strategic relationship management

**2.15** To assist in carrying out their joint and individual administrative responsibilities for the Concession, DITR, the ATO and the Board have established a written Memorandum of Understanding (MOU). The objective of the MOU is:

...to promote a free flow of relevant information between the ATO, the Board and DITR to facilitate the efficient and effective administration of the Concession.<sup>48</sup>

**2.16** This agreement is used by the agencies to define their roles, responsibilities, level of cooperation and interaction and administrative cooperation. It is seen as a high level 'facilitative' document by all parties. That is, it is not intended to be legally binding nor a Service Level Agreement with defined performance measures.

**2.17** The ANAO found that the MOU establishes a clear working framework for the arrangement between the parties; identifies relevant legislation and policies; describes security arrangements; and specifies the period of the agreement. Furthermore, the ANAO observed that the agencies cooperate well and that they comply with the provisions of the MOU.

**2.18** However, there are no criteria against which agencies could be measured for performing and addressing criteria set out or relationship management contained in the MOU. Nor does the MOU address, at a strategic level, joint risk management and corporate governance considerations.

**2.19** The current MOU is due for review by all parties. The ANAO suggests that as part of this review, the MOU be amended to incorporate the considerations discussed above, which would be consistent with the ATO's template for MOUs with other organisations. This would strengthen governance arrangements for the whole of the R&D Tax Concession program. Measurement criteria for the MOU might include assessing key matters addressed in the MOU, such as timeliness and quality of information exchange, extent of exchange of staff, and frequency of meetings.

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<sup>47</sup> ANAO Audit Report No.23, *The Management of Tax Debt Collection*, 1999–2000, p. 58, and ANAO Audit Report No.31, *Administration of Tax Penalties*, 1999–2000, p. 34.

<sup>48</sup> *MOU between the Industry Research and Development Board, the Department of Industry Science and Resources and the Australia Taxation Office concerning the joint administration of the R&D Tax Concession for Research and Development*, 2000, Provision 1.2.

## Recommendation No.1

**2.20** The ANAO recommends that the MOU between the IR&D Board, DITR and the ATO incorporate measurement criteria to enable reporting on the level of achievement of the objectives identified in the MOU, to better assist in the overall administration of the program.

### *ATO Response*

**2.21** Agreed. Discussions in connection with the review of the MOU have commenced and measurement criteria will be incorporated as appropriate.

### *DITR Response*

**2.22** Agreed. Negotiations on a new MOU have commenced and performance measures and reporting mechanisms will be incorporated where appropriate.

## Risk management

**2.23** Management of the Concession requires management of an array of risks, including whole of government considerations for a program involving administration by two separate agencies and an independent Board. The separate and joint approaches of the IR&D Board, AusIndustry and the ATO are discussed below.

### **IR&D Board/AusIndustry**

**2.24** The Board and AusIndustry risk management processes have identified the Concession as a high risk program due, in part, to its relative size and the self assessment nature of the Concession. A detailed strategy for risk management, including plans and sectional frameworks for implementation has been developed. The risk management policy for the Concession aims to minimise events that may adversely affect the encouragement of Australian industry undertaking more systematic R&D activities. This is achieved by minimising the likelihood and effect of risks which may adversely affect the efficient and effective provision of advice, information and delivery of the Concession.

**2.25** The ANAO found that steps for risk mitigation had been implemented, reviewed and updated since inception including, for example, better definitions of terms, information campaigns, review of the registration process, increased training and development of program guidelines. A scheduled review of the Risk Management Strategy for the Concession is due shortly.

**2.26** This risk management approach is supported by an R&D Tax Concession Compliance Framework. The framework addresses both statutory and non-statutory processes undertaken by AusIndustry in assisting the Board to ensure customers comply with the legislative requirements. It broadly identifies four main compliance monitoring and assessment activities for the Concession (discussed further at paragraph 5.21) namely:

- preliminary investigation;
- customer advisory visits;
- assessments of compliance with legislative requirements; and
- liaison with the ATO on matters that may affect claims for the Concession in company tax returns.

**2.27** Overall, the ANAO considers that strategic risk management is in line with the high risk rating of the program.

## **ATO**

**2.28** Risk management for the Concession takes place within the ATO's overall approach to risk management and compliance. This approach has been examined in previous ANAO audits.<sup>49</sup> Broadly, it involves each of the ATO business lines identifying and assessing major areas of risk, and establishing plans to manage those risks within available resources. As part of this approach, the ATO has adopted a structured approach to managing taxpayer compliance, known as the ATO Compliance Model.

**2.29** The Model acknowledges that the majority of taxpayers comply voluntarily with no need for the ATO to intervene. However, others will not comply in the first instance but will if prompted further. A small proportion will not comply voluntarily and may need enforcement action.

**2.30** The ATO considers that the risks attached to R&D expense allocation through self assessment are low. This is because, inter alia, the tax expenditure is a relatively small part (0.2 per cent) of the overall revenue base and because previous studies<sup>50</sup> have indicated companies' cost accounting systems to be reliable sources of expenditure for Concession purposes.

**2.31** Because of its low risk rating, the ATO has not undertaken a specific risk assessment for the program. Instead, risk management for the Concession forms part of the overall ATO risk management approach.

<sup>49</sup> ANAO Audit Report No.37, *The Use of Audit in Compliance Management of Individual Taxpayers*, 2000–01, and ANAO Audit Report No.27, *Risk Management of Individual Taxpayer Refunds*, 1999–2000.

<sup>50</sup> For example, a 1997 field work project testing expenditure claims from a sample of 10 companies with R&D claims under \$500 000 concluded that the compliance risk was 'minimal'.

## Whole of government risk management

2.32 The ANAO found that, individually, AusIndustry and the ATO manage their risk and compliance consistent with the above approaches and their separate responsibilities. In practice, AusIndustry has rated the Concession as relatively high risk compared with other risks facing the portfolio; whereas the ATO considers the Concession is relatively low risk.

2.33 Although both agencies have carried out detailed risk management analysis, planning and implementation, there is no means for systematic joint consideration of the overall risks associated with the program. In the absence of such joint consideration, assessment of risks and resulting management actions may be uneven across a program with shared management responsibilities.

2.34 The Joint Committee of Public Accounts and Audit (JCPAA) has previously commented on the need for improved accountability arrangements where there are shared outcomes between agencies.<sup>51</sup> There would also be merit in agencies with shared responsibilities having an agreed approach to ensuring risk management is complementary and adequate for the program as a whole.

2.35 Accordingly, the ANAO considers that risk management for the program would be strengthened by adopting procedures to jointly consider the risks of the program as a whole. With the review of the MOU due, it would be opportune to consider incorporating program risk management into the new arrangement. Any such arrangements need not be exhaustive, but fit for purpose to promote discussions regarding overall risk management.

## Recommendation No.2

2.36 The ANAO recommends that the ATO and DITR adopt procedures to jointly identify and address risks to the program as a whole. This process should be reflected in the MOU.

### *DITR Response*

2.37 Agreed. DITR and the ATO already cooperate through such mechanisms as formal six monthly liaison meetings, ATO attendance at Tax Concession Committee meetings, and joint participation in the Administration Consultative Group. A framework for joint risk management to provide greater context and strengthen these processes will be included in the new MOU.

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<sup>51</sup> Joint Committee of Public Accounts and Audit (JCPAA), *Report 388, Review of the Accrual Budget Documentation*, Canberra, 2002, p. iv.

## *ATO Response*

**2.38** Agreed. The ATO and DITR currently closely cooperate in assessing and treating R&D Concession risks. This is achieved through several avenues including bi-annual liaison meetings, R&D Concession Consultative Group meetings and the presence of an ATO officer at Tax Concession Committee meetings.

**2.39** In terms of compliance strategies, the ATO and DITR conduct the joint Top 30 program and the ATO actions compliance referrals from AusIndustry. There is also a systematic data exchange between the two departments to ensure that the Tax Concession is granted only to those taxpayers who have registered with AusIndustry. The ATO also undertakes industry customer risk reviews as part of its Large Client Program.

**2.40** The agencies will formalise the various elements of the framework for joint risk management of the program for inclusion in the revised MOU and will extend the framework to tax offset cases.

## **Managing perceived conflict of interest**

**2.41** The Board and the TCC membership is drawn largely from the private sector.<sup>52</sup> This provides the relevant commercial and technical expertise necessary when making decisions as to eligibility of R&D activity under the *Industry Research and Development Act 1986* (the IR&D Act). Inevitably, this means that many of these members have links to industry, so there will often be the risk of perceived or actual conflicts of interest arising that need to be managed. In addition, when administering the program, AusIndustry staff often have access to commercially sensitive and potentially valuable information, which needs to be addressed by appropriate administrative procedures.

**2.42** For the Board, the *IR&D Board Handbook* is the key means of providing conflict of interest guidelines and procedures. The handbook is supported by an induction course for Board and Committee members. The handbook provides details of:

- the statutory requirements for managing conflicts of interest in the *Australian Public Service Act 1999* are defined in the Code of Conduct, and all members are bound as statutory office holders;
- requirements under the IR&D Act for Board and Committee members to disclose at relevant meetings details of direct or indirect pecuniary interests, and for these to be recorded in the meeting minutes; and

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<sup>52</sup> There is an AusIndustry member on each body, and a representative of the ATO on the TCC as an observer. AusIndustry and ATO staff provide advice to the TCC as required.

- policies and procedures adopted by the Board on the registration of pecuniary interests, principles for determining materiality in relation to disclosure of interests, and meeting procedures to handle actual or potential conflicts of interest.<sup>53</sup>

2.43 These processes also apply to acting members and to members of the Board's Committees, such as the TCC. The ANAO found that they are implemented systematically, with support from AusIndustry.

2.44 AusIndustry has also recognised the need to strengthen and systematise its internal conflict of interest procedures. It has *Conflict of Interest Guidelines* for its employees, which address:

- legal responsibilities with respect to conflicts of interest;
- the meaning and occurrence of conflicts of interest;
- procedures for declaring a conflict of interest and considerations for assessing the materiality of the interest and any required action; and
- the requirement for an annual declaration that employees have not been involved in activities that constitute a conflict of interest.

2.45 Overall, evidence indicates that conflict of interest arrangements for the program are soundly based.

## Consultation with industry stakeholders

2.46 The value of consultation with stakeholders is recognised through a number of consultative mechanisms. For example, DITR and the ATO consult with stakeholders on specific issues, such as on the legislative changes in 2001. Stakeholders advised the ANAO that these consultations were effective in ensuring that the legislative outcome was workable for industry.

2.47 AusIndustry also markets the Concession and its requirements (see paragraph 4.4) and assesses customer satisfaction (see paragraph 3.11). However, until recently, consultation on administrative issues was ad-hoc. To address this concern, the ATO and AusIndustry established an R&D Tax Concession Administration Consultative Group in November 2001.

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<sup>53</sup> Board and Committee members prepare and lodge with the Secretariat a disclosure statement of known pecuniary (and other personal) interests of themselves and of their immediate family/spouse. If a Board or Committee member is aware of an actual or potential conflict of interest, pecuniary or otherwise, the member must advise the meeting prior to that item being discussed. To facilitate this, an early agenda is distributed and members disclose any interests prior to the meeting. When the particular agenda item is discussed during the meeting, the member leaves the room. Reports or information relating to the agenda item are not distributed to the member. The minutes of the meeting record the member declaring the interest; the nature of the interest; if it was judged material or immaterial by the Board or Committee; and the departure of members from the room. Discussions regarding the member's interest are deleted from the member's copy of the minutes.

**2.48** The Consultative Group has some 20 representative industry stakeholders, and aims to meet 2–3 times a year. It considers operational and administrative issues, such as the Concession application form, guidelines and changes in the delivery mechanism. Currently, the group meets in Sydney and Melbourne. It would be consistent with whole of government trends for enhanced Regional access to examine the potential to hold meetings in areas other than metropolitan Sydney and Melbourne. AusIndustry has advised that it will consider options for enhancing Regional access to the Consultative Group, but noted that major accounting firms are represented on the group, facilitating a wider coverage.

## Information exchange between agencies

### Exchange of data

**2.49** One of the key matters addressed by the MOU is the need for information to be exchanged between DITR and the ATO at officer level.<sup>54</sup> This is a key aspect of the joint administration of the program, and is necessary for both agencies to carry out their responsibilities effectively.

**2.50** The main information exchanges that occur are:

- the transfer of registrant data to the ATO. Previously this occurred via physical delivery of a CD,<sup>55</sup> but is now undertaken via a secure website. The ATO Innovation Segment have access to the data via help desk request; and
- information provided by AusIndustry necessary for further investigation by the ATO of those companies identified by AusIndustry as possibly high risk and requiring investigation.

**2.51** The ANAO found that some of the processes for these data exchanges were undocumented.<sup>56</sup> This raises the risk that data may be exchanged inaccurately, inadequately, or inappropriately. This can be a particular consideration where there is high staff turnover, which has been the case in the relevant area of the ATO. (In this context, ATO staff have requested AusIndustry Concession data outside of the data exchange process, notwithstanding the strict security requirements on the release of this data).

**2.52** Better practice in the exchange of data between databases includes mechanisms to provide assurance that the data loaded into the receiving database

<sup>54</sup> MOU, Provision 5.1 (ii) and Section 16 of the *Income Tax Assessment Act 1936*.

