

Senate Standing Committee on Economics
Supplementary Budget Estimates 2006-2007
1-2 November 2006

Private and Confidential
Mr Nick Baker
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Tabled Document No 10
By: Mr Michael D'Ascenzo (ATO)
Date: 2/11/06

5 January 2006

Dear Sir

**Financial, Accounting and Business Services
Independent Review of 97 Debt Management Cases**

1. Terms of reference

KPMG was invited by the Australian Taxation Office ("ATO") to submit a proposal for the provision of Financial, Accounting and Business Services on 27 October 2004 and was appointed, on 4 March 2005, to conduct three (3) independent reviews of 97 debt management cases to be selected at random from a case list provided to KPMG by the ATO.

McGrathNicol+Partners ("McGrath Nicol") was subsequently appointed, by way of a sub-contract, on 4 March 2005 to conduct the review on KPMG's behalf.

Accordingly, this report presents the findings of our third and final review based on the terms of reference set out in the Official Order APCM123.02.027 dated 2 March 2005.

The focus of the review is to provide a level of assurance that the collections processes of the ATO, in seeking payment of outstanding tax, do not prematurely lead to the insolvency of businesses that could reasonably be considered viable.

In this connection, KPMG was specifically requested to:

- Select at random a total of 97 cases from a case list provided by the ATO, where a business has had a liquidator, administrator or trustee appointed during the period 1 July 2005 to 30 November 2005 as a result of ATO legal recovery actions (see 2 below);
- Examine the ATO's legal recovery actions in relation to the management of each case and assess whether the taxpayer was provided with clear opportunity to meet their obligations and discuss alternative arrangements to avoid insolvency;

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- Assess whether the actions of the ATO, in seeking payment of the outstanding tax in each case, were too early and led to the premature insolvency of a business that could reasonably be considered viable based on the information provided by the taxpayer and available to the ATO; and
- Advise whether there were other practical options the ATO should have taken to avoid the business being declared insolvent, without putting the collection of tax at unreasonable risk.

2. Sample selection process

2.1 Case list population

The ATO established the criteria used to determine the files that will be available for review. This criteria is summarised below. We understand that approximately 542 cases satisfied the chosen criteria. From this McGrath Nicol staff were responsible for the random selection of the 97 files actually reviewed.

Files were required to meet the following criteria to be included in the case list population.

- The taxpayer had an insolvency administration that commenced between 1 July 2005 and 30 November 2005 (but excluding those with Schemes of Arrangements or where Receivers and Managers had been appointed); and
- Where legal recovery action (e.g. Garnishee notices, S459E notices, applications for judgement, Bankruptcy notices, winding-up actions, bankruptcy proceedings) had been commenced by the ATO prior to the insolvency administration.

The following types of taxpayers were then removed from the case list:

- Any Deed of Arrangement, Deed of Composition or Deed of Assignment cases where no Director Penalty Notice ("DPN") had been issued;
- Any Voluntary Administration, Liquidation or Miscellaneous Administration cases where no winding-up petition or DPN was issued; or
- Where the cases were finalised before the commencement of insolvency.

We understand that there were no geographical limiters used in the selection of the cases for review. As a result, the files reviewed had been managed by a variety of ATO offices around Australia.

2.2 Rationale for selection of 97 random cases

The decision on the number of files to review was also the responsibility of the ATO. We have been informed that 97 sample cases had been determined by the ATO to be an appropriate sample size as it would correspond to a relative standard error ("RSE") of 10%.

The reliability of various RSEs, as provided by the ATO, is as follows:

Relative Standard Error	Description
Less than 5%	Highly reliable
Between 5% and 10%	Reliable
Between 10% and 15%	Exercise some caution in interpreting results
Greater than 15%	Broad level, indicative information only

2.3 Sampling of population

The cases were numbered from 1 to 542 at the time of sampling. No other details were supplied when the 97 cases were selected to ensure that the selection was totally random. We were informed that the ATO had separately identified the Case ID corresponding to each of the individual numbers. These details were provided after the selection was completed.

A McGrath Nicol staff member then randomly selected 150 cases using the Sampling function in Microsoft Excel. It is noted that 53 additional cases were selected as alternates in the event that any of the first 97 taxpayers were found to be unsuitable or conflicts of interest arose. It was agreed that conflicts of interest would arise where KPMG was either the tax agent or auditor of the taxpayer, or where a relationship exists between KPMG and a taxpayer that could be interpreted as an actual or perceived conflict. It is noted that in some cases, KPMG or McGrath Nicol might have been appointed in an insolvency capacity (i.e. as Liquidator) but this does not represent a conflict of interest. Checks were performed to determine the extent of any conflicts.

