EXTERNAL COMPLIANCE ASSURANCE PROCESS (ECAP)

HIGH LEVEL DESIGN

This document articulates the high level design for the ATO’s external compliance assurance process (ECAP).

Under ECAP, selected taxpayers in the public groups and international taxpayer market will be given a choice of reviewer for factual matters identified by the ATO as requiring assurance.

This document will also be used to ensure that any potential pilot is achieving the intent and intended outcomes of the ECAP project.
INTENT

The ECAP project will explore options to allow selected taxpayers to choose their own reviewer when the ATO requires assurance on factual matters, therefore allowing more efficiency and providing certainty and transparency for taxpayers and the ATO.

The ECAP project aims to:
- reduce red tape, by using whole-of-government resources to provide an efficient and effective assurance process
- give selected PG&I taxpayers more choice and control over managing their tax compliance within their natural business systems now and into the future, allowing them to get on with business
- give the ATO assurance over a greater portion of our taxpayer population
- enable the ATO to redirect resources to higher risk matters in the PG&I market

CONTEXT

The ATO is exploring an initiative for undertaking assurance work through the ECAP project.

An ECAP is assurance work, conducted by an external party, that assists in providing the ATO assurance that a taxpayer is meeting their tax obligations in relation to an ATO identified factual matter or matters.

Under the proposed model, taxpayers would have increased control and be provided with greater choice of reviewers: the ATO or an ECAP provider. The pilot will focus on post-lodgment issues but will simultaneously test possibility of pre-lodgment in the future, for example, taxpayers self-assure using publicly available tools and advice.

The project aligns with the Commissioner’s statement 2013–14 to:
- simplify administrative requirements and make participation in the tax and superannuation systems as easy and seamless as possible
- ensure our services and communications match contemporary practices of business and government

Models in Singapore and the Netherlands, as well as self-managed super funds here in Australia, have influenced our thinking and design considerations.

SCOPE

- ECAP will be offered to selected public groups that:
  - have a turnover between $100 million and $5 billion
  - exhibit factual matter(s) that are suitable for an ECAP
  - have an ATO risk rating of medium or lower.
- ECAP will focus on factual matters and will not supplant the Commissioner’s determination and application of the law.
- ECAPs will be undertaken by taxpayer’s existing statutory auditors only and will be conducted as agreed-upon procedure engagements.
- The ATO’s ECAP decision is not binding where fraud or collusion are detected.
- Broadly, the ATO would:
  - identify the tax matter(s) requiring assurance
  - initiate and offer the taxpayer a choice after they have lodged their income tax return
  - provide guidance and standards for completing an ECAP (pre- and post-lodgment)
  - provide clarification assistance
  - upon receiving the ECAP report, make an assurance decision on the ECAP findings
  - perform integrity checks on a sample of completed ECAPs.

After a suggestion from the Inspector-General of Taxation and other external stakeholders, the ATO has been working on a possible concept with industry and taxpayers.

CONSULTATION AT WORK
PEOPLE
User groups, stakeholders and co-design activities

1,400 public groups and 200 individual entities

Approximately 5000 registered company auditors and 86 audit firms

USER GROUPS
- Public groups that meet the ECAP criteria:
  - $100 million to $5 billion turnover
  - only have ECAP issues
- Firms/entities that provide the statutory auditor function/services may choose to provide ECAP services to eligible taxpayers
- ATO staff.

What do we know about them?
Public companies:
- About 1,400 public groups and 200 individual entities within population range, with most using Tier 1 & 2 firms.

Statutory auditors:
- Approximately 5000 registered company auditors and 86 audit firms.
- The big 4 firms provide tax advice services to over half the ECAP taxpayer population.

STAKEHOLDERS
ATO
- Public Groups and International (PG&I) business line
- Indirect Tax business line
- Private Groups and High Wealth Individuals business line
- Fraud Prevention and Internal Investigation unit

Externals
- Accounting firms
- Law firms
- Professional associations
  - The Law Council of Australia
  - The Institute of Chartered Accountants in Australia (ICAA)
  - Certified Practicing Accountants Australia (CPA)
- Public sector unions
- Taxpayers within the ECAP population

- Government regulatory bodies
  - Australian Securities and Investments Commission (ASIC)
  - Accounting Professional and Ethical Standards Board (APESB)
  - Auditing and Assurance Standards Board (AUASB)
  - Tax Practitioners Board (TPB)
  - The Australian National Audit Office (ANAO)
  - Inspector-General of Taxation
**CO-DESIGN ACTIVITIES**

**Activities to date**
- Meetings with individual stakeholders to understand the industry.
- Meetings with regulators to understand the regulatory framework.
- Key issue working groups exploring:
  - independence of auditors
  - role and fit of tax advice
  - materiality and scope of assurance.
- Consultation workshops – delivery of progress and design features.
- Taxpayer surveys – to understand user experience and acceptance levels.

