Presented pursuant to the Government Resources & Accounts Act 2000 c20 s6
and the Exchequer & Audit Departments Act 1921 c52 s2

HM Customs and Excise 2004-05 Accounts

- Resource Accounts
- Trust Statement
- Standard Report

(For the year ended 31 March 2005)

Ordered by the House of Commons
to be printed 10 October 2005

LONDON: The Stationery Office 10 October 2005

HC 447 £16.00

HM Customs and Excise 2004-05 Accounts

Contents Page

Statement on Internal Control

1. Scope of responsibility

1.1 As Principal Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of HM Revenue and Customs (HMRC), and previously HM Customs and Excise (HMCE), policies, aims and objectives, whilst safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Government Accounting.

1.2 I am the Executive Chairman of HMRC which was formed by Act of Parliament in April 2005, and prior to that I was Executive Chairman of HMCE. As Executive Chairman of HMRC I am accountable to the Chancellor, and to the Paymaster General, to whom the Chancellor has delegated responsibility for the day-to-day oversight of the Department. The Paymaster General is kept informed of progress and significant issues facing the Department in the course of regular bi-lateral meetings that she has with me and the other Board members. Previously, as Executive Chairman of HMCE I was accountable to the Chancellor who in turn delegated responsibility for day-to-day oversight to the Economic Secretary to HM Treasury.

1.3 As Principal Accounting Officer for HMRC, and previously for HMCE, I am supported by a number of Additional Accounting Officers. Each of these has clearly defined responsibilities outlined in their appointment letters. Their relationship with me is also clearly set out in separate Memoranda of Understanding.

2. The purpose of the system of internal control

2.1 The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to: identify and prioritise the risks to the achievement of departmental policies, aims and objectives; to evaluate the likelihood of those risks being realised and the impact should they be realised; and to manage them efficiently, effectively and economically. The system of internal control has been in place in HMCE for the year ended 31 March 2005 and in HMRC up to the date of approval of the annual report and accounts, and accords with Treasury guidance.

2.2 In the period leading up to and following the creation of HMRC on 18 April 2005, we have been putting in place key elements of the governance, risk and control framework for the new Department. An overview of these elements is set out in the following sections. It will take time to fully embed the structural, managerial and behavioural changes that will be required to meet the challenges facing HMRC but, even at this early stage, we have made significant progress.

3. Governance

3.1 One of the earliest and most important challenges in the last year has been the establishment of a high-level governance structure, which will provide the leadership for the creation of a successful new department while at the same time ensuring that existing targets continue to be met. In my statements for the two former departments last year, I set out the initial steps towards this. I can now outline the major developments that have taken place since then.

3.2 The Commissioners of HMRC, created by the Act of Parliament, met in April 2005 and put in place a high level governance structure that includes:

- A Board that comprises the members of the Executive Committee, the Chief Executive of the Valuation Office Agency and the Non-Executive Directors. Its role is to set the Department's strategic direction and to provide advice to the Executive.

- An Executive Committee that is the primary decision making forum for the Department. Its members' portfolios span the whole of the organisation of the department.
- An Operating Committee that supports the Executive Committee by providing an oversight of the Department's day-to-day performance.
- An Audit Committee that comprises non-executive board members and provides me with advice and support in my responsibilities for risk management, internal control, corporate governance and associated assurance.

3.3 In addition to these a Social Responsibility Steering Group will meet from September to oversee the department's corporate responsibility agenda and review progress against specific objectives; and a People Committee that will support major HR policy initiatives. I have also established a General Counsel role to provide me with expertise and direct support on legal and governance issues.

3.4 Finally we are developing relationships with those external bodies that provide both scrutiny of and support for the work done by HMRC that is linked to the criminal justice system. Her Majesty's Inspectorate of Constabulary (HMIC) provide external inspection of our standards of compliance with criminal justice requirements and the Independent Police Complaints Commission (IPCC) are tasked with consideration of serious complaints against HMRC officials. The Revenue and Customs Prosecution Office (RCPO) is responsible for prosecuting all criminal cases involving drug smuggling, money laundering and tax fraud brought as a result of HMRC investigations.

4. Risk Management

4.1 The two former revenue departments had well understood (and externally well regarded) risk management frameworks, based on principles, standards and practices now common across central government. We are building on the progress that has been made in the two departments, but we are also taking the opportunity provided by the creation of HMRC to secure a step-change in the way that we manage risks to delivery. For instance the Executive Committee is taking a more direct and active role in the identification and management of risk. This has had an impact on the risk profile of the organisation as risks are escalated and discussed more openly. We are also integrating risk reporting with our new performance reporting process. We are keeping at the forefront of risk management developments in central government, and I sit on the Civil Service Management Board sub-group on risk.

Capacity to Handle Risk

4.2 Integration of the two departments presented significant risks both in terms of achieving the merger itself and maintaining delivery of business objectives. The decision was therefore taken to reduce the risks associated with the process as far as possible. As a result, the legislation addressed the specific issues necessary to get the new organisation in place, while integration was carefully managed to minimise the impact on delivery and to ensure there was no inappropriate spend on HMRC prior to successful passage of the Bill.

4.3 In balancing the need to manage the change against the need to manage the business, in November 2004 the joint Board agreed an approach to create a single strategic view of risks across the organisation. A workshop was held in February 2005 when the senior management team reached a consensus on the top risks to delivery. Progress in managing these top risks is part of the information that is available for the weekly meetings of the Executive Committee.

4.4 Staff in the two former departments continue to have access, through the intranet, to risk management guidance. We are in the process of drawing this guidance together into a single risk framework for HMRC.

The risk and control framework

4.5 The risk management frameworks developed in the two former departments, although different, were consistent with common risk management principles and practices. Each involved a process for identifying top risks, taking account of impact and probability, and the upward reporting of these. The new risk management framework we are putting in place for HMRC will retain these fundamental elements and will seek to embed them across the organisation. We are also putting in place arrangements to integrate risk and performance reporting. Risk management is also a key component of the Management Framework that has been developed for all HMRC managers.

5. Control

5.1 Another key aspect of our control framework is the development throughout 2004 of a new business design model, and the organisational structure that is emerging in 2005 to deliver this. The model, which is overseen by the Executive Committee, is based on four interrelated work groups:

- **Operations.** These include the 12 core businesses employing the majority of staff in the Department.
- **Corporate Functions.** These will deliver cost effective customer focused services to all staff.
- **Product and Process Groups.** These are the taxes, duties, credits and benefits that form the basis of the Department's business and the schemes by which products are delivered. Staff in these areas are responsible for design, specification and providing advice to departmental staff and Ministers.
- **Customer Units.** These will focus on identifying and understanding the requirements and behaviours of our customers, and the risks associated with them. The aim is to make it easier for customers to comply and to reduce compliance costs.

5.2 The aim is for this model to be the foundation for a transformation in performance by placing greater emphasis on the customer. We are aiming also for a balanced organisation that requires collaborative working across and between its different elements while also introducing clear accountabilities within each element.

5.3 A major challenge that faced senior managers in Inland Revenue and HM Customs and Excise was the integration of different control mechanisms that existed in those departments, while at the same time continuing to meet stretching targets. The statements I have received from my fellow Executive Committee members of their own reviews of internal controls reflect the vital work that has taken place in this area. Examples of this include:

- Integrated management structures and common policies and practices quickly established.
- Key managers undertaking thorough reviews of their new areas of responsibility to ensure that best practice is identified and promulgated.
- A specialist professional team established early in 2005 to identify risks to delivery and improve compliance in the Commerce and Estates areas.
- Integrated business planning and resource allocation procedures designed and implemented.
- Common systems of financial management and reporting introduced, including combined management accounts established in August 2004.
- An active approach to fraud prevention, detection and redress for our corporate systems, including full investigation of all incidents of suspected internal fraud.
- A data quality executive supported by a multi-discipline data quality task force established in January 2005. This aims to 'cleanse' over the next year the address and identity data held by HMRC by comparing it to third party databases held by employers and others. Clean data will ensure that we work more efficiently and also provide a better service to our customers.

6. Review of Effectiveness

6.1 As Principal Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within the Department who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letters and other reports.

6.2 I discuss significant control issues with my executive team at our weekly Executive Committee meetings, and I meet Directors individually to discuss performance. These meetings are informed by an assessment of our current exposure to risks associated with our major programmes and projects. I also receive detailed, monthly Management Accounts, which highlight potential areas of concern.

6.3 To provide me with an assurance on the effectiveness of the system of internal control, the Director of Internal Audit now provides me with a summary of the findings from every internal audit review, and he also alerts me to significant control issues as they arise. The Chairman of the Audit Committee, who is also a non-Executive Board member, provides the Board with a written report after each Audit Committee meeting.

6.4 The Director Generals and other senior managers have drawn up statements that set out the governance, risk and control arrangements in their business areas. Taking these statements into account, and the views of the Director of Internal Audit and external auditors, I recognise that there are a number of significant control weaknesses. These are detailed below. I am giving priority to the plans that we have put in place to address these weaknesses.

Update on Issues Raised in 2003-04 Statement

Shipbuilders Relief (SBR)

6.5 Last year I reported that the Department had significantly underestimated its contingent liability for future SBR claims and had put in place an action plan to address the control failings leading to the error and to ensure a better flow of information on the expected level of claims. This plan is now fully embedded and the Department receives a good supply of information from a variety of sources that allows it to adequately monitor, and update where necessary, the level of expected claims.

Legacy Information Systems

6.6 Successive recent HMCE SIC's have disclosed the continuing risk posed by potential failure of legacy systems pending the introduction of e-based systems. This risk did not materialise in 2003-04 and the 2003-04 SIC described the development of the transformational e-business programme allied with strengthened support for the legacy mainframe environment ensuring continuity of service and reduction of the risk materialising. The Department has continued to augment its controls following the 2003-04 SIC statement. This includes the Service Improvement Programme, which is being developed to ensure timely action is taken to maintain service levels. This demonstrated high levels of process maturity in Service Support and identified areas where controls could be enhanced for Service Delivery. Work has also started on the identification of potential retirement dates for legacy systems in relation to the introduction of new services on the e-Programme Roadmap. For example a major Law Enforcement system (CEDRIC) and a major HR system (CUPID) were both replaced in 2004-05. The Department continues to effectively control the diminishing risk. Unless it re-emerges in 2005-06 I do not intend to return to this issue.

New Issue Raised in 2004-05

Impact of Recent Court Cases on Departmental Reputation

6.7 The review of HMCE Law Enforcement conducted by Mr Justice Butterfield concluded in 2003 that the department's management of investigations and prosecutions in the mid-1990's surrounding a bonded warehouse (London City Bond) had been flawed. Mr Justice Butterfield also concluded that the department had made significant progress in improving its management, training and procedures since these cases. To further embed the improvements already made, HMRC has recognised the need for new mechanisms to improve transparency and accountability, and has taken steps to put those in place.

These steps include changes to internal process and structures:

- Bringing HMRC within the coverage of the IPCC to allow investigation of serious complaints and allegations against HMRC staff.
- Extending the remit of HMIC to investigate HMRC's law enforcement procedures and practice, and
- Establishing an independent RCPO accountable directly to the Attorney General.

6.8 The reputation of HMRC is at risk in light of legacy cases and judgements that criticise the department and/or the actions of staff. As a result of the recent judgements in the case of Operation Venison (24 June) and by the Court of Appeal in the cases of Operation Hellvellyn and others (4 July) (also referred collectively as Operation Brandfield), HMRC has agreed with IPCC that they will oversee the investigation into criticism of the actions of individual officers in Operation Venison.

6.9 The judgement also highlights past failings of disclosure and informant handling. To address such failings HMRC is implementing a £68 million programme of training and IT. Already over 2000 HMRC officers have received specialist training in disclosure and the management of informants. A new electronic informant handling system has now been introduced and the first phase of the document handling system will go live later this year.

6.10 HMIC will begin in September their full programme of inspection to examine informant handling, controlled deliveries and disclosure, including the issues raised in the judgement of Operation Venison and Operation Hellvellyn and others.

Impact of Changes in Missing Trader intra-Community (MTIC) VAT fraud

6.11 MTIC fraud involves obtaining a VAT registration number in the UK for the purposes of purchasing goods free from VAT in another EU Member State, selling them at a VAT inclusive price in the UK and then going missing without paying the output tax due to Customs. The most abusive form of the fraud, known as carousel fraud, involves the same goods circulating repeatedly between the UK and other countries, with the VAT being stolen on each circuit. The goods involved are generally small volume, high value goods such as mobile phones and computer chips. It is widely accepted that the fraud affects most European countries.

6.12 In September 2000 HMCE put in place a coordinated strategy to reduce the VAT lost as a result of MTIC fraud. Since then the rapid increase in fraud levels has been reversed, with estimated VAT losses falling from a peak of between £1.73 billion and £2.53 billion in 2001-02, to between £1.06 billion and £1.73 billion in 2003-04.

6.13 Over the past year we have seen changes in the pattern of trading associated with MTIC fraud. For example, the value of exports to non-EU countries by known MTIC traders has risen while the value of their EU sales has declined. We believe that this diversion of sales from EU to non-EU destinations is a direct response to the success of our tactics in tracking and tracing goods moving within the EU. But it remains to be seen whether it translates into higher year-end fraud estimates, which are published each year alongside the Pre-Budget Report.

6.14 Because HMRC closely monitor this type of trading, it has been possible to identify and respond to this new trend at an early stage. HMRC has already taken steps to develop and strengthen its MTIC strategy and is specifically tightening up checks on MTIC goods at the point of export, requiring physical examination prior to export, marking the containers and recording the bar codes. This makes it easier for UK and EU authorities to identify the goods as they return to the EU carousel. We are also developing and strengthening our mutual assistance arrangements with authorities in the main non-EU destinations for MTIC goods.

6.15 A project has been set up between HMRC and the Office of National Statistics to review and assess the impact of changes in MTIC trading patterns on the UK Trade and Balance of Payments estimates.

DAVID VARNEY
Principal Accounting Officer
5 October 2005

Resource Accounts

Resource Accounts for the year ended 31 March 2005

Contents Page

Annual Report on the Resource Accounts for the period 1 April 2004 to 31 March 2005

Scope

1. As Chairman and Principal Accounting Officer for HM Customs and Excise I am pleased to present the Resource Accounts for the period 1 April 2004 to 31 March 2005. Following the Chancellor's announcement in his March 2004 budget speech, legislation received Royal Assent on 7 April 2005 bringing into existence a new department, HM Revenue and Customs. This became a legal entity on 18 April 2005, incorporating the Inland Revenue and HM Customs and Excise. These Resource Accounts report on the final full financial year of HM Customs and Excise. This was a non-Ministerial Government Department with responsibility for collecting indirect taxes and enforcing Government requirements relating to the movement of goods across the UK national and the EU common frontier. Our focus was on managing certain major risks on behalf of the Government and the public. In addition to the revenue, ranging from simple errors in tax declarations to major frauds targeted on indirect systems, the focus also included managing the risks to society that arose from the illegal importation of prohibited or restricted goods such as drugs, firearms or paedophile material.

Operating and Financial Review

2. In the Spending Review 2002 the Department's PSA for the three years 2003-06 contained the following two objectives;

   - To collect the right revenue at the right time from indirect taxes and to improve the level of compliance with Customs and statistical requirements; and
   - To reduce crime and drug dependency by detecting and deterring the smuggling of illegal drugs and other prohibited and restricted goods.

3. A progress report on the Department's performance against the Spending Review 2002 PSA targets was given in the Spring Departmental Report 2005 (published in June 2005 under Cmnd 6542). In addition, performance updates will be given in the Annual Report covering the 2004-05 performances for the two former departments, which will be published later in the 2005-06 financial year. The departmental reports are available from The Stationery Office and the HMRC website (www.hmrc.gov.uk).

Structure of the Department as at 31 March 2005

4. During 2004-05 the Department's operational activities were separated into the two core functions of Business Services and Taxes (BST) and Law Enforcement (LE). The Customs and Excise Prosecutions Office (CEPO) undertook all Customs' prosecutions casework. From April 2005 CEPO was replaced by the creation of the independent Revenue and Customs Prosecutions Office (RCPO). The Department's support services were provided by three areas: Departmental Legal Services (DLS); Information and e-Services (IeS); and Logistics and Finance (L&F). They provided essential backing to operational units and carried out corporate functions. There were no non Departmental public bodies or on-vote agencies within the Departmental boundary.

5. For 2004-05 the Department's resources were deployed across its functions as follows:

	Salaried staff years	DEL gross resource costs £m	% of the gross DEL total
Business Services and Taxes	**12,138**	**386**	**28**
Law Enforcement	**7,627**	**378**	**28**
Support Services	**3,635**	**570**	**42**
Customs & Excise Prosecutions Offices	**204**	**28**	**2**
Total	**23,604**	**1,362**	**100**

Statutory Framework

6. The Commissioners of HM Customs and Excise were established civil servants collectively appointed by the Queen under the Great Seal. Their authority was from Parliament and they were responsible for the collection, care and management of customs duties, excise duties, Value Added Tax (VAT), Insurance Premium Tax, Air Passenger Duty, Aggregates Levy, Landfill Tax, Climate Change Levy and the Money Laundering regime (MLR). They were also responsible for the enforcement of import and export prohibitions and restrictions and the collection of overseas trade statistics.

Funding Arrangements

7. The Department was funded by a single Parliamentary Vote covering two "Requests for Resource (RfR)". The RfRs provided for:

- "Administering the indirect tax and customs control systems fairly and efficiently, enabling individuals and businesses to understand and comply with their obligations"; and
- "The effective and efficient prosecution of cases in accordance with the Code for Crown Prosecutors".

8. The Department's resources were expended and invested to support the Commissioners in meeting the responsibilities laid to them, and to achieve key PSA objectives and associated outcomes and outputs. For 2004-05 the Department's Resource Estimate was:

£m	Administration Costs	Programme Costs	Appropriations -in-Aid	Net Total
Departmental Expenditure Limit (DEL)	**1,263.2**	**139.9**	**24.6**	**1,378.5**

Notes:

- **DEL Administration Costs** cover the majority of the Department's resource expenditure including Paybill. It also includes non-cash items such as depreciation, cost of capital, and provisions.
- **DEL Programme Costs** are demand led costs required to support the Department's business, e.g. legal expenses, debt management, Lorry Road User scheme and investigatory costs including non-cash items. Also included are costs relating to the payment of Shipbuilders' Relief.
- **DEL Appropriations-in-Aid** are receipts, which are appropriated in aid of resource expenditure, e.g. receipts from International Assistance work, legal fees recovered, and debt management fees recovered.

9. For 2004-05 the Department's Capital Investment estimate was:

£m

	Capital	Capital Appropriations-in-Aid	Net Total
	174.9	**11.0**	**163.9**

The principal capital investments are in Estates Major Works, Vehicles, Vessels, Scientific Aids and Information Systems.

2004-05 Expenditure against Estimate (Schedule 1)

10. Expenditure outturn for the year (including capital investment) was some £38.0m below estimate. The Resource and Capital DEL under-spends are expected to be carried forward as End Year Flexibility into future years, subject to the approval of the Treasury. The components of this under-spend were:

- DEL Resource Costs £33.9m. This includes some ring-fenced budget under-spends, including an underspend of £2.3m relating to the Customs and Excise Prosecutions Office and an underspend of £17m on expected payments of shipbuilders' relief.
- Capital investment £4.1m.

The under-spends in Resource and Capital were in large part due to the Department preparing for joint programmes in the new Department.

Key features within the 2004-05 Resource Accounts

11. 2004-05 was the second year of the Spending Review 2002. Significant features of the Spending Review 2002 were continued investment in the Department's fraud strategies and the e-Business transition programme. New money was also received for work relating to Products of Animal Origin, Recovery of Assets Incentivisation Fund and the Lorry Road User Charge, together with additional funding for the VAT Strategy.

Private Finance Initiative (PFI) Contracts

12. The Department had three significant PFI contracts, which are included within the Resource Accounts (all three contracts have been taken over by the new HM Revenue and Customs Department from April 2005).

- **Fujitsu contract for information systems infrastructure**. 2004-05 was the fifth year of this ten-year contract. Costs of £137.0m were incurred for provision and service of the IS infrastructure and systems developments.
- **Mapeley contract for private sector ownership and management of the Departmental estate**. This is a joint contract with the Inland Revenue (including the Valuation Office Agency). 2004-05 was the fourth full year of this twenty-year contract. Costs of some £61.1m were incurred for the provision of serviced accommodation.
- **Exchequer Partnerships contract for private sector ownership of 100 Parliament Street**. The Department relocated staff to 100 Parliament Street, London in November 2004. This is a joint contract with the Inland Revenue that provides serviced accommodation for 33 years.

Pay Settlement 2004

13. The Department's annual pay award was made with effect from 1 June. For 2004 the award provided a percentage increase for re-valorisation as the basic award, a consolidated award for progression through pay ranges and a non-consolidated bonus for top performers. The percentage values of awards vary, but good performers on the main pay range received 4.2%.

Controls and Risk

14. The Department's resources have been managed and controlled in accordance with delegated authority from Treasury, and Treasury guidance (e.g. Government Accounting and the Government Financial Reporting Manual). Internal budgetary delegation and expenditure is controlled by a framework of systems and procedures that enable effective decision making and reporting. The resource management system is subject to review as part of the assessment for the "Statement on Internal Control", covering both effectiveness and risk management. This Statement is contained within these Resource Accounts.

New Responsibilities

15. In Budget 2004, the Chancellor announced that responsibility for the Lorry Road-User Charge (LRUC) would be assigned to HM Customs and Excise and that the Department would act as the Management Authority. In July 2005 the Secretary of State for Transport confirmed in a statement that the Government had decided that its plans for Lorry Road User charging should be progressed as part of its wider work being taken forward on National Road Pricing - to work for a single comprehensive, cost-effective system. A consequence of this approach is that the procurement for LRUC has been cancelled.

16. In October 2004, as part of the Efficiency review (led by Sir Peter Gershon), part of the tax policy function was transferred to HM Treasury. See Note 2 to this account.

Forward Look

17. Under the Commissioners for Revenue and Customs Act 2005 HM Customs and Excise and the Inland Revenue became one combined Department in the name of HM Revenue and Customs. The new Department came into existence in April 2005. A commentary on the governance and risk and control framework arrangements for the new Department is included in the Statement of Internal Control paragraphs 2.2 to 5.3.

18. The Revenue and Customs Prosecutions Office (RCPO) was created in April 2005 as a new department accountable to Parliament by the Attorney General. The Principal Accounting Officer's responsibilities were transferred across to the Law Officers' Department.

19. The Serious Organised Crime Agency will be created from April 2006. Some staff from Law Enforcement will move into the new agency.

Management

20. During 2004-05, the Chairman of HM Customs and Excise was accountable to the Chancellor of the Exchequer for the administration of its affairs and the implementation and stewardship of tax policy. The Chancellor was supported by two Departmental Ministers who assumed day-to-day responsibility for HM Customs and Excise during the year. The Paymaster General, the Rt Hon Dawn Primarolo MP took over from the Economic Secretary John Healey MP on 17 September, 2004. John Healey MP remained responsible for excise duties, gambling and Lorry Road-User charge.

21. During the year, the executive members comprising the Statutory Board of Customs and Excise were:

Name	Post	Period held (if not for whole year)
David Varney	Chairman	from 1 September, 2004
Paul Gray CB	Deputy Chairman	from 1 September, 2004
Mike Eland	Acting Chairman Director General	from 1 April to 31 August, 2004 from 1 September, 2004
Mike Hanson MBE	Acting Director General	
Terry Byrne CB	Director General	to 29 September, 2004
David Garlick OBE	Director	
Steve Lamey	Chief Information Officer	from 18 October, 2004
David Hogg CB	Acting Solicitor	from 1 October, 2004
David Pickup CB	Solicitor	to 29 September, 2004
Mike Norgrove	Director	to 31 August, 2004

The following non-executive Board members, together with the Statutory Board members, formed the Departmental Management Board.

Tony Hall	Non-executive Board member	to 31 March, 2005
Sir Stephen Lander KCB	Non-executive Board member	to 31 March, 2005
Barry Quirk CBE	Non-executive Board member	
David Spencer	Non-executive Board member	

The Chairman of the Board of Customs and Excise and other members of the Board were appointed in accordance with the procedures in the Civil Service Management Code.

The remuneration of the executive members of the Statutory Board (see note 3 to these Resource Accounts) was determined in accordance with the report of the Senior Salaries Review Body.

Public Interest and Other

Pensions

22. Present and past employees have been covered by the provisions of the Principal Civil Service Pension Scheme (PCSPS), which is non-contributory and non-funded. Further information on the pension scheme can be found at note 3 to the Resource Accounts.

Policy on employment of Disabled Persons

23. The Department's policy on the employment of disabled persons is included in the Corporate Social Responsibility Statement concerning diversity and is reported on page 21 of the Board's Annual Report for 2003-04.

Policy on Diversity and Equal Opportunities

24. The Department's policy on diversity and equality has been to:

- Ensure that we recruit and retain the very best people from the widest possible pool;
- Value our people as individuals and the differences between them;
- Harness those differences to improve our business performance to provide the best possible service for all our different customers;
- Promote diversity and equality in a pro-active way, consistent with our business performance standards.

Policy on Payment of Suppliers

25. Where there is no contractual provision or other understanding or accepted practice governing the timing of payment, the Department undertook to pay within 30 days of receipt of goods or services or on the presentation of a valid invoice or similar demand for payment, whichever is the later. During 2004-05 98.5% (2003-04 98.6%) of suppliers were paid within 30 days of receipt of their invoice in the Department.
No interest charges were paid in respect of late payment of commercial debts during 2004-05 or 2003-04.

Auditors

26. The Comptroller and Auditor General audits these Resource Accounts in accordance with section 6 of the Government Resources and Accounts Act 2000. The notional charge for these audit services is £0.20m (2003-04: £0.19m). In addition, the Comptroller and Auditor General audits the Trust Statement and it has been agreed that it is also appropriate to reflect the cost of this audit in these Resource Accounts. For 2004-05 the cost of the audit of the Trust Statement amounted to £0.27m. As a result, the total notional audit fee reported in these Resource Accounts is £0.465m.

Provision of Information and Consultation with Employees

27. The Department has been committed to maintaining good industrial relations with its staff. Consultation with our trade unions provided an appropriate focus for this and ensured that staff interests were properly taken into account when decisions were taken.

The Department made comprehensive use of an Intranet system, which can be accessed by all staff to provide information concerning all aspects of work and developments. In recent months, the use of a direct dial message system has been made available to all staff so that they can hear recorded interviews from senior managers. This includes interviews with the new Chairman, David Varney, Deputy Chairman Paul Gray CB and other Board members.

Details of Company directorships and other significant interests held by the Board

28. Apart from the matters disclosed in Note 27 to the Accounts, no directorships or other significant interests were held by members of the Board. No conflict arose between the Board's responsibilities and those other interests.

DAVID VARNEY
Principal Accounting Officer
5 October 2005

Statement of Accounting Officer's Responsibilities year ended 31 March 2005

1. Under the Government Resources and Accounts Act 2000 the Department is required to prepare Resource Accounts for each financial year, in conformity with a Treasury direction, detailing the resources acquired, held, or disposed of during the year and the use of resources by the Department during the year.

2. The Resource Accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of the Department, the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the financial year.

3. HM Treasury has appointed the Permanent Head of the Department as Accounting Officer of the Department, with responsibility for preparing the Department's accounts and for transmitting them to the Comptroller and Auditor General.

4. In preparing the accounts the Accounting Officer is required to comply with the 'Resource Accounting Manual' prepared by the Treasury, and in particular to:

   - observe the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
   - make judgements and estimates on a reasonable basis;
   - state whether applicable accounting standards, as set out in the 'Resource Accounting Manual', have been followed and disclose and explain any material departures in the accounts; and
   - prepare the accounts on a going concern basis.

5. In addition HM Treasury has appointed an additional Accounting Officer to be accountable for those parts of the Department's accounts relating to specified requests for resources and the associated assets, liabilities and cashflows. These appointments do not detract from the Head of Department's overall responsibility as Accounting Officer for the Department's accounts.

6. The allocation of Accounting Officer responsibilities in the Department is as follows:

   For the period 1 April 2004 to 31 August 2004 the Principal Accounting Officer was Mike Eland.

   On 1 September 2004 David Varney became Principal Accounting Officer, following his appointment as Chairman of HM Customs and Excise. At the same time, the following additional Accounting Officers were appointed:

   Paul Gray, in respect of
   Request for Resources 1:
   Administering the indirect tax and customs control systems etc.

   Mike Eland, in respect of
   Request for Resources 2:
   The effective and efficient prosecution of cases in accordance with the Code for Crown Prosecutors.

   In succession to Mike Eland, David Green QC was appointed as the Additional Accounting Officer for Request for Resources 2 from 6 December 2004.

7. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which an Accounting Officer is answerable, for keeping proper records and for safeguarding the Department's assets, are set out in the *'Accounting Officer's Memorandum',* issued by HM Treasury and published in *'Government Accounting'.* Under the terms of the Accounting Officers' Memorandum, the relationship between the Department's principal and additional Accounting Officers, together with their respective responsibilities, is set out in writing.

Statement on Internal Control

The Department's Statement on Internal Control, covering both the Resource Accounts and the Trust Statement, is shown on pages 1 to 6.

Certificate and Report of the Comptroller and Auditor General to the House of Commons

I certify that I have audited the financial statements on pages 18 to 57 under the Government Resources and Accounts Act 2000. These financial statements have been prepared under the historical cost convention as modified by the revaluation of certain fixed assets and the accounting policies set out on pages 25 to 28.

Respective responsibilities of the Accounting Officer and auditor

As described on page 14, the Accounting Officer is responsible for the preparation of the financial statements in accordance with the Government Resources and Accounts Act 2000 and Treasury directions made thereunder and for ensuring the regularity of financial transactions. The Accounting Officer is also responsible for the preparation of the other contents of the Accounts. My responsibilities, as independent auditor, are established by statute and I have regard to the standards and guidance issued by the Auditing Practices Board and the ethical guidance applicable to the auditing profession.

I report my opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Government Resources and Accounts Act 2000 and Treasury directions made thereunder, and whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. I also report if, in my opinion, the Annual Report on pages 8 to 13 is not consistent with the financial statements, if the Department has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit.

I read the other information contained in the Accounts, and consider whether it is consistent with the audited financial statements. I consider the implications for my certificate if I become aware of any apparent misstatements or material inconsistencies with the financial statements.

I review whether the statement on pages 1 to 6 reflects the Department's compliance with Treasury's guidance on the Statement on Internal Control. I report if it does not meet the requirements specified by Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered whether the Accounting Officer's Statement on Internal Control covers all risks and controls. I am also not required to form an opinion on the effectiveness of the Department's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

I conducted my audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Department in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Department's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by error, or by fraud or other irregularity and that, in all material respects, the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I have also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In my opinion:

- the financial statements give a true and fair view of the state of affairs of the Department of HM Customs and Excise at 31 March 2005 and of the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the year then ended, and have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by Treasury; and
- in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

I have no observations to make on these financial statements.

