Report by the
Comptroller and Auditor General

HM Customs and Excise

Improving VAT Assurance

HC 15 Session 1999-00
24 November 1999

Report by the
Comptroller and Auditor General

HM Customs and Excise

Improving VAT Assurance

Ordered by the
House of Commons
to be printed 22 November 1999

LONDON: The Stationery Office
£0.00

HC 15 Session 1999–00
Published 24 November 1999

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

John Bourn	National Audit Office
Comptroller and Auditor General	29 October 1999

The Comptroller and Auditor General is the head of the National Audit Office employing some 750 staff. He, and the National Audit Office, are totally independent of Government. He certifies the accounts of all Government departments and a wide range of other public sector bodies; and he has statutory authority to report to Parliament on the economy, efficiency and effectiveness with which departments and other bodies have used their resources.

For further information about the National Audit Office please contact:

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

Tel: 0171-798 7400

email:nao@gtnet.gov.uk

Web site address: http://www.open.gov.uk/nao/home.htm

Contents

Executive summary

1 Value Added Tax (VAT) is a self assessed tax that is collected by 1.6 million registered traders who are required to keep adequate records to calculate their VAT liability correctly and to enable the Department to verify their VAT returns. This Report examines the Department's changing approach to assuring VAT receipts from the vast majority of these traders. It does not examine arrangements for assuring receipts from around 1,800 large traders who, together, contributed £12.1 billion in 1998-99 and are subject to enhanced systems of control. We reported on these arrangements in our Report: "Checking Large Traders' VAT Liability" (HC368 1996-97) in March 1997.

2 Through the targeting and conduct of their work the Department seek to maximise their direct impact by identifying trader errors and their indirect impact - both preventive and deterrent - by encouraging trader compliance with VAT regulations. Their approach is based on risk analysis, making use of information and intelligence, and traders' past performance. Risk analysis has been used for the selection of VAT traders for assurance audits since the early 1980s. Over time, the analysis has become more comprehensive and more reliable. Currently the whole of the trader population is subject to a twice a year risk assessment, which examines 29 different data items including, turnover, trade classification and visit related information. The Department's methodology is being considered for adoption by a number of other countries and has been benchmarked in co-operation with the Australian Tax Office (**paragraph 1.4**).

3 In 1994-95, a review of the Department's main business activities, including VAT, suggested that, by shifting the emphasis of assurance effort towards higher risk traders, the Department could save over 700 staff years by March 1996 whilst maintaining revenue receipts and trader compliance at existing levels. The review further suggested that by improving their assurance support arrangements, including trader education, and their risk assessment methodologies the Department could save a further 1,100 staff years by 1998-99. Building on these proposals, the Department initiated the Revised Assurance Process project in June 1995. Subsequently, under the "Spend to Save" initiative, announced by the then Chancellor of the Exchequer in November 1996, the 1,100 staff were retained in the expectation that, by using revised working practices, they would generate £1,470 million in additional revenue by 31 March 2000 (**paragraph 1.5 to 1.7**).

4 During the period from 1992-93 to 1998-99:

- VAT receipts from the general trader population increased from £14.9 billion, 35 per cent of total VAT receipts, to £29.6 billion in 1998-99, 57 per cent of total VAT receipts;
- the registered trader population remained at about 1.6 million traders;
- VAT assurance staff numbers increased from 4,548 to a peak of 5,013 in 1994-95 before declining to 4,179 in 1998-99;
- the number of audits undertaken by these staff each year fell by around 50 per cent from 350,000 to 180,000; while
- the net additional revenue generated by these audits increased by 15.1 per cent from £862 million to £992 million, at 1998-99 prices.

In all years but one the impact of the increase in average revenue per audit has been greater than the impact of the reduction in the number of audits. Over the whole period, the increase in the average revenue per audit has more than recovered the decline due to the reduction in audits undertaken (**paragraphs 1.12 to 1.15**).

5 In 1996, the Department estimated that the direct benefit of revising their approach to trader audits and maintaining staff at existing levels would be to increase additional revenue from trader audits by a further £210 million in both 1998-99 and 1999-2000. In 1998-99, the figures reported to the Department's Board showed that they exceeded this additional revenue target by some £5 million. (**paragraph 1.16**).

6 To maximise the results of their assurance programme, the Department need to ensure that the revised working methods are introduced successfully at all local offices, that there is a continuing shift towards higher risk traders in the mix of audits undertaken, and that effective use is maintained of officers engaged on assurance work. Against this background, we investigated the Department's performance in auditing the general trader population, including the management of the changes to working practices (**paragraphs 1.23 and 1.24**). Our examination considered:

- the focusing of audit resources, including the efficiency of staff utilisation; and

- the selection and auditing of individual traders.

Focusing audit resources

7 The audit strategy adopted by the Department since the early 1990s, and given added impetus by the 1994-95 review, required a shift in auditing effort towards those traders presenting the highest risks to the revenue. In their report for the Comprehensive Spending Review, in July 1998, the Department identified problems of trader compliance with VAT regulations as one of a number of growing threats to the revenue (**paragraphs 2.1 to 2.2**).

8 To assist them in their work, the Department employ a centralised risk analysis system that allocates traders to risk groups, one of which is for newly registered traders. In 1995-96, the Department replaced their policy of visiting all newly registered traders within three years of registration with one of offering such traders a range of options most suited to their individual needs, including a visit by VAT staff. Most other traders are allocated to four other risk groups designated low, medium, high or exceptional risk. The number of traders in the highest two risk groups remained fairly steady throughout the period, together averaging some 211,000 traders (**paragraphs 2.5 to 2.9**).

9 During the period 1994-95 to 1998-99, the Department achieved a steady increase in the average revenue yield per audit across all risk groups and there was a change in the broad balance of audits undertaken. The proportion of audits directed at high and exceptional risk traders increased from 31 per cent to 38 per cent, with a corresponding decrease in the proportion of audits directed at lower risk groups. The level of attention given to higher risk traders has not, however, matched the coverage envisaged by the Department (**paragraphs 2.9 to 2.16**).

10 The Department have improved their operational effectiveness, with net additional revenue discovered by assurance staff rising from £5.98 per £1 spent in 1994-95, to £7.48 in 1998-99. We found on average, however, that audits are taking 20 per cent longer and staff are spending more time on activities such as trader selection and enquiries. Overall, direct audit activities accounted for 62 per cent of staff time in 1998-99 compared to 74 per cent in 1994-95. We calculate that there has been a 40 per cent reduction in the number of audits carried out during this period compared with a 17 per cent reduction in available assurance staff years. In November 1997, the Department undertook research into the possible diversion of assurance resources to overhead tasks. In their responses, local offices suggested that targeting less compliant traders, in line with the revised strategy, had led to longer, more complex audits and reductions in their number. The Department intend to continue to monitor the effective deployment of assurance resources. There may be scope for the Department to increase the use of audit staff on direct activities, leading to additional revenue benefits. (**paragraphs 2.17 to 2.25**).

11 **On the focusing of audit resources, we make the following key recommendations** (further details are at paragraph **2.28**):

Recommendation 1

To maximise additional revenue assessed per audit

The Department should test the impact of concerted action to increase the proportion of high and exceptional risk traders audited each year, and of separate quantified performance targets for errors found within each trader group.

Recommendation 2

To continue improving their operational effectiveness

The Department should ensure, as far as possible, that trained assurance staff are not diverted to undertaking work not necessarily requiring their skill levels and should examine the scope to deploy a greater proportion of existing resources on direct audit work. The Department have undertaken to continue to monitor these issues as part of their research into the effective use of resources.

Selecting and auditing individual traders

12 Following trials at selected local offices, the Department implemented revised assurance procedures at all offices from 1 April 1998. Under the revised approach, responsibility for selecting traders for audit rests with centralised teams within each local office, rather than with individual assurance officers as before. These teams, working under the guidance of locally appointed risk managers, sift traders prioritised for audit by the computerised selection system and pass on to assurance staff only those traders whom they assess as being potentially non-compliant. This is known as the Sift process (**paragraph 3.6**).

13 The risk manager is responsible for ensuring an appropriate balance of coverage of the local trader population. To test the soundness of judgements made by the sift teams, local offices are also required to audit a three per cent random sample of traders initially assessed as compliant. Samples examined during the trial phase were insufficient to allow the Department to draw any firm conclusions

about the effectiveness of the sift process and they are to monitor local office performance and the results of the sample audit programme (**paragraphs 3.11 to 3.14**).

14 As with the Sift process, trials have been undertaken of the use of central teams to arrange individual audit visits. The Department have introduced such centralised booking at many locations and will evaluate the results in due course. In undertaking audits, assurance officers carry out such tests as they judge necessary to gauge both a trader's credibility and the accuracy of the VAT returns being examined. While the Department's assurance programme remains primarily based on visits to traders' premises, staff may use alternative means of gaining assurance, such as telephone calls, where they might enhance revenue returns with minimum effort. The volume of detailed testing of traders' accounts and subsidiary records depends upon the original reason for the audit and on any concerns subsequently identified. In the sample of 294 trader files examined, we found only 6 folders out of a possible 115 contained a proforma audit planning document summarising the risk concerns of assurance staff and how these have been addressed during the visit. As part of their revised assurance procedures, the Department have enhanced the risk information held on traders' folders to include details of risks identified during the Sift process (**paragraphs 3.15 to 3.25 and 3.35**).

15 Assurance staff record the outcome of their audit checks on a standard visit report. These reports serve several purposes, including recording assurances about the trader and the consistency of testing with the perceived risks. In the majority of folders we examined, although completed audit reports described areas and types of transactions audited, supporting tests were not clearly focused on trader risks and the amount of testing was not always clearly visible from the reports. The Department are to consider the quality of visit reports as part of their review of the published Departmental auditing standard (**paragraphs 3.26 to 3.28**).

16 Some managers interviewed by us were concerned that they had no objective measure by which to assess the quality of work undertaken by their staff. For example, they were unable to gauge whether the particular skills and experience of their staff were commensurate with the inherent risks presented by their trader populations and whether there was a need for further training or recruitment. The Department expect to address these concerns through the development of the national audit standard and the continuation of the quality visiting project. This project is aimed at identifying the factors that make an assurance visit successful and developing ways of measuring these factors on a nationally consistent basis (**paragraphs 3.30 to 3.32**).

17 When officers raise assessments for additional tax they record the related error under one of a number of classifications. The Department draw on this information to compile a list of common trader errors in their public notice advising newly registered traders, and others, about how to complete a VAT return. They also plan to include a similar list in a revised public notice about correcting errors on VAT returns which was due for publication during 1999 (**paragraph 3.34**).

18 **On selecting and conducting audits we make the following key recommendations** (further details are at **paragraph 3.40**):

Recommendation 3

To ensure that the selection process remains effective

The Department should include the results of local offices' sample audits in measuring the outcome of Sift procedures.

Recommendation 4

To maintain the best use of experienced audit staff

The Department should continue to promote centralised booking of trader audits, ensure that local offices maintain adequate, accurate and up to date data in trader folders, and investigate the scope for streamlining the trader audit reporting process.

Recommendation 5

To ensure that the quality of the work is of a sufficient standard

The Department should ensure that audit completion reports record sufficient key information about the level and nature of testing undertaken; review the quality control arrangements in place at local offices; and issue guidance on good practice.

Part 1: Introduction

1.1 VAT is a self-assessed tax that is collected by some 1.6 million registered traders who are required to keep adequate records to calculate their VAT liabilities correctly and to enable the Department to verify their VAT returns. The Department seek to manage the VAT yield through a range of activities, from the efficient collection and monitoring of VAT receipts to the detection of fraud and countering of evasion and tax avoidance schemes. A fundamental part of this approach is the maximisation of trader compliance through trader education and a risk based programme of auditing traders. In undertaking their work the Department have regard to the easing of burdens on business.

