Presented pursuant to the GRA At 2000 c20. s.6 and the Exchequer & Audit Departments Act 1921 c52. s.2

Department of Inland Revenue

2002-03 Accounts

- Consolidated Resource Accounts
- Trust Statement
- Standard Report

LONDON: The Stationery Office
HC 1072

19 November 2003

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(For the year ended 31 March 2003)

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Contents

ANNUAL REPORT TO THE RESOURCE ACCOUNTS

Scope

These resource accounts include expenditure and income relating to the Core Department and the Valuation Office Agency (VOA). The Inland Revenue has a close relationship with the Department for Work & Pensions (DWP) and its counterpart in Northern Ireland, the Department of Social Development (DSD), as they are responsible for the collection of National Insurance Contributions. Expenditure relating to the collection of National Insurance Contributions is included in the Operating Cost Statement while associated income recovered from the National Insurance Funds is included as Appropriations in Aid (A in A). Receipts and payments of direct taxes and National Insurance Contributions and payments of Tax Credits are accounted for in a trust statement which is separate from these resource accounts.

RN Ltd, a Nominee Company registered in 1933, was set up to hold taxpayers' assets as security for outstanding taxes and liabilities. These assets do not belong to the Department and are not included in these Resource Accounts.

The resource accounts include the activity of tax appeal tribunals which, as non-departmental public bodies, are strictly outside the boundary of these accounts. The costs, however, are not considered to be material.

The Inland Revenue in 2002-03 was responsible for:

- collecting income tax, corporation tax, capital gains tax, petroleum revenue tax, inheritance tax, stamp duty and National Insurance Contributions;
- administering Working Families' Tax Credits and Disabled Person's Tax Credits and preparing for New Tax Credits;
- providing valuation services for rating, Council Tax, Inland Revenue and other public sector purposes;
- providing policy advice to Ministers in all the above areas;
- administering Oil and Gas Royalties and enforcing the National Minimum Wage on behalf of the Department of Trade and Industry;
- collecting student loan repayments;

The Inland Revenue operates through an area network of local, regional and specialist offices across the country.

The Department's Aim and Objective for 2002-03 were:

Aim

To administer the tax system fairly and efficiently, make it as easy as possible for individuals and businesses to understand and comply with their obligations and receive their tax credit and other entitlements.

Objective

To collect the right revenue and give the right entitlements, at the right time. This Objective is subdivided into four activities as described in Schedule 5 (see page 20).

Operating and Financial Review

The Inland Revenue's Departmental Report published in Spring 2003 (Cm 5925) sets out the Department's spending plans for 2003 to 2006 and reports progress on its objectives and performance. Details of the Valuation Office Agency's objectives and performance can be found in its Annual Report and Accounts; its Forward Plan provides information about future priorities and developments.

The Inland Revenue's performance is assessed through its Public Service Agreement (PSA), Service Delivery Agreement (SDA) and other work targets. The Department's PSA for the period 2001-04 (set out in the Spending Review (SR) 2000) contained the following five key targets against which preliminary summaries of the Department's performance are provided. Full details of performance against those targets will be included in the main body of the Commissioners' Annual Report due to be published in the Autumn of 2003.

PSA target 1: *Deliver year on year improvements in the number of individuals and businesses who comply with their obligations and receive their entitlements.*

Overall, we met in 2002-03 13 out of 17 measurable Service Delivery Agreement targets which support this PSA target. Nearly all targets ensuring customer compliance were met. However, we missed three of our accuracy targets for dealing with entitlement claims.

PSA target 2: *Deliver year on year reductions in compliance costs that act as a barrier to the establishment and growth of small businesses.*

Initiatives in support of this target in 2002-03 included:

- reform of company car taxation - employee benefit based on emissions - this removes the need to maintain records of car mileage;
- rewriting tax legislation in plainer language - Schedule E legislation;
- provision of frequently asked questions (FAQ) helpsheet and offer of help with tax returns completion to small businesses at risk of filing incorrectly.

PSA target 3: *Ensure by 2005 that 100% of services are offered electronically, wherever possible, through a common Government portal, and a take-up rate for these services of at least 50%.*

In 2002-03 we continued to make it easier for more and more of our customers to do business with us electronically. We made further significant investments in consolidating, developing and promoting electronic services during the year and over half of our core services are now available online.

We promoted increased take-up of the Internet service for Self Assessment (SA) by improving the user-friendliness of our online return. In 2002-03, 335,639 SA returns for 2001-02 were submitted over the Internet, more than four times the number for the corresponding period in the previous year. In the meantime, the Electronic Lodgement Service (for use by SA customers' agents) has also continued to grow steadily, with 370,051 returns filed this way in 2002-03.

PSA target 4: *Improve value for money by achieving annual productivity gains of at least 2.5% per year until March 2004, without detriment to accuracy or customer satisfaction.*

We measure annual productivity by comparing the volumes of tax processing work, tax credit decisions and National Insurance (NI) work items handled with the number of staff deployed. During 2002-03 we exceeded the targets for tax processing, tax credits and NI productivity. However, we missed accuracy targets. For Self Assessment cases we just missed the stretching accuracy target of 95%, achieving 94%. For cases outside of Self Assessment, we met our overall accuracy target (95.5%) but missed our target of 90% for cases handled directly by staff (achieving 88%). We also missed our accuracy targets for dealing with Working Families' and Disabled Person's Tax Credits (targets 93% for both and achieved 88.6% and 91.7% respectively) and repayment claims in our specialist repayment offices (target 96% and actual 95%).

PSA target 5: *Achieve a 2.5 point improvement in customer service by March 2004, as measured by an annual customer service index.*

The 2002 survey produced an indicator (rounded down) of 69 (out of 100). This represents an overall increase of 1 point on last year's indicator and is mainly attributable to an improvement in the scores for the ease of which they coped with the basic forms, processes and guidance.

In July 2002, the Tax Credit Act 2002 received Royal Assent and was followed by regulations setting out the detailed entitlement rules. During 2002-03, we made the final preparations for the start of the Child and Working Tax Credits in April 2003. These new credits replace the Working Families' Tax Credit, Disabled Person's Tax Credit and the Children's Tax Credit (and from 2004, the child elements of Income Support and Jobseeker's Allowance), with a single system of support for families with children. Claims forms were issued from August 2002 and supported by a comprehensive advertising and information campaign to encourage people to claim in good time. By the 2003 Budget, 3.9 million claims had been received. It is estimated that around five million families will receive tax credits in 2003-04.

The following three main events will affect future accounting periods:

- From 1 April 2003 the Inland Revenue started to pay new tax credits, the Child Tax Credit and Working Tax Credit, to families with children and individuals in work under certain circumstances. The administration costs will be accounted for in the Department's Resource Accounts. The payment of tax credits will, as now for Working Families Tax Credits and Disabled Person's Tax Credits, be accounted for in the Trust Statement.
- The Inland Revenue assumed responsibility for Child Benefit from 1 April 2003 (payments of approximately £8 billion/year). The costs of administering Child Benefit and the programme expenditure itself will both be accounted for in the Department's Resource Accounts.
- The Inland Revenue is conducting a commercial competition to re-let the Department's IT contracts (known as ASPIRE - Acquiring Strategic Partners for the Inland Revenue). The tendering for this contract is at an advanced stage and is due to be concluded by the end of 2003, with the new contract coming into force during 2004.

The Inland Revenue's website (www.inlandrevenue.gov.uk) includes the published Investment Strategy. The main features affecting the Resource Accounts are:

- The commercial competition to replace our IT contracts with EDS and Accenture (mentioned above). The new contract aims to facilitate business change to deliver our strategic objectives including joining-up Government services, where necessary, and to deliver high standards of IT infrastructure.
- A joint PFI, with HM Customs & Excise, to relocate a substantial part of our Head Office function, in late 2004, to Great George St., London. This is in addition to the existing premises PFI contract and the other accommodation PFI contracts.

Other elements of our investment strategy are customer focused, such as implementing proposals from the Patrick Carter Review of Payroll Services, Electronic Service Delivery and Improving Cashflow. These investments are aimed at improving:

- Services to Inland Revenue customers - the cashflows from which are accounted for in the Trust Statement; and
- The Cost/Yield Ratios, which are included in the Commissioners' Annual Report due to be published in the Autumn of 2003.

Total expenditure for the year was £121m (4.4%) below the amount authorised by Parliament. Reasons for the underspend are set out in the notes to Schedule 1 on page 14 of these Resource Accounts.

Management

The Chairman of the Board of Inland Revenue is accountable to Gordon Brown MP, the Chancellor of the Exchequer, Dawn Primarolo MP, the Paymaster General, has day-to-day responsibility for the Department.

During 2002-03, the Statutory Board of the Inland Revenue comprised:

Chairman	- Sir Nicholas Montagu KCB
Deputy Chairmen	- Tim Flesher CB *
	- Ann Chant CB
Head of Revenue Policy	- Dave Hartnett CB
Chief Executive Valuation Office Agency	- Michael Johns CB

The Statutory Board was assisted by non-executive members Rene Carayol, Dorothy Dalton, Kate Owen and Pat Stafford forming the Departmental Board.

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

The Remuneration of the Members of the Statutory Board (see note 2C to these Resource Accounts) was determined in accordance with the report of the Senior Salaries Review Body.

* Tim Flesher left the Department on 11 April 2003, having been appointed Deputy Chief of Defence Logistics at the Ministry of Defence and was succeeded by Helen Ghosh, previously Director of the Machinery of Government Secretariat in the Cabinet Office.

Pensions

Present and past employees are covered by the provisions of the Principal Civil Service Pension Scheme (PCSPS) which is non-contributory and non-funded (note 1.10).

Diversity and Equality

Our diversity and equality policy aims to enable everyone to give their best, valuing differences in people and harnessing those differences to improve our work for the benefit of all our different customers. We will not unlawfully or unjustifiably discriminate against anyone on any grounds, including their race, colour, nationality, ethnic or national origin, sex or sexual orientation, working pattern, marital status, religion, gender reassignment, disability or age. We will act positively to address under-representation, particularly of women, people from ethnic minorities and people with disabilities. In Northern Ireland, we will also eliminate unfair discrimination because of political opinion and act positively to address under-representation of people due to their religious beliefs or political opinions.

Policy on Payment of Suppliers

Where there is no contractual provision or other understanding or accepted practice governing the timing of payment, the Department will 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 2002-03 99.35% (2001-02 98.90%) of suppliers were paid within 30 days.

Auditors

The Comptroller and Auditor General audits these Resource Accounts in accordance with section 6 of the Government Resources and Accounts Act 2000.

Sir Nicholas Montagu KCB
Accounting Officer

Date 27 October 2003

STATEMENT OF ACCOUNTING OFFICER'S RESPONSIBILITIES

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 (Appendix 1), detailing the resources acquired, held, or disposed of during the year and the use of resources by the Department during the year.

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 cashflows for the financial year.

In my role as Chairman of the Board of Inland Revenue, HM Treasury has appointed me as the Department's principal Accounting Officer with responsibility for preparing the Department's accounts and for transmitting them to the Comptroller and Auditor General.

In preparing the accounts, as Accounting Officer, I am required to comply with the Resource Accounting Manual prepared by HM 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;
- prepare the accounts on a going concern basis.

In addition, HM Treasury has appointed an additional Accounting Officer to be accountable for that part of the Department's accounts relating to specified requests for resources and the associated assets, liabilities and cashflows. The appointment does not detract from the Head of Department's overall responsibility as Accounting Officer for the Department's accounts.

The allocation of Accounting Officer responsibilities in the Department are:

Sir Nicholas Montagu KCB:-

Request for Resources 1:
Enabling businesses and individuals to understand and comply with their obligations in respect of their dealings with the Inland Revenue.

Request for Resources 3:
Providing payments in lieu of tax relief to certain bodies

Michael Johns CB:-

Request for Resources 2:
Growing a contribution to the good management of property where the public interest is involved.

Request for Resources 4:
Making payments of rates to Local Authorities on behalf of certain bodies.

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. Under the terms of the Accounting Officer's Memorandum, the relationship between the Department's principal and additional Accounting Officer, together with their respective responsibilities, is set out in writing.

Sir Nicholas Montagu KCB Date 27 October 2003
Accounting Officer

STATEMENT ON INTERNAL CONTROL

This statement is given in respect of the Resource Accounts, which incorporate the transactions and net assets of the Core Department and the Valuation Office Agency (VOA) which falls within the departmental boundary for resource accounting purposes.

The Chief Executive of the VOA is responsible for the maintenance and operation of the system of internal control in that body and has signed a statement relating to that system which is reproduced in the accounts of the Agency. As Accounting Officer for the Inland Revenue, I am responsible for ensuring that the Department and Agency maintain and operate a sound system of internal control that supports the achievement of departmental policies, aims and objectives whilst safeguarding the public funds and departmental assets, for which I am personally responsible.

The Department's control framework is designed to manage rather than eliminate the risk of failure to achieve departmental aims and objectives. It can therefore provide only reasonable and not absolute assurance of effectiveness.

During the year ended 31 March 2003 (and up to the date of approval of the annual report and accounts) we have made further progress in embedding risk management and the Department is now compliant with the requirements set out in DAO (GEN) letter 13/00. Work on improving risk management will continue, in particular taking forward the risk improvement programme arising from the Cabinet Office's recent risk report, "Risk: Improving Government's Capability to Handle Risk and Uncertainty" Strategy Unit Report, November 2002.

As Accounting Officer, I also have responsibility for reviewing the effectiveness of the system of internal control. The main elements of the Department's control framework are set out below.

Control Environment

- I have a clearly defined 'Statement of Accounting Officer (AO) Responsibilities' (which forms part of these resource accounts).
- There is a departmental committee structure, with clear terms of reference and defined membership. There are four non-executive members on the Departmental Board, one of whom chairs the Departmental Audit & Security Committee (DASC). The DASC meets three times a year. The Departmental Management Committee (DMC) meets fortnightly to consider the plans and strategic direction of the Department. The Departmental Finance Committee (DFC) meets at least three times a year, at appropriate intervals in the budgeting cycle, and any other meetings as necessary. DFC considers how best to deploy financial resources and has a non-executive member among its membership.
- In 2001-02 we drew up a new accountability framework for operational Directors. During 2002-03 we have agreed frameworks for the corporate support, policy and other head office Directors and these came into effect on 6 June 2003. These frameworks clarify generic corporate accountabilities and complement our primary mechanisms for business accountabilities, which are the Operating Plans for each business area and the individual performance agreements that are agreed annually. Frameworks for Board members will be drawn up during 2003-04.
- There is detailed guidance on standards of behaviour and conduct, diversity and equal opportunities on the Revenue intranet. The initial extensive fraud awareness programme, carried out by Internal Audit, was attended by 95% of all staff. A Fraud Awareness module is included in the National Induction Programme to ensure new members of staff receive the necessary awareness information. Following analysis of results from the initial programme new fraud awareness initiatives are being considered for launch in 2003-04. In February 2003, our new policy on computer misuse was launched jointly by the Board and the Trade Unions. Every member of staff has received a copy of the policy.

New Business Developments

Mapeley – STEPS (Strategic Transfer of the Estate to the Private Sector)

Following the 1998 Comprehensive Spending Review, it was proposed that Customs and Excise and the Inland Revenue (including the Valuation Office Agency) should outsource their accommodation requirements. Following an open competition, the contract was awarded to the Mapeley STEPS Contractor Ltd.

The contract was structured so that in return for the transfer of their properties to Mapeley STEPS Ltd, the Inland Revenue and Customs & Excise received an up front cash payment of £220 million, together with a further £150 million in the form of lower service prices. Under the contract, the Departments pay a "Facilities Payment" in return for the provision of fully serviced accommodation.

Issues arose during the procurement and early stages of the contract which should have been referred to the Customs and Inland Revenue Boards, and to Ministers, earlier than they were. We have learnt lessons from how the procurement, and the management of the early stages of the contract, were handled. In particular, we have taken steps to improve the management of our processes to ensure that senior managers are aware of significant issues as they arise. Major procurement projects and other programmes are now handled following the OGC recommendations in "Managing Successful Programmes", including the appointment of a Senior Responsible Owner (SRO) who will usually be a Board member. The SRO will chair the project/programme Board. They may also attend other key meetings to ensure that they are fully informed and discharge their responsibilities for its success, including realising the benefits. We have also issued further guidance on a number of related matters.

The head of the IR procurement section has issued guidance to all budget holders on the need to establish the group structure and tax planning arrangements of all bidders at an early stage of a procurement process and we will look at the conclusions and recommendations set out in the Treasury Select Committee report on 23 July 2003 to see if we need to make further changes to our guidance.

The further guidance on procurement issues recently sent to Accounting Officers by the Treasury has been circulated to all Directors.

Guidance drawing explicitly on Government Accounting has been issued, covering all the relevant considerations that need to be taken into account if issuing a "letter of comfort".

Tax Credits

The Committees described above all consider tax credits issues regularly. But in addition, there are particular arrangements in place for managing tax credits. The SRO, a main Board member and Deputy Chairman, chairs a Programme Board which includes the Deputy Chairman responsible for business operations as well as other senior officials from this Department, DWP and from EDS. This Programme Board meets fortnightly. The governance arrangements for tax credits have been reviewed by OGC and found to be exemplary. The SRO and the Deputy Chairman responsible for business operations have closely monitored the implementation of the new credits instigating contingency procedures and re-deploying resources where difficulties have been experienced. They will also lead in identifying the lessons to be learned.

Risk Management

We continue to build on the progress we have made in embedding risk management processes in the Department.

Capacity to Handle Risk

In recognition of my personal responsibility, as Accounting Officer, for ensuring that we have effective risk management arrangements in the Department, I lead the risk management reviews at our DMC meetings.

We are continually looking at ways to improve the strategic risk management process. As a result of discussions I had with the Risk Support team and their chair of DASC, we have decided to set up a senior risk review group to examine risks and action plans in greater depth.

Risk management guidance is available to our staff through the intranet and the Risk Support team provide additional advice and support (for example through presentations to staff, or by running risk workshops).

<u>The Risk Environment</u>

The model of risk management that we have adopted requires upward reporting of risks (to ensure comprehensive risk identification) and risk stewardship arrangements which are top-down.

There is ownership of the most significant risks by individual Board members, with responsibility for managing them assigned to individual Directors.

Our risk management strategy requires teams throughout the Department to identify risks as part of their annual planning cycle and include details of their top risks in regular performance reports.

Control Activities

We have comprehensive procedures covering all aspects of the conduct of business. Financial procedures are set out in the Finance Manual and the Inland Revenue "Guide" for staff, which are available on our intranet.

Information & Communication

- In September 2002 we appointed our first Director of Information Resources. The Departmental Information Strategy, which was agreed at DMC in February 2003, has three main principles:
- to manage our data, knowledge and information as a shared resource;
- to make sure that people who work with data, information and knowledge can do so quickly, easily and cost effectively; and
- to make sure that the data, information and knowledge we have is accurate, up to date and complete.
- In 2001-02 we started to develop a Balanced Scorecard to provide the Board with regular performance information on our strategic business drivers. The scorecard has been going through a process of refinement, in discussion with the Board, to ensure it meets their strategic needs.
- We have continued with our programme of Modernisation Seminars. These are designed to develop all leaders to the same level of commitment to the Core Purpose and change and enable them to communicate this message to their teams. A Board member delivers a session to each seminar. During 2002-03, there were 525 participants at 26 events.
- Apart from their involvement in Modernisation Seminars, Board members and Directors have been active in explaining to staff the detail and implications of the Core Purpose and the transformation agenda through:
  - articles in internal publications;
  - attendance at Departmental conferences and seminars;
  - personal visits to local offices; and
  - telephone open days for staff.

In addition, I took part in a week long ‘back to the floor’ event in one of our area offices.

To communicate and embed the Revenue’s Core Purpose to all of our staff, we have begun a programme of modular-based interactive workshops which are designed to allow staff to discuss the key challenges facing the Revenue today. At the end of September 2003, 96% of all Revenue staff had completed two of the four modules.

Monitoring

- We have a security assurance process which requires Directors to certify annually that their teams have carried out mandatory security checks. These checks, which are detailed in the Security Assurance Manual, cover the following main areas:
  - Buildings and fixed assets;
  - IT and information systems;
  - Financial Control; and
  - People.
- The Director of Internal Audit reports regularly to the DASC to standards defined in the Government Internal Audit Manual. These reports include the Director of Internal Audit's opinion on the adequacy and effectiveness of the Department's system of risk management, control and governance.
- The external independent Chair of the DASC reports to me.
- We have Annual Regularity & Propriety reviews, with a briefing to the Principal Finance Officer about the effectiveness of internal financial controls.
- We undertake assessments of compliance with the principal recommendations in the Cabinet Office report "Successful IT: Modernising Government in Action".
- The Adjudicator reports quarterly on the outcome of complaint cases.
- My assessment of the effectiveness of the system of internal control is based on the work of the internal auditors and reports from the chair of the DASC and is also informed by regular reports and updates from senior managers.
- In making my assessment, I also take account of the management letters made by the NAO, the C & AG's report to Parliament, and of the findings of the Committee of Public Accounts (PAC).

Sir Nicholas Montagu KCB
Accounting Officer

Date 27 October 2003

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 14 to 41 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 21 to 24.

Respective Responsibilities of the Accounting Officer and Auditor

As described on page 7, the Accounting Officer is responsible for the preparation of the financial statements and for ensuring the regularity of financial transactions. The Accounting Officer is also responsible for the preparation of the other contents of the Annual Report. My responsibilities, as independent auditor, are established by statute and guided by the Auditing Practices Board and the auditing profession's ethical guidance.

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 3 to 6 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 8 to 11 reflects the Department's compliance with Treasury's guidance *Corporate Governance: Statement on Internal Controls*. I report if it does not meet the requirements specified by the Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements.

