

Tax Debt Collection
Australian Taxation Office
Performance Audit

Tabled 18 November 1996

Audit Report No. 13 1996-97

Abbreviations

A & R	Appeals and Review
ABS	Australian Bureau of Statistics
AGPS	Australian Government Publishing Service
AIS	ATO Integrated System
ANAO	Australian National Audit Office
APS	Australian Public Service
ATLP	Additional Tax on Late Payment
ATO	Australian Taxation Office
CLRU	Complex Legal Recovery Unit
COMPACT	COMPUter Assistance for the Collection of Taxes
CST	Client Service Team
DMIS	Debt Management Improvement Strategy
DRS	Debt Reduction Strategy

DSS	Department of Social Security
FBT	Fringe Benefits Tax
FBTAA	Fringe Benefits Tax Assessment Act 1986
GAO	United States General Accounting Office
INB	Individual Non Business
ITAA	Income Tax Assessment Act 1936
ITAR	Income Tax Accounting Redevelopment
JCPA	Joint Committee Public Accounts
LBI	Large Business Income
MIR	Management Information Reports
PAYE	Pay As You Earn
PPS	Prescribed Payments System
QA	Quality Assurance
QPT	Quarterly Provisional Tax
SBI	Small Business Income
SDA	Source Deduction Auditor
STAA	Sales Tax Assessment Acts 1992

TAA Taxation Administration Act 1953

WHT Withholding and Indirect Taxes

Summary

Tax debt collection

1. The Australian Taxation Office (ATO) is the Commonwealth's principal revenue collection agency. Its purpose is to collect taxation revenue properly payable, so that government may fund services and support for the people of Australia. In 1995-96 the ATO collected \$98.62 billion, representing approximately 80 per cent of total government revenue. Legislation governing the ATO requires it to take action against those taxpayers who do not pay their tax on time. The ATO's debt collection function (referred to as Debt Collection in this report) therefore plays an integral role in taking action against non-compliant taxpayers.

2. The objective of ATO's Debt Collection is to collect overdue taxes as quickly and effectively as possible, by ensuring that accounts are finalised as close as possible to the due date, and in the most cost-effective manner. Outstanding tax debt is a significant issue requiring effective management and appropriate recovery action. In 1995-96, some 366 000 cases were referred to Debt Collection for debt recovery action involving debts of \$16.5 billion, with over 352 000 cases involving debt of \$16.1 billion being finalised.

The purpose of the audit

3. The purpose of the audit was to examine how efficiently and effectively the ATO managed its collection of outstanding tax debt.

4. Debt collection was of interest because of the significant amount of revenue managed by Debt Collection and the potential changes to the operating environment of Debt Collection resulting from the ATO business systems modernisation program.

5. A framework for analysing the ATO's approach to collecting outstanding debt was established by the ANAO. This framework reflected five key criteria in the collection process as they apply to managing outstanding debt, namely:

- initiatives to promote timely payment;
- identification of outstanding debt;
- setting priorities for collecting outstanding debt;
- management of collection practices; and
- collection results.

6. The framework for analysis also included the following three support areas that assist the management of the above processes:

- performance information;
- debt collection research; and

- coordination and planning.

Overall conclusion

7. The audit found that there is scope for improvement in the performance of ATO Debt Collection. While a number of ATO corporate initiatives, including improvements in ATO corporate business systems, are yielding benefits to the management of Debt Collection, the ANAO considers there are additional opportunities for more timely, efficient and effective recovery of outstanding debt. These opportunities offer a significant potential financial gain to the Commonwealth through increased revenue, more efficient use of resources, and savings in terms of public debt interest and interest receipts.

8. A review of private sector debt collection practices found that private sector organisations placed considerable reliance on automated business systems throughout the debt recovery process. The audit concluded that there is substantial benefit for the ATO to significantly enhance its debt collection related business systems to reflect private sector practices. Improved business system capacity to identify, maintain and establish priorities for recovering outstanding debts, and to control and monitor the recovery process, would improve the ATO's capacity to make more effective use of its resources.

9. Opportunities for savings to the Commonwealth have been identified through improved debt identification processes and management of the Additional Tax for Late Payment penalty (ATLP) regime. The ANAO found significant, unnecessary, and in-built delays between debt becoming outstanding and receiving effective recovery action. Likewise, an ANAO risk assessment found that there is a significant risk that ATLP is not being imposed according to legislation, thus posing a risk to the revenue base and the integrity of the tax system. In a number of instances the ATO has not imposed ATLP according to legislation. Several recommendations have been made to assist the ATO with improving the administration of the debt identification process.

10. The audit concluded that performance information did not present an accurate picture of the ATO's outstanding debt nor of the cost-effectiveness of ATO debt collection strategies on different client segments of the outstanding debtor population. The ANAO made a number of recommendations aimed at improving the accuracy, quality and relevance of performance information to promote informed decision-making regarding the selection of the most cost-effective collection strategies.

11. The ANAO suggested improvements to the ATO's management of collection processes and ATO activities that promote timely payment of accounts, including better education of taxpayers. The ANAO found that the ATO's record of maintaining policy and procedural documentation was unsatisfactory, although in the past year the ATO has taken action to correct these deficiencies.

Key findings

Business systems

12. Debt Collection has a case actioning and case management computer system known as COMPACT to support the collection of outstanding tax debts. Under the ATO's modernisation program, the interaction between COMPACT and core accounting systems has been enhanced. Although this has considerably improved the degree of automatic referral of outstanding taxes to COMPACT, the ANAO found significant in-built delays

in referral time, and considers that the time taken for cases to be automatically referred to COMPACT can be reduced.

13. There is scope for greater automation of debt collection work, significantly increasing the efficiency and effectiveness of debt collection. For example, greater automation of basic collection processes, such as sending reminder notices/messages by mail, fax or phone, would give staff more time to pursue those cases where individual attention and expertise would prove most productive. In addition, a fully automated case actioning system would assist the ATO in employing strategies aimed at particular debtor segments of the taxpayer population based on the risk profile of the segment.

14. The ANAO found that the ATO has not taken full advantage of available data when developing a risk profile of a debt for the basis of setting priorities for recovery action. This has limited the ATO's capacity to automate basic recovery processes in an efficient and effective manner.

15. The audit identified scope for improvement to the ATO's business systems capability to:

- provide relevant, quality performance information and the capacity to conduct research to assist informed decision-making;
- assist the monitoring and control of collection processes;
- automatically allocate priorities for cases, based on client profiles; and
- support debt identification and the application of penalties.

Cost-effective debt collection action

16. The ATO could reduce the amount of debt becoming overdue by increasing its other compliance activities, such as taxpayer education and encouragement. Research into the outstanding debtor population would assist the ATO to identify initiatives to promote timely payment.

17. In addition to the in-built delays associated with the timing of initial recovery action, the ANAO found that this action was generic in a large number of circumstances, thus limiting the effectiveness of initial action. The audit concluded that there would be considerable benefit to the ATO by both improving the automation and reducing the in-built delays in the recovery process. Further, the enhancement of ATO business systems so that they can automatically generate different collection activities based on the risks associated with various debts would significantly improve the effectiveness of automated collection tools to recover debt.

18. ATO Debt Collection staff undertake substantial manual reconciliation of accounts in order to calculate penalties and prepare statements of accounts to be attached to correspondence. The ATO's timely actioning of debt is also hindered by debt collection staff having to spend disproportionate amounts of time dealing with processing and systems errors. These errors cause non-genuine debts to be referred for recovery action.

Performance information and research

19. It is imperative that the contents and relevance of performance information be of the highest quality if debt collection functions are to be cost-effectively managed. The ANAO concluded that performance information did not present an accurate picture of the ATO's outstanding debt. Further, performance information did not measure the success of alternative collection strategies on various segments of the debtor population. This limits the ATO's ability to make informed decisions regarding collection strategies. The ANAO identified a number of improvements to address the accuracy, quality and relevance of performance information.

20. The ANAO also identified improvements to business systems support for research and the management of debt collection research. Of particular concern was the absence of research into the costs of collection strategies, which is critical to the selection of appropriate strategies and decisions regarding when debts are considered uneconomic to collect.

Penalties

21. The various taxation laws provide for the automatic imposition of additional charges, that is, ATLP, when a debt is paid late. This ATLP can be remitted at the discretion of the Commissioner of Taxation once the ATLP has been imposed. The ANAO found that there was insufficient management information to accurately identify the ATO's performance regarding the imposition, remission and collection of ATLP. Separating performance information for ATLP in the reporting of debt collection would help rectify this shortcoming.

22. In a number of instances the ATO has not imposed ATLP according to legislation. The ANAO conducted a risk assessment using the limited ATLP data available on outstanding debtor accounts finalised in 1995-96 to establish the occurrence of ATLP imposition and remission. The ANAO found that there is a significant risk to revenue resulting from ATLP not being imposed according to legislation. The ANAO considers that the main contributing factor to this risk is the ATO business systems' limited capacity to impose ATLP automatically.

Policy and procedures

23. The audit concluded that systematic evaluation and review of collection policy, practices and business systems are required. In past years, the ATO's record for maintaining a clear and consistent policy document and procedures has been unsatisfactory. Differences in approach to debt collection between branches and regions have been observed. Recently, the ATO began rectifying this by drafting a new policy document which is due for release in late 1996. This revised policy should be updated regularly so that it reflects any changes to the ATO's approach to collecting outstanding debt.

24. The audit identified several improvements to the debt recovery processes, including maintenance and accessibility of policy and procedures and the use of technology and data. The audit recommended that the ATO introduce technology that presents key risk data associated with outstanding debt in a structured format, as well as providing interpretative information (such as financial ratios and risk indices) to improve the efficiency and effectiveness of decision-making.

Potential net benefits to the Commonwealth

25. The ANAO analysed 1995-96 Debt Collection performance data to determine net benefits to the Commonwealth which could result from the implementation of initiatives to improve both the timeliness of debt collection and recovery levels. It is the opinion of the ANAO that there are potentially significant net ongoing annual benefits to the Commonwealth that would result from slight improvements in the timeliness and effectiveness of recovery action.

26. For example, analysis indicates that a combination of minor improvements in areas identified in this report would provide a net benefit to the Commonwealth of \$142 million per annum. This benefit would result from a \$51 million net increase in revenue and a \$91 million saving in terms of public debt interest and interest receipts.

Acknowledgments

27. The ANAO would like to thank all ATO officers who assisted in the conduct of this audit and the ATO for providing a secondee to the audit team. The ATO officers' positive attitudes and expertise greatly assisted the audit and the preparation of this report.

Recommendations

Set out below are the ANAO's recommendations with Report paragraph references and the ATO's responses. More detailed responses and any ANAO comments are shown in the body of the report. The ANAO considers that the ATO should give priority to Recommendations 1, 5, 6, 7, 8, 10, 11, 12, 15, 16, 18, 19, 21, 22, 23, 24, 26 and 27.

Recommendation
No.1
Para. 2.6

The ANAO *recommends* that the ATO conduct research into the outstanding debtors' population to identify causes of outstanding debt, high-risk taxpayer population segments and opportunities for improvements to compliance strategies.

ATO response: The ATO agrees with this recommendation.

Recommendation
No.2
Para. 2.11

The ANAO *recommends* that the ATO conduct research into payment methods to identify additional cost-effective methods of payment.

ATO response: The ATO agrees with this recommendation. The ATO has for some time been involved in research into alternative payment methods of the kinds mentioned in paragraph 2.10. This research is ongoing.

Recommendation
No.3
Para. 2.17

The ANAO *recommends* that the ATO review its use of key publications to clarify the consequences of failure to pay tax debts on time. Clarification should include the taxpayer's payment responsibilities, the possibility of legal action, the extent of late payment penalty and the ATO's policy regarding special circumstances.

ATO response: The ATO agrees with this recommendation. Compliance research needs to be done to ascertain whether this is best done through existing publications, another approach (increasingly by electronic

means), or a combination of both.

Recommendation
No.4
Para. 2.24

The ANAO *recommends* that the ATO review its use of DSS forms and publications to help taxpayers make the appropriate financial arrangements for future tax obligations arising from loss of employment

ATO response: The ATO accepts that it should continue to work with DSS to help taxpayers make appropriate financial arrangements for their potential taxation liabilities arising from a loss of employment during a year of income.

Recommendation
No.5
Para. 2.30

The ANAO *recommends* that the ATO develop an automatic system of reminder letters and additional information on notices of assessments, encouraging taxpayers in particular risk groups to pay their tax in a timely manner. Such encouragement should state specific collection techniques that would apply for recurring non-compliance.

ATO response: The ATO agrees that it should develop computer systems that will enable it to vary its debt collection actions/techniques to the risk profile of individual debtors. Subject to research on its effectiveness, the collection techniques developed may include systems to automatically issue letters or initiate other means of reminding high-risk debtors about their future taxation obligations, and collection techniques that would apply for recurring non-compliance.

The ANAO *recommends* that the ATO develop the capacity of its debt collection business systems to:

Recommendation
No.6
Para. 3.14

- identify all outstanding debts as soon they fall overdue and/or are established;
- provide flexibility for targeting action based on risks of recovery action immediately after debts are identified as being overdue; and
- monitor all outstanding debt and all recovery action.

ATO response: The ATO agrees that:

- it needs to utilise the capacity of its debt collection business systems to action all large debts as soon as they fall due and/or are established and subject to availability of enhanced computer case actioning systems, identify all other debts as soon as they fall due and/or are established;
- it needs to develop computer systems that will enable it to vary its debt collection actions/techniques to the risk profile of individual debtors, and to monitor the effectiveness of those actions/techniques; and
- all outstanding debt should be monitored on ATO debt collection business systems, when enhanced systems are developed.

Recommendation
No.7
Para. 3.25

The ANAO *recommends* that the ATO give higher priority to the implementation of proposed improvements to business systems to batch-produce large groups of statements as part of automated recovery processes.

ATO response: The ATO accepts the direction of this recommendation. The ATO has been considering options to implement this functionality. These options will require substantial changes to ATO business systems. There are significant lead times to systems enhancements of this scale. Functionality to produce account statements for income taxpayers is expected to be available from late 1997.

Recommendation
No.8
Para. 3.28

The ANAO *recommends* that the ATO give higher priority to the implementation of proposed enhancements to business systems to produce cross-revenue line statements.

ATO response: The ATO accepts the direction of this recommendation. The ATO has been considering options to implement this functionality. These options will require substantial changes to ATO business systems. There are significant lead times to systems enhancements of this scale.

Recommendation
No.9
Para. 3.36

The ANAO *recommends* that the ATO develop the capacity of ATO business systems to separate disputed assessments into disputed and undisputed components to assist the recovery process.

ATO response: The ATO agrees with this recommendation. Nevertheless, the ATO anticipates that there may be some delay in implementing the recommendation because of the systems changes needed to produce a separation of disputed and undisputed components of any individual debt.

Recommendation
No.10
Para. 3.53

The ANAO *recommends* that the ATO ensure that proposed improvements to the business systems' capacity to automatically impose ATLP are implemented as soon as possible.

ATO response: The ATO agrees with this recommendation.

Recommendation
No.11
Para. 4.12

The ANAO *recommends* that the ATO enhance the business system's capacity to automatically segment the debtor population by risk characteristics of the debtor and characteristics of the debt, using data available on ATO business systems.

ATO response: The ATO agrees with the directions of this recommendation. The basis of risk assessment may not be restricted to data on ATO business systems.

Recommendation
No.12
Para. 4.21

The ANAO *recommends* that the ATO increase the capacity of the business system to control and monitor the recovery process on a national basis.

ATO response: The ATO agrees with this recommendation.

Recommendation
No.13
Para. 5.11

The ANAO *recommends* that the ATO ensure the systematic revision of debt collection policy and rulings in response to changes in the legislative framework and collection environment.

ATO response: The ATO agrees with this recommendation. A draft policy manual for the collection of debts was released for internal and external comment in early July 1996. The feedback received is currently

being reviewed. The revised manual will be released shortly. The manual will be reviewed in early July 1997 to address any subsequent feedback and amendments proposed by the Bankruptcy Law Amendment Bill 1996. Work to revise relevant taxation rulings will commence with the release of the policy manual.

Recommendation
No.14
Para. 5.15

The ANAO *recommends* that the ATO develop and disseminate clear and comprehensive standards for debt collection activity.

ATO response: The ATO agrees with this recommendation.

Recommendation
No.15
Para. 5.31

The ANAO *recommends* that the ATO develop and implement a comprehensive debt collection Quality Assurance (QA) program. This program should take advantage of the efficiencies associated with business system automation of case selection, review and reporting, supplemented by an appropriate manual QA program.

ATO response: The ATO accepts the direction of this recommendation. Implementation of the recommendation, however, will probably have to be phased in over time. Initially the QA process will be manual. This process will be modified as systems enhancements are introduced.

Recommendation
No.16
Para. 5.36

The ANAO *recommends* that the ATO develop national procedural documentation to provide clear and consistent guidelines on collection processes.

ATO response: The ATO agrees with this recommendation. The ATO has planned for some time to start revising its procedural documentation when the policy manual has been released. As noted on paragraph 5.12, the manual is to be issued in the near future.

Recommendation
No.17
Para. 5.48

The ANAO *recommends* that the ATO review existing debt collection delegations and authorisations with a view to national consistency and increase the ATO's business systems' capacity to control and monitor delegations and authorisations.

ATO response: The ATO agrees with this recommendation. Some of the key delegations used by debt collection officers have already been revised to achieve national consistency. The remaining delegations will be revised shortly. The ATO is currently exploring the use of business systems to control and monitor delegations and authorisations.

Recommendation
No.18
Para. 5.59

The ANAO *recommends* that the ATO improve its debt collection business systems to provide a greater degree of automated recovery action throughout the collection process.

ATO response: The ATO agrees with this recommendation. The timing of implementation of improvements to business systems will be addressed through ATO systems planning processes. Under this process, proposed systems enhancements will be evaluated and allocated a priority. The ATO will advance this recommendation in the next cycle commencing early 1997. Implementation is likely to be phased.

Recommendation
No.19
Para. 5.67

The ANAO *recommends* that the ATO improve the capacity of its business systems to structure key risk data associated with outstanding debt, and provide interpretative data, such as financial ratios and risks indices, to assist efficient and effective decision-making by recovery staff.

ATO response: The ATO agrees with this recommendation. The timing of implementation of improvements to business systems will be addressed through ATO systems planning processes. Under this process, proposed systems enhancements will be evaluated and allocated a priority. The ATO will advance this recommendation in the next cycle commencing early 1997. Implementation is likely to be phased.

Recommendation
No.20
Para. 5.72

The ANAO *recommends* that the ATO implement a program for evaluating and improving debt collection procedures, training and business systems.

ATO response: The ATO agrees with this recommendation.

The ANAO *recommends* that the ATO report debt collection performance information by the following segments:

Recommendation
No.21
Para. 7.9

- primary debt outstanding;
- additional debt applied as late payment tax;
- additional debt paid on time while an outstanding debt is on account; and
- debt arising from system errors.

ATO response: The ATO agrees with the direction of this recommendation. The ATO accepts that it needs to revise its debt collection performance reports, especially when it begins to stratify its debts. The ATO will analyse this complex issue to settle what performance information should be produced.

Recommendation
No.22
Para. 7.20

The ANAO *recommends* that the ATO's performance reports age outstanding debt with reference to the date that the debt becomes outstanding.

ATO response: The ATO agrees to take steps to modify the manner in which it ages its debts, and the performance reports that monitor the age of outstanding debts.

Recommendation
No.23
Para. 7.26

The ANAO *recommends* that the ATO develop and implement performance information that reflects the effectiveness of recovering outstanding debt (in terms of finalisation by collection and finalisation by other means) and the associated costs within an aged profile of debt. This performance information would provide the means for improving internal and external benchmarking and the selection of the most cost-effective options for recovery.

ATO response: The ATO agrees with this recommendation. Research will be undertaken into how to develop and implement an activity based costing approach and how to effectively record and analyse this data.

Recommendation
No.24
Para. 7.37

The ANAO *recommends* that the ATO develop the ability to report performance on client segments of the outstanding debtor population.

ATO response: The ATO agrees with this recommendation. To date, the ATO has been concentrating on macro client segment data as a result of its move to a client based structure.

Recommendation
No.25
Para. 8.7

The ANAO *recommends* that the ATO establish a framework for coordinating debt collection research across business lines.

ATO response: The ATO agrees with this recommendation.

Recommendation
No.26
Para. 8.13

The ANAO *recommends* that the ATO conduct research to estimate the costs incurred by both the ATO and the Commonwealth for each collection technique, and that it implement a system that automatically assigns estimated costs to collection cases.

ATO response: The ATO agrees with the direction of this recommendation, but needs to consider further the ATO's ability to estimate all Commonwealth costs. The ATO recognises that costs of collection is not the only relevant factor to consider when determining what is the appropriate strategy for collecting taxation debts. Community compliance is also relevant.

Recommendation
No.27
Para. 8.18

The ANAO *recommends* that the ATO ensure that the debt collection case management system has the capacity to isolate groups of outstanding debtors nationally to control test the cost-effectiveness of new collection strategies with reference to a control group.

ATO response: The ATO agrees with this recommendation.

Recommendation
No.28
Para. 9.10

The ANAO *recommends* that the ATO review its overall coverage of plans to ensure that all debt collection units have plans in place, thereby promoting a degree of consistency across the whole of Debt Collection on a branch, region, business line and national level.

ATO response: The ATO agrees to review current plans in debt collection areas in the context of promoting overall corporate consistency.

Recommendation
No.29
Para. 9.15

The ANAO *recommends* that the ATO examine the development of more user-friendly and consistent approaches of providing access to debt collection reference materials for debt collection staff.

ATO response: The ATO agrees with this recommendation.

Other ATO comments: The ATO agrees with the general thrust of comments made in the Report. They are totally consistent with the directions the ATO has been moving in, and has been working towards, for some time. However, notwithstanding the improvements that have been made and which are acknowledged in the Report, there remains scope to improve ATO business systems and processes, debt collection actioning systems and their priorities, and policy and procedural documentation.