JOHN BOURN
Comptroller and Auditor General
7 October 2005

National Audit Office
157-197 Buckingham
Palace Road
Victoria
London SW1W 9SP

The maintenance and integrity of the HM Revenue and Customs' website is the responsibility of the Accounting Officer; the work carried out by the auditors does not involve consideration of these matters and accordingly the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Schedule 1: Summary of Resource Outturn 2004-05

	2004-05							2003-04
	Estimate			Outturn				
	1	2	3	4	5	6	7	8
	Gross expenditure £000	A in A £000	NET TOTAL £000	Gross expenditure £000	A in A £000	NET TOTAL £000	Net total outturn compared with Estimate saving/ (excess) £000	Restated Prior Year Outturn* £000
Request for Resources 1 (Notes 7, 11)	1,373,104	24,649	1,348,455	1,334,465	17,627	1,316,838	31,617	1,119,832
Request for Resources 2 (Note 11)	29,996	-	29,996	27,682	-	27,682	2,314	22,078
Total Resources	**1,403,100**	**24,649**	**1,378,451**	**1,362 ,147**	**17,627**	**1,344,520**	**33,931**	**1,141,910**
Non-Operating Cost A in A (Note 7)			**11,078**			**765**	**10,313**	**715**
Net Cash Requirement			**1,349,686**			**1,273,108**	**76,578**	**1,137,433**

** Certain prior year figures been restated as per note 2. The Net Cash Requirement of £1,137m in 2003-04 is shown net of the transfer of £2.5m to HM Treasury in respect of the transfer of policy function (see Schedule 4).*

Summary of income payable to the Consolidated Fund

In addition to Appropriations in Aid, the following income relates to the Department and is payable to the Consolidated Fund:

		2004-05 Forecast		2004-05 Outturn	
	Note	Income £000	Receipts £000	Income* £000	Receipts £000
Total	**6**	**145,000**	**145,000**	**260,749**	**135,596**

** The Department is recording and reporting Fines & Penalties income on an accruals basis for the first time in 2004/05. Therefore, income due to the Consolidated Fund includes an amount of £119,458k in respect of the 1 April 2004 opening debtor balance. At the time of forecasting, it was not planned that the Fines & Penalties income was to be accounted for on an accruals basis.*

The notes of pages 25 to 57 form part of these accounts.

Reconciliation of Resources to Cash Requirement

	Note	2004-05 Estimate £000	2004-05 Outturn £000	2004-05 Net total outturn compared with Estimate saving/ (excess) £000	2003-04 Restated Prior year Net Total* £000
Net Total Resources		1,378,451	1,344,520	33,931	1,141,910
Capital:					
Acquisition of fixed assets	10,12, 13	174,934	160,503	14,431	54,833
Investments	32	-	-	-	-
Non operating A in A					
Proceeds of fixed asset disposals	7,10	(11,078)	(765)	(10,313)	(715)
Excess non operating A in A payable to the Consolidated Fund	20	-	-	-	-
Accruals Adjustments					
Non-cash items	4, 5	(110,070)	(143,846)	33,776	(52,735)
Changes in working capital other than cash	14	(1,879)	(9,539)	7,660	(11,458)
Changes in creditors falling due after more than one year	18	(84,210)	(84,442)	232	-
Use of provision	19	3,538	6,677	(3,139)	5,598
Net Cash Requirement (Schedule 4)		**1,349,686**	**1,273,108**	**76,578**	**1,137,433**

Explanation of the variation between Estimated net cash requirement and outturn (net cash requirement):

The overall variance is around 6% but within this there are fluctuations in excess of 10% in respect of the individual lines shown in the reconciliation table above. These include:

- Proceeds of fixed asset disposals were £10.3m less than the Estimate provision. At the time the Estimate was produced the accounting treatment of the transfer of land and antiques relating to the move to 100, Parliament Street was expected to be neutral, with income matching expenditure. However, the final accounting treatment was that £10.4m was paid to the Treasury for assets received, with no compensating receipt. As this was an inter-government transaction there was no overall increase to government expenditure.
- Changes in working capital - The main variance against the Estimate relates to debtors which were expected to decrease. However, prepayments increased by £6.7m due to the timing of payments for rent and rates.
- Use of provisions - the main variance relates to the payment of legal claims previously provided for.

The notes of pages 25 to 57 form part of these accounts.

Schedule 2: Operating Cost Statement

	Note	£000	2004-05 £000	£000	Restated 2003-04** £000
for the year ended 31 March 05					
Administration Costs					
Staff costs	3	727,551		685,675	
Other administration costs	4	437,898		372,982	
Exceptional Item - Building Revaluation*	4	53,168		-	
Gross Administration Costs		**1,218,617**		**1,058,657**	
Less: Operating Income	7	(8,257)		(9,570)	
Net Administration Costs			**1,210,360**		**1,049,087**
Programme Costs					
Request for Resources 1:					
Staff costs	3	2,744		-	
Expenditure	5	124,617		90,867	
Less: Income	7	(9,370)		(9,668)	
		117,991		**81,199**	
Request for Resources 2:					
Expenditure	5	16,169		11,624	
Less: Income	7	-		-	
		16,169		11,624	
Net Programme Costs (including staff costs)			**134,160**		**92,823**
Net Operating Cost	9		**1,344,520**		**1,141,910**
Net Resource Outturn	9		**1,344,520**		**1,141,910**

**This exceptional expense relates to the revaluation of the asset 100 Parliament Street, see Note 12.*

***Certain prior year figures have been restated as per note 2.*

All income and expenditure are derived from continuing operations.

Statement of Recognised Gains and Losses

	Note	2004-05 £000	2003-04 £000
for the year ended 31 March 2005			
Net Gain on revaluation of tangible fixed assets	21	6,308	270
Total recognised gains for the financial year		**6,308**	**270**

The notes of pages 25 to 57 form part of these accounts.

Schedule 3: Balance Sheet

	Note	31 March 2005 £000	31 March 2005 £000	Restated 31 March 2004* £000	Restated 31 March 2004* £000
as at 31 March 2005					
Fixed Assets					
Tangible assets	12	306,940		245,511	
Intangible assets	13	6,602		7,247	
			313,542		**252,758**
Debtors falling due after more than one year	16		**37,540**		**40,238**
Current Assets					
Stocks and work in progress	15	1,214		887	
Debtors	16	157,300		147,704	
Cash at bank and in hand	17	22,658		86,211	
		181,172		**234,802**	
Creditors falling due within one year	18	(241,986)		(286,230)	
Net Current Assets/(Liabilities)			**(60,814)**		**(51,428)**
Total Assets less Current Liabilities			**290,268**		**241,568**
Creditors (amounts falling due after more than one year)	18		**(84,442)**		**-**
Provisions for Liabilities and Charges	19		**(42,481)**		**(20,415)**
			163,345		**221,153**
Taxpayers' Equity					
General Fund	20		**136,718**		**199,730**
Revaluation reserve	21		**26,617**		**21,403**
Donated Assets reserve	21		**10**		**20**
			163,345		**221,153**

** Certain prior year figures have been restated as per Note 7.*

DAVID VARNEY
Principal Accounting Officer
5 October 2005

The notes of pages 25 to 57 form part of these accounts.

Schedule 4: Cash Flow Statement

	2004-05	Restated 2003-04*
	£000	£000
For the year ended 31 March 2005		
Net cash outflow from operating activities (a)	**(1,197,812)**	**(1,079,062)**
Capital expenditure and financial investment (b)	(75,001)	(54,118)
Receipts due to the Consolidated Fund which are outside the scope of the Department's activities (Note 6)	135,596	188,715
Payments of amounts due to the Consolidated Fund	(135,596)	(189,646)
Financing (c)	1,209,260	1,185,964
Increase/(Decrease) in cash in the period (Note 17)	**(63,553)**	**51,853**

Notes

a See the table below giving a reconciliation of operating cost to operating cash flows.

b See the table below giving an analysis of capital expenditure and financial investment.

c See the table below giving an analysis of financing and a reconciliation to the net cash requirement.

a) Reconciliation of operating cost to operating cash flows

	2004-05	Restated 2003-04*
Net operating cost (Sch 1)	1,344,520	1,141,910
Adjustments for non-cash transactions (Notes 4 and 5)	(143,846)	(52,735)
Adjustments for movements in working capital other than cash (Note 14)	(9,539)	(15,711)
Use of provision (Note 19)	6,677	5,598
Net cash outflow from operating activities	**1,197,812**	**1,079,062**

b) Analysis of capital expenditure and financial investment

	2004-05	Restated 2003-04*
Tangible fixed asset additions (Note 12)	157,586	48,132
Finance lease acquisitions	(84,737)	-
Intangible fixed asset additions (Note 13)	2,917	6,701
Proceeds of disposals of fixed assets (Note 7)	(765)	(715)
Net cash outflow from investing activities	**75,001**	**54,118**

The notes of pages 25 to 57 form part of these accounts.

	2004-05	Restated 2003-04*
	£000	£000
Analysis of financing and reconciliation to the net cash requirement		
From the Consolidated Fund (Supply) - current year[1]	1,209,555	1,188,497
Capital element of payments in respect of finance leases and on-balance sheet PFI contracts	(295)	-
Transfer to HM Treasury in respect of transferred function	-	(2,533)
Net financing	**1,209,260**	**1,185,964**
Decrease/(Increase) in cash (Note 17)	**63,553**	**(51,853)**
Net cash flows other than financing	**1,272,813**	**1,134,111**
Transitional adjustment	-	4,253
Adjustments for payments and receipts not related to Supply:		
Adjustments for receipts not due to supply (Note 7.3)	135,596	188,715
Amounts paid to Consolidated Fund not due to supply (Note 6)	(135,596)	(188,715)
Amounts due to Consolidated Fund received and not paid over (Note 17)	-	-
Amounts due to Consolidated Fund received in a prior year and paid over	-	(931)
Supply-financed repayment of financing		
Capital element of payments in respect of finance leases and on-balance sheet PFI contracts	295	-
Net cash requirement (Schedule 1)	**1,273,108**	**1,137,433**

** Certain prior year figures have been restated as per note 2.*

[1] Amount of grant actually issued to support the net cash requirement £1,209,555,000.00

The notes of pages 25 to 57 form part of these accounts.

Schedule 5: Resources by Departmental Aims and Objectives

	2004-05			Restated 2003-04*		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
for the year ended 31 March 2005						
RfR 1: Aim Administering the indirect tax and customs control systems fairly and efficiently, enabling individuals and businesses to understand and comply with their obligations.						
RfR 1: Objectives 1. To collect the right revenue at the right time from indirect taxes and to improve the level of compliance with customs and statistical requirements.	1,015,113	(16,974)	998,139	877,867	(17,830)	860,037
2. To reduce crime and drug dependency by detecting and deterring the smuggling of illegal drugs and other prohibited and restricted goods.	315,114	-	315,114	252,093	-	252,093
Payments and receipts in respect of shipbuilders' relief.	4,238	(653)	3,585	9,110	(1,408)	7,702
TOTAL RfR 1	**1,334,465**	**(17,627)**	**1,316,838**	**1,139,070**	**(19,238)**	**1,119,832**
RfR 2: Aim & Objective The effective and efficient prosecution of cases in accordance with the Code for Crown Prosecutors.						
TOTAL RfR 2	27,682	-	27,682	22,078	-	22,078
Net Operating Costs	**1,362,147**	**(17,627)**	**1,344,520**	**1,161,148**	**(19,238)**	**1,141,910**

** Certain prior year figures have been restated as per note 2.*

Notes to Schedule 5 are in Note 29 to these accounts.

Notes to the Departmental Resource Accounts for 2004-2005

1. Statement of accounting policies

The financial statements have been prepared in accordance with the 2004-05 'Resource Accounting Manual (RAM)' issued by HM Treasury. The accounting policies contained in the 'RAM' follow UK Generally Accepted Accounting Practice for companies (UK GAAP) to the extent that it is meaningful and appropriate to the public sector. Where the 'RAM' permits a choice of accounting policy, the accounting policy judged to be most appropriate to the particular circumstances of the Department for the purpose of giving a true and fair view has been selected. The Department's accounting policies have been applied consistently in dealing with items considered material in relation to the accounts.

1.1 Accounting convention

These accounts have been prepared under the historical cost convention modified to account for the revaluation of fixed assets, and stocks where material, at their value to the business by reference to their current costs.

1.2 Tangible fixed assets

Freehold land and buildings have been stated at current cost using professional valuations at least every five years and appropriate indices in intervening years from April 2001. Leasehold properties are accounted for as either operating or finance leases depending on the underlying nature of the lease contract. Currently all leasehold properties held are operating leases.

Other tangible assets have been stated at current cost using appropriate indices.

The minimum level for capitalisation of a tangible fixed asset is generally £1,000.

From 2004/05, the value and depreciation of furniture and fittings are estimated on the basis of the average number of staff accommodated, the average current furniture costs for each employee and the useful economic life ascribed to furniture assets. Actual furniture costs each year are expensed. The methodology provides a reasonable approximation of the actual values and depreciation of the thousands of individual items of furniture which individually are of relatively low value, but collectively are material to the accounts. Adopting this capitation estimating method avoids the Department having to incur significant costs in maintaining and validating detailed records.

The only material development costs are those incurred on in-house developed software which are capitalised in line with SSAP13.

Major enhancements to leasehold properties which result in the creation of an asset are capitalised. For the year 1st April 2004 to 31st March 2005 the capitalisation threshold for this type of asset was £50,000.

Assets under construction are valued at cost. On completion they are released into the appropriate asset category and become subject to indexation.

All tangible fixed assets other than assets under construction are subject to indexation.

1.3 Intangible Fixed Assets

The Department capitalises initial one-off software licence payments where such payments are above the capitalisation threshold (£1,000). Ongoing software licence fees payable at regular intervals are treated as period rentals and accounted for as expense items.

Intangible fixed assets are not subject to indexation.

1.4 Depreciation and Amortisation

Freehold land is not depreciated. For all assets, except leasehold buildings, depreciation is provided at rates calculated to write off the cost (less residual value) of such assets on a straight line basis over their estimated useful economic life. The range of standard useful lives is:

Assets Category	Standard Life
Freehold Land	Not depreciated
Freehold Buildings	Remaining economic life
Enhancements to Leasehold properties	Unexpired period of lease
Assets under construction	Not depreciated
Computer Equipment	5 to 7 years
Computer Software	Remaining economic life not greater than 10 years
Furniture and Fittings	10 years
Scientific Aids	3 to 10 years
Vehicles	4 to 7 years
Vessels	10 to 20 years
Other Equipment	5 to 10 years
Intangible Assets (3rd party software licences)	Remaining economic life

1.5 Donated assets

Donated tangible fixed assets are capitalised at their value on receipt, and the value is credited to the donated asset reserve, with subsequent revaluations also taken to the reserve. Each year, an amount equal to the depreciation charge on the asset is released from the donated asset reserve to the Operating Cost Statement.

Assets seized by the Department and permanently appropriated for the Department's use are treated as donated assets.

1.6 Stocks and work in progress

Stocks are valued at their original cost, or, where materially different, the current replacement cost. However, when they either cannot or will not be used they are valued at net realisable value. Stocks consist of purchased uniforms, vessel spare parts and operational equipment.

For reasons of prudence the Department's forms and notices are not valued for stock purposes, as legislative changes could render such forms and notices obsolete.

Work in progress represents the cost of services provided which are not yet completed and which will be sold in a future period.

1.7 Operating income

Operating income is income which relates directly to the operating activities of the Department. It includes not only income appropriated in aid of the voted expenditure but also income to the Consolidated Fund, which in accordance with the 'RAM' is treated as operating income.

Operating income is stated net of VAT.

1.8 Administration and programme expenditure

The Operating Cost Statement is analysed between administration and programme costs as required by the 'RAM'. Administration costs reflect the costs of running the Department as defined under the administration cost-control regime, together with associated operating income. Income is analysed at Note 7 between that which, under the regime, is allowed to be offset against gross administrative costs in determining the outturn against the administration cost limit, and that operating income which is not. Programme costs reflect non-administration costs, including legal and investigation costs, losses and special payments and funds transferred to the World Customs Organisation.

1.9 Cash at bank and in hand

These are balances in respect of administering the Department only and exclude all tax and duty revenues collected. The latter are included in the Department's Trust Statement account.

1.10 Capital charge

A charge, reflecting the cost of capital utilised by the Department, is included in the operating costs. The charge is calculated at the Government's standard rate of 3.5% on all assets, less liabilities, except for donated assets, cash balances with the Office of the Paymaster General (OPG) and the cash balances payable to the Consolidated Fund where the charge is nil.

1.11 Foreign exchange

Payments in foreign currencies are translated to sterling at the rate of exchange ruling on the date of payment.

1.12 Pensions

Past and present employees are covered by the provisions of the Principal Civil Service Pension Scheme (PCSPS), which are described in Note 3. The defined benefit schemes are unfunded and non-contributory except in respect of dependants' benefits. The Department recognises the expected cost of providing pensions on a systematic and rational basis over the period during which it benefits from employees' services by payment to the PCSPS of amounts calculated on an accruing basis. Liability for payment of future benefits is a charge on the PCSPS.

1.13 Provisions

The Department provides for legal or constructive obligations which are of uncertain timing or amount at the balance sheet date using the best estimate of the expenditure required to settle the obligation.

1.14 Leases

Where substantially all risks and rewards of ownership of a leased asset are borne by the Department, the asset is recorded as a tangible fixed asset and a debt is recorded to the lessor of the minimum lease payments discounted by the interest rate implicit in the lease. The interest element of the finance lease payment is charged to the Operating Cost Statement over the period of the lease at a constant rate in relation to the balance outstanding. Other leases are regarded as operating leases and the rentals are charged to the Operating Cost Statement on a single-line basis over the term of the lease. All the Department's leases are operating leases.

Other than rental income from minor occupiers of shared property there is no income from operating leases.

1.15 Third Party Assets Held

The Department holds assets (Euros) on behalf of the European Union (EU) in relation to the EU's twinning project. These Euros are not recognised in the accounts since neither the Department, nor the Government more generally, has a direct beneficial interest in them. See Note 28.

The Department manages interest bearing accounts containing seized money, and also holds cash as physical evidence in connection with ongoing legal proceedings. These funds are held as part of the Department's law enforcement activities and as such do not form part of these accounts.

Other non-monetary assets are held in connection with ongoing legal proceedings. These assets are held as part of the Department's law enforcement activities and as such do not form part of these accounts.

1.16 Private Finance Initiative

PFI transactions have been accounted for in accordance with Technical Note No.1 (Revised), entitled 'How to Account for PFI Transactions', as required by the 'RAM'. Where the balance of the risks and rewards of ownership of the PFI property are borne by the PFI operator, and the PFI payments form part of the unitary service charge, they are recorded as an operating cost. Where the balance of risks and rewards of ownership of the PFI property is borne by the Department, the property is recognised as a fixed asset and the liability to pay for it is accounted for as a finance lease. Contract payments are apportioned between an imputed finance lease charge and a service charge.

Where the risks and rewards have been transferred to the Department via an up-front payment and a call option exists on the asset (as with the IS infrastructure contract), the assets are capitalised and depreciated over their useful economic lives.

1.17 Value Added Tax

Most of the costs of the Department's administrative activities are outside the scope of VAT and, in general output tax does not apply and input tax on purchases is not recoverable. Irrecoverable VAT is charged, as appropriate, to the relevant expenditure category or included in the capitalised additions to fixed assets. Income and expenditure is otherwise shown net of VAT.

1.18 Contingent Liabilities

In addition to contingent liabilities disclosed in accordance with FRS 12, the Department discloses for parliamentary reporting and accountability purposes certain contingent liabilities where the likelihood of a transfer of economic benefit is remote. These comprise:

a items over £100,000 (or lower, where required by specific statute) that do not arise in the normal course of business and which are reported to Parliament by Departmental Minute prior to the Department entering into the arrangement;

b all items (whether or not they arise in the normal course of business) over £100,000 (or lower, where required by specific statute or where material in the context of resource accounts) which are required by the Resource Accounting Manual to be noted in the resource accounts.

Where the time value of money is material, contingent liabilities which are required to be disclosed under FRS 12 are stated at discounted amounts and the amount reported to Parliament separately noted. Contingent liabilities that are not required to be disclosed by FRS 12 are stated at the amounts reported to Parliament.

2. Transfer of function from HM Customs & Excise

During 2004-05 the function of providing advice to ministers concerning tax policy was transferred to HM Treasury. During the year, the staff previously working for HM Customs & Excise were transferred and they moved into HM Treasury accommodation. No assets relating to delivering this service were transferred to HM Treasury.

The transfer has been accounted for as a business combination using merger accounting principles in accordance with HM Treasury resource accounting requirements. Accordingly, the results and cash flows relating to the transferred service have been brought to account from the start of the financial year. Prior-year comparative figures have been restated.

The share of the operating cost for the year attributable to the transferred function was £2,533,467.

Restatement of Operating Cost Statement at 31 March 2004

	Published accounts at 31 March 2004 £000	Function transferred to HMT £000	Restated at 31 March 2004 £000
Administration Costs			
Staff Costs	687,901	2,226	685,675
Other Administration costs	373,289	307	372,982
Gross Administration costs	**1,061,190**	**2,533**	**1,058,657**

3a. Staff Numbers and Related Costs

Staff costs consist of:

	Staff permanently employed by the Dept. £000	Others engaged on the objectives of the Dept. £000	**2004-05** Total £000	**Restated** *2003-04** Total £000
Wages and salaries	554,803	1,434	556,237	522,852
Overtime	45,681	-	45,681	43,008
Social Security costs	44,933	90	45,023	42,329
Other pension costs	83,354	-	83,354	77,486
Sub total	**728,771**	**1,524**	**730,295**	**685,675**
Less recoveries in respect of outward secondments	**(1,851)**	-	**(1,851)**	**(1,145)**
Total Net Cost	**726,920**	**1,524**	**728,444**	**684,530**

** Certain prior year figures have been restated as per note 2.*

No ministers or special advisors were employed in HM Customs and Excise in 2004-05. The Departmental Minister was paid from the Treasury Resource Account.

The Principal Civil Service Pension Scheme (PCSPS) is an unfunded multi-employer defined benefit scheme but HM Customs and Excise is unable to identify its share of the underlying assets and liabilities. The Scheme Actuary valued the Scheme as at 31 March 2003. Details can be found in the resource accounts of the Cabinet Office: Civil Superannuation (www.civilservice-pensions.gov.uk).

For 2004-05, employer's contributions of £78,199,938 were payable to the PCSPS (2003-04 £72,753,010) at one of four rates in the range 12 to 18.5 per cent of pensionable pay, based on salary bands. The scheme's Actuary reviews employer contributions every four years following a full scheme valuation. From 2005-06 the salary bands will be revised and the rates will be in a range between 16.2 per cent and 24.6 per cent.

The contribution rates reflect benefits as they accrue, not the costs as they are actually incurred, and reflect past experience of the scheme. Employees can opt to open a partnership pension account, a stakeholder pension with an employer contribution. Employer's contributions of £349,562.01 were paid to one or more of a panel of four appointed stakeholder pension providers.

Employer contributions are age-related and range from 3 to 12.5 per cent of pensionable pay. Employers also match employee contributions up to 3 per cent of pensionable pay. In addition, employer contributions of £26,816.57, 0.8 per cent of pensionable pay, were payable to the PCSPS to cover the cost of the future provision of lump sum benefits on death in service and ill health retirement of these employees.

Contributions due to the partnership pension providers at the balance sheet date were nil. Contributions prepaid at that date were nil.

Forty six people retired early on ill-health grounds; the total additional accrued pension liabilities in the year amounted to £83,006.94.

3b Staff numbers and related costs (continued)

Average number of persons employed

The average number of whole-time equivalent persons employed during the year was as follows.

	2004-05			2003-04
		Number		
	Staff permanently employed by the Dept	Others engaged on the objectives of the Dept	Total	**Number** Total
RfR 1				
Objective 1				
To collect the right revenue at the right time from indirect taxes and to improve the level of compliance with customs and statistical requirements	18,587	173	18,760	18,551
RfR 1				
Objective 2				
To reduce crime and drug dependency by detecting and deterring the smuggling of illegal drugs and other prohibited and restricted goods.	4,764	41	4,805	4,318
RfR 2				
Objective 1				
The effective and efficient prosecution of cases in accordance with the Code for Crown Prosecutors	203	-	203	207
Staff Engaged in Capital Projects	50	50	100	226
TOTAL	**23,604**	**264**	**23,868**	**23,302**

The Department does not employ any Special Advisors or Ministers.

3c Staff numbers and related costs (continued)

Senior Management:

The following section provides details of remuneration and pension interests of the most senior officials of the Department.

Remuneration

	2004-05		2003-04	
Officials[1]	Salary £'000[2]	Benefits in kind (to nearest £100)	Salary £'000	Benefits in kind (to nearest £100)
David Varney[2] (from 1 September 2004)	25-30 (full year equivalent 150-155)	3,800	N/A	NIL
Paul Gray CB[2] (from 1 September 2004)	20-25 (full year equivalent 140-145)	5,500	N/A	NIL
Mike Eland	145-150	NIL	150-155	NIL
Mike Hanson MBE	125-130	NIL	110-115	NIL
David Garlick OBE	95-100	NIL	95-100	NIL
David Hogg CB (from 1 October 2004)	60-65 (full year equivalent 120-125)	NIL	N/A	N/A
Steve Lamey[2] (from 18 October 2004)	25-30 (full year equivalent 200-205)	NIL	N/A	N/A
Terry Byrne CB[3] (to 25 November 2004)	85-90 (full year equivalent 130-135)	NIL	125-130	NIL
David Pickup CB[4]	115-120	NIL	110-115	NIL
Mike Norgrove	100-105	NIL	95-100	NIL

Salary

'Salary' includes gross salary; performance pay or bonuses; overtime; reserved rights to London weighting or London allowances; recruitment and retention allowances; private office allowances and any other allowance to the extent that it is subject to UK taxation.

This presentation is based on payments made by the Department and thus recorded in these accounts.

Benefits in kind

The monetary value of benefits in kind covers any benefits provided by the employer and treated by the Inland Revenue as a taxable emolument. David Varney and Paul Gray CB had the private use of an allocated car in the circumstances permitted by the Civil Service Management Code.

[1] *The salary details for the following members of the Inland Revenue and HM Customs and Excise transitional Board are shown in the Inland Revenue Resource Accounts: Dave Hartnett CB, Ann Chant CB, Helen Ghosh and Steve Heminsley.*

[2] *David Varney, Paul Gray CB and Steve Lamey were funded by Customs and Excise to a total of 30% of their staff costs. The remaining 70% was funded by the Inland Revenue and is accounted for in their Resource Accounts.*

[3] *Terry Byrne CB was suspended from duty on 29th September, 2004 and retired on 25 November, 2004.*

[4] *David Pickup CB was suspended from duty on 29th September, 2004.*

Pension Benefits

Officials[5]	Accrued pension at age 60 as at 31 March 2005 and related lump sum £'000	Real increase in pension and related lump sum at age 60 £'000	CETV at 31 March 2004 £'000	CETV at 31 March 2005 £'000	Real increase in CETV £'000	Employer Contribution to Partnership pension Account £'000
David Varney [6, 7] (from 1 September 2004)	0-5.0	0-2.5	NIL	14	12	NIL
Paul Gray CB [6, 7] (from 1 September 2004)	70-75	5.0-7.5	852	982	82	NIL
Mike Eland	50-55 plus 160-165 lump sum	0-2.5 plus 5.0-7.5 lump sum	786	870	35	NIL
Mike Hanson MBE	40-45 plus 125-130 lump sum	2.5-5.0 plus 12.5-15.0 lump sum	645	754	73	NIL
David Garlick OBE [6]	50-55	0-2.5	659	729	31	NIL
David Hogg CB (from 1 October 2004)	55-60 plus 170-175 lump sum	0-2.5 plus 5.0-7.5 lump sum	648	713	25	NIL
Steve Lamey [6, 7] (from 18 October 2004)	0-5.0	0-2.5	NIL	9	8	NIL
Terry Byrne CB [6] (to 25 November 2004)	75-80	2.5-5.0	1037	1118	51	NIL
David Pickup CB	35-40 plus 110-115 lump sum	0-2.5 plus 2.5-5.0 lump sum	535	593	23	NIL
Mike Norgrove	30-35 plus 95-100 lump sum	0-2.5 plus 2.5-5.0 lump sum	435	483	21	NIL

[5] *The pension details of the following members of the Inland Revenue and HM Customs and Excise transitional Board are shown in the Inland Revenue Resource Accounts: Dave Hartnett CB, Ann Chant CB, Helen Ghosh and Steve Heminsley.*

[6] *David Varney, Paul Gray CB, Steve Lamey, David Garlic OBE and Terry Byne CB are members of the Premium Scheme, therefore a lump sum is not applicable.*

[7] *The pension benefits for David Varney, Paul Gray CB and Steve Lamey are shown in full in both the Inland Revenue and HM Customs and Excise Resource Accounts, although the employers benefit are funded at 70% by the Inland Revenue and 30% by HM Customs and Excise .*

Civil Service Pensions

Pension benefits are provided through the CSP arrangements. From 1 October 2002, civil servants may be in one of three statutory based 'final salary' defined benefit schemes (classic, premium, and classic plus). The Schemes are unfunded with the cost of benefits met by monies voted by Parliament each year. Pensions payable under classic, premium, and classic plus are increased annually in line with changes in the Retail Prices Index. New entrants after 1 October 2002 may choose between membership of premium or joining a good quality 'money purchase' stakeholder arrangement with a significant employer contribution (Partnership Pension Account).

Employee contributions are set at the rate of 1.5% of pensionable earnings for classic and 3.5% for premium and classic plus. Benefits in classic accrue at the rate of 1/80th of pensionable salary for each year of service. In addition, a lump sum equivalent to three years' pension is payable on retirement. For premium, benefits accrue at the rate of 1/60th of final pensionable earnings for each year of service. Unlike classic, there is no automatic lump sum (but members may give up (commute) some of their pension to provide a lump sum). Classic plus is essentially a variation of premium, but with benefits in respect of service before 1 October 2002 calculated broadly as per classic.

The Partnership Pension Account is a stakeholder pension arrangement. The employer makes a basic contribution of between 3% and 12.5% (depending on the age of the member) into a stakeholder pension product chosen by the employee. The employee does not have to contribute but where they do make contributions, the employer will match these up to a limit of 3% of pensionable salary (in addition to the employer's basic contribution). Employers also contribute a further 0.8% of pensionable salary to cover the cost of centrally-provided risk benefit cover (death in service and ill health retirement).