Basis of 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, 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 conformed 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 Inland Revenue at 31 March 2003 and of the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the year then ended, and the statements have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by the Treasury;
- 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

30 October 2003

National Audit Office
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Schedule 1

Summary of Resource Outturn for 2002-03	2002-03							2001-02
	Estimate			**Outturn**				
	Gross expenditure	A in A	NET TOTAL	Gross expenditure	A in A	NET TOTAL[1]	Net total Outturn compared to Estimated Saving/ (excess)	Prior year Outturn
	1	2	3	4	5	6	7	8
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Administration	2,919.9	(411.7)	2,508.2	2808.7	(411.6)	2,397.1	111.1	2,115.5
Valuation Office Agency	172.5	(172.5)	-	162.2	(162.2)	-	-	-
Payments in lieu of Tax Relief	201.0	-	201.0	192.6	-	192.6	8.4	227.6
Payments of Local Authority Rates	31.6	(3.1)	28.5	30.0	(3.1)	26.9	1.6	24.5
Total Resources	**3,325.0**	**(587.3)**	**2,737.7**	**3,193.5**	**(576.9)**	**2,616.6**	**121.1**	**2,367.6**
Non Operating Cost								
A in A (Note 5)	**-**	**-**	**7.9**	**-**	**-**	**7.4**	**0.5**	**2.3**
Net Cash Requirement	**-**	**-**	**2,685.2**	**-**	**-**	**2,514.6**	**170.6**	**2,392.3**

Reconciliation of Resources to Cash Requirement	Note	**£m**	**£m**	**£m**
Net Total Resources (schedule 2)		**2,737.7**	**2,616.6**	**121.1**
Capital :				
Acquisition of fixed assets	9 and 10			
Cash purchase		175.5	135.5	40.0
Finance lease		-	25.7	(25.7)
Investments		-	-	-
Non operating A in A				
Book value of fixed asset disposals		(7.9)	(7.4)	(0.5)
Accruals adjustments:				
Non cash items	3	(249.2)	(258.0)	8.8
Capital repayment of finance leased assets [2]		-	(25.7)	25.7
Changes in working capital other than cash	11	20.5	(16.8)	37.3
Changes in creditors falling due after more than one year [2]	15	-	32.7	(32.7)
Use of provisions	16	8.6	12.0	(3.4)
Net Cash Requirement (schedule 4)		**2,685.2**	**2,514.6**	**170.6**

The notes on pages 21 to 41 form part of these accounts.

Explanation of the variation between Estimate and Outturn:

Resource expenditure for the year was £121m below the amount authorised by Parliament, mostly relating to underspends on central initiatives and projects. Delivery of the projects mentioned below remains on track. Underspends include:

- a reprofiling of expenditure on several large modernisation projects, designed to deliver the Governments targets. Main underspends in respect of E-business (£5m) and the modernising of PAYE returns (£30m).
- an underspend on the Transformation Fund, set up at the end of last year to improve efficiency (£13m).
- the slower recruitment of staff than expected for new Inland Revenue business (£9m).
- an underspend on programme expenditure in respect of Payments in lieu of Tax Relief (£8m) and Payments of Local Authority Rates (£2m).

The remaining underspend was spread across both core and developmental business areas.

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

The net cash requirement was £171m less than estimated. The shortfall was due to the reduction in expenditure detailed above, and a decrease in debtors resulting from improved debt recovery practices, particularly in relation to inter departmental transactions and an increase in creditors, where a larger creditor figure was identified at the year end.

The notes on pages 21 to 41 form part of these accounts.

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 (cash receipts being shown in italics).

		Forecast 2002-03		Outturn 2002-03	
		Income	*Receipts*	Income	*Receipts*
	Note	£m	*£m*	£m	*£m*
Operating Income and receipts - excess A in A	5	-	-	(27.2)	*(27.2)*
Non-operating Income and receipts - excess A in A	17	-	-	(3.0)	*(3.0)*
Subtotal [3]		**-**	-	**(30.2)**	*(30.2)*
Other operating Income and receipts not classified as A in A	5	-	-	(0.2)	*(0.2)*
Other non-operating Income and receipts not classified as A in A	Schedule 4	(40.1)	*(40.1)*	(80.8)	*(80.8)*
Other amounts collectable on behalf of the Consolidated Fund	5	-	-	-	-
Total [4]		**(40.1)**	*(40.1)*	**(111.2)**	*(111.2)*

[1] **Actual outturn - resources:**

Administration: Actual amount net resources outturn £2,397,052,803.03. Actual amount of savings in resource over Estimate: £111,120,196.97.

Valuation Office Agency: Actual amount net resources outturn £Nil. Actual amount of savings in resource over Estimate: £Nil.

Payments in Lieu of Tax Relief: Actual amount net resources outturn £192,694,166.40. Actual amount of savings in resource over Estimate: £8,305,833.60.

Payments of Local Authority Rates: Actual amount net resources outturn £26,899,990.42. Actual amount of savings in resource over Estimate: £1,600,009.58.

[2] The capital repayment of finance leased assets is represented by assets acquired under finance leases in the year.

The movement in creditors over one year in Schedule 1 is represented by the net value of both the capital repayment of finance leased assets and changes in creditors in note15 falling due after more than one year.

Actual outturn - cash:

Net cash requirement: Outturn net requirement £2,514,585,669.11 which is £170,642,330.89 less than Estimate.

[3] Of this amount, £nil has been applied to the Excess Vote, leaving a balance of £30,206,352.52 surrenderable to the Consolidated Fund

[4] The actual receipts were [surrenderable to the Consolidated Fund] £nil has been applied to the Excess Vote, leaving a balance of £111,191,749.81 surrenderable to the Consolidated Fund.

The notes on pages 21 to 41 form part of these accounts.

Schedule 2

Operating Cost Statement
for the year ended 31 March 2003

	Note	2002-03		2001-02	
		£m	£m	£m	£m
Administration Costs					
Staff costs	2		1,659.9		1,565.0
Other administration costs	3		1,293.9		1,121.9
Gross administration costs			**2,953.8**		**2,686.9**
Operating income	5		(581.9)		(591.2)
Net administration costs			**2,371.9**		**2,095.7**
Programme costs					
Payments of Local Authority Rates:					
Expenditure	4	30.0		28.2	
Less: Income	5	(5.3)	24.7	(7.6)	20.6
Payments in lieu of tax reliefs:					
Expenditure	4	192.6		227.6	
Less: Income		-	192.6	227.6	-
Net programme costs	4		**217.3**		**248.2**
Net Operating Cost	7		**2,589.2**		**2,343.9**
Net Resource Outturn	7		**2,616.6**		**2,367.6**

All income and expenditure are derived from continuing operations.

Statement of Recognised Gains and Losses
for the year ended 31 March 2003

	2002-03	2001-02
	£m	£m
Net gain/ (loss) on revaluation of tangible fixed assets	3.9	(2.5)
Total recognised gains and losses for the financial year	**3.9**	**(2.5)**

The notes on pages 21 to 41 form part of these accounts.

Schedule 3

Balance Sheet
as at 31 March 2003

	Note	31 March 2003 £m	31 March 2003 £m	31 March 2002 £m	31 March 2002 £m
Fixed Assets					
Tangible assets	10		**445.3**		**484.1**
Debtors falling due after more than one year	13		**135.2**		**141.1**
Current assets					
Stocks	12	5.9		4.8	
Debtors	13	144.2		161.7	
Cash at bank and in hand	14	159.1		139.2	
		309.2		305.7	
Creditors (amounts falling due within one year)	15	(311.8)		(293.1)	
Net Current (Liabilities)/Assets			**(2.6)**		**12.6**
Total assets less current liabilities			**577.9**		**637.8**
Creditors (amounts falling due after more than one year)	15	(0.1)		(7.1)	
Provisions for liabilities and charges	16	(46.2)		(27.2)	
			(46.3)		**(34.3)**
			531.6		**603.5**
Taxpayers' Equity					
General Fund	17		526.4		586.4
Revaluation Reserve	18		5.2		17.1
			531.6		**603.5**

Sir Nicholas Montagu KCB
Accounting Officer

Date 27 October 2003

The notes on pages 21 to 41 form part of these accounts.

Schedule 4

Cash Flow Statement
for the year ended 31 March 2003

	2002-03 £m	2001-02 £m
Net cash outflow from operating activities (Note a)	(2,306.6)	(2,150.0)
Capital expenditure and financial investment (Note b)	(128.7)	(129.0)
Receipts due to the Consolidated Fund which are outside the scope of the Department's activities	80.8	53.4
Payments of amounts due to the Consolidated Fund	(81.0)	(103.9)
Financing (Note c)	2,455.4	2,342.0
Increase/(Decrease) in cash in the period	19.9	12.5

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 reconciliation to the net cash requirement.

(a) Reconciliation of operating cost to operating cash flows	2002-03	2001-02
Net operating cost	**2,589.2**	**2,343.9**
Less interest on finance leased assets	(0.2)	(9.1)
Adjustments for non-cash transactions (see note 3a)	(261.4)	(174.7)
Adjustments for movements in working capital other than cash (see Note 11)	(33.0)	(22.8)
Use of provisions	12.0	12.5
Net cash outflow from operating activities	**2,306.6**	**2,149.8**

(b) Analysis of capital expenditure and financial investment	2002-03	2001-02
Tangible fixed asset additions	161.2	155.7
Finance Lease acquisitions	(25.7)	(31.9)
Proceeds of disposal of fixed assets	(7.0)	(3.9)
Interest element of finance lease	0.2	9.1
Net cash outflow from investing activities	**128.7**	**129.0**

(c) Analysis of financing and reconciliation to the net cash requirement	2002-03	2001-02
From the Consolidated Fund (Supply) - current year [1]	2,486.9	2,469.5
From the Consolidated Fund (Supply) - prior year [2]	1.3	-
Capital element of payments in respect of finance leases and on-balance sheet PFI contracts	(32.8)	(127.5)
Net financing	**2,455.4**	**2,342.0**
(Increase)/Decrease in cash (see note 14)	(19.9)	(12.5)
Net cash flows other than financing	**2,435.5**	**2,329.5**
Adjustments for payments and receipts not related to Supply:		
Amounts due to the Consolidated Fund - received and not paid over	38.9	12.7
Amounts due to the Consolidated Fund - received in a prior year paid over	(8.8)	(35.6)
Add: Supply-financed repayments of financing		
Capital element of payments in respect of finance leases and on-balance-sheet PFI contracts	32.8	127.5
Transitional Adjustments (see note 11)	16.2	(41.8)
Net cash requirement (Schedule 1)	**2,514.6**	**2,392.3**

[1] Amount of grant actually issued to support the net cash requirement = £2,486,952,000.00
[2] Amount of grant actually issued to support the prior year net cash requirement = £1,332,516.71

The notes on pages 21 to 41 form part of these accounts.

Schedule 5

Resources by Departmental Aim and Objectives
for the year ended 31 March 2003

	2002-03			2001-02		
	Gross	Income	Net	Gross	Income	Net
	£m	£m	£m	£m	£m	£m
Aim: To administer the tax system fairly and efficiently, make it as easy as possible for individuals and businesses to understand and comply with their obligations and receive their tax credit and other entitlements.						
Objectives						
To collect the right revenue and give the right entitlements, at the right time. We have subdivided this objective into the following four activities:						
Activity 1 – bringing into the Exchequer the taxes, national insurance contributions and other receipts, maintaining contributory records and disbursing tax reliefs and credits, for which the Revenue are responsible;	2,923.9	(409.5)	2,514.4	2,751.9	(441.2)	2,310.7
Activity 2 – providing Ministers with high quality analysis and advice on direct tax and national insurance contribution policy reflecting the government's tax objectives;	60.9	-	60.9	21.8	(0.1)	21.7
Activity 3 – providing high quality valuation services for rating, council tax and other public sector purposes;	161.6	(172.4)	(10.8)	156.0	(165.1)	(9.1)
Activity 4 – collecting and making payments of local authority rates in respect of government departments and others.	30.0	(5.3)	24.7	28.2	(7.6)	20.6
Net Operating Costs (Schedule 2)	**3,176.4**	**(587.2)**	**2,589.2**	**2,957.9**	**(614.0)**	**2,343.9**

[1] See note 19 for the basis of the distribution of capital employed, administration costs and income amongst objectives.

The notes on pages 21 to 41 form part of these accounts.

Notes to the Departmental Resource Accounts

1 Statement of Accounting Policies

The financial statements have been prepared in accordance with the 2002-03 Resource Accounting Manual (RAM) issued by HM Treasury. The accounting policies contained in the RAM follow UK generally accepted accounting practice (UK GAAP) for companies 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 which has been 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 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 include the revaluation of fixed assets at their value to the business by reference to their current costs. The accounts comply with the accounting principles and policies laid down in the Resource Accounting Manual issued by HM Treasury, as supplemented by specific Treasury guidance or direction.

1.2 Basis of Consolidation

These accounts comprise a consolidation of the core Department and the Valuation Office Agency, which fall within the Departmental boundary as defined in the Resource Accounting Manual (Section 1.5) issued by HM Treasury. Transactions between entities included in the consolidation are eliminated. Financial information about the Valuation Office Agency is published separately from these Resource Accounts in the Agency's annual report and accounts.

1.3 Tangible Fixed Assets

Except for furniture utilised by the Core Department (see below), tangible fixed assets are stated at the lower of replacement cost and recoverable amount. Generally, expenditure on tangible fixed assets of over £1,000 is capitalised. On initial recognition they are measured at cost including any costs such as installation directly attributable to bringing them into working condition. Appropriate indices are applied to each class of asset shown in note 1.4 for all assets which have not been formally valued during the year. Following guidance from the Office of National Statistics, a new index has been applied to all IT assets and this has resulted in a significant reduction in the value of those assets as at 31 March 2003.

All property assets, with the exception of Sheraton House, were transferred from the Inland Revenue to Mapeley STEPS Ltd., in March 2001, under a twenty-year Private Finance Initiative (PFI) contract. Sheraton House is unoccupied and is in the process of being disposed of. It is included as a fixed asset in these accounts. Other freehold land and buildings included in note 10 relate to costs of refurbishments of properties occupied by the Valuation Office Agency.

For the Core Department, the value and depreciation of furniture are estimated on the basis of average the 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. This methodology provides a reasonable approximation of the actual values and depreciation that would have been available had the Department maintained detailed records for the hundreds of thousands of individual items of furniture, which individually are of relatively low value, but collectively are material to these accounts. Adopting this capitation estimating method avoids the Department having to incur significant costs in maintaining and validating detailed records.

The computer equipment used by the computer services partner, Electronic Data Systems Ltd. (EDS), is subject to a finance lease (note 21).

National tax system computer software, including new Tax Credit software, that has been developed by the Department and its partner (EDS), and for which the Department has ownership rights e.g. the corporate tax collecting software, has been capitalised. This capitalisation includes the cost of staff and mainframe resources used in the development of the programs.

1.4 Depreciation

Depreciation is provided at rates calculated to write down their values to their residual values on a straight line basis over their estimated useful lives. Freehold land is not depreciated since it has an unlimited or very long estimated useful life. Asset lives are normally as follows:

Freehold buildings	up to 60 years
Building refurbishments	4 to 7 years
Leasehold buildings	period of the lease
Office equipment and furniture	10 years
Desktop computer equipment	3 years
Other computer equipment including mainframe hardware	5 years
Vehicles	3 or 7 years
Developed software	up to 10 years
EDS held computer assets	5 years (desktop) and 7 years (mainframe)

1.5 Stocks and Work-in-Progress

Stocks and work-in-progress are valued as follows:

i. stocks (mainly leaflets and forms) held in official stores for future use or free issue to the general public are valued at a weighted average cost, after making due allowance for obsolescence.

ii. work in progress relates to the Valuation Office Agency only and is an accounting estimate determined by applying the lower of selling price or an outturn unit cost for each type of work to the number of outstanding cases at year-end.

1.6 Operating Income

Operating income relates directly to the operating activities of the Department and comprises fees and charges for services provided to external customers and public sector repayment work. It includes both operating income appropriated-in-aid of the Estimate and income to the Consolidated Fund which in accordance with the RAM is to be treated as operating income. Operating income is stated net of VAT.

1.7 Administration and Programme Expenditure

The operating cost statement is analysed between administration and programme costs. Administration costs reflect the costs of running the Department. These include both those administrative costs through the Departmental Expenditure Limits, and those that are in the Annually Managed Expenditure (capital charges other than those on the civil estate and all other non-cash items), together with associated operating income. Income is analysed in the notes between that which 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 by the Department.

1.8 Capital Charge

A notional capital charge, reflecting the cost of capital utilised by the Department, is included in operating costs and calculated at the Government's standard rate of 6% (2001-02 6%) in real terms on the average carrying amount of all assets less liabilities after adjusting for balances in respect of cash balances with the Office of the Paymaster General and taxes, duties and other items outside the boundary of resource accounting and budgeting.

1.9 Foreign Exchange

Transactions that are denominated in foreign currencies are translated into sterling at the rate of exchange ruling on the date of the transaction and any gain or loss on exchange is borne by the payer.

1.10 Pensions

Past and present employees are covered by the provisions of the Principal Civil Service Pension Scheme (PCSPS) which is a defined benefit scheme and is unfunded and non-contributory. 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.

1.11 Provisions

The Department provides for legal or constructive obligations which are of uncertain timing or amount at the balance sheet date on the basis of the best estimate of the expenditure required to settle the obligation. Where the effect of the time value of money is significant, the estimated risk-adjusted cash flows are discounted using the Treasury discount rate of 6 per cent in real terms.

1.12 Early departure costs

The Department is required to meet the additional cost of benefits beyond the normal PCSPS benefits in respect of employees who retire early. The Department provides in full for this cost when the early retirement programme has been announced and is binding on the Department. The Department has, in certain circumstances, settled some or all of its liability in advance by making a payment to the Paymaster General's account at the Bank of England for credit of the Civil Service Superannuation Vote.

1.13 Value Added Tax

Most of the activities of the Department 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 to the relevant expenditure category or included in the capitalised purchase cost of fixed assets. Where output tax is charged or input VAT is recoverable, the amounts are stated net of VAT.

1.14 Provision for Doubtful Debt

A general provision for doubtful debts has been made in respect of legal costs that have been awarded to the Department. These costs arise as a result of legal proceedings against taxpayers for the recovery of outstanding tax liabilities. The provision of 25% (2001-02 25%) has been estimated having regard to the level of debts not recovered during 2002-03.

A provision of 70% has been made in respect of penalty debtors (note 1.16) to allow for penalties which are remitted as they can subsequently cease to be collectable and for debts which the Department is unable to collect.

1.15 Leases

Where substantially all risks and rewards of ownership of a leased asset is borne by the Department it 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 straight-line basis over the term of the lease.

1.16 Penalty Debtors

HM Treasury has directed that income arising from the levying of tax penalties should be matched against the expenditure incurred in determining and collecting those debts. The penalties covered by HM Treasury directive exclude those where the Department and the taxpayer have agreed a settlement without recourse to the Commissioners, mainly Class 1A National Insurance Contributions settlements. The income generated from penalties are classified either as appropriations-in-aid, where there is a significant related cost, or CFER, where the penalty is levied automatically, such as self-assessment late filing, and little administrative expense is incurred. Penalties reported as CFER are shown on the basis of cash received.

1.17 Private Finance Initiative (PFI) Transactions

PFI transactions have been accounted for in accordance with Technical Note No. 1 (Revised) "*How to account for PFI transactions*" as required by the RAM. Where the balance of risks and rewards of ownership of the PFI property are borne by the PFI operator, the PFI payments are recorded as an operating cost. Where the Department has contributed assets a prepayment for their fair value is recognised and amortised over the life of the PFI contract. Where at the end of the PFI contract a property reverts to the Department, the difference between the expected fair value of the residual on reversion and any agreed payment on reversion is built up over the life of the contract by capitalising part of the unitary charge each year.

Where the balance of risks and rewards of ownership of the PFI property are borne by the Department it 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.

2. Staff Numbers and Costs

A. Staff costs consist of :-

	2002-03	2001-02
	£m	**£m**
Wages and salaries	1,389.3	1,305.6
Social Security costs	88.1	87.9
Other pension costs	182.5	171.5
Total	1,659.9	1,565.0

The Department does not pay the salary of the minister, Dawn Primarolo MP, who has responsibility for the Inland Revenue. This is paid out of central funds and can be found in HM Treasury resource accounts.

The PCSPS is an unfunded multi-employer defined benefit scheme but the Inland Revenue is unable to identify its share of the underlying assets and liabilities. A full actuarial valuation was carried out at 31 March 2000 and details can be found in the separate scheme statement of the PCSPS. For 2002-03, normal employer contributions of £182,483,108 (2001-02 £171,536,322) were payable to the PCSPS at rates in the range 12-18.5% (2001-02 12-18.5%) of pensionable pay. It has been agreed that contributions will remain at that level for the next two years. Employer contribution rates are reviewed every three years following a scheme valuation by the Government Actuary. The contribution rates reflect benefits as they are accrued, not when the costs are actually incurred; and they reflect past experience of the scheme.

B. The average number of whole-time equivalent persons employed (including senior management, special advisors, staff on secondment or loan into the Department and agency/temporary staff, but excluding staff on secondment to other organisations) during the year was as follows:

	2002-03	2001-02
	Number	Number
Assessment & Collection of Taxes, National Insurance Tax Credits [1]	66,740	62,323
Tax policy	535	537
Valuation	3,841	3,812
Payments of Local Authority Rates	2	2
TOTAL	**71,118**	**66,674**

[1] No specific staff resource is employed in the disbursing public expenditure for tax relief for mortgage interest and of other tax reliefs. These reliefs are given within the assessment and collection of taxes.

C. The salary and pension entitlements of the most senior members of the Inland Revenue were in the following ranges: -

	Age Years	Salary [a]		Real Increase in pension at age 60 [b]		Total accrued pension at age 60 at 31/03/03		Benefits in kind [c] (Rounded to the nearest £100)
		(£000)	(£000)	(£000)	(£000)	(£000)	(£000)	
		2002-03	2001-02	2002-03	2001-02	2002-03	2001-02	2002-03
Nick Montagu KCB *Chairman*	59	140-145	130-135	2.5-5.0	5.0-7.5*	50-55	45-50	
Tim Flesher CB *Deputy Chairman*	53	110-115	105-110	2.0-2.5	2.5-5.0	40-45	35-40	
Ann Chant CB *Deputy Chairman*	57	120-125	115-120	2.5-5.0	2.5-5.0	60-65	55-60	
Dave Hartnett CB *Head of Revenue Policy*	52	110-115	100-105	2.5-5.0	5.0-7.5*	35-40	30-35	300
Michael Johns CB *Chief Executive* *Valuation Office Agency*	56	105-110	100-105	2.5-5.0	2.5-5.0	45-50	40-45	

* The real increase in pension at 60 has been corrected.