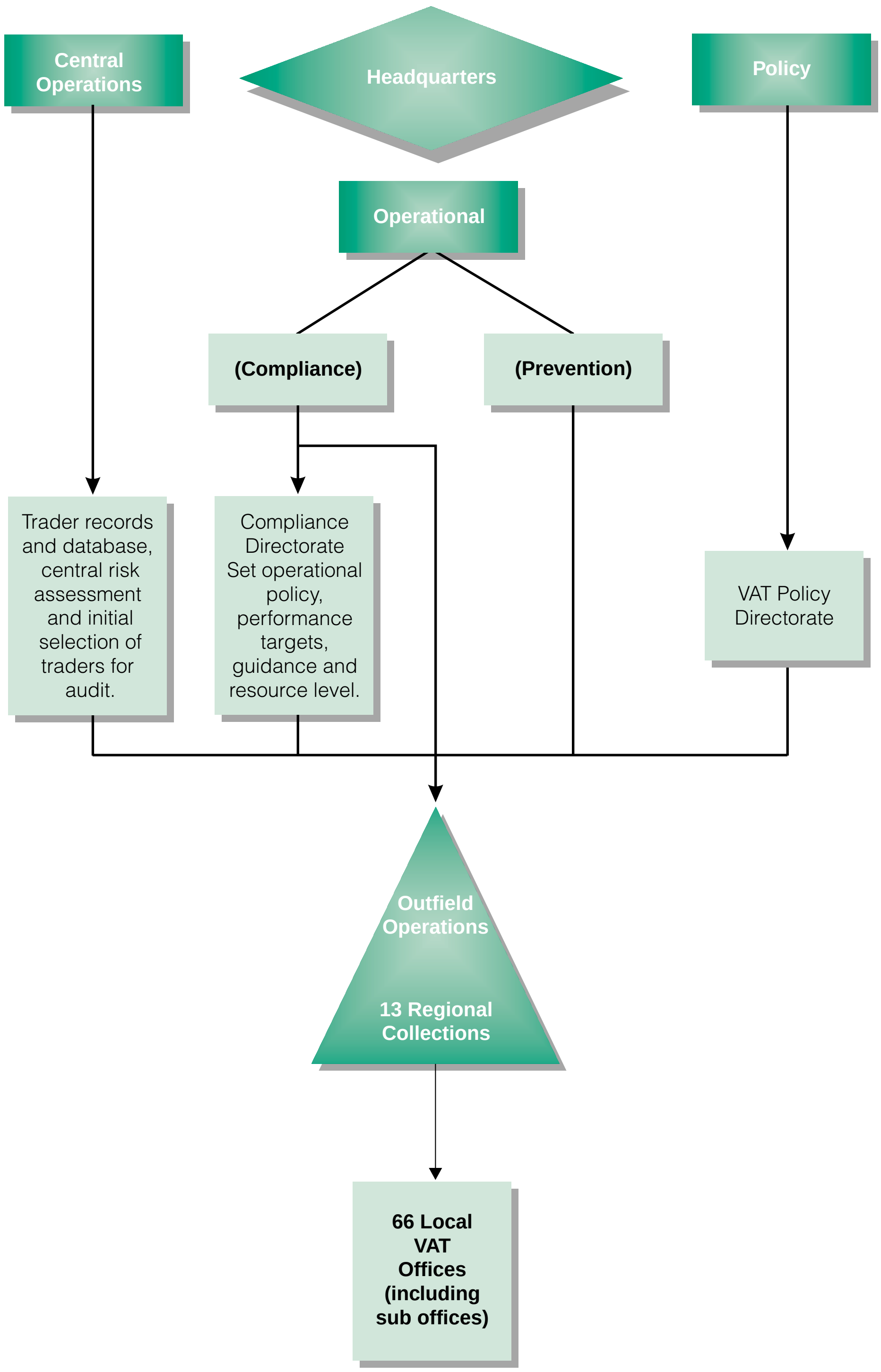
1.2 Figure 1 shows the relevant parts of the Department's organisational structure. The Department separate their activities between headquarters, central operations, and local operations; the latter within 14 regional executive units known as collections. Headquarters set policy and performance targets; allocate resources to collections; provide guidance; and determine training requirements. Central operations maintain databases recording VAT trader details and accounting records, undertake central risk analysis and carry out initial selection of traders for audit. Staff located at 66 local offices within 13 of the collections undertake VAT assurance work. Heads of collections (known as Collectors) are responsible for the delivery of training programmes, deploying resources, organising assurance work and delivering results in line with targets set out in the Department's management plan each year.

1.3 In 1998-99, excluding £10.6 billion VAT collected on imports, net VAT receipts from registered traders amounted to some £41.7 billion. Of this total, some £12.1 billion (29 per cent) was contributed by around 1,800 large traders, for whom HM Customs and Excise have adopted enhanced systems of control. We reported on the operation of these arrangements in our Report: "Checking Large Traders' VAT Liability" (HC 368, 1996-97) published in March 1997. This Report examines how Customs and Excise assure themselves about the accuracy and completeness of the balance of the revenue yield of £29.6 billion, which is contributed by the remainder of the trader population.

Organisational structure for administration of trader audits

Figure 1

The Department separate their activities between the policy functions in Headquarters, and operational functions at Central Operations and at local offices



Source: HM Customs and Excise

Objectives and resources

1.4 Through the targeting and conduct of their work the Department seek to maximise their direct impact, by identifying trader errors, and their indirect impact, both preventive and deterrent, by encouraging trader compliance with VAT regulations. Their approach is based on risk analysis, making use of information and intelligence and traders' past performance. Risk analysis has been used for the selection of VAT traders for assurance audits since the early 1980s. Over time, the analysis has become more comprehensive and more reliable. Currently the whole of the trader population is subject to a twice a year risk assessment, which examines 29 different data items, including turnover, trade classification and audit history information. The Department's methodology is being considered for adoption by a number of other countries and has been benchmarked in co-operation with the Australian Tax Office.

1.5 In 1992-93, the Department deployed some 4,500 staff years to this work (Figure 2b). Changes in frontier controls, following the advent of the single market on 1 January 1993, resulted in a significant proportion of VAT previously collected from importers being collectable from the general trader population. Staff years rose in 1994-95 to some 5,000. The Department have since undertaken a number of initiatives to increase the efficiency and effectiveness of their VAT collection activities and by 1998-99 staff numbers had fallen to 4,179.

1.6 In 1994-95, the Department undertook a review of their main business activities, including VAT. This suggested that over 700 staff years could be saved by March 1996, whilst maintaining revenue receipts and trader compliance at the existing levels, by shifting the emphasis of assurance effort away from smaller and lower risk businesses towards higher risk traders. The review also suggested improving assurance support arrangements, for example through increased trader education, and developing risk assessment methodologies that would target, more specifically, less compliant traders. Building on these proposals, the Department initiated a Revised Assurance Process project, which comprised a series of inter-related local office trials aimed at allocating resources to achieve the best results.

1.7 The Department estimated that the Revised Assurance Process could, while maintaining trader compliance, save the Department a further 1,100 staff years by 1998-99, not all of whom were attributed to audit work. As part of the "Spend to Save" initiative however, announced by the then Chancellor of the Exchequer in November 1996, Ministers decided that the proposed 1,100 staff cuts would not take place. These staff numbers would instead be retained to undertake further work, using the revised working practices developed in the trials referred to above. The Department estimated that these additional staff resources would contribute a total of £1,470 million (at 1997-98 prices) in increased revenue yield between 1 April 1998 and 31 March 2000. The direct impact over the two years was estimated at £420 million, with the remaining £1,050 million arising from the preventive and deterrent effects of their work.

1.8 Over the period 1993 to 1998, the Department's assurance activities have been affected by the following key events:

January 1993	European Single Market: The abolition of frontier fiscal controls increased the need for inland assurance work.
April 1993	Local Visit Selection system introduced: System provided much improved information and greater flexibility for local offices to make their final selection of traders to be audited taking into account central risk analysis (**paragraph 2.5**).
April 1995	Fundamental Expenditure Review report (**paragraph 1.6**).
June 1995 - June 1996	Revised Assurance Process project: 1st stage, single site trials (**paragraph 3.3**).
November 1996	Fundamental Expenditure Review: 2nd stage, integrated with the "Spend-to-Save" initiative (**paragraph 1.7**).
January 1997	Revised Assurance Process project: Integrated trials that combined the best developments and approaches from the single site trials (**paragraphs 3.4 and 3.6**).
September 1997	Career Management and Development Review: Recommended enhanced legal and technical training for assurance staff to increase their professionalism.
April 1998	Revised Assurance Process project: Revised assurance methods applied nationally (**paragraph 3.5**).

Yield of audit work on the general trader population

1.9 The Department's 1998-99 management plan contained an overall aim to improve the management of the revenue yield and safeguard the integrity of the taxes and duties. The Department's key objectives included improving compliance by ensuring the accuracy of traders' declaration by:

- a risk based assurance programme;

- detecting more revenue fraud by risk analysis, intelligence and operational planning systems, ensuring resources are aimed primarily at serious fraud and high risk areas; and

- countering tax avoidance.

1.10 Before 1995-96, the Department measured their success in auditing the trader population as a whole in terms of the value of misdeclarations of tax identified as a result of the assurance programme. In 1995-96, the Department introduced two key performance measures, based on visits being targeted more strongly on higher risk traders. These were:

- the average value of net errors per visit; and

- the percentage of visits on which net errors are found.

1.11 The Department's published performance measures have not hitherto distinguished between the results of their work arising from large traders (**paragraph 1.3**) and those relating to the general trader population. Following our earlier Report on large traders, the Department took steps to enable them to make this distinction in future. Unless otherwise stated, performance figures used in this Report have been extracted from Departmental data by us and exclude large traders.

1.12 Net VAT receipts from the general trader population, having increased by around 33 per cent following the introduction of the single market in 1992-93, have since increased at about 8 per cent per year, rising to £29.6 billion by 1998-99 (Figure 2a). Over the same period, changes in audit work on this population have been affected as follows.

i) Between 1992-93 and 1995-96, the number of registered VAT traders declined by some 4.7 per cent. Since 1995-96, trader numbers have increased ending in 1998-99 only 0.3 per cent lower than in 1992-93. Over the same period, staff resources allocated to auditing showed a largely inverse pattern, rising by 10 per cent from 4,548 staff years to a peak of 5,013 staff years in 1994-95 before falling by 17 per cent ending at 4,179 staff years (Figure 2b).

ii) The number of audits undertaken has also declined, having reduced by 49 per cent, from 350,000 audits in 1992-93 to 180,000 in 1998-99. On the other hand additional revenue, detected as a result of these audits, increased on average by nearly 3 per cent per year, ending the period 15.1 per cent higher (Figure 2c).

Net VAT receipts excluding large traders 1992-93 to 1998-99

Figure 2a

Since 1993-94, net receipts have increased steadily

Notes: 1. All values are adjusted to 1998-99 levels by the GDP deflator.

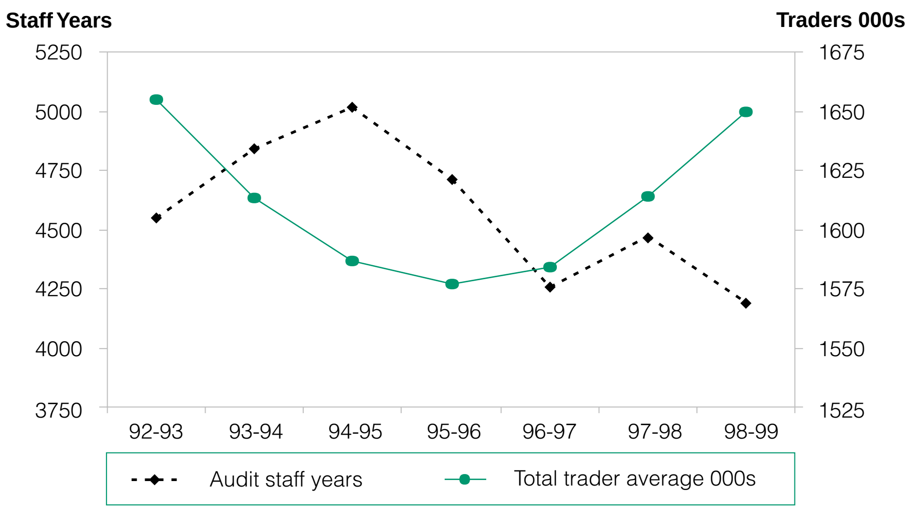
2. The marked increase between 1992-93 and 1993-94 arose on the UK's entry into the Single European Market, when the responsibility for collecting VAT due on European Union goods shifted from ports of entry to trader returns

Source: HM Customs and Excise

Registered trader population and assurance staff resources 1992-93 to 1998-99

Figure 2b

There has been a largely inverse relationship between changes in the size of the trader register and the number of staff years employed on auditing this population



Notes: 1. The number of registered traders is an average of the number at the start and end of each year.