Further details about the CSP arrangements can be found at the website www.civilservice-pensions.gov.uk

Cash Equivalent Transfer Value

A Cash Equivalent Transfer Value (CETV) is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme. The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies. The CETV figures, and from 2003-04 the other pension details, include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the CSP arrangements and for which the CS Vote has received a transfer payment commensurate to the additional pension liabilities being assumed. They also include any additional pension benefit accrued to the member as a result of their purchasing additional years of pension service in the scheme at their own cost. CETVs are calculated within the guidelines and framework prescribed by the Institute and Faculty of Actuaries.

Real increase in CETV

This reflects the increase in CETV effectively funded by the employer. It takes account of the increase in accrued pension due to inflation, contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement) and uses common market valuation factors for the start and end of the period.

Non-executive members of the Management Board

The Department's Departmental Board comprises both senior operational management and external appointees. The remuneration of senior management is included above. External Board appointees remuneration, excluding pension contributions, was in the following ranges:

	2004-05 Salary	**2003-04 Salary**
	£000	£000
Tony Hall (to 31 March 2005)	15-20	15-20
Sir Stephen Lander KCB (to 31 March 2005)	15-20	15-20
Barry Quirk CBE	15-20	15-20
David Spencer	15-20	15-20

No pension payments were made by the Department on behalf of non-executive members of the Board.

4 Other administration costs

	2004-05		Restated 2003-04*	
	£000	£000	£000	£000
Rental under operating leases:				
hire of plant and machinery	268		206	
other operating leases	1,185		1,035	
		1,453		1,241
Interest charges for on-balance sheet contract		1,453		-
PFI service charges:				
Off-balance sheet contracts	198,149		158,923	
Service element of on-balance sheet contracts	445		-	
Indexation of PFI creditor	1,375		-	
		199,969		158,923
Non-cash items:				
Exceptional item:				
- building revaluation[1] (Note 12)	53,168		-	
depreciation (Notes 12 & 13)	29,820		32,310	
loss on disposal of fixed assets	408		409	
asset write-off (Note 12)	7,164		-	
cost of capital charge on net administration assets	5,317		5,859	
loss/(gain) on revaluation of fixed assets (Note 12)	2,349		(1,657)	
transfer from donated asset reserve (Note 21)	(10)		(6)	
auditor's remuneration and expenses[2]	465		190	
PFI barter element prepayments	2,543		2,402	
non-cash movement in provisions (Note 19)	15,793		1,468	
		117,017		40,975
Other expenditure[3]:				
travel, subsistence and hospitality	41,124		41,767	
accommodation expenses	35,367		35,126	
administrative staff related costs	1,396		1,457	
printing, post and stationery	11,235		11,904	
telephone expenses	4,016		3,370	
IT services and consumables	42,385		39,033	
consultancy	4,458		6,254	
contracted out services	2,377		2,125	
publicity	2,487		3,577	
bank charges	732		621	
other miscellaneous expenditure	25,597		26,609	
		171,174		171,843
Total		**491,066**		**372,982**

**Certain prior year figures have been restated as per note 2.*

[1]Land and building 100 Parliament Street, on the site formerly known as Government Offices on Great George Street (GOGGS).

HMC&E is contracted to pay Exchequer Partnership (EP2) an annual unitary amount of £8.3m at 1999 prices for the 33-year term of the contract subject to deductions for non-availability and under-performance, starting in September 2004. The payment finances the cost of the refurbishment, maintenance, lifecycle replacement costs and ongoing services over the 33-year term.

The contract requires that the building be maintained in its condition at the beginning of the contract throughout the contract period at no additional cost to HMC&E. During the contract period EP2 bears the risk of latent defects, building maintenance requirements and the cost of replacing capital items.

The difference of £53.2m between the existing use value of the building, excluding the land element, at the date of occupation, and the opening fair value of the creditor under the finance lease agreement has been taken to the Operating Cost Statement for 2004-05 (see Schedule 2).

This difference arises because the valuation reflects rental potential in a depressed property market. The refurbishment cost reflects a policy decision for the Inland Revenue and HM Customs & Excise to occupy the building and to modernise and maintain an important Grade II listed building with long-term heritage value whilst providing good quality, flexible and modern office space.

[2] Auditor's remuneration and expenses are for audit work only. For 2004/05, the figure includes remuneration and expenses of £265k for audit work relating to the Department's Trust Statement.

[3] The breakdown of Other Expenditure has been revised to achieve consistency with the Inland Revenue's disclosure.

5 Other Programme costs

		2004-05		**2003-04**
	£000	£000	£000	£000
Non-cash items:				
depreciation of assets in respect of programme expenditure (Notes 12 & 13)	11,739		10,712	
asset write off	613		-	
non-cash movement in provisions in respect of other programme expenditure (Note 19)	12,950		(845)	
cost of capital charge on net programme assets	1,527		1,893	
		26,829		11,760
Other expenditure:				
legal and investigation		68,829		65,455
Lorry road user charge[1]		27,988		-
Shipbuilders' relief		4,238		9,110
Inward secondments		1,524		1,684
other programme expenses		11,275		14,425
transfer to World Customs Organisation		103		57
Total costs		**140,786**		**102,491**
Less: programme income (Note 7)		(9,370)		(9,668)
Net total (excluding staff costs)		**131,416**		**92,823**

[1] The most significant component of this total is external consultancy, £27.8m.

6 Analysis of income payable to the Consolidated Fund

In addition to Appropriations in Aid, the following income relates to the Department and is payable to the Consolidated Fund:

		2004-05 Forecast		2004-05 Outturn	
		Income	Receipts	Income	Receipts
	Note	£000	£000	£000	£000
Other operating income and receipts not classified as A in A		-	-	-	-
Other non-operating income and receipts not classified as A in A	7	-	-	15,025	15,025
Other amounts collectable on behalf of the Consolidated Fund *	7	145,000	145,000	245,724	120,571
Excess cash surrenderable to the Consolidated Fund		-	-	-	-
Total		**145,000**	**145,000**	**260,749**	**135,596**

** The Department is recording and reporting Fines & Penalties income on an accruals basis for the first time in 2004/05. Therefore, income due to the Consolidated Fund includes an amount of £119,458k in respect of the 1 April 2004 opening debtor balance. At the time of forecasting, it was not expected that the Fines & Penalties income was to be accounted for on an accruals basis.*

7 Income and Appropriations in Aid

7.1 Operating Income

	2004-05		2003-04	
	Appropriated in aid		Appropriated in aid	
	£000	£000	£000	£000
Administration income:				
Allowable within admin. cost limits	5,059		3,154	
Rental income from external tenants	692		1,983	
EU income	427		436	
Fees and charges to external customers	865		999	
Fees and charges to other departments	1,214		2,998	
		8,257		**9,570**
Programme income:				
Legal costs recovered	8,717		8,260	
Receipts from DfT re. Shipbuilders' relief	653		1,408	
		9,370		**9,668**
Total operating income		**17,627**		**19,238**

All operating income was appropriated in aid. The EU income relates to statistical services provided on behalf of the EU, the reimbursement of expenditure incurred in relation to the EU's Fiscalis Programme and the recovery of European travel and subsistence incurred by the Department. This EU income is negative public expenditure reducing the burden on the UK Exchequer.

Of total operating income received, the following relates to services provided to external and public sector customers on a full cost recovery basis:

			2004-05			2003-04
	Income	Full Cost	Surplus/ (deficit)	Income	Full Cost	Surplus/ (deficit)
	£000	£000	£000	£000	£000	£000
International Assistance	1,214	912	302	2,998	2,440	558
Money Service Businesses	2,200	2,200	-	1,823	1,823	-
Merchants charges	865	1,413	(548)	999	1,003	(4)
Total	**4,279**	**4,525**	**(246)**	**5,820**	**5,266**	**554**

7.2 Non-operating income classified as A in A

	2004-05	2003-04
	£000	£000
Disposal of Fixed Assets	765	715
Total	**765**	**715**

7.3 Non-operating income not classified as A in A

(a) Non-Budget

	2004-05	2003-04
	£000	£000
SEA payments to OMS	(1,766)	(249)
SEA Receipts from OMS	16,791	13,561
Surrendered to Consolidated Fund	**15,025**	**13,312**

The Department received Single European Authorisation Income (SEA) from Other Member States (OMS) of the EC during the year, which was not regarded as income for the Department and was surrendered to the Consolidated Fund. Payments were also made to OMS in respect of their share of Customs Duty collected in the UK.

(b) Other amounts Collectable on behalf of the Consolidated Fund

	2004-05	
	Income	Receipts
	£000	£000
Fines and Penalties 2004-05*	120,902	115,207
Fines and Penalties debtor at 1 April 2004 *	119,458	-
Sale of Seized Goods	3,560	3,560
Miscellaneous Receipts**	1,804	1,804
Surrendered to Consolidated Fund	**245,724**	**120,571**

The above amounts are not regarded as income of the Department as they are received as a result of the Department's management of the various tax regimes and its law enforcement activities. As such, the above receipts were surrendered to the Consolidated Fund.

** The Department is recording and reporting Fines & Penalties income on an accruals basis for the first time in 2004/05. Therefore, income due to the Consolidated Fund includes an amount of £119,458k in respect of the 1 April 2004 opening debtor balance. This is an adjusted figure and represents estimated recoverable debtors. Prior year figures have been restated.*

***From 2004-05, interest on revenue receivable collected on behalf of the Consolidated Fund is reported in the Department's Trust Statement.*

8 Administration cost limits

The outturn within the administration costs control regime shown against individual administrative cost limits is as follows:

		2004-05		**Restated 2003-04***
	Outturn	Limits	Outturn	Limits
	£000	£000	£000	£000
Request for resources 1 (Gross Limit)	1,207,104	1,250,295	1,032,560	1,128,795
Request for resources 2 (Gross Limit)	11,513	12,942	10,454	10,563
Total within administration cost control	**1,218,617**	**1,263,237**	**1,043,014**	**1,139,358**
Administration Expenditure excluded from administration cost limit	-	-	-	-
Administration Income allowable within the administration cost limit	(8,257)	(10,728)	(8,871)	(8,871)
Total administration outturn	**1,210,360**	**1,252,509**	**1,034,143**	**1,130,487**

9 Reconciliation of net operating cost and net resource outturn

	2004-05	**Restated 2003-04***
	£000	£000
Net operating costs for the year (Schedule 2)	1,344,520	1,141,910
Net resource outturn (Schedule 1)	1,344,520	1,141,910

**Certain prior year figures have been restated as per note 2.*

Net operating cost is the total of expenditure and income appearing in the Operating Cost Statement (Schedule 2). Net resource outturn is the total of those elements of expenditure and income that are subject to Parliamentary approval and included in the Department's Supply Estimate. The outturn against the Estimate is shown in the Summary of Resource Outturn (Schedule 1).

10 Analysis of capital expenditure, financial investment and associated A in A

	2004-05				2003-04
	Capital expenditure £000	Loans, etc £000	A in A £000	Net Total £000	Net Total £000
RfR 1	160,503	-	(765)	159,738	54,118
RfR 2	-	-	-	-	-
Total	**160,503**	**-**	**(765)**	**159,738**	**54,118**

11 Analysis of net resource outturn by function and reconciliation to Operating Cost Statement

	2004-05							2003-04
	Admin £000	Other current £000	Gross resource expenditure £000	A in A £000	Net total £000	Estimate £000	Net total outturn compared with Estimate £000	Restated* Prior Year outturn £000
Request for resources 1:								
Objective 1	939,240	75,873	1,015,113	(16,974)	998,139	1,047,190	(49,051)	860,037
Objective 2	268,293	46,821	315,114	-	315,114	296,446	18,668	252,093
Shipbuilders Relief	-	4,238	4,238	(653)	3,585	4,819	(1,234)	7,702
Total Request for Resources 1	**1,207,533**	**126,932**	**1,334,465**	**(17,627)**	**1,316,838**	**1,348,455**	**(31,617)**	**1,119,832**
Request for resources 2								
Objective 1	11,513	16,169	27,682	-	27,682	29,996	(2,314)	22,078
Total Request for Resources 2	**11,513**	**16,169**	**27,682**	**-**	**27,682**	**29,996**	**(2,314)**	**22,078**
Resource Outturn	**1,219,046**	**143,101**	**1,362,147**	**(17,627)**	**1,344,520**	**1,378,451**	**(33,931)**	**1,141,910**
Reconciliation to Operating Cost Statement								
Gross operating expenditure	**1,219,046**	**143,101**	**1,362,147**	-	-	-	-	-
Operating income	-	-	-	**(17,627)**	-	-	-	-
Net operating cost	**1,219,046**	**143,101**	**1,362,147**	**(17,627)**	**1,344,520**	**1,378,451**	**(33,931)**	**1,141,910**

** Certain prior year figures have been restated as per note 2*

12 Tangible Fixed Assets

	Freehold land and buildings £000	Enhancements to Modern Leaseholds £000	Assets under construction £000	Furniture and fittings £000	Vessels £000	Vehicles £000	Computer equipment £000	Computer software £000	Scientific aids £000	Donated Assets £000	Other equipment £000	Total £000
Cost or valuation												
At 1 April 2004	1,474	119,342	42,218	52,903	25,376	31,759	21,702	68,993	76,857	101	20,158	460,883
Additions	94,533	-	37,922	238	1,031	5,578	4,022	5,423	8,036	-	803	157,586
Written off	-	(11,289)	-	-	(26)	-	(688)	-	(4,733)	-	-	(16,736)
Transfers	-	21,238	(29,345)	9	2,925	-	(2,047)	3,626	3,779	-	12	197
Donations	-	-	-	-	-	-	-	-	-	-	-	-
Disposals	-	-	-	(24,047)	(1,997)	(5,209)	(272)	(246)	(2,741)	(37)	(782)	(35,331)
Revaluations	(53,013)	5,980	-	(364)	801	796	(3,077)	2,805	(764)	1	(13)	(46,848)
At 31 March 2005	**42,994**	**135,271**	**50,795**	**28,739**	**28,110**	**32,924**	**19,640**	**80,601**	**80,434**	**65**	**20,178**	**519,751**
Depreciation												
At 1 April 2004	332	37,403	-	39,408	7,325	17,600	6,538	57,481	37,737	81	11,467	215,372
Charged in year	355	9,349	-	228	1,359	4,936	2,229	7,978	10,220	3	2,057	38,714
Written off	-	(4,813)	-	-	-	-	-	-	(4,146)	-	-	(8,959)
Transfers	-	-	-	-	-	-	(268)	-	323	-	10	65
Disposals	-	-	-	(25,044)	(1,717)	(4,541)	(146)	(195)	(2,573)	(30)	(496)	(34,742)
Revaluations	30	1,836	-	(271)	(272)	507	(964)	2,195	(604)	1	(97)	2,361
At 31 March 2005	**717**	**43,775**	**-**	**14,321**	**6,695**	**18,502**	**7,389**	**67,459**	**40,957**	**55**	**12,941**	**212,811**
Net book value at 31 March 2005	**42,277**	**91,496**	**50,795**	**14,418**	**21,415**	**14,422**	**12,251**	**13,142**	**39,477**	**10**	**7,237**	**306,940**
Net book value at 1 April 2004	**1,142**	**81,939**	**42,218**	**13,495**	**18,051**	**14,159**	**15,164**	**11,512**	**39,120**	**20**	**8,691**	**245,511**
Asset financing:												
Owned	11,547	91,496	50,795	14,418	21,415	14,422	12,251	13,142	39,477	10	7,237	276,210
On-balance sheet PFI contracts	30,730	-	-	-	-	-	-	-	-	-	-	30,730
	42,277	**91,496**	**50,795**	**14,418**	**21,415**	**14,422**	**12,251**	**13,142**	**39,477**	**10**	**7,237**	**306,940**

Included within the NBV above is £7,893,780 (2004:£6,143,369) of assets which have been capitalised in accordance with the accounting policy for assets obtained under the PFI contracts (Note 1.16). Legal title of these assets remains with the PFI operator. All other assets are owned by the Department.

12 Tangible Fixed Assets (continued)

Assets under construction as at 31 March are:

	2004-05	2003-04
	£000	£000
Estates	5,198	8,875
Vessels	-	2,569
Furniture & Fittings	3,492	-
Computer equipment	920	833
Computer software	33,397	28,210
Scientific aids	7,435	1,279
Other equipment	353	452
Total	**50,795**	**42,218**

The Department has one remaining property not included in the STEPS PFI contract. This is Elmbridge Court, Gloucester. The NBV as at 31 March 2005 was £1,198,610. This property is included in the Note above under Freehold Land and Buildings.

Land and building 100 Parliament Street, on the site formerly known as Government Offices on Great George Street (GOGGS).

The accounting treatment adopted by HMC&E in respect of its arrangement with HM Treasury in respect of the land and building on the site, which was formerly known as Government Offices on Great George Street (GOGGS), is consistent with that adopted by HM Treasury and the Inland Revenue.

The contract

The Inland Revenue and HM Customs & Excise entered into a joint 33-year finance lease agreement with Exchequer Partnership (EP2) in September 2002 in respect of 100 Parliament Street, part of the site formerly known as GOGGS.

This agreement provided for the refurbishment and provision of serviced office accommodation to the Inland Revenue and HM Customs & Excise from November 2004 to October 2037 in return for an annual unitary payment.

The building is subject to a 35-year Private Finance Initiative contract commencing in August 2002 between HM Treasury and EP2. It was in operational use by HM Treasury until vacated in August 2002.

Refurbishment work started in December 2002 and was completed in October 2004. The Inland Revenue and HM Customs & Excise commenced relocation to the building in November 2004.

The decision to refurbish GOGGS followed a review by HM Treasury of available alternative locations. EP2 agreed to undertake the risks of planning, construction, ongoing maintenance of the fabric and plant and machinery and the delivery of serviced accommodation to standards originally specified by HM Treasury in advance.

The Treasury sought to ensure that EP2's bid for refurbishment of the building represented good value for money by detailed evaluation of the technical and financial aspects, benchmarking against the Public Sector Comparator and market rentals at the time. HM Treasury tendered the external project funding to introduce a further element of competition.

Valuation

The land on which 100 Parliament Street is sited was reflected on HM Treasury's balance sheet on 31 March 2004 at a net book value of £15.1m, the building was reported as nil value as it required refurbishment. All values for the property transferred have been split between the Inland Revenue and HM Customs & Excise on the basis of staff occupancy numbers. HM Customs & Excise's share of the land has been capitalised at the value of £10.4m and the value of the refurbishment building work at £84.2m. This is shown as an addition to tangible fixed assets above at £94.6m. On completion of the refurbishment by EP2 the Valuation Office Agency (VOA) valued the building and land in November 2004. HM Customs and Excise's share was valued at £41.4m. The reduction in value of £53.2m has been reported as an exceptional item of expenditure in the Operating Cost Statement, Schedule 2.

Reconciliation of current year depreciation from notes 4 and 5 to notes 12 and 13

Depreciation

	Note	2004-05 £000	2003-04 £000
Administration depreciation	4	29,820	32,310
Programme depreciation	5	11,739	10,712
Total		**41,559**	**43,022**
Tangible fixed asset depreciation	12	38,714	40,353
Intangible fixed asset depreciation	13	2,845	2,669
Total		**41,559**	**43,022**

Reconciliation of current year revaluation from notes 4 and 5 to notes 12, 13 and 21

Exceptional Revaluation	Note	£000	2004-05 £000
Fixed asset building revaluation:			
Cost revaluation	12	53,013	
Depreciation revaluation	12	30	
			53,043
Add back positive revaluation of Elmbridge Court			125
Exceptional Building revaluation expenditure	4		53,168

Loss/(Gain) on revaluation	Note	2004-05 £000	2004-05 £000	2003-04 £000	2003-04 £000
Tangible fixed asset revaluation					
Cost revaluation	12	46,848		878	
Depreciation revaluation	12	2,361		(2,805)	
			49,209		(1,927)
Less: building revaluation	4		(53,168)		-
			(3,959)		(1,927)
Revaluation reserve	21		6,308		270
Loss/(Gain) on revaluation of fixed assets	4		**2,349**		**(1,657)**

13 Intangible Fixed Assets

The Department's intangible fixed assets comprise purchased software licences.

	Purchased Software licences
	£000
Cost	
At 1 April 2004	**10,899**
Additions	2,917
Transfers	(197)
Donations	-
Disposals	(2,562)
Revaluations	-
At 31 March 2005	**11,057**
Amortisation	
At 1 April 2004	3,652
Charged in year	2,845
Transfers	(65)
Disposals	(1,977)
Revaluations	-
At 31 March 2005	**4,455**
Net Book Value at 31 March 2005	**6,602**
Net Book Value at 31 March 2004	**7,247**

Included within the NBV above are £1,140,723 (2004: £1,880,777) of assets which have been capitalised in accordance with the accounting policy for assets obtained under PFI contracts (Note 1.16).

14 Movements in working capital other than cash

The movements in working capital used in the Reconciliation of resources to cash required comprise:

	2004-05	2003-04*
	£000	£000
Increase/(Decrease) in stocks and WIP	327	(277)
Increase in debtors (excluding prepayments for PFI assets)	9,443	123,444
Decrease/(Increase) in creditors falling due within one year	44,244	(186,480)
	54,014	**(63,313)**
Adjustment: movement in working capital not related to net operating costs		
(Decrease)/Increase in amounts due to the Consolidated Fund	(63,553)	47,602
Net Decrease in working capital other than cash	**(9,539)**	**(15,711)**

The movements in working capital other than cash used in the Cash Flow Statement comprise:

	2004-05	2003-04*
	£000	£000
Increase/(Decrease) in stocks and WIP	327	(277)
Increase in debtors (excluding prepayments for PFI assets)	9,443	123,444
Decrease/(Increase) in creditors falling due within one year	44,244	(186,480)
	54,014	**(63,313)**
Adjustment: movement in working capital not related to voted resource consumption		
(Decrease)/Increase in amounts due to the Consolidated Fund	(63,553)	47,602
Transitional adjustment	-	4,253
Net Decrease in working capital other than cash	**(9,539)**	**(11,458)**

** Certain prior year figures have been restated as per Note 7.*

15 Stocks and work in progress

	2004-05	2003-04
	£000	£000
Stocks	764	545
Work in progress	450	342
Total	**1,214**	**887**

16 Debtors

	2004-05	Restated 2003-04*
	£000	£000
Amounts falling due within one year		
Deposits and advances	1,430	7,092
Other debtors	3,383	607
Fines and Penalties*	125,153	119,458
VAT **	6,800	6,680
Prepayments and accrued income	17,716	10,994
Civil Recovery Deposits ***	116	277
Prepayment for PFI Assets	2,698	2,545
Prepayment for early retirements	4	51
	157,300	**147,704**
Amounts falling due after more than one year:		
Prepayment for PFI Assets	**37,540**	**40,238**

** The Department is reporting CFER income (Fines & Penalties) on an accruals basis for the first time in 2004/05. Income not yet received (receivables) is reported as a debtor in the Balance Sheet matched by a corresponding creditor to the Consolidated Fund (see Note 18). This is in line with Treasury guidance on Resource Accounting. Prior year figures have been restated.*

*** The Department pays and reclaims VAT on its taxable activities. This balance represents the net position at the year end.*

**** This represents the outstanding deposits paid to courts in respect of winding up and bankruptcy applications.*

17 Cash at Bank and in hand

	2004-05	2003-04
	£000	£000
Balance at 1 April	86,211	34,358
Net cash outflow	(63,553)	51,853
Balance at 31 March	**22,658**	**86,211**
The following balances at 31 March are held at:		
Office of HM Paymaster General (OPG)	22,653	86,195
Commercial banks and cash in hand	5	16
Balance at 31 March	**22,658**	**86,211**
The balance at 31 March comprises:		
Amounts issued from the Consolidated Fund for supply but not spent at year end	22,658	86,211
Consolidated Fund extra receipts received and due to be paid to the Consolidated Fund	-	-
	22,658	**86,211**

18 Creditors

Amounts falling due within one year:

	2004-05	Restated 2003-04*
	£000	£000
Trade creditors	38,333	25,656
Accruals and deferred income	55,019	54,905
Finance Leases	823	-
Amounts issued from the Consolidated Fund for supply but not spent at year end	22,658	86,211
Other amounts collectable on behalf of the Consolidated Fund*	125,153	119,458
	241,986	**286,230**

Amounts falling due after more than one year:		
Finance Leases	**84,442**	-

** The Department is reporting CFER income (Fines & Penalties) on an accruals basis for the first time in 2004-05. Income not yet received (receivables) is reported as a debtor in the Balance Sheet (see Note 16) matched by this corresponding creditor to the Consolidated Fund. This is in line with Treasury guidance on Resource Accounting. Prior year figures have been restated.*

Land and building 100 Parliament Street, on the site formerly known as Government Offices at Great George Street (GOGGS)

The Inland Revenue and HM Customs & Excise have recognised the apportioned cost of refurbishment as a finance lease creditor to be paid off during the period of the contract with EP2 on an annuity basis. The creditor balance has been indexed annually at the same rate as the unitary payment. The HM Customs & Excise share of the creditor as at 31 March 2005 was calculated as follows:

	2004-05	2003-04
	£000	£000
Fair value of the building	84,185	-
Uplift for inflation on future unitary payments (note 4)	1,375	-
Principal repaid during 2004-05	(295)	-
	85,265	-
Creditor payable within 12 months	823	-
Creditor payable in more than 12 months	84,442	-
	85,265	**-**

19 Provisions for liabilities and charges

	Early Retirement and Pension Commitments	Legal Claims	Property Dilapidation	Leases and Commercial Agreements	Total
	£000	£000	£000	£000	£000
Balance at 1 April 2004	**5,308**	**10,248**	**961**	**3,898**	**20,415**
Increase in provisions	17,577	20,855	854	2,611	41,897
Released	-	(7,905)	(1,580)	(3,855)	(13,340)
Discounting	186	-	-	-	186
Non Cash Movement (notes 4 and 5)	**17,763**	**12,950**	**(726)**	**(1,244)**	**28,743**
Applied	(2,096)	(4,183)	(10)	(388)	(6,677)
Balance at 31 March 2005	**20,975**	**19,015**	**225**	**2,266**	**42,481**

Early Retirement and Pension Commitments

The Department meets the additional costs of benefits beyond the normal PCSPS benefits in respect of employees who retire early by paying the required amounts annually to the PCSPS over the period between early departure and normal retirement date. The Department provides for this in full when the early retirement programme becomes binding on the Department by establishing a provision for the estimated payments discounted by the Treasury discount rate of 3.5 per cent in real terms. In past years the Department paid in advance some of its liability for early retirement by making payments to the Paymaster General's Account at the Bank of England for the credit of the Civil Service Superannuation Vote. The balance remaining is treated as a prepayment.

During 2004-05 the Department ran an Approved Early Retirement (AER) scheme. The Departmental cost of benefits relating to the scheme has been reflected in the increase in provisions for the year.

Legal Claims

Provisions in relation to legal claims are recognised where legal advice indicates that it is more than 50 per cent probable that the claim will be successful and the amount of the claim can be reliably estimated. The estimated liability is established by reference to the initial costs and compensation served against the Department, along with legal advice obtained.

Legal claims which may succeed but are less likely to do so, or cannot be estimated reliably are disclosed as contingent liabilities in Note 26.

Property Dilapidation

Where leasehold properties have been vacated, dilapidation costs may be payable. The provision is established by reference to the total claimed and experience of previous settlements negotiated.

Leases and Commercial Agreements

This category covers provisions in respect of onerous leases and probable liabilities relating to commercial agreements.

20 Reconciliation of net operating cost to changes in general fund

	2004-05		Restated 2003-04*	
	£000	£000	£000	£000
Net operating costs for the year (Schedule 2)		**(1,344,520)**		**(1,141,910)**
Net Parliamentary funding				
Drawn Down	1,209,555		1,188,497	
Transferred to HM Treasury in respect of transferred tax policy function	-		(2,533)	
Deemed Supply	86,208		37,678	
		1,295,763		**1,223,642**
Due to Consolidated Fund (Note 17):				
A in A excess over Estimate	-		-	
Cash drawn but not spent	(22,658)		(86,211)	
		(22,658)		(86,211)
Transfer to general fund of realised element of revaluation reserve (Note 21)		1,094		1,009
Non-cash charges:				
Cost of capital (Notes 4 & 5)	6,844		7,752	
Auditor's remuneration (Note 4)	465		190	
		7,309		7,942
Net (decrease)/ increase in General Fund		**(63,012)**		**4,472**
General Fund at 1 April		199,730		195,258
General Fund at 31 March (Schedule 3)		**136,718**		**199,730**

** Certain prior year figures have been restated as per note 2.*

21 Reserves

Revaluation Reserve

	2004-05	2003-04
	£000	£000
Balance at 1 April	21,403	22,142
Arising on revaluation during the year (net)	6,308	270
Transferred to General Fund in respect of realised element of revaluation reserve	(1,094)	(1,009)
Balance at 31 March	26,617	21,403

The revaluation reserve reflects the unrealised element of the cumulative balance of indexation and revaluation adjustments (excluding donated assets).

Donated Assets Reserve

	2004-05	2003-04
	£000	£000
Balance at 1 April	20	26
Disposals during the year	(7)	-
Revaluation	-	-
Transferred to operating cost statement in respect of depreciation charged in year	(3)	(6)
Balance at 31 March	**10**	**20**

The donated assets reserve reflects the net book value of assets donated to the Department.

22 Capital Commitments

	2004-05	2003-04
	£000	£000
Contracted capital commitments at 31 March for which no provision has been made	3,952	8,574

23 Commitments under operating leases

	2004-05		2003-04	
	Land and buildings	Other	Land and buildings	Other
	£000	£000	£000	£000
At 31 March the Department was committed to making the following payments during the next year in respect of the operating leases expiring:				
within one year	272	256	265	206
between two and five years	-	544	-	641
after five years	-	-	-	-
	272	**800**	**265**	**847**

24 Other financial commitments

The Department has entered into non-cancellable contracts (which are not operating leases or PFI contracts) for various services. The payments to which the Department is committed during 2005-06 analysed by the period which the commitment expires as follows.

	2004-05	**2003-04**
	£000	£000
within one year	3,441	1,903
between two and five years	11,379	12,177
after five years	-	900
	14,820	**14,980**

25 Commitments under PFI Contracts

The Department has entered into the following PFI contracts:

25.1 Off-balance sheet

Description of Scheme	**Estimated Capital Value** £000	**Contract Start Date**	**Contract End Date**
Transfer of IS infrastructure to private sector	14,270	April 2000	August 2009
Strategic Transfer of Estate to Private Sector (STEPS)	99,400	April 2001	March 2021

The Department's existing IS infrastructure, Freehold Land & Buildings and Historical Leasehold property assets (STEPS PFI) were transferred to private sector providers. Both contracts were the subject of a barter element (IS £14,270,000; STEPS £36,400,000). These barter elements are treated as prepayments in the accounts and are being written down over the life of the contract to reflect comparable reduced service charges.