3. Methodology and sources of information

3.1 Sources of information

We understand that the ATO currently employs “paperless” systems wherever possible. Given this, the information utilised in the review was extracted from the computerised systems used by the ATO and included, but was not limited to, the following:

- Notes made by the ATO officers in communicating with the taxpayer;
- Transcripts of various demand letters sent to the taxpayer requesting payment; and
- Details of payment arrangements made with taxpayers.

The information was extracted by ATO staff and provided for review in file form.

In conducting the review, reference was also made to the ATO’s Receivables Policy, which is available on its website. This policy was used only to gain an understanding of the ATO’s general procedures in dealing with taxpayers for the collection of outstanding taxes.

3.2 Methodology of review

Each case selected was reviewed by a McGrath Nicol staff member in accordance with the terms of reference. The information available for the individual cases differed to the extent of the circumstances surrounding each case.

The methodology adopted was as follows:

- Review all notes and files, where available, made by ATO officers in dealing with the taxpayer, i.e. documentation of conversations / contact with the taxpayer;
- Determine the chronology of contact with the taxpayer, including demand letters sent by the ATO as well as letters and proposals received from the taxpayer;
- Review the compliance history of the taxpayer;
- Determine the circumstances surrounding the case and information available to the ATO at those material points in time; and
- Prepare an Individual Case Review Form for each taxpayer documenting our comments and conclusions from the file review.

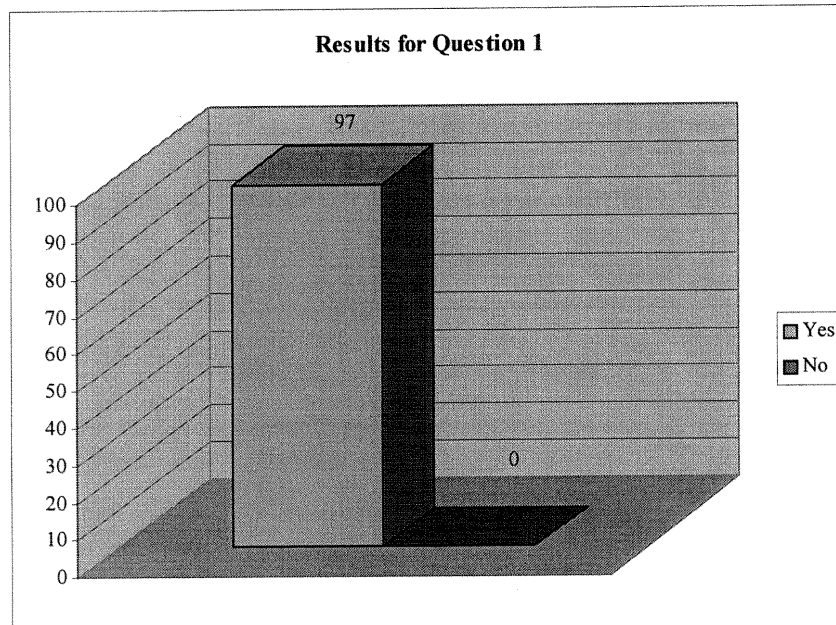
All cases were reviewed by Mike Hill, the Partner responsible for the review to ensure there was a consistency in approach to each review.

4. Results of review and comments

The Individual Case Review Form sets out the three questions where McGrath Nicol's comments were required. The questions were:

- Question 1 : Did the ATO provide the taxpayer with the opportunity to meet their obligations and discuss alternative arrangements to avoid insolvency?
- Question 2 : Were the actions of the ATO, in seeking payment of outstanding tax in this case, too early and did this lead to the premature insolvency of a business that could reasonably be considered viable based on the information provided by the taxpayer and available to the ATO?
- Question 3 : Were there other practical options available to the ATO that should have been taken to avoid the business being declared insolvent, without putting the collection of tax at unreasonable risk?