Notes

A "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.

B Officials' pension benefits are provided through the Principal Civil Service Pension Scheme (PCSPS). From 1 October 2002, this may be in one of three statutory based "final salary" defined benefit schemes (Classic, Premium, and Classic Plus). New entrants after 1 October 2002 may choose between membership of premium or joining a good quality "money purchase" stakeholder based arrangement with a significant employer contribution (partnership pension account).

Classic Scheme

Benefits 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. Members pay contributions of 1.5 per cent of pensionable earnings. On death, pensions are payable to the surviving spouse at a rate of half the member's pension. On death in service, the scheme pays a lump sum benefit of twice pensionable pay and also provides a service enhancement on computing the spouse's pension. The enhancement depends on length of service and cannot exceed 10 years. Medical retirement is possible in the event of serious ill health. In this case, pensions are brought into payment immediately without actuarial reduction and with service enhanced as for widow(er) pensions.

Premium Scheme

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 commute some of their pension to provide a lump sum up to a maximum of 3/80ths of final pensionable earnings for each year of service or 2.25 times pension if greater (the commutation rate is £12 of lump sum for each £1 of pension given up). For the purposes of pension disclosure the tables assume maximum commutation. Members pay contributions of 3.5 per cent of pensionable earnings. On death, pensions are payable to the surviving spouse or eligible partner at a rate of 3/8ths the member's pension (before any commutation). On death in service, the scheme pays a lump-sum benefit of three times pensionable earnings and also provides a service enhancement on computing the spouse's pension. The enhancement depends on length of service and cannot exceed 10 years. Medical retirement is possible in the event of serious ill health. In this case, pensions are brought into payment immediately without actuarial reduction. Where the member's ill health is such that it permanently prevents them undertaking any gainful employment, service is enhanced to what they would have accrued at age 60.

Classic Plus Scheme
This is essentially a variation of Premium, but with benefits in respect of service before 1 October 2002 calculated broadly as per classic.

Pensions payable under Classic, Premium, and Classic Plus are increased in line with the Retail Prices Index.

C The estimated monetary value of benefits in kind covers any benefits provided and treated by the Inland Revenue as taxable income. Mr Hartnett had the private use of an allocated car in the circumstances permitted by the Civil Service Management Code.

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: -

	Age	Salary (£000)	
	Years	2002-03	2001-02
Rene Carayol *Non executive Board Member*	44	15.0-20.0	15.0-20.0
Dorothy Dalton *Non executive Board Member*	54	15.0-20.0	15.0-20.0
Kate Owen *Non executive Board Member*	52	15.0-20.0	15.0-20.0 *
Pat Stafford *Non executive Board Member*	42	20.0-25.0	30.0-35.0
Sue Wilson *Non executive Board Member* *Until May 2001*	51	-	0.0-5.0

* The prior year salary has been corrected; in the 2001-02 accounts the salary was incorrectly shown in the range of 20.0 to 25.0

3. Other Administration Costs

	2002-03 £m	2002-03 £m	2001-02 £m	2001-02 £m
Rentals under operating Leases				
Hire of plant and machinery		3.8		3.9
Other operating leases		11.3		34.6
		15.1		38.5
Interest charges				
Finance Leases		0.2		9.1
PFI service charges: [1]				
Off balance sheet contracts		221.4		207.2
Non cash items (Notes a & b)				
Depreciation and amortisation of fixed assets:				
Tangible fixed assets	97.3		124.6	
EDS share of discount on asset purchase	-		0.9	
Barter deal prepayments	4.2		4.2	
Net (profit)/loss disposal of assets	3.5		2.5	
Net (profit)/loss on revaluation	96.1		1.5	
Cost of capital charge	29.0		27.5	
Auditors remuneration and expenses	0.3		0.3	
Provision for liabilities and charges	25.2		3.2	
Provision for early departure costs	5.3		9.5	
Unwinding of early departure costs discounting	0.5		0.5	
		261.4		174.7
Other expenditure: [2]				
Travel, subsistence and hospitality		51.3		49.2
Accommodation Expenses		101.8		97.2
Staff Related Costs		5.8		2.1
Printing, Postage & Stationery		112.4		96.3
Telephone Expenses		24.7		20.1
IT & Office Equipment		280.4		278.2
Other miscellaneous expenditure		219.4		149.3
		1,293.9		1,121.9

[1] Discussions continue between the Inland Revenue, HM Customs and Excise and Mapeley STEPS Contractor Ltd about certain minor elements of charges relating to properties transferred in 2001 under a 20 year private finance initiative contract. Charges relating to the major elements of this contract are unaffected. The Department expects the financial impact of any changes relating to those elements still under discussion not to be material to these accounts.

[2] In 2001-02 other administrative expenditure was shown as a single figure of £643.2m. This has been presented in greater detail above.

Note a - the total of non-cash transactions included in the Reconciliation of Operating Costs to Operating Cashflows in Schedule 4 comprises:

	2002-03 £m
Other administration costs - non-cash items (as above)	261.4
Add: other non-cash amounts charged to operating expenditure	-
Less non-cash income	
– profit on sale of fixed assets	-
Total non-cash transaction	**261.4**

Note b - the total of non-cash items included in the Reconciliation of Resources to Net Cash Requirement in Schedule 1 comprises:

	£m
Total non-cash transactions as above	261.4
Adjustment for profits and losses on disposal of fixed assets	
– losses on disposal of tangible fixed assets	(4.6)
– profits on disposal of tangible fixed assets	1.2
Non-cash items per reconciliation of resources to net cash requirement	**258.0**

4. Net programme costs

	2002-03 £m	£m	2001-02 £m	£m
Life assurance premium relief, mortgage interest relief, private medical insurance premium relief, and vocational training relief		17.8		25.1
Remitted Stamp Duty		0.5		0.8
Transitional payments to charities		87.8		141.1
Supplement on payroll giving to charities		7.5		6.6
Stakeholder pensions		79.0		54.0
Payment of Local Authority Rates	30.0		28.2	
Less: programme income (Note 5)	(5.3)	24.7	(7.6)	20.6
		217.3		**248.2**

5. Income and Appropriations in Aid

Operating income

Operating income not appropriated in aid (i.e. transferred to the Consolidated Fund) is analysed for resource budget purposes between that which is included in public expenditure and that which is not (see note 7). In 2002-03 all operating income not classified as A in A was within public expenditure.

2002-03

Reconciliation to Operating Cost Statement

	Resource Outturn A in A	Transfer of estimate cover from Inland Revenue	Payable to Consolidated Fund	Operating Cost Statement Income
	£m	**£m**	**£m**	**£m**
Administrative income:				
Fees and charges to external customers	(185.9)	-	-	(185.9)
Fees and charges to other departments and the National Insurance Fund	(349.2)	-	(25.2)	(374.4)
Operating leases external income	(1.6)	-	-	(1.6)
Operating leases OGD income	(20.0)	-	-	(20.0)
	(556.7)	-	(25.2)	(581.9)
Programme income:				
Payments of local authority rates	(3.1)	-	(2.2)	(5.3)
Total	**(559.8)**	**-**	**(27.4)**	**(587.2)**

5. Income and Appropriations in Aid (continued)

	2001-02			
Administration income:				
Fees and charges to external customers	(181.7)	-	-	(181.7)
Fees and charges to other departments and the National Insurance Fund	(371.8)	-	(19.3)	(391.1)
Operating leases external income	(0.5)	-	-	(0.5)
Operating leases OGD income	(17.9)	-	-	(17.9)
	(571.9)		(19.3)	(591.2)
Programme income:				
Payments of local authority rates	(3.7)	-	(3.9)	(7.6)
Total	**(575.6)**	**-**	**(23.2)**	**(598.8)**

Non-operating appropriations in aid	**2002-03**	**2001-02**
	£m	£m
Principal repayment of voted loans	-	-
Disposal of fixed assets	(7.4)	(2.3)
	(7.4)	**(2.3)**

6. Administration Cost Limits

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

	2002-03		**2001-02**	
	Outturn **£m**	Limits **£m**	Outturn **£m**	Limits **£m**
Administration (Gross Limit)	2,546.3	2,644.6	2,376.8	2,436.5
Valuation Office Agency (Net Limit)	(16.7)	(6.6)	(10.6)	(6.1)
	2,529.6	**2,638.0**	**2,366.2**	**2,430.4**

7. Reconciliation of net operating cost to control total and net resource outturn

	2002-03 £m	**2001-02 £m**
Net operating cost (note a)	2,589.2	2,343.9
-Remove non-supply income scored as Consolidated Fund Extra Receipts (CFERs)	27.4	23.7
Net resource outturn (Note a)	**2,616.6**	**2,367.6**

Note a 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).

8. Analysis of Total Resources by spending body
This analyses funding by the Department to the relevant spending body.

Spending Body	2002-03		2001-02	
	Estimate	Outturn	Estimate	Outturn
	£m	**£m**	**£m**	**£m**
Core Department	2,709.2	2,589.7	2,524.6	2,332.5
Valuation Office Agency	28.5	26.9	31.2	11.6
	2,737.7	**2,616.6**	**2,555.8**	**2,344.1**

9. Analysis of capital expenditure, financial investment and associated Appropriations in Aid

	2002-03		
	Capital expenditure	A in A	Net Total
	£m	**£m**	**£m**
Administration	151.6	(3.1)	148.5
Valuation Office Agency	9.6	(0.9)	8.7
Total	**161.2**	**(4.0)**	**157.2**

	2001-02		
	£m	£m	£m
Administration	149.0	(2.1)	146.9
Valuation Office Agency	6.7	(0.2)	6.5
Total	**155.7**	**(2.3)**	**153.4**

10. Tangible Fixed Assets

	Freehold Land & Buildings	Office & Computer Equipment[2]	Vehicles	Furniture 1&2	Developed Computer Software	Software being developed	EDS held computer equipment[2]	Total
Cost or Valuation:	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
At 1 April 2002	8.9	206.8	16.4	124.9	383.9	54.6	315.1	1,110.6
Additions	1.7	30.2	-	11.2	2.4	90.0	25.7	161.2
Assets completed	-	-	-	-	33.1	(33.1)	-	-
Disposals	(0.3)	(55.9)	(11.1)	(5.1)	(48.6)	-	(1.7)	(122.7)
Revaluation	0.3	(37.4)	-	0.8	(100.6)	-	(154.3)	(291.2)
At 31 March 2003	**10.6**	**143.7**	**5.3**	**131.8**	**270.2**	**111.5**	**184.8**	**857.9**
Depreciation								
At 1 April 2002	(4.2)	(125.2)	(7.4)	(73.0)	(198.7)	-	(218.0)	(626.5)
Charged in year	(1.6)	(27.9)	(1.6)	(11.1)	(30.8)	-	(24.3)	(97.3)
Disposals	-	52.1	5.9	3.7	48.6	-	1.7	112.0
Revaluations	(0.1)	14.3	-	8.2	50.0	-	126.8	199.2
At 31 March 2003	**(5.9)**	**(86.7)**	**(3.1)**	**(72.2)**	**(130.9)**	**-**	**(113.8)**	**(412.6)**
Net Book Value:								
At 31 March 2003	4.7	57.0	2.2	59.6	139.3	111.5	71.0	445.3
At 1 April 2002	**4.7**	**81.6**	**9.0**	**51.9**	**185.2**	**54.6**	**97.1**	**484.1**

1 See note 1.3 for accounting policy for furniture.

2 Balances of £2.3m at 1 April 2002 have been restated to reflect the correct classification of computer equipment held by the Valuation Office Agency.

11. Movements in working capital other than cash

The movement in working capital used in the Reconciliation of resources to cash requirement comprises:

	2002-03 £m	2001-02 £m
(Decrease) / increase in stocks/work in progress	1.1	(2.9)
(Decrease) / increase in debtors	(4.2)	36.6
Decrease / (increase) in creditors falling due within one year	(29.9)	(56.5)
	(33.0)	**(22.8)**
Adjustment:		
movement in working capital not related to net operating costs	16.2	(41.8)
Net decrease in working capital other than cash	**(16.8)**	**(64.6)**

11. Movements in working capital other than cash (continued)
The movements in working capital other than cash used in the Cash Flow Statement comprises:

	2002-03 £m	2001-02 £m
(Decrease) / increase in stocks/work in progress	1.1	(2.9)
(Decrease) / increase in debtors	(4.2)	36.7
Decrease / (increase) in creditors falling due within one year	(29.9)	(56.6)
	(33.0)	**(22.8)**
Adjustment:		
movement in working capital not related to voted resource consumption (net)	-	-
Net decrease in working capital other than cash	**(33.0)**	**(22.8)**

12. Stocks and work in progress

	2002-03 £m	2001-02 £m
Stocks	3.6	3.0
Work in progress	2.3	1.8
	5.9	**4.8**

13. Debtors

	2002-03 £m	2001-02 £m
Amounts falling due within one year:		
Amounts falling due within one year:		
Trade debtors	5.1	6.1
Deposits and advances	9.9	9.7
VAT	34.0	34.4
Other debtors	47.4	58.5
Prepayments and accrued income	13.4	8.1
PFI Barter deals	4.4	4.5
Tax penalty debtors (note 1.16)	30.0	25.4
Amounts due from the Consolidated Fund in respect of supply	-	15.0
	144.2	**161.7**
Amounts falling due after more than one year:		
Other debtors	1.9	3.7
PFI Barter deals	133.3	137.4
	279.4	**302.8**

Loans have been advanced to staff in accordance with rules established for Government departments. At 31 March 2003 these totalled £3,338,592 (31 March 2002 £7,222,621) and were made to 5,015 (31 March 2002 4,972) members of staff.

14. Cash at Bank and in Hand

	2002-03 £m	2001-02 £m
Balance 1 April	139.2	126.7
Net change in cash balances:	19.9	12.5
Balance at 31 March	**159.1**	**139.2**
The following balances at 31 March are held at:		
Office of HM Paymaster General	159.3	139.2
Commercial banks and cash in hand	(0.2)	-
Balance at 31 March	**159.1**	**139.2**

The balance at 31 March comprises:

Cash due to be paid to the Consolidated Fund

	2002-03 £m	2001-02 £m
Amounts issued from the Consolidated Fund for supply but not spent at year end	116.3	111.5
Consolidated Fund extra receipts received and due to be paid to the Consolidated Fund	42.8	27.7
	159.1	**139.2**

15. Creditors

	2002-03 £m	2001-02 £m
Amounts falling due within one year:		
Other taxation and social security	(33.1)	(41.6)
Revenue banking	-	-
Trade creditors	(32.0)	(13.0)
Other creditors	(6.1)	(26.2)
Accruals and deferred income	(81.3)	(40.4)
Current part of finance leases	(0.2)	(1.6)
Current part of imputed finance lease element of on balance sheet PFI contracts	-	-
Amounts issued from the Consolidated Fund for supply but not spent at year end	(116.3)	(142.6)
Consolidated Fund extra receipts received and receivable and other payments due to be paid to the Consolidated Fund	(42.8)	(27.7)
	(311.8)	**(293.1)**
Amounts falling due after more than one year:		
Finance leases	(0.1)	(7.1)
Imputed finance lease element of on balance sheet PFI contracts	-	-
Total	**(311.9)**	**(300.2)**

16. Provisions for Liabilities and Charges

	Early Departure costs	Other	Total
	£m	**£m**	**£m**
Balance at 1 April 2002	(20.3)	(6.9)	(27.2)
Provided in the year	(5.3)	(26.1)	(31.4)
Provisions not required written back	-	0.9	0.9
Provisions utilised in the year	11.0	1.0	12.0
Unwinding of discount (see note 3)	(0.5)	-	(0.5)
Balance at 31 March 2003	**(15.1)**	**(31.1)**	**(46.2)**

Early Departure Costs

The Department meets the additional costs of benefits beyond the normal PCSPS 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 6 per cent in real terms. In past years the Department paid in advance some of its liability for early retirement by making a payment 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.

Legal Claims

Provision of £4.1m has been made for various legal claims against the Department. The provision reflects all known claims where legal advice indicates that it is probable that the claim will be successful and the amount of the claim can be reliably estimated. Legal claims which may succeed but are less likely to do so or cannot be estimated reliably are disclosed as contingent liabilities in Note 24.

National Insurance Recording System 2

Delayed Age Related Rebates (ARR's); a future estimated payment of £2.242m to the National Insurance Fund in respect of compensation for the delayed payments of Age Related Rebates made to pension providers on behalf of their clients who opted out of SERPS in favour of a personal pension.

Overpaid Age Related Rebates; estimated compensation payments of £15.3m to Pension Providers, who suffered financial loss when we delayed the recovery of overpaid ARR's.

17. Reconciliation of net operating cost to changes in general fund

		2002-03		2001-02	
		£m	£m	£m	£m
Net operating cost for the year (Schedule 2)		(2,589.2)		(2,343.9)	
Income not appropriated in aid payable to Consolidated Fund		(27.4)		(23.7)	
Non A in A income from disposal of fixed assets		(3.0)		(4.1)	
			(2,619.6)		(2,371.7)
Net Parliamentary funding			2,514.5		2,392.3
Transferred to general fund of realised element of revaluation reserve (Note 18)			15.8		0.3
Non-cash charges:					
Cost of capital	Note 3	29.0		27.5	
Auditors' remuneration	Note 3	0.3		0.3	
			29.3		27.8
Prior-period adjustments			-		-
Adjustment to opening balances as a result of implementing resource based supply			-		(17.7)
Net decrease in General Fund			**(60.0)**		**31.0**
General Fund at 1 April			**586.4**		**555.4**
General Fund at 31 March (Schedule 3)			**526.4**		**586.4**

18. Reserves

	2002-03	2001-02
	Revaluation reserve	Revaluation reserve
	£m	£m
Balance at 1 April	17.1	19.9
Arising on revaluation during the year (net)	3.9	(2.5)
Transferred to general fund in respect of realised element of revaluation reserve	(15.8)	(0.3)
Balance at 31 March	**5.2**	**17.1**

19. Notes to Schedule 5

The Inland Revenue's capital is employed exclusively for administration purposes. Its distribution amongst objectives is therefore not markedly different from the proportion of the related gross administration cost.

Administration costs have been attributed to objectives in accordance with the Department's normal management accounting practices.

The income allocated in Schedule 5 includes receipts which cannot be appropriated in aid (Consolidated Fund Extra Receipts CFER); this differs from the income shown in Schedule 1 which does not include CFER.

20. Capital Commitments

	2002-03	2001-02
	£m	£m
Contracted capital commitments at 31 March 2003 for which no provision has been made	8.1	2.4

21. Commitments under leases

Operating Leases

Commitments under operating leases to pay rentals during the year following the year of these accounts are given in the table below, analysed according to the period in which the lease expires.

	2002-03		2001-02	
	Land & buildings	Other	Land & buildings	Other
	£m	£m	£m	£m
Obligations under operating leases comprise:				
Expiry within 1 year	-	2.0	-	-
Expiry after 1 year but not more than 5 years	-	42.8	-	34.1
Expiry thereafter	179.5	-	166.0	-
	179.5	**44.8**	**166.0**	**34.1**
Obligations under finance leases comprise:				
Rentals due within 1 year	-	0.2	-	2.0
Rentals due after 1 year but within 5 years	-	0.1	-	7.9
	-	**0.3**	**-**	**9.9**

The Inland Revenue entered into a contract in 1994 with EDS, to obtain Information Technology (IT) services. This contract involved the sale of existing IT equipment to EDS and the transfer of Inland Revenue staff who operated that equipment and provided the associated services. The contract provides for the use of those computer systems in delivering the IT services to the Department and certain risks in relation to these assets remain with the Inland Revenue. As a consequence the contract is to be regarded as a finance lease. This contract operates for a period of ten years. From 2001-02 the Inland Revenue exercised its right under its contract with EDS to buy out the future finance lease obligations of some of the EDS held assets without affecting the legal status of the lease contracts.

22. Commitments under PFI contracts

The Department has entered into the following PFI contracts:

Off balance sheet

Description of Scheme	Estimated Capital Value £m	Contract Start Date	Contract End Date
Manchester New Office Structure - Serviced office accommodation for 1900 staff.	32	09-1998	09-2013
Glasgow New Office Structure - Serviced office accommodation for 290 staff.	10	12-1998	12-2013
Edinburgh New Office Structure - Serviced office accommodation for 320 staff.	10	11-1998	11-2013
Stockport New Office Structure - Serviced office accommodation for 400 staff.	6	05-1999	05-2014
St John's House Bootle - FICO - office accommodation for 700 staff.	12	05-2000	05-2025
National Insurance Records System (NIRS2)	134	05-1995	04-2004
Newcastle Estate Development	164	01-1998	12-2023
Strategic Transfer Estate to Private Sector	271	04-2001	03-2021

Charges 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 £225.6m (2001-02 £211.4m) and the payments to which the Department is committed during 2003-04, analysed by the period during which the commitment expires, is as follows:

	At 31 March 2003 £m	31 At March 2002 £m
Expiry within 1 year	-	-
Expiry within 2 to 5 years	42.8	28.5
Expiry within 6 to 10 years	-	-
Expiry within 11 to 15 years	11.1	11.1
Expiry within 16 to 20 years	142.3	140.0
Expiry within 21 to 25 years	26.1	23.3
Expiry within 26 to 30 years	-	-
	222.3	**202.9**

23. Other financial commitments

The Department has entered into non-cancellable contracts (which are not leases or PFI contracts), for the maintenance of IT equipment. The payments to which the department is committed during 2003-04, analysed by the period during which the commitment expires are as follows:

	At 31 March 2003 £m	At 31 March 2002 £m
Expiry within 1 year	51.3	47.2
Expiry within 2 to 5 years	12.0	60.0
Expiry thereafter	-	-
	63.3	**107.2**

24. Contingent liabilities disclosed under FRS 12

At 31st March 2003 Contingent Liabilities existed in respect of:

Accommodation costs: certain leases within the STEPS PFI contract give rise to potential liabilities, such as dilapidations, in four cases estimated at £1.4m.

High Court legal action where there is a possibility of losing the proceedings £3.1m - five cases (31 March 2002 £4.7m - 14 cases)

Action where appointed liquidators have been guaranteed costs with a view to recovery of outstanding tax liabilities £1.1m - 169 cases (31 March 2002 £1.3m - 178 cases)

There is a potential liability of £0.2m arising from the EDS contract in relation to their share of the discounts achieved in purchasing computer assets on behalf of the Department.

