



Treasury Minutes on the Thirty-second to the Thirty-fourth and Thirty-sixth Reports from the Committee of Public Accounts 2003-2004

- 32nd Report: HM Customs and Excise Standard Report
- 33rd Report: Income generated by museums and galleries
- 34th Report: Strategic Rail Authority: improving passenger rail services through new trains
- 36th Report: Tackling VAT fraud

**Presented to Parliament by the Financial Secretary
to the Treasury by Command of Her Majesty
September 2004**

TREASURY MINUTES DATED 15 SEPTEMBER 2004 ON
THE THIRTY-SECOND TO THE THIRTY-FOURTH AND
THIRTY-SIXTH REPORTS FROM THE COMMITTEE OF
PUBLIC ACCOUNTS, SESSION 2003-2004

© Crown Copyright 2004

The text in this document (excluding the Royal Arms and departmental logos) may be reproduced free of charge in any format or medium providing that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as Crown copyright and the title of the document specified.

Any enquiries relating to the copyright in this document should be addressed to The Licensing Division, HMSO, St Clements House, 2-16 Colegate, Norwich, NR3 1BQ. Fax: 01603 723000 or e-mail: licensing@cabinet-office.x.gsi.gov.uk

Thirty-second Report

HM Customs and Excise Standard Report

PAC conclusion (i): There is significant uncertainty about any estimates of spirits fraud based upon current methodologies and data sources. The methodologies and data sources used by Customs and the Scotch Whisky Association for estimating spirits fraud levels result in widely different estimates of consumption. Customs should disclose ranges of values to reflect the uncertainty.

1. The Department accepts the Committee's recommendation. Measures of illegal activities inherently have a degree of uncertainty attached to them and for this reason we already publish accuracy ranges for some of our estimates. This approach will be extended to cover all revenue loss and market share estimates.

PAC conclusion (ii): Manufacturers will face significant costs in buying tax stamps and incorporating them into production processes. Measures were announced in the Budget speech aimed at offsetting additional costs caused by introducing tax stamps. Drawing upon the recently completed Regulatory Impact Assessment, Customs need to identify likely additional costs arising from the introduction of tax stamps and take appropriate steps to mitigate these costs.

2. The Department agrees with the Committee's recommendation. Ministers and Customs have given clear assurances that the additional costs to the industry of tax stamps will be minimised, consistent with the need for a robust system which tackles spirits fraud.

3. The compliance costs set out in the Regulatory Impact Assessment (RIA) were calculated on the basis of industry paying for the duty stamp and were gross of any offsetting measures. As the Committee is aware, the net compliance costs will be much lower as the Government has undertaken to bear the production and distribution costs of the stamps and to seek to avoid a requirement that stamps be paid up front. These measures could reduce the industry's estimated cashflow costs, which make up 40 per cent of ongoing compliance costs. In addition, the Government has committed to freeze spirits duty rates for the remainder of the Parliament and provide a £3 million fund for assistance with capital investment.

4. In addition the Government introduced amendments to the Finance Bill at Report Stage which would allow the duty stamp to be included in the label on a bottle rather than in a strip over the bottle opening. If adopted, incorporating the duty stamp into bottle labels could lead to a 40 per cent reduction in the compliance costs identified in the RIA.

5. Discussions are continuing with the industry, mainly through the auspices of the Joint Alcohol and Tobacco Consultation Group (JATCG), on ways to minimise compliance costs still further and to assess the impact of offsetting measures. Since the budget, 10 meetings have been held with JATCG representatives and a working group has been established to focus on compliance costs and potential offsetting measures. The Department has also met with other trade associations and a number of individual businesses to explore how to reduce company specific compliance costs.

PAC conclusion (iii): Customs should make better use of existing information from alcohol producers to track suspected illicit products. Customs could then target resources more effectively at the point where alcohol is diverted in the supply chain. They should also discuss with the trade the effectiveness of current anti-fraud measures and the opportunity for further regulatory or operational improvement.

6. The Department accepts the Committee's recommendation. We are currently expanding the system by which we attempt to track and trace the supply chain associated with a seized consignment of illicit spirits. This work can often be thwarted, however, if the UK producer concerned is unable to identify confidently a single, exclusive customer from the batch numbers on the bottles, or when large consignments are broken down into smaller quantities as the product passes down the supply chain.

7. A number of fora are in place for the Department to meet regularly with the trade representatives, with the two main bodies being the Joint Spirits Fraud Task Force and the Joint Alcohol and Tobacco Consultation Group. Through these discussions we continue to examine ways in which information provided by the industry can be used effectively to combat fraud.

PAC conclusion (iv): Customs' estimates would suggest that there is no beer and wine duty fraud though operational teams have seized non-duty paid beer and wine so fraud is clearly taking place. Customs should seek to develop alternative methodologies and identify new data sources to produce better estimates.

