

GST and integrity of business system risks

Identifies common errors made by businesses and explains how ineffective business systems and processes can cause GST reporting errors.

WHAT ARE INTEGRITY OF BUSINESS SYSTEM RISKS?

Businesses may report incorrect amounts of GST if their systems for capturing and recording GST information fail. We refer to these errors as integrity of business system risks.

We have found that businesses going through change are most at risk of incorrectly reporting GST. For example, businesses experiencing rapid growth, restructure, mergers or de-mergers, installation of new accounting software or changes to accounting staff. Other common causes include:

- failure of accounting systems
- incorrect or incomplete business activity statements (BAS)
- incorrect interpretation of the GST legislation
- classification of taxable supplies as GST-free or non-taxable.

WHO IS AT RISK?

In 2007–08 we had contact with 1,864 taxpayers at risk of incorrectly reporting GST. As a result of our review of these taxpayers, we raised \$363 million in GST liabilities.

In 2007–08, the industries with the highest number of GST reporting adjustments because of business system risks were:

Large market:

- manufacturing – accounting for 29% of adjustments
- mining – accounting for 18% of adjustments
- financial and insurance services – accounting for 18% of adjustments

SME market:

- retail trade – accounting for 17% of adjustments
- rental, hiring and real estate services – accounting for 14% of adjustments
- construction – accounting for 13% of adjustments

To identify businesses at risk we use information reported on tax returns and BAS, company published reports, information reported in the media and information on external databases such as the Australian Security Investment Commission (ASIC).



WHY ERRORS OCCUR

Inadequate, non-existent or poorly documented controls can lead to a wide range of errors. The table below identifies common errors and shows the frequency of occurrence within large and SME markets. This information is based on 2007–08 figures. The table also shows the average amount of liabilities raised.

Cause of error	Compliance results in SME market	Compliance results in Large market	Average amount of net GST shortfall identified	Examples of errors
BAS preparation	51%	58%	\$288,569	<ul style="list-style-type: none"> ■ transposing figures when completing BAS ■ claiming GST credits without a valid tax invoice ■ excluding invoices produced outside normal accounting system ■ incorrect transfer of GST information between associated entities ■ GST control accounts not cleared ■ activity statement reconciliations not completed
Incorrect interpretation of GST legislation	12%	26%	\$204,327	<ul style="list-style-type: none"> ■ misclassification of supplies or acquisitions ■ claiming GST credits on total tax invoice amounts when part of the transaction is not subject to GST ■ exceeding the financial acquisition threshold as a result of merger, acquisition or capital raising
Change of accounting software	9%	5%	\$289,467	<ul style="list-style-type: none"> ■ new accounting system automatically overriding entries that had been recorded as non-allowable ■ incorrect GST codes allocated as GST-free on non-taxable items
Change of accounting staff	9%	5%	\$1,144,207	<ul style="list-style-type: none"> ■ lack of understanding about internal processes, leading to errors in capturing and reporting GST information
Incorrect set up of accounting systems or internal controls	5%	3%	\$69,462	<ul style="list-style-type: none"> ■ errors processing one-off transactions ■ GST on taxable supplies incorrectly off-set against credits ■ rebates processed incorrectly
Change of business structure	1%	3%	\$54,445	<ul style="list-style-type: none"> ■ sales not reported for new branches ■ trading stock incorrectly invoiced on transfer to a new business ■ entities not eligible to form a GST group ■ incorrectly treating sales as taxable when supplied to a member of a GST group ■ claiming GST credits for associated entities which have recently left a GST group ■ system integration issues
Incorrect supply status	5%	0%	\$293,496	<ul style="list-style-type: none"> ■ incorrectly recording the transaction as GST-free or non-taxable.

CASE STUDY

As a result of risk modelling, we identified a financial services company that was possibly experiencing business system failure.

We undertook a review of the business' BAS and found that they had over claimed GST credits and under reported GST payable on a number of business transactions. In preparing the BAS, the business:

- did not include all tax invoices
- entered the value of acquisitions in foreign currency rather than Australian dollars
- posted some transactions to related companies outside the GST group
- included some transactions more than once.

We reviewed business records and found that the following factors contributed to the errors:

- some company divisions operated their own financial systems. The tax function relied on employees operating the external systems under divisional guidelines.
- poor data input and reconciliation controls
- BAS were prepared offshore with no documentation of procedures
- accounts were not checked for consistency against supporting documents
- high staff turnover in the BAS preparation area.

The business conducted a review of their records which identified over \$300,000 in unpaid GST. It subsequently made a voluntary disclosure. The business incurred a penalty fee of \$28,000 for failure to take reasonable care. The business has since paid the amount in full.

The business owner also conducted a review of their internal control processes to identify areas for improvement and to ensure errors were not made in future BAS.

REDUCING THE RISK OF MAKING ERRORS

There are steps you can take to reduce the risk of making errors.

You should consider the errors and causes listed in the table on page 2, then determine if these could be relevant to your business now or in the future.

- 1 Review your business systems and the controls you have in place:
 - are those controls adequately documented?
 - do your employees know and understand those controls?
- 2 Review how you manage significant one-off transactions:
 - are one-off transactions properly documented?
 - are one-off transactions processed appropriately?

VOLUNTARY DISCLOSURE

After reviewing your business systems and controls you may discover a discrepancy in reported GST amounts. If this occurs, we encourage you to make a voluntary disclosure. Reduced penalties will apply to those who disclose before an audit is conducted.

For more information about making a voluntary disclosure:

- visit our website at **www.ato.gov.au/voldisclosurereform**
- contact your client relationship manager

MORE INFORMATION

For more information:

- visit our website at **www.ato.gov.au**
- contact your **client relationship manager**.

If you do not speak English well and need help from the Tax Office, phone the Translating and Interpreting Service on **13 14 50**.

If you are deaf, or have a hearing or speech impairment, phone the Tax Office through the National Relay Service (NRS) on the numbers listed below:

- TTY users, phone **13 36 77** and ask for the Tax Office number you need
- Speak and Listen (speech-to-speech relay) users, phone **1300 555 727** and ask for the Tax Office number you need
- internet relay users, connect to the NRS on **www.relayservice.com.au** and ask for the Tax Office number you need.

OUR COMMITMENT TO YOU

We are committed to providing you with guidance you can rely on. If you feel that this publication does not fully cover your circumstances, or you are unsure how it applies to you, you can seek further assistance from us.

We regularly revise our publications to take account of any changes to the law, so make sure that you have the latest information. If you are unsure, you can check for a more recent version on our website at **www.ato.gov.au** or contact us.

This publication was current at **October 2009**.