

VICTORIA

Auditor-General
of Victoria

SPECIAL REPORT No. 58

STATE REVENUE OFFICE

A customer service focus towards improving taxation collection

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The President
The Speaker
Parliament House
Melbourne Vic. 3002

Sir

Under the provisions of section 16 of the *Audit Act* 1994, I transmit the Auditor-General's Special Report No. 58, "*State Revenue Office: A customer service focus towards improving taxation collection*".

Yours faithfully

C.A. BARAGWANATH
Auditor-General

October 1998

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Foreword

In order to ensure that the Government efficiently and effectively collects tax revenue to finance services for the benefit of the community, it is important that quality revenue management services be provided by its major revenue collection agency - the State Revenue Office.

This Report on the way in which the State Revenue Office discharged its key revenue collection responsibilities is the first of 8 performance audits directly assigned to Audit Victoria under transitional provisions that amended the *Audit Act* 1994 in December 1997. Audit Victoria is the new government statutory body established under legislation to participate in the contestability process along with private sector service providers. The progressive implementation of the contestability regime for my performance audit responsibilities will commence later in this financial year.

One contentious issue that I have had to consider relates to whether, in the public interest, the value of a major outsourcing contract at the State Revenue Office should be disclosed in this Report, or on the grounds of commercial confidentiality, this amount should be concealed from public knowledge. Under the terms of the commercial in confidence contract, the service provider has not consented to such disclosure as this information is regarded as proprietary and its public release could place the contractor at a competitive disadvantage. The State Revenue Office also maintains that reporting such details may influence or dissuade some prospective outsourcing companies when the contract is due for renewal.

The disclosure by audit of information that could be regarded as commercially confidential is an issue that has arisen from time to time since the early 1990s. For example, in my *Report on the Finance Statement for the year ended 30 June 1991* I concluded, after experiencing difficulties in reviewing the financing arrangements associated with the construction of the World Congress Centre that:

“... the issue of commercial confidentiality and sensitivity should not override the fundamental obligation of government to be fully accountable at all times for all financial arrangements involving public moneys”.

While I am aware of the importance of promoting practices that enable the benefits of competition to flow from the operation of a fully competitive market, it is my view that the introduction of contestability and the involvement of contractors in the provision of government services should not provide public sector agencies with an avenue for not disclosing the cost of publicly-funded services. The Parliament has the power to make these decisions and where it has seen a need to protect commercial confidentiality, as in the case of the Grand Prix, it has passed legislation to this effect.

Accordingly, I have elected to disclose the value of the contract to outsource the Office's information technology services in order to enhance accountability and preserve the public's interest in the right to know how their taxes have been spent. It is my view that the same level of disclosure in annual reports of agencies as applies to consultancies should also apply to outsourcing contracts.

C.A. BARAGWANATH
Auditor-General

Part 1

Executive summary

Part 1.1

Overall audit conclusion

Role of the State Revenue Office

1.1.1 The State Revenue Office is the Government's major revenue collection agency. In collecting around \$5.9 billion in taxes annually, it plays a critical role in serving the people of Victoria given that taxation receipts are used to finance public services.

Key responsibilities discharged efficiently and effectively

1.1.2 The overall conclusion drawn from the audit is that the Office has discharged the vast majority of its key responsibilities efficiently and effectively. Collecting the level of revenue required by the Government and the Office's ability to deal quickly with clients' objections are examples of good performance. In addition, the Office has achieved a high level of customer service. Commendable features relating to the way in which activities have been managed include:

- introducing a change program focusing on improving all aspects of the Office's operations to ensure the needs of present and future clients continue to be met;
- continuously improving the performance management framework with an emphasis on quality and best practice; and
- outsourcing of non-core functions, including information technology, to improve efficiency.

1.1.3 Audit acknowledges the professionalism and competence exhibited by the Office in managing its important revenue collection role. Clearly, it is an organisation that has willingly embraced change and the pursuit of best practice.

1.1.4 The audit also disclosed a range of areas where improved measures are required to better assess the effectiveness of the Office in meeting its objectives. Some of these relate to ensuring that everyone meets all their tax obligations, reducing client compliance costs and the provision of quality policy advice to the Government.



Difficulties in measuring the tax gap

1.1.5 Searches of national and international literature undertaken by audit found that a key measure for assessing the effectiveness of collection agencies is the level of taxpayer compliance. This can be determined by identifying all potential taxpayers and comparing the amount that they would have to pay, i.e. the potential taxation base, with the amount of assessed liabilities. The difference is referred to as the “tax gap”. Theoretically, the size of the tax gap and the extent to which it is minimised reflect the collection agency’s performance in maximising taxpayer compliance.

1.1.6 To date, a reliable method for measuring the tax gap has not been identified due to the complexity of the task, which audit understands is a recognised problem facing taxation collection agencies world-wide. In line with this position, the Office has been unable to quantify or estimate the size of the tax gap to measure its effectiveness in maximising revenue collections with any degree of confidence. Until reliable methods of measurement are available to make a reasonable estimate of the tax owed to the Government, the Office cannot be assured that it is achieving its compliance objective of ensuring that everybody meets all their obligations under tax legislation. The Office intends to undertake further research to assess potential options for establishing a cost-effective method of assessing the tax gap.

Deficiencies in the land tax database

1.1.7 The Office has also recognised that until the current arrangements for maintaining land information across the State are changed by the Government, the cost of collecting land tax relative to other taxes and duties will remain high, and it will not be possible to provide assurances that all land tax revenue due has been collected. The Office, in a June 1998 submission to the Department of Treasury and Finance addressing this issue, indicated that its land tax database is inaccurate and incomplete due mainly to the inherent problems of the current arrangements with local councils. Further, it will take another 2 years to update the database with rural land valuation data to take account of legislative changes introduced by the Government to widen the taxpayer base. Given that I conveyed critical comment on many of these issues to the Parliament in 1989 and in subsequent years, corrective action is long overdue.

.....

Measuring performance

1.1.8 Audit found that key performance measures and targets covering quality, quantity, timeliness and costs of service delivery, adopted by the Office as part of its service agreement with the Department and expanded as a result of the introduction of output-based budgeting by the Government, were satisfactorily met. However, there is a lack of precision in some of the targets used as part of the Government's output-based budgeting initiative. For example revenue is to be collected within a broad margin of +/- 5 per cent, which in dollar terms for 1997-98 equated to +/- \$261 million. This measure could be seen as a disincentive to pursuing strategies to maximise revenue collections through the identification of non-complying taxpayers. A smaller margin would encourage meaningful reporting of variations such as the collection of additional tax previously unidentified and contribute to ensuring the tax burden is fairly shared.

1.1.9 The Office believes that by making it easier for all taxpayers to conduct business with the Office, the outcome will be improved taxpayer compliance and the maximisation of revenue collections. The effectiveness of this strategy has not been fully assessed by the Office.

1.1.10 It is pleasing to report that during the course of the audit, in recognition of some limitations of its performance reporting framework, the Office further developed its performance measures. From 1998-99 onwards, the Office will provide the Government and other interested parties with improved information on its performance in meeting its key objectives including obligations under its service agreement.

1.1.11 This initiative includes a commitment to undertake research to develop measures for reporting its performance in maximising taxpayer compliance and reducing taxpayer compliance costs. The decision in July 1998 to implement the Australian Quality Council's Australian Business Excellence Framework, which incorporates principles of self-assessment and continuous improvement, will further strengthen the Office's performance measurement framework. It is important that the Office sets more precise and challenging targets for the performance measures in place to ensure they are an integral component of its continuous improvement program.

1.1.12 The inter-jurisdictional benchmarking study covering revenue collection agencies Australia-wide identified some instances of apparent better performance which the Victorian Office should investigate in regard to best practice.



Positive effect of structural and business reforms

1.1.13 Generally speaking, the reforms over recent years to the Office’s structure and business practices have contributed to improving the quality and efficiency of service delivery. Examples of the positive effect that various reforms have had on service delivery are outlined below:

- Amalgamation of the former State Taxation and Stamp Duties Offices has contributed to improving the quality and efficiency of service delivery. Significant reductions in staff numbers over the past 6 years have reduced operating costs while the Office has continued to collect around \$5.9 billion of taxation revenue annually;
- Outsourcing its information technology function has delivered cost gains to the Office; and
- The Office is committed to achieving further efficiencies through enhancement of its information technology. Government funding has been requested to replace the Office’s 2 core revenue management systems with one integrated system, and to develop options for conducting its business electronically.

Part 1.2

Summary of major audit findings

MAXIMISING REVENUE COLLECTION

Page 31

- As is the case in other jurisdictions, the State Revenue Office has not adequately measured that proportion of revenue not identified but required by legislation to be paid due to the complex nature of the task. Initiatives aimed at identifying a cost-effective method of calculating this proportion of revenue, known as the “tax gap”, have been recently introduced by the Office.
Paras 4.18 to 4.27
- Scope exists for the Office to improve the means by which it measures the effectiveness of the components of its compliance enhancement strategy.
Paras 4.28 to 4.30
- Currently, 17 000 employers are liable for payroll tax which amounted to \$2.4 billion for 1997-98.
Paras 4.31 to 4.32
- The Office is developing a more sophisticated means of identifying non-compliant taxpayers across tax revenue streams. Initial enhancements are expected to generate additional payroll tax revenue of \$11 million over a 3 year period from 1999-2000.
Paras 4.34 to 4.40
- Land tax collections in 1997-98 totalled \$264 million compared with a target of \$305 million. This variation was largely due to legislative changes in December 1997 and May 1998 which caused assessments to be issued later than anticipated.
Paras 4.41 to 4.44

- The Office has identified that:
 - Property and land valuation data required to assess land tax liabilities is purchased from councils for an annual cost of \$4 million;
 - Annual costs of \$1.9 million are incurred in reformatting data purchased from councils, correcting errors and keeping it up-to-date;
 - Existing land information systems are incomplete, inaccurate and costly to maintain thereby inhibiting the capacity of the Office to identify all taxpayers liable for land tax and provide an assurance that all revenue due is collected; and
 - At 30 June 1998, only one-third of valuations for rural land parcels potentially liable for land tax as a result of legislative amendments, was entered in the Office's database. The Office has estimated it will take 3 years to complete the process.
Paras 4.45 to 4.60
- The Office has proposed to the Department of Treasury and Finance that an integrated land information system be introduced across the State to address these long-standing problems.
Paras 4.62 to 4.65
- Scope exists to improve the usefulness of performance information for assessing the efficiency and effectiveness of the Office's Investigations Branch.
Paras 4.70 to 4.78
- Sound processes currently exist to facilitate a consistent and equitable approach towards the imposition of penalties in accordance with the legislation.
Paras 4.79 to 4.87
- The Office does not assess whether imposing penalties on particular non-compliant taxpayers provides an effective deterrent against non-compliance in subsequent years.
Paras 4.88 to 4.91
- The Office has made significant advances in customer service. The introduction of a number of initiatives aimed at promoting a customer service ethos across the organisation and delivering a quality service to customers have resulted in improved customer service and greater flexibility for taxpayers.
Paras 4.97 to 4.98
- Customer service initiatives were based on the Office's perceptions of customer needs and developed in the absence of an organisation-wide customer service strategy. Significantly, at the time the Office's Taxpayers' Charter was released in December 1994, there had been no assessment of the type and level of service desired by customers in relation to the Office's obligations to taxpayers and its standards of service delivery.
Para. 4.100

MAXIMISING REVENUE COLLECTION - *continued***Page 31**

- A customer service strategy was not approved until March 1997, 12 months after the initial endorsement was sought. At the date of audit, achievements against the strategic goals outlined in the strategy had not been assessed.
Paras 4.99 to 4.103
- Research involving consultation with customers to identify desired levels of service was commenced by the Office in July 1998.
Paras 4.104 to 4.106
- Although the Office's performance against its Taxpayers' Charter has been reported since 1995, conclusions have been based primarily on the Office's own limited assessment. To date, a coherent reporting methodology has not been established.
Para. 4.109
- While comprehensive monthly reporting was undertaken, targets to enable annual assessment and trend analysis of overall customer satisfaction with service provided had not been established. The Office indicated action has now been taken in this regard.
Paras 4.111 to 4.117
- The Office has achieved a high level of customer service which is reflected in feedback from customers. However, structured training to develop technical knowledge levels of staff is required to further enhance customer service delivery.
Paras 4.118 to 4.122
- The effect of the customer service component of the compliance enhancement strategy on improving taxpayer compliance has not been fully assessed.
Paras 4.123 to 4.127

MEASURING TIMELINESS AND COST-EFFECTIVENESS**Page 59**

- Except for some minor departures, service delivery performance targets of the State Revenue Office were satisfactorily met for 1996-97 and 1997-98.
Paras 5.6 to 5.12
- Performance measures reported to the Government by the Office for 1997-98 did not fully address all key objectives and some objectives were not reported on at all. For example:
 - information on the extent to which the revenue target reflects the total amount of revenue due to the State was not provided;
 - the extent to which taxpayer compliance costs had been reduced was not measured; and
 - the overall operational efficiency of the Office was not measured.
Paras 5.13 to 5.19
- Action has recently been initiated to assess the extent to which activities undertaken by the Office have reduced taxpayers' compliance costs.
Paras 5.52 to 5.57

MEASURING TIMELINESS AND COST-EFFECTIVENESS - continued**Page 59**

- In October 1997, the Office undertook a significant re-assessment of its strategic planning and quality assurance processes with the aim of enhancing the link between branch activities and corporate objectives.
Paras 5.20 to 5.22
- Measures introduced for 1998-99 were a significant improvement on those used for the previous 2 financial years. However, further improvement could be made to the suite of measures developed.
Paras 5.23 to 5.25
- Inter-jurisdictional benchmarking undertaken across Australian revenue collection agencies identified that, while the Office compares well on a number of fronts, in some areas there is potential for improvement.
Paras 5.34 to 5.36 and 5.41 to 5.51
- Revenue collected per dollar spent by the best performing Australian revenue collection agencies was \$179 in 1996-97, compared with \$130 in Victoria.
Paras 5.37 to 5.40

OUTCOMES OF REFORMS**Page 79**

- Although improvements in efficiency are evident since the amalgamation of the former Stamp Duties and State Taxation Offices, the State Revenue Office has not undertaken any formal assessment of the extent to which the envisaged benefits from the 1992 amalgamation have been realised.
Paras 6.5 to 6.11 and 6.17 to 6.19
- Revenue collected per employee has risen from \$5.6 million in 1991-92 to \$12.9 million in 1996-97, notwithstanding reductions in staff numbers from 1 024 to 499 during the same period. However for 1997-98, the collections decreased to \$9.8 million with staff numbers increasing to 545.
Paras 6.12 to 6.13
- In October 1996, consultants completed an organisational review in conjunction with in-house staff at a cost of \$1.8 million. The review confirmed that the Office should continue to pursue its strategic directions. Eleven projects designed to deliver qualitative and quantitative operational benefits evolving from the review were subsequently commenced.
Paras 6.20 to 6.26
- Evaluations to determine whether the envisaged benefits from the organisational review had been realised for the 10 projects completed at the date of audit had not been undertaken.
Paras 6.31 to 6.34
- In April 1996, the Office outsourced its information technology function with the expectation of achieving significant benefits including cost savings of between 10 and 15 per cent annually after 5 years. The Office advised that the cost to date of outsourcing this function has been less than the cost of retaining the service in-house, and that the envisaged benefits are gradually materialising.
Paras 6.40 to 6.41 and 6.46

OUTCOMES OF REFORMS - *continued***Page 79**

- The Office's tender selection process to appoint the information technology service provider was carried out in a thorough and professional manner.
Paras 6.36 to 6.39
- The core costs of the outsourcing arrangement including enhancements to the system have remained constant at around \$9.2 million annually, compared with operating costs of \$9.3 million prior to outsourcing.
Para 6.42
- As recent staff changes within the 2 organisations had placed some strain on their relationship, audit commends the initiatives taken by the Office to address the situation and ensure that both organisations share common values and are committed to a unified team-based approach.
Paras 6.43 to 6.45
- Problems encountered since entering into the information technology outsourcing arrangements include:
 - untimely repair of defective equipment;
 - staff dissatisfaction with the *help desk* facility;
 - concern over responsibility for the security of the operating environment;
 - the contractor's failure to meet certain contractual obligations; and
 - inadequate service charge adjustments for non-compliance with certain contractual requirements.*Paras 6.47 to 6.55 and 6.70 to 6.73*
- Given that action has recently been taken with the contractor to address these matters, and that the framework established for monitoring the outsourcing arrangements is relatively sound, overall the Office has received a satisfactory level of service.
Paras 6.46 and 6.56 to 6.69
- Although the magnitude of the change that has occurred within the Office over the past 5 years has been considerable, the Office had not complemented various forums for eliciting staff attitudes with the use of periodic surveys.
Paras 6.79 to 6.85

q RESPONSE *provided by the Commissioner, State Revenue Office*

The Auditor-General has undertaken an extensive review of the State Revenue Office over the past 8 months. We are pleased to note that this Report affirms the considerable achievements made over the past 6 years, which have provided benefits to taxpayers and the Government (Para.1.1.2).

The Office has noted audit's comments on the need to improve performance measures and has already implemented some of audit's suggestions in the current budget cycle. The difficulty and cost of developing and using appropriate measurement systems for some of the specific areas mentioned is not to be underestimated (Para. 1.1.4).

q RESPONSE provided by the Commissioner, State Revenue Office - continued

The feasibility of this approach would need careful consideration especially given the diverse and, on the whole, indirect nature of the tax lines administered. This is further compounded by the fact that taxpayers move in and out of tax bases, depending on a range of factors. As audit acknowledged elsewhere in the Report, reliable and valid methodologies to measure whether the objective has been met or not, are yet to be developed by this Office or any other revenue office in Australia or internationally.

Research has indicated that the methods developed to date basically fall into 2 types:

- *macro methods - which attempt to infer the unknown amount of revenue using independent economic data; and*
- *micro methods - which use either existing audit results or audit results from a stratified random sample.*

Both approaches have inherent difficulties. There is no recognised national or international method available and indeed the usefulness of this approach, in a taxation environment is not universally accepted. Of the approaches available, there is not one that this Office would consider could be reliably used as anything other than a very broad indicator to be used in trend analysis.

On the evidence available, the known Victorian taxpayers generally have a very high level of compliance. This is borne out by revenue collection and the results of our investigations and other compliance activities. The Office would argue that the annual process for developing revenue forecasts is currently the best available approach to quantify the expected tax revenue to the Government in any particular financial year. These forecasts are developed in conjunction with the Department of Treasury and Finance and are based upon historical data, expected economic conditions and variations to taxation policy and legislation (Para. 1.1.5).

Audit has commented on the lack of precision of some performance targets and concluded that the tolerance range of +/- 5 per cent in our revenue targets could act as a disincentive to the Office maximising revenue. This assumes that performance targets are the only motivators possible and is at odds with audit's own findings. On all available evidence, it is clear that this has not eventuated. A clear focus of management attention and budget expenditure has been on increasing the Office's activity and effectiveness in maintaining and increasing the level of compliance. Considerable effort has gone into identifying the elements of non-compliance and developing appropriate holistic strategies. Revenue targets are a key business driver for staff at all levels. These targets are based on expected future economic activity within the State and are closely monitored by the Office and the Department of Treasury and Finance. Where variations do occur, considerable effort is applied in attempting to discern the causes of the variations (Para. 1.1.8).

The Office has made considerable headway in improving the way taxpayers interact with the Office. This is well supported by our revenue collection, the results of investigations and other compliance activities and our customer feedback, including the State Taxes Consultative Council. The difficulty and cost of attempting to isolate and measure the effectiveness of one factor in a multi-factor approach to enhancing compliance is not acknowledged by this audit comment. The Office asserts that it is self-evident that in an increasingly complex and volatile commercial environment compliance will improve if it is easier to understand and pay taxes (Para. 1.1.9).

Q RESPONSE provided by the Commissioner, State Revenue Office - continued

The Office's current initiatives in relation to the measurement of our performance in reducing taxpayer compliance costs and maximising taxpayer compliance are focused on exploring the feasibility, cost and usefulness of the known measurement approaches to these areas. The different circumstances of taxpayers make the development of appropriate measures problematical (Para. 1.1.11).

The Inter-jurisdictional Benchmarking Study has been supported by the Office over the past 5 years, because it enabled the development of comparative performance data which could act as another stimulus to continuous performance improvement. All State revenue offices have recently agreed in principle to engage an external independent organisation to collect, validate and report blinded performance benchmarking data to improve the robustness and relevance of the data collected (Para. 1.1.12).

Maximising revenue collection

Audit has made a number of findings relating to revenue collection. The key observations relate to the measurement of the tax gap, measurement of the effectiveness of components of the compliance strategy, land tax and customer service.

Tax gap

The gap notionally represents the difference between the level of anticipated revenue when compared with the amount of tax collected. The issue is not the complexity but the availability of a reliable model. It should be noted that gap analysis is a high level assessment based on predictor information given the extent of the assumptions and the definitional differences between the objective state and the tax base. It has limited usefulness as it does not produce information that identifies the industries, areas, or parties who may not be compliant or the issues which are the underlying causes for the indicated non-compliance. At this point, the Office has not been able to identify any robust and reliable system from either domestic or overseas investigation.