25.2 On-balance sheet

Description of Scheme	**Estimated Capital Value** £000	**Contract Start Date**	**Contract End Date**
100 Parliament Street - Serviced accommodation for 730 staff	41,390	November 2004	October 2037

	2004-05	**2003-04**
	£000	£000
Imputed finance lease obligations under on-balance sheet PFI contracts comprises:		
Rentals due within 1 year	6,612	-
Rentals due within 2 to 5 years	28,351	-
Rentals due thereafter	309,632	-
	344,595	-
Less interest element	(183,561)	-
	161,034	-

25.3 Charge to the Operating Cost Statement and future commitments

The total amount charged in the Operating Cost Statement in respect of off-balance sheet PFI transactions was £198,149,000 (2003-04: £158,923,000); and at 31 March the Department is contractually committed to make the following payments during 2005-06 in respect of contracts expiring:

	2004-05	**2003-04**
	£000	£000
within 1 year	-	-
between 1 and 5 years	-	-
between 6 and 10 years	136,549	134,480
between 11 and 15 years	-	-
between 16 and 20 years	56,194	59,780
between 21 and 25 years	-	-
between 26 and 30 years	-	-
between 31 and 35 years	1,684	-

26 Contingent Liabilities

Contingent liabilities disclosed under FRS 12

The Department has contingent liabilities at 31 March 2005 relating to 8 claims that are subject to judicial process. The legal opinion obtained by the Department is that these claims can be successfully resisted. Details on these cases have not been given because disclosure could affect the outcome of the proceedings.

The Department also has a contingent liability in relation to 18 Shipbuilders' Relief claims amounting to a possible £106m.

In addition to the above, the Department has a small number of property dilapidation contingent liabilities relating to lease terminations.

Contingent liabilities not required to be disclosed under FRS 12 but included for parliamentary reporting and accountability

Quantifiable

HM Customs and Excise has entered into quantifiable contingent liabilities by offering 12 indemnities to the value of £941k. None of these is a contingent liability within the meaning of FRS 12 since the likelihood of a transfer of economic benefit in settlement is too remote. The Department has not entered into any guarantees or letters of comfort.

Unquantifiable

The Department has entered into no unquantifiable contingent liabilities by offering guarantees, indemnities or by giving letters of comfort.

27 Related-party transactions

Sir Stephen Lander, a non-executive member of the Management Board until March 2005, is also a non-executive Director of Northgate Information Solutions plc. This company became a payroll administration provider for HM Revenue and Customs from April 2005. The Department incurred costs of £689,493 with Northgate for the provision of services during 2004-05. The contract was awarded to Northgate through appropriate procurement procedures and Sir Stephen Lander had no involvement in the review of tenders, negotiations or any other aspect to establish the contract.

Sir Stephen Lander was also an advisor to the Board of Detica Group plc until August 2004, with whom the Department incurred costs of £10,608,639 during the year for the provision of services in the normal course of business. Sir Stephen Lander was not involved in advising Detica on its relationship with the Department or on issues that were connected with the Department's business.

Sir Stephen Lander declared both of his Northgate and Detica relationships to the Department and, in both cases the Chairman took the view that there was no conflict of interest with Sir Stephen Lander's role as a Non-Executive Director for HM Customs and Excise.

No other Board members, key managerial staff or other related parties have undertaken material transactions with the Department during the year.

The Department has had a small number of transactions with other Government Departments and other Central Government bodies.

28 Third Party Assets

EU Funds

The Department holds euro deposits in relation to European Union (EU) Twinning Projects. For such projects it is common for the lead body to hold euro funds on behalf of the EU. The funds are payable to other EU member states as reimbursement for work undertaken in assisting EU candidate states in preparing for membership of the EU. The Department holds these funds as an agent of the EU. Neither the Department nor the Government generally have any beneficial interest in these funds, which total €62,693, and are separately held at the Bank of England.

Seized Monies

The Department manages interest bearing accounts at the Bank of England containing seized monies. At 31 March 2005 the amount in sterling on deposit was £27.2m (£31.5m as at 31 March 2004). An amount of $1.4m in US dollars ($3.6m as at 31 March 2004) was also held on deposit at the Bank of England. The Department also holds cash retained as physical evidence in connection with ongoing legal proceedings. These monies are held as part of the Department's law enforcement activities and as such do not form part of these accounts. Once legal proceedings have been completed any money then due to the Exchequer is included within note 7 "Other Amounts Collectable on behalf of the Consolidated Fund".

Other Seized Assets

Other significant assets held in connection with ongoing legal proceedings at the Balance Sheet date to which it was not practical to ascribe a monetary value comprised 1504 motor vehicles, and 4 vessels. These assets are held as part of the Department's law enforcement activities and as such do not form part of these accounts. Once legal proceedings have been completed any money due from the sale of seized assets is included within note 7 "Other Amounts Collectable on behalf of the Consolidated Fund".

29 Notes to Schedule 5

Expenditure, including the cost of capital employed, is incurred for administration and operational purposes. The distribution to objectives of that expenditure and the related operating income has been undertaken in accordance with Departmental costing practices. A framework of operational and support activities is used to attribute costs to objectives, either directly or through the application of apportionment methodologies. The vast majority of operating costs and income are directly attributable to objectives.

The resources include the Department's International Assistance programme. The costs of the programme are recovered in full through charges raised against external sponsors. Resources for 2004-05 also include the costs of Detached National Experts (DNEs), Departmental staff from a variety of specialist fields (e.g. customs, excise, statistics), on temporary appointment to the European Commission or the Council Secretariat. The costs of DNEs are met by the Department.

Payments and receipts in respect of shipbuilders' relief meet non-discretionary legal obligations and are not considered to have a direct link to the achievement or cost of the Departmental objectives.

Programme grants and other current expenditures have been allocated as follows:

	2004-05	**2003-04***
	£000	£000
RfR 1 Objective 1	998,138	860,037
RfR 1 Objective 2	315,114	252,093
RfR 2 Objective 1	27,682	22,078
	1,340,934	1,134,208

** Certain prior year figures have been restated as per note 2*

Capital Employed by Departmental Aims and Objectives

	2004-05	**2003-04***
At 31 March	Capital employed	Capital employed
Aim:	£000	£000
RfR 1 Objective 1	124,150	171,137
RfR 1 Objective 2	39,195	50,016
RfR 2 Objective 1	-	-
	163,345	**221,153**

*Prior year figures have been restated to agree with the total capital employed on the Balance Sheet

30 Losses Statement

	2004-05
	£000
Cash losses (507 cases)	373
Stores losses (926 cases)	326
Fruitless payments (3 cases)	3
Claims abandoned (80 cases)	861
Total (1,516 cases)	**1,563**

Details (cases over £100,000)

Subsequent to an Internal Audit review of controls and procedures relating to compensation and court costs (collected on HMC&E's behalf by Magistrates Courts), old debtors were removed from databases. Following Treasury approval, one case totalling £194,000 was 'written off' on the authority of the Finance Director.

In 2001-02, payments received to settle a trader's VAT Penalty arrears were incorrectly posted to the wrong consolidated fund account. Treasury rules do not allow monies accounted for in a previous 'signed off' year to be recovered due to the funds having been utilised. On the authority of the Finance Director, the amount involved of £124,104 was included in the account as a 'cash loss'.

31 Special Payments

	2004-05
	£000
Total (1,591 cases)	2,334

Details (cases over £100,000)

A claim was made against the Department following an investigation into suspected evasion of Anti-Dumping Duty. After investigation, no offences were found to have been committed. Following mediation and Counsel's advice, a settlement of £135,000 was approved by the Finance Director.

32 Loans and investments

The Department has issued no loans, nor does it hold any investments.

33 Late payment of commercial debts

No interest charges were paid in respect of late payments of commercial debts (2003-04: nil payments).

34 Financial Instruments

FRS 13 'Derivatives and Other Financial Instruments', requires disclosure of the role financial instruments have had during the period in creating or changing the risk an entity faces in undertaking its activities. Because of the largely non-trading nature of its activities and the way government departments are financed, the Department is not exposed to the degree of financial risk faced by business entities. Moreover, financial instruments play a much more limited role in creating or changing risk that would be typical of the listed companies to which FRS 13 mainly applies. The Department has very limited powers to borrow or invest surplus funds. All financial assets and liabilities are generated by day-to-day operational activities and are not held to change the risks facing the Department in undertaking its activities.

Liquidity Risk

The Department's net revenue resource requirements are financed by resources voted annually by Parliament, as largely is its capital expenditure. It is not, therefore, exposed to significant liquidity risks.

Interest Rate Risk

All of the Department's financial assets and liabilities carry nil or fixed rates of interest and the Department is not therefore exposed to significant interest rate risk. The interest profile of the Department's financial liabilities and assets has therefore not been disclosed separately.

Foreign Currency Risk

The Department's exposure to foreign currency risk is not significant. Foreign currency income and expenditure are negligible.

Fair Values

The book values of the Department's financial assets and liabilities at 31 March 2005 are not materially different from their fair values. They have accordingly not been shown separately.

35 Entities within the Departmental boundary

During 2004-05 there were no supply financed agencies, NDPBs or other entities within the Departmental boundary.

36 Intra-government Balances

	Debtors: amounts falling due within one year £000	Debtors: amounts falling due after more than one year £000	Creditors: amounts falling due within one year £000	Creditors: amounts falling due after more than one year £000
Balances with other central government bodies	386	-	154,115	-
Balances with local authorities	-	-	-	-
Balances with NHS Trusts	-	-	-	-
Balances with public corporations and trading funds	-	-	-	-
Balances with bodies external to government	156,914	37,540	87,871	84,442
At 31 March 2005	**157,300**	**37,540**	**241,986**	**84,442**
Balances with other central government bodies	2,583	-	214,117	-
Balances with local authorities	-	-	-	-
Balances with NHS Trusts	-	-	-	-
Balances with public corporations and trading funds	-	-	-	-
Balances with bodies external to government	145,121	40,238	72,113	-
At 31 March 2004	**147,704**	**40,238**	**286,230**	**-**

37 Post Balance Sheet Event

On 5 July 2005, the Government announced that plans for distance based lorry-charging would be taken forward by the Department for Transport (DfT) as part of wider work on national road pricing - to work for a single, comprehensive, cost effective system - and that the current procurement for HMRC Lorry Road-User Charging would therefore not be continued. The Lorry Road-User Charge programme began a process of closing down, ensuring the completion and organisation of necessary documentation, and passing on of relevant knowledge and information to DfT. Although the programme formally closed on 30 September 2005, some of this residual work and arrangements for the payment of staff salaries are expected to continue through 2005-06.

Accounts Direction given by HM Treasury

ACCOUNTS DIRECTION GIVEN BY THE TREASURY IN ACCORDANCE WITH SECTION 5(2) OF THE GOVERNMENT RESOURCES AND ACCOUNTS ACT 2000 AND WITH SECTION 2(3) OF THE EXCHEQUER AND AUDIT DEPARTMENTS ACT 1921.

1. Her Majesty's Revenue and Customs shall prepare Resource Accounts in respect of HM Customs and Excise for the year ended 31 March 2005 in compliance with the accounting principles and disclosure requirements of the edition of the Resource Accounting Manual issued by HM Treasury (the Resource Accounting Manual) which is in force for that financial year.
2. HM Customs and Excise's Resource Accounts shall be prepared so as to give a true and fair view of the state of affairs at 31 March 2005 and of the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the financial year then ended. The Resource Accounts shall also be prepared so as to provide disclosure of any material expenditure or income that has not been applied to the purposes intended by Parliament or material transactions that have not conformed to the authorities which govern them.
3. Compliance with the requirements of the Resource Accounting Manual will, in all but exceptional circumstances, be necessary for the Resource Accounts to give a true and fair view. If, in these exceptional circumstances, compliance with the requirements of the Resource Accounting Manual is inconsistent with the requirement to give a true and fair view, the requirements of the Resource Accounting Manual should be departed from only to the extent necessary to give a true and fair view. In such cases, informed and unbiased judgement should be used to devise an appropriate alternative treatment, which should be consistent with both the economic characteristics of the circumstances concerned and the spirit of the Resource Accounting Manual. Any material departure from the Resource Accounting Manual should be discussed in the first instance with the Treasury.
4. Her Majesty's Revenue and Customs shall prepare a Trust Statement in respect of HM Customs and Excise for the financial year ended 31 March 2005, which shall give a true and fair view of the state of affairs relating to the collection and allocation of taxes and duties administered by the Department and the revenue income and expenditure and cash flows for the financial year then ended. When preparing this Statement, Her Majesty's Revenue and Customs shall have regard to the format of the accounts as shown in the appendix to this Direction, and shall also agree the format of the Operating and Financial Review and supporting notes (including the accounting policies, particularly with regard to income recognition), with the Treasury. Regard shall also be given to all relevant accounting and disclosure requirements given in "Government Accounting," other guidance as issued by the Treasury and the principles underlying UK Generally Accepted Accounting Practice.
5. The Resource Account shall be transmitted to the Comptroller and Auditor General together with the Trust Statement, by a date agreed with the Comptroller and Auditor General and the Treasury, but in any event no later than 30 November 2005, for the purpose of his audit examination and report.

6. HM Customs and Excise's Resource Accounts and the Trust Statement, together with this Direction, but with the exception of any appendices, shall be laid before Parliament in one volume containing both financial statements and the Report produced by the Comptroller and Auditor General under Section 2(2) of the Exchequer and Audit Departments Act 1921.
7. This Direction supersedes the Resource Accounts and Trust Statement Directions for HM Customs and Excise dated 15 March 2004.

DAVID A CRUDEN FCA
Head of the Central Accountancy Team
HM Treasury

22 July 2005

Trust Statement

Trust Statement for the year ended 31 March 2005

Contents Page

Accounting Officer's Foreword to the Trust Statement

Scope

The Trust Statement is an account of the revenue and expenditure related to the taxes and duties for the year 2004-05 and reports the final financial year's activity of HM Customs and Excise ("the Department"). The costs of running the Department are included in the Department's Resource Accounts. Following the Chancellor's announcement in his March 2004 budget speech, the legislation to create HM Revenue and Customs received Royal Assent on 7 April 2005. The new Department came into existence on 18 April 2005, incorporating HM Customs and Excise and the Inland Revenue.

HM Customs and Excise was a non-ministerial Government Department with responsibility for collecting indirect taxes and enforcing Government requirements relating to the movement of goods across the UK national and the EU common frontier. Our focus was on managing certain risks on behalf of the Government and the public. We managed risks to revenue, ranging from the simple errors in tax declarations to major frauds targeted on indirect tax systems. We also managed the risks to society that arise from the illegal importation of prohibited or restricted goods such as drugs, firearms or paedophile material.

Statutory Framework

The Commissioners of HM Customs and Excise were established civil servants collectively appointed by the Queen under the Great Seal. Their authority was from Parliament and they were responsible for the collection, care and management of customs duties, excise duties, Value Added Tax (VAT), Insurance Premium Tax, Air Passenger Duty, Aggregates Levy, Landfill Tax, Climate Change Levy and the Money Service Business (MSB) regime. They were also responsible for the enforcement of import and export prohibitions and restrictions and the collection of overseas trade statistics.

Operating and Financial Review

The Department's Aim and Objectives for 2004-05 were:

Aim

- To administer the tax system fairly and efficiently and make it as easy as possible for individuals and businesses to understand and comply with their obligations.

Objectives

- To collect the right revenue at the right time from indirect taxes and to improve the level of compliance with Customs and statistical requirements; and
- To reduce crime and drug dependency by detecting and deterring the smuggling of illegal drugs and other prohibited and restricted goods.

HM Customs and Excise's performance was assessed through its PSA Service Delivery Agreement and other work targets. The Department's PSA for the period 2003-2006 (set out in the Spending Review (SR) 2002) contained four key targets. Full details of performance against those targets are reported in the Department's Annual Report and its Spring and Autumn Performance Reports.

New Basis for the production of the Trust Statement

The HM Treasury accounts direction issued under Section 2 of the Exchequer and Audit Departments Act 1921 requires the Department to produce the Trust Statement to give a true and fair view of the state of affairs relating to the collection and allocations of taxes and duties and the revenue income and expenditure and cash flows for the financial year. Regard shall be given to all relevant accounting and disclosure requirements given in Government Accounting and other guidance issued by HM Treasury and the principles underlying generally accepted accounting practice.

In previous years, the Trust Statement was produced on a cash basis. In 2004-05, it is prepared on an accruals basis, which shifts the emphasis of the Trust Statement from reporting the net cash received in a given year to the revenue earned in respect of that year. Over the last three years, the Department has produced dry run accruals-based Trust Statements and has been working closely with HM Treasury and NAO to develop a full set of accruals accounts, supported by a comprehensive set of accounting policies. Work has been carried out on the Department's systems to develop reports to produce the level of detail required for these accounts. The comparatives for 2003-04 are from the 2003-04 dry run accruals-based Trust Statement.

One of the effects of this change is that we will publish a Trust Statement Balance Sheet and a Cash Flow Statement for the first time and have identified new figures in the accounts, including:

- **Debtors**

  Debtors comprise all money owed to the Department as at 31st March.

- **Accrued Revenue Receivable**

  Accrued Revenue Receivable consists of amounts that relate to the accounting year that become payable to the Department from taxpayers or traders. The liability was established within the financial year, but the due date for payment falls after the year-end.

- **Accrued Revenue Liabilities**

  Similarly, this figure represents the amounts that relate to the accounting year that become repayable to taxpayers or traders. The liability was established within the financial year, but the due date for payment falls after the year-end.

- **Remissions and Write-offs**

  All recorded debts are reviewed and where amounts are deemed to be bad debts or not collectable for a number of reasons they are remitted or written off. The remissions and write-offs figures are now shown as an expense (i.e. equivalent to bad debt expense) included in bad and doubtful debts on the face of the Trust Statement. This has previously been included as a note to the cash-based Trust Statement (at summary level). More details of the difference between remissions and write-offs are included at note 1.3.4.1.

- **Doubtful Debt Provisions**

  Under GAAP, and in line with commercial practice, we not only report debts that have been written off, but we also provide for debts that are likely to become uncollectable in the future, for various reasons. Our balance sheet debtor figures are quoted net of provisions, but we disclose these amounts, as well as the movement in the provision, in note 4a to the account.

- **Contingent Liabilities/Provisions for Liabilities**

  In accordance with Financial Reporting Standard (FRS) 12, contingent liabilities and provisions for liabilities are included in the accounts. This shows information about the expected outflow of money from court cases, which have progressed beyond the tribunal stage, or where the outcome may not favour the Department. Movement in the provision for liabilities will be shown as an expense in the Statement of Revenue and Expenditure, on the Balance Sheet and as a note to the accounts. Contingent Liabilities are disclosed in a note. There is further information about these items in note 1.3.6 to the account.

Selection of appropriate Accounting Policies for the Trust Statement and use of judgements and estimates

As Principal Accounting Officer, it is my responsibility to apply suitable accounting policies in the preparation of the Trust Statement. With the move to the accruals basis the Department has reviewed its accounting policies. The underlying approach to accruals measurement is that revenues from taxation are deemed to accrue evenly over the (tax return) period for which they are due. Revenues are recognised in the period in which the event that generates the revenue occurs.

The Cash Flow Statement provides an analysis of the cash position, which can be compared with the Net Revenue.

Events in 2004-05

In March 2004, the Government accepted in full the recommendations of the review of the Revenue Departments, led by Permanent Secretary to the Treasury, Gus O'Donnell. The key recommendation of the review was the creation of a new Department, integrating HM Customs and Excise and the Inland Revenue, tasked with improving customer services, particularly reducing compliance costs, improving compliance with tax law, and increasing efficiency. David Varney was appointed Chairman of this new Department with Paul Gray as the deputy. All responsibilities relating to the assessment, collection and allocation of taxes and duties transferred to the new Department in April 2005.

Financial Review

During the year, the Department has raised total net revenue of £123.0 billion, an increase of £4.6 billion (3.9%) on 2003-04.

VAT net revenue, which accounted for 60.3% of total net revenue, increased by £3.1 billion (4.4%), driven by economic growth and the effects of the VAT compliance strategy.

Tobacco duties net revenue decreased by £0.5 billion (5.8%). This was mainly due to the unusually high outturn in 2003-04. This was fuelled by Tobacco companies forestalling[1] large quantities during that particular year.

Alcohol duties net revenue increased by £1.5 billion (19.7%). This was largely driven by one large liability of £1.2 billion, later remitted[2] under approval by the Chairman. For more information, see note 4b to the account. If this was excluded, the net increase would have been 3.9%.

The bad and doubtful debts also increased considerably due, in particular, to this same remission.

Forward Look

For the 2005-06 financial year, one Trust Statement for HM Revenue and Customs will be published reporting the combined net tax revenues of the two former Departments (HM Customs and Excise and Inland Revenue).

Management of the Department

During 2004-05, the Chairman of Customs and Excise was accountable to the Chancellor of the Exchequer for the administration of its affairs and the implementation and stewardship of tax policy. Two Departmental Ministers, who assumed day-to-day responsibility for Customs and Excise during the year, supported the Chancellor. The Paymaster General, the Rt Hon Dawn Primarolo MP took over from the Economic Secretary John Healey MP on 17th September 2004. John Healey remained responsible for excise duties, gambling duties and the Lorry Road-User charge.

Full details regarding the management of the Department is included in the Department's Resource Account.

Auditors

The Trust Statement is audited by the Comptroller and Auditor General under Section 2(3) of the Exchequer and Audit Departments Act 1921. The auditor's notional remuneration for this is included in the Department's Resource Accounts.

DAVID VARNEY
Principal Accounting Officer
5 October 2005

[1] This is the practice whereby excessive quantities of goods are removed for home-use on payment of duty because an increase in the rate of duty is expected.

[2] Remissions are debts capable of recovery but the Department has decided not to pursue the liability because, for example, of hardship or official error.

Statement of Accounting Officer's Responsibilities in respect of these accounts

The Accounting Officer for HM Customs and Excise is responsible for ensuring that there is a high standard of financial management, including a sound system of internal control; that financial systems and procedures promote the efficient and economical conduct of business and safeguard financial propriety and regularity; that financial considerations are fully taken into account in decisions on policy proposals; and that risk is considered in relation to assessing value for money.

HM Treasury has appointed the Permanent Head of the Department as Principal Accounting Officer and, under section 2(3) of the Exchequer and Audit Departments (E&AD) Act 1921, he is responsible for the preparation and submission to the Comptroller and Auditor General of a Trust Statement for HM Customs and Excise for the financial year 2004-05. In conforming with HM Treasury direction (see page 79 of this Trust Statement), it details the revenue collected and expenditure in respect of taxes and duties administered by the Department.

The Trust Statement is prepared on an accruals basis and must give a true and fair view of the state of affairs relating to the collection and allocation of taxes and duties administered by the Department and the revenue income and expenditure and cash flows for the financial year then ended.

The Trust Statement should include a Statement on Internal Control (SIC), which sets out the governance risk and control arrangements for the Department. The SIC process is firmly and clearly linked to the risk management process in the Department.

In preparing the accounts, the Principal Accounting Officer is required to:

- observe the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards have been followed and disclose and explain any material departures in the account.

The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which an Accounting Officer is answerable, for keeping proper records and for safeguarding the Department's assets, are set out in the Accounting Officers' Memorandum issued by HM Treasury and published in Government Accounting.

Statement on Internal Control

The Department's Statement on Internal Control, covering both the Resource Accounts and the Trust Statement, is shown on pages 1 to 6.

The Certificate and Report of the Comptroller and Auditor General to the House of Commons

I certify that I have audited the financial statements on pages 68 to 78 under section 2 of the Exchequer and Audit Departments Act 1921. These financial statements have been prepared under an accruals basis and the accounting policies set out on pages 71 to 73.

Respective responsibilities of the Accounting Officer and Auditor

As described on page 64, the Accounting Officer is responsible for the preparation of the financial statements in accordance with the Exchequer and Audit Departments Act 1921 and Treasury directions made thereunder and for ensuring the regularity of financial transactions. The Accounting Officer is also responsible for the preparation of the other contents of the Accounts. My responsibilities, as independent auditor, are established by statute and I have regard to the standards and guidance issued by the Auditing Practices Board and the ethical guidance applicable to the auditing profession.

I report my opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Exchequer and Audit Departments Act 1921 and Treasury directions made thereunder, and whether in all material respects the revenue and expenditure have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. I also report if, in my opinion, the Foreword on pages 61 to 63 is not consistent with the financial statements, if the Department has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit.

I read the other information contained in the Accounts and in the appendix to the Accounts at pages 81 to 85, and consider whether it is consistent with the audited financial statements. I consider the implications for my certificate if I become aware of any apparent misstatements or inconsistencies with the financial statements.

I review whether the statement on pages 1 to 6 reflects the Department's compliance with Treasury's guidance on the Statement on Internal Control. I report if it does not meet the requirements specified by Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered whether the Accounting Officer's Statement on Internal Control covers all risks and controls. I am also not required to form an opinion on the effectiveness of the Department's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

I conducted my audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Department in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Department's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by error, or by fraud or other irregularity and that, in all material respects, the revenue and expenditure have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I have also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In my opinion:

- the financial statements give a true and fair view of the state of affairs relating to the collection and allocation of taxes and duties administered by HM Customs and Excise and of the revenue and expenditure and cash flows for the financial year ended 31 March 2005 and the balances held at that date, and have been properly prepared in accordance with section 2(3) of the Exchequer and Audit Departments Act 1921 and directions made thereunder by Treasury; and
- in all material respects the revenue and expenditure have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

I have no observations to make on these financial statements.

JOHN BOURN
Comptroller and Auditor General
7 October 2005

National Audit Office
157-197 Buckingham Palace Road
Victoria
London SW1W 9SP

The maintenance and integrity of the HM Revenue and Customs' website is the responsibility of the Accounting Officer; the work carried out by the auditors does not involve consideration of these matters and accordingly the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Statement of Revenue and Expenditure for the year ended 31 March 2005

	Notes	**2004-05** £ billion	2003-04* £ billion
Taxes and Duties			
Value Added Tax	2a	74.2	71.1
Hydrocarbon Oils Duties		23.3	22.9
Tobacco Duties		8.1	8.6
Alcohol Duties		9.1	7.6
Other Taxes and Duties	2b	8.3	8.2
Total Taxes and Duties		**123.0**	118.4
Less Expenditure and Disbursements			
Taxation Revenue due to the Isle of Man	3	(0.2)	(0.1)
Bad and Doubtful Debts	4a	(2.1)	(0.8)
Provision for Liabilities	5	(0.1)	-
Total Expenditure and Disbursements		**(2.4)**	(0.9)
Net Revenue for the Consolidated Fund		**120.6**	117.5

** These figures have been restated on an accruals basis*

There were no recognised gains and losses accounted for outside the above Statement of Revenue and Expenditure.

The notes at pages 71 to 78 form part of this Statement.

Balance Sheet as at 31 March 2005

	Notes	**31 March 2005** £ billion	31 March 2004 £ billion
Current Assets			
Debtors	6	3.5	3.3
Accrued Revenue Receivable	6	23.1	22.4
Cash at Bank and in Hand		0.1	0.3
		26.7	26.0
Current Liabilities			
Creditors	7	2.1	1.9
Accrued Revenue Liabilities	7	7.0	6.3
		9.1	8.2
Total Current Assets less Current Liabilities		17.6	17.8
Provision for Liabilities	5	(0.1)	-
		17.5	17.8
Represented by:			
Balance on Consolidated Fund Account as at 31 March	8	**17.5**	17.8

The Balance Sheet was approved by the Principal Accounting Officer.

The notes at pages 71 to 78 form part of this Statement.

DAVID VARNEY
Principal Accounting Officer
5 October 2005

Cash Flow Statement for the year ended 31 March 2005

	Notes	**2004-05** £ billion	2003-04 £ billion
Net Cash Flow from Revenue Activities	A	120.7	115.7
Cash paid to Consolidated Fund		(120.9)	(115.7)
Increase/(Decrease) in Cash in this period	B	**(0.2)**	-

Notes to the Cash Flow Statement

A: Reconciliation of Net Cash Flow to movement in Net Funds

	2004-05 £ billion	2003-04 £ billion
Net revenue for the Consolidated Fund	120.6	117.5
(Increase) in Non-cash Assets	(0.9)	(1.7)
Increase/(Decrease) in Liabilities	0.9	(0.1)
Increase in Provision for Liabilities	0.1	-
Net Cash Flow from Revenue Activities	**120.7**	115.7

B: Analysis Of Changes In Net Funds

	2004-05 £ billion	2003-04 £ billion
Increase/(Decrease) in Cash in this period	(0.2)	-
Net Funds as at 1 April (Opening Cash at Bank)	0.3	0.3
Net Funds as at 31 March (Closing Cash at Bank)	**0.1**	0.3

The notes at pages 71 to 78 form part of this Statement.

Notes to the Trust Statement

1. Statement of Accounting Policies

1.1 Basis of Accounting

The Trust Statement is prepared in accordance with the accounts direction issued by HM Treasury under the Exchequer and Audit Department Act 1921. The Statement is produced in accordance with UK Generally Accepted Accounting Practice (GAAP) to the extent that they are meaningful and appropriate. The accounting policies detailed below have been applied consistently.

1.2 Accounting Convention

These accounts have been prepared on an accruals basis and in accordance with the historical cost convention.

As this is the first year that the Trust Statement has been produced on an accruals basis, there is a difference between the closing balance on the Consolidated Fund Account shown in last year's published accounts, produced on a cash basis, and the opening balance on these accounts. The comparatives have been restated on an accruals basis.

1.3 General Accounting Policies

1.3.1 Net Accounting

1.3.1.1 All taxes and duties excluding VAT

All taxes and duties, other than VAT, are shown net in the Statement of Revenue and Expenditure, i.e. gross revenue adjusted for repayments or refunds. This is a change from previous years as a review has shown that the majority of repayments are actually refunds (e.g. where the trader has made a mistake and overpaid, so the Department was never due the money) so revenue should be stated net of such refunds.

1.3.1.2 VAT

Value Added Tax (VAT) is shown net in the Statement of Revenue and Expenditure. The gross receipts and repayments are detailed in Note 2a.

1.3.2 Interest

Total net revenue includes tax (stated net of repayments and refunds) and interest receivable and payable.

1.3.3 Fines and Penalties

Income generated from fines and penalties is recorded in the Department's Resource Accounts as either Appropriations in Aid or as payable to the Consolidated Fund. This is in line with the Treasury Resource Accounting Manual.

1.3.4 Bad and Doubtful Debts

Bad and doubtful debts include the remissions and write-offs for the year and the movement on the provision for doubtful debts.

1.3.4.1Remissions and Write-offs

Remissions are debts capable of recovery but the Department has decided not to pursue the liability because, for example, of hardship or official error. Write-offs are debts that are irrecoverable because there is no practical or economical means for pursuing the liability. Remissions and write-offs are recognised in the year they are authorised. These amounts may have been included in the provision for doubtful debts in previous years. However, some may only have become a bad or doubtful debt within the year, for example in the case of insolvency.