<sup>55</sup> Initiated by an email request from the ATO to AusIndustry's Information Management Group.

<sup>56</sup> Better practice documentation would include: roles and responsibilities; sequence of events; timing; permanency of import file storage on the ATO network; CD handling, storage and destruction procedures; and contact list.



matches the data initially extracted. This is facilitated through use of 'batch control totals' that include, for example, the number of records and arithmetic totals of numeric columns. However, AusIndustry did not supply batch control totals to the ATO. Further, while the ATO had some procedures for testing the data after loading into the ATO databases, these were undocumented. No record of the success or failure of these tests was kept to verify the data. Strengthening data transfer procedures would provide greater assurance of the integrity of the data transferred.

### Recommendation No.3

2.53 The ANAO recommends that data exchange processes between AusIndustry and the ATO be agreed, documented and tested and include processes that confirm the integrity of the data transferred (e.g: batch control totals).

#### *DITR Response*

2.54 Agreed. The main data exchange process between AusIndustry and the ATO, the secure web site, has been agreed, documented and tested. AusIndustry will enhance procedures related to the approval and recording of the informal exchange of information with the ATO. Batch control totals have been developed, tested and documented for the secure web site, and are now in production.

#### *ATO Response*

2.55 Agreed. Secure processes for data exchange with AusIndustry have been agreed and documented between the ATO and AusIndustry. The ATO has already implemented its part of the joint processes. These processes include appropriate batch controls to ensure all records are accounted for.

### Security protocols

2.56 The Concession data provided by AusIndustry is stored on a shared network drive at the ATO. This is referred to as the client/server TaxLAN environment. As noted in a previous ANAO audit, the ATO's IT security policies do not adequately address the sharing of data on the wide area network.<sup>57</sup> In response, the ATO is developing—revised IT security policy and procedures to address storage of data outside of its mainframe environment. This is an ongoing process.

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<sup>57</sup> ANAO Audit Report No.16, *Australian Taxation Office Internal Fraud Control Arrangements, 2000–01*, pp 78–79 and Recommendation No.6.



**2.57** At the time of the audit, Concession data stored at the ATO was not subject to application level access controls, nor was it password protected. Consequently, there is a risk that data is vulnerable to unauthorised alteration, which the ATO is currently unable to detect. The ANAO suggests that ATO's revised security policies address this through, for example, introducing access controls to the databases; and storing copies of the databases in separate network drives.

# 3. Program Performance

*The importance of aligning targets and outcomes to the overall program performance and the requirement of accurate data used in calculating tax expenditure by the Commonwealth are discussed in this chapter.*

## Introduction

**3.1** Accountability frameworks are critical to measure and assess program performance, allowing for timely corrective action to be implemented, where necessary. Performance information supports this, by providing a basis for measuring and assessing program performance against government, agency and customer expectations.

**3.2** This Chapter assesses the performance information framework for the Concession and the underlying results to date.

## DITR performance measurement of outputs/outcomes

**3.3** The R&D Tax Concession contributed to DITR Outcome 2: ‘Enhanced economic and social benefits through a strengthened national system of innovation’ for 2001–02 (the most recent year for which data were available). The performance indicators for this Outcome and associated Output 2.3 for the year are presented below.<sup>58</sup>

**Figure 3.1**

**Performance information Outcome 2 & Output 2.3  
Outcome 2, research and development**

<i>Indicator</i>	<i>Measure</i>
1. <i>Trends in business expenditure on R&amp;D</i>	1. <i>Annual Change in ABS data on business expenditure on R&amp;D</i>
2. <i>Trend in Industry IR&amp;DB programs</i>	2. <i>Number of registrants for the Tax Concession</i> 3. <i>Demand for start grants and loans</i> 4. <i>Take-up of the IIF; and</i> 5. <i>Take-up of Commercialising Emerging Technologies (COMET)</i>

Note: measures 3, 4 and 5 do not apply to the R&D Tax Concession

<sup>58</sup> Industry, Science and Resources Portfolio, *Portfolio Budget Statements 2001–02*, p. 61 & p. 64.

## Output 2.3, Innovation program implementation & management

<i>Indicator Category</i>	<i>Measure</i>
1. Quantity	1. Number of customers assisted 2. Estimated dollar value of Concessions delivered
2. Quality	3. Key processes completed within time target 4. Customer satisfaction * Service by staff; and * Overall service delivery.
3. Cost Performance	5. Service per firm assisted

Note: There were some changes to these indicators for 2002–03 (*Portfolio Budget Statements 2002–03*). The outcome indicator for that year includes 'increased Australian business investment in R&D'. 'Customer satisfaction' is not an output measure for the year.

3.4 The ANAO found that the agency measures its performance against these indicators, and reports the results in detail to internal management Committees. However, public reporting in the Annual Report for some indicators is aggregated.

3.5 The performance indicators associated with the Concession for 2001–02 were:<sup>59</sup>

- trends in the number of registrants and value of registrations;
- trend in the BERD;
- timeliness of key processes;
- customer satisfaction; and
- cost of service delivery.

3.6 These measures are regularly reported to senior management in relevant performance reporting, and to the Parliament through annual reporting. There are no standards or targets associated with these indicators, apart from the timeliness standard. DITR advised, in response to the draft audit report, that it was not considered appropriate to establish a target for increased R&D because business R&D depends on a multiplicity of factors and only a few of these are influenced by government policies.

3.7 Trends in business expenditure on R&D have been discussed at paragraph 1.2. The other key performance indicators (KPIs) are discussed below, along with some additional performance information on the program.

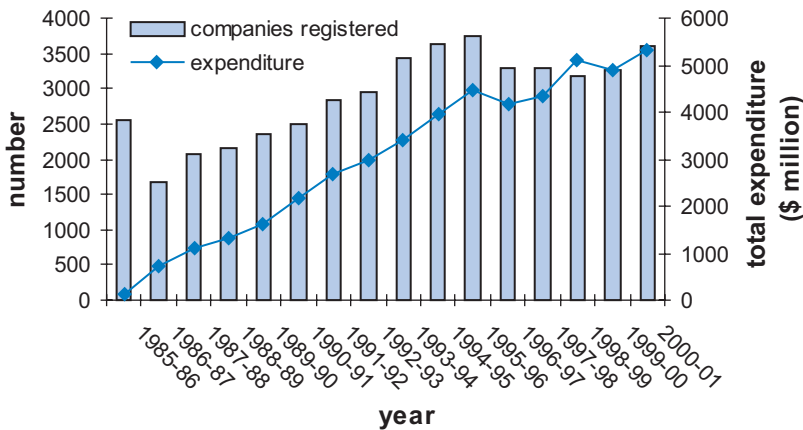
<sup>59</sup> Industry, Science and Resources Portfolio, *Portfolio Budget Statements 2001–02*, p. 61 to p. 64.

## Number and value of registrations

3.8 R&D registrations and associated reported expenditure increased steadily up to 1996 (see Figure 3.2). Due to changes in the concessional rate and the removal of access to syndication in 1996, there was a fall in registrations for a few years. DITR expect that the newly introduced 175 per cent premium rate and the tax offset (see Table 1.1) will lead to further increases from 2001.

**Figure 3.2**

### Registration applications 1985–86 to 2000–01



Source: AusIndustry

## Timeliness

3.9 The AusIndustry Customer Service Charter sets a target of 30 days for decisions to be made on registration of applications, where all relevant material is supplied by the applicant. AusIndustry performance data indicates that, in 2001–02, prima facie, 85 per cent of applications met the target.

3.10 However, the 15 per cent of applications that apparently failed to meet the target include applications that were incomplete. The target does not apply in these cases since delay is caused by the customer. Allowing for this, the ANAO estimates that 5 to 10 per cent of properly completed applications did not meet the target of 30 days.

## Customer satisfaction

3.11 AusIndustry has assessed customer satisfaction through a customer survey. This indicates an overall satisfaction rate for AusIndustry management of the program of 60 per cent; 32 per cent were neither satisfied nor dissatisfied; and 8 per cent were dissatisfied. Further analysis by AusIndustry suggested

that key drivers in satisfaction were professionalism in dealing with customers, staff's knowledge of the program, adequacy of information supplied about requirements and other relevant services.

**3.12** The AusIndustry customer satisfaction survey also sought to identify where improvement in delivery processes was required. Following the survey, AusIndustry developed an action plan to identify specific actions to deal with the issues raised by customers. The action plan sets out priorities, proposed action, performance measures, officer assigned responsibility and a milestone and/or completion date. The AusIndustry Executive Committee received quarterly reports on progress against the action plan.

**3.13** The ANAO found that AusIndustry has implemented the action plan. As a result, substantial progress has been made to improve customer service delivery. Actions taken include updating the website, staff training, establishment of an Administrative Consultative Committee<sup>60</sup> and revision of the registration form.

**3.14** The customer survey was undertaken in 2001. AusIndustry has advised that it intended to repeat the survey annually. However, this had not occurred due to a lack of resources. AusIndustry advised, in response to the draft audit report, that it was undertaking a new survey in March 2003.

**3.15** Customer satisfaction results and subsequent actions are discussed further in Chapter 4.

### **Cost of service delivery**

**3.16** The total cost of administration of the program by AusIndustry and the ATO is estimated at \$10.2 million (see Figure 3.3). AusIndustry's major administration costs relate to the registration process and monitoring of compliance with legislative requirements. The ATO's major administrative costs relate to the Innovation Segment.<sup>61</sup>

**3.17** AusIndustry has recently introduced time-based costing. This is expected to produce a more reliable cost estimate in future.

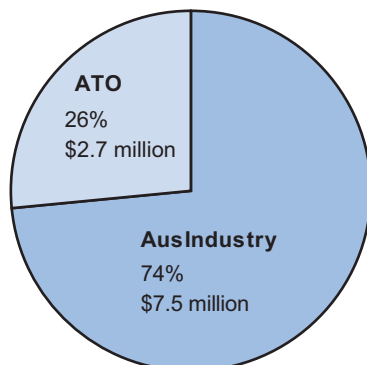
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<sup>60</sup> In November 2001, the ATO and AusIndustry established an R&D Tax Concession Administrative Consultative Committee in order to consult with stakeholders on operational and administrative issues.

<sup>61</sup> Innovation Segment costs are estimated by the ATO at \$2 million. Relevant non-Innovation Segment costs are estimated at \$0.7 million.

**Figure 3.3**

**Administration cost of the Concession 2001–02**



Source: AusIndustry and ATO

**Other key performance measures**

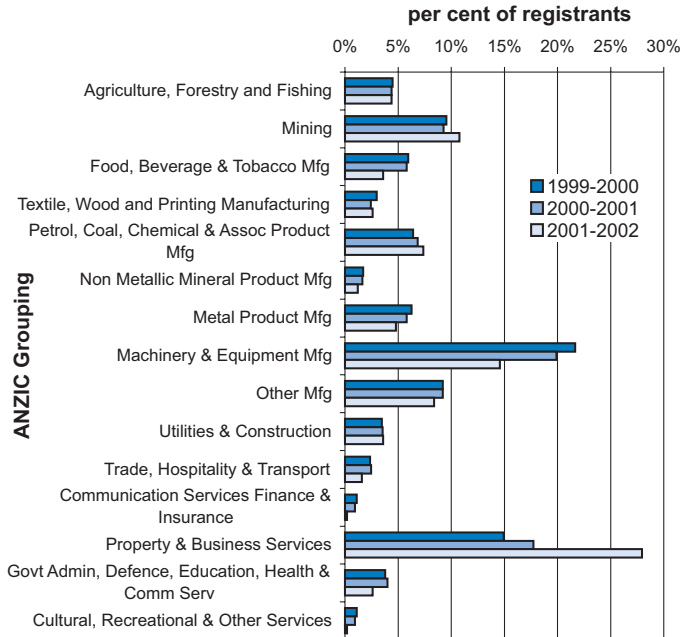
**3.18** In addition to the above performance measures, internal performance and management information are produced by AusIndustry and DITR. These include a detailed Operations Report provided by the AusIndustry to the TCC. As well as the above measures, the report addresses the results of AusIndustry risk assessments and industry sector coverage. In addition, AusIndustry provides KPI reports to the Board on a quarterly basis.

**Characteristics of Concession claimants**

**3.19** The Concession is accessed by companies across a wide range of industries (see Figure 3.4). The mining, machinery and equipment manufacturing, and property and business services sectors account for over 50 per cent of registrants in 2001–02.