**Activities underway**
- Finalisation of ECAP concept and test model.
- Internal functional design to support ECAP including:
  - new processes
  - culture and capability change.
- Development of high level design, user pathways and guidance materials.

**Activities planned**
- Draft project findings circulated to stakeholders for comment – May 2014.
- Final report provided to PG&I Executive for consideration of recommendations – by late May 2014.
- If approved by PG&I Executive, proceed to implementation pilot – commence in July 2014.
- If pilot goes ahead, create a steering group composed of ATO and key externals.

**Benefit**
"...the ECAP option would need to be guaranteed to provide a more efficient solution, for the reasons outlined in the proposal...” Taxpayer survey.

**Benefit**
"...just forms part of the normal program of work undertaken by the auditor if an issue is raised ...” Taxpayer survey.

**Choice**
"...though ATO does good job as well, but most likely we will go with the ECAP provider...” Taxpayer survey

**Choice of reviewer**
"Governance! The choice allows for the relevant parts of the business (eg. Audit committee, board) to be involved and make choices broader than just ATO or ECAP (eg. Cost, business interruption) ..” Taxpayer feedback.

**Deductibility**
"Any assurance undertaken by an ECAP provider could potentially be realised far more quicker...” Taxpayer survey

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**After presentation of the initial concept, stakeholders have contributed to, and assisted with, key issue management and honing the design**

**ATO or ECAP**
"The use of the Auditor is attractive for all sorts of reasons, but mostly because it allows the business to continue and the Auditor does not need much assistance..” Taxpayer feedback.

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**CONSULTATION AT WORK**
**What is a high level design?**

**Design assumptions and dependencies**

High level design: proposed end-to-end ECAP process

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**WHAT IS A HIGH LEVEL DESIGN (HLD)?**

A HLD is a complete, integrated framework that is used as the basis for the detailed design work that follows. During the design process we take a holistic perspective of the user's experience with the tax system, rather than concentrating on a single product or piece of legislation.

The HLD helps us to:

- understand the end-to-end design from the users’ perspective (i.e. how will things be different for them and what are the potential impacts?)
- identify the internal ATO capability needed to build, deliver and administer the solution
- assist sponsors and other stakeholders to make informed decisions
- ensure the design is complete and key products and services have been identified.

A critical part of the HLD are **user pathways**, which represent the end-to-end experience, or life cycle, of each user group, including their actions and interactions, and what needs to be changed or created to deliver the best outcome.

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**DESIGN ASSUMPTIONS**

- There will be two options:
  - **ATO-initiated ECAP** (matter(s) identified after lodgment).
  - **Taxpayer-initiated ECAP** (before lodgment of their income tax return)
- Taxpayers can choose the reviewer – either their existing statutory auditor or the ATO.
- The auditor will:
  - use existing natural systems and their knowledge of the taxpayer
  - follow regulatory standards and ATO requirements
  - report on factual matters only – no opinions or judgments.
- The existing company regulatory framework will be the foundation of the ECAP model in relation to standards, ethics and due diligence.
- An ECAP should be an easy and low cost process of short duration.
- Condition where an ECAP should not be accepted by the taxpayer will be outlined in the ECAP letter, for example, where:
  - the auditor does not meet independence or ethical requirements
  - legal professional privilege or other concessions apply.
- The ATO is the nominated end user of the ECAP report and makes the decision on assurance.
- ECAP issues identified by the ATO are considered a ‘prompted’ voluntary disclosure, where an error is reported.
- New issues uncovered during the ECAP, and reported to the ATO, will be considered an ‘unprompted’ voluntary disclosure.

