

The Auditor-General

Audit Report No.34 1998-99

Performance Audit

Fringe Benefits Tax

Australian Taxation Office

Australian National Audit Office

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Canberra ACT
31 March 1999

Dear Madam President
Dear Mr Speaker

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

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

Yours sincerely



P. J. Barrett
Auditor-General

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

AUDITING FOR AUSTRALIA

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Abbreviations/Glossary

| | |
|--------|--|
| AFL | Australian Football League |
| AIS | ATO Integrated System |
| ANAO | Australian National Audit Office |
| ATO | Australian Taxation Office |
| ELS | Electronic Lodgement System |
| FBT | Fringe Benefits Tax |
| GST | Goods and Services Tax |
| HOTSAs | Health of the System Assessment |
| KATE | Key Abnormal Tax Agent Evaluation |
| KCM | Key Client Manager |
| LB&I | Large Business and International business line |
| MOU | Memorandum of Understanding |
| NTLG | National Tax Liaison Group |
| PBI | Public Benevolent Institution |
| PBR | Private Binding Ruling |
| PR | Product Ruling |
| PRS | Problem Resolution Service |
| RKR | Record Keeping Review |
| RTO | Regional Technical Officer |
| RTR | Real Time Review |
| SBI | Small Business Income business line |

Summary and Recommendations

Summary

Overview of FBT

1. The Australian Taxation Office (ATO) is the Commonwealth's principal revenue collection agency. In 1997–98, the ATO collected tax revenue of \$110.3 billion.¹ Fringe Benefits Tax (FBT) revenue in the same period was \$3.3 billion,² representing some 3 per cent of total ATO tax revenue collected.

2. FBT was introduced on 1 July 1986 to ensure that tax is paid on benefits provided in place of, or as well as, salary and wages. Until the introduction of FBT, deficiencies in the income tax law meant that fringe benefits were income which was effectively free from tax. The tax is levied on the 'grossed up' taxable value of the fringe benefits and the FBT liability is the responsibility of the employer. Grossing up the taxable value of the fringe benefits means that the tax paid on the benefit is the same as the tax which would be payable at the top personal marginal rate on the equivalent value of remuneration in wages and salary.

3. FBT is administered by the Small Business Income (SBI) business line in the ATO.³ Under the ATO's business and service organisational structure, SBI provides a range of services to the two million or so Australian businesses with annual turnover of less than \$10 million. The strategic development and management of FBT is the responsibility of the FBT National Leader. The day to day operational aspects of FBT are performed by FBT Business Teams, in branch offices around Australia. In 1997–98, the average staffing level for FBT administration was 214.

4. The ATO's strategic objectives in the administration of FBT are to ensure that the Government and community have full confidence in the integrity and equity of FBT and that employers providing benefits meet their FBT obligations, with any risks to revenue identified and managed effectively by the ATO.

¹ Accrual basis.

² Accrual basis.

³ On 1 March 1999, the Small Business Income business line ceased to exist and the administration of FBT was placed in the newly-created Small Business line. This organisational change came into operation during the final reporting phase of the audit and after the ATO provided its response. This report comments on the administrative arrangements which were current during the audit process.

5. The ATO currently faces the challenge to administer the existing taxation regime, while significant changes to the taxation system are imminent.

Audit objective and approach

6. The administration of FBT is a topic of interest because FBT is significant in terms of the revenue it represents and because it is a high profile and contentious tax in the community.

7. The objective of the audit was to ascertain and report to Parliament on the ATO's administration of FBT and to identify opportunities for improvement. To accomplish this objective, the Australian National Audit Office (ANAO) identified five key issues relevant to the effective administration of FBT:

- knowledge of the taxpayer base;
- education of taxpayers;
- client service relating to advice handling;
- other enforcement activities—audits and reviews; and
- the systems required to support the administration of FBT, including staff skills and training and information systems.

8. As part of the audit, specific criteria were determined to examine the administrative processes relating to these key issues.

9. There has been significant policy debate regarding reform of the Australian tax system during the audit. Several significant changes are proposed in relation to FBT, for example:

- from 1 July 1999, employers will be required to identify on group certificates the grossed up taxable value of employees' fringe benefits, where the taxable value exceeds \$1000;⁴
- Public Benevolent Institutions and certain other non-profit organisations are not liable for FBT under the current legislation. Some other organisations receive a rebate. From the 2000–01 FBT year, this concessional treatment will be limited to \$17 000 of grossed up taxable value of benefits per employee; and
- FBT will be extended to cover benefits in excess of \$1000 a year provided by companies to their shareholders, or by trustees to their beneficiaries, where these benefits are not currently taxed.

⁴ To do this, effective systems to record benefits provided to individual employees must be in place for 1 April 1999. In other words, the group certificate reporting requirements effectively apply from 1 April 1999.

10. These proposed changes are of considerable significance. They are intended to enhance the fairness of the taxation and social security systems by enabling the value of fringe benefits to be taken into account in income tests for determining entitlement to government benefits, and liability to tax surcharges and income related obligations. They expand the administrative and reporting aspects of FBT and are probably amongst the most significant amendments since the introduction of FBT in 1986.

11. At present, the proposed changes are Government policy. The legislation with respect to some of these proposed FBT changes is currently before Parliament in *A New Tax System (Fringe Benefits Reporting) Bill 1998* and in *A New Tax System (Medicare Levy Surcharge-Fringe Benefits) Bill 1998*.

12. Subject to the passage of the tax reform legislation, the Government's proposed changes will significantly impact on the administration of FBT. Nevertheless, the recommendations contained in this report can be readily adopted in the administration of FBT, regardless of the final outcome in respect of the Government's proposed legislative changes.

Overall conclusion

13. The ATO has administered FBT for nearly thirteen years. Since its introduction, FBT has undergone significant change. Over this time the systems and organisational arrangements the ATO has used in administering the tax have also changed significantly.

14. We found that there is a high level of complexity in the application of FBT law and the estimated cost of compliance for FBT is relatively high.

15. Against this background, the ATO has taken a number of initiatives in recent years to improve its administration of FBT, such as the creation of FBT Business Teams and the use of national projects and research to assess compliance risks. We found that the ATO is currently putting in place several key strategies which have the potential to enhance its FBT administration considerably. These include the introduction of a compliance model which is designed to focus appropriate compliance and regulatory activity according to the nature of the particular taxpayer; increased attention to the need to gain a thorough knowledge of the FBT taxpayer base; and a greater emphasis on taxpayer education to improve compliance.

16. Notwithstanding these initiatives and strategies, the ATO still faces a number of significant challenges in its administration of FBT. Many

of these are recognised by the ATO itself. We found that the ATO does not yet have the comprehensive knowledge that it needs in relation to its FBT client groups. It is now beginning to identify its client groups and the risks associated with them, and to address those risks accordingly. Many clients also suffer from inadequate knowledge about FBT matters or even awareness of their responsibilities in those regards. We also found the ATO's FBT client service measures could be better supported with quality assurance monitoring of the oral advice provided by ATO officers and implementation of a system to monitor frequently asked questions. A broader range of enforcement tools would enhance the comprehensiveness of the ATO's FBT enforcement strategy and thereby facilitate the appropriate treatment of identified risks. One of the main challenges for FBT administration lies in the systems area, however the ATO's ability to overcome these impediments to efficient processing is constrained at this time by other systems priorities.

17. The expanded administrative and reporting requirements associated with the proposed FBT changes are likely to result in increased compliance costs on FBT taxpayers and consequent greater challenges for ATO in administering FBT efficiently and effectively.

18. It should be noted that this audit focused on only one area, albeit a quite significant one, in the extensive, highly complex and evolving system of taxation in Australia. However, even in this discrete area the audit observed the administrative consequences of generally ongoing, incremental and reactive changes in the tax system in the past with their implications both for the cost and overall effectiveness of taxation collections.

19. The ATO responded positively to the audit and accepted all of its recommendations.

Key Findings

The FBT environment (Chapter 1)

20. The application of FBT law is highly complex and consequently not well understood by the taxpayer base. ATO research has found that small businesses make elementary mistakes in FBT. Over 50 per cent of employers do not fully understand their obligations, and some small tax agents also have inadequate knowledge. The large number of different and specific valuation rules contributes to this high level of complexity.

21. FBT is considered by many taxpayers to impose a significant compliance burden, with costs reflecting that burden. The specific valuation requirements and the onerous record keeping demands also make compliance with FBT expensive relative to most other taxes. These factors contribute to the level of non-compliance. The cost of compliance will increase with the implementation of the Government's proposed reforms in relation to FBT.

Knowledge of the taxpayer base (Chapter 2)

22. The ATO has completed a large number of projects over recent years to improve its knowledge of the taxpayer base.

23. ATO research has shown, for example, that 76 per cent of FBT taxpayers lodged their returns through tax agents, accounting for 47 per cent of the revenue collected. Twenty-one tax agents prepared returns relating to 58 per cent of the revenue lodged by tax agents generally.

24. From other ATO research, it would appear that many employers with an FBT liability do not comply, because they are not aware that they have a liability.

25. The ATO does not yet have a comprehensive knowledge of the FBT taxpayer base. Even with the project work done to date, the ATO does not know enough about the key characteristics of each of the three groups of taxpayers (that is, lodgers, compliant non-lodgers and non-lodgers). For example, knowledge of the taxpayer base in terms of the various groups' areas of concern in relation to the legislation, their education needs, their preferred service delivery mechanisms and their level of compliance, would provide a much stronger basis for the ATO's efforts in administering FBT more efficiently and effectively.

26. At this stage, projects tend to be viewed separately, with results not having been drawn together. Drawing together the project information would allow officers to use more effectively the work undertaken and to build on current knowledge and intelligence. The ATO intends to do a stocktake of projects to establish lessons learned and to disseminate appropriate information.

Taxpayer education (Chapter 3)

27. The ATO recognises education as an important means of improving taxpayer knowledge and compliance. However, the results from ATO studies show that its clients often have a lack of knowledge about FBT matters or even awareness of their responsibilities. ATO research found that there is generally poor comprehension of the FBT legislation and that appropriate education is needed to address this deficiency. For example, the ATO found that 50 per cent of the small business community does not meet its responsibility fully and up to 50 per cent of tax agent prepared tax returns are incorrect to some degree.

28. There is therefore a strong case for the ATO to consider initiatives to significantly enhance the understanding of both current and potential taxpayers in relation to their FBT obligations.

29. Although the ATO's main education product relating to FBT (the Employers Guide) is highly regarded by the ATO's clients, the ATO's progressive development of other information products recognises that different taxpayers have different needs. We see considerable value in the ATO providing a wider range of products and delivery options than currently exists, to allow taxpayers to choose those products and delivery methods most appropriate to their circumstances.

Client service - advice handling (Chapter 4)

30. Among the FBT stakeholders we consulted, there were perceived differences in client service. Some stakeholders even thought that there were differences in treatment between clients depending on their size. This view may relate to the fact that large businesses may have a key client contact officer within the Large Business and International business line of the ATO and that this contact officer can offer significant client assistance. Given the large number of FBT clients, providing such individual contact officers is not practical for all the FBT clients in the Small Business Income business line. A useful improvement for the FBT clients is the ATO's proposed introduction of Key Client Managers for the tax agents who account for large numbers of FBT returns.⁵ This

⁵ Large FBT tax agents are those who lodge more than 100 FBT returns.

measure should go some way toward improving information flows between the ATO, tax agents and their clients and towards enhancing client service and taxpayer perceptions of the accessibility and helpfulness of the ATO.

31. The ATO recognises the need to provide timely, accurate and consistent information and advice to its clients.

32. There is currently no quality assurance process involved with oral advice provided by ATO officers, although with the Government's proposed tax reforms, the ATO is to be bound by such advice.⁶

33. The ATO's client service initiatives could be better supported with quality assurance processes for oral advice and implementation of a system to monitor frequently asked questions. Such systems could promote accuracy, help to identify matters causing confusion for taxpayers and assist in the appropriate targeting of education products and services.

Other enforcement activities (Chapter 5)

34. A consistent, coordinated approach to enforcement activity is required to treat identified risks appropriately. The ATO also uses enforcement activities to gain information about particular groups of taxpayers.

35. At present, the range of FBT enforcement activity employed by the ATO is fairly narrow, relying, in the main, on traditional audits. The ATO is, however, in the process of tailoring other enforcement activities, including Record Keeping Reviews, for FBT audit staff.

36. Large business FBT taxpayers are the smallest client group numerically, but they account for approximately 65 per cent of FBT revenue. The risks associated with large businesses in relation to FBT are unknown and, as a result, this segment of the taxpayer population may not receive sufficient audit attention. There are informal links between FBT Business Teams and the audit teams responsible for large businesses. However, the lack of more formal links between business lines within the ATO is not conducive to systematic coverage of the entire taxpayer population, nor of consistency of approach, particularly where a degree of integration can have benefits for both overall administration and for taxpayers.

⁶ The Government's proposed tax reform package includes provisions to make the ATO more accountable for its oral advice. It specifies that taxpayers with simple tax affairs will be able to rely on oral advice received from the ATO and that this advice will be binding.

Supporting the FBT function (Chapter 6)

37. FBT Business Teams are responsible for a significant volume and variety of functions.

38. There are over 15 different systems, plus desktop systems (such as the word processing and electronic mail applications) with which FBT Business Teams must be familiar. One of the main challenges for FBT administration lies in the IT systems area. For example, some current IT difficulties cause flow on problems elsewhere in the FBT system which often require intervention to rectify. There is no single platform for the whole FBT system, and because there is no fast-track between the numerous applications, users must exit any application before entering another. However, the ATO's ability to overcome these impediments to efficient processing is constrained at this time given its other systems priorities.

39. The skills required by staff range from technical expertise and a sound knowledge of the FBT legislation, to knowing how to operate the numerous computer systems used within FBT Business Teams. Branches and regions generally assess their training needs on an individual basis. The National Team is developing a more coordinated, nationally-managed approach to address such training needs.

40. FBT Business Teams report against their required service standards under the Taxpayers' Charter. This information is collated with that from other work areas on a regional basis. However, there is no formal monitoring against Taxpayers' Charter obligations for the administration of FBT as a whole, either as a management aid or accountability tool.

Recommendations

Set out below are the ANAO's recommendations aimed at improving the ATO's administration of FBT. Report paragraph references and abbreviated ATO responses are also included. More detailed responses are shown in the body of the report. The ANAO considers the ATO should give priority to Recommendations 1, 2 and 4.

Recommendation No.1 The ANAO recommends that, to further improve its knowledge of the FBT taxpayer base, the ATO:

Para 2.36

- put in place cost-effective mechanisms to collate and disseminate the results of work undertaken; and
- ensure that the intelligence and insights gained are well understood and appropriately applied by FBT Business Teams.