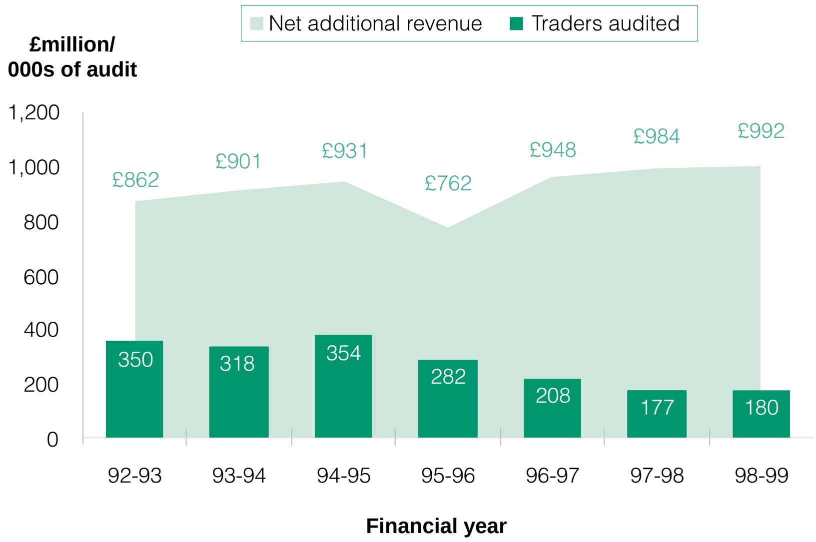
2. The staff years exclude audits of large VAT traders. They comprise those audits shown at Figure 2c together with other assurance activity, eg repayment credibility visits, miscellaneous visits.

Source: HM Customs and Excise

Comparison of net additional revenue assessed and total audits undertaken

Figure 2c

Between 1992-93 and 1998-99, while the number of audit visits reduced by some 48 per cent, net additional tax increased by 15.1 per cent.



Source: HM Customs and Excise

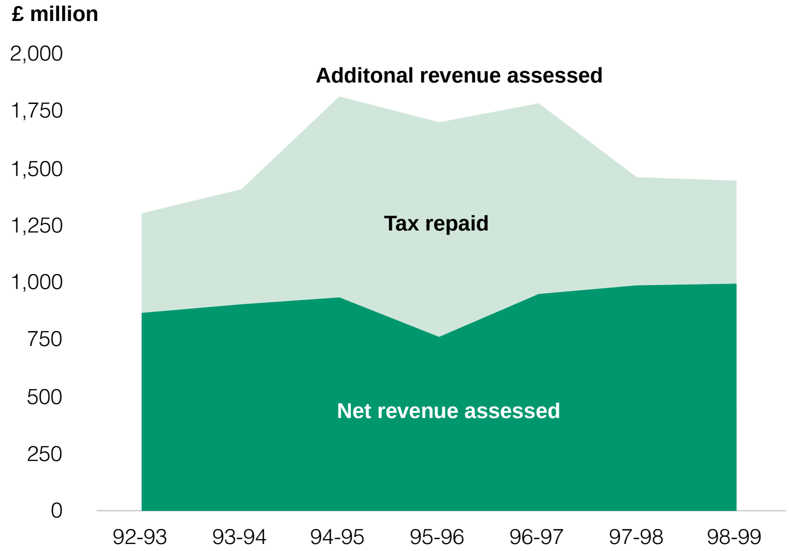
1.13 Figure 3 shows, at 1998-99 prices, how the total value of net additional revenue resulting from audits during the period 1992-93 to 1998-99 arose from gross values of under-declarations (additional revenue assessed as due to the Department) and of over-declarations (repayments of tax due to traders). The gross value of under-declarations discovered has varied considerably during the period. Having peaked in 1994-95 at £1.8 billion, an increase of £400 million on the previous year, it fell by the end of the period to £1.4 billion or £145 million higher than in 1992-93. The dip in net revenue in 1995-96, largely reflects the initial decline in the number of audits carried out prior to the full introduction of the revised audit approach.

1.14 Some of the increases in additional revenue assessed arose from errors made by traders in accounting for VAT on goods traded between member states, following the completion of the Single Market in January 1993. These errors affected both additional revenue and tax repaid. The effect on the general trader population figures is not separately available. For the whole trader population, including large VAT traders, the gross effect of these counterbalancing errors peaked in 1995-96 at some £450 million, declining to some £200 million in 1997-98.

Net additional liability assessed, 1992-93 to 1998-99

Figure 3

Net revenue has increased by £130 million between 1992-93 and 1998-99



Additonal revenue assessed	£1,300	£1,405	£1,813	£1,701	£1,780	£1,462	£1,445
Tax repaid	£438	£504	£882	£939	£832	£478	£452
Net revenue assessed	£862	£901	£931	£762	£948	£984	£992

Note: 1. All values are adjusted to1998-99 levels by the GDP deflator.

2. Some increases in additional revenue assessed and tax repaid reflect counterbalancing errors, resulting from entry into the single market in 1993-94. These errors declined towards the end of the period, as traders became familiar with the revised system. For the whole trader population, including large VAT traders, the gross effect of these counterbalancing errors peaked in 1995-96 at some £450 million, declining to some £200 million in 1997-98.

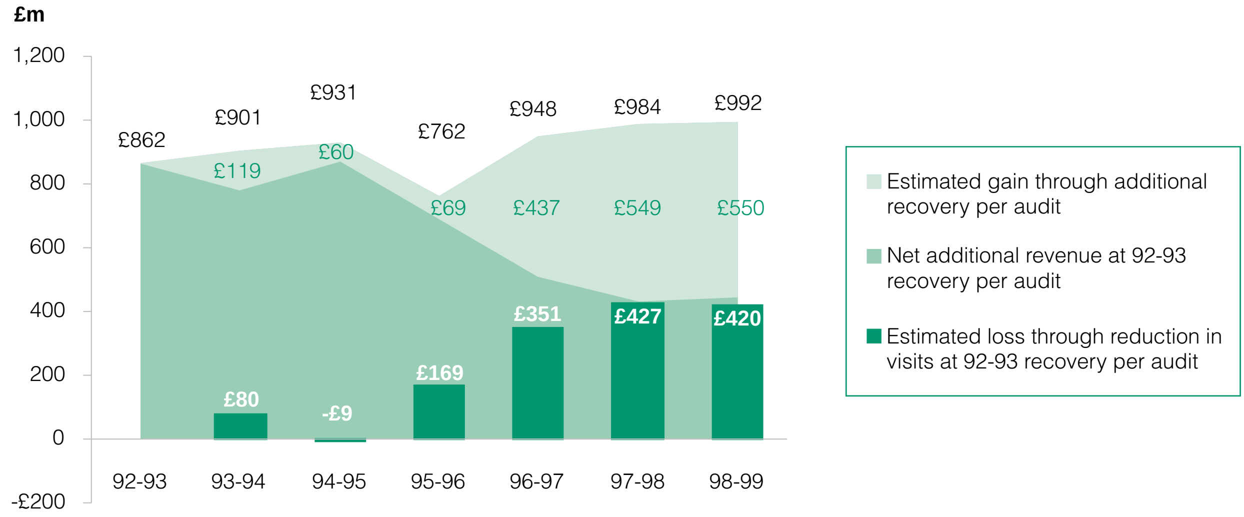
Source: HM Customs and Excise

1.15 Analysis of changes in the results of the Department's audit work (Figure 4) shows that the 15.1 per cent increase in additional revenue detected by audits (**paragraph 1.12 ii**), reflects a balance between increases in revenue per audit and reductions in the numbers of audits. In all but one year, the impact of the increase in average revenue per audit has been greater than the impact of the change in the number of audits. Over the whole period, the increase in the average revenue per audit has recovered one and a quarter times the decline due to the reduction in audits undertaken.

Figure 4

The effect of the number and value of audits on net additional revenue

In 1998-99, the increase in revenue per visit, compared to 1992-93 levels of recovery, provided £550 million net additional revenue. This more than offset the potential decline of £420 million in net additional revenue arising from the reduction in the number of audits undertaken.



Note: All values are adjusted to 1998-99 levels by the GDP deflator

Source: HM Customs and Excise and National Audit Office

Results of the revised approach

Direct results of trader audits

1.16 In 1996, the Department estimated the combined effect of retaining the 1,100 staff posts, which were to have been cut under previous proposals, and the adoption of revised working practices. They estimated a direct yield of net additional revenue of £210 million in cash terms, in each of the two years to 31 March 2000 (**paragraph 1.7**). As a consequence, the Department's target for net additional liability discovered on assurance audits in 1998-99 was increased to £1,043 million, (£1,013 million at 1997-98 prices). The figures reported to the Department's Board showed that they exceeded this target by some £5 million in both 1997-98 and 1998-99.

1.17 The tables at Figure 5 compare the results achieved in 1997-98 by the integrated trial sites (**paragraph 1.6**) with those of the Department as a whole, and in 1998-99 following full implementation of the revised assurance process at all local offices. These results are analysed in line with the Department's risk grading of traders. Group 1 is for newly registered traders, who present a mix of risk levels, whereas groups 2 to 5 distinguish between low, medium, high and exceptional risk traders (further details of the risk grouping are given at Appendix B).

1.18 Although the trial sites are not statistically representative of the Department, they illustrate the potential for improved levels of performance in error detection and additional liability discovered per audit visit. In 1998-99, for the Department as a whole, the increased proportion of audits where additional liability was detected suggests a positive impact of the wider implementation of the revised approach. In the same year, compared with 1997-98, the Department largely maintained error detection rates for the two higher risk groups (4 and 5). Although the total average additional liability per visit increased this was entirely due to improved results for the two lowest risk groups. Overall, the pattern of visits undertaken in the year did not match the mix of audits across risk groups, contained in the Department's VAT Business Assurance Model, which was advised to collections in October 1997 (Figure 5, Table A).

Indirect effects of trader audits

1.19 The potential indirect revenue effects (**paragraph 1.7**) arising from audit work comprise the preventive effect of assurance visits and the overall deterrent effect of the Department's assurance programme on general levels of trader compliance.

1.20 The preventive effect is defined as the increase in a trader's declared returns following an assurance audit. Based on operational research carried out by their internal management consultants, on a sample of 36,000 traders visited between 1986 and 1993, the Department estimated that the preventive effect of assurance audit was some £2.2 billion to £3 billion. This is equivalent to approximately twice the value of the direct revenue impact achieved. The Department's research indicated that the preventive effect of assurance audits accrues over a period of up to four years but for the purpose of their estimates each year, they limit the revenue to two years, arising from:

- the total first year effect on all traders visited in the previous year; and
- the total second year effect of all traders visited two years previously.

Figure 5

Comparison of results achieved by trial sites and by the Department as a whole in 1997-98 and in 1998-99 [1]

Trader Groups	Low risk: Group 2	Medium risk: Group 3	Newly registered Group 1[2]	High risk: Group 4	Exceptional risk: Group 5	Total
A: Proportion of total audit visits						
1998-99 Business assurance model[3]	5.7%	16.3%	28.6%	38.8%	10.6%	100%
1997-98 Actual[5]	18.4%	13.0%	32.0%	29.1%	7.5%	100%
1998-99 Actual	15.2%	10.5%	35.8%	28.1%	10.4%	100%
B: Proportion of visits where additional liability detected[6]						
Trial sites[4]	31.1%	41.3%	51.3%	46.8%	56.3%	45.5%
1997-98 Actual[5]	26.6%	35.2%	39.7%	49.3%	60.4%	40.5%
1998-99 Actual	32.7%	41.9%	44.0%	48.5%	61.7%	44.7%
C: Average additional liability found per visit[6]						
Trial site[4]	£1,963	£3,260	£4,759	£5,602	£8,777	£4,863
1997-98 Actual[5]	£1,719	£2,819	£4,122	£5,979	£17,280	£4,771
1998-99 Actual	£1,882	£4,054	£4,094	£4,916	£13,402	£4,795

Notes:
1. 1998-99 was the first year that the revised assurance process was implemented at all local offices.
2. Newly registered traders present a mix of risk levels.
3. To allocate resources in accordance with assessed risk, the Department estimate the number of assurance visits needed to be undertaken to achieve their revenue projections.
4. Trial sites are not statistically representative of the Department as a whole.
5. 1997-98 was a transitional year during which many offices adopted some elements of the revised approach.
6. These figures relate to additional liability detected as a result of an assurance visit and exclude, for example, the results of miscellaneous visits and credibility visits. Individual assessments have been capped at £2.5 million to reduce the distorting effect on group averages of exceptional assessments.