8. The Department partially agrees with the committee's recommendation. However, the description of our estimates is misleading. We explicitly recognised the existence of some beer fraud in the last published set of fraud estimates¹ in which it was assessed that there were no clear indications that such fraud represented more than four per cent of the UK beer market.

9. There is typically an inherent margin of error of several percentage points (plus or minus) when tax gap methodologies are used. This can give rise to a statistical result of zero even though fraud is known to take place. This is the case with beer and wine fraud.

10. At no stage have we sought to suggest that there is no beer or wine fraud, indeed we publish details of wine and beer seizures in our annual report. We will continue to publish our best assessment of the scale of beer and wine fraud, drawing on all available data sources.

PAC recommendation (v): Poor communication within Customs has undermined anti-fraud operations and prosecutions. Customs need to improve communication between their anti-fraud teams throughout the Department to avoid repeating failures in previous operations which have led to the loss of key evidence and the destruction of documentation. Customs also need to improve the sharing of lessons learned from successful operations across the Department to allow these to be taken into account in future anti-fraud activities.

11. The Department partially accepts the Committee's recommendation. Communications between operational teams have been greatly improved with the on-going re-structuring of our intelligence work. A senior manager has been appointed as National Intelligence Co-Ordinator for alcohol (and for the other priority commodities) and will be accountable for the delivery of alcohol intelligence across the department. This role will be supported by the formation of a single, central team to receive, analyse and distribute risk information and other alcohol intelligence. This team, based on the models successfully deployed in the VAT, tobacco and oils sectors, will be operational by the end of 2004 and will help co-ordinate our alcohol operational activity across the UK.

¹ "Measuring and Tackling Indirect Tax Losses", published alongside the Pre-Budget Report December 2003.

12. We have recently implemented the first phase of a systems development to upgrade our secure suspect and offenders database. The system now provides a more robust framework for the review and retention of data. We will start to implement the second phase by the end of 2004 which will extend access to more operational users and replace a range of older databases, and will serve to further improve communications between operational teams.

13. A recently created cross-functional expert group, which meets once a month, has the primary function to agree our anti-fraud exercises for the next period. It is also key in identifying and disseminating lessons learnt from previous operations.

14. These developments have created an environment in which it is unlikely that the sort of communications problems highlighted by the National Audit Office can recur.

PAC Conclusions (vi): Customs need a consistent and effective way of evaluating the results of the work of the Large Business Group and the Regional Business Services and the contribution of these groups to departmental targets. Customs... need to develop more effective measures than are currently available to evaluate the return on their investment in large business work.

15. The Department agrees with the committee's recommendation. The Department already has performance management teams for VAT, Excise and Customs who develop measures, evaluate performance and report against departmental targets across Large Business Group (LBS) and Regional Business Services (RBS) activities.

16. These teams report on such issues as tax yield, levels of return and payment compliance and include, for example, the relationship between net additional liability and staff year usage for various functional areas. High level indicators are supported by a number of lower level measures that can be used to perform trend analysis and evaluate the results of interventions and actions.

17. Businesses are ranked by risk, and counter measures to these risks form part of our assurance programme. The appropriate cross-functional intervention can then be deployed to address those risks.

18. We have recently modified the means by which we measure the level of compliance of businesses engaged in International Trade. Based upon compliance history and behaviours exhibited by businesses, we have positioned each at a point along the Compliance Continuum, such that we can better target those where there is the greatest need to improve performance. Thus a combination of trader risk, regime risk, and the level of compliance combine to inform the frequency and nature of our assurance activity. The results of that assurance activity are used to re-inform risk, and causal analysis of detected errors is used to prevent recurrences.

19. For VAT, developments on sticking tax² measurement will enable the Department to report achievement across LBG and RBS. This indicator reflects the direct impact of assurance processes on increased tax yield. Currently this measure is not statistically robust, but further work will be undertaken to improve it. Measures research, planned for later this year, will also build on work undertaken last year to better understand the correlation between our large business assurance work and increased yield. The Department will also improve their monitoring of tax yield by looking at VAT yield by trader sector. This, together with a sectorised analysis of large business Strategic Assurance Plans should provide us with a better insight into the relationship between resourcing to risk and improved yield.

² Sticking Tax is the amount of VAT which is paid to the department by a trader and which is not subsequently reclaimed as input tax by another trader. The tax therefore "sticks" with the department and has a direct impact on yield.

Thirty-third Report

Department for Culture, Media and Sport

Income generated by the museums and galleries

PAC conclusion (i): The museums and galleries have achieved a creditable performance in generating their own income but there is unrealised potential. There is scope for growth across a wide range of activities including catering, shops, mail order and e-commerce. Fundraising and venue hire continue to be promising areas for income growth, which usually give a high return. And there are opportunities to learn from new and innovative ways money is being made at some of the museums and galleries, and in the wider museums sector.