ATO Response: Agreed

Recommendation No.2 The ANAO recommends that, to increase taxpayer knowledge of FBT and enable easier access to relevant education products:

Para 3.29

- the ATO undertake a cost-benefit analysis to consider various initiatives which may be undertaken to raise general awareness concerning FBT for potential taxpayers and to enhance the understanding of current taxpayers in relation to their obligations;
- given the significant changes proposed by the Government in relation to FBT, the ATO deliver taxpayer education regarding the Government's FBT amendments; and
- the ATO, as a high priority, develop a cost-effective range of products to allow taxpayers to select the education materials and delivery mechanisms which best suit their needs.

ATO Response: Agreed

**Recommendation No.3
Para 4.45** The ANAO recommends that, to improve client service, the ATO consider the cost-effectiveness of developing and implementing:

- a single system to enable the monitoring of frequently asked questions, both in writing and orally to provide an indication of significant issues affecting taxpayers; and
- a method of assessing and monitoring the quality of oral advice (in terms of consistency and accuracy) provided to ATO clients.

ATO Response: Agreed

**Recommendation No.4
Para 5.38** The ANAO recommends that, to promote the cost-effective application of its enforcement strategy in FBT, the ATO:

- include Real Time Reviews as part of a broader range of enforcement tools for FBT Business Teams;
- as a matter of priority, undertake research with the involvement of the area administering FBT, in conjunction with the Large Business and International business line, to identify, assess, prioritise and treat risks in the large business segment;
- improve coordination mechanisms and information exchange between business lines on FBT matters; and
- develop a national strategy for enforcement activity to contribute to the coordinated identification, assessment, prioritisation and treatment of compliance risks.

ATO Response: Agreed

**Recommendation No.5
Para 6.36** The ANAO recommends that the ATO establish cost-effective mechanisms to monitor overall FBT performance against Taxpayers' Charter service standards.

ATO Response: Agreed

Audit Findings and Conclusions

1. The Fringe Benefits Tax Environment

This chapter provides background on the features of Fringe Benefits Tax and its administrative environment. It also sets out the objectives and methodology of the audit and the structure of this report.

Background

1.1 The Australian Taxation Office (ATO) is the Commonwealth's principal revenue collection agency. The ATO is responsible for collecting a number of different taxes. In 1997–98, the ATO collected tax revenue of \$110.3 billion.⁷ Fringe Benefits Tax (FBT) revenue in the same period was \$3.3 billion,⁸ representing some 3 per cent of total ATO tax revenue collected. Revenue raised by FBT has steadily risen since its introduction in 1986. In 1986–87, the ATO reported revenue collections of \$52.9 billion.⁹ In the same period, FBT revenue collections were \$535 million (representing only 1 per cent of the ATO's revenue collections).¹⁰

FBT in brief

1.2 FBT was introduced on 1 July 1986 to ensure that tax is paid on benefits provided in place of, or as well as, salary and wages. Until the introduction of FBT, deficiencies in the income tax law meant that fringe benefits were income which was effectively free from tax. More and more employers and employees were taking advantage in their salary packaging of these deficiencies, to minimise tax liability. This led to an unfair share of the income tax burden being taken by those who did not or could not take advantage of such salary packaging.

1.3 A fringe benefit is a benefit which is provided to an employee or an associate of the employee (usually a family member), in respect of employment.¹¹ The benefit does not have to be provided directly by the employer in order for FBT to apply. FBT may still apply if the benefit is provided by arrangements with others.

⁷ Accrual basis.

⁸ Accrual basis.

⁹ Cash basis. The ATO revenue collections figure includes sales tax collections by the Australian Customs Service.

¹⁰ Cash basis.

¹¹ This direct relationship to employment will change under the Government's proposed reforms. The reform package as it affects FBT is discussed in more detail later in this chapter.

1.4 The tax is levied on the 'grossed up' taxable value of the fringe benefits. Grossing up the taxable value of the benefits means that the tax paid on the benefits is the same as the tax which would be payable at the top personal marginal rate on the equivalent value of remuneration in wages and salary. The formula for grossing up is: $\frac{1}{1 - \text{FBT rate}}$.

The grossing up rules were introduced for the 1994–95 FBT year to restore equity between the provision of wage/salary and the provision of fringe benefits to employees. In order to compensate for this gross up basis of taxation, an income tax deduction is allowed for the amount of FBT paid. A rebate is allowed in determining the FBT payable for some income tax-exempt employers who derive no benefit from the deductibility of FBT for income tax purposes.

1.5 The FBT year commences on 1 April and runs to 31 March. For the FBT year commencing 1 April 1998, the rate of FBT is 48.5 per cent and is calculated on the tax-inclusive (that is, grossed up) value of the fringe benefits provided in the year (that is, on the total value of the benefits increased by 94.17 per cent). An example of the calculation of FBT payable on benefits is at Appendix 1.

1.6 There are thirteen categories of fringe benefits, each with its own valuation rules. These are: motor vehicles; loans; debt waivers; expense payments; housing; living away from home allowances; airline transport (airlines and travel agents only); board; property; meal entertainment; entertainment provided by tax exempt organisations; car parking; and residual benefits.

Legislation

1.7 FBT is administered under the *Fringe Benefits Tax Assessment Act 1986* and its related Rating Act, the *Fringe Benefits Tax Act 1986*. The *Fringe Benefits Tax (Application to the Commonwealth) Act 1986* ensures, among other things, that Commonwealth entities do not escape their FBT obligations. The *Fringe Benefits Tax (Miscellaneous Provisions) Act 1986* amended the Income Tax Assessment Act so that employees would not be liable for income tax on the fringe benefits they received.

The ATO

1.8 The ATO is structured around groups of clients, into business lines and service lines. Each business line has responsibility for one major market segment. The ATO business lines are: individuals; small business;

large business and international; withholding and indirect taxes; superannuation; legislative services; the tax counsel; and the valuation office.

1.9 The Small Business Income (SBI) business line, which provides a range of services to the two million or so Australian businesses with annual turnover of less than \$10 million, is responsible for all FBT matters.¹² The FBT strategic objectives are to ensure that the Government and community have full confidence in the integrity and equity of FBT, and that employers providing benefits meet their FBT obligations, with any risks to revenue identified and managed effectively by the ATO.

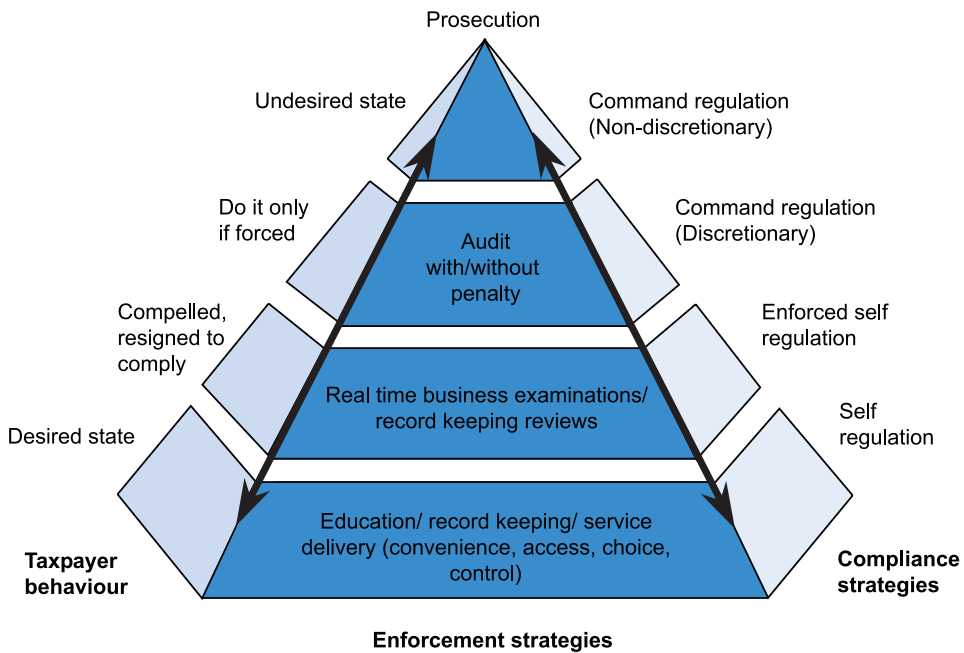
1.10 The strategic development and direction of FBT are the responsibilities of the FBT National Leader, supported by a National Team. The day to day operational aspects of FBT are performed by FBT Business Teams in branch offices around Australia. The FBT Business Teams are located in 16 of the 25 ATO branch offices. The teams are managed by the respective Regional Commissioners. Regional Commissioners are required to deliver against agreed outcomes and are accountable for these outcomes. The National Team receives funding for the strategic and coordination functions. The Regional Commissioners obtain a residual amount of resources to undertake operational matters and contribute to the ATO's reviews of risks, such as reviews through the Health of the System Assessment (HOTSA)¹³ process.

1.11 One of the aims of the FBT National Team and the FBT Business Teams is to improve compliance. SBI is currently introducing a compliance model which is designed to focus appropriate compliance and regulatory activity according to the nature of the particular taxpayer. Education, service delivery and other enforcement activities, including reviews and audits, are included in the range of enforcement activity applied by the ATO. The model, illustrated at Figure 1, is being applied to all compliance activity within SBI.

¹² On 1 March 1999, the Small Business Income business line ceased to exist and the administration of FBT was placed in the newly-created Small Business line. This organisational change came into operation during the final reporting phase of the audit and after the ATO provided its response. This report comments on the administrative arrangements which were current during the audit process.

¹³ The HOTSA is the ATO's formal risk management process which forms part of its strategic planning framework. The HOTSA process is discussed in Auditor-General, Audit Report No.37 1996-97, Performance Audit, *Risk Management Australian Taxation Office*, AGPS, Canberra, 1997 and Auditor-General, Audit Report No.19 1997-98, Performance Audit, *Risk Management in ATO Small Business Income Australian Taxation Office*, AGPS, Canberra, 1997.

Figure 1:
The compliance model



Source: Adapted from Report of the Cash Economy Task Force, *Improving Tax Compliance in the Cash Economy*, Canberra, April 1998, p25.

1.12 One impact of the compliance model, for the ATO’s administration of FBT, is that it puts a premium on having a good knowledge of taxpayers and their behaviour and requires ATO staff to be skilled in responding to these behaviours with the appropriate enforcement strategy.

Resources

1.13 In 1997–98, FBT had an average staffing level of 214. Expenditure on salaries and administration, excluding below the line costs (for example, superannuation) and other overheads (for example, accommodation), was \$9.6 million.

The FBT environment

1.14 The ATO’s strategic objectives in the administration of FBT are to ensure that the Government and community have full confidence in the integrity and equity of FBT and that employers providing benefits meet their FBT obligations, with any risks to revenue identified and managed effectively by the ATO. The ATO currently faces the challenge to administer the existing taxation regime, while significant changes to the taxation system are imminent. The Government’s proposed taxation

changes include the abolition of sales tax, the introduction of a goods and services tax (GST) and the implementation of a Pay As You Go payment system as a mechanism for collecting a number of taxes. Other current issues facing the ATO, apart from the proposed reform of the taxation system, include identifying and reducing the cash economy and examining the potential taxation issues arising from the growth of electronic commerce.

1.15 Changes to FBT in the past have generally been incremental and reactive. This section outlines the Government's proposed taxation reform package as it affects FBT, as well as other key environmental factors influencing FBT administration.

Proposed FBT reform

1.16 There are four elements to the reform of FBT proposed by the Government. These are discussed in turn in the following paragraphs of this sub-section. In addition, from July 2000 there will be an adjustment to the gross up rate. This adjustment is intended to ensure neutrality of treatment between fringe benefits and cash salary following the proposed introduction of the GST. We note that there will be some difficulties in ensuring neutrality by a simple, across the board adjustment to the gross up rate. For example, some fringe benefits do not give rise to a GST input tax credit for the employer, and therefore they would not require any adjustment to the current FBT gross up rate to maintain neutrality.

1.17 From 1 July 1999, employers will be required to identify on group certificates the grossed up taxable value of employees' fringe benefits, where the taxable value exceeds \$1000. To do this, effective systems to record benefits provided to individual employees must be in place for 1 April 1999. In other words, the group certificate reporting requirements effectively apply from 1 April 1999. Tax liability will remain with the employer, however the value will be included as income when determining liability for tax surcharges (for example, the Medicare Levy Surcharge and the Superannuation Contributions Surcharge) and child support obligations. The grossed up taxable value of fringe benefits will also be included in assessing entitlement to income-tested government assistance. This proposal introduces some administrative complexities for taxpayers and is also likely to increase compliance costs. For example, apportioning some benefits to individual employees may be difficult. It also extends the scope of employers who must be aware of the operation of the FBT legislation in order to discharge properly their group certificate reporting obligations even though they are exempt from FBT.

1.18 Currently, Public Benevolent Institutions and certain other non-profit organisations are not liable for FBT under the current legislation. Some other organisations receive a rebate. From the 2000–01 FBT year, this concessional treatment will be limited to \$17 000 of grossed up taxable value of benefits per employee. This value is equivalent to an average six cylinder car plus some additional benefits which are of minor value. Any amount above this limit will be subject to normal FBT treatment.

1.19 FBT will be extended to cover benefits in excess of \$1000 a year provided by companies to their shareholders or by trustees to their beneficiaries where these benefits are not currently taxed. This will apply from the 2000–01 FBT year.

1.20 FBT exemptions for remote area housing will be extended to the mining industry. This provides the mining industry with the same treatment as primary producers. This will apply from the 2000–01 year.

1.21 Over recent years, the incidence of salary sacrifice has increased. (Salary sacrifice is the practice of foregoing salary and obtaining an equivalent value in other forms of remuneration, that is as benefits.) The Government's proposed tax changes could have a significant impact on the FBT taxpayer population by dissuading employees from including benefits in their remuneration packages. The inclusion on group certificates of the taxable value of benefits provided, may offer a disincentive to salary sacrifice. Similarly, in the absence of any reduction in the FBT rate, the Government's proposed lower income tax rates reduce the taxation advantage of salary sacrificing to all employees except those on the top marginal tax rate.

1.22 At present, the proposed changes are Government policy. The legislation with respect to some of these FBT changes is currently before Parliament in *A New Tax System (Fringe Benefits Reporting) Bill 1998* and in *A New Tax System (Medicare Levy Surcharge-Fringe Benefits) Bill 1998*.

Taxpayers' Charter

1.23 The ATO's Taxpayers' Charter was developed following the Joint Committee of Public Accounts inquiry into the ATO in 1993, after extensive community and staff consultation.¹⁴ The Charter outlines the rights and obligations of both the ATO and taxpayers. It also spells out specific levels of service which taxpayers can expect from the ATO, and the way with which complaints or problems will be dealt.

¹⁴ Joint Committee of Public Accounts, *Report 326, An Assessment of Tax*, November 1993. See also Auditor-General, Audit Report No.22 1996-97, *Client Service Australian Taxation Office*, AGPS, Canberra, 1996, pp18-19.