**Figure 3.4**

**Tax Concession registrants by industry<sup>62</sup> 1999–2000 to 2001–02<sup>63</sup>**

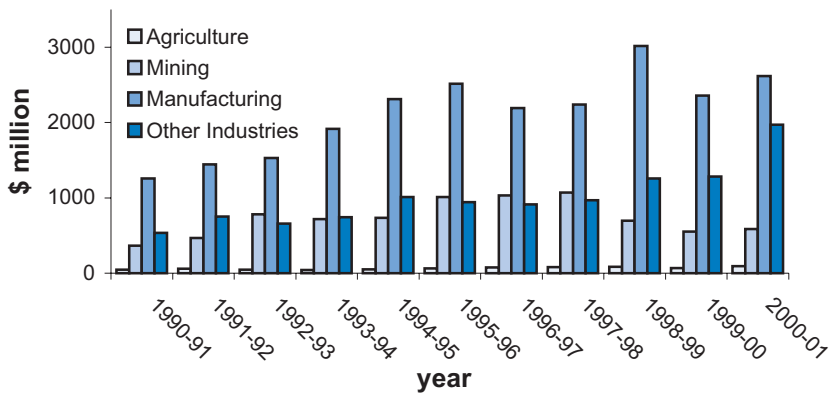


Source: AusIndustry

3.20 As indicated by Figure 3.5, manufacturing industries account for a large amount of R&D expenditure by registrants.

**Figure 3.5**

**Sectoral distribution of R&D expenditure by Tax Concession registrants 1990–91 to 2000–01**



Source: AusIndustry

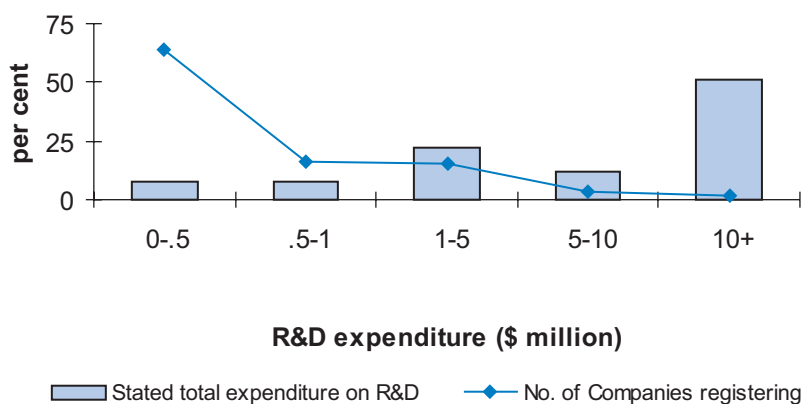
<sup>62</sup> Industry Codes are the ANZSIC Code. ANZSIC is the coding system maintained by the Australian Bureau of Statistics to collect data and provide statistical information about industry.

<sup>63</sup> Part year.

3.21 Concession claimants vary by size. Twenty five per cent of Concession registrants, in 2000–01, nominated their turnover to be less than \$500 000 and 56 per cent less than \$5 million. On the other hand, large companies with turnover of over \$50 million and above represented 17 per cent of the total.

3.22 As represented in Figure 3.6, 64 per cent of companies registering for the Concession advised their R&D expenditure would be less than \$500 000, representing 8 per cent of the total expected R&D. Only 3 per cent of registrants indicated expenditure over \$10 million, but this represents 51 per cent of the total expected R&D expenditure.

**Figure 3.6**  
**Registrations by expenditure 2000–01**



Source: AusIndustry

## ATO performance framework

3.23 The ATO measures performance against its Outcome 1: ‘Effectively managed and shaped systems that support and fund services for Australians and give effect to social and economic policy through the tax system’,<sup>64</sup> and reports on this in its Annual Report. The Concession is one element of the Large Business and International (LB&I) business line Output/Outcome framework, which in turn contributes to the ATO Outcome. At the macro level, the ATO does not have specific performance indicators on the Concession. However, at the micro level, its Innovation Segment is responsible for implementing a plan which includes some performance indicators for the Concession.<sup>65</sup>

<sup>64</sup> ATO Annual Report 2002, Part 2 p. 56.

<sup>65</sup> See Appendix 3.



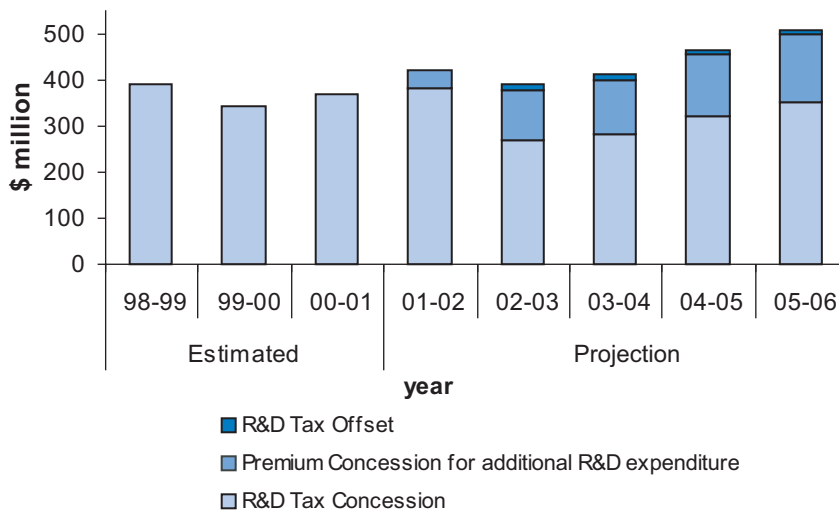
3.24 The Innovation Segment, which has primary responsibility for the Concession in the ATO also, has an internal management report which covers emerging issues relating to the Concession as well as segment activities such as legislation development, risk assessments, syndication audits, compliance activity and rulings.

### Cost of tax expenditure

3.25 The estimated cost of the R&D Concession (including Premium Concession), as a tax expenditure, was \$420 million in 2001–02. It is estimated to be a total of \$390 million in 2002–03.<sup>66</sup> Figure 3.7 represents in detail the Tax Expenditure Statement for 2002 for the years 1998–99 to 2005–06.

**Figure 3.7**

#### Estimated cost of R&D Tax Concession



Source: *Tax Expenditure Statement, 2002*

3.26 This cost is estimated by the Treasury using data provided by the ATO. The accuracy of this data is discussed further at paragraph 6.33.

<sup>66</sup> Treasury, *Tax Expenditure Statement 2002*. Includes the newly introduced premium of 175 per cent for longer term investment in R&D within Australia, and the R&D refundable tax offset for small companies.

## Strengthening performance measurement

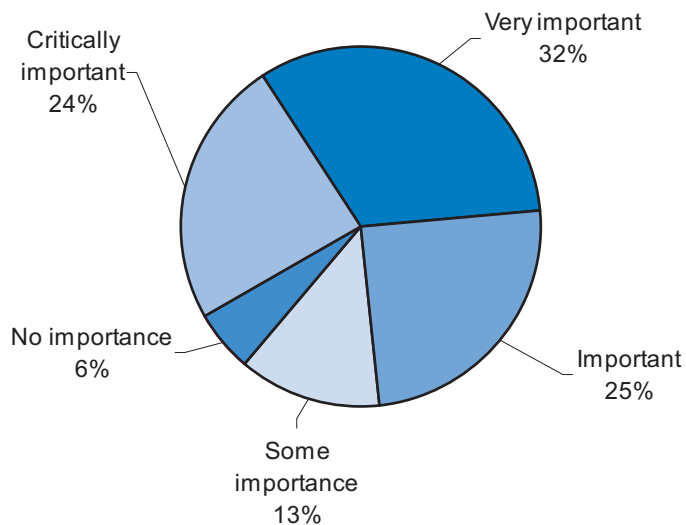
3.27 The JCPAA has recommended that a lead agency should be identified where agencies have a shared outcome.<sup>67</sup> Effectively, the IR&D Board, supported by DITR, has this lead role as it undertakes performance reporting for the program. Limitations in ATO data on actual claims as tax expenses mean that its data is of limited value for performance reporting purposes (see paragraph 6.36).

3.28 The ANAO notes that the performance indicators described above primarily focus on inputs and outputs, rather than providing direct assessment of the effect of the Concession in increasing investment by eligible companies in defined R&D, a key objective of the program.

3.29 DITR conducted an evaluation of the Program in 2000 which included a survey of companies that were registered, or had been registered, for the Concession.<sup>68</sup> The survey found that the Concession is an important influence on R&D activity for a large number of firms, but was unable to quantify the extent to which the Concession acted as an inducement to increased investment in R&D (see Figures 3.8 and 3.9). The ANAO suggests that, in future, there would be merit in such analysis also addressing the characteristics of companies for which the Concession is highly influential.

**Figure 3.8**

### Influence of the Concession on R&D expenditure of registrants

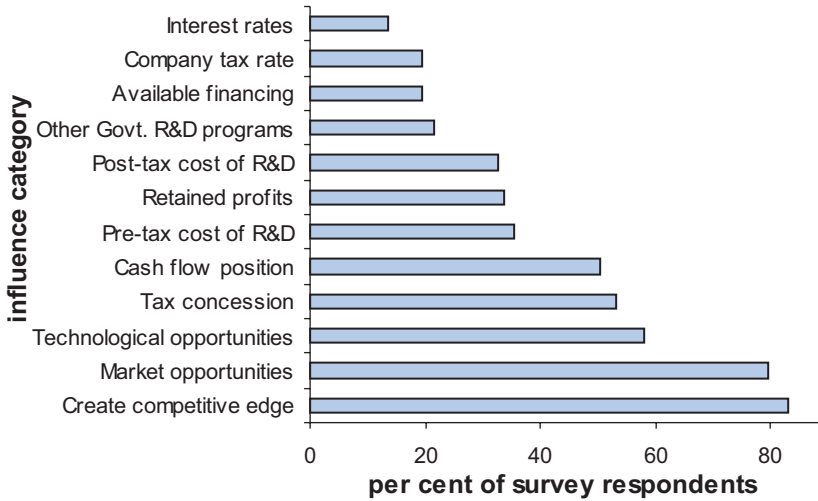


Source: AusIndustry

<sup>67</sup> Joint Committee of Public Accounts and Audit, *Report 388, Review of the Accrual Budget Documentation*, Canberra, 2002

<sup>68</sup> Total survey target was 2700. There was a 30 per cent response to this survey.

**Figure 3.9**  
**Influences on R&D expenditure<sup>69</sup>**



Source: AusIndustry

3.30 ANAO discussions with Concession recipients also indicated that the Concession is important in making strategic decisions to conduct R&D in Australia, but that it is one of a number of considerations taken into account in deciding to undertake a particular R&D project.

3.31 In order for DITR to report more thoroughly and accurately on the influence of the program on long-term investment in R&D in Australia, it would be desirable to include in KPIs some means of assessing the impact of the Concession. DITR has advised that it is drafting new departmental performance indicators, as part of the *Backing Australia's Ability* statement, to enhance assessment of their innovation programs, including for the Concession. It further advised, in response to the draft audit report, that the higher order objective of inducing additional R&D as a result of the program is a longer term indicator; this will be measured through a survey of industry as part of evaluation. The ANAO considers that, if the effectiveness of the Concession in meeting the objectives is to be reliably assessed through a survey, a response rate of more than 30 per cent is necessary (see paragraph 3.29 and footnote 68).

<sup>69</sup> Figure 3.9 shows the proportion of firms that rated the identified influences as very or critically important.

## 4. Informing Customers

*This chapter discusses the quality and accessibility of information available to customers about the R&D Tax Concession.*

### Introduction

4.1 Customer-focussed organisations manage customer expectations by ensuring that they are provided with information as to what the organisation can or will deliver. Customer dissatisfaction can be minimised when information about the products or services are clearly communicated to customers.<sup>70</sup>

4.2 AusIndustry has developed a customer focus as part of its new arrangements to be the principal delivery agency for business assistance programs. Underpinning this focus are the AusIndustry Customer Focus Principles, which became part of the 2000–01 Business Plan. The values, which drive this focus, are outlined in Table 4.1.

**Table 4.1**

#### **AusIndustry’s customer service values**

<b>Understanding</b>	We understand and have a genuine interest in our customers and their business—from their perspective, ‘know me, know my business’. We tailor our services to meet their circumstances.
<b>Professionalism</b>	We are professional and objective, always demonstrating integrity. We are knowledgeable in all our products and services, provide accurate and clear information, and give sound advice.
<b>Confidentiality</b>	We understand and respect the confidentiality of our customers’ information.
<b>Transparency</b>	Our processes are clear, consistent and easy to access. Customers always know where they stand, and why.
<b>Responsiveness</b>	We meet agreed time frames, and follow up all queries. Customers see us as accessible—through phone, fax, e-mail and visits—they don’t get the ‘run around’.

Source: AusIndustry

4.3 AusIndustry has sought to integrate this focus into the delivery of the Concession, through identifying customer needs; informing customers about the program and eligibility criteria; and delivering quality customer service.

<sup>70</sup> ANAO Audit Report No.25, *Customer Service*, 1996–97.

## Promoting the R&D Tax Concession

4.4 AusIndustry is responsible for marketing the Concession, along with approximately 30 other business assistance products and services of the department. Marketing of the Concession takes place under a National Marketing Strategy, which seeks to maximise the opportunities for Customer Service Managers (CSMs) in each AusIndustry Regional office to attract customers into the various programs. Each AusIndustry State office also has a marketing strategy linked to the national strategy.

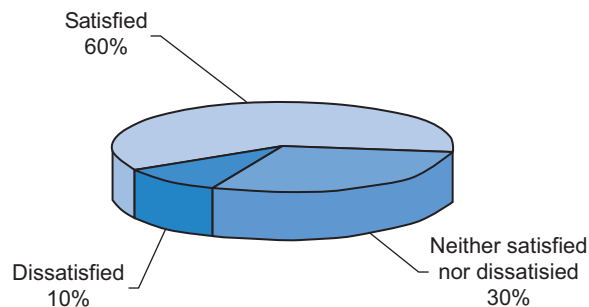
4.5 AusIndustry's market research has found that the target audience for its products and services is diverse. There is no simple demographic indicator that identifies potential eligible AusIndustry customers from the approximately 1.3 million business customers in Australia. Consequently, AusIndustry products are not marketed individually. Rather, the products are grouped to target industry sectors and business needs. The groups comprise: innovation, venture capital, general industry incentives, industry-specific incentives and information services.