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

25.1 Quantifiable

The Inland Revenue has entered into the following quantifiable contingent liabilities by offering guarantees, indemnities or by giving letters of comfort. 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.

	1 April 2002	Increase in year	Liabilities crystallised in year	Obligation expired in year	31 March 2003	Amount reported to Parliament by departmental Minute
	£m	£m	£m	£m	£m	£m
Guarantees	-	-	-	-	-	-
Indemnities	-	-	-	-	-	-
Letters of comfort	-	-	-	-	-	-
	-	-	-	-	-	-

25.2 Unquantifiable

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

26. Losses and Special payments

Losses statement:	£m
Total (1,396 cases)	20.2

Included in the above are net gains relating to prior year reported losses amounting to £2.1m. The £20.2m shown above is net of these gains.

Details of cases over £100,000
1. £16.6m VAT write-off when we did not recover VAT within the prescribed 30 day time limit for year-end corrections. This amount is included in HM Customs & Excise Trust Statement so the net cost to Government is nil.

Special Payments:	£m
Total (7,844 cases)	46.3

Included in the above are net gains relating to prior year reported losses amounting to £0.2m. The £46.3m shown above is net of these gains.

Details of cases over £100,000:
1. £1.3m – Full and final settlement with Newcastle Estate Partnership (NEP) which related to the additional costs incurred in asbestos removal from Benton Park View;
2. £0.1m – Upper limb disorder compensation payments for injury sustained in the workplace;
3. £0.1m – Upper limb disorder compensation payments for injury sustained in the workplace;
4. £1.2m – EDI claims from 3 pension providers following the switch-off of an electronic data-link preventing correct payments being made.

National Insurance Recording System 2

5. £14.4m – Delayed Age Related Rebates (ARRS); payment of £14.4m to the National Insurance Fund in respect of compensation for the delayed payments of Age Related Rebates made to pension providers on behalf of their clients who opted out of SERPS in favour of a personal pension.
6. £7.9 m – Delayed Age Related Rebates as in 5 above;
7. £2.2m – Delayed Age Related Rebates; a future estimated payment to the National Insurance Fund in 2003/04
8. £15.3m – Overpaid Age Related Rebates; estimated compensation payments to Pension Providers, who suffered financial loss when we delayed the recovery of overpaid ARRS.

27. Related Party transactions

The Inland Revenue is the parent of the Valuation Office Agency. This body is regarded as a related party with which the Inland Revenue has had various material transactions during the year.

The Valuation Office Agency has had a significant number of material transactions with other government departments. Most of these transactions have been with the Department of Transport, Office of the Deputy Prime Minister and the Welsh Assembly Government.

None of the board members, key managerial staff or other related parties have undertaken any material transactions with the Inland Revenue during the year

28. Financial Instruments

FRS 13, *Derivatives and Other Financial Instruments*, requires disclosure of the role which financial instruments have had during the period in creating or changing the risks 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 than 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 and, except for relatively insignificant forward purchases of foreign currency, 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. The Department is therefore not exposed to significant interest rate risk. The interest profile of the Department's financial liabilities and assets has not been shown/ 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 2003 are not significantly different from their fair values. They have accordingly not been shown separately.

29. Late payment of commercial debts

Interest charges amounting to £27,086 for 37 invoices (2001-02 £17,816 for 48 invoices) were paid in respect of late payment of commercial debts.

30. Entities within the departmental boundary

The entities within the boundary during 2002-03 were as follows:

- supply-financed agencies: Valuation Office Agency
- Non-executive NDPB's: None
- Other entities: None

The annual report and accounts of the Valuation Office Agency are published separately and are published under HC reference 759.

APPENDIX 1

BOARD OF INLAND REVENUE

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

1. The Board of Inland Revenue shall prepare resource accounts for the year ended 31 March 2003 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. The Board's accounts shall be prepared so as to give a true and fair view of the state of affairs at 31 March 2003 and of the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the financial year then ended.

3. Compliance with the requirements of the Resource Accounting Manual will, in all but exceptional circumstances, be necessary for the 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. The Resource Account shall be transmitted to the Comptroller and Auditor General no later than 30 November 2003, for the purpose of audit examination. Notwithstanding this statutory requirement, the Board of Inland Revenue should adhere to the administrative deadlines agreed with the Treasury and the National Audit Office.

5. The Board's Resource Accounts and Trust Statement audited by the Comptroller and Auditor General, together with the Accounts Direction (with the exception of any appendices), and the report of the Comptroller and Auditor General shall be laid before the House of Commons in one volume. In addition, the annual report of the Commissioners of Her Majesty's Inland Revenue shall include the Board's Resource Accounts and Trust Statement audited by the Comptroller and Auditor General, together with the Accounts Directions (with the exception of any appendices), and shall be laid before Parliament in one volume.

6.This direction supersedes the Resource Accounts Direction for departments dated 19 February 2003 and that for the Board of Inland Revenue dated 23 October 2002.

....
David Loweth
Head of the Central Accountancy Team
HM Treasury
15 July 2003

Trust Statement for the Year Ended 31 March 2003

FOREWORD

1 About the Inland Revenue

The Inland Revenue is a Government Department managed by a Board of Commissioners appointed by Royal Warrant. The Chairman of the Board is directly accountable to the Chancellor of the Exchequer for the Department's performance and expenditure.

The Inland Revenue in 2002-03 was responsible for:

- collecting income tax; corporation tax; capital gains tax; petroleum revenue tax; inheritance tax, stamp duty, and National Insurance Contributions;
- administering Working Families' Tax Credits and Disabled Person's Tax Credits and preparing for New Tax Credits;
- providing valuation services for rating; council tax; Inland Revenue and other public sector purposes;
- providing policy advice to Ministers in all the above areas;
- administering Oil and Gas Royalties and enforcing the National Minimum Wage on behalf of Department of Trade and Industry; and
- collecting student loan repayments.

Policy advice and services in relation to the valuation of land are provided by the Valuation Office Agency, an Executive Agency within the Inland Revenue, managed by a Chief Executive who is accountable to the Chairman of the Board, and through the Chairman to the Chancellor of the Exchequer.

The Chairman of the Board is directly accountable to the Chancellor of the Exchequer, Gordon Brown MP. Dawn Primarolo MP, Paymaster General, has day to day responsibility for the Department.

2 Board of Inland Revenue

During 2002-03, the statutory Board comprised:

Chairman	-	Sir Nicholas Montagu KCB
Deputy Chairmen	-	Tim Flesher CB * Ann Chant CB
Head of Revenue Policy	-	Dave Hartnett CB
Chief Executive Valuation Office Agency	-	Michael Johns CB

* Tim Flesher left the Department on 11 April 2003, having been appointed Deputy Chief of Defence Logistics at the Ministry of Defence and was succeeded by Helen Ghosh, previously Director of the Machinery of Government Secretariat in the Cabinet Office.

The statutory Board was assisted by non-executive members Rene Carayol, Dorothy Dalton, Kate Owen and Pat Stafford forming the Departmental Board.

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

The Remuneration of the Members of the Board was determined in accordance with the report of the Senior Salaries Review Body.

3 About the Trust Statement

The Trust Statement shows how much money the Inland Revenue has collected from or paid to individual and corporate taxpayers, and other Government Departments; and the disposition of these funds. It is published in accordance with an accounts direction issued by HM Treasury on 15 July 2003, under the Exchequer and Audit Departments Act 1921 (See page 58 of this Report).

The Trust Statement contains information on National Insurance Contributions collected by the Department of Inland Revenue and paid over to the National Insurance Funds of Great Britain and Northern Ireland and to the National Health Service. Accounts for the National Insurance Funds are published separately as House of Commons Papers.

The costs of running the Department are included in the Consolidated Resource Accounts.

Sir Nicholas Montagu KCB
Accounting Officer

22 October 2003

Statement of Accounting Officer’s Responsibilities for the Trust Statement

Under the HM Treasury direction of 15 July 2003, set out on page 58 of this report, the Board of Inland Revenue is required to prepare for each financial year a trust statement, prepared on a cash basis, and which shall properly present the collection and allocation of taxes, duties, National Insurance Contributions and tax credits administered by the Department.

When preparing the Trust Statement, the Board of Inland Revenue shall have regard to the example format shown in the appendix to this direction, and shall also agree the format of the supporting notes, including a statement of the policies adopted in respect of any material items the disclosure of which is necessary for a proper understanding of the Statement, with the Treasury. Regard shall also be given to all relevant accounting and disclosure requirements given in “Government Accounting” and other guidance as issued by the Treasury and, for tax credits, by the Organisation for Economic Cooperation and Development.

As the Chairman of the Board of Inland Revenue I am the Department's Accounting Officer. My responsibilities as a Departmental Accounting Officer, including my responsibility for the propriety and regularity of the public finances for which I am answerable and for the keeping of proper records, are set out in the Accounting Officer's Memorandum issued by HM Treasury and published in "Government Accounting".

Sir Nicholas Montagu KCB
Accounting Officer

22 October 2003

Statement on Internal Control

1. This statement is given in respect of the Trust Statement.

2. As Accounting Officer for the Inland Revenue, I am responsible for ensuring that the Department maintain and operate a sound system of internal control that supports the achievement of departmental policies, aims and objectives whilst safeguarding the public funds and departmental assets for which I am personally responsible.

3. The Department's control framework is designed to manage rather than eliminate the risk of failure to achieve departmental aims and objectives. It can therefore provide only reasonable and not absolute assurance of effectiveness.

4. During the year ended 31 March 2003 (and up to the date of approval of the annual report and accounts) we have made further progress in embedding risk management, and the Department is now compliant with the requirements set out in DAO (GEN) letter 13/00. Work on improving risk management will continue, in particular taking forward the risk improvement programme arising from the Cabinet Office's recent risk report *.

5. As Accounting Officer I also have responsibility for reviewing the effectiveness of the system of internal control. The main elements of the Department's control framework are set out below.

5.1 Control Environment

(a) I have clearly defined "Statement of AO Responsibilities" (which forms part of this Trust Statement).

(b) There is a departmental committee structure, with clear terms of reference and defined membership. There are four non-executive members on the Departmental Board, one of whom chairs the Departmental Audit & Security Committee (DASC). The DASC meets three times a year. The Departmental Management Committee (DMC) meets fortnightly to consider the plans and strategic direction of the Department. The Departmental Finance Committee (DFC) meets at least three times a year, at appropriate intervals in the budgeting cycle, and any other meetings as necessary. DFC considers how best to deploy financial resources and has a non-executive director among its membership.

(c) In 2001/02 we drew up a new accountability framework for operational Directors. During 2002/03 we have agreed frameworks for the corporate support, policy and other head office Directors, and these came in to effect on 6 June 2003. These frameworks clarify generic corporate accountabilities, and complement our primary mechanisms for business accountabilities, which are the operating plans for each business area, and the individual performance agreements that are agreed annually. Frameworks for Board members will be drawn up during 2003/04.

(d) There is detailed guidance on standards of behaviour and conduct, diversity and equal opportunities on the Revenue intranet. The initial extensive fraud awareness programme, carried out by Internal Audit, was attended by 95% of all staff. A Fraud Awareness module is included in the National Induction Programme to ensure new members of staff receive the necessary awareness information. Following analysis of results from the initial programme new fraud awareness initiatives are being considered for launch in 2003/04. In February 2003, our new policy on computer misuse was launched jointly by the Board and the Trade Unions. Every member of staff has received a copy of the policy.

* "Risk: Improving government's capability to handle risk and uncertainty" Strategy Unit Report, November 2002.

<u>New Business Developments</u>

(e) Tax Credits

The Committees described at (b) above all, consider tax credits issues regularly. But in addition, there are particular arrangements in place for managing tax credits. The Senior Responsible Officer (SRO), a main Board member and Deputy Chairman, chairs a Programme Board which includes the Deputy Chairman responsible for business operations as well as other senior officials from this Department, Department for Works and Pensions (DWP) and from EDS (our strategic partner). This Programme Board meets fortnightly. The governance arrangements for tax credits have been reviewed by The Office of Government Commerce (OGC) and found to be exemplary. The SRO and the Deputy Chairman responsible for business operations have closely monitored the implementation of the new credits instigating contingency procedures and re-deploying resources where difficulties have been experienced. They will also lead in identifying the lessons to be learned.

5.2 Risk Management

(a) We continue to build on the progress we have made in embedding risk management processes in the Department.

<u>Capacity to Handle Risk</u>

(b) In recognition of my personal responsibility, as Accounting Officer, for ensuring that we have effective risk management arrangements in the Department, I lead the risk management reviews at our DMC meetings.

(c) We are continually looking at ways to improve the strategic risk management process. As a result of discussions I had with the Risk Support team and the chair of DASC, we have decided to set up a senior risk review group to examine risks and action plans in greater depth.

(d) Risk management guidance is available to our staff through the intranet, and the Risk Support team provide additional advice and support (for example through presentations to staff, or by running risk workshops).

<u>The Risk Environment</u>

(e) The model of risk management that we have adopted requires upward reporting of risks (to ensure comprehensive risk identification) and risk stewardship arrangements which are top-down.

(f) There is ownership of the most significant risks by individual Board members, with responsibility for managing them assigned to individual Directors.

(g) Our risk management strategy requires teams throughout the Department to identify risks as part of their annual planning cycle, and include details of their top risks in regular performance reports.

5.3 Control Activities

We have comprehensive procedures covering all aspects of the conduct of business. Financial procedures are set out in the Finance Manual and the Inland Revenue “Guide” for staff, which are available on our intranet.

5.4 Information & Communication

(a) In September 2002 we appointed our first Director of Information Resources. The Departmental Information Strategy, which was agreed at DMC in February 2003, has three main principles:

- to manage our data, knowledge and information as a shared resource;
- to make sure that people who work with data, information and knowledge can do so quickly, easily and cost effectively; and
- to make sure that the data, information and knowledge we have is accurate, up to date and complete.

(b) In 2001/02 we started to develop a Balanced Scorecard to provide the Board with regular performance information on our strategic business drivers. The scorecard has been going through a process of refinement, in discussion with the Board, to ensure it meets their strategic needs.

(c) We have continued with our programme of Modernisation Seminars. These are designed to develop all leaders to the same level of commitment to the Core Purpose and change, and enable them to communicate this message to their teams. A Board Member delivers a session to each seminar. During 2002/03, there were 525 participants at 26 events.

(d) Apart from their involvement in Modernisation Seminars, Board members and Directors have been active in explaining to staff the detail and implications of the Core Purpose and the transformation agenda through:

- articles in internal publications;
- attendance at Departmental conferences and seminars;
- personal visits to local offices; and
- telephone open days for staff.

In addition, I took part in a week long 'back to the floor' event in one of our area offices.

(e) To communicate and embed the Revenue's Core Purpose to all of our staff, we have begun a programme of modular-based interactive workshops which are designed to allow staff to discuss the key challenges facing the Revenue today. At the end of September 2003, 96% of all Revenue staff had completed two of the four modules.

(f) We have a comprehensive range of indicators, against which we measure our performance. The results of key indicators, in particular those linking to our Public Service Agreement (PSA 1**) and Service Delivery Agreements (SDA) are published in our Annual Report. Internal Audit validate a range of key indicators linked to PSA 1, and during 2003/04 they will be exploring how best to provide an assurance over the other PSA targets.

5.5 Monitoring

(a) We have a security assurance process which requires Directors to certify annually that their teams have carried out mandatory security checks. These checks, which are detailed in the Security Assurance Manual, cover the following main areas:

Buildings and fixed assets;
IT and information systems;
Financial Control; and
People.

** PSA 1: Deliver improvements in the number of individuals and businesses who comply with their obligations and receive their entitlements.

(b) The Director of Internal Audit reports in Spring and Autumn to the DASC, to standards defined in the Government Internal Audit Manual. These reports include the Director of Internal Audit's opinion on the adequacy and effectiveness of the Department's system of risk management, control and governance.

(c) The external independent Chair of the DASC reports to me.

(d) Our Quality Programme focuses on the improvement of individual performance in core business areas. It provides a clear structure for managing the quality of work, and the development of the necessary staff skills to deliver a quality service.

(e) We undertake assessments of compliance with the principal recommendations in the Cabinet Office report "Successful IT: Modernising Government in Action".

(f) The Adjudicator reports quarterly on the outcome of complaint cases.

6. My assessment of the effectiveness of the system of internal control is based on the work of the internal auditors, and reports from the chair of DASC, and is also informed by regular reports and updates from senior managers.

7. In making my assessment, I take account of the management letters made by the NAO, the C&AG's reports to Parliament, and of the findings of the Committee of Public Accounts (PAC).

8. Last year I highlighted two specific areas where we needed to improve our performance, and we have been able to make significant progress on these during the year:

- Tax Credit Payments; the results of our sampling exercise for 2001-02 which looks at payments made via employer were encouraging, with 99.7% of cases examined reconciled exactly. We continue to work with NAO, and the sampling exercise for 2002/03 is being carried out in full consultation with them.

- Clearance of open tax records; the Department set up a National Open Case Recovery Programme in March 2002, involving staff from across the whole Department and its suppliers, to concentrate on clearance of open tax records. As a result of huge efforts by those involved, a record number of open tax records were cleared during 2002/03, and substantial inroads made into outstanding cases. We have made good progress, but we have not quite yet returned to normal levels of clearance. So that we achieve this, the Programme will continue until March 2004, with top priority given to open records relating to the earliest years.

9. Over the coming year, we intend to focus on the following area which has been identified as needing improvement:

Management Information; our systems currently do not uniformly, fully support our existing and emerging business needs. We are giving high priority to this important area, and have appointed a Director of Information Resources (see 5.4(a) above) to define the future direction of management information, and we have allocated substantial funds to the Performance and Management Information Programme to enable further development. During 2003/04, we also expect to add to or further develop information in a number of areas, including Tax Credits, Employer Compliance and Stamp Duty.

Sir Nicholas Montagu KCB
Accounting Officer

22 October 2003

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

I certify that I have audited the Trust Statement on pages 52 to 57 under section 2 of the Exchequer and Audit Departments Act 1921. These financial statements have been prepared under a cash basis and the accounting policies set out on page 53.

Respective responsibilities of the Board of the Inland Revenue, Accounting Office and Auditor

As described on page 45, the Board of the Inland Revenue is responsible for the preparation of the Trust Statement in accordance with the Exchequer and Audit Departments Act 1921 and Treasury directions made thereunder. The Chairman of the Board of Inland Revenue is responsible for ensuring the propriety and regularity of public finances and for keeping proper records. The Board and Chairman are also responsible for the preparation of the Department's Annual Report. My responsibilities, as independent auditor, are established by statute and guided by the Auditing Practices Board and the auditing profession's ethical guidance.

I report my opinion as to whether the financial statements properly present the receipts and payments during the year and the balances held at that date and are properly prepared in accordance with section 2(3) of the Exchequer and Audit Departments Act 1921 and Treasury directions made thereunder; and in all material respects the receipts and payments have been applied to the purposes intended by Parliament and conform to the authorities which govern them. I also report if, in my opinion, the Foreword is not consistent with the financial statements, proper accounting records have not been kept, or if I have not received all the information and explanations I require for my audit.

I review whether the statement on pages 46 to 49 reflects the Inland Revenue's compliance with Treasury's guidance 'Corporate governance: Statement on Internal Control'. I report if it does not meet the requirements specified by the Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements.

Basis of Opinion

I conducted my audit in accordance with 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 Accounting Officer 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 payments and receipts have been applied to the purposes intended by Parliament and conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements.

Qualified opinion arising because the financial statements include tax credit payments that have not been applied to the purposes intended by Parliament

The Inland Revenue examined samples of tax credit applications made during parts of 2000-01 and 2001-02. The results of this exercise were only made available to me in August 2003. They indicate that error rates were 10 to 14 per cent by value and the estimated level of overpayments for a full year was £510 million to £710 million. The Inland Revenue has not repeated the exercise for later years, and I have seen no evidence to demonstrate that changes in the compliance regime since that time will have produced a significant reduction in the rate of error. As disclosed in Note 4 to the Trust Statement, the Inland Revenue made tax credit payments totalling £5.7 billion in 2001-02 and £6.5 billion in 2002-03.

Hence the overpayments could be of the order of £700 million and £800 million respectively. I have therefore concluded that the rate of error remained unacceptably high, leading me to qualify my audit opinion in respect of tax credit payments. Details of this are in part 2 of my report on the Inland Revenue Accounts.

In my opinion:

- the financial statements properly present the receipts and payments of the Inland Revenue in respect of taxes, duties, National Insurance Contributions, tax credits and certain other items for the year ended 31 March 2003 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

- except for the level of error leading to material amounts of overpayments of tax credits referred to above, in all material respects the receipts and payments have been applied to the purposes intended by Parliament and conform to the authorities which govern them.

John Bourn
Comptroller and Auditor General

24 October 2003

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

Trust Statement for the Year Ended 31 March 2003

Receipts and payments in respect of Taxes, Duties, National Insurance Contributions, payment of Tax Credits and certain other payments.

	Notes	2002-03	2001-02
Receipts: (gross)		**£m**	**£m**
Taxes and Duties	2	166,627	167,553
National Insurance Contributions (NIC)	3	67,712	65,591
Tax credits treated as negative taxation	4	(790)	(695)
Other Receipts	5	276	190
Total Receipts		**233,825**	**232,639**
Payments:			
Repayment of Taxes and Duties		14,742	13,181
Tax Credits treated as payments of entitlement		5,668	4,980
Refunds of National Insurance Contributions (NIC)		302	270
Transfer of NIC to the National Insurance Fund (NIF)		58,510	56,368
Transfer of NIC to the Northern Ireland NIF		1,126	1,115
Transfer of NIC to NHS		7,603	7,623
Other Payments	5	234	227
Total Payments		**88,185**	**83,764**
Net Receipts Due to the Consolidated Fund for year		145,640	148,875
Balance at 1 April brought forward		(258)	(21)
Surrendered to the Consolidated Fund in year		(145,898)	(149,112)
Balance at 31 March carried forward		**(516)**	**(258)**
Balance at 31 March Represented by :-			
Cash at bank and in hand	6	90	219 *
Revenue payments not cleared at the Bank of England	6	(611)	(505) *
Advances for revenue purposes		(3)	(6)
Other items		8	34
Closing Balance		**(516)**	**(258)**

*Restated - see note 6a

The notes on pages 53 to 57 form part of this statement

Sir Nicholas Montagu KCB
Accounting Officer

22 October 2003

Notes to the Trust Statement

NOTE 1 Statement of Accounting Policies

1.1 This Trust Statement has been prepared on a cash basis, in accordance with the accounts direction issued by HM Treasury (see Annex A) under the Exchequer and Audit Departments Act 1921. It properly presents the collection and allocation of taxes, duties, National Insurance Contributions and tax credits administered by the Department and any other items that fall outside the boundary of the Department's resource accounts. Except where described below, the statement shows the actual amounts received and repaid in the year and the corresponding balances.

