HM Revenue & Customs

Annual Report and Accounts 2013-14

– Report by the Comptroller and Auditor General

National Audit Office

HM Revenue & Customs 2013-14 Accounts

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This report provides the findings and overall conclusion of work conducted under section 2 of the Exchequer and Audit Departments Act 1921, by which the Comptroller and Auditor General must consider the adequacy of the systems to assess, collect and allocate tax revenues.

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About this report

1 This report provides the findings and overall conclusion of work conducted under section 2 of the Exchequer and Audit Departments Act 1921, by which the Comptroller and Auditor General (C&AG) must consider the adequacy of the systems to assess and collect taxes. It forms part of our programme of audit work on HM Revenue & Customs (HMRC), which includes our examination under section 2, our annual financial audit of HMRC's accounts under the Government Resources and Accounts Act 2000, and value-for-money studies under the National Audit Act 1983.

2 In this report, we provide a commentary on, and evaluation of, HMRC's performance in revenue administration in 2013-14, drawing together conclusions from all our recent audit work and HMRC's own measures of performance published in its Annual Report and Accounts and Trust Statement.

3 The report is arranged into five parts:

- The Summary describes the scope of the audit, our main findings, overall conclusion and recommendations.
- Part One is our commentary on key numbers in HMRC's Trust Statement and Annual Report and Accounts.
- Part Two evaluates how HMRC measures and reports its performance in increasing tax revenues through compliance activities.
- Part Three evaluates how HMRC allocates its resources to the compliance risks it faces.
- Part Four sets out significant findings from our audit of HMRC's revenue systems.
- Part Five explains the C&AG's qualification of HMRC's Resource Accounts, and gives an update on HMRC's progress in managing fraud, error and debt from the personal tax credits system.

Scope of the audit

4 Section 2 of the Exchequer and Audit Departments Act 1921 requires the C&AG to examine the accounts of HMRC "to ascertain that adequate regulations and procedure have been framed to secure an effective check on the assessment, collection and proper allocation of revenue, and the C&AG shall satisfy himself that any such regulations and procedure are being duly carried out". The C&AG is also required by that Act to examine the correctness of the sums brought to account and to report the results to the House of Commons. Taken alongside the C&AG's audit opinion on HMRC's Trust Statement, which records the tax revenues HMRC has collected, this report meets that requirement.

5 The C&AG provides a separate audit opinion on HMRC's Resource Accounts under the Government Resources and Accounts Act 2000. These accounts record HMRC's running costs and other spending, of which the largest component is spending on personal tax credits. For ease of reporting, we have included our examination of tax credits in this report.

Summary findings

6 In collecting tax, HMRC aims to achieve the highest levels of compliance with tax law possible whilst demonstrating efficiency and maintaining public confidence in the tax system. HMRC estimates that it collects 93 per cent of the tax it should theoretically collect based on its interpretation of tax law. HMRC must choose where to focus its resources balancing the need for efficient systems which help those who pay their tax willingly with activities to encourage and, where necessary, enforce compliance with tax law.

Performance in 2013-14

7 Total tax revenues increased by nearly 7 per cent this year, from £476 billion in 2012-13 to £506 billion in 2013-14. HMRC had collected by the year end over 77 per cent of the revenue that was due for the year (compared to 78 per cent in 2012-13). Some taxes – such as corporation tax and income tax self assessment – are not due until some months after the year end. For these, HMRC estimates the value of revenues it is entitled to collect but which are not yet collectable by forecasting the likely final tax liabilities of individuals and companies. At 31 March 2014, this estimate was £89 billion (£82 billion at 31 March 2013).

8 HMRC has also accounted for some £24 billion of taxes that are due to be collected, which includes £13.3 billion of tax debt, which is when a tax liability is outstanding after its due payment date and is under active debt management.

9 HMRC is decreasing its running costs over time from £3.4 billion in 2010-11 to £3.3 billion in 2013-14. HMRC's spending was within the overall limits set by Parliament.

HMRC's effectiveness in increasing revenues from its compliance work

10 The aim of HMRC's compliance work is to reduce the tax gap: the difference between the tax that is theoretically due and the tax HMRC actually collects. But HMRC also needs a more direct measure of the effectiveness of its compliance work as the tax gap is subject to long reporting delays and affected by factors outside HMRC's control, such as the strength of the economy. HMRC measures compliance yield both to provide accountability for its overall performance and to manage its business and the performance of its compliance teams on a day-to-day basis.

11 HMRC's strategy since the 2010 Spending Review has been to do more compliance work to secure additional revenues. Its settlement with HM Treasury (the Treasury) included a £917 million reinvestment in compliance work in order to generate additional revenues of £7 billion a year by 2014-15. HMRC's success in delivering this strategy depends on its ability to:

- identify the risks to tax compliance and design effective interventions;
- allocate resources to address these interventions; and
- measure the effectiveness of its compliance work.

12 Our review this year has focused on the measurement of compliance performance and the allocation of compliance resources. Our summarised findings are at paragraphs 13 to 21.

How HMRC measures the effectiveness of compliance work

13 HMRC's estimate of compliance yield has increased throughout the current spending review period reaching £23.9 billion in 2013-14, the highest level ever reported. It is a complex hybrid of measures, calculated in different ways and covering different time periods, which are designed to reflect the breadth of HMRC's compliance activities. The figure reported in 2013-14 includes four different components:

- Cash collected of £9.2 billion (39 per cent);
- Revenue losses prevented of £8.0 billion (33 per cent);
- Future revenue benefit of £5.5 billion (23 per cent); and
- Product and process yield of £1.2 billion (5 per cent).

Most, but not all, of this additional revenue had a direct benefit to the exchequer in 2013-14. HMRC will in practice receive some of the cash collected after the end of the financial year, and the future revenue benefits of £5.5 billion is a reasonable estimate of what will be generated over the next five years through compliance work in 2013-14 which has changed taxpayers' behaviour (paragraphs 2.1 and 2.15).

14 HMRC has improved its measurement of compliance yield since 2010-11 so that it reflects a wider range of the impacts of compliance work. HMRC has progressively improved the evidence on which it bases its estimates and adapted the measure to reflect changes in the nature of its compliance work. As it has evolved the measure, HMRC has taken a prudent approach, collecting relevant evidence before making changes and reducing its estimates appropriately where there is uncertainty. We found that the methodology and processes HMRC used to estimate compliance yield in 2013-14 were sound, and that the measure provides a reasonable proxy for the beneficial impacts of its compliance work (paragraphs 2.15 to 2.41).

15 When HMRC agreed performance targets with the Treasury for the spending review period, it set its baseline too low which made the targets easier to achieve. This has not diminished the focus and energy HMRC has put into maximising revenue from its compliance work, but it has made the targets less challenging. In responding to our review, HMRC identified errors it had made when calculating its baseline in 2010-11, which had the effect of understating the baseline by £1.9 billion. HMRC reported that it had exceeded its performance targets by £1.9 billion and £2.0 billion in 2011-12 and 2012-13 respectively, when in fact it had achieved almost exactly the level of performance improvement required under its settlement. Partly in response to this apparent over-achievement, HMRC agreed with the Treasury to stretch its target for 2013-14 by a further £3.0 billion. HMRC's performance in 2013-14 exceeded this new target and it is now reviewing whether the targets it has set for future years are adequate to meet the settlement requirement (paragraphs 2.4 to 2.14).

16 In external reporting, HMRC has inadvertently overstated the degree of improvement in its performance. The way HMRC has measured compliance yield during this spending review period is substantially different to the way it reported its yield in 2010-11 and before, preventing a like-for-like comparison. Until it identified the error in its baseline, HMRC was not aware that such comparison was significantly flawed. Therefore, in presenting the trend in its compliance performance information prior to this year's annual report, HMRC has inadvertently overstated the increase in the additional revenue it has generated since 2011-12 compared to earlier years (paragraphs 2.38 to 2.40).

17 In this year's annual report, HMRC has substantially improved the accuracy, clarity and transparency of the way it reports its compliance yield. While the measure is complex, we consider that the way the data had been reported in previous years did not adequately disclose what the measure contained, such as what element represented HMRC's estimate of revenue benefits expected in future years. We welcome the fact that HMRC has produced a much fuller and clearer explanation of its compliance yield in 2013-14, which also discloses the understatement in its baseline calculation and recognises that comparison of the data with the figures reported before 2011-12 would be inappropriate (paragraph 2.41).

How HMRC allocates compliance resources

18 HMRC has used £1 billion of additional funding between 2011-12 and 2014-15 to increase tax revenues and target specific risk areas. HMRC responded to the challenge to improve public finances in the short term by bringing in more revenue from its compliance work and, over the longer term, seeking to promote more compliant behaviour among taxpayers. It had a clear rationale for using the funding in this way, which extended its coverage of areas of significant risk. For example, HMRC is now undertaking more compliance checks and increasing the number of prosecutions to deter evasion by small and medium-sized businesses, and strengthening its ability to tackle organised crime (paragraphs 3.2 to 3.6).

19 HMRC has improved its assessment of tax risks but this needs to be used more consistently in the allocation of compliance resources. HMRC cannot yet fully show how its use of resources aligns with its assessment of tax risks but is improving its management information to test these decisions. It is also developing a new Strategic Picture of Risk to bring together data, intelligence and economic analysis to provide a more comprehensive and current view of risks across its business. HMRC intends to use the new assessment more directly in its management of the business, developing a more explicit link between risks and the decisions it makes about where to allocate resources. It is also building new models to test the potential for better outcomes from different configurations of compliance work (paragraphs 3.14, 3.17, 3.18, 3.20 and 3.21).

20 HMRC is constrained in how flexibly it can reallocate compliance resources, but has responded to changing threats to tax revenue by shifting the balance of its activities. A number of factors constrain HMRC's ability to redirect its compliance effort quickly, including: the geographical spread of its offices; the need to train staff for new roles; and the volume of compliance cases it has in the pipeline, which can make it difficult to replace staff who have been investigating cases for a long time. However, HMRC has redeployed resources in response to new risks as they have emerged and then receded, such as the fraudulent exploitation of VAT rules though Missing Trader Intra-Community fraud; and in 2013-14, it created a new directorate to coordinate and lead its work to counter tax avoidance (paragraphs 3.13 and 3.19).

21 As HMRC's strategy for compliance work changes, its performance framework and approach to resource deployment will need to adapt. HMRC is aiming to do more to promote voluntary compliance and deter evasion and avoidance before it happens, thereby reducing the reliance on compliance interventions after the event. It has started to redesign its performance framework to capture the impact of its work to promote compliance, focusing increasingly on changing customer behaviours. Strengthening its understanding of how resources align to risks and the effectiveness of different compliance activities will improve the evidence on which HMRC makes decisions about where to deploy resources (paragraphs 2.46 and 3.22 to 3.24).

Progress in performance of revenue systems since last year

22 **HMRC continue to modernise Pay As You Earn by rolling out its Real Time Information system.** RTI collects timely payroll information from employers. Most employers have been able to file their returns using RTI but some smaller employers experienced problems as they struggled to adapt their internal processes and systems in time. HMRC has announced a package of support for these employers (paragraph 4.7).

23 **HMRC's 'tax debt' has increased to £13.3 billion at 31 March 2014 from £12.2 billion last year.** But HMRC has collected £39.6 billion in 2013-14 (£34.5 billion in 2012-13) and focused on clearing debt older than one year resulting in this balance falling to £3.7 billion (£4.2 billion last year). HMRC is currently finalising a new debt management strategy, which extends the use of private sector debt collection agencies and the use of improved data (paragraph 4.11).

24 **The UK-Swiss Tax Agreement, which came into force in January 2013, had brought in £1 billion by 31 March 2014, significantly less than HMRC had originally expected, but in line with its updated forecasts.** HMRC has gained new data to enable it to better inform its future interventions for tackling offshore evasion (paragraphs 4.13 to 4.18).

Progress reducing tax credits error and fraud

25 **The C&AG has qualified his regularity audit opinion on HMRC's 2013-14 Resource Accounts because of material levels of error and fraud in the payments of personal tax credits.** HMRC's central estimate of error and fraud in 2012-13 is £2.0 billion which represents 7.0 per cent of finalised entitlement. This is the lowest proportion since the current personal tax credits scheme was introduced in 2003-04 (paragraph 5.10).

26 **Personal tax credits debt rose in 2013-14, from £4.8 billion at 1 April 2013 to £5.5 billion at 31 March 2014.** In-year recoveries increased from £763 million in 2012-13 to £921 million in 2013-14, but recovery rates from HMRC's use of private sector debt collection agencies have so far been well below forecast (paragraphs 5.19 to 5.26).

Conclusion

27 In forming his conclusion on the adequacy and effectiveness of HMRC's tax collection systems, the Comptroller and Auditor General considers the results of our financial audit of HMRC's accounts, our section 2 examinations and findings from value-for-money reports. We have published two value-for-money reports on HMRC in the last year: *Gift aid and reliefs on donations*[1] and *Tax reliefs.*[2]

28 The primary focus of HMRC's compliance work since the 2010 Spending Review has been to meet on its commitment to deliver additional tax revenue over the spending review period by investing in compliance projects. HMRC has been broadly successful to date in delivering on this objective as measured by its estimates of compliance yield. HMRC has also flexed its resources to address significant threats and has increased its coverage in key areas, such as by doing more compliance checks to tackle fraud and evasion by small and medium-sized businesses.

29 HMRC has designed a reasonable basis for its estimation of compliance yield as a proxy for the effectiveness of its compliance work. The measure is a complex hybrid of different elements which reflects the breadth of impacts from a wide variety of compliance activities, but demonstrates the positive impact of HMRC's investment in compliance work on the public finances. I am concerned that an error of as much as £1.9 billion in HMRC's baseline calculation led it to report the trend in its performance in a way that inadvertently exaggerated the improvement in its performance since 2010-11. That this error came to light as a result of the NAO's audit raises concerns about HMRC's governance and use of its management information that I intend to explore further in future work. Despite this, I am satisfied from the evidence we have seen that HMRC's compliance performance has improved throughout the spending review period and that its effectiveness continues to increase as HMRC develops new ways to deter, detect and prevent abuse of the tax system.

30 Our work in the year has demonstrated that there are other areas of HMRC's business where it lacks good management information and continues to be exposed to risk. Tax reliefs are essential to the effective operation of the tax system. Reliefs also create the opportunity to misuse and avoid tax. Our systemic review of Tax Reliefs identified that the value of reliefs is significant and the number of reliefs is growing, but that there is no specific framework governing their introduction or modification. We found that HMRC has responded proactively to address opportunities for abuse, but that the time needed to collect data and take remedial action places an onus on robust design and monitoring of their performance. Our study on Gift Aid showed that HMRC had not collected the data to enable a robust evaluation of the effectiveness of the reliefs on donations to charities. We intend to report later in 2014 on how HMRC administers and assesses the impact of those tax reliefs with an objective to influence behaviour.

1 Comptroller and Auditor General, *Gift Aid and reliefs on donations*, Session 2013-14, HC 833, National Audit Office, November 2013.

2 Comptroller and Auditor General, *Tax reliefs*, Session 2013-14, HC 1180, National Audit Office, March 2013.

31 In fulfilling our statutory duties under the Exchequer and Audit Act 1921, while recognising that no tax collection system can ensure that all those who have a tax liability comply with their obligations, we conclude that in 2013-14 HMRC has framed adequate regulations and procedures to secure an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out. This assurance is subject to the observations on specific aspects of the administration of taxes in this report and our other reports to Parliament.

Recommendations

32 HMRC recognises the importance of developing its performance framework as its compliance strategy evolves. HMRC has also accepted the principle that there should be external scrutiny of the data it publishes on its compliance performance in future, and has invited the National Audit Office to play an ongoing role in providing independent assurance about the data's quality.

33 To further improve its strategic planning processes, HMRC should:

- Use its assessment of the risks it faces to inform explicitly the deployment of resources and development of their medium-term operating model.
- Build a risk-based view of the optimal deployment of its resources (by regime, customer group and behaviour).
- Continue building an evidence base to support a more sophisticated set of performance measures that capture the breadth of impact it has on customers paying the right amount of tax.

34 HMRC should investigate why the levels of error and fraud in personal tax credits associated with undeclared partners have continued to rise despite its initiatives undertaken to date to tackle this specific risk.

Part One

Financial performance

1.1 This part provides a brief commentary on HMRC's financial performance as reported in HMRC's 2013-14 Trust Statement and HMRC's 2013-14 Resource Accounts. It also summarises our recent work on tax reliefs.