1.24 The FBT National Team and the FBT Business Teams are required to conform to certain performance standards under the Charter. The standards for 1998–99 include:

- responding to correspondence within 28 days;
- processing FBT returns within 42 days (if not lodged electronically) or 14 days (for electronic lodgement); and
- responding to a request for a private ruling within 28 days.

1.25 These service standards ensure that taxpayers are provided with timely service.

Self-assessment

1.26 Like most other taxes, FBT is self-assessed, meaning that taxpayers are required to calculate their liability and pay their tax. Placing the onus of understanding and applying the legislation on taxpayers has inherent risks. Under self-assessment, non-compliance is likely if taxpayers are unaware that they have a liability, unsure of their obligations or believe that the enforcement activity of the ATO is unlikely to capture them if they do not comply. Under the new compliance model, particularly, education is a vital element in ensuring that self-assessment does not mean extensive non-compliance.

Complexity

1.27 There is a high level of complexity in the application of FBT law. Part of the reason that the legislation is considered to be complex is the specific nature of valuation rules for each benefit type. These rules give the taxpayer some choice, and therefore encourage the taxpayer to calculate their liability using all methods, in order to determine the most tax-efficient method for that item, for that year. The large number of different and specific valuation rules, creates a high level of complexity and contributes to the level of non-compliance.

Costs of compliance

1.28 FBT is considered by many taxpayers to impose a significant compliance burden and associated compliance costs. Independent research commissioned by the ATO has shown that the estimated compliance cost for FBT is relatively high, with only the Prescribed Payments System having higher compliance costs.¹⁵ Table 1 shows estimated business taxpayer compliance costs as a proportion of revenue in 1994–95.

¹⁵ *A Report into Taxpayer Costs of Compliance*, ATAX, UNSW, November 1997. Note that the Prescribed Payments System is to be abolished under the Government's proposed reform of the taxation system.

Table 1:
Cost of compliance 1994–95

| Tax Type | Compliance costs \$ m | Revenue \$ m | Proportion of revenue per cent |
|--|--------------------------|-----------------|-----------------------------------|
| Income Tax (including Capital Gains Tax) | 2 106 | 31 000 | 6.8 |
| Fringe Benefits Tax | 286 | 2 736 | 10.5 |
| Pay As You Earn | 688 | 51 238 | 1.3 |
| Wholesale Sales Tax | 519 | 11 100 | 4.7 |
| Prescribed Payments System | 477 | 2 169 | 22.0 |

Source: *A Report into Taxpayer Costs of Compliance*, ATAX, UNSW, November 1997.

External scrutiny

1.29 FBT is a contentious and high profile tax. Since its introduction, FBT has been subject to ongoing formal examination and review. Key reviews are outlined below.

Previous efficiency audit of the administration of FBT

1.30 An efficiency audit of the FBT system by the Australian National Audit Office (ANAO) in 1991–92 revealed a number of inadequacies.¹⁶

1.31 Both legislative and administrative aspects of the scheme have changed significantly since 1991. The most significant changes to the legislation have been the introduction of the ‘grossing up’ concept and additional exempt benefits. As noted earlier, the grossing up provisions bring the actual FBT paid into line with the income tax which would have been payable if the benefit had been paid as wages or salary. There have also been ongoing organisational and administrative changes within the ATO relating to FBT since the 1991–92 ANAO audit. The ATO introduced business lines which relate directly to the clients serviced rather than to the tax functions performed. When business lines were first introduced, responsibility for FBT fell across several business lines. In 1995, the administration of FBT was moved to SBI.

1.32 In considering the current relevance of the recommendations of the previous audit, we found that the recommendations were either no longer relevant due to the substantial change in the FBT system and the ATO environment, or action in response to the recommendations had been taken or was under way.¹⁷

¹⁶ Auditor-General, Audit Report No.33 1991-92, *Australian Taxation Office: Administration of Fringe Benefits Tax*, AGPS, Canberra, 1992.

¹⁷ For example, the introduction in 1997 of Division 7A legislation (of the *Income Tax Assessment Act 1936*) addressed Recommendation 46, concerning the use of shareholder loan accounts; and a public education strategy is being developed in response to Recommendation 52, which advocated seminars.

1.33 Some issues in the previous audit such as compliance, the rulings system and training, are also covered in the current audit.

Other reviews

1.34 The House of Representatives Standing Committee on Banking, Finance and Public Administration 1995 report, *Taxing Relaxing*, raised FBT as a matter of some concern across the tourism industry.¹⁸ High compliance costs were identified as a major issue.

1.35 In 1995, the Treasurer announced the results of a review of FBT compliance costs undertaken by the Treasury. The resultant changes included increased exemptions, changes to declaration requirements, the introduction of the 50/50 rule for meal entertainment fringe benefits,¹⁹ changes to car parking requirements such as the introduction of a wider range of valuation methods for this benefit, and a decrease in the period required for retaining records. These changes were introduced on a revenue neutral basis, with the revenue effect of the exemptions and concessions that were introduced, offset by an increase in the statutory fractions which applied for the purposes of determining the taxable value of motor vehicles by the relevant method.²⁰

1.36 The Small Business Deregulation Task Force²¹ examined FBT as it relates to small businesses, particularly compliance costs. This examination led to some significant changes, including a reduction in record keeping requirements.

Overseas experience

1.37 Australia is one of only four countries in which the tax on benefits is imposed on the employer. The other countries are Malawi, Lesotho and New Zealand. The 'employer approach' has the advantage that it reduces the administration burden on the collection agency by reducing

¹⁸ House of Representatives Standing Committee on Banking, Finance and Public Administration, *Taxing Relaxing: Report on the inquiry into the impact of Australia's taxation regime on the tourism industry*, AGPS, Canberra, 1995.

¹⁹ Employers have three options for determining the value of meal entertainment. The simplest of these methods will accept that 50 per cent of expenditure on entertainment meals is subject to FBT, with the balance being non-deductible to the employer. Alternatives are to keep an actual record of expenditure, or keep records for a representative twelve week period which can then be used to calculate annual expenditure.

²⁰ The taxable value of a car fringe benefit can be determined by either the statutory formula method or by the operating cost method. The effect of the statutory formula is to value a car fringe benefit by applying a statutory fraction to the determined value of the car. The fractions vary according to the total distance the car travels during the year. The increased statutory fractions meant that a given motor vehicle benefit had an increased taxable value.

²¹ Report of the Small Business Deregulation Task Force, *Time For Business*, November 1996.

the numbers of reporting and collection points. Although other systems, whereby employees are liable for the tax on benefits, are more common overseas, nearly every country taxes benefits. For example, in the United States and Canada, the benefit is required to be put on group certificates and employees are liable for the tax.²² Another variant of the 'employee approach' requires employees to include the benefit on their income tax returns.

Audit objective and methodology

1.38 The administration of FBT is a topic of interest because it is significant in terms of revenue and is a high profile and contentious tax.

1.39 The objective of the audit was to ascertain and report to Parliament on the ATO's administration of FBT and to identify opportunities for improvement. To accomplish this objective, the ANAO identified five key issues relevant to the effective administration of FBT:

- knowledge of the taxpayer base;
- education of taxpayers;
- client service relating to advice handling;
- other enforcement activities; and
- the systems required to support the administration of FBT, including staff skills and training and information systems.

1.40 As part of the audit, criteria were determined to examine the administrative processes relating to the key issues.

1.41 The ANAO engaged the firm Ernst & Young to provide expert advice to the audit team on technical issues identified in FBT administration.

1.42 Fieldwork was conducted in 11 ATO branch offices as well as the National Office in Canberra over a period of four months. The audit team spoke to industry and professional representatives and the then Acting Special Adviser to the Commonwealth Ombudsman to gain their views on the administration of FBT.

1.43 The total cost of the audit was approximately \$239 000, as at the time of tabling. The audit was conducted in accordance with ANAO auditing standards.

²² The Government's proposed changes will require employers from 1 April 1999, to declare benefits provided on the employee's group certificate. Unlike other countries, however, the employer will still be liable for the tax due.

Report structure

1.44 The report is structured around the five issues, noted above, which were identified to be of key importance to the effective administration of FBT.

1.45 Chapter 2 outlines the groups in the FBT taxpayer base and examines the ATO's knowledge of them. A thorough knowledge of the taxpayer base is important for the ATO so that it can appropriately target its education and enforcement activities.

1.46 Chapter 3 considers the ATO's work to educate its FBT clients. Education is important as a means to secure compliance, to minimise the cost of compliance for taxpayers, and to promote the legitimacy of FBT.

1.47 Chapter 4 examines the ATO's client service activities, particularly focusing on its provision of advice. Such client service can improve compliance by providing ongoing help and support to FBT taxpayers.

1.48 Chapter 5 reviews the ATO's enforcement activities such as audits and other reviews. Activities in this category are key elements of the ATO's range of enforcement tools and complement its education and client service enforcement measures.

1.49 Chapter 6 considers the administrative systems supporting the operational functions of the FBT Business Teams. It considers the systems to support FBT processing, training for staff, monitoring performance against Charter obligations, and the level of complaints.

Acknowledgments

1.50 We would like to recognise the contribution of the ATO officers who assisted in the conduct of this audit. We are also grateful for the cooperation of the industry and professional representatives we consulted.

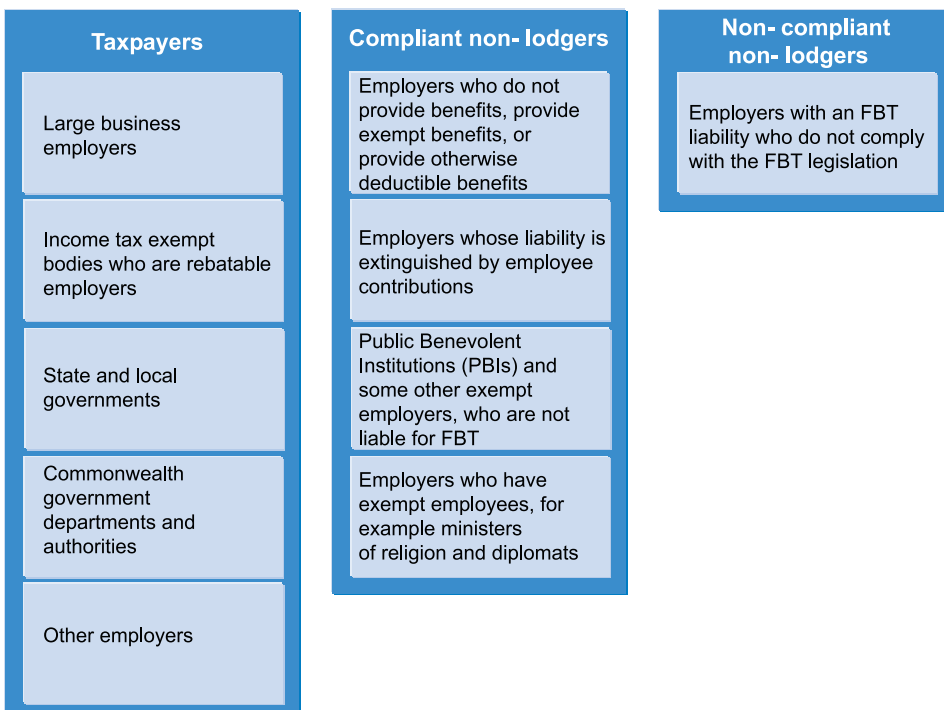
2. Knowledge of the Taxpayer Base

This chapter considers the FBT taxpayer base and examines the ATO's knowledge of this base. It concludes that although the ATO has administered FBT for over 12 years, it does not currently have the comprehensive knowledge that it needs in relation to its FBT clients. This situation is being addressed by the ATO.

The taxpayer base

2.1 The potential FBT taxpayer base can be broken into three groups—taxpayers, compliant non-lodgers and non-compliant non-lodgers. Each of these groups can be further subdivided, as illustrated in Figure 2. The number in each category is not known. However, indicative of the potential sizes of these categories, in 1997–98 there were approximately 817 000 employers potentially able to provide fringe benefits, but only 85 000 fringe benefit taxpayers. The difference is accounted for by the numbers of compliant non-lodgers and non-compliant non-lodgers.

Figure 2:
The composition of the potential FBT taxpayer base



2.2 Key features of these groups are outlined in turn, in this section.

Taxpayers

2.3 Large businesses²³ make up only 13.5 per cent of the FBT taxpayer population, but account for 65 per cent of the revenue raised by FBT.

2.4 Income tax exempt bodies are exempt from income tax but are generally liable for FBT. They include professional sporting bodies, universities and semi government bodies. There are approximately 5 800 taxpayers in this market segment, and it provided approximately \$395 million of FBT revenue in 1996–97.

2.5 Rebatable employers are employers who operate non-profit organisations. Because they do not pay income tax, they are unable to claim the income tax deduction which is available to other employers on the FBT paid. To ensure that they were not disadvantaged, a rebate of FBT at the rate of 48 per cent is available. These employers include religious institutions, trade unions, hospitals which are run by a non-profit society or association, non-profit societies, associations or clubs established for the encouragement or promotion of a game or sport, and non-profit, non-government schools.

2.6 Local and state government entities are a significant group of FBT taxpayers. They are fully subject to FBT. Because they do not pay income tax, they are unable to claim the income tax deduction which is available to other employers on the FBT paid. However, unlike the rebatable organisations, they do not receive a rebate.

2.7 Commonwealth government departments and agencies pay approximately \$280 million in FBT. The Department of Defence is the single biggest FBT taxpayer. FBT payments by Commonwealth departments and agencies are not included in the statistics or revenue figures relating to FBT, as their FBT payments are classified as 'offsets within outlays'. They have no net effect on aggregate budget outlays. Like local and state government entities, there is no rebate for Commonwealth agencies.

2.8 The group of 'other employers' includes small businesses, sole traders, partnerships, superannuation funds, trusts, and other companies who are not classified as large businesses. They account for the majority of the taxpaying population.

²³ The ATO defines as a large business one with a turnover greater than \$10 million.

Compliant non-lodgers

2.9 There is a significant, but unknown, number of ‘compliant non-lodgers’. They are a ‘hidden’ clientele in the FBT taxpayer base. This group includes employers who have considered the implications of FBT when making business decisions. They may have decided that they will not provide any benefits to their employees, have converted benefits to salary and wages, and therefore have no FBT liability.

2.10 Another group of compliant non-lodgers are employers who would have an FBT liability, except that they have made the decision to receive contributions to reduce the taxable value of the benefit so that the taxable value is nil. This means, in turn, that the associated FBT liability is nil. They do this by making relevant adjustments to the company’s equity accounts (the Shareholders Loan Account) or by receiving employee contributions to cover the taxable value of the benefits. These contributions are then included as assessable income in the company’s income tax return. The new Division 7A provisions of the *Income Tax Assessment Act 1936* seek to ensure that the company’s debit loan accounts are not used to avoid taxation obligations. The new provisions mean that instead of the loan account being used as a perpetual loan, never to be paid back, structured loans must be created if the account is in debit.