Source: HM Customs & Excise

1.21 The deterrent effect, on the other hand, is defined as the revenue impact secured by the assurance programme from the remainder of the trader population who are not selected for specific audit attention in any year. Hitherto, the Department calculated that the value of the deterrent effect was half that of the value of the direct effect. Academic research commissioned by the Department in 1997, however, indicated that this value may be some £3 billion, equal to twice the direct effect of all VAT assurance activity, including large trader audits.

1.22 Since 1993, the Department's assurance procedures have been subject to many changes, which are still continuing. These may have triggered different preventive and deterrent effects within the general trader population. The Department's research focused on traders' behaviour in the light of VAT audits conducted under the previous assurance procedures and the Department accept that these effects may vary with changing working practices. Nonetheless the Department feel that the estimates they have are sufficiently robust to give a reasonable indication of the indirect effects of their assurance activity.

Scope of the National Audit Office examination

1.23 The increases in average revenue per audit and the achievement of the Department's spend to save target reflect the effectiveness of the Department's revised targeting of audit effort. It might also, however, be the result of a decline in traders' compliance with VAT regulations. To maximise the direct results of their assurance programme, the Department need to ensure:

- the successful introduction of revised working methods at all local offices;
- a continuing shift in the mix of traders audited towards those categorised as presenting a greater risk to the revenue; and
- the maintenance of the effective use of available time by officers engaged on assurance work.

1.24 We examined the Department's progress in these areas by considering their performance in auditing the general trader population, including the management of the changes to working practices. Our examination concentrated on changes since the 1994-95 review (**paragraph 1.6**) and considered:

- the focusing of audit resources, including the efficiency of staff utilisation (Part 2 of this Report); and
- the selection and auditing of individual traders (Part 3).

1.25 We issued a questionnaire to all local offices responsible for VAT assurance activities to obtain information about the staffing, organisation and management of this work. We also carried out interviews at Customs and Excise headquarters and 10 local offices in six collections and examined a sample of 294 trader audit files. In addition, we appointed an independent consultant to conduct six focus groups to explore staff attitudes to assurance visiting and the changes taking place. These groups were attended by a representative selection of experienced assurance officers from all collections. Further details of our audit methodology are given at Appendix A.

Part 2: Focusing audit resources

2.1 The Department's audit strategy, adopted since the early 1990s and given added impetus by the 1994-95 review (**paragraph 1.6**), was based on the offer of education and advice to newly registered traders coupled with an increasing emphasis on the audit of all traders assumed to present higher risks to the revenue. This Part of the Report examines the reporting and targeting of performance, the assessment of risk to the revenue and the efficiency of staff utilisation. It is based on an analysis of the Department's performance measures, other management information, and the views of audit staff attending focus groups organised by us.

Trader compliance

2.2 In their report for the Comprehensive Spending Review, in July 1998, the Department identified problems of trader compliance with VAT regulations as one of a number of growing threats to the revenue. Departmental and academic research has indicated that factors influencing traders contemplating non-compliance include the probability of detection, the visibility of income, the magnitude of penalties, social norms and traders' own attitude to risk. Factors, encouraging trader compliance included contact with tax authorities, trader education, advertising the benefits of taxation and the use of sanctions. The Department believe that tight economic conditions may lead to worsening compliance.

2.3 A key role of assurance staff is to identify instances of non-compliance by traders. Some assurance staff, attending focus groups organised by us, noted that risk targeting had identified more non-compliant traders for attention. Other staff perceived non-compliance as a major, and growing, problem among traders. They attributed this to the following factors:

- increasing use by traders of specialist advice on the avoidance of VAT;
- the relaxation of the serious misdeclarations penalty regime in 1993-94;
- the introduction in July 1996 of capping legislation halving to three years the period over which Customs are able to assess additional tax liability arising from misdeclarations by traders; and

- traders' awareness of a reduced likelihood of being audited by Customs under the revised approach to assurance work adopted by the Department.

The Department's post implementation reviews of the changes to the serious misdeclaration penalty regime and the 1996 capping legislation found no indication that these had led to reduced compliance.

2.4 As part of the assurance training programme, new staff undertake audits of traders categorised as not complex and representing a low revenue risk. One VAT office told us that despite this categorisation, over a recent two month period, trainee assurance staff had discovered errors on one-half of such audits. These errors were mostly of small monetary value and less than the discovery rate of experienced officers. Nonetheless, local office staff believed that these results indicated increasing non-compliance within the trader population. The Department acknowledge that the sample examined suggests a level of non-compliance in those businesses examined, but note that these results are not representative of the national picture for trainee audits. The Department believe that national records for this type of visit do not suggest that trader compliance is worsening; they show a detection rate for errors of 37 per cent in total, and 16 per cent for errors over £500.

Targeting trader groups

2.5 The Department have developed a method of prioritising groups of traders for assurance action according to their perceived risk to the revenue. The method employs a computerised system, known as the local visit selection system, to categorise traders for possible assurance action. The system, introduced in 1993-94, draws on a centralised risk analysis and suggests the level of resource required by local offices to assure the tax against the analysed risk associated with individual traders.

2.6 The system allocates traders to one of 12 trader groups, including one for newly registered traders, depending on their risk characteristics. The system then allocates a points score for each trader to prioritise them within each trader group, based on the risk analysis and the time since the trader was last audited. Trader groups 1 to 5 comprise the majority of the traders audited under arrangements examined in this Report. Within this grouping, 1 represents newly registered traders, and 2 to 5 represent increasing risk ranging from "low" to "exceptional".

Within each group, traders are listed in descending order of risk. These risk allocations are updated twice a year (further details of the system are contained at Appendix B).

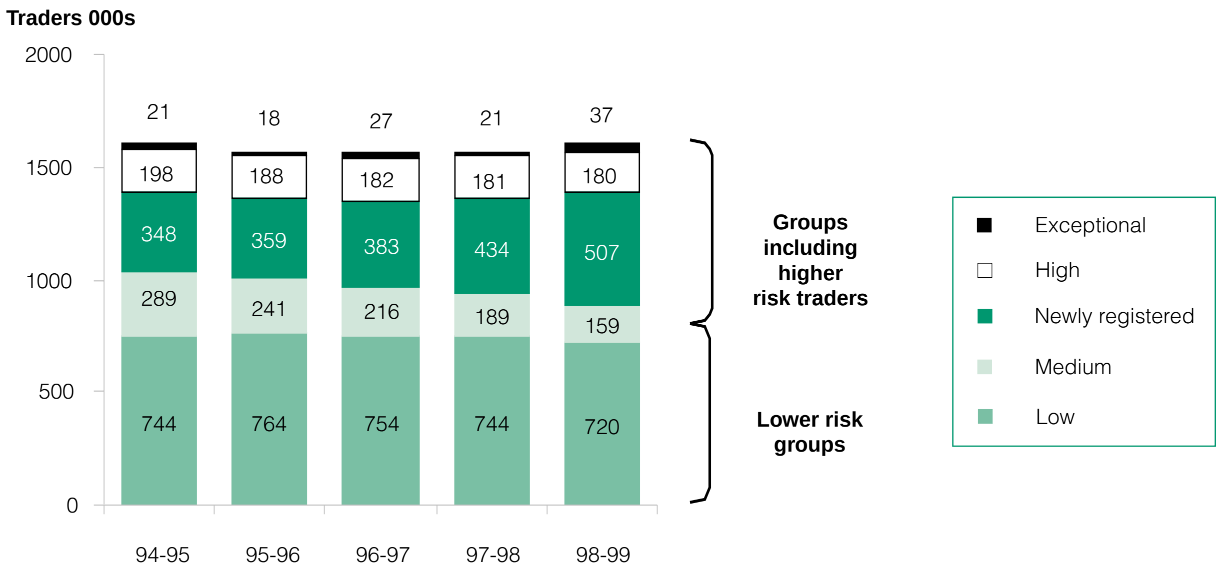
2.7 Assurance officers use the suggested risk prioritisation, together with their own local knowledge, to determine the nature and timing of their assurance activities. The total number of registered traders has remained fairly stable since 1994-95 at around 1.6 million, with approximately half being classified as low risk traders. Newly registered traders, about whom the Department may hold little detailed information initially, are categorised as group 1 until the Department have assessed the bona fides of the trader and established further information for use in the risk analysis. The number of such traders increased from 348,000 in 1994-95 to 507,000 in 1998-99. Most other traders are allocated to four other risk groups designated low, medium, high or exceptional risk. The number of traders in the highest two risk groups remained fairly steady throughout the period, together averaging some 211,000 traders (Figure 6).

2.8 The increasing number of traders within risk group 1 reflects increasing registrations coupled with a change in the Department's approach to new traders. In 1995-96, they introduced a national VAT education programme for newly registered traders, known as the "Learn about VAT Menu", and dispensed with their previous policy of visiting all newly registered traders within the first three years of registration. Under the education programme, traders are able to choose the service that is most suited to their individual needs, from a range of options including a visit by VAT staff. This policy means that newly registered traders are less likely to receive an audit visit and therefore tend to remain longer in group 1. As at June 1999, Customs and Excise had identified some 74,000 group 1 traders whom they considered to be of low enough risk not to warrant an audit visit. The Department are undertaking further research to improve their analysis of risks associated with unvisited traders.

2.9 In December 1997 the biannual risk revision exercise, which considers the boundary scores between each group, resulted in changes to the composition of individual risk groups with a net increase of 20,000 traders in risk group 5 and a similar decrease in group 3.

Figure 6 Numbers of traders by risk groups(1)

Within a largely stable population, the main change has been the growth of newly registered traders



Notes: 1. For resource allocation purposes, each December's trader risk review totals form the basis for the following financial year. So, for example, financial year 1998-99 reflects the December 1997 risk review.

2. Newly registered traders (Group 1) present a range of risk potential, on average greater than traders in groups 2 and 3.

3. Each year, the Department determine the boundaries between trader risk groups based on the outcome of trader risk analysis.

Source: HM Customs and Excise

Revenue yield by risk group

2.10 As noted at **paragraph 1.15**, increases in additional revenue detected by audits have more than offset potential revenue shortfalls due to declining numbers of audits. Analysis for the years 1994-95, 1997-98 and 1998-99 shows that the average value of the additional revenue gained per audit in each group each year reflected the hierarchy of assessed risk groupings (Figure 7). For example:

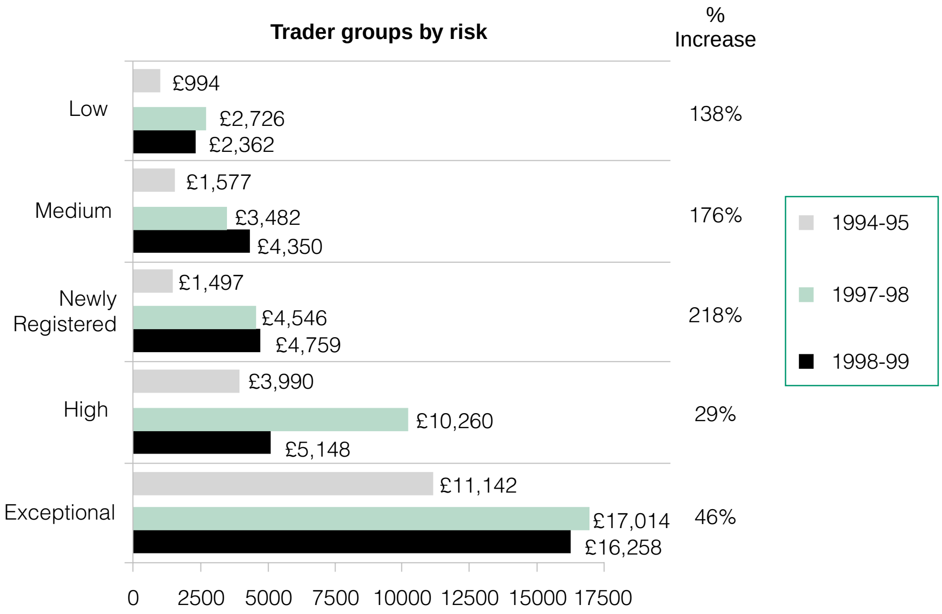
- the additional revenue gained from auditing exceptional risk traders, group 5, ranged from seven to eleven times more than that from auditing low risk traders, group 2; and

- in 1997-98, audits of high risk traders, produced 3.8 times as much additional revenue as low risk traders, but only 2.2 times as much in 1998-99.