Tax revenues

1.2 In 2013-14, total revenue increased to £505.8 billion from £475.6 billion in 2012-13 (6.3 per cent) – **Figure 1**. The taxes that contributed most of this increase are income tax and national insurance which increased by £16.2 billion (6.4 per cent), VAT by £7.2 billion (7.1 per cent) and stamp taxes which have significantly increased by £3.4 billion (35.8 per cent).

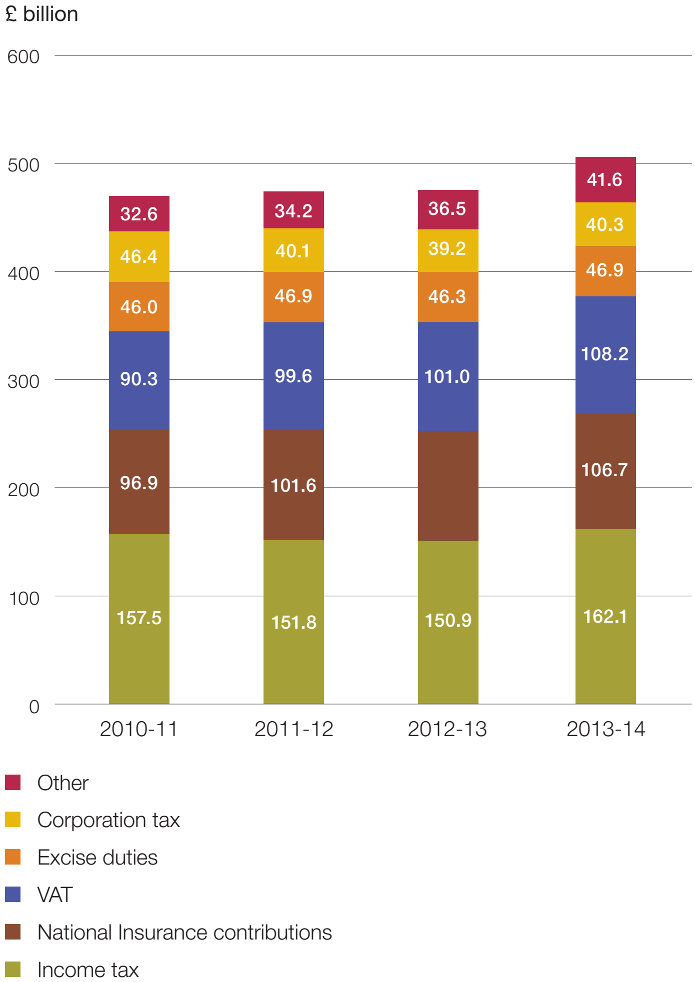
Tax collection

1.3 The Trust Statement accounts for revenue on an accruals basis, reporting tax due on earned income or activities during the financial year, regardless of when the cash is actually received. Of its 2013-14 revenue of £505.8 billion (2012-13 £475.6 billion), HMRC has not yet received £113.6 billion, 23 per cent of revenue (2012-13 £104.8 billion, 22 per cent). This consists of £24.3 billion due from taxpayers but not yet received and £89.3 billion of taxes not yet due from taxpayers, but earned in the financial year (note 4 to the Trust Statement).

1.4 As there is some risk that this revenue will not be collected or may subsequently prove not to be due, accounting standards require the Trust Statement to reflect this risk. The £24.3 billion of tax due is reduced by £6.6 billion to £17.7 billion to cover the likelihood of tax not being paid or proving not to be due (2012-13 £22.4 billion reduced by £6.2 billion to £16.2 billion). This 'impairment' does not mean that HMRC will not collect these amounts and the degree of impairment varies across taxes (**Figure 2** on page 14). HMRC's estimates show that amounts due for VAT, income tax and national insurance contributions carry the highest level of risk, and so receive the largest level of impairment. VAT liabilities are impaired to account for the risks of company insolvencies and VAT balances under dispute, whereas personal taxes take into account that some debts may be potentially spurious following the implementation of HMRC's Real Time Information (RTI) system.

Figure 1

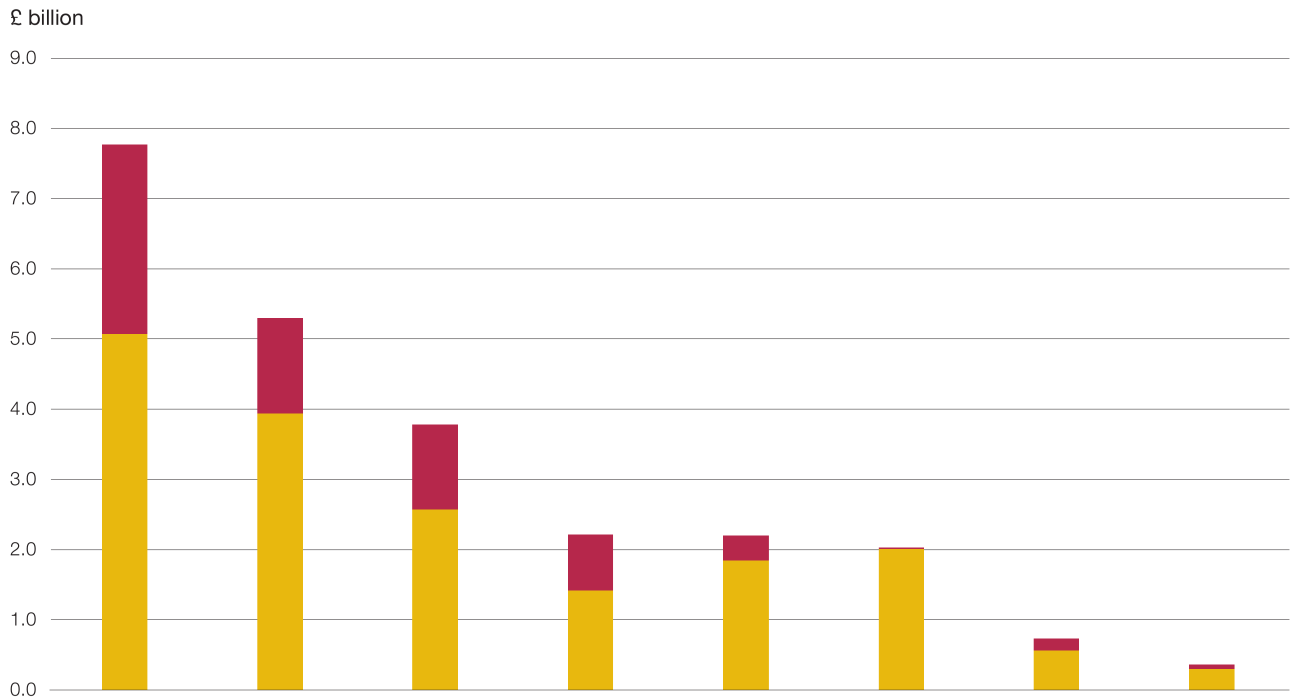
Tax revenues 2010-11 to 2013-14



Source: HM Revenue & Customs Trust Statements 2010-11 to 2013-14

Figure 2

Impairment of receivables varies across taxes



	VAT	Income tax	National insurance	Penalties	Corporation tax	Other direct taxes	Other indirect taxes	Capital gains tax
Impairment	2.7	1.4	1.2	0.8	0.4	0.0	0.2	0.1
Net receivable	5.1	3.9	2.6	1.4	1.8	2.0	0.6	0.3
Percentage of gross receivable impaired	35%	26%	32%	36%	16%	1%	23%	15%

Note

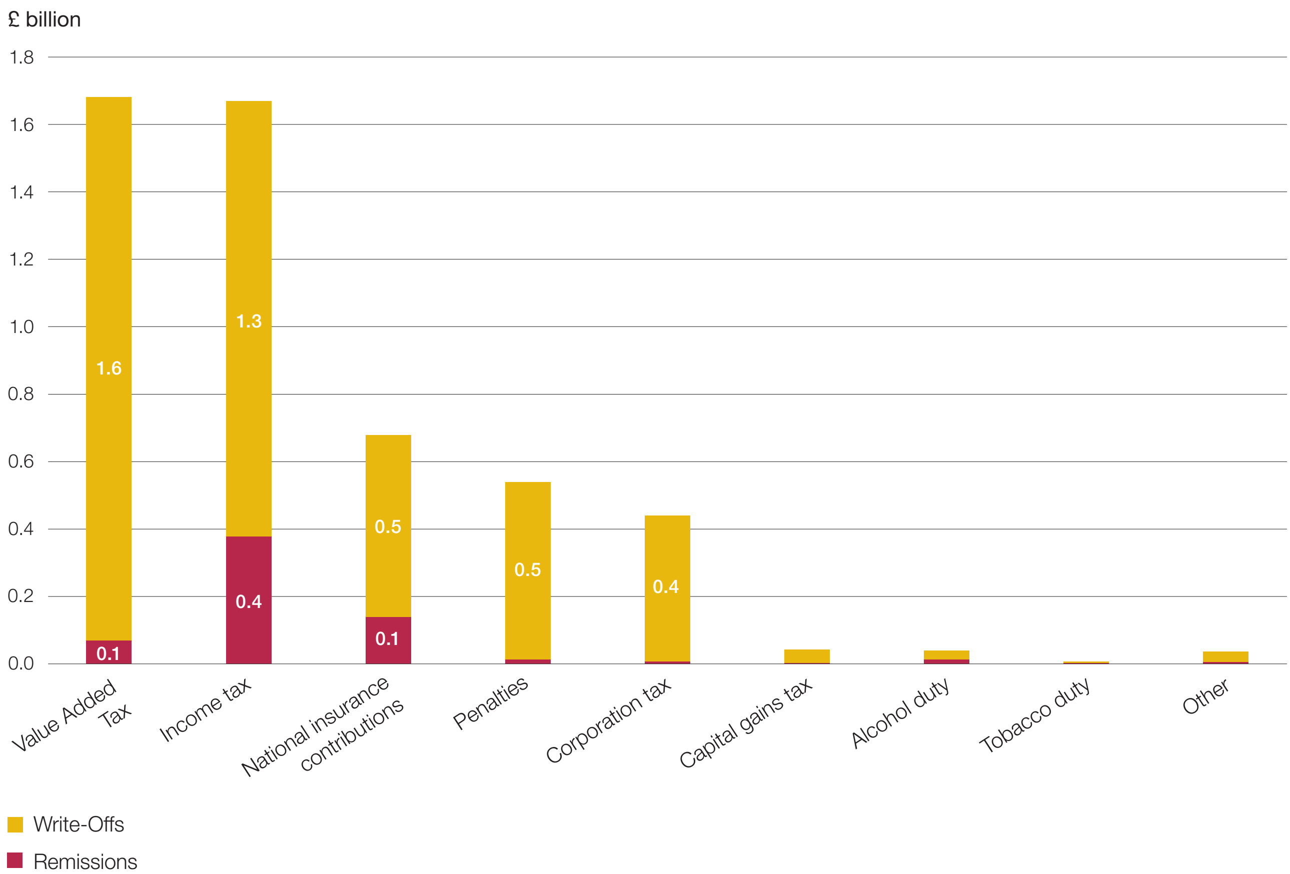
1 The total impairment shown above does not sum to £6.6 billion due to rounding.

Source: National Audit Office analysis of HM Revenue & Customs data

1.5 HMRC had revenue losses, where it has assessed that tax owed is unlikely to be collected, of £5.1 billion in 2013-14 compared to £5.3 billion in 2012-13. Where HMRC has no practical way to pursue a liability it can write this off, the most common cause being debtor insolvency. Some £4.5 billion was written off in 2013-14, compared to £4.4 billion in 2012-13. HMRC can also remit debt where it decides not to pursue a tax liability on value-for-money or hardship grounds. In 2013-14, remissions were £0.6 billion, a fall from £0.9 billion in 2012-13. Debt due to official error can be written-off or remitted. The main reasons for losses, including those for high value cases (over £10 million), are disclosed in note 7.2 of the Trust Statement. **Figure 3** shows that most of the losses come from VAT, income tax and national insurance, equating to 0 per cent to 2 per cent of these taxes.

Figure 3

Main sources of loss 2013-14



Source: National Audit Office analysis of note 7.2 of the Trust Statement

Provisions and Contingent Liabilities

1.6 Some revenue collected and reported will subsequently be repaid to taxpayers. This may be because taxpayers have overpaid, because taxes due are reassessed for previous tax years or because reliefs and allowances are claimed. HMRC reports two types of provision for the future repayment of tax in its Trust Statement (£8.5 billion at 31 March 2014 compared to £8.0 billion as at 31 March 2013):

- **Legal claims** where taxpayers have disputed the interpretation of legislation through the courts and are seeking a reassessment of the tax payable. The outcome depends on litigation, but HMRC expects that they will repay some £5.4 billion as at 31 March 2014 (£4.2 billion as at 31 March 2013).
- **Oil field decommissioning costs** where companies offset costs of decommissioning oil and gas fields in the North Sea against petroleum revenue tax and corporation tax they have previously paid on those fields. These are recognised because decommissioning costs can be carried back to earlier years indefinitely, in contrast to other taxes that are time limited. HMRC has estimated that they will repay some £3.1 billion as at 31 March 2014 (£3.8 billion at 31 March 2013).

1.7 HMRC also discloses contingent liabilities, which are possible liabilities to HMRC. These have increased significantly to £29.2 billion at 31 March 2014 (£14.5 billion at 31 March 2013) due to a revision of the estimates for cases currently in litigation and taking into account court decisions during the year. It will be important for HMRC to maintain an up-to-date assessment of the progress of key legal cases and any potential accounting and budgetary consequences.

Expenditure

1.8 HMRC has cut its running costs while maximising revenue (**Figure 4**). Also, the amount spent on benefits and credits increased in 2011-12 and 2012-13, but decreased this year. Part of these cost reductions are because HMRC reduced its full-time equivalent headcount by over 5,000 (8 per cent) from 66,900 in March 2011 to 61,400 in March 2014. Enforcement and Compliance headcounts have increased, despite this overall reduction, reflecting HMRC's strategic shift into this area (**Figure 5**).

Figure 4

Revenue collected, benefits and credits paid and administrative spend

	2010-11 (£bn)	2011-12 (£bn)	2012-13 (£bn)	2013-14 (£bn)
Revenue	468.9	474.2	475.6	505.8
Benefits and credits spend	42.3	42.8	43.1	42.5
Administration spend	3.4	3.3	3.3	3.3

Notes

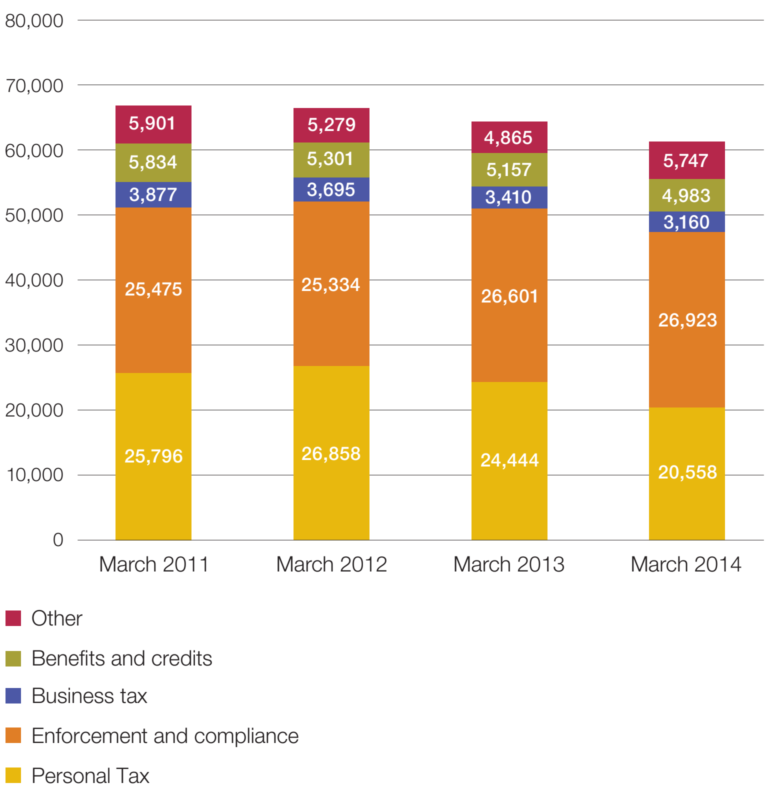
1 Benefits and credits spend includes Resource Accounts subheads: E Social benefits and grants, F Providing payments in lieu of tax relief to certain bodies, L Personal tax credits and M Other reliefs and allowances.