The ATO's ability to effect these improvements is clearly subject to some limitations. Many of the recommendations have significant systems, work and job design, and debt collection process implications and will be resource intensive. The pace of implementation of enhancements in any area will therefore be dependent on overall corporate priorities and the availability of funding to meet competing needs, both within this important function itself and across all ATO activities.

1. Introduction

This chapter outlines the role of Debt Collection within the ATO. The importance of ensuring that taxpayers comply with their obligations under the law is fundamental to the ATO if it is to maintain the integrity of the tax system and collect the revenue duly payable. As such, Debt Collection's role as an enforcement area of the ATO is to take action against those taxpayers who fail to pay their tax by the due date.

Context

1.1 The ATO's primary purpose is *to collect revenue, properly payable, so as to fund services and support for the people of Australia.*¹ As the Commonwealth's principal revenue-raising agency, it collected \$98.62 billion in 1995-96, representing approximately 80 per cent of total government revenue.

1.2 The ATO relies primarily on a self-assessment system to collect the revenue. The adoption of a self-assessment system influences the way the ATO manages the risks to revenue. To maximise its revenue collections the ATO employs a combination of compliance strategies. These include administrative arrangements, education, encouragement and enforcement.

1.3 Debt collection is an enforcement activity that occurs after taxpayers have failed to pay their tax. The purpose of Debt Collection is to collect overdue taxes as quickly and effectively as possible, by ensuring that accounts are finalised as close as possible to the due date, in the most cost-effective manner. Outstanding tax debt is a significant issue requiring effective management and appropriate recovery action. In 1995-96 some 366 000 cases were referred to Debt Collection for debt recovery action, involving debts of \$16.5 billion, with over 352 000 cases involving debt of \$16.1 billion being finalised.

Audit objective and methodology

1.4 The objective of the audit was to ascertain how efficiently and effectively the ATO managed its collection of outstanding tax debt. As part of this audit the ANAO did not review the ATO's Child Support Agency debt collection activities. These activities were excluded from the audit due to the differences in the nature of the debt and the systems used to collect this debt compared with tax debt.

1.5 A framework for analysing the ATO's approach to collecting outstanding debt was established by the ANAO. This framework reflected five key criteria in the collection process as they apply to managing outstanding debt. The criteria are:

- initiatives to promote timely payment;
- identification of outstanding debt;
- priorities for collection;

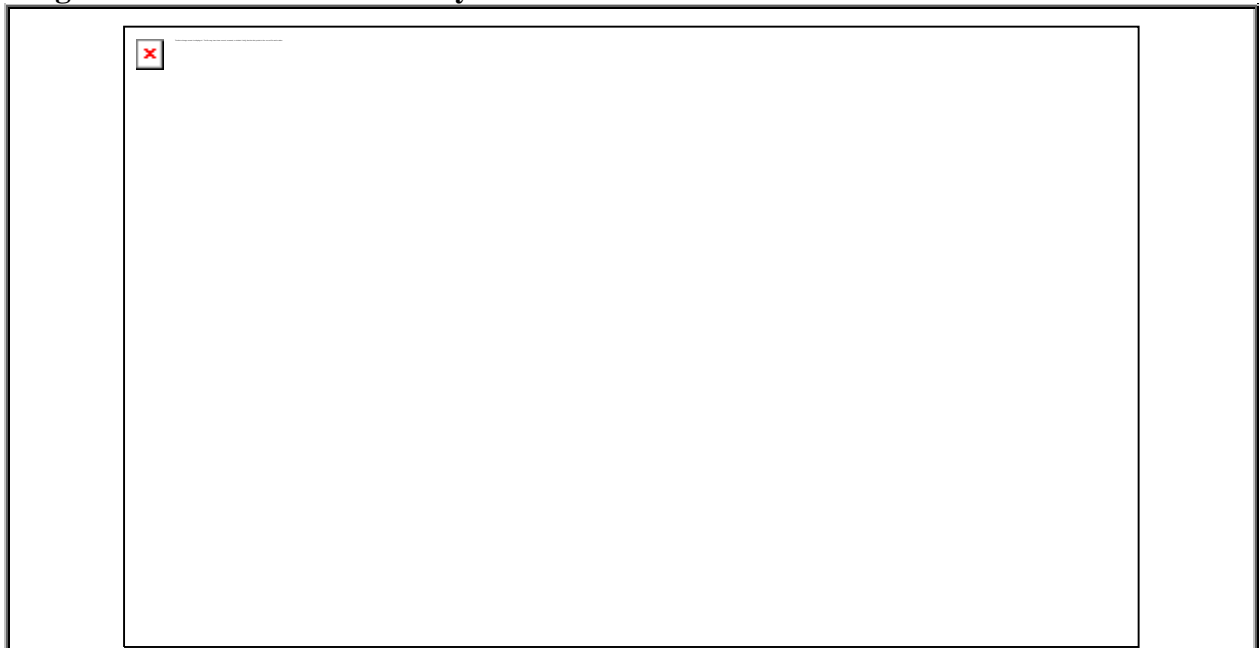
- management of collection practices; and
- collection results.

1.6 The audit included a review of initiatives to promote timely payment, as a number of strategies can be adopted before a debt becomes due that reduce the amount of debt that becomes outstanding. The framework for analysis also included three support areas that assisted the management of these processes. The three areas are:

- performance information;
- debt collection research; and
- coordination and planning.

1.7 In designing this framework, the ANAO took into account those areas which affected the efficiency and effectiveness of the debt collection process. Diagram 1 illustrates this framework and the eight key areas within the framework which were reviewed by the ANAO as part of the audit.

Diagram 1: Framework for Analysis of Debt Collection



1.8 The ANAO's field work was conducted between November 1995 and May 1996. The ANAO examined an extensive range of ATO material. Field work was carried out in the ATO national office and within branch offices in New South Wales, Queensland, Victoria and Western Australia.

1.9 During the course of the audit, the ANAO consulted a number of taxpayer and professional bodies, as well as the Tax Division of the Community and Public Sector Union. In addition, the audit benefited from expert consultant advice from:

- the Receivables Management Group² on private sector debt collection practices; and

- the Australian Bureau of Statistics (ABS) on sample design and sample sizes for a Quality Assurance program for Debt Collection.

1.10 The audit was conducted in accordance with ANAO auditing standards and cost \$355 000.

Other reviews

1.11 During the course of the audit the Special Tax Adviser to the Commonwealth Ombudsman commenced a review of the decision-making aspects of the ATO's debt collection operations. The ANAO liaised with the Ombudsman on an ongoing basis during the audit to ensure there was no unnecessary duplication between the two reviews.

1.12 The ATO's internal audit function as part of the 1994-95 financial statements audit focused on a number of internal controls, including the ATO Debt Collection's function of imposing late payment charges. The results of this audit are reported in Chapter 3.

ATO Debt Collection

1.13 Management of the debt recovery process is a complex and sensitive activity, involving the maximisation of the collection of outstanding revenue while ensuring the fair and professional treatment of debtors. The debt collection environment is increasingly challenging, as staff are required to apply a widening array of rules contained in tax legislation, rulings and policies, corporations law, bankruptcy and privacy acts and court rules.

1.14 Debt collection staff are also involved in ensuring that taxpayers are up to date with lodging taxation returns and other remittances, and providing advice to taxpayers about other aspects of their taxation obligations (e.g. advice on provisional tax variations and objecting to assessments). Also, as articulated in the proposed draft Taxpayers' Charter, taxpayers have both rights and service entitlements. Consequently, as part of the debt collection process, ATO staff are obliged to advise taxpayers of their rights and to provide them with the level of service to which they are entitled.

Nature of taxation debts

1.15 Tax revenue becomes due to the Commonwealth under a number of statutes, including:

- *Income Tax Assessment Act 1936* (ITAA);
- *Sales Tax Assessment Acts 1992* (STAA);
- *Fringe Benefits Tax Assessment Act 1986* (FBTAA); and
- *Superannuation Guarantee (Administration) Act 1992* (SGAA).

1.16 Taxation debts can result from an assessment by the ATO or by self-assessment by the taxpayer. Where the ATO makes the assessment, a notice of assessment specifying the date due and payable is forwarded to the debtor. For example, income taxpayers primarily lodge income tax return forms which the ATO uses as a basis to assess tax. Where the taxpayer has insufficient tax credits, a debit assessment notice is sent. The date on which the debt becomes due and payable for individual income taxpayers is a minimum of 30

days after service of the notice of assessment.

1.17 Conversely, where the tax or charge is fully self-assessed by the taxpayer, the due date for payment of the debt is usually the due date for lodgment of the return. For example, group employers remit to the ATO the equivalent of the total tax instalment deductions withheld from the salary and wages of employees during a specified period, together with the signed remittance advice form detailing information on the amount and nature of payment. These have ramifications for debt collection in that if the group employer does not remit deductions for a period, the ATO then needs to establish whether a debt in fact exists before declaring it outstanding.

Policy

1.18 Debt Collection's function is to collect overdue taxes as quickly and effectively as possible, by ensuring that accounts are finalised as close as possible to the due date, in the most cost-effective manner. The ATO expects taxation debtors to pay their taxation debts as and when they fall due for payment. This is because:

- the ATO is not a lending institution;
- taxpayers are expected to organise their financial affairs to ensure they pay their taxes on time; and
- taxpayers are expected to treat their tax debts with the same priority as they treat their other debts.

1.19 Where a taxpayer fails to pay a taxation debt in full, the tax legislation enables the ATO to take action to collect these unpaid taxes. The Commissioner of Taxation's recovery powers are legislated in a number of taxation acts as well as the *Taxation Administration Act 1953 (TAA)*. Liability to pay an amount of outstanding tax is not deferred because of any action to dispute that amount.

Collection techniques

1.20 The techniques currently employed by Debt Collection in the collection of outstanding debt include telephone negotiations, letters of demand, garnisheeing of wages and bank accounts and a range of legal processes, including bankruptcy proceedings, warrants of execution and mareva injunctions.³ The ATO may accept payments of debts by instalments in appropriate cases. The ATO also has the power under legislation to make company directors personally liable for the debts of their company in certain circumstances (e.g. Prescribed Payments System [PPS], Group Tax and dividend and interest withholding taxes).

Additional charges due to late payment

1.21 The various taxation laws provide for the automatic imposition of additional charges when a debt is paid late. These additional charges are a punitive measure to deny late payers an advantage over those who do pay on time.

1.22 For some taxes, an additional penalty interest component operates to compensate the Commonwealth for the loss suffered during the period the amounts were outstanding. This

interest may be compared to what is acceptable commercial practice for use of funds and it is calculated on a base using the thirteen-week Treasury Bond rate of interest.

1.23 In certain circumstances the Commissioner of Taxation is able to remit this additional tax, under the various statutes discussed earlier in the chapter. Generally, the Commissioner will only remit these additional taxes provided the taxpayer can demonstrate that the circumstances which led to the delay in payment of the tax were outside the taxpayer's control. In addition, the taxpayer must also undertake reasonable steps to mitigate the effects of those circumstances. Such circumstances would include strikes, sudden ill health of key personnel where the taxpayer is a sole trader or operates a small business, and the unforeseen collapse of a major debtor.⁴ Additional tax on late payment is discussed further in Chapter 3.

Write-offs and reliefs

1.24 In a number of circumstances the Commissioner of Taxation can either write-off a debt or release a taxpayer from an obligation to pay a debt. Writing-off debt is a method of clearing a debt where the amount is either irrecoverable at law, classified as uneconomical to pursue or classified as irrecoverable as there are no assets or income from which payment could be made. A debt that has been written off as uneconomical to pursue or because a debtor has insufficient funds or assets may be re-raised and action to collect commenced, if the financial position of the debtor improves or the circumstances which led to the write-off alter.

1.25 Sections 265 ITAA and 133 FBTAA provide for the release of debtors in cases where payment of the income tax or fringe benefits tax debt will cause serious hardship. The Tax Relief Board considers applications for release lodged by debtors. Although the then Government announced in 1991-92 its intention to repeal the relief provisions of the legislation, these provisions have yet to be changed because the ATO is still considering various options to make the process more efficient and equitable. The ATO advised that some delay was incurred while awaiting advice from the Department of Finance and the Administrative Review Council (ARC). The ARC indicated that in 1994 it had discussions on the matter with the ATO and that since then the ATO had not sought further advice from the ARC. The ANAO suggests that the ATO and relevant government agencies review and address any possible deficiencies of the relief process as soon as possible.

The structure of Debt Collection

1.26 The ATO currently has 25 branch offices Australia-wide, each with a debt collection presence. As part of a reorganisation in 1994, the ATO established separate business lines within the ATO. The ATO's program structure is outlined in Appendix 1. Debt collection activities subsequently became a sub-section of the following three business lines: Individuals Non Business (INB), Small Business Income (SBI) and Withholding and Indirect Taxes (WHT). Due to the small number of outstanding debts attributable to Large Business Income (LBI), SBI is responsible for recovering outstanding LBI debts.

1.27 The result of this reorganisation is that there are over 1200 tax officers employed in Debt Collection, spread across some 70 Debt Collection units around Australia.

1.28 As part of this restructuring, the ATO is currently embarking on the work and job

redesign project for all ATO staff. This process of reviewing and redesigning how work is done in the ATO is likely to affect Debt Collection by possibly increasing the number of tax officers with debt collection responsibilities. The ANAO identified a number of key considerations for this process, as discussed in Chapter 9 of this report.

Business systems

1.29 Debt Collection has a dedicated computer system known as COMPACT (COMPUter Assistance for the Collection of Taxes). COMPACT was developed by the ATO in the 1980s and is the case actioning and case management system to support the collection of overdue taxes. Enhancements to other ATO accounting systems under the ATO business system modernisation program have significantly improved the interface between COMPACT and core accounting systems.

1.30 The current primary focus of the ATO's modernisation program is the Income Tax Accounting Redevelopment (ITAR) project. The overall purpose of this project is to redevelop the system of accounting for income tax and will entail the achievement of the following objectives:

- integrating accounting for income tax functionality and data into the ATO Integrated System;
- providing accounting functionality to support the emerging outcomes of the work and job redesign project; and
- improving functionality (capacity of the business system to support a range of compliance activities) to satisfy current and projected business requirements.

1.31 The ATO business system centre is currently finalising functionality specifications for the new system. This is expected to improve the capacity of the business systems to produce quality account statements resulting in more efficient debt collection activity. Aspects of this project are reviewed in the context of identifying outstanding debt for collection (Chapter 3).

Debt Reduction Strategy

1.32 In the Federal Budget for 1994-95 the ATO received additional funds in the new policy context to invest in specific revenue-raising activities. The ATO proposal was developed in the context of workplace bargaining. As part of this proposal, Debt Collection received additional funds on the understanding that it was to bring in an additional \$100 million per year above normal collection activities over a three-year period. As part of the Debt Reduction Strategy (DRS), the ATO redeployed 295 personnel from their normal duties to a number of Debt Collection areas. The ANAO reviewed the performance of the DRS, the results of which are reported in Chapter 6.

Debt Collection in the Commonwealth

1.33 Commonwealth agencies are operating in an increasingly contestable working environment. This includes the prospect of competition in public sector activities to improve both program efficiency and effectiveness. ⁵

1.34 As the prospect of contestability becomes more widespread throughout the

Australian Public Service (APS), areas such as Debt Collection may be required to justify the reasons why they should be the preferred option for collecting outstanding tax on behalf of the Commonwealth. In light of contestability, the ANAO reviewed the relevance of the ATO's debt collection performance information in assisting internal and external benchmarking (Chapter 7).

Potential net benefits to the Commonwealth

1.35 The ANAO analysed the 1995-96 debt collection data contained in COMPACT to determine net benefits to the Commonwealth which could result from the implementation of initiatives to improve both the timeliness of debt collection and recovery levels.

1.36 Estimates of benefits obtained were based on data contained in 1995-96 Debt Collection Performance Summary Reports and took into consideration estimates of:

- average genuine outstanding debt referred daily to Debt Collection discounted by debts that are usually finalised by means other than payment (such as credit amendments, non-genuine debt and provisional tax variations);
- debt outstanding but yet to be referred;
- average amount of penalty applied and collected net of remissions per day;
- average number of days to finalise cases once referred to Debt Collection; and
- average number of days for cases to be referred to Debt Collection.

1.37 Potential ongoing benefits were calculated using a two-part process, firstly calculating savings achievable through more timely collection of debts and secondly, calculating savings achievable as a result of higher recovery levels.

1.38 The implementation of timeliness initiatives provides savings in terms of Public Debt Interest (PDI) and interest receipts. The ANAO interest savings estimates are based on the thirteen-week Treasury note interest rate of 7.4 per cent (as at 2 September 1996) and represents the cost to the Commonwealth of outstanding debts. The less time taken to collect debts, the lower is the PDI payable by the Commonwealth or the higher the interest receipts.

1.39 This interest effect is offset by a slight reduction in ATLP as the reduction in time to recover debt may result in the reduction in the amount of ATLP imposed and collected net of remissions.

1.40 Benefits arising from improvements in recovery levels result from higher recovery of primary debt and a higher rate of imposition and collection of ATLP, net of remissions.

1.41 Estimates are based on a cascading process where savings identified in preceding steps are considered when calculating the savings associated with each subsequent step. Figure 1 sets out the two-part process undertaken and identifies the potential scale of net benefits achievable as a result of improvements to the timeliness (Part 1) and effectiveness of the recovery process (Part 2).

1.42 Part 1B of Figure 1 illustrates that a reduction in referral time to COMPACT to seven

days for non-WHT and fourteen days for WHT (allowing an additional seven days to establish WHT debts - refer discussion in Chapter 3) provides a net benefit to the Commonwealth of \$25 million. The remaining Parts of the estimate demonstrate the sensitivity of revenue and PDI (and interest receipts) to slight improvements in timeliness and effectiveness of recovery action. For example, analysis indicates that a combination of:

- a 5 per cent reduction in the amount of debt falling overdue as a result of improvements in initiatives to promote timely payment (Part 1A);
- the aforementioned reduction in referral time (Part 1B);
- a 5 per cent reduction in time taken to finalise debts once referred to COMPACT (Part 1C);
- a 0.5 per cent improvement in the recovery rate (Part 2A); and
- a 5 per cent increase in the amount of ATLP imposed and collected net of remissions (Part 2B);

provides a net benefit to the Commonwealth of \$142 million, consisting of \$51 million increase in revenue and \$91 million saving in terms of PDI and interest receipts. Alternatively, this \$142 million can be considered to be the result of a \$52 million net gain from improvements in the time taken to collect debts (Part 1) and a \$90 million net gain from improvements in the effectiveness of recovery action (Part 2).

1.43 It is the opinion of the ANAO that there are potentially significant net ongoing annual benefits to the Commonwealth well in excess of \$142 million. We consider that there are potentially larger percentage improvements in identified areas than the above analysis suggests. Further, the analysis does not include benefits arising from a potential reduction in annual running costs nor take into consideration the one-off cost associated with implementing recommendations.

Figure 1: Estimate of potential net benefits to the Commonwealth



Note 1: Interest saving results from either a reduction in PDI or an increase in interest receipts.

Note 2: Net gain to revenue results from revenue benefits identified in Part 2 offset by decreases in revenue (ATLP) in Part 1.

Note 3 : Total of the interest savings identified in Part 1.

2. Initiatives to Promote Timely Payment

This chapter outlines the ANAO's assessment of the ATO's compliance activities in relation to promoting timely payment of accounts. The audit identified scope for improvement in administrative arrangements, encouragement and education activities.

Introduction

2.1 A core principle underlying the ATO's debt collection policy is that taxpayers are

expected to organise their affairs to ensure they pay their debts on time. However, ATO research on the 1994-95 return year established that approximately 20 per cent of income taxpayers who received debit assessments did not pay their account by the due date. This non-compliance is likely where taxpayers are forgetful, unaware or unsure of their obligations, believe that the ATO's enforcement strategies are inadequate, or believe the administrative framework for the establishment of liabilities and the collection of monies is inadequate.

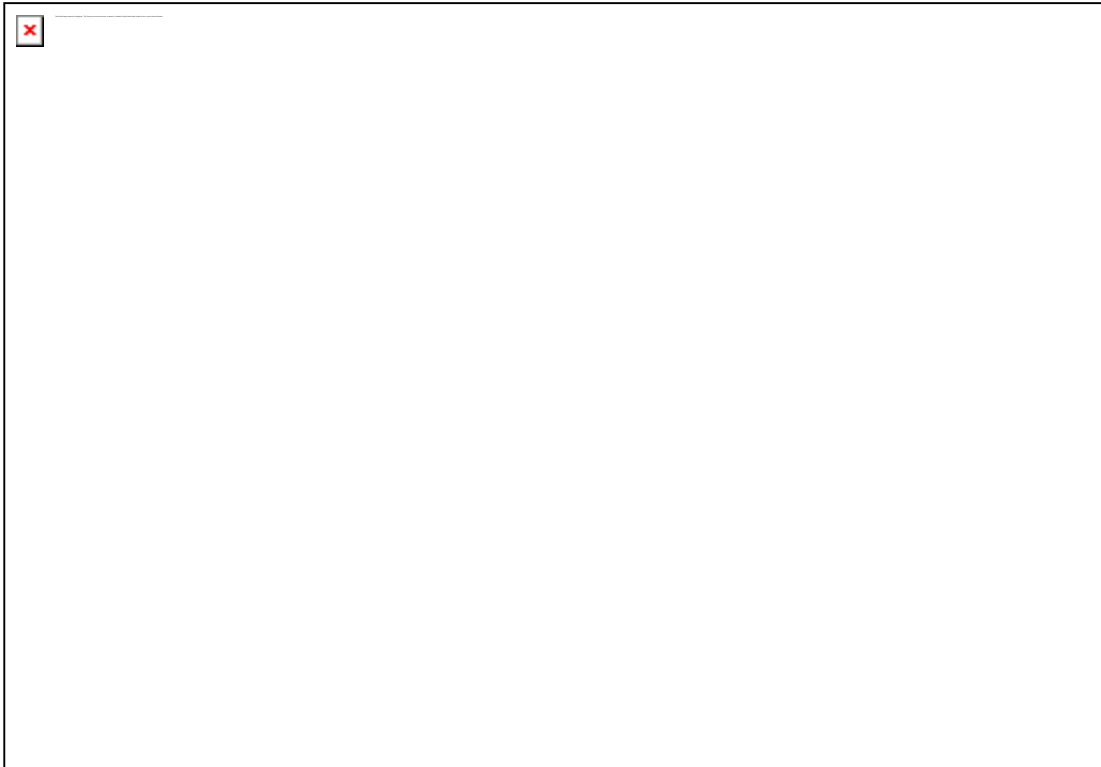
2.2 Given the large proportion of non-compliance, the ANAO considers that there is scope for improvement in education, encouragement, and administrative arrangements to reduce the number of taxpayers who are not meeting their tax obligations in a timely manner.