2.11 Some bodies are exempt from FBT at this stage.²⁴ They make up another group of compliant non-lodgers. These are religious institutions (in respect of benefits provided to a minister or full time member of a religious order in respect of that person’s religious work), international bodies that are exempt generally from taxation, foreign government representatives (in relation to benefits provided to employees who have diplomatic exemptions) and Public Benevolent Institutions (PBIs), such as public hospitals.

2.12 Since these bodies are currently exempt from FBT, the extent of the concessions they enjoy is unknown. However, it is possible to obtain some indication of the magnitude of the concession currently available to PBIs in not having to pay FBT. The ATO has estimated that if public hospital employees had 30 per cent of their remuneration paid as fringe benefits (and this may be a conservative proportion), the Pay As You Earn liability that would have otherwise been payable in respect of those employees would have totaled \$836 million.

²⁴ To stop the over use of concessional FBT treatment of exempt bodies, the Government proposes under the tax reform package that a limit be imposed on the benefits subject to concessional treatment. (See Chapter 1)

Non-compliant non-lodgers

2.13 The non-compliant non-lodgers are those employers who should be lodging FBT returns but are not doing so. It is the most difficult group to determine, both in terms of taxpayer numbers and revenue lost.

Other features of the FBT taxpayer base

2.14 Tax agents play an important role in FBT, as they have significant coverage of the taxpayer population and therefore play a key role in ensuring tax compliance. For example, 76 per cent of FBT taxpayers lodged their returns through tax agents, accounting for 47 per cent of the revenue collected. Twenty-one tax agents prepared returns relating to 58 per cent of the revenue lodged by tax agents.

The need for knowledge

2.15 The ATO needs a thorough knowledge of its client base and the extent to which it complies with the FBT legislation to ensure that it appropriately targets its education products and enforcement activity. Without appropriate targeting of these products, FBT taxpayers will not receive the necessary help and support to enable them to comply with the legislation. To improve its knowledge about FBT clients and the extent to which they comply, the ATO should carry out research (with other ATO business lines where necessary). The ATO should know its clients in terms of identifying them, determining their behaviour and recognising what problems they are having to help it manage its compliance risks effectively. As the ATO improves its knowledge of taxpayers, it will be better able to identify the risks and develop methods to treat those risks, with well planned and targeted assistance or other mechanisms.

2.16 A sound knowledge of the taxpayer base is essential if the ATO's new compliance model is to work well. Its application relies on knowing who the taxpayers are, which category they fall into, what their needs are (for education and information) and whether they are compliant or not.

Gaining adequate knowledge

2.17 The ATO is currently seeking to improve its knowledge of both existing taxpayers (lodgers) as well as non-lodgers.

Current taxpayers

2.18 To effectively target education products, both in terms of delivery mechanism and content, the ATO will benefit from understanding the population of current taxpayers and the shortcomings in their understanding of their FBT obligations. ATO research has shown that in

excess of 50 per cent of employers do not understand their FBT obligations. The ATO has some information, from its various research projects and from information provided on taxpayer return forms, about who the taxpayers are, what benefits they provide and whether they lodge through a tax agent or not. However, the ATO has limited information about the types of errors they make in their returns and the areas of FBT legislation about which they need additional assistance or education.

2.19 The large number of projects the ATO has completed over recent years each provide the ATO with a better picture of the population or particular groups in the population. Projects include: a significant project on local councils to determine the extent of risk associated with these entities and where their problems lie; the Key Abnormal Tax Agent Evaluation (KATE) project, which examined FBT clients of tax agents who had records outside the average profile; and a regional, cross business line project which looked at all taxation aspects of Australian Football League (AFL) football clubs. Many other projects focus on non-lodging employers who may have an FBT liability.

2.20 The ANAO observes that, at present, the projects tend to stand as discrete pieces of information that have not been drawn together. The ATO is proposing to do a stocktake of projects to determine lessons learned and to disseminate the information more widely. Drawing together the project information would allow ATO officers to use, more effectively, the work that has been undertaken, permit broader profiling, and build on current knowledge. This stocktake will also allow the ATO to identify gaps in its knowledge and to be the basis for further work, if necessary.

2.21 Taxpayers seek assistance through tax agents or by contacting the ATO for advice. The subjects about which they have concerns are not recorded formally by the ATO to determine what areas are of concern to a number of taxpayers. To gain this knowledge, many branches undertake informal monitoring of frequently asked questions. This, however, does not provide a national picture to assist in shaping national education and information strategies.

2.22 The ATO has proposed a project to monitor common themes coming through its telephone help line to address its shortfall in knowledge of existing taxpayers. The aim of this project is to determine the questions being asked most frequently in relation to FBT. This would give the ATO an idea of what issues need to be addressed when planning education and other information activities. This project is discussed further in Chapter 4.

2.23 In addition to having information from projects and other relevant information relating to taxpayers, gathered together to build up the complete picture, it is also important that the results be well disseminated to ensure that the FBT Business Teams, on the ground, are able to apply the knowledge in their dealings with clients. While some leverage activities were undertaken following the Councils and the AFL projects, enforcement activities of a more wide ranging scope following up the projects could also yield valuable results. The knowledge gained from projects and follow up activities would also usefully inform the development of education and client service strategies. In this way, the ATO could obtain greater returns from the considerable amount of varied work it has undertaken to increase its knowledge of the FBT taxpayer base.

Compliant non-lodgers

2.24 Compliant non-lodgers make a large number of errors when calculating the employee contributions to cover their FBT liability. These incorrect calculations do not impact on FBT revenue (rather, on income tax revenue) but are the responsibility of the FBT teams to detect and correct. The ATO's Non-Lodger Phase 2 project showed that (in a random sample of 264 companies) 41 per cent of the sample population had employee contributions. The project found that 44 per cent of these cases required adjustments due to miscalculations of the amount of employee contributions required to offset their FBT. The project also found that the average adjustment of FBT payable by each employer who made errors in using employee contributions to reduce benefits was \$9 918.

2.25 In order to measure the volume of compliant non-lodgers, the ATO has added new labels to the Partnerships, Companies and Trusts Income Tax Return Forms. The label will provide information on the value of employee contributions received in relation to benefits provided to employees. This measure will provide an indication of the value and number of employers who do not lodge FBT returns, but who recognise, and seek to take account of, their FBT liability.

2.26 The ANAO observes that the label will be very useful, but it has a number of drawbacks. The measure still leaves a number of potential fringe benefit providers not providing any information to the ATO in relation to FBT. One group is the sole traders, who fill out the Individuals Income Tax Return Form. We also note that the new label will add to FBT compliance costs. This measure also does not provide an indication of the benefits provided and whether errors are being made in calculating liability.

2.27 While determining the size of the compliant non-lodger population is a 'step in the right direction', there is still a need for the ATO to obtain further information about this client group. Once the ATO has quantified the number of taxpayers and the gross amount of their contributions, more work would be necessary to determine the risks associated with, and behaviour of, this group of employers. Once the risks and client behaviour are assessed, the ATO would be able to determine the measures and assistance required, under the compliance model, to reduce errors.

Non-compliant non-lodgers

2.28 ATO research projects show that this population is diverse and significant and that it represents a high risk to revenue. Results from the Non-Lodger Phase 2 project noted above, for example, indicate that 46 per cent of non-lodging taxpayers sampled had an FBT liability. Such non-compliance can affect the willingness of other taxpayers to be compliant, if the non-compliant group is considered to be 'getting away' with being non-compliant.

2.29 The ATO is not able to quantify the extent of non-lodgement and the potential revenue leakage due to non-detection of the non-compliant non-lodger client group. The Non-Lodger Phase 2 project, referred to above, attempted to quantify the revenue at risk. In a specifically-targeted 'high risk' population of 26 411 companies of which a sample of 264 were audited, the project determined that the potential loss was between \$80 million and \$100 million, for those 26 411 companies. Since this was a high risk population the results may not be indicative of the risk for the entire population. Nonetheless the project indicates that considerable revenue is at risk from non-lodgers.

2.30 The ATO recognised from its projects that more work needed to be undertaken on non-compliant non-lodgers. A consultant undertook research in 1998 to determine the reasons why employers with an FBT liability who should lodge an FBT return do not do so. From this research, it would appear that many employers with an FBT liability do not comply, because they are not aware that they have a liability. Consistent with this research finding, we were informed of one complaint to the Commonwealth Ombudsman about an FBT matter which showed that the taxpayer was not aware that he had an FBT liability. We conclude that there is considerable work for the ATO to do to determine what the potential FBT client base might be in the non-compliant non-lodger group and then to develop appropriate responses to educate clients and encourage compliance.

Tax agents

2.31 As noted above, tax agents have an important role in promoting compliance. Tax agents are important because one agent can be responsible for a large number of clients. ATO statistics show that 21 agents lodge more than 100 FBT returns each. The agents account for only 0.29 per cent of the number of agents lodging returns, but account for 58 per cent of the value of benefits disclosed on agent-lodged returns.

2.32 The ATO recognises the importance of tax agents, and products such as Tax Agents Portfolio²⁵ are available, to assist both the ATO and tax agents in their dealings with each other. There are also external consultative forums, including the National Tax Liaison Group (NTLG) FBT Sub-Committee, which allow ideas and concerns to be exchanged between the ATO and other stakeholders. The NTLG FBT Sub-Committee is chaired by the ATO, with members from a variety of professional organisations.

2.33 The ATO proposes to conduct a project to provide Key Client Managers (KCMs) for large tax agents. The KCMs would provide a single point of contact, allowing better relationships to be developed. These improved relationships could provide feedback and information on taxpayers, tax agents and their client service and education needs, further improving the ATO's knowledge of taxpayers. The ANAO supports this initiative. We believe that it will provide positive benefits, to the ATO, tax agents and taxpayers more generally.

Conclusion

2.34 We are concerned that, even with the project work done to date, the ATO does not know enough about the key characteristics of each of the three groups of taxpayers (that is, lodgers, compliant non-lodgers and non-lodgers). For example, knowledge of the taxpayer base in terms of the various groups' areas of concern in relation to the legislation, their education needs and their level of compliance would provide a much stronger basis for the ATO's efforts in administering FBT more efficiently and effectively. We acknowledge that the ATO's numerous projects are designed to improve its knowledge in this regard.

2.35 We also conclude that the ATO could obtain somewhat better effect from the considerable and diverse work it has done to increase its knowledge of the FBT taxpayer base, by ensuring that the results are collated, shared and used.

²⁵ Tax Agents Portfolio is an electronic version of some of the ATO information which is relevant to Tax Agents.

Recommendation 1

2.36 The ANAO recommends that, to further improve its knowledge of the FBT taxpayer base, the ATO:

- put in place cost-effective mechanisms to collate and disseminate the results of work undertaken; and
- ensure that the intelligence and insights gained are well understood and appropriately applied by FBT Business Teams.

ATO response

2.37 Agreed.

- The ATO is developing an interactive system which contains the information gleaned from previous activities.
- The above information will be shared with the FBT Business Teams. An FBT national compliance working group has been formed which includes national and regional staff. This group will be used to collect, analyse and disseminate information, develop compliance and education strategies and evaluate the results of these actions.

2.38 A sound knowledge of the taxpayer base is essential if the ATO is to target education products correctly to particular groups of clients. Taxpayer education is discussed further in Chapter 3. Other chapters discuss the implications on client service and other enforcement activities of the ATO having insufficient knowledge about the taxpayer base.

3. Taxpayer Education

This chapter considers the ATO's work to educate its FBT clients. It concludes that considerable effort has been invested in devising a strategy for appropriate taxpayer education. It observes that there are ongoing challenges for the ATO in meeting current, as well as future, needs.

Why education is necessary

3.1 Education is necessary to secure compliance, to minimise the cost of compliance for taxpayers, and to promote the legitimacy of FBT.

3.2 Education has some advantages as a compliance tool over *ex post* review and audit because it focuses on preventing errors, rather than correcting them. The objective for taxpayers is to get it right the first time, reducing the time (and the associated expense) involved in complying with the legislation. Also, for the ATO, education could be a cost-effective way of changing the behaviour of a whole category of taxpayers by conveying to them the rationale for the FBT measures. Such group behaviour change may be more readily achieved with education than by seeking the same result using individual audits.

3.3 Education is an integral part of the compliance model of the ATO and the principles above are reflected in the ATO's education and communication strategy. The ATO considers that with regard to FBT, at least in the short term, the education of taxpayers will be its highest priority task in seeking to improve compliance.

What the ATO has done to educate taxpayers

Materials

3.4 The ATO developed a comprehensive Guide to FBT for Employers in 1995 and updated this in May 1998. Electronic versions of this are available on disk and on the ATO website, *ATOassist*, the internet address of which is www.ato.gov.au. Research by the ATO's Corporate Affairs and Marketing area, and ANAO discussions with accounting professionals, found that the Guide for Employers is very highly regarded. It is the mainstay of the ATO's education materials.

3.5 In addition, the ATO has also provided a Fact Sheet designed to introduce basic aspects of the administration of FBT to people who may be providing fringe benefits. This is available as a *Fax from Tax*, on the

internet and in a brochure *Fringe Benefits Tax, Does it apply to you?*. The ATO also introduced in 1998 a faxed Bulletin to Tax Agents entitled *Newsflash*. It is in the process of developing and marketing the car FBT Guide and Workbook.

3.6 Seminars and other face to face contact with client groups are undertaken by FBT Business Teams. Visits by members of the FBT Business Teams and other specific compliance projects are also part of the macro communication program with the ATO sending letters outlining broad findings and insights gained from projects to relevant groups.

Strategy

3.7 In 1996, the ATO committed itself to an intensive public education program regarding FBT, over two years, in response to the recommendations of the Small Business Deregulation Taskforce. The communication and education strategy responds to this undertaking.

3.8 The ATO's plan to address education and communication needs in the shorter term involved both public relations initiatives as well as public education. It included preparing the return form guide, updating the employers guide, developing and marketing seminars and developing a strategy for the use of trade journals and the internet.

3.9 As well as the shorter term plan, the ATO has developed a more wide-ranging communication and education strategy and is developing the associated education and communication program. The strategy aims to reduce the costs of compliance for FBT clients, increase government and community confidence in the integrity and equity of FBT and improve compliance with a good appreciation of client needs and mutual understanding between the ATO and clients.

3.10 The FBT communication and education strategy involves conducting research to identify the client base, undertaking research to establish client needs and preferred channels of communication and aligning the communication and education mechanisms with client needs and the ATO's business objectives.

3.11 The ATO commissioned a range of research to obtain strategic guidance on the development of the education and communication strategy and to improve its knowledge of clients prior to developing a range of education and communication products. One research task undertaken by a consulting firm in early 1998, based on focus groups, was able to establish the priority order of importance of ATO's FBT communication products and the communication channels. Of interest regarding the preferred delivery mechanism is the conclusion that the

ATO will need to employ more traditional media outlets to reach their target audiences (for example, faxes, seminars and journals and only email and the internet in the longer term).