2 Administration spend is Resource Accounts subhead: A HMRC administration (DEL).

Source: HM Revenue & Customs' Trust Statement and Resource Accounts

Figure 5

Changes in staff numbers (full-time equivalents)



Source: National Audit Office analysis of full-time equivalent staff data

Tax reliefs

1.9 In March 2014, our first report on tax reliefs reported that the value of tax reliefs is significant and the number of reliefs had increased from 1,048 in March 2011 to 1,128 by December 2013.[3] Tax reliefs are often used for practical purposes such as setting the right income and profit for tax purposes and making the tax system simpler to use. Reliefs also create the opportunity to misuse and avoid tax. We found that there is no specific framework governing the introduction or modification of reliefs, and that HMRC has not systematically categorised tax reliefs according to the function they perform.

1.10 We also found that the value of tax at risk from the abuse of reliefs is unknown but likely to be significant. HMRC has responded proactively to address opportunities for abuse, although it could collect data to assess the extent of emerging threats sooner, allowing it to act more quickly to safeguard revenue. Our study on Gift Aid showed that HMRC had not collected the data to enable a robust evaluation of the effectiveness of the reliefs on donations to charities. We intend to report later in 2014 on how HMRC administers and assesses the impact of those tax reliefs with an objective to influence behaviour.

3 Comptroller & Auditor General, *The exchequer departments: Tax reliefs*, Session 2013-14, HC 1256, March 2014.

Part Two

Measuring compliance yield

What HMRC measures and why

2.1 HMRC assesses the impact of its compliance work by estimating compliance yield, a measure of the additional revenue it generates through its compliance activities. HMRC reported compliance yield of £23.9 billion in 2013-14 – its highest yield to date.

2.2 HMRC estimates compliance yield to provide accountability and to support decision-making. The long-term aim of compliance work is to reduce the tax gap: the difference between the tax that is theoretically due and the tax HMRC actually collects. But a more direct measure of compliance yield is also necessary as the tax gap is subject to long reporting delays and is affected by factors outside HMRC's control, such as the strength of the economy and changes to tax rates. HMRC therefore estimates the additional tax revenue attributable to its compliance activities, both to provide accountability for its overall performance and to manage its business and the performance of its compliance teams on a day-to-day basis.

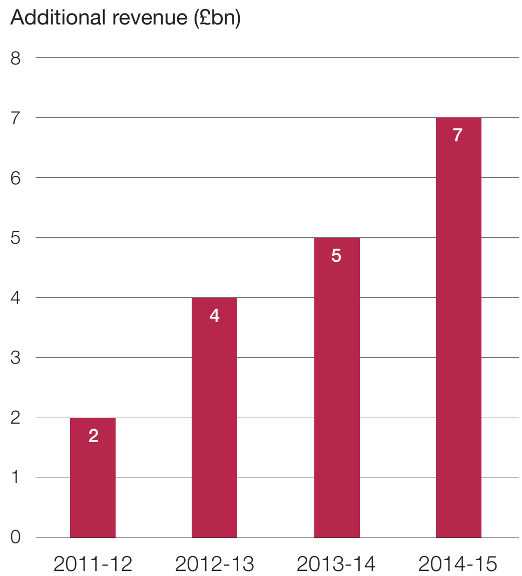
2.3 This part considers how HMRC estimates and reports compliance yield. We did not seek to verify the accuracy of the figures reported by HMRC in 2013-14, but rather to assess whether the way HMRC estimates yield is reasonable and whether it has adequate processes to validate its estimates.

The 2010 spending review settlement

2.4 The 2010 Spending Review set HMRC's funding and delivery commitments until 2014-15. HMRC committed to make efficiency savings while doing more compliance work to secure additional revenues. Overall, HMRC agreed to make efficiency savings which would reduce its running costs from £3.4 billion in 2010-11 to £3.3 billion in 2014-15 (Figure 4 on page R17), while increasing the additional revenue generated from its compliance work by £7 billion a year by 2014-15 (**Figure 6** overleaf). HM Treasury (the Treasury) agreed that to achieve this additional revenue, HMRC could reinvest a total of £917 million of its efficiency savings.

Figure 6

Targets agreed at the start of the 2010 spending review period for incremental increases in compliance yield



Source: National Audit Office analysis of spending review 2010 documents

Calculating the baseline from which targets were set

2.5 To measure incremental improvements over the spending review period, HMRC needed to establish a baseline level of performance. The calculation of this baseline was complicated because HMRC also agreed with the Treasury that it would change its measurement methodology to provide a more accurate assessment of the breadth of its compliance activities. The new approach extended the scope of the compliance measure and refined it to improve its accuracy.

2.6 Calculating this baseline was complex and involved a number of stages. HMRC set its baseline by forecasting the additional revenue its work would generate in 2010-11, based on a mid-year estimate, and adjusting this figure to account for the impact of the methodological changes it was making. Its targets for each year of the spending review period were then agreed by adding a greater increment in each year to the baseline.

2.7 In June 2011, HMRC reviewed its mid-year estimate for 2010-11 against the actual outturn it had achieved in that year to ensure it was accurate. Although the original forecast was £13 billion and actual performance was £13.9 billion, HMRC agreed with the Treasury not to revise the forecast because it believed the additional £0.9 billion was based on unusual performance in one area of the business that could not be sustained in future years.

2.8 HMRC has reported its performance against these targets during the spending review period. However, our audit identified a significant error in the baseline calculation. The impact of this error, and how it came about, is set out in the following paragraphs.

The impact of the error

2.9 The error in HMRC's baseline calculation had the effect of understating the baseline, and therefore reduced the targets that HMRC agreed in each year of the spending review period, by £1.9 billion. While not diminishing the focus and energy HMRC has put into maximising revenue from its compliance work, this made the original targets easier to achieve. For example, in the first year HMRC agreed to deliver an incremental improvement of £2 billion. As the baseline against which it was measuring was set £1.9 billion too low, the incremental improvement required to meet the target was in reality only £100 million. In practice, HMRC exceeded its target in 2011-12 by £2 billion, thus achieving the incremental improvement it had agreed with the Treasury but – taking into account the error in the baseline – not exceeding it.

2.10 Despite this effect, HMRC has still delivered the incremental improvement required of it in each year of the spending review period to date. As a consequence of the baseline error, HMRC reported that it had achieved additional revenue in excess of targets by £1.9 billion and £2 billion in 2011-12 and 2012-13 respectively. It is now clear that this apparent over-performance was actually attributable to the baseline error, and so HMRC in fact achieved almost exactly the level of performance improvement that was required.

2.11 Partly in response to this apparent over achievement, HMRC agreed with the Treasury to increase its target for 2013-14. It agreed to deliver an additional £3.0 billion of yield without further funding[4] and £0.3 billion in relation to extra funding it was granted in the 2012 Autumn Statement. This meant that HMRC had a target in 2013-14 of £23.0 billion. In practice, HMRC delivered £23.9 billion of additional revenue in 2013-14, exceeding even its revised target by £0.9 billion. HMRC is now reviewing whether the targets it has agreed for future years are adequate to meet the settlement requirement.

How the error came about

2.12 HMRC agreed its 2010-11 baseline with the Treasury in November 2010. It had to use a forecast because at that stage it did not know what its outturn for the year would be. HMRC also assessed the impact of its new methodology for measuring yield. These changes were significant and the calculation to adjust the baseline was therefore complex.

4 2013-14 targets were stretched in Autumn Statement 2012, by £0.5 billion, and Autumn Statement 2013, by £2.5 billion.

2.13 One significant change to the way HMRC measured its additional revenue was to include the revenue protected from its work to disrupt organised crime within its wider measure of compliance yield. While HMRC uplifted its baseline by £0.84 billion to reflect its forecast of the yield from organised crime, it did not make a further adjustment to take into account that the revenue protected by this work in 2010-11 was ultimately £2.52 billion. As a consequence, HMRC failed to include £1.68 billion of yield from organised crime in its baseline, even though this type of yield was to be counted in future years.

2.14 HMRC also made a number of smaller calculation errors in adjusting its baseline to take account of methodological changes, resulting in a further understatement of £0.22 billion. The combined effect of these errors was to understate the baseline by £1.9 billion.

HMRC's methodology for estimating yield

2.15 HMRC's current measure of compliance yield is complex. It is a hybrid of measures, calculated in different ways and covering different time periods, which are designed to reflect the breadth of HMRC's compliance activities. The total of £23.9 billion reported in 2013-14 includes four different components (**Figure 7** and **Figure 8** on page R24):

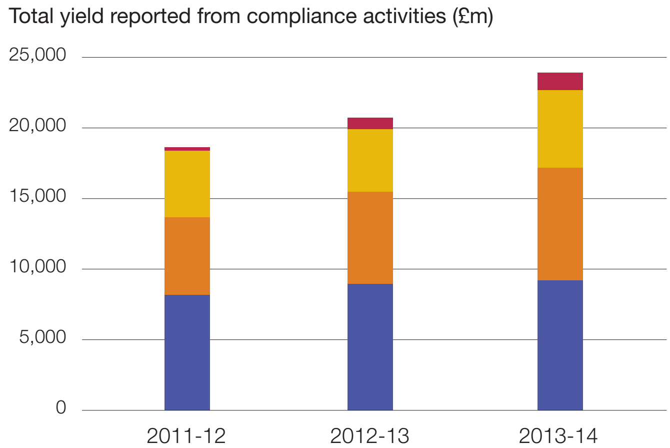
- **i** Cash collected of £9.2 billion (39 per cent), which is an estimate of the additional tax HMRC has collected by identifying and challenging non-compliance;

- **ii** Revenue losses prevented of £8.0 billion (33 per cent), which is tax revenue HMRC has protected either by refusing or reducing repayments claims because they are fraudulent or in error, or by disrupting criminal activity;

- **iii** Future revenue benefit of £5.5 billion (23 per cent), which is HMRC's estimate of the revenue benefits over the next five years where it considers it has changed the behaviour of taxpayers; and

- **iv** Product and process yield of £1.2 billion (5 per cent), which is the impact of legislative changes made since April 2011 to close tax loopholes and changes to HMRC's processes which reduce opportunities to avoid or evade tax.

Figure 7
Compliance yield reported by HMRC since 2011-12



Yield type	2011-12 (£m)	2011-12 (%)	2012-13 (£m)	2012-13 (%)	2013-14 (£m)	2013-14 (%)
Product and process yield	240	1	794	4	1,233	5
Future revenue benefit	4,700	25	4,441	22	5,508	23
Revenue losses prevented	5,509	30	6,512	31	8,003	33
Cash collected	8,178	44	8,975	43	9,182	39
Total	**18,627**		**20,722**		**23,926**	

Note

1 Percentages shown here have been rounded to add up to 100 per cent.

Source: National Audit Office analysis of HM Revenue & Customs performance data

Figure 8

There are four principal types of compliance yield calculated in different ways

Yield type	When the revenue benefits occur	What is measured
Cash collected		
An estimate of the additional tax HMRC has collected by identifying and challenging non-compliance, such as tax avoidance and evasion	All relate to tax assessments completed in year. Some will be collected after the year end	Additional tax liabilities and behavioural penalties are recorded when the compliance officer issues the taxpayer with a statement of the tax due. HMRC discounts the amount it records to recognise that some tax liabilities are not collected, for example because the taxpayer becomes insolvent.
Revenue losses prevented		
Comprises two separate measures which represent tax revenue HMRC has protected within the year	In-year	1 Losses prevented are recorded when HMRC refuses or reduces repayment claims because they are incorrect or fraudulent (87 per cent of revenue losses prevented in 2013-14). 2 HMRC estimates the value of criminal activity disrupted when HMRC seizes illicit goods (13 per cent of revenue losses prevented in 2013-14).
Product and process		
An estimate of the impact of legislative changes to close tax loopholes and changes to HMRC's processes that reduce opportunities to avoid or evade tax	In-year benefits of all legislative changes since April 2011	When legislative changes are made HMRC estimates the likely impact on revenues over up to five years. Each year it reviews these estimates and records the cumulative impact of all legislative changes made since April 2011.
Future revenue benefit		
An estimate of the future benefits of compliance work through changing the behaviour of taxpayers	Future years (1 to 5 years)	Whenever a compliance investigation is concluded, staff assess whether and for what period they should record the revenue benefits that will accrue in future years. In doing so, they estimate how long the taxpayer's behaviour will change as a result of the intervention, based on the taxpayer's characteristics and circumstances.

Source: National Audit Office analysis of HM Revenue & Customs compliance yield guidance

Our analysis of HMRC's methodology

2.16 HMRC recognises that it has to reconcile the competing objectives of improving the accuracy of the measure as a proxy for the effectiveness of all of its compliance work and reporting its performance in a way that is understandable and comparable from one year to another. We examined HMRC's methodology to test whether the measure:

a reflects the range of impacts from different types of compliance intervention based on the best evidence available;

b is subject to robust processes to assure the quality of the data that underpin it;

c allows comparison of HMRC's performance over time; and

d is reported in a way that is meaningful and understandable as an indicator of HMRC's performance.

a Does the measure reflect the impact of different types of compliance intervention based on the best evidence available?

2.17 HMRC has developed and extended the measure over time to include the impact of an increasingly wide range of its compliance activities, and to identify separately the different types of yield that make up the aggregate figure. Overall, we saw evidence that HMRC's measurement of yield provides a fair reflection of the range of compliance interventions and their impacts; and that HMRC has improved the measure, collecting evidence to support or challenge how it is constructed, and making reasonable adjustments to its measurement methodology which take account of this evidence. We set out below our findings in respect of each of the four types of yield.

Cash collected

2.18 HMRC changed how it measures cash collected in 2011-12 so that reported performance more closely reflects the revenue HMRC can expect to receive. It now discounts the amount it records to recognise that some tax liabilities identified at the conclusion of a compliance case are not ultimately collected, for example because the taxpayer becomes insolvent. HMRC estimated in 2010-11 that around 10 per cent of low value compliance assessments were not subsequently paid, and has discounted the amount of cash collected it scores from these cases by 10 per cent ever since. HMRC is now seeking to update its estimates of how much cash it collects from its compliance work.

Revenue losses prevented

2.19 Revenue losses prevented is made up of two elements, the first relates to changes made to actual repayment claims found to be incorrect or fraudulent: the second is a prediction of the impact on revenues of disrupting criminal activity.

2.20 These two measures carry different levels of certainty and precision. The value of repayments that have been prevented is known with reasonable certainty and accuracy and we found that the recording of this type of yield was straightforward and clearly understood by compliance teams. Estimates of the impact of HMRC's compliance work in disrupting organised crime are less certain and more judgemental. Officials are required to make a judgement about how long the criminality would have continued without the intervention, and the extent to which seizures of illicit goods will change the behaviour of consumers.

Future revenue benefit

2.21 HMRC expanded its measurement of future revenue benefit across its compliance business from 2012-13 to capture the impact of its work on smaller companies and individuals. This was a significant change in approach as HMRC had previously only identified future revenue benefit from its work with large businesses. HMRC took a cautious approach when it extended the measure by piloting the effect of the changes in 2011-12 to develop an evidence base, and limiting the period over which benefits could be calculated in areas of its business where the measure was new.

2.22 Future revenue benefit is inherently less certain, harder to estimate and more susceptible to errors as estimation is judgemental. But measuring future benefit is important: benefit sustained over a longer period of time may reduce the need for compliance work in future; the measure encourages staff to consider both the immediate and longer-term benefit of their work; and the calculation of future revenue benefit provides relevant evidence to inform decision-making.

2.23 HMRC is in the early stages of developing its understanding of the impact of its compliance work on future taxpayer behaviour. Its research has confirmed that businesses declare bigger increases in their tax liabilities in subsequent years when future revenue benefit has been scored when compared with cases where it has not.

Product and process yield

2.24 Product and process yield is an estimate of the impact of legislative changes to close tax loopholes and changes to HMRC's processes that reduce opportunities to avoid or evade tax. HMRC both estimates the in-year impact of such changes and forecasts the impact of the change forward to estimate the impact in future years.

2.25 HMRC assesses the impact of legislative changes on tax revenues at the end of each year. Its initial estimates are checked by the Office of Budgetary Responsibility and HMRC then revises those estimates if customer behaviour has not changed in line with expectations. This means estimates are reasonably certain and accurate.

2.26 The amounts HMRC has recorded in each year of this spending review period are cumulative but only take account of changes made since April 2011. For example, in 2013-14, HMRC reported the cumulative impact of three years of legislative changes, whereas in 2011-12, it only measured the impact of changes made in that year. As a result, what appears to be an upward trend in product and process yield is partly a consequence of the methodology HMRC uses and not necessarily the result of better performance year-on-year.