2.3 Diagram 2 is a simplified illustration of the relationship of the compliance strategies used to manage collection (administrative arrangements, education, encouragement and enforcement) with the generic collection process within the self-assessment environment. The diagram depicts how the critical events in a generic collection process may align with these compliance activities. Furthermore, it represents the collection of outstanding debt as an enforcement activity that occurs at the end of the time-frame when collection is less likely.

Research

2.4 Undertaking research on debt collection cases for the purposes of identifying common causes for late payment enables the identification of possible deficiencies in the ATO's administrative framework and education activities. The ANAO reviewed research conducted by the ATO, including a review of the ATO's use of key ATO publications and forms to provide general education on financial obligations. In addition, the ANAO reviewed the ATO's practices of targeting encouragement (raising taxpayer awareness of the consequences of non-payment) at habitual late payers.

Diagram 2: Compliance strategies and the generic collection process



2.5 The ANAO found that the ATO has conducted only limited research into the client profile of outstanding debtors. An analysis of COMPACT data with reference to other ATO databases (including externally-sourced data stored in the tax data warehouse) would improve understanding of both the causes of outstanding debt (such as the loss of a job) and high-risk segments of the taxpayer population (e.g. a specific industry). This would identify possible improvements to the ATO's administrative framework and education activities. The identification of high-risk segments of the taxpayer population would form the basis for cost-effective targeting of compliance activities at specific taxpayer segments and subsequent corrective action.

Recommendation No.1

2.6 The ANAO *recommends* that the ATO conduct research into the outstanding debtors' population to identify causes of outstanding debt, high-risk taxpayer population segments and opportunities for improvements to compliance strategies.

ATO response

2.7 The ATO agrees with this recommendation.

Administrative framework

2.8 The administrative framework is the system by which taxes are collected and includes the legislative framework, collection processes (e.g. methods for payment) and return forms. The ANAO reviewed ATO initiatives regarding methods of payments which are likely to facilitate timely payment.

Payment options

2.9 An appropriate range of payment options promotes timely payment and reduces cost

of compliance. In recent years the ATO has expanded the range of payment options available to taxpayers. The five methods currently available for paying a tax bill are:

- Mailpay;
- ATO counter service;
- Australia Post Billpay;
- direct debit; and
- electronic funds transfer.

2.10 In expanding the payment options, the ANAO recognises that the ATO must take into consideration the cost to the Commonwealth (including both administration costs and the cost in interest benefits if money is not banked promptly), the cost to the taxpayer and the degree to which a payment method increases the likelihood of timely payment. The ANAO found that the ATO had conducted preliminary analysis into payment options, including credit cards. The advent of phone banking, *smart* cards and the expansion of computer-based payroll systems are possible further opportunities for the ATO.

Recommendation No.2

2.11 The ANAO *recommends* that the ATO conduct research into payment methods to identify additional cost-effective methods of payment.

ATO response

2.12 The ATO agrees with this recommendation. The ATO has for some time been involved in research into alternative payment methods of the kinds mentioned in paragraph 2.10. This research is ongoing.

Education and encouragement

2.13 A key element of a balanced compliance program is education. Under the self-assessment system, the ATO has an obligation to address the information needs of taxpayers, including educating taxpayers to organise their affairs to ensure they pay their tax debts on time. Likewise, raising taxpayer awareness of ATO debt collection activities (enforcement practices) and thus the consequences of late or non-payment is an effective means of encouraging taxpayers to comply. A number of taxpayer associations consulted by the ANAO during the audit considered that education of taxpayers to organise their affairs to meet future tax obligations was critical.

2.14 The ANAO reviewed the ATO's use of general publications, such as TaxPack and instruction booklets, for education and encouragement. In addition, the ANAO reviewed the ATO approach to targeting education and encouragement at specific taxpayer groups by way of specific ATO publications and correspondence and other publications.

General education and encouragement

2.15 The ATO produces a number of publications aimed at advising taxpayers of their obligations and also raising taxpayers' awareness of enforcement activities. Examples include TaxPack, Group Employers Payment booklets and Company Form instructions. The ANAO found minor references in the ATO's general publications to taxpayers'

financial responsibilities and the consequences of non-payment. The majority of publications, including TaxPack, advise that extensions of payment are granted in special circumstances and additional tax for late payment will apply. The exception is the ATO's Group Employers Guide, which advises of both the possibility of legal action to recover debts and the size of penalties for late payment.

2.16 Both the *Principles Underlying the Debt Collection Policy of the ATO for Taxation Debts* and the current draft of the *Taxpayers' Charter* reflect the ATO policy that taxpayers are expected to organise their affairs to ensure they pay their tax debts on time. The ANAO considers that there is scope for improvement in general ATO publications regarding providing advice on taxpayer responsibilities with respect to timely payment, especially advice on the consequences of late payment or non-payment (including the extent of penalties).

Recommendation No.3

2.17 The ANAO *recommends* that the ATO review its use of key publications to clarify the consequences of failure to pay tax debts on time. Clarification should include the taxpayer's payment responsibilities, the possibility of legal action, the extent of late payment penalty and the ATO's policy regarding special circumstances.

ATO response

2.18 The ATO agrees with this recommendation. Compliance research needs to be done to ascertain whether this is best done through existing publications, another approach (increasingly by electronic means), or a combination of both.

Targeted education

2.19 Income taxpayers generally rely on the administrative framework (e.g. Provisional Tax and Pay As You Earn [PAYE]) to assist them in making provisions for tax obligations. For example, the PAYE system deducts tax by instalments from employee income and even varies the rate of deduction when taxpayers engage in a second job.

2.20 It is not practical to refine the administrative arrangements that deduct tax during an income year in order to reflect changes in circumstances in all instances. A cost-effective alternative for the ATO is to advise taxpayers at the time of a change in circumstances to review their financial arrangements to ensure that they can meet future tax debts.

2.21 Recommendation No.1 addresses research into debtor profiles that will facilitate improvements to the targeting of education, such as information on how to organise financial affairs to pay tax. ATO officers advised that loss of employment during an income year often causes a short-fall in tax credits and may affect the taxpayer's capacity to pay if the taxpayer does not recognise the need to make the appropriate arrangements.

2.22 The ANAO reviewed the ATO's use of Department of Social Security (DSS) publications to raise taxpayer awareness that loss of employment may have implications for future tax liabilities.

2.23 The ANAO found that the ATO distributes employment separation certificates for the DSS to employers with their ATO Group Employers Payment Book and Guide. Employers are required to complete the details of the certificate, at the request of former

employees, so that the former employee can apply for a social security benefit. The information for former employees provided with this certificate makes no reference to possible tax implications of loss of employment. The ANAO considers that the inclusion of tax advice on these certificates would assist taxpayers who ceased employment during an income year to understand their tax responsibilities and thus increase the likelihood of them making provisions for any future liability.

Recommendation No.4

2.24 The ANAO *recommends* that the ATO review its use of DSS forms and publications to help taxpayers make the appropriate financial arrangements for future tax obligations arising from loss of employment.

ATO response

2.25 The ATO accepts that it should continue to work with DSS to help taxpayers make appropriate financial arrangements for their potential taxation liabilities arising from a loss of employment during a year of income.

Targeted encouragement

2.26 Advice of ATO debt collection practices, targeted at high-risk taxpayers, is a cost-effective method for encouraging compliance. A review of private sector practices found that customer awareness programs are critical, as are clarifying the terms and consequences of non-payment. Specifically, the best results are obtained from pro-active methods, such as sending reminders before due dates for high-risk debts.

2.27 The ANAO reviewed the ATO's use of reminders and messages on notices of assessment to encourage taxpayers belonging to particular risk segments. The ANAO found that the ATO made limited use of these methods to encourage debtors with particular risk characteristics to pay on time. For example, debit notices of assessments do not advise of the amount of late payment penalty that will apply or that the ATO may initiate legal action if the taxpayer fails to pay by the due date.

2.28 The tailoring of specific messages for habitual late payers, emphasising that the ATO will immediately instigate specific collection methods if the debt becomes overdue, unless the ATO is contacted before the due date, would also encourage compliance. Modifications to the system to enable the automatic categorisation of taxpayers into risk groups (as discussed in Chapter 4) would provide the means for automatic adjustment of notices of assessments for risk groups. In addition, automatic reminders advising of ATO enforcement could be sent to employers who have a poor compliance history reminding them when they are scheduled to next remit Group Tax.

2.29 The ATO is familiar with the use of pro-active techniques to collect debt. The ANAO found evidence of one branch issuing a number of pro-active reminder letters at the start of 1996 to habitual late income taxpayers regarding future tax obligations. However, the ANAO considers that a comprehensive automatic approach to pro-actively encouraging certain taxpayers with particular risks would be a cost-effective technique of encouraging compliance.

Recommendation No.5

2.30 The ANAO *recommends* that the ATO develop an automatic system of reminder letters and additional information on notices of assessments, encouraging taxpayers in particular risk groups to pay their tax in a timely manner. Such encouragement should state specific collection techniques that would apply for recurring non-compliance.

ATO response

2.31 The ATO agrees that it should develop computer systems that will enable it to vary its debt collection actions/techniques to the risk profile of individual debtors. Subject to research on its effectiveness, the collection techniques developed may include systems to automatically issue letters or initiate other means of reminding high-risk debtors about their future taxation obligations, and collection techniques that would apply for recurring non-compliance.

1

ATO Corporate Plan 1995-1998, page 4.

2

The Receivables Management Group was a private debt collection specialist contracted by the ANAO to provide specialist advice as to how the private sector managed debt collection operations.

3

A *mareva* injunction is an interlocutory injunction which restrains a defendant or the defendant's agents, servants or otherwise from removing assets from the jurisdiction or disposing of or dealing with those assets so as to frustrate a creditor seeking to recover from the debtor.

4

CCH Tax Editors, *1996 Australian Master Tax Guide*, 27th edition, page 1091.

5

Department of Finance, *Examining Contestability within the APS: Initial information, concepts, case studies and lessons learned*, November 1995, page 1.

3. Debt Identification

This chapter outlines the ANAO's assessment of the ATO's ability to efficiently and effectively identify outstanding debt. Debt identification includes establishing components of primary outstanding debt, applying penalties and linking related entities. The ANAO found that debt identification could be improved by the ATO reviewing and updating the capacity of its business systems.

Introduction

3.1 The quick identification of outstanding tax debt allows for more timely debt collection activity, resulting in an increase in the likelihood that the debt will be collected. This involves the identification of the tax accounts that relate to a taxpayer and establishing the taxpayer's full liability. It also includes the identification of any components of debt that have been disputed (e.g. when a taxpayer objects to an assessment).

3.2 A second key aspect of identifying debt is the maintenance of outstanding debt on accounts. Both this and the efficient and effective application of late payment penalties (i.e. ATLP) are critical to the debt collection process.

3.3 The ANAO reviewed the process of identifying primary outstanding debt (initial debt outstanding before applying ATLP) and the ATO's efficiency at identifying those components. In addition, the ANAO reviewed the ATO's performance of applying ATLP and the ATO's policies for linking related taxpayer entities.

Identification of outstanding debt

Initial identification

3.4 Effective management of outstanding debt includes the quick and efficient identification of all outstanding debt and the targeting of effective collection practices in a timely manner. Both the nature of the initial recovery action and the timing of this action significantly influence the integrity of the tax system and the likelihood of full recovery. The ANAO reviewed the ATO's process of identifying outstanding debt and the timing of effective recovery action. We found that the debt identification process is twofold, consisting of:

- pre-recovery action generated by core accounting systems, which generally involves generic final notices advising of an outstanding debt or that a payment was expected, and in some instances processes to establish debt; and
- subsequent referral of remaining outstanding debt(s) to COMPACT for debt collection recovery action.

3.5 The ANAO found that the ATO had made significant improvements since early 1994 in the automatic referral of outstanding taxes to COMPACT from the core accounting systems. For example, as a result of business systems modernisation, a connection between COMPACT and the PAYE, PPS and FBT accounts has been established, resulting in the capture of a backlog of debt that had previously been manually input into COMPACT. The ATO, as part of the ongoing integration of accounting data, is aiming to establish a business system interface between other accounts currently not automatically linked, such as Quarterly Provisional Tax (QPT) accounts and COMPACT.

3.6 However, there is scope for further improvement in the management of this twofold debt identification process. The ANAO found significant in-built delays between debt becoming outstanding, debt receiving pre-recovery action and debt receiving recovery action. Automated pre-recovery action did not occur until somewhere between 10 and 16 days after debt had become overdue and subsequent recovery action was not occurring until between 17 and 68 days after debt became overdue.

3.7 Table 1 illustrates these in-built delays as they affect income tax and the remittance of PAYE deduction by group employers. During the course of the audit, ATO research that focused on improving the management of withholding and indirect tax accounts, also raised concern over these delays in identifying outstanding debt for action.

3.8 The ANAO found that there is a significant number of cases manually down-loaded into COMPACT before normal referral date. One ATO debt collection unit reviewed COMPACT data at the request of the ANAO to identify the extent cases are being down-loaded early. The branch office unit found that 1517 of the 5995 small business income tax cases referred to COMPACT between 1 July 1995 and 16 May 1996 were down-loaded early into COMPACT by staff after receiving a phone call, fax or correspondence from a taxpayer before the case would normally have been referred to COMPACT. Given that a significant number of debts are being down-loaded into COMPACT early, the ANAO considers there is benefit in the ATO automatically referring debts to COMPACT sooner.

Table 1: Timing and nature of recovery action after taxpayer fails to pay tax obligation by due date

Stage of debt	Example 1: Failure to pay income tax debts		Example 2: Failure by group employer to remit tax instalment deductions (PAYE) from employees' wages and salaries	
	Nature of action	Age of outstanding debt when actioned	Nature of action	Age of outstanding debt when actioned
Pre-recovery phase ¹	Generic final notice seeking payment sent from core accounting system in the majority of circumstances	10-16 days dependent on day of week that debt falls due	Generic final lodgment notice sent to some taxpayers from core accounting system 12 days after remission expected. If no reply after 28 days, the ATO investigates further whether employer required to remit and thus has an outstanding debt. ²	12 days
Recovery phase ³	Referral to COMPACT for debt collection recovery action	17-44 days dependent on size of debt, with smaller debts referred 21 days later than larger debts	Referral to COMPACT for debt collection recovery action	47-68 days dependent on size of debt, with smaller debts referred 21 days later than larger debts

Note 1: During the pre-recovery phase, a number of accounts are manually down-loaded to COMPACT before the normal date of referral as a taxpayer with an outstanding debt contacts the ATO before the debt is referred to COMPACT.

Note 2: Final demand notices are not forwarded to quarterly remitters, which represent the majority of remitters.

Note 3: Very small income tax debts are not referred to COMPACT, rather they are held in abeyance until the next assessment.

3.9 The ANAO identified several other aspects of debt recovery that support reducing the referral time of debts to COMPACT. For instance, smaller debts are referred to COMPACT up to 21 days later than larger debts. This delay is based on the need to reduce the large volume of smaller debts by giving these debts time to be paid before the case is referred to COMPACT for individual case management. However, the ANAO

found that these smaller debts on referral to COMPACT were handled in groups, with automatic processes issued with some degree of manual intervention for account reconciliation. As smaller debts receive generic automatic recovery action when referred to COMPACT, there is limited benefit in having significant time referral differences between small and large debts to reduce the volume of small debts before they are received by COMPACT.

3.10 Likewise, the benefits of generic pre-recovery action are limited in light of the in-built delays between the time when final notices are issued and the referral of remaining accounts to COMPACT. For example, research conducted by INB found that 75 per cent of income taxpayers who received final notices in 1994-95 did not pay before the elapsed time for referral to Debt Collection. Consequently 75 per cent of income tax outstanding debts did not receive effective initial action within 17 to 44 days of the debt falling overdue.

3.11 The ANAO considers that the delays of referral to COMPACT for the purposes of pre-recovery action limit the ATO's flexibility in applying a range of first recovery techniques to different segments of the outstanding debtor population. The initial segmentation of the debtor population into risk groups after debt becomes outstanding would allow habitual late payers to receive immediate effective recovery action (such as the initiation of legal recovery rather than another generic final notice). Furthermore, high-risk large debts where significant amounts are involved would receive immediate personal attention.

3.12 A review of private sector practices found that debt was referred for specific debt collection action between 1 and 7 days after becoming outstanding. Private sector better practice consisted of referring debt cases for immediate action the day after accounts become outstanding.

3.13 In light of these concerns, the capacity of the business systems to identify all outstanding debts as soon as they become overdue and/or are established would be of considerable benefit to the collection of outstanding debt. The ATO would then be able to track the full extent of its outstanding debts, monitor all recovery action, provide functionality to target initial action, and manage any subsequent additional action (such as follow-up phone calls) in a more timely fashion.

Recommendation No.6

3.14 The ANAO *recommends* that the ATO develop the capacity of its debt collection business systems to:

- identify all outstanding debts as soon they fall overdue and/or are established;
- provide flexibility for targeting action based on risks of recovery action immediately after debts are identified as being overdue; and
- monitor all outstanding debt and all recovery action.

ATO response

3.15 The ATO agrees that:

- it needs to utilise the capacity of its debt collection business systems to action all large debts as soon as they fall due and/or are established and subject to availability of enhanced computer case actioning systems, identify all other debts as soon as they fall due and/or are established;
- it needs to develop computer systems that will enable it to vary its debt collection actions/techniques to the risk profile of individual debtors, and to monitor the effectiveness of those actions/techniques; and
- all outstanding debt should be monitored on ATO debt collection business systems, when enhanced systems are developed.

System errors

3.16 Research conducted by the ATO indicates that a significant amount of manual work is undertaken in maintaining PAYE accounts. For example, it was found that 80 per cent of potential PAYE debts were not genuine debts. Instead, these cases resulted from either liabilities and payments being posted to the incorrect liability period, a nil liability (i.e. where there was no employment and no obligation to advise that a remittance was not necessary) or an inactive or cancelled PAYE remitter registration that had not been processed. The ANAO found that the ATO was exploring options for corrective action and suggests that the ATO ensure that these causes of non-genuine debt are addressed.

3.17 ATO branch officers advised that there are several other systems anomalies that cause the referral of non-genuine debts and consequent inefficiencies. The ANAO found that the performance information produced by COMPACT did not isolate non-genuine debts so as to identify the causes of significant errors. The ANAO's review of debt collection performance information, as reported in Chapter 7, recommends the separation of non-genuine debts for reporting purposes. The ANAO suggests that the ATO explore options in modifying performance information to identify the extent and possible causes of system errors.

Identification of components of principal outstanding debt

3.18 A taxpayer's debt may comprise a number of tax debts. These debts may result from non-payment of several debts related to a particular debt (e.g. a number of PAYE debts) or a number of debts related to different taxes imposed on the taxpayer (e.g. a sales tax debt and PAYE debt). Similarly, included in the identification of debts is the establishment of components of debts that are in dispute (where a taxpayer has appealed against part or all of an assessment) and those components that are not.

3.19 The ANAO reviewed the process of identifying multiple debts for collection in terms of identifying debts involving multiple taxes, and the ATO record of reconciling accounts for the purposes of initiating recovery action. The ANAO also focused on the process of identifying debts where a dispute is involved.

Multiple debts

3.20 A single taxpayer may have several tax responsibilities or tax roles, spanning, for example, income tax, provisional tax, FBT, sales tax and PAYE. The ANAO found that the COMPACT business system allows two-way linking or *cross referencing* of related cases. This generally occurs automatically for cases with the same tax file number (for

example income tax and FBT accounts) or exactly the same name. Debt collection staff can also manually enter a link between two debtor cases if required.

3.21 The ANAO found that, under the new business line structure, the ATO had identified WHT taxes to manage composite debts (where there are a number of outstanding debts associated with different taxes) at a national level and branch offices had clarified business line responsibilities regarding technicalities within this policy. For instance, some branches clarified that if there was only a small ATLP debt for PAYE and a large income tax debt, this debt was best managed by INB or SBI rather than WHT even though it could be categorised as a composite debt. The ANAO found that the national policy did not clarify these technicalities and the ANAO suggests that the ATO clarify these technical issues on a national basis.

Reconciling client accounts

3.22 The ANAO found that ATO debt collection staff undertook substantial manual reconciliation of accounts in order to calculate penalties and prepare statements of accounts to be attached with correspondence. The ATO has expressed concern internally that account reconciliations are time-consuming activities. A review of private sector practices found that manual reconciliation of accounts or balances is virtually non-existent as systems are fully automated.

3.23 As part of the modernisation project and the first release of the ATO Integrated System (AIS), the ATO identified the requirement for client statements to be produced for sales tax and PAYE clients. However, due to other priorities at the time, the construction of the client statement function was deferred. The current ITAR project is addressing the business systems' capacity to produce client statements.

3.24 The ANAO found that the ITAR project is progressing with the development of separate client accounts for each tax that can be generated on an *individual* basis. Debt collection staff have identified the option to automatically produce bulk numbers of statements for groups of taxpayers as part of automatic recovery processes (*batch-produce*) and ITAR is considering this functionality for future revisions. The ANAO considers the enhancement of the business system to batch-produce a large number of client statements would greatly improve the effectiveness of Debt Collection's automated processes. Chapters 4 and 5 identify additional improvements to the automation of key aspects of the recovery process.

