

GST and the integrity of your business systems

What you need to know to keep your systems healthy



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If you follow our information in this publication and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we must still apply the law correctly. If that means you owe us money, we must ask you to pay it but we will not charge you a penalty. Also, if you acted reasonably and in good faith we will not charge you interest.

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Are your business systems costing you time and money?

When the systems businesses use for capturing and recording GST information fail, often those businesses will go on to report incorrect amounts of GST and make potentially costly errors. We refer to these errors as the integrity of business systems (IBS) risk.

Systems may fail because they are not set up properly to start with or because they are left unchecked for long periods of time. Whether you are a new or established business, we encourage you to review your business systems, processes and controls – they could be costing you time and money!

Who is at risk?

Businesses going through a change are most at risk of incorrectly reporting their GST. This can include businesses that are:

- growing rapidly
- restructuring
- going through a merger or de-merger
- installing new accounting software
- experiencing a change in accounting staff.

A business with out of date systems or inadequate control points is more likely to:

- report incorrectly, resulting in the need to review and amend activity statements
- have debt and lodgement difficulties
- have an increased chance of review

In 2009–10, we identified \$21 million in unreported GST liabilities after contacting 503 small and medium enterprise (SME) taxpayers who were at risk of incorrectly reporting GST.

In the same year, the SME industries that had the highest number of GST reporting adjustments because of business system risks were:

- retail trade – accounting for 25.3% of adjustments
- wholesale trade – accounting for 19.2% of adjustments
- financial and insurance services – accounting for 13.25% of adjustments
- manufacturing – accounting for 13.25% of adjustments.

Why do errors occur?

Inadequate or out of date systems and non-existent or poorly documented controls can lead to a wide range of errors and issues. Common causes of system errors include:

- accounting systems failing
- incorrect or incomplete activity statements
- incorrectly interpreting GST legislation
- classifying taxable supplies as GST-free or non-taxable.

The table below identifies common errors and shows how frequently they occur for SME businesses. This information is based on 2009–10 figures and shows the total amount of GST that was owed.

Type of error or issue	%	Shortfall amount
Activity statement preparation errors	32%	\$6,720,000
Technical understanding	27%	\$5,670,000
System related issues	24%	\$5,040,000
Other – for example, change in business structure or unsure of GST treatment	8%	\$1,680,000
Miscommunication between related entities	6%	\$1,260,000
Staff turnover and controls	3%	\$210,000

How do we identify businesses at risk?

We identify business who are at risk by using:

- information reported on tax returns and activity statements
- published company reports
- information reported in the media
- information from other government databases.

10 reasons to review your systems – why invest?

Effective accounting and business systems play an integral role within a business. Conducting a ‘health check’ on your business systems will bring many benefits to your business. By getting your system right the first time, your business can be more effective.

1 You can be confident your systems aren’t costing you time and money

Businesses can report incorrect amounts of GST (often without realising) when their systems for capturing and recording GST information fail. If you take time out to review your business systems, it can help you lessen the costs of complying with your obligations and add value to your business through correct reporting.

Check that your systems and controls:

- Allow for figures to be correctly copied when completing the activity statement
- Only allow you to claim GST credits with a valid tax invoice
- Include invoices produced outside your normal accounting system
- Correctly transfer GST information between associates
- Clear GST control accounts
- Complete reconciliations

2 Healthy systems offer certainty when growing or changing your business

We have found that businesses going through change are most at risk of incorrectly reporting GST. For example, those businesses experiencing rapid growth, restructure, mergers or demergers.

Check that your systems and controls:

- Identify and report new branches
- Invoice trading stock correctly on transfer to a new business
- Correctly treat sales as non-taxable when supplied to another member of the same GST group
- Integrate with any new systems

3 Know the little things won't have a big cost

Errors in GST reporting can cost your business money. It is important you keep your systems up to date with changes to GST so you avoid potentially costly mistakes.

Check that your systems and controls:

- Are accurate
- Correctly classify all your sales and purchases
- Can correctly classify mixed supplies
- Do not leave information out of your activity statements

4 Help manage your cash flow

We understand that cash flow is the lifeblood of business. Unfortunately businesses often report GST transactions incorrectly because their systems let them down. These IBS errors can adversely impact your cash flow.