Measurement of the compliance strategy

At this point, the Office has not undertaken any detailed work to assess the comparative effectiveness of individual components of the compliance strategy. However, feedback from customers participating in information seminars and the results they produce in terms of voluntary disclosures, is substantive evidence of the effectiveness of this component of the strategy. The Penalties and Interest Policy has been formulated to take into account previous compliance or non-compliance when determining the appropriate level of penalty. Further, the impact of penalties is continually reviewed as part of our normal day-to-day operations. Considerable time and effort would be required to isolate and analyse the specific benefits of each individual component of the integrated compliance strategy. The Office would question whether having this specific information would have a significant impact on the current compliance strategy and therefore whether the costs of what would be a complex evaluation task are justifiable.



Q RESPONSE provided by the Commissioner, State Revenue Office - continued

Land tax

At the time of the April 1998 Budget, the Office estimated that the 1997-98 land tax receipts would be \$305 million. This estimate was based on the an assessment issue cycle that would have all assessments issued and due for payment before 30 June 1998. The legislation allowing for the PPR exemption was delayed and did not pass through the Parliament until late May, which did delay the issue of assessments worth \$23 million until June.

Customer service

A customer service strategy has been in operation since the establishment of the Office in 1992 and has been a clear organisational driver. Steps were taken in March 1998 to develop a document that encapsulated this strategy. The needs of the customer is an evolving process. To date, the Office has monitored these needs through complaint and compliments registers, industry consultation and various surveys. Information on customers' service elements have been gathered by a variety of means since the Office commenced. These sources have included mystery shopper surveys, counter surveys, customer surveys as part of the Business Renewal Study, a survey of customer preferences for a range of payments options and the Australian Quality Council studies. The Office's customer service strategy and practices have been examined and some pertinent observations have been made on how to further improve focus in this area. Responses to specific comments on the customer service strategy and staff training are included elsewhere in this Report, with which the Office has some disagreement.

The Office was the first State revenue agency in Australia to introduce a Taxpayers' Charter. It was formulated to articulate clearly the legislative obligations that were placed on the Office and to communicate the standards of service and behaviour of the Office that a taxpayer is entitled to expect. In this way, taxpayers and our staff had a clear view of the standards which the Office had to meet. All reporting on the Charter has been against the clear legislative and administrative standards that have been set. The Charter has been updated following consultation with taxpayers and tax practitioner representative bodies.

Ensuring timeliness and cost effectiveness

Audit findings focused on performance measures and the interjurisdictional benchmarking exercise.

Current performance measures

The Office believes that the current measures that have been developed and refined in co-operation with the Department of Treasury and Finance provide effective performance data. The Office acknowledges that performance measures require constant review and evaluation to ensure they remain comprehensive and robust. The Quality and Planning Unit is assisting the operational areas develop their performance measures as part of the quality initiative.

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Q RESPONSE provided by the Commissioner, State Revenue Office - continued

Interjurisdictional benchmarking

The Office has used the outcomes from these annual studies to help identify areas where further improvement may be possible. The measures used in the study are subject to an annual review process. All State revenue offices have recently agreed in principle to engage an external independent organisation to collect, validate and report blinded performance benchmarking data to improve the robustness and relevance of the data collected.

Outcomes of reforms

Key issues considered concern the benefits of amalgamation of the Stamp Duties Office and the State Taxation Office, Business Renewal Study and IT outsourcing.

Amalgamation

The Office believes that this matter has been adequately addressed through all the regular reporting channels with the Department of Treasury and Finance and the Treasurer, although no formal report has been prepared.

Business Renewal Study

Post-implementation reviews are planned for these projects. However, it should be noted that as the majority of these projects have only been recently completed that a reasonable settling period needs to be allowed to enable an objective evaluation of the benefits.

IT outsourcing

The IT outsourcing was undertaken for a range of reasons, which included improved flexibility, greater access to resources and improved service delivery. Cost saving, though important, were not the overriding driver. However, it should be noted that in 1998 dollars our outsourced IT baseline service is costing less than our internal baseline costs in 1995 dollars.

Part 2

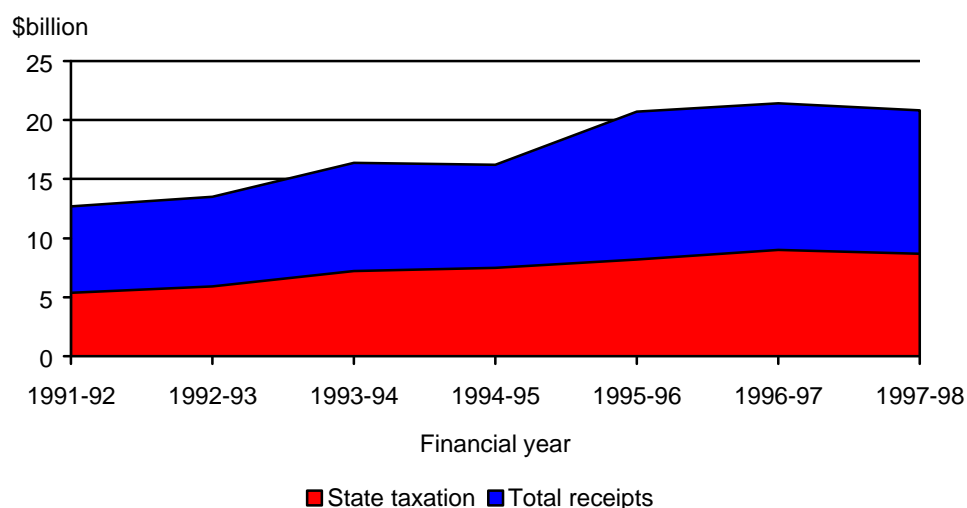
Background

REVENUE COLLECTION IN VICTORIA

2.1 Revenue collected by the State Government is a key source for funding many services provided by government agencies. It is therefore paramount that this revenue is collected efficiently and effectively, and in accordance with the Government’s fiscal policy and strategic directions.

2.2 Since 1991-92, total receipts to the Consolidated Fund, excluding borrowings, have steadily increased, particularly in 1995-96 and 1996-97 as a result of sales of a number of State-owned enterprises. Chart 2A shows total receipts, including the taxation component, from 1991-92 to 1997-98.

CHART 2A
TOTAL RECEIPTS, 1991-92 TO 1997-98
((\$billion))



Source: Reports of the Auditor-General on the Government’s Annual Financial Statement.

2.3 Taxation in the form of stamp duties and taxes on financial and capital transactions, payroll tax and taxes on gambling activities and property holdings, is the largest source of State revenue. In 1997-98, collected taxes totalled \$8.7 billion. The State Revenue Office is responsible for the collection of these taxes, excluding gambling taxes which are the responsibility of the Victorian Casino and Gaming Authority.

THE STATE REVENUE OFFICE

Formation of the Office

2.4 The State Revenue Office was formed in April 1992 through the amalgamation of the former Stamp Duties and State Taxation Offices. Previously, these 2 agencies operated as separate administrations within the then Department of the Treasury and collected around 86 per cent of the taxation component of the State’s revenue. I concluded in my *Report on the Finance Statement* for the year ended 30 June 1991 that there were strong grounds for amalgamation.

2.5 The decision of the former Government to amalgamate was based primarily on the envisaged benefits, including efficiency gains, that would result from rationalising the functions of the 2 agencies.

Relationship with the Department of Treasury and Finance

2.6 The Office continued to operate as an administrative unit within the Department of Treasury and Finance until December 1994 when it was established as the State's first service agency with responsibility for collecting certain State taxes. A Framework Agreement was entered into between the Commissioner of State Revenue, the Treasurer and the Secretary to the Department to formalise the relationship between the parties and their associated roles and responsibilities.

2.7 Under the initial Agreement, which covered a 3 year period to December 1997, the Office was able to operate with considerable independence in delivering agreed outcomes. In broad terms, the Agreement addressed:

- the Office's aims and objectives;
- preparation of strategic and annual business plans;
- the Office's reporting responsibilities and the monitoring role to be undertaken by the Department; and
- financial and staffing arrangements.

2.8 A new agreement covering the above elements for the 3 year period to December 2000 was finalised in March 1998.

2.9 The performance of the Office is regularly and systematically assessed by the Department. Each quarter, the Department is provided with reports on the Office's progress in meeting both its objectives and targets as specified in the annual business plan and the key performance measures and targets agreed with the Department. These reports are supplemented with regular discussions between senior managers from each agency. The Office also prepares an annual report which includes details of its activities, financial results and performance against key targets and objectives. The report is tabled in the Parliament and circulated to relevant industry associations and other interested parties.

Roles and responsibilities

2.10 The Office's Mission Statement, presented in its 1997-98 Business Plan, clearly emphasised its responsibilities to both the Government and the public. The Office also has stated objectives which provide a basis for measuring its success. The Office's 1997-98 mission and objectives are outlined in Chart 2B.

**CHART 2B
1997-98 MISSION AND OBJECTIVES**

<p><i>Mission Statement</i></p> <p><i>The State Revenue Office proudly serves the people of Victoria by ensuring that their Government receives tax revenue to finance services for the benefit of all Victorians.</i></p>
<p><i>Objectives</i></p> <p><i>Client Services</i></p> <p><i>Being responsive to the expectations of stakeholders, taxpayers and our other clients by meeting the performance standards of the Taxpayers' Charter, by reducing clients' compliance costs, by maintaining the security of confidential information, by quickly dealing with clients' concerns and by making it easy for everyone to do business with us.</i></p> <p><i>Compliance</i></p> <p><i>Ensuring that everybody understands and meets all their obligations under tax legislation, including paying the correct tax at the right time, keeping complete records and providing accurate information.</i></p> <p><i>Policy</i></p> <p><i>Developing a better Victorian tax regime by providing authoritative policy advice to the Government, by consulting with other jurisdictions to improve consistency and by administering tax legislation professionally and sensibly.</i></p> <p><i>Efficiency</i></p> <p><i>Increasing our productivity and efficiency by improving our procedures, by developing the competencies of our people, by adopting modern technologies and by using service providers for appropriate functions.</i></p> <p><i>Integrity</i></p> <p><i>Applying the highest ethical standards in all our activities.</i></p> <p><i>Staff Relationships</i></p> <p><i>Respecting and valuing all our people and providing a work environment that is challenging and rewarding and gives everyone an equal opportunity to contribute, learn and grow.</i></p>

2.11 In line with the Office's customer service ethos, the objectives and mission for 1998-99 have been amended to portray the Office as a provider of revenue management services rather than just a collector of taxation revenue. The current mission now states:

"The purpose of the State Revenue Office is to provide customers with quality revenue management services which are fair, efficient and deliver benefits for all Victorians."

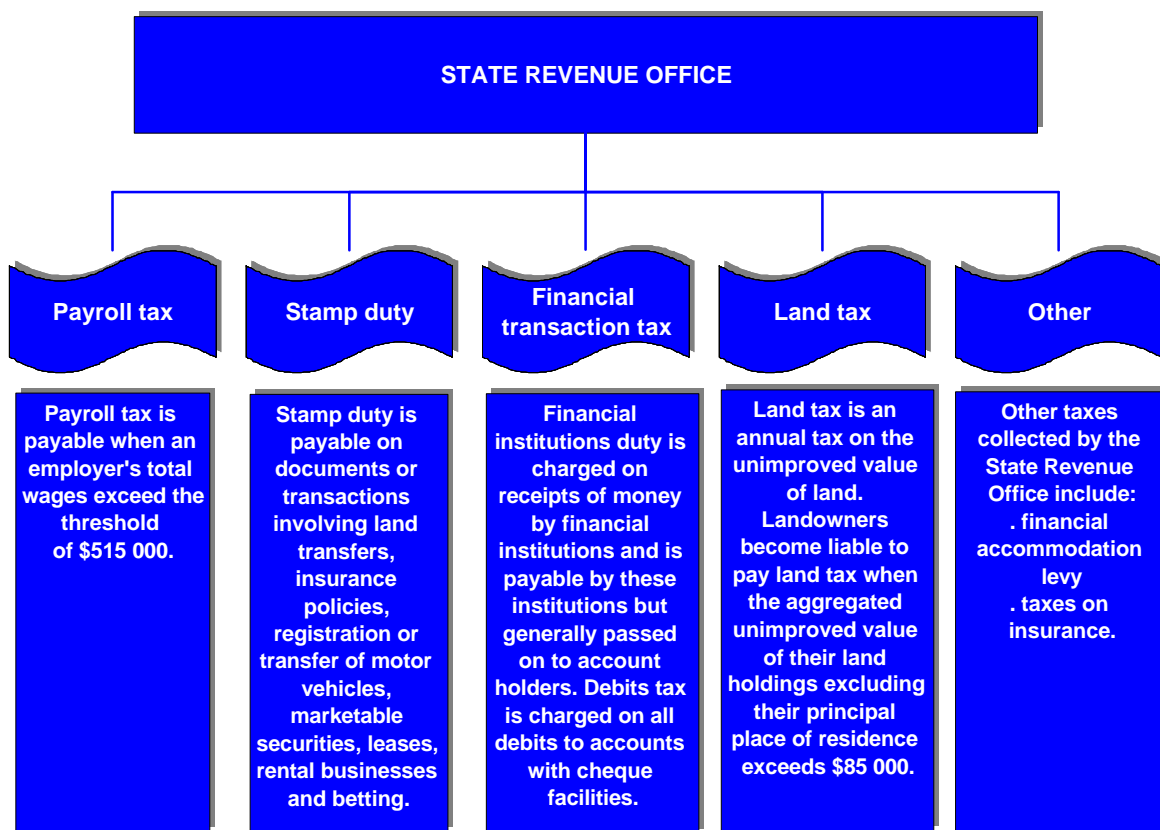
2.12 The Office has 3 core functions namely:

- managing the collection of tax revenue;
- developing revenue and taxation policy; and
- providing management and budget information to the Government.

Taxes collected

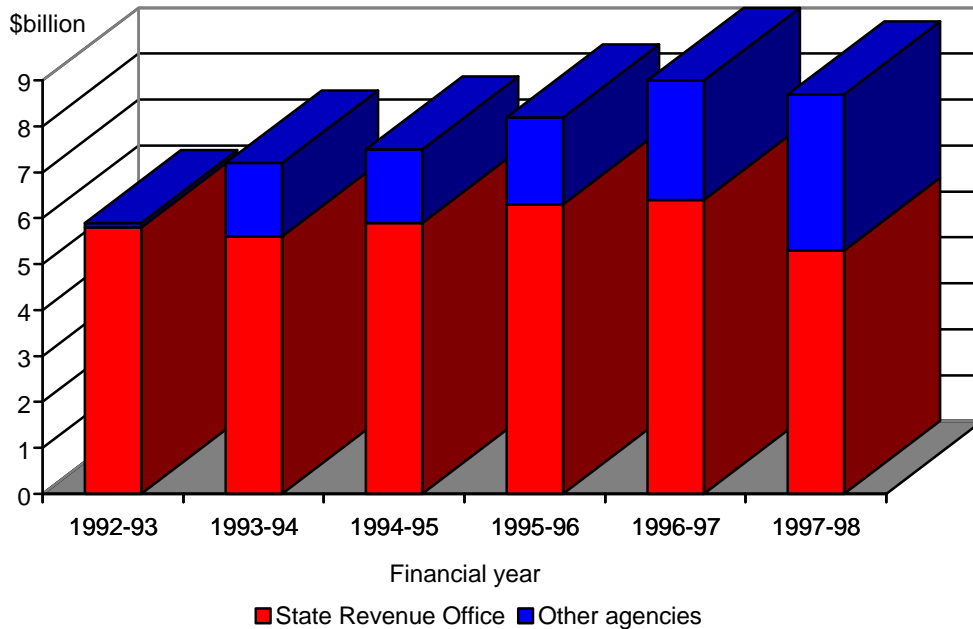
2.13 The Office administers 13 Acts of Parliament and is responsible for managing the collection of 17 different categories of taxes and duties including payroll tax, land tax, debits tax, stamp duty and financial institutions duty. Details of the major taxation revenue categories collected by the Office are outlined in Chart 2C.

**CHART 2C
MAJOR CATEGORIES OF TAXATION REVENUE COLLECTED BY THE OFFICE**



2.14 Over the past 6 years, the amount of the State's taxation revenue collected by the Office has averaged around \$5.9 billion per year. Chart 2D shows the proportion of the State's taxation revenue collected by the Office since 1992-93.

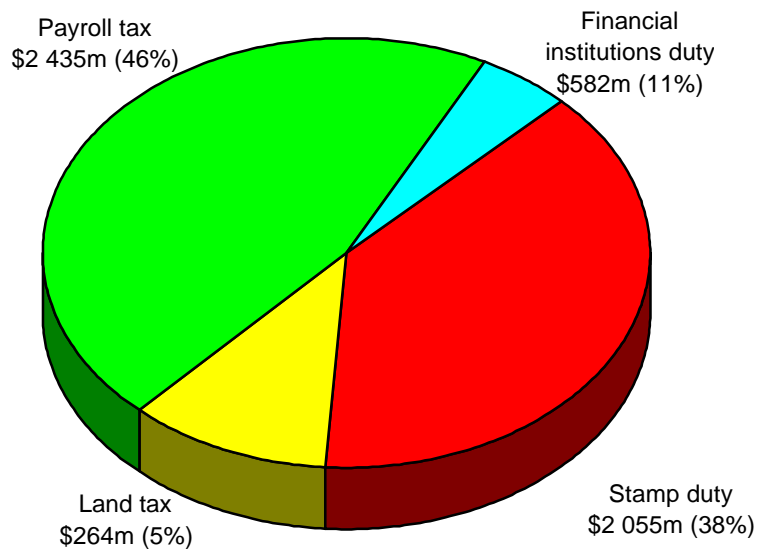
CHART 2D
PROPORTION OF STATE TAXATION REVENUE COLLECTED BY THE OFFICE,
1992-93 TO 1997-98
 (\$billion)



2.15 The drop in revenue for 1997-98, as shown in the above chart, although in line with the budget forecast, was primarily due to the non-collection of business franchise revenue. A High Court ruling in August 1997 determined that the New South Wales tobacco franchise fee legislation was unconstitutional. As a consequence, all State and Territory Governments decided to discontinue collecting fees on all 3 business franchises, i.e. tobacco, petroleum and liquor. Collection of these franchises by the Office for 1996-97 amounted to \$1.3 billion. The level of State revenue has been maintained subsequent to 1997-98 as a consequence of arrangements entered into with the Australian Government.

2.16 Details of revenue collected by the Office for 1997-98, which totalled \$5.3 billion or 61 per cent of total State taxation revenue, are outlined in Chart 2E.

CHART 2E
COMPOSITION OF REVENUE COLLECTED BY THE OFFICE,
1997-98
 (\$million)



2.17 As indicated in Chart 2E, payroll tax is the main source of revenue collected by the Office.

AN AGENDA FOR CHANGE

2.18 Since its formation, the State Revenue Office has embarked on a significant change program which has redefined both the culture and business processes of the organisation. The establishment of a client service ethos has driven much of the change, together with an expanded use of information technology. The emphasis given to client service is based on the Office's view that improved revenue collection can be achieved through educating taxpayers about their obligations and by responding to their needs as customers.

2.19 Other key changes initiated by the Office are outlined in the following paragraphs:

- *Business Renewal Study.* The Study focused on improving the Office's core processes by comparing many aspects of the Office's operations including business processes, technology, culture and structure against best practice;
- *Outsourcing of non-core functions.* Over the past 3 years a number of non-core functions have been contracted out as the Office considered external providers would deliver these services in a more effective and economical manner. These functions include information technology services, mail and payment processing, printing services, debt collection for amounts of less than \$1 000, and various training and development programs; and
- *Quality management framework.* In 1998, work commenced on implementing a quality management framework, which incorporates the concept of continuous improvement, to enhance the quality of services provided by the Office. Organisational self-assessment will form the nucleus of the framework.

.....

2.20 The Office envisages that enhancements to strategic planning processes, management information systems and the performance measurement framework will provide the means for ongoing improvement.

CHANGES TO STATE TAXES AND TAX ADMINISTRATION

Aligning State taxation administrations

2.21 In recent years there have been significant reforms enacted between the States and Territories in relation to their tax jurisdictions designed to eliminate inefficiencies within the administration and collection of taxes.

2.22 In Victoria the recently introduced *Taxation Administration Act 1997*, covering payroll tax, financial institutions duty and debits tax, is designed to create consistency in the administration and collection of taxes, reduce taxpayer compliance costs and simplify the interpretation of legislation for tax advisers. Similar legislation has been passed in the Australian Capital Territory, New South Wales, South Australia and Tasmania as a result of a multi-jurisdictional project with other revenue offices. Work on new legislation to replace the *Stamps Act 1958* is continuing under a similar arrangement.

2.23 As a result of this consultative approach, the Annual Adjustment Disk, developed in Victoria to provide a computerised program for self-assessment of payroll tax returns, will be developed for use in other jurisdictions. It is then intended to further develop the Disk to incorporate the tax regimes for all jurisdictions. This will enable taxpayers to complete their payroll tax returns for Victoria and other jurisdictions using the Disk.

2.24 In order to deliver further efficiencies to taxpayers and revenue offices, all jurisdictions have agreed to explore other opportunities for harmonisation of taxation systems and processes across States and Territories. Suggestions include:

- aligning the timing of payments;
- using forms of the same design for each tax across jurisdictions; and
- investigating the feasibility of a one-stop shop in each jurisdiction capable of handling assessments and payments for all jurisdictions, and passing revenue on.