1.3.4.2 Provision for Doubtful Debts

In order to present the debtors figure that we consider is collectable, it is necessary to make an allowance for those amounts which we believe will be remitted, written off or withdrawn in the future. This provision for doubtful debts has been estimated using debt analysis, trend analysis (including use of the remissions and write-offs figures from the previous year) and expert opinion.

The debtors figure in the Balance Sheet is shown net of the provision for doubtful debts.

1.3.5 Third Party Assets Held

Where the Department holds assets (funds) on behalf of other parties, these assets are not due to the United Kingdom (UK) and do not form part of these accounts. Therefore the balance of such assets held at year-end is disclosed in Note 11.

1.3.6 Contingent Assets and Liabilities and Provisions for Liabilities

The Department is involved in revenue related legal actions. The courts may decide these cases for or against the Department. Where a case is still to be heard at court, or is subject to appeal, there is a large degree of uncertainty as to whether the Department has a contingent liability or contingent asset and the amounts involved.

Where the amounts involved are material and there is a possible chance that the Department will have to repay amounts of revenue, we will disclose these amounts as contingent liabilities in note 12. Some test cases may set a precedent that may result in further claims for repayment of revenue previously paid. Where appropriate, these amounts have also been included in the note.

When a decision has been made that there is likely to be a repayment of revenue, which the Department can reliably estimate, we recognise this provision in the accounts. This treatment is compliant with FRS 12.

Where the outcome of court cases has gone against the Department and the case is uncontested, legal and administrative costs have either been provided for or charged through the Department's Resource Accounts.

1.3.7 Revenue Recognition

1.3.7.1 General

From this year, the Department's accounts are reported on an accruals basis, which means that revenue and expenditure are matched to the period to which it relates. Previously, revenue was recognised when it was received or payments were made. This method of reporting requires us to have revenue recognition points for the taxes and duties for which the Department has responsibility. Duty becomes established at the recognition points and is due to be reported in the accounts, if those points fall within the accounting year to 31 March.

Where taxes or duties are declared on returns, for accounting periods that cover more than one month, the tax or duty is deemed to accrue evenly over the period concerned. Therefore, where the period in question covers more than one accounting year, the tax or duty is apportioned so that only the amount appropriate to the reporting year is included in the accounts. This applies equally to the Excise Deferment Scheme, which is spread across two months.

Similarly, if a tax or duty has a facility for paying amounts in advance and the period of advance payment falls into two accounting years, the amount applicable to the second accounting year must be included as an amount of deferred revenue in the accounts for the reporting year. This occurs in the case of Amusement Machine Licence Duty where a licence is purchased in full. It also occurs in particular circumstances in the payments on account regime for large traders.

Accounting for taxation revenue is not fully covered by UK GAAP; therefore revenue recognition is determined by guidance from HM Treasury which is reviewed by the Financial Reporting Advisory Board (FRAB)[3]. FRAB acts as an independent review body in the process of setting accounting standards for government.

Where revenue from taxes and duties derives from taxpayers' self-assessments of liability, the self-assessments may be subject to examination. This can result in additional receipts or repayments in future years. The amounts to be received or repaid are normally accounted for in the year that the tax liability arose. Where this is not possible, amounts received or repaid in later accounting periods are accounted for as early as practicable, but in any event no later than in the years in which the liabilities become certain.

1.3.7.2 Non-period Based Transactions

The Department has the following non-period based receipts and repayments, which occur on an ad hoc basis:

- Claims that are submitted, for example, where duty paid goods are exported, are recognised on the date of receipt.
- Receipts that occur, for example, when an individual imports goods into the United Kingdom, are recognised on the date of receipt.
- Secondary assessments (a further assessment resulting from a visit to a trader where an error has been found on a previous return or assessment) are recognised on the date of issue.

In some instances, predominantly at the end of the accounting period, where items received in April relate to events in March, the policy may result in the amounts concerned being reported in the following accounting year. This does not comply with GAAP, however the amounts involved are not considered to be material. Any material amounts will be identified and appropriate accounting action taken to ensure that they are reported in the proper accounting year. These items were not identified in the 2003-04 figures.

3 More information about the FRAB can be found on HM Treasury website, the address of which is www.hm-treasury.gov.uk.

2 Taxes and Duties Due

2a VAT Repayments

For 2004-05 the net VAT revenue of £74,155 million is made up of VAT Gross Revenue Due of £125,337 million (£119,542 million for 2003-04) less Repayments Due in the year of £51,182 million (£48,401 million for 2003-04).

2b Other Taxes and Duties

	Note	**Net Revenue Due 2004-05 £ million**	Net Revenue Due 2003-04 £ million
Insurance Premium Tax		2,362	2,327
Customs Duties		1,501	1,612
Betting And Gaming Duties		1,414	1,379
Air Passenger Duty		874	799
Climate Change Levy		743	822
Landfill Tax	2c	673	625
Agricultural Duties		369	341
Aggregates Levy		320	335
Total Revenue Due		**8,256**	8,240

2c Landfill Tax

The Landfill Tax revenue of £673 million is that receivable after a reduction of £43.9 million (£59.5 million in 2003-04) has been made for contributions made to environmental bodies by landfill operators, under the Landfill Tax Credit Scheme.

3 Taxation Revenue due to the Isle of Man

Under the Isle of Man Act 1979, the Isle of Man Government is entitled to a share of common revenues collected in the UK by the Department.

The cash payments for 2004-05 were £202 million. The opening debtors were £26 million and the closing debtors were £1 million. Therefore, the total taxation revenue due to the Isle of Man for 2004-05 was £227 million.

4 Bad and Doubtful Debts

Bad and Doubtful Debts are made up of revenue remissions and write-offs and the movement in the provision for doubtful debts. The split is shown below:

4a Breakdown of Bad and Doubtful Debts

	Notes	**2004-05** £ million	2003-04 £ million
Revenue Remissions and Write-offs	4b	(2,070)	(1,053)
(Increase)/Decrease in Provision for Doubtful Debts	4c	(9)	272
Total Bad and Doubtful Debts		**(2,079)**	(781)

4b Revenue Remissions and Write-offs

	Remissions 2004-05 £ million	Write-offs 2004-05 £ million	Total **2004-05** £ million	Remissions 2003-04 £ million	Write-offs 2003-04 £ million	Total 2003-04 £ million
Value Added Tax	23	835	858	10	1,031	1,041
Hydrocarbon Oils Duties	-	1	1	-	1	1
Tobacco Duties	-	7	7	-	1	1
Alcohol Duties	1,198	1	1,199	-	6	6
Other Remissions and Write-offs	1	4	5	-	4	4
Total Revenue Remissions and Write-Offs	**1,222**	**848**	**2,070**	10	1,043	1,053
Number of cases	94	53,264	53,358	137	58,235	58,372

The number of cases does not include those where the value was less than £1. These are included within the value.

Remissions and write-offs are reduced when either further money is recovered relating to a past remission or write-off, or when the original debt is later found to have not been due, so the remission or write-off should never have occurred. For example, when a trader becomes insolvent, the Department immediately writes off the debt. After administration, it may be that the Department recovers an amount of money or the original assessment may be found to be incorrect. Sometimes these adjusted amounts relate to remissions and write-offs from a previous year.

For 2004-05, the Department recovered monies totalling £66 million relating to write-offs in previous years. Also, the withdrawal of original debts led to remissions and write-offs being further reduced by £69 million relating to previous years.

The following details Revenue Remissions and Write-offs greater than £10 million:

- There was a remission of £1,198 million of excise duty, over 4 years, relating to a failure of a manufacturer to follow a prescribed formula. It was decided that, as the trader did not gain any commercial advantage and the law has since been changed, to remit this amount on the basis that strict application of the law would have been both oppressive and unfair.
- There were seven write-offs relating to VAT insolvency over £10 million each. These total £123 million out of total VAT write-offs in the year of £847.7 million.
- There was a remission of £17 million of VAT on the grounds of equity, in a case where the Department gave a trader incorrect advice on its VAT status. However, this did not actually represent a loss to the Consolidated Fund as the 'trader' involved was a Non-Departmental Public Body. This was by far the largest of a total of 84 cases where VAT of £22.9 million was remitted where there had been official error.

4c Provision for Doubtful Debts

	2004-05 £ million	2003-04 £ million
Balance as at 1 April	2,309	2,581
Balance as at 31 March	2,318	2,309
(Increase)/Decrease in Provision for Doubtful Debts	**(9)**	**272**

Debtors in the Balance Sheet are reported after the deduction of the Provision.

5 Provision for Liabilities

	Legal Claims £ million
Balance at 1 April 2004	-
Provided in the year	(82)
Provision not required written back	-
Provision utilised in the year	-
Balance at 31 March 2005	**(82)**

A provision has been made for a legal claim against the Department, where it is probable that there will be a material amount of revenue repaid to traders.

Legal claims, which may succeed but are less likely to do so, or cannot be measured reliably, are disclosed as contingent liabilities in note 12.

6 Debtors and Accrued Revenue Receivable

A breakdown of Debtors and Accrued Revenue Receivable falling due within one year is as follows:

	Debtors as at 31 March 2005 £ million	Accrued Revenue Receivable as at 31 March 2005 £ million	Total as at **31 March 2005** £ million	Total as at 31 March 2004 £ million
Value Added Tax	4,935	19,025	23,960	22,739
Hydrocarbon Oils Duties	64	1,129	1,193	1,168
Tobacco Duties	198	1,145	1,343	1,391
Alcohol Duties	430	503	933	918
Other Taxes and Duties	150	1,289	1,439	1,790
Other Debtors	2	-	2	28
Totals before Provision	**5,779**	**23,091**	**28,870**	28,034
Less Provision (Note 4c)	(2,318)	-	(2,318)	(2,309)
Total	**3,461**	**23,091**	**26,552**	25,725

Debtors are taxpayers or traders that have established liabilities due to the Department and, at the Balance Sheet date, these payments have not been received in full.

Accrued Revenue Receivable is amounts with due dates falling after the Balance Sheet date of the financial year to which they relate.

There are no debtors which fall due after one year.

7 Creditors, Accrued Revenue Liabilities and Deferred Revenue

A breakdown of Creditors, Accrued Revenue Liabilities and Deferred Revenue falling due within one year is as follows:

	Creditors as at 31 March 2005 £ million	Accrued Revenue Liabilities as at 31 March 2005 £ million	Deferred Revenue as at 31 March 2005 £ million	Total as at **31 March 2005** £ million	Total as at 31 March 2004 £ million
Value Added Tax	2,023	7,011	1	9,035	8,054
Hydrocarbon Oils Duties	3	4	-	7	3
Tobacco Duties	-	-	-	-	-
Alcohol Duties	3	-	-	3	4
Other Revenue Creditors	3	2	33	38	31
Sundry Creditors	54	-	-	54	70
Total	**2,086**	**7,017**	**34**	**9,137**	8,162

Creditors are amounts established as due at the Balance Sheet date but payment has not been made in full.

Accrued Revenue Liabilities includes amounts due to taxpayers or traders that have an established revenue liability relating to the financial year, but the date the claim is received is after the Balance Sheet date.

Deferred Revenue is duties and taxes paid in the current year that relate to future accounting periods.

There are no creditors which fall due after one year.

8 Balance on Consolidated Fund Account

	2004-05 £ million	2003-04 £ million
Balance on Consolidated Fund Account as at 1 April	17,888	16,045
Net Revenue for the Consolidated Fund	120,511	117,504
Less amount paid to Consolidated Fund	(120,924)	(115,661)
Balance on Consolidated Fund Account as at 31 March	**17,475**	17,888

9 Excise Diversion Fraud

Excise Diversion Fraud occurred in the period 1994-1998. "Outward Diversion Fraud" relates to cases where duty suspended goods were removed from a bonded warehouse and diverted onto the home or overseas markets without payment of the duty due. "Other Revenue Fraud" relates to mainly cases of goods imported and destined for a bonded warehouse that were diverted on to the home market after frontier controls and without payment of the duty due.

In the previously published cash-based Trust Statement, a note was included showing an update to the disclosed Excise Diversion Fraud. Now that the Trust Statement is produced on an accruals basis, the remaining live cases have been added to the debtors figures to show the established liability for the Department and an appropriate provision for doubtful debt has been applied, so that the debtors figure in the Balance Sheet is reported as the amount the Department expects to collect.

10 Interest Receivable and Payable

During the accounting period, interest totalling £92 million was receivable by the Department and interest totalling £144 million was payable by the Department.

11 Third Party Assets

The Department holds deposits at year-end in relation to VAT on e-services. The money, collected on behalf of other European Union (EU) member States, is not due to the UK but is paid to those member States and, as such, does not form part of these accounts. The balance held at the year-end awaiting payment to other EU countries was £185k.

12 Contingent Liabilities

The Department is engaged in litigation with taxpayers across a range of cases, which may result in repayments of revenue. The Department's contingent liabilities are estimated to be in the region of £640 million (2 cases). The estimate is subject to a degree of uncertainty and the timing of any potential outflow is also uncertain, as litigation can take several years to conclude.

13 Related Party Transactions

Due to the nature of the Department's business, we have a large number of transactions, relating to taxation revenue, with other departments, other Central Government Bodies, managerial staff and taxpayers. During the year, none of the Board members or other related parties have undertaken material transactions with the Department.

Related party disclosures connected with the Department's administration transactions are included at note 27 to the Department's Resource Account.

Accounts Direction given by HM Treasury

ACCOUNTS DIRECTION GIVEN BY THE TREASURY IN ACCORDANCE WITH SECTION 5(2) OF THE GOVERNMENT RESOURCES AND ACCOUNTS ACT 2000 AND WITH SECTION 2(3) OF THE EXCHEQUER AND AUDIT DEPARTMENTS ACT 1921.

1. Her Majesty's Revenue and Customs shall prepare Resource Accounts in respect of HM Customs and Excise for the year ended 31 March 2005 in compliance with the accounting principles and disclosure requirements of the edition of the Resource Accounting Manual issued by H M Treasury (the Resource Accounting Manual) which is in force for that financial year.

2. HM Customs and Excise's Resource Accounts shall be prepared so as to give a true and fair view of the state of affairs at 31 March 2005 and of the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the financial year then ended. The Resource Accounts shall also be prepared so as to provide disclosure of any material expenditure or income that has not been applied to the purposes intended by Parliament or material transactions that have not conformed to the authorities which govern them.

3. Compliance with the requirements of the Resource Accounting Manual will, in all but exceptional circumstances, be necessary for the Resource Accounts to give a true and fair view. If, in these exceptional circumstances, compliance with the requirements of the Resource Accounting Manual is inconsistent with the requirement to give a true and fair view, the requirements of the Resource Accounting Manual should be departed from, only to the extent necessary to give a true and fair view. In such cases, informed and unbiased judgement should be used to devise an appropriate alternative treatment, which should be consistent with both the economic characteristics of the circumstances concerned and the spirit of the Resource Accounting Manual. Any material departure from the Resource Accounting Manual should be discussed in the first instance with the Treasury.

4. Her Majesty's Revenue and Customs shall prepare a Trust Statement in respect of HM Customs and Excise for the financial year ended 31 March 2005, which shall give a true and fair view of the state of affairs relating to the collection and allocation of taxes and duties administered by the Department and the revenue income and expenditure and cash flows for the financial year then ended. When preparing this Statement, Her Majesty's Revenue and Customs shall have regard to the format of the accounts as shown in the appendix to this Direction, and shall also agree the format of the Operating and Financial Review and supporting notes (including the accounting policies, particularly with regard to income recognition), with the Treasury. Regard shall also be given to all relevant accounting and disclosure requirements given in "Government Accounting," other guidance as issued by the Treasury and the principles underlying UK Generally Accepted Accounting Practice.

5. The Resource Account shall be transmitted to the Comptroller and Auditor General together with the Trust Statement, by a date agreed with the Comptroller and Auditor General and the Treasury, but in any event no later than 30 November 2005, for the purpose of his audit examination and report.

6. HM Customs and Excise's Resource Accounts and the Trust Statement, together with this Direction, but with the exception of any appendices, shall be laid before Parliament in one volume containing both financial statements and the Report produced by the Comptroller and Auditor General under Section 2(2) of the Exchequer and Audit Departments Act 1921.

7. This Direction supersedes the Resource Accounts and Trust Statement Directions for HM Customs and Excise dated 15 March 2004.

DAVID A CRUDEN FCA
Head of the Central Accountancy Team
HM Treasury

22 July 2005

Appendix to the 2004-05 Trust Statement

This appendix does not form part of the accounts. It provides further information on the taxes and duties for which the Department has responsibility.

1. Value Added Tax

Value Added Tax (VAT) is a tax charged on the supply of goods and services in the United Kingdom (UK) or Isle of Man. It is also charged on goods, and some services that are imported from places outside the European Union (EU) and on acquisitions, and some services, received from the EU.

Traders are required to register their liability if their turnover exceeds a defined limit. Traders operating below this threshold can apply for voluntary registration. Registered traders are required to charge output tax at the appropriate rate on their taxable supplies and may deduct VAT paid on their running costs and purchases as input tax, subject to certain regulations.

Traders make returns to declare the tax payable by them (normally on a quarterly basis) or to claim the repayment (where their input tax exceeds their output tax) due to them. In most cases the return has to be rendered and paid one month after the end of the accounting period but variations exist for large businesses making payments on account and those businesses on annual accounting.

2. Hydrocarbon Oils Duties

Hydrocarbon Oils Duty (HCO) is a generic heading including duties on mineral oils, fuel substitutes and additives and gas for use as road fuel.

Mineral Oils traders, who provide the majority of HCO revenue, render monthly warrants (returns) in mid-month, and make payment at the end of each month by CHAPS, direct debit or cheque. Other HCO traders have monthly, quarterly or annual returns.

3. Alcohol Duties

Alcohol Duties is a tax/duty head covering duties on beer, spirits and wine, cider and perry.

3.1 *Beer Duties*

Beer is a collective term, which includes ales, porters, stout and lagers. It becomes liable to duty when it is produced or imported. UK brewers and their production premises must be registered for beer duty purposes with the duty chargeable on the quantity and alcoholic strength (alcohol by volume) of the beer.

For UK produced beer, returns are made on a monthly basis and are due by the 15th of the following month, with payment due within the next ten days of the due date for returns.

Use of the duty deferment scheme predominates for non-EU importations and beer held free of duty in the warehousing regime.

3.2 *Spirits Duties*

The term "spirits" is defined as ethanol (ethyl alcohol) and covers all mixtures, compounds and preparations containing ethanol of a strength exceeding 1.2%, other than denatured alcohol.

Duty is due when spirits are delivered from a distillery or warehouse for home use, or on importation. In practice, however, most of the revenue by value is collected through the duty deferment scheme.

No other alcohols (e.g. methanol) are chargeable with Excise Duty under the alcoholic duties charging provisions. However, they may be subject to Hydrocarbon Oil Duties if used as a fuel.

3.3 *Wine, Cider and Perry Duties*

Wine, cider and perry produced in or imported to the UK for sale is liable to Excise Duty. Producers must register or obtain a licence for each separate set of premises used.

Producers must account for duty at the end of each accounting period, either a calendar month or a 4 to 5 week period. The return form and payment must reach the Department by the 15th day following the end of the accounting period.

There are a number of duty bands, dependent upon the product, its strength and whether it is still or sparkling.

Wine or cider produced or made is liable to Excise Duty from the time at which it is deemed to be made or produced. However, traders may hold their wine or cider in duty suspension until it is sent out (delivered) from their entered premises to home use.

4. Tobacco Duties

Tobacco duties cover cigarettes, cigars, hand-rolling tobacco, other smoking tobacco (e.g. pipe tobacco) and chewing tobacco. These are all liable to tobacco products duty if they are made wholly or partly from tobacco or from any substance used as a substitute for tobacco.

Duty is chargeable on both home produced and imported tobacco products.

Home producers of tobacco products are required to render monthly returns with the duty collected electronically by the duty deferment system.

5. Betting and Gaming Duties

Betting and Gaming Duties is a tax/duty head covering duties on bingo, pool betting, lotteries, gaming, off-course betting and amusement machines.

5.1 *Bingo Duty*

All bingo played in the United Kingdom is liable to duty unless it is on a very small scale and falls into one of the exemption categories.

Duty is charged as a percentage of a promoter's profits (i.e. the difference between the promotion receipts and expenditure).

Operators must register and a majority submit their returns on a monthly basis, though they may be allowed to do so over a different period. The standard accounting period ends on the last Sunday of the month. Non-standard accounting periods may be agreed with HM Customs and Excise. Returns must be rendered and paid within 15 days of the period to which they relate.

5.2 *Pool Betting Duty*

Duty is chargeable on all pool betting as a percentage of the operators' gross profit.

Returns and duty payments are required monthly. The accounting periods finish on the last Saturday of each calendar month and the due date for payment is the 15th of the month immediately following the end of the accounting period.

5.3 *Lottery Duty*

Lottery Duty is due as a percentage of the stake. The accounting period ends on the last Saturday of the month and returns and payment are due 13 days after the end of the accounting period. The payment is made electronically and must be credited to HM Customs and Excise's bank account on or before the due date.

5.4 *Gaming Duty*

Anyone who is the holder of a gaming licence under the Gaming Act 1968, a provider of premises used for dutiable gaming, or concerned in the management or organisation of dutiable gaming on unlicensed premises, for as long as that gaming takes place, must register for Gaming Duty.

The duty is based on a variable percentage of the gross gaming yield defined by turnover bandings. Accounting periods are of six months duration, usually starting on 1 April and 1 October, at the end of which a return must be rendered and the duty paid. An interim return and payment on account of the duty likely to be chargeable at the end of the period is required after the first three months of the period. At the end of the six-month period, Gaming Duty for the entire period is calculated, and then the amount of any payment made on the previous interim report should be deducted from the total amount due. The due date for rendering the six-month and interim return and paying any tax due is one month after the end of the accounting period.

5.5 *General Betting Duty*

General Betting Duty is chargeable on all bets that are made off-course. All bets made off-course with UK bookmakers, the Tote and 'Bet Brokers' are liable to duty. Bets deemed to be on-course are not liable to the duty. Duty is chargeable on bookmakers' gross profit.

Bookmakers can render returns either monthly or quarterly, as agreed with HM Customs and Excise, with standard periods ending on the last day of the month or quarter. Non-standard accounting periods are also permissible. Returns and payment are due within 15 days of the end of the accounting period.

5.6 *Amusement Machine Licence Duty*

A licence must be held before a dutiable Amusement Machine can be made available for play. Depending on its category, a licence can be issued for any number of months between one and twelve and can start on any day of any month, at the discretion of the applicant and subject to HM Customs and Excise receiving the application before the requested start date.

There are five categories of duty, determined by the type of machine being licensed and payment can be made either in full when applying for the licence or, for annual licences only, by 12 monthly instalments.

Licences paid in full upon application can be surrendered at any point and the cost of any unexpired portion will be reimbursed. They can be valid for up to twelve months, covering two financial years and, in these circumstances, costs need to be apportioned between the respective financial years to calculate the prepaid amount for the second year.

The revenue recognition point is the date of receipt of payment where the full cost of the licence is received in advance or the date of the instalment payment where the licence is paid by instalments.

6. Insurance Premium Tax

Insurance Premium Tax (IPT) is a tax on premiums received under taxable insurance contracts. All types of insurance risk located in the United Kingdom are taxable at either the standard or lower rate, unless they are specifically exempted.

IPT traders render returns quarterly. Traders may request to have specially tailored accounting periods. Returns must be rendered with payment by the last day of the month following the end of the relevant three-month accounting period.

7. Air Passenger Duty

Air Passenger Duty (APD) is a duty of excise, which is levied on the carriage from a UK airport, of chargeable passengers on chargeable aircraft.

There are two standard and two reduced rates of duty depending on class of travel and destination.

APD traders render monthly returns. The Department must receive the return with payment no later than the date shown on the front of the return, which is normally the 22nd day of the following month.

8. Landfill Tax

Landfill Tax applies to all waste disposed of by way of landfill, at a licensed landfill site, unless the waste is specifically exempt. Traders can claim credits for contributions made to approved environmental bodies. The tax is chargeable by weight at either the standard or lower rate, for qualifying materials.

Traders registered for Landfill Tax must render returns and payments quarterly by the last working day of the month following the end of the return period.

9. Climate Change Levy

Climate Change Levy (CCL) is an environmental tax. The levy is chargeable on the industrial and commercial supply of taxable commodities for lighting, heating and power to consumers in the Industry, Commerce, Agriculture, Public Administration and Other Services business sectors.

The levy does not apply to taxable commodities used by domestic consumers, or by charities for non-business use.

The levy is imposed at the time of supply to industrial and commercial consumers rather than at the time of consumption by end-users.

Persons registered for the levy are required to render a quarterly return and payment on the last working day of the month following the period end dates shown on the form.

From 1 June 2002 a concession became available to those registered persons with an annual CCL liability of £2,000 or less to render and pay their liability annually, provided they have been registered for at least 12 months.

10. Aggregates Levy

Aggregates Levy applies to any aggregate that is subjected to commercial exploitation. For the purposes of the levy, aggregate is classified as rock, gravel or sand, and whatever substances are incorporated in rock, gravel or sand or those that naturally occur when mixed with it.

The levy is a specific one stage non-deductible tax. There is a single fixed rate per whole tonne.

The tax point occurs when a quantity of aggregate is first subject to commercial exploitation and the levy must be accounted for in the accounting period in which the tax point occurs.

Persons registered for the levy are required to submit a quarterly return and pay any tax due on the last working day of the month following the period end dates shown on the return form.

Qualifying businesses may apply to render their returns monthly or annually.

11. Customs Duties

Goods imported from outside the EU are liable to Customs Duty and Value Added Tax, and may also be liable to Excise Duties, Anti-Dumping Duties, Agricultural Levy and Countervailing Charge, depending on their nature.

Goods originating in a country enjoying preferential trade agreements with the EU may be imported at a reduced rate or zero rate of Customs Duty. Goods being imported for processing purposes can either attract duty relief or have any duty paid reimbursed on subsequent exportation.

At the time of importation, the importer or an authorised agent is required to deliver a written declaration, more commonly known as an entry, to HM Customs and Excise. Entries, normally made on a Single Administrative Document (SAD), are required for duty collection and relief, the control of prohibited and restricted substances and to provide trade statistic information.

Duties and taxes should be paid at the time of importation. However, traders may apply for approval to operate within the duty deferment scheme and such traders account for the majority of importations by value.

12. Agricultural Duties

It is a feature of the Common Agricultural Policy (CAP) that, when third country agricultural products are imported into the European Union (EU), an agricultural specific Customs Duty (or other charge) is imposed to protect the internal market. These charges are intended to prevent the undercutting of EU prices without disrupting world trade, and may be accompanied by other protective measures.

Imports of agricultural produce into the UK from non-EU countries, as for any other type of importation, must be entered on the SAD Form C88.

The charges that apply under the Common Agricultural Policy to non-EU goods are specific Customs Duty, ad valorem Customs Duty, countervailing charge, safeguard charges and preferential rates of CAP charge.

Not all agricultural goods will be liable to the charges specified. The commodity code determines the one(s) that may be applicable.

Many agricultural commodities cannot be imported into the EU without a valid licence. Licences may also be used to restrict imports by imposing quantitative limits, or allow a reduced rate of duty.

Duties and taxes should be paid at the time of import. However, traders may apply for approval to operate within the duty deferment scheme and such traders account for the majority of importations by value.

Comptroller and Auditor General's Standard Report on the Accounts of HM Customs and Excise 2004-05

Issued under Section 2 of the Exchequer and Audit Departments Act 1921
as amended by the Government Resources and Accounts Act 2000

John Bourn
Comptroller and Auditor General
7 October 2005

EXECUTIVE SUMMARY

1 Section 2 of the Exchequer and Audit Departments Act 1921, as amended by the Government Resources and Accounts Act 2000, requires me to examine the accounts of HM Customs and Excise (Customs) on behalf of the House of Commons to ascertain that adequate regulations and procedures have been framed to secure an effective check on the assessment, collection and proper allocation of revenue. I am also required by that Act to examine the correctness of sums brought to account; and to report the results to the House of Commons. A detailed breakdown of the gross receipts and repayments for each tax stream, along with my audit certificate, is separately reported within the Trust Statement account, included in the Department's Annual Accounts.

2 This report describes a number of significant developments on the management of VAT debt and the strategy implemented by Customs to tackle tobacco fraud. The results of my work not detailed in this report and suggestions of further improvements in controls have been notified to the department in management letters. In 2002 the Committee of Public Accounts examined the Department's progress in implementing the tobacco strategy and made a number of recommendations. The Department responded positively to these and Customs went on to agree a Memorandum of Understanding with Imperial Tobacco resulting in more effective co-operation.

3 Since April 2005, the functions of Customs have been transferred into a new tax department, Her Majesty's Revenue and Customs (HMRC). All of my recommendations and conclusions are intended to assist the new Department to achieve their objectives, and remain relevant for the new organisation. The work that the NAO has carried out focuses on the Department's efforts to manage VAT debt, and references to 'the Department' prior to April 2005 are references to HM Customs and Excise which was responsible for the collection and management of VAT prior to the creation of HMRC. The structures and procedures referred to prior to April 2005 are, therefore, structures that were in place within Customs and Excise.

The Tobacco Strategy

4 Tobacco Duty Fraud has been the source of annual revenue losses estimated to exceed £2.5 billion since the late 1990s. The strategic response developed by HM Revenue and Customs (HMRC) to combat this fraud was set out in their March 2000 publication Tackling Tobacco Smuggling. The aim of the strategy was first to slow the growth in, and then to cut the level of tobacco fraud.

5 Over the lifetime of the strategy, the market share for illicit cigarettes has fallen from an estimated 21 per cent in 2000-01 to a projected 15 per cent in 2004-05. HMRC are therefore on course to meet their Public Service Agreement (PSA) commitment to reduce the size of the illicit market for cigarettes to 17 per cent by the end of March 2006. Revenue losses from all forms of tobacco fraud have fallen from an estimated £3.4 billion in 2000-01 to £2.6 billion in 2003-04.

6 Estimated reductions in the level of cigarette fraud were most pronounced in the first two years of the strategy, and have been consolidated in subsequent years. In order to fulfill the new PSA commitment of a 13 per cent illicit market share by the end of March 2008, HMRC are considering ways to refocus the strategy to reflect the constantly changing nature of fraud.

7 The Department's success in reducing the illicit market share for cigarettes has resulted in organised criminal gangs becoming ever more sophisticated in their methods. It has also led to displacement from genuine UK brands towards counterfeit tobacco products. A report by the House of Commons Treasury Sub Committee (TSC) earlier this year also noted the 'extraordinarily high' level of smuggling of hand rolling tobacco and called for 'urgent action' to be taken.