Average additional revenue per audit by trader risk group 1994-95 to 1998-99

Figure 7

Additional revenue from auditing exceptional risk traders was seven times greater in 1998-99 than that from auditing group 2 risk traders.



Notes: 1. All values are adjusted to 1998-99 levels by the GDP deflator

2. Over the same period, VAT yield from all traders increased by 29 per cent

Source: HM Customs and Excise

2.11 The Department have achieved a steady increase in the average revenue yield per audit across all risk groups during the period, with a particularly marked increase (218 per cent) discovered on audits of newly registered traders (Group 1). The Department suggest that these results reflect the better targeting of less compliant traders within each risk group, although they could also arise from greater non-compliance amongst traders generally.

Audit effort by risk group

2.12 The steady increase in the average additional liability detected reflects in part a change in the balance of audits undertaken between risk groups. Figure 8a and Figure 8b analyse changes in the numbers of traders within each risk group audited by Customs staff between 1994-95 and 1998-99, and in the proportion of traders audited in each group. Detailed statistics are contained in Appendix D1.

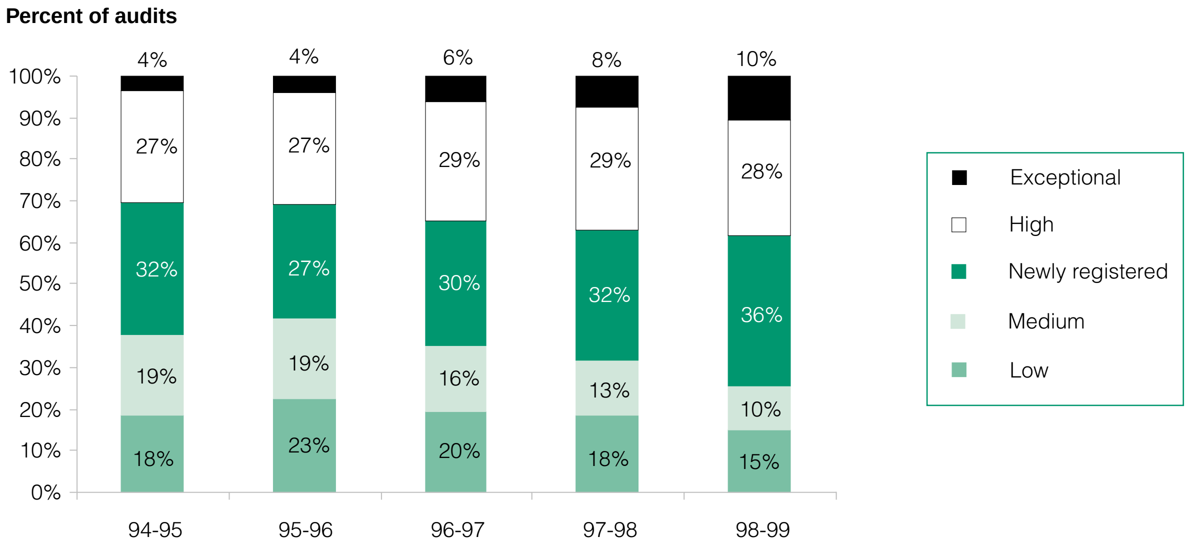
2.13 With the introduction of the trader education package for newly registered traders in 1995-96 (**paragraph 2.8**), the focus of the Department's audits shifted from newly registered traders towards the lower risk groups. The net effect in

1995-96 was the switching of 5 per cent of audits from newly registered traders to low risk traders. By 1998-99, however, the main changes from 1994-95 were increases of 6 per cent and 4 per cent in exceptional risk and newly registered traders respectively, and decreases of 9 per cent and 3 per cent in medium and low risk traders respectively. By 1998-99, some 38 per cent of the Department's audits were directed at higher and exceptional risk traders, up from 31 per cent in 1995-96. (Figure 8a).

Figure 8a

Percentage of total audits by risk groups, 1994-95 to 1998-99

Approximately one third of all audits undertaken in the period related to higher or exceptional risk traders



Note: For underlying data see Annex D1

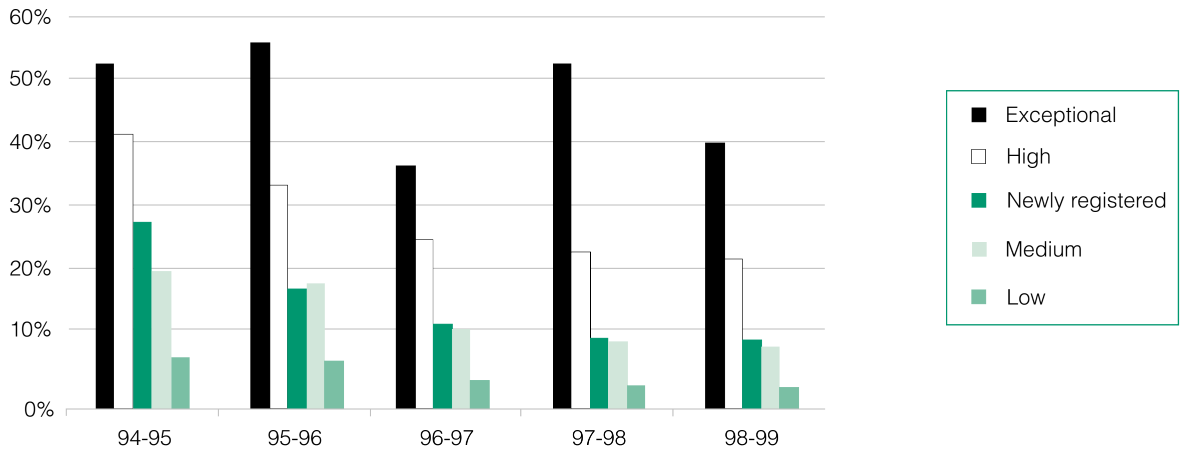
Source: HM Customs and Excise

2.14 Other than for those traders assessed as presenting exceptional risks to the revenue (risk group 5), the proportion of traders audited within each risk group have fallen each year. This reduction is particularly marked in the case of newly registered traders (group 1), where the proportion of traders audited fell from 28.4 per cent to 10.5 per cent, and high risk traders (group 4), where the proportion fell from 41.9 per cent to 22.8 per cent (Figure 8b).

2.15 Prior to 1995-96, other than for newly registered traders (group 1), the Department's operational policy division did not generally set local office targets for the proportion of each trader group to be audited each year. In September 1996, however, they suggested to local offices that they should aim each year to audit 40 per cent of high risk group 4 traders and 90 per cent of exceptional risk group 5 traders. For 1997-98, we calculate that this would have

Figure 8b **Ratio of visits made to numbers of traders per trader group, 1994-95 to 1998-99**

Apart from exceptional risk traders in group 5, the ratio of visits to the number of traders in each risk group has fallen each year between 1994-95 and 1998-99



Note: For underlying data see Annex D1

Source: HM Customs and Excise

meant auditing a total of 91,000 group 4 and 5 traders: comprising 72,000 group 4 traders and 19,000 group 5 traders. The actual total for 1997-98 was 54,000: comprising 43,000 group 4 (47,000 in 1996-97) and 11,000 group 5 (10,000 in 1996-97).

2.16 In December 1997, when reclassifying traders **(paragraph 2.9)**, the Department reduced the suggested audit coverage for group 4 traders from 40 per cent to 37.5 per cent, and for group 5 traders from 90 per cent to 75 per cent. To achieve this would have entailed auditing a total of 95,000 group 4 and group 5 traders in 1998-99, or 65 per cent of the total number of audits undertaken that year, compared with 56,000 actually achieved, or 38 per cent.

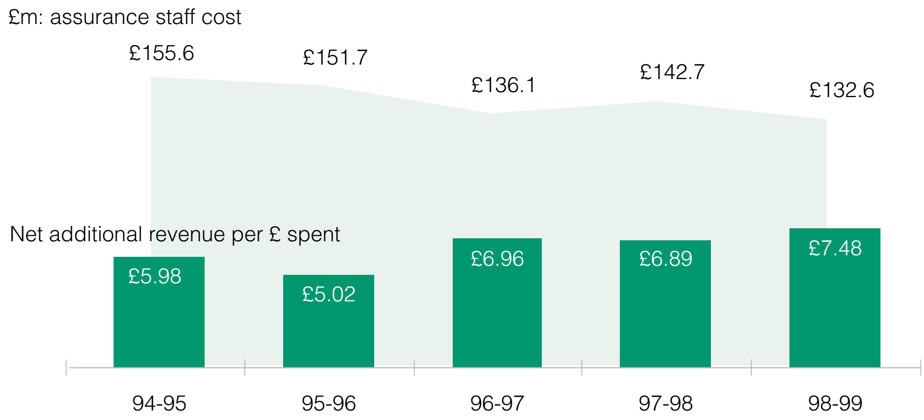
Operational effectiveness

2.17 Since 1994-95 total assurance staff costs averaged some 9.5 per cent lower, ending at 14.8 per cent lower in 1998-99 (Figure 9). Excluding the initial fall in 1995-96 (**paragraph 1.13**), net additional revenue that derived from this work averaged 4.7 per cent higher over the same period. By the end of the period, net additional revenue discovered by assurance staff had increased from £5.98 per £1 spent in 1994-95, to £7.48 per £1 spent in 1998-99.

Total cost of assurance work and net additional revenue per £ spent

Figure 9

Operational effectiveness has improved since 1994-95



Note: 1. All values are adjusted by the GDP deflator to 1998-99 levels

2. Cost estimates reflect the apportionment of resources between Large VAT traders and other VAT traders and changes in the apportionment basis following the introduction of the resource management accounting system.

3. The net additional revenue per £ spent includes only the amounts assessed as a direct result of the audits. It excludes any further revenue arising from the preventive and deterrent effects of the work.

4. Reductions in spending in 1996-97 reflect implementation of the 1994-95 review recommendations.

Source: HM Customs and Excise

Staff utilisation

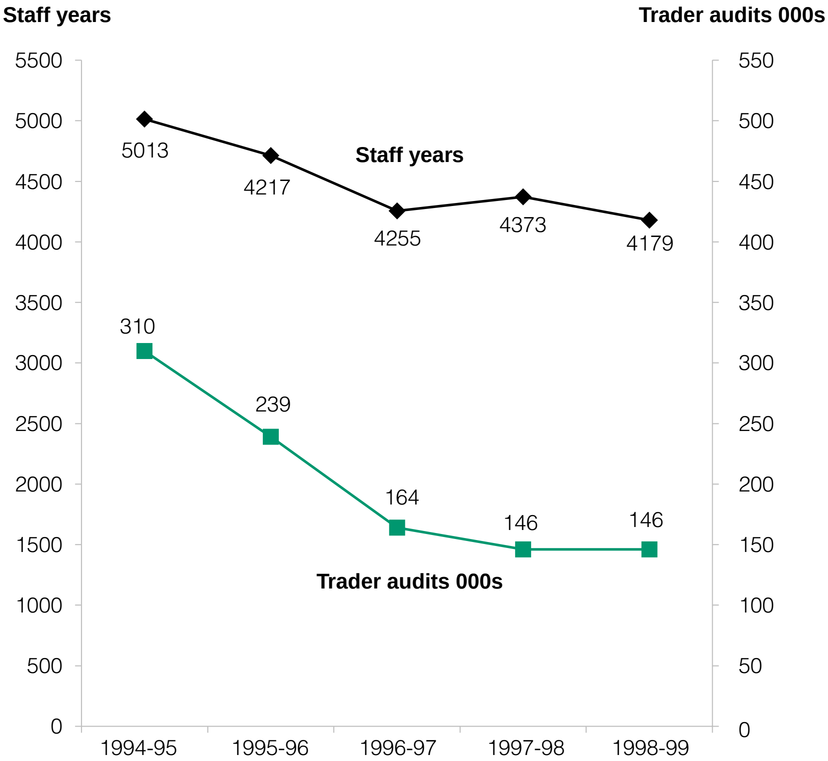
2.18 As shown in Figure 10a, the number of trader audits undertaken by the Department during the period 1994-95 to 1998-99 has declined to a greater extent than staff resources deployed on this work. In evaluating revised working practices at selected trial sites (**paragraph 1.6**), the Department noted that they had not achieved the planned numbers of audits, although they had made good progress towards identifying expected amounts of net errors in appropriate trader risk groups.