4.1 Results and comments for Question 1

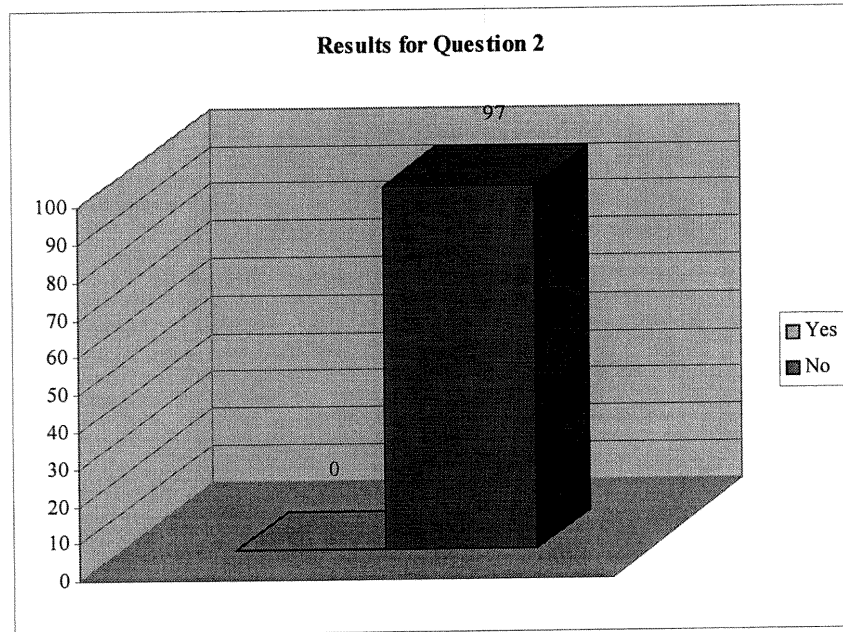


Our review indicates that the ATO had, in all of the cases reviewed, provided sufficient opportunity to the taxpayers to meet their obligations and discuss alternative arrangements to avoid insolvency.

We make the following comments:

- Letters from the ATO requesting or demanding payment invite the taxpayer to contact the ATO case officer if they are unable to meet the payment obligations. Similarly, other demand letters, such as Notice of Intended Legal Action provide the option for the taxpayer to contact the ATO;
- Verbal contact with the taxpayer, tax agent or accountant was made or attempted prior to instituting legal action;
- In the majority of cases, payment arrangements had been agreed although there were subsequent defaults;
- Where legal action was commenced, it was often due to a lack of response or co-operation or where attempts by the taxpayer to settle the debts (via arrangements or otherwise) had failed; and
- In most cases a considerable period of time elapsed between the debt arising and the instigation of legal action to recover the debt.

4.2 Results and comments for Question 2



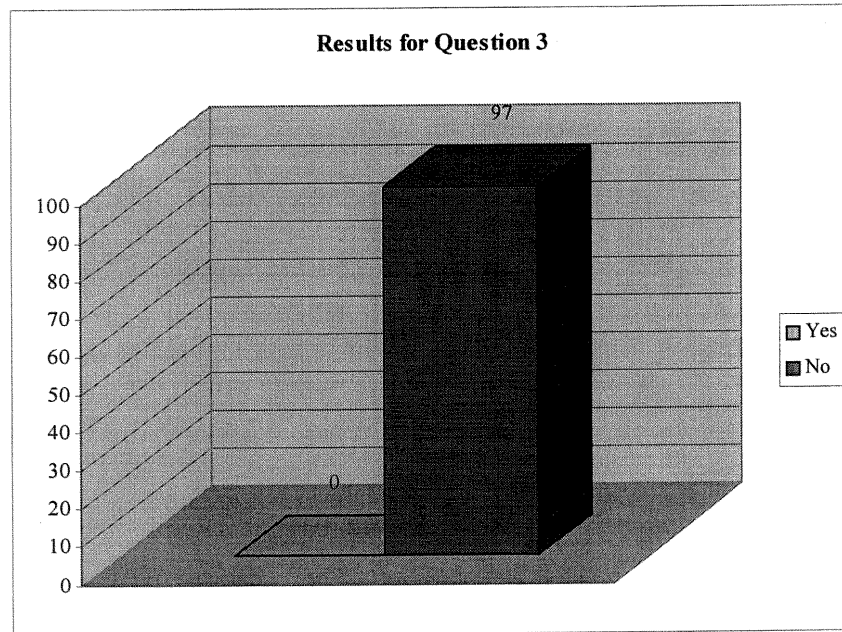
Our review indicates that, in all of the cases reviewed, the actions of the ATO, in seeking payment of outstanding tax, were not too early nor did it lead to the premature insolvency of the business.