Good record keeping systems let you focus on growing your business by helping you better manage your cash flow.

Check that your systems and controls:

- Accurately track the GST paid and charged for both electronic or paper-based transactions
- Track the flow of your invoices to ensure you claim your GST credits on time
- Identify areas of GST impact in your systems to ensure they receive the correct GST treatment
- Adjust prices to include GST

5 Get the credit you deserve

When your systems correctly classify your transactions (sales, mixed sales and purchases) you can have confidence that you are paying the correct amount of GST to us and that you are not missing out on any GST credits.

Check that your systems and controls:

- Correctly classify and record all of your sales or purchases
- For mixed supplies, allow you to claim GST credits on the part of the tax invoice that is subject to GST
- Have safeguards for processing one-off transactions or rebates

6 You can be confident your one-off transactions are managed effectively

You need to be particularly careful when making one-off transactions. Often they can be significant for the business but if your system is not set up to deal with them correctly, an error could mean penalties or interest.

Check that your systems and controls:

- Can identify one-off transactions
- Properly document and process one-off transactions
- Have a built in point for manual checking

7 Know that when you go through change you will be less likely to experience errors and downtime

When your systems, controls and processes go through periods of change, it can be disruptive for your GST reporting. Examples of these types of changes include introducing a new accounting system or a change in accounting staff.

Check that:

- When transferring to a new system, it does not override important settings you had in place in your old system – keep a record of your old system settings
- Your staff know your internal processes and are trained to use your system correctly
- Your system controls and internal processes are adequately documented

8 Know that a review isn't around the corner

Getting your system right will save you time and money in the long run. Doing a business systems health check can streamline your reporting and reduce the possibility of errors. Knowing you have control over your systems can also help you manage your internal reporting and help you track where your money is going. Reducing the likelihood of error means it is less likely your tax affairs will be reviewed.

9 Know your activity statement is lodged on time and correct.

Knowing your activity statement is correct and on time can help improve the productivity of your business, save you time, administration costs and help you manage your cash flow. When your systems are set up correctly to record and account for your transactions, your activity statement lodgement can be a much smoother process.

Check that your systems and controls:

- Allow for figures to be correctly copied when completing the activity statement
- Manage your cash flow and reflect your correct financial position
- Include invoices produced outside a normal accounting system
- Correctly transfer GST information between associates
- Clear GST control accounts
- Complete reconciliations

10 Be confident you are reporting correctly

Reporting your GST correctly can give you more control over your business. Good systems help you to avoid or find errors before they come back to hurt your business.

After your business systems have been set up and include controls such as the use of exception reporting, it can be useful to review them every year to check they are still up to date and in-line with your business practices and transactions.

Case Studies

The following case studies show the importance of systems integrity to correct GST reporting.

Case study 1

Shop&Shop Ltd operates a large wholesaling business. As Shop&Shop Ltd often make large and one-off transactions, they make sure they regularly review their systems, making sure they have adequate controls in place.

Recently, reduced cash flow placed substantial strain on the business. Shop&Shop Ltd initiated an internal investigation to work out the cause.

As part of this investigation, they reviewed their systems and found that they had made a coding error in their purpose built accounting and inventory management system. They found their system was incorrectly identifying transactions between their branches as taxable and that they had overpaid approx \$1.8 million over a period of 2 years.

After discovering the error, Shop&Shop Ltd applied to us for a refund. As the refund was quite large and unexpected, we selected the refund for review. During the review Shop&Shop Ltd were able to demonstrate to us why the error occurred and the refund owing was paid to them.

Shop&Shop Ltd then adjusted their systems and processes so the error would not continue to occur.

Case study 2

The City-break Company is part of the hospitality industry – they rely on their point of sale (POS) systems to capture their GST reporting information, but do not have any control procedures around the systems.

We identified City-break as being at risk and undertook a review of their recent activity statements. We found that they had over claimed GST credits and under reported the GST payable on a number of transactions.