2.27 This approach to recording yield differs from HMRC's approach to measuring other types of yield. Elsewhere HMRC records all the impact in the year it has done the work, rather than attributing impact in future years. HMRC is considering developing how it reports impact from this type of work, so that it can better show comparative performance over time.

b Is the measure subject to robust processes to assure data quality?

2.28 Generally, HMRC's internal processes for assuring the robustness of the measure are well-developed and effective. We reviewed the processes in place for 2013-14. We found that HMRC has established guidance for staff that explains how they should measure different kinds of yield. There are processes to check that HMRC's teams follow this guidance and to challenge the reasonableness of their assumptions. HMRC employs a wide range of internal checks on data quality:

- Internal audit reviews of compliance yield cover the areas that contribute most yield.
- Further in-house audits and quality checks conducted by HMRC staff cover a large number of smaller value cases, and all the compliance yield recorded in the large business area.
- Technical panels consider how yield should be recorded in unusual and exceptional compliance cases, or in relation to new types of compliance work, such as taxpayer education programmes.

2.29 Where internal checks have identified weaknesses in methodology or errors in how yield was recorded, HMRC has taken steps to adjust the data before reporting its performance. It has not found a cost-effective way to determine the net impact of errors on its reported yield in those areas where its quality checks cover only a sample of compliance cases. HMRC believes that its current checks provide an appropriate level of control without spending disproportionate amounts of money on an assurance regime.

2.30 While HMRC's internal processes for testing and challenging in-year estimates of yield are sound, they did not pick up the significant error in the 2010-11 baseline calculation we identified during the course of our audit. The measurement of compliance yield is complex drawing on information from across HMRC's business and HMRC also changes its approach to measurement to reflect the best evidence available. This increases the risk that the data is inconsistent from one year to the next. HMRC has regular discussions of performance figures with the Treasury during the year, but does not subject its compliance yield data to other external scrutiny. HMRC has accepted the principle that there should be external scrutiny of the data it publishes on its compliance performance in future, and has invited the National Audit Office to play an ongoing role in providing independent assurance about the data's quality.

c Does the measure allow comparison of HMRC's performance over time?

2.31 HMRC improved its management information systems in 2011-12 to enable it to separately identify its performance across the four yield types. Although all four types of yield were recorded before 2011-12, HMRC could not break down its aggregate yield into those categories. The performance trend for each category of yield is therefore only identifiable between 2011-12 and 2013-14.

2.32 HMRC's current measure provides a good indication of trends in performance since 2011-12. The yield data is not comparable with data from before 2011-12, because of changes HMRC made to its methodology for measuring yields and the impact of the error it made in estimating its 2010-11 baseline. This makes it impractical to compare HMRC's performance over the longer term.

2.33 Consistency of the measure over time is important. The measure is both a key indicator of HMRC's overall performance and a means to demonstrate that it is meeting its commitments to generate additional revenues from compliance work. HMRC has taken two important actions to provide a sound basis for comparing its compliance measure for the period since 2011-12:

- It identifies and excludes exceptional items that would distort the underlying trend in its performance; and
- It has restated figures for this spending review period after making significant changes in methodology, so that it can describe trends in performance on a comparable basis.

Identifying and excluding exceptional items

2.34 HMRC has established sound practices, broadly equivalent to accounting principles, to identify high-value compliance cases that would distort the underlying trend in its performance. The impact of including exceptional items in HMRC's reported yield would be significant and would make any trend in performance hard to detect. In 2011-12, for example, HMRC excluded an exceptional item worth £4.3 billion, or 23 per cent of the total yield reported in that year, whereas in 2012-13 it identified none. For a case, or group of cases, to be considered exceptional and excluded from its reported performance, HMRC must show that all the conditions below apply:

- reporting yield from the case would distort the underlying trend in HMRC's performance;
- the case or type of case is a one-off and not repeatable; and
- that type of case was not included in the baseline or targets against which performance is assessed.

2.35 We found that HMRC has established a governance process to ensure that it treats exceptional items consistently. HMRC identifies potential exceptional cases throughout the year and these are considered by a challenge panel. Decisions by the panel are taken on a case-by-case basis and recorded before HMRC's aggregate outturn for the year is known.

Adjusting prior year's data for changes in measurement methodology

2.36 HMRC made one significant revision to prior year's performance in 2012-13 when it reported the results of its evaluation of the wider measurement of future revenue benefits introduced for the spending review 2010 period. It gathered evidence in 2011-12 to estimate the impact of the change and then increased both its 2010-11 baseline and its outturn for 2011-12 (by £1.7 billion and £1.9 billion respectively) to reflect the impact of this change in methodology. This process was well controlled and cautious, and HMRC did not report figures until it had developed its evidence and could determine the effect of the measure.

2.37 This revision was important to ensure that the trend in data since 2011-12 reflected changes in performance rather than being distorted by the changes in measurement. HMRC also increased the targets it had agreed with the Treasury by the same amount in each year of the spending review period.

d Is the measure reported in a way that is meaningful and understandable as an indicator of HMRC's performance?

2.38 When reporting its results publicly, HMRC has inadvertently overstated the degree of improvement in its performance. The way HMRC has measured compliance yield during this spending review period is substantially different to the way it reported its yield in 2010-11 and before, preventing a like-for-like comparison. Until it identified the error in its baseline, HMRC was not aware that such comparison was significantly flawed. Therefore, in presenting the trend in its compliance performance information prior to this year's annual report, HMRC has inadvertently overstated the increase in the additional revenue it has generated since 2011-12 compared to earlier years. HMRC has also made such comparisons in other publications and in its briefing of ministers.

2.39 While HMRC has frequently used footnotes and other caveats when publishing data to explain that methodologies were not directly comparable, it has not done so consistently and such caveats have not always been strong enough or sufficiently prominent. In its 2012-13 Annual Report, HMRC showed the trend in its performance since 2005-06 without making sufficiently clear that it had used different measurement methodologies over that period and the figures could not be compared on a like-for-like basis. Given the baseline issues that have now been identified, this had the consequence of overstating significantly the improvement in performance between 2010-11 and 2011-12.

2.40 We also consider that HMRC should have been more transparent in reporting its compliance yield and describing what it included. In past years it has not made it clear enough that only some of the yields are in-year revenue benefits, or that there are uncertainties in the data. Unlike other areas of its reporting, such as on the tax gap, HMRC has not produced sufficient detail describing its methodology and approach.

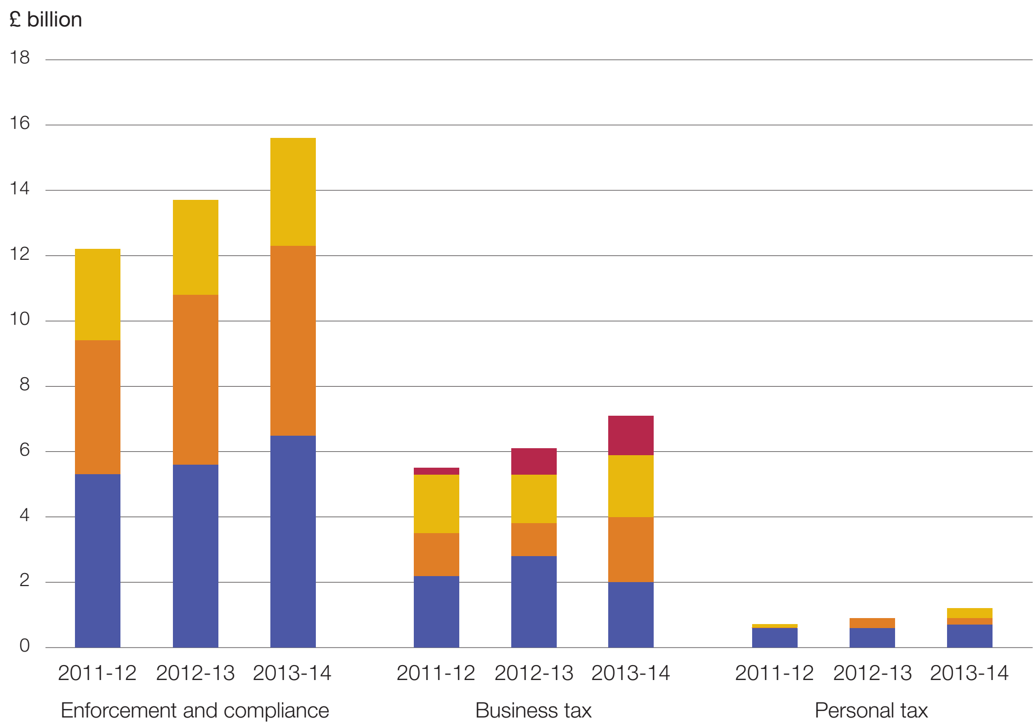
2.41 HMRC has substantially improved the accuracy, clarity and transparency of the way it reports its compliance yield in this year's Annual Report. It reports its yields broken down by type, showing those yields that relate to future years. It has also recognised that compliance yields up to 2010-11 are not comparable with the data it has reported since. HMRC has also explained the error it made when setting its baseline and the impact of the error on its performance relative to targets.

Managing performance

2.42 Those parts of HMRC's business that do the most compliance work and deal with the greatest amounts of tax at risk make the biggest contributions to reported yield. Sixty-six per cent of yield comes from the compliance and enforcement business area, which undertakes compliance investigations across all tax streams. Almost 30 per cent of yield was recorded by the business tax area, which undertakes compliance work on large businesses, while 5 per cent came from the personal tax area, including those teams dealing with charities, pensions, and affluent individuals (**Figure 9**).

Figure 9

Directorates' contributions to compliance yield



	Enforcement and compliance 2011-12	2012-13	2013-14	Business tax 2011-12	2012-13	2013-14	Personal tax 2011-12	2012-13	2013-14
Product and process yield	0.0	0.0	0.0	0.2	0.8	1.2	0.0	0.0	0.0
Future revenue benefit	2.8	2.9	3.3	1.8	1.5	1.9	0.1	0.0	0.3
Revenue losses prevented	4.1	5.2	5.8	1.3	1.0	2.0	0.0	0.3	0.2
Cash collected	5.3	5.6	6.5	2.2	2.8	2.0	0.6	0.6	0.7

Source: National Audit Office analysis of HM Revenue & Customs data

2.43 HMRC sets targets for each Directorate, and monitors progress against these each month. It regularly reviews progress against its targets with the Treasury. HMRC revises its forecasts for yield during the year based on information about how its compliance cases are progressing.

2.44 HMRC's process for monitoring and managing its performance includes regular challenge of performance data across its business. Compliance yield data is scrutinised by each part of the business at monthly performance meetings. The results are aggregated and reported to HMRC's Executive Committee. Before compliance data is reported as management information, each team performs quality checks on its data. Performance data is regularly discussed, compared and challenged – for example, teams performing similar work compare the ratio of cash collected to future revenue benefits in order to understand any differences.

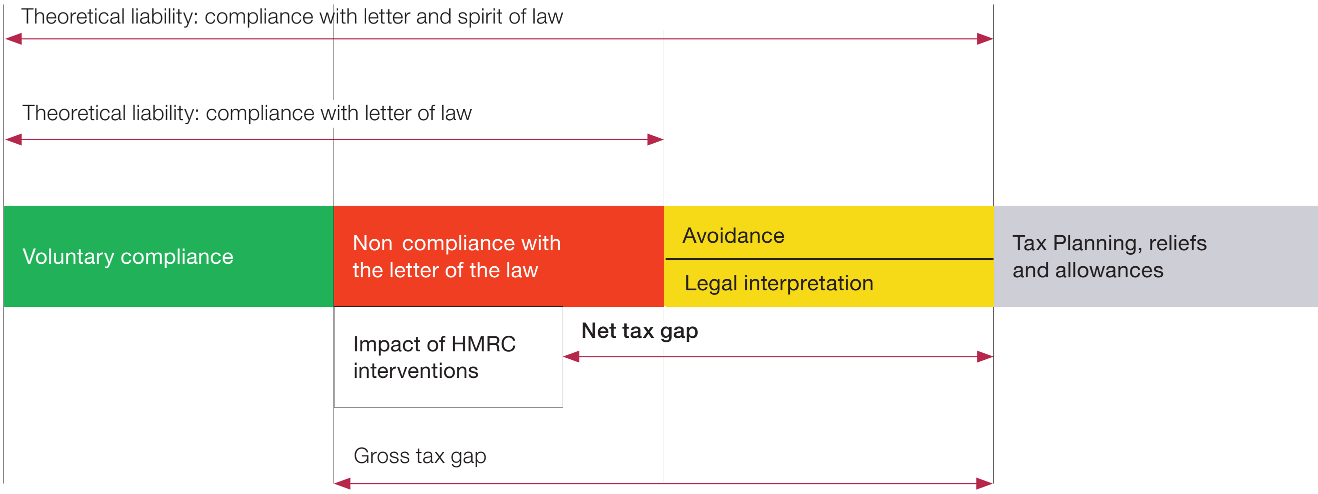
Measuring the long-term benefits of compliance work

2.45 HMRC estimates that in 2011-12, the latest year for which data is available, it collected 93 per cent of the tax that was due.[5] The remaining 7 per cent (£35 billion) it defines as the tax gap (**Figure 10** overleaf). Although in absolute terms the tax gap increased from the previous year, it fell as a proportion of the overall tax take from 7.1 per cent (**Figure 11** overleaf).

2.46 It is reasonable to expect that over the long-term the tax gap should decrease if HMRC is successful in increasing compliance with tax law. However, it is not straightforward to link compliance yield to reductions in the tax gap, which is affected by external factors such as economic conditions and changes in tax rates. For example, should HMRC be successful in encouraging more people to comply with their tax obligations voluntarily, it is conceivable that the tax gap would fall and that so would the amount of yield HMRC could generate from its compliance work. Further, a substantial amount of compliance work is needed to contain the tax gap and prevent it from growing. As HMRC's compliance strategy evolves it will therefore need to develop the framework by which it measures its performance further.

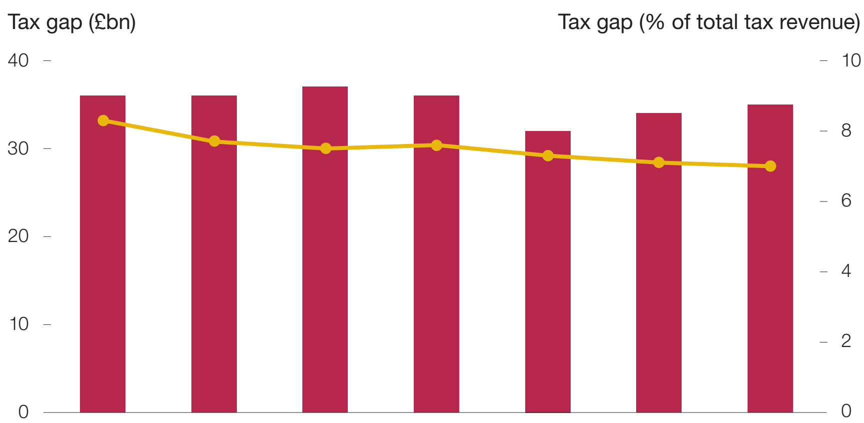
5 HM Revenue & Customs, *Measuring tax gaps 2013 edition*, October 2013.

Figure 10
HMRC's definition of the tax gap



Source: National Audit Office presentation of HM Revenue & Custom's definition of tax gap

Figure 11
Tax gap long-term trend



	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Tax gap (£)	36	36	37	36	32	34	35
Tax gap (%)	8.3	7.7	7.5	7.6	7.3	7.1	7.0

Source: HM Revenue & Customs, *Measuring tax gaps 2013 edition* publication

Part Three

How HMRC resources compliance work

3.1 HMRC invests £1.1billion a year tackling non-compliance (**Figure 12** overleaf). In return, it has committed to bring in additional tax revenue, rising to £26.3 billion per year by March 2016.[6] This part looks at how HMRC allocates its compliance resources to meet its targets to increase tax revenues and, over the long term, close the tax gap.

How HMRC bids for resources

3.2 HMRC considered a range of factors when negotiating its spending review settlement with HM Treasury (the Treasury). The primary focus for the 2011-2015 spending review period was on increasing tax revenues, which reflected the wider government objective to improve public finances. HMRC considered the potential impact of reducing costs on tax revenues and coverage of different customer groups. It estimated that a 25 per cent reduction in funding would increase the tax gap by at least £0.7 billion by 2014-15. HMRC forecast that any reduction in investment would increase non-compliance by small and medium-sized businesses, where its coverage had fallen to 2 per cent of businesses due to staff reductions in previous years.[7]

3.3 HMRC presented possible projects to the Treasury, assessing the impact of increased interventions on tax revenues and the wider deterrent effect on customer behaviours. Treasury Ministers selected their preferred options, agreeing that HMRC could invest £917 million of its efficiency savings across four years from 2011-12, to bring in extra compliance revenues of £7 billion a year by March 2015, an overall return of 18:1 across the period. The extra investment has allowed HMRC to increase the number of staff tackling non-compliance from 25,500 in March 2011 to 27,000 by March 2014, despite an overall reduction in staff across the department. By March 2015, HMRC expects to increase the number of staff tackling non-compliance by a further 1,000.