Future reform of Commonwealth/State taxation arrangements

2.25 In August 1997, the Prime Minister announced the establishment of a task force to address national tax reform which included reform of Commonwealth/State financial relations. In response, the Victorian Government has stated that it would be prepared to abolish some of its more inefficient taxes in return for gaining a share of the personal income tax base. Since that announcement, the Australian Government has released some details of its proposed tax reform package which includes the abolition of certain State taxes.

2.26 Debate on tax reform at a State level has canvassed options for taxes within States, increased alignment of taxes between States, changes to the tax mix between the 3 tiers of government and broadening the current set of State taxes. In its May 1998 research paper, *Directions for State Tax Reform*, the Productivity Commission identified a range of issues in relation to State taxes concerning their equity and efficiency.

2.27 Notwithstanding changes that could be made to address some of the issues, reform options for State taxes are, to a large extent, dependent on decisions ultimately made by the Australian Government both in relation to national tax reform and Commonwealth/State revenue sharing arrangements.

Part 3

Conduct of the audit

AUDIT OBJECTIVES

3.1 The overall objective of the audit was to evaluate the effectiveness and efficiency of the State Revenue Office in discharging its key responsibilities as the State’s major revenue collection agency.

3.2 Specifically, the audit assessed whether:

- a structured management framework had been established to facilitate systematic appraisal over time of actual performance against the Office’s goals and targets, and meaningful reporting to the Parliament;
- effective and efficient strategies have been implemented to enhance the level of taxpayer compliance; and
- reforms over recent years to the Office’s structure and business practices have contributed to improving the quality and efficiency of service delivery.

3.3 In pursuit of this objective, audit sought to give recognition to initiatives taken by the Office to improve the management of revenue collections.

SCOPE OF AUDIT

3.4 The following areas were examined during the audit:

- the Framework Agreement between the State Revenue Office and the Department of Treasury and Finance;
- outcomes of reforms introduced within the Office;
- performance measurement of the Office’s activities;
- compliance strategies in place, including key areas such as the level of customer service, the nature and extent of investigatory activities, and the imposition of penalties;
- project management frameworks;
- outsourcing arrangements entered into with external suppliers; and
- follow-up of issues raised in previous performance audits.

Period covered by audit

3.5 The audit covered the period from the formation of the Office in April 1992 to June 1998. Any significant developments beyond this date have been acknowledged by audit.

Compliance with auditing standards

3.6 The audit was performed in accordance with Australian Auditing Standards applicable to performance audits and, accordingly, included such tests and other procedures considered necessary in the circumstances.



SPECIALIST ASSISTANCE

3.7 Specialist assistance was provided to audit by Mr Murray Rees, Project Consultant with the Australian Institute of Management. Specific advice related to customer service and included:

- the establishment of service standards and targets;
- the development of charters;
- appropriate performance measures, benchmarking and best practice; and
- the effective use of data obtained from surveys and other forms of feedback in the process of continuous improvement.

3.8 Mr Rees has a decade of experience as a marketing practitioner and extensive experience as a consultant to firms and government agencies in relation to customer needs and service delivery.

Other assistance provided to audit

3.9 During the course of the audit, discussions were held in regard to research conducted on taxpayer compliance costs with the Department of State Development. A member of the State Taxes Consultative Council was consulted in relation to client services. In addition, an extensive literature search of current national and international research was conducted by audit.

Part 4

Maximising revenue collection

OVERVIEW

4.1 A key role of revenue collection agencies is to maximise taxation collections by maintaining complete and accurate records of taxpayers, and ensuring taxpayers know and comply with their legislative responsibilities.

4.2 Audit found that determining a reliable method for measuring the level of taxpayer compliance has been the subject of much debate and consternation for revenue collection agencies within Australia and overseas and, to date, the complexity of the task has impeded the development of an acceptable methodology. As a result, the State Revenue Office has been unable to confidently quantify or even estimate the extent to which it is maximising revenue collections.

4.3 In May 1997, the Office began developing an improved method of identifying non-compliant taxpayers, commencing with payroll tax which is the Office's largest source of revenue.

4.4 The inadequacy of land tax records has proven to be a long-standing issue. Previous Auditor-General's Reports dating back to 1989 have drawn attention to this matter. The Office has expressed its concern to the Department of Treasury and Finance over a number of years that existing land information systems are not only inefficient and costly to maintain, but also that incomplete and inaccurate data inhibit the Office's capacity to reliably identify all taxpayers liable for land tax and provide assurance that all such revenue due to the State is collected. Around 97 per cent of entries onto the Office's land information system to update ownership details are rejected due primarily to the poor quality of the information. Furthermore, up to 17 staff are employed to correct errors. Given the continuing history of this issue and the ongoing loss of land tax revenue, audit considers that corrective action is long overdue.

4.5 The Office considers that revenue collections can be best maximised through adopting a holistic approach to compliance by addressing all factors which impact on compliance behaviour. Key components include an investigation function to uncover non-compliance, the imposition of penalties to deter non-compliance and, through improved customer services, making it easier for taxpayers to conduct business with the Office.

4.6 Audit found that the extent to which the key components of the compliance enhancement strategy have improved the level of taxpayer compliance, including the cost-effectiveness of such components of the strategy, has not been fully evaluated by the Office.

4.7 The collection of more comprehensive information in relation to the efficiency and effectiveness of the Office's Investigation Branch would enable management to be in a stronger position to assess whether the resources applied to its investigative component are appropriate relative to its other compliance enhancement strategies.

OVERVIEW - continued

4.8 While sound processes have been established to facilitate a consistent and equitable approach to the imposition of penalties, the Office has not assessed the impact of penalties on compliance. Consequently, the Office cannot be assured that the value of penalties and the circumstances in which they are imposed provides an effective deterrent to non-compliance.

4.9 As the Taxpayers' Charter should form the centrepiece of the Office's approach to customer service, various suggestions were made by audit to raise the Charter's profile, both internally and externally.

4.10 In relation to staff training directed at customer service, the audit found that issues addressed in the training were well handled by staff. The Office, in receiving more compliments than complaints, and through the results of various customer surveys, has received endorsement from its customers of the professionalism and courtesy of its staff. Although various strategies have been implemented to develop technical knowledge of operational staff, a more structured approach is needed in the provision of technical training, similar to that of the customer service training course.

4.11 Due to the complexity of the tasks, audit could not distinguish between the individual effect of customer service as distinct from investigations and the imposition of penalties on enhancing taxpayer compliance. Various broad approaches were suggested by audit to assist in measuring the effectiveness of the Office's customer service focus.

q RESPONSE provided by the Commissioner, State Revenue Office

The Office has continually evaluated the benefits of the compliance enhancement strategy and has been active in refining the strategy to ensure it supported maximum compliance. Customer research being undertaken in November 1998 will collect some additional information on customer views about taxpayer compliance costs, ways to assist compliance and will seek to elicit customer views on needs that are not met on current services.

Investigations Branch currently provides comprehensive performance information including feedback via customer surveys. The Quality Unit is currently assisting the Branch to undertake a review of the adequacy and appropriateness of all performance measures.

Q RESPONSE provided by the Commissioner, State Revenue Office - continued

While there is a linkage between the level of penalties and the corresponding level of compliance, this does not necessarily imply that raising penalties translates directly into a quantifiable improvement in compliance. Furthermore, the level of penalty imposed on a particular taxpayer is unknown to others. The Office has developed a detailed penalty policy which has been specifically designed to set appropriate levels of penalty based on the taxpayer's actions. This policy has been very effective in encouraging compliance, however, the Courts and the Victorian Civil and Administrative Tribunal have the power to reduce a penalty on appeal. To undertake further work in this area would involve additional costs for both the Office and taxpayers in gathering data without any immediate or apparent benefit.

Audit acknowledges the difficulty of trying to isolate and analyse the specific benefits of the components of an integrated compliance strategy. The Office will consider audit's comments where some tangible benefits can be identified. However, we repeat that the direct feedback from customers and the observable results from individual programs clearly confirm that providing education to taxpayers improves future compliance and rectification of past understatements.

REVENUE LEAKAGE

Introduction

4.12 Revenue leakage in the context of taxation revenue represents moneys due to government that are not collected. Factors causing revenue leakage include taxpayers not knowing or understanding their legislative responsibilities or simply electing not to comply with those obligations. Leakage also arises where the collection agency has inadvertently failed to identify an individual or organisation liable for the payment of taxation or maintain complete and accurate records of taxpayers.

4.13 From a government perspective, it is important that agencies responsible for the collection of taxation have sound strategies in place aimed at minimising the extent of revenue leakage.

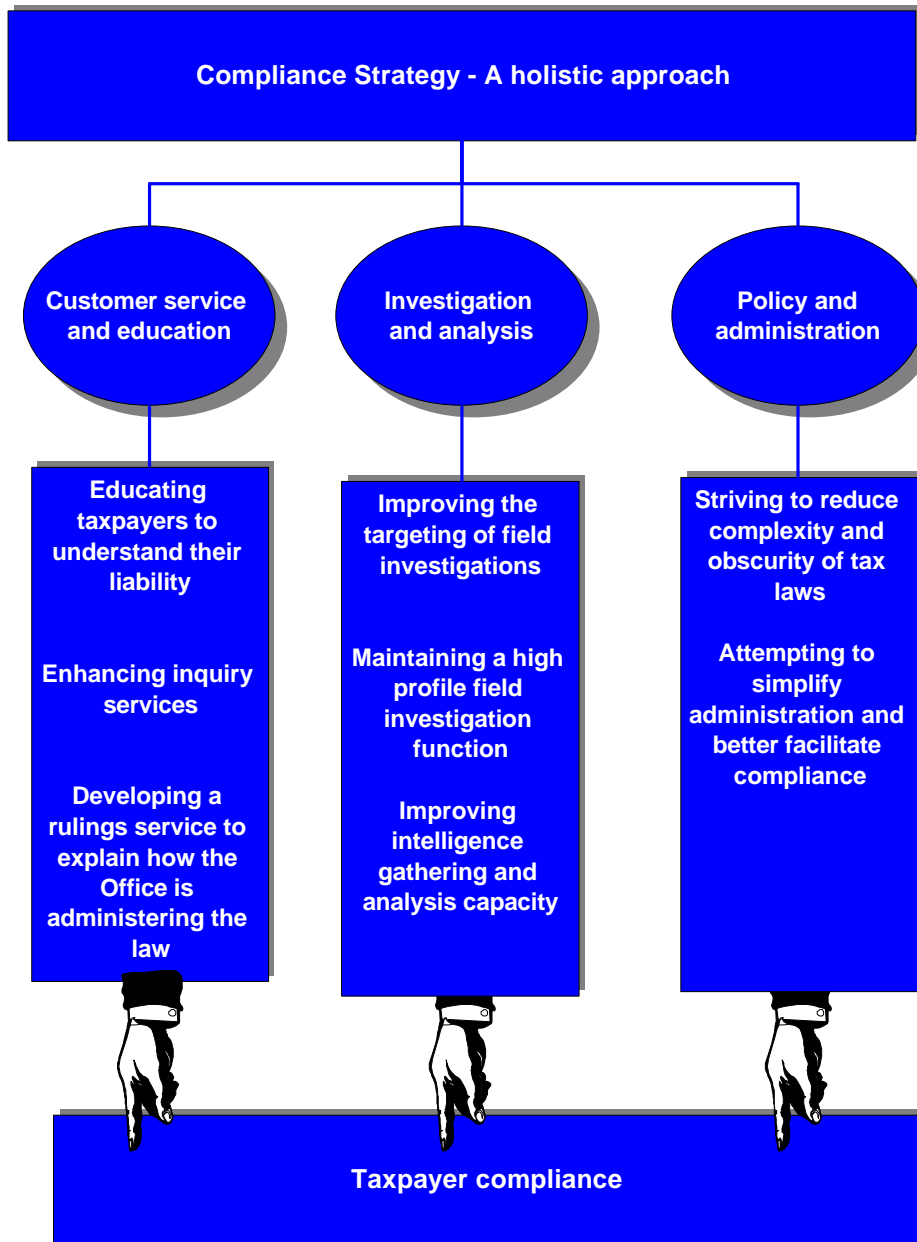
4.14 Over the years, the State Revenue Office has identified that the main reasons for non-compliance by taxpayers are:

- genuine ignorance of their taxation obligations;
- scope to plead confusion or raise legal objections;
- overly complex legislation which is difficult to interpret and therefore susceptible to challenge; and
- a preparedness to risk detection of non-compliance.

4.15 Mindful of these reasons and approaches adopted by other taxation collection agencies to enhance compliance, the Office considers revenue collection can be best maximised through adopting a holistic approach to compliance by addressing all factors which impact on compliance behaviour.

4.16 This approach, which encompasses all aspects of tax administration, is illustrated in Chart 4A.

CHART 4A
KEY ELEMENTS OF THE OFFICE'S COMPLIANCE STRATEGY



4.17 Responsibility for improving taxpayer compliance is shared across the Office although a key role rests with the Compliance Enhancement Division which comprises 3 Branches, namely, Investigations, Receivables Management and Communications.

Identifying the tax gap

4.18 Searches of national and international literature undertaken by audit found that a key measure of the effectiveness of a taxation collection agency, in terms of maximising revenue collection, is the level of taxpayer compliance. Compliance can be determined by identifying all potential taxpayers and comparing the amount that they would have to pay, i.e. the potential taxation base, with the amount of assessed liabilities. The difference is referred to as the “tax gap”. Theoretically, the size of the tax gap and the extent to which it is minimised, reflects the collection agency’s performance in maximising taxpayer compliance.

4.19 Audit is also aware that determining a reliable method for measuring the tax gap has been the subject of much debate and consternation for revenue collection agencies within Australia and overseas, and to date the complexity of the task has impeded the development of an acceptable methodology.

4.20 In relation to the Office, audit found the customer base for each category of taxation could be described as a moving target. Economic fluctuations, amendments to legislation and a general lack of awareness by companies and individuals of their taxation obligations makes the Office’s task of identifying the total customer base for each revenue line almost impossible. Accordingly, in relation to making professional judgements on the size of the tax gap, to date the Office has not been able to adequately measure the size of the gap.

4.21 In the absence of an overall measure of effectiveness, the Office’s approach to reporting its performance has been based on specific project outcomes and results of activities. Examples presented in past annual reports have included:

- quantification of unpaid taxation revenue detected from targeted investigation activities (e.g. \$65 million in 1995-96 and \$50 million in 1996-97);
- voluntary declaration of revenue by taxpayers who had participated in education programs aimed at assisting them to understand their taxation obligations; and
- recoup of revenue through the detection of loopholes in legislation.

4.22 While the information presented in the Office’s annual reports over the years provides some insight into its effectiveness, audit considers the information could be substantially improved if supplemented with an assessment of compliance levels for each revenue category. It is pleasing to note that in recognition of the importance of this information, the Office has recently initiated action aimed at identifying the most cost-effective methodologies for assessing the level of compliance for each revenue category.

International approaches to measuring the tax gap

4.23 Research by audit revealed that some work has been undertaken to measure the tax gap in the United Kingdom and the United States of America.

4.24 A report published in February 1996 by the National Audit Office in the United Kingdom, *Change Management in the Inland Revenue*, included comment on some approaches to measuring the tax gap adopted by the United Kingdom Inland Revenue Department and the Internal Revenue Service of the United States of America.



4.25 In the United Kingdom, the Inland Revenue Department was developing 2 new approaches. The first involved assessing taxpayers' perceptions of the effectiveness of compliance work through questions included in customer surveys. The second involved estimating the current level of risk of non-compliance in tax returns and comparing it with the actual level of non-compliance as identified by inspectors when processing returns.

4.26 According to the National Audit Office report the Internal Revenue Service of the United States of America undertakes detailed investigations of a large random sample of taxpayers' records and extrapolates the results to give a national estimate of non-compliance.

4.27 Audit has been advised by the State Revenue Office that it will consider these approaches as part of its research into identifying cost-effective methodologies for measuring taxpayer compliance levels.

Q RESPONSE provided by the Commissioner, State Revenue Office

While the Office would like to believe that the size of this gap is fully due to our collective efforts, reality would suggest that the outcome is also influenced by a number of external environmental factors.

Our achievements to date in revenue collection, investigations and detection reflect most favourably on the competency of the professional judgement exercised throughout the Office.

The Office has committed limited resources to research tax gap identification methodologies. The lack of precision in the data and assumptions limit the confidence in, and the usefulness of, the outcome. A dollar figure of a tax gap provides no useful indicator of the reason for it. Hence, the Office has focused resources on developing intelligence and analyse capabilities and developing techniques such as data matching to identifying non-compliance. This is complemented by field investigations testing sectors of the tax base or undertaking targeted audits arising from the above research.

The Report points to 2 revenue gap assessment projects based on income tax that have been set up to measure the level of underpayment. Both are based on extrapolation of investigation findings. In the United States, investigation targets for this purpose are selected using a statistical sampling technique. In both countries the focus is on income tax, whereas the Office is responsible for the collection of a wide range of taxes, which adds further complexity for tax gap analysis.

These approaches are worthy of further consideration. However, the fact that these results are based on a limited sample may in fact limit the ability of these approaches to provide good, robust revenue collection estimates.

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Measuring the effectiveness of the compliance enhancement strategy

4.28 Audit considers scope also exists to improve assessments of the effectiveness of the Office’s compliance enhancement strategy. Under the holistic approach to compliance adopted by the Office, outlined earlier in Chart 4A, each key component contributes to achieving the overall goal of increased levels of taxpayer compliance.

4.29 Audit recognises it is difficult to measure or quantify the direct impact that each component has on compliance levels. However, by setting specific sub-goals or desired outcomes for each key component of the strategy and then measuring the extent to which they have been achieved, the Office would be in a stronger position to assess the relative merits of each component. Such information would also assist the Office in determining resource allocations including whether individual components of the compliance strategy need to be revised or replaced.

4.30 Although enhancements to the Office’s 1998-99 performance measures will help in assessing the effectiveness of the individual components of the compliance enhancement strategy, more work needs to be undertaken to develop performance measures for the investigations function, a factor acknowledged by the Office. Consideration should also be given to supplementing performance measurement data with periodic evaluations of the effect individual components have on changing taxpayer behaviour or specific research on the causes of behavioural changes.

Q RESPONSE provided by the Commissioner, State Revenue Office

The Office disagrees with audit's comment. The discussion with audit on this matter has failed to satisfy us that setting particular goals for completing particular elements of the compliance strategy reveals anything about the effectiveness of that element in enhancing compliance. Having said that, it is still appropriate to have such goals for other management purposes.

Audit has placed considerable emphasis on the lack of performance measures to evaluate the effectiveness of each component of the holistic strategy. While the Office acknowledges more can be done in this area, the Office refers to audit's own acknowledgment of the complexity of this in many areas. The Office would also emphasise that the holistic strategy requires all elements to be resourced. Judgements are made in respect of which strategy or combination of strategies (e.g. industry-targeted seminars first followed by field investigations) to adopt according to the circumstances. Direct feedback from the taxpayers, practitioners and in particular the State Taxes Consultative Council confirms that each component is effective, necessary and appreciated. The majority of taxes are business-based and the holistic approach provides benefits to businesses and maximises compliance. By educating taxpayers through a range of strategies, it allows them to cost the correct level of tax and avoid assessments for arrears and penalties which can be detrimental to a business. By operating a substantial field investigations program targeted by a range of increasingly sophisticated methodologies taxpayers are dissuaded from risking non-compliance. By providing a better service to resolve taxpayers queries and providing systems for taxpayers to obtain information and pay the taxes more easily, it removes a range of obstacles and facilitate compliance by the taxpayer.

Identification of payroll tax compliance risks

4.31 Payroll tax, which is the Office’s largest source of revenue, is levied on employers based upon the level of payments to employees for salaries and wages, commissions, bonuses, allowances and remuneration under contracts. Employer superannuation contributions are also subject to payroll tax. Currently, the rate of tax payable by employers is set at 6.25 per cent of annual payroll payments which exceed \$515 000.

4.32 Payroll tax operates on a self-assessment basis in that the onus is on employers to firstly declare their liability for the payment of tax and then to pay the correct amount. Currently, around 17 000 employers are liable for payroll tax which, for 1997-98 amounted to \$2.4 billion.

4.33 In line with the Office’s key objectives, processes and procedures should be in place to support the regular detection of non-compliant taxpayers. Over the years, the Office has examined a number of methods of identifying taxpayers who fail to comply with their payroll tax obligations. For example, in 1994-95 the Office cross-matched its payroll tax database with the Victorian WorkCover Authority’s database of employers registered for workers’ compensation insurance. Although this particular exercise detected additional revenue of \$3.1 million over a 3 year period, the Office considered the methods of data matching it adopted were cumbersome and ad-hoc.

Compliance Information Collection and Analysis Project

4.34 In 1997, the Office commenced the development of an improved method of identifying non-compliant taxpayers. This method evolved from the *Compliance Information Collection and Analysis Project* which in broad terms is aimed at:

- developing a more sophisticated data matching process;
- defining processes that will identify non-compliant taxpayers; and
- identifying and establishing internal and external data sources relating to areas of non-compliance.

4.35 The Project evolved from 3 projects identified in the Office’s Business Renewal Study, described in Part 2 of this Report, which were subsequently merged into a single project in May 1997. As a starting point, the Office has focused on payroll tax because:

- at that time this revenue stream constituted around 44 per cent of its revenue base;
- payroll data is readily available from the Office’s database; and
- the experience gained from database matching of payroll tax records undertaken in the past could be built upon.