We found that these errors arose because their POS system was not set-up to correctly classify the types of transactions the business was making and there was a lack of control procedures around the systems.

This resulted in City-break making errors, including:

- incorrectly classifying items sold over the counter because of coding errors introduced when the POS system was originally set-up
- omitting GST on over the counter meals
- not accounting for many taxable sales – this was the result of a change in POS terminal set-up
- incorrectly classifying takeaway sales in the system.

As a result of these errors, City-break understated their GST sales by \$360,000, over a period of 4 years. In addition to the GST shortfall, City-break was required to pay penalties and interest.

Case study 3

Fiexo, a manufacturing company, was identified by us as being at risk. We worked with them to understand their business operations and provided them with some recommendations for improving the integrity of their business systems.

During the course of our review we identified Fiexo had a number of systematic issues which contributed to errors in their business activity statements including:

- not reconciling GST reports to the GST general ledger accounts
- a lack of documentation on the procedures around the processing of accounts payable, accounts receivable and preparing the business activity statement
- insufficient procedures regarding the processing of sales invoices resulting in sales being omitted from activity statements
- purchases paid on behalf of related entities incorrectly included on activity statements
- using incorrect tax codes resulting in incorrect GST treatment.

Fiexo made their IT consultant available during the review, which allowed them to identify and introduce system modifications to address these issues.

Fiexo also instigated an internal examination during the course of our review that resulted in a discovery and a disclosure of over \$500,000 in unpaid GST. Despite having to pay a substantial amount of GST, Fiexo was confident the outcome resulted in better business systems and processes, ensuring it was unlikely they would be in the same situation again.

Checklist – what you can do

There are a few key things you can do to lower your risk profile for the IBS risk and ensure your systems are best placed to support your business and report correctly.

Do you have written procedures in place?

Written, documented procedures are important for:

- identifying the correct GST treatment of each supply and acquisition
- identifying processes to be followed for unusual, large or one-off transactions
- tracking and processing adjustment events such as cancellations and payment changes
- preparing your activity statements correctly.

Do you have control over your internal environment?

Strong internal controls over your systems and processes will help you:

- to introduce GST governance and risk management processes
- have levels of delegated authority and clear escalation procedures
- have an established process for seeking external advice
- use your accounting software effectively to generate exception reports
- perform monthly reconciliations
- have a clear separation of duties.

Do your staff receive training and support mechanisms?

When your staff receive training specific to your systems and business needs, this will help you manage risk. You can:

- have help cards and other material to assist staff
- create succession plans – having several people within your business capable of undertaking the same role
- have a process for mentoring and guiding new staff
- provide training for existing staff to keep their knowledge and skills regularly updated.

Do you conduct regular reviews?

Regular internal reviews can ensure your systems and business processes are on track, allow you to update and include any relevant changes to GST law and help you manage risk. You can:

- engage the services of a tax practitioner or auditor to perform an external review
- perform an independent internal review of your tax processes
- ask your systems software provider to review your systems
- review and update your written procedures and software regularly
- monitor reporting trends.

Are your systems secure?

System security is important for managing the IBS risk. You should ensure that:

- access to your financial and accounting systems is restricted and has an audit trail
- you have a 'lockdown' process for month and year end
- there are clear authorisation levels for processing unusual or one-off transactions.

Do you have well established relationships when you need tax advice?

Knowing where to go and who to ask when you need resolution to a tax or system issue can help you manage business system risk. It is important that you:

- have a good working relationship with your tax agent, accountant, bookkeeper or software developer
- are aware of where you can go to obtain advice.

How do you report an error?

After reviewing your business systems and controls you may discover an error or discrepancy with your reported GST. If this happens, we encourage you to make a voluntary disclosure. Reduced penalties may apply if you let us know before an audit is commenced.

- **For more information about making a voluntary disclosure visit our website at www.ato.gov.au/voldisclosureform**

More information

For more information:

- refer to *Record keeping for small business* (NAT 3029)
- visit our website at **www.ato.gov.au**
- phone us on **13 28 66**
- write to us at **PO Box 9935 in your capital city.**

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

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

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