8 HMRC need to ensure that the resources deployed to deal with tobacco fraud continue to be appropriate to achieve ever more challenging targets. Resource decisions should take account of the full range of indicators available given the timing and uncertainties of the annual fraud estimates.

9 The Department need to enhance the current fraud estimates to reflect total risks to tobacco revenue. Work to establish a PSA-type target to reduce fraud relating to hand rolling tobacco will help to address this.

10 HMRC have established an effective model for ensuring cooperation across traditional work streams to reduce the level of tobacco fraud. The Department is constantly seeking ways to improve delivery, including a significant reorganisation of the tobacco intelligence teams during 2004-05. Implementation of the conclusions of the Department's review of the deployment of overseas intelligence staff will provide assurance that that network is appropriately resourced and properly located to address all relevant risks.

11 HMRC should continue their review of the adequacy of current operational targets below the top level PSA in order to optimise efforts to disrupt criminal gangs and ensure that senior management has a clear view of current progress towards reducing the level of fraud.

12 The work HMRC has undertaken with the tobacco manufacturers has successfully restricted the availability to smugglers of genuine UK tobacco products. HMRC are looking to enhance their relationship with the tobacco manufacturers to ensure greater control of legitimate supply chains and introduce further measures to address the problem of counterfeit product.

13 HMRC also recognise that it is time to review the existing Memorandum of Understanding with major cigarette manufacturers to ensure that the current arrangements represent the best interests of taxpayers. HMRC should also look to formalise its cooperation with Philip Morris International in the context of the recent agreement between that company and the European Union, perhaps through the agreement of a memoranda of understanding.

VAT Debt Management

14 HMRC are responsible for the collection of gross VAT receipts of more than £125 billion each year. As part of my 2001-02 Standard report on Customs, I noted a rapid rise in debt levels and weaknesses in IT systems which resulted in poor management information and impaired performance. The Committee of Public Accounts recommended that Customs improve their IT systems handling debt management and take action to reverse the rising trend in debt levels.

15 Debt management makes an important contribution to the delivery of the Department's Public Service Agreement (PSA) target to reduce VAT losses to no more than 12 per cent by March 2006. In responding to this challenge, the Department have significantly improved their collection rates for recoverable debt, and steadily reduced the level of outstanding debt available for collection. The report examines how the Department's arrangements for managing VAT debt have developed.

16 The use of legacy IT systems continues to provide major problems for HMRC. Many of the legacy systems on which the Department relies were due for replacement or upgrade as part of Customs' e-Business solution. However, ongoing work to make improvements to legacy systems had to undergo continual re-evaluation and prioritisation.

17 In May 2002, key systems failed to reconcile by £300 million. This meant that £300 million of outstanding debt was not passed to debt management units for monitoring or collection. Since then the unreconciled difference has grown, and by March 2005 stood at approximately £900 million. The Department have established that most of this balance represents debt not likely to be immediately recoverable as it relates to fraud cases under investigation, and assessments made by the Department against which traders have appealed. Of the total £900 million, about £35 million of this accrued debt should have been pursued and, although the Department are now taking action in respect of this debt, delays in starting recovery action may make collection more difficult.

18 HMRC have taken positive action to reduce the levels of outstanding recoverable debt. Structures, systems and training have been re-engineered, aimed at ensuring national consistency based on best practice, with a focus on risk and compliance management. This has been supplemented by high quality, commercial style training.

19 In 2004-05 HM Treasury provided funding for 150 additional debt management staff. This led to a major re-organisation, supported by an upgrade to the debt management case handling system allowing the Department to reorganise and focus of specific areas of debt. In return for this investment, the debt management business had a target to collect an additional £185 million of receipts in 2004-05. This target was exceeded with an additional £299 million being collected by March 2005, an increase of 13.5 per cent from the previous year. These measures have also translated into improvements in some aspects of debt management performance. Debt that is classified as immediately recoverable stands at its lowest level for 3 years.

20 The Department did, though, fail to meet some of its internal targets associated with debt management. March 2005 VAT arrears represented 2.32 per cent of the total VAT liability figure against a target of 2.06 per cent. VAT debt at 31 March 2005 was £2.56 billion, up by 24 per cent from £2.06 billion by March 2002. Management review in the Department showed that this was largely due to increasing amounts of debt being identified as owing from Missing Trader Intra-Community fraud cases, as part of the Department's strategy to tackle fraud, and because of an increase in the proportion of traders appealing against departmental assessments.

21 HMRC is currently restructuring the debt management and banking business. The new Department remains committed to collecting taxes efficiently and in a cost effective manner.

CHAPTER ONE

Audit approach and scope

1 In order to review the Department's systems and procedures to ensure an effective check on the assessment, collection and allocation of revenue, the National Audit Office undertake:

- examinations of the Department's internal controls, including the ongoing development of governance arrangements;
- reviews of quality assurance and other checks carried out by the Department on the tax systems;
- periodic in-depth reviews of existing systems and significant changes to them, and the evaluation of new systems; including reviews of the Department's computer installations, networks and specific information technology applications; and
- test examinations of individual transactions and balances.

2 Information technology is essential for the administration of taxes and duties. The Department's information systems hold data on all traders, process information, and produce a range of outputs designed to assist the trader and the Department to discharge their obligations accurately and efficiently. The National Audit Office, therefore, conduct regular examinations of how Customs manage the risks associated with the operation of their information systems. In 2004-05, the National Audit Office's coverage included the following examinations:

- Customs and Excise Core Accounting System (CECAS);
- General Computing Controls;
- VAT Systems;
- Customs Handling of import-Export Freight (CHIEF);
- Duty Deferment;
- Law Enforcement IT Systems; and
- Tobacco Systems.

3 In addition to my examination of revenue systems under Section 2 of the Exchequer and Audit Departments Act 1921, I also examine the economy, efficiency and effectiveness with which Customs have used their resources. I report my findings to the House of Commons under Section 9 of the National Audit Office Act 1983. Since my last report on Customs' systems and procedures, I have also reported on Gambling Duties (HC 188 2004-05) and Stopping Illegal Imports of Animal Products into Great Britain (HC 365 2004-05).

Statement on Internal Control

4 Each Accounting Officer is required to make a Statement on Internal Control covering all operations and financial systems. The Department produces a statement, covering both the Resource Accounts covering administration costs, and the Trust Statement, covering taxes and duties brought to account. The statement reports that the Department's framework of internal control is designed to manage rather than eliminate risk of failure to achieve objectives, or to account properly for public funds. The statement also explains that a balance has to be struck between empowerment to achieve objectives, and controls to safeguard and account for public funds.

5 In previous years I have reported how Customs has updated its corporate governance structure, constructed a departmental risk register comprising corporate and operational risks, and adopted a strategic approach to minimising the risks to revenue. This is reflected in the publication of strategies covering VAT Compliance, Tobacco and Oils as a way of strengthening regulations and procedures to minimise the risk of revenue leakage or loss. Procedures were also implemented to ensure that the risks to the Department are regularly reviewed, and that they are the responsibility of the Customs management team, who own, monitor and work to mitigate identified risks.

6 The transfer of functions from HM Customs and the Inland Revenue to HMRC has major implications for the control framework, and for the Statement of the Accounting Officer. In his Statements on Internal Control he acknowledges his responsibility for assessing the effectiveness of the control framework. In reviewing its effectiveness and formulating his statements, he has had regard to three tests: the benefit of any given control in safeguarding public funds; the impact of that control in achieving objectives; and its cost. He has therefore considered whether any given control is reducing risk while allowing the Department to achieve its core objectives, and whether the cost associated with the controls is commensurate with the risk.

7 The Statement made by the Accounting Officer highlight weaknesses in the systems of internal control employed by the Department, and report progress in addressing those weaknesses identified in earlier years. The Department have now implemented systems to allow for the effective management of shipbuilders' relief claims. In past years the Department has also noted the risks associated with the potential failures of legacy IT systems. Further work has been completed to enhance controls and schedule the replacement of systems. There were no major system failures during 2004-05.

8 In 2004-05 the Accounting Officer has also reported on reputational risks faced by the Department, following the loss of a number of high-profile court cases. To address these weaknesses the Department are implementing a major training programme for staff, and monitoring of Law Enforcement activity has now been brought within the remit of Her Majesty's Inspector of Constabularies and the Independent Police Complaints Commission. An independent prosecution office has also been established accountable to the Attorney General.

9 I am content that the Accounting Officer's Statements on internal Control are consistent with the National Audit Office's knowledge of Customs and Excise.

HM Revenue and Customs

10 In July 2003, the Chancellor of the Exchequer announced a major review of the organisations dealing with tax policy and administration. The review led by Gus O'Donnell reported in March 2004 and recommended that a new Department should be created. HM Revenue and Customs (HMRC) were established in April 2005 by the Commissioners for Revenue and Customs Act which brought together most of the functions of the Inland Revenue and HM Customs and Excise.

11 Good governance is vital for any organisation, particularly one as complex and wide ranging as HMRC. A group of Commissioners has statutory responsibility and authority for running the new organisation. They have created a departmental Board, including several non-Executive Directors, responsible for strategic oversight and providing advice. They are also supported by a number of Committees, of which the Executive Committee, chaired by the Chairman of HMRC, is responsible for strategy and driving performance across the business. Other top-level groups include an Operating Committee and an Audit Committee comprised of and chaired by Non-Executives. Core management processes include an annual planning and performance management cycle, with an important feature being a quarterly Chairman's review of each of HMRC's 36 business units.

12 Efficient and effective Information Technology (IT) is essential to the administration of taxes. In October 2004, the Department made a new Board-level post of Chief Information Officer. The departmental integration offered the opportunity of improving the service IT provided. The Chief Information Officer's unit has taken a more active role in identifying and pursuing business opportunities, with a more customer-focused approach. In bringing the IT together, the Department is undertaking an ongoing programme of health checks of the IT systems during the first half of 2005 and the National Audit Office will monitor the resulting changes.

13 Integration offers the new Department the opportunity to adopt a more effective approach to taxpayer compliance across all tax streams. The Department reviewed the implications of the integration for its compliance strategy and the tax gap.

14 There are also risks involved in the integration of two large departments including risks that existing priorities could be disrupted. The Department set up a Change Management Centre to oversee the changes, provide information and make recommendations on risks posed by the Department's capacity to deal with the number of planned changes. The new Department is responsible for a number of the Government's nominated "mission critical" projects and they need to remain focused on them.

Efficiency Savings

15 The 2004 Spending Review required HMRC to achieve staff reductions and annual efficiency savings of £507 million by 2007-08, out of an annual budget of about £4.6 billion. The Department had 98,370 Full time Equivalent (FTE) staff in post at 1 April 2004 and planned to reduce this by a net 12,500 FTE posts by 1 April 2008.

16 By July 2005, the Department had identified how the forecast savings would be achieved through:

- Investment in Information and Communication Technology;
- Reform of back office functions;
- Savings in procurement of goods and services; and
- Improvements in productive time.

17 A significant challenge for the Department was to establish effective governance and monitoring arrangements to ensure the savings do not adversely affect service provision or the new IT systems underpinning intended efficiency gains. The Department established an Efficiency Programme Board to manage these risks and meet targets. The Office of Government Commerce concluded that achieving the Departments' efficiency savings posed a very high challenge.

Conclusions

18 I have given unqualified opinions on Customs' 2004-05 Resource Accounts and their Trust Statement on which taxes and duties are brought to account.

19 In discharging my responsibilities under Section 2 of the 1921 Act, I have regard to the Accounting Officer's Statements on Internal Control, and particularly to the statement that 'his system of internal control supports (within the resources available) the achievement of departmental objectives, as defined by statute and Ministers'.

20 The Accounting Officer has reported in his Statement on internal Control how the Department's control framework operates, including controls associated with the collection of revenue, and significant control issues arising from his own review of internal controls. Subject to those issues and in the light of matters outlined in the detail of my report, my work in 2004-05 provides assurance that Customs' regulations and procedures provided an effective check over the assessment, collection and allocation of tax.

CHAPTER TWO
The Tobacco Strategy

Introduction

Scope of the report

1 In examining HMRC's Tobacco Strategy, the National Audit Office's (NAO) main objective was to evaluate the success of the strategy and to understand how it has evolved to meet changing circumstances. The NAO reviewed the effectiveness of HMRC's systems and procedures in place to address the risks to revenue, taking account of the Department's need to fulfil its other obligations including the strengthening of frontier protection against threats to the security, social and economic integrity of the United Kingdom.

2 We interviewed a number of groups and individuals including HMRC officers, representatives of the legitimate tobacco trade and Action on Smoking and Health (ASH).

Overview of the 'Tackling Tobacco Smuggling Strategy'

3 Smuggling of tobacco products into the UK has been the cause of significant revenue losses for many years. The Chancellor's Pre-Budget Report 2004 stated that,

"Tobacco smuggling undermines the Government's health objectives, involves serious and widespread criminality, and costs over £2.5bn a year in lost tax revenue".

4 The Department's latest estimates show that the UK lost approximately £1.9 billion as a result of cigarette fraud and smuggling in 2003-04 and £0.8 billion relating to Hand-Rolling Tobacco. These figures include duty and VAT. HMRC currently estimate actual tobacco duty receipts for 2005-06 will reach £8.4 billion.

5 In March 2000, Customs and HM Treasury jointly published a strategy document, Tackling Tobacco Smuggling. This set out an analysis of the problem as the government then saw it and contained a series of proposals to reduce the level of fraud. The programme of work involved £209 million of additional funding, covered the three financial years from 2000-01 to 2002-03. The strategy aimed to provide around 1,000 extra staff in support of law enforcement activity and a network of x-ray scanners to be deployed at UK ports. Additional measures included the introduction of 'UK Duty Paid' fiscal marks for UK manufactured tobacco products and stronger penalties for smuggling offences.

6 Along with the new strategy, the Department for the first time produced an estimation of the tax gap arising from tobacco fraud. The Department compares, on an annual basis, total tobacco consumed in the UK with actual UK duty paid cigarettes sold. An adjustment is made to reflect legitimate intra EU cross-border and duty-free imports. This is used to estimate the size of the residual 'illicit' market share. Latest estimates of the scale of the tax gap are published annually alongside the Pre-Budget Report.

7 The publication of a 'tax gap' estimate allows the Department to measure progress against targets on an annual basis. HMRC have been able to review progress and refocus the measures to tackle tobacco smuggling based on the results achieved to date.

8 Reducing the level of tobacco fraud is one of the Department's specific departmental PSA commitments. Under PSA objective 1 for 2003-04 to 2005-06, HMRC are required to reduce the illicit market share for tobacco to 17 per cent by 31 March 2006. The Department's updated PSA 1 Objective amends this to 13 per cent by 2007-08.

Previous NAO and Parliamentary Scrutiny

9 In April and June 2002, the Committee of Public Accounts examined:

- the success of the strategy in tackling tobacco smuggling;
- co-operation between Customs and the tobacco manufacturers;
- the sanctions being used as a deterrent to smuggling; and,
- the use of x-ray scanners to detect illicit tobacco.

10 The Committee concluded that:

- there were concerns about the level of co-operation from Imperial Tobacco;
- HMRC and Imperial Tobacco should work towards signing a Memorandum of Understanding;
- HMRC should consider applying penalties and sanctions to lower level smugglers as a deterrent;
- HMRC should ensure its publicity campaigns were effective; and,
- more scanners were needed to provide additional coverage for the network of maritime ports.

11 The Government's responses to the Committee's reports on tobacco smuggling[1] were positive. Subsequent to the Committee's hearing with the Chief Executive of Imperial Tobacco, and further discussions between Customs and Imperial Tobacco which ensued, seizures of the company's cigarettes fell significantly. Customs went on to agree a Memorandum of Understanding with Imperial Tobacco, resulting in more effective co-operation with the UK's largest manufacturer of cigarettes.

12 The main achievement of the Memorandum is that it allows the Department to work with Imperial Tobacco, in highlighting exports of cigarettes to markets, where the supplies were being diverted by smugglers rather than satisfying local demand. Customs are satisfied that, as a result of this greater co-operation, Imperial's exports no longer show these patterns (see paragraphs 75-78).

1 Responses to the Third and Twenty First Reports of the Committee 2002-03

13 In May 2002 the House of Commons Scottish Affairs Committee published a report on Customs' Services in Scotland which considered the issue of tobacco smuggling in a Scottish context. The Committee expressed the view that the predominantly intelligence-led approach adopted by the Department in recent years had led to a reduction in the preventative or deterrent impact of regular Customs presence at strategic points. The government responded by arguing that flexible intelligence led deployments were the most efficient and effective way of dealing with smuggling risks, but conceded that:

"Customs recognises the importance of maintaining public support and confidence in all aspects of its work. The Department's deployments therefore take account of the need to produce a visible anti-smuggling presence as a means of deterring potential smugglers and as an avenue for local people to support the Department's law enforcement work. The Department recognises that this has been an area of concern and is taking additional steps to respond to these concerns."

14 The Government agreed that additional resources for frontier controls were necessary and pledged an additional £2 million for 2002-03 and further funding for the next three years to enable the Department to enhance its anti-smuggling effort at the frontier[2].

15 In March 2005 the House of Commons Treasury Sub Committee reported on Excise Duty Fraud. With regard to tobacco fraud, the Committee concluded that:

- the strategy has had some success in reducing the smuggling of cigarettes there was 'still a long way to go';
- by contrast the size of the illicit market for hand rolling tobacco was, 'a matter of very serious concern', and 'effective action was now urgently required';
- HMRC should consider the benefits of the recent agreement signed by Philip Morris and the EU and review the existing Memoranda of Understanding (MoU) with tobacco manufacturers; and
- HMRC should enter into an agreement with Philip Morris.

Detailed Findings

16 Our detailed findings are set out in the following four sections:

- Has the Tobacco Strategy Succeeded?
- Operational Delivery of the Tobacco Strategy
- The Effect of Changing Threats on the Strategy
- Relations with the Tobacco Manufacturers

Has the Tobacco Strategy Succeeded?

Measuring the success of the Strategy

17 Tackling Tobacco Smuggling introduced a single key measure to monitor progress, namely the extent to which the market penetration of illicit tobacco declines. In addition, further indicators of success were identified and reported. These have subsequently been supplemented by the PSA target for reducing the illicit market share. The table below sets out the results to date against these initial targets. In reviewing the overall achievement of HMRC in the period from 2000 to 2005 the changing nature of tobacco fraud needs to be considered. As a result of the Department's actions, organised smuggling gangs have adopted increasingly sophisticated methods. There has also been a change in the type of product being smuggled, with a growing threat from counterfeit cigarettes. The environment in which HMRC operates has also changed, particularly in relation to intra-EU smuggling as a result of high profile legal challenges.

18 These measures have proved successful in first halting the previously rapid growth of cigarette smuggling, and then reducing its level. The section on Illicit Market Share below demonstrates that this success appears to have been consolidated in the period to March 2005.

19 Performance against lower level measures has been less consistent and suggests that the strategy needs to be updated to reflect the nature of current threats to revenue. HMRC are aware of this need and are taking action to identify improvements to the strategy.

2 Scottish Affairs Committee, Second Special Report, November 2002, Appendix: Memorandum by John Healey MP (paragraph 16).

Key Measure	Were HMRC successful?
Slow the growth in smuggling in the next financial year, and put smuggling into decline in the third year.	Yes - the illicit market share grew more slowly to 20% in 2001-02 and subsequently decreased to an estimated 15% (+/- 2%) by the end of 2003-04. HMRC believe that without any action the illicit market could have grown to over 35% in the same period.
Additional Data Sources	**Were HMRC successful?**
Customs/ HMRC expect to raise the number of cigarettes they seize to over 2 billion in 2000-01, 3.5 billion in 2001-02 and to 5 billion in 2002-03.	No - Customs exceeded their seizures target in 2000-01 but fell significantly behind in the following two years. In 2002-03 outturn was 1.9bn, a shortfall of 3.1bn . Seizures were 1.8 billion for 2003-04. Specific targets for seizures no longer exist as HMRC now use a range of other measures which contribute to the 'outcome' target of reducing illicit market share.
They aim to reduce the revenue loss from... [Cross-Channel]... smuggling by 10% a year.	Not Known - Customs estimated that they had reduced the level of cross-channel smuggling by 72% in 2000-01, and a further 23% in 2001-02. However the survey work carried out in support of these estimates was discontinued in 2003 and no disaggregated data is available for subsequent years.
….through their enhanced investigative effort, Customs plan to break or disrupt at least 50 tobacco smuggling gangs next year, 55 the year thereafter and 75 in 2002-03.	Yes - HMRC exceeded the target of 180 gangs over the three year period, successfully disrupting 190 criminal gangs in the period (see paragraph 38).
For the first time Customs/ HMRC will also introduce financial targets against tobacco smuggling involving asset seizures (benefit determined by the courts) of £15 million, £16.5 million and £18 million over the next three financial years.	Yes - these figures are published annually in the Pre-Budget Report. The total outturn for these three years exceeded the target by £153m.
The strategy would generate an estimated £2.25bn over the three years from 'higher tobacco duty revenue and consequential VAT'; a total of £3bn extra revenue including indirect benefits.	Yes - figures published in 2003 suggested an outturn against this indicator for tobacco duty only of c. £3bn for the period to 31 March 2003. The Department also reported in the 2005 Spring Report that (unaudited) revenues totalling £5.8bn have been protected over the life of the strategy.
Under the 'getting tougher' policy more vehicles would be seized.	Yes Prior to the launch of the strategy vehicle seizures stood at around 5,200 per annum. This increased to 10,219 in 2000-01 and 11,064 in the following year. However there has been a sharp reduction in subsequent years to the total of 6,848 recorded for 2003-04.
Targets would be set for confiscations of criminal financial assets.	Yes Targets were set.
The relative size of the UK Duty Paid market would increase in relation to the Non UK Duty Paid (NUKDP) market and net receipts would increase.	Yes -for cigarettes the UKDP proportion increased from 73% of total consumption in 2000-01 to 76% in 2003-04. For hand rolling tobacco the implied UKDP share shows a marginal increase from 27% in 2000-01 to 29% in 2003-04. Total tobacco excise revenues increased in this period from £7.6bn in 2000-01 to £8bn in 2003-04.
Pressure on illicit supplies would lead to an increase in street prices.	No - the strategy estimated that the street price for a carton of 200 cigarettes was about £25, c. £2.50 for a pack of 20 against an average legitimate price of £4.20. The street price for illicit product does not appear to have risen as a result of the strategy although HMRC argue that this is the result of the changing dynamics of the licit market with lower priced brands having become more popular and profit margins being cut for illicit.

Illicit Market Share

20 The calculation of the fraud estimates relies on official survey data which is produced annually. HMRC report progress against PSA targets each year in the Pre-Budget Report. An analysis is published of the illicit market share for both cigarettes and hand rolling tobacco but there are, as yet, no targets to reduce the level of hand rolling tobacco fraud. In addition to the periodic PSA targets HMRC have interim objectives which set out the expected maximum cigarette related tax gap at the end of each year. The following results have been published (the results are accurate within a tolerance of +/- 2%):

PSA target and outturn data for the illicit market

Year	PSA Target (%)	Outturn (%)
2000-01	21	21
2001-02	22	20
2002-03	21	15
2003-04	20	15
2004-05	18	-
2005-06	17	-
2006-07	13	-
2007-08	13	-

Source: HM Revenue and Customs

21 The official estimate of illicit market share for the year 2004-05 has not yet been published, although HMRC have said, in their 2005 Spring Report that, "We expect, at least, to match our performance of 2003-04, when we reduced the illicit market share to 15 per cent."

22 In Measuring and Tackling Indirect Tax Losses – 2004 HMRC recognised that, "the scale of illicit activity is inherently uncertain", but argued that the methodologies used represented the "most up-to-date" estimates currently available. Figures for outturn illicit market share in 2002-3 were also revised downwards from 18 per cent to 15 per cent between publication of the PBR in 2003 and 2004.

23 In interpreting the outturn figures above it is important to consider these uncertainties. However, HMRC can undoubtedly take credit for a significant reduction in the overall level of cigarette fraud as a result of the new strategic approach adopted in 2000, and appears to have achieved its PSA target two years early.

24 If the final fraud figures for 2004-5 were to show an illicit market share for cigarettes of 15 per cent, however, this could suggest that the current approach has reached the limit of its effectiveness in continuing to reduce the level of fraud. HMRC believe that consolidating early gains is a significant achievement because of the fluid and constantly changing nature of the threat.

25 The PSA target, against which performance is measured, is based around the level of smuggling for cigarettes. HMRC are able to produce separate estimates for the scale of the illicit market for both cigarettes and hand rolling tobacco. A combined estimate for the illicit market share for all tobacco products would be useful in identifying the totality of fraud, and the overall trend in the illicit market.

26 There has been a shift in resources away from tobacco during 2004-05 towards other high risk revenue streams and high profile PSA targets. HMRC believe that this redeployment illustrated strategic flexibility and was the proper response to the 'basket of risks' faced by the department as a whole. HMRC also consider that resources deployed to deal with tobacco fraud will inevitably reduce as the illicit market share and estimated revenue losses decrease.

27 HMRC should consider all relevant indicators when deploying available resources. For tobacco this should include the range of measures reported to the Tobacco Strategy Group (see paragraph 47) on a quarterly basis. A continuing redeployment of resources away from tobacco may undermine achievement of further reductions in illicit market share.

28 The major UK tobacco manufacturers commission independent surveys to assess the size of the Non UK Duty Paid market. These are derived from a variety of methods including Pack Swap surveys (where a smoker will exchange the pack of cigarettes they are currently using for a brand new one) and discarded pack collections. The trade's estimates produce a total for Non UK Duty Paid and rely on HMRC estimates for duty free and cross-channel shopping to produce an illicit market share.

29 Each methodology for estimating illicit market share has shortcomings. The companies we spoke to agreed that Pack Swaps tend to under-report the size of the illicit market. There are a number of reasons for this including the locations where the surveys are conducted and the number of refusals by smokers. Discarded pack collections supply useful additional information but tend to be completed at major social and sporting events to ensure a large volume of packs for analysis. This introduces a further bias into the estimates.

30 The manufacturers believe that the size of the Non UK Duty Paid (NUKDP) market in the UK is 3-4 per cent higher than HMRC estimates. However, the manufacturers do not base their overall assessment on the unadjusted results from the survey, instead forming a consensus view which includes a subjective assessment based on their understanding of the market. As a result, their assessment is somewhat higher than the Department's. The manufacturers argue that they have a better commercial understanding of the tobacco market than HMRC. For their part the Department remain confident in the robustness of their own fraud estimates.

31 The manufacturers also contend that the high level fraud estimates produced by Customs disguise underlying trends in the source of illicit tobacco. They argue that HMRC seizure data tends to overstate the amount of counterfeit product, and that a greater proportion of the UK market is supplied from EU sources than HMRC believes. They argue that this could have a significant impact on the strategic response to the problem of smuggling.

32 Based on their detailed analysis of data from cigarette seizures, HMRC reported in 2004 that 54 per cent of cigarettes seized were counterfeit. They considered that this indicated a significant new threat. HMRC also estimate the number of cigarettes which they believe have been successfully smuggled each year. In the 2004 'Counterfeit cigarettes' handbook the Department estimated that counterfeit cigarettes represented around a quarter of the smuggled market. Discarded Pack collection survey results produced by the Tobacco Manufacturers Association in June 2005 imply a total counterfeit penetration in the UK market of 2-3 per cent.

33 In their submission to the Treasury Sub Committee investigation on Excise Fraud, the Tobacco Manufacturers' Association argued that intra-EU smuggling or 'bootlegging' is more significant than HMRC believe. They claimed that estimates based on seizures overstate the extra-EU origin of illicit tobacco products.

34 These disparities reflect the different perspectives of the competing methodologies. The seizure data which HMRC publishes as part of its fraud estimates tends to profile the product targeted at the UK. Trade estimates tend to under-report the illicit market, but also provide important information about the product which has evaded frontier detection.

35 HMRC make use of the results of the various surveys commissioned by the trade when assessing tobacco trends. The tobacco manufacturers are keen to develop a more consistent analysis of the total NUKDP market and its constituent parts. HMRC would benefit from seeking to reconcile departmental fraud estimates with the analyses produced by the trade.

36 The current PSA target does not reflect the totality of the market for illicit tobacco products. The problem of Hand-Rolling Tobacco in particular has increased in significance. According to the most recently published fraud figures this amounted to just under one third of the total £2.6 billion estimated annual revenue loss. We consider that any new strategic approach to deal with this problem will require a PSA type fraud target.

Seizures

37 A considerable proportion of the resources deployed by the Department at the start of the Tobacco Strategy were intended to facilitate detection and seizures of smuggled cigarettes. The resources included the purchase and deployment of a network of x-ray scanners to be based at UK ports. Seizure levels were also thought to represent an important measure of the success of the strategy. Seizure statistics on their own, though, can be difficult to interpret, and do not give an indication on their own of either increasing or decreasing fraud.

38 Thus over the same period that HMRC met their target to reduce illicit market share, they did not meet their seizure targets. This corresponded to a fall in the number of cigarettes which HMRC estimate were 'successfully smuggled' from 16 billion in 2000-01 to 10.4 billion in 2003-04. Over that period HMRC believed it had continued to successfully intercept a broadly consistent proportion (around 14.75 per cent) of smuggled cigarettes.

39 The level of seizures of hand rolling tobacco has declined from 472 tonnes in 2000-01 to 185 tonnes in 2003-04. HMRC can point to a declining illicit market share for cigarettes, but there are growing revenue losses in the hand rolling tobacco area. HMRC needs to take action to identify ways to increase hand rolling tobacco seizures. The Department has announced work to address this.

Disruption and Dismantling of Smuggling Gangs

40 HMRC achieved its targets for disruptions of organised criminal gangs in the first three years of the strategy. But the Department have fallen behind internal targets in subsequent years. The following targets and outturn have been recorded:

Criminal gangs disrupted

Year	Target	Outturn	Difference
2000-01	50	43	-7
2001-02	55	60	+5
2002-03	75	87	+12
2003-04	87	69	-18
2004-05	87	66	-21

Source: HM Revenue and Customs

The Seizure and Confiscation of Criminal Assets

41 The level of criminal assets that the Courts have authorised HMRC to seize in each year of the strategy have risen from £10.7 million in 2000-01 to £181.25 million in 2003-04. HMRC sets annual targets for confiscation orders for financial assets. The actual level of assets physically seized by the Department in 2003-04 was £9.45 million. Seizure of criminal finances is increasingly supported by inter-agency co-operation with bodies such as the Assets Recovery Agency (ARA) and the Concerted Inter-agency Criminal Finances Action Group (CICFA). HMRC are aware of the need to maximise financial seizures against serious crime groups through the innovative use of confiscation and civil recovery options and improving the financial awareness and expertise of Law Enforcement Officers.