2.19 The Department explored the reasons for the lower than expected audit rates and found that resources being deployed on direct audits were also lower than planned. To establish the causes for this diversion of resources the operational policy division issued a questionnaire to all local offices in November 1997. They reported a range of reasons including increased training activity and specialist co-ordination work associated with developing best practice and tackling tax avoidance issues. Local offices also suggested that targeting less compliant traders had led to longer, more complex audits. The Department

Assurance resources and trader audits 1994-95 to 1998-99

Figure 10a

The number of trader audits declined to a greater extent than the staff resources deployed on the work



Source: HM Customs and Excise

informed us that they are budgeting for some re-assignment of assurance and other resources to facilitate local management initiatives aimed at efficiency savings and other long term benefits. The Department intend to continue to monitor the effective deployment of assurance resources.

Audit efficiency

2.20 Staff time records are summarised into two broad categories:

- direct assurance time – work that is directly attributable to various types of trader audits, including any follow up activities with individual traders; and
- indirect assurance time – for example, dealing with trader enquiries; pre-visit work; specialist co-ordination activities such as tax avoidance; and attending management meetings.

2.21 Between 1994-95 and 1998-99, there were significant changes in the time spent by assurance staff on their various tasks (**Figure 10b and Appendix D2**). An overall reduction in direct time was partly offset by increases in indirect time. The overall net decline of 53,000 staff days was mainly accounted for by a net decrease of 121,000 staff days spent on assurance audits offset by the introduction of trader sifting, 42,000 staff days. In their response to our questionnaire, local offices observed that this reflected additional time being spent on pre-audit and selection activities. Some other changes in the types and level of activity undertaken by assurance staff (Figure 10c) also reflect planned changes in the Department's strategy and working practices following the 1994 review, for example:

- increases in miscellaneous audit time, from 23,000 staff days in 1994-95 to 34,000 staff days in 1998-99, arising from work by cash teams and shadow economy teams;

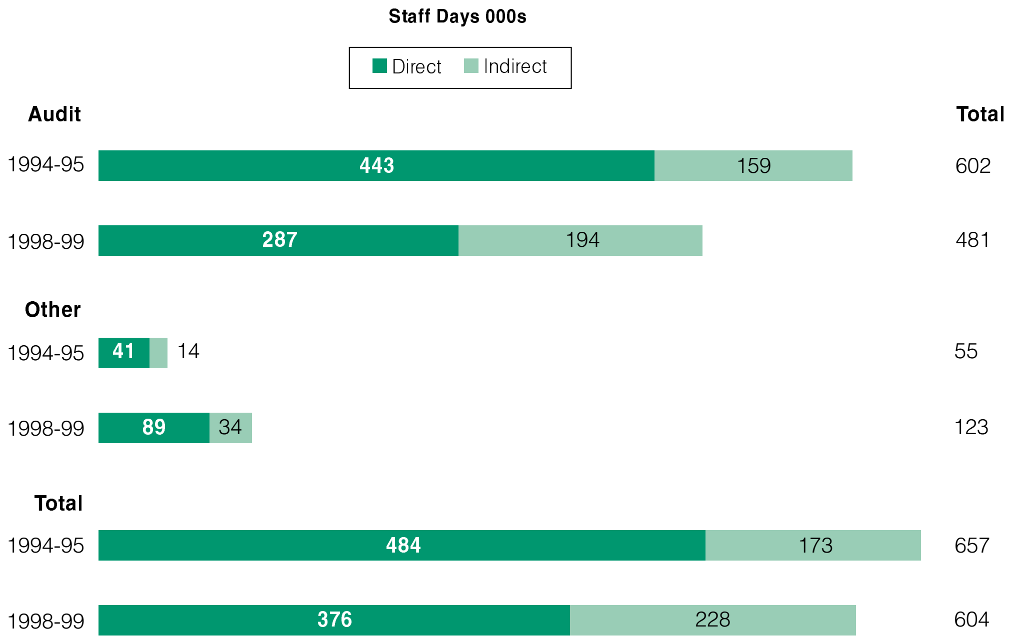
- increases in desk checking of repayment claims, reflecting the development of alternatives to audit as a means of gaining assurance; and

- time spent on educating traders, recorded in 1998-99 but not in 1994-95, reflecting the withdrawal of the policy of visiting all new traders within three years of registration in favour of options offered under the Department's "Learn about VAT Menu" (**paragraph 2.8**).

Figure 10b

Use of assurance resources[1]

Between 1994-95 and 1998-99, direct audit time has fallen whereas indirect time has increased.



Notes: 1. Direct time was 74% of total time in 1994-95 and 62% in 1998-99. For underlying data see Appenidx D2.

2. Direct assurance work is time spent preparing for, and auditing, specific traders either at their premises or in the office.

3. Indirect assurance work includes, for example: dealing with traders' enquiries; pre-visit work; specialist co-ordination activities such as tax avoidance; and attending management meetings.

4. Staff record time in hours and minutes which are aggregated and reported in half day units referred to as sessions. The National Audit Office figures are based on 2 sessions = 1 staff day.

Source: HM Customs and Excise and National Audit Office

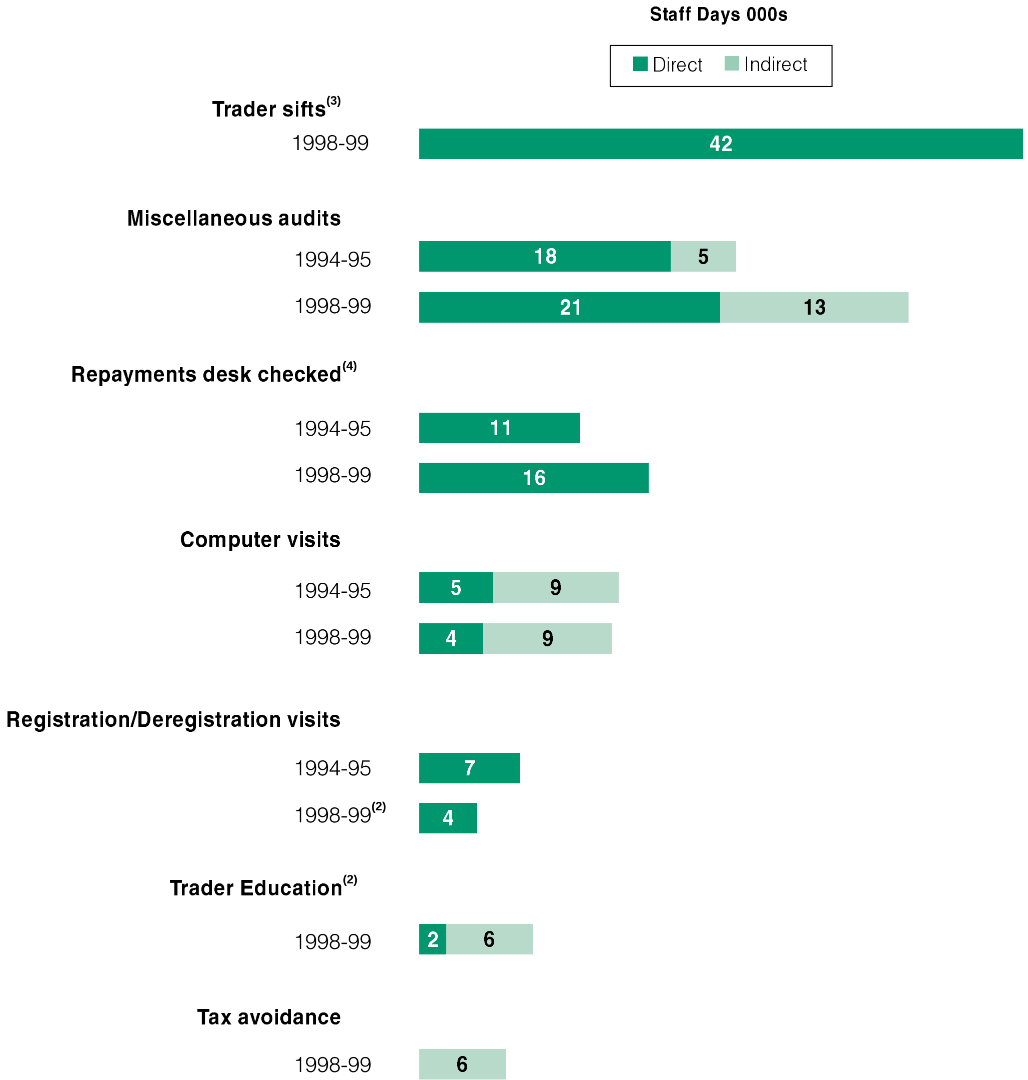
2.22 All direct time is spent on trader assurance, including audits. Between 1994-95 and 1998-99 the average time per audit increased by a fifth, rising from 10 hours 4 minutes in 1994-95 to 12 hours 8 minutes in 1998-99 (Figure 11). The time spent comprises three discrete elements: audit activity in the office, audit testing at traders' premises, and travelling to and from traders. Of the 2 hour 4 minutes increase, an assurance officer now spends, on average:

- 1 hour 33 minutes (38 per cent) more in office;
- 19 minutes (7 per cent) longer at traders' premises; and
- 12 minutes (14 per cent) extra in travelling time.

Figure 10c

Staff usage on other direct and indirect assurance activities by type, 1994-95 and 1998-99[1]

The most significant increases in other assurance activities have been the introduction of sifting traders for audit visits and in miscellaneous audits arising from cash and shadow economy team activities.



Notes: 1. For underlying data see Appendix D2

2. Other assurance activities include: Miscellaneous audits to resolve specific concerns relating to individual traders. Registration and deregistration visits target specific risks associated with these events, though traders can now request an education visit following initial registration. Computer visits that are requested by assurance staff where a trader relies on a complex computer system to support their trading activities

3. Trader sifting covers selection of traders for audit and may include analysis of supplementary information provided by the trader prior to a decision being made on any further audit activity.

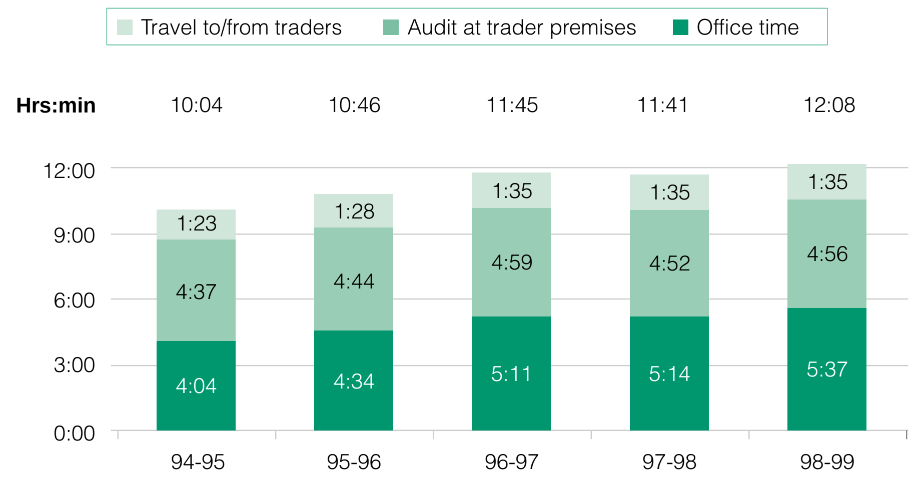
4. All duty repayments are subject to a range of credibility tests. Those that do not satisfy these checks may be subject to checks at local offices to confirm the accuracy/validity of the repayment.

Source: HM Customs and Excise

Figure 11

Average duration of audits by activity, 1992-93 to 1998-99

Most of the increased average assurance time per audit is attributed to time spent within the office



Source: HM Customs and Excise and National Audit Office

2.23 In response to our questionnaire, local offices suggested more time was being spent in office on trader audits because of:

- auditing higher risk traders in line with the Department's revised strategy;
- collecting evidence of trader turnover when carrying out cash trader, shadow economy and trade class exercises;
- spending greater time dealing with traders' professional advisers; and
- increasing correspondence with traders following audits.