Recommendation No.7

3.25 The ANAO *recommends* that the ATO give higher priority to the implementation of proposed improvements to business systems to batch-produce large groups of statements as part of automated recovery processes.

ATO response

3.26 The ATO accepts the direction of this recommendation. The ATO has been considering options to implement this functionality. These options will require substantial changes to ATO business systems. There are significant lead times to systems enhancements of this scale. Functionality to produce account statements for income taxpayers is expected to be available from late 1997.

3.27 The ITAR project has indicated that it will also analyse requirements for cross-revenue line statements (statements that incorporate all tax obligations in one statement) as part of future revisions of the business system. The ATO considers that these statements will assist in providing a complete picture of a client's financial position. In light of advice received by the ANAO on private sector practices, the ANAO considers the proposed cross-revenue line statements would not only be of significant benefit but would be industry better practice.

Recommendation No.8

3.28 The ANAO *recommends* that the ATO give higher priority to the implementation of proposed enhancements to business systems to produce cross-revenue line statements.

ATO response

3.29 The ATO accepts the direction of this recommendation. The ATO has been considering options to implement this functionality. These options will require substantial changes to ATO business systems. There are significant lead times to systems enhancements of this scale.

Disputed assessments

3.30 A taxpayer dissatisfied with an assessment or other taxation decision may challenge that decision, pursuant to Part IVC of the Taxation Administration Act. An objection against a decision can be lodged with the Commissioner of Taxation within four years of the service of notice of assessment or 60 days after the notice of assessment if the assessment was issued before

1 July 1992. However, the liability to pay assessed tax, additional tax or any other amount is not suspended pending the outcome of an application for review or appeal.

3.31 Currently, Income Tax Ruling IT2569 advises that extensions of time to pay a debt may be granted subject to payment of 50 per cent of the amount in dispute together with the full amount not in dispute. The ATO is currently reviewing this policy regarding debts where a dispute is involved. The ATO's current draft policy (released for consultation in July 1996) for disputed outstanding debts states that action to recover will not be taken until an objection is formally determined, except in those circumstances where there is:

- an undisputed amount that has not been paid; or
- a perceived risk to the revenue by not taking action to recover; or
- the debtor has either not provided substantial security, or not paid the disputed amount or a part of the disputed amount when requested to do so by the officer dealing with the dispute.

3.32 The ANAO considers that, regardless of whether the policy changes regarding disputed components of debt, policy still dictates that taxpayers pay the undisputed component of debts.

3.33 The ANAO found that the ATO had conducted extensive research into the issues associated with recovering disputed outstanding debt. A primary concern in this regard is the timely identification of the undisputed components of disputed assessments so that

recovery of these components can be pursued in a timely manner.

3.34 We found that ATO debt collection officers are dependent on advice from Appeals and Review (A & R) officers as to the component of debt that is disputed and the maintenance of information on business systems on the status of a dispute. ATO officers advised that this process caused delays. Chapter 9 of this report addresses the development of service agreements between A & R and Debt Collection to ensure more efficient management of impeded debt.

3.35 ATO research found that its business systems identify assessments that may involve a dispute but do not segment this debt into disputed and undisputed components. As such, performance information on the amount of debt impeded by dispute is inaccurate as it includes the undisputed components of such assessments. The ANAO considers that the absence of this debt profile hinders effective collection of collectable debts.

Recommendation No.9

3.36 The ANAO *recommends* that the ATO develop the capacity of ATO business systems to separate disputed assessments into disputed and undisputed components to assist the recovery process.

ATO response

3.37 The ATO agrees with this recommendation. Nevertheless, the ATO anticipates that there may be some delay in implementing the recommendation because of the systems changes needed to produce a separation of disputed and undisputed components of any individual debt.

Maintaining debt

- penalties

3.38 The various taxation laws provide for the automatic imposition of additional charges when a debt is paid late. The reasons for these penalties are essentially to:

- encourage taxpayers to pay on time by acting as a deterrent to late payment;
- avoid giving late payers an unfair advantage over those who do pay on time; and
- compensate the government for not having the use of monies properly payable.

3.39 For some taxes, the additional tax for late payment (ATLP) may consist of a combination of:

- an interest per annum component to compensate for any loss of revenue caused by the delay in collection;
- a penalty per annum component, aimed at penalising late payers; and/or
- a flat rate culpability penalty component, aimed at penalising late payers.

3.40 For example, the ATLP for income taxes is 19.5 per cent per annum (July 1996) and consists of an 8 per cent per annum late payment penalty component and a 11.5 per cent per annum late payment interest component which is linked to the thirteen-week Treasury Bond rate. However, PAYE and PPS ATLP is a 20 per cent flat culpability component

plus a 16 per cent per annum penalty component that applies to both the primary debt and the culpability component.

3.41 The law identifies the circumstances when the Commissioner of Taxation may remit the application of ATLP. Generally the Commissioner will only remit ATLP provided the taxpayer can demonstrate that the circumstances that led to the delay in payment of the tax were outside their control. In addition, the taxpayer must also undertake reasonable steps to mitigate the effects of those circumstances. Such circumstances would include strikes, sudden ill health of key personnel where the taxpayer is a sole trader or operates a small business, and the unforeseen collapse of a major debtor.

3.42 Appendix 2 lists some of the relevant provisions of the taxation statutes imposing additional charges for late payment and the provisions providing the Commissioner of Taxation with the discretion to remit these charges.

3.43 According to ATO's accounting data, in 1995-96 the Commissioner of Taxation applied \$370 million of ATLP, later remitting \$53 million of these charges.¹ The ANAO reviewed the ATO's performance in applying and remitting ATLP within the legislative framework.

Risks associated with ATLP

3.44 The ANAO considers that there is a significant risk that ATLP is not being imposed according to legislation, thus posing a risk to the revenue base and the integrity of the tax system. The ANAO found that there was insufficient management information to accurately identify the ATO's performance regarding the imposition, remission and collection of ATLP.² However, the ANAO conducted a risk assessment using the limited data available to establish the occurrence of ATLP imposition and remission.

3.45 The risk assessment was based on a count of account postings of some 118 000 finalised cases on COMPACT in 1995-96 that were finalised by payment (that is, it excludes cases finalised by write-off or by other credit such as a credit amendment). The ANAO found that 22 per cent of these outstanding debt cases that had ATLP imposed on account had at least some amount of the ATLP remitted. However, 41 000 cases (35 per cent of these outstanding debt cases finalised by payment) had no ATLP imposed on account.

3.46 The imposition of ATLP in cases where an account is paid late is mandatory. The Commissioner of Taxation does not have the discretion not to impose ATLP on unpaid amounts, although, as discussed, the Commissioner does have the discretion to remit ATLP which has been imposed.

3.47 The ANAO acknowledges that a portion of the 41 000 cases is likely to have been remitted having regard to the intent of the legislation. However, the degree of non-imposition is a significant risk given that the occurrence of non-imposition is not dependent on the amount of debt. Table 2 illustrates that the rate of non-imposition is similar irrespective of the amount of debt involved.

**Table 2: ANAO risk assessment:
Percentage of accounts finalised by payment in 1995-96 where no ATLP was imposed¹**

Classification of debt	Non-WHT (%) ²	WHT (%) ³	Total (%)
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<\$2,500	39	34	38
\$2,500 - \$7,499	30	24	29
\$7,500 - \$24,999	27	22	26
\$25,000 - \$49,999	26	20	24
\$50,000 - \$99,999	28	25	26
>\$100,000	35	28	32
Total	36	30	35
Note 1: Excludes cases finalised by write-off or other credits such as credit amendments and provisional tax variations.			
Note 2: Taxes administered by INB, SBI, and LBI primarily being income taxes			
Note 3: Taxes administered by WHT only include PAYE, sales tax and a few PPS cases representing the vast majority of all WHT cases etc.			

3.48 The results of the risk assessment are supported by the findings arising from the 1994-95 financial statements audit conducted by the ATO's Internal Audit function. ATO internal audit found that ATLP is not being imposed as per the relevant legislation. The ATO sampled 180 cases across a number of revenue lines (e.g. income tax, sales tax, etc.) in three branch offices and found that seven per cent of the total amount of ATLP that should have been imposed had not been imposed.

3.49 The ANAO reviewed three key aspects of the ATO's administration of ATLP, namely business system support, administrative practices and legislative framework.

Business system support

3.50 The ANAO found that the ATO business systems have a limited capacity to automatically impose ATLP. Results of the risk assessment found that only one per cent of finalised income tax cases had ATLP automatically imposed. One ATO branch office, at the request of the ANAO, monitored the time taken to manually impose penalties on income tax accounts where the business system could not calculate the penalties. The branch reported that manual calculations were not cost/time-efficient, taking 24.8 hours to impose penalties on 90 cases.

3.51 We found that the ATO had made significant improvements with regard to the automatic imposition of ATLP on WHT cases. This improvement was due to the migration of the majority of WHT accounts onto the AIS as part of the ATO business system modernisation program. The risk assessment results indicate that, for these cases, ATLP was imposed automatically on 55 per cent. The ANAO notes that the income tax cases are also scheduled to be integrated on the AIS system in the future, which is likely to improve substantially the degree of automatic imposition of penalties for income taxes. However, the ANAO considers the manual calculation of ATLP to be inefficient and to be a contributing factor to the limited application of the ATLP. Consequently, there is significant benefit in the ATO improving the new business systems' capacity to automatically impose ATLP on more than 55 per cent of finalised outstanding debts.

3.52 The ATO has examined the automatic imposition of ATLP as part of the processes for developing business system enhancements. The automatic imposition of ATLP for income taxes

was considered by ITAR when developing its specifications, with the intention of eventually including withholding taxes in future revisions. The ATO has advised that the implementation of the current ITAR specifications (currently limited to income taxes) is subject to decisions whether the ATO wishes to match specific debits against specific credits on the system.

Recommendation No.10

3.53 The ANAO *recommends* that the ATO ensure that proposed improvements to the business systems' capacity to automatically impose ATLP are implemented as soon as possible.

ATO response

3.54 The ATO agrees with this recommendation.

Administrative practices

3.55 The results of the ANAO risk assessment were that the rate of remission where penalties were imposed increased as the amount of debt grew. The risk assessment found that the remission rate steadily grew from less than 19 per cent for cases where the debt was less than \$2500 to 44 per cent for cases where the debts was larger than \$100 000. ATO management has noted that the inappropriate work practice of using penalties as a negotiating tool in debt collection has eroded the collection of penalty debts where the legislation requires taxpayers to pay a penalty.

3.56 The ANAO considers this risk of penalties being used inappropriately as a negotiating tool poses a risk to the integrity of the ATLP regime, the integrity of the tax system and thus the revenue base. Chapter 5 outlines recommendations for improvement in the ATO's management of collection practices, including practices regarding the application and remission of ATLP.

Legislative framework

3.57 The penalty provisions for late payment of taxes are contained in a number of taxation acts. Some acts require the imposition of both interest and culpability components, while others require just an interest component (Appendix 2 lists the relevant provisions of the more common taxation statutes regarding imposition and remission of ATLP).

3.58 The ANAO found that in 1995 the ATO had reviewed its administration of ATLP. The review had the aim of improving the fairness, consistency, cost-effectiveness and leveraging effect of the ATO's application of late payment penalties so as to improve taxpayers' compliance with their payment obligations. The review found that there are several ATLP issues requiring attention, including the inconsistency in the penalty provisions outlined in a multitude of ATLP provisions within the ITAA and other taxation acts.

3.59 As part of its brief, Tax Law Improvement Project (TLIP) has the simplification of the administration provisions of the ITAA. This includes the debt recovery sections. The scope of TLIP's work, however, does not extend to sales tax.

3.60 The ANAO considers there is benefit in the ATO reviewing the tax laws regarding additional charges for late payment penalty, for the purposes of identifying opportunities for simplification and areas of inconsistency. This may reduce the cost of compliance to the community. It may also facilitate improved efficiency and effectiveness of the ATO's administration of the ATLP by reducing the amount of policy and procedural documentation and simplifying the complex requirements of the business systems for imposing ATLP. The ANAO suggests that the ATO review the legislative framework for the ATLP for all taxes, including

sales tax, for the purposes of simplifying the relevant legislation and thus reducing the costs of compliance for both the community and the ATO.

Linking of related entities

3.61 In a number of instances, the ATO may link various taxpayers (companies, individuals, etc.) during the recovery process. This is particularly pertinent when the ATO uses the directors' penalties instrument outlined in Chapter 1. This instrument enables the ATO under legislation to make company directors personally liable for the debts of their company in certain circumstances.

3.62 The ANAO found that COMPACT provides a company directors' database, using details of directors' names and addresses manually entered by debt collection staff. Directors' details can be searched to identify other company debt cases associated with a particular director. This provides the ATO with the ability to identify and monitor directors associated with a number of failed companies in the past. The ANAO suggests that the ATO explore opportunities with the Australian Securities Commission to eliminate the need for manual entry of director data and thus fully automate the linking of directors with companies.

4. Priorities for Collection

This chapter outlines the ANAO's assessment of the ATO's process in setting priorities for collecting outstanding debt. Setting priorities for recovery action based on the risks associated with debts significantly influences the likelihood of collection. The audit found that the ATO had not taken full advantage of available data when developing a risk profile for the basis of setting priorities. The ANAO recommended improvement to business systems for the control and monitoring of debt recovery priorities.

Introduction

4.1 The policy and method of setting priorities of debts for recovery action substantially influences the likelihood of collection and reflects on the integrity of the tax system. As discussed in Chapter 3, the initial segmentation of the debtor population into risk groups helps to assess different cost-effective collection techniques and improves the likelihood of timely collection. Likewise, setting priorities for action based on the risks associated with debts also influences the likelihood of collection.

4.2 In this context, the ANAO reviewed the ATO's basis for establishing priorities of debts for recovery action. The ANAO also reviewed how the ATO implemented its debt collection priorities.

Policy for establishing priorities

4.3 The ATO recognises that risk management is an important component of collecting outstanding debts and that evaluating the risks to revenue is integral when making decisions regarding recovery practices. The ATO's draft debt collection policy document and other ATO research state that factors which affect the likelihood of a taxpayer paying include the age of debt, the taxpayer's previous compliance history and other aspects related to the taxpayer's current credit status. Likewise, the size and nature of the debt reflect the consequences of a taxpayer failing to pay, particularly if a debt is likely to escalate (e.g. some PAYE obligations are bimonthly and therefore debt can grow rapidly). Hence, managing the risks to revenue is the foundation for establishing priorities for recovery action.

4.4 The private sector review confirmed this philosophy, indicating that the major aspects influencing collection decisions are the nature and size of the debt and the person whose debt it is. The ANAO considers that there are several risks to revenue associated with outstanding debt. Diagram 3 provides examples of factors that influence the risk to revenue and thus form the basis of priority setting for recovery action. The diagram categorises these factors as:

- the likelihood of collection given the nature of the debt;
- the likelihood of collection given client characteristics (financial, compliance history and demographics);
- direct consequence (amount of debt); and
- indirect consequence (integrity of the system).

4.5 The ANAO acknowledges that the ATO does not necessarily have all of this information when establishing priorities for cases, although additional information is obtained during the recovery process. For example, the ATO business systems contain historical income data which may guide initial decisions but may be supplemented by financial data obtained by debt collection staff during the recovery process. Thus, establishing priorities for recovery action via the grouping of debtors for different recovery strategies is best based on available information on risk factors. We reviewed the ATO's basis for establishing priorities for recovery action with reference to the above illustrated risk factors and the availability of information regarding risk factors.

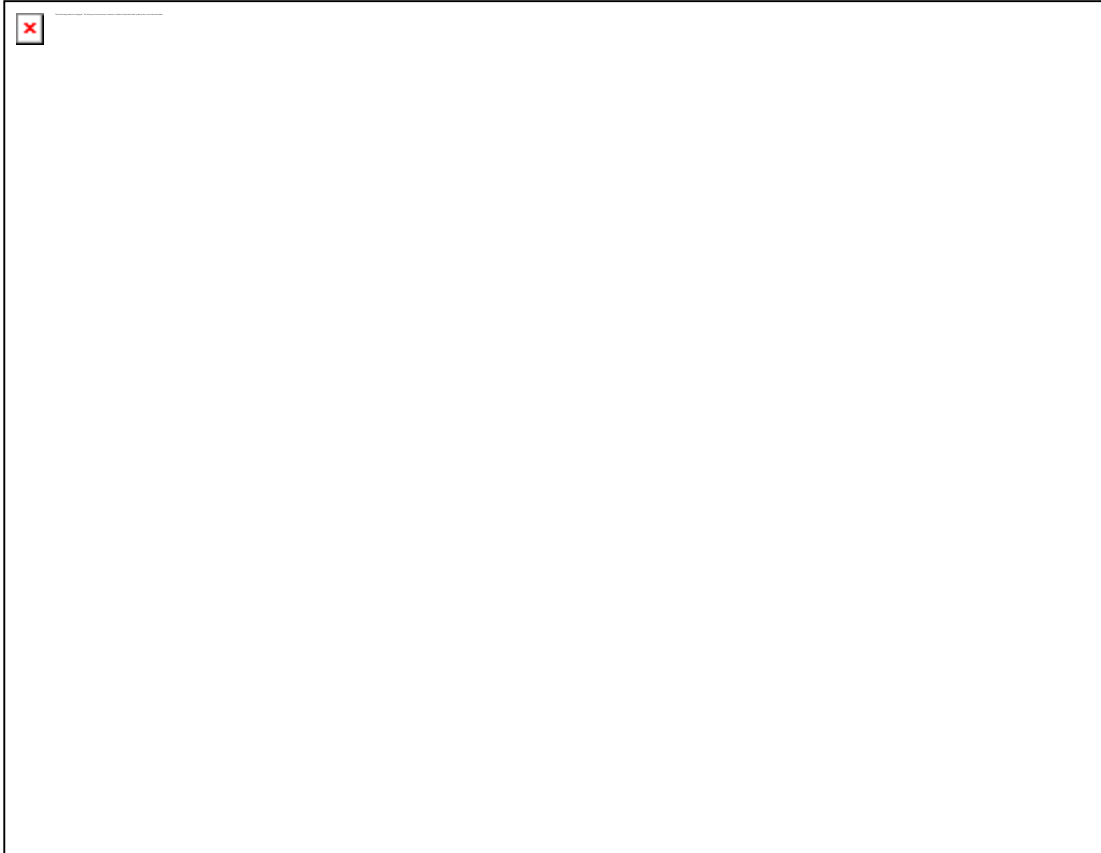
4.6 We found that the ATO's categorisation of the debtor population for priority setting was based on performance targets related to the age of debt (part of Factor 1 in Diagram 3) and the amount of debt (part of Factor 3 in Diagram 3). Each business line has a number of stated targets which debt collection units use as a guide to establishing priorities to cases for collection. The common target for all three business lines was that 90 per cent of new cases referred to Debt Collection should have been partially finalised³ or finalised within 90 days of referral. The other targets that formed the basis for priority setting varied between the three business lines, but generally reflected a higher degree of finalisation of large debts and the reduction of debt outstanding overall.

4.7 As a consequence of these targets, debt collection units, with the assistance of COMPACT, sort debt collection cases depending on the amount of debt and the age of debt. Smaller debts generally receive additional demand notices while the larger and older cases receive individual case management depending on the resources available. Thus, as the debtor population is sorted by age and amount of debt, only the large debts and a number of the older debts receive tailored initial action, while the smaller debts are seen as lower risks and thus receive generic action.

4.8 The ATO has not taken full advantage of available data when developing a risk profile of a debt for the basis of establishing priorities, limiting risk factors only to age and amount of debt. The ANAO found that the ATO has a significant amount of data available on ATO business systems that would support the development of client profiles. For example, the AIS and NTS contain information on taxable incomes, industry and occupation groups, return form data, lodgment history and audit results. This data, when combined with data from the tax data warehouse in a structured format, would enable the development of client profiles and facilitate the segmentation of the outstanding debtor population on COMPACT for

different collection strategies.

Diagram 3: Risk factors that form the Basis for Establishing Priorities for Recovery Action



4.9 A factor critical to client segmentation and collection strategies is the categorisation of habitual late payers. Currently, the identification of habitual late payers is restricted to individual case review of accounting and narrative history. COMPACT cannot categorise taxpayers on the payment history. The ability to categorise habitual late payers would make possible the efficient and effective implementation of targeted compliance strategies for habitual late payers. For example, the ATO could employ a combination of targeted encouragement in the form of automatic warning letters to these taxpayers before accounts are due (discussed in Chapter 2) and immediate automatic application of more stringent collection techniques when non-payment re-occurs.

4.10 The ANAO considers that there is significant scope for improvement in the ATO's approach to setting priorities for cases for recovery action. The ATO is well positioned to develop indices to reflect the compliance history of the taxpayer and other client characteristics such as income history.

4.11 The capacity to automatically segment the debtor population based on the taxpayer's profile, as well as the other factors outlined above (refer Diagram 3), would conform to industry better practice. As the amount of available staff resources guides the capacity of Debt Collection to individually manage a debt collection case, the ability to segment a debtor population on key available risk characteristics such as payment history will assist in the allocation of cases for individual case management. In addition, the capacity of the business system to segment the debtor population on risk characteristics will enable a greater degree of tailoring of automated collection instruments (e.g. demand notices) and thus improve the

effectiveness of these automated processes.

Recommendation No.11

4.12 The ANAO *recommends* that the ATO enhance the business systems' capacity to automatically segment the debtor population by risk characteristics of the debtor and characteristics of the debt, using data available on ATO business systems.

ATO response

4.13 The ATO agrees with the directions of this recommendation. The basis of risk assessment may not be restricted to data on ATO business systems.

Implementation control

4.14 A key part of instituting a policy for establishing priorities for debt recovery action is the method of implementing that policy. The ATO has noted that resource and system constraints have limited their ability to accurately monitor and control debt collection operations. An ability to monitor and control operations nationally would help the ATO maintain a system of priorities and internal standards.