42 To assist the Department to further strengthen and enhance the skills base of law enforcement staff, a formal review of the skills type and mix required to underpin this aspect of the strategy should be carried out. In addition, the gains already made will need to be safeguarded as the Department continues to reorganise in readiness for the launch of the Serious Organised Crime Agency, due in April 2006.

Additional Revenue and the UK Duty Paid Market

43 Total annual revenue losses have decreased from an estimated £3.4 billion in 2000-01 to £2.6 billion in 2003-04. In recent years, some of the reductions in cigarette losses have been offset by an increase in smuggling of hand-rolling tobacco. In the 2005 Spring Departmental Report HMRC reported that the strategy had 'protected' £5.8 billion of revenue.

44 Many factors influence the overall level of receipts including consumption, tax rates, the level of cross-border shopping and the size of the illicit market. In the Pre-Budget Report 2004 HMRC estimated tobacco revenue receipts for 2004-05 to be £8.1 billion, on total consumption of 71billion licit and illicit cigarettes. This equalled outturn for 2003-04. The projection for 2005-06 is £8.4 billion.

45 HMRC achieved just over £3 billion of additional revenue during the first three years of the strategy. Most was attributable to successfully tackling fraud and smuggling, with an additional £760 million of revenue due to a lower than projected illicit market share resulting in higher revenue receipts from legitimate sales.

Operational Delivery of the Tobacco Strategy

Background

46 Responsibility for implementing the strategy lies predominantly within the Law Enforcement sections in HMRC's Operations Division. Staff in other areas of the Department who carry out trader inspections to protect revenues also have a role in providing an assurance function for the legitimate trade. The Department have set up a coordinating body called the Tobacco Strategy Group (TSG). This model, designed to co-ordinate traditional work streams, has subsequently been deployed in support of other strategies as a result of the perceived success in dealing with tobacco fraud.

The Tobacco Strategy Group (TSG)

47 The TSG does not make detailed decisions about resource deployments, but is a forum, meeting at six-weekly intervals, where such decisions can be discussed and challenged. The TSG also provides an important forum for discussing the results of operational activity, and for reviewing key assumptions underpinning the strategy as a whole. Where frontline teams believe they have identified a significant new risk they can bring it to TSG for consideration. The TSG also formally approves the annual programme of work for the tobacco intelligence teams.

Intelligence

48 Correctly managing intelligence is vital if assurance work is to be properly targeted against the huge volumes of traffic at the major points of entry into the UK. Tobacco Intelligence was significantly reorganised during 2004-05. The reorganisation included the appointment of a National Commodity Coordinator (NCC) to oversee tobacco intelligence work. The NCC also attends meetings of the TSG.

49 We examined a large variety of tobacco intelligence material. We noted that recommendations made to improve intelligence gathering were circulated to appropriate staff who were given an opportunity to respond. A review of the risks from maritime container traffic for example included a series of recommendations to enhance the Department's performance against this threat. The relevant operational staff at a UK container port prepared a full response and an indication of timescales for delivery of enhancements.

50 As part of the reorganisation of the Intelligence function one team has taken on responsibility for collating and disseminating information provided by the network of overseas Fiscal Liaison Officers (FLOs). FLOs provide intelligence and international liaison across a number of different activities. FLOs are now seen as increasingly important in the effort to identify shipments of illicit tobacco and the organised criminal gangs behind them. HMRC are in the process of reviewing the allocated resources for this programme to ensure that it is adequate to provide effective intelligence from a number of major overseas locations. The complement of FLOs for one key location is in the process of being increased as a result.

Detection

51 HMRC have used information gathered by law enforcement staff to build up a national picture of detection risk, and to evaluate the effectiveness of their approach to tackling fraud and smuggling. The seizure statistics are the most direct measure of the success of the Detection function and the focus of its activities. Detection staff are based around UK points of entry, predominantly at the maritime ports. Data show major fluctuations in seizure levels at various locations.

52 HMRC have recognised the need for an overall assessment of the relative risks and threats posed at UK points of entry. Such an assessment would inform key decisions on resource deployments – including both manpower and technology.

53 The Department have developed innovative methods within Detection to tackle revenue risks from fraud and smuggling. These include a maritime pre-selection hub, the establishment of dedicated profiling teams, and the deployment of the National Strike Force. This is supplemented by the Department's National and Regional Deployment Centres.

54 HMRC's profiling and targeting teams are responsible for identifying potential shipments of illicit tobacco goods from ship manifests. This information is then used to direct the efforts of intervention staff. The processes used to profile incoming container are largely manual, relying on the skill and experience of the individual profiler. There is scope for greater automation through the use of a dedicated software package. Although the system which is currently used does have some of this capacity, a more automated package to collect and manage all relevant data would allow greater coverage of incoming traffic. Information which may also be of use in profiling traders is available on the Department's Electronic Folder System used by VAT staff to record trader data, which is not accessible by staff working on Excise.

55 The Department are working to make improvements through better and more efficient use of technology, including expanding access to trader data through the development of an e-frontiers system to support the implementation of the Frontiers Strategy.

Investigation

56 Investigation staff are responsible for identifying the supply chains and criminal gangs associated with tobacco smuggling. Their effectiveness is measured through an assessment of the number of major tobacco smuggling organisations disrupted/dismantled, and the value of tobacco related criminal assets confiscated.

57 HMRC's performance in these areas peaked in 2002-03, since when HMRC have failed to meet their disruption targets. Law Enforcement Officers regard the most important indicator of the success of the tobacco strategy as the falling illicit market share for cigarettes.

58 Investigation officers use a baseline of seizure volume and potential revenue loss as one trigger for becoming involved in particular cases. Other factors are considered, such as frequency and pattern of seizures, with the aim of targeting larger scale smuggling operations.

59 Organised criminal gangs have grown in sophistication and are often based outside the UK. Those parts of the smuggling chain which operate within the UK may not be fundamental to the organisation, and that successful seizures may not translate into a 'dismantling' of the gang behind the operation. Dealing with the trans-national nature of these groups requires complex and increasing levels of cooperation with overseas law enforcement agencies.

Resources Deployed

60 The tobacco strategy's original proposals set out in detail the intended deployments of additional resources including:

- Up to 520 additional staff at high risk border and inland locations, with 170 dedicated to tourist lanes;
- 95 additional intelligence staff, including overseas Fiscal Liaison Officers;
- Up to 310 more Investigation Staff based around the UK;
- An additional 30 staff in the Solicitor's Office.

61 The Department made no commitments beyond the original three year strategic horizon, and stressed that the numbers were 'indicative' with some flexibility in the deployment of additional staff. In practice it has proved difficult to identify how many additional staff were actually assigned to tobacco work, and in which parts of the Department they were employed. This is due, in part, to the ongoing reorganisation of the Department, and the development of 'multi-functional' law enforcement officers.

62 In 2004-05 there was a clear shift of resources from tackling tobacco fraud to tackling the risks posed by class A drugs. Analysis provided to the Tobacco Strategy Group for March 2005 showed that 1,726 Law Enforcement staff years were deployed on tobacco against a complement of 2,108.

Scanners

63 To improve cigarette detection rates at major UK ports, £44 million of the original £209 million of total funding was allocated for the purchase of mobile scanners. The poor performance of the scanners when first deployed was a cause of concern for the Committee of Public Accounts. The Department have since addressed these operational concerns.

64 The Committee also recommended, that the scanner network, used for a range of revenue protection and anti-smuggling work, be increased. In 2003, the Department acquired two further machines. In 2004 the Department carried out a major review of the use and deployment of scanners, the results of which will help to determine their use in the tobacco strategy going forward.

The Effect of Changing Threats on the Strategy

Evolution of the Strategy

65 The illicit market for tobacco has not been static since the launch of the strategy in 2000. HMRC's work has undoubtedly been a major factor in the displacement of criminal activity from the smuggling of genuine UK brand cigarettes towards other contraband. As the illicit market has changed so has the strategy, although rather than 're-launching' a revised strategy, there has been a process of incremental review and evolution.

Internal Reviews of the Tobacco Strategy

66 Internal departmental papers record two formal assessments of the tobacco strategy to date:

- In September 2003 the Department prepared a paper setting out the achievements of the first three years and emerging issues. This reflected the perceived change from smuggled genuine product to counterfeit and also identified intelligence gaps which HMRC needed to address. Tangible results from this review include the reorganisation of tobacco intelligence, an increase in resources devoted to air passenger smuggling, the establishment of a freight selection hub and a reinvigorated publicity campaign.
- The Department undertook a further review in November 2004 under the auspices of the TSG. This was against the background of the new PSA target to further reduce the illicit market share for cigarettes to 13 per cent by the end of March 2008.

67 As a result of these reviews, HMRC have refocused resources to provide intensified detection activity at UK airports, a more systematic approach to maritime freight targeting, and a major publicity campaign against counterfeit cigarettes.

68 It is too early to report on whether the available resources will allow HMRC to meet the new, more challenging PSA target for reducing the size of the illicit market.

Hand Rolling Tobacco

69 Smuggling of Hand Rolling Tobacco (HRT) has been a problem since at least the mid 1990s. It was discussed in the original Tobacco Strategy document published in 2000. According to the most recently published fraud figures, smuggled hand rolling tobacco has grown in significance relative to other forms of tobacco fraud. The Department have already made a public commitment in the 2004 Pre Budget Report to take action to reduce the level of hand rolling tobacco fraud, with a more detailed package of proposals expected in the autumn of 2005.

70 The dynamics of the illicit market in hand rolling tobacco are different from that of smuggled cigarettes in a number of important ways. This includes the fact that smuggled hand rolling tobacco appears to originate within the EU, is dominated by one brand, is usually genuine rather than counterfeit and is believed to be smuggled through cross channel and air passenger routes.

71 The department have been considering their response to this growing threat for some time. Tobacco Strategy Group minutes show that a strategic response was suggested as early as December 2003. Work has since been undertaken to identify the resourcing implications of any departmental response. HMRC will need to consider how this can be done without damaging current work targeting cigarette fraud and smuggling. HMRC should also introduce a quarterly intelligence analysis of hand rolling tobacco seizures in order to provide routine and up-to-date analysis on the trends in this market. This is already being done for cigarettes.

Counterfeit

72 HMRC and the tobacco manufacturing companies have cooperated closely on publicity campaigns to highlight the dangers associated with counterfeit cigarettes. In late 2004 HMRC launched its most high profile campaign to date and produced a booklet called Counterfeit Cigarettes to publicise the problem of counterfeit and the help given by trade bodies.

73 There are ongoing difficulties in estimating accurately the scale of the counterfeit market. The Department's estimates for counterfeit seizures could be improved. Currently only counterfeit from seizures of greater than 500,000 are included in the published figures. Including the results of all counterfeit seizures would improve the quality of published estimates.

74 HMRC also publish breakdowns of the most seized UK brands in each year. HMRC should also consider publishing the brands which are most likely to be counterfeit and therefore, likely to contain higher levels of toxins that are more harmful to health. This would help publicity campaigns by identifying those brands which are most at risk.

Relations with the Tobacco Manufacturers

Background

75 When the Committee of Public Accounts previously examined the issue of tobacco fraud the Committee identified the conduct of the legitimate tobacco trade as an area for concern, made specific criticisms about the export policies of individual companies and noted an apparent reluctance to cooperate with the Department.

76 The Committee called the Chief Executive of Imperial Tobacco as a witness, because of their concerns that Imperial were not co-operating with the Department to tackle smuggling, particularly by stemming exports to markets where the supplies were being diverted by smugglers. Following the hearing, Imperial and the Department agreed a Memorandum of Understanding to target this, resulting in a significant reduction in seizures of Imperial's cigarettes, and an end to the pattern of exports to markets from where the brands were being diverted rather than satisfying domestic demand.

Managing the Relationship with UK Tobacco Manufacturers

77 HMRC's development of Memoranda of Understanding with three of the major UK tobacco manufacturers represents a significant development since the PAC hearing in 2002. The Department regards the signing of these agreements as emblematic of a more cooperative relationship and of willingness by the trade to fully engage with the problem of tobacco smuggling. The results to date provide evidence that the approach has been an effective one. The memoranda provide a framework for cooperation on a range of issues relating to tobacco fraud. HMRC have devoted considerable time and resources to enhancing and improving the dialogue between the Department and the legitimate trade.

78 HMRC have taken measures to enhance their contacts with the companies whose brands have traditionally been most at risk from smuggling. Regular meetings and other ad hoc contacts provide both sides with opportunities to raise issues of concern and identify new trends or sources of illicit tobacco products.

79 A problem for the Department in managing its relations with the legitimate trade has been in the handling of sensitive human intelligence. The trade have often felt that HMRC has been too limited in the feedback it gives on the outcome of tips and information about suspect loads or sales of tobacco. Concerted efforts to explain the legal constraints and complexities involved during 2004-05 has resulted in a clearer understanding by the manufacturers of the constraints under which the Department must operate.

80 HMRC also communicate regularly with the Tobacco Manufacturers Association (TMA), which is the main trade body representing manufacturers and retailers in this sector. This allows the Department to communicate with a broader cross-section of those involved with the trade. Where HMRC feel it is necessary they work on a more ad-hoc basis with companies with a smaller market presence in the UK.

Allegations of a proposed amnesty with tobacco manufacturers

81 In February 2005, the Sunday Times published allegations that in 1999-2000 the Department had instructed a major accountancy firm to approach the UK's largest tobacco producers, and discuss a proposal whereby the producers would agree to pay VAT and excise duty allegedly lost to the Exchequer as a result of cigarette smuggling, in return for an amnesty from prosecution. These allegations were denied by the Department.

82 In response, the Chairman asked for an investigation to be carried out by a member of the Inland Revenue Board independent of the operational areas affected.

83 As this was not a tax investigation, the Department had to rely on the goodwill of the tobacco industry and their advisers in gathering evidence for the report.

84 The resultant report concluded that:

- Discussions were held between the Department and the firm about how tobacco companies could be encouraged to prevent the smuggling of their products;
- All of the available evidence suggested that the idea of an amnesty as described in the Sunday Times was a marketing initiative of the firm although it seems that the word "amnesty" was first used by a Customs official. One of the then employees of the accountancy firm suggested Customs saw the 'amnesty scenario' as a strategic initiative but there is no independent evidence to support this;
- There was no evidence that Customs were willing to offer immunity from prosecution in return for payment of substantial duties; and
- There was no evidence that Customs were acting in any way as agents for HM Treasury, or that HM Treasury played any role at all in discussions between the parties concerned in late 1999 and early 2000.

85 The National Audit Office examined the report, along with supporting documentation. The evidence gathered by the Department supports the conclusions drawn in the report; namely that the Department did not propose or sanction an amnesty. The Department's approach was instead to work to engage with tobacco manufacturers to prevent smuggling.

86 Nevertheless, the National Audit Office considered there to be some weaknesses which emerged as a result of the investigation, which the Department needs to address:

- The Department was unable to produce records of meetings held with the advisers of tobacco manufacturers. The investigation carried out by the Department had been reliant on recreating records through interview, and obtaining copies of records retained by tobacco manufacturers, the Tobacco Manufacturers' Association and other third parties.

- The Department's investigation was delayed because one officer, currently on secondment overseas, had difficulty in recalling, without access to records, details of meetings at which he was present which were key to the allegations made by the Sunday Times. The Department should ensure that notes of key meetings are made and retained to provide a chain of evidence to demonstrate how decisions are taken.
- The Department found that one official involved was at least a close acquaintance and possibly a personal friend of one of the employees of the accountancy firm developing the amnesty proposal. The official should have disclosed that to his managers and the Department should now consider the adequacy of its guidance on potential conflicts of interest.

Philip Morris Agreement

87 Another major development since the previous PAC report has been the agreement between the European Union and Philip Morris International to cooperate in combating the smuggling of non-duty paid Philip Morris product into the EU. This agreement was associated with the resolution of a legal dispute and included significant monetary payments by PMI to Member States involved in the litigation. The UK Government is not a signatory to the agreement, nor is it a beneficiary of any payments from PMI.

88 The main components of the agreement include:

- compliance protocols;
- customer oversight provisions;
- product tracking and tracing provisions; and
- monetary contribution, including penalty payments.

89 Some stakeholders have argued that the Philip Morris agreement represents a 'gold standard' against which other similar agreements need to be measured. The penalty payments which must be made if a certain quantity of contraband Philip Morris tobacco is seized are seen as a particular step forward. The establishment of a track and trace database[3], (whereby particular movements of tobacco products can be traced via an on-line system to show where the consignment was produced and where it was being delivered to) with 24 hour access is also seen to be an improvement on current arrangements.

90 An anti-smoking group told us that they believed the agreement enhanced the relationship between tax authorities and legitimate traders. Whilst they concede that the current MoUs appear to have been effective in reducing seizures of genuine UK brands, they continue to push for a legally enforceable agreement.

TSC concluded that,

We are concerned to note…that Customs have not sought a similar agreement with Philip Morris. Whether it would be better for the UK to sign the EU agreement or to seek a separate memorandum of understanding with Philip Morris depends upon the arrangements that can be negotiated with the company. But doing nothing is unacceptable.

91 HMRC estimated that the revenue benefits from penalty payments, had the UK signed the agreement with Philip Morris would be less than £1 million for the 2003-04 financial year. In their evidence to the Treasury Committee HMRC stated that that they worked, "… with Philip Morris in much the same way as we work with each of the UK manufacturers. We seek to track and trace their product in the same way as we seek to with UK manufacturers and we meet with Philip Morris on a regular basis." Philip Morris confirmed that they currently cooperate with HMRC, including sharing a seizure database, identifying suspect container loads, training and other information sharing exercises.

92 Philip Morris believe that the 'track and trace' arrangements for 'master cases' of cigarettes[4] in their EU agreement are superior to those in place in the current memoranda of understanding. However other manufacturers consider that current arrangements are not inferior, allowing a similar 'track and trace' to the first customer and intended destination market for individual packs of cigarettes rather than just for 'master cases'. The one apparent advantage of the Philip Morris agreement is the existence of a database with 24 hour access for law enforcement agencies. However the agreement only relates to product originating from outside the EU, whereas under the memoranda HMRC can ask manufacturers for information about all shipments of genuine UK product.

3 See paragraphs 87-88.
4 A master case contains 10,000 cigarettes.

93 Tracking and tracing tobacco consignments is not without its limitations. 'First customer' information is provided in all cases (i.e. the system records the intended customer, but not any subsequent customers that the consignment is shipped on to, either as a whole, or broken down into smaller consignments). The nature of intra-EU hub and spoke distribution chains means that any track and trace arrangements are more useful for product being imported into or exported from the EU. In some cases UK manufacturers export to their own subsidiaries within the EU for onward sales and distribution. This means that the information about the first customer would be of limited value to HMRC.

94 This highlights an area in which the current memoranda could be improved. HMRC would benefit from having information about the first sale outside a group of companies in addition to the original transfer to the inter-group subsidiary. HMRC needs to address the issue of overseas production of UK sensitive brands, and the provision for track and trace for this product. Not all UK sensitive brands produced overseas currently contain track and trace pack markings. This is something which HMRC may wish to see in future.

95 The Philip Morris agreement has only been in operation for a little over one year, and the European Union has not published details of the benefits or penalty payments which have resulted from it. A representative of OLAF reported that during the first year of the agreement the EU was 'more than satisfied' with the level of cooperation it had established with Philip Morris, although without data on the level of penalty payments made, and the effect of the agreement on fraud and smuggling, it is too early to comment further on the effectiveness of the agreement.

Memoranda of Understanding

96 HMRC have recognised the need to review the current Memoranda of Understanding. These agreements were developed in an iterative process between April 2002 and June 2003 and vary considerably in the detail and commitments they contain. Some of the manufacturers with whom we spoke felt that there should not be a standard 'one size fits all' document. They believe that HMRC requires different levels of cooperation from different companies depending on factors such as market presence and vulnerability of their brands to smuggling.

97 There would be significant benefits to the department in standardising the document and ensuring that the most effective clauses are included in all versions. These include specific commitments to discuss and provide information about new export markets and customers. The current review of the adequacy of the memoranda will assist the Department to achieve this.

Oversight of the Supply Chains and Export Markets

98 Some aspects of the relationships between the tobacco manufacturers and HMRC predate the existence of memoranda. This includes the system of 'yellow' and 'red' cards through which the Department can provide warnings to companies about potentially problematic customers. This system requires the manufacturers to take measures to ensure that their exports are going to legitimate and responsible customers. The ultimate sanction is for the company to cease trading with that company.

99 It is not currently the case that a customer who is red carded by HMRC would automatically be 'blacklisted'. HMRC are not, however, aware of any cases where a red-carded customer has been able to trade with other UK manufacturers, and do not consider there is any legal basis for blacklisting distributors unless they have been convicted of an offence.

100 Manufacturers believe that HMRC could improve the quality of information it supplied on seizures. When the Department track and trace illicit product they provide seizure data on excel spreadsheets to the tobacco companies rather than in a consistent data format. This limits significantly the amount of analysis which can be done on the data to identify patterns. The Department have pointed out, in response, that they are limited by law as to the extent of the information they may disclose.

101 The information provided by HMRC to manufacturers will include quantity seized, type of brands and some samples for analysis; however there is no breakdown of the quantity of each brand within the seizure. For instance, one manufacturer has its own software which it is prepared, at a cost, to share and develop with HMRC. Use of such a product would allow HMRC to generate reports very quickly identifying the intended customer, destination and brands.

102 In addition, the Department could also expand its analysis work through the use of specialist consultants with knowledge of the global tobacco markets. In one such case, consultants Euromonitor (a European trade analysis resource) produce a detailed analysis of trade movements and brand penetration which may assist the Department in further enhancing its understanding of areas of greatest risk.

Conclusion

103 The Department have made significant progress in dealing with the problem of illicit cigarettes, although more recently the size of the illicit market has plateaued rather than continued to reduce. The strategy has evolved over time to reflect the changing nature of organised crime and smuggling in this sector. A strong commitment exists within the Department to tackle the problem, and clear lines of responsibility exist to ensure delivery. The Department will need to ensure that the level of resources deployed to tackle tobacco fraud continues to be appropriate to the level of risk, and will also allow the Department to make further progress on reducing the size of the illicit market.

104 The relationship between HMRC and the legitimate tobacco manufacturers has improved considerably since the Committee of Public Accounts last considered this issue in 2002. This has delivered benefits, with a continuing reduction in the quantity of genuine UK brand cigarettes being seized by Customs Officers. There is scope for even closer cooperation, particularly in relation to published estimates of the level of fraud. HMRC will also need to consider the implications of the Philip Morris Agreement with the EU.

105 The displacement of tobacco fraud into counterfeit cigarettes and hand rolling tobacco also poses new challenges for the department. HMRC are renewing their strategy to face these challenges, but believe that this must be accompanied by specific targets and a clear idea of the level of resources which will be needed to respond to them.

Recommendations

The National Audit Office recommends that HMRC should:

- consider the benefits of producing and publishing an aggregate revenue based fraud estimate to include all forms of illicit tobacco products (cigarettes, hand rolling tobacco cigars and other products). This would be in addition to the current separate figures for cigarettes and hand rolling tobacco.
- work with the legitimate trade to include within their fraud estimates a more consistent analysis of the component parts of the non-UK duty paid sector below the high level fraud estimates. This would allow HMRC to identify quickly new trends and react accordingly.
- establish a PSA type target to reduce the illicit market share for Hand Rolling Tobacco. This should be consistent with the method developed to deal with cigarettes.
- take immediate action to increase the level of hand rolling tobacco seizures through targeted disruption activity.
- seek ways to further enhance their profiling of maritime traffic by investigating the potential for greater automation and exploitation of IT capacity, as well as through providing staff access to data stored on the Department's Electronic Folder system.
- embed analysis of hand rolling tobacco seizure information into routine seizure intelligence/analytical reports as they already do for cigarettes.
- publish more precise estimates of the likely penetration of counterfeit product by including data from all seizures made where samples are taken, rather than simply those of more than 500,000.
- publish a breakdown of the brands most affected by counterfeit each year in order to publicise the nature of this market and better warn smokers of the associated risks and dangers.
- consider an additional clause in the current memoranda of understanding which commits the manufacturers to providing information on UK brand sensitive exports outside company groups, as well as intra-group transfers and sales.
- review the procedures in place for oversight of the overseas production of UK brands by the major tobacco manufacturing companies.
- look at ways to improve the analysis of seizure data provided to tobacco manufacturers, and used by the Department to target their own work.

CHAPTER THREE
VAT Debt Management

Introduction

1 One of the early changes, arising from the creation of HMRC, was the decision to merge the debt management and banking functions of the two predecessor departments with effect from February 2005.

2 The most significant Customs tax stream in 2004-05 was Value Added Tax (VAT), with £126 billion of gross receipts, accounting for 72 per cent of total indirect tax receipts for the year. Traders have a legal obligation to calculate the amount of VAT they are due to pay and then to remit the sum to the Department by the due date. Most businesses pay their VAT on time but a number fall into arrears because they are unable or unwilling to pay. As at March 2005, the Department reported that overdue VAT they were owed amounted to £2.554 billion.

3 The overall aims of HMRC's debt management activities are to reduce debt outstanding, to maximise revenue collected and to encourage greater future voluntary compliance amongst the whole customer population. Traders who fail to pay established liabilities will be notified in writing when payment is overdue. VAT debt cases which remain unpaid are dealt with by one of the Department's 10 core or four national debt management units. The Department may not be able to collect this because it is owed by traders who cannot be contacted, or because it is under negotiation because the trader disputes the debt and payment would cause financial hardship, or is being paid off in agreed instalments, or is the subject of criminal investigation. Recovery action on these cases (of suspended debt) is "suspended" until the issue involved is resolved allowing the suspension to be lifted.

4 In the case of recoverable debt, HMRC contacts the trader to arrange settlement of the current debt at the earliest opportunity, and to discuss how the trader can be assisted to avoid incurring debts in the future. Action on the current debt can include negotiating time to pay for the amount owed or arranging for bailiffs to seize goods to recover the amount owed. Where it is not possible to recover the debt using these options the Department can seek bankruptcy in the case of a sole trader or partnership, or seek the winding up of a limited company where circumstances permit. Where a debt cannot be recovered, the Department may consider writing it off. In the year ended 31 March 2005, Customs wrote off £835 million of VAT debt in total.

2001-02 Standard Report

5 Debt rose rapidly in the five-year period to 31 March 2002 due to a number of factors. These included a rising tax yield, success in tackling certain types of fraud, and an increase in the proportion of traders challenging assessments of VAT due made by the Department.

6 In June 2003, the Committee of Public Accounts recommended that the Department should look to demonstrate that after a number of years of increasing debt balances, it could reduce outstanding debt.

7 Since 2003, the Department have taken steps to improve debt management. Changes introduced are linked to the VAT Compliance Strategy launched by Customs in April 2003. The Department introduced the National Business Model[5] to promote consistency in the business, with a focus on risk and compliance. This was supported by an extensive, commercial style training programme, to provide caseworkers with essential debt management skills. To measure performance, the Department set an internal target for 2004-05 to restrict VAT arrears to no more than 2.06 per cent of a rolling 12 month VAT liability figure. In 2004-05, as part of a special initiative, HM Treasury provided additional resources which led to a major re-organisation of the debt management business, supported by an upgrade to the IT case handling system.

Debt Management Organisation

8 The management of VAT debt was split between the following areas:

- The Debt Management Functional Management Team, with 9 staff responsible for strategic oversight of national debt management operations including civil recovery, development of policy and working practices, national performance monitoring, training and guidance.
- 10 core and 4 national debt management units, responsible for the recovery of debts. There are also specialist teams dealing with specific aspects of debt management including insolvency, asset recovery and the collection of non-VAT debt. The debt management business handles an average of 47,000 new VAT debt cases worth a total of £375 million each month.

9 Until February 2005, debt management formed part of the Business Services and Taxes division in Customs. Since then work has been ongoing to create a single Debt Management and Banking business function responsible for all incoming cash flow including overdue payments and returns on all tax streams. This business unit is, in turn, part of HMRC's Operations business area responsible for customer service, tax and benefit compliance and frontier protection in HM Revenue and Customs. **Figure 1** below sets out the reorganised structure of the Debt Management and Banking Business introduced in August 2005.

1 New HMRC Debt Management and Banking Structure

Banking Operations	People & Planning	Debt Management
Deputy Director	Director (Reports to the Executive Committee through Director General Corporate) Services)	Deputy Director
Process & Strategy	Performance Development	Business Design

Source: HM Revenue and Customs

5 See paragraphs 20-23.

Scope of Our Review

10 This part of my report focuses on:

- The level of reported debt;
- Action taken by the Department in recent years to improve debt management;
- The operation of the debt management business; and
- The Department's reported debt management performance.

Level of Reported Debt

11 The Department's management of VAT debt is supported by two key IT systems; the VAT Mainframe and the Departmental Trader Register. The VAT Mainframe system is a central record of information on all VAT registered traders, and is updated with details of new transactions with traders on a daily basis. The Departmental Trader Register is the VAT debt management case handling system. It is updated three times a month with information from the VAT Mainframe, including the notification of new debt. It is used by the Debt Management Units as the basis of their contact with traders for debt recovery action.

12 The VAT Mainframe and Departmental Trader Register are old, large and complex systems. An interrogation of the two systems by the National Audit Office in July 2002 identified approximately £300 million of debt recorded on the VAT Mainframe that could not be traced to the Departmental Trader Register system.

13 In March 2005, the discrepancy had increased to approximately £1.3 billion. Of the £1.3 billion difference identified, the Department identified £400 million as attributable to timing differences since the VAT Mainframe is updated daily, but the Departmental Trader Register case handling system (though it is used and updated by case workers with case specific information daily) is only updated from the Mainframe three times a month. Approximately £900 million represented debt that should have been downloaded onto the Departmental Trader Register, but had not been because of inhibitors on the VAT Mainframe which prevented the download of certain types of debt.

14 In 2004-05, after a feasibility review, the Department took action to reconcile the two systems. This exercise involved an interrogation of the VAT Mainframe and Departmental Trader Register at a single point in time, in order to identify, on a trader by trader basis, all the differences that existed between the two systems and the reason for each one. The exercise was undertaken using data for 16 May 2005, when there were 200,000 traders with debt balances which differed between the two systems. The Department will use the results of the May 2005 reconciliation as the basis for arranging for the removal of all non-essential inhibitors by 31 March 2006. This will ensure that debt is correctly downloaded to the Departmental Trader Register in future.

15 In advance of the results of the May 2005 exercise, the debt management Functional Management Team undertook a separate exercise analysing the high value differences between trader balances on the two systems. As a result arrangements were made to manually add a number of high value debts totalling around £700 million onto the Departmental Trader Register in June and July 2005.

16 Debt on the VAT Mainframe which is not notified to the debt management business cannot be actively managed by properly trained debt management staff using the appropriate systems. Most of the inhibited debt relates to missing traders and cases under appeal, although a more detailed explanation and a breakdown of the additional amounts of suspended debt by type will not be available until the Department have completed their review.