4.6 The Concession is marketed under the Innovation group of products. Using a variety of media, the Concession has been promoted, over the last three years, consistent with the national strategy, including: media releases, sponsorship and strategic partnerships, advertising on radio, industry publications and newspapers, merchandising and promotional events.

4.7 However, the 2001 AusIndustry customer satisfaction survey (see paragraph 3.11) found that, while the majority of customers were satisfied with the level of promotion of the Concession program, 10 per cent were dissatisfied (see Figure 4.1). The survey responses indicated that promotion of the program should be better targeted; that more information should be available on other programs; and that seminars be used more effectively to promote the program.

**Figure 4.1**

### Customer satisfaction with promotion of the program



Source: AusIndustry

4.8 In response to these findings, a new Marketing Plan was implemented in 2001–02 to better target and promote the Concession.<sup>71</sup> Advertising is now targeted at industry-specific publications and further customer information seminars have been held.

## Informing customers about eligibility criteria

4.9 AusIndustry and the ATO have developed a number of tools to communicate to potential customers information about the Concession, eligibility requirements and processes to register for, and claim, the Concession.

4.10 A joint AusIndustry and ATO publication, *The Guide to R&D Tax Concession*, provides comprehensive information about the program, including the definition of R&D, eligibility issues and monitoring of the program.

4.11 The AusIndustry website is also a key source of information about the Concession. The website contains the guide, a shorter version of the guide which communicates the key elements of the Concession, as well as Board guidelines, taxation rulings and relevant legislation. The website also has links to fact sheets, registration forms, media releases, information bulletins and success stories.

4.12 The ATO and AusIndustry also run joint seminars to inform customers of changes to the Concession and consultants attend these seminars. (Industry commonly uses consultants and accountants to provide expert advice to business on the Concession). Customers attending these seminars have mostly been satisfied with their content and relevance (see Table 4.2).

**Table 4.2**

### Customer satisfaction with ATO/AusIndustry seminars

	Understanding content (per cent)	Relevance to needs (per cent)	Sufficiency of information (per cent)	Effectiveness of presentation (per cent)	Average (per cent)
<b>Good</b>	89	87	78	81	84
<b>Average</b>	11	9	20	17	14
<b>Poor</b>	0	4	2	2	2

Source: AusIndustry

4.13 The above sources of information are supplemented by a newsletter, published six times a year by AusIndustry, which is mailed out to regular customers of the Concession. There is also an AusIndustry hotline number for customer enquiries. As well, the ATO provides Concession eligibility information with company tax returns.

<sup>71</sup> Approximately \$160 000 will be spent on marketing the Concession in 2002–03, specifically to promote the 175 per cent premium and offset options.

**4.14** The AusIndustry customer satisfaction survey showed that 90 per cent of respondents considered that information about the program was readily available. Customers were generally satisfied with the quality of information available (70 per cent rating), with customers most often accessing the information bulletins.

**4.15** Stakeholders consulted by the ANAO confirmed that they found the information disseminated by AusIndustry valuable. However, some were not aware of the extent of the availability of information.

## TaxRED

**4.16** Another key means by which customers are informed of the requirements of the Concession is the R&D Tax Concession Regional Delivery Strategy (TaxRED). TaxRED has two key purposes: providing information to customers and improving compliance.<sup>72</sup>

**4.17** Once a customer has registered for the Concession with the Board (through AusIndustry), the customer may be identified for a TaxRED visit or desk review by a CSM from a Regional office of AusIndustry. The objectives of TaxRED are outlined in Table 4.3.

**Table 4.3**

### TaxRED objectives

<ul style="list-style-type: none"> <li>• To achieve contact with customers as early as possible in the life of its R&amp;D activity.</li> </ul>
<ul style="list-style-type: none"> <li>• To expand customers' knowledge of the R&amp;D Tax Concession:               <ul style="list-style-type: none"> <li>— to assist customers with self assessment under the program; and</li> <li>— of AusIndustry and its other products.</li> </ul> </li> </ul>
<ul style="list-style-type: none"> <li>• To give customers as much certainty as possible regarding the outcomes of their R&amp;D Tax Concession claim.</li> </ul>
<ul style="list-style-type: none"> <li>• To improve compliance in a non-adversarial way which supports self assessment through:               <ul style="list-style-type: none"> <li>— establishment of a visible presence, achieved through wide visit/contact coverage;</li> <li>— advice, education, and negotiation; and</li> <li>— risk-screening based on knowledge of the customer.</li> </ul> </li> </ul>
<ul style="list-style-type: none"> <li>• To ensure that decisions are made quickly, are made as close to the customer as possible, and are made by the AusIndustry officers who know the customer best.</li> </ul>

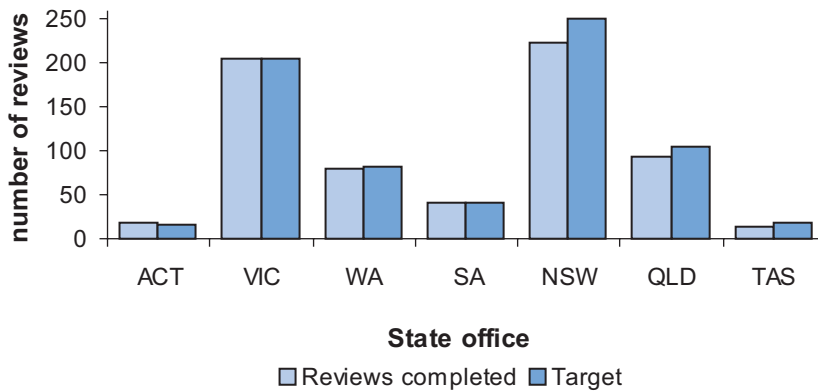
Source: AusIndustry

<sup>72</sup> The compliance monitoring aspect of TaxRED is discussed in Chapter 5.

## Meeting TaxRED objectives

4.18 AusIndustry had an overall target of 720 TaxRED reviews in 2001–02 and achieved 94 per cent of the target. The ANAO found that offices with CSMs dedicated to delivering the Concession have been more effective at meeting their quota than offices that have CSMs handling several programs at once. As demonstrated in Figure 4.2, the ACT and Victoria are in the former category, whereas Tasmania and NSW distribute Concession work amongst its CSMs, who also deliver other programs.

**Figure 4.2**  
**TaxRED targets 2001–02**



Source: AusIndustry

4.19 Customers who had received a TaxRED visit had higher overall satisfaction with the program (79 per cent compared with 60 per cent overall), suggesting that direct customer contact was beneficial in improving service delivery. ANAO observations of TaxRED visits also indicated that the process was useful in assisting customers gain assurance about the accuracy of their claims.

4.20 Industry stakeholders advised that AusIndustry has made a concerted effort to improve customer service. It has adopted a constructive approach to industry, without compromising the integrity of the program.

## ATO customer satisfaction

4.21 The main interface with customers of the Concession is through AusIndustry, using initiatives such as TaxRED. Expenditure claims for the Concession are received from companies as part of their company tax return. Consequently, specific assessment of customer satisfaction through the ATO is not undertaken.



**4.22** The ATO does not collect customer satisfaction data specifically in relation to the Concession program. At a higher level, however, the ATO has conducted focus groups<sup>73</sup> with representatives of large corporations and tax advisers, to evaluate the performance of staff in the LB&I business line in achieving professional standards of service, as articulated in the Taxpayers' Charter and Agency Agreement.

**4.23** A summary of the qualitative results is illustrated in Table 4.4 below.

**Table 4.4**  
**ATO focus group results**

Issue addressed	Summary of results
<b>Overall perceptions of the ATO</b>	Mixed views, positive views more prevalent amongst Sydney companies, negative views more pronounced in Melbourne. Proactive initiatives by ATO appreciated, favourable feedback on industry forums conducted by ATO. Some concern over lack of commercial understanding of business, ATO over-cautious/risk averse.
<b>Contact/Interaction with the ATO</b>	Feedback about Key Customer Managers (KCMs) very favourable. LB&I specialists highly regarded.
<b>Professionalism ratings</b>	ATO staff other than KCMs rated less favourably. Negative results with regard to ATO as an organisation. Dissatisfaction related to helping to minimise compliance costs, understanding the needs of business, and building supportive relationships.
<b>Sources of information/communication</b>	ATO website rated very favourably. Customers prefer personal interaction rather than email as a form of communication. Industry forums rated favourably.
<b>Some suggestions for future initiatives</b>	Expand role of KCMs, expand the ATO website, empower mid-level staff, consider trial runs for complex policy/legislative changes.

Source: ATO

**4.24** Feedback from customers consulted by the ANAO indicated that there were concerns that the introduction of a schedule, to be attached to the company tax return form for claimants of the Concession, would increase the burden of compliance. AusIndustry and the ATO are currently negotiating streamlining the process for the registration form and the schedule in order to address this concern. A joint working group, including the Australian Bureau of Statistics, will examine the feasibility of harmonising and reducing data collected (see paragraph 5.15).

<sup>73</sup> Most recently in June 2001 in Sydney and Melbourne.

# 5. Registration and Self-Assessment of R&D Activity

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*This chapter assesses the key elements of AusIndustry's administration of the R&D Tax Concession including registration procedures, compliance activities, and supporting systems.*

## Introduction

**5.1** Registration of R&D activities with the Board under section 39J of the *Industry Research and Development Act 1986* is a legal prerequisite for companies intending to claim the Concession. An 'eligible company'<sup>74</sup> must register in respect of R&D activities carried out by the company for each year of income in which the R&D expenditure is incurred.<sup>75</sup> It must spend over \$20 000 on R&D in the year, unless the R&D is contracted to a Registered Research Agency.<sup>76</sup>

**5.2** Once registration is granted, it cannot be revoked. However, the Board may, under a separate power of the Act, subsequently determine that some activities do not meet the definition of eligible R&D activities, in which case the Concession cannot be claimed for these activities.

**5.3** Applications must be lodged within 10 months of the end of the company's income year. Advance registration is available for three years, which is designed to give certainty to companies involved in long-term projects. However, companies must also continue to register annually.

## Purpose of registration and information collection

### Purpose of registration

**5.4** The formal stated purpose of enabling the Board to register or not register companies for the Concession is:

...to reduce the incidence of companies being required to reimburse tax benefits subsequent to a tax audit, the Bill empowers the Board to refuse to register a

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<sup>74</sup> A body corporate incorporated under a law of the Commonwealth or a State or Territory.

<sup>75</sup> Registration by the IR&D Board under section 39J of the IR&D Act does not mean, and should not be taken to imply, that either:

- all or any of the activities described in the application are necessarily eligible research and development activities for the purposes of the Concession; or
- expenditure incurred in relation to the described activities will necessarily qualify for the Concession.

<sup>76</sup> An RRA is an organization approved by the IR&D Board which is capable of performing contracted R&D, on one or more classes of research activity, on behalf of eligible companies, or through a group of companies who have entered into an collaborative arrangement.

company if the activities cited in the application for registration are not R&D activities or for such other specified reasons as may be within the Board's authority to determine.<sup>77</sup>

**5.5** Notwithstanding this statement, AusIndustry and the Board do not verify each activity. A company is registered if it is an 'eligible company'. Thus, registration is essentially a self assessment process.

**5.6** In practice, one of the main purposes of registration is to provide AusIndustry with its main source of statistical information. This information is used for its compliance activity and is the basis for program performance information (see Chapter 3).

## **Use of information collected**

**5.7** At the time of the audit, registration processes for the Concession required all companies to supply a considerable amount of information as part of their application. As well as information contained in the main body of the application form, such as company turnover and staffing, it was a requirement to complete a schedule summarising R&D activities. Larger registrants were required to complete a schedule of more detailed information on the R&D activities. Appendix 4 outlines the information required. In some cases, the schedules could run to several hundred pages of detailed documentation.

**5.8** However, the ANAO found that there were limitations in the accuracy of the information entered onto the AusIndustry information system (see paragraph 5.18), and the latter schedule was not entered at all.

**5.9** In practice, AusIndustry has made little use of the registrants' application information to determine whether or not compliance activities will be undertaken (see paragraph 5.26 for selection methodology). The information contained in the schedules is used when staff undertake compliance activity; around 25 per cent of AusIndustry customers are selected for compliance activity each year.

**5.10** Some registration information is used for performance information purposes. However, only a small part of it is actually used for this purpose. As discussed in Chapter 6, there may be alternative sources such as the recently introduced schedule required by the ATO.

**5.11** In this context, the ANAO notes that the average time reported by companies to complete the registration application was 34 hours.<sup>78</sup> The full costs

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<sup>77</sup> *Research and Development Legislation Amendment Bill 1998* - Explanatory Memorandum paragraph 4.

<sup>78</sup> These estimates are indicative only, since they are based on a the time box on the form, which is completed by only 15 per cent of customers. The average time was 34 hours, although the distribution was skewed—50 per cent taking five hours or less and 10 per cent taking 60 hours or more. Time boxes were introduced in 2001 and the study was undertaken in 2002.

associated with registration and claiming of the Concession also involve maintenance of information, and other compliance costs for the claimant. An AusIndustry survey of Concession registrants found the average compliance cost to be 3.4 per cent of R&D expenditure.