1. The Department for Culture, Media and Sport (DCMS) welcomes the Committee's report on the income generated by the 17 museums and galleries that it sponsors. Together with the National Audit Office (NAO) the Department will hold a seminar in November 2004 which will provide an important opportunity to discuss with all its sponsored museums and galleries the lessons of this report and how they can be taken forward. The Department appreciates the Committee's recognition of the "creditable performance" of these bodies in generating their own income (£108 million in 2002-03) but acknowledges that there is scope for further growth. As the Department told the Committee, every one of these sponsored bodies has a plan to generate more income and is keen to do so.

PAC conclusion (ii): The museums should set five-year targets for income growth, with milestones, against which they and the Department can monitor progress. Targets should be supported by plans based on a systematic review of their assets and opportunities, an appreciation of which areas are most profitable and an assessment of the risks.

2. Through its Funding Agreements with each of its sponsored museums and galleries, the Department will encourage them to set targets for income generation. In line with the targets for all the Department's Funding Agreements, these will cover a three-year spending review period. The targets will be negotiated on the basis of each institution's funding plans for the spending review period and beyond and will have full regard to assets and resources, opportunities and the assessment, by each body, of the risks.

PAC conclusion (iii): The museums and galleries need a better understanding of the costs they incur in generating income. Many of the museums and galleries do not know with any accuracy what profit they make on some of their income generating activities and some have lost money. For each of their moneymaking activities, including those not undertaken solely for commercial reasons, they need clear objectives and financial targets, and accounting systems to measure financial performance.

3. The Department agrees that museums and galleries need a full understanding of the costs and risks that they incur in generating income. All income generating businesses entail an element of risk and potential loss and the income generating activities of the sponsored museums and galleries are no exception. The Department therefore encourages all its sponsored museums and galleries to have in place effective risk management strategies and will subject these strategies to scrutiny.

4. In some cases, bearing a loss initially may be part of the cost of building a brand. In others, such as academic publishing, where the activity is primarily to disseminate knowledge rather than generate income, some subsidy may be justified. The Department recognises that it is important that museums should have robust and sufficiently business-like management information systems, to ensure that such subsidies are accurately identified and considered against other priorities in the use of resources, and should an unintended loss occur, that it is identified quickly and dealt with.

PAC conclusion (iv): The Department should explore with Partnerships UK how to make investment funding for income generation schemes more accessible to museums and galleries. Museums and galleries are heavily reliant on finding private sector partners for new business ventures, which can be difficult and time-consuming.

5. The Department agrees with the Committee's conclusion and is exploring investment funding with Partnerships UK. Partnerships UK will be represented at the income generation seminar that the NAO and the Department will hold jointly on 16 November 2004.

PAC conclusion (v): The museums and galleries need to be more entrepreneurial. To help identify new ideas for income generation and advise on how best to deliver them, the Department should see what can be done to draw on the knowledge and skills of experienced entrepreneurs. The Department should appoint more entrepreneurs as trustees and encourage Boards to appoint entrepreneurial Directors.

6. The Department agrees that while its sponsored museums and galleries have been very willing to develop a more entrepreneurial approach to income generation, there is scope to do more. The Department is taking a number of steps to address this. First, the Department is appointing more business trustees to the Boards of its sponsored museums and galleries. For example, between January 2002 and March 2004 the Department arranged the appointment of 20 business trustees. Second, the Department encourages sponsored museums and galleries to recruit appropriately experienced and skilled staff, including senior managers. The Department is also working with the new Clore Leadership Foundation which is running fellowships for the arts leaders of the future. As the Department told the Committee, the Foundation will be putting financial acumen and entrepreneurial skills at the core of the curriculum. Third, the Department will encourage development training, very rigorous business plans and business management procedures. The Department also supports the proposed Creative and Cultural Industries Sector Skills Council which is expected to play an important role in developing workforce skills. The Museums themselves are increasingly working together on training and personal development.

PAC conclusion (vi): The museums and galleries need to develop their skills for income generation across most of the core areas, such as retailing and fundraising. The Department should promote greater sharing of knowledge and skills by:

- exploring whether some smaller museums and galleries could pool staff resources and work together to generate income;
- establishing an exchange programme between the museums and galleries; and
- putting on a programme of events and training, for example in collaboration with the Museums Trading Association.

7. The Department welcomes the Committee's recommendations and encourages the sponsored museums and galleries to put them into practice. The Department will discuss with the museums and galleries the opportunities for pooling staff resources and working together to generate income and will explore the potential for establishing an exchange programme. The Department has invited a representative from the Museums Trading Association to the seminar that DCMS and NAO are organising on the theme of income generation on 16 November 2004. This will provide a valuable opportunity for sharing of information and for supporting the Museums Trading Association in its role. The Department is keen to create the conditions for success through a mixture of development, training, very rigorous business plans and business management procedures.