1.2 These accounting policies have been applied consistently in dealing with items considered material in relation to the Trust Statement. Where further amounts of taxes, duties and National Insurance Contributions are received in subsequent years or where amounts received in the current or earlier years are repaid, such items are recorded in the year of receipt or repayment. This complies with the principles of Government Accounting.

1.3 Under self-assessment, taxpayers have separate liabilities to Income Tax and Capital Gains Tax and some National Insurance Contributions. Inland Revenue systems record taxpayers' total liability, but do not provide actual allocations to these three categories in time to inform the preparation of this Trust Statement. The actual total for self-assessment receipts is, therefore, allocated to these three categories using estimates based on historical patterns of actual allocations (see Notes 2 and 3). The same allocation proportions used to calculate gross receipts are used to allocate repayments/refunds.

1.4 The figure for Tax Credits paid via employers is estimated from information available at the time of preparation of the Trust Statement. The total amount shown for Other Income Tax includes an estimated amount for Payments Via Employers of Tax Credits due in March 2003 and paid by employers in April 2003.

1.5 Working Families' Tax Credit and Disabled Person's Tax Credit are treated as negative tax to the extent that the tax credits are less than or equal to the income tax liability of the family unit and as public expenditure (referred to as payments of entitlement in the Trust Statement) to the extent that credits exceed the liability. This definition is consistent with OECD classification rules and international best practice for the calculation of net taxes and social security contributions.

1.6 The Department of Inland Revenue may, with the agreement of the relevant Secretary of State, accept qualifying assets on behalf of the Department for Culture, Media and Sport, in settlement of Inheritance Tax liabilities. The value of assets accepted in lieu of Inheritance Tax liabilities are not accounted for in the Trust Statement. They are, however, recorded in Note 2c.

1.7 HM Treasury has directed that income arising from the levying of penalties should be matched against the expenditure incurred in determining and collecting those debts. These exclude those where the Department and the taxpayer have agreed a settlement without recourse to the Commissioners - mainly Class 1A settlements. Income generated from penalties is recorded in the Department's Resource Account as either Appropriations in Aid or as payable to the Consolidated Fund.

NOTE 2 Taxes and duties	Receipts 2002-03 £m	Payments 2002-03 £m	Net Receipts 2002-03 £m	Receipts 2001-02 £m	Payments 2001-02 £m	Net Receipts 2001-02 £m
Self assessed income tax	19,937	3,878	16,059	18,441	3,160	15,281
Other income tax	99,695	5,433	94,262	98,515	5,098	93,417
Income tax (gross of tax credits)	119,632	9,311	110,321	116,956	8,258	108,698
Self assessed capital gains tax	1,642	51	1,591	3,071	29	3,042
Other capital gains tax	10	5	5	12	20	(8)
Corporation tax	34,070	4,963	29,107	36,463	4,473	31,990
Inheritance tax	2,497	143	2,354	2,472	117	2,355
Stamp duties	7,653	104	7,549	7,085	101	6,984
Petroleum revenue tax	1,123	165	958	1,494	183	1,311
Total (Gross of tax credits)	**166,627**	**14,742**	**151,885**	**167,553**	**13,181**	**154,372**

2(a) See Note 1.3.

2(b) At 31 March each year there are receipts which cannot be allocated to a head of duty for various reasons, but which will normally be allocated to the appropriate head of duty during the following months. These include amounts paid in advance, overpayments, unidentified items and sums in transit. These sums have been apportioned across income tax, capital gains tax and, corporation tax, using the information available at 31st March.

The cumulative total of such items were £1,459m at 31 March 2003 (£1,583m at 31 March 2002).

2(c) Inheritance Tax transactions (cash and assets accepted in lieu – see Note 1.6) were:

Inheritance Tax	Receipts 2002-03 £m	Repayments 2002-03 £m	Net Receipts 2002-03 £m	Receipts 2001-02 £m	Repayments 2001-02 £m	Net Receipts 2001-02 £m
Receipts and payments	2,497	143	2,354	2,472	117	2,355
Assets accepted in lieu of inheritance tax liabilities	14	-	14	26	-	26
	2,511	**143**	**2,368**	**2,498**	**117**	**2,381**

2(d) Taxes and duties receipts include a notional element for amounts paid via employers (PVE) from PAYE to pay Tax Credits to employees.

	2002-03 £m	2001-02 £m
Actual cash received	165,047	165,448
Tax Credit paid via employers (PVE)	1,661	2,229
PVE funded by Inland Revenue	(81)	(124)
Notional cash received (Gross of Tax Credits)	**166,627**	**167,533**

NOTE 3 National Insurance Contributions	Receipts 2002-03 £m	Payments 2002-03 £m	Net Receipts 2002-03 £m	Receipts 2001-02 £m	Payments 2001-02 £m	Net Receipts 2001-02 £m
Great Britain	66,397	293	66,104	64,311	264	64,047
Northern Ireland	1,315	9	1,306	1,280	6	1,274
	67,712	**302**	**67,410**	**65,591**	**270**	**65,321**

3(a) See Note 1.3. The allocation of receipts between the Great Britain and Northern Ireland National Insurance Funds is (partly) based on estimates made using information available when the Trust Statement was prepared.

3(b) The receipt figures exclude estimated amounts recovered from national insurance contributions by employers in respect of payments to employees for Statutory Sick pay and Statutory Maternity pay.

	2002-03	2001-02
	£m	£m
The analysis of the estimate is :		
Great Britain	755	666
Northern Ireland	19	17
Total	**774**	**683**

In addition, payments of national insurance contribution rebates and incentives are made to personal pension providers on behalf of the contributors. These amounts are funded from the National Insurance Fund but are included here to be compatible with the published National statistics.

	2002-03	2001-02
	£m	£m
These amounts (net of the tax relief element) totalled	**3,336**	**2,841**

NOTE 4	**Receipts 2002-03 £m**	**Payments 2002-03 £m**	**Net Payments 2002-03 £m**	**Receipts 2001-02 £m**	**Payments 2001-02 £m**	**Net Payments 2001-02 £m**
Tax Credits						
Working families' tax credits	4	6,306	6,302	2	5,549	5,547
Disabled person's tax credits	-	156	156	-	128	128
	4	**6,462**	**6,458**	**2**	**5,677**	**5,675**

Of this, the estimated breakdown of Tax Credits for Working Families and Disabled persons is:

	Negative Tax 2002-03 £m	**Payments of Entitlement 2002-03 £m**	**Net Payments 2002-03 £m**	**Negative Tax 2001-02 £m**	**Payments of Entitlement 2001-02 £m**	**Net Payments 2001-02 £m**
Working families' tax credits	753	5,549	6,302	665	4,882	5,547
Disabled person's tax credits	37	119	156	30	98	128
	790	**5,668**	**6,458**	**695**	**4,980**	**5,675**
of which						
Paid via employers	211	1,450	1,661	281	1,947	2,228
Other	579	4,218	4,797	414	3,033	3,447
	790	**5,668**	**6,458**	**695**	**4,980**	**5,675**

4(a) There were no amounts for receipts of other income tax and payments of tax credits paid to Tax Credit recipients via employers in March 2003 from receipts due to be paid to the Inland Revenue in April 2003 as payments via employer had ceased by February 2003. The corresponding figure for 2002 was estimated as £190 million.

4(b) The cost of managing and paying tax credits was:

	2002-03	2001-02
	£m	£m
Working families' tax credits	139	141
Disabled person's tax credits	4	3
Total	**143**	**144**

4(c) Company Tax Credits

The Corporation Tax receipts at Note 2 are net of Research & Development, and Contaminated Land Tax Credits. The estimated figures are:

	2002-03	2001-02
	£m	£m
Contaminated Land	1	-
Research & Development	220	58
	221	**58**

NOTE 5

	Receipts 2002-03	Payments 2002-03	Net Receipts 2002-03	Receipts 2001-02	Payments 2001-02	Net Receipts 2001-02
Other items	£m	£m	£m	£m	£m	£m
Certificates of Tax Deposit						
NLF issues	59	59	-	76	77	(1)
NLF Redemptions	173	175	(2)	101	100	1
Other Governments	-	-	-	-	1	(1)
Student Loans	44	-	44	13	49	(36)
	276	**234**	**42**	**190**	**227**	**(37)**

5(a) The Inland Revenue recovers student loans through the taxes system, on behalf of the DfES, from those former students eligible to make repayments. On receipt of the funds from IR, DfES will arrange a transfer of a proportion to the Scottish Executive and the Department for Education and Learning Northern Ireland based on the percentages of student loan borrowers between England and Wales, Scotland and Northern Ireland.

For 2001-02 payments to DfES of loans recovered were based on estimates provided by them. At the end of 2001-02 an estimated overpayment of £45.1m was registered and payments to DfES were suspended to recoup the overpayments. Latest estimates, based on end of year returns submitted up to the middle of July 2003, in respect of the 2002-03 tax year, indicate that recoveries have substantially increased and the final amount is expected to be £44m. This leaves a net overpayment of £1.1m to DfES at 31 March 2003 which, with H M Treasury authorisation, will be dealt with once the end of year returns have been processed.

NOTE 6 Cash at Bank and In Hand

6(a) For the 2002-03 Trust Statement payable instruments which have not been presented for payment, have been included in the figure for "Cash at bank and in hand". In the Trust Statement for 2001-02 similar items were excluded and so for comparative purposes the prior year figures have been restated - the "Cash at bank and in hand figure" and the "Revenue payments not cleared at the Bank of England" figures have been increased by £57.7m.

6(b) Cash at Bank and Tax Receipts at 31 March 2003 included £73,000 (31 March 2002 : £21,000) which relates to closing balances on the Euro bank accounts.

NOTE 7 Reconciliation between Repayments of Taxes and Duties reported in this Trust Statement and Repayments of Duties reported in the Consolidated Fund Statement.

Under the direction of HM Treasury, repayments of taxes and duties and the payment of tax credits are reported in the Trust Statement when a payable instrument has been issued. Under the reporting requirements for the Consolidated Fund Statement, repayments of taxes and duties and payment of tax credits are reported when the payable instruments have been encashed by third parties through the Department's bank accounts. The difference represents the net year-on-year movement in the value of payable instruments that have been issued but not encashed. The following table reconciles the amounts recorded in the two statements:

	2002-03		2001-02	
	£m		£m	
Payments (gross of tax credits) as shown in Note 2		**14,742**		**13,181**
Add Net movement in the value of payable instruments issued but not encashed:-				
Income tax	(1)		(47)	
Corporation tax	1		(10)	
Capital gains tax	-		(1)	
Inheritance tax	-		-	
Stamp duties	1		-	
Petroleum revenue tax	-		-	
Working families' tax credit	182		(23)	
Disabled person's tax credit	4		(1)	
		187		(82)
Add Tax Credits paid		6,462		5,678
As shown in Consolidated Fund		**21,391**		**18,777**

ANNEX A

BOARD OF INLAND REVENUE

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

1. The Board of Inland Revenue shall prepare a Trust Statement for the financial year ended 31 March 2003, which shall properly present the receipts, payments and balances held at that date in respect of the collection and allocation of taxes, duties, National Insurance Contributions and tax credits administered by the Department of Inland Revenue. When preparing this statement, the Board of Inland Revenue shall have regard to the example format shown in the appendix to this direction, and shall also agree the format of the supporting notes, including a statement of the policies adopted in respect of any material items the disclosure of which is necessary for a proper understanding of the Statement, with the Treasury. Regard shall also be given to all relevant accounting and disclosure requirements given in "Government Accounting" and other guidance as issued by the Treasury and, for Tax Credits, by the Organisation for Economic Cooperation and Development

2. The Trust Statement shall be transmitted to the Comptroller and Auditor General for the purposes of audit examination at the same time as the Board of Inland Revenue's Resource Account is transmitted.

3. The Board's Resource Accounts and Trust Statement audited by the Comptroller and Auditor General, together with the Accounts Directions (with the exception of any appendices), and the report of the Comptroller and Auditor General shall be laid before the House of Commons in one volume. In addition, the annual report of the Commissioners of Her Majesty's Inland Revenue shall include, the Board's Resource Accounts and Trust Statement audited by the Comptroller and Auditor General, together with the Accounts Directions (with the exception of any appendices), and shall be laid before Parliament in one volume.

4. This direction supersedes the Trust Statement Accounts Direction for the Board of Inland Revenue dated 23 October 2002.

David Loweth
Head of the Central Accountancy Team
HM Treasury
15th July 2003

Comptroller and Auditor General's Standard Report on the Accounts of the Inland Revenue 2002-03

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
6 November 2003

Contents

Executive Summary

1. Section 2 of the Exchequer and Audit Departments Act 1921 requires me to examine the accounts of the Inland Revenue 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, and that they are being duly carried out. 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.

2. This report fulfils my responsibility under Section 2(2) of the 1921 Act. No tax collection system can ensure that all taxpayers and potential taxpayers comply with their obligations. As part of the Department's Public Service Agreement targets they aim to reduce the number of individuals and businesses who do not comply. Subject to:

   - the major reservations I have recorded about tax credit error;
   - recognising that it is not possible to secure full compliance;
   - other specific matters raised in this report, and matters outstanding from earlier years' reports,

   the National Audit Office's work in 2002-03 provided overall assurance that the Inland Revenue's regulations and procedure continued to provide an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out.

3. The Inland Revenue prepared Resource Accounts and a Trust Statement account of taxes and tax credits. I qualified my audit opinion on the latter in respect solely of error rates on tax credits (see paragraphs 2.5 - 2.7). I gave an unqualified opinion on the Resource Accounts.

4. I also present to Parliament Value for Money reports on the economy, efficiency and effectiveness with which the Department have used their resources. Since my last report on the Department's accounts in December 2002, I have reported on External Fraud against the Inland Revenue (HC 429) along with a similar report on the Department for Work and Pensions. I shall report later in 2003-04 on the Strategic Transfer of the Estate to the Private Sector - STEPS - project.

5. This report records audit observations on certain developments in corporate governance, Tax Credits, Employer Compliance with tax requirements and Capital Gains Tax. The main points arising from these examinations were as follows.

Working Families' and Disabled Person's Tax Credits

6. The Working Families' and Disabled Person's Tax Credit schemes began in 1999, ended on 6 April 2003 and spent some £17.8 billion. The Department were able only in August 2003 to provide me with the results of their examination of samples of tax credit applications made during part of 2000-01. Error rates were 10-14 per cent by value and the estimated level of overpayment for a full year was between £510 and £710 million.

7. The Department have not undertaken similar exercises for 2001-02 or 2002-03. The Department emphasise that they had incorporated the lessons learned into their design of the new tax credits. For these tax credits the Department must consider undertaking an exercise each year to determine the effectiveness of their controls in detecting error and ensuring that payments are properly calculated to reflect claimants' circumstances.

8. The level of overpayment identified by the Department is cause for serious concern and as a result I have qualified my opinion on the Trust Statement for 2002-03. The improved controls in the new tax credit system should help to reduce overpayments. But the Department are not yet able to assess the likely extent of that reduction.

New Tax Credits

9. New tax credits represented for the Department a major challenge in an area of work which was relatively new to them. The level of the problems caused to tax credit claimants and employers as the systems went live demonstrated that there were undetected gaps in the design of the testing regime for the systems.

10. In July 2003 the Department received from EDS an explanation of the technical problems that had delayed payment to claimants. The results of the audit by independent consultants should enable the Department to check whether there are any other technical issues outstanding so that they can be sure that they have learnt the lessons sufficiently to give assurance that similar problems will not occur as the tax credit systems are expanded.

11. The Department's consideration with EDS of the underlying technical problems had to have regard to the discussions between them about compensation for the unsatisfactory performance of the system, and the possibility of legal action. In November these discussions were continuing and the Department hoped to resolve them shortly. Once they are resolved I shall return to these aspects.

12. The Department must pay particular attention to ensuring that recovery from the problems with the introduction of new tax credits does not undermine their reputation for integrity of processing of taxpayers affairs, which is essential to the effective assessment and collection of tax.

13. In addition to the significant challenges of maintaining day to day running of the system and catching up on backlogs, there are many major issues for the Department in controlling tax credits for 2003-04. These include ensuring that:

- they have a rigorous approach to deciding how many, and which applications are "higher risk" as they require only those applications to be checked against prior-year income records before payment;
- they can manage the risk if claimants delay reporting changes in their circumstances;
- the problems with the start of the new tax credit systems and recovery from that position, have not led to errors in detailed information about claims or payments.

Employer Compliance

14. The Department's employer compliance activities provide assurance that employers are collecting PAYE Income Tax and National Insurance Contributions correctly. These activities are important to the collection of some £155 billion, or 68 per cent of total revenue. The Department have introduced many new initiatives to target more effectively their compliance resources and to help employers. The Department should develop further their methods to measure the impact of their compliance activities, including enabling activities designed to improve employer compliance.

15. Departmental statistics suggest significant geographical variations in employer compliance performance, such as in the percentage of cases where penalties are levied. The rate of penalties levied for large employers have been applied consistently. The Department need to consider ways in which they can monitor and report more effectively on the equity of treatment of smaller employers and consistency of performance. The Department should also continue to consider the overall effectiveness of the penalty regime.

16. Employer Compliance checks on aspects of payroll administration such as tax credits may not be sufficient to provide adequate assurance to the Board and to Parliament on the proper treatment of those items by employers overall. Employer Compliance and tax credit claimant compliance teams, worked separately in 2002-03. Following a National Audit Office suggestion, the Department are to undertake a joint review to consider the opportunities of a more co-ordinated approach to tax credit compliance. They should consider the sufficiency and validity of the current checks and the need for quantifiable assurance on tax credits.

Capital Gains Tax

17. Capital Gains Tax contributed £ 1.6 billion – around one per cent of the total taxes collected by the Inland Revenue in 2002-03. Some 32 per cent of Capital Gains Tax payers provided just one per cent of that collected, whilst one per cent of taxpayers contributed some 34 per cent. Recent initiatives to enhance the effectiveness of the Capital Gains Tax systems include the creation of teams specialising in Complex Personal Returns and, in some geographical areas, small specialist teams. The Department are undertaking internal reviews to improve the information available to management to help them target resources to best effect.

18. The Department are developing their research into areas of non-compliance but do not consider it practicable to measure the tax gap specifically attributable to Capital Gains Tax. Most Capital Gains Tax arises from taxpayers with high net income or high worth and so it is likely that non-compliance on the part of those taxpayers covered by Complex Personal Returns teams would have the biggest impact on the Capital Gains Tax yield. The Department should ensure that their research explores as fully as possible the scope for detecting, estimating and minimising non-compliance with Capital Gains Tax obligations in this particular customer group.

Part 1: Scope of the Audit and Corporate Governance

1.1 This part of my report covers the scope of the National Audit Office's work and observations on corporate governance at the Inland Revenue (the Department) as reflected in the Accounting Officer's Statement on Internal Control. It also covers developments in certain tax streams.

1.2 In 2002-03, the Department collected some £219 billion. Figure 1 shows the trends in collections from 1999-2000 to 2002-03. Income Tax, National Insurance and Tax Credits have increased again in 2002-03 whilst Corporation Tax, Capital Gains Tax and Petroleum Revenue Tax have decreased as a proportion of total revenue, and in absolute terms.

Figure 1: Inland Revenue - Tax and National Insurance receipts and Tax Credit payments 1999-2000 to 2002-03

	Net Receipts and Tax Credit Payments			
	1999-2000 £bn	2000-01 £bn	2001-02 £bn	**2002-03** **£bn**
Income Tax	94.0	106.0	108.7	**110.3**
Payment of Tax Credits (Working Families' and Disabled Person's)	(1.1)	(4.6)	(5.7)	**(6.4)**
Corporation Tax	34.4	32.4	32.0	**29.1**
Capital Gains Tax	2.1	3.2	3.0	**1.6**
Inheritance tax	2.0	2.2	2.4	**2.4**
Stamp Duty	6.9	8.2	7.0	**7.5**
Petroleum Revenue Tax	0.9	1.5	1.3	**1.0**
Total	**139.2**	**148.9**	**148.7**	**145.5**
National Insurance Contributions	58.4	62.7	65.3	**67.3**
Total	**197.6**	**211.6**	**214.0**	**212.8**

Note: These receipts are shown net after allowing for tax reliefs and allowances, and for repayments. Repayments totalled £14.7 billion (£13.2bn in 2001-02).

Source: Inland Revenue accounts

Audit approach and Coverage

1.3 The National Audit Office review periodically existing and new systems and significant changes to them, and undertake test examinations of individual transactions and balances as necessary. The audit approach seeks to emphasise aspects of management control over business and tax streams, as set out in Figure 2.

Figure 2: Emphasis of National Audit Office Audit Approach

Who is accountable, and how is accountability formally documented, reviewed and used to improve performance?
How does the tax or business stream owner assure that all is in order with regard to corporate governance concerns?
How effective are the quality assurance procedures upon which management relies?
What risk analysis has there been for the tax or business stream and what risks has the stream owner and the Department identified?
How do the Department demonstrate routinely the sufficiency of their management of risk?
What obstacles to the assessment and collection of the tax in question have the Department identified and how are those obstacles tackled?
How are operational issues assessed, prioritised and their impact managed so as to minimise disruption to tax flows?
What management information does the tax or business stream owner and the Department receive and use to check the quality of tax assessments and taxpayer compliance work, and to judge the success of the business stream?

Source: National Audit Office

1.4 The National Audit Office also review Departmental progress in response to recommendations for business and tax streams arising from my reports and those of the Committee of Public Accounts. Figure 3 summarises the coverage of the work of the National Audit Office in 2002-03. The results of work not detailed in this report and suggestions of further improvements in controls that could be made, have been notified to the Department in management letters.