**5.12** The ANAO concluded that there would be benefit both in confirming what data is needed for program administration, and considering alternative and less DITR effort and customer-costly means of obtaining information required to manage the program.

**5.13** In response to the draft audit report, DITR advised that it considers that registration is important for:

- maintaining the integrity of the Tax Concession, especially in preventing the practice of 'grave-digging' by limiting the time frame for companies to identify claimed R&D;
- as a mechanism for drawing companies' attention to the requirements of the Tax Concession in a self assessment environment, to reduce the possibility of erroneous claims;
- enabling AusIndustry to readily and speedily identify its customers to enable information and advice to be provided to them; and
- allowing the collection of detailed data at the company level for compliance monitoring purposes, performance reporting and policy analysis.

**5.14** However, there has been action since the audit to reduce the cost burden of information provision at registration. DITR has advised that, following a review of data needs, the Board has approved a new registration application form for 2003. This form will reduce data requirements compared with previous years, including removing the requirement of the more detailed schedule for larger applicants.

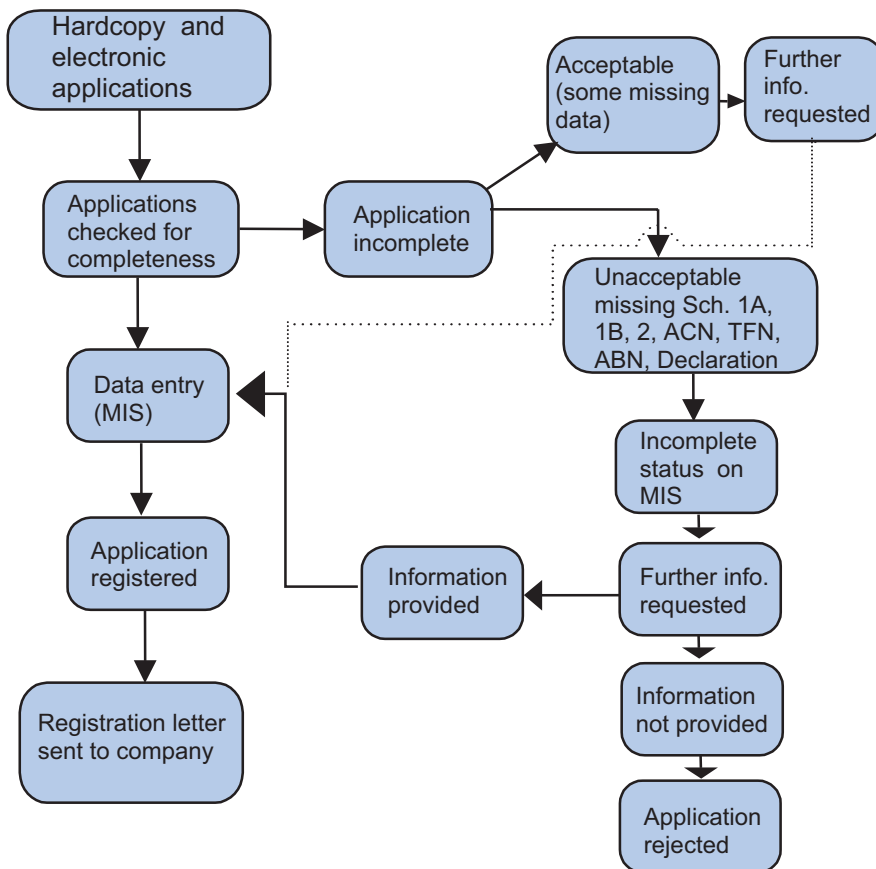
**5.15** DITR advised, in response to the draft audit report, that further work is under way to streamline data collection for the 2004 year. AusIndustry is working with the ATO and the Australian Bureau of Statistics to look at harmonising data collection under the Tax Concession. A joint working group will examine the feasibility of reducing data collected, taking account of the need for efficient and effective administration of the program, including the need to maintain access to company data on use of the R&D Tax Concession for monitoring and policy development purposes.

## Managing the registration process

5.16 Applications are lodged at AusIndustry Regional offices, or electronically through the AusIndustry website.<sup>79</sup> All applications are then processed in Canberra. The procedures for registration are summarised in Figure 5.1 below.

**Figure 5.1**

### Registration process for eligible companies



Source: ANAO based on information supplied by AusIndustry.

5.17 The majority of applications follow the standard registration process. The ANAO examined a sample of companies seeking registration for the 1999–2000 year.<sup>80</sup> The ANAO found that, of the 12 per cent of applications for the 1999–2000 year which had unacceptable missing information (see Figure 5.1), only 0.6 per cent were ultimately rejected due to incompleteness.

<sup>79</sup> Appendix 5 describes electronic registration procedures and supporting systems.

<sup>80</sup> The ANAO sample consisted of 66 applications for registration, which were stratified by size of the R&D expenditure and location of the company. The ANAO selected a sample using random numbers generated by the ANAO sampling system.

## Data entry accuracy

5.18 The ANAO found that some two thirds of the total sample of registrations had some form of data entry error. Many of the errors were minor typographical errors. There were no errors in primary data affecting registration, such as company name and tax file numbers. However, some 40 per cent of the errors did involve:

- schedule data incorrectly entered, including:
  - expenditure not broken down by activity;
  - Registered Research Agency/Co-operative Research Centre data not included; and
  - other contract data not included;
- time boxes not entered;
- incorrect addresses;
- advance ruling not noted; and
- errors in company turnover.

5.19 These error rates reduce the value of these elements for compliance and performance reporting purposes. The ANAO suggests that data entry quality assurance processes be reviewed, to ensure accuracy of data required for administration and reporting purposes.

5.20 AusIndustry advised that there were some particular circumstances that led to an unusually high level of errors at that time. Procedural improvements for data entry have been undertaken since then. AusIndustry advised that these improvements have included updating the Registration Manual used for training purposes, and a formal, documented data integrity checking process, resulting in substantial improvements in data accuracy.

## Compliance activities

5.21 There are three main levels to AusIndustry's compliance framework:

- non-legislative monitoring through customer advisory visits;
- legislative assessments of the eligibility of claimed R&D activity; and
- litigation and legal review.

5.22 Compliance monitoring is a key part of this framework by providing assurance that recipients of the Concession are meeting legislative requirements.

**5.23** Two types of compliance monitoring undertaken by AusIndustry related to the registered R&D expenditure are as follows:

- TaxRED<sup>81</sup> monitoring: addresses companies claiming up to \$2.5 million R&D expenditure per year. In 2000–01 there were 3242 companies in this cohort, amounting to 91 per cent by number and representing 27 per cent of R&D expenditure.
- Large Case Monitoring (LCM): addresses those companies claiming over \$2.5 million R&D expenditure per year. In 2000–01 there were 337 such companies, or 9 per cent of the total, representing 73 per cent of R&D expenditure.

**5.24** In addition, there is a joint compliance monitoring approach in conjunction with the ATO for the Top 30<sup>82</sup> groups of companies. These account for approximately 5 per cent of the total number of registrations, but 40 per cent of the annual total claims for the Concession.

**5.25** TaxRED monitoring is delivered by AusIndustry’s CSMs in its State and Regional offices, whereas LCM is delivered by a specialist AusIndustry unit in Canberra.<sup>83</sup> The rigour of monitoring increases across the spectrum in line with the increasing size of claimed R&D expenditure. Thus, LCM monitoring is more in depth than for TaxRED. Likewise, Top 30 monitoring is more rigorous than for LCM.<sup>84</sup>

**5.26** AusIndustry aims to monitor some 20-30 per cent of each category annually. TaxRED and LCM companies are selected for monitoring as follows:

- all companies rated as ‘medium risk’ in the previous year, unless the company has attended to the issues raised previously;
- all new registrants. The targeting of new registrants aims both to establish a customer relationship and to ensure ongoing compliance at an early stage; and
- a sample of companies with financial details outside of an expected norm, if there is still an unfilled quota (i.e. less than 25 per cent).<sup>85</sup>

<sup>81</sup> See paragraph 4.16.

<sup>82</sup> The number of the group of companies included in the program can vary as different companies may drop out due to mergers, acquisitions, wind ups etc. The actual number may be up to 35. Companies are grouped, as separate entities may come under one large umbrella parent company. There may be up to 200 companies covered by the Top 30 groups.

<sup>83</sup> AusIndustry advised during the audit that it intends to transfer the compliance monitoring of claims over \$2.5 million (Large Case Monitoring) to the AusIndustry State offices.

<sup>84</sup> Large claims are considered to be much more likely to involve aggressive testing of the R&D definition, which may involve AusIndustry working closely with the ATO. Companies in the smaller category are considered more likely to require advice about other programs or be candidates for some of AusIndustry’s other products such as COMET, START and IIF (see Appendix 1).

<sup>85</sup> In 2000–01 there were no such companies monitored, as there were a large number (826) of new registrants.

5.27 AusIndustry has advised that all applicants for the R&D Tax Offset will be treated as first time registrants for the purpose of monitoring activity in 2002–03. For 2003–04, companies claiming the 175 per cent premium may also be included, although management of this is yet to be determined.

5.28 For the Top 30 program, six company groups are selected annually for active monitoring, including a visit. The remainder are subject to an annual update of their ‘health card’.<sup>86</sup>

5.29 Monitoring can involve either an internal desk review, or a review involving a visit<sup>87</sup> to the customer’s premises. In most cases there is a visit, (see Table 5.1) with the key determining factor being that if there is a higher uncertainty about eligible expenditure, a visit will be undertaken.

**Table 5.1**

**AusIndustry planned monitoring activity 2001–02**

	Monitoring target (number)	Proportion of category monitored (per cent)	Proportion of those monitored visited (per cent)
TaxRED	720	22	87
LCM	100	30	62
Top 30	6	20	100
Total	826	23	N/A

Source: AusIndustry

5.30 AusIndustry has detailed standard operating procedures for all types of monitoring outlining the selection, methodology and reporting processes. The ANAO found that these procedures, and the associated training, provide a sound basis for conducting monitoring activities.

5.31 A review of a sample of compliance activities by the ANAO found that AusIndustry staff were largely following standard operating procedures. However, there was some variation in adherence to formal documented procedures, such as:

- formally communicating intentions to visit customers. Notification of an intention to visit or confirmation of a date of a visit was done in an informal way (by telephone or email) rather than a formal letter, as is required;
- documenting preliminary research prior to a visit. In one quarter of cases, no such research was documented on files, so it may have not been undertaken; and

<sup>86</sup> The aim of the health card is to provide a baseline of key data on a company that can be used by AusIndustry and the ATO in joint risk assessment and case selection. See also paragraph 6.21.

<sup>87</sup> A visit to a company’s premises involves examining a sample of the projects being claimed and interviews with financial officers and researchers of the company.



- recording the results of desk reviews. While there is a standard form report for TaxRED visits, desk review reports ranged from hand-written notes, to typed minutes, to modification to the visit form.

5.32 This suggests that either efforts to ensure adherence to procedural requirements are required, or that the requirements should be revised if activities are no longer necessary.

## Outcomes of monitoring

5.33 The results of TaxRED, LCM and Top 30 monitoring are summarised in standard-form reports, and are subject to clearance and quality assurance processes.<sup>88</sup> Once the report is cleared, the customer is advised of the outcome. The primary outcome for TaxRED and LCM activity is a risk rating as follows:

Rating	Action
<b>Low</b>	No further action required.
<b>Medium</b>	Significant concerns with aspects of claim. Company advised that assessment action may occur or asked to reconsider claim. The case is reviewed the following year to see whether advice has been acted upon.
<b>High</b>	Generally result in a legislative assessment.
<b>ATO issues<sup>89</sup></b>	Issues related to expenditure identified by AusIndustry officers are referred to the ATO.

Source: AusIndustry

5.34 For the Top 30 program, the result is either a 'settlement' (no further action required) or a recommendation for a legislative assessment of the activity.

5.35 The outcomes of the monitoring activity are summarised in Table 5.2.

<sup>88</sup> Appendix 6 outlines process for monitoring and assessments in more detail.

<sup>89</sup> More recently, another risk rating relating to finance scheme issues has been introduced. As discussed in Chapter 6, AusIndustry refers to the ATO those cases where its officers identify issues of R&D expenditure that might not meet the ATO's legislative requirements.

**Table 5.2****Monitoring activity outcomes 2001–02**

	TaxRED		LCM			Top 30	
	Number	Per cent	Number	Per cent		Number	Per cent
<b>Low</b>	605	90	87	93	Settlement <sup>90</sup>	6	100
<b>Medium</b>	56	8	3	3			
<b>High</b>	13	2	3	3	Assessment	-	-
<b>ATO issues</b>	62	9	1	1			

Source: AusIndustry data.

5.36 The outcomes of the TaxRED and LCM monitoring activity are that some 90 per cent of companies reviewed are not subject to further action. There may therefore be merit in reviewing the need for the current level of compliance activity—some 25 per cent of all companies—and its targeting, on risk management grounds (including consideration of any deterrent effect).