PAC conclusion (vii): Charging for special exhibitions should not exclude people on low incomes from seeing the best of what museums and galleries offer. Income from paying exhibitions has doubled since the introduction of free admission to the main museum or gallery in 2001 but the Department cannot say what impact these charges are having on attendance by people from lower income groups.

PAC conclusion (viii): Museums and galleries should collect data on the socio-economic status of visitors to paying exhibitions as well as to the museum in general. If people on low incomes tend not to visit special exhibitions, the Department, in conjunction with the museums and galleries, should review pricing policies; in particular the use of concessions, and the targeting of audiences in the way exhibitions are promoted.

8. The Department notes the Committee's conclusions. Access to the permanent collections of DCMS sponsored museums and galleries and to exhibitions of the very best of those collections is free and the impact of that provision has been assessed. Special exhibitions, on the other hand, entail the assembly of important pieces from other collections, often from abroad and at high cost. They enable people to see objects from all over the world without the inconvenience and substantially higher cost of travelling to see them. Concession tickets are usually available for entry to special exhibitions. It is possible that some targeted special exhibitions may not be charged but that is at the discretion of the trustees, as is the pricing policy in general. The Department will discuss this issue with the sponsored museums and galleries when discussing the Funding Agreements and marketing and will establish whether there are any changes that can usefully be made.

9. The Department will invite its sponsored museums and galleries to assess separately the extent to which special exhibitions for which admission is charged attract visitors from the lower income groups.

Thirty-fourth Report

Strategic Rail Authority: improving passenger rail services through new trains

Since the time that the National Audit Office submitted its report to the Committee, the Government has announced (on 15 July) the outcome of its review of the rail industry. Its conclusions, set out in the White Paper “The Future of Rail” published on the same day, mirror many of the Committee’s concerns, particularly about the fragmentation of the industry and the need for it to have a coherent and effective management structure. One of the White Paper’s main proposals is that the Department for Transport should take on responsibility for giving strategic direction to the industry and that the SRA should be wound up. The detailed responses to the Committee’s recommendations which follow reflect that proposed shift of responsibility as well as other changes expected to be brought about by the implementation of EU Directives.

PAC conclusion (i): The SRA should require TOCs and ROSCOs to work more closely with manufacturers and passenger representatives to take account of the features and facilities that passengers need in the design of new trains.

1. The Government agrees with the Committee on the need for early involvement of passenger groups in the specification process. The Strategic Rail Authority (SRA), and, after the SRA’s winding-up, the Department for Transport (DfT), will therefore investigate ways of encouraging Train Operating Companies (TOCs) to engage with, and provide feedback to, passenger representatives early in the process of developing the internal configuration of new and refurbished rolling stock. Where appropriate, these comments will be reflected in the specifications agreed with Rolling Stock Companies (ROSCOs) and manufacturers. The Rail Passengers Committee (RPC) will also be requested to provide passenger feedback to help inform refurbishment or future design of rolling stock. However, an essential part of the SRA’s (and subsequently the DfT’s) role will be to balance the preferences of user groups against the need to ensure costs are properly controlled and value for money maximised.

PAC conclusion (ii): To facilitate the more timely introduction of new trains, the SRA should require TOCs to agree with all the parties involved in introducing a new train fleet a realistic programme and timetable for bringing the trains into service.

PAC conclusion (iii): The SRA should specify in its franchise agreements with TOCs reliability levels that new trains must meet.

2. The Government agrees with the Committee’s recommendations and the SRA has already identified the need to ensure that realistic “in-service dates” are contractualised by all parties involved in bringing new rolling stock on to the network. This is reflected in the new form Franchise Agreement which includes a schedule entitled “Committed Obligations”. This specifies a date by which new trains must enter service and sets out remedies for non-performance by the Franchisee. TOCs will therefore have a commercial incentive to ensure that both ROSCOs and manufacturers face contractual penalties if they fail to deliver stock on time. A further feature of the new Franchise Agreement is that bidders will be required to commit to an improvement in delay minutes incurred over the franchise term. Train reliability will be key to this, so there will be competitive pressure on bidders to commit to improvements in train performance during the refranchising process. Franchising is one of the key areas for which the Department will take responsibility when the SRA is wound up and it expects to maintain the improvements in this area begun by the SRA.

PAC conclusion (iv): The SRA should require TOCs, in turn, to include reliability targets in their agreements with the ROSCOs or other firms responsible for maintaining new trains.

3. The Government agrees with the aims of the Committee's recommendation and the SRA has promoted the inclusion of reliability targets in TOCs' lease agreements with ROSCOs since the SRA published its Franchising Policy Statement in November 2002. The SRA and, following the SRA's winding up, the Department will also support TOCs in their efforts to require guarantees and penalties from ROSCOs for late delivery or poor initial reliability of new trains.