3.12 Further research to assist the formulation of the FBT Communication plan was undertaken in mid 1998. That study examined the reasons for non-compliance and was designed to provide the ATO with information about how best to overcome the barriers to compliance.

Stocktake of products

3.13 In the latter part of 1998 the ATO surveyed the products on FBT available to organisations. This stocktake covered not only the products produced by the ATO but also products developed and distributed by other organisations, for example, the guidance material provided by the accounting firms to assist their clients.

3.14 Conducting such a survey is a sound approach. It is a useful first step to determining the needs and preferences for the products that could be developed and promoted by the ATO to assist taxpayers determine their FBT liability. We observe that it is unlikely, or perhaps not even desirable given resource constraints, for the ATO to develop its own exhaustive range of ATO products on FBT 'matching' those available from other organisations. Once the results from the stocktake are available, we suggest that the ATO give consideration to further examining the products prepared by other organisations and, if appropriate, give its endorsement to the products that meet appropriate standards.

Client education issues for the ATO

3.15 Until early 1998, the ATO's approach to FBT communication and education was largely based on two products. The ATO is now developing different products and use of different media for the education of FBT clients. This is appropriate because different client segments have different characteristics and therefore also different requirements and preferences both in the level of detail in the information provided, and in the way it is provided. The research which has been undertaken, both by the ATO and by its external consultants, was designed to determine client needs better.

3.16 ATO research found that there is poor comprehension of the FBT legislation and that education is needed to address this. For example, the ATO found that over 50 per cent of employers do not fully understand their FBT obligations, 50 per cent of the small business community does not meet its responsibility fully, and up to 50 per cent of tax agent prepared tax returns are incorrect to some degree. Other research commissioned by the ATO found that there is confusion and ignorance about FBT.

3.17 The ATO's National FBT Tax Agents Project (the Non-Lodger Project Phase 1) involved visiting tax agents with a low level of lodgements and examining the 1994 records of a sample of their non-lodging clients. It found that tax agents were generally satisfied with the ATO's information but there were some gaps in tax agents' awareness of the ATO's support services. The project concluded that assistance and education is required for some tax agents and many employers. Among other things, it also recognised the ongoing need for seminars and workshops to assist and educate tax agents to increase the level of voluntary compliance.

3.18 As noted in Chapter 2, the ATO's National Non-Lodgers Phase 2 project sought to assess the extent of non-lodgement in a selected high risk segment of employers (264 private companies with particular characteristics regarding gross income and wages and motor vehicle expenses). This project highlighted particular features regarding non-lodgement and non-compliance. Of relevance in the context of taxpayer education is its observation that lack of knowledge appears to be a major factor leading to non-lodgement, and that in view of the high incidence of error in the calculation of car FBT liabilities, tax agent knowledge is an area which deserves particular attention. (In the Non-Lodgers Phase 2 project, 66 per cent of cases adjusted had car FBT liabilities, which is the most common benefit provided.)

3.19 As well as FBT-specific research, studies of client groups (such as 'small business') overlapping with the FBT client base and covering other tax issues as well as FBT, found that ATO literature on FBT is hard to understand. The studies also identified the need for the ATO to use practical examples and illustrations in explaining tax laws.

3.20 There are clearly major challenges for the ATO in successfully developing and implementing its client education activities in a timely way for the client groups which need them.

3.21 As noted above and in Chapter 2, research commissioned by the ATO into aspects of the non-compliant non-lodger population shows that many taxpayers are simply not aware that they have an obligation. In recognition of the large numbers of taxpayers who are unaware that they may have an FBT liability, the ANAO considers that there may be merit in the ATO undertaking measures to raise general awareness of FBT. We consider that if the relevant population as a whole is broadly aware of its potential FBT obligations, the ATO's more specific and targeted education products may have somewhat more impact than they would otherwise have.

3.22 The high incidence of incorrect lodgement as well as non-lodgement among clients also underlines the fact that education to improve compliance is a priority issue for the ATO. The ATO estimates that the total amount at risk in the small business market due to non-lodgement and incorrect FBT lodgement exceeds \$100 million. The ANAO considers that while action to contribute to the development of education and communication solutions for compliance in the future by non-lodgers is necessarily important, the needs of current lodgers also require attention—given lodgers’ documented, poor compliance risk characteristics. The ANAO considers that the current education needs of lodgers requires somewhat more attention from the ATO to improve their knowledge and compliance.

3.23 The ANAO is aware that changes foreshadowed in the administration of FBT will impose some extra record keeping requirements on employers and curtail some concessions. These changes were outlined in detail in Chapter 1. For example, one change requires employers as of the 1999–00 year of income to identify on group certificates the grossed up taxable value of employees’ fringe benefits, where the taxable value of the benefits exceeds \$1000. Another change which takes effect from the 2000–01 FBT year restricts the concessional FBT treatment of Public Benevolent Institutions and certain other not-for-profit organisations. The latter provision will require Public Benevolent Institutions and certain other not-for-profit organisations to account for the grossed up taxable value of fringe benefits provided to employees and to subject these benefits to normal FBT treatment where the grossed up taxable value exceeds \$17 000.

3.24 These changes (and others as outlined in Chapter 1) will therefore increase employers’ record keeping and compliance costs associated with the provision of fringe benefits. They will also bring a new category of client (the Public Benevolent Institutions and certain other not-for-profit organisations) into the scope of FBT administration, whereas previously that category of client was outside the FBT system. The changes have the effect of introducing new administrative obligations to report benefits on group certificates; extending the scope of employers who must be aware of the operation of the FBT legislation in order to discharge properly their group certificate reporting obligations even though they are exempt from FBT; and broadening the operation of FBT by removing the required nexus between the benefit and employment. The changes will place extra demands on the ATO’s education strategies to obtain compliance with these measures. Given that the first set of changes is scheduled to occur from 1 April 1999, the need to address the education issue is urgent.

Conclusion

3.25 Results from many ATO studies show that its clients suffer from a lack of knowledge about FBT matters or even awareness of their responsibilities. We conclude that the education needs of both lodgers and non-lodgers require attention from the ATO. There is a strong case for the ATO considering initiatives to ensure that current and potential taxpayers are aware of their obligations.

3.26 There are a number of possible initiatives which the ATO could consider to increase all current and potential taxpayers' awareness. These include the ATO undertaking a special (and possibly expensive) 'high saturation' FBT awareness campaign or it sending out education materials to employers selected using information currently held in other parts of the ATO (such as information collected by the Withholding and Indirect Taxes business line, which is responsible for the administration of the Pay As You Earn and the Prescribed Payments Systems). A third possible initiative which the ATO could consider, to increase all current and potential taxpayers' awareness, could be to work with and provide education to key external parties supplying relevant infrastructure and services to employers who make up the potential FBT taxpayer base. These include, for example, the enterprises which develop the payroll system software and those which are the payroll service providers to employers.

3.27 The ATO's communication and education strategy is appropriate, being based on a sound framework which includes client research and a stocktake of products. We consider that the ATO should continue to apply this strategy. However, we note that the ATO's education delivery program which would show the range of products and how they will be used, is not yet in place. Given the compliance problems for existing taxpayers and the likely impact of the proposed reforms, which mean new requirements and new taxpayers, we consider that it is vital that the ATO has in place a comprehensive education delivery program.

3.28 The ATO has developed education products, and other products are available from other sources. These education products are very useful, however different taxpayers have different needs and we see considerable value in the ATO providing a wider range of products than currently exists, to allow taxpayers to choose education products most appropriate to their circumstances and delivery mechanisms they find most suitable.

Recommendation 2

3.29 The ANAO recommends that, to increase taxpayer knowledge of FBT and enable easier access to relevant education products:

- the ATO undertake a cost-benefit analysis to consider various initiatives which may be undertaken to raise general awareness concerning FBT for potential taxpayers and to enhance the understanding of current taxpayers in relation to their obligations;
- given the significant changes proposed by the Government in relation to FBT, the ATO deliver taxpayer education regarding the Government's FBT amendments; and
- the ATO, as a high priority, develop a cost-effective range of products to allow taxpayers to select the education materials and delivery mechanisms which best suit their needs.

ATO response

3.30 Agreed.

- The ATO is planning further market research around profiling clients with a view to the better targeting of products. In addition with extensive education around tax reform beginning, the opportunity is being taken to increase help and education for all aspects of FBT via seminars, workshops and field presence.
- The ATO has developed a comprehensive communication strategy for communicating the FBT reform changes which are expected to affect clients from 1 April 1999. The strategy identifies different FBT client segments and recognises that the client segments have different needs. Communication products, including seminar packages, have been developed to cater for these differing needs.
- The mainstay for FBT education remains *FBT A guide for employers* which is updated regularly and is available on disk, in hard copy and on the ATO internet site, *ATOassist*. A new product, the car workbook, is now in circulation and has been well received in market testing and at its recent release at the Tax and Technology Expos. This product is designed to reduce the cost of compliance through assisting clients with their calculations of car fringe benefits. Development of further educational products will be delayed pending the Government's response to the Review of Business Taxation, due to report by 30 June 1999.

4. Client Service—Advice Handling

Client service is part of the ATO's enforcement strategy. This chapter focuses on the aspect of client service involving the provision of advice. It observes that the ATO uses many methods in providing advice, such as by phone, in writing and through rulings. It concludes that the effectiveness of these can be improved.

FBT Business Teams provide client service

4.1 Client service, in terms of providing information in relation to specific circumstances and situations, can improve compliance by providing ongoing help and support to FBT taxpayers. The FBT Business Teams (located in 16 of the 25 ATO branch offices) provide a wide range of services to FBT clients. They are multi-functional teams, which generally handle all work associated with FBT except for appeals, objections and prosecutions. The services they provide to FBT clients range from providing oral and written technical advice to processing returns and performing other accounting procedures.

4.2 We focus here on the provision of advice and assistance, as this is an area of concern for FBT stakeholders. The considerable amount of more routine processing and other administrative work done by the teams is discussed in Chapter 6.

4.3 Many of the teams split their functions into operations, advisings and audit. Some teams operate with a technical/operations split. The operations staff handle telephone enquiries, undertake all processing work, perform debt collection and lodgement enforcement functions and a variety of other tasks. The technical staff perform audit activity, respond to the more complex or technical questions, handle requests for rulings and ministerial correspondence and are generally the 'technical/legislative brain of the team'. All teams have a team leader, who is responsible for the entire FBT function for a particular group of FBT clients—both current taxpayers and potential FBT taxpayers. Teams range in size from 5 to 19 people. The way each team manages its workload varies, depending upon the experience of the team and the team leader's management style. It also is affected by the way the region is managed.

Factors impacting on the service provided

4.4 A number of factors, beyond the control of the ATO impact on the type of service required by FBT clients. These factors are considered in this section. Some of these factors were also mentioned in Chapter 1.

Complexity

4.5 There is a high level of complexity in the application of FBT law. This complexity is a risk area for the ATO. ATO research has found that small businesses make elementary mistakes in FBT, over 50 per cent of employers do not understand their obligations, and some small tax agents also have a poor knowledge. These findings suggest inadequate information and/or excessive administrative complexity in the system.

4.6 Part of the reason that the legislation is considered to be complex is the number of alternative valuation rules for particular benefits. These rules give the taxpayer some choice, and therefore may encourage the payer to calculate their liability using all methods, in order to determine the most tax-efficient method for that item, for that year.

4.7 These factors mean that good education and information products for clients are important to assist with compliance. These factors also require the ATO, through its FBT Business Teams, to provide high quality technical and other advice to clients.

Cost of compliance

4.8 As discussed in Chapter 1, there is a widely-held view by business that complying with FBT is burdensome. The specific valuation requirements and onerous record keeping requirements make compliance with FBT expensive. Some examples of the need to undertake extensive record keeping activities are:

- entertainment—around thirty different sub-accounts are required to classify correctly every situation which may give rise to an FBT liability; and
- car parking—there can be differing values within one central business district and the process to establish the potential value can be resource intensive. The employer must survey car parks in the relevant area (requiring time and the cooperation of a car park operator who has nothing to gain from assisting) on the final day of the FBT year. Where a taxpayer chooses to adopt the market value basis of valuation, the requirement to obtain a valuer's report can be a costly exercise.

4.9 There is a high use of professional advisers when dealing with FBT, further adding to compliance costs—71 per cent of FBT taxpayers lodge through a tax agent.

4.10 In order to reduce the actual costs of compliance with the FBT legislation, it is important to have an efficient and effective telephone enquiry service and to provide sound technical advice through rulings, Private Binding Rulings (PBRs) and other written advice.

Taxpayer business systems

4.11 Some stakeholders advised the ANAO that the systems used by smaller taxpayers are quite modest. From this we deduce that these systems may not be able to deal readily with FBT administrative requirements. It would appear that these difficulties with taxpayers' systems compound record keeping problems for smaller organisations. It would also appear that, if employers put appropriate systems in place and maintained them, this would, in turn, reduce the employers' compliance burden.

4.12 The impact on the ATO's client service, with many businesses not having adequate systems and records, is that there may be many more queries and a greater need for advice than would otherwise be the case.

Taxpayer perceptions

4.13 The ANAO found in its discussions with FBT industry stakeholders that there were perceived differences in client service. According to some stakeholders we consulted, the ATO is considered inaccessible to some taxpayers. They indicated that some parts of the community have the view that the 'big end of town' is treated differently from the smaller employers. This view of the ATO does not appear to be limited to FBT matters.

4.14 A view was expressed that better client service was obtained in large companies. (This view may relate to the fact that large businesses have a key client contact officer within the Large Business and International business line of the ATO, and that this contact officer can offer significant client assistance.) On the other hand, representatives of small businesses and some accounting professionals advised us that they believed the ATO treated smaller clients differently from larger clients and that smaller clients obtained different (poorer) results from the ATO.

4.15 Some accounting professionals were concerned at what they perceived to be poor technical advice provided by the ATO.

4.16 Given taxpayer concerns about equitable treatment and authoritative advice, it is obviously important for the ATO to pay particular attention to the accuracy and comprehensiveness of the

information and guidance it provides. Consistent advice and treatment, while taking the taxpayer's individual circumstances into account, are also important, regardless of the taxpayer.

4.17 A mechanism such as a client service manager or client contact officer for a taxpayer can be a useful way of facilitating client service. However, we recognise that the introduction of a cost-effective system of client service managers is not easy to achieve for the large numbers of smaller taxpayers with which the ATO must deal. That said, we are aware that the ATO proposes to introduce a mechanism which should assist client service for smaller taxpayers with the establishment of Key Client Managers for the large tax agents. As noted in Chapter 2, this measure should go some way toward improving information flow between the ATO, tax agents and their clients and towards enhancing client service and taxpayer perceptions of the accessibility of the ATO.