6 HM Revenue & Customs, *HMRC Business Plan 2014–16*, April 2014.
7 HC Committee of Public Accounts, *HM Revenue & Customs: Compliance and Enforcement Programme*, Eighty-Seventh Report of Session 2010-12, HC 1892, May 2012. Recommendation: "The Committee is not convinced that the decision to reduce staff numbers in this area represented value for money for the taxpayer. The Department estimated that its commitment to reduce staff numbers by more than 3,300 (about 11 per cent) over the Programme's lifecycle reduced the additional yield that could have been generated by £1.1 billion."

Figure 12

HMRC's funding across the 2010 and 2013 spending review periods

	2010-11 Actual (£m)	2011-12 Actual (£m)	2012-13 Actual (£m)	2013-14 Actual (£m)	2014-15 Forecast (£m)	2015-16 Forecast (£m)
Total Departmental Administration Expenditure	3,394	3,323	3,290	3,292	3,278	3,097
Resources devoted to compliance work	1,119	1,126	1,134	1,143	1,194	1,157
Compliance resources as a proportion of total resources	33%	34%	34%	35%	36%	37%

Notes

1 Total Departmental Administration Expenditure shows actual or forecast administration expenditure within Resource Accounts subhead: A HMRC administration (DEL).

2 Figures for 'resources devoted to compliance work', cover parts of the business tackling non-compliance: Enforcement and Compliance, Large Business and Specialist Personal Tax.

Source: *HM Revenue & Customs annual reports and accounts*; HM Revenue & Customs management accounts

3.4 In addition to its funding allocation across spending review periods, HMRC can bid for extra funding through the Autumn Statement and Budget processes. It exploited this mechanism in the *Autumn Statement 2012* and obtained £77 million to strengthen its risk capability across Enforcement and Compliance and Large Business. In return, HMRC committed to increasing tax revenues by a further £1.8 billion a year.[8]

3.5 HMRC used a range of measures to determine the level of investment in new projects. The main aim was to close the tax gap, and the projects sought to achieve this by increasing the amount of tax collected and protected, influencing taxpayer behaviours and extending HMRC's coverage of specific customer groups (**Figure 13**). Return on investment was an important factor in determining the focus of projects – the forecast return ranged from 11:1 to 62:1 – but was not the only factor. HMRC recognised that, used alone, return on investment can be a disincentive to investment in certain types of work, such as improving systems to prevent taxpayers making mistakes in the first place. In addition, potential returns vary across different types of work. For example, Large Business work delivers a high return on investment because the tax at stake in each case is higher than in other areas of work (paragraph 3.7).

8 HM Treasury, *Autumn Statement 2012*, December 2012.

Figure 13
Factors considered in using additional funding for compliance work

Spending review projects	Cost and benefit (original spending review plans): Investment across SR10 period (£m)	Yield across SR10 period (£m)	Projected return on investment across SR10 period	Emphasis HMRC put on these aims when developing projects: Yield	Value of Tax Gap	Deterrence	Coverage	Strengthening capability	Extent of risks
Affluent individuals	17	259	15:1	✔✔	✔	✔✔	✔	✔✔	✔
Wider coverage	548	7,037	13:1	✔✔	✔✔✔	✔✔✔	✔✔✔	✔✔	✔✔✔
Volume crime	60	930	16:1	✔	✔✔	✔✔✔	✔✔	✔	✔
Evasion publicity	8	330	41:1	✔	✔✔	✔✔✔	✔✔	✔	✔✔
Organised crime	96	4,315	45:1	✔✔	✔✔	✔✔	✔✔	✔✔	✔✔✔
Avoidance package for Large Business	25	1,550	62:1	✔✔✔	✔✔✔	✔	✔✔✔	✔✔	✔✔
Expanding the use of debt collection agencies	101	1,105	11:1	✔✔	✔✔	✔✔	✔	✔	✔
Debt – staff reinvestment	62	918	15:1	✔✔	✔✔	✔✔	✔	✔	✔
Total	**917**	**16,444**	**18:1**						

Strong emphasis

Moderate emphasis

Low emphasis

Notes

1 All investment and yield figures are original forecasts. These may have changed during the course of the spending review period.

2 HMRC also initiated a project to develop the compliance skills of its Large Business staff as part of HMRC's Change Programme. This project was not funded through the investment package for compliance work.

Source: National Audit Office analysis of spending review 2010 project business cases

3.6 HMRC had a clear rationale for using the spending review funding. It increased its focus on customer behaviours, extended its coverage and strengthened its capabilities (**Case Study 1**). In particular, it used the funding to:

- **Tackle customer error**
  It is increasing efficiency in tackling customer error by streamlining processes in compliance centres. This frees up people to focus on serious avoidance and evasion, and increases coverage of small and medium-sized businesses from 2 per cent to 9 per cent by 2015.

- **Undertake campaigns and taskforces for specific groups**
  It is undertaking four campaigns each year to target specific taxpayer groups, such as medics, encouraging them to declare their income voluntarily. HMRC also increased the number of taskforces to 30 per year to focus on evasion risks in specific trades and professions in particular regions.

- **Address fraud, evasion and avoidance**
  It is recruiting criminal and civil investigators, and training over 5,000 staff to identify and tackle fraud, evasion and avoidance.

- **Increase risk capability**
  It is developing its technology to improve risk profiling across Enforcement and Compliance. It is also increasing resource in Large Business to strengthen risk assessment capability using the Large Business risk taskforce.

Case Study 1
Volume crime project

HMRC used the extra funding to strengthen its capability to undertake more complex investigations and increase its coverage of deliberate evasion. It is investing £41 million in the volume crime project to increase the number of fraud prosecutions of individuals and businesses that deliberately avoid their tax obligations. It recruited an extra 200 investigators to increase the number of prosecutions from 165 in 2010-11 to 1,174 in 2014-15. HMRC forecast increased revenues of £497 million – a return of 12:1 – and a stronger deterrent effect.

In 2013-14, there were 804 prosecutions as a result of the volume crime project. HMRC is conducting ongoing research to understand the impact of prosecutions on behaviours. Its initial research suggests that businesses are aware of HMRC's tougher approach although there is not yet sufficient evidence to confirm this.

Note

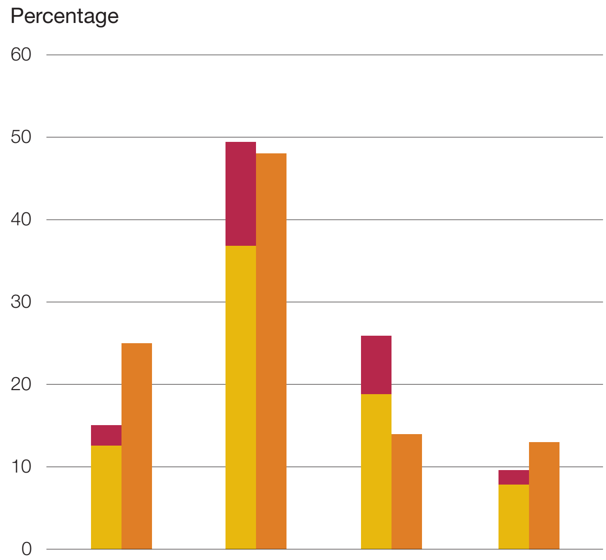
1 Investment and revenue figures are current forecasts.

3.7 HMRC used its spending review settlement to help close the tax gap, based on an analysis of the potential returns in areas where it was previously under-represented. For example, it invested approximately half of the additional funding in the small and medium-sized business sector, which comprised 48 per cent of the tax gap (**Figure 14**), increasing the number of staff to improve the ratio of interventions to businesses in this sector from 2 per cent to 9 per cent. By contrast, it judged that the return on its investment by putting more staff into the large business sector would be smaller. In the former Large Business Service, which dealt with the 800 largest businesses, the ratio of investigators to businesses was already more than 1:1, giving HMRC 100 per cent coverage of these businesses. HMRC concluded that for Large Business, better returns could be achieved by maintaining existing staff numbers and enhancing their compliance skills through further training.

Figure 14

How HMRC used additional funding to address the tax gap

Percentage of compliance staff deployed in 2013-14 against percentage tax gap by customer group



	Large Business	SMEs	Individuals	Organised criminals
Additional staff	2	13	7	2
Existing staff	13	37	19	8
Tax gap	25	48	14	13

Notes

1 Staff measured in full-time equivalents.

2 Existing staff represent the staff already in post tackling these customer groups prior to the additional funding with additional staff being funded through the spending review investment package.

3 The chart shows the four largest customer groups which represent 97 per cent of all staff engaged in compliance work.

Source: National Audit Office analysis of HM Revenue & Custom's Tax Compliance Risk Overview and compliance staff numbers

3.8 In 2012, the Committee of Public Accounts' report *HMRC: Compliance and Enforcement Programme*[9] concluded that the Committee was not confident that there was a regular discussion with policy makers in which HMRC was sufficiently clear about the marginal rate of return it could achieve from different levels of spending. HMRC recognises that good quality information on marginal returns is an important part of decisions about resources,[10] and was already modelling different scenarios in some areas of the business to assess likely returns (paragraph 3.14). We found that, since 2012, HMRC has also started to analyse the point at which marginal returns start to diminish in four tax regimes – Corporation Tax, VAT, Self Assessment and Employer Compliance. In each case, it found that its existing coverage was significantly below the point at which further investment would mean marginal returns would start to fall. HMRC has not yet extended this analysis to different customer groups.

How HMRC allocates resources each year

3.9 HMRC's key governance arrangements for allocating compliance funding each year are as follows:

- **Setting budgets**
  The Executive Committee sets budgets and targets across the whole department, reflecting its objectives and ministerial priorities.

- **Deciding what to resource**
  The central finance team supports the Executive Committee in deciding where to deploy resources. It reviews budget allocations across business areas and considers proposed changes to the previous year's allocations against departmental priorities.

- **Assigning budgets**
  Business areas assign annual budgets to their directorates, using the previous year's allocation as the start point. The primary focus is on the need to meet revenue targets, while also considering the department's wider objectives and emerging risks.

- **Monitoring performance**
  Business areas monitor performance against targets and report back to the Executive Committee.

9 HC Committee of Public Accounts, *HM Revenue and Customs: Compliance and Enforcement Programme*, Eighty-Seventh Report of Session 2010-12, HC 1892, May 2012.

10 HM Treasury, Treasury Minutes, *The Government's responses on the Seventy-Fifth, the Seventy-Seventh, the Seventy-Ninth to the Eighty-First and the Eighty-Third to the Eighty-Eighth Reports from the Committee of Public Accounts*: *Session 2010-12*, CM 8416, July 2012, Eighty-Seventh Report, Paragraph 2.3.

3.10 Until 2011, HMRC did not have a consistent means of coordinating its response to risks. In 2011, the Enforcement and Compliance business area introduced planning groups to coordinate and focus its efforts on three significant areas of risk. These were: organised crime, mass market evasion and avoidance. The Personal Tax and Business Tax areas also have their own planning groups which coordinate work across their directorates. Large Business also has a tactical delivery plan which sets priorities for compliance work with large businesses dealt with across both Business Tax and Enforcement and Compliance. The planning groups help to set the strategy for tackling risks, and work with the directorates to advise on the type of interventions and resources needed.

3.11 The planning groups are important in providing an organisation-wide focus on specific risks and a cross-departmental response. In practice, each group operates differently and influences decision-making to varying degrees. For example, the Mass Market and Evasion Group has taken a collaborative approach with directorates to ensure they meet targets, whereas the Avoidance, Legal Interpretation, Complex and Offshore Group performs a more strategic advisory role. HMRC is reviewing the role of the planning groups to ensure they provide consistent and effective challenge to resource deployment decisions.

Factors considered in deploying resources

3.12 The Executive Committee and business areas have decided how to allocate resources based primarily on judgements, taking account of a range of factors. The priorities have been delivering annual revenue targets, while maintaining coverage across tax regimes and customer groups and, over the longer-term, strengthening capabilities. Using the spending review funding, HMRC redeployed staff across compliance work. Over the last three years, 6,500 staff have either joined or been redeployed within the Enforcement and Compliance business area, enabling HMRC to increase the number of compliance interventions.

3.13 HMRC faces practical constraints which restrict the extent to which resources can be reallocated each year and mean that reconsidering allocations from scratch is impractical. For example, compliance staff are spread over 100 sites; are committed to delivering existing work, including lengthy investigations; or may need further training before undertaking more complex work. For example, it takes two years to train a criminal investigator and four years to train a tax inspector. The Enforcement and Compliance area has sought to increase its flexibility by implementing a major training programme, providing training to over 5,000 staff over the last three years.

3.14 The Enforcement and Compliance area has used modelling to test the impact of different resource mixes on potential returns in the mass market sector, which includes small and medium-sized businesses and most individuals. We assessed that the modelling was sophisticated, demonstrating good practice by considering a range of scenarios and assumptions. However, we also found that the modelling did not cover all directorates or different types of compliance work, such as criminal investigations, and had not been used outside the Enforcement and Compliance business area. HMRC is building models in other areas to assess the impact of different resource mixes on potential returns and customer behaviours. This will build confidence that it is making optimal resource deployment decisions across the totality of its compliance work.

3.15 This year, for the first time, senior management are taking a cross-departmental view on the allocation of compliance resources to take account of wider departmental priorities, and are planning to redeploy compliance staff to other parts of the business. For example, HMRC expects almost 1,000 compliance staff to move into customer contact centres this year to help manage the annual peak in demand for the renewal of tax credits.

Consideration of risks when deploying resources

3.16 HMRC faces a wide range of risks, from simple mistakes to deliberate evasion to criminal attack. HMRC continually assesses these risks, investing funds and developing new technologies to better understand the threats. For the largest businesses, risks are identified on a case-by-case basis. HMRC used the additional spending review funding to increase its coverage of specific risks, increasing the number of interventions on small and medium-sized businesses, and focusing more on rule breakers and organised crime.

3.17 HMRC produces an annual summary of the main risks to tax collection. It ranks these on the basis of the amount of tax at risk, the possible social harm the risk could cause, and the potential impact on its reputation. The annual summary does not, though, provide a complete or current view of the risks to tax revenue. We found that the information on financial impact is based on historical data, and it does not consider the impact of future risks which may vary as economic and other circumstances change. Recognising its limitations, HMRC has not consistently used the annual assessment of risks when making resource deployment decisions.

3.18 HMRC is developing a new 'Strategic Picture of Risk' which aims to bring together data, intelligence and economic analysis to provide a more comprehensive and current view of risks. This includes more detailed analysis to show how risks relate to customer groups and behaviours. It intends to use the new assessment more explicitly in managing its business, developing a clearer link to the resource allocation process and providing senior management with better information to support decision-making.

3.19 Directorates have, though, reallocated resources to tackle significant risks. For example, HMRC has responded to the increasing profile of tax avoidance by creating a new Counter Avoidance Directorate, drawing 600 staff from across the department to provide a more consistent and coordinated response to this risk. We also found that HMRC had moved staff to tackle other major threats in the past. For example, it moved and trained over 1,000 staff to tackle Missing Trader Intra-Community (MTIC) fraud in 2005, when that risk was at its highest (**Figure 15** overleaf). HMRC refined its approach as its understanding of the fraud improved and, in line with the diminishing risk, reduced the number of staff to 300. HMRC's investment in tackling MTIC fraud over a 15-year period has considerably reduced the tax lost to this type of fraud. HMRC continues to tailor its response to the scale of the threat.

Availability of management information

3.20 To make informed resourcing decisions, HMRC needs good management information on risks and on performance in different parts of its business. By developing the Strategic Picture of Risk, HMRC is seeking to provide a better strategic outcome from its risk assessments. To assess performance, HMRC now uses four measures of compliance which provide HMRC with indicators of the returns from a broad range of its interventions to tackle non-compliance and improve voluntary compliance (Part Two).

3.21 We reviewed how HMRC allocates resources by risk, customer group and customer behaviour. We found that there was good management information on how HMRC allocated the spending review funding, and the projects could be mapped to specific risks. However, HMRC had incomplete and inconsistent management information on the distribution of annual resource allocations by risk type, customer groups or behaviours. There is scope for HMRC to improve the use of its management information to provide a clearer view on the extent to which it aligns its compliance resources with risks. It could also build its understanding of the behaviours that lead to non-compliance in different population groups.