4.15 As discussed in the previous section, the ATO controls its priorities via performance targets. Tax debt collection units have discretion on how they achieve these targets. For example, they may use the COMPACT business system to sort cases by age and amount of debt or to provide individual case management. COMPACT can be used by an individual debt collector to set priorities for his/her allotted debtor accounts and nominate a review date for follow-up action. Reports generated by COMPACT can be used to monitor performance against targets.

4.16 The ANAO observed that recovery units applied different collection techniques depending on their local anecdotal experiences on the effectiveness of the technique. We found that this resulted in significant differences in the use of various collection instruments. The ANAO found that the ATO also has limited capacity to monitor its collection strategies. COMPACT has the capacity to monitor the delays between each action occurring on an account and report accounts where the time exceeds nationally agreed deadlines. However, the ATO is unable to consolidate this data to provide a national view of the timeliness of action and the ANAO found no evidence that branches used this function of COMPACT. Likewise, the management reports provide limited data on the use of collection instruments. This issue is further discussed in Chapter 7 which addresses performance information.

4.17 The ANAO considers the use of targets to be integral in ensuring operations maximise performance. However, such targets operate best when effective methods of both controlling and monitoring priorities are in place. This reflects private sector operations that set performance targets but supplement these targets with automated processes. Private sector experience indicates that business system control and monitoring of the debt collection process is fundamental to ensuring maximum efficiency. The review of the private sector found that software for debt collection business systems is customised to each organisation's particular needs, with collection procedures automated for paths of action and monitored for adherence to standard procedures.

4.18 The ANAO found that COMPACT does not automate procedures nor identify the most appropriate action(s) given known circumstances. The ANAO considers that there are

benefits in the ATO enhancing the business system to automatically identify the preferred collection technique for a business segment based on the recorded national success of the techniques in resolving cases in particular segments. This would enable the ATO to take full advantage of its experiences nationally and improve control and accountability in the collection process through regulation, review and reporting of high-risk activities.

4.19 For instance, by using effective performance information, the ATO may be able to identify that a particular demand notice, followed by telephone negotiation, may be the most cost-effective collection alternative for a particular segment, based on national experience in that segment. The system could subsequently flag this action when new debt accounts are referred, while also monitoring the degree to which the practices were applied in the various units. The success at resolving these cases would assist in identifying both better and poor practices. The capacity of the system to automate key processes based on national experiences would also ensure that the ATO makes best use of the directors' penalty legislation powers on a nationally consistent basis.⁴

4.20 A fully automated case actioning system would also assist the ATO to employ specific strategies aimed at maintaining the integrity of the tax system (Factor 4 in Diagram 3). The ATO, via its actions, must ensure that the public perceives that no taxpayer can avoid the payment of their tax debt by virtue of the ATO's incapacity to pursue recovery. Consequently, the ATO's priorities should reflect both the direct and indirect effects of the degree to which debts are pursued. Although some small debts individually may be uneconomical to pursue, the ATO's strategy should provide for the pursuit of a small number of these debts to ensure that taxpayers are aware that no taxpayer can avoid paying tax. An automated system would assist in identifying a sample of small debts to pursue based on risk characteristics. For example, the business system may identify small debts associated with habitual late-payers to be pursued to a greater degree.

Recommendation No.12

4.21 The ANAO *recommends* that the ATO increase the capacity of the business system to control and monitor the recovery process on a national basis.

ATO response

4.22 The ATO agrees with this recommendation.



1

This amount does not include the ATLP applied and remitted with respect to PPS debts as, due to the conversion of PPS to new business systems, the data was unavailable.

2

Chapter 7 recommends that the ATO Debt Collection performance information be reported separately for ATLP.

3

Payment arrangement in place or legal action initiated.

4

The ATO has the power under legislation to make company directors personally liable for the debts of their company in certain circumstances.

5. Management of Collection Practices

This chapter outlines the ANAO's assessment of the ATO's management of collection practices. The audit identified the need for clear and comprehensive standards for the collection process to provide the basis for systematic monitoring and review. In addition, the audit found that further development of business systems is required to increase automation of collection activities and controls. The ANAO concluded that systematic evaluation and review of collection policy, practices and business systems are required.

Introduction

5.1 Debt collection staff located in over 70 units Australia-wide are required to apply an extensive and complex array of rules with professionalism, sensitivity and sound commercial judgment. In the process of collecting outstanding debts, they are faced with a number of critical decisions and processes which substantially influence the likelihood of recovering outstanding debt. Failure to apply appropriate collection practices can have various consequences, including the ATO forgoing an amount of debt and the undermining of the integrity of the tax system. Thus, managing these and other risks is an integral component of efficient and effective administration of a recovery program.

5.2 The ANAO analysed the ATO's management of collection practices within the risk management framework illustrated in Diagram 4. Within this context, the ANAO reviewed the ATO's management of the collection process, and in particular how the ATO identified and managed these inherent risks in the collection process.

5.3 We focused on the ATO's debt collection policy and standards, its performance in collection of outstanding debt against those standards, and the degree to which it had monitored collection practices so as to identify high-risk practices.

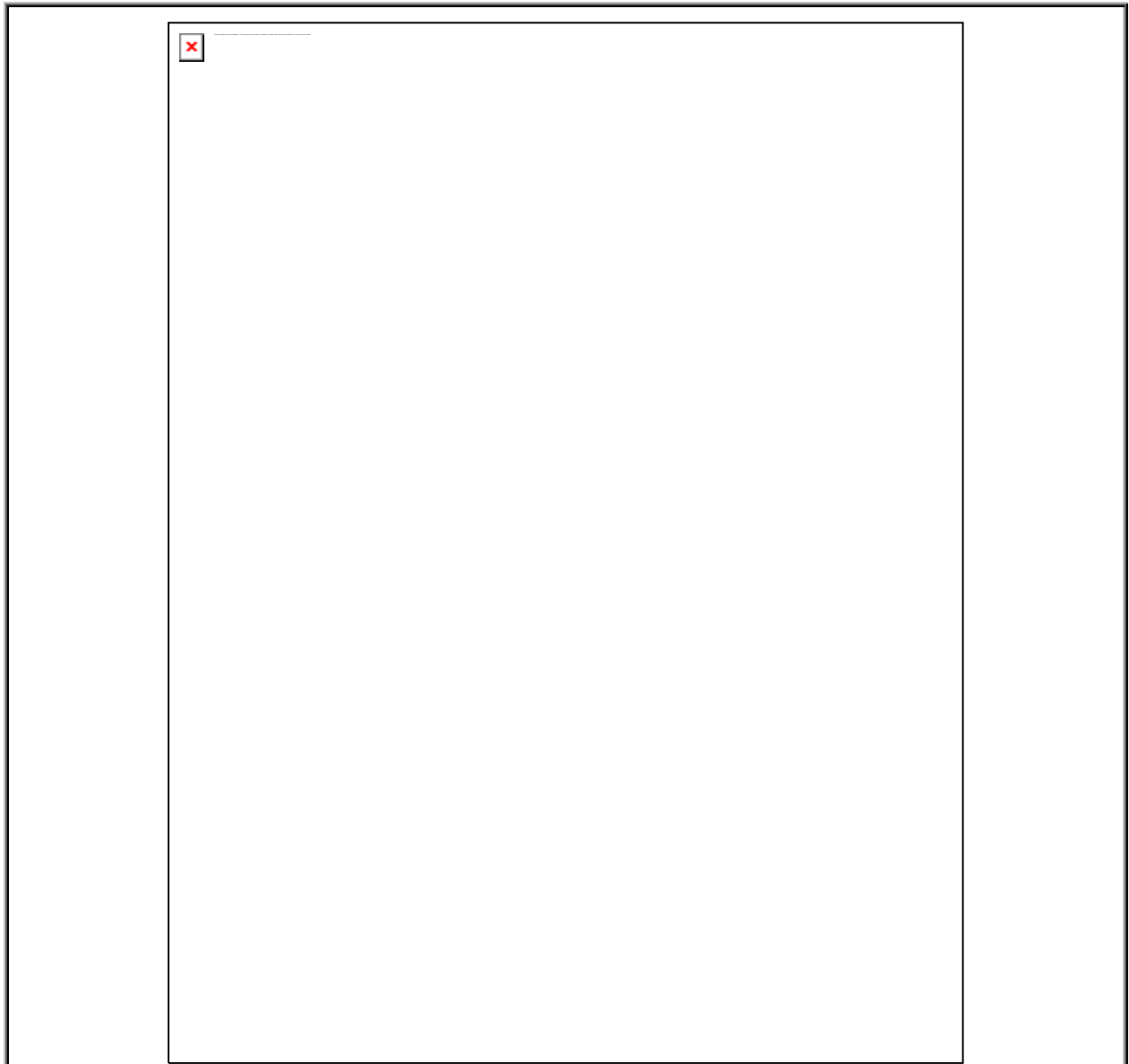
5.4 Subsequently the ANAO reviewed a number of elements that are used to treat risks, including process controls such as delegations, procedures, skilling programs and business support systems, and the ATO's record for continually reviewing the application of practices.

Policy and standards

Policy

5.5 Policy statements interpret the intent of the Parliament and its legislation, providing further details of an agency's considered view on a particular issue. The publication of formal policy documents and rulings seeks to provide certainty and consistency for tax professionals and the community, through explicit and uniform guidelines for ATO interpretation and application.

Diagram 4: Conceptual risk management framework for the analysis of debt collection practices



5.6 The ANAO reviewed current debt collection policy, focusing in particular on policy revision. The *Debt Collection Reference and Policy Manual*, released in December 1991, is the primary policy document for ATO Debt Collection. However, this document was not released to the public, leaving the earlier 1986 version as the last debt collection policy document released externally. In addition, policy and administrative interpretation are set out in a number of documents including:

- six key Tax Rulings (IT2569, IT2570, IT2440, IT2171, IT2209, and SST3), most of which were released from 1985 to 1989;
- *Recovery of Unremitted Amounts*, documenting the use of Estimates and Directors' Penalty legislation;

- nineteen *Debt Collection Advices*, issued from 1993 to provide guidance on legislation, policy and procedures;
- a *Handbook on Release Provisions*;
- directions appended to the Department of Finance delegations, providing guidelines for those exercising delegations;
- various Complex Legal Recovery Unit bulletins;
- a number of internal office minutes; and
- legal opinions provided by either counsel or the Australian Government Solicitor.

The majority of these documents have been developed since 1991 as a result of new legislation and policy measures.

5.7 The Debt Collection policy document and relevant tax rulings comprise the key documents publicly released for external reference. The ANAO considers that the ATO's record of maintaining policy in the public domain has been unsatisfactory. The delays in replacing IT2171, which outlines the Commissioner of Taxation's stance on the remission of ATLP on outstanding PAYE debts, is an example. The ruling, issued in 1985, automatically reduced the flat penalty component of the ATLP from 20 per cent to 4 per cent due to the excessive nature of the penalty when combined with a *per annum* component. The ruling advised that the ATO intended to adopt a penalty system whereby second and subsequent offences would attract progressively higher levels of the flat penalty. The ruling stated that a separate taxation ruling would be issued on this aspect when final policy is formulated.

5.8 The ANAO found that the ATO had identified possible improvements to ATLP and PAYE as part of the recent review of ATLP referred to in Chapter 3. However, the ATO has not yet developed administrative policy regarding ATLP and PAYE, nor has a new taxation ruling been issued.

5.9 In 1993 the JCPA Report 326 recommended that the ATO determine *a comprehensive national policy for debt collection*. Subsequently, in September 1995 the ATO released the *Principles Underlying the Debt Collection Policy of the ATO*. This document articulated the philosophy underlying the ATO's collection of outstanding debts, and formed the basis for redrafting the debt collection policy, which commenced late in 1995. The ATO is finalising this draft policy, which was released for external consultation in July 1996.

5.10 Although the ANAO acknowledges the ATO's recent efforts in developing the new policy document, the ANAO considers that the ATO's record in maintaining a clear and consistent central policy document has been poor. The lack of an appropriately maintained clear and consistent policy framework, both internally and externally, undermines effective recovery of outstanding debts. The ANAO considers that it is critical that the ATO initiate measures to ensure that the revised policy is maintained in the future. A critical step in achieving a consistent policy position entails the scheduling of revised tax rulings in line with changes to the new policy document.

Recommendation No.13

5.11 The ANAO *recommends* that the ATO ensure the systematic revision of debt collection policy and rulings in response to changes in the legislative framework and collection environment.

ATO response

5.12 The ATO agrees with this recommendation. A draft policy manual for the collection of debts was released for internal and external comment in early July 1996. The feedback received is currently being reviewed. The revised manual will be released shortly. The manual will be reviewed in early July 1997 to address any subsequent feedback and amendments proposed by the Bankruptcy Law Amendment Bill 1996. Work to revise relevant taxation rulings will commence with the release of the policy manual.

Standards

5.13 Standards are *formally documented requirements, against which performance can be assessed*.¹ Standards for debt collection may include requirements for documentation of decision-making processes, accounting controls, and measures for timeliness of action. Prescribed standards seek to ensure that both staff and clients gain a common understanding of expectations and requirements, thus providing a basis for monitoring and control.

5.14 The ANAO found that there was no comprehensive and clear articulation of standards for debt collection activities. A number of ATO documents touch on requirements, for example some training material and internal minutes. In addition, SBI developed a set of *SBI Debt Collection National Performance Standards* as part of its draft Debt Collection Quality Assurance package, circulated to regions during the course of the audit. Likewise, the COMPACT system contains a set of designated acceptable time standards for certain recovery action. But, as discussed in Chapter 4, this facility is not extensively used.

Recommendation No.14

5.15 The ANAO *recommends* that the ATO develop and disseminate clear and comprehensive standards for debt collection activity.

ATO response

5.16 The ATO agrees with this recommendation.

Monitoring performance against standards

5.17 Systematic monitoring of an activity enables the identification of recurring sub-standard practices, the consequences of these practices, and opportunities for improvement. A poor practice may result in the ATO forgoing revenue and the undermining of the integrity of the tax system. Identification of these practices and their consequences enables the treatment of risks that significantly impair the efficiency and effectiveness of program performance. Treatment of risks usually includes the development and implementation of measures to improve practices.

5.18 The development and implementation of improvement measures involves initial and ongoing costs (including salary, administrative and system costs) which can outweigh the

benefits. Risk management involves a balancing of these costs and benefits, and may necessitate accepting a degree of inherent risk where a measure seems too costly given the benefits. However, it is necessary to continuously review the process to evaluate the effectiveness of current strategies in the face of changing risks.

5.19 The ANAO found that the ATO is not in a position to systematically identify and treat systematic risks in the debt collection process other than on an ad hoc basis. The ATO has not undertaken a risk analysis which would form the basis for appropriate accountability and review mechanisms in Debt Collection.

Quality Assurance program

5.20 One important mechanism for reviewing practices is a Quality Assurance (QA) program. Currently there is no nationally coordinated approach to the development of a consistent QA process. Each business line has pursued a separate approach to debt collection QA. An ATO survey found that only a small number of debt collection units were either developing or using a QA program.

5.21 The SBI Debt Collection QA program, which was circulated to its debt collection units in April 1996, has not been fully implemented. The SBI program is based on the regional review of 120 cases Australia-wide, and a branch level review of 10 cases for each collection operative. Both INB and WHT business lines have identified development of QA as a key initiative in their 1996-97 business plans.

5.22 The ANAO found no documentation to support the ATO's rationale for its approach to sampling. As sampling methodology affects both the confidence the ATO can place on the results of a QA program, as well as the costs of undertaking the review of a significant number of cases, the ANAO sought advice from the ABS on sample design and sample sizes.

5.23 The ABS advised that a number of steps should be taken in a sample design process to ensure that there is an acceptable degree of validity in the results. These steps included:

- consultation with stakeholders to determine the QA program's objectives, reporting requirements and practical constraints (including timing, costs and accuracy requirements);
- determination of the most appropriate sample design and data collection methodology, given the key characteristics of the population; and
- pilot testing of the program to review the sampling assumptions as well as the overall methodology and implementation.

5.24 In order to obtain an estimate of the number of cases that adhere to particular QA criteria, it is practical to take a representative sample of the whole population of cases on COMPACT. The ABS provided the ANAO with a schedule of different sample sizes based on:

- stratifying the population based on particular factors;
- an estimate of the expected rate of cases that fail to meet the QA standards (error rate); and

- a desired accuracy level of this error rate.

5.25 The ABS investigated sampling on a number of bases, including sampling guided by branches, business lines and current status. This advice also illustrated that the larger the sample size, the more confident the ATO can be that the sample estimate of the number of cases that fail to meet specified standards will be close to the actual amount of sub-standard cases for all the population.

5.26 For instance, suppose the actual number of sub-standard cases is five per cent of the population, or in other words 25 000 cases.² The ABS advised that a sample size of 28 665, stratified on a regional as opposed to a branch basis, would enable the sampler to be 95 per cent confident that the estimate of sub-standard cases resulting from the sample would be between

23 750 and 26 250 cases. By lowering the sample size and therefore the accuracy level of the sample estimate of sub-standard cases, the 95 per cent confidence interval increases. For example, reducing the sample size to about 1200 produces a 95 per cent confidence interval for the occurrence of sub-standard cases of about 18 500 to 31 500 cases, increasing the likelihood that the sample estimate may differ dramatically from 25 000.

5.27 The ANAO considers that in order to obtain an accurate representation of sub-standard collection practices that pose a risk to revenue, a substantially large sample, in the vicinity of 28 000, would be required to ensure informed decision-making and thus the efficient allocation of resources.

5.28 Given the sample size required, the ANAO considers a fully manual QA system to be impractical as it is not administratively feasible to review individually such a large sample. Consequently, the ANAO considers the benefits of the current approach to be limited and recommends that the ATO implement an automated QA system supplemented by some manual QA features as a more efficient and effective approach.

5.29 Private sector better practice uses computer-driven review and control of collection activities, providing management reports on results, trends, and areas requiring urgent action. Business systems can apply criteria that reflect an acceptable degree of risk, with exception cases flagged for management review. Debtors with previously good compliance records who have been granted short-term payment arrangements may be designated as low risk, thus requiring minimal manual scrutiny. However, there are qualitative aspects of debt collection activities which could not be audited effectively by business systems, for example the quality of decision-making in granting remission of penalties.

5.30 The ANAO considers there to be benefits in automating the review of debt collection operations against key performance standards, supplemented by more rigorous personal scrutiny in the form of manual QA programs, applied to high-risk activities. In addition, there is significant benefit in having the business system support QA by identifying for manual review those cases that exceed acceptable risk criteria. This would involve manual review of:

- a small sample of cases that meet business system standards;
- larger samples of those cases which the business system identifies as falling outside the standards, and thus requiring greater manual scrutiny; and

- cases which are too complex for system audit.

This framework provides a more cost-effective approach to the thorough and systematic review of a large volume of cases than the ATO's proposed method.

Recommendation No.15

5.31 The ANAO *recommends* that the ATO develop and implement a comprehensive debt collection Quality Assurance program. This program should take advantage of the efficiencies associated with business system automation of case selection, review and reporting, supplemented by an appropriate manual QA program.

ATO response

5.32 The ATO accepts the direction of this recommendation. Implementation of the recommendation, however, will probably have to be phased in over time. Initially the QA process will be manual. This process will be modified as systems enhancements are introduced.

Procedures

5.33 Clear procedures are an effective measure for ensuring that collection practices are consistently applied according to policy and standards. They assist staff through the collection process, outlining the key steps required for effective recovery of outstanding debt, while taking into consideration individual circumstances. This concept of procedural fairness is a cornerstone of equitable treatment of taxpayers.

5.34 The ANAO found that there is only a small number of national instructions for debt collection procedures. Several years ago, an electronic reference manual was developed in Victoria, with national access to this manual implemented a short time later. This manual has not been maintained, contains minimal procedural documentation and so does not reflect current collection practices. As a result, various branches have developed their own procedural documentation, which vary in coverage and content. The ANAO considers that this parallel development of local procedural documentation is administratively inefficient and may cause the entrenchment of inconsistent approaches to collection.

5.35 While basic procedural information is given in both the draft national policy and training documents, there has been no systematic or comprehensive program to coordinate procedural material nationally. The ANAO acknowledges that there are differing requirements regarding legal procedures due to different State jurisdictions. However, the ANAO considers that this does not impinge on the commonality of most collection practices and that jurisdictional issues could easily be incorporated into a national procedural framework. Hence, we consider there to be efficiency gains, as well as improvement in equity and consistency, in the national development of procedural material.

Recommendation No.16

5.36 The ANAO *recommends* that the ATO develop national procedural documentation to provide clear and consistent guidelines on collection processes.

ATO response

5.37 The ATO agrees with this recommendation. The ATO has planned for some time to start revising its procedural documentation when the policy manual has been released. As noted in paragraph 5.12, the manual is to be issued in the near future.

Training

5.38 Debt collection staff are required to apply a very broad range of knowledge and skills. For instance, knowledge of various taxing provisions, ATO business systems, corporations and bankruptcy laws, court systems and procedures, as well as the ability to assess financial statements and negotiate with taxpayers and tax professionals, will be required in most collection work. Many of these aspects are best conveyed through collection policy and procedures. However, training is generally also required to ensure that staff have sufficient skills and knowledge to recover debts, within this policy and procedural framework.

5.39 Collection activity is currently undertaken by over 1200 ATO debt collection staff Australia-wide, with the ATO envisaging that additional ATO staff will also have some collection responsibilities in the near future. Both an ATO survey of tax professionals and ATO branch staff highlighted concerns over levels of inexperience due to high rates of staff turnover. Increased numbers of new staff place greater demands on debt collection areas in providing sufficient training and support to ensure that collection skills are acquired and maintained.

5.40 The ATO has recognised that in the past training has been ad hoc and inconsistent, lacking focus and direction. Local development of training materials is common, resulting in gaps and duplication of training resources, and the risk of inconsistent policies and practices between branches and business lines. A national debt collection training forum was instituted in 1995 to develop and implement a structured and integrated skilling program. A staged process for development of nineteen training packages covering all debt collection activities is under way, and draft packages have already been distributed for peer review as scheduled.