5.37 In this context, it is relevant to note that the initial decision to monitor around 25 per cent of Concession cases each year was not based on an explicit assessment of the level of acceptable non-compliance risk and a resulting allocation of resources. Rather, it was based on a level of the activity that could be met from available resources. This level of compliance activity was, in part, influenced by the fact that TaxRED also has a customer education function.

5.38 AusIndustry staff advised that most customers selected for monitoring, while often initially expressing misgivings about the process, ultimately ended up stating their appreciation of it. This view is supported by the AusIndustry customer satisfaction survey, which found that customers that had received a TaxRED visit were more satisfied with the service delivery of the program than customers that had not received a visit. The ANAO also observed that customers visited in the monitoring process were more confident about the self assessment nature of the Concession than those not subject to monitoring activity.

## Legislative assessments

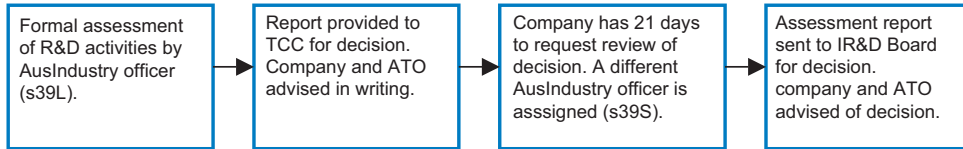
5.39 Prior to the introduction of monitoring activity in early 2000, AusIndustry's compliance program began with legislative assessments of eligible activity (with flow-on effects to litigation activity). Since 2000, legislative assessments are conducted only if a company is rated high risk as a result of compliance monitoring. A legislative assessment involves an assessment by AusIndustry

<sup>90</sup> At the time of the audit, no Top 30 activities had led to legislative assessments. Of the 56 projects reviewed, 45 had been found to have 'no issues'. However, three companies had agreed to withdraw claims for three projects, and two projects had been referred to the ATO. However there have been no significant issues identified.

(under section 39L of the *Industry Research and Development Act 1986*), with a final decision by the Tax Concession Committee (TCC). Customers dissatisfied with the decision may request, under section 39S of the Act, a review of the assessment by the Board. Figure 5.2 summarises the stages.

**Figure 5.2**

**Legislative assessments**



Source: AusIndustry

**5.40** The decision of the Board can be appealed to the Administrative Appeals Tribunal (AAT) and to the Federal Court for review of the legality of decision under the Act.<sup>91</sup> The Board also conducts negotiated settlements with companies at this stage.

**5.41** The ANAO found that the process for legislative assessment of the eligibility of R&D activities is robust and well documented. It is supported by substantial quality assurance mechanisms. The TCC and the Board review assessments.

## Outcomes of legislative assessments

**5.42** Since 1997, 1183 projects valued at \$2.9 billion have been assessed under section 39L, covering some 242 companies. Around half of all projects assessed were found to be not allowable, or only partly allowable. These projects accounted for over 80 per cent of the value of the projects assessed (see Table 5.3).

**Table 5.3**

**Outcomes of section 39L assessments 1997–2002**

	Proportion of projects (per cent)	Value (per cent)
<b>Fully allowed</b>	50	17
<b>Partly allowed</b>	6	12
<b>Not allowed</b>	44	71

Source: AusIndustry data.

<sup>91</sup> The *Administrative Decisions (Judicial Review) Act 1977* (ADJR Act) provides a mechanism by which the Federal Court (or Federal Magistrates Court) may review the legality of a decision under the IR&D Act or the ITAA. The ADJR Act does not enable the Court to review the merits of a decision, but to determine if the relevant action was lawful.

5.43 As described in Figure 5.2, those projects, which were disallowed or only partly allowed may be reviewed under section 39S at the request of the company. Since 1997, 581 such projects valued at \$1.6 billion have been reviewed, covering some 123 companies. This review resulted in a changed assessment for over half of the projects, as summarised in Table 5.4.

**Table 5.4**

**Outcomes of section 39S assessments 1997-2002**

	Proportion of projects (per cent)	Value (per cent)
Fully allowed	58	34
Partly allowed	7	22
Not allowed	35	44

Source: AusIndustry data.

5.44 Consequently, most projects assessed have ultimately been found to be allowable; only 17<sup>92</sup> per cent of projects (25 per cent of value) initially subject to legislative assessment were ultimately not allowed.

5.45 The ANAO notes that, since 1995, assessments have led to a total of 71 AAT matters (mostly related to the definition of R&D activities) and 15 Federal Court actions (on various points of law) for projects valued at \$1.23 billion. Of these claims, 82 per cent of expenditure (\$1 billion) was found to be eligible.<sup>93</sup> This result raises the question of the cost effectiveness of the administration of legislative assessments as the main means of managing compliance.

### **Legislative assessments are becoming more targeted**

5.46 The introduction of AusIndustry compliance activity in 2000 sought to provide ‘front end’ management of compliance, and filtering out of unproductive legislative assessment on a risk managed basis. The impact of a Federal Court decision in 2000<sup>94</sup> also affected the level of assessments and litigation.

5.47 This is reflected in the decline of legislative assessments in the past two years, from an average of over 100 39S assessments per year to fewer than 10 a year. Similarly, newly initiated litigation has reduced since its peak in 1999–2000 (22 new matters) to eight and seven new matters in the last two years 2000–01 and 2001–02, respectively.

<sup>92</sup> Does not include rounding.

<sup>93</sup> Claims around \$226 million or 18 per cent of the expenditure was found to be ineligible, which translates to a revenue saving in the order of \$40 million. Legal costs in contesting these matters totals around \$6.8 million.

<sup>94</sup> The *Industry Research & Development Board v Coal & Allied Operations Pty Ltd* [2000] FCA 979 decision—substantially reduced the IR&D Board’s ability to reject claims under the pre 1996 definition of research and development activities.

**5.48** While it is too early to determine the extent to which the new arrangements have reduced the extent of less productive assessment, the evidence to date suggests that they have increased the rates of disallowment.<sup>95</sup>

## Supporting information systems

**5.49** The ANAO found that the departmental information systems which support administration of the Concession function well and meet operational needs. However, there were weaknesses in some aspects of IT procedures, in particular documentation of operational/maintenance procedures, use of security auditing and disaster recovery. These matters warrant attention to increase assurance of the security of Concession data and the capacity of the department to respond appropriately to a major systems failure.

**5.50** While system documentation for the Concession system was of a high quality, this was not the case for documentation of operational/maintenance procedures. In particular, the procedures for requesting and varying access to Concession data, and for disabling inactive Oracle user accounts, were undocumented. This reduces assurance that access to systems is appropriately restricted to those who need such access.

**5.51** Furthermore, security auditing had not been enabled or configured on the AusIndustry Oracle database,<sup>96</sup> increasing the risk that unauthorised actions could not be identified and resolved in a timely manner

**5.52** The ANAO also found that, at the time of the audit, the department did not have a current Business Continuity Plan, nor an IT Disaster Recovery plan. DITR has advised that it is now finalising its Business Continuity Plan.

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<sup>95</sup> Of the six section 39S decisions made in 2001–02, over half of the projects were not allowed or only partly allowed. Over 90 per cent were deemed to be not allowed. This is substantially higher than the historical average at Table 5.4. None of these cases has yet had finalised litigation activity. All of the cases in which expenditure was deemed ineligible were appealed to the AAT.

<sup>96</sup> Security auditing was only conducted at the higher, application level, which would not identify misuse of the data.

## Recommendation No.4

5.53 The ANAO recommends that DITR strengthen the integrity and security of R&D Tax Concession information systems by documenting processes for security, backup and recovery of R&D Tax Concession data.

### *DITR Response*

5.54 Agreed. DITR is:

- Establishing formal procedures for providing access to and disabling accounts to applications.
- Undertaking quarterly audits of access rights;
- Introducing a strengthened security policy to control access to the database by IT staff.

5.55 DITR has finalised the Business Continuity Plan which includes an IT Disaster Plan. The outsourced IT service provider is contracted to back up data on a daily basis.

## 6. Expenditure Claims

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*This chapter examines administration by the Australian Taxation Office of R&D Tax Concession claims on company tax returns.*

### Background

**6.1** After registering with AusIndustry, companies are eligible to claim the Concession through the company tax return. It is one claimable item on a multi-faceted annual company tax return.

**6.2** The Australian Taxation Office (ATO) is responsible for ensuring compliance with the Concession provisions of the *Income Tax Assessment Act 1936*, including determining the accuracy of deductions claimed under the Concession. The Concession is relatively small in the context of company income tax revenues. The ATO collected company revenue of \$27 billion in 2001–02<sup>97</sup>, compared to projected tax expenditure for the Concession of \$420 million<sup>98</sup> (1.56 per cent of company income tax).

**6.3** Responsibility for delivering services relating to the Concession is shared between a number of areas, principally, the Innovation Segment in the Large Business and International (LB&I) business line. However, other areas within LB&I also undertake activities relating to the Concession from time to time, as does the Small Business line.

**6.4** This chapter examines the ATO's approach to managing processes to address the integrity of self assessed Concession expenditure claims, in particular:

- compliance management activities; and
- ATO data on expenditure claims.

### Compliance management

#### Risk management

**6.5** As discussed at paragraph 2.28, risk management for the Concession takes place within the ATO's overall approach to risk management and compliance. The risks attached to R&D expense allocation, through self assessment, have been assessed as low. Risk management is undertaken within the overall ATO risk management approach.

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<sup>97</sup> ATO *Annual Report 2002* (Output 1.1.2—Provide Revenue).

<sup>98</sup> Includes the Premium Tax Concession for additional R&D expenditure.

6.6 Consequently, risk related activities in relation to the Concession are limited to those areas of highest assessed risk within the program, or when there are synergies with the activities of other parts of the ATO, or with AusIndustry.

6.7 Management of compliance for the Concession is discussed below in the context of the three stages of the ATO's Cooperative Compliance model, namely:

- self-regulation and cooperation, such as through taxation rulings (interpretative advice for taxpayers);
- assisted self-regulation such as risk assessment activity (e.g: Top 30); and
- active enforcement (e.g: audits and litigation).

## Taxation rulings

6.8 An important element of the ATO's administration of taxation law is the provision of interpretative advice on taxation issues to taxpayers. This is particularly important given Australia's self assessment taxation system<sup>99</sup>. A key mechanism used by the ATO to disseminate the Commissioner of Taxation's interpretative advice on the Australian taxation law is taxation rulings.<sup>100</sup>

6.9 The taxation rulings system comprises primarily public rulings (which include taxation rulings and taxation determinations, and product rulings), and private rulings.<sup>101</sup>

6.10 The ANAO has previously audited the ATO's administration of taxation rulings<sup>102</sup>, concluding, that:

The processes for the production of **public** rulings of high technical quality operate effectively overall but the collection, analysis and use of performance information could be enhanced in some areas. The administrative processes for **private** rulings have operated poorly in many respects. Our assessment for **private** rulings confirmed the findings of administrative inefficiencies noted in reports prepared for the ATO over a number of years, while recognising that steps have been, and are being, taken to address these, particularly in recent times.

6.11 The ATO agreed with ANAO recommendations in the audit report to improve management of the taxation rulings system.

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<sup>99</sup> Self assessment puts an onus on the taxpayer to have a good understanding of the taxation law in order to fulfill their taxation obligations.

<sup>100</sup> Rulings are legally binding once given by the Commissioner of Taxation.

<sup>101</sup> The ATO rulings systems also includes: *oral rulings* (introduced in mid 2000), although very few oral rulings have been issued by the ATO; *Taxation rulings* which include rulings published before 1 July 1992; published rulings on procedural, administrative or tax collection matters and rulings on liability issues under a law other than 'a tax law' within Part IVA of the *Taxation Administration Act 1953* (TAA).

<sup>102</sup> ANAO Audit Report No.3 2001-02, *The Australian Taxation Office's Administration of Taxation Rulings*.



**6.12** It was not the purpose of this audit to assess the ATO's implementation of the previous audit report recommendations. However, this audit has addressed ATO practices in relation to rulings for the Concession.

**6.13** Rulings in respect of the Concession are the responsibility of the Innovation Segment. Given the established nature of the Concession, the volume of rulings for the Concession is relatively small, averaging 10 per year.<sup>103</sup> Most rulings are private rulings. Public rulings are rare.

**6.14** The ANAO found that rulings were being prepared in accordance with ATO guidelines, known as a *Practice Statement*, and were complying with corporate standards such as the recording of clearance and sign-off on information systems.

**6.15** The ATO has established a timeliness service standard of 28 days for the preparation of private rulings.<sup>104</sup> The ANAO found that this standard was met in 88 per cent of private rulings at the time of this audit. The ATO advised that the principal cause of delays was in the forwarding of requests to the Innovation Segment, in Adelaide, by the office in which it was received.

**6.16** Industry stakeholders consulted by the ANAO indicated that they were generally satisfied with the outcomes of the processes for the public ruling on plant expenditure.

## **Assisted self regulation**

**6.17** The principal means by which assisted self-regulation occurs, in relation to the Concession, is through risk assessment activity. Consistent with the ATO's overall risk management strategy and view that the Concession represents a relatively low risk, the range of risk assessment activities is focussed on larger companies.

**6.18** The Top 30 program is the only systematic risk assessment activity by the ATO specifically focussed on the Concession. It targets the largest groups of companies. These companies account for approximately 5 per cent of the total registrations and 40 per cent of the annual total expenditure claims for the Concession.