2.24 They said that the audit of higher risk traders can lead, in some instances, to the need to further examine trader documents in the office rather than at traders' premises. In-office examination allows staff more time to verify trader records and to clear trader queries. Removal of records may also prevent potential avoidance or evasive activities by the trader. Time spent by staff dealing with trader representatives had led to greater consideration, in depth, of more complex tax issues, such as avoidance.

2.25 Direct time recorded in 1994-95 amounted to 74 per cent of total resource time, declining to 62 per cent by 1998-99 (**Appendix D2**). Of an available staff year of 220 working days, the Department calculate that their staff will spend 140 days on audit. Based on an audit year of 140 days, we calculated that, between 1994-95 and 1998-99, the average number of audits undertaken by each assurance officer each week had declined from 2.52 trader audits to 1.53 trader audits. This equates to a 40 per cent reduction in audits carried out compared with a 17 per cent reduction in available staff years for assurance work.

Conclusions and recommendations

2.26 The Department have been successful in increasing the level of net additional liability discovered whilst reducing the resources applied to audit work. Despite this, however, the Comprehensive Spending Review concluded in July 1998 that problems with trader compliance were a growing threat to the revenue. The views of some focus group members and other audit staff echoed this.

2.27 Our evaluation has led us to the following conclusions.

a) The increase in errors found across all risk classifications suggests that the staff may have improved their selection for audit within each risk group. Although there is an increasing movement of audit effort towards the higher risk groups, however, this has not yet matched the guidance produced by the Department's operational policy division. In particular, local offices are not visiting as many of the highest risk traders as recommended.

b) There has been an improvement in operational effectiveness between 1994-95 and 1998-99. Nonetheless, there may still be scope for the Department to increase further the use of assurance staff on direct activities, leading to additional revenue benefits. The Department's objective should be to ensure that trained officers devote as much of their time as possible to auditing traders and avoid being diverted into associated tasks which do not necessarily require their skill levels.

c) Audits are taking longer and staff are spending significantly more time on indirect assurance activities. Local offices perceive that audits are taking longer partly because of a shift of their work towards higher risk traders (**paragraph 2.23**). The Department's November 1997 research initiative into the possible diversion of assurance resources is a welcome development, which should help them to identify more fully how efficiently and effectively their staff are deployed.

2.28 **With respect to the focusing of audit resources, we recommend that:**

To maximise the additional revenue assessed per audit the Department should test the impact of:

a) concerted action to increase the proportion of high and exceptional risk traders audited each year; and

b) separate quantified performance targets for errors found within each trader group.

To continue to improve their operational effectiveness the Department should:

c) as far as possible, ensure that trained assurance staff are not diverted to undertaking work which do not necessarily require their skill levels; and

d) examine the scope to deploy a greater proportion of existing resources on direct audit work.

The Department have undertaken to continue to monitor these issues as part of their research into the effective use of resources.

Part 3: Selecting and auditing individual traders

3.1 In addition to the information provided by their computerised risk evaluations, trade class information and local knowledge, audits undertaken by the Department's staff provide assurance about the accuracy of traders' VAT returns and their compliance with VAT regulations. Such audits, which include examination of traders' records and accounts, are normally undertaken during on-site visits to traders' premises. This Part of the Report examines how, since the 1994-95 review, (**paragraph 1.6**), the Department have sought to improve the efficiency of their audits through the introduction of revised working practices.

3.2 The 1994-95 review suggested that the Department could maintain the previous levels of discovery of net additional revenue, but with fewer staff. The review suggested that this could be achieved by:

- improving trader selection processes;
- improving the quality of visits to traders; and
- reducing where appropriate the scope of some audits.

3.3 The Department pursued these three key developments as part of their Revised Assurance Process project, within which they established a two-stage trial to test each of a number of revised working methods. The first stage comprised trials held in 49 local VAT offices between September 1995 and May 1996. Within the overall approach, the Department encouraged all offices to undertake local initiatives with the intention of choosing the best of them for further testing at selected offices.

3.4 The second stage comprised integrated trials of the chosen initiatives at local offices in Coventry, Edinburgh and Luton. These trials were conducted between January and December 1997. Unlike the first phase, the trials involved each office testing the same methodologies for each element of the project. The Department's interim evaluations of the trials indicated that the trial sites were close to achieving their targets for the amount and percentages of errors identified per audit. Because of the need to become familiar with the new process, however, the trial sites failed to achieve the planned numbers of audits.

3.5 The Department introduced revised assurance procedures at all offices from 1 April 1998, as planned. In June 1998, their report of the results of their full evaluation noted that the trial sites completed 3,742 audits against a target of 6,176. The main reason for this was that the sites had operated with fewer staff in post than complement. All trial sites accelerated their visiting rate over the second half of the year and, by December 1998, were exceeding their daily target of visits required.

Selecting traders for audit

3.6 Under the computerised local visit selection system introduced in 1993-94 (**paragraph 2.5**), many assurance officers were individually responsible for choosing the traders that they would audit. Their achievements, in terms of audit results obtained, were measured against personal targets set in their annual performance agreements with their line managers. Under a project, stemming from the 1994 review, to assist the focusing of resources on the less compliant trader population, it was proposed that a number of local VAT offices should conduct a trial, using a central team, to locally sift traders suggested for audit by the computerised selection system. This "Sift" team would then pass on to assurance officers for audit only those traders whom they had assessed as being potentially non-compliant.

3.7 In the first stage of this trial, the best results from sites using Sift teams showed a considerable improvement in performance. On the basis of these findings, and the interim findings of the second stage trials, the Department concluded that all local offices should adopt the use of Sift teams in selecting traders for audit and recommended that they should:

- establish a centralised team in each local office to carry out the Sift process and integrate the use of intelligence, thus providing a focal point of expertise and developing uniformity of approach;

- appoint a risk manager to lead each central Sift team, to monitor the matching of assurance resources to risk through the Sift process, and prioritise the varied range of demand led assurance work handled by staff, for example repayment queries; and

- provide training to assurance staff covering the technical issues that would arise from the revised approach, and the developments in team working that it would require.

3.8 The first stage of the trials identified a need for a case tracking system to monitor the progress and outcome of Sift cases and to record the balance of audits between risk groups. This system was developed in time for testing by the integrated trial sites. The Department estimate that local offices will employ some 573 staff years on the Sift process each year.

3.9 The Department also advised local offices to make more effective use of available intelligence facilities; both local intelligence, which is gathered by staff working within local VAT offices, and national intelligence, gathered by the Department's National Intelligence Division. During 1996-97, VAT local intelligence officers became progressively more integrated within Sift teams and at Collection level analytical teams were introduced to support assurance staff. Most local offices responding to our questionnaire reported that they now make effective use of local intelligence to inform their selection of traders. In addition, the Department's Operational Policy Division commissioned the National Intelligence Division to carry out projects to assist the revised approach as a high priority during 1998-99.

3.10 Members of the Department whom we interviewed, as well as those staff who attended the focus groups (**paragraph 1.25**), held mixed views about the impact of Sift. Some staff felt that Sift teams had led to greater efficiency and time savings. Others, particularly those who had not been involved in the later integrated trial phase, were concerned that the Sift process would reduce their ability to select the audits on which they would be judged, under the Department's performance appraisal system. Some observed that trials had been unsuccessful where Sift teams comprised staff with insufficient experience of carrying out audits at traders' premises.

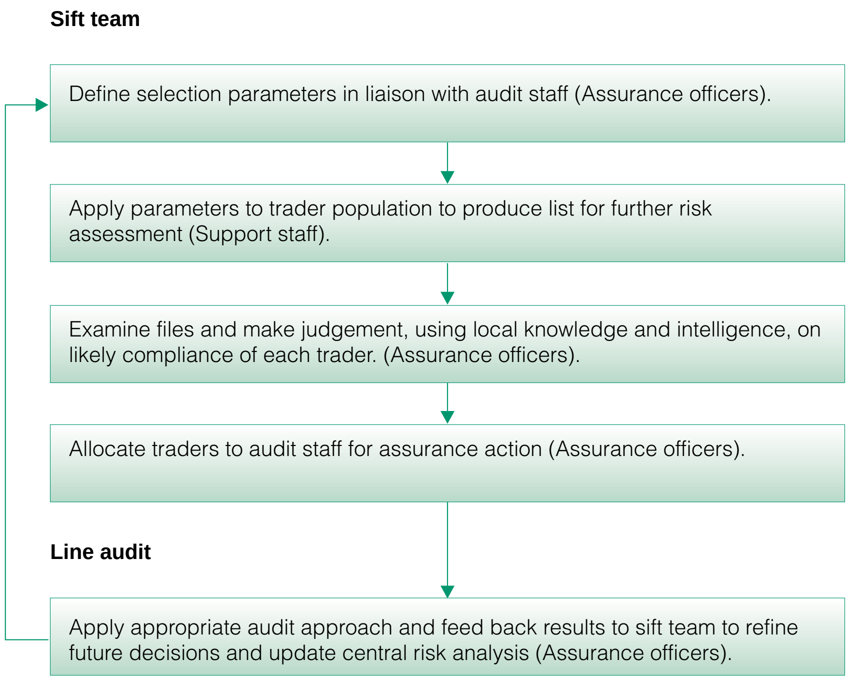
3.11 Focus group participants were unanimously of the view that, to be successful, Sift teams needed to include experienced assurance officers who would be better able to compensate for any shortcomings in the Department's trader information records and associated reports and to interpret the information available.

3.12 In evaluating the initial trials and developing the principles and practices for the integrated trials, the Department addressed staff concerns. Focus group members agreed that the approach to the Sift process adopted by the integrated trial sites appeared more effective. This approach entailed experienced assurance staff within the Sift team, in liaison with officers deployed on trader audits, defining a number of parameters within which administrative support staff would identify the traders which satisfied the set parameters. The Sift team would then examine and review the selected traders' files to identify potentially non-compliant traders, and record the reasons for their decision, before allocating traders to assurance staff to determine the audit approach (Figure 12). The selected audit approach might comprise an office based examination of trader's records or a visit to a trader's premises.

3.13 As noted in **paragraph 2.3**, the law was changed with effect from July 1996 to halve to three years the maximum period on which officers can raise assessments. This reinforces the need for collections to ensure an appropriate balance in the number and mix of audits undertaken. The model at Figure 12 includes the continued involvement of assurance officers in the trader selection process. Nonetheless, the risk manager must consider the balance between central planning and resourcing assumptions, audits prioritised by the computerised selection system, and audits based on local knowledge, so as to maintain an appropriate coverage of the trader population.

The "integrated approach" to trader selection

Figure 12



3.14 Local offices also need to ensure that they test the soundness of the judgements made. Under the revised approach, local offices are expected to audit a 3 per cent sample of traders assessed as compliant. The integrated trial sites reported that they had completed only 90 sample audits during the period of the trial, a much smaller percentage. Despite improving results at the trial sites, the Department considered that this smaller percentage provided an insufficient basis on which to draw any firm conclusions about the effectiveness of the Sift process. The Department recognise the importance of sample visiting and have undertaken to monitor performance and results against the 3 per cent target.

Undertaking trader audits

3.15 Audits undertaken by assurance staff normally comprise three elements: audit preparation (including booking audit visits in most cases); audit examination; and recording of results obtained. Departmental guidance offers advice about each of these processes, and a series of forms are available to assist officers to document each stage of the audit. Completed forms should be retained on individual trader folders. In addition, assurance officers maintain detailed records in personal notebooks, which are available to line managers when reviewing officers' work. Trader files should therefore provide a continuous basic record of information about each trader and about the nature and outcome of any audits undertaken. Brief details of the primary documentation held on individual trader folders which we examined are shown at **Appendix C**.

3.16 Details of traders' VAT accounts are maintained on the Department's computerised trader database. We reviewed accounting data and trader folders relating to 294 audits conducted during the 12 months ending June 1997. The trader folders were selected at random from the 10 local offices visited by us. These local offices agreed that, generally, the folders selected represented a reasonable cross section of the work encountered by their staff.