1.5 Information technology (IT) is essential to the administration of taxes and increasingly so as tax returns are filed on-line and payments made electronically. The National Audit Office examine each year aspects of how IT related risks are managed. Most Departmental IT services are operated by private sector IT service providers, in partnership with the Department. They are re-tendering these services in a major project called ASPIRE, as the current contract will expire in 2004. A formal announcement of the ASPIRE partner is planned for the end of 2003, with new arrangements operating from mid 2004. Two of the bidding consortia were selected as preferred bidders in July 2003.

Figure 3: National Audit Office coverage 2002-03

	Areas Examined
Corporate Governance and Information Technology	• Examination of the Department's internal controls, including the development of governance arrangements and the management information available to support the Statement on Internal Control • Follow up of progress in implementing previous National Audit Office and Public Accounts Committee recommendations • Management of IT related risks
Working Families' and Disabled Person's Tax Credits	• Payment and compliance arrangements • Plans for the closure of these schemes
Child Tax Credit and Working Tax Credit	• Introduction of Child Tax Credit and Working Tax Credit
Employer Compliance with tax and Tax Credit obligations	• Progress and developments in Employer Compliance • Opportunities to enhance the assurance provided by Employer Compliance
Income Tax	• Progress and developments in Self Assessed Income Tax • Take up of e-filing of Self Assessment Tax returns
Capital Gains Tax	• Progress and developments in Capital Gains Tax
Construction Industry Scheme	• Proposals to change the Construction Industry Scheme and consultative process
Inheritance Tax	• Progress and developments in Inheritance Tax
Debt Management	• Integrated Debt Management System
Petroleum Revenue Tax	• Review of developments since the C&AG's report on this tax in 2000

Source: National Audit Office

Compliance and Enforcement Initiatives

1.6 As announced in the Chancellor's Budget 2003, the Department are introducing a new compliance and enforcement package for tax and National Insurance Contributions (NIC) which should generate an additional £1,370 million over the three years to 2005-06. Additional staff in new specialist teams, backed by new IT and the use of outside legal and other expertise, are being deployed in three areas where the Department have identified significant risks to revenue:

- protecting the Exchequer from non-payment of tax and NIC debt and from failure to file tax returns;
- tackling fraud involving concealment of undeclared income or profits offshore;
- countering avoidance of Corporation Tax and of NIC and tax on earnings.

1.7 Under Sections 156 and 157 of the Finance Act 1998, the Chancellor asked me to determine whether the revenue impact of the package estimated was reasonable and cautious. I noted that it would be important that the Department's monitoring and evaluation arrangements were implemented as planned and concluded that overall the approach to projecting the revenue benefits of the package were reasonable. The National Audit Office will monitor progress and management's supervision of this package of measures.

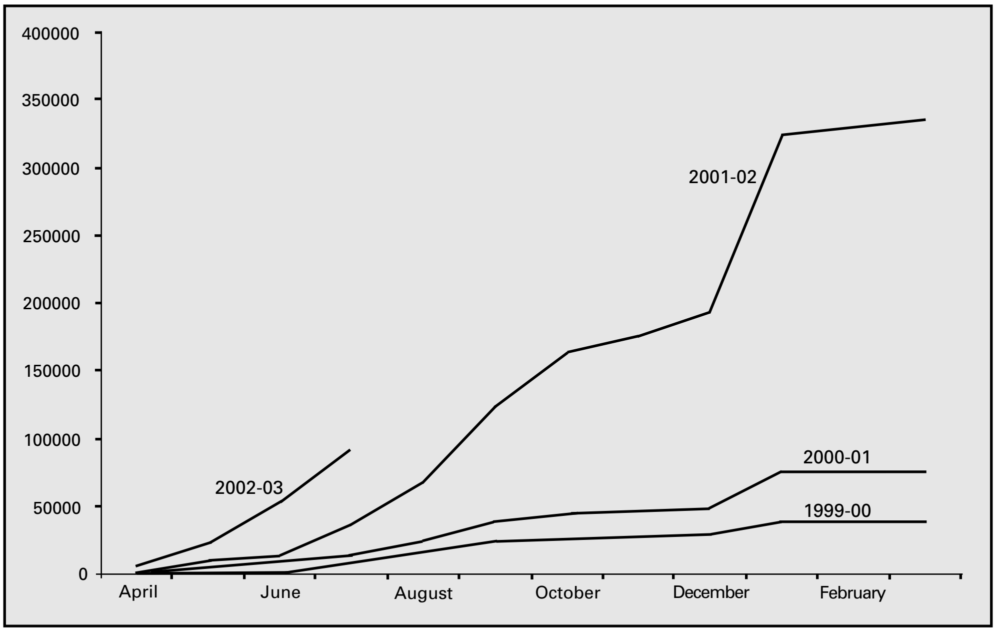
Self Assessment Returns

1.8 Self Assessment returns are received from some 8.8 million individuals. They declare some £16 billion of tax due representing 11 per cent of net tax receipts.

1.9 The Department encourage taxpayers to submit their tax returns electronically, but the level of take up of this option is dependent on a variety of factors including taxpayer confidence in security over the Internet. In May 2002 there were a very small number of reported cases where taxpayers filing returns electronically were able to see other taxpayer's data. The Department reacted promptly by closing down the service. The seriousness of the situation was apparent to the Department, who, with the IT service providers and other interested parties, initiated an exhaustive investigation of the underlying causes which were technical and complex. When they had been fully diagnosed, remedial measures were designed and implemented. The Department used IT and Internet security specialists to help test the amended systems, then the service was resumed. The Department wrote to all taxpayers who had been affected or who could possibly have been affected to explain what had happened and that the problem had now been remedied. The Department shared the lessons learnt from the events with other Government Departments and agencies, and beyond. There has been no repetition of these technical problems with internet filing since Summer 2002.

1.10 From 6 April 2002 to 31 January 2003, some 325,000 Self Assessment returns for the 2001-02 tax year were submitted over the Internet, more than four times the number for the same period in the previous year. For the same tax year, electronic returns lodged by agents on behalf of self assessment customers grew to some 365,000.

Figure 4: Numbers of taxpayers filing returns via the Internet



Source: Inland Revenue

1.11 The Department have developed a shortened, four page, version of the standard tax return for the tax year ending 5th April 2003. This has been issued as a pilot to 50,000 taxpayers who in previous returns have indicated that they had relatively simple tax affairs. Initial indications are encouraging in terms of completed returns received and feedback from both users and the media. If the pilot is successful, the Department will consider extending it to more taxpayers. They estimate that some 1.5 million individuals could benefit from this initiative.

1.12 The shortened tax return pilot exercise also offers taxpayers the option to file by telephone, as it requires far less information than a standard form. The system operates using voice recognition software and taxpayers can also speak to staff if they need help. This initiative is being evaluated as part of the short return pilot. Initial feedback has been good and take-up to June 2003 accounted for approximately 2.2 per cent of pilot returns received.

1.13 Taxpayers may fail to comply with their tax obligations by not submitting a return, or failing to submit it on time; alternatively they may not provide the correct details; or fail to pay tax due at the right time. The Department have researched taxpayer attitudes towards compliance, and are also looking at barriers to compliance. They are considering ways to influence behaviour to increase compliance for specific customer groups.

Construction Industry Scheme – New proposal

1.14 In the past, the Construction Industry Scheme has been of particular interest to members of the Committee of Public Accounts. Since 1972, a special tax deduction scheme for the construction industry has existed. This was established to deal with problems, endemic in the industry, of engaging workers on a "cash in hand" basis, coupled with a poor record of complying with tax obligations. The current Construction Industry Scheme was introduced in 1999. Tax and National Insurance Contributions are deducted directly from payments to subcontractors. The Scheme is intended to benefit businesses and sub-contractors since it encourages tax compliance across the industry and reduces the likelihood of non-compliant businesses benefiting from tax evasion.

1.15 The majority of subcontractors apply for a Registration Card to obtain all payments for labour from the contractor after a deduction of 18 per cent in respect of Income Tax and National Insurance Contributions. The Inland Revenue also issue Subcontractor Tax Certificates which allow subcontractors to be paid gross if they meet certain qualifying conditions, including recent compliance with taxation processes.

1.16 Since its introduction, this Scheme has suffered from problems, for example over contractor voucher supply, and businesses are concerned about the costs of complying with the Scheme. In 2000-01, the Department began preparations for introducing a new scheme designed to:

- reduce the regulatory burden of the scheme on construction businesses;
- improve the level of compliance by construction businesses with their tax obligations; and
- help construction businesses to get the employment status of their workers right.

1.17 In order to ensure the success of the new scheme and to gain industry-wide acceptance, a consultation document was issued in November 2002 requiring comments by the end of February 2003. Responses from the Industry show that there is sufficient support and justification for a new Scheme.

1.18 The main proposals of the new Scheme are:

- To replace the Registration Cards and Gross Payment Certificates with an e-verification service and alternative more traditional methods;
- To introduce a new employment status declaration;
- To replace the contractor vouchers with periodic returns;
- To create a new system to support e-services, including communication over the Internet.

1.19 The Department plan to introduce the new Scheme for the tax year 2005-06. The National Audit Office will continue to monitor progress in developing and implementing the Department's proposals.

Accounting Officer Responsibilities, his Statement on Internal Control and Departmental Performance Measurement

1.20 The Treasury require each Accounting Officer to make a Statement on Internal Control in their accounts covering operational, policy-making and financial systems. The Statements assert the Accounting Officer's responsibility for maintaining a sound system of internal control that supports the achievement of departmental policies, aims and objectives, whilst safeguarding public funds and departmental assets for which he is personally responsible.

Compiling the Statement on Internal Control

1.21 The Accounting Officer's assessment of the effectiveness of the system of internal control is based on the work of the internal auditors and reports from the Chair of the Departmental Audit and Security Committee, and is also informed by wide consultation across the Department in the form of regular reports and updates from key contributors. The Internal Audit Office provide the Accounting Officer with an independent and objective opinion of the effectiveness of risk management, control and governance. They provide specific Assurance Reports twice a year to the Departmental Audit and Security Committee.

1.22 The Accounting Officer's Statement on Internal Control complies with Treasury requirements and sets out in a public document his view on the control framework. Under Treasury's current requirements, the Department had until 1 April 2003 to complete all development work necessary for a full statement on internal control to be made for 2003-04. Figure 5 summarises progress made in particular aspects of the control environment this year, compared with 2001-02. Further detail on certain of these aspects is provided in the paragraphs which follow.

Figure 5: Progress in aspects of the control environment

	2001-02	2002-03
Accountability Framework Clarifies generic corporate accountabilities and complements business operating plans and individual performance agreements.	In place for operational areas of the Department such as Regions and business streams and being developed for non-operational areas such as Head Office functions.	As for 2001-02, development ongoing. Frameworks for policy and head office Directors were issued on 6 June 2003.
Committee Structures Ensures decisions are made properly on a corporate basis.	Clearly defined structures in place for the existing Departmental Audit and Security; Departmental Management; and Project Investments Committees, all with basic terms of reference. New Departmental Finance Committee to be established.	As for 2001-02, plus Departmental Finance Committee established as planned. Recommendations made by internal review of committees to be implemented 2003-4. This will be taken forward by the Director General, Corporate Services, a Board member.
Risk Management Processes Ensures risks to the Department and the Department's business are identified, owned and managed.	Risk management processes still under development. Bi-annual stock-takes with the Departmental Management Committee are held to review top risk, with risk ownership at Board level.	Continued development of risk management processes across the whole Department, with increased formalisation. Model of risk management adopted requiring upward reporting of risks. A new Risk Review Group established to meet from September 2003.

	2001-02	2002-03
Performance Indicators Demonstrate the Department's performance against stated objectives and targets and how the business has been managed.	Range of indicators in place, including key indicators linked to Public Service Agreements (PSA), some of which cannot be measured reliably. Some results are validated by Internal Audit.	As for 2001-02, a range of indicators in place, some of which cannot be measured reliably. Some results are validated by Internal Audit. Delivery plans are in place for each revised PSA target, 2003-06. PSA objectives are allocated to Board members and Directors.
Departmental Balanced Scorecard A system to manage and monitor the Department's performance against its strategy and objectives.	Began process of developing a Balanced Scorecard. Twenty four scorecard measures were agreed by the Board.	Continued development. Some scorecard targets being measured. Scorecard made available at Board meetings. Some business streams have developed their own performance measures based on a balanced scorecard, for example the Large Business Office and Service Delivery Support (Compliance).

Source: National Audit Office

Accountability

1.23 In 2002, the Department reviewed existing accountability arrangements to develop a framework supporting more consistent and effective decision-making, leading to the introduction of an "Accountability Framework". This initial Framework was developed for operational Directors, who agreed a generic list of corporate areas of accountability, such as responsibility for leadership, financial management, human resources, diversity, health & safety and managing risks.

1.24 The Accountability Framework is designed to complement a Director's specific business accountabilities or responsibilities for their business stream, which should be recorded in Operating Plans and individual performance agreements agreed with line managers. The Department do not intend for there to be a single document recording all accountabilities for individual Directors. The Accountability Framework overall is still under development and specific Accountability Frameworks for Board Members are to be developed during 2003-04. The issue of how to implement and monitor the Framework is currently under consideration.

Committee Structures

1.25 In July 2002 an accountabilities review team reported on Departmental Committee accountabilities. They noted that committees' terms of reference did not focus on who the committees were accountable to; how accountabilities would be manifested; and how the committees would delegate work downwards. This lack of focus could undermine the effectiveness of decision-making within the Department. The report also recommended the development of a process of approval for new committees, and that terms of reference should clarify links with other committees and incorporate critical aspects of performance review.

1.26 In mid June 2003, the Director General, Corporate Services, a Board member, agreed to take forward work on the Department's committee structures. This work may need to take account of the Government's review of Customs and Excise and the Inland Revenue, which is due to report before the Chancellor's Pre-Budget Report in November 2003.

Risk Management

1.27 The National Audit Office examination of the Department's risk management processes found that they were better developed in some areas than others. For example the Large Business Office identify top risks to their business and to the delivery of Departmental objectives; assign ownership of risks to senior management, who report regularly against risks and key objectives; and update the risk register quarterly. However, in some areas, risk registers were being compiled reactively providing more of an issues log.

1.28 The Accounting Officer says in the Statement on Internal Control that the Department continue to build on progress made in embedding risk management processes. During 2002-03 the Department's Internal Audit Office commissioned an external independent review of the central risk management processes being put in place. The majority of the issues raised by this review are in hand or are intended to be addressed by new measures such as the Risk Review Group. In early June 2003, the Finance Director agreed proposals for establishing this group, aimed at improving corporate risk management. The first meeting was scheduled for September 2003 to be chaired initially by the Finance Director, with a view to passing that role to a non-executive Board member. The Internal Audit Office plan to undertake in 2003-04 a series of reviews of individual business streams and key areas to evaluate the level of maturity in their risk management arrangements.

Measurement of Performance against Indicators

1.29 The Department have made progress in performance measurement and monitoring, especially in relation to Public Service Agreement (PSA) objectives and Service Delivery Agreement (SDA) targets. A Board Member now owns each PSA objective and the Director of Strategy and Planning has oversight responsibility for the agreement and coordination of PSA objectives and SDA targets, across the Department. The Department have developed Delivery Plans for each PSA objective. These outline ownership, an overview of the PSA objective, delivery strategy for individual SDA targets, information systems availability and reporting lines.

1.30 PSA performance results are published in the Department's Annual Report and are validated by the Department's Internal Audit Office. The Office validate some of the results but for others their work is limited to developing an understanding of the system, reviewing controls and building an audit trail of data, in order to carry out full validation in future years. The National Audit Office recommended that the Department disclose more fully the extent of validation work when presenting performance results in their Annual Report.

Conclusion

1.31 The Department have in hand several important initiatives, including developments in corporate governance arrangements, the full benefits of which should be demonstrated in future years.

Part 2: Working Families' and Disabled Person's Tax Credits

2.1 This part of my report examines four aspects of Working Families' and Disabled Person's Tax Credits: applicant compliance; the accuracy of awards; payment via employers; and employer compliance. It also examines the Department's plans to close those schemes.

2.2 Working Families' Tax Credit and the Disabled Person's Tax Credits started in October 1999 as part of the Government's reforms to make work pay ended on 6 April and spent some £17.8 billion. Figure 6 shows the number of recipients and average weekly award during the four years of the tax credits. From 6th April 2003 they were superseded by the Child Tax Credit and the Working Tax Credit (Part 3).

Figure 6: Average Value of Weekly Award and Number of Recipients

	1999-00		2000-01		2001-02		2002-03	
	Weekly Award (£)	Recipients	Weekly Award (£)	Recipients	Weekly Award (£)	Recipients	Weekly Award (£)	Recipients
Working Families' Tax Credit	71	1,026,000	80	1,226,000	83	1,317,000	87	1,377,000
Disabled Person's Tax Credit	66	21,017	73	27,954	77	32,815	78	38,164

Note: Figures for 2002-03 are indicative only.

Source: Inland Revenue.

2.3 Working Families' Tax Credit was available to couples with children and single parents who worked at least 16 hours per week but were on low incomes. Similarly, Disabled Person's Tax Credit was available to people with disabilities who were in work but on low incomes. The amount payable was based on the net weekly income of the applicant's household and comprised a basic entitlement, with additions, for example, for children and childcare costs. Awards were reduced by 55 pence for every pound of income above a prescribed threshold (£94.50 per week for Working Families' Tax Credit awarded in 2002-03).

2.4 The methods of payment of Working Families' and Disabled Person's Tax Credits were: automatic credit transfer; order book; girocheque; or via the claimant's employer. The Department paid out some £4.7 billion in 2002-03 (2001-02, £3.44 billion) through the first three methods and some £1.7 billion (2001-02, £2.2 billion) via employers.

Applicant Compliance

2.5 My report for 2000-01 detailed how the Department were taking steps to improve their intelligence on the likely level and types of non-compliance amongst applicants for Working Families' and Disabled Person's Tax Credit. For this purpose they had examined a representative sample of applications made between August 2000 and August 2001 but they were unable to provide me with the results of the exercise when I finalised my 2001-02 report. At the Committee of Public Accounts hearing in June 2003 on my report on External Fraud against the Inland Revenue, the

Department reported the most common types of non-compliance in tax credit applications identified by this exercise. They told the Committee that they had incorporated the lessons learned into their design of the New Tax Credits. The full results of the exercise on 2000-01 data were made available to me in August 2003.

2.6 The Department estimated that some 10-14 per cent of tax credit payments by value in 2000-01 may have been overpayments due to applicant non-compliance. This represents between £510 million and £710 million for that year. Very few underpayments were detected. The main reasons for the errors were: understated or undeclared income (13% of all applications); understated or undeclared capital (3% of all applications); undeclared partner (3% of all applications).

2.7 The Department regard the 2000-01 exercise as a one-off and have not repeated it for 2001-02 or 2002-03. The results from the 2000-01 exercise do not necessarily reflect the levels of error in 2002-03, as some changes have been made to the compliance regime. But I have seen no evidence to demonstrate that those changes will have produced a significant reduction in the rate of error. I have therefore concluded that the probable rate of error in 2002-03 remained unacceptably high, leading me to qualify my audit opinion on the Trust Statement account for 2002-03 in respect of tax credits payments.

Accuracy of Tax Credit Awards

2.8 In addition to the risk from incorrect information from applicants, Inland Revenue staff made errors when processing applications and calculating awards, resulting in under or over payments. The levels of errors made in processing and calculating awards are shown in Figure 7 below.

Figure 7: Accuracy of processing and calculating awards

	2000-01 %	2001-02 %	2002-03 %
Target Accuracy	92	92	93
Working Families Tax Credit	93.7	87.1	85.2
Disabled Persons Tax Credit	98.0	95.0	90.9

Source: Inland Revenue (these figures are for Tax Credit Office (GB) only).

2.9 As Figure 7 shows, the accuracy in processing tax credits in 2002-03 was lower than in previous years and did not meet the Department's Public Service Agreement target. The value of financial errors made in awards is shown in Figure 8. The rate of error in 2002-03 was much higher than in 2001-02. Although the net cost to the Exchequer of overpayments and underpayments was small, the effect on tax credit recipients increased significantly in 2002-03.

Figure 8: Errors in Tax Credit awards

	2000-01	2001-02	2002-03
Rate of error in awards by value	1.22%	1.73%	3.29%
Potential Overpayment	£27.2m	£53m	£90.8m
Potential Underpayment	£30.4m	£42.6m	£87.6m

Source: Inland Revenue (these figures are for Tax Credit Office (GB) only).

Payments via Employers 2000-01 and 2001-02

2.10 The amount of tax credit expenditure shown by the Department in their Trust Statement account is based on awards made by the Department. The Department can only know that the amount shown as spent reached beneficiaries by checking that employers made payments in accordance with awards. For 2000-01 and 2001-02, I reported that in-year employer compliance work did not enable the Department to evaluate the level of error in tax credits payments by employers. The Department were therefore unable to provide sufficient assurance that employers were paying the amounts awarded by the Inland Revenue.

2.11 As an alternative, the Department sought to obtain assurance by reconciling amounts reported as paid by employers to Departmental records of awards made. This exercise undertaken in respect of 2000-01, identified a number of discrepancies and the Department investigated a sample of 50 of these to see if they could be reconciled. There were 15 outstanding cases which indicated a total overpayment of £9.7 million at the time of my report on 2001-02. The National Audit Office reviewed progress on this exercise as part of their audit for 2002-03 and found that by the end of June 2003 the Department had reconciled these cases to within £0.6 million and had decided to do no further work in respect of 2000-01. The main reasons for the discrepancies were errors in employers reporting tax credit payments and overlaps of payroll periods at the beginning and end of the tax credit year.

2.12 For 2001-02, the Department took a substantial sample of tax credit awards and checked them to the statutory return from employers for individual employees rather than reconciling to employers' end of year tax returns which cover all employees. The Department also traced the original awards from a substantial sample of forms submitted by employers. This work was underway when I reported last year and the final reconciliation rate was over 99 per cent, as notified at the Committee of Public Accounts in January 2003. The Department have found that the main reason for discrepancies remained the overlaps of payroll periods at the beginning and end of the year. In two cases there was no explanation for a significant discrepancy and the employer compliance teams are to investigate further, with a view to recovering any overpayment from the employer.