5.41 The ANAO found that ATO branch management were generally assessing the training requirements of their staff, with a view to providing appropriate formal or on-the-job training. The ANAO commends the ATO's recent efforts in developing a national approach to skilling.

Process control

5.42 There are a number of controls which can be implemented during the collection process to ensure conformance to policy where a substantial risk to revenue is involved, for example when writing-off debt. The ANAO focused on use of delegations and authorisations.

Delegations and authorisations

5.43 In-line controls for debt collection predominantly consist of system access restrictions on certain high-risk transactions, as specified by delegations and authorisations. Delegations and authorisations include the approval of payment arrangements, the remission of late payment penalties, writing-off tax debts as uncollectable, and the pursuit of bankruptcy action. These delegations often specify monetary limits for each staff classification level.

5.44 Debt collection delegations are primarily contained in a number of schedules authorised by the Minister of Finance. While delegations involving account alterations may be subject to business system controls, others such as the approval of payment arrangements are not subject to any automated controls. In these cases, it is the responsibility of staff and management to ensure adherence to parameters set by delegations for certain work practices. The review of private sector debt collection activity found that private sector better practice for process controls involves a hierarchy of authorities relating to similar aspects of the collection process.

5.45 The ANAO found evidence of significant variation in levels of delegations and authorisations between branches and business lines. For example, Finance delegations for writing off irrecoverable revenue at the ASO4 level range from nil to \$250 000 in different branches. Given that Debt Collection has specified uniform core competencies for staff at this level across all branches, the significant difference in delegated responsibilities is inappropriate.

5.46 If a consistent level of judgment and expertise is required at each level, wide disparities in delegated authorities indicate that either some staff are under-using their skills, or conversely are expected to exercise a higher level of judgment than their peers, increasing the level of risk to revenue through inappropriate decision-making.

5.47 This inconsistency is compounded by inadequate controls on ATO business systems. For instance, the COMPACT system controls access to certain transactions depending on staff level and the amount of revenue involved. However, a significant proportion of debt collection staff have access to these transactions on ATO core accounting systems outside the control of COMPACT. As this access does not limit the amount of revenue in line with delegations, the controls imposed by COMPACT may have limited effect.

Recommendation No.17

5.48 The ANAO *recommends* that the ATO review existing debt collection delegations and authorisations with a view to national consistency and increase the ATO's business systems' capacity to control and monitor delegations and authorisations.

ATO response

5.49 The ATO agrees with this recommendation. Some of the key delegations used by debt collection officers have already been revised to achieve national consistency. The remaining delegations will be revised shortly. The ATO is currently exploring the use of business systems to control and monitor delegations and authorisations.

Business system support

5.50 Business systems can provide substantial efficiency gains. Such systems are used extensively throughout the collection process within the private sector, and are seen as the linchpin in maximising debt collection performance. As discussed in Chapter 1, the ATO uses COMPACT as the case management tool for debt collection. Chapter 4 reviewed COMPACT's capacity to control and monitor ATO recovery priorities and recovery action. In addition, we have reviewed COMPACT's capabilities in the following areas:

- automation of routine collection activities; and

- decision support.

Automation of routine collection activities

5.51 Earlier chapters have identified scope for improvement in the use of business systems to prepare and maintain accounting information and to establish priorities for cases for actioning. Further, Chapter 4 recommends the use of the business system to automatically segment the debtor population for initial action. The ANAO found that a number of overseas tax collection agencies and local private sector organisations are using a combination of effective automated letter and telephone recovery techniques.

5.52 For example, overseas tax collection agencies and private sector firms are increasingly adopting risk profiling (e.g. compliance history) as the basis for automating collection strategies. This can provide a basis for business systems to apply a sequential series of automated collection actions based on risk category. For instance, the business system may automatically issue a range of demand letters of increasing severity depending on the taxpayer's failure to respond and other compliance characteristics, then flag cases for individual attention. On the other hand, the business system may trigger write-off action based on debt amounts and estimated cost of collection where standard recovery processes have proved fruitless.

5.53 In a number of private sector collection firms, telephone contact is found to be more effective than letter demands in the debt collection process. This has led to the development of interactive telephone technology, which provides automatic dialling and messaging functions. Interactive telephone systems eliminate wasted effort in reaching unattended or busy telephone lines, thus substantially reducing unproductive telephone work and allowing collection staff to contact a greater number of debtors.

5.54 A U.S. Internal Revenue Service (IRS) survey revealed that 73 per cent of debtors were prompted to act by a call, and almost half stated that they would not have responded similarly to a written demand. The IRS noted that equipment costs were low, however, benefits included increased cash flows and earlier action on non-complying debtors.

5.55 The IRS has implemented an *Early Intervention* program for debt collection, which accelerates the demand notice cycle and increases the use of telephone contact (particularly outside working hours). Likewise, a United States General Accounting Office (GAO) Report ³ found that the contacting of taxpayers outside working hours (evening hours during weekdays as well as on Saturdays), was quite a successful collection technique employed by one State in collecting outstanding debt. In fact, for each dollar the State invested in this phase of telephone operations, \$25 in revenue had been realised. ⁴

5.56 The ANAO considers that there is significant benefit in the adoption of automated collection activities, especially given the significant volume of smaller debts that are referred to Debt Collection for recovery action. The COMPACT system provides partially automated actioning in a number of instances, including the generation of demand letters and garnishee notices based on nominated selection criteria. However, the criteria are essentially limited to debt amount and age, to the exclusion of other key debtor characteristics that influence the likely response to automated collection actions.

5.57 For example, the business system currently lacks the capacity to automatically target

a specific range of letters to habitual late payers, as opposed to those taxpayers who have failed to pay for the first time. We also found that other documents, including most correspondence, statements of account and legal processes, are generally drafted using a separate word-processing package, thus requiring significant individual intervention.

5.58 We consider there are significant efficiency gains from fully automating basic collection processes using a combination of correspondence, facsimile and telephone technology targeted to debtor segments. This will increase staff resources available to pursue those cases where their individual attention and expertise will prove most productive.

Recommendation No.18

5.59 The ANAO *recommends* that the ATO improve its debt collection business systems to provide a greater degree of automated recovery action throughout the collection process.

ATO response

5.60 The ATO agrees with this recommendation. The timing of implementation of improvements to business systems will be addressed through ATO systems planning processes. Under this process, proposed systems enhancements will be evaluated and allocated a priority. The ATO will advance this recommendation in the next cycle commencing early 1997. Implementation is likely to be phased.

Decision support tools

5.61 Where activities are too complex to allow full automation, business systems can provide decision support tools to assist collection staff. To supplement policy, procedures and training, business system tools such as *decision-trees* and financial modelling programs can improve procedural fairness and consistency by providing a structured and soundly-based approach to the decision-making process.

5.62 The ANAO found that during the recovery process, debt collection staff can assess the debtor's compliance history only by scanning accounting details and return form details on ATO business systems and case notes for any record of late payment, legal action or broken agreements. Additional and more current financial details, where obtained during the recovery process, are stored on paper files or summarised on case narrations. Thus, critical details which could affect collection decisions may be overlooked in the extensive case notes. Furthermore, as financial data is presented in a raw form, and in a number of locations, there are limited interpretative financial ratios available. Thus, debt recovery staff require financial analysis skills to interpret relatively complex financial information.

5.63 The ANAO considers that there is significant scope for improvement in the ATO structuring client data so as to ensure that key client details are best used to assist structured decision-making in an efficient manner. The risk profile that is relevant to the collection process includes financial information, credit and compliance history and business demographics (as outlined in Diagram 3 in Chapter 4) as well as interpretive information (e.g. financial ratios, risk ratings, etc.) to support informed decision-making.

5.64 As discussed earlier, the ATO is well positioned to take advantage of such decisions system support as a significant amount of relevant data is contained on other debt collection business systems.

5.65 Decision support software can provide an indication of business viability, using standard accounting details and ratios. For example, such systems allow banks to decide loan applications over the phone and on field visits.

5.66 The potential benefits in improving the availability and access to key client data on ATO business systems are evidenced by the results of the ATO's recently completed client location project. The project conducted a small trial, involving a single skilled staff member using readily available resources to find current debtors' addresses. These debtors owed approximately \$180 000, which was to have been written off that day as uneconomic to collect because the taxpayers could not be located (these debts can be resurrected if the client is subsequently located). However, the trial found new addresses for 100 per cent of the previously untraceable debtors, facilitating recovery action. The results of this project illustrate that readily accessible up-to-date data on the location of outstanding debtors and other taxpayers improves the efficiency and effectiveness of recovery action.

Recommendation No.19

5.67 The ANAO *recommends* that the ATO improve the capacity of its business systems to structure key risk data associated with outstanding debt, and provide interpretative data, such as financial ratios and risks indices, to assist efficient and effective decision-making by recovery staff.

ATO response

5.68 The ATO agrees with this recommendation. The timing of implementation of improvements to business systems will be addressed through ATO systems planning processes. Under this process, proposed systems enhancements will be evaluated and allocated a priority. The ATO will advance this recommendation in the next cycle commencing early 1997. Implementation is likely to be phased.

Continual review

5.69 The regular and systematic review of organisational practices provides an evaluation of the effectiveness of current approaches and a sound basis for improvement initiatives. As discussed in Chapter 8, in the past year ATO Debt Collection areas have commenced a number of research projects aimed at improving debt collection. Implementation of the results of these projects will necessitate modification of policy, procedures, training and business systems.

5.70 As discussed earlier in this chapter, the ANAO found that the ATO had a poor record of maintaining policy. Likewise, the ANAO found that the ATO had a poor record in reviewing and maintaining debt collection procedures and tools. Given the dynamic operating environment of Debt Collection and the potential gains which may be identified through research, implementation of measures to review and maintain these key debt collection tools is essential to efficient and effective performance.

5.71 The client location project previously cited shows the benefits of evaluation and

review of current practices and resources. The implementation of project recommendations regarding better use of business system data and procedures is expected to provide significant benefits for the effective management of debt. The project noted that since 1991 at least \$64.5 million in revenue has been written off as untraceable, demonstrating a clear economic imperative for improved work practices.

Recommendation No. 20

5.72 The ANAO *recommends* that the ATO implement a program for evaluating and improving debt collection procedures, training and business systems.

ATO response

5.73 The ATO agrees with this recommendation.

1

Australian Quality Council, 1996 Australian quality awards assessment criteria: Public Sector Guidelines.

2

This figure is based on a broad case population of 500 000 which includes both live and finalised cases (the ATO QA program currently in place analyses both live and finalised cases). This population is based on the number of live and finalised cases currently on COMPACT. Although this population could be reduced to 300 000 or 400 000, this would not substantially reduce the sample size required for a QA process that has a high degree of integrity.

3

United States General Accounting Office, *Tax Administration - State Tax Administrators Views on Delinquent Tax Collection Methods*, February 1994, page 7.

4

ibid.

6. Collection Results

This chapter analyses the ATO's Debt Collection performance over the past six years, with particular attention paid to its performance in 1995-96. In addition, this chapter analyses debt collection staffing and the Debt Reduction Strategy.

Introduction

6.1 The information presented in this chapter is primarily based on data obtained from COMPACT. However, as discussed in Chapter 7, the ANAO recognises that the data in COMPACT has some limitations regarding the reporting of debt collection performance.

ATO's overall debt collection performance

6.2 Analysis of the ATO's overall debt collection performance over the past six years has revealed that debt on hand at the end of 1995-96 has risen almost to the levels of three years earlier. This is apparent from Table 3.

Table 3: ATO debt collection figures 1990-91 to 1995-96 ¹

	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96
A. Cases referred	343 847	278 162	311 298	321 247	343 002	366 294
B. Cases finalised	319 499	318 992	331 685	324 871	367 109	352 400
C. Cases on hand 30 June	364 482	323 652	301 391	297 789	273 682	287 551
D. Debt referred (\$b)	5.70	11.13	12.11	12.04	16.77	16.50
E. Debt finalised (\$b)	6.43	10.66	12.08	11.96	16.89	16.07
F. Debt on hand at 30 June (\$b)	4.42	4.35 ¹	4.22 ²	4.23 ³	3.88 ⁴	4.16 ⁵

Note 1: This amount excludes \$0.42b tax not due for payment at 30/6/92.
Note 2: This amount excludes \$0.07b tax not due for payment at 30/6/93.
Note 3: This amount excludes \$0.06b tax not due for payment at 30/6/94. Apparent increase due to rounding.
Note 4: This amount excludes \$0.05b tax not due for payment at 30/6/95.
Note 5: The amount excludes \$0.04b tax not due for payment at 30/6/96.

6.3 From 1990-91 to 1994-95, the ATO's debt on hand was steadily decreasing (refer row F of Table 3). This is despite the amount of debt referred tripling over the six-year period (row D). In contrast, the number of cases referred in 1995-96 is slightly larger than the number in 1990-91 (row A). However, the ATO has substantially reduced the number of cases on hand over the six-year period (row C). This indicates that the average amount of debt per case has increased markedly since 1990-91.

6.4 The overall growth in the amount of debt increases the risks associated with outstanding tax debt and consequently the priority assigned to ensuring that Debt Collection operates efficiently and effectively. Recommendations outlined in Chapter 2 are aimed at implementing initiatives to promote timely payment in order to reduce the amount of debt referred for recovery action.

6.5 Table 3 also reveals that Debt Collection's minimum debt on hand was reached at the end of 1994-95 even though the amount of debt referred to Debt Collection in that year increased considerably from the similar levels of the previous three years. As discussed in Chapter 3, this increase in debt referred was caused primarily by a substantial increase in new WHT debt referrals resulting from improved debt identification processes. The debt referrals in 1995-96 have been influenced by the automation of PPS referrals in May 1996.

6.6 The \$16.5 billion referred to Debt Collection during 1995-96 represents 17 per cent of total taxation revenue collected by the ATO. However, a large component of this debt referred to Debt Collection is not outstanding debt but rather current liabilities (discussed later in this chapter). Hence, the actual amount of outstanding debt referred during the year could be substantially lower than the amount reported.

6.7 Table 4 reports debt on hand for Debt Collection as a percentage of total collections for the past six years. Although debt on hand is currently at the same level as that of 1990-91, total collections have experienced a significant growth in recent years. Consequently, debt as a percentage of collections has fallen. As discussed in Chapter 7 on performance information, this indicates that the ATO's performance in collecting established debt overall, through a combination of education, administrative arrangements and enforcement, has improved.

Table 4: Outstanding Debt as a Percentage of Total Collections

	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96
Debt on hand at 30 June (\$b)	4.42	4.35 ¹	4.22 ²	4.23 ³	3.88 ⁴	4.16 ⁵
Total collections (\$b)	77.48	73.42	74.73	78.09	88.31	98.26
Debt on hand/Total coll. (%)	5.7	5.9	5.6	5.4	4.4	4.2
Note 1: This amount excludes \$0.42b tax not due for payment at 30/6/92. Note 2: This amount excludes \$0.07b tax not due for payment at 30/6/93. Note 3: This amount excludes \$0.06b tax not due for payment at 30/6/94. Apparent increase due to rounding. Note 4: This amount excludes \$0.05b tax not due for payment at 30/6/95. Note 5: The amount excludes \$0.04b tax not due for payment at 30/6/96.						

Review of debt outstanding from 1993-94 to 1995-96

6.8 The level of debt on hand for Debt Collection over the last three years (1993-94 to 1995-96) has remained fairly constant. This is shown in Figure 2 which shows debt on hand, debt referred and debt finalised by Debt Collection from July 1993 to June 1996.

6.9 October 1995 represents the peak amount of debt on hand (\$5.2 billion) in the last three years and was the culmination of a five-month increasing trend in the debt on hand from the three-year debt on hand low in June 1995. Subsequently, debt on hand from October 1995 has been reduced by approximately \$1 billion to \$4.2 billion at 30 June 1996.

Figure 2: Analysis of all Debt Outstanding from July 1993 to June 1996



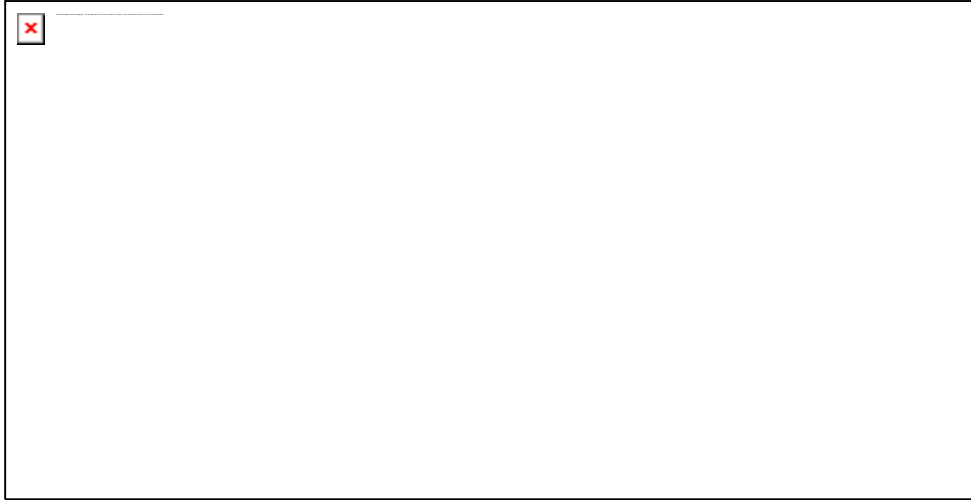
6.10 The chart clearly shows how the level of debt on hand is affected by the relative amounts of debt referred and finalised during a month. For example, the amount of debt referred in each of May 1994 (following the automation of PAYE cases) and October 1995 ² is significantly greater than the amount finalised and hence there is a sharp increase in debt on hand. As discussed in the previous section, the amount of debt referred has gradually increased over the past three years. This is also evident in the upward trend of debt referred in Figure 2. The ANAO considers that one reason for this increasing trend is improved debt identification processes (as discussed in Chapter 3). Other contributing factors that cannot be separately identified are economic conditions and taxpayers' perceptions of the integrity of the system.

6.11 Figure 2 illustrates that in June 1995 the amount of debt finalised exceeded the amount of debt referred by a considerable margin. The ANAO analysed the amount of debt finalised by collection (compared with finalisation by write-off or other credit) for each quarter in the last two years. It was found that the quarter corresponding to June 1995 had the lowest rate of finalisation by collection in the last two years. Furthermore, the average rate of finalisation by collection had fallen from 80 per cent in 1994-95 to 76 per cent in 1995-96. Figure 3 presents the rate of finalisation by collection by quarters for the past two years. ³

6.12 Figure 3 shows the cycles of case completions. The ATO advised that during each year a number of special projects are undertaken with the intention of writing off debts identified as uneconomical to pursue. This project work assists the ATO in reducing the number of old and ancient cases on hand to a more controllable level as the new financial year commences. The annual cycle, which depicts a reduction in the rate of finalisation by collection in the latter half of the financial year, suggests that the results of such project work are recognised during this time.

6.13 Recommendations aimed at improving Debt Collection's policy and method of setting priorities for recovery action would address the need for such project work and the consequent risks associated with project work that focuses primarily on writing off debt.

Figure 3: Percentage of Finalised Debt that is Finalised by Collections by quarter for 1994-95 and 1995-96



Components of debt on hand

Tax type

6.14 Figure 4 gives a breakdown of the average composition of cases on hand by tax type for the past two years.

6.15 Quarterly data on debt on hand segmented into different tax types for the past two years was used to calculate an average debt on hand level for each tax type. The percentages in Figure 4 were then calculated using these averages. This is because debt on hand levels vary over the duration of the tax year and tax types exhibit varying degrees of seasonality. Taking a snapshot of debt on hand by tax type at one point in the year would not accurately represent the breakdown of tax debts that Debt Collection manages over a period of time. Averaging the figures over a two-year period attempts to overcome the seasonality in the data.

6.16 Figure 4 clearly shows that, on average, non-disputed income tax cases made up the majority of debt collection cases on hand (73 per cent) over the past two years. However, these cases accounted for only 39 per cent of the actual debt on hand. In contrast, only two per cent of all debt cases on hand on average over the past two years were disputed income tax debt cases, though these cases accounted for 33 per cent of the debt on hand.

Figure 4: Percentage composition of *cases* and percentage composition of *debt on hand* by tax type for the period 1994-96 using averaged quarterly data



Disputed debt

6.17 Further analysis of the value of these debt cases reveals that the total value of disputed income tax cases is similar to the total value of non-disputed income tax cases. These disputed income tax cases are probably large company debt cases (the average disputed income tax case is \$200 000; more than twenty times the average non-disputed income tax debt case). As discussed in Chapter 3, the disputed debt reported in COMPACT reflects debts where a dispute is involved and thus includes a significant amount of debt that is undisputed.

6.18 In Chapter 3 the ANAO identified improvements in the ATO's business system capacity to segment disputed assessments into disputed and undisputed components so as to facilitate effective recovery action. Recommended improvements in performance information outlined in Chapter 7 will enable the ATO to identify its success in recovering debt in a timely manner where a dispute is involved.

6.19 The ANAO found that the ATO had substantially reduced the amount of outstanding debt on hand in which a dispute was involved. The amount had been reduced from \$1.35 billion in 1994-95 to \$627 million in 1995-96. This reduction is primarily the result of a number of disputes in the large business segment being resolved. COMPACT reports indicate that LBI disputed debt fell from \$872 million in 1994-95 to \$394 million in 1995-96. In contrast, the number of debt collection cases where a dispute is involved has increased from 6573 to 7797.

6.20 The recovery of outstanding debt in which a dispute is involved remains a significant issue. The ANAO considers that recommendations regarding clarification of roles and responsibilities (particularly with respect to Appeals and Review) in the debt collection process (Chapter 9), combined with improvements in the ATO's setting of priorities for recovery action (Chapter 4) and the recovery process (Chapter 5), will greatly assist the ATO in improving the management of recovering disputed debts.