**6.19** The program is undertaken jointly by the Innovation Segment and AusIndustry. The outcomes of review are described at paragraph 5.33 onwards. Broadly, six company groups are examined in any one year. For 2001, most projects had been found to have no significant issues. However, three companies had withdrawn a portion of the original claim and two projects had been identified for further examination by the ATO.

<sup>103</sup> Half are syndication related (years 1999–2002).

<sup>104</sup> There are no published standards for public rulings or other rulings.

**6.20** In addition, while not specifically targeted at the Concession, LB&I industry segments conduct customer risk reviews as part of a standardised Large Customer Program. These reviews target company groups with turnover greater than \$100 million per annum,<sup>103</sup> and include a visit to the taxpayer. The ANAO found that the staff undertaking the reviews appropriately draw upon the expertise of the Innovation Segment in undertaking their risk assessments.

**6.21** A product of this program is an assessment of material risks, which are recorded on a 'health card' database. These data confirm the ATO view that the Concession is relatively low risk (it accounts for some 1 per cent of the value of assessments).

**6.22** The ATO is planning to extend this type of risk assessment activity to smaller company groups.<sup>106</sup>

**6.23** While the Top 30 program is the ATO's only Concession specific risk assessment process, the Innovation Segment does also receive compliance referrals from AusIndustry. These result from AusIndustry compliance activities, such as TaxRED, during which it has identified possible issues of ATO interest. The ATO advised that this is an efficient means of capturing risk information about the smaller end of the Concession market.

**6.24** During 2001 the ATO had received 64 such referrals; 32 cases were resolved relatively speedily after checking ATO records and data, or making contact with the relevant companies, and therefore required no further action. Of the remainder, only one referral has so far been identified as high risk (seven were medium risk).

## **Integrating risk activity**

**6.25** The ANAO found that various risk assessment activities described above had not been well coordinated or integrated by the ATO. This deficiency has been recognised by the ATO. Consequently, LB&I is developing a business line wide risk and treatment framework for technical compliance risks. This framework will be managed by a risk management Committee which aims to integrate the current range of risk assessment and treatment processes, including the Large Company, Top 30, and new middle market programs across the business line. The ANAO considers that there would also be merit in considering the integration into this framework of information gathered from other sources, such as AusIndustry referrals.

<sup>105</sup> The program focuses on the approximately 1000 company groups with turnover greater than \$100 million per annum, which accounts for 70–80 per cent of the LB&I tax revenue base. To date, risk assessments under the program have focussed on the 100–200 largest company groups of this cohort.

<sup>106</sup> LB&I is commencing work to develop a 'middle market' strategy, to extend risk assessment activity to the approximately 11 000 company groups with turnover in the range \$10m–\$100m. At the time of the audit, the middle market strategy had not yet commenced.

## Data matching

**6.26** In addition to the above activities, the ATO has adopted a structured approach to establishing that legal requirements for registration with the Board have been fulfilled prior to claiming the Concession. As part of this approach, it has been undertaking data matching with AusIndustry registration information since 1997.

**6.27** This matching initially found that substantial numbers of Concession claimants had not been registered prior to claiming the Concession, as required by law. However, the number of claimants requiring an adjustment has declined (from over 300 a year initially to less than 20 in 2000) as companies have become more aware of registration requirements, and as the volume of 'exceptional circumstances' registration has increased.<sup>107</sup>

**6.28** To date, this data matching has found that projects totalling \$68 million had been incorrectly claimed, resulting in tax savings of \$12.8 million when adjustments and penalties were sought from the relevant claimants.<sup>108</sup>

**6.29** The Innovation Segment also analyses AusIndustry registration data for trends in expenditure that may warrant closer examination. For example, a recent taxation ruling on plant expenditure was triggered by Innovation Segment analysis of registration data.

## Enforcement

**6.30** Under the ATO's Cooperative Compliance Model, it is intended that active enforcement activities, such as audits and litigation, should constitute the final, and least frequently used, aspect of compliance activity. This is the case with the Concession, consistent with its assessment as a relatively low risk expense.

**6.31** Accordingly, the Innovation Segment has not been conducting audits of current Concession claims, although it does undertake auditing directed at the remaining R&D Tax Concession program syndicates.<sup>109</sup>

**6.32** Concession issues do arise through the auditing activities of other LB&I industry segments, although this is a material concern in less than 2 per cent of such audits. This supports the ATO's view that it is a relatively low risk activity. Where Concession issues are raised during audit activities, appropriate expert advice is sought from the Innovation Segment.

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<sup>107</sup> The IR&D Act does not allow companies to register if their applications are received after the deadline date, unless the applicant can demonstrate that its late lodgement was the result of exceptional circumstances under section 39JF of the Act.

<sup>108</sup> In addition, some \$12.7 million in 'notional' tax has been raised from adjustments to company tax losses. This tax may be payable depending on future tax outcomes.

<sup>109</sup> Syndication provided for more than one company to share the financial risk of large R&D projects.

## Accuracy of expenditure claim data

**6.33** On registration with AusIndustry, companies record the intended R&D expenditure but are not required to subsequently report actual expenditures claimed in their taxation return. Thus, the ATO is the only source of information on actual claims of the Concession as a tax expense.

**6.34** The estimation of tax expenditure on the Concession is carried out by Treasury based on data provided by the ATO. The estimates are published in the Tax Expenditures Statement (see paragraph 3.25).

**6.35** The data supplied by the ATO is based on information collected from companies when they lodge their annual tax returns. Companies are required, through the self assessment process, to complete label L of the tax return if they are claiming the Concession. The amount to be entered represents the additional tax benefit associated with the expenditure. Thus, for a company claiming the normal Concession, label L<sup>110</sup> should show 25 per cent of the eligible expenditure.

**6.36** There have been, however, a number of limitations in the reliability of these data held by the ATO. These limitations flow from taxpayer behaviour in completing the form, and from limitations in ATO information systems.

## Number of claimants

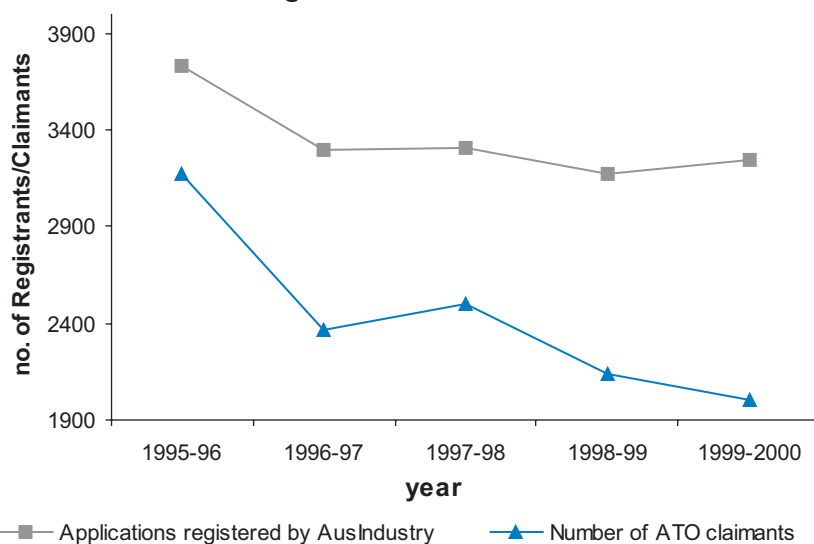
**6.37** Companies generally register with AusIndustry at around the same time that their tax returns are due for lodgement. Notwithstanding this, the number of AusIndustry registrants substantially exceeds the number of claimants recorded on the ATO systems.

**6.38** On average, for the period 1995–96 to 1999–2000, the number of claimants identified in the ATO information system was, on average, 28 per cent less than registrants with AusIndustry. (see Figure 6.1).

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<sup>110</sup> Label L is where companies enter the R&D expenditure on the company tax return.

**Figure 6.1**  
**R&D Tax Concession registrants and claimants**



Source: ATO and AusIndustry.

**6.39** The ATO has sought to identify the reasons for this difference. A survey exercise in 2000 found that some 80 per cent of the apparent non-claimants did actually claim the Concession. Of these, most either used an incorrect label on the tax return form (some 40 per cent), or claimed the Concession by amendment<sup>111</sup> (some 20 per cent)<sup>112</sup>. While the former is a result of taxpayer error, it should be noted that this does not affect self assessed tax liability. The latter omission is caused by the ATO information systems not being able to identify the particular labels that have changed as a result of the amendment.

**6.40** These two effects lead to under-recording on the ATO information systems and, therefore, underestimation of the amounts claimed. It also means that these companies are not identified as claimants in risk assessment and audit activity in relation to the Concession.

**6.41** The companies affected by these underestimations tend to be smaller companies. Over 30 per cent of the ANAO sample contained the above problems. However, they represented less than 10 per cent of the value of Concessions claimed.

**6.42** The ANAO also found that the value of data on the ATO information systems, with respect to the Concession, is further reduced by some companies

<sup>111</sup> A claim by amendment would occur, for example, when a company submits a tax return for particular year with no R&D claim, and subsequently amends their tax return to include an amount at the R&D Concession label.

<sup>112</sup> The remaining 20 per cent are explained by, for example, claims through syndicates, claims by adjustment to prior years, etc.

mis-completing their tax return form with respect to the amount of the claimed expenditure entered at label L on the return. This was identified as a substantial problem in the ANAO's previous audit.<sup>113</sup>

**6.43** The ANAO undertook further analysis of its sample of ATO data and compared it with the amount that would have been expected from AusIndustry registration data. For around 50 per cent of the sample, Concession claims matched the expected claim from registration data exactly. There was also some variation of Concession claim amounts around the registration amount, which would be expected due to changes occurring after registration, including advice resulting from TaxRED visits. However, some 8 to 10 per cent of the sample had amounts of around five times the concessional amount. This indicates that they have incorrectly entered 125 per cent, rather than 25 per cent at label L (i.e. the R&D expenditure plus the concessional amount). Subsequent ATO analysis confirmed this rate of error for the year 2000.

**6.44** In contrast to the effect of the other errors/system limitations described above, this has the effect of overstating the amount of the Concession on ATO information systems.

**6.45** As with the other types of error, the ANAO sample suggests that it is smaller companies that are making these types of error in completing the form. The overall impact on estimates, of all these errors may therefore be less than 10 per cent. However, in the absence of more reliable information, this cannot be established more reliably without further work by the ATO and AusIndustry.

**6.46** A new schedule was introduced at the beginning of the tax year 2002 to assist in capturing further data related to the Concession. This addresses situations where data required for reporting and analysis has not been available. In the new schedule, extra information is required to be completed, including capturing amended tax returns and Board registration number. This information would clearly identify the concessional amount claimable (ie. 25 per cent or the incremental amount, 75 per cent) as well as identify claims for the Tax Offset. There is also a requirement for an R&D schedule to be lodged for an amendment that includes changes to a company's R&D claim.

**6.47** The ATO has acknowledged that it has previously been unable to prepare detailed reports on tax expenditure because of the issues related to the data collection on the tax returns. In the next period, the ATO will be able to report more accurately on the expenditure being claimed, including that through amendments. Therefore, the ATO envisages that the new schedule will largely resolve the problems of companies completing the wrong label or recording the

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<sup>113</sup> ANAO Audit Report No.12, *Administration of the 150% Taxation Incentive for Industry Research and Development*, 1993–94 p. 20.

wrong amount of expenditure, including significant improvements for capturing whether a company is registered.

6.48 The ATO advised that this has been supported by an extensive publicity and education campaign. The ATO advised, in response to the draft audit report, that it will extend data matching with AusIndustry to support correct tax return preparation. It also advised a process is already underway to ensure figures from the R&D schedules, relating to amendments, will be made available for revenue and tax expenditure analysis.

## Conclusion

6.49 The ANAO concludes that ATO data on the Concession claims has involved systemic inaccuracies arising from taxpayer behaviour and ATO systems weaknesses. The ATO has introduced measures that should substantially improve the accuracy of its data. The ANAO considers that it would be desirable for the ATO and AusIndustry to work together to better inform the Treasury of likely R&D tax deduction claims for budget estimation purposes. In response to the draft audit report Treasury advised that it supports improvements in the ATO's data collection.