PAC conclusion (v): The SRA should work with the rail industry to streamline the complex process for introducing new trains.

4. The Government agrees that existing procedures are complex and the SRA has worked closely with the industry body, the Rail Safety and Standards Board (RSSB) and the Health and Safety Executive (HSE), to improve the process of introducing new trains through the collaborative involvement of all the key participants, having regard to the impact of European legislation.

5. For the future the Department will take responsibility for this area as the SRA is wound up. The HSE is consulting on a package of new safety legislation to meet European requirements. As part of this package, the current permissioning regime that applies to all new rolling stock will be revoked. The industry will remain obliged to ensure that the level of risk is "as low as reasonably practicable" (ALARP). However, the current arrangements would be replaced by a system of conformity assessment against clear criteria undertaken by independent notified bodies, engaged on behalf of those procuring new trains. The process would be overseen by HSE as the supervisory authority. Agreement has already been reached to reduce the number of national notified standards against which conformity assessment would be required and there is a greater emphasis on the early provision of new technical specifications to interested parties. The SRA is meanwhile leading on the production of DfT/ HSE/industry guidance to accompany the Conventional Interoperability Regulations when they are published, which is currently expected to be in mid 2005. It will then be for the industry itself to develop detailed acceptance procedures which both take account of the guidance and meet the requirements of European and domestic legislation.

PAC conclusion (vi): In conjunction with the Office of the Rail Regulator, the SRA should require Network Rail to compile complete, accurate and up to date information about the network to meet the needs of the industry.

6. The Government accepts the need for better network information and several initiatives are under way which complement the Rail Regulator's requirement for Network Rail to produce an Asset Register under licence condition 24. These include:

- the development of the Industry Data Initiative (IDI). Network Rail is producing documents to clarify the characteristics of the Electrical Equipment and Control Systems (EECS) currently found on the network;
- new and revised Railway Group Standards were brought into effect by the RSSB, which will assist Network Rail implement its requirement to provide train operators, ROSCOs, and manufacturers with timely and accurate information as necessary for the efficient design, building, commissioning and testing of new rolling stock for use on the network;
- the Rail Regulator's intention to publish model Vehicle and Route Acceptance Contracts (VRAC) for new rolling stock. These contracts will deal among other things with the quality of information provided on asset condition; and

- DfT intends to implement two European Directives, on Access to Networks (2001/14) and Interoperability (2001/06), which will build upon the work already carried out under the auspices of the IDI and VRAC initiatives and provide a comprehensive solution to the problem highlighted by the PAC.

PAC conclusion (vii): In order to sustain manufacturing and managerial expertise in the UK rail industry, the SRA should provide the industry with the information that it needs to help smooth out peaks and troughs in future train orders. The SRA should take a longer-term view of the need for any future new passenger trains and make indicative information available to the industry on a periodic basis to help manufacturers and TOCs plan better for future train orders.

7. The Government recognises the need for the industry to have as much information as possible at its disposal. With this in mind, the SRA will shortly publish information on:

- the current deployment and characteristics, including age, of TOC rolling stock fleets; and
- the criteria it uses to assess future rolling stock demand.

8. As it takes on responsibility for rolling stock strategy from the SRA the Department will look to supplement this in future with a longer term rolling stock strategy and further information subject to the constraints of commercial confidentiality and the need not unduly to constrain competition or the scope for commercial innovation.

PAC conclusion (viii): The SRA should take more concerted action with the Office of the Rail Regulator and Network Rail to tackle the difficulties in securing access for testing new trains on the live network.

9. The Government accepts the need for thorough testing of new trains, on both dedicated test tracks and on the live network. All major suppliers have access to test facilities in the UK or elsewhere. The SRA, and subsequently the Department will seek to ensure that this remains the case. The Government agrees that, following test track running, a period of reliability growth and demonstration testing on the live network is necessary and it believes that the initial part of this period should, if possible, be out of revenue service to avoid disruption to passengers. The SRA and the Department will therefore encourage the inclusion, in future rolling stock contracts, of provision for access to the operational railway for the initial (out of service) period of reliability demonstration, together with staged targets for release of trains into service.

PAC conclusion (ix): The Health and Safety Executive should reappraise the process by which TOCs are expected to show that the risks associated with their new trains are ALARP, so that the process better conforms to the principles of good regulation.

10. The Government accepts that there have been difficulties with the application of the ALARP test and supports the continuation of initiatives to address these issues. In particular, the SRA, and subsequently the Department will continue to work with the parties concerned to apply best practice to ensure that safety issues are dealt with at the design stage rather than later when lack of clarity can generate risk, delay and significant additional cost. In so far as the SRA and the Department are involved in the procurement of new trains they do, and will continue to, discuss design intentions with HSE. In the context of processes brought about by the European Directives on interoperability, the HSE has engaged and continues to engage constructively with the industry to ensure that the new processes are significantly simpler than those they replace.