Payment via Employers 2002-03

2.13 For 2002-03, the Department again reconciled employers' end of year tax returns for individual employees to award notification to gain assurance about the tax credit expenditure reported in the Trust Statement account and the regularity of payments made by employers. The reconciliation exercise will not be competed until later in 2003 in line with the annual cycle of PAYE returns from employers. The Department consider that their initial results are promising, with a high overall reconciliation rate. The National Audit Office will monitor completion of this exercise.

Employer Compliance

2.14 Since my report on 2000-01, the Department's employer compliance teams have increased the information recorded about their visits and improved the documentation of testing. For 2002-03, the Department can identify the number of employers visited who paid tax credits and for large employers, can identify the number of employees checked and the number of errors found. The Department do not, however, quantify or extrapolate the results of their testing so as to estimate the overall level of error, partly because risk-based cases cannot provide an accurate picture of overall compliance. However the Department consider that the reconciliation exercise described in paragraphs 2.11 and 2.12 provides assurance.

Closure of the Working Families' and Disabled Person's Tax Credit Schemes

2.15 In December 2002, the Department produced an outline "decommissioning strategy" for Working Families' and Disabled Person's Tax Credits which focussed on arrangements to wind-down the IT systems. The strategy is closely linked to the Department's emerging Information Strategy. Work has commenced and will continue to progress throughout 2003 and into 2004.

2.16 New instructions for employers to pay tax credits had ceased in August 2002, but payments under those instructions could continue into 2003 depending on the frequency of payroll. This was to allow employers to make preparations for the new tax credits. All payments by employers would have ceased by April 2003. The Department will only know whether employers acted in accordance with their instructions, after they have reconciled employers' end of year returns and awards. This work will not be finalised until the end of 2003. The Department then will assess the level of discrepancy between directions to employers and amounts recorded on employers' end of year tax returns, and decide how to proceed. Any overpayments of Tax Credit to individuals as a result of employer error will be recovered directly from the employer.

2.17 Claims for Working Families' Tax Credit could be backdated for a maximum of three months, but only in exceptional circumstances. Claims could also be backdated for up to one month but only for good administrative reasons. Claims for Disabled Person's Tax Credit followed similar rules, although it was possible to get further backdating if the claim was linked to another sickness or disability benefit. Except for a very few situations, which are specified in regulations, the award of tax credits will not change, whether it is a 26 week award, or an extended award due to the wind down of the old tax credit scheme. This means that changes to family circumstances, earnings or savings that occur during the duration of an award do not affect the amount a family is paid. However, to provide support for ongoing work (for example, associated with appeals) the systems will not be decommissioned until April 2005.

Conclusions

2.18 The Working Families' and Disabled Person's Tax Credit schemes began in 1999, ended on 6 April 2003 and spent some £17.8 billion. The Department were able only in August 2003 to provide me with the results of their examination of samples of tax credit applications made during part of 2000-01. Error rates were 10-14 per cent by value and the estimated level of overpayment for a full year was between £510 and £710 million.

2.19 The Department have not undertaken similar exercises for 2001-02 or 2002-03. The Department emphasise that they had incorporated the lessons learned into their design of the new tax credits. For these tax credits the Department must consider undertaking an exercise each year to determine the effectiveness of their controls in detecting error and ensuring that payments are properly calculated to reflect claimants' circumstances.

2.20 The level of overpayment identified by the Department is cause for serious concern and as a result I have qualified my opinion on the Trust Statement for 2002-03. The improved controls in the new tax credit system should help to reduce overpayments. But the Department are not yet able to assess the likely extent of that reduction.

Part 3: New Tax Credits - Child Tax Credit and Working Tax Credit

3.1 This part of my report examines some aspects of the introduction of Child Tax Credit and Working Tax Credit in April 2003 and important considerations for future developments of the management of these schemes. The Department received some 4.5 million applications and paid some £2.6 billion by the end of June 2003. These two tax credits are expected to cost some £16 billion per year.

3.2 Claimants encountered problems when the new tax credits were introduced. Claims for the tax credits could be submitted from August 2002, and the Department intended that all who claimed by 31 January 2003, were eligible and had provided all necessary information, would receive payment on the relevant payment dates from the start of the schemes in April 2003.

3.3 On 28 April 2003, the Paymaster General made a statement to the House of Commons on the introduction of the new tax credits. In the subsequent debate Members of Parliament expressed concern that: many claimants who had complied with the Department's request to submit application by the 31 January 2003 had yet to receive an award; applications were taking up to seven months to be processed; claimants opting for weekly payments had not received payments three weeks after the first payment date; the helplines supporting claimants and MPs were not able to deal with the number of calls received; and that there were staff concerns over the IT system introduced for the new tax credits.

Child Tax Credit and Working Tax Credit

3.4 There are around 7 million families with children in the UK and the Department estimate that nine out of ten families with children will be eligible for Child Tax Credit. A total of 5.75 million families are expected to benefit from Child Tax Credit during 2003-04, including 1.2 million families on Income Support and Jobseekers Allowance receiving extra support for their children through their benefits. Some 1.35 million families are expected to benefit from Working Tax Credit this year, including 250,000 families without children or a disabled worker, who previously did not qualify for in-work support.

3.5 Tax credits must be claimed and there is a single form for both credits. The Department verify claims and arrange payment to successful claimants. The main features of the tax credits are summarised in Figure 9 below. A tax credit award runs until the end of the tax year, unless the claimant ceases to be eligible and the award is brought to an end earlier. Awards can be adjusted during the year to take account of changes in circumstances. Certain changes in circumstances must be notified to the Inland Revenue within three months, for example those that would bring an award to an end or which are likely to have a large effect on the amount of the award. Other changes do not have to be reported during the year, although the Department encourages claimants to report them if their award would be affected, to keep awards in-line with entitlement. Any increase in entitlement can be backdated for up to three months. Any reduction in entitlement will be backdated to the date when the change in circumstance occurred.

Figure 9: Main Features of Child Tax Credit and Working Tax Credit

Child Tax Credit is:

- available to those aged 16 or over, ordinarily resident and present in the UK, and who are responsible for at least one child, whether working or not
- paid direct to the main carer
- composed of several elements:

Element	**Maximum (annually)**
Family Element (one per family)	£545
Higher Family Element (in first year of child's life)	£545
Child Element (for each child)	£1,445
Disability Element (for each disabled child)	£2,155
Severe Disability Element (for each severely disabled child)	£865

Working Tax Credit is:

- available to working people aged 16 or over, working at least 16 hours per week, with dependent children or a disability **or**, for those without children or a disability, aged 25 years or over and working at least 30 hours per week
- paid via the employer, with the childcare element paid direct to the main carer
- composed of several elements:

Element	**Maximum (annually)**
Basic Element	£1,525
Second adult and Lone Parent Element	£1,500
30 Hour Element	£620
Disabled Worker Element	£2,040
Severe Disability Element	£865
50+ Element 16-29 Hours	£1,045
50+ Element 30+ Hours	£1,565
Childcare Element - childcare costs cannot exceed £135 per week for one child and £200 per week for two or more children	70 per cent of costs

Source: National Audit Office

Preparations for the Introduction of Child Tax Credit and Working Tax Credit

3.6 The Government's intention to go ahead with Child Tax Credit and Working Tax Credit was announced in the 2000 Budget. The Department recognised this to be a large and complex undertaking to be completed to a challenging yet achievable timetable so as to go live in 2003. It included advising Ministers on detailed policy and legislative issues; designing and implementing business and IT systems; and recruiting, training and accommodating staff. The Department started to distribute claim forms for the new Tax Credits in August 2002. They conducted routine and risk-based checks on the completed forms before approving them for payment. The Department intended to carry out this work and put into payment by April 2003 all claims that they had received by 31 January 2003 and that required no further information from claimants. Figure 10 shows their progress in processing claims.

Figure 10: Claim Processing volumes (millions)

	31/01/03	09/04/03	28/04/03	02/07/03
Received	2.7	3.9	4.0	4.5
In payment or ready for payment	1.4	2.8	3.2	4.2
Being processed	1.3	1.1	0.8	0.2
Rejected or identified for rejection	0	0	0	0.1

Source: Inland Revenue

3.7 The Department's IT service provider, EDS, created the new IT systems for processing tax credits. The central component, known as NTC Core, uses links to other Inland Revenue databases and electronic exchange of data with the Department for Work and Pensions to conduct verification checks on claim forms. The NTC Core also calculates awards and where payment is due sends instructions to the Department's payments software. The Department are improving the system to support management information and end of year activities including annual renewals of tax credits.

3.8 The Office of Government Commerce have a central role overseeing major system developments that are critical to government programmes, and conduct Gateway reviews during project development. Their Gateway 3 review in January 2002, which was limited to reviewing governance arrangements, found that the Tax Credits Programme had highly effective governance arrangements which the Office considered set a benchmark for this type of Programme. In December 2002, the Gateway 4 review, "Readiness for Service" described the Programme as "an exemplar of good Programme management", while noting that a large amount of work remained against a tight schedule. The Office of Government Commerce noted throughout these reviews that the Tax Credit Programme was already well advanced when the full Gateway review process was introduced by them in February 2001, hence it was not possible to introduce the Gateway process at project initiation. This meant it was not possible to realise many of the benefits the process brings, which for example covers business justification, scope and modularity.

3.9 The implementation of new tax credits and the systems to support it were overseen by a Programme Board, chaired by a Deputy Chairman of the Inland Revenue, with senior representation from Inland Revenue and Department for Work and Pensions and EDS. It received regular reports about progress from Inland Revenue and EDS teams. But individual software problems were recorded on 'trouble tickets' and these were managed at working level. During the second half of 2002-03 the Programme Board was actively monitoring progress towards implementation and it did not consider that any of the issues raised with it would be likely to prevent delivery of a working system. However, the Programme Board recognised that when the system went live there would still be a number of trouble tickets to be corrected.

Operation of the Child Tax Credit and Working Tax Credit

3.10 There was some slow running and system downtime from January 2003 which the Department considered could be addressed by redeploying resources. When the software release for April went live a number of known IT errors required clerical interventions. The Department and EDS did not consider this to be unusual for IT developments. However, serious problems with system performance from April meant that some processing was delayed. When these performance problems arose they affected the system's:

- stability – staff could not complete the processing of claims and had to start again;
- speed – staff had to wait too long to access information and records;
- availability – significant time in the working day was lost when the system was closed down to clear internal queues.

3.11 Analysis of the technical problems by EDS and "tuning" the system to perform more reliably took several weeks. By mid-June 2003 the Department felt that the system was performing at a reasonable level. In July 2003, the Department told the National Audit Office that they intended to ensure that by autumn 2003 the lessons from the experience on New Tax Credits during the first part of 2003-04 would be learned fully for the benefit of future developments. At the same time they engaged consultants to conduct a review to provide further, independent assurance as to the analysis of the technical problems and the action being taken to address them.

3.12 The Department's consideration with EDS of the underlying technical problems had to have regard to the discussions between them about compensation for the unsatisfactory performance of the system, and the possibility of legal action. In November these discussions were continuing and the Department hoped to resolve them shortly. In the light of this, my report documents in summary the two parties' position and their overall interpretation of events. It was also relevant that EDS were competing for the Department's overall IT service provision, in a project called ASPIRE, a decision on which was due by the end of 2003.

3.13 The Department and EDS told me that in their view:

> "The Inland Revenue and EDS worked together with other parties involved, on testing to make sure that key functions needed for April were ready. This was a complex task. To ensure robust IT functions were available at the time they were needed, the testing strategy was to prioritise the functionality needed first, and to delay less urgent testing. The period of instability in the early months of the live service was caused by queues building up in the channels between system components. The causes of these queues were not detected during testing. The nature of the particular testing regime meant that the underlying technical faults could not have been discovered and corrected in testing although more testing might have reduced the effects of some of the problems. The Department and EDS are considering what lessons can be learned about technical system design and testing strategy, including the effects of a compressed testing timetable."

Recovery plans

3.14 The Department transferred many staff from other work in response to the problems with new tax credits. They subsequently revised their business plans and targets to take account of the effects on the areas concerned and made arrangements to catch up on the backlogs where possible. They consider that they will have recovered much of the lost ground by March 2004 but will not be fully back on track until the end of 2004-05.

3.15 Employers had a significant workload preparing for the new tax credits schemes. They and providers of payroll software were engaged closely by the Department as they devised the flows of tax credit data and forms between the Department and employers. Nonetheless, some employers experienced many problems with the notifications they received from the Department, for example those instructing them to start paying tax credits to individual employees, to vary the amounts and to cease payments. The timing and frequency of notifications was a particular problem at the start of the new schemes. The Department have standing arrangements to log the detailed problems and to discuss them and broader concerns with employers' representative bodies.

3.16 The Department need to resolve as soon as possible in 2003-04 the problems for employers, to ensure that underlying causes are removed and that individual recipients are paid correctly with their wages where appropriate. It will be particularly important for the system of entitlement notifications to be working reliably to enable the Department to check payments by employers.

Making the Tax Credit Payments

3.17 The Government intended that Child Tax Credit payments and payments of the childcare element of the Working Tax Credit would generally be made by automated credit transfer directly into claimants' bank accounts. However, at the end of September 2003 over 500,000 claimants were being paid by giro cheque where bank account details were missing or mis-stated on claim forms to avoid delaying payments whilst the correct details are obtained. Claimants currently being paid by giro cheque and who require a Post Office Card Account will be progressively moved to those new arrangements over the coming months. By mid September around 2,500 claimants were being paid via these accounts. Issuing the additional giro cheques cost some £2.2million over the first three months of the new tax credits.

3.18 The Department had arrangements to provide by giro cheque interim payments to claimants in cases where an expected payment had not been received. In the light of the difficulty caused by slow running IT systems, and in anticipation of high numbers of personal callers, the Department revisited their plans and provided extra resources in Enquiry Centres to deal with the expected rise in requests for interim payments.

3.19 Claimants could claim a payment of up to five weeks' worth of tax credit at their local tax office if they had not received a payment or their claim had not been processed. In April 25,000 interim payments were made, in May 175,000 and in June 75,000. The peak of these payments in May was short-lived and the significant drop in June reflected the growing stability of the IT system and the clearance of the backlog as claims were processed. The Department did not expect to be able to estimate the value of interim payments until the end of November 2003 because of the backlog in processing the manual records of the payments made.

3.20 When a local office made a payment it needed access to the NTC core IT system to update records. The slow running of the system prevented this access in some cases, leading to manual lists of payments made, which had to be transferred to the NTC system when available. The Department face a considerable challenge in ensuring that payments reconcile retrospectively to awards, claimants and eligibility.

Controls over tax credit awards and payments

3.21 When the new tax credits payment cycle was designed, it provided for automatic daily reconciliations between payments authorised and payments made. None of these reconciliations were able to take place because the IT systems could not support the reconciliations. The Department aim to put in place detailed arrangements for catching up with this reconciliation work and for resolving any discrepancies detected by their reconciliations. They told me in September that they were still working with EDS on the reconciliation issues and had not yet finalised their plans. Their work had already identified a large number of cases of apparent underpayments and overpayments.

Conclusions

3.22 New tax credits represented for the Department a major challenge in an area of work which was relatively new to them. The level of the problems caused to tax credit claimants and employers as the systems went live demonstrated that there were undetected gaps in the design of the testing regime for the systems.

3.23 In July 2003 the Department received from EDS an explanation of the technical problems that had delayed payment to claimants. The results of the audit by independent consultants should enable the Department to check whether there are any other technical issues outstanding so that they can be sure that they have learnt the lessons sufficiently to give assurance that similar problems will not occur as the tax credit systems are expanded.

3.24 The Department's consideration with EDS of the underlying technical problems had to have regard to the discussions between them about compensation for the unsatisfactory performance of the system, and the possibility of legal action. In November these discussions were continuing and the Department hoped to resolve them shortly. Once they are resolved I shall return to these aspects .

3.25 The Department must pay particular attention to ensuring that recovery from the problems with the introduction of new tax credits does not undermine their reputation for integrity of processing of taxpayers affairs, which is essential to the effective assessment and collection of tax.

3.26 In addition to the significant challenges of maintaining day to day running of the system and catching up on backlogs, there are many major issues for the Department in controlling Tax Credits for 2003-04. These include ensuring that:

- they have a rigorous approach to deciding how many, and which applications are "higher risk" as they require only those applications to be checked against prior-year income records before payment;
- they can manage the risk if claimants delay reporting changes in their circumstances;
- the problems with the start of the new tax credit systems and recovery from that position, have not led to errors in detailed information about claims or payments.

Part 4: Employer Compliance

4.1 This part of my report examines the Department's Employer Compliance function. Employer compliance reviews provide assurance to the Department on whether employers are meeting their statutory obligations in operating and collecting Pay As You Earn (PAYE) and National Insurance Contributions (NIC) correctly. Reviews also consider compliance relating to: Construction Industry Scheme deductions; Employee benefits; Statutory Sick Pay and Statutory Maternity Pay; tax credits; and student loan deductions.

4.2 In 2002-03, the Department collected £155 billion from employers in PAYE and Class 1 National Insurance Contributions. This represented around 68 per cent of the total gross tax and National Insurance revenue for the year.

The Structure of Employer Compliance

4.3 Employer Compliance is carried out by two parts of the Department, the Large Business Office and the Regional/Area Office network, referred to as the Employer Compliance Network. Figure 11 shows key operational statistics for the two functions for 2002-03.

Figure 11: Key Operational Statistics 2002-03

	Large Business Office Employer Compliance	**Employer Compliance Network**
Number of offices	12 offices operating in 5 clusters	69 Employer Compliance Units operating in 7 Regions
Number of staff	230	2,160
Employer base	3,000 employers operating 20,000 PAYE schemes	Over 1.2 million employers operating 1.6 million PAYE schemes
Reviews taken up	260	35,000
Additional tax and NI collected, interest and penalties as a result of employer compliance reviews	£50.9 million	£258.8 million

Source: Inland Revenue

4.4 The Large Business Office Employer Compliance team, (the Large Business Office), reviews the UK's largest employers (over 1,000 employees), large public sector bodies and smaller, specialist entities such as foreign banks and Lloyd's of London underwriting syndicates.

4.5 The Large Business Office and the Employer Compliance Network carry out two types of compliance review on employers: full or aspect. A full review covers all elements of an employer's operations and includes mandatory checks relating to statutory payroll obligations including PAYE, NIC, Statutory Sick Pay, Statutory Maternity Pay, tax credits, etc. Aspect reviews focus on one or more perceived risks relating to a statutory payroll obligation such as tax credits or to a wider aspect of an employer's operations such as the treatment of expenses and benefits.

Previous Recommendations

4.6 My earlier report on Employer Compliance (HC25, 1999-2000) followed the merger of the Department with the Contributions Agency, bringing together the compliance functions for PAYE and National Insurance. Since the report, the Department have addressed the major issues raised and the Large Business Office and Employer Compliance Network have also reviewed their employer compliance strategies.

Large Business Office Strategy

4.7 For the Large Business Office new developments have been driven by key reviews such as "Review of Links with Business" and "Bridging the Gap between Large Business Office Employer Compliance and Corporation Tax". The "Review of Links with Business" report looked at how the Department could be more supportive to large businesses. Extensive consultations with businesses, accountants, advisers and representative bodies have led to many recommendations and improvements, including:

- developing a "ringmaster" role whereby Large Business Office Case Directors will coordinate all compliance activities, to provide a more consistent service to large businesses.
- establishing a Large Business Office Technical Team, to provide guidance on specific complex technical issues.
- creating Large Business Office Enabling Teams to provide coordinated advice and support to large businesses.

4.8 The "Bridging the Gap" report focused on how the Employer Compliance and Corporation Tax teams of the Large Business Office could work together more closely to support the wider "ringmaster" role of the Case Director.

4.9 The aim of the Large Business Office is to align the customer bases of employer compliance and Corporation Tax to provide a more focused service to large businesses. Some employers currently reviewed by the Large Business Office will transfer to the Employer Compliance Network, for example local authorities and hospital trusts which tend to be single-site employers with less complex tax issues than large corporations.

Employer Compliance Network Strategy

4.10 The Department published in March 2003 a strategic review of the Employer Compliance Network (the Network), which made ninety recommendations being considered during Summer 2003, including:

- the Large Business Office and the Network should work more closely together to ensure consistency of operations and treatment of employers.
- a number of roles in the Network and specific specialist teams should be reviewed and redefined.
- resources should be targeted more effectively on the basis of risk analysis, for example to Areas with higher concentrations of "risky" employers.

4.11 Like the Large Business Office, the Network have also been redeveloping compliance processes facilitated by Department-wide programmes such as the "Modernising PAYE Processes for Customers". The Carter "Review of Payroll Services" report on improving support provided by the Department to small employers, recommended that:

- compliance reviews should concentrate on major problems in the operation of PAYE and National Insurance, rather than narrower issues.
- there should be more emphasis on improvements employers need to make to ensure compliance in the future.
- employers should be encouraged to agree with the Department treatment of particular expenses or benefits in kind to make tax administration easier (known as a "dispensation").

Recent Developments in Employer Compliance

4.12 Figure 12 summarises some of the recent developments in both the Large Business Office and the Network. Some of these developments are covered in more detail in the paragraphs that follow.