4.36 The payroll tax component of the Project has 2 phases. The first phase, which was completed in August 1997, analysed the payroll tax environment and produced a conceptual model of compliance risks. The second phase focuses on the 6 most significant payroll tax compliance risks to firstly develop and evaluate processes for detecting non-compliance and then, if the evaluation of the new processes proves satisfactory, proceed to implementation. At the date of the audit, the Office indicated phase 2 was expected to be completed by September 1998. If successful, the Office envisages extending the detection processes to all identified risk areas within payroll tax.



4.37 Expected development costs and benefits in the form of additional revenue raised have been identified by the Office. Over a 3 year development period to 1998-99, it is estimated costs incurred and revenue generated will total \$740 000 and \$3 million, respectively. Based upon the level of revenue detected from past payroll tax investigations and judgements of relevant staff, when the project is fully implemented, it is estimated that additional payroll tax revenue of \$11 million will be raised over a 3 year period from 1999-2000.

4.38 Moreover, if successful the payroll tax component of the Project will result in:

- enhancements to the completeness and accuracy of the payroll tax client database;
- a decrease in refunds due to incorrect registration data; and
- an increase in the amount of unpaid revenue detected by investigations due to improved targeting processes.

4.39 At the completion of this phase, the Office intends to apply this methodology to achieve similar results in all revenue categories.

4.40 Audit acknowledges that the Project is a positive initiative which clearly has the potential to contribute to enhancing the Office’s capacity to maximise the amount of taxation revenue collected for the State. Furthermore, while this Project is not focused on quantifying the tax gap, the expected additional revenue of \$3 million by 1998-99 and a further \$11 million over the following 3 year period, contributes to identifying the size of the gap as it relates to payroll tax.

q RESPONSE provided by the Commissioner, State Revenue Office

The Office asserts that allocating scarce resources to this type of project rather than tax gap measurement produces greater benefits because the process used identifies the non-compliant parties.

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Improving the land tax client base

4.41 Land tax is an annual tax based on the unimproved value of land which is determined through formal valuations undertaken by local councils. As formal valuations are not conducted each year, councils adjust land values by an annual equalisation factor determined by the Valuer-General. This factor represents the average change in land value between the last formal valuation and a date determined by the Treasurer.

4.42 The 1997 land tax assessments for the metropolitan area were largely based on land valuations adjusted by equalisation factors reflecting average land value changes to 30 June 1995.

4.43 Based upon valuation data obtained from local councils, the Office identifies those property owners liable for the payment of land tax and then issues assessment notices.

4.44 In December 1997 and May 1998, the Government altered the land tax system by, *inter alia*, reducing the liability threshold from \$200 000 to \$85 000 and exempting principal places of residence. Land tax collections amounted to \$264 million in 1997-98 which was around 13 per cent less than the budget forecast. This variation was largely due to the legislative changes which caused the later than anticipated issue of the 1998 assessments. Problems relating to the land tax database, described below, have also contributed to the Office's difficulty to maximise land tax revenue.

Deficiencies in land ownership and valuation data

4.45 As information on property ownership and land valuations is held by local councils, for the purpose of assessing land tax liabilities, it is necessary for the Office to purchase this information from councils and load it on to its database.

4.46 Over a number of years the Office has expressed concern to the Department of Treasury and Finance that these arrangements have hindered the efficient and effective collection of land tax revenue, particularly as the Office pays a fee of around \$4 million annually for the council records. As this data is held in various formats such as manual or incompatible electronic systems, a further \$1.9 million per annum is incurred by the Office to reformat the data and keep it up-to-date.

4.47 In essence, the Office considered that, not only were existing land information systems inefficient and costly to maintain, incomplete and inaccurate data inhibited the Office's capacity to reliably identify all taxpayers that were liable for land tax and provide an assurance that all such revenue due to the State was collected.

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March 1998 submission to Department of Treasury and Finance

4.48 Following deliberations with the Department on the need to improve Victoria's land information management systems and processes, in March 1998 the Office prepared a submission to the Department requesting the development of an integrated land information system.

4.49 The Office recommended that a high level interdepartmental committee be established comprising representatives from the participating agencies, namely, the Office, the Departments of Natural Resources and Environment, and Infrastructure and the Municipal Association of Victoria to represent local councils. The Office considered this committee should undertake a detailed feasibility study in order to provide the Government with recommendations on:

- a framework capable of delivering an integrated system in the short and long-term;
- the economic benefits to agencies and the State as a whole;
- legislative changes required; and
- opportunities for commercial enhancement of the system.

4.50 In June 1998, the Department advised the Office of its in-principal agreement with the recommendation to establish the committee to examine the matter in more detail.

Further submission to Department of Treasury and Finance

4.51 In June 1998, the Office made a further submission to the Department to more clearly articulate the inherent problems of the current arrangements for acquiring land and property ownership information. Key points included in the submission are outlined in the following paragraphs.

Quality of source data

4.52 Information held on the Office's land tax database is compiled from:

- Notices of Acquisition received from the Land Titles Office (to identify property owners); and
- valuation data supplied by local councils (to identify tax liability).

4.53 The quality of information on the Notices varies. They are not always complete or accurate and the Office is uncertain it receives them all.

4.54 Information from the Notice is entered onto the Office's land information system to update ownership details held on that database. Currently, around 97 per cent of these entries are rejected during the data matching process, due primarily to the poor quality of the information. The high incidence of rejections adds substantially to the overall maintenance costs of the database given that up to 17 staff are required to follow-up with local government officers, solicitors, conveyancing agents and individuals to correct errors. Audit was advised by the Office that a recent proposal by the Land Titles Office to combine its Transfer of Land form and the Notice of Acquisition will help to address these problems.



4.55 As a great number of rural municipalities provide valuation data only in hard copy form, it is necessary to undertake an intensive manual process to enter the data on the Office's database. This task has now become more critical following recent legislative changes which audit understands has increased the number of property owners liable for land tax from 78 000 to 120 000. At June 1998, the Office estimated that of the 750 000 rural land parcels recorded on its database, a total of around 225 000 parcels are now likely to be liable for land tax. To date, only approximately one-third (81 000) of these parcels had been updated in the Office's database with their current valuations. Audit was advised by the Office that in order to maximise revenue collections, strategies were developed to identify the high value parcels for updating ahead of the other parcels. All rural land valuation data will need to be entered in the database, a process the Office estimates will take 3 years to complete.

4.56 Other problems faced by the Office, which need to be addressed to facilitate workable and timely exchanges of data between agencies, include the need for:

- a standard format for recording data;
- an agreement between agencies to exchange data in the most expedient way, namely, electronically; and
- Notice forms to be sent to the Office in a timely manner as the present delays of between 3 to 6 months after land sales increases the potential for assessments to continue to be sent to previous owners.

Costs of maintaining the Office's database

4.57 The cost of maintaining the Office's database is relatively high compared with other revenue categories due, primarily, to the highly labour intensive processes.

4.58 As previously mentioned, the Office estimates that, on average, the annual costs incurred total \$5.9 million.

Effect on maximising revenue collections

4.59 At present, the Office does not hold a complete set of data on land valuations and owner details, and much of what is held is not up-to-date. In these circumstances, all revenue due to the State may not be collected because:

- land not recorded on the database cannot be assessed;
- incomplete land information may inhibit the Office from assigning a valuation; and
- incomplete land owner details may lead to incorrect assessments or even a failure to aggregate their land holdings.

4.60 The Office maintains improvements to the completeness and accuracy of its database will not be possible until it is able to continuously validate the data held by cross-matching such data with that held by other government agencies.

Action initiated to address shortcomings

4.61 Actions initiated by the Office and other government agencies that may lead to improvements to the land tax database are outlined below:

- Land Victoria, within the Department of Natural Resources and Environment, is developing a geographic information system which will provide a graphical view of property in Victoria. This system will be of considerable assistance to the Office in determining property locations and assessing the quality of data received from other sources;
- The Valuer-General is providing guidelines and other practical assistance to municipalities for effectively managing the valuation process which will enhance the quality of council valuation data; and
- The Office is undertaking a review of the methodology used to reimburse councils for the valuation data which they supply with a view to reducing these costs.

4.62 The Office has proposed that land data systems held by individual agencies be brought together under a *data warehouse concept*. This concept would provide each agency with a view of their own and other participating agencies' data while continuing to manage how their own information is created, maintained and stored. In turn, considerable efficiencies could be achieved in terms of the total costs associated with maintaining all the existing disparate systems and associated paperwork used in land information.

4.63 Audit understands that the matters raised by the Office will be considered by the interdepartmental committee established by the Department of Treasury and Finance.

4.64 Given the Office's concerns, and in particular the ongoing loss of land tax revenue occasioned by the restrictions on its capacity to ensure the completeness and accuracy of the current land tax client base, audit fully supports the Department of Treasury and Finance's endorsement of the Office's proposal to further explore the long-standing issue of the inadequacies of the State's land information management systems.

4.65 The problems with the Office's land tax database have been well documented over a long period of time. In my Report to Parliament on the Finance Statement for the year ended 30 June 1989, I commented that previous Reports to Parliament had highlighted the deficiencies with the database and that although some progress had been made in improving data accuracy, the weaknesses continued to restrict the identification of all tax due to the State. It is clear that 9 years on the problem still exists and in fact has been compounded with the decrease in the tax threshold expanding the number of taxpayers potentially liable for land tax. Audit considers that in these circumstances, effective corrective action is long overdue particularly as the State has been disadvantaged by the Office's restricted capacity to maximise taxation revenue and the costs associated with an inefficient collection system.



q RESPONSE provided by the Commissioner, State Revenue Office

There are approximately 750 000 rural land parcels contained on the Office's land and owner database. Of this number, approximately 525 000 were identified as being exempt with either the primary production land (PPL) or principal place of residence (PPR) exemption applying. The balance of 225 000 could not immediately be identified as either fitting specifically under the PPL or PPR exemptions. Since then, steps were taken to identify rural land holdings with a value greater than the threshold which identified around 90 000 properties. These properties have had valuations loaded and assessments issued for the 1998 year where applicable. These form part of \$90 million worth of assessments that were issued after 30 June 1998, and currently \$85 million has been collected from these assessments. Work is proceeding to load data for the remaining properties.

DETECTION OF NON-COMPLIANT TAXPAYERS

Role of investigations

4.66 The Investigations Branch plays a key role in ensuring that the State Revenue Office's clients comply with their taxation obligations by focusing on:

- identifying areas of non-compliance;
- identifying the reasons for non-compliance;
- developing strategies to ensure long-term voluntary compliance; and
- promoting compliance education.

4.67 While an investigative function will uncover areas of non-compliance, it may also identify instances where taxpayers have overpaid their tax obligations which may result in refunds.

4.68 Deterrence is another key aspect of an effective investigative function. The presence of investigations can enhance voluntary compliance and thereby encourage the future lodgement of correct returns. Although difficult to measure, its impact can be considerable.

4.69 Together with other functions and activities undertaken by the Office, such as client communication and customer service, investigative activity is a key component of the Office's holistic approach to compliance enhancement.

Measuring the impact of investigative activity on compliance enhancement

4.70 The Investigations Branch's business plan for the 1997-2000 period outlines the following 6 "areas of excellence", which mirror the Office's 1996-97 key objectives, and provides a basis for measuring its success:

- compliance;
- client services;
- efficiency;
- integrity;
- employment policies; and
- policy.

.....

4.71 The Branch produces an annual performance report that provides a review of its achievements against critical result areas outlined in its business plan, and details the results of investigations undertaken.

4.72 Audit examination of the Branch's 1996-97 annual performance report revealed that scope existed to improve the usefulness of some of the performance information.

4.73 The Branch's performance in relation to compliance is measured by the level of revenue detected through investigation activity, e.g. for 1996-97 the level of detected revenue totalled \$50.5 million. This approach is consistent with measures adopted by other collection agencies although audit noted that in 1988-89, the Office identified the net return from investigation activity, i.e. revenue detected less investigation costs.

4.74 For the area of client services, the Branch surveys all taxpayers who were investigated to ascertain their views on a number of aspects, including the investigator's level of professionalism, whether the investigation helped them to better understand their legislative obligations and their information needs. The survey provides a valuable source of information which can assist the Branch not only in the measurement of performance but also in identifying improvements to the investigative process, e.g. for 1996-97, 99 per cent of survey respondents were satisfied with the level and quality of service provided by investigators.

4.75 Audit considers both measurements are sound.

4.76 In relation to the other "areas of excellence", the information presented on the overall performance of the Branch was, in most instances, merely a summary of activities undertaken in respect of the particular area. For example, in relation to efficiency, information was provided on the range of activities undertaken by the Branch aimed at improving its productivity and processes. However, the extent to which productivity had been improved was not reported. In audit opinion, the information provided is of limited use in assessing performance because the link between completion of the activity and the achievement of the area of excellence is not clear.

4.77 Audit considers the Branch needs to develop its own specific objectives which provide a clearer statement of its purpose, are outcome-focused and reflect the Office's key objectives. Specific performance measures linked to Branch objectives would provide a better basis for assessing its performance. Such information would also assist the Branch to improve its evaluation of the contribution to improved levels of taxpayer compliance made by the investigative component of the compliance enhancement strategy. In particular, information on the efficiency and effectiveness of the Branch would assist in determining whether it would be more beneficial to apply additional resources to investigative activity rather than to other compliance enhancement activities.



4.78 Audit understands action is in train which will help the Investigations Branch to improve its performance measures. The Branch is participating in a benchmarking study of investigative functions with 4 other organisations with the view to improving its processes and developing improved performance measures, including those for measuring its effectiveness.

Q RESPONSE provided by the Commissioner, State Revenue Office

The Quality and Planning Unit is currently assisting the Branch to undertake a review of the adequacy and appropriateness of all performance measures.

IMPOSING PENALTIES TO DETER NON-COMPLIANCE

Introduction

4.79 Penalties imposed on non-compliant taxpayers are another component of the Office’s overall compliance strategy. Penalties by their very nature are intended to act as a deterrent to those taxpayers who otherwise may not comply with their legislative requirements.

4.80 Most taxation acts administered by the Office incorporate a principle of self-assessment. This requires taxpayers to exercise reasonable care in calculating their tax liabilities, and to pay them on time. Interest and penalties deter non-compliance by making such action costly for taxpayers and promote equity among taxpayers by ensuring that those who meet their tax obligations are not disadvantaged. They also compensate the Government for delays in the use of funds to which it is entitled.

4.81 In order to facilitate a consistent approach towards the imposition of penalties, the Office has implemented a *Compliance Penalty Policy (September 1995)* and the related *Interest and Penalties Revenue Ruling* pursuant to the *Taxation Administration Act 1997*. The *Ruling* outlines the manner in which interest and penalties will be applied in accordance with the *Taxation Administration Act*. The *Policy* and *Ruling* documentation essentially forms the basis by which penalties are issued and importantly, is aimed at ensuring that an equitable and ethical approach is applied in all cases.

4.82 Taxpayers have the opportunity to object to penalties or interest imposed, provided the objection meets criteria set out in the penalties policy, which include that the offence was beyond the taxpayer’s control and that reasonable care was taken in assessing the taxation payable.

4.83 For 1997-98, penalties collected by the Office totalled \$2.4 million.

Initiatives aimed at enhancing compliance

4.84 The Office has recently introduced a number of initiatives aimed at improving both its administration of revenue collection and reducing taxpayer compliance burdens, including the incidence of penalty impositions. These initiatives included:

- the Payroll Tax Annual Adjustment Disk designed to simplify the preparation and lodgement of payroll tax annual adjustment reconciliations;
- reduction in the frequency with which taxpayers are required to lodge returns for certain revenue lines; and
- the introduction of direct banking facilities for taxation payments.

4.85 Consistent with its customer service focus, audit found that wherever possible, the Office has attempted to adopt a personal approach towards achieving taxpayer compliance. For example, under the Taxpayers’ Charter, the Office presumes that taxpayers have dealt with their tax affairs openly and honestly, and that consequently, any error has arisen from ignorance or mistake rather than deliberate intent.

4.86 As indicated earlier, the Office considers educating its customers helps to ensure taxpayers are fully aware of their legislative responsibilities and this in turn improves compliance in the future. Furthermore, the Office believes taxpayers are educated each time they are penalised as it makes them aware of the specific area of non-compliance. Examples of some approaches adopted by the Office in this regard are presented below:

- Where taxpayers have failed to comply with their legislative requirements, default assessments and penalty notices are issued together with explanations of why penalties have been imposed;
- Investigating officers who detect instances of non-compliance are required to explain to these taxpayers why they are non-compliant and how to avoid repeating the indiscretion in future; and
- In certain cases where taxes and penalties were not paid by the due date, particularly with respect to taxpayers who are liable for a significant amount of tax, personal contact via a telephone call is made with the taxpayer to ascertain why the amounts owed had not been paid and to encourage payment. If this approach is not successful, a more formal approach is adopted.

4.87 Audit considers the Office has put in place sound processes to facilitate a consistent and equitable approach towards the imposition of penalties, which is intended to contribute to improved taxpayer compliance.

Effectiveness of penalties

4.88 Notwithstanding that the imposition of penalties is a tool available to the Office to increase compliance by individuals with relevant legislation or regulations, audit found that the Office did not, on a year-to-year basis, assess the impact that penalties imposed on particular taxpayers in one year had on their compliance in subsequent years.

4.89 This form of trend analysis would provide the Office with a useful indicator of the effectiveness of both the level of the penalty and impact the penalty had on future compliance.

4.90 Audit considers the absence of such information inhibits the Office in assessing, for example, whether the value of penalties or the circumstances in which they are imposed provides an effective deterrent to non-compliance.

4.91 While imposing penalties is only one means of enhancing taxpayer compliance, audit considers it would be beneficial to measure the effect that the imposition of penalties has on encouraging future compliance, through the introduction of a suitable indicator such as the incidence of repeat offenders.

q RESPONSE provided by the Commissioner, State Revenue Office

The current Penalty and Interest Policy imposes a higher level penalty for repeat offenders. Analysis of the behaviour of particular taxpayers will not usefully contribute to the penalty policy or be indicative of taxpayers generally. Furthermore, there is an unproven underlying assumption that compliant behaviour is attributable to the penalty. The Office is not resourced to undertake this type of behavioural research, which is complex and costly.

While there is a linkage between the level of penalties and the corresponding level of compliance, this does not necessarily imply that raising penalties translates directly into a quantifiable improvement in compliance. The Office has developed a detailed penalty policy which has been specifically designed to set appropriate levels of penalty based on the taxpayer's actions. This policy has been very effective in encouraging compliance, however, the Victorian Civil and Administrative Tribunal has the power to reduce a penalty on appeal. To undertake further work in this area would involve additional costs for both the Office and taxpayers in gathering data without any immediate or apparent benefit.

DELIVERING QUALITY CUSTOMER SERVICE

Introduction

4.92 The development of quality customer service delivery has been a goal of the State Revenue Office since its establishment in 1992.

4.93 The release of the *Customer Service Commitment* document under the Government's 1994 *Management Improvement Initiative* reinforced the importance of quality customer service. The Office's commitment to the initiative was spelt out in the 1995 Framework Agreement between the Department of Treasury and Finance and the Office and reiterated in the current agreement which states "*quality leadership that is customer focused*" and "*a commitment to quality customer service delivery*" are management principles under which the Office is to operate.

4.94 From 1992 onwards, the Office has progressively introduced projects and activities designed to enhance customer service. A project known as the Client Services Management Project was commenced during 1997-98 to co-ordinate client service strategies implemented throughout the Office.

4.95 In July 1998, the Office moved to implementing the Australian Quality Council's *Australian Business Excellence Framework*. In relation to customer service, the *Framework* advocates focusing on customers and emphasises the importance to organisations of managing relationships with customers. It is envisaged that use of the *Framework* will assist the Office to better understand and integrate customer needs with service delivery.

4.96 Consistent with approaches adopted by other taxation collection agencies, the Office believes that by making it easier for all taxpayers to conduct business with the Office, the outcome will be improved taxpayer compliance.

Enhancing customer service

4.97 In addressing the need to develop a customer focus, the Office has made significant advances in customer service. Initiatives introduced include:

- a Taxpayers' Charter which commits the Office to providing certain levels of service and outlines taxpayers' rights and obligations;
- a customer complaints policy and complaint handling mechanism;
- training in customer service for staff;
- a One Stop Shop for the assessment and payment of stamp duties, combining 2 systems which were previously separately located;
- client education seminars on different aspects of taxation;
- programs designed to educate taxpayers in areas of non-compliance;
- customer surveys to assess satisfaction with service delivery, e.g. client education programs and investigations;
- the establishment of a Land Tax Call Centre in April 1998 to deal with the high volume of inquiries expected after changes to the land tax legislation;



- incorporation of customer service skills within the key selection criteria of the Office’s generic job descriptions; and
- numerous technological and other improvements to processes and procedures such as:
 - the development of the Payroll Tax Annual Adjustment Disk;
 - the introduction of the Document Return System that allows tax agents and other authorised persons to stamp documents without having to present them to the Office;
 - outsourcing the collection of revenue to 2 major banks; and
 - providing for the payment of land tax by instalments.

4.98 In audit opinion, these initiatives have resulted in improved responsiveness to customer needs and greater flexibility for taxpayers. They have also received external recognition, with one member of the State Taxes Consultative Council, an entity established to facilitate consultation with the Office’s major client groups, describing the Office’s customer service as “*close to as good as you can get for a revenue office*”. Customer surveys have identified satisfaction with the Office’s customer service delivery, with the client education role in particular being regarded as highly effective.