We make the following comments:

- As indicated in Question 1, the ATO had generally provided ample time and opportunity to the taxpayers to settle their outstanding taxes and hence the ATO's actions could not be deemed to be too early;
- The ATO had agreed to payment arrangements with the taxpayers in the majority of the cases or had at least requested for the taxpayer to put in payment proposals for the ATO to consider. However, in most cases, the taxpayers had not made any meaningful attempts to address their debt with the ATO or had defaulted on payment arrangements;
- The outstanding debt had generally escalated (due to imposition of penalties, interest or additional lodgements) over the time where the ATO had attempted to seek a settlement of the debt;
- In a number of cases the taxpayer was responsible for the entering into of an insolvency administration themselves, confirming that the taxpayer was insolvent; and

- In the vast majority of cases where the dividend from the insolvency appointment was known, the return was minimal or the whole debt was written off. This confirms the insolvency of the taxpayer in those circumstances.

4.3 Results and comments for Question 3



Our review indicates that, in all of the cases reviewed, there were no other practical options available to the ATO to avoid the taxpayer being declared insolvent without putting the collection of tax at unreasonable risk.

We make the following comments:

- The ATO had generally sought to contact the taxpayer, tax agent or accountant and in most cases such actions were successful in establishing contact. The files indicate that in most cases, considerable efforts were made to contact the taxpayer prior to proceeding to enforcement;
- The period between the time when demand letters, DPNs, S459E or bankruptcy notices were sent and commencement of legal actions had generally provided the taxpayers with sufficient opportunity to respond. In addition, the various demands and notices invited the taxpayer to contact the ATO if they had difficulties in meeting the payments;
- In cases where payment arrangements were agreed to, the taxpayers had defaulted on the instalment payments, sometimes on numerous occasions. In a number of cases, the ATO had agreed to more than one instalment payment although the agreements invariably defaulted;

- There were a number of instances where garnishee notices had been issued to banks and other parties; and
- The failure of the taxpayer to either put forward an arrangement proposal or to comply with such a proposal, left the ATO with very limited options for the pursuit of the debt.

5. Overall assessment

Our review of the 97 cases indicates that the ATO had provided the taxpayer with ample opportunity and time to settle the outstanding debts owing. This was achieved through a combination of demand letters and attempts to contact the taxpayer over a period of time (usually greater than 12 months).

The timing of legal actions by the ATO did not appear to be premature. As indicated above, this was due to the length of time and opportunities provided to the taxpayer to settle the outstanding debt.

In respect of the practical options available at the time of legal actions, we believe that, in the cases reviewed, the ATO had no other practical options at the time, which would have avoided the taxpayer being declared insolvent.

In summary, our review indicates that, in all the 97 cases reviewed, the actions of the ATO, in seeking payment of outstanding taxes, did not prematurely lead to insolvency of a business that could reasonably be considered viable.

6. ATO's comments

A copy of the draft report was provided to the ATO for their comments.

7. Limiting conditions

This report has been prepared at the request of KPMG in accordance with Official Order APCM123.02.027 between KPMG and the ATO. An independent review of 97 debt management cases was conducted to provide an a level of assurance that the actions of the ATO, in seeking payment of outstanding tax, do not prematurely lead to insolvency of a business that could reasonably be considered viable.

McGrath Nicol has prepared this report solely for use by KPMG and the ATO. In accordance with our firm policy, we advise that neither the firm nor any member or employee of the firm undertakes responsibility arising in any way whatsoever, including by way of errors or omissions arising through negligence or otherwise however caused, to any persons other than to KPMG or the ATO.

We have considered and relied upon information that we believe to be reliable, complete and not misleading. We have no reason to believe that any material facts have been withheld from us but do not warrant that our enquiries have revealed all of the matters which an audit or extensive examination might disclose. Statements and opinions included in this report are given in good faith and in the belief that such statements and opinions are not false or misleading.

Our opinion is based solely on the information and methodology set out in sections 2 and 3 above. We reserve the right to amend any conclusions, if necessary, should any further information become available. Nothing in this report should be taken to imply that McGrath Nicol has verified any information supplied to us, or has in any way carried out an audit of any information supplied to us other than as expressly stated in this report.

Yours faithfully

A handwritten signature in black ink, appearing to read "Mike Hill", is written over a thin vertical line that extends upwards from the signature.

Mike Hill
Partner