Figure 12: Recent Developments

<table>
<tr><th></th><th>Large Business Office Employer Compliance</th><th>Employer Compliance Network</th></tr>
<tr><td>Enabling</td><td>Introduction of Enabling Teams, including dedicated Customer Account Managers.</td><td>5% of Network resources dedicated to enabling activities.</td></tr>
<tr><td>Performance Measures and Management Information</td><td colspan="2">Introduction of more balanced compliance measures focusing on qualitative as well as quantitative outcomes.
Some improvements to the integrity and reliability of data have been made. Data interrogation facilities have improved.</td></tr>
<tr><td>Communications and sharing best practice</td><td colspan="2">Greater degree of joint-working and communication between the Large Business Office and the Network and also across the Department</td></tr>
<tr><td>Planning and Conduct of Reviews</td><td></td><td></td></tr>
<tr><td>• Risk Assessment</td><td>Introduction of a formal risk assessment process to select employers for review.</td><td>Central Risk team provide analysis and risk assessment criteria for reviews.
Area Risk Intelligence and Analysis Teams provide local, specialist risk analysis and support to review teams.</td></tr>
<tr><td>• Systems-based audit approach</td><td>Currently being developed for implementation in Autumn 2003.</td><td>Currently being developed with planned roll out in 2004.</td></tr>
<tr><td>• Quality monitoring</td><td>The Large Business Office Technical Team provide technical advice, support and training to review teams.
Refinement of quality monitoring processes.</td><td>Extension of quality monitoring to all employer compliance reviews.
Introduction of regional Compliance Audit Programme.</td></tr>
</table>

Source: National Audit Office

Enabling Activities

4.13 Compliance activities are increasingly focused on encouraging employers to correct payroll processes for the future, helping improve compliance in the medium term. The Large Business Office have introduced a dedicated Enabling Team, whose responsibilities include:

- acting as a single, permanent contact point for employers and supporting the "ringmaster" role.
- post-review monitoring of employers and completion of a post-review questionnaire.
- ensuring consistency in technical matters and assisting employers with tax dispensations.
- facilitating communication between employer compliance and corporation tax teams.

4.14 The Network have deployed 5 per cent of resources on specific proactive enabling activities, such as post-review visits. Current reviews include some reactive enabling activities but the Department are further developing processes to have a greater focus on enabling, such as a more systems-based audit approach and emphasis on helping employers. The Department plan to have the necessary changes and training in place by April 2004. The National Audit Office support the greater focus on enabling but note that the Department will need to closely monitor and clearly communicate the strategy and required activities. This will allow the Department to measure the benefits of allocating specific resources to enabling and inform business decisions.

Performance Measurement and Management Information

4.15 In 2002, the Large Business Office and the Network introduced new, wider performance measures for employer compliance, based on the Department's balanced scorecard. The National Audit Office welcome the development of a wider range of indicators, but consider that further enhancements are needed to measure more fully the effect of their activities and whether they are improving compliance.

4.16 In 1998 the Department introduced the Employer Compliance System, a database of employer information including details of employers' tax returns and the benefits and expenses provided for their employees which the Large Business Office and Network use to record the outcome of employer compliance activity. The Department have made improvements to the range of information held in the Employer Compliance System and plan further enhancements, including the migration of data from the Employer Compliance System onto the Department's Corporate Data Warehouse - a central repository of shared information - to enable more flexible analysis of data. The Large Business Office have also introduced new processes for recording and monitoring of enabling activities, risk assessments and the results of assurance checks, which have been developed outside of the Employer Compliance System.

4.17 The Department produce standardised reports of regional performance against the national performance measures, accessible at Area, Region and national level. Several Regions produce their own more detailed statistics on performance for each of their Area Offices, which include a number of additional performance measures such as the percentage of cases where penalties are levied. National compliance performance at a regional level is compared centrally whereas compliance performance at Area Office level is compared regionally. At present, extracting performance information at Area Office level centrally is done infrequently because the regular collation of data across all Area Offices would be very time-consuming. With the migration of information from the Employer Compliance System to the Data Warehouse in 2004, the Department are considering the business benefits of creating standardised reports of performance data additional to the national performance measures.

Equity of Treatment and Penalty Rates

4.18 The "settlement" stage of a compliance review requires the Department to negotiate and agree with employers any additional tax, accrued interest and penalties due. Penalties are only due on errors made by the employer in the operation of a PAYE system (known as "culpable" tax), and not where the tax liability is deemed to lie with the employees, for example employee benefits. The penalty is not automatic and at a maximum is 100 per cent of the culpable tax owed, but the penalty charged is abated in the light of the extent of cooperation and disclosures made by the employer, and size and gravity of the errors.

4.19 The Large Business Office ensure equity of treatment through supervision, quality monitoring and authorisation of settlements. Their rate of penalties has averaged around 10 per cent of culpable tax over the last four years. Culpable tax collected has increased over the last four years from £12.7m to £17.4m, which could be due to several factors, such as more widespread non-compliance or more effective review processes. The Department have not analysed formally whether penalties provide an incentive for compliance or deterrent against non-compliance. They have however considered their effectiveness in more general terms as part of the continuing development of the Department's compliance strategy. In that context, the Department should pay specific attention to the impact of penalties.

4.20 The Network also have a quality monitoring regime and management review of settlements. Each Area Office and Region is responsible for ensuring equitable treatment of employers. The National Audit Office found there was some inconsistency of treatment of employers across Area Offices. On the basis of indicators such as penalties and additional tax collected, there are significant variations in performance. The percentage of cases where penalties are levied in some Area Offices is more than double the rate in others. Some variations such as additional tax collected can be explained by specific demographic factors in particular Areas, but differences in the percentage of penalty cases cannot be explained. The lack of readily available comparable data between Area Offices nationally, as noted in paragraph 4.17 above, means the extent of differences cannot be fully evaluated at national level.

4.21 The Department are concerned about the consistency of performance across the Network and have started to tackle variations in performance with initiatives to improve knowledge and understanding of penalties and the sharing of best practice. The introduction of the regional Compliance Audit Programme and the extension of quality monitoring to all reviews, may also improve consistency of performance across Regions and Area Offices.

The Planning and Conduct of Compliance Reviews

4.22 Since 1999-00, the Department have made improvements to the planning and conduct of reviews. Standardised working papers record work done, documents reviewed and conclusions reached. More integrated quality monitoring procedures help ensure each stage of the review is undertaken in accordance with defined standards and requirements.

4.23 Until 2003-04, the Large Business Office operated a very limited form of risk assessment. Under the recently introduced more comprehensive system, a proportion of employers are risk-assessed annually, based on cyclical coverage of the customer base. In the future, when the customer bases of the Large Business Office are aligned, all large employers will be risk scored annually. This alignment is already in place for 250 large employers and the Department expects to complete the alignment for all large employers by July 2004. In order to evaluate this and other revised processes, the Large Business Office are recording and monitoring separately data on identified risks and outcomes from compliance reviews.

4.24 The Network are developing a more systems-based approach to reviews, similar to that developed by the Large Business Office. In 2004-05 they plan to have more structured reviews, based on an assessment of the risks in the processes and systems operated by employers. The Network have an established risk assessment process, led by a central risk team who undertake very detailed analysis of employers and compliance review results. They determine the characteristics and types of employer likely to be non-compliant and provide criteria for the selection of 40 per cent of all employer compliance reviews. The Network is also supported by local Risk Intelligence and Analysis Teams providing local risk and intelligence services. Risk Intelligence and Analysis Teams work in partnership with the Network employer compliance teams to ensure reviews are focused on risky employers. In addition, random reviews are undertaken, which act as a deterrent across the employer population and enable better understanding of the nature and extent of non-compliance.

4.25 A great deal of research and analysis has been undertaken by the Network, for example on the effectiveness of random reviews compared to risk-based reviews. The National Audit Office recognise there is an inherent delay between review completion and collection of resulting data, but found that little analysis had yet been undertaken on the different types of employer compliance review. Evaluation of Risk Intelligence and Analysis Teams' selection is particularly important, to ensure consistency of performance across the Network. The National Audit Office also noted that no evaluation of Aspect reviews had been undertaken to date. The Department plan to carry out further evaluations in 2003-04, such as geographical analysis of employers and Aspect reviews.

Opportunities to enhance assurance provided by Employer Compliance

4.26 The Large Business Office and the Network are required to provide assurances to the Chairman and Board of the Inland Revenue that employers are meeting their statutory obligations in correctly operating and collecting PAYE and National Insurance Contributions. Assurances are also given on the operation and administration of Statutory Sick Pay and Statutory Maternity Pay, student loan deductions, tax credits and the Construction Industry Scheme.

4.27 The National Audit Office found that the number of records selected for some of the assurance checks at employers is very small and not based on statistical methods. Hence it is not possible for the Department to extrapolate reliably and to draw quantified and reasonably precise levels of assurance from this work. For example, only three employees are checked for tax credits compliance in a large employer, whilst in the Network at least one employee is checked. With the introduction of new tax credits the Network will increase the number of employees checked to five per employer, in 2003-04.

4.28 The National Audit Office also found that only limited information on the results of these checks was recorded or available to provide readily accessible management information. The Large Business Office report the number of employees tested and volume of errors found. The Network record results on the Employer Compliance System only if the checks led to additional tax collected. They know the number of employers reviewed that pay tax credits, but not the number of employees tested or types of error found. Planned enhancements in 2004 aim to allow more detailed information on testing undertaken and errors found. The limited information held on the results of these checks which can be easily interrogated further reduces the level of evaluation which can be undertaken to provide assurance.

4.29 The National Audit Office looked at checks carried out by the Department on Tax Credits paid via employers. During a review, the following checks for a sample of employees are undertaken:

- whether the employer is paying Tax Credits to employees in accordance with the notification from the Department's Tax Credits Office.
- tax credit start dates and stop/cancellation notices issued by the Tax Credits Office to employers.
- reasonableness of any Departmental pre-funding requested by the employer to help with their cash flow.
- Large Business Office officers are instructed to do a reasonableness check on an individual's Tax Credit entitlement by looking at the employer's records on pay and hours worked and any indications of possible collusion or fraud.

4.30 Employer compliance teams work with other sections of the Department such as the Tax Credits Office, Special Compliance Office and Risk Intelligence and Analysis Teams. Where there is any evidence of possible fraud or collusion, employer compliance teams will refer the case to the Special Compliance Office. Similarly, the Tax Credits Office make referrals to Employer Compliance Investigation Teams, to carry out an Aspect review on tax credits for that employer.

4.31 The National Audit Office believe there is merit in considering further opportunities for the employer compliance and claimant compliance teams to work more closely together on tax credit compliance. At present, employer compliance teams check that the employer complies with Tax Credits Office notifications, whilst claimant compliance officers check entitlement to tax credits. There may be duplication of effort, inefficient use of available information and an inconsistent approach under the current regime of separate testing carried out by different teams. For example, employer compliance teams could check whether hours and pay declared by an employee on a tax credit application form are consistent with the employer's records.

Conclusions

4.32 The Department's employer compliance activities provide assurance that employers are collecting PAYE income tax and National Insurance Contributions correctly. These activities are important to the collection of some £155 billion, or 68 per cent of total revenue. The National Audit Office found no major weaknesses in the systems relating to employer compliance.

4.33 The Department have introduced many new initiatives to target more effectively their compliance resources and to help employers. The Department should develop further their methods to measure the impact of their compliance activities, including enabling activities designed to improve employer compliance.

4.34 Departmental statistics suggest geographical variations in employer compliance performance, such as in the percentage of cases where penalties are levied. The rate of penalties levied for large employers have been applied consistently. The Department need to consider ways in which they can monitor and report more effectively on the equity of treatment of smaller employers and consistency of performance. The Department should also continue to consider the overall effectiveness of the penalty regime.

4.35 Employer Compliance checks on aspects of payroll administration such as tax credits may not be sufficient to provide adequate assurance to the Board and to Parliament on the proper treatment of those items by employers overall. Employer Compliance and tax credit claimant compliance teams, worked separately in 2002-03. Following a National Audit Office suggestion, the Department are to undertake a joint review to consider the opportunities of a more co-ordinated approach to tax credit compliance. They should consider the sufficiency and validity of the current checks and the need for quantifiable assurance on tax credits.

Part 5: Capital Gains Tax

5.1 This part of my report examines arrangements for assessment of Capital Gains Tax. The amount of tax collected is relatively small compared to other tax streams. In 2002-03 £1.6 billion was collected representing some 1 per cent of gross Inland Revenue receipts (excluding National Insurance Contributions). Capital Gains Tax was introduced in 1965 and is chargeable on the disposal of certain assets by individuals, personal representatives and trustees. The main assets incurring a charge on disposal under Capital Gains Tax are shares in companies (70 per cent of total gains) and land and property (23 per cent of total gains) (based on figures for 2000-01 the latest data available).

5.2 The capital gain is the difference between the sale price and allowable expenditure on the asset including the cost of acquisition. This capital gain may be reduced by a number of statutory reliefs and deductions to give the "chargeable" gain. For 2002-03, tax is payable on chargeable gains exceeding a minimum threshold of £7,700 for individuals and £3,850 for Trustees. Companies account for capital gains in a similar manner but the amount chargeable is subject to Corporation Tax rather than Capital Gains Tax.

5.3 Between 1992-93 and 1999-2000 the numbers of taxpaying individuals declaring capital gains on their tax returns increased considerably, from some 60,000 to 186,000 (Figure 13). The amount of gains recorded on asset disposals also increased significantly reflecting movements in company share values over the period. Increases in the value of shares after purchase are traditionally the largest generator of Capital Gains Tax. The latest statistics indicate that the number of taxpayers peaked in 1999-2000, reducing to 179,000 in 2000-01 and 123,000 in 2001-02. The number of Trusts declaring capital gains has increased by a similar proportion but the total number and amounts involved are smaller than for individuals.

Figure 13: Numbers of taxpayers declaring capital gains and amounts involved (estimates)

Year	Individuals			Trusts		
	Number (000)	Gains (£bn)	Tax (£bn)	Number (000)	Gains (£bn)	Tax (£bn)
1992-3	60	1.9	0.5	9	0.3	0.1
1993-4	77	2.7	0.8	12	0.4	0.1
1994-5	64	2.2	0.7	10	0.4	0.1
1995-6	86	3.1	0.9	13	0.8	0.2
1996-7	97	3.9	1.2	20	1.0	0.3
1997-8	142	5.4	1.7	28	1.6	0.4
1998-9	135	6.0	1.9	25	1.0	0.3
1999-0	186	8.8	2.8	29	1.5	0.5
2000-1	179	7.8	2.4	25	1.3	0.4
2001-2	123	4.5	1.3	17	0.8	0.3
2002-3	Detailed figures are not yet available for 2002-03					

Source: Inland Revenue

5.4 The amount of Capital Gains Tax received in 2002-03 was some 44 per cent less than 2001-02. The main reasons for this significant diminution in receipts were the reduction in capital value of companies on the Stock Market and resultant losses rather than gains being made on the disposal of shares.

5.5 For 2001-02, Figure 14 shows the numbers of individual taxpayers and amounts of tax paid stratified by range of gains. Similar results occurred for the two previous years. Of the 123,000 taxpayers liable to Capital Gains Tax, 32 per cent of taxpayers in the lowest range contribute only 1 per cent of the tax yield whilst the top one per cent of taxpayers account for 34 per cent. Analysis of capital gains by the amount of individual taxpayers' income shows that those with an income in excess of £50,000 account for some 49 per cent of all gains.

Figure 14: Analysis of taxpayers (individuals only) by amounts of capital gains made (2001-02)

Range of gain (lower limit in £)	Individuals		Tax paid	
	Number (000)	Percentage	Amount (£m)	Percentage
1	39	32	12	1
10,000	51	42	118	9
25,000	18	15	158	12
50,000	8	6	179	14
100,000	4	3	234	18
250,000	1	1	164	12
500,000	1	1	147	11
1,000,000	-	-	300	23

Source: Inland Revenue

Accountability and Capital Gains Tax management

5.6 Different management areas within the Inland Revenue are collectively accountable for the administration of Capital Gains Tax. The Capital Taxes business stream is responsible for policy advice to Ministers regarding legislative changes and for technical guidance on the operation of the tax including specialist advice to operational staff on difficult issues. The operational work is undertaken by staff in Area Offices and the Complex Personal Return teams. A 'virtual' Capital Gains Tax Board has been formed to provide a single strategic view of the tax stream. The Board provides a forum where those with the main responsibilities for the tax can co-ordinate their actions to achieve Government objectives.

5.7 The Policy Group within Capital Taxes was reviewed recently by Internal Audit who found that the effect of policy changes was not always being evaluated after implementation. Without evaluation it is difficult to assess the effect of changes. Internal Audit recommended that, in future, the effect of policy changes should be monitored. Capital Taxes have accepted this recommendation and are working to improve their evaluation of new policy.

Capital Gains Tax Avoidance

5.8 Tax avoidance is a term used to describe actions taken by taxpayers and their advisors to reduce tax liability by exploiting loopholes in legislation. When the Department identify a capital gains avoidance scheme, it is referred to the Capital Taxes Technical Group for analysis and guidance. The Group is staffed by Capital Gains Tax specialists who undertake complex technical work and act as a centre of expertise for compliance staff. They also liaise with and provide assistance to Departmental teams tasked with combating avoidance schemes. If significant amounts of Capital Gains Tax are being lost due to the use of a scheme which is legally sound, the Technical Group consults with the Policy Group about amending legislation.

Compliance

5.9 Declarations of Capital Gains Tax are made annually on Self Assessment returns and are covered by the same quality procedures. The processing of capital gains information on the returns and any subsequent enquiries follow the procedures for Self Assessment. Cases for enquiry are selected by assessing the risk suggested by the information on returns and identifying cases where misdeclarations may have occurred. Where the value of an asset disposal is in doubt, details are referred to a specialist section within the Inland Revenue for verification of the value used.

5.10 If Inland Revenue enquiry staff suspect that the stated disposal value of an asset is incorrect they refer the details to an area known as "Shares Valuation", who use internal expertise and specialist information sources to provide an open market valuation on the item in question. Referrals are also made in respect of transactions which will be declared on future returns, usually in response to a query from the taxpayer. If the value cannot be readily calculated from information supplied, or the estimate differs from that shown by the taxpayer, they will negotiate and come to an agreed figure. Most valuations concern the sale of unquoted company shares but the area also covers a wide spectrum of other assets including foreign property, boats, aeroplanes, wine collections, mineral rights and bloodstock. Valuations on UK property are provided by the Valuation Office Agency, property in Northern Ireland is valued by the Valuation and Lands Agency.

5.11 In 2002-03 the Shares Valuation area received a total of 20,943 valuation requests, of which 11,357 were in respect of capital gains by individuals and Trusts resulting in increases to valuations totalling £487million - an average of nearly £43,000 per case. Where the Department considered it necessary to negotiate with the taxpayer, some 36 per cent of the cases resulted in agreed adjustments to the original value.

5.12 The Department have developed considerable expertise in determining which types of asset disposals are most likely to be incorrectly stated by taxpayers. This information is of considerable interest to staff in Area offices who select returns for enquiry. During 2002, Shares Valuation staff initiated a programme of liaison visits with the intention of sharing best practice. By the end of March 2003, most Area offices had been visited and the number of valuations which they queried in relation to capital gains tax had risen by 15 per cent.

New Initiatives

5.13 Staff from the Capital Taxes area and the Department's Service Delivery Support organisation meet regularly and are jointly responsible for a project known as the "Capital Gains Initiative". The objectives of the initiative include:

- improving the understanding of Capital Gains Tax by taxpayers and their advisors;
- improving co-ordination of compliance activities;
- assisting consistency of approach nationally; and
- making more effective use of resources.

5.14 During 2002-03, the Department had:

- commenced the Capital Gains Tax manual revision;
- issued new guidance for area compliance staff;
- provided specialist guidance and training for staff on the new Complex Personal Return teams; and
- introduced targets for initiating Capital Gains related enquiries.

5.15 In 2002-03 the number of adjustments made to taxpayer Capital Gains calculations as a result of enquiry work increased from the previous year by 28 per cent. The total amount of adjustments to declared gains increased by 117 per cent to over £465 million.

5.16 The tax affairs of individuals with high income and/or net worth are generally more complex than other taxpayers. These taxpayers were monitored by the national network of area offices but in February 2000, an internal review team recommended that specialist teams should be formed so that the Department could better manage the tax and provide better customer service to these taxpayers.

5.17 During 2002, "Complex Personal Return" teams were set up throughout the United Kingdom managing the most complex 40,000 Self Assessment taxpayers. The intention is that the teams should accumulate knowledge on the complexities of these taxpayers' arrangements and as a result, improve customer assistance and compliance, and maximise the value of available resources. Internal Audit assisted implementation and have subsequently reviewed the arrangements, giving assurance that the enhanced training and guidance has been effective. The teams were fully operational from April 2003 and the Department will undertake a post implementation review to evaluate the effectiveness of the initiative overall.

5.18 Outside of the Complex Personal Return teams, compliance work on Capital Gains Tax is undertaken by regional Income Tax Self Assessment enquiry staff. In some Areas small specialist teams have been formed to concentrate on Capital Gains Tax. Adjustments to taxpayer returns were significantly higher when Areas used specialist teams. As part of their review of Capital Gains Tax, Internal Audit have recommended, and the National Audit Office support, that the use of such teams should be encouraged.

Performance and Management Information Systems

5.19 Performance measures for Capital Gains Tax do not contribute directly towards the Department's Service Delivery Agreement targets. They are, however, used by management to monitor effectiveness and efficiency of the administration of the tax stream. The management information available to staff engaged on Capital Gains Tax work is currently not as extensive as it could be.

5.20 Taxpayers are required to submit detailed information on transactions relevant to the tax on their Self Assessment forms but the Department do not record all of this information. Internal Audit's recent review recommended improvements to the system to increase the amount of information available to staff engaged on Capital Gains work. Inland Revenue staff are currently studying options for improvement.

5.21 The Department do not believe that a reliable estimate of the amount of capital gains which taxpayers do not declare could be prepared, because of the absence of an independent measure of total liability and the difficulties in gathering enough pertinent data. Instead they target compliance effort using an approach based on risk assessment. The absence of such an estimate may constrain the Department's ability to assess the effectiveness of capital gains compliance.

Conclusions

5.22 Capital Gains Tax contributed £ 1.6 billion – around one per cent of the total taxes collected by the Inland Revenue in 2002-03. Some 32 per cent of Capital Gains Tax payers provided just one per cent of that collected, whilst one per cent of taxpayers contributed some 34 per cent. Recent initiatives to enhance the effectiveness of the Capital Gains Tax systems include the creation of teams specialising in Complex Personal Returns and, in some geographical areas, small specialist teams. The Department are undertaking internal reviews to improve the information available to management to help them target resources to best effect.

5.23 The Department are developing their research into areas of non-compliance but do not consider it practicable to measure the tax gap specifically attributable to Capital Gains Tax. Most Capital Gains Tax arises from taxpayers with high net income or high worth and so it is likely that non-compliance on the part of those taxpayers covered by Complex Personal Returns teams would have the biggest impact on the Capital Gains Tax yield. The Department should ensure that their research explores as fully as possible the scope for detecting, estimating and minimising non-compliance with Capital Gains Tax obligations in this particular customer group.

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