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**DESIGN DEPENDENCIES**

- Relevant regulatory agencies endorse the approach.
- Proposed users (taxpayers, auditors and ATO officers) endorse the design and product.
- Adequate priority and resources being allocated to support the concept development and pilot testing.
- Supporting materials being easily understood and accessible.
- ATO staff committing to the underpinning principle of assurance (capability and culture (for example, review the reviewer)).
- Statutory auditors understanding and delivering the required work.
HIGH LEVEL DESIGN: proposed end-to-end ECAP process

**Design Considerations**

- **Detail in guidance materials should be sufficient** to enable auditor to meet the ATO requirements.
- **The depth of detail in the ECAP report required for ATO to gain assurance** on the need to place trust elsewhere and streamlined processes.
- **How to manage materiality in a financial Standards sense** and ensuring the work is appropriately scoped.
- **Focused on short duration, streamlined processes** and low cost for taxpayers.
- **Using a statutory company auditor** and whether there be some flexibility.
- **How to manage legal professional privilege and other concessions**.
- **Ensuring the roles of the taxpayers, ECAP provider and ATO are clearly articulated**.
- **Ensuring that the privacy requirements are upheld in the tripartite relationship of ECAP work**.
- **Explore email or other innovative ways as an option for certain elements in the ECAP pilot**.
- **Voluntary disclosure treatment**.
**DESIGN CONSIDERATIONS**

- How ATO will monitor taxpayer mitigation implementation.
- The importance of giving a taxpayer **precise evidence of why** the ATO requires further work with the taxpayer following an ECAP (an additional burden), especially if the ATO has not accepted a nil error ECAP report.

Some examples of when further work or clarification maybe required by the ATO are:
- the report identifies errors, but does not offer mitigation or mitigation offered does not appear to address the issue
- the report identifies new issues (errors) that are separate to ECAP, but does not offer mitigation, or mitigation offered does not appear to address the issue
- the ATO has new or other information that the report may not have considered
PROJECT PRINCIPLES

- Design a solution that:
  - wherever possible, will reduce regulatory reporting burdens, red tape, processes and any potential cost for both taxpayers and the ATO
  - uses existing natural systems
  - reuses existing processes, technology and frameworks
  - does not require legislative change
  - does not limit our thinking around existing structures and systems.
- Work collaboratively with a core design team (CDT) to deliver a design that can be tested further if a pilot is approved.
- Accept that, and document change of scope or direction is likely.
- Develop solution that is aimed at enhancing the end user experience.
- Be managed within the approved resource and budget allocation.

PROJECT OUTCOMES

The project will deliver:

- an assurance model for piloting that reflects:
  - improved experience, quicker certainty and reduced compliance costs for PG&I taxpayers
  - an assurance process that is appropriately proportionate to the matter(s) identified and the taxpayer’s risk rating
  - taxpayers more informed about the ATO view of their risk of non-compliance with their tax obligations
  - an improved ATO compliance delivery, providing appropriate assurance over risk to revenue.
- a well-documented, evidence-based approach to ECAP and its operation, which will be explainable and defensible to taxpayers, government, broader community and external scrutineers.

PROJECT TIMELINE

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<th>APRIL</th>
<th>MAY</th>
<th>JUNE</th>
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<tr>
<td>Workshop / working group outcomes</td>
<td>ECAP report Draft project report circulated to stakeholders for comment</td>
<td>Pilot decision</td>
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<td>Functional design</td>
<td>Exec report Final report provided to PG&amp;I Executive for consideration</td>
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<td>High level design – user pathways</td>
<td>ATO Executive meeting</td>
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PROJECT FINDINGS

- ECAP should proceed to pilot.
- A steering group should be formed to guide and set direction in relation to ECAP.
- The scope of a pilot should remain on factual matters.
- The ECAP provider for the pilot should be the existing company auditor.
- The procedure to be tested in the pilot should be limited to an agreed-upon procedure engagement (AUP) while assurance engagement options are further explored.
- A minimum of eight audit firms, covering 16 taxpayers, will be offered the opportunity to participate in the pilot.
- Error(s) identified during an ECAP will be treated as a voluntary disclosure and penalty remission will be considered.
- Six risks will be tested including: research and development clawback, CGT, losses, capital allowance, non-resident withholding tax and consolidation losses on exits.
- Communications and AUP guidance standards will be provided.

ONGOING CONSULTATION WITH AGENCIES