Implementing a customer service strategy

4.99 A key feature of customer focused organisations is a customer service strategy that has been articulated by senior management and is shared by all staff. Customer service strategies identify the organisation’s customers and the type and levels of service they desire. Service delivery is then designed to meet desired service levels. A continuous improvement framework which is aligned to ongoing customer research is an essential element of customer service. This often involves the use of improvement teams consisting of operational staff who are encouraged to identify potential enhancements to systems and processes and are empowered to implement changes that benefit the organisation’s relationships with its customers.

4.100 Audit found many of the customer service initiatives introduced by the Office, such as the Taxpayers’ Charter released in December 1994, were based on the Office’s perceptions of customer needs and developed in the absence of an organisation-wide customer service strategy. Significantly, there had been no direct consultation with customers on desired levels of service in relation to their obligations as taxpayers and the Office’s standards of service delivery at the time the Charter was developed.

4.101 Although a customer service strategy had been actively advocated within the Office since 1995, it was not approved until March 1997, some 12 months after endorsement was initially sought.

4.102 The Customer Service Strategy adopted by the Office has the following 4 goals:

- “*to respond to client expectations;*
- *to develop a better tax regime;*
- *to provide employment policies to support client service goals; and*
- *to design and promote a better client service culture”.*



4.103 Audit found that achievements against the strategic goals had not been assessed or reported. In fact, the Strategy did not specify evaluation and reporting requirements.

4.104 Despite the objective in the Strategy to respond to client expectations set by the Office and the importance placed on consulting with customers on their service needs, it was not until July 1998 that the Office entered into a consultancy to research customers needs. The Office advised audit that the determination of customer needs was based on staff experience in interacting with customers.

4.105 Audit concluded that the Office had not fully implemented a customer service strategy that:

- determined customers’ desired levels of service;
- aligned service delivery to meet those desires; and
- evaluated performance and identified and implemented continuous improvement strategies.

4.106 The above deficiency has not been a major impediment to the provision of good customer service by the Office although arguably such service could be improved if the customer’s point of view was known. With the benefit of the results of customer research commenced in July, the Office will be in a stronger position to fully meet the Government’s objective of responding to client expectations. The use of process improvement teams would also enhance client service.

Service standards and the Taxpayers’ Charter

4.107 The Taxpayers’ Charter was issued by the Office in December 1994 and subsequently reviewed in 1997. Following this review, a staff guide detailing the performance standards of the Charter and the role of staff in meeting the standards was released.

4.108 Audit found that the standards were based on existing practices and legislative requirements, without customer research into their perceptions of the appropriateness and desirability of the standards. In relation to the Charter, audit also found that key areas of customer service, such as issuing assessments, processing returns, and over-the-counter service were not addressed.

TAXPAYERS' CHARTER



Taxpayers' Charter

This Charter summarises your rights and obligations as a taxpayer and a customer of the State Revenue Office of Victoria, and the standard of service you can expect from us.

Courtesy and Consideration

- We treat you with courtesy and consideration at all times.

Help and Information

- We help you to understand and meet your Victorian tax obligations.
- We explain to you the reasons for decisions made by us concerning your affairs.
- We expect you to give us the information needed to determine the amount of tax to be paid.

Fairness and Equity

- We treat all taxpayers and customers equally.
- We act with integrity and impartiality in all our dealings with you, so that you pay only the amount of tax legally due.
- We strive to finalise refund requests within 60 days and, where the law allows, pay you interest on the amount.
- We presume that you deal with your tax affairs openly and honestly.

Privacy and Confidentiality

- We treat any information obtained, received or held by us as private and confidential.
- We will not use or divulge any information, except as permitted by law.

Customer Service

- We aim to provide a high level of customer service and strive to:
 - resolve matters promptly;
 - answer all written enquiries within 21 days;
 - deal with urgent requests as quickly as possible;
 - answer your telephone call promptly;
 - deal with your telephone call without unnecessary transfer; and
 - return your telephone call as quickly as possible.

Investigations

- Under normal circumstances, we will give you at least seven days' notice before the conduct of an investigation. The start of an investigation can usually be negotiated between you and the investigator.
- We will advise you of the scope of the investigation and our requirements.
- You will be given the opportunity to have your legal or taxation adviser present during an investigation. If your adviser is not present, you will be given the opportunity to seek advice.
- You will normally receive, within 21 days of the completion of the investigation, written advice of the result of that investigation including the reasons for any decision and, where an assessment has been issued, details of how the assessment was calculated.

Compliance Costs

- We strive to keep your costs in complying with the law to a minimum, subject to our duty to collect the revenue that is due to the people of Victoria.

Review, Objection and Appeal

- We will fully explain your rights of review, objection and appeal if you are unsure of them or need clarification.
- We will ensure objections are conducted by a person independent of the original decision maker.
- We will determine your objection within 60 days unless we require more information to do so, or the issues are complex.
- We will give you reasons if your objection has been completely or partially disallowed.
- If you object or appeal against a decision we will request further information from you only where it is necessary to resolve the issues in dispute.
- You can ask us to review your case if you consider we have not handled your affairs properly.

Comments from You

We continually strive to improve the level of service and quality of information and advice that we provide. As a result of your comments we review this Charter periodically.

We welcome your suggestions on improvements and seek your co-operation in meeting our obligations and enhancing our services.

If you believe that either your entitlements or rights have been infringed by us, or that your expectations have not been met in your dealings with us, please write to me or discuss your concerns with my staff.

If you require information about your statutory obligations or if you want general information about the State Revenue Office, contact our Communications Branch on telephone 03 9628 0000 or facsimile 03 9628 6222.

David Pollard
Commissioner of State Revenue
April 1998



4.109 The Office's performance in relation to the Charter has been reported in its 1995 and 1996 *Annual Reports*. The reported performance was based on the Office's own assessment drawn from various information sources available at the time. While these included some customer survey information, it only partially addressed the commitments given in the Charter. For example, commitments relating to taxpayer satisfaction with review, objection and appeal processes and help and information were not addressed. Furthermore, a coherent reporting methodology had not been established. At the date of the audit, further reporting was proposed for the 1998 *Annual Report* although a reporting methodology had still not been determined.

4.110 As the Taxpayers' Charter should form the centrepiece of the Office's approach to customer service, the following audit suggestions are made to increase the Charter's profile both within and outside the Office:

- As the Office's review, objection and appeal functions and investigative role form a substantial part of the Charter, these client commitments, their standards and how performance is to be measured should be revised by staff carrying out these roles. This revision should incorporate consultation with customers to determine their desired levels of service;
- Consideration should be given to providing some service guarantees within the Charter. For example, the Office could undertake to protect taxpayers in cases where decisions made by the Office lead to erroneous assessments; and
- The Office should consult further with the State Taxes Consultative Council on issues of service standards and guarantees, accountability for the Charter and public reporting of performance to obtain a client view of these issues.

Customer service performance measures

4.111 Key performance indicators and targets relating to customer service were included in branch business plans and reflected the standards underpinning the Taxpayers' Charter. Branches compiled reports on their performance against most of the key performance targets which were regularly presented to senior managers.

4.112 While comprehensive reporting occurred on a monthly basis, annual reports on key performance measures were not as comprehensive in that there was no overall annual assessment of the Office's client service delivery against an established target or baseline data, and no trend analysis of year-to-year performance.

4.113 Audit recommendations to the Office for improving the quality and usefulness of performance measures for client service delivery have been acted upon, and this is discussed in Part 5 of this Report.

Identifying customer satisfaction with service delivery

4.114 The Office conducts a significant number of surveys to determine customer satisfaction with services provided. Almost all branches within the Office had some form of ongoing or semi-regular process of surveying customers within their particular function or revenue category.



4.115 Audit found that:

- a profile of the customer population and the extent to which all customers were represented in surveys undertaken had not been established;
- there was no information as to the extent to which all types of customers were surveyed, the proportions of each customer type represented in the surveys and whether the timing and frequency of surveys conducted at branch level were appropriate;
- an Office policy or strategy governing the use of customer surveys was not in place; and
- an analysis of survey results was not undertaken to enable the Office to identify the extent to which its customers were satisfied with services provided across the range of taxation revenue lines.

4.116 At the date of audit, the Office was letting a consultancy brief to assist branches with the design and development of customer surveys. Audit suggested that:

- the consultancy also be used to address the need to develop a central overview of customer surveys and their results in terms of establishing adequate proportional coverage of the customer base and developing a picture of overall satisfaction; and
- surveys address the customer service commitments given in the Taxpayers' Charter, and be conducted on the basis of stratified statistical sampling to ensure adequate representation and extrapolation of results.

4.117 In relation to service improvements, the Office should conduct internal benchmarking exercises among branches measuring functions common to all, such as those specified in the Taxpayers' Charter. Process improvement teams could then be used to identify methods for improving service.

Staff training in customer service

4.118 Training in customer service has been provided to 25 per cent of staff since June 1997, with the intention of having all staff participate in the long-term. The training course focused on key customer service principles of *self-esteem*, *empathy* and *involvement*.

4.119 Audit analysis of customer survey data and information held in the Office's Compliments and Complaints Register indicated that the issues addressed in the customer service training are in fact well-handled by staff. The Office receives many more compliments than complaints and, in comments to the Office, customers have acknowledged the professionalism and courtesy of staff. Information from the client survey conducted as part of the 1996 *Business Renewal Study* suggested that the technical knowledge levels of operational staff were of greater concern to customers than customer service principles. For example, comments typical of the responses made were that "*the attitude of staff is helpful, and the face-to-face contact is good*" and "*the technical skills of front line staff are not good, with their accuracy and confidence in the information being low*".

4.120 In March 1998, in response to the need to develop technical knowledge among operational staff within the Office, self-paced technical skills learning modules were introduced. These modules were designed to impart a basic level of technical knowledge. Audit found that the development and introduction of these modules has been slow and unco-ordinated in that a module has not been developed for each revenue category and there is no method for assessing the technical skill levels of staff and their training needs. Furthermore, the modules have not been evaluated in terms of their impact on improving the technical knowledge of staff.

4.121 Audit was advised that action has been initiated to develop strategies to address these issues and that development of higher level technical training in the form of mentoring and case study based research is also underway.

4.122 Although skills in customer service are an important attribute, audit considers that staff training leading to improved technical knowledge is a greater priority for the Office and should be afforded a structured process similar to that of the customer service training course. Incorporating a requirement within performance plans for staff to develop their technical knowledge would also help in this regard.

Q RESPONSE provided by the Commissioner, State Revenue Office

The Office has responded to the findings of the Business Renewal Study customer survey by increasing its commitment to technical training and developing an effective technical training program for all tax lines.

A variety of technical training programs have been in place since 1994. These were specifically targeted at raising the general level of technical knowledge across the Office. Front line staff are supported by specialist technical advising staff, who have high levels of technical expertise.

There exists a comprehensive technical training structure encompassing self-paced learning modules, formal lectures and workshops, and complimented by on-the-job training. Specialist courses have also been developed with Monash University, whereby participants sit for examination and receive formal accreditation

Measuring the impact of customer service on improving taxpayer compliance

4.123 The Office is commended for the wide range of initiatives it has introduced to improve customer service. In terms of measuring the extent to which customer service initiatives improve taxpayer compliance, audit would have expected the Office to have assessed the cost-effectiveness of these initiatives relative to other strategies such as investigations and penalties.

4.124 While the Office identifies the costs of individual customer service projects, determining cost-effectiveness by way of a cost-benefit analysis would require these costs to be aggregated. In considering this issue in terms of benefits, it is recognised that there are inherent limitations to separating and quantifying the effects of different strategies on improving compliance.



4.125 In addition, changed assessment and payment arrangements arising from customer service initiatives would also have to be assessed. For example, the effect of collecting revenue at banks in reducing the Office’s collection costs and of the Annual Adjustment Disk on improving the quality and timeliness of payroll tax returns would have to be determined.

4.126 Without detracting from the importance of providing services that meet the needs of customers, the complexity of applying a cost-benefit analysis is such that the effect of customer service initiatives on improving taxpayer compliance could not be determined.

4.127 In order to obtain some comfort that the introduction of a customer service focus is a bona fide approach to improving compliance, the Office should:

- establish sub-objectives for customer service initiatives that are designed to demonstrate a contribution to improved compliance; and
- consider the application of methodologies used by other tax collection agencies to measure the impact of particular strategies on compliance.

q *RESPONSE* provided by the Commissioner, State Revenue Office

Considerable time and effort would be required to isolate and analyse the specific impact of the customer service component of an integrated compliance strategy. The Office would question whether having this specific information would have a significant impact on the overall compliance strategy.

Part 5

Measuring timeliness and cost-effectiveness

OVERVIEW

5.1 The performance information reported by the State Revenue Office on delivering specified outputs to the Government for 1996-97 and 1997-98 indicated that, except for some minor departures, all service delivery targets were satisfactorily met.

5.2 In terms of assessing the Office's achievements against its corporate objectives for 1997-98, audit formed the view that the performance measures covering service delivery did not fully address all key objectives and some were not reported on at all. However, the Office's revised suite of performance measures for 1998-99 constitute a significant improvement on those utilised in the past in that they are more comprehensive, relevant and focused.

5.3 In relation to performance measurement generally, audit found that:

- There are limitations in relying upon performance measures exclusively as an effective evaluation tool. Such measures should be supplemented with other information drawn from program evaluations and stakeholder feedback to provide a richer information base but the costs associated with compiling the performance data should not outweigh the potential benefit. Where cost-effective, appropriate information technology systems should be used to minimise the time consuming and costly nature of such reporting;
- Given the use made of performance information, including public reporting, greater assurance needs to be obtained on the completeness and accuracy of the source data. It would also be appropriate for the performance measures compiled by the Office for annual reporting purposes to be subject to audit on an ongoing basis; and
- Training in all key aspects of performance measurement needs to be provided for Office staff involved in such activities.

5.4 Since 1993, the Office has participated in a benchmarking study covering revenue collection agencies Australia-wide. The study reports the performance of each agency across a range of functions undertaken in the course of collecting their revenue. Based on the 1995-96 and 1996-97 benchmarking results, the Office should investigate areas of potential improvement such as revenue collected per dollar spent. In other areas, the Office was in a position of comparative strength.

5.5 Although the Office has introduced initiatives aimed at reducing taxpayer compliance costs, to date it has not undertaken assessments to determine the extent of any cost reductions achieved.

q RESPONSE provided by the Commissioner, State Revenue Office

The benchmark figure collected per dollar spent has not been adjusted for major interjurisdictional differences such as the cost of maintaining a separate land data base (not undertaken by the other revenue offices) commented on by audit in this Report. These differences also include the ready access to the Victorian Civil and Administrative Tribunal to appeal against assessments, which is not a feature of other States' administration, and other service commitments by the Office to provide full reasons for decisions, particularly for decisions on objections.

PERFORMANCE DATA REQUIRED BY GOVERNMENT
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5.6 From 1997-98, the Government reformed financial management with the formal introduction of output-based budgeting. Under this reform, departments and agencies are required to deliver key outputs in the form of specified products or services which are linked to the achievement of the Government's policy objectives and outcomes. The accountability arrangements associated with this reform include a requirement for each department to present a statement outlining its key outputs and a range of performance measures and targets against which the performance of the department or agency in delivering those outputs is to be assessed.

5.7 In line with the Government's reform, the State Revenue Office is required to provide the Department of Treasury and Finance with details of its achievements against 2 key outputs, namely "*Taxpayer/Customer Advice and Support Services*" and "*Taxation Management Services to Government*". The 1997-98 Budget Paper No. 3 stated that these outputs form the *Taxation Management Services Output Group* described as:

- *"Ensuring the efficient collection of revenue to fund government services;*
- *Maximising compliance with taxation laws at minimum cost to clients and the State Revenue Office;*
- *The provision of advice on establishing a competitive taxation regime and administrative support framework; and*
- *The provision of the highest standard of client service to taxpayers".*

5.8 For output-based budgeting purposes the Office, in conjunction with the Department, has expanded the range of performance measures included in the Framework Agreement for reporting on the results of delivering its specified outputs. Chart 5A details the agreed performance measures for 1997-98.

CHART 5A
SERVICE DELIVERY PERFORMANCE MEASURES, 1997-98

<p>TAXPAYER/CUSTOMER ADVICE AND SUPPORT SERVICES</p> <ul style="list-style-type: none"> • Customer satisfaction with education and compliance programs • Customer satisfaction with public rulings and publications • Land tax assessments amendment rate • Timely issue of Section 97 certificates (a) • Timely refunds • Timely handling of objections 	
<p>TAXATION MANAGEMENT SERVICES TO GOVERNMENT</p> <ul style="list-style-type: none"> • Accuracy of cashflow projection • Revenue banked on day of receipt • Revenue collected within agreed budget • Ratio of outstanding debt to total revenue • Revenue received within 2 days of due date • Meet Cabinet and Parliament timeframes in legislation 	

(a) These certificates detail the value of any outstanding land tax on a particular land parcel.

5.9 Also, in conjunction with the Department, performance targets are set for each measure, based on historical trend data and on judgements regarding the impact the economic environment and legislative changes may have on estimating the level of taxation revenue due to the State. The targets are required to be reviewed each year as part of the Government's budget cycle.

Service achievements for 1996-97 and 1997-98

5.10 Table 5B details the achievements of the Office compared with its targets in relation to key service delivery outputs for 1996-97 and 1997-98.

TABLE 5B
KEY SERVICE DELIVERY RESULTS OF THE STATE REVENUE OFFICE,
1996-97 AND 1997-98

Key outputs / Performance measures	1996-97		1997-98	
	Target	Actual	Target	Actual
<i>Taxpayer/Customer Advice and Support Services</i>				
Customer satisfaction with education and compliance programs needed	(a)	(a)	95%	98%
Customer satisfaction with public rulings and publications	(a)	(a)	95%	98%
Land tax assessments amendment rate	< 3.0%	2.8%	< 3.0%	14.8 % (b)
Timely issue of Section 97 certificates	(a)	(a)	99% < 5 days	91.6% < 5 days (c)
Timely refunds	100% < 60 days	95.6% < 60 days	100% < 60 days	93.5% < 60 days (d)
Timely handling of objections	100% < 60 days	100% < 60 days	100% < 60 days	97.6% < 60 days (e)
<i>Taxation Management Services to Government</i>				
Accuracy of cashflow projection	+/- 5%	4.9%	+/- 5%	+ 4.6%
Revenue banked on day of receipt	≥ 99%	99%	99%	99%
Revenue collected within agreed budget	+/- 5% of target	+ 3%	+/-5% of target	+ 2.3%
Ratio of outstanding debt to total revenue	< 2%	0.6%	< 2%	1.14%
Revenue received within 2 days of due date	≥ 90%	92%	90%	97%
Meet Cabinet and Parliament timeframes in legislation	100%	93% (f)	100%	100%

(a) These measures were introduced in 1997-98.

(b) The target was set before changes to the land tax legislation were announced.

(c) An increased number of applications for Section 97 certificates and the manual, rather than automated, issue of certificates caused delays in 1997-98.

(d) The complexity of some claims and the failure of taxpayers to submit information as required caused delays in refunding overpayments in both years.

(e) Complex legal issues associated with some objections caused handling delays during 1997-98.

(f) Negotiations between the collection agencies of each State and Territory on proposed legislative changes affecting inter-jurisdictional revenue caused delays in meeting the parliamentary timeframes in 1996-97.

Source: State Revenue Office.

5.11 The information presented by the Office indicates that except for some minor departures, all service delivery targets for 1996-97 and 1997-98 were satisfactorily met.

5.12 However, there is a lack of precision in some of the targets used as part of the Government's output-based budgeting initiative. For example revenue is to be collected within a broad margin of +/- 5 per cent, which in dollar terms for 1997-98 equated to +/- \$261 million. This measure could be seen as a disincentive to pursuing strategies to maximise revenue collections through the identification of non-complying taxpayers. A smaller margin would encourage meaningful reporting of variations such as the collection of additional tax previously unidentified and contribute to ensuring the tax burden is fairly shared.

q RESPONSE provided by the Commissioner, State Revenue Office

Revenue targets are a key business driver at all levels and considerable effort is spent gathering information to explain the variances from budget. Budget revenue targets are developed in co-operation with the Department of Treasury and Finance and based on expected future activity within the State. The tolerance margin that has been set is considered reasonable, based on expected activity levels which are outside the Office's direct control.

Limitations of the performance reporting framework

5.13 To complement the output-based performance measures agreed with the Government, the Office identifies key objectives in its annual business plan. Audit found that, in terms of assessing the Office's performance against its key objectives for 1997-98, the service delivery performance measures reported to the Government did not fully address all key objectives and some were not reported on at all.

5.14 Comments on the limitations within the existing performance reporting framework are detailed in the following paragraphs.

Maximising revenue collection

5.15 A key objective relating to compliance which states "*Ensuring that everyone understands and meets all their obligations under tax legislation ...*" was not measured. In essence, this objective commits the Office to collecting all revenue due to the State by ensuring all taxpayers comply with their legislative obligations. Although the Office reports the amount of revenue collected compared with the target agreed with the Department, no information is given on the extent to which the target represents the total amount of revenue due to the State. As outlined in Part 4 of this Report, determining the total amount of revenue payable by taxpayers is a very complex task. To date, the Office has not been able to estimate this amount.

Reducing taxpayer compliance costs

5.16 Another key objective not measured relates to "*reducing clients' compliance costs*". As described later in this Part of the Report, the Office has implemented a range of initiatives aimed at reducing taxpayer compliance costs, albeit without fully measuring their impact.