Figure 15

Case Study 2: Missing Trader Intra-Community (MTIC) Fraud

1999 2000	MTIC fraud increases in early 2000s VAT system targeted through chains of companies. Traders go missing without paying VAT due HM Customs & Excise tackles MTIC fraud through Criminal Investigations	Respond
2005 06	HMRC loses test case in European Court, MTIC fraud increases HMRC receives huge VAT repayment claims amounting to £4 billion in three months HMRC moves 1,000 staff into tackling MTIC fraud	
2006-07	HMRC starts using new civil intervention to challenge fraudulent repayment claims Succeeds rapidly in reducing the level of fraud Fraudsters diversify into new products, creating new risks for HMRC	Prevent
2008 09	Fraudsters start exploiting carbon credits market HMRC uses powers to enact emergency legislation to zero-rate carbon credits Move towards civil rather than criminal action against fraudsters	
2010 11	Fraudsters move into gas and power industries HMRC monitors suspicious traders intensively, often preventing fraud HMRC focuses on promoting awareness, educating banks and large businesses to spot signs of fraud	Promote
2013 14	Numbers of staff reduce to around 300 Intensive trader monitoring work continues to prevent involvement in fraud Threat to UK high but contained. Collaborative cross-EU work ongoing to prevent and disrupt fraud	

Source: National Audit Office analysis of MTIC project business cases and Enforcement and Compliance business plans

How HMRC is developing its compliance strategy

3.22 HMRC is developing a new long-term strategy for compliance work to tackle the behaviours that lead to non-compliance (**Figure 16** overleaf). Its objectives are to:

- 'Promote' voluntary compliance by designing better systems and using communications guidance and publicity to help people to comply voluntarily;
- 'Prevent' non-compliance by intervening to stop obvious errors and frauds at the point of transaction; and
- 'Respond' robustly to non-compliance by focusing resources directly on those who deliberately evade or avoid paying tax.

3.23 HMRC already builds in a range of factors when deciding on the types of compliance intervention required and the resources needed. It is now considering how to measure and report the impact of the totality of its compliance work. HMRC will now need to ensure it aligns its management information with the new strategy to make informed decisions on the allocation of its compliance resources. Its work to develop its risk assessment (paragraph 3.18) and measure its performance (Part Two) will provide a stronger basis to achieve this. HMRC also needs to strengthen its understanding of the link between risks and resource deployment, and extend its use of modelling to trade-off allocations between different types of compliance work.

3.24 To maximise its impact, HMRC also needs to understand the balance of compliance work needed to deliver responsive actions to collect or protect yield, against the longer-term impact of activities to promote compliance and change behaviours. Developing a broader range of performance measures, which recognise the impact of different types of work, alongside a better understanding of how resources are allocated against risks, should give HMRC a stronger basis to achieve the new strategy.

Figure 16

HMRC's approach to improve voluntary compliance

Upstream | At transaction | Downstream

Promote

Design compliance into systems and processes

Scan for risk

Nudge customers

Direct to next steps

Opportunity to **correct**

Prevent

Block mistakes

Prompt compliance

Personalise return

Respond

Personalise response

Self correct and **Self-serve**

Cost-effective **triage**

Hard-edged follow up

Underpinned by flexible, cross-cutting capability in two areas:

Leverage and deter

Agents and third parties, Transparency, Taxpayer responsibilities

Analyse

Strategic use of data, Customer understanding, Early risk scanning, Feedback

Source: HM Revenue & Customs' new strategy for compliance

Part Four

Other significant developments

4.1 This part gives an update on the following areas, which we highlighted in previous reports:

- Pay As You Earn;
- Tax debt management; and
- The UK-Switzerland tax agreement.

Pay As You Earn

4.2 Pay As You Earn (PAYE) is HMRC's largest tax collection process. In 2013-14, HMRC collected £162.1 billion in income tax and £106.7 billion in National Insurance contributions, about 90 per cent of which was through PAYE. HMRC collects this tax through around 1.7 million active employer schemes, which annually produce approximately 62 million returns for separate employments and pensions each year.

4.3 In recent years HMRC has invested in improving its PAYE systems. In 2009, it introduced the new National Insurance and PAYE Service (NPS). NPS created a single record for an individual's PAYE pay and tax details irrespective of the number of sources of income they have. This consolidated 12 regional databases into a single employee-focused national database. NPS improved HMRC's ability to provide more accurate tax codes and reduced the likelihood of people over or underpaying tax.

4.4 In 2013-14, HMRC changed PAYE so it could collect more timely data from employers through the Real Time Information system (RTI). RTI offers HMRC the prospect of tracking changes in income and employment in year, helping to keep people on the correct tax code when their employments change and thereby reducing the levels of under and overpayments of tax. RTI also allows HMRC to identify PAYE debt in year rather than at the end-of-year reconciliation.

4.5 We reported previously that the introduction of NPS in 2009 was not smooth,[11] adding to previous work backlogs and causing delays in updating taxpayer records. However, we noted in 2012-13 that HMRC had met its targets to clear these backlogs and stabilise the service.[12] This has allowed HMRC to operate a more normal PAYE service and to further reduce manual workloads. In 2012-13, we reported that the NPS system generated 20.5 million 'work items' (where manual intervention may be required to correct or update an employee's tax record), which was 4.5 million more than HMRC had the capacity to deal with. In 2013-14, the system was being used more effectively to automate tasks meaning that only 7.8 million work items were generated, which HMRC had the capacity to clear.

4.6 HMRC piloted RTI in 2012-13 before introducing it for all employers in 2013-14. As at 31 March 2014, 1.6 million employer schemes (94 per cent) are filing through RTI, comprising 47.7 million employments (over 99 per cent). Data quality has improved and HMRC's own evaluation suggests that RTI is helping to change employer behaviour by encouraging them to tell HMRC of changes in employee circumstances earlier.[13]

4.7 HMRC's employer survey suggests that, for most employers, changing to RTI has not been unduly burdensome. HMRC has nevertheless recognised that some smaller employers struggled to adapt their internal processes and systems in time.[14] For example, in December 2013, it allowed employers with nine or fewer employees to report PAYE information on or before the last payday in the tax month until April 2016.

Tax debt management

4.8 HMRC's Trust Statement reports a figure of £24.3 billion 'receivables' at 31 March 2014, which means taxes owed. This includes £13.3 billion of tax debt, which is when a tax liability is outstanding and collectable after its due payment date. HMRC's total debt balance makes up around 70 per cent of the overdue debt owed to government.[15] Tax debt excludes tax credits debt which we discuss in Part Five of this report.

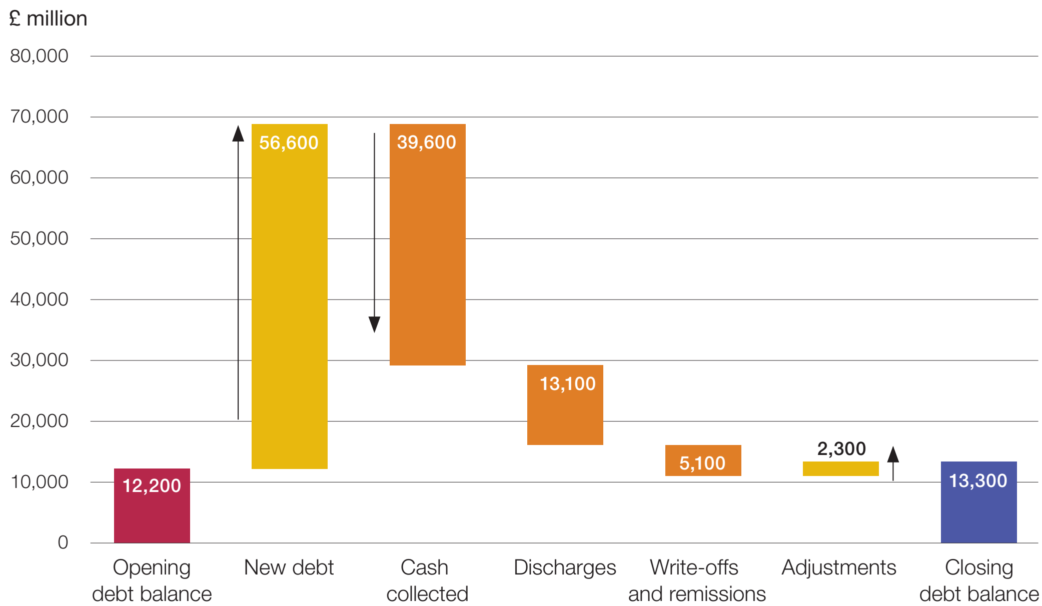
4.9 The value of tax debt at year end increased to £13.3 billion at 31 March 2014 compared with £12.2 billion at 31 March 2013 (**Figure 17**). HMRC managed a total of £56.6 billion of debt during 2013-14, 33 per cent more than in the previous year. During the year, HMRC collected £39.6 billion in 2013-14 (£34.5 billion in 2012-13). Of this extra cash collected, an estimated £4.4 billion has been the result of earlier debt recovery action as a result of the introduction of Real Time Information. RTI means that PAYE debts can be identified sooner. The net effect of RTI is a significant factor in the £1.1 billion increase in the debt balance as at 31 March 2014.

11 Comptroller and Auditor General, *HM Revenue & Customs Annual Report and Accounts 2009-10, HC 299, July 2010,* Comptroller and Auditor General, *HM Revenue & Customs Annual Report and Accounts 2010-11, HC 981, July 2011,* Comptroller and Auditor General, *HM Revenue & Customs Annual Report and Accounts 2011-12*, HC 38, June 2012.
12 Comptroller and Auditor General, *HM Revenue & Customs Annual Report and Accounts 2012-13, HC 10, July 2013*.
13 Available at: www.hmrc.gov.uk/research/report304.pdf, page 10.
14 Available at: www.gov.uk/government/publications/real-time-information-rti-assessment-of-impact-of-on-or-before-reporting
15 Comptroller and Auditor General, *Managing debt owed to government*, Session 2013-14, HC 967, National Audit Office, February 2014; See also: Comptroller and Auditor General, *HM Revenue & Customs annual report and accounts 2012-13*, HC 10, June 2013.

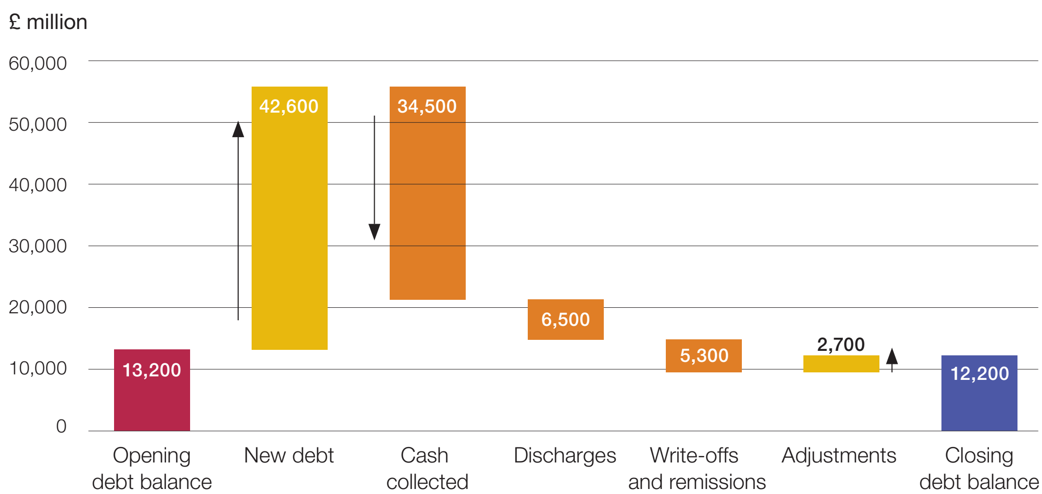
Figure 17

Increasing tax debt flows in 2013-14

Debt movements 2013-14



Debt movements 2012-13



Notes

1 Movements here exclude tax credits debt.

2 Debt is written off in situations where there is no practical way to pursue the liability. Some write-offs occur automatically and are outside a department's control such as where the debtor is insolvent.

3 Debt 'remission' (a concept unique to government) is where a department decides not to pursue a debt primarily on the grounds of value for money, i.e. the cost of pursuing it would be greater than the benefit, or it is not the most efficient use of limited resources, compared with other priorities.

4 Discharged debt is where HMRC amends or cancels a debt as further information is received that determines the taxpayer's final liability as being lower than the originally estimated figure.

5 Adjustments are due to manual adjustments to reconcile between debt balance figures in debt management systems and movements, such as cash collected, in other financial systems.

Source: HM Revenue & Customs

4.10 In 2013-14, HMRC focused on clearing its older debt, which was more than 34 per cent of its previous year-end balance (28 per cent at 31 March 2014). This resulted in the balance of debt aged over 12 months reducing to £3.7 billion from £4.2 billion at 31 March 2013 (**Figure 18**).

4.11 HMRC is completing a new debt management strategy, which has the following key components:

- **More strategic use of private sector debt collection agencies (DCAs)** to collect government debt, in particular through a cross-government 'debt market integrator.' HMRC sent £879 million of debt to DCAs in 2013-14 as extra capacity for low priority debts. The market integrator should act as a single point of contact to manage debt placements on behalf of HMRC and other government bodies, and should enable HMRC debt to be placed more intelligently with DCAs.
- **Improved Analytics.** HMRC is using its analytics system to design debt collection campaigns based on risk profiling and customer segmentation. This allows for more tailored and flexible approaches. It also requires less manual intervention for allocating debts. HMRC is running this in parallel with previous systems and this should bring further benefits in 2014-15.
- **Early collections and tailored approaches.** Collecting debts early: to ensure that debts are placed into debt recovery processes quickly and additional support is given to debtors in difficulty through allowing instalment pay arrangements.

4.12 HMRC has a wide range of performance data to measure its debt management performance and there are a range of key performance measures which are reported monthly to HMRC's Executive Management Committee. These include the period end debt balance, new debt, and roll rate calculation which measures the proportion of new debt that HMRC has collected within 30 or 90 days. HMRC is improving the roll rate calculation in 2014-15 to include a wider range of taxes including Value Added Tax.

UK-Switzerland tax agreement

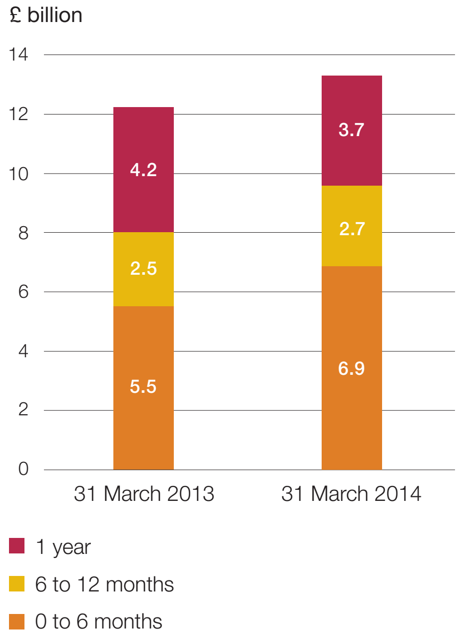
4.13 HMRC has a strategy for tackling offshore evasion[16] which aims to ensure that UK taxpayers meet their tax obligations, through cooperation with other tax jurisdictions. Including the UK, 44 jurisdictions have committed to the early adoption of a new standard on automatic exchange of information (known as 'The Organisation for Economic Co-operation and Development Common Reporting Standards').[17] Ten jurisdictions, including the UK Crown Dependencies and Overseas Territories, have already signed agreements to this standard with the UK. These agreements simply allow information to be shared between tax authorities.

16 HM Revenue & Customs, *No Safe Havens 2014*.

17 Under the OECD Common Reporting Standard, jurisdictions obtain financial information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis. Based on an initiative of the G8 in 2013, the standards were developed by the OECD, working with G20 countries and in close cooperation with the EU.

Figure 18
The breakdown of HMRC's debt by age

Debt breakdown by age 2012-2014



Note

1 Trend analysis showing reduction in age of debt.

Source: HM Revenue & Customs

4.14 The UK-Switzerland tax agreement came into force on 1st January 2013. This agreement is unique as it allows individuals to avoid having their account details shared with HMRC if they pay a charge. Under the agreement, UK domiciled individuals with bank accounts in Switzerland can:

- opt to pay a withholding tax[18] based on the balance of their Swiss accounts between 2002 and 2012, and avoid having their details shared with HMRC; or
- opt to disclose the details of their accounts either through the Liechtenstein Disclosure Facility (LDF)[19] or directly to HMRC.