PAC conclusion (x): The SRA should identify and disseminate best practice across the industry to help improve new train introduction.

11. The Government agrees with the Committee's recommendation and will ensure that best practice continues to be disseminated. TOCs, through the Association of Train operating Companies (ATOC), in concert with the ROSCOs have implemented a number of initiatives for sharing good practice in day to day fleet operations through two industry-led initiatives: the National Rail Performance Plan (NRPP) and the National Fleet Reliability Improvement Programme (NFRIP). Both of these initiatives have been actively supported by the SRA. In July 2003, the SRA launched a programme, jointly sponsored by the National Task Force (the senior industry operational forum), requiring TOCs to deliver performance improvements plans including, in particular, actions to improve the reliability of new and old rolling stock. A key output of SRA's Rolling Stock Strategy seeks to bring together the key industry parties in order to develop "model" processes for introduction of new trains.

12. In taking forward these initiatives, following the winding up of the SRA, the Government will draw on the progress made by the Southern Region New Trains Programme which has brought together TOCs, NR, SRA and other stakeholders and has already overseen the introduction of 1000 new vehicles to replace Mark 1 slam door stock. The lessons of this project will be applied to future rolling stock replacement programmes.

PAC conclusion (xi): The difficulties in bringing reliable new trains into service on time demonstrate the need for clear leadership in a fragmented industry. The Government should use the opportunity of its review to make clear who should take the lead in tackling the various problems affecting the introduction of new trains, and should provide them with the powers, sanctions and incentives that they require in order to drive through the improvements that are needed.

13. The report acknowledges that the SRA has little direct involvement in the process of introducing new trains and has no powers to direct, manage or control either the process or other organisations' involvement in it. Despite this, the SRA has achieved much in the way of industry co-operation. Nevertheless, the Government has recognised that the industry's organisation remains inefficient. This was the principal reason for the rail review which was announced by Ministers in January 2004. The result was the Government's White Paper of July 2004 (The Future of Rail), the prime aim of which is the establishment of a coherent and effective management structure for the railway. In particular the White Paper explains that the need for clear strategic leadership will be met by giving Ministers responsibility for setting strategy for the railways.

PAC conclusion (xii): The Department should equip the SRA with the tools for the job it is expected to perform. The SRA's objectives include speeding up the process for delivery, testing and acceptance of new rolling stock, though it can only guide the industry through dialogue and persuasion. The SRA needs the powers, incentives and sanctions necessary to match its responsibility for providing leadership and tackling problems within a fragmented industry.

14. The Government agrees with the Committee that the organisations concerned, whatever their precise form, need to have the powers and authority effectively to carry out the tasks assigned to them. The Government believes that the SRA was set an impossible task: it could not act as a true industry leader because it sat outside the industry; and it could never have full responsibility for the Government's rail strategy since ultimate responsibility for that lies with Ministers. The White Paper therefore made it clear that Ministers have concluded that a new management structure is needed to take the industry forward. Subject to securing changes to primary legislation, this will involve the winding up of the SRA. The Government will ensure that the new management structure has the tools for the job.

Thirty-sixth Report

HM Customs and Excise

Tackling VAT Fraud

PAC Conclusion (i): Customs' work to measure the losses from fraud and error on VAT is an important first step in determining the size and nature of the problem, as well as providing a benchmark for judging progress. Customs produces annual estimates for missing trader fraud but only has one-off estimates, made in 2001-02, for the other three main areas of loss. It should regularly update these estimates, so that it can assess progress in tackling the different types of loss, alongside progress in meeting its overall target.

1. The Department welcomes the Committee's comments. We have, as the PAC acknowledges, made major strides forward in estimating the amount lost from VAT and lead Europe in this activity. Our work in this area has enabled us to determine new strategies, deploy resources to address the problem and set targets for further reducing loss.

2. We have taken a new strategic approach to reduce the VAT gap by continuing the attack on organised fraud, introducing new measures and extra resources to close avoidance schemes, providing guidance and support to businesses to help them remain compliant and providing an opportunity for traders that have failed to register for VAT to do so belatedly without incurring a penalty.

3. We are updating estimates of losses for 2002-03 which will be published in due course and will be refreshed annually.

PAC Conclusion (ii): Customs needs better information to determine the most effective response to non-compliance by traders. Between £2.5 billion and £4 billion a year is lost through non-compliance by traders. But Customs has no estimate of the breakdown between genuine errors, which might be remedied through education campaigns, and more serious abuse calling for punitive action. Customs should therefore conduct a pilot investigation, drawing on the experience of the Department for Work and Pensions, to produce broad estimates of fraud and error to help judge the balance between education and advice, and investigations and sanctions.