Authoritative policy advice

5.17 The objective relating to the provision of policy advice stated, “*Developing a better Victorian tax regime by providing authoritative policy advice to the Government, by consulting with other jurisdictions to improve consistency and by administering tax legislation professionally and sensibly*”. Although the timeliness of the provision of policy advice was measured, the Government’s satisfaction with that advice in terms of its quality was not sought.

Operating efficiency

5.18 Another objective relating to the Office’s operating efficiency stated “*Increasing our productivity and efficiency by improving our procedures, by developing the competencies of our people, by adopting modern technologies and by using service providers for appropriate functions*”. While some measures of efficiency in terms of the timely processing of certain documents and the banking of revenue are reported, a measure reflecting the Office’s overall operating efficiency was not reported.

Other objectives

5.19 Other objectives of the Office relating to applying the highest ethical standards in all its activities and respecting and valuing staff were also not measured.

q RESPONSE *provided by the Commissioner, State Revenue Office*

The Office is fully satisfied that it has continually satisfied this objective through our holistic compliance approach, and this is supported by the outcomes of investigations to date. The key issue underlying this comment is the lack of measures of the total revenue base for each tax line. The Office is keen to take on any initiatives that further improve revenue management, at this point the Office has not been able to identify a reliable and robust measurement model, from domestic or overseas research.

Compliance costs generally have been reduced for both taxpayers and the Government. The AA disk for Payroll Tax, the One Stop Shop and the payment options project are good examples of the considerable work that has been done to help reduce taxpayer administration costs. Additional steps will be taken to gather specific information on compliance costs from a representative cross section of taxpayers.

The customer research being undertaken in November 1998 will include specific questions about customer perceptions on compliance costs. The Office is also reviewing studies undertaken to date into taxpayer compliance costs to determine if a cost-effective methodology to determine a range of benchmark taxpayer compliance costs for the range of tax lines administered can be developed.

Enhancements to the Office’s performance measures

5.20 The Office has recently taken action to improve its performance measurement and reporting with a view to providing the Government and other interested parties with enhanced performance information especially on the extent to which the Office’s objectives, including service delivery obligations, are met.



5.21 In October 1997, the Office undertook a significant reassessment of its strategic planning and quality assurance processes with the aim of ensuring the activities of individual branches were linked to its key objectives. This process also included revising and expanding the suite of organisational and branch performance measures which, from 1998-99, are to be used for annual external reporting and more frequent internal reporting purposes.

5.22 In the course of revising the performance measures, the Office requested audit to provide input into the process. This input included comment on the need for the Office to develop a measure of its overall efficiency in terms of the cost of revenue collection and its effectiveness in terms of maximising taxpayer compliance.

5.23 In June 1998, the Office's revised suite of performance measures, which numbered 53 and covered the 5 key organisational objectives, were incorporated in its 1998-99 Business Plan. Audit considers that these measures constitute a significant improvement on those utilised in the past in that they are more comprehensive, relevant and focused.

5.24 Audit also found that, although certain important measures relating to the Office's performance in reducing taxpayer compliance costs and maximising the level of taxpayer compliance had not been included, the Business Plan incorporated a commitment to undertake research to address these exclusions.

5.25 Audit recognises that the development of performance measures is a difficult and complex task which improves over time commensurate with an organisation's experience in this area. In order for the Office to build on its achievements to date, it needs to:

- Monitor the continued relevance and appropriateness of the current measures given the relatively high number in place;
- Give consideration to confining the number of measures to be reported in the annual report to a smaller number. A total of around 10 key performance measures representing an assessment of efficiency and effectiveness for each of the 5 organisational objectives described in the Business Plan may suffice;
- Include certain additional measures relating to the Office's effectiveness and efficiency in the suite of measures required to be reported to the Department; and
- Provide evaluative comments for each measure included in the annual report which explain the Office's views on the reported results. For example, it would be desirable to explain the reasons for departures from expected performance.

5.26 Further audit comment on matters relating to performance measures is detailed in the following paragraphs.

Limitations on the use of performance measures

5.27 Audit considers the Office needs to be mindful that there are limitations to the exclusive use of performance measures as an effective evaluation tool. For example, measures can:

- highlight changes in performance but not identify the cause of the change;
- cause goal displacement by focusing people's attention only on those things that are measured to the exclusion of other equally important activities that are harder to measure; and
- be manipulated to present a distorted view of achievements.

5.28 Performance measures should be supplemented with other information drawn from program evaluations and stakeholder feedback to provide a richer information base. In addition, the costs associated with compiling the performance data need to be identified and monitored to ensure that they do not outweigh the potential benefits.

Information systems used in compiling performance data.

5.29 Performance data is partly compiled by the Office using computerised systems, and as these systems are not available across all branches, manual systems are also used. In view of the ongoing requirement to report on performance, it is important that, where cost-effective, appropriate information technology systems are used to minimise the time consuming and costly nature of such reporting. Audit understands the Office is reviewing its information technology requirements for reporting purposes.

5.30 In relation to controls over the completeness and accuracy of performance data, audit found the extent of such checks undertaken throughout the Office was very limited and in some cases non-existent. Furthermore, in compiling performance reports for presentation to the Department, complete reliance is placed on the originator for the completeness and accuracy of the source data. Given the importance of performance information and that some of it is to be included in annual reports for presentation to the Parliament, greater assurance needs to be obtained on the completeness and accuracy of the source data.

5.31 Audit understands that appropriate action has been initiated by the Office in this regard such as requiring branches to check the completeness and accuracy of source data. Consistent with the legislative requirement for local councils, it would also be appropriate for the performance measures compiled by the Office for annual reporting purposes to be subject to audit on an ongoing basis.

Staff training in performance measurement

5.32 Although it was commendable that the responsibility for developing performance measures at the branch level involved a range of staff, audit found that staff training in performance measurement did not occur. Appropriate training would include the development of performance measures, data collection and analysis, reporting and utilising results as part of a continuous improvement process. Failure to provide staff with appropriate training in performance measurement may have contributed to the shortcomings of the Office's measures previously commented upon. Training can also contribute to strengthening staff ownership and commitment to the effective operation of a performance measurement framework.

5.33 Audit considers training in all aspects of performance measurement should be provided for Office staff involved in such activities.

COMPARING THE OFFICE'S PERFORMANCE WITH OTHER JURISDICTIONS

5.34 Since 1993, the State Revenue Office has participated in an ongoing inter-jurisdictional benchmarking study with the equivalent revenue collection agencies from the other Australian States and Territories. Each year, a benchmarking report is prepared which sets out the performance of each agency across a range of functions undertaken in the course of collecting revenue.

5.35 Audit understands that differing operating arrangements and legislation can effect the results of the benchmarking exercise within each State and Territory. For example, Victoria is the only State with a decentralised land valuation system which adds substantially to the costs of administering land tax. Nevertheless, the Office indicated it is intended that participating agencies use the annual benchmarking results to target aspects of their operations that could be improved, rather than as a definitive assessment of performance. For the Office to achieve value from the resources it has utilised to participate in the inter-jurisdictional benchmarking exercise, it is important that it actively identifies areas for improvement from the reported results, notwithstanding the differences across agencies.

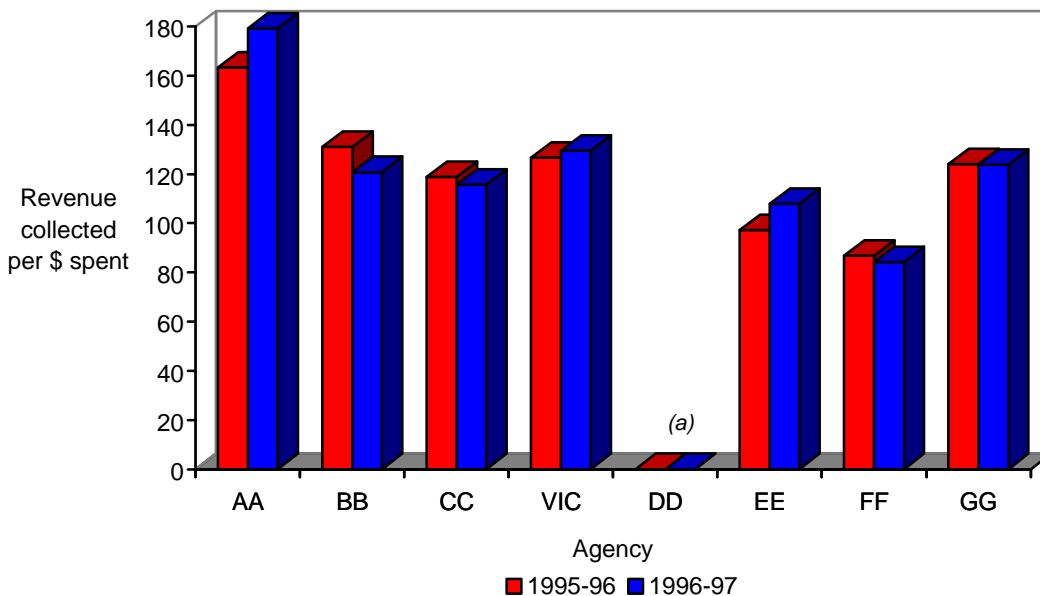
5.36 The indicative information included in the 1995-96 and 1996-97 benchmarking reports has been used by audit to identify some areas of potential improvement that should be investigated by the Office, and areas of comparative strength. Information for 1997-98 was not available at the date of audit for comparative purposes. Charts 5C to 5H show Victoria's results while respecting the confidentiality and comments of the other participating agencies.

Efficiency of revenue collections

5.37 An important performance indicator for revenue collection agencies is the efficiency with which they collect revenue, by maximising the amount of revenue collected at least cost to the agency.

5.38 A broad measure of efficiency developed by audit is the amount of revenue collected for each dollar spent. Using the information in the benchmarking reports, Chart 5C shows a comparison between revenue collection agencies of revenue collected per dollar spent for 1995-96 and 1996-97.

**CHART 5C
REVENUE COLLECTED PER DOLLAR SPENT,
1995-96 AND 1996-97
(\$)**



(a) Information withheld by request.

Source: Chart developed by audit from data obtained from State Revenue Office.

5.39 As indicated in Chart 5C, the Office’s efficiency level in 1996-97 was \$130 compared with \$179 in the best performed agency.

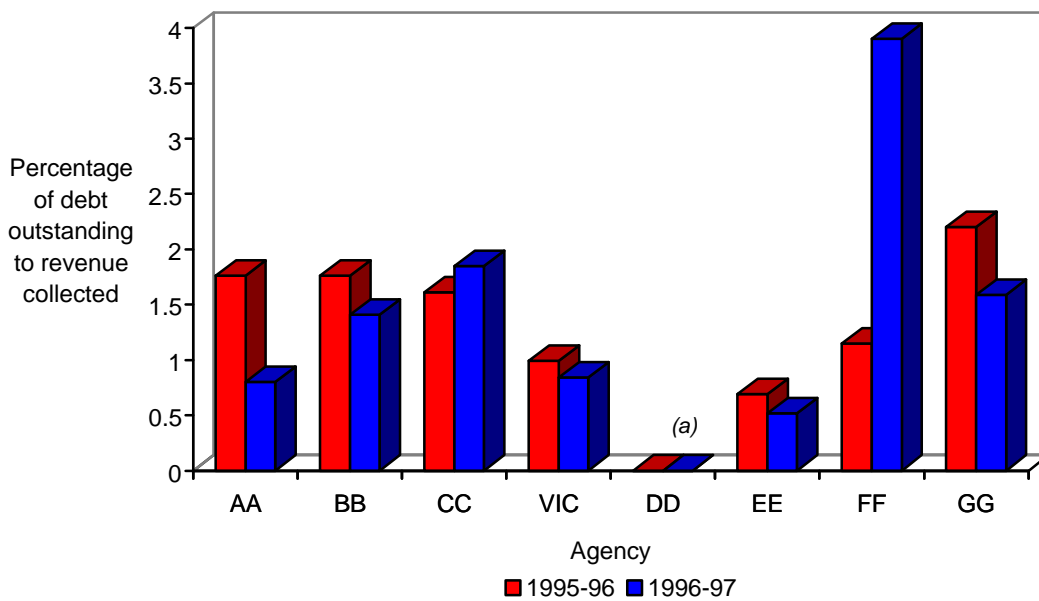
5.40 Further comment on the performance of the State Revenue Office since its formation following the amalgamation of the 2 former Offices is detailed in Part 6 of this Report.

Debt management

5.41 As collecting all moneys due to the State is a key function of revenue collection agencies, it is important that outstanding debts and write-offs of bad debts are minimised.

5.42 Chart 5D details the level of uncollected revenue (primary tax) expressed as a percentage of total revenue collected for 1995-96 and 1996-97 for each agency.

CHART 5D
DEBT LEVEL AS A PROPORTION OF REVENUE COLLECTED,
1995-96 AND 1996-97
 (per cent)



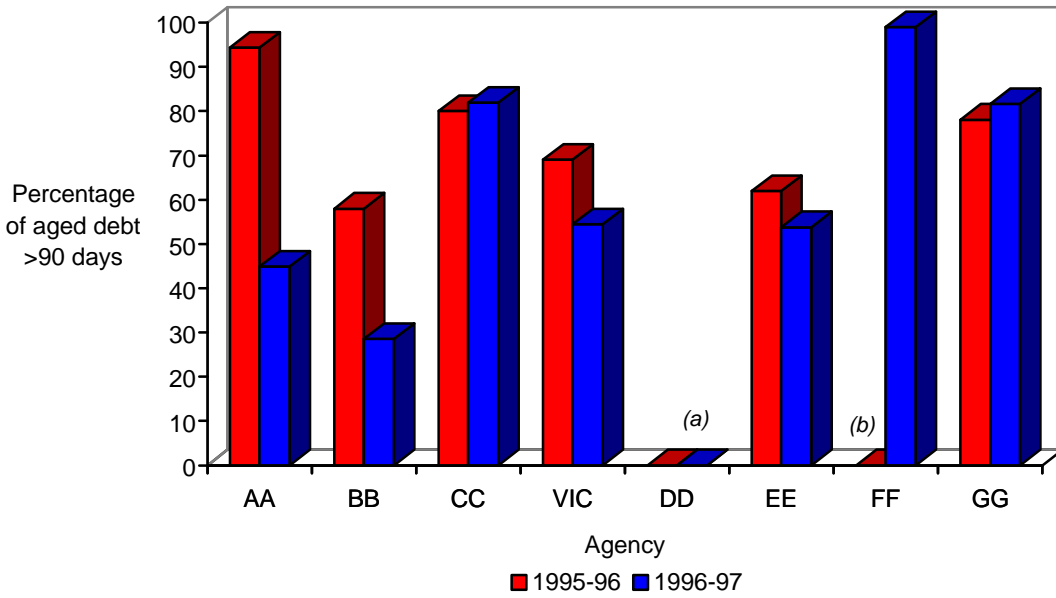
(a) Information withheld by request.

Source: Chart developed by audit from data obtained from State Revenue Office.

5.43 In relation to outstanding debts, the level of uncollected revenue at year-end was expressed as a percentage of total revenue collected for the year. For the Office, this was 0.99 per cent and 0.84 per cent in 1995-96 and 1996-97, respectively, as shown in Chart 5D. For 1996-97 the Office compared favourably with most agencies, but not as favourably with better performers with ratios of 0.52 per cent and 0.80 per cent.

5.44 For aged debt, Chart 5E shows the level of debt outstanding for 90 or more days expressed as a percentage of total debt.

CHART 5E
LEVEL OF DEBT OUTSTANDING FOR 90 OR MORE DAYS,
AT 30 JUNE 1996 AND 1997
 (per cent)

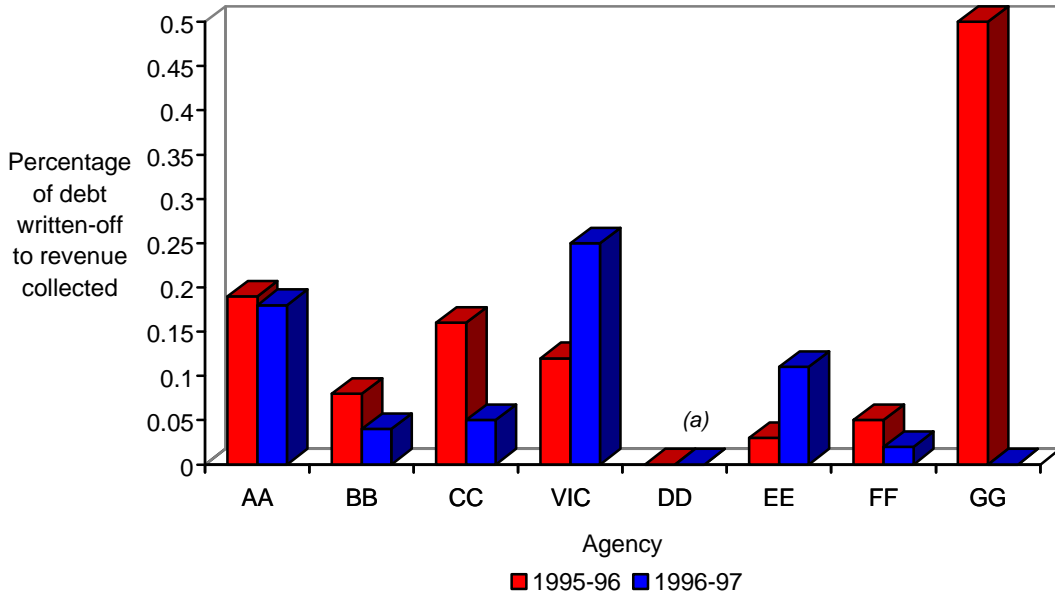


(a) Information withheld by request.
 (b) Details were not reported in the benchmarking reports.
 Source: Chart developed by audit from data obtained from State Revenue Office.

5.45 Chart 5E shows that the Office compared favourably with most agencies. In Victoria at 30 June 1996 and 1997, the level of debt outstanding for 90 or more days expressed as a percentage of total debt was 69 per cent and 54.5 per cent, respectively. Total debt for these years was \$60.6 million and \$54.5 million, respectively.

5.46 Chart 5F shows the level of debt written-off expressed as a percentage of revenue collected.

CHART 5F
DEBT WRITTEN-OFF AS PERCENTAGE OF REVENUE COLLECTED,
1995-96 AND 1996-97
 (per cent)



(a) Information withheld by request.

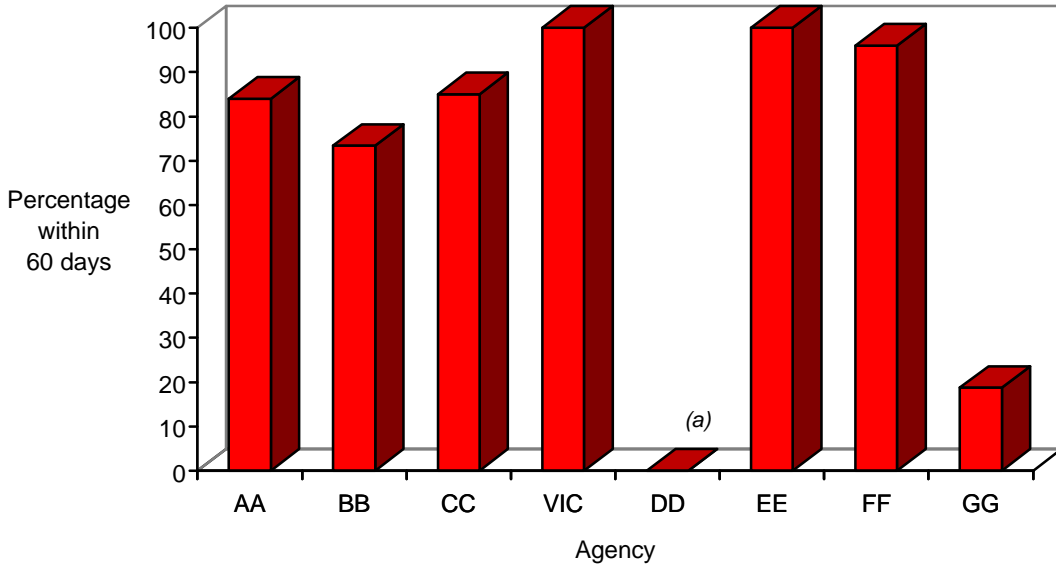
Source: Chart developed by audit from data obtained from State Revenue Office.

5.47 In analysing the above results, it is acknowledged that marked fluctuations between the level of debt written-off by agencies can occur from year-to-year. For the Office, the level increased from 0.12 per cent in 1995-96 to 0.25 per cent in 1996-97. Victoria was the poorest performing agency in 1996-97.

Timeliness in dealing with objections and Ministerial correspondence

5.48 Another important function relates to the timeliness in dealing with clients. In this regard, the annual benchmarking report provides information on the time taken by agencies to respond to objections lodged by taxpayers, concerning, for example, taxpayer assessments, and Ministerial correspondence such as a request for briefing documentation. Chart 5G shows the percentage of taxpayer objections responded to within 60 days for 1996-97. Equivalent information was not available for 1995-96.