18 Withholding tax is a tax levied on income or assets held abroad by a third party on behalf of a government.

19 The Liechtenstein Disclosure Facility (LDF) is a facility to deal with those who want to disclose that they may have a UK tax liability. The LDF allows people with relevant property in Liechtenstein to settle their tax liability on all offshore assets with HMRC under this arrangement.

4.15 HMRC originally forecast that it would collect £5.0 billion revenue from the UK-Switzerland tax agreement by March 2016.[20] Following indications from the Swiss government that the agreement is likely to raise much less than originally expected, the Department revised its estimate and, in Autumn Statement 2013, it reduced the forecast of expected revenue to £1.7 billion by March 2016 (**Figure 19**).[21] HMRC had collected £808 million of withholding tax by March 2014 against a forecast of £955 million. Compliance work is ongoing to quantify revenue from the LDF and direct disclosures to HMRC related to the agreement. So far, HMRC has identified £6 million in direct disclosures and over £260 million in revenue from the LDF which it considers is likely to have been disclosed as a result of the UK-Switzerland tax agreement, bringing the total revenue received by March 2014 to £1,074 million. In April 2014, HMRC received a further £58 million in withholding tax relating to 2013-14.

4.16 HMRC used a range of external sources and data from its own compliance activities to revise its revenue estimates. In its latest forecast, HMRC used the most up to date information available but had to rely on its own judgement and experience of the agreement's performance so far, in particular for assumptions about how account holders would respond to the agreement, because there was no robust evidence for some of the factors that might impact on revenue. The factors used in the forecasts, many of which remain highly uncertain, included:

- the total value of UK funds in Switzerland;
- whether account holders had been declaring those funds to HMRC previously;
- how account holders respond to the agreement, including the level of capital flight out of Switzerland; and
- the extent to which account holders can find ways to circumvent the deal.

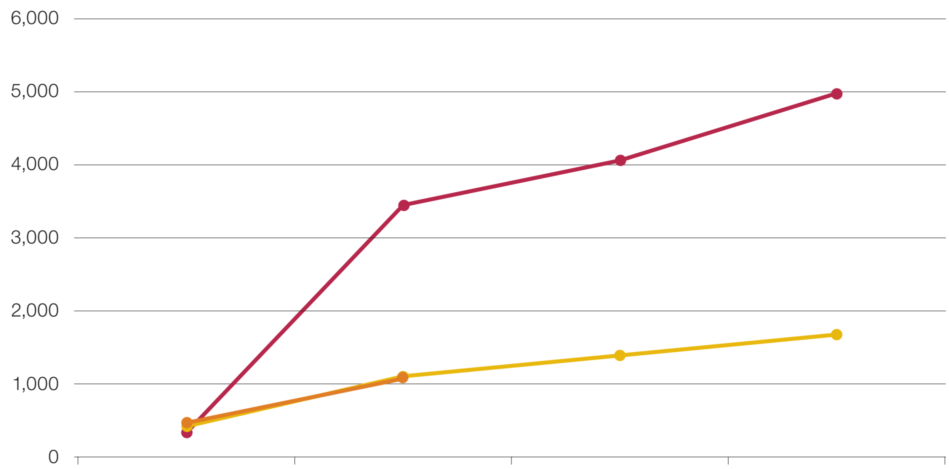
4.17 HMRC has gained new data as a result of its agreement with the Swiss authorities. This includes personal information about account holders who opt for disclosure, including the balance of their accounts between 2002 and 2012 and a list of the top ten countries where people have moved assets from Switzerland. It plans to use this data to validate its own analysis and to support negotiations over new tax agreements with other countries.

4.18 While HMRC has a wider strategy for tackling offshore evasion, which sets out how it plans to use data sharing agreements, it has not set out detailed performance measures, or longer-term objectives, other than expected revenues, specific to this agreement. It is not clear how HMRC proposes to exploit the lessons learned from the UK-Switzerland tax agreement.

20 The tax due on bank accounts which fall under the UK-Swiss tax agreement comprises two parts: firstly, a one-off payment based on the balance of the account at 31 December 2012, the length of time that the account was held and any increases over that time; secondly, a tax on income and gains for the future from 1 January 2013.

21 The Office for Budget Responsibility (OBR) certified HMRC's original forecasts for revenue from the UK-Swiss tax agreement but highlighted the uncertainties inherent in these forecasts due to lack of information about the value of UK assets in Switzerland. In 2013, it agreed the revised forecasts with HMRC and included these in its *Economic and Fiscal Outlook 2013*.

Figure 19
Forecast and actual revenues (cumulative)



	2012-13	2013-14	2014-15	2015-16
Original revenue estimate	330	3,450	4,060	4,980
Updated revenue estimate	420	1,105	1,390	1,675
Actual revenue to date	466	1,074	–	–

Notes

1 'Actual revenue to date' includes revenue from the withholding tax and HMRC's estimates to date of revenue connected to the Switzerland agreement through the LDF and through direct disclosures to HMRC.

2 Revenue for the Switzerland agreement is accounted for on a cash basis; £58 million relating to 2013-14 but received in April 2014, has therefore not been included in the actual revenue to date figures shown above.

Source: HM Revenue & Customs' models and actual revenue data

Part Five

Personal tax credits

Introduction

5.1 In 2013-14, HMRC spent £29 billion on child and working tax credits (personal tax credits). Tax credits give financial support to around 4.7 million families, supporting around 7.8 million children.

5.2 The personal tax credits scheme is designed to be flexible enough to react to changes in claimants' circumstances. Claimants do not always, however, understand their obligations to tell HMRC when their circumstances change and to report their actual income and circumstances at the end of the tax year. Claimants may make mistakes in their applications, which result in result in overpayments or underpayments. For example, claimants may misunderstand what they should report as income, or miscalculate their childcare costs. Final entitlements, based on their actual income and circumstances in the year, can only be calculated after the end of each year as part of the finalisation process. If claimants have been paid more than they were entitled to, HMRC will seek to recover the resulting overpayment.

5.3 HMRC expects the introduction of Real Time Information (RTI) for PAYE to address much of the error in the personal tax credits system arising as a result of undeclared or understated income. Its initial analysis assumed that the majority of such error and fraud for employment income would be removed once RTI was fully implemented. Following the successful implementation of RTI (see Part Four) the vast majority of employers are now reporting in real time. RTI earnings data for 2013-14 is currently being used in support of tax credit renewals for 2014-15. It is too early to assess the impact of RTI on levels of personal tax credit error and fraud because the final reconciliation of individuals' tax credits entitlement for the 2013-14 tax year, including the identification of overpayments and underpayments of tax credits, will not commence until summer 2014 and the estimate of error and fraud for that year will not be published until 2015.

5.4 In October 2010, the government announced its intention to introduce a new 'Universal Credit' to replace many of the current working-age benefits, including working and child tax credits, with a single means-tested payment. The government's current assumption is for the Universal Credit service to be available in each part of Great Britain during 2016, with the majority of the remaining legacy benefit caseload moving to Universal Credit during 2016 and 2017.

5.5 This part of the report describes:

- how HMRC's accounts report personal tax credits;
- why the Comptroller and Auditor General (C&AG) qualified his audit opinion in 2013-14; and
- the actions HMRC is taking to reduce personal tax credits error and fraud; manage personal tax credits debt; and prepare for the implementation of Universal Credit.

Accounting for personal tax credits

5.6 2013-14 is the third year that HMRC has reported personal tax credits in its Resource Accounts: until 2010-11, personal tax credits were reported in HMRC's Trust Statement. After HM Treasury's 'clear line of sight' initiative, HMRC has reported personal tax credits in the Resource Accounts, which also show running costs and wider expenditure. Total expenditure recorded in HMRC's 2013-14 Resource Accounts is £46 billion, of which £29 billion was on personal tax credits.

The C&AG's audit opinion

5.7 In forming his audit opinion on HMRC's Resource Accounts, under the Government Resources and Accounts Act 2000, the C&AG is required to obtain evidence sufficient to give reasonable assurance that the expenditure and income reported have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities that govern them (his regularity opinion).

5.8 The C&AG has qualified his regularity opinion on HMRC's 2013-14 Resource Accounts owing to the material level of error and fraud in personal tax credits expenditure. This expenditure has not been applied to the purposes intended by Parliament and does not conform to the requirements of the Tax Credits Act 2002. The Act specifies the criteria that govern entitlement to personal tax credits and the method to be used to calculate the amounts to be paid. Transactions do not conform to the governing legislation and are therefore irregular for one of two reasons:

- error or fraud results in payments of personal tax credits to households that are not entitled to those credits; or
- error or fraud results in underpayments or overpayments which differ from the entitlement specified in the legislation.

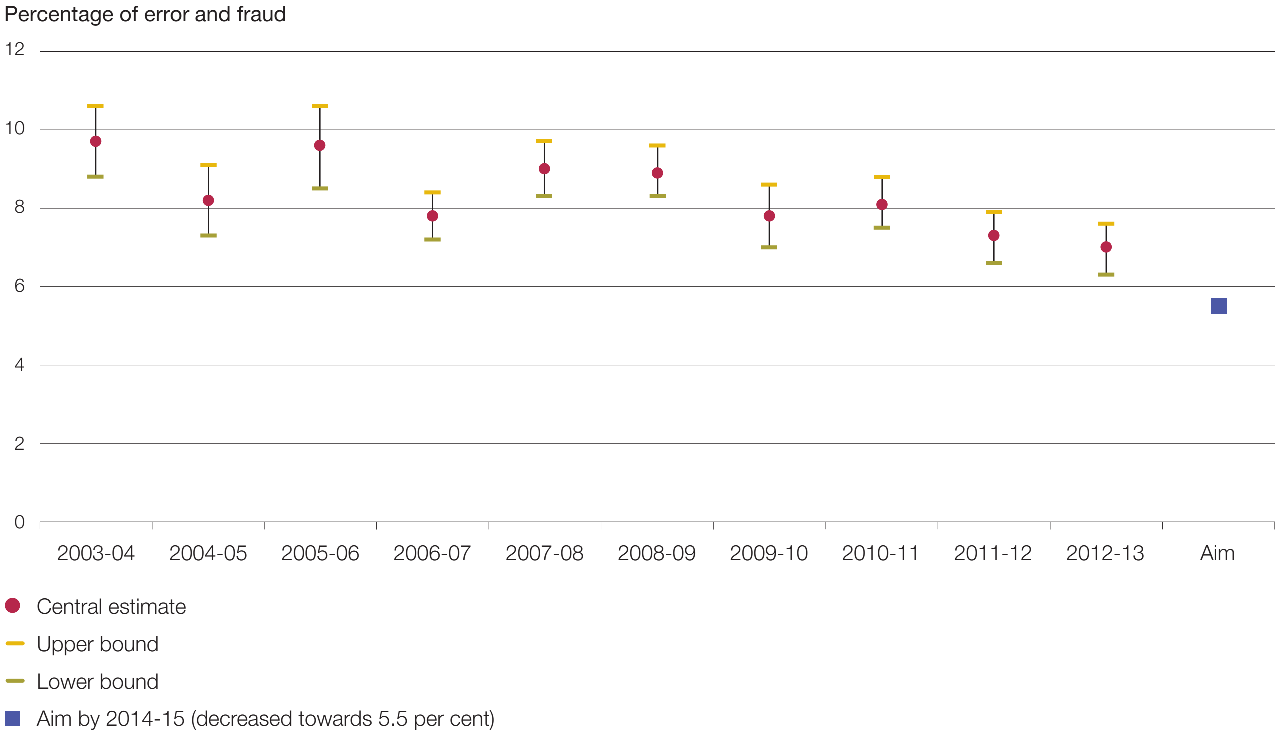
5.9 This is the third year in which HMRC's Resource Accounts have been qualified in respect of the regularity of personal tax credits expenditure, however HMRC's Trust Statement, in which personal tax credits were reported in previous years, received similar qualified audit opinions since the scheme commenced in 2003-04. The C&AG has reported to Parliament on personal tax credits every year since they were introduced.

Levels of error and fraud in 2012-13

5.10 HMRC's estimate of error and fraud within the personal tax credits system decreased from between 6.6 per cent and 7.9 per cent in 2011-12 to between 6.3 per cent and 7.6 per cent in 2012-13, as shown in **Figure 20**. The 2012-13 central estimate of error and fraud is 7.0 per cent (7.3 per cent midpoint 2011-12) and is the lowest since the current personal tax credits scheme was introduced in 2003-04. The 2012-13 error and fraud percentages equate to payments of between £1.8 billion and £2.2 billion being made to claimants incorrectly because of error or fraud and a further £70 million to £320 million not being paid to claimants because of error. The overall levels of error and fraud in finalised awards are significant within the context of the £29 billion spent on personal tax credits in 2013-14. Note 6.3 to HMRC's Resource Accounts discloses its best estimate of all error and fraud within the personal tax credits system.

Figure 20

HMRC's error and fraud estimates from 2003-04 to 2012-13, including projections to 2014-15 'towards 5.5 per cent' aim



Note

1 HMRC reports error and fraud within a range around a central estimate. The figures referred to within this report are the central estimates. The National Audit Office reviews the methodology for producing this estimate, which meets the national standard for official statistics. It is the best estimate of error and fraud available.

Source: HM Revenue & Customs, *Child and Working Tax Credits Error and Fraud Statistics, 2003-04 to 2012-13*

5.11 The relative proportions of error and fraud in the total published estimate have changed significantly between 2011-12 and 2012-13. Error accounted for £880 million (44 per cent) of the estimated £2.01 billion error and fraud favouring the customer in 2012-13. This compares to £1.22 billion (58 per cent of the £2.09 billion per the published statistics) for 2011-12. Fraud accounted for the remaining £1.13 billion (56 per cent) in 2012-13 compared to £870 million (42 per cent) in 2011-12. HMRC has informed us this is in part due to the increase in losses around claimants having undeclared partners.

Work to reduce error and fraud in 2013-14

5.12 In the Autumn Statement 2013, the government announced that HMRC would aim to reduce losses through error and fraud in the personal tax credits system towards 5.5 per cent of finalised personal tax credits entitlement by 2014-15. It announced a number of initiatives to help meet this objective, including working in partnership with a private sector provider to carry out fraud and error checks to prevent money being paid out to tax credits claimants erroneously.

5.13 Achieving this aim will be challenging and HMRC has engaged private sector partners to enhance its capacity to tackle error and fraud from September 2014. Our report *Tackling tax credits error and fraud*[22] recommended that HMRC should evaluate ways to improve the quality and volume of interventions through the use of third parties. Following a successful pilot exercise with Transactis in spring 2013, HMRC planned to appoint a partner for three years in 2014 to provide a data analytics service and make checks on personal tax credits claimants to reduce error and fraud in the claims of those individuals. Following an open procurement process, HMRC signed a contract with Synnex-Concentrix UK Ltd in May 2014 for checking to commence in September 2014. The contract uses a payment by results model, offering a cost-effective means of identifying and correcting awards.