4. We accept the Committee's conclusion. The Department is committed to continuing to improve its understanding of the components of the VAT gap and, in particular, the distinction between fraud and error although, as recognised, it is difficult to determine criminal intent statistically across a large block of activity¹. Estimates already exist for the most serious kind of fraud, Missing Trader Intra Community (MTIC) fraud, and for losses due from businesses trading above the VAT threshold without being registered for VAT.

5. The scope of "General Non-Compliance" includes a range of non-compliant behaviours from fraud at one end of the spectrum to genuine error or misunderstanding at the other. We have commissioned further analysis, drawing on internal and external experience, to develop our understanding of how losses are distributed across the business population. We have also made contact with the Department for Work and Pensions in respect of their 'Targeting Fraud Campaign'. Our aim is to learn all we can from the work they have undertaken and feed this into our 'Fraud and Error' analyses.

¹ NAO report: HM Customs and Excise; Tackling VAT Fraud: HC 357; 3 March 2004; paragraph 1.8

6. Under the VAT Compliance Strategy, the Department does distinguish between those businesses having difficulty complying and those who are out to deliberately defraud the system. Resources are subsequently deployed using our advanced risk-management systems. While recognizing that this process can be refined further still, early indications suggest that this balance of effort between encouraging voluntary compliance and taking action against willful non-compliance is beginning to bear fruit.

PAC Conclusion (iii): Better use of data matching with the Inland Revenue is needed to detect traders who are evading VAT by operating in the shadow economy. Customs' joint working with other departments has had some success in detecting traders who should be registered for VAT. But Customs has so far made little use of data matching with records held by the Inland Revenue. The recent review of the Revenue Departments confirmed the scope for greater data sharing, and recommended that the Treasury and the new revenue department should bring forward legislation to allow best use of information in the new department.

7. The Department welcomes the Committee's acknowledgement of our success. Through Joint Shadow Economy Teams (JOSETS) we work closely with the Department for Work and Pensions and Inland Revenue to share information in order to detect traders working in the Shadow Economy. In 2002–03 these teams secured 3633 VAT registrations and collected additional revenue of £65 million. We are working closely with Inland Revenue Tracing Centre, using their systems to track missing traders who owe a debt to the Department.

8. The Department recognises the importance of using all available information to identify those operating in the shadow economy. Working jointly with the Inland Revenue to pilot a large scale data matching exercise we have had some success in doing this, although this has highlighted some technical difficulties when processing data which is not directly compatible. We will deal with this issue during the transition to the new HM Revenue and Customs Department to ensure the most effective use of the data currently held by both departments.

PAC Conclusion (iv): Prompt exchange of accurate and up to date information on traders with other member states is particularly important in tackling missing trader fraud. The European Commission has announced a feasibility study with the aim of modernising the current EU-wide VAT Information Exchange System to enable more rapid and effective exchange of information on intra-community trade. Customs should work closely with the Commission in devising proposals for the new system to address the inaccuracies and delays in exchanging data experienced with the current system.

9. The Department endorses the Committee's conclusion; we recognise that swift exchange of information between Member States is key to tackling major fraud such as Missing Trader Intra Community (MTIC) fraud.²

10. The cross border nature of MTIC fraud requires bilateral cooperation between EU countries. To this end we have entered into bi-lateral exchange agreements with the fraud units of several other member states and supported the introduction of an EU- wide arrangement for the collection and exchange of this type of information. This has led to proposals for a significantly improved EU VAT Information Exchange System (VIES) and we continue to work closely with the Commission to improve the system even further.

² VAT missing trader fraud, of which the most abusive variant is 'carousel' fraud, is a Europe-wide systematic attack on the VAT system orchestrated by sophisticated criminals. It involves a fraudster obtaining a VAT registration number in the UK to purchase goods VAT free from a business in another EU Member State under the rules which govern intra-community transactions between EU businesses. The fraudster sells the goods at a VAT-inclusive price to a second UK trader, and disappears with the full amount without paying over the VAT to Customs. The second trader reclaims from Customs the VAT paid on the purchase, leaving the Exchequer to foot the bill for the fraud. In 'carousel' fraud, the same consignment of goods are sold through a series of contrived transactions back and forth between Member State to steal the sums charged as VAT every time the goods go around the circle.

PAC Conclusion (v): The scale of VAT losses suggests that more investigations and prosecutions for all types of VAT fraud would be cost effective. Customs prosecutes around 90 VAT fraud cases a year and the number of investigations resulting in civil evasion penalties has fallen to around 270 cases. In the many other cases where Customs finds under-declarations of VAT but does not launch an investigation of the trader, the maximum penalty is 15% of the amount mis-declared. Customs should analyse the level of repeat offending by traders to consider whether the number and level of penalties for under-declarations and for civil evasion should be raised to create a greater deterrent.