CHART 5G
PERCENTAGE OF TAXPAYER OBJECTIONS
RESPONDED TO WITHIN 60 DAYS, 1996-97
 (per cent)



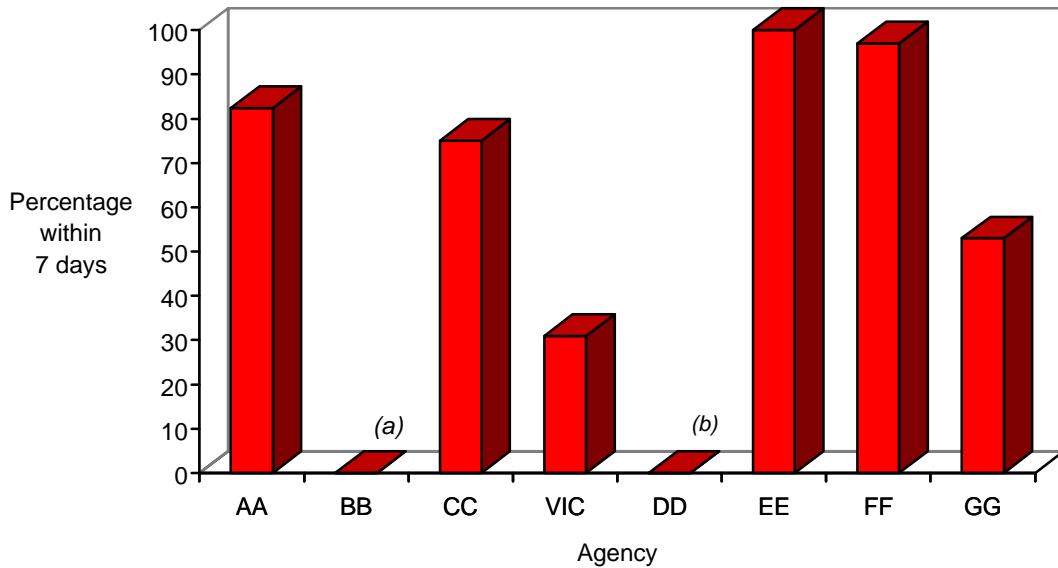
(a) Information withheld by request.

Source: Chart developed by audit from data obtained from State Revenue Office.

5.49 Chart 5G indicates the Office achieved a 100 per cent turnaround of objections within 60 days compared with poorer performances by all but one other agency. In the light of the Office’s stated commitment to a customer service approach, this result would suggest that consideration should be given to setting a shorter turnaround target.

5.50 Chart 5H shows the percentage of Ministerial correspondence responded to within 7 days for 1996-97. Equivalent information was not available for 1995-96.

CHART 5H
TURNAROUND TIMES FOR MINISTERIAL CORRESPONDENCE,
1996-97



(a) Details were not reported in the benchmarking reports.

(b) Information withheld by request.

Source: Chart developed by audit from data obtained from State Revenue Office.

5.51 In responding to Ministerial correspondence, Chart 5H indicates the Office achieved only a 31 per cent turnaround within 7 days, compared with better results for all other agencies.

REDUCING TAXPAYER COMPLIANCE COSTS

5.52 Compliance costs incurred by taxpayers in meeting their legislative obligations include expenses such as maintaining relevant records and remitting taxation payable.

5.53 In recent years, surveys and other research undertaken have identified that these costs are regressive in that small businesses bear a disproportionate amount of the costs involved in complying. In the interests of small business, the Government indicated reducing the compliance burden is a key objective in attracting business investment to Victoria.

5.54 In relation to State taxes, in 1996 the Government pledged that it would work closely with the Office to reduce compliance costs. In this regard, the Office's goal statement relating to customer service includes "*reducing clients' compliance costs*" and the Taxpayers' Charter commits the Office to keeping these costs to a minimum.



5.55 Initiatives that have reduced compliance costs include the Document Return System, One Stop Shop and the Payroll Tax Annual Adjustment Disk, which were described in Part 4 of this Report. However, assessments of the extent to which compliance cost reductions had been achieved were not carried out. For example, the Office did not compile data on the value and extent of compliance costs, seek such data from its customers or assess its performance in relation to reducing these costs.

5.56 In order for the Office to assess its performance in reducing taxpayer compliance costs, consideration should be given to:

- including questions in customer surveys relating to the cost of complying;
- undertaking a benchmarking study to identify the most expensive compliance areas; and
- establishing process improvement teams to identify methods of decreasing costs under a process of continuous improvement.

5.57 It was pleasing to note that action has been initiated by the Office to address these matters.

Q RESPONSE provided by the Commissioner, State Revenue Office

Compliance cost measurement concerns the direct cost to taxpayers in meeting their obligations and the net cost of taxation administration which is funded by Government. While the Office recognises that the compliance cost benefit of these 2 success projects have not been formally measured, they have reduced the Office's administration costs and general taxpayer feedback also confirms that they have reduced taxpayer compliance costs.

Research on compliance costs

5.58 In 1995, the Department of State Development undertook research into the cost of compliance with State taxes which identified that payroll tax was an area of difficulty for small businesses. In line with the Government's 1996 policy, the Department is updating this research.

5.59 Audit suggested that the Office be recognised as a stakeholder in this research, and participate in the current exercise as well as any future research. The research results could be used to determine the extent to which taxation compliance costs are an issue for small business, and in which areas, and to target priority areas for improvement within the Office.



Q RESPONSE provided by the Commissioner, State Revenue Office

The Office did participate in the initial survey. However, its usefulness was limited by the very low response rate. In addition, the answers suggested that respondents had some difficulty distinguishing between State and Commonwealth tax regimes when determining the costs associated with a particular tax like payroll tax.

At this point, the Office has not gathered specific data on the reduction in compliance costs that have accrued as a result of initiatives such as the AA disk, one stop shop, payment options project etc. The Office has been mindful that to collect measurement data would impose further costs on taxpayers, which in part would negate some of these savings. Further, the study undertaken by the Department of State Development also highlighted the fact that business had some difficulty identifying and isolating costs between State and Federal taxes.

Part 6

Outcomes of reforms

OVERVIEW

6.1 Through the amalgamation of the State Taxation and Stamp Duties Offices in April 1992, the former Government envisaged that substantial benefits could be realised including operating efficiencies, improved services to clients, enhanced compliance by taxpayers and improved career paths for staff. Although there have been some obvious efficiency gains in terms of revenue collections, to date the Office has not undertaken a formal assessment to determine the progress it has made towards realising the anticipated benefits.

6.2 To ensure that the Office is in a position to meet the needs of its clients now and into the future, a complete organisational review was conducted during 1995 and 1996. The review confirmed that the Office should continue to pursue its strategic directions, and identified approximately 20 projects, which were subsequently rationalised into 11, that would deliver further qualitative and quantitative operational benefits. Audit found that although the majority of these projects have been completed, the extent to which the envisaged benefits have been realised has not yet been fully evaluated by the Office.

6.3 In October 1995 the Office determined to outsource its information technology function in expectation of realising a number benefits including cost savings of between 10 and 15 per cent. Overall, audit found the Office has realised cost savings from the arrangement. Apart from some exceptions including the untimely repair of defective equipment and delays in the delivery of certain services, the Office has received a satisfactory level of service.

6.4 Although the magnitude of the change that has occurred within the Office over the past 5 years has been considerable, the Office had not complemented various forums for eliciting staff attitudes with the use of periodic surveys. These surveys could have provided valuable information on the effects of change on staff and the likelihood of success or otherwise of the change program.

AMALGAMATION OF THE STAMP DUTIES AND THE STATE TAXATION OFFICES

6.5 In relation to the performance audit of the former Stamp Duties Office, the Auditor-General concluded in part in his Report on the Treasurer’s Statement for the year ended 30 June 1991 that substantial efficiencies could be achieved if the operations of the Stamp Duties Office and the State Taxation Office were amalgamated. At the time, the Auditor-General was advised that the costs and benefits of an amalgamation were under consideration by the then Department of the Treasury.

6.6 Following the former Government’s in-principle decision in October 1991 to amalgamate the 2 Offices, the Treasurer established a Task Force to develop a plan of implementation. This Task Force included representatives from the Departments of the Treasury, and the Premier and Cabinet, and each of the amalgamating agencies.

6.7 After consideration of a range of issues pertaining to the proposed amalgamation, including the likely benefits, the Task Force completed its report in November 1991. In summary, it reported that there should be:

- *“Operating efficiencies with the amalgamated Office, particularly in the ability of management to move staff to cover seasonal or other peaks in the workload for particular revenue items;*
- *An improved service to taxpayers/clients. The operating efficiencies referred to above should, by themselves, lead to an improved service. Improved knowledge of the various revenue items by all staff members (for example, through training and staff rotation) should also improve the service to clients;*
- *Significantly improved career paths and job prospects for staff;*
- *Enhanced revenue collection through improved taxpayer compliance;*
- *Increased flexibility in the amalgamated office, thus making it easier to adapt to changes in the State’s revenue base and revenue items;*
- *Increased efficiencies in the support operations necessary for the amalgamated office to function; and*
- *Opportunities for greater uniformity in the administration of the various revenue items within Victoria, for example in terms of approach to clients, compliance, and penalties for late payment and non-compliance.”*

6.8 In December 1991, the Treasurer accepted the broad thrust of the Task Force’s recommendations. In communicating this acceptance to the staff of the 2 former agencies, the Treasurer stated that:

“I see significant benefits from the move to a State Revenue Office, including as I have indicated previously, improved customer service, gains in efficiency of operations, enhanced revenue compliance and enhanced career opportunities for all staff.”

6.9 The Treasurer also informed staff of his intention to establish a Steering Committee to oversee the implementation of the amalgamation and a Working Party to drive the change. The Working Party included representatives from the 2 former agencies and the then Victorian Public Service Association and was headed by an independent person well versed in public sector issues.

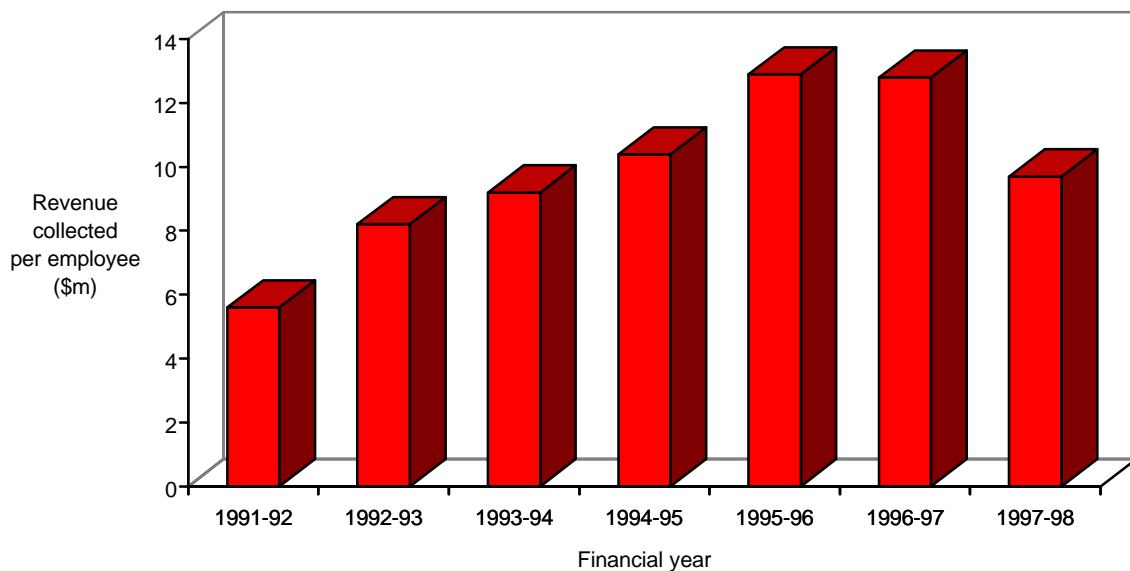
6.10 The Treasurer’s comments coupled with the benefits outlined above, clearly showed that the former Government expected significant benefits to be realised from the amalgamation.

Realisation of expected benefits

6.11 In discussion with audit, in August 1996, the Department of Treasury and Finance expressed a desire to have the Auditor-General assess whether the benefits expected from the amalgamation have been realised. The audit revealed that to date the Office has not undertaken any formal assessment of the envisaged benefits. In order to assess the extent to which the expected benefits have been realised, an audit analysis of data maintained by the Office indicated that the amalgamation of the 2 agencies in April 1992 contributed to improving the efficiency of revenue collections.

6.12 Chart 6A details the revenue collected per employee over a 7 year period to 1997-98.

CHART 6A
REVENUE COLLECTED PER EMPLOYEE,
1991-92 TO 1997-98
 (\$million)

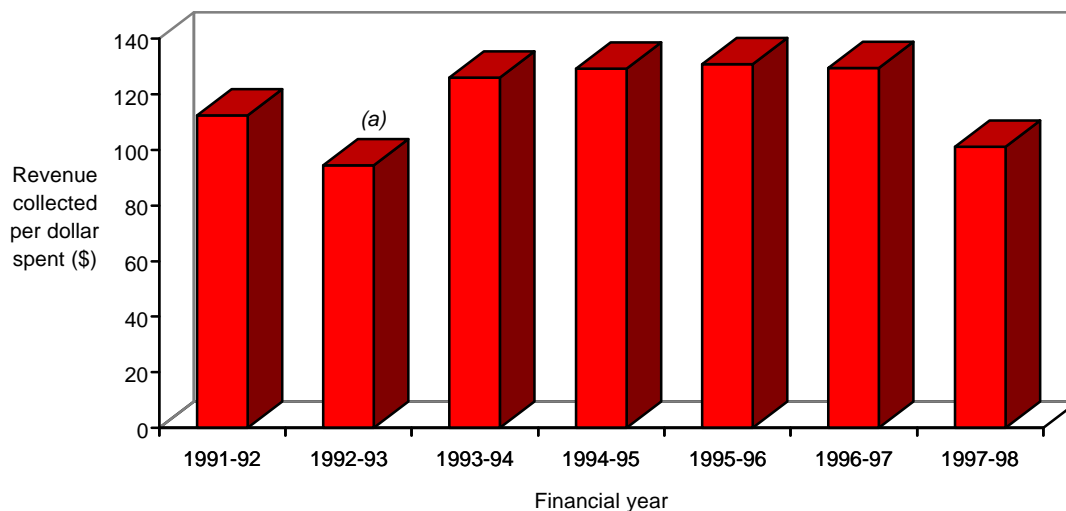


Source: Chart developed by audit from data obtained from State Revenue Office.

6.13 Chart 6A shows that notwithstanding the rationalisation of staffing levels subsequent to the amalgamation from 1 024 at June 1992 to 499 at June 1997, the amount of revenue collected per employee has steadily increased from \$5.6 million in 1991-92 to \$12.9 million in 1996-97. For 1997-98, collections per employee decreased to \$9.8 million while staff numbers increased to 545. This decline was primarily due to a High Court decision in August 1997 which prevented the States from collecting business franchise revenue. The increase in staff numbers was primarily related to the need to address problems in the administration of land tax revenue.

6.14 Chart 6B provides a comparison of revenue collected for each dollar spent by the Office from 1991-92 to 1997-98.

CHART 6B
REVENUE COLLECTED PER DOLLAR SPENT,
1991-92 TO 1997-98
 (\$)



(a) Includes additional costs for the purchase of land valuation data and the implementation of information strategies.

Source: Chart developed by audit from data obtained from State Revenue Office.

6.15 Chart 6B shows that revenue collected per dollar spent has increased from \$112 in 1991-92 to \$130 in 1996-97. However, as reported in Part 5, this performance has not matched the result achieved by the best performing revenue collection agency in Australia. As previously explained, the loss of business franchise revenue by the Office during 1997-98 has contributed to a decrease in revenue collected per dollar spent to \$101 for that year. The net operating costs of the Office also increased in 1997-98 by \$3.1 million or 6.3 per cent from the previous year primarily due to the cost of administering land tax revenue.

6.16 In addition to the efficiency gains, audit found that the Office has adopted a strong customer service ethos, as described in Part 4 of this Report, and implemented a number of initiatives designed to enhance the service it provides to taxpayers.

6.17 Audit considers that in the absence of a formal assessment, the Office may not be cognisant of any need to initiate corrective action to ensure, as far as is possible, the benefits are realised. Furthermore the Government, a key stakeholder in the outcome of the amalgamation, has not had the benefit of such an assessment.

6.18 Notwithstanding the passage of time since the amalgamation, audit considers the Office should assess the extent to which all of the expected benefits of amalgamation have been realised and report the results to the Department.



6.19 In this regard, the Office advised audit that information presented in its annual report and ongoing consultation with the Treasurer provided the necessary avenues for informing the Government of the progress made in realising the expected benefits.

q RESPONSE provided by the Commissioner, State Revenue Office

The Interjurisdictional Benchmarking Study provides a wide range of performance indicators based on raw data collected from all the States and Territories on an annual basis. This particular measure does not take into account natural factors that can have a significant influence on the levels of revenue generated such as population, industry/business concentration and land values.

REVIEWING THE OFFICE'S CORE BUSINESS ACTIVITIES

Business Renewal Study

6.20 In October 1995, the Office initiated a complete organisational review in order to ensure the needs of its present and future clients continued to be met. This review, known as the *Business Renewal Study*, was aimed at transforming the Office into a "Centre of Business Excellence" and involved examining all aspects of its operations including business processes, technology, and the organisational culture and structure. It was envisaged that the Study would take approximately 7 months to complete and cost around \$1.3 million.

6.21 In December 1995, the Office appointed consultants to undertake the Study as it was perceived that the required expertise was not available internally. The Office also recognised that there was a degree of risk associated with undertaking a project of this size and cost, particularly as the consultants bidding for the work could not demonstrate past experience in undertaking a "whole of organisation" review of this type.

6.22 The Office sought to minimise this risk by dividing the project into 4 key phases which are outlined in Table 6C.

**TABLE 6C
KEY PHASES OF THE BUSINESS RENEWAL STUDY**

<i>Phase 1 Evaluate</i>	<i>Phase 2 Envision</i>	<i>Phase 3 Empower</i>	<i>Phase 4 Excel</i>
<p>Validating the Office's strategies based on reviewing documentation and undertaking extensive discussions with the Office executive.</p> <p>Assessing the current environment, including gaining a detailed understanding of the Office culture and client requirements and operational processes.</p> <p>Analysing issues and opportunities and clearly demonstrating the benefits of continuing the Study.</p>	<p>Focus on envisioning the future Office at a strategic level and designing the operating environment needed to achieve the vision.</p> <p>Envisioning the future information technology and information technology requirements.</p> <p>Envisioning workshops to confirm the vision for the Office of the future and design parameters for the target environment design.</p> <p>Transforming the vision into reality by designing the required processes, culture, organisation and high level technology.</p>	<p>Two key inputs from the Envision Phase will be:</p> <ul style="list-style-type: none"> • implementation issues noted during the target environment design work; and • implementation plan developed. 	<p>Reviews of implementation results and some fine-tuning to ensure achievement of objectives.</p>

Source: State Revenue Office's Business Renewal Study Report.

6.23 The total cost of the project, including cost of Office staff who worked alongside the consulting team, was around \$1.8 million, which was \$500 000 more than expected. The original time estimate was exceeded by approximately 5 months. The Office advised audit that due to the size and complexity of the task these overruns were justified.

6.24 At the completion of the Study in October 1996, the consultants reported 4 key findings, namely:

- *“Confirmation that the strategic directions and initiatives identified in the 1993 Strategic Plan are the correct ones for the Office to pursue;*
- *Confirmation that the Office is utilising world best practice in a number of key aspects of its operations;*



- *Identification of over 20 projects that will deliver qualitative benefits to the Office’s operations BUT only limited additional qualitative benefits to those already delivered. Implementation of these projects will enable the Office to be equal to and, in some areas, lead world best practice; and*
- *Identification that significant additional investment is required to enable the Office’s technology platform to evolve to effectively meet future operational needs. The Office’s 2 main information technology systems, the Generic Revenue Collection System and the Corporate Data System provide similar functionality, but are essentially incompatible in design and require replacement with one system at a cost of approximately \$11 million”.*

6.25 The findings of the Study were strongly supported by management, particularly as they reaffirmed the intended future directions of the Office and identified scope for further operational improvements.

Projects for delivering operational benefits

6.26 Approximately 20 key projects were identified by the Study and subsequently rationalised into 11 projects which constituted most of the work required to deliver the envisaged qualitative and quantitative benefits to the Office. Detailed costings and timeframes were established for each of the individual projects. Since October 1996, key projects undertaken by the Office have included the development of electronic payment options, debt recovery management systems, improvements in software applications and workforce planning and training initiatives. At the date of the audit, and in line with established timeframes, one key project relating to the enhancements to the current 2 core revenue collection systems was still in the planning phase.

6.27 The funding for implementation of the projects was provided from the Government’s Microeconomic Reform Fund. This Fund was established to encourage departments and agencies to initiate process improvement projects.

Project management framework

6.28 The Office committed considerable resources to ensuring that a robust project management framework was in place to support implementation of the various projects which formed the Study. This framework has enabled each project to be managed in a consistent and structured manner. Interestingly, in a report by an external contractor, appointed to review the framework, the following comment was made:

“In reviewing the Program and Project procedures established it is evident that a significant framework has been put in place. The framework however is overly complex and demanding for the level of project management maturity within the State Revenue Office, and in fact, would be far more than required in all but a very few, very large project environments.”

6.29 Discussion with the Office revealed that while it had given a strong commitment to the provision of staff project management training, the project management framework would be re-assessed in light of the contractor’s comments.



6.30 Audit review of the project management framework and its application, confirmed the consistent use of the framework across the Office and a demonstrated understanding of project management principles by those officers involved in managing each project.