Methods for providing advice

4.18 A number of publications are issued by the ATO to help taxpayers understand and meet their obligations under the tax laws. Many of these may be accessed via the internet. Those relevant to FBT have been discussed in Chapter 3. Taxpayers can contact the ATO in a number of ways to obtain more specific or detailed advice and information. They have access to the FBT telephone enquiry number, ATO branch office counters and can contact the ATO in writing.

4.19 When providing advice, the taxation officer needs to consider the FBT legislation (and the Income Tax Assessment Act, if relevant), any relevant case law and rulings issued by the ATO. The ANAO recognises that, given the complexity of the legislation, it is an enormous task for ATO staff to provide accurate and consistent advice. Nonetheless, certain mechanisms can be put in place to promote accuracy and consistency. These are outlined in the following sections.

Oral advice

4.20 Approximately 74 000 phone calls are answered by FBT Business Teams each year. There are also an unknown number of clients who go to the counter in the various branch offices to ask questions. The responses to these queries fall into the 'oral advice' category. These queries may be simple requests from taxpayers for extra stationery, queries from taxpayers about their account balances, or other administrative matters. However, many are requests for more technical information, either of a general nature or relating to the specific situations of individual taxpayers. These requests for technical information may come from existing taxpayers, other employers within the taxpayer base or from employees.

4.21 At present, oral advice is not binding on the ATO.²⁶ The ATO is, however, required under the law to take care in providing oral information and advice.

4.22 When a taxpayer has a complex query or needs firm certainty in the response, they will be asked to forward the request, including all relevant details, in writing.

Rulings and other written advice

Rulings

4.23 Rulings are the Commissioner of Taxation's interpretation of the application of the taxation legislation. They are designed to provide assistance and guidance to taxpayers. The system of providing rulings developed because of the highly complex nature of taxation. The rulings system is an important element in the self-assessment system. The rulings system applies in income tax and FBT.

4.24 A ruling which satisfies the requirements of a 'public ruling' or which represents a 'private binding ruling' is binding on the Commissioner to the extent that it is favourable to taxpayers. A ruling is only a public ruling if it contains a statement that it is a public ruling and it is published on or after 1 July 1992. Public rulings can be withdrawn by notification in the Gazette or by publishing a new ruling inconsistent with the previous ruling, which states that it replaces the previous one. Taxpayers cannot object to a public ruling. However, if they do not consider that the public ruling should apply to the particular circumstances of their case, they can seek a private ruling. Major public rulings are cleared by a Rulings Panel, which consists of senior tax officers and private sector consultants.

4.25 PBRs result from a request by a taxpayer to determine how the law may apply in respect of existing or proposed transactions. A PBR applies only to a specific arrangement identified by a particular taxpayer. All relevant facts must be disclosed by the taxpayer. The ATO can decline to provide a PBR in a number of situations, including where an audit is being carried out on the issue or where there is a question of fact at stake, rather than a question of law. Taxpayers may lodge an objection to a PBR. However, they may not be able to object to a decision in relation to the PBR to the extent that it relates to a prospective transaction. Taxpayers can also have the decision on the objection reviewed by the Administrative Appeals Tribunal or the Federal Court.

²⁶ The Government's proposed tax reform package includes provisions to make the ATO more accountable for its oral advice. Taxpayers with simple tax affairs will be able to rely on oral advice received from the ATO. This advice will be binding.

4.26 A new type of ruling, the Product Ruling (PR), has been introduced to enable the Commissioner to rule publicly on the availability of claimed benefits from ‘products’. A product refers to an arrangement such as an investment arrangement, a tax effective arrangement, a financial arrangement or an insurance arrangement, in which a number of taxpayers individually enter into substantially the same transactions with a common entity or group of entities. A PR provides investors with a binding ruling as to the tax consequences of the particular product. PRs are binding public rulings, issued in relation to the income tax and fringe benefits tax law. They are prospective in nature, applying only from the date the PR was made. Promoters or the persons involved as principals in the carrying out of the arrangement (but not participants or intermediaries) may apply for a PR.

4.27 Tax Determinations may also be issued by the Commissioner. These are essentially the same as rulings, but are brief in nature and address only a particular tax issue. They do not involve any analysis or discussion on the issue to which they relate. They are binding, except in the case of those relating to the Superannuation Guarantee Scheme.

Other written interpretations and advice

4.28 There are various situations in which a PBR cannot be given to a taxpayer. In such a situation, however, a taxpayer may seek a non-binding advance opinion from the ATO. For example, taxpayers can request specific advice where the issue relates to administration (for example, debt recovery) but not the calculation or determination of taxation liability. When seeking such written advice, all relevant facts should be disclosed.

4.29 This written advice is not legally binding on the ATO. The ATO will stand by the advice, unless the law has changed since the advice was given, a court decision has affected the ATO’s interpretation since the advice was given or where the advice is no longer appropriate (for example, where commercial practice has changed).

High level technical advice

4.30 FBT Business Teams have access to a number of technical officers for technical advice. Regional Technical Officers (RTOs) are regional resources, and are the first element in the escalation process if issues cannot be resolved by the operational or technical staff in the FBT Business Team. Nine RTOs have responsibility for solving, and escalating if necessary, complex technical issues.

4.31 If the issue cannot be resolved by the RTO, it will be raised at the relevant Regional FBT Practice Forum. There are two forums, made up of RTOs from the relevant region. If they are unable to determine the

matter, and it is considered significant, it is escalated to the FBT Technical Leader or technical members of the National Team. These officers are responsible for escalating and resolving significant FBT technical issues. Issues which cannot be addressed in this manner are escalated to the FBT Specialist Cell. The FBT Cell is made up of the FBT Technical Leader, three RTOs, the FBT National Leader and representatives from the ATO's Tax Counsel, Individual Non-Business and Large Business and International business and service lines.

4.32 This escalation process ensures that high level advice is available, and that these resources are dedicated to resolving significant and complex issues.

Measures for improving the service provided

Oral advice

4.33 The ANAO notes that there is no formal mechanism for monitoring frequently asked questions. Without a good knowledge of its clients and an indication of their information and education needs, the ATO cannot readily provide appropriate tools to assist taxpayers. The ANAO considers that such a mechanism for monitoring frequently asked questions would go some way to addressing a client service problem recognised by the ATO. The ATO has acknowledged that a major hurdle in providing good client service is an inadequate knowledge of client information and advice requirements.

4.34 In early 1996, a system was being developed to record some information about queries. This met some opposition in the ATO, as it was considered to add to workloads but to have few apparent benefits. We have been advised that work is again being undertaken to establish a system to undertake formal, national monitoring of frequently asked questions and issues of concern to taxpayers. The system was to be trailed in six FBT teams from November 1998, but this has been delayed. At the time of the audit, there were some difficulties with making the system available on the ATO network. The ANAO sees considerable merit in developing such a system, in order for the ATO to have an indication of the areas where taxpayers have difficulties. This would help to improve client service and contribute to the development of education strategies.

4.35 There is currently no quality assurance on the advice provided orally by the FBT Business Teams. Although the ANAO recognises that this is difficult to achieve, we note that quality assurance is to become an issue of more importance as the Government proposes that the ATO is to be bound by oral advice. The quality of oral advice is also an area of

increasing visibility, with many operational staff having their performance assessed against a criterion that they should provide accurate, consistent advice. We note that this is an issue for the whole of the ATO.

4.36 The ANAO considers that there would be merit in the ATO developing a method of ensuring that advice is consistent and accurate in order to provide taxpayers with more confidence in the system. Possible options which the ATO could consider include a quality assurance person monitoring a sample of phone calls, and ‘mystery shopping’, with a person contacting each branch office and assessing the accuracy and consistency of advice provided on the same issue. These issues and possible methods that the ATO could consider are discussed in the Better Practice Guide to Quality Customer Service, jointly published by the ANAO and the Management Advisory Board.²⁷

4.37 The ANAO is aware that the Individual Non-Business enquiries area in the ATO has appointed a consultant to develop and implement a nation wide program to ensure that taxpayers receive consistent and accurate advice from the telephone enquiry staff. We consider that it would be worthwhile for the ATO to evaluate the usefulness of this program for implementation in the FBT Business Teams.

4.38 There is currently an ATO project under way to determine whether to implement call centres, as a way of providing better service to small business clients. Recommendations from the project include providing better support tools to assist staff in providing accurate and consistent advice and taking a more systematic and disciplined approach to collecting and analysing telephone call data. It is uncertain at this stage whether FBT matters will be included in the call centres. The ANAO considers that, while there can be benefits in pooling calls in one location, it is essential that the high level of expertise demonstrated by the FBT Business Teams is not lost. If there were to be reduced levels of expertise of the FBT Business Teams and unsatisfactory technical expertise available at the call centres, the quality of advice provided to taxpayers would be reduced.

Written advice

4.39 Stakeholders indicated that they have some concerns about the ruling system in general. These include the length of time for rulings to be developed and that a different opinion may be given in a later ruling. Rulings, including the timeliness of rulings, was an issue mentioned in

²⁷ Management Advisory Board/ Australian National Audit Office, *Better Practice Guide to Quality Customer Service*, MAB/ANAO, November 1997.

the 1991–92 Audit Report.²⁸ The ANAO recognises these issues but considers that these are not specific to FBT and furthermore that they are not the major issue for FBT, given the relatively small number which relate to FBT. (Of the 1365 rulings which are current, only 130 relate to FBT.) While the legislation is complex and taxpayers need advice which relates to their specific needs, the rulings process will remain.

4.40 The ANAO found that not all correspondence is recorded in a single system. While a national system is available to record information about correspondence, some branch offices use manual systems and others use their own, automated systems. The use of separate systems means that the true volume of FBT workload involved in responding to requests for information and advice to taxpayers is not readily known, and the issues commonly raised in correspondence are not readily identifiable. The ANAO considers that it would be useful for the ATO to have a single system for recording common issues raised by taxpayers, regardless of the mechanism used to contact the ATO. This would be a way of recording issues that are causing taxpayers concern and could lead to improved client service and compliance.

4.41 The ATO applies a quality assurance process to written technical work (including PBRs, substantive administrative amendments, objections and other interpretive advice). This process involves an extensive checklist for the approving officer's examination of the process of case management, documentation, technical quality, the IT systems procedures and client relations aspects of the case. The ANAO considers that this is a worthwhile aspect of providing good client service and a useful way to promote quality and to improve service.

Individual service

4.42 The ATO has recognised that there are administrative advantages in enlisting the help of the tax profession, noting that *To encourage voluntary compliance, the ATO needs to enlist the help of tax professionals...*²⁹ Consistent with this goal, as noted in Chapter 2, the ATO is developing a project to establish Key Client Managers (KCMs) to build alliances with large FBT tax agents. Apart from providing better service to these agents, it is anticipated that they will become a point of contact for obtaining feedback and input on proposed strategies and products. It is anticipated that they will be implemented prior to the 1999 lodgement period. The

²⁸ Auditor-General, Audit Report No.33 1991-92, *Australian Taxation Office Administration of Fringe Benefits Tax*, AGPS, Canberra, 1992.

²⁹ Report of the Cash Economy Task Force, *Improving Tax Compliance in the Cash Economy*, Canberra, April 1998.

ANAO supports such a development as a cost-effective way of conveying key messages to highly influential players.

Conclusion

4.43 It is clear that the ATO recognises the need to provide timely, accurate, consistent information and advice.

4.44 The ATO is undertaking some projects which will improve client service, for example, the KCM project. The ANAO considers that these efforts could be better supported with some specific, extra mechanisms, for example, a quality assurance process on oral advice and monitoring of frequently asked questions. Implementation of these mechanisms could also mean that the ATO may be able to improve administration and could lead to improved compliance.

Recommendation 3

4.45 The ANAO recommends that, to improve client service, the ATO consider the cost-effectiveness of developing and implementing:

- a single system to enable the monitoring of frequently asked questions, both in writing and orally to provide an indication of significant issues affecting taxpayers; and
- a method of assessing and monitoring the quality of oral advice (in terms of consistency and accuracy) provided to ATO clients.

ATO response

4.46 Agreed.

- The ATO is now examining a number of systems that may meet future needs with regards to monitoring questions and identification of issues. FBT business teams are currently piloting a product that will provide this information.
- In regard to oral advice, FBT has a representative on the ATO working party currently looking into the issues surrounding oral advice. The methods used by FBT to assess consistency and accuracy will be the same as for the ATO as a whole.

5. Other Enforcement Activities— Audits and Reviews

The ATO uses various enforcement activities. Education and client service, discussed in Chapters 3 and 4, are elements of the ATO's enforcement strategy. This chapter discusses activities which require more intervention, such as audits and other reviews. It observes that many audit-type activities are now being adapted to meet the needs of the FBT Business Teams. It concludes that a consistent, coordinated approach and better links between business lines would permit better coverage by enforcement activities of the entire FBT taxpayer population and ensure consistency of approach, particularly where a degree of integration can have benefits for both administration and taxpayers.

The compliance model

5.1 As discussed in Chapter 1, SBI is currently introducing a compliance model which is designed to focus appropriate compliance and regulatory activity according to the nature (behaviour) of the particular taxpayer. The model is being applied to all compliance activity within SBI. The emphasis is on voluntary compliance, and the ATO has access to an escalating range of enforcement activities to encourage compliance.

5.2 The current ATO Business Plan is based around (among other things) *the new tax compliance model, which recognises and supports those trying to do the right thing while targeting firm and determined action for those who are not.*³⁰ That the whole ATO's three year Business Plan is based around the compliance model, indicates the importance for all areas of the ATO, which administer particular taxes, of being able to apply appropriately the model to groups of taxpayers and to individuals.

5.3 Enforcement activities are being developed and used by the ATO, both for appropriately targeting activity and for identifying non-compliant taxpayers. These enforcement activities include record keeping reviews, real time reviews, surveys and traditional field audits. At present, the traditional field audit is the main enforcement technique used by FBT teams.

³⁰ Australian Taxation Office, *1998 to 2001 Plan - Supporting the Community*, 1 July 1998.

Range of enforcement activities

Record keeping reviews

5.4 A review of the small business market undertaken by the ATO in consultation with the small business community found that the ATO's record keeping review (RKR) program has had a significant impact on small business record keeping. It also found that improvement has come about through the efforts of accountants and tax agents to improve education in this area.

5.5 An RKR in FBT is defined as 'using current records to identify current problems, focusing on the future'. Currently this type of review is not undertaken by FBT teams. In part, this is due to the nature of FBT records. Many FBT records are determined by using the end of year value or adjusting other accounting information, and therefore do not as readily lend themselves to contemporaneous review as the records for some other taxes. While we note this feature of the FBT records, there appears to be some scope for RKR. One example is where people are using the operating cost basis for valuing cars for FBT purposes.

Real time reviews

5.6 Real time reviews (RTRs) are defined as being *a review of current records (last year's records in the case of FBT) with a focus on getting it right for the future*. These are a type of review which the ATO considers is currently proving very successful in the ATO examining the cash economy area. They are thought to be a positive, pro-active method of encouraging compliance. This type of review is currently being undertaken, in a range of forms, by FBT teams. One of the aims of RTRs is to increase the 'visibility' of FBT, which should lead to an increased understanding of FBT obligations.