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Canberra ACT  
22 April 2003



P. J. Barrett  
Auditor-General





# Appendices



## Appendix 1

### DITR programs to promote business R&D

Program	Brief Description	\$ Value 2001–02
<b>R&amp;D Tax Concession</b>	Broad-based, market driven Tax Concession which allows companies to deduct 125 per cent of qualifying expenditure incurred on R&D activities.	\$420 million (estimated tax expenditure)
<b>Automotive Competitiveness and Investment Scheme (ACIS)</b>	Provides import duty credits to registered automotive industry participants to encourage new investment and innovation in the automotive industry.	\$400 million <sup>114</sup>
<b>R&amp;D Start, Grants and Loans</b>	Competitive, merit based grants and loans program that supports businesses to undertake R&D and related activities.	\$221 million
<b>Textile Clothing Footwear—Strategic Investment Program Scheme (TCF-SIP)</b>	Provides incentives in the form of grants to promote investment, innovation and value adding in the Australian textile, clothing and footwear industries.	\$121 million
<b>Pre-seed Fund</b>	Addresses the gap between promising scientific discoveries by universities and public sector research agencies and their commercialisation.	\$72 million <sup>115</sup>
<b>Pharmaceutical Industry Investment Program</b>	Offers partial compensation to companies to stimulate investment in pharmaceutical activity and to develop Australia as a Regional centre of excellence in both R&D and manufacturing.	\$50 million
<b>Innovation Investment Fund</b>	Venture capital equity program that assists small early stage companies to commercialise the outcomes of Australian R&D capability.	\$27 million
<b>Commercialising Emerging Technologies (COMET)</b>	Competitive, merit based grants program which supports businesses and individuals to increase the commercialisation of innovative products, processes and services.	\$12 million
<b>Biotechnology Innovation Fund (BIF)</b>	Aims to assist biotechnology companies progress projects from the research stage through to early commercialisation.	\$4 million
<b>Shipbuilding Innovation Scheme</b>	Provides financial assistance for registered shipbuilders who undertake eligible R&D activities related to the construction or modification of a bountiable vessel.	\$4 million
<b>Renewable Energy Equity Fund (REEF)</b>	Venture capital equity to assist companies to commercialise R&D in renewable energy technologies.	\$1 million

Other R&D and innovation support programs are provided through various Commonwealth Government agencies, including Agriculture, Fisheries and Forestry—Australia, Department of Education, Science and Training and Department of Communications, Information Technology and the Arts. As well, the State and Territory governments administer a range of programs to encourage firms to undertake innovation projects.

<sup>114</sup> ACIS is based on calendar year 2001 estimate.

<sup>115</sup> \$72 million dollars allocated to four fund managers, but no Pre-Seed Fund capital was drawn down in 2001–02.

## Appendix 2

### **Terms of reference of the House of Representatives Standing Committee on Science and Innovation: Inquiry into Business Commitment to R&D in Australia**

International comparisons indicate that while the public sector in Australia supports R&D at an impressive level, business investment is less impressive.

With particular consideration of:

- the R&D drivers in small and medium sized business;
- the needs of fast-growing companies; and
- the considerations by which major international corporations site R&D investment.

The Committee seeks to address three questions.

- What would be the economic benefit for Australia from a greater private sector investment in R&D?;
- What are the impediments to business investment in R&D?; and
- What steps need to be taken to better demonstrate to business the benefits of higher private sector investment in R & D?

## Appendix 3

### Innovation Segment Level 2 Plan

#### Performance indicator framework 2001–02 (summary)

LB&I Outcome measure	Innovation Segment contribution	Innovation Segment performance indicators
1. Tax policy, legislation and administrative design—tax legislation is easier to comply with, enforce and aligned with markets, our policy views sought and acted upon, the government is fully briefed on current and emerging issues	<ul style="list-style-type: none"> <li>• Significant contribution to development and implementation of R&amp;D Tax Concession initiatives announced in Governments Innovation Action Plan</li> <li>• Integrated tax design principles used</li> <li>• Significant contribution to venture capital legislative project</li> </ul>	Positive feedback from stakeholders involved in the design process Legislation passed
2. Revenue collection—LB&I revenue is sustainable and predictable and our share of budgeted revenue is collected	<ul style="list-style-type: none"> <li>• Monitor and forecast costs of Government Innovation initiatives with particular emphasis on new R&amp;D initiatives</li> <li>• Develop tools methods to enhance ability to forecast costs and measure benefits of government measures designed to support innovation.</li> <li>• Enhance real time intelligence about innovation and its impact on the tax system</li> </ul>	Predictable incentive costs
3. International and globalisation—tax paid on international dealings represents Australia's fair share	<ul style="list-style-type: none"> <li>• Address international aspects of innovation and it impacts on the tax system</li> </ul>	Compliance program results
4. Tax planning—aggressive tax planning and the opportunity for its promotion is reduced	<ul style="list-style-type: none"> <li>• Combat aggressive tax planning through continuation of R&amp;D syndicate audit projects</li> <li>• Continue work in terminating syndicates in conjunction with AusIndustry</li> <li>• Risk assessment of pooled development fund program</li> </ul>	Compliance program results
5. Compliance assurance—LB&I is improving overall compliance and satisfies the community that we are addressing non-compliance	<ul style="list-style-type: none"> <li>• Top 30 program</li> <li>• Analysis, risk assessment and where appropriate, treatment of claims made by other companies</li> <li>• Feedstock project</li> <li>• AusIndustry referrals project</li> <li>• R&amp;D Registration monitoring</li> </ul>	Compliance program results
6. Customer focus—LB&I customers are satisfied that we understand each other; we are fair and professional, and take into account the impacts of our administration on them	<ul style="list-style-type: none"> <li>• Advising</li> <li>• Public ruling—plant</li> <li>• Joint presentations to industry</li> <li>• Establish joint R&amp;D industry Consultative Group</li> <li>• Revision of tax aspects of R&amp;D Guide to Benefits</li> <li>• Regular contributions to R&amp;D Bulletin</li> </ul>	Tax payer charter standards Industry feedback
7. Internal capability—LB&I is aligned with markets, achieving world best practice and delivering the LB&I outcome	<ul style="list-style-type: none"> <li>• Cost structure</li> <li>• Training and development</li> <li>• Graduate program</li> </ul>	Budgets achieved Appropriately skilled staff

Source: ANAO summary of Innovation Segment Level 2 Plan 2001–02

## Appendix 4

### Required registration information

Under section 39JD of the *Industry Research and Development Act 1986*, an application to the Board for registration in respect of a year of income must:

- Specify the name of the eligible company; and
- contain the information required by the application form in respect of the research and development activities in relation to which registration is sought; and
- contain a declaration, by an officer of the company who is authorised by the company to make the declaration, stating that the company has, while carrying on the activities, maintained records that substantiate the company's carrying on of the activities; and
- specify the expenditure incurred by the company in relation to the activities during the year of income; and
- specify which (if any) of the activities have been the subject of advance registration in respect of that year; and
- include such other information as is specified in the regulations.

Outlined below is the information that was collected on the 2001–02 application form:

- Part one requires company information including such things as turnover, taxable income or loss and total number of employees as well as contact information. An authorised officer of the company is required to sign a declaration stating that the company has maintained contemporaneous records, including an R&D Plan, that substantiate the carrying on of the activities.
- Part two of the application requires a description of the R&D activities and expenditure. whether the activities contain adequate Australian content, were the activities carried out overseas and if the Premium or Rebate is being claimed.
- Schedule 1A requires information on R&D expenditure by project.
- Schedule 1B is completed if the R&D expenditure has been incurred by way of contracts to Registered Research Agencies (RRA), Cooperative Research Centres (CRC) or other organisations.

- Schedule 1C is completed when advanced registration has previously been granted.
- Schedule 1D is completed for each R&D project that is undertaken as a joint venture or partnership.
- Schedule 2 requests a more detailed description of R&D activities and is completed only if, in the company's income year, the total expenditure on projects listed in Schedule 1A exceeds \$1 million, or a single project's estimated expenditure will exceed \$1 million during the life cycle of the project and it is the first year that the activities are undertaken.

## Appendix 5

### Electronic registration

Most companies apply for registration by completing a paper form supplied by AusIndustry. However, AusIndustry also provides downloadable forms available on its website. These forms could be completed and returned to AusIndustry, for example, via fax, email, post or computer disk. Forms are available in the following format:

- a PDF file; and
- an intelligent form application ('Omniform') for offline completion.

Intelligent forms can deliver a number of benefits to customers and administering agencies, because customers can enter data in a form that can be readily imported into business systems without re-keying, which would reduce data errors. In addition, organisations can implement basic data syntax and completeness verification checks on these forms thereby minimising administrative time accepting forms from customers.

However, IT auditors engaged by the ANAO found that there is no validation of input in the AusIndustry registration Omniform. Invalid data can be entered into fields and incomplete application forms can be printed without warning to customers or to AusIndustry staff. Consequently, AusIndustry staff currently must manually verify the format of field contents and also check that all required fields have been filled in correctly.

AusIndustry advised that the Omniform was introduced as a low-cost electronic form option for customer, and that its future is being assessed in the context of DITR's broader IT environment and capabilities following machinery of government changes in 2001.

#### *Online registration*

Since March 2002 AusIndustry has provided companies with an online application option for registering their Concession application. Information is entered and submitted through the AusIndustry website.

The introduction of online registration enables companies to complete their registration forms more easily and accurately, and reduces the costs and risks associated with manual data entry by AusIndustry staff.

The ANAO concludes that the introduction of online registration represents a substantial contribution to AusIndustry's objective achieving a more customer focussed and accessible organisation.



## Appendix 6

### Processes for compliance activity and assessments

#### *TaxRED reporting*

AusIndustry Customer Service Managers (CSMs) deliver the TaxRED program to customers on behalf of AusIndustry. To assist them in this role AusIndustry has developed *A Guide to the Implementation of the R&D Tax Concession Regional Delivery Strategy* that provides the basis of the TaxRED operating procedures. It outlines the steps involved, including: case assignment and work planning; registration application stage; finalisation of visit selection; visit stage and post-visit decision-making process and reporting arrangements.

Following a TaxRED visit or desk review, a CSM is required to prepare a report on the outcomes. The report is reviewed by a delegated officer in the State or Regional office, and, if approved, a letter is sent to the customer advising them of the outcome.

A timeliness target of 30 days has been set for reports to be signed off by the delegate.<sup>115</sup> The ANAO's examination of a sample of TaxRED reports found that the average time for a CSM to complete a report was 17 days. On average, reports were approved by the delegate in four days, while on average customers were advised of the outcome within 15 days of approval. Consequently, while, approval by the delegate of a report was well within the 30 day target, the overall average time elapsed from customer visit to customer advice was 38 days.

The AusIndustry Tax Concession Committee (AITC), which meets monthly, has established a quality assurance process for TaxRED reports. The AITC reviews a random sample of TaxRED reports and provides feedback to CSMs if any issues arise. Quarterly summaries of TaxRED reports are submitted to the TCC for consideration.

#### *LCM reporting*

LCM is delivered by a specialist unit in Canberra. There are (draft) standard operating procedures in place to guide staff in their conduct of LCM activity. It outlines the selection, methodology and reporting processes for staff undertaking LCM reviews and also includes risk selection criteria.

As with TaxRED, a report of LCM activity is prepared by the AusIndustry officer. Approved reports giving a low or medium risk ranking are submitted to the AITC for approval. When approved, the company is informed that no further action will be taken at this stage. However companies given a medium risk

<sup>115</sup> The timeliness target has not been formally endorsed.

ranking are advised that they will be monitored over the following two years to determine if the identified risk has been addressed (if it is not addressed, the company may be escalated to the high-risk category).

In the case of a high risk ranking, the AITC will recommend to the TCC that a legislative assessment should be undertaken. Where the TCC agrees to undertake a legislative review, the company will be notified that AusIndustry has identified issues regarding the eligibility of the activities and that a section 39L assessment has been initiated.

There is no aggregate annual reporting for LCM activity. However, AusIndustry has prepared a draft report analysing the results to date.

### *Top 30 reporting*

The Top 30 program is a joint compliance monitoring approach in conjunction with the ATO. The objectives of the Top 30 program are to:

- identify the Top 30 company groups that represent the majority of the cost of the Concession;
- analyse claims and gather information to be recorded on the (ATO) health card system;
- prioritise the selection of company groups for review according to perceived risk to revenue and other compliance issues; and
- treat risks by carrying out joint reviews to determine the level of compliance and take any further action considered necessary.

Since March 2002 the Top 30 program has had a joint program management document in place, endorsed by the TCC, that outlines case selection, methodology and reporting and review processes to assist staff from both AusIndustry and the ATO on the conduct of reviews.

Company groups that are selected for detailed review participate in a four-stage process.

- Stage one involves an initial joint meeting with the ATO and AusIndustry to undertake a desk audit of the company's R&D activities. A preliminary report is prepared to record discussions that took place.
- Stage two involves a site visit with the ATO and AusIndustry to discuss a selection of projects with company technical staff. The preliminary report is revised and presented to the AITC and TCC.
- Stage three involves a meeting held jointly with the company, ATO and AusIndustry to further discuss issues of eligibility.

- Finally, a future strategy for the company is jointly developed between the ATO and AusIndustry and endorsed by the TCC.

Preliminary Top 30 reports are provided to the AITC and the TCC for information and comments. Final reports are provided to the TCC for endorsement. The TCC also receives a program management report. However, there is no aggregate reporting done on Top 30 activity and outcomes.

### *Legislative assessments reporting*

The process for reporting the outcome of a legislative assessment is for a report to be prepared for a delegate of the Board for a decision on the eligibility of R&D activities. The delegate will consider the assessment report to determine the eligibility or otherwise of the activities. Each project undertaken by that company is evaluated against the legislative definition of R&D activities. Where a project comprises several different activities the delegate may rule on the eligibility of activities within a project.

The company is then advised in writing of the decision. In the event that part, or all, of a project claimed for the Concession does not comply with the definition of R&D, the company is advised in writing that the activity is ineligible. The advice includes a brief summary of the reasons for the adverse determination and outlines the company's appeal rights.

The Commissioner of Taxation is also advised in a written certificate of the decision under section 73B(34) of the *ITAA 1936* and the decision is binding on the Commissioner.

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