11. The Department is committed to ensuring that it deals with the range of non-compliant behaviour by taxpayers with a proportionate and effective range of sanctions. It also recognises the deterrent effect of appropriate sanctions.

12. Where there is evidence of fraud we can apply a wide range of sanctions according to the individual circumstances of each case to encourage compliance. We can impose penalties up to 100 per cent of the tax evaded or institute criminal proceedings where appropriate.

13. We will carry out further analysis as recommended by the Committee to enable us to assess whether we have the right balance of civil and criminal sanctions and whether the penalties applicable in each case are appropriate.

PAC Conclusion (vi): To achieve the maximum effect from prosecutions for VAT fraud, court time should be made available promptly so that cases are brought to trial more quickly. It can take up to a year for court time and lawyers to become available to try a complex VAT fraud case. Customs and the Department of Constitutional Affairs need to finalise and implement their proposals for reducing the delays. Once new arrangements are in force Customs should assess the effect on the time taken to bring cases to trial.

14. The Department accepts the Committee's conclusion; we are very conscious of the need to bring prosecutions to court promptly. We continue to work closely with the Department for Constitutional Affairs to remove the obstacles that prevent this.

PAC Conclusion (vii): Despite the thousands of under-declarations of VAT discovered each year Customs has only reported the accountant or other professionals involved to their professional body on four occasions. Only 24 VAT investigations have been in cases where professionals such as accountants, lawyers and tax advisers were involved. Customs should make greater use of such sanctions, working with the business community and professional bodies concerned to agree criteria for reporting and the remedial action expected.

15. The Department accepts the Committee's comments and recognises the need to take a proactive approach in reporting instances of unethical behaviour by professionals. Where we have evidence of incompetence or corruption we take remedial action as appropriate. We will discuss the Committee's recommendation with the relevant professional bodies.

16. Our own tax professionals, who will report individuals to their professional bodies, have recently carried out workshops with officers working in Law Enforcement and MTIC areas in order to increase awareness and encourage more reporting. We expect to see an increase this year in the number of those reported to their professional bodies

17. The Department takes every opportunity to resist vexatious claims, which are the result of the application of poor professional standards. As an example, we are currently resisting a number of vexatious claims lodged by one major accountancy firm. These claims are such that, with even the most cursory examination of the facts, a competent professional would have realised the errors in them. We use such actions to act as a warning that we will take a tough stance against abuses across the whole profession.

PAC Conclusion (viii): To maintain public confidence in the standard of investigations, Customs' training needs to match standards of good practice applied in the wider profession. In response to our predecessors' earlier Report on *Checking large traders' VAT liability* (HC 445, Session 1997–98) Customs introduced externally accredited training for internal investigators and staff carrying out assurance work on large traders. It now plans to extend external accreditation of its training, and externally recognised qualifications, to all investigation staff. It should set a timetable for achieving accreditation and milestones for progressively increasing the number of investigation staff holding externally recognised qualifications or in accredited training.

18. The Department welcomes the Committee's acknowledgment of our efforts to increase still further the professionalism of our staff. All our investigators working on VAT fraud receive investigation training, beginning with a six week Basic Investigation Techniques course. This is followed by six months' on-the-job training, under the supervision of an allocated Practical Training Officer (PTO).

19. As part of our commitment to building a more mobile, flexible and professional Law Enforcement workforce, the Department signed up to the Police Skills and Standards Organisation (PSSO) in August 2003, now known as Skills for Justice (SfJ). A Project Team is now working closely with SfJ to confirm that all Customs' Law Enforcement training meets the National Occupational Standards and so can be accredited by independent external assessors.



Published by TSO (The Stationery Office) and available from:

Online

www.tso.co.uk/bookshop

Mail, Telephone, Fax & E-mail

TSO

PO Box 29, Norwich NR3 1GN

Telephone orders/General enquiries: 0870 600 5522

Order through the Parliamentary Hotline Lo-call 0845 7 023474

Fax orders: 0870 600 5533

E-mail: book.orders@tso.co.uk

Textphone 0870 240 3701

TSO Shops

123 Kingsway, London WC2B 6PQ

020 7242 6393 Fax 020 7242 6394

68-69 Bull Street, Birmingham B4 6AD

0121 236 9696 Fax 0121 236 9699

9-21 Princess Street, Manchester M60 8AS

0161 834 7201 Fax 0161 833 0634

16 Arthur Street, Belfast BT1 4GD

028 9023 8451 Fax 028 9023 5401

18-19 High Street, Cardiff CF10 1PT

029 2039 5548 Fax 029 2038 4347

71 Lothian Road, Edinburgh EH3 9AZ

0870 606 5566 Fax 0870 606 5588

TSO Accredited Agents

(See Yellow Pages)

and through good booksellers

ISBN 0-10-163042-5