17 Early analysis of the data led HMRC to estimate that £35 million of the accrued debt blocked on the VAT Mainframe is currently recoverable. Even when the inhibitors for the recoverable debts are removed, however, in some circumstances the chances of collecting the amounts may be substantially diminished because of their age.

18 A number of high profile and ongoing legal cases have caused the variance to increase markedly. In addition, reconciliation work has been delayed by resourcing difficulties and because decisions were ongoing about changes to IT systems needed to support the business more effectively in a period of significant organisational change.

Developments in the National Debt Management Business

19 Customs carried out an internal review of their debt management activities in September 2002. The review concluded that improvements could be achieved from a better application of current systems. It recommended action in the short term to improve management information and performance measures, update policy, training and assurance and to ensure a greater focus on key risk areas. The review also recognised that a long term step change, supported by enhanced IT systems, would be needed to secure significant improvements in performance.

The National Business Model

20 In May 2003, the Department implemented a revised framework for the business called the National Business Model, setting standards for the debt management business. It was developed by a team of representatives from the debt management units and the central Functional Management Team. The aim was to provide a basis for improvements in the business, consistent with the VAT Compliance Strategy and without significant system change. The objectives identified for the debt management business were 'to categorise and identify debtor behaviour and to devise strategies for':

- Improving revenue flow
- Minimising write-off
- Improving compliance
- Removing persistent non-compliant businesses from the trading population
- Promoting timely payment; and
- Providing help and support to vulnerable but viable businesses.

21 The Department placed greater emphasis on dealing with the debtor rather than the debt and identifying underlying causes for late or non-payment. The new approach involved dividing debtors into two groups:

- First time and occasional defaulters, who would normally be contacted by telephone, not only to obtain payment of the outstanding debt but also to identify the key reasons for the debt arising. This allows the Department to offer targeted advice, education and support, to improve compliance in future.
- Persistent defaulters, where trader information already held would be used to inform and target activity so that prompt action can be taken in order to protect against future revenue loss.

22 The approach recognised that early action on new debt was essential to improve recovery and reduce write off. The National Business Model stipulated that the performance of individual debt management units should be measured against the following national standards:

- To achieve a positive outcome for 100 per cent of recoverable debts within 3 months for first time and occasional defaulters
- To achieve a positive outcome for 100 per cent of recoverable debts within 6 months in the case of persistent defaulters
- To review time to pay and other suspended debt on a timely basis to ensure prompt and appropriate recovery action is taken.

23 The National Business Model also proposed a preferred structure for the Debt Management Units. This recommended setting up centralised teams to deal with certain key areas of suspended debt and missing trader fraud debt, freeing other staff to concentrate on the clearance of new recoverable debt. The Department continued to support the National Business Model by issuing good practice guidance on debt management for first time and occasional defaulters, and persistent defaulters.

The Operation of the Debt Management Business

Trends in Suspended Debt

24 **Figure 2** includes analysis by type of suspended debt, and shows the amounts outstanding at March 2002 and March 2005 and the increase or decrease in the intervening three year period. These figures do not include the 'inhibited' debt held within the VAT Mainframe computer system and not passed to the debt management business.

25 The only category of suspended debt where there has been a reduction is that relating to time to pay, an area of activity fully controlled by the debt management business. This has seen a drop of £49 million (35 per cent) in the 3 years to March 2005. This category of debt now stands at its lowest level since 1998.

2 Analysis of debt

Type of debt	March 2002 (£m)	March 2005 (£m)	+/- (£m)	Definition
Suspended Debt				
Law Enforcement investigation	216	792	576	Debt assessed where a trader is under Customs investigation.
Under Appeal	243	426	183	A disputed liability where a trader has appealed to an independent VAT Tribunal or protective assessments pending legal action.
Missing Trader	178	204	26	Debt owed by traders who cannot be traced by the Department.
Disputed liability	51	60	9	A disputed liability where no appeal is in progress.
Time-To-Pay	141	92	- 49	An agreement between Customs and the trader to receive money in instalments
Other	-7	67	74	New suspended debt categories
Total Suspended	822	1,641	819	
Recoverable	1,240	913	-327	Debt available for recovery action, including by legal process in the Civil Courts.
Total Debt	**2,062**	**2,554**	**492**	

Source: HM Revenue and Customs

26 The substantial part of the overall increase in suspended debt is attributable to debt resulting from law enforcement investigations, which has risen by £576 million in the three year period to March 2005. The majority of this is due to the Department's efforts to identify and tackle Missing Trader Intra-Community fraud (MTIC) debt. The nature of this fraud means that these balances remain recognised as debt while the criminal investigations continue. Debt suspended because an officer's assessment of VAT due from a trader is under internal reconsideration or appeal to an independent VAT Tribunal has also increased significantly. Cases may not be concluded in some instances until the Courts have ruled in favour of HMRC or the trader.

27 An example of this has arisen from HMRC's efforts to require a number of businesses to register their card handling companies for VAT. Pending the completion of legal action, the Department have issued protective assessments to the businesses which will be enforced if the litigation is successful. In the meantime the amounts are recorded as suspended debt. The litigation may take several years to go through the Courts. In the meantime the reported level of debt is expected to rise significantly.

28 HMRC see these increases as, in large part, the natural consequence of addressing MTIC fraud and VAT avoidance activities. As such, they consider that the increases should be taken as a sign that the Department is successfully tackling serious non-compliance. Unlike recoverable debt, HMRC recognise that a significant proportion of suspended debt will not be recoverable for some time, possibly even several of years. A significant proportion may ultimately need to be written off. We agree with the Department's view.

29 As part of an ongoing departmental review process, in the last few years the debt management business has taken various actions to improve arrangements to control suspended debt. This included a review in 2004 of the "hardship" policy for officers' assessments under appeal. This found that the policy for suspension of debt where an officer's assessment is under appeal to a tribunal was not always being correctly applied.

30 Once that assessment is issued, the law requires that the VAT must be paid before the appeal is heard, unless payment of the amount would cause genuine hardship to the trader. In some instances, debts under appeal had remained suspended, where hardship had not been explicitly applied for by the trader. As a result guidance on the matter was revised. Arrangements were introduced to provide for central monitoring of assessments suspended due to hardship. This action is a contributory factor in the fall in this category of debt during 2004-05. The March 2005 figure of £322 million represents a drop of 14 per cent from the figure of £375 million recorded as at March 2004.

31 Although recommended by the National Business Model, some debt management units did not have a central team responsible for monitoring suspended debt. Responsibility for monitoring cases was assigned to individual caseworkers, who often had problems identifying and then making contact with the Law Enforcement officers responsible for suspended debt cases. There were also variations in the timescales for reviewing progress on suspended debt cases, from one month up to 21 months in one case, with an average time of 5 months.

32 Since May 2004, the Large Debt Unit, which managed debts worth more than £100,000, has assumed responsibility for much of the suspended debt, since the cases tend to be high value. The Large Debt Unit is developing arrangements to improve communication with law enforcement officers in relation to suspended debt. The status of suspended debt cases will be reviewed and updated as necessary at specified periods based on the predicted timescale for developments on the law enforcement operation the debt relates to. Responsibility within law enforcement for the initial raising of suspended debt and then its monitoring will also be centralised.

Write Off of Debt

33 It is a key principle of the Department's National Business Model that early action on new recoverable debt is essential to improve recovery rates and reduce write off. Once a recoverable debt is more than 6 months old the chances of collecting the debt diminish rapidly in certain circumstances.

34 Different considerations apply in the case of suspended debt where cases can remain unenforceable for several years due to law enforcement action or appeals. The nature of much of this debt is such that there is a greater probability that when the debt ultimately is deemed recoverable it will be written off. Regardless of the type of debt, it is important that appropriate and justified write off action is taken on a timely basis to prevent total debt from being overstated. This is especially important now that the Department's Trust Statement account, which discloses total tax revenues, is prepared on an accruals basis. As a result the Department is required to disclose the level of debtors at the year end. Debt management currently advise on any provisions for doubtful debts for inclusion in the accounts.

35 Three years ago the NAO recommended that Customs should speed up the write off of debt deemed irrecoverable. Since then the Department have taken action aimed at improving arrangements. In 2003, the procedures for the handling of aged debt relating to traders who are missing or deregistered were revised to encourage timely write off of these cases where there is little or no prospect of recovery. Periodically since then, there have been drives to write off debt deemed irrecoverable. We noted one such exercise towards the end of 2004-05. Additionally the Department commissioned a review in 2004 which considered delays in the write off process.

36 The level of write offs has nonetheless fallen significantly in recent years. The graph in **Figure 3** shows the value of VAT debt written off for each of the financial years since 2001-02. This shows that amounts written off almost doubled in the 2002-03 financial year to a figure of £1,714 million (105,196 cases) but since then has fallen significantly to £835 million (46,096 cases) in 2004-05.

37 The major reduction in 2004-05 in the level of write off cases could indicate that irrecoverable debt is not being written off on a timely basis and, therefore, debt may be overstated. There were problems preparing cases for write off because the required evidence was not readily available, either because of the age of the debt or the fact that the information was not held by the debt management unit. This meant that the average age of debt put forward for write off action for the sample we examined was 33 months.

3 Trends in write off cases by number and value since 2001-02

Figure 3(a) – By value

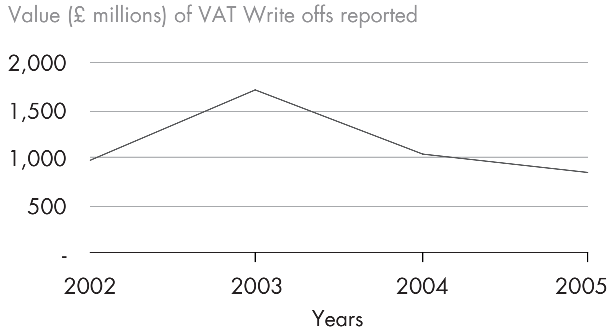

Figure 3(b) – By number

Source: HM Revenue and Customs

38 Departmental guidance specifies the delegated authority levels for writing off debt, depending on value. The process for authorisation of proposals can be lengthy, particularly for high value debts which go through several stages of review before submission to senior management. Even then, there was sometimes a reluctance to write off amounts when officers considered that a debt may have been inappropriately managed in the past.

39 For the sample of debts written off in 2004-05 examined by the NAO, on average it took 5 months for a write off case to be processed and often longer if the debt is high value. The process for the write off of debt is expected to speed up under the new structure for the debt management. Additionally, the Department is in the process of developing new departmental write off guidance.

40 The focus for caseworkers to take early action on new debt to maximise the prospects of recovery may also have contributed to a reluctance to write off debt. Success here, as demonstrated by the additional £299 million banked in 2004-05, may have been at the expense of clearing debt appropriate for write off. The Department's Large Debt Unit has recently undertaken a major exercise to establish the status of all high value suspended debt cases. Although the results of this exercise are not yet available, the Unit expects that a significant number of debts will be written off.

The National Business Model

41 The National Business Model was developed by Customs to provide a consistent way for Customs to manage debt across the range of debt management units. It resulted in a number of positive developments as a result. These include:

- The issue by the Functional Management Team of a management assurance programme to test the quality and accuracy of work done by caseworkers for use by the debt management units, to check that resources are being directed to risk areas, and to highlight any additional training needs;
- The requirement for debt management units to submit quarterly reports to the Functional Management Team reporting on performance against national standards, the results of management assurance activity and problem areas for example on staffing or IT;
- Periodic site visits made by staff from the Functional Management Team to the regional sites to follow up on issues identified in the quarterly reports
- Periodic meetings of key individuals from the business to discuss issues affecting the national business
- The use of staff from the debt management units in the Functional Management Team or on specific projects associated with the national business.

42 The Department's debt management units still need to address some inconsistencies over the application of the National Business Model. For example, although the Model proposes specialised teams to deal with suspended debt and deregistered traders, these did not operate in many units. These inconsistencies also affected the application of a national programme of management assurance which was inconsistently applied and evidenced in the regions. Many units no longer adopted the management assurance programme. The result of this was to increase the risk that quality thresholds for management assurance would not be met, and therefore, that resources would not be properly targeted to maximise recovery rates. The Department are currently carrying out an internal review into management assurance which will report in the Autumn of 2005.

Management Information

43 Any effective debt management business needs reliable, detailed and up-to-date management information to allow the business to manage individual debts efficiently, to allocate staff resources in response to risk and workloads, and to assess the effectiveness of various debt management actions. It also enables performance to be monitored over time against appropriate targets and indicators.

44 In 2004-05, the Department had arrangements in place for monitoring and reporting of debt management performance against internal targets. Progress against the target, to restrict VAT arrears to no more than 2.06 per cent of total VAT liability, was reported on in the Department's monthly Management Accounts. In the case of the 4 national targets, details of performance were reported to management in the VAT business in the monthly "VAT Business Performance Pack" (VAT pack). Unlike with the Management Accounts, there was no commentary to accompany the performance data. The data for these reports was compiled by the Functional Management Team based on information extracted from the Departmental Trader Register.

45 In addition to reporting the position for the national business as a whole, during 2004-05 the "VAT Business Performance Pack" included details of performance against national targets for each of the 10 core and four national debt management units. The information in the Packs is an important tool for regional and functional management with responsibility for debt management. It allows them to monitor outturn against targets for the debt management units in their region. It also provides an overview of the comparative performance of the different debt management units.

46 The 2004-05 VAT Pack performance data for the individual management contained a number of deficiencies:

- Performance for the 4 national debt management units was reported against standard targets, those being debt cleared as a percentage of debt advised and debt paid as a percentage of collectable debt advised. Although these targets had been assigned to the 10 core debt management units dealing with the routine processing of new debt; they were inappropriate for the national teams given the specialist nature of their work in chasing up older debts relating, for instance to fraud cases. No alternative performance data for the national teams was included in the VAT Packs, although lower level data was available, though not included;
- Data on individual unit performance was based on flawed information. The management information system in place could not support the revised business structure introduced in May 2004. For much of the year, this system continued to generate information on the basis of debt being handled by 10 rather than 14 debt management units. Functional Management Team efforts to manually adjust data generated by the IT system to reflect the impact of transfers of debt from the regional debt management units to the national teams proved unsuccessful. Aggregate national data was, however, accurate; and
- Understanding of the performance data, which was presented in graphs or tables, would have been enhanced if it had been accompanied by a narrative to explain what the data meant and to provide the appropriate context. For example the linkage to the related targets was not clear; there was no commentary about whether the recorded performance was satisfactory and if not, how this would be addressed. The Department used this information as the basis for regular monthly VAT performance meetings. At these meetings performance data was analysed, and points needing clarification discussed.

47 Most debt management units had their own arrangements in place to generate more reliable local management information on performance against targets. The quality of monitoring arrangements varied significantly. Most of the new national teams had particular problems in generating reliable information of performance against their targets. As a result individual units developed separate procedures as required.

48 The quality of information from the Departmental Trader Register improved in the latter part of the year and it is expected that the system will produce reliable information in future once the upgrade is completed later in 2005. This will be of key importance, not only to monitor departmental performance, but to be able to assess the effectiveness of different types of enforcement action against debtors. This sort of analysis is not currently possible and is crucial to a risk and compliance based approach to debt management.

Staffing and resources

49 In 2004-05 HM Treasury provided an extra 150 staff for the Customs debt management business for a two year period under a "Spend to Raise" initiative to deliver an additional £185m of revenue for each of the two years. The majority of the additional staff were deployed in 4 new specialist National Units from April 2004, covering Large Debts, Missing Trader cases and two covering Aged Debts dealing with cases more than six months old. These new national units took casework from the core regional units. The balance of additional staff resources were assigned to the 10 regional debt management units and the legal recovery units, providing an increase in resources overall to permit the quicker clearance of new debt.

50 In 2004 the Department also approved an upgrade to Departmental Trader Register. The key improvements to be introduced by the upgrade were:

- providing system access to the 150 new debt management staff;
- supporting the four new National Units; providing more accurate and enhanced management information;
- providing the Civil Recovery Unit with the reporting and monitoring tools necessary to support it's specialist work; and
- to allow additional debts to be downloaded from the VAT Mainframe to Departmental Trader Register.

In view of the short timescale and the limited specialist IT resources available to perform the work, the upgrade was performed in 3 phases. The first phase was delivered in May 2004 to address priority issues. HMRC will deliver the final phase of the enhancement in September 2005. This release will:

- introduce corrections to the missing and deregistered trader debts from the mainframe to the Departmental Trader Register;
- introduce a case tracking system; and
- make improvements to management information systems.

51 The additional staff resources funded by HM Treasury increased the total staff complement to 1,095 for the 2004-05 financial year. At the start of the financial year, however, taking account of the working time lost due to training requirements, the debt management business was operating at only 77 per cent of the allocated number of staff. The position improved as the year progressed so that by March 2005 the business had 916 assigned staff on debt management activities, which was 84 per cent of the optimum staff complement.

52 The debt management units were given relatively short notice of the additional 150 staff that the business would have for the 2004-05 financial year; as a result some of the extra staff were not in post at the start of the year. The business tends to see a relatively high turnover of staff, particularly in the caseworker grade, because the skills acquired and training received on debt management work are readily transferable elsewhere in the Department so staff can easily move, often on promotion.

53 In 2004-05, staffing of the debt management units was a regional responsibility, not the debt management Functional Management Team. As a result, during 2004-05 some debt management units were unable to recruit staff even though they were below complement because of a freeze on recruitment due to surplus staff deployed on other tasks elsewhere in the region. The impact of this varied depending on the region; however some debt management units were particularly badly affected. For example, the number of caseworkers at the largest debt management unit was 20 per cent below complement for 6 months of the year. Looking to the future this kind of problem should not arise, because in HMRC debt management will be organised on a functional rather than a regional basis.

54 Staff responsible for VAT debt management can expect to see an increased workload during 2005-06 following the upgrade to the Departmental Trade Register and the results of the reconciliation exercise with the VAT Mainframe which will result in the notification of additional debt. The challenge will be to deal with this at a time when reductions in staffing are required to deliver agreed efficiency savings. Work is currently underway within the Department to identify the structure and staffing levels required.

Training and guidance

55 Recent years have seen the development and implementation of a comprehensive and structured training programme for debt management staff to ensure that they have the required knowledge and skills to deliver a professional debt management service. Key elements of this have included:

- The delivery of telephone pursuit training from a commercial market leader in the technique, introduced in 2003 which involved a five day training programme delivered to over 600 staff;
- A new course on financial and commercial awareness specific to debt management, designed to equip caseworkers with the necessary skills to become effective debt managers – the first of its kind in the Department;
- Each debt management site has a training manager responsible for supporting local trainees and assisting the Functional Management Team in the development and delivery of the national training programme;
- Guided learning units on debt management and related topics, designed to complement the formal training;
- In 2005-06 the VAT debt management area introduced an accreditation programme for debt management training; and
- In 2004 a management mentoring programme was delivered by a commercial training organisation at one of the debt management sites. Following very positive results it is intended to apply the lessons learnt in other debt management units in 2006.

56 Departmental guidance forms the backbone of the information available to debt management staff. Although those relevant to debt management had been updated in February 2005, aspects were out of date, including reference to legislation. The coverage given to some aspects was too brief given the importance and complexity of the subject, for example the guidance on suspended debt and write off. In order to address the latter point, a number of debt management units had developed their own local guidance on write offs.

57 Within the debt management business, there are a number of 'guided learning units' (training modules that can be used by staff new to the business), intended to complement the formal training programme. These have been developed by staff from the debt management business. The Department have not promptly updated the documents to reflect the impact of organisational change, leading to some confusion about the respective responsibilities of debt management units and new national teams. This also led to the inappropriate transfer of some cases from regional debt management units to the national teams responsible for missing trader and civil recovery work.

58 Although the Department addressed this specific point through the issue of new guidance towards the end of 2004-05, a number of the guided learning units are still out of date. For example the one on "introduction to the Debt Management Unit" was last updated in 2001.

59 There are disparities between the guided learning units with regard to the way they are written and their technical content. The document on suspended debt in particular was too simplistic given the nature of the subject. However, a number of the learning units were clear, comprehensive and well set out. These included the ones in specialised national units dealing with "Missing Traders" and "Civil Recovery Case Referrals".

Debt Management Performance

60 There are a number of factors relevant to assessing the Department's performance in managing debt:

- The Department's targets and results,
- Trends in reported debt levels over time;
- The impact of wider economic factors; and
- Overall picture on debt management performance.

The Department's Targets and Results

61 The Department's main objective is to reduce the VAT gap to less than 12 per cent by March 2006. To measure the progress of the VAT Compliance Strategy in delivering this, the Department have developed a number of top-level indicators. In 2004-05 the target for debt management was to restrict VAT arrears to no more than 2.06 per cent of a rolling 12 month VAT liability figure. The table below shows that the Department failed to meet this target in 2004-05 and, overall, in 3 of the 4 most recent financial years. With the exception of an improvement in 2003-04, the level of debt relative to the overall VAT liability is on an upward trend: see **Figure 4** below.

4 Performance against high level targets – monthly arrears as a percentage of liability

Year	Target	Outturn	Result
2004-05	2.06 per cent	2.32 per cent	Missed
2003-04	2.20 per cent	2.09 per cent	Achieved
2002-03	1.57 per cent	2.23 per cent	Missed
2001-02	1.41 per cent	1.95 per cent	Missed

Source: HM Revenue and Customs

62 The Department consider that this target is not an accurate absolute measure of overall performance for the debt management business. It is not solely a debt management measure as the level of VAT liability declared is outside the control of the debt management function. The level of monthly arrears, and therefore the percentage of debt relative to total VAT liability, is increasing due to the impact of measures taken elsewhere within HMRC as part of the VAT Compliance Strategy, for example through the identification of debt attributable to Missing Trader Intra-Community fraud. At the same time, however, recoverable debt has fallen, and cash receipts have increased.

63 The top level target is supported by four underlying national targets for the VAT debt management business; those for 2004-05 were set out in a Delivery Agreement for Customs' Regional Business Service division. The outturn against the 2004-05 targets is recorded in **Figure 5**, and shows that two of the four national targets were achieved, and two were not.

5 2004-05 performance against national targets

National Targets	Target	Outturn	Result
Debt cleared as a per cent of debt advised	101 per cent	100 per cent[6]	Missed
Reduce recoverable debt	£790m	£918m[7]	Missed
Debt paid as a per cent of collectable debt advised	72 per cent	78 per cent	Exceeded
"Spend to Raise" target for additional cash in the bank	£185m	£299m	Exceeded

Source: HM Revenue and Customs

64 The longer an amount is outstanding, the more difficult it becomes to collect. Targets 1 and 2 were, therefore, designed to provide the Department with a means of measuring the clearance rate for debt. Target 1 on debt clearance was missed, albeit by a small margin. Whilst the department has succeeded in reducing the level of recoverable debt outstanding, levels of suspended debt have increased. This debt is not immediately available for collection and clearance, contributing to the failure to meet the target.

6 Actual outturn 100.2 per cent.
7 See paragraph 65.

65 Performance in clearing recoverable debt has improved. However, as suspended debt accounts for a larger and larger proportion of total debt the Department will find it difficult to meet the target by increasing the collection rate for recoverable debt alone. It may, therefore, be appropriate to identify an alternative target to use so that the performance of the Department in managing the debt it is able to directly control can be assessed. Part of the reason for the failure to meet Target 2 on reducing the level of recoverable debt was that there was an unexpected increase of £72 million in debt, relating to recoverable debt not advised to the debt management business until late (March 2005) in the financial year.

66 Although targets 1 and 2 were missed, the 2004-05 position represented an improvement from the previous year. In particular, the level of recoverable debt as at March 2005 of £913 million represented a drop of nearly 9 per cent from the March 2004 figure of £1,001 million, and was 26 per cent below the March 2002 figure of £1,240 million.

67 The fact that targets 3 and 4 were met is a reflection of the fact that the debt management business was successful in translating debt advised into cash in the bank in 2004-05. The outturn of 78 per cent debt paid as a percentage of debt advised recorded under the third target is up from 68 per cent recorded in 2003-04. The provision of an extra 150 staff from April 2004 was specifically linked to delivery of the extra cash recorded as delivered under Target 4. In fact, money banked by Customs in 2004-05 as a result of debt management action was £2,417 million. This was £299 million more than that banked in 2003-04, representing an increase of 12 per cent in one year.

68 Compliance management is now a key aspect of debt management, an upgrade to the Departmental Trader Register planned for late 2005 should allow collection of management information which will allow the effect of compliance management work on debt to be assessed.

The Impact of Wider Economic Factors

69 When the NAO reported on VAT debt management 3 years ago, the then Chairman of Customs stated that the recent significant increases in VAT debt level should be interpreted in the context of wider economic factors which were beyond the control of Customs. For this review of debt management, and with the assistance of specialist consultants, we therefore identified the relevant external factors, estimated the contribution that these may have made to VAT debt levels and then sought to "correct" the reported levels of VAT debt accordingly.

70 The key step in the analysis is to estimate the contribution of external factors on the levels of VAT debt. To do this, we have used data on the levels of debt owing to local authorities in relation to national non-domestic rates. Business rates and VAT debt both relate to amounts owed by businesses to public bodies, both relate to the non-payment of liabilities that are incurred in the course of running a business and which can not be written off unless business operations cease. Therefore, we considered it reasonable to expect that both types of debt would be affected by similar external economic factors.

71 The role of economic growth and the number of new cases of company insolvency were considered as external factors as part of the analysis. Between 1998 and 2004 annual real growth varied around 2.5 per cent. The number of new cases of company insolvency in England and Wales remained relatively stable at around 5,000 cases each year. Analysis could only be performed on data up to March 2004 because the local authority data for later periods was not available.

72 The analysis excluded the effect of MTIC fraud on debt management performance, since the debt is unique to VAT and results from positive anti-fraud measures taken by the Department. Similar considerations apply to debt suspended pending the outcome of law enforcement investigations. Once debt has been adjusted for these, the level of VAT debt fell by 4 per cent from £1,849 million as at March 2002 to £1,767 million as at March 2005.

73 The ratio of VAT debt (excluding MTIC and law enforcement investigations) to receipts fell by 17 per cent between March 2002 and March 2004. Although this is welcome progress, the reduction in the ratio of debt to receipts came at a time of economic growth, and where business insolvency rates were comparatively low.

74 In the case of the performance of Local Authorities, after making an allowance for targeted debt management activities, the debt to receipts ratio fell by an estimated 19 per cent. If improvement was attributable to the performance of the wider economy, it may also imply that the Department's performance was aided by a positive economic climate.

Conclusion

75 In creating a single debt management and banking unit incorporating both Customs and Revenue debt management staff, HMRC is effectively forming the largest debt collection agency in the United Kingdom. Since the NAO last reported on the performance of debt management in Customs in 2001-02, the Department have successfully 'turned the tide' in respect of the collection of recoverable debt, where an additional £299 million was banked in 2004-05.

76 Overall debt, though, has continued to increase. This is primarily as a result of additional liabilities identified through the Department's compliance and anti-fraud activities that are not available for immediate recovery. Suspended debt, therefore, continues to be a challenge, even more so following the download of an extra £900 million of debt from the VAT Mainframe.

77 At present, debt management for VAT, the third largest tax stream for the new Department and accounting for almost 20 per cent of total gross receipts, continues to rely on legacy IT systems. We found that certain debt data had not been transferred from the VAT mainframe system to the Departmental Trader Register (the debt management case handling system) associated with the accounting for and the management of debt.

78 The Departments' own reconciliation work, indicates that the amount of un-notified debt as at March 2005, setting aside timing differences, was in the region of £900 million, £865 million of which was suspended. The Department have work in progress to address the issue by reconciling the VAT Mainframe and the Departmental Trader Register.

79 The reorganisation of the debt management business, and the creation of specialised national units to address particular types of debt has increased the Department's skills base and their capacity to process debt more quickly than before realising more cash. This has been supplemented by high quality, commercial style training.

80 The changes that the Department have initiated are still to bed in fully. For instance, the benefits that should have been delivered from the implementation of the National Business Model have yet to be fully realised. There continue to be inconsistencies between the ways in which individual debt management units process cases and check the quality of work done by staff. However, as the changes introduced bed in further the enhanced systems will help the Department to deliver performance improvements.

81 Looking to the future, HMRC will need to ensure that the redesigned debt management business operates an efficient, effective service, supported by appropriate technology. Obviously this will need to be considered in the context of the overall IT requirements for HMRC.

Recommendations

The National Audit Office recommends that:

- As long as the Department continues to use the existing systems the VAT Mainframe and the Departmental Trader Register should be reconciled on an on-going basis to ensure that all differences between the debtor balances in the two systems are valid. We understand from the Department that improved management information arising from the upgrade of the Departmental Trader Register may reduce the work required in future.
- The Department are removing inhibitors blocking the download of debt from the VAT Mainframe to the Departmental Trader Register. In future, the Department should ensure that, unless essential, nothing inhibits the notification of debt to the debt management business.
- The debt management business should urgently press ahead with their work already underway to enhance procedures for the monitoring of suspended debt. We consider that the arrangements being developed by the Large Debt Unit to improve liaison with Law Enforcement could be used as the basis for revised arrangements in other debt management units. We would expect enhanced procedures:
  - to clarify responsibilities, so that individuals are named as liaison points for suspended debt in Law Enforcement and debt management units;
  - to ensure efficient arrangements for the timely monitoring of cases;
  - to provide robust management information, including that necessary for performance measurement; and
  - to be supported by appropriate guidance and training.
- The debt management business should speed up the process for the write off once debt is deemed irrecoverable. This should include setting deadlines to escalate cases for senior management consideration if the debt management unit is unable to progress the case within a given timescale.
- The Department should ensure, in restructuring its debt management business, that a consistent standard of management assurance checking is applied across different locations.
- Performance reporting against targets for debt management units should be supported by readily available, reliable management information.
- In developing a new business structure for debt management in HMRC, the Department needs to consider carefully those areas where staff resources can be reduced whilst maintaining effective performance.
- HMRC should review their departmental guidance and the Guided Learning Units relevant to VAT debt management to ensure that references to legislation, policy, procedures and structures are up to date. The department should also update and enhance the guidance on suspended debt and write offs.
- Any departmental VAT debt management targets set should take due account of factors outside the control of the debt management business. In view of the specific issues associated with the management of suspended debt, which accounted for 64 per cent of total debt as at 31 March 2005, consideration should be given to measuring performance here under a separate set of targets to those used for recoverable debt.
- Once the Departmental Trader Register upgrade is complete, the Department should set targets to help assess the impact on debt management activities of work designed to deliver improvements in the future compliance of traders.
- The Department should compare their performance with appropriate public sector organisations in both the United Kingdom and internationally, as well as commercial debt collection agencies. The aim should be to review performance against that achieved by other debt recovery bodies to determine relative performance and compare collection practices.

Printed in the UK by the Stationery Office limited
on behalf of the Controller of Her Majesty's Stationery Office
182652 10/05