Insolvency action debt cases

6.21 The amount of debt on hand for cases where insolvency action and/or write-off action has been, or is to be, undertaken has remained steady at around \$610m-\$650m

(around 15 per cent of total debt on hand) in 1993-94, 1994-95 and 1995-96. The likelihood of recovering outstanding debt is lower where an insolvency action has or will be commenced. Chapter 7 discusses improvements in segment reporting of performance information to assist the ATO in estimating the likelihood of recovery in these processes.

New debt, old debt and ancient debt

6.22 Chapter 4 highlighted that the timeliness of action affects the likelihood of collection. Hence, as debt remains outstanding for a longer period, it is less likely that the ATO will recover that debt. The ATO monitors the age of its outstanding debt with reference to the date that a taxpayer was originally referred to Debt Collection.

6.23 The ANAO found distortions in this reporting and recommended improvements in the ageing of debt (Chapter 7). However, based on the available data in COMPACT for the past three years (and noting the distortions), the ANAO found that the amount of old and ancient debt on hand was at a level similar to two years ago. Table 5 below illustrates that old and ancient debt for 1995-96 (at around 75 per cent of all debt) had returned to the level of two years ago.

Table 5: New, Old and Ancient Debt on Hand for 1993-94, 1994-95 and 1995-96

Component of Debt	1993-94	1994-95	1995-96
New Debt On Hand ¹ (\$b)	1.01 (24%)	0.66 (17%)	0.99 (24%)
Old Debt On Hand ² (\$b)	1.91 (44%)	1.54 (39%)	1.56 (37%)
Ancient Debt On Hand ³ (\$b)	1.38 (32%)	1.70 (44%)	1.65 (39%)
Total Debt On Hand (\$b)	4.30	3.90	4.20
Note 1: Debt that is on hand less than 90 days after referral to COMPACT . Note 2: Debt that is on hand between 90 days and 2 years after referral to COMPACT. Note 3: Debt that is on hand more than 2 years after referral to COMPACT.			

6.24 Improvements in performance information, outlined in Chapter 7, will assist the ATO to better monitor debt with regard to the actual period of time the debt has been outstanding. In addition, recommendations outlined in previous chapters are directed at increasing the timeliness of effective recovery action and thus reducing the age of debt.

Analysis of write-offs

6.25 As mentioned above, debt cases can be finalised either by payment or by reduction. Cases finalised by reduction can be classified into three main categories:

- write-off - irrecoverable (write-off at law or no assets);
- write-off - uneconomical (which can be resurrected later if there is subsequent activity on the taxpayer's account); and

- finalised by other credit (e.g. correcting system errors).

6.26 As discussed in Chapters 3 and 7 on debt identification and performance information respectively, the ANAO has identified scope for improvement in the reporting of debt finalised by other credit. The ANAO considers there is benefit in the ATO breaking down other credit so as to separate non-genuine debts (e.g. system errors) from other credits such as credit amendments and provisional tax variations.

6.27 Table 6 provides end-of-year figures for the last two years of the amount of debt written-off at law and written-off as being uneconomical to collect.

Table 6 Amounts Written-Off in 1994-95 and 1995-96

Year	Write-off - irrecoverable (\$m)	Write-off - uneconomical (\$m)	Total write-offs (\$m)
1994-95	470	358	828
1995-96 ¹	663	88	751

Note 1: Does not include PPS write-offs, as unavailable due to conversion of PPS to new business systems.

6.28 As is evident from Table 6, total write-offs have decreased from 1994-95 to 1995-96. The primary reason for this is the decrease in uneconomical-to-collect write-offs over this period by 75 per cent. In contrast, over this same period debts written-off at law have increased by 41 per cent.

6.29 These figures have been obtained from the ATO's accounting system. They differ from figures produced by COMPACT because not all write-offs are identified by COMPACT. ANAO recommendations in Chapters 3 and 7 are aimed at ensuring that all outstanding debt is monitored by the Debt Collection business systems and that all the results of recovery action, including write-offs, are reported in the business system. This will enable the ATO to track performance and form the basis for future informed decision-making regarding collection strategies.

6.30 The ANAO considers that improvement in automation and recovery cost information would help the ATO reduce the amount of uneconomical write-offs. Other chapters in this report contain recommendations that address this issue.

Effect of current liabilities on debt collection figures

6.31 A significant component of the \$16.5 billion of debt referred to COMPACT is not outstanding debt. Where Debt Collection has identified a taxpayer as having outstanding debt, all subsequent transactions, including the payment of subsequent tax liabilities by due date (maintenance of current liabilities), are recorded as debt finalised by collection. This artificially inflates both the level of outstanding debt and the percentage of actual outstanding debt that is finalised by collection as compared with write-offs. The effect of current liabilities is a significant issue for more frequently paid taxes such as PAYE or

PPS that require payment as often as twice a month.

6.32 The ANAO found that the ATO did not separate current liabilities for reporting purposes with the exception of the Debt Management Improvement Strategy (DMIS) ⁴ reports.

6.33 The effects of current liabilities on collection results are illustrated by analysing the effects of current liabilities on DMIS results. In 1995-96 DMIS reported \$507 million of debt finalised, of which \$499 million was finalised by collection, giving a collection rate of 98 per cent. However, \$333 million (66 per cent) of this finalised debt was made up of current liabilities. Removing this amount of current liabilities from the \$499 million finalised by collection gives a new collection rate of 95 per cent of initial debt referred.

6.34 These figures show that for DMIS, current liabilities make up a significant proportion of the total collection results and thus influence the collection results of Debt Collection. Chapter 7 recommends that current liabilities be separated for reporting purposes.

Debt collection staffing

6.35 In 1995-96 1229 Full-Time-Equivalent (FTE) staff were working in ATO Debt Collection. ⁵ The corresponding salary costs (excluding superannuation) for these debt collection staff totalled approximately \$46 million. Included in the 1229 staff were staff engaged in debt collection as part of the Debt Reduction Strategy which is discussed later in this chapter. In addition, as at 30 June 1996 the ATO employed 8 staff to manage the COMPACT business system and 29 staff in Complex Legal Recovery Units (CLRU) around Australia. Salary costs for these staff totalled over \$1.5 million.

6.36 The ANAO found the ATO's process of collating and monitoring debt collection staff data to be cumbersome, with the level of monitoring varying between business lines. The ANAO suggests that the ATO review its mechanisms for collating debt collection staff data and the business needs for monitoring debt collection staff resources.

6.37 In order to assess the workload of debt collection staff around Australia, the ANAO analysed the number of cases referred per unit of FTE staff (i.e. per officer) for each region within each business line for 1995-96. The results of this analysis are given in Figure 5.

6.38 Figure 5 reveals that in 1995-96 INB on average referred the most number of debt cases per officer (an average of 423 cases), followed by SBI (352 cases) and then WHT (163 cases). The variance in average cases per officer between business lines is likely to be attributable to differences in the average size of debt handled by each business line and differences in the complexities associated with the recovery of the various tax debts.

Figure 5: Number of Cases Referred per Unit of annualised Full-Time-Equivalent debt collection staff by regions by business line for 1995-96



6.39 Figure 5 also illustrates variation in the average number of cases per officer between regions in the same business lines. For example, SBI's average number of cases per officer in NSW/ACT is significantly lower than the averages for SBI in the other regions. Differences in the characterises of the debtor population in regions may influence staff requirements, although there is insufficient information available to ascertain reasons for the differences. Improvements identified in Chapters 2, 4 and 7 will assist segmenting the debtor population and the risk characteristics of the debtor populations of regions and branches and thus the allocation of staff resources.

Debt Collection - Debt Reduction Strategy

6.40 In the Federal Budget for 1994-95 the ATO received additional funds in the new policy context to invest in specific revenue-raising activities. The ATO proposal was developed in the context of workplace bargaining. In return for continued funding for 845 staff freed up from workplace reform and additional funding for 500 unfunded staff, the ATO committed to engage these staff in both direct and indirect revenue activities.

6.41 This policy was known as the Debt Reduction Strategy (DRS) of which Debt Collection received additional funding on the understanding that it was to bring in an additional \$100 million per year above normal collection activities over a three-year period. The ANAO did not review the other non-Debt Collection aspects of the DRS as part of the audit. The ATO intends to carry out a comprehensive evaluation of the DRS in the near future.

6.42 As part of the DRS, the ATO in effect redeployed 295 personnel from their normal duties to a number of Debt Collection areas. One area was to reduce the amount of old and ancient debt on hand. As reported earlier in this chapter, according to COMPACT figures the amount of old and ancient debt has remained at around the same level for the last two years. Taking into account distortions discussed in Chapter 7, the ANAO is concerned that the ATO has not improved its position with respect to old and ancient debt as a result of DRS.

6.43 Also as part of the DRS, the ATO developed the Debt Management Improvement Strategy (DMIS). This focused on shifting the responsibility for initial PAYE debt collection activity to Source Deduction Auditors (SDAs) and Client Service Teams (CSTs), leaving debt collection specialists free to focus on legal collection and the more difficult cases. This meant that SDAs and CSTs were able to enter into payment arrangements as well as negotiate additional time for clients to pay, in much the same way as debt collection operatives generally work. The results of this aspect of the DRS were closely monitored and a review of the approach by the ATO showed positive outcomes. The strategy has now been adopted as business as usual for PAYE, PPS and sales tax debts and is being considered as part of the work and job redesign for the ATO. This is discussed further in Chapter 9.

6.44 As the DRS was funded separately, the ATO was obliged to account for those staff freed up and the extra revenue raised. This was done so as to distinguish the amount collected under the scheme from that of normal collection activity. This would allow the ATO to effectively monitor the results of the additional staff, as well as ensuring that the current debt collection activities were not detrimentally affected as a result of the DRS. Thus, separate modules in the ATO Debt Collection reporting system (COMPACT) were established to accomplish such a task.

6.45 The ATO Internal Audit function reviewed the Debt Collection DRS results and found that the amount collected for 1994-95 was over \$200 million. The ANAO notes that this outcome has surpassed ATO Debt Collection's annual \$100 million commitment to the DRS, although it is concerned as to how some of the information was constructed for reporting purposes.

6.46 For example, an internal audit report produced by the ATO showed that seven branch offices had not correctly recorded their income tax results in the appropriate reporting module. Consequently, performance reports for this module were incomplete. Difficulties in calculating the accuracy of the DRS results were further compounded by the need for the ATO to remove some cases that fell outside the scope of the exercise but were erroneously included in the reporting modules.

6.47 Although the accuracy of the \$200 million in 1994-95 is in doubt given the ATO's limited capacity to separate the debt for monitoring (thus requiring a degree of estimation), the ANAO considers that ATO Debt Collection met and surpassed its first-year commitment to raise \$100 million as part of the DRS in 1994-95, although it has not achieved its goal of substantially reducing old and ancient debt. Performance reports indicate that Debt Collection collected over \$300 million in 1995-96 as part of DRS although the monitoring problems associated with DRS in 1994-95 continue to occur. Chapters 4, 5, 7 and 8 address improvements in performance information, control and monitoring to improve the accuracy of performance results of specifically funded projects.

7. Performance Information

This chapter outlines the ANAO's assessment of the ATO's debt collection performance information. It is imperative that the contents and relevance of performance information be of the highest quality if debt collection functions are to be effectively managed. The audit concluded that performance information did not present a comprehensive and accurate

picture of the ATO's outstanding debt nor of the cost-effectiveness of ATO debt collection strategies on different client segments of the outstanding debtor population.

Introduction

7.1 Performance information can be simply described as evidence about performance which is collected and used systematically. It encompasses a range of activities such as setting objectives, strategies, indicators, targets, standards and benchmarking for performance. It also facilitates effective management in that it provides a basis for informed decision-making on where the best results will be achieved from the effective allocation of limited resources.

7.2 Quality performance information is pivotal to the management of outstanding debt. Significant benefits can be gained by ensuring that debt collection performance information provides the means for making key decisions. This is especially pertinent in the current APS environment where the contestability of debt collection operations is being established.

7.3 The ANAO focused on the degree to which current performance information was appropriately structured, in terms of the ability to allow the ATO to internally and externally benchmark its quantitative effectiveness in collecting outstanding debt. Chapter 5 addressed qualitative performance information as part of the ATO's approach to Quality Assurance to identify and treat risks in applying collection strategies.

Profile of outstanding debt

7.4 Currently, the ATO bases its reporting of debt collection on debt that has been referred via the COMPACT management system. In 1995-96 the amount of debt referred to ATO Debt Collection was \$16.5 billion, which represented 17 per cent of the total revenue collected by the ATO.

7.5 The ANAO found that the debt on COMPACT comprised:

- primary debt actually outstanding;
- additional debt applied as late payment tax;
- additional debts paid on time while an outstanding debt is on account; ⁶ and
- debt arising from system errors.

7.6 Currently, the collection rates which are produced as part of the Management Information Reports (MIRs) are based on the amount of debt that has been referred. The ANAO considers that there would be significant benefits in segmenting the various components of debt so as to ascertain the ATO's performance in collecting actual outstanding debt, the maintenance of current liabilities, the collection of late payment penalties and the extent of system errors.

7.7 The benefits of reporting separately the ATO's performance at applying, remitting and collecting additional debt applied as late payment tax are apparent given the concerns raised on performance in this area in Chapter 3 of this report. Likewise, the separation of current liabilities for WHT is a significant issue (this is discussed in Chapter 6).

7.8 A review by the ANAO of international practices showed that the Inland Revenue Office of New Zealand separated its debt into its various components for reporting purposes. This was done to obtain an overview of the percentage reduction or increase in each component of debt.

Recommendation No.21

7.9 The ANAO *recommends* that the ATO report debt collection performance information by the following segments:

- primary debt outstanding;
- additional debt applied as late payment tax;
- additional debt paid on time while an outstanding debt is on account; and
- debt arising from system errors.

ATO response

7.10 The ATO agrees with the direction of this recommendation. The ATO accepts that it needs to revise its debt collection performance reports, especially when it begins to stratify its debts. The ATO will analyse this complex issue to settle what performance information should be produced.

Collection of debt

7.11 A review of the ATO's existing performance information systems revealed that the dissemination of such information occurs through monthly MIRs which are generated via COMPACT. Business lines and branches review their performance with reference to these MIRs.

7.12 The ANAO found that these MIRs reported a number of indicators by business line, branch and, in some instances, tax types or debt level. The indicators reported included:

- percentage of cases where either legal action has commenced or an arrangement has been negotiated or the debt has been collected within 90 days of referral to Debt Collection;
- percentage of finalised debt actually collected by both amount and cases (this includes the components of debt as outlined above by the ANAO);
- percentage of debt on hand in dispute; and
- a change in debt on hand from the previous year.

7.13 The ATO also monitors the average time to finalise cases based on their initial referral date; and produces age analysis reports which age debt on the following basis:

- debt that has been with Debt Collection for less than 90 days (new debt);
- debt that has been with Debt Collection for between 90 days and two years (old debt); and

- debt that has been with Debt Collection for more than two years (ancient debt).

7.14 These age analysis reports indicate whether or not cases have at least had either legal action commenced, an arrangement negotiated or have been finalised.

7.15 In addition to the aforementioned indicators, the ATO is also planning to monitor its debt on hand as a percentage of collections. Improvements in education, administrative arrangements and encouragement will result in a reduction in the amount of debt becoming outstanding and, combined with the performance of Debt Collection, reduce the debt on hand as a percentage of collection. The ANAO considers this to be a valuable measure of the ATO's performance in determining its effectiveness in collecting established debt overall. However, the ANAO considers that additional measures that are specific to the collection of outstanding debt are required so as to assist management in the decision-making process.

7.16 The ANAO found that there was scope for improvement of Debt Collection's performance information in terms of internal and external benchmarking. These improvements specifically related to the timeliness of action and the cost-effectiveness of collection strategies.

Timeliness

7.17 Currently the ATO bases its ageing schedule on the referral date and not on the due date for outstanding debt. As debt is not separated for reporting purposes, this further distorts the age profile within the ageing schedule reports. For instance, a new debt for a taxpayer who has had small outstanding penalty debt on account for more than two years has the new debt classified as being older than two years. This is despite the fact that the debt is a new debt.

7.18 During the course of the audit, the ATO accountant conducted an age analysis of outstanding debt, using information obtained from the ATO's accounting systems. The ANAO reconciled these reports (as at 30 June 1996) against those age analysis reports produced by COMPACT. Table 7 illustrates the distortions caused by:

- ageing debt based on different dates;
- debts not being aged separately but with all a taxpayer's debts being assigned the same age based on the first referral date; and
- COMPACT not including all outstanding debt.

Table 7: Age Profile of Debts on COMPACT compared with core accounting systems

No days debt is outstanding	COMPACT ¹ (\$m)	Total debt (%)	ATO Accountant (\$m)	Total debt (%)
< 90 days	987	24	1247	29
90 days to 2 years	1565	37	1839	43
> 2 years	1647	39	1211	28

Total	4199	100	4297	100
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Note 1: Information reported in COMPACT does not include all debts as at 30 June 1996, as some debt has yet to be referred to COMPACT (Chapter 3) and some debt is never referred to COMPACT. Additional distortions arise as a result of the basis for ageing debts discussed above.

7.19 The age of debt significantly influences the likelihood that outstanding debt will be collected, while the timeliness of enforcement is critical in ensuring the integrity of the tax system is maintained. Hence, the monitoring of timeliness of action and finalisation of cases within an accurate age schedule are pivotal to managing outstanding debt. This information will enable the ATO to monitor and benchmark its effectiveness in relation to the timeliness of its debt collection activity.

Recommendation No.22

7.20 The ANAO *recommends* that the ATO's performance reports age outstanding debt with reference to the date that the debt becomes outstanding.

ATO response

7.21 The ATO agrees to take steps to modify the manner in which it ages its debts, and the performance reports that monitor the age of outstanding debts.

Cost-effectiveness

7.22 Presently the ATO reports its finalisation rates on a monthly basis using the following indicators:

- amount of debt finalised;
- percentage of debt that was finalised by collection;
- percentage of debt that was finalised by other means (includes write-offs, credit amendments, provisional tax variations, company tax instalments variations, removal of non-genuine debts etc.); and
- number of cases finalised.

7.23 The success of Debt Collection is ultimately measured in terms of the amount of outstanding debt collected and the associated cost of finalisation. Private sector debt collection performance measures focus on collection and collection costs. The ANAO found the ATO's key performance measures are directed towards the actioning of cases within 90 days as opposed to finalising cases. In addition, the ATO's performance information excluded costs of finalising cases (both for finalisation by collection and by reduction). Hence, the ATO is unable to ascertain whether or not it is collecting outstanding debt in the most cost-effective manner.

7.24 Performance information regarding the success of reducing outstanding debt (in terms of finalisation rate and collection rate) and the cost of finalising debt within an aged structure forms a sound basis for selecting the most cost-effective alternative for recovering debt. The lack of performance information on finalisation costs means that the ATO is unable to ascertain whether its collection practices are more cost-effective than

those of external agencies. By restructuring performance information to reflect these key components, Debt Collection will be well positioned to benefit from information which will allow it to select the most cost-effective recovery option, be it internal or external to the ATO.

7.25 The ANAO is aware that it would not be cost-effective for the ATO to record all actual costs (including salary costs) against each debt collection case. Chapter 8 identifies the benefits in the ATO conducting research to estimate standard costs of collection strategies and having these costs automatically assigned to cases as strategies are applied.

Recommendation No.23

7.26 The ANAO *recommends* that the ATO develop and implement performance information that reflects the effectiveness of recovering outstanding debt (in terms of finalisation by collection and finalisation by other means) and the associated costs within an aged profile of debt. This performance information would provide the means for improving internal and external benchmarking and the selection of the most cost-effective options for recovery.

ATO response

7.27 The ATO agrees with this recommendation. Research will be undertaken into how to develop and implement an activity based costing approach and how to effectively record and analyse this data.

Contestability

7.28 As the Commonwealth moves towards a more contestable working environment, there is an increasing need for agencies to ensure that their operations are conducted in a cost-effective and efficient manner. This is particularly so as agencies face the increasing prospect of competition from both within and outside the APS. Within this context, contestability can be defined as:

*the prospect of competition in public sector activities to improve both program efficiency and effectiveness. Contestability in the public service does not necessarily imply transfer of provision of services to the private sector but may include contracting out. In numerous instances, services that were once provided by the federal public service are now being delivered by a different arm or level of government. Indeed, many services continue to be delivered by the same provider but in a better manner because of the effect of contestability.*⁷

7.29 Ensuring that performance information allows an analysis of contestability of collection strategies on a variety of debtor segments would assist management to effectively select the most cost-effective collection strategies for different segments of the debtor population. Furthermore, were the ATO to ensure that performance information allowed an analysis of contestability this would help both internal and external benchmarking.

Segment reporting

7.30 A review of the ATO's performance information indicated that it was limited in terms of its ability to report the performance of its various client bases on a segmented basis.

7.31 The ANAO is of the opinion that there are significant benefits for the ATO in client segment reporting on its taxpayer population, as it would help in the identification of non-compliant areas and, as such, allow the ATO to review its collection strategies on those non-compliant areas. For instance, client segmentation would assist the ATO in being able to explore more cost-effective alternative collections in those segments that are not performing well.