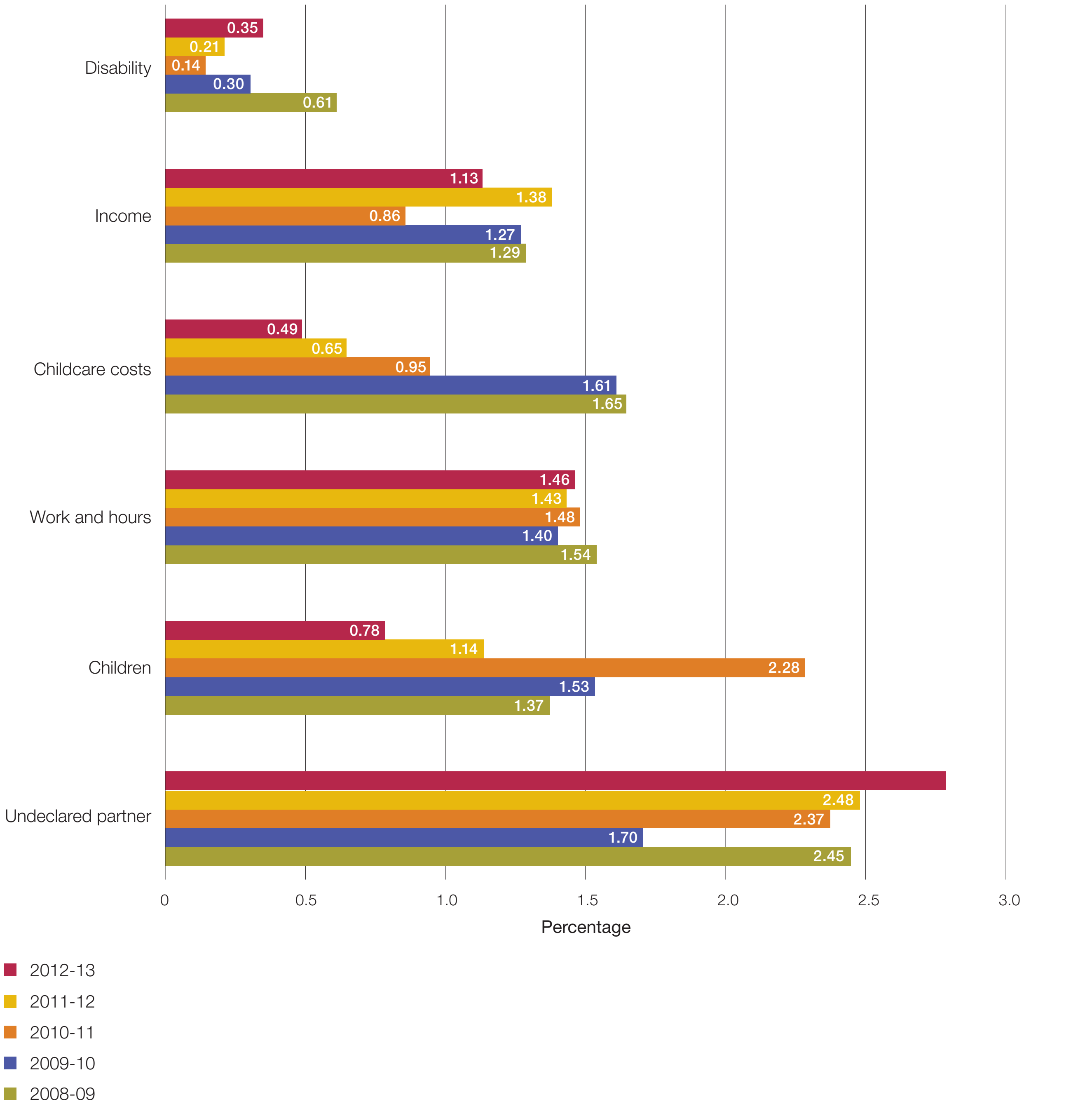
5.14 HMRC performs annual analysis to estimate the level of error and fraud in six key risk areas.

5.15 HMRC's analysis of error and fraud in finalised 2012-13 awards, as shown in **Figure 21** overleaf, indicates that it has made progress in three of the six risk areas since 2011-12: income, children and childcare, but error rates have increased for the disability and undeclared partner risk areas.

22 Comptroller and Auditor General, *Tackling tax credits error and fraud*, Session 2012-13, HC 891, National Audit Office, February 2013.

Figure 21
HMRC's error and fraud estimates by risk area for 2008-09 to 2012-13

Error and fraud losses have reduced in 2012-13 in three of the six identified risk areas



Note

1 The values are HMRC's best estimate of the primary reason for an adjustment to awards. HMRC does not publish confidence intervals for these estimates.

Source: National Audit Office analysis of HM Revenue & Customs' *Child and Working Tax Credits: Error and Fraud Statistics 2012-13*

5.16 The increase in the level of error and fraud in the undeclared partner risk category is disappointing as HMRC used credit reference agency data as well as HMRC risk tools throughout 2012-13 to help identify cases with a risk of an undeclared partner. The figures published in June 2014 suggest that these actions were insufficient to reduce error and fraud in this risk area.

5.17 As discussed in Part Four of this report, following the introduction of the Real Time Information (RTI) system, HMRC holds up-to-date data on income for every employee whose taxes are paid through PAYE. This data should help to improve levels of error and fraud in the income risk area. However, this will not be able to tackle incorrect self employed income reported by claimants.

Levels of personal tax credits debt

5.18 Personal tax credits debt arises when a personal tax credit recipient is paid in excess of what they are entitled to receive. HMRC will then seek to recover this debt.

5.19 Personal tax credits debt rose in 2013-14. As at 31 March 2014 the total value of personal tax credits debt was £5.5 billion (£4.8 billion at 31 March 2013). The £0.7 billion increase in total debt between 31 March 2013 and 2014 is the net effect of £1.8 billion of new debts that HMRC identified in year, offset by £0.9 billion of recoveries and £0.2 billion of debt remissions.

5.20 In addition, for the first time in its accounts HMRC now recognises its estimate of overpayments made in the most recent tax credits award year. This is correctly accounted for as a receivable as opposed to debt, and explains why Note 6.2 to HMRC's Resource Accounts records net receivables at 31 March 2014 of £2.4 billion (£1.9 billion at 31 March 2013).

HMRC actions to improve management of personal tax credits debts in 2013-14

5.21 HMRC has an additional target for personal tax credits debt as a result of conclusions drawn by the cross-government Fraud, Error and Debt Taskforce, which is the strategic body for all fraud and error, debt and grant efficiency initiatives across government.

5.22 In contrast to the target of reducing the gross personal tax credits debt balance to £3.7 billion by March 2015, the new target focuses on debt recovery rates. HMRC's recovery target for 2014-15 is £970 million, compared to actual recoveries in 2013-14 of £815 million (£660 million in 2012-13).[23] There was no target set for 2013-14.

23 The figures quoted here for recovery do not align directly with the figures disclosed in Note 6.2 of the 2013-14 Resource Accounts. The recovery target captures only cash collected and the value of time to pay arrangements. The Resource Accounts figures also include other adjustments to the receivables balance.

5.23 HMRC has changed its approach to recognise that a target on the personal tax credits debt balance may not be the most appropriate measure of success. Personal tax credit debt levels are likely to increase further because of Budget changes affecting eligibility.[24] In addition, initiatives to improve HMRC's error and fraud detection capabilities would, if successful, serve to increase the amount of identified debt. Instead, HMRC's key performance measure is now to maximise its recovery of cash.

5.24 HMRC has continued to track its historical debt to calculate its recovery rates. This has led it to increase its estimated recovery rates by 3 per cent (from 31.4 per cent to 34.1 per cent). Despite this, the provision for irrecoverable debt increased by £374 million (to £3.6 billion) as the stock of debt increased during 2013-14. HMRC's estimated overpayments arising from the 2013-14 finalisation process, which are now recognised in the Resource Account as receivables, are impaired at a lower rate than other personal tax credits debt. These receivables are expected to be recovered sooner and to have higher recoverability rates.

5.25 In the Autumn Statement 2013, the government announced that HMRC would expand its capacity to recover benefit and personal tax credits debts through an increased use of private sector debt collection agencies. Recovery rates from HMRC's trial use of these agencies are not as high as initial expectations. HMRC estimated that the increased use of debt collection agencies from January 2013 would result in the recovery of an additional £90 million of debt by the end of 2014-15. While HMRC is on track to deliver this target, the current recovery rate is well below the initial expectation of approximately 30 per cent.

5.26 HMRC estimates that the current overall recovery rate is 18 per cent so far (see **Figure 22**). Recoveries fall into two distinct categories:

- **Recoveries after giving 'final opportunity letters'** where HMRC sends final opportunity letters before it passes the debt to a debt collection agency. Customers are given a minimum of 14 days to repay the debt or contact HMRC to set up a direct debit arrangement. Recoveries made during this period are classed as final opportunity letter recoveries.

- **Debt collection agency recoveries** where recoveries are made because of action taken by a debt collection agency.

5.27 In June 2013, we reported on HMRC's project to recover £520 million of historical tax credits debt. The project, with a planned start date of April 2014, involved HMRC updating its IT systems to allow it to collect historical debt by deducting proportions of payments from new claimant awards. The expected start date for this recovery method is now October 2014 and expected benefits have reduced to £480 million.

24 The level by which income can increase before it impacts on the level of award has been reduced from £10,000 in April 2011 to £5,000 from April 2013. Overpayments that were previously out of scope for recovery will be pursued and will increase the number of cases in future debt campaigns.

Figure 22

Debt recovery rates from 1 January 2013 to 28 March 2014[1]

Initiative	Total debt stock subject to intervention (£m)	Amount recovered[3] (£m)	Recovery rate (%)
Final opportunity letter sent by HMRC	771	108	14
Debt processed by debt collection agency	571[2]	31	6
Overall recovery rate (debt subject to either one or both of the above interventions)	771	139	18

Notes

1 Debts were passed to debt collection agencies in tranches for an average duration of five months between 1 January 2013 and 28 March 2014.

2 Some debts initially selected as part of the measure were removed before being sent to the debt collection agency. This is because HMRC was able to start debt collection following the final opportunity letter (£108 million). In addition, some debts were found not to be suitable for referral to a debt collection agency at this time due to changes to the customer debt on the system (£92 million).

3 This balance is made up of actual cash recoveries and direct debit arrangements set up (as at 28 March 2014). Actual recoveries may be lower if obligations under direct debit arrangements are not fully met.

Source: National Audit Office analysis of March 2014 HM Revenue & Customs' Debt Management and Banking management information

Universal Credit

5.28 We reported in 2012-13 that HMRC was working closely with the Department for Work & Pensions (DWP) on the transition to Universal Credit. HMRC is responsible for stopping existing personal tax credits claims when a claimant becomes eligible for Universal Credit.

5.29 Since April 2013, DWP has been using pilot schemes (Pathfinders) to roll-out Universal Credit. The government's current assumption is for the Universal Credit service to be available in each part of Great Britain during 2016, with the majority of the remaining legacy benefit caseload moving to Universal Credit during 2016 and 2017. To date the impact on HMRC has been minimal as very few tax credits claimants have transferred to Universal Credit.

5.30 At present, the government has yet to announce whether HMRC or DWP will be accountable for recovering historical tax credit debt once individuals move into claiming Universal Credit. Both departments are working closely to determine the detail of the transitional arrangements.

Appendix One

Progress on last year's recommendations

In our report on HMRC's 2012-13 accounts, we identified five broad themes that linked our findings and recommendations to our wider value-for-money work on HMRC's activities. We recommended that HMRC should seek to apply these lessons across the full range of its activities. Our analysis of HMRC's progress in each of these areas is summarised in **Figure 23**.

Figure 23

HMRC's progress on last year's recommendations

NAO recommendation	Progress	Commentary
PAYE & Real Time Information: To improve PAYE's operations in order to keep workloads up to date, to gain internal financial accreditation by improving RTI's financial system design to improve online contingency measures and to clarify the future operating model for PAYE and RTI.	Good	Progress has been made against a number of these points and HMRC acknowledge there is further work to be done. On PAYE, HMRC is working to reduce and automate the number of back-office tasks that it is required to do. On RTI, work has begun supporting internal financial reporting systems. HMRC believe that it has adequate measures in place for RTI disaster recovery. HMRC has developed a high-level vision for the PAYE operating model. However, the detail of this vision, including the processes to be re-engineered and the opportunities to maximise RTI data, still needs to be refined.
Tackling VAT fraud: To enhance the risk profiling of VAT payment returns, the response to fraud risks from internet traders, and review the performance of the online VAT registration system.	Good	HMRC has made progress in developing its strategic intelligence and staff capability. HMRC is developing a pilot project to risk profile VAT payment returns and has appointed senior sponsors to take forward cross-HMRC work on combating online fraud. HMRC is currently completing its review of the implementation of its enhanced online VAT registration system. Emerging findings suggest that there were some implementation problems, such as interfaces between components and some evidence of increased attempted fraud. However, overall the system has been successful in identifying and rejecting fraudulent registration attempts and all elements of the new system were delivered satisfactorily.
Personal tax credits: To continue to reduce losses from fraud and error, and to enhance the analysis and collection of tax credits debt.	Limited	This is covered in Part Five of our report. The 7.0 per cent central point of HMRC's estimate of error and fraud within the personal tax credits system in 2012-13 is the lowest ever recorded. While overall progress is being made, the level of error in relation to the risk associated with undeclared partners increased in 2012-13 despite HMRC's initiatives. HMRC is outsourcing more personal tax credits debt and is on track to meet its target of collecting an additional £90 million through this initiative. The current recovery rate so far is, however, well below initial projections.

Figure 23 *continued*

HMRC's progress on last year's recommendations

NAO recommendation	Progress	Commentary
Customer Focus: To identify and apply best practice in customer service, and promote cultural change throughout its business to put customers and their needs at the heart of its decision-making so it becomes easier for all taxpayers to pay the right tax at the right time.	N/A	HMRC has developed a high-level customer service strategy and is setting out the detail around refining its business processes and performance measures. However, we have not conducted detailed work in this area in 2013-14.
Data Quality: To improve the quality of its data and to improve management information and information systems to aid decision-making and performance.	Good	HMRC has worked on improving the quality of its Resource Accounts general ledger system and the reliability of the data coming out of its Enterprise Resource Planning system as management information has been improved. To enhance its decision-making processes, HMRC has a project to improve its costing data and its management information on the cost of anti-avoidance activity, though this has been slightly delayed. HMRC is currently recruiting a Director of Data Exploitation, and is establishing a new Data Cluster and Enterprise Data Hub, and developing detailed plans for different business units as part of HMRC's transformation agenda.

Source: National Audit Office's financial and section 2 audit work and HM Revenue & Customs' review of its implementation of recommendations

Appendix Two

Our evidence base

1 We reached our conclusions on HMRC using evidence collected between September 2013 and June 2014.

2 As part of our **financial audit**, we reviewed the supporting information for HMRC's Trust Statement and Resource Accounts and their disclosures. We analysed and discussed with officials the supporting data prepared by a variety of business units in HMRC.

3 As part of our **Section 2 audit** on the adequacy and integrity of HMRC's revenue collection systems, we reviewed the systems for revenue collection across all different tax streams, as well as HMRC's debt management system, and the Real Time Information system introduced for PAYE.

4 Our **analytical review** in Part One was based on an analysis of the numbers published in the financial statements, plus an analysis of supporting information provided during the course of the financial audit.

5 Our review in Part Two of HMRC's systems for reporting **compliance yield** included testing of the controls around the scoring and reporting of compliance yield, document review, interviews, site visits to local compliance offices, and reviews of 45 case files including Large Business cases. We also reviewed HMRC's reported performance against the underlying data. We reviewed compliance yield against a framework of four criteria:

- Reasonableness. Where we used interviews with HMRC staff and document review including guidance notes to consider whether the measure reflects the impact of different kinds of compliance intervention and whether it is based on the best evidence available;
- Consistency. Where we looked at changes in methodology and exceptional items to consider whether the measure allows comparison of performance over time;
- Reliability. Where we looked at the robustness of quality assurance processes to ensure data quality, governance processes, and reviewed the systems for calculating cash collected, revenue loss prevented, future revenue benefit, and product and process yield; and
- Understandability. Where we investigated how well the measure is disclosed and reported as an indicator of HMRC's performance internally, to the centre of government, and in HMRC's corporate documents.

6 As part of our review of **how HMRC resources compliance work** in Part Three we performed the following work:

- we reviewed existing evidence and research on good practice in resource deployment, and assessed HMRC's methods for deploying resources including an assessment of its compliance resource allocation model;
- we performed a document review of its risk assessment methodology and examined how HMRC aligns its resources with the risks it faces;
- we reviewed budgeting evidence, including its budgeting processes and management accounts, and analysed HMRC's spending review 2010 settlement and the business cases for the reinvestment and autumn statement funding;
- we undertook interviews with members of the central finance team, HMRC staff involved in making resourcing decisions, and HMRC staff involved in understanding the risks the department faces; and
- we carried out case studies on the MTIC and volume crime projects, which involved reviewing all documentation related to the projects and interviews around recruitment and training with staff involved in setting up and overseeing the projects.

7 To provide the evidence for Part Four's consideration of HMRC's **new revenue systems and systems for new taxes**, we reviewed HMRC's new strategies and performance measures, attended performance meetings in business hubs and conducted interviews with key members of staff, and considered the evaluations of the performance of new systems. We reviewed HMRC's forecasting of revenues for new taxes, including using Monte Carlo analysis to consider uncertainty.

8 In addition to our standard **financial audit work around personal tax credits**, for Part Five we also reviewed HMRC's error and fraud statistics analysis, information on the performance of initiatives to reduce error and fraud in tax credit payments. We also interviewed key staff and reviewed documents on HMRC plans and strategies around tax credit debt, and reviewed the performance of strategic initiatives such as the use of debt collection agencies.

9 In addition, we also reviewed:

- HMRC's internal audit reports to understand their management of risks and challenges.
- We reviewed HMRC's corporate publications on measuring the tax gap, on compliance performance.

We reviewed relevant NAO and PAC reports on HMRC's performance in the past year including reports on tax reliefs, gift aid, and cross-government debt management.