Post-project evaluations

6.31 Undertaking progressive and post-implementation evaluations of each project is a key determinant in assessing whether:

- the envisaged benefits have been realised;
- there are more effective or efficient methods for achieving the benefits;
- resources have been efficiently and effectively utilised;
- implementation should continue; and
- other alternative strategies for achieving the desired outcome should be explored by the organisation.

6.32 Audit found that evaluations of the extent to which the expected benefits associated with implementation of the projects have been realised had not been undertaken.

6.33 While the majority of the key projects of the Study have been completed, audit recognises that some projects will require an initial implementation period before any meaningful evaluation of their outcomes can be conducted. However, given the substantial cost and timeframe of the Study, audit considers that it is critical that the Office undertakes progressive and post-implementation evaluations for each project.

6.34 According to the Office the real benefits of the Study will only be realised after planned enhancements to the current information technology platform are introduced.

6.35 Given the Office’s aim of obtaining quality certification, audit considers that much of the work that has been undertaken as part of the Study, such as the documentation of current and revised processes, should form the foundation of work required to be undertaken for quality accreditation. Failure to utilise this information could result in the costly and unnecessary duplication of existing data.

q *RESPONSE provided by the Commissioner, State Revenue Office*

The Office is very pleased with the successful establishment of project management methodology with a dedicated resource group to ensure effective administration and oversighting of projects as they move through their various stages. The Infact Report has recommended some re-adjustment of the project methodology. Prior to the development and introduction of this methodology, there were limited project frameworks in place that were effective. The current framework is robust and has enabled the Office to deliver on key projects.

One of the primary reasons for post-implementation reviews is to assess the extent to which the expected benefits have been realised. A number of these projects have only been completed this year and the Office will schedule reviews early next year, when the full benefits will be evident and able to be fully assessed.

OUTSOURCING OF INFORMATION TECHNOLOGY SERVICES

Selection of service provider

6.36 In March 1995, the Office commenced an evaluation of the feasibility of outsourcing its entire information technology function. Given the Office’s desire to generate greater efficiencies and the Government’s policy of expanding outsourcing within the public sector, the prospect of outsourcing was seen by the Office as an attractive alternative.

6.37 After examining the potential benefits and possible exposures to the Office and consideration of advice provided by consultants, the Office determined in October 1995 to outsource its information technology function.

6.38 After an extensive tender selection process, a contractor was appointed in December 1995 to provide information technology and telecommunications services to the Office over a 5 year period, commencing in April 1996, for an annual fee of around \$8 million. These services included computer operations, support for the revenue collection and corporate data systems, application support (e.g. Windows and Lotus Notes), communication and customer support.

6.39 Audit considers the tender selection process employed by the Office in the appointment of an information technology service provider was carried out in a thorough and professional manner. Furthermore, notwithstanding that formal outsourcing guidelines had not been developed by the Government at that time, audit commends the Office for its initiative in establishing a process which was premised on the principles of equity, probity and integrity.

Expected benefits of outsourcing

6.40 Key benefits expected by the Office from the outsourcing arrangement included:

- a capacity to concentrate on its core business competencies and strategic tasks;
- the transfer of some of the risks associated with relying totally on in-house service delivery; and
- the availability of up-to-date skills without the need to regularly re-train staff.

6.41 Another key factor in the outsourcing decision was the extent of cost savings that could be realised. The Office’s 1996 *Annual Report* stated that, “*The costs involved in the information technology and telecommunication delivery are being reduced, with a saving of between 10% and 15% ... being realised after 5 years*”.

6.42 Audit was advised by the Office that the core costs associated with the outsourcing arrangement have been relatively constant and are currently still around \$9.2 million annually compared with operating costs of \$9.3 million prior to outsourcing. However, the total information technology and telecommunication costs for the Office have increased by \$1.2 million since the decision to outsource was made, due primarily to changes in business conditions and enhancements to desktop applications, such as Windows and Lotus Notes, rather than increases in the core cost of the outsourced service.



6.43 Audit was advised by the Office that recent staff changes at both organisations have placed some strain on their relationship which has required a reassessment of service values and strategies aimed at driving the outsourcing arrangements. As a result, considerable attention has recently been directed towards ensuring both parties work together so that the Office is better placed to reap the benefits of the arrangement.

6.44 In order to improve the situation, the Office, at an additional cost over and above the monthly service charge, appointed a consultant to convene a 3 day workshop in May 1998 aimed at:

- improving the relationship between the respective information technology staff within both organisations;
- providing a greater understanding of the values and strategies driving each organisation; and
- producing an agreed set of actions that will assist the contractor to meet the Office's requirements.

6.45 Audit discussions with representatives from both the contractor and the Office indicated that the outcome of the workshop was successful in that each organisation strengthened and reinforced its commitment to a unified team-based approach.

6.46 The Office advised audit that, overall, the cost of outsourcing the information technology function is still less than it would have been if the service was provided in-house, and that the benefits it envisaged are gradually materialising. This was further supported by the results of a benchmarking study which found that the outsourcing arrangement was competitively priced. Audit acknowledges that the Office has benefited from the arrangement in terms of the overall cost of service.



q RESPONSE provided by the Commissioner, State Revenue Office

The key drivers behind the IT outsourcing were:

- *greater access to resources;*
- *improved service delivery;*
- *flexibility in meeting changing demands;*
- *focus on core business;*
- *avoidance of major capital outlay;*
- *sharing/transfer of risks; and*
- *government initiatives.*

It should be noted that the Office is realising the expected benefits and the base line service cost in 1998 is less in absolute terms than in 1995.

Performance of the service provider

6.47 The audit disclosed that there were a number of service delivery issues which required attention and these are detailed in the following paragraphs.

Help desk facility

6.48 Under the service contract, the contractor is required to establish a help desk facility to provide a point of contact for staff to raise service delivery issues. Feedback obtained by the contractor from staff during 1997 identified a degree of dissatisfaction with regard to this facility. Some areas of dissatisfaction included the lack of feedback from help desk staff on their progress in responding to a request for help and the lack of understanding of the operational role of the Office’s branches, including their specific information technology needs.

6.49 Audit understands that the Office and the contractor are to initiate corrective action to address these concerns.

6.50 Audit also found that the Office does not have access to feedback obtained by the contractor from Office staff on its responsiveness to help desk requests. Audit considers that this data, if received on a periodic basis, would provide the Office with a further source of qualitative information on service delivery performance which could complement any direct feedback provided by Office staff on the operation of the help desk.

Repair of hardware breakdowns

6.51 The timely repair of defective information technology hardware, known as the *break-fix* result, is an important element of quality service delivery which ensures that any disruptions to the Office, such as delays in issuing land tax assessments, are minimised. The agency appointed by the contractor to facilitate the benchmarking study, undertaken pursuant to the contractual arrangements, indicated that the industry standard for this activity was 2 days. However, the contractor's performance fell well short of the standard. For a 2 month period covering May and June 1998, no breakdowns were repaired within 2 days and only 13 per cent were repaired within 5 days. Of the remainder, 40 per cent were not repaired within the month during which the breakdown occurred.

6.52 Audit was advised that following discussions between the Office and the contractor, the contractor agreed to liaise with the respective hardware suppliers with the view to reducing the extent of equipment breakdowns and also improving the time taken to fix the breakdown. This matter needs to be closely monitored by the Office to ensure that the assurance given by the contractor results in the timely repair of all defective equipment in line with the industry standard.

Information technology operating environment

6.53 A secure operating environment contributes to safeguarding an organisation's information technology assets by ensuring that access to these assets is restricted to only authorised personnel.

6.54 Audit was advised by the Office of its concern whether the contractor is providing a secure information technology operating environment which fully meets its business requirements. As the Office is ultimately responsible for the outsourced function, it is clearly in its interests to ensure that any exposure to the business is adequately managed. It is also vital that both parties clearly understand the level of security that is required by the Office.

6.55 Audit considers that the Office should communicate its concerns in relation to the operating environment to the contractor with the view to clarifying and agreeing on strategies that need to be employed to minimise any agreed risk.

Monitoring the quality of service provided

6.56 A key element of outsourcing arrangements is the need for the service recipient to establish processes for monitoring the performance of the contractor in meeting the requirements of the contract, particularly in ensuring that the quality of service delivery meets the expectations of the recipient of those services.



6.57 For this purpose, the Office has established a monitoring framework which measures the performance of the contractor against the many service standards outlined in the contract. The outsourcing contract stipulates the performance measures and the standard to be achieved by the contractor. Achievement of the required service levels is the primary means for determining the amount of the monthly service charge to be paid to the contractor. In certain circumstances, achieving above the desired standard attracts a bonus to the contractor, while a failure to meet the standard could result in a penalty to the contractor.

6.58 The Office has engaged a Contract Manager to actively monitor the level of service delivered by the contractor. Each month, performance reports are forwarded from the contractor to the Contract Manager for detailed review. In addition, weekly meetings between the Contract Manager and the contractor, daily monitoring of feedback from Office staff and annual benchmarking studies provide the basis for the Office’s monitoring framework.

6.59 Audit considers the framework established by the Office for monitoring the provision of information technology services is relatively sound. However, as outlined in the following paragraphs, scope exists to strengthen certain aspects of that framework.

Benchmarking

6.60 Benchmarking is a valuable tool for monitoring performance and instigating improvement in the quality of service delivery. Each year, in accordance with the contract, the contractor is required to compile and present to the Office benchmark data on the quality and cost of service to the service recipient which reflects current international standards.

6.61 Although the contract specifies that monitoring service quality is to form part of the benchmarking activity undertaken by the service provider, at present this activity provides the Office with little, if any, comparative data on important qualitative performance information such as customer satisfaction. Audit considers that the Office should request such information be included in subsequent benchmarking studies arranged by the contractor.

6.62 A review of the outsourcing arrangements was undertaken by the Office’s internal auditor in 1997. The auditor’s report highlighted, inter alia, that the Office may be at risk in placing too much reliance on the benchmarking results as performance data relating to service provision is supplied directly by the contractor to the organisation engaged to conduct the benchmarking activity without the contractor first taking steps to confirm the accuracy and completeness of that data.

6.63 The results of the benchmarking study covering the period May 1996 to April 1997, were provided by the contractor to the Office in August 1997. However, at the date of the audit, a further study covering the period May 1997 to April 1998 has not yet been arranged by the contractor as required under the service contract. As the failure to conduct benchmarking studies in a timely manner can inhibit the usefulness of the data collected, the Office should ensure that the contractor complies with the contractual obligations or the monthly service charge is appropriately adjusted for failing to do so.



Staff satisfaction surveys

6.64 The Office monitors some of the key qualitative factors associated with the delivery of the information technology services, such as the adequacy of feedback to staff on the progress of requests made to the help desk, and the friendliness and approachability of support service staff, through the conduct of staff satisfaction surveys.

6.65 Audit found that in response to a number of concerns relating to the impartiality and validity of these surveys, the contractor now provides input into their content and distribution. In order to alleviate potential concerns by either party regarding the reliability of the survey data, audit considers that the surveys need to be conducted by an independent market research firm.

6.66 Staff responses to surveys undertaken to date have been averaged to provide an overall level of their satisfaction, expressed as a percentage, with services provided. As this approach does not take into account the relative importance of the many types of services provided, there is potential for the monthly service fee to be paid to the contractor, albeit some key components of the service may not have met the required level.

6.67 Audit recommended to the Office that it should adopt a more robust approach to monitoring the quality of service delivery by developing specified service standards for each key element of service delivery covered in the survey. The payment of monthly service fees could then be based on the achievement or otherwise of each key element of service delivery rather than the overall level of service.

6.68 The Office's monitoring framework could also be enhanced by establishing staff focus groups across the Office to assess particular areas of service delivery. For example, customer service issues raised by staff during a customer survey could be fully explored through a series of focus groups.

6.69 Focus groups provide staff with an opportunity to freely air their views and this information provides the Office with a greater understanding of any of their concerns. The information obtained could improve the usefulness of the performance data and complement the data currently derived from customer surveys and systematic monitoring undertaken.

Penalties for non-performance

6.70 While audit understands that contracts should not disclose penalty clauses as such, the outsourcing contract specifies clauses relating to service charge adjustments, and refers to penalties to be imposed on the contractor, usually in the month following the performance period, if the agreed service standards are not met.

6.71 Based on the results of staff satisfaction surveys covering performance for the 6 month period to June 1997, the Office determined the level of service provided by the contractor did not reach the required standard. As a result, a service charge adjustment amounting to \$1 000 was imposed in the month following the release of the survey results. Given that the poor performance could occur for up to 6 months, in audit's view, the quantum of the service charge adjustment imposed does not adequately safeguard the Office in the event of poor performance over an extended period.



6.72 Audit is of the view that the Office should examine its legal position in terms of including the term “penalty” in future contracts and reconsider the appropriateness of the level of service charge adjustments imposed relative to the consequences to the Office of poor performance.

6.73 As a result of other instances of non-completion of certain critical tasks within the required timeframe during 1997, the contractor incurred service charge adjustments of around \$35 000. For example, some elements of disaster recovery planning which were not completed until 3 months after the required timeframe attracted service charge adjustments of only \$16 000. Although the imposition of these adjustments was in accordance with the contract, audit considers the cost to the Office, and to the State, would have been significantly greater if revenue collections were unnecessarily disrupted through system failure. This reinforces the Office’s need to ensure that service charge adjustments adequately reflect the consequences to the Office of any disruption to service delivery for this and any future outsourcing arrangements.

q RESPONSE provided by the Commissioner, State Revenue Office

The Office is satisfied with the adequacy of security over the current environment. Contractors have also been engaged to assist the Office in defining baseline security requirements for all new systems and processes.

Benchmarking by GECITS is normally done in conjunction with the service load and reviewed in April each year. The intention is that it will be scheduled for completion by the end of the first quarter 1999.



Internal audit examination of the outsourcing arrangement

6.74 In December 1997, the Office’s internal auditors issued a report on the results of a review of the Office’s information technology outsourcing arrangements. Findings included in the report were that:

- the contractor had provided the required services and satisfactorily met the service schedules outlined within the contract;
- the contractor had satisfactorily complied with the requirement to achieve certification under the international standard known as ISO 9000;
- the Office had exercised good judgement and demonstrated maturity in imposing penalties in relation to certain critical tasks not completed within the required timeframe during 1997;
- the due date for completing certain elements of the Disaster Recovery Plan, as specified in the contract, was not met by the contractor;
- the Office did not have sufficient technical expertise to independently confirm the detailed veracity of the source data supporting the contractor’s invoices; and
- the Office relied on the benchmarking results without verifying the completeness and accuracy of the source data relating to the performance of the contractor.

6.75 Audit was advised by the Office that future payments to the contractor will only be made after verifying that the requested service has been received.

Enhancement of information technology systems

6.76 Since the formation of the Office, 2 major information technology systems have been introduced. These systems have provided the technology needed to support revenue collection processes adopted across the agency, assisted in improving service delivery to clients and generated efficiency gains for the Office by automating manual-based systems.

6.77 Audit was advised by the Office that its business needs are no longer adequately served by its computerised systems and that its information technology requires enhancement if further efficiency gains in relation to revenue collections are to be generated.

6.78 The *Business Renewal Study* referred to earlier in this Part of the Report, identified that there was a need to replace the 2 core revenue collection systems with one integrated system and that this would cost around \$11 million. The Office has advised audit that a capital funding request has been made to the Government’s Budget and Economic Review Committee for this amount and a further \$11 million for the costs associated with systems development, introducing new technology and developing electronic commerce options for the future.

MANAGING STAFF IN A CLIMATE OF CHANGE

6.79 As previously mentioned, a key feature of the Office since its establishment has been the extent of structural and other organisational changes. These changes which would have had a significant cultural impact on staff and their working environment, included:

- downsizing of staff numbers;
- increased use of information technology;
- internal reorganisations; and
- adopting new and different approaches to its core business of collecting taxation revenue.

6.80 Encouraging staff participation in change programs is an important factor for the successful implementation of change. Similarly, it is important to monitor staff attitudes to assess both the effects of change on employees and the likelihood of success or otherwise of the change program. In my Special Report No. 44 titled *Timeliness of service delivery: A customer's right*, which was tabled in the Parliament in October 1996, I indicated that the effective management of staff in a changing environment is an issue that needs to be addressed in order to minimise any adverse effects on the timeliness and quality of service delivery. A number of strategies were offered as a guide to agencies endeavouring to improve staff moral while introducing significant change.

6.81 In this regard, a number of initiatives have been actively pursued by the Office which included:

- involving around 33 per cent (175) of the staff in designing the new business processes as part of the *Business Renewal Study*;
- providing staff with forums in the form of workshops to discuss issues of concern; and
- surveying a small number of staff at the end of 1995, as part of the *Business Renewal Study*, on their attitude towards cultural change.

6.82 The Office's Human Resource Management Plan (November 1996) highlighted the need to reduce risks to organisational performance due to, among other things, poor workplace relationships and staff dissatisfaction. In addition, the subsequent Plan for 1997 included a commitment to monitor the impact of changes on the culture of the Office although at the date of audit, a survey of employees for this purpose had not been undertaken.

6.83 Audit acknowledges that the Office is aware of the need to compile information on how staff have been affected by the ongoing change. Nevertheless, given the magnitude of the change, it was surprising that the Office had not sought to regularly monitor staff attitudes throughout the change period by supplementing its procedures through the use of periodic Office-wide employee attitudinal surveys. Surveys of this nature could assist the Office by gathering vital information on:

- staff understanding and opinion of the Office's mission and strategy for its achievement;
- the extent to which staff believe that the Office's leaders are communicating the elements of change and how this change will impact on staff and their positions;
- organisational culture including the extent of information sharing, new approaches to work and trust between teams;
- staff opinion on the structure of the organisation and the extent to which this structure supports or hinders the pursuit of the Office's objectives;
- staff understanding of the rationale for structural changes; and
- the progress of the Office in managing change.

6.84 In addition, survey information could have been used to establish benchmarks against which future surveys could track changes in employee attitudes regarding the change program.

6.85 Audit was informed that the Office plans to conduct an organisational self-assessment based on the Australian Business Excellence Framework which will incorporate the conduct of a staff attitudinal survey. Given the potential usefulness of such a survey, it is important that the Office gives consideration to the matters previously raised by audit. In particular, the Office should consider:

- obtaining specialist input into the design and conduct of the survey and subsequent collation and analysis of the information gathered;
- surveying all staff;
- ensuring the confidentiality of responses;
- communicating its commitment to the survey and the results thereof to all staff; and
- obtaining staff input in acting on the results.

Appendix A

**Summary of
audit's suggestions
for improvement**

A number of suggestions for improvement are contained throughout the Report. A listing of the applicable references is summarised in the following table.

**SUMMARY OF
AUDIT'S SUGGESTIONS FOR IMPROVEMENT**

<i>Report reference</i>	<i>Suggestion</i>	<i>Paragraph number</i>
<i>Part 4: Maximising revenue collection</i>	Assess taxpayer compliance levels for each revenue category	4.22
	Examine international approaches to measuring the tax gap	4.27
	Measure the effectiveness of the individual components of the compliance enhancement strategy	4.29
	Conduct periodic evaluations of the impact on taxpayer behaviour of compliance strategies	4.30
	Develop specific objectives for the Investigations Branch	4.77
	Measure the effect of imposing penalties on taxpayer compliance	4.91
	Increase the profile of the Taxpayers' Charter	4.110
	Improve the usefulness of customer surveys	4.116
	Conduct internal benchmarking of service delivery	4.117
	Provide more training to develop the technical knowledge of staff	4.122
	Measure the impact of customer service on improving taxpayer compliance	4.127
<i>Part 5: Measuring timeliness and cost-effectiveness</i>	Introduce a greater degree of precision in the setting of margins for targets such as the level of revenue to be collected	5.12
	Introduce further improvements to existing performance measures	5.25
	Improve performance information with program evaluations and stakeholder feedback	5.28
	Improve controls over the completeness and accuracy of performance data	5.30
	Provide training in performance measurement for staff	5.33
	Use the inter-jurisdictional benchmarking exercise to actively identify areas for improving performance	5.35
	Consider setting a shorter turnaround target for responding to taxpayer objections	5.49
	Assess performance in reducing taxpayer compliance costs	5.56
	Participate in research on compliance costs	5.59



**SUMMARY OF
AUDIT'S SUGGESTIONS FOR IMPROVEMENT - *continued***

<i>Report reference</i>	<i>Suggestion</i>	<i>Paragraph number</i>
<i>Part 6: Outcomes of reforms</i>	Assess and report on the realisation of benefits from the 1992 amalgamation	6.18
	Undertake post-implementation evaluations of the Business Renewal Study projects	6.33
	Avoid unnecessary duplication of existing data for quality accreditation purposes	6.35
	Obtain access to staff feedback on the help desk compiled by the contractor	6.50
	Closely monitor the contractor's performance in improving the timely repair of equipment	6.52
	Clarify and agree on strategies with the contractor regarding the security of the operating environment.	6.55
	Customer satisfaction should be assessed in benchmarking activity undertaken by the contractor	6.61
	Ensure the contractor is appropriately penalised for non-compliance with contractual obligations	6.63
	Use an independent firm to conduct staff satisfaction surveys	6.65
	Develop specified service standards for each key element of service delivery	6.67
	Establish staff focus groups for assessing service delivery	6.68
	Ensure that service charge adjustments imposed on contractors adequately reflect consequences in terms of the risk of disruption to service delivery	6.73
	Conduct periodic employee attitudinal surveys	6.85