Audits

5.7 FBT audits involve an examination of all aspects of a taxpayer's FBT affairs. Appropriate use of this tool is essential for the sound operation of the compliance model. While education and other reviews are important in improving compliance, the only way to verify the effectiveness of the whole compliance strategy is to undertake a thorough examination and bring non-compliant taxpayers to account.

5.8 Many of the audits done by FBT teams are conducted as part of a project, with a particular focus or theme. The project can be national or regional. Occasionally individual FBT Business Teams undertake project-based audits. One of the rationales for doing a project-based audit is to gain a better understanding of taxpayers (as discussed in Chapter 2).

5.9 Compliance improvement activity undertaken by the ATO with regard to FBT includes: national projects (such as the non-lodgers projects and the councils projects mentioned in Chapters 2 and 3); audits of SBI clients; audits of LB&I clients; and local or regional initiatives (such as the AFL project mentioned in Chapter 2). Some audit activity is the result of ‘tip-offs’, both from the public and from other areas of the ATO.

5.10 All audit activity has specific procedures or protocols. These include recording information relating to the audit on the appropriate system, receiving appropriate approvals and observing specific guidelines for keeping the taxpayer informed.

5.11 Audits can be FBT specific. These are usually undertaken by the FBT teams. Audits may also be undertaken by SBI staff across the range of taxation matters, and include an examination of FBT but not be FBT specific. FBT may also be examined within an audit of a large business by LB&I.

5.12 The number of audits conducted each year varies according to priorities and resources. The decline in recent years also reflects the view that audits may not be as cost-effective a compliance tool in some circumstances, as other tools such as education activities could be. In the period since 1990–91, the number of audits has ranged from 633 in 1990–91 to a high of 1894 in 1995–96. In 1997–98, 375 audits were undertaken which examined FBT matters. Audits undertaken in large businesses which touched on FBT as part of audits of large businesses are recorded in a different ATO audit case management system, and are not readily available from the ATO. It is therefore not clear how many audits of large businesses touched on FBT matters. However, anecdotal information from the stakeholders and ATO officers to whom we spoke suggests that the numbers are not large.

Data matching

5.13 Data matching can be an effective compliance strategy offering considerable benefits in terms of increased compliance, additional revenue and lower administrative costs compared to alternative compliance approaches. The scope for data matching is limited. The only FBT-related data that could be matched relates to the income tax deduction which employers can claim and the value of payments made by the employer. At present, the ATO does not undertake data matching in relation to the information collected in FBT returns.

5.14 The Government’s proposal to require the reporting of fringe benefits on employees’ group certificates will not increase the scope for data matching. This is because certain ‘excluded fringe benefits’ are

outside the scope of the FBT group certificate reporting rules.³¹ Furthermore, reporting will only be required for employees receiving benefits which exceed \$1000 in taxable value. These features mean that it will not necessarily be possible to reconcile employer FBT returns with employee group certificates.

Prosecutions

5.15 Prosecutions are not done by the FBT teams. FBT Teams gather evidence, then approach the Prosecutions Unit in SBI to determine if there is justification to take the matter further. If the case is to be taken further, the Prosecutions Unit prepares the brief for the Director of Public Prosecutions. Non-lodgement cases are handled by the Prosecutions Unit. There have been very few prosecutions in FBT. Those which have been done, relate to non-lodgement offences.

Non-compliance risks

Large business risks

5.16 Large business FBT taxpayers are the smallest client group numerically, but they account for approximately 65 per cent of FBT revenue. Therefore the risk to revenue of non-compliance among that group of taxpayers could be significant. Large business entities are potentially high risk for the FBT teams. There are also a number of high wealth/high profile individuals who receive large amounts of fringe benefits who could potentially represent a risk. However, within the context of the LB&I environment, which deals with \$13 billion tax paid by just 27 800 LB&I clients, FBT matters are not considered to be a high risk.

5.17 We found that responsibility for FBT in relation to large business is unclear. We also found that there does not appear to be extensive, ongoing or formal liaison or cooperation between FBT audit teams and LB&I audit teams. There are concerns in the respective work areas about inadequate expertise. For example, some staff administering FBT are concerned that LB&I staff may not have adequate FBT experience to deal with FBT issues. There are mirrored concerns that FBT auditors may lack the exposure to large business entities they would require to perform an FBT audit within a large business.

5.18 The lack of systematic treatment of large businesses in relation to FBT is also identified as a risk area by SBI, however, there is no

³¹ Excluded fringe benefits are fringe benefits provided in respect of the provision of meal entertainment or a car parking fringe benefit, or a fringe benefit prescribed by regulation as excluded (proposed in section 5E of the *A New Tax System (Fringe Benefits Reporting) Bill 1998*).

corresponding identification by LB&I that this is a risk. The ANAO in its Efficiency Audit of 1991–92 and the NTLG FBT Sub-Committee have also recognised the risks. Apart from the issue of revenue at risk, the lack of large business coverage may also give the impression that there is different treatment for different taxpayers.

5.19 The ATO is beginning to address these issues with the initiation of some action. These measures are highlighted below.

5.20 SBI and LB&I have a Memorandum of Understanding (MOU) in place. The MOU states that *In respect of the areas of commonality ... we will work together sharing skills and information.* The MOU identified common work areas such as FBT, Capital Gains Tax and electronic commerce. The MOU also contains specific guidelines for other areas such as lodgement enforcement, debt collection and processing. However, there are no specific guidelines in the MOU for FBT matters such as enforcement activity planning. We consider that a formal system to guide operational interaction on FBT matters would provide worthwhile guidance to FBT Business Teams and the LB&I audit staff.

5.21 The FBT Large Business project which commenced in July 1997 examined a sample of 16 non-lodgers in the two industries in LB&I (Finance and Manufacturing) which are considered to be the highest risk for FBT. It was designed to develop an initial measure of FBT compliance by looking at the highest risk industries of the large business market. There were some difficulties which impeded the project. One was that SBI and LB&I use different systems for case management. They also use different information systems. These different systems meant that it was not possible for ATO staff to retrieve readily the information they required on the structure of companies. Furthermore, the lack of adequate, common information systems in SBI and LB&I meant that many of the large businesses selected as FBT non-lodgers actually lodge FBT returns as part of a consolidated group of entities. Unfortunately this information was not initially apparent from the systems.

5.22 The FBT Large Business project has not yet been completed. Interim results indicate that approximately 44 per cent of the sample of non-lodging large business FBT employers have a FBT liability which is not being dealt with correctly. However revenue associated with these errors is not large, with only two cases likely to have more than \$20 000 in taxable benefits.

5.23 The ANAO notes that the FBT Large Business Project targeted non-lodgers. This approach does not give any indication of the level of compliance in those entities which *do* lodge FBT returns. While we

acknowledge that the risk of non-compliance among lodging companies may not be great,³² the assumption has never been tested.

5.24 As well as the MOU and the joint project, another measure the ATO has taken to address the large business market is liaison regarding FBT. While there are no formal arrangements in place, informal liaison at the branch level between LB&I and FBT teams means that there is some treatment of FBT in large business.

5.25 The ANAO considers that these actions are worthwhile. However, we consider that the ATO is not yet in a position to determine the level of risk associated with FBT in large businesses. The ANAO considers that more work is required to determine the risks associated with different types of large businesses. Because results will vary between industry types, work which goes across industry groups is necessary. One recommendation from the interim report of the project was to undertake research in conjunction with LB&I to determine a strategy to deal with the large business segment. We consider that this would be a positive step to be followed through.

5.26 The ANAO also considers that there would be value in the ATO putting protocols in place to ensure that there is effective coordination for FBT matters between business lines, and particularly between LB&I and the FBT teams.

Other lodger risks

5.27 The FBT legislation is complex. This factor alone means that the risk of non-compliance (either through error or lack of desire to invest time in complying) could be high for other categories of lodgers (those who are not large businesses). To encourage better compliance, visible activity assessing and improving compliance among taxpayers who lodge FBT returns, is important. Visible enforcement activity can be used to obtain improved compliance in the broader community. A comprehensive compliance program would include examining lodgers in RKR, RTR and audits. At present the ATO does not have a comprehensive compliance program for these clients.

Non-lodger risks

5.28 The non-lodger population is a high risk and one with which it is difficult for the ATO to deal. Without investigation, the ATO cannot determine whether the non-lodger is compliant or not. (Whether they

³² Large businesses generally have internal expert advice on taxation matters. They also have access to more sophisticated systems for maintaining FBT records. These factors indicate that the risks might be lower than for the smaller entities who do not have these tools available.

are compliant may become more apparent with the introduction of the income tax return label discussed Chapter 2.)

5.29 Both 'compliant' and non-compliant non-lodger groups are potential risks. As observed in Chapters 2 and 3 ATO research has shown that many non-lodgers who think they do not need to lodge because they have sought to offset the taxable value of benefits with a payment from the employee, should indeed be lodging because they have an FBT liability but do not correctly bring that to account. They either do not account for it at all or make errors when calculating their liability.

5.30 The ATO's projects targeting the non-lodger population have identified numerous errors but the errors generally do not represent substantial amounts of money. Nevertheless, the ANAO considers that without continued enforcement efforts in this area, both to add further to its knowledge of the taxpayer base and to encourage more compliant behaviour, the non-lodger category of the ATO's taxpayer base could well become an area of increased risk. Education, as well as other enforcement activity, each have a role in managing non-lodger risks.

Other matters

5.31 The ANAO is aware that there is a national system within the ATO for the recording of tip-offs. This system is not used by FBT teams. Tip-offs are a source of some (limited) audit activity in FBT. At present these are managed in an ad hoc way. Tip-offs are managed at a branch level on a case-by-case basis, and staff at the branches do not necessarily keep records. We consider that it could be worthwhile managing tip-offs in a more systematic way. This might mean that FBT teams could be in a better position to identify recurring themes and to indicate areas of non-compliance and emerging risks.

5.32 Another matter relevant to the ATO's management of the risks of non-compliance is an organisational one. With a change in the structure of the National Team, a change in its focus and the functions it performs, there is to be a change in the role of the compliance coordinator. It is proposed that the new role will have a reduced function in terms of coordinating compliance activity, and will focus more on risk and knowledge, in recognition of the ATO's need to improve its knowledge of the FBT taxpayer base and to identify risks.

5.33 We have a concern that with the organisational change, there will not be adequate coordination of compliance activity. We see this as very important, as much of the ATO's knowledge about taxpayers comes from well-organised, national enforcement projects undertaken in a

coordinated way. The ANAO considers that national directions for enforcement activity are required, and that detailed guidance is also required to ensure that results can be aggregated to develop further the ATO's knowledge of the taxpayer base. The importance of the enforcement projects means that it is vital that the ATO maximises the returns from these projects by ensuring they are conducted and reported in a nationally coordinated way.

Conclusion

5.34 The ANAO considers that more work is required to determine the risks associated with large businesses. One method to achieve this is to undertake research in conjunction with LB&I, as recommended in the FBT Large Business Market Project report.

5.35 We also consider that better links between business lines are required to ensure adequate coverage of the entire taxpayer population.

5.36 At present, the range of enforcement tools used in the administration of FBT is quite narrowly based primarily on traditional audits. Other enforcement activities, as well as traditional audits, require further development to enable FBT auditors to use the most appropriate and cost-effective mechanism for ensuring compliance.

5.37 A consistent, coordinated approach to enforcement activity is required to treat identified risks appropriately. We conclude that at present, the ATO does not have a comprehensive enforcement strategy.

Recommendation 4

5.38 The ANAO recommends that, to promote the cost-effective application of its enforcement strategy in FBT, the ATO:

- include Real Time Reviews as part of a broader range of enforcement tools for FBT Business Teams;
- as a matter of priority, undertake research with the involvement of the area administering FBT, in conjunction with the Large Business and International business line, to identify, assess, prioritise and treat risks in the large business segment;
- improve coordination mechanisms and information exchange between business lines on FBT matters; and
- develop a national strategy for enforcement activity to contribute to the coordinated identification assessment, prioritisation and treatment of compliance risks.

ATO response

5.39 Agreed.

- The ATO is currently seeking to establish Real Time Reviews as an FBT enforcement tool. The ATO does not believe further enforcement tools are required at this time as our most recent market research indicates that more public education, Record Keeping Reviews and Real Time Reviews are required over other enforcement products.
- The Large Business and International (LB&I) business line has developed a risk assessment paper as the first step in the process of assessing levels of compliance in LB&I taxpayers. The task of identifying, ranking, assessing and treating key FBT risks in the large business segment is a sequential process where the results of each step determine the need, if any, to proceed to the next. LB&I's FBT risk assessment paper is expected to receive wide circulation and comment from the FBT team in the ATO. A decision on any resourcing of future tasks will be made from the context of LB&I's 1999 HOTSAs process and its prioritisation of business activities.
- Business lines in the ATO are always looking for ways to work more closely and exchange information. LB&I and the new Small Business line will work together to ensure FBT risks are identified. LB&I and Small Business are currently discussing the expansion of the Memorandum of Understanding between the two business lines with a view to include areas of common interest and potential conflict such as FBT.
- An FBT National compliance working group containing regional representation has been formed. This group will identify and prioritise risks then develop a range of strategies to address these risks. A data mining instrument is also being developed which will allow for instant profiling using all available and relevant ATO information.

6. Supporting the FBT Function

This chapter examines the administrative systems supporting the operational functions of the FBT Business Teams. It considers the automated systems to support FBT processing, training for staff, monitoring performance against Charter obligations and the level of complaints.

It concludes that the systems supporting the FBT function are performing reasonably well, but that some aspects of the administrative system, over which the area administering FBT has limited control, impede efficient processing.

The staff performing and supporting the day to day FBT functions

6.1 As discussed in Chapter 4, FBT Business Teams are responsible for all the operational aspects of the FBT function. These activities include processing returns and answering queries.

6.2 National support for the operational functions of the FBT Business Teams is provided by the Operations Strategy and Policy staff within the FBT National Team. They are responsible for identifying problems with the systems for administering FBT (not just the IT systems) and rectifying the problems. The staff may do this by developing a strategy to fix the problem itself, or by arranging for modifications to be made. They are also responsible for providing a help desk function to rectify Business Teams' problems with the FBT IT system. Their other responsibilities include establishing policy guidelines and ensuring that FBT forms are kept up to date.

FBT systems and information needs

6.3 The systems used by staff in the FBT Business Teams range widely from help systems which enable staff to access legislation, rulings, and other research information, to systems which hold information on taxpayers and their returns. There are over 15 different systems, plus desktop systems (such as the word processing and electronic mail applications) with which FBT Business Teams must be familiar. The two key systems are the system holding the registration details (the ATO Integrated System 'AIS') and the one holding the financial details in relation to all lodging FBT taxpayers (the FBT system).