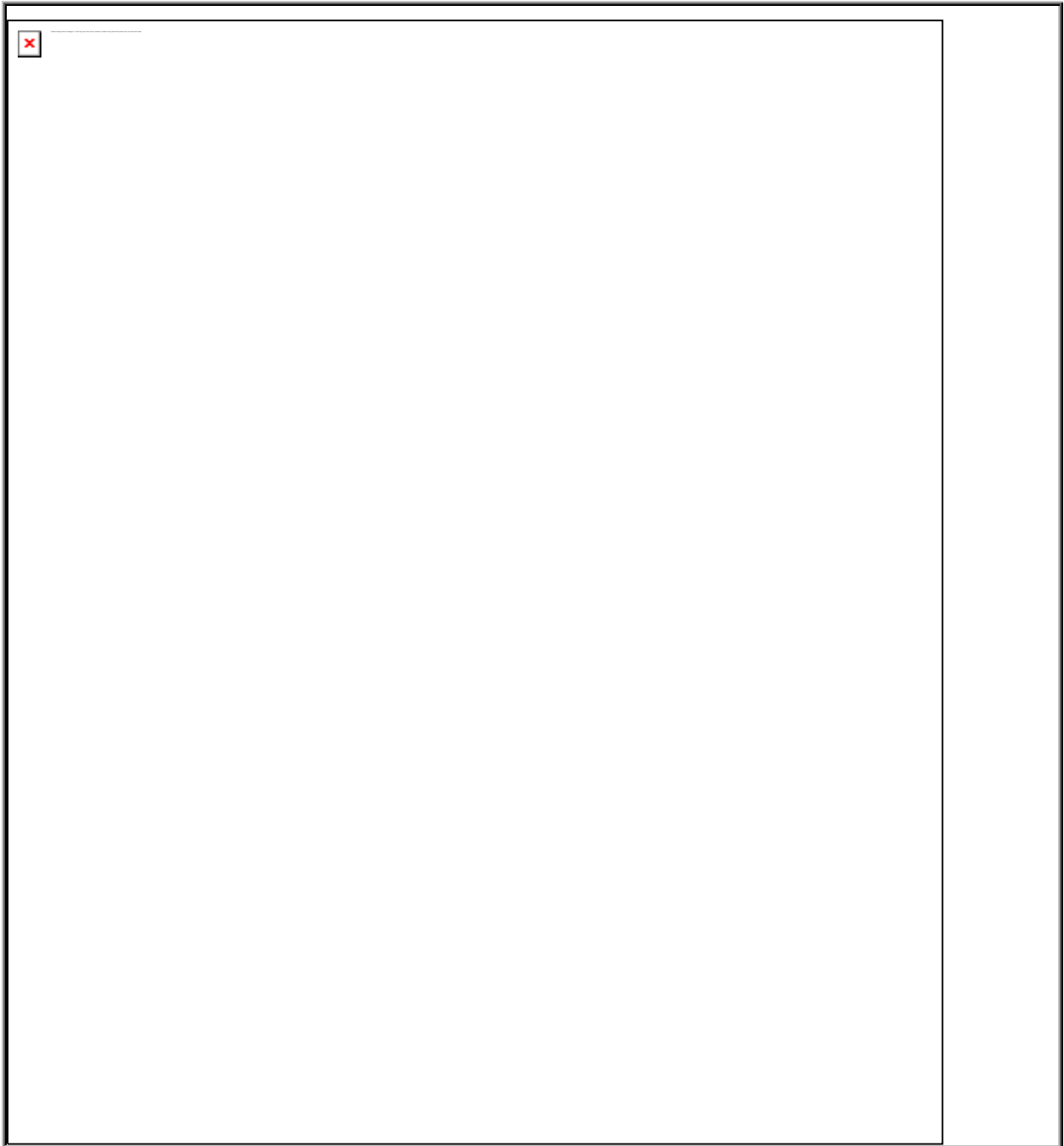
7.32 This information may also indicate that the ATO is relatively cost-effective in recovering debt within the first 30 days for smaller debts in a particular industry, but does not perform as well in the industry as the debt becomes older. Consequently, the ATO would be in a strong position to explore other collection strategies after the debt became more than 30 days old.

7.33 This would also apply to the collection of disputed debt. As indicated in Chapter 3, ATO officers advised that disputed debt affected their ability to collect outstanding debt and that the ATO is not pursuing disputed debts in a timely manner. The ANAO found that the ATO had limited performance information on the cost-effectiveness of collecting disputed debt, including the collection of late payment penalties where a dispute was originally involved. The ability to report the ATO's performance with regard to disputed debt would enhance the ATO's understanding of the risks to revenue resulting from disputation.

7.34 Diagram 5 illustrates the levels into which performance information could be segmented for analysis regarding internal and external benchmarking.

7.35 As depicted in Diagram 5, the basis of information to support an analysis of contestability is dependent upon the ATO's ability to determine the cost-effectiveness of its collection techniques on its various client segments and debt components, within an allocated time-frame.

Diagram 5: Debt Collection Performance Information for internal\external benchmarking



7.36 Once performance information allows an analysis of contestability, it can then be reported on a segmented basis when required. The capacity to produce segment reports on an ad hoc basis will substantially improve informed decision-making without producing an overwhelming amount of performance information on a regular basis. This allows the ATO to effectively determine its effectiveness both internally and externally in the collection of debt. For instance, the ATO may discover garnishee notices have a higher success rate and are more cost-effective in collecting smaller debts within the first 30 days as opposed to the issuing of demand letters.

Recommendation No.24

7.37 The ANAO *recommends* that the ATO develop the ability to report performance on client segments of the outstanding debtor population.

ATO response

7.38 The ATO agrees with this recommendation. To date, the ATO has been concentrating on macro client segment data as a result of its move to a client based structure.

8. Debt collection research

This chapter outlines the ANAO's assessment of the ATO's research program on outstanding debtors. Research into the compliance characteristics of the outstanding debtor population and the cost-effectiveness of collection activities and key performance information provides a basis for sound decision-making. The ANAO identified scope for improving the management of the ATO debt collection research program and the systems support for research, as well as identifying areas for additional research.

Introduction

8.1 In the debt collection context, compliance research involves research into the compliance characteristics of the debtor population and the cost-effectiveness of collection activities on client segments. Most data required for research into the debtor population is already contained in ATO business systems. A research program that complements key performance information provides a basis for sound decision-making and thus effective management.

8.2 The ANAO reviewed the research conducted by the ATO to ascertain the support it provided for informed decision-making. The ANAO also considered the management of the ATO debt collection program and the business systems support for research.

Research program

Research program and client profiling

8.3 The ANAO found that the ATO had commenced research into causes of impeded debt and the effectiveness of debt collection notices and letters. Preliminary research had been conducted into a number of areas including the use of credit cards for payment of debts, with the ATO regularly seeking updates on debt collection practice from conferences and the ongoing legal research of the CLRU.

8.4 The ATO has a number of corporate projects that are relevant to debt collection. These include the ATO Client Location Project, which reviewed the ATO's effectiveness in locating clients and managing client address data (locating taxpayers is an integral step for debt recovery) as well as several projects related to work and job design and collection processes.

8.5 During the course of the audit, WHT, SBI and INB Debt Collection each identified a number of broad areas requiring research over the next three years. To varying degrees the research areas address the analysis of the client characteristics of the debtor population (e.g. industry, occupation, age of business, etc.). In most cases, the research identified by

each business line is similar in nature and/or based on common clients. To date, these projects have not received formal business line management approval, priority or funding, although in mid-1996 INB set aside funding for 25 staff for research purposes.

8.6 The ANAO considers that significant synergies can be achieved by the ATO coordinating research between the business lines. This would enable similar research projects to be combined (or eliminated as the case may be), as well as the joint resourcing of significant research projects and the dissemination of results across business lines.

Recommendation No.25

8.7 The ANAO *recommends* that the ATO establish a framework for coordinating debt collection research across business lines.

ATO response

8.8 The ATO agrees with this recommendation.

8.9 As discussed in Chapter 2, the ATO would benefit from conducting research, within a coordinated framework, into the client profile of the outstanding debtor population. The purpose of this research would be to identify causes of outstanding debt, high-risk taxpayer population segments and opportunities for improvements in compliance strategies, including recovery action (Recommendation No.1).

Cost-effectiveness of collection options

8.10 Notwithstanding the aforementioned research projects, the ANAO found that the ATO has not considered undertaking research into the cost-effectiveness of collection techniques on its client segments. Performance information bolstered by research into debt collection costs would facilitate the cost-effective targeting of collection practices at various client groups.

8.11 The ATO has not identified the costs incurred by both the ATO and the Commonwealth (e.g. the Australian Government Solicitor) from the use of various available collection techniques. The availability of data on collection costs in general (including for particular segments of the debtor population and individual debtors) would assist in the selection of the most cost-effective combination of collection techniques.

8.12 The ATO would be well positioned to effectively select cost-effective collection options and identify when a debt is uneconomic to collect were it to use data on the cost-effectiveness of collection techniques (see Recommendation No.3 in Chapter 7 regarding performance information). A system that automatically assigns estimated costs to individual debt collection cases would be sound.

Recommendation No.26

8.13 The ANAO *recommends* that the ATO conduct research to estimate the costs incurred by both the ATO and the Commonwealth for each collection technique, and that it implement a system that automatically assigns estimated costs to collection cases.

ATO response

8.14 The ATO agrees with the direction of this recommendation, but needs to consider

further the ATO's ability to estimate all Commonwealth costs. The ATO recognises that costs of collection is not the only relevant factor to consider when determining what is the appropriate strategy for collecting taxation debts. Community compliance is also relevant.

Business system support

8.15 In Chapter 4 the ANAO recommended that the ATO enhance the business systems' capacity to automatically segment the debtor population by risk characteristics of the debtor and characteristics of the debt. This improvement would also be of considerable benefit for debt collection research. In addition, the ANAO reviewed the business system capacity to test collection strategies.

Testing new strategies

8.16 Chapter 7 on performance information recommends measuring the effectiveness of collection techniques and strategies. This, combined with data on estimated costs, forms a valuable basis for ascertaining the contestability of collection options. Testing collection techniques (and combinations of) on client segments to identify collection strategies more cost-effective than the ones in existence is regarded as better practice in the private sector.

8.17 To some degree ATO branch offices, via project work, monitor the success of some of their automated collection techniques. For instance, branch offices will allocate a number of debt collection cases into an operator number to receive a combination of collection strategies. Managers then review the extent that cases are finalised within a set period. The ANAO found this process to be inefficient and limited the ability to test strategies on a national basis on a section of a specific client segment with reference to a control group. Likewise, the ATO can separate certain debts into modules for recording, although it has had limited success in controlling the use of modules and thus the control group. This was evidenced by the problems that the ATO incurred in monitoring the success of DRS, as discussed in Chapter 6.

Recommendation No.27

8.18 The ANAO *recommends* that the ATO ensure that the debt collection case management system has the capacity to isolate groups of outstanding debtors nationally to control-test the cost-effectiveness of new collection strategies with reference to a control group.

ATO response

8.19 The ATO agrees with this recommendation.

9. Coordination and Planning

This chapter outlines the ANAO's assessment of the ATO's coordination of debt recovery operations, including roles and responsibilities, planning and accessibility of core documentation. The chapter also comments on ATO business systems for debt recovery. The ANAO found that there would be significant benefits to the ATO in clarifying the roles and responsibilities of ATO staff, increasing coverage of its plans and improving the accessibility of core documentation.

Introduction

9.1 *Working together* and *Working as one team* are two of the fundamental principles contained within the ATO corporate mission statement. These principles are very much applicable to the ATO's key objectives in its efforts to collect outstanding debt. This is particularly so, given the segmentation of debt collection activities among three business lines, which has meant that there are over 1200 staff dispersed across some 70 units Australia-wide.

9.2 In this context the ANAO reviewed the clarification of roles and responsibilities, planning documentation, and the dissemination and accessibility of core documentation.

Roles and responsibilities

9.3 In an effort to consolidate its new organisational structure, the ATO has identified the clarification of roles and responsibilities of all ATO staff as one of its keys objectives in the reorganisation. As such, it is presently reviewing the roles of all ATO tax officers through the work and job redesign process. For example, Debt Collection national office is currently drafting a chart which will display the collection role and relationship of WHT staff.

9.4 In ensuring the effective collection of all outstanding tax, the ATO seeks advice from several specialist areas. In addition, numerous tax officers, other than debt collection staff, can be in contact with taxpayers with outstanding debts in relation to other taxation matters. These specialist areas include:

- the Complex Legal Recovery Unit;
- Appeals and Review;
- Source Deduction Audit (SDA);
- Primary Audit;
- WHT Client Service Teams;
- Special Audit; and
- Enquiries.

9.5 As these tax officers are involved to various degrees during the recovery process, they can influence the likelihood of the ATO recovering revenue from outstanding debts. A review by the ANAO indicated that a small number of branches had entered into special agreements with A & R for the purpose of recovering outstanding debts where a dispute is involved. Generally, the ANAO found that where these agreements were in existence they were quite specific in outlining the roles and responsibilities of each area with respect to one another. However, the ANAO found that, with the exception of Source Deduction Audit and Client Service Teams, the roles and responsibilities of these specialist areas with respect to debt recovery are not clearly articulated.

9.6 The DRS identified benefit in extending initial recovery work to Source Deduction Auditors and Client Service Teams. The ATO advised that the work and job redesign process was considering those tax officers' roles during the recovery process. The ANAO acknowledges the complexity of this task in taking into consideration the multiplicity of functions the ATO performs in collecting the revenue. Within this context, the ANAO

suggests that the ATO consider the influence that the aforementioned areas have on the recovery process during the work and job redesign process.

Plans

9.7 Sound planning is important for organisational success. It is through the use of plans and the planning process that an organisation can effectively determine and communicate its goals and objectives for a given period of time. This assists in making staff aware of the direction in which the organisation is heading, thus promoting a common focus on achieving such objectives.

9.8 The ATO currently groups its debt collection units into four regions representing north (Qld), south (Vic, Tas), east (NSW and ACT) and west (WA, NT and SA). A review of the ATO's existing plans indicated that there was a lack of consistency across business lines in the structure and quality of debt collection plans throughout the various regions and branches. The ANAO found that in a number of branches debt collection units adopted their regional business line debt collection plans as their own while others had no regional or branch plan. The ANAO also observed that some debt collection units' plans consisted of a series of predetermined target goals, while in a number of other branch debt collection units, plans were non-existent.

9.9 This variability in the nature and standard, or non-existence of plans across the ATO, is having a detrimental effect on Debt Collection's ability to improve its overall performance. Moreover, plans cannot be effectively compared with those of previous years or of other regions, branches and business lines.

Recommendation No.28

9.10 The ANAO *recommends* that the ATO review its overall coverage of plans to ensure that all debt collection units have plans in place, thereby promoting a degree of consistency across the whole of Debt Collection on a branch, region, business line and national level.

ATO response

9.11 The ATO agrees to review current plans in debt collection areas in the context of promoting overall corporate consistency.

Dissemination and accessibility

9.12 The ANAO found that current methods of dissemination of core debt collection documentation (policy, standards, procedures, etc.) did not achieve a high level of recognition by operational staff, compromising the likelihood of consistent application in the workplace. Consequently, differences in the approach have evolved between branches and regions as national policy and standards have changed. Examples include the application of differing rules on acceptable proposals for payment arrangements, and the allocation of payments.

9.13 The ATO has advised that it will be disseminating national policy and procedural documentation as it is developed electronically to staff in branch offices. The ANAO considers this will go some way to improving awareness and overall access to core documentation. However, as discussed in Chapter 5, debt collection involves the application of an extensive and complex combination of rules and processes.

Consequently, policy and procedural documentation is likely to be extensive and complex, and thus the user-friendliness of accessibility is critical.

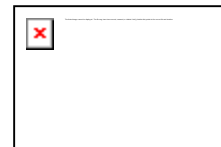
9.14 The ATO has developed a range of tools for the dissemination and user-friendly access of tax law and interpretation information to improve the quality of technical decision-making. These include the tax technical database and a database of significant issues (SIGNUM). Similar issues are faced by Debt Collection in assisting staff to assimilate and use a complex body of legislation and policy. The ANAO suggests that there may be synergies in Debt Collection working with Tax Technical staff, given their experience in the use of business systems for information management, to assist the distribution and user-friendly access of debt collection material.

Recommendation No.29

9.15 The ANAO *recommends* that the ATO examine the development of more user-friendly and consistent approaches of providing access to debt collection reference materials for debt collection staff.

ATO response

9.16 The ATO agrees with this recommendation.



Canberra ACT
15 November 1996

P. J. Barrett
Auditor-General

1

The figures given in this table are as reported in ATO Annual Reports. The ANAO has reconciled the debt on hand figures with COMPACT management reports and between years and has found discrepancies with some of the data after taking into consideration the amount of tax debt not yet due. For example, the ANAO is concerned that in years such as 1991-92, when the debt referred exceeds the debt finalised, the debt on hand figure decreases, not increases. The ATO advised that these discrepancies may be the result of changes to management reports in the early 1990s.

2

As there were no adjustments to the business systems, this increase is likely to be the consequence of a surge in referrals resulting from lodgment cycles.

3

Note that the amount of debt finalised in each quarter differs for all eight quarters depicted in Figure 3. Specifically, a larger amount of debt was finalised in the quarters with lower finalisation by collection rates in 1995-96 thus causing the annual rate for finalised by collection for 1995-96 (76 per cent) to be lower than in 1994-95 (80 per cent).

4

DMIS was a specific project undertaken by ATO as part of the DRS. The DRS results are discussed in the following section. We found that DMIS reports separate debt referred to COMPACT into initial debt referred, additional debt raised through current liabilities while the account is with COMPACT, and penalties raised. The report tracks the ATO collection performance with respect to each of these three debts enabling the ATO to identify its collection rate for outstanding debt alone.

5

This figure was calculated using the annualised FTE staffing figures for 1995-96 provided by each of the three business lines.

6

Where Debt Collection has identified a taxpayer as having outstanding debt, all subsequent transactions, including the payment of subsequent tax liabilities by the due date (maintenance of current liabilities), are recorded as debt finalised by collection.

7

Department of Finance, *Examining Contestability within the APS: Initial information, concepts, case studies and lessons learned*, November 1995, page 1.

Appendix 1 - ATO Program Structure

1. The ATO has based its organisational structure around particular client groups. In addition, it has established a specialist tax law program and created specialist functional groups to assist the client group programs.
2. The ATO's client group programs, around which the ATO focuses its program delivery, are listed below:
 - *Individuals Non Business*: deals with salary and wage earners and investors;
 - *Small Business Income*: clients are businesses with annual turnovers of less than \$10 million; also deals with fringe benefits tax matters for all taxpayers;
 - *Large Business Income*: clients are large corporate groups with annual turnovers in excess of \$10 million; also deals with international tax;
 - *Withholding and Indirect Taxes*: includes prescribed payments, sales tax and PAYE; and
 - *Child Support Agency*.

3. The ATO has set up the following separate support program to take responsibility for the tax technical service delivery:

- *Tax Law Services*: takes in the Tax Law Improvement Project, Legislative Services, the Tax Counsel Network and Practice Management and Development.

4. The corporate, financial and information technology needs for the client group programs are provided by the following support programs:

- *Financial Services*;
- *Corporate Services*; and
- *Information Technology Service*.

5. The ATO expects that this organisational structure will be of benefit by enhancing output and placing greater emphasis on taxpayer compliance strategies, taxpayer education, and being accountable for outcomes.

Appendix 2 - Additional Charges for Late Payment

Examples of the relevant provisions of the taxation statutes imposing additional charges for late payment and providing a discretion for the Commissioner of Taxation to remit those charges are:

Tax Liability	Imposition (section)	**	Penalty type	Remission (section)
Income Tax	207(1)		per annum	207(1)
	207A(1)		per annum	207A(4)
Reportable Payments	220AT(3)(a)		flat penalty	220AU(2)
	220AT(3)(b)		per annum	220AU(3)
	220AT(4)	gb	per annum	220AU(3)

Tax instalments	221F(12)(b)(i)	gb	per annum	221N(1)
	221F(12)(b)(ii)(A)		flat penalty	221N(1)
	221F(12)(b)(ii)(B)		per annum	221N(1)
Prescribed payments	221YHJ(1)(b)(i)	gb	per annum	221YHL(1)
	221YHJ(1)(b)(ii)(A)		flat penalty	221YHL(1)
	221YHJ(1)(b)(ii)(B)		per annum	221YHL(1)
Natural resource	221YHZD(2)(b)(i)	gb	per annum	221YHZE(1)
	221YHZD(2)(b)(ii)(A)	gb	per annum	221YHZE(1)
	221YHZD(2)(b)(ii)(B)	gb	per annum	221YHZE(1)
Withholding tax	221YN(4)(b)		per annum	221YN(5)
Mining withholding tax	221ZC(4)		per annum	221ZC(5)
Estimated liabilities	222AJA(3)(a)	gb	per annum	222AJC(1)
	222AJA(3)(b)(i)	gb	flat penalty	222AJC(1)
	222AJA(3)(b)(ii)	gb	per annum	222AJC(1)

Fringe benefits	93(1)		per annum	93(4)
Sales tax	68(1)		per annum	68(4)

** gb = section applicable for government body

Appendix 3 - Bibliography

Australian Taxation Office *Corporate Plan, 1995-98* (AGPS, Canberra, 1995).

CCH Tax Editors, *1996 Australian Master Tax Guide, 27th Edition* (CCH Australia, North Ryde, 1996).

Department of Finance, *Examining Contestability Within the APS: Initial Information, Concepts, Case Studies and Lessons Learned* (Department of Finance, Canberra, 1995).

Australian Quality Council, *1996 Australian quality awards assessment criteria: Public Sector Guidelines* (Australian Quality Council, St Leonards, 1996).

United States General Accounting Office, *Tax Administration, State Tax Administrators' Views on Delinquent Tax Collection Methods*, (GAO, Washington, 1994).

Joint Committee of Public Accounts, *Report 326 - An Assessment of Tax*, (AGPS, Canberra, 1993).

Appendix 4 - Performance Audits in the Australian Taxation Office

Set out below are the titles of the reports of the main performance audits by the ANAO in the Australian Taxation Office tabled in Parliament in the past three years.

Audit Report No.12 1993-94

Administration of the 150% Taxation Incentive for Industry Research and Development

- Department of Industry, Technology and Regional Development
- Australian Taxation Office

Audit Report No.24 1993-94

Management of Appeals and Review

Audit Report No.39 1993-94
Management of the Child Support Agency

Audit Report No.3 1993-94
Project Audit - Wool Tax

Audit Report No.6 1993-94
Efficiency Audit - ATO - Information Technology Security

Audit Report No.1 1994-95
Income Matching System

Audit Report No.16 1995-96
Assessable Government Industry Assistance.