- **AIS**—At present, registration details are the only FBT client information stored on the AIS. The accounting records are recorded in the FBT system. The ATO intends to move the FBT accounting

system to AIS, to have one integrated system for all FBT taxpayer information. This will mean that AIS will contain a single client register for the ATO, with integrated client accounts. Once completed, the system will enable the ATO to link all aspects of a taxpayer's dealings, regardless of the revenue line involved.

- **FBT system and FBToonline**—The FBT system is the accounting system which provides current balances and financial information on all transactions. It is a batch processing system. The on-line component of the system is used for viewing account details but is currently only available for a limited range of on-line update functions.

System problems

6.4 The ANAO is aware that the current systems have a number of problems and some of these problems cause reverse work-flows (that is, the problems cause flow on problems elsewhere, which require intervention to rectify). These problems are noted below.

6.5 As noted in the previous section, the registration of FBT Taxpayers is recorded on AIS. The accounting information is recorded within the FBT system. We have been advised that a lack of resources to assist in the transfer of the data from the FBT system to AIS has caused ongoing problems in the administration of FBT. Given that the ATO also proposes to transfer the account information into AIS, it is important that the previous difficulties do not recur.

6.6 We note that there is not one platform for the whole system for FBT administration, and there is no fast path between the numerous applications. This means that users must leave one application before entering another. Use of the system by the FBT Business Team members would be improved if the whole FBT system were on one platform and if all elements of the system were integrated.

6.7 FBT Electronic Lodgement of returns was implemented during 1996–97. There was a take up of approximately 8.5 per cent. The low use of the Electronic Lodgement System (ELS) by taxpayers and some ongoing problems with the system, along with delays in getting cases on to the FBT system, meant that productivity gains from implementing the new system were not realised. ELS has also been a source of some reverse work-flows. The ATO is examining these issues in a project to enhance its effectiveness through greater use of ELS. The 1997–98 ATO Annual Report indicates that 41 per cent of all FBT lodgements were submitted electronically in 1997–98.

6.8 The systems problems affecting FBT are not unique to that area. They are also unlikely to be resolved in the short to medium term, given

the number of competing priorities for the systems staff at present. The ATO advised us that the Government's proposed tax reform agenda and tight time frame for its implementation will absorb a significant amount of resources and be one of the main priorities for IT staff. Another priority for the ATO is ensuring that the systems are Year 2000 compliant. Given these competing priorities, enhancements to the FBT system, and even routine maintenance, have a relatively low priority.

6.9 Although these systems issues are not readily solvable, they are still significant and they will have an impact on the ATO's ability to accomplish some of its other initiatives with regard to FBT. For example, unless the transaction/processing systems allow improved efficiency, the ATO will not be able to free resources to undertake the increased field-based work for FBT, with increased taxpayer contact, as intended.

Staff skills and training

6.10 Given the range of tasks undertaken in the FBT Business Teams, high level technical skills and skills in the relevant systems are required. We found that in most branches we observed, training needs are identified as part of the performance agreement process which focuses on activities for the next 12 months. Most training is provided on-the-job, supplemented by opportunities to gain further skills through other channels in SBI or the ATO.

6.11 We were advised that given the relatively small number of staff involved in administering FBT (just 214 ASL in the 1997-98 financial year), and the relatively low turnover, team leaders consider that on-the-job training is the most effective way of ensuring that all staff have the necessary skills. We observed that the training available to staff varies from team to team.

6.12 An important aspect of the on-the-job training provided to staff administering FBT is the training provided as part of certain national compliance projects. Some compliance projects, notably the Council's project, as noted in Chapter 2, have involved the development of comprehensive training packages to provide detailed background material and to assist staff undertake that particular project.

6.13 A self-paced FBT training package is available on the ATO network. We were advised that this package is being now being reviewed and updated by a technical member of the National Team.

6.14 SBI has a Skilling Programme available to FBT staff. The program identifies the activities undertaken by different staff in different areas of SBI. It enables staff to determine whether they have the core skills

and knowledge which have been identified as necessary to do the relevant tasks. Staff can work through the 'checklist' of skills either individually or with their supervisor. After an initial assessment has been made, the staff member and the supervisor can identify learning needs. A reference section provides some options for gaining the knowledge or skills. These options may include specific topics within the ATO-wide training program and the FBT self-paced training package.

6.15 The ANAO understands that the SBI Skilling Programme 'checklist' is not widely used to assess the level of skills and training needs of staff administering FBT. The ANAO considers that the SBI Skilling Programme may be a valuable resource to assist FBT Business Team managers to identify the training needs of staff and options for addressing those needs. We suggest that FBT Business Team leaders consider using this tool more actively.

6.16 Training at the ATO corporate level is provided in the ATO's Taxation Officer Development program. Training at the ATO corporate level is also provided through courses provided by ATAX or through other university training, with the support of the ATO.

6.17 The ANAO observes that the adoption of the new compliance model, the move from reactive, processing type work to more proactive work requiring more interaction with taxpayers, and the move to have more staff visible in the community, will place extra demands on training.

6.18 The ANAO observes that, at this stage, it appears that each region is planning to address its FBT training needs on an individual basis. The ANAO acknowledges that there are potential benefits in regions being able to assess their particular training requirements and being able to respond to them, however there is also merit in having aspects performed in a coordinated way, using a nationally-managed approach. The ANAO considers that a national approach and direction is important to ensure that the training meets the strategic and dynamic needs of the FBT Business Teams. The ANAO also sees the need for such coordination of training to be a matter of some urgency, given that the regions are attempting to address the new training demands as quickly as possible.

6.19 During the audit, the ATO began planning the implementation of a national training strategy for FBT Business Teams. The ANAO believes that this is a positive measure, which should address some of the issues we have raised. We are also aware that a national review is being undertaken to assess the skills needed to undertake the challenges of the work of the proposed new small business line. This will lead to a review of the current skill levels within SBI, including FBT, and the development of learning strategies to meet any skilling needs identified. This, too, is

a useful course of action in addressing staff skills and training regarding FBT.

Taxpayers' Charter obligations

6.20 The ATO's Taxpayers' Charter outlines the rights, obligations and standards which can be expected by taxpayers from the ATO. It also articulates taxpayers' obligations when dealing with the ATO. These include that taxpayers must: take care to be truthful in their dealings with the ATO; keep records according to the legislation; take all reasonable care in fulfilling their obligations; lodge necessary documents and information by due dates; and pay taxation liabilities by the due dates.

6.21 As part of the Charter, the ATO has set certain standards of service which it must meet. These standards are published and the ATO's performance against them is reported. The specific service standards for 1998–99 relevant to FBT include:

- processing electronic returns within 14 days;
- processing paper returns within 42 days;
- issuing refunds within 28 days;
- providing a decision, ruling or objection to a private ruling within 28 days;
- responding to all correspondence within 28 days;
- answering phone calls within two minutes (five minutes in busy times);
- attending to taxpayers within ten minutes (fifteen minutes in busy times) of arrival in a branch office; and
- providing notification of the outcome of an audit within seven days of making a decision.

Reporting against Charter standards

6.22 The ANAO found that although there are service standards under the Charter and performance against these standards must be reported, the ATO does not have automated systems in place to measure performance against each standard with respect to FBT. The inability to measure performance easily at the work area level is a problem across the ATO and is not limited to FBT.

6.23 Information is reported on a regional basis for the whole of SBI and it is not possible to disaggregate these regional reports to identify FBT separately. As a consequence at present, there is no national reporting on how the work area administering FBT is managing its obligations, so it is not possible to examine how this area is performing against its service standards.

6.24 Information on the performance of service standards in the administration of FBT is already collected to provide input to the regional reports. If mechanisms were introduced to collect and report performance information for FBT administration as a whole, this is likely to be useful for managers administering FBT, as well as other managers in SBI. Such reporting would allow managers to be informed about the full extent of the FBT work area's workload and how well it is collectively managing to meet the service standards. Such specific FBT reports at the regional level would also enable senior managers to gain an indication as to whether the regions were applying resources to support the administration of FBT effectively.

Complaints

6.25 In the ATO, complaints are categorised in one of three levels, and are escalated, if necessary, through the three levels. Level 1 complaints are handled by the operative staff member. Level 2 complaints are those which are escalated to the manager/director. Level 3 complaints are handled by staff in the ATO's Problem Resolution Service (PRS). These complaints may come to them directly from the taxpayer or be referred to PRS by another area of the ATO or the Commonwealth Ombudsman.

6.26 Only six of the 154 level 3 complaints relating to SBI issues in the year ended 30 June 1998, related to FBT. Only four of these complaints were upheld. To put these figures into context, there were approximately 600 level 3 complaints for the entire ATO for that period.

6.27 Complaints to the Commonwealth Ombudsman are also minimal. In the 1997 calendar year, there were just 18 cases referred to the Ombudsman which related to FBT. This is just a small proportion of the 2000 or so complaints received relating to the ATO.

Performance information

6.28 The ATO collected over \$3 billion in FBT in each of the past three years. Collections exceeded Budget estimates in two of those years. As noted previously, the average staffing level was 214 in 1997–98. These statistics mean that FBT revenue collection is quite effective in terms of the amount collected and relatively efficient in terms of the staff numbers required to do that.

6.29 The ATO monitors a number of items to determine how each individual branch, and each region, is performing. Some of the categories in which performance is measured are: revenue collections; return lodgements; reductions in outstanding debt; compliance activity; and education activity. This information enables team leaders and Regional Commissioners to assess the performance of each FBT Business Team, and determine areas which need additional attention.

6.30 Each region prepares an annual performance report, which includes some information relating to FBT. The regional reports include overall comments whether Taxpayers' Charter standards have been met for FBT, but do not give performance details against each standard.

6.31 The annual SBI Accountability Report gives a consolidated view of the business line's performance. It reports on each of the SBI risk areas and includes highlights of the activities of the FBT Business Teams. The SBI Accountability Report's statement of performance against the Taxpayers' Charter is made at the business line level. It does not separately identify FBT performance against relevant aspects of the Taxpayers' Charter.

6.32 The ANAO considers that a report that is FBT specific which is more comprehensive than the material currently reported, would be useful. A consolidated report indicating how the FBT Business Teams performed against each performance indicator in each region, and overall, would provide an indication of how well FBT was being managed, and may help identify potential or emerging risks.

Conclusion

6.33 One of the main challenges in relation to the administration of FBT lies in the systems area, however the ATO's ability to overcome these impediments to efficient processing is constrained at this time given its other systems priorities.

6.34 The skills required by staff in the FBT Business Teams and how these skill needs are addressed are important issues for team leaders. A range of tools is available to assist in identifying training needs, however the range is not being used widely. We suggest that the efforts of team leaders could be better supported by their using some of the currently available tools, such as the SBI Skilling Program. Branches and regions generally assess their training needs on an individual basis. A more coordinated, nationally-managed approach to address training needs is being developed by the National Team, to ensure that teams are not individually developing training material, ensuring consistency and improving cost-effectiveness.

6.35 FBT Business Teams are responsible for a significant volume and variety of functions. There are very few formal complaints about FBT administration. However, given the lack of monitoring against Charter obligations, it is not possible to establish how well the area administering FBT is performing. This would seem to be a shortcoming in program management and accountability.

Recommendation 5

6.36 The ANAO recommends that the ATO establish cost-effective mechanisms to monitor overall FBT performance against Taxpayers' Charter service standards.

ATO Response

6.37 Agreed. The ATO has a National Management reporting program being tested through ATOconnect (the ATO internal web site). Full operation is expected early in 1999. This will be in addition to current regional reports.



Canberra ACT
31 March 1999

P.J. Barrett
Auditor-General

Appendices

Appendix 1

Calculating FBT payable—a simple example

Calculating FBT payable is a four step process. First the taxable value of each individual fringe benefit provided to each employee must be established. Then the aggregate fringe benefits amount is calculated by adding all the taxable values. Next the fringe benefits taxable amount is calculated, by 'grossing up' the aggregate fringe benefit amount. Finally, the amount of tax payable is calculated, as a percentage of the FBT amount.

The following is an example of calculating the FBT payable by an employer who provides one motor vehicle (the most common benefit provided). We have assumed that:

- the current rate of FBT (48.5%) applies;
- the car is purchased by the employer for \$25 000 on 1 April 1997 (further complexities are introduced if the vehicle is not owned by the employer for the entire FBT year);
- the car is available for private use for the entire FBT year;
- the employee pays a \$500 contribution; and
- the employee travels 20 000 kilometres.

Step 1:

Determine the taxable value of a fringe benefit

Motor Vehicle—there is a choice of two methods:

- the statutory formula method, where the taxable value is a percentage of the car's value. The percentage varies with the distance travelled by the car during the FBT year, regardless of whether it is private or business travel. The greater the distance, the less the taxable value.
- the operating cost method, where the taxable value is a percentage of the total costs of operating the car during the FBT year. The percentage varies with the extent of private use—the lower the incidence of private use, the lower the taxable value.

To determine the taxable value by the statutory formula method, which is the most commonly used method:

$$\text{The taxable value} = A \times B \times \frac{C}{D} - E$$

where: A = the base value of the car

B = the statutory percentage

C = the number of days in the FBT year when the car was used or available for the private use of employees

D = the number of days in the FBT year

E = the employee contribution

The base value of the car is the original purchase price, including the cost of any accessories not required for the business use of the car. Dealer 'delivery' charges are included in the base value of the car, but registration and stamp duty charges are not. If sales tax or customs duty exemptions apply, the base value must include the amount that would have been paid if those concessions were not available. In determining the base value of a car, 'deemed market value' rules apply in determining the original purchase price.

The statutory percentages for the FBT year are:

| Total kilometres travelled during the year | Statutory percentage |
|--|----------------------|
| Less than 15 000 | 26 |
| 15 000 to 24 999 | 20 |
| 25 000 to 40 000 | 11 |
| Over 40 000 | 7 |

$$\begin{aligned} \text{Therefore, the taxable value} &= \$25\,000 \times 20\% \times \frac{365}{365} - \$500 \\ &= \$4\,500 \end{aligned}$$

Step 2:

Determine the aggregate fringe benefits amount

As we have assumed only one benefit is provided, this step is not necessary.

Step 3: Determine the fringe benefits taxable amount

fringe benefits

$$\begin{aligned}
 \text{taxable amount} &= \text{aggregate fringe benefits amount} = x \frac{1}{(1 - \text{FBT rate})} \\
 &= \$4\,500 \times \frac{1}{(1 - 0.485)} \\
 &= \$4\,500 \times \frac{1}{(0.515)} \\
 &= \$8\,737
 \end{aligned}$$

Step 4: Determine the tax payable

$$\begin{aligned}
 \text{Fringe Benefits Tax payable} &= \$8\,737.86 \times 0.485 \\
 &= \$4\,237.44
 \end{aligned}$$

This is a very simple, illustrative example, that assumes that the employer bought the car, the car is less than 4 years old and that the employer is not eligible for a rebate. Also, the example does not discuss the record keeping requirements associated with providing benefits.

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