Booking audit visits

3.17 In 1997, an evaluation by the Department's internal consultants noted potential efficiency savings in changing the arrangements for booking trader audits. Having selected the traders to be visited, individual assurance officers in the majority of local offices had been responsible for arranging the audits with the traders concerned. In some offices this had instead been undertaken centrally and staff at Belfast local office estimated that they could save one executive staff year by introducing centralised booking. The Department told us that centralised visit booking has been introduced at many, but not all, sites and they plan to review this during their further evaluation of the revised assurance process. Guidance has been issued to local offices recommending this approach where applicable.

3.18 Within the focus groups, officers who were familiar with the trials commented favourably on the procedure. They agreed, however, that success was dependent on the calibre of the staff arranging the audits. They emphasised that the central booking teams needed to comprise staff with sufficient knowledge and appreciation of assurance audit requirements to ask the right questions, deal with trader queries and secure their co-operation for the audit.

Audit preparation

3.19 In preparing for an audit, assurance staff collect business, technical, legal and specialist information about each trader. These data are obtained from a Departmental summary of trading activities and business records and other papers kept on the trader's folder, the central trader databases, and supporting guidelines and publications. Assurance staff analyse this information, together with any Departmental rulings, decisions and previous audit reports held on the trader's folder to inform their audit approach.

3.20 A proforma planning document is available for assurance staff also to summarise their concerns beforehand and record how they have been addressed during the visit. Although this may not be required where audits are undertaken in response to a specific event, such as the need to clear a central query before a repayment claim can be processed, its use should aid the review of audit progress and the selection of future audits. Of 294 trader folders examined, the use of the document could have been appropriate in around 115 cases. We found, however, only 6 cases where staff had completed it. In its absence, we were not able to determine the effectiveness of the preparatory work undertaken for each trader nor to confirm, in particular, what key risks had been identified and addressed. As part of their revised assurance procedures, the Department have enhanced the risk information held on traders' folders to include details of risks identified during the sift process.

3.21 Of the sample of 294 trader folders which we examined in 159 instances the folders contained minimal or out of date trader information. It is, however, inevitable that some trader information is out of date particularly for traders classified as medium to low risk, where audits may be infrequent. We also found that 13 folders lacked a proforma report summarising the main trading activities and business records kept by the traders and that, in a further seven cases, staff were continuing to use an obsolete 1982 version of this report.

3.22 Some local offices, participating in the Sift trials, had sought to aid trader selection by sending questionnaires to traders seeking basic trading information and copies of recent accounts. Although this led to additional staff time being spent, in evaluating this further information prior to finally selecting traders for audit, it has been adopted within the Sift arrangements as part of the Department's revised approach. The approach had a number of benefits:

- assurance staff had been provided with more up to date information on which to select their audits;
- some contacts with traders had led to voluntary improvement in trader compliance, reducing the need for an audit visit; and
- assurance staff were able to clear their concerns about some of the smaller traders simply through examining such supplementary information without recourse to on-site audit visits.

Audit examination

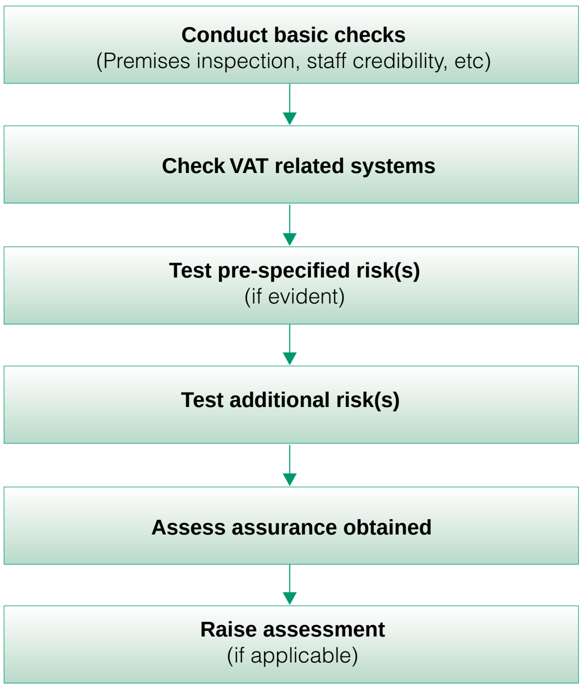
3.23 Within the focus groups, officers agreed that each audit differed according to the individual circumstances of the trader and that most officers' approach to assurance work combined investigative skills with the application of experience. In addition, an officer's judgement about a trader's credibility was not solely dependent upon checks that were readily recorded, such as transaction testing. Officers also took account of a trader's surroundings, premises, lifestyle, and other factors that may support or contradict any documentary evidence examined.

3.24 The Department's objective in conducting trader audits is to form an opinion about whether traders have properly declared and paid the true amount of tax. While they do not seek to provide any form of assurance to the traders themselves, they do use visits to provide advice and guidance as the need arises. Assurance officers undertake those audit tests they judge necessary to assess both a trader's credibility and the accuracy of the VAT returns being examined. The volume of detailed testing of traders' accounts and subsidiary records depends upon the original reason for the audit and on any concerns subsequently identified.

3.25 Officers usually apply an exploratory approach to their testing, initially matching traders' main accounting and tax records to their VAT returns. They then undertake secondary level tests on traders' VAT input, output and subsidiary records either to confirm the accuracy of the main records or to explore concerns that have been identified. They may also conduct further testing on any special schemes or exemptions that the trader is entitled to operate. This process is illustrated in Figure 13.

The audit process

Figure 13



Recording results and controlling quality

3.26 Assurance staff record details of the nature and outcome of their audit checks on a standard visit report. The visit report itself serves three main purposes:

- it provides assurances about the trader and that testing was consistent with the identified risk;

- it provides information about the risks to revenue and the optimisation of resource to risk, particularly when considered in conjunction with a range of visit reports to other traders; and

- it serves as a reference point for future audits.

The visit report, together with the officers' notebook, may also be relied upon in the event of a legal dispute between the Department and the trader. In this respect, the report should clearly identify sufficient information to support any assessments that may be raised.

3.27 We found that, in the majority of folders examined, the completed audit reports did not meet all of the above requirements for two main reasons:

- trader risks were not clearly linked to supporting tests undertaken; and

- although test areas were identified, the amount of testing was not always clearly visible from the reports.

3.28 We noted that the recent introduction of a revised form for simple audits provided officers with a more structured framework in which to produce their reports, which might also be applied to more complex audits. Completion of these reports, however, was subject to similar shortcomings. Following the recent completion of a quality visiting project, the audit process, incorporating the reports, is being considered together with the published Departmental auditing standard.

3.29 The quality visiting project, noted at paragraph 3.28, aimed at identifying the factors that make an assurance visit successful and developing the measurement of these factors on a nationally consistent basis. Through this project, undertaken in two stages, the Department have sought to achieve more efficient operation of the visit process, more effective use of assurance officers' knowledge and experience, and improved trader compliance.

3.30 The first stage trials proved too resource intensive and lacked appropriate technological support to measure adequately the results achieved. Seven offices undertook further trials to establish fixed criteria by which the quality of visiting could be assessed. These trials divided the visiting process into discrete stages to enable managers to identify any inefficiency in the visiting process and thereby assess the effectiveness of visits by activity rather than by the final outcome of the audit, as is often the case currently. An evaluation of the trials by the Department's internal consultants identified costs of delays, both before and during visits, of some £0.9 million. Although further work would be required to identify the extent to which these costs could be reduced, the consultants took the view that measures might be available to save some 20 per cent of these costs annually. The Department's operational policy division is progressing the programme as part of the implementation of a national audit standard.

3.31 Currently, the Department obtain annual assurance certificates from collectors as the principal means (in addition to internal audit) of assurance as to the quality of local office work. These certificates are based on reports from line managers and collection assurance teams. In support of the assurances provided by them, managers review a proportion (some nine per cent in our sample) of trader folders upon completion of an audit.

3.32 Managers at several local offices, which we visited, were concerned about the absence of any objective measures by which to assess the quality of work undertaken by officers. For example, the work is not assessed in the light of the profile of traders in each risk group, what experience and seniority staff should require to address particular risks, what training needs should be addressed, and whether recruitment needs are being met. The Department expect that the development of the national audit standard and of the quality visiting project will contribute to overcoming these concerns.

Using the results of the audits

3.33 Officers intending to raise an assessment as a consequence of an audit may, if appropriate, write to the trader giving the basis for the assessment, allowing up to 28 days for the findings to be challenged before raising the assessment. In most cases, the officer and the trader agree in principle, at the conclusion of the audit, whether an assessment will be raised; the value of the assessment, including details of any interest and penalties due is notified formally later.

3.34 When officers raise assessments for additional tax they record the related error under one of a number of classifications. The Department draw on this information to compile a list of common trader errors in their public notice advising newly registered traders, and others, about how to complete a VAT return. They also plan to include a similar list in a revised public notice about correcting errors on VAT returns which was due for publication during 1999.

Alternatives to a fully scoped audit

3.35 To improve efficiency and effectiveness, and to reduce the potential burden on compliant traders, local offices may employ alternative means of gaining assurance about the trader, thus reducing the scope of the audit to provide a better focus. For example, they might not visit a trader's premises, resolving their concerns more economically by a telephone call. Or they might target an audit on one specific area of a trader's business. The Department believed that full audits should remain the main form of assurance effort, but that alternative methods should be used in circumstances where they might enhance revenue returns with minimum effort.

3.36 The Sift process, through analysis of trader information collected from questionnaires and accounts, may identify a specific risk that an assurance officer may be required to audit. Such audits are known as "hot audits". Focus group participants, while recognising that the targeting of specific risks might result more readily in assessments for additional revenue, pointed out that the effectiveness of hot audits relied upon good quality risk identification at the selection stage.

3.37 Focus group participants were concerned that hot audits, although resolving the specific issue in question, could not be relied upon to provide more general assurance about the trader or to ensure that all major risks were considered. They were worried that they might be held responsible for not having identified other equally significant risks. The Department believe that these concerns will be removed as officers gain practical experience of hot audits. Although the enhanced risk assessments, provided by the local Sift teams, should select the most appropriate scope for each audit, assurance officers will be empowered to exercise their judgement and widen their enquiries as appropriate.

Conclusions and recommendations

3.38 The Revised Assurance Process project, in particular the integrated trials, has demonstrated the potential for improved performance within the Department's strategic aim of gearing resources to risk. The combination of the local visit selection system with the Sift process has enhanced the Department's ability to target their assurance efforts at less compliant traders and maintain or improve revenue yield. This is reinforced by local office Sift teams drawing upon the judgement of experienced assurance officers and by the appointment of local risk managers. In addition, local offices are making improved use of intelligence to inform their selection of traders.

3.39 We were concerned, however, that:

a) insufficient sample audits have been carried out to assess the soundness of the judgements made in selecting traders via the sift process **(paragraph 3.14)**;

b) although central guidance had been issued, the opportunity provided by centralised booking of trader audits to release experienced assurance officers for more appropriate duties had not been fully taken up **(paragraph 3.17)**;

c) we found a significant number of trader folders did not contain adequate records of audit plans, trader information and reports of work done **(paragraphs 3.20, 3.21, 3.27 & 3.28)**;

d) too many offices lacked appropriate formal arrangements for gauging the quality of assurance work undertaken on the general trader population and what their resulting training and recruitment needs were **(paragraph 3.32)**.

3.40 **With respect to selecting and conducting audits we recommend that:**

To ensure that the selection process remains effective the Department should:

a) include the separate results of each local office's sample audit in measuring the outcome of Sift procedures.

To maintain the best use of experienced audit staff the Department should:

b) continue to promote centralised booking of trader audits at all local offices;

c) ensure that local offices maintain adequate, accurate and up to date data in trader folders; and

d) investigate the scope for streamlining the trader audit reporting process while continuing to meet quality standards and management and traders' needs.

To ensure that the quality of the work is of a sufficient standard the Department should:

e) ensure that audit completion reports record sufficient key information about the level and nature of testing undertaken to enable managers to assess the work done; and

f) review the quality control arrangements in place at local offices and issue guidance on good practice.

Appendix A: National Audit Office methodology

A.1 Our examination comprised principally: visits to the Department's headquarters divisions, collections and local offices including a sample examination of trader visit reports; a questionnaire to the heads of all local VAT offices; and focus group meetings. The main features of the study methodology are set out below.

Examination at the Department

A.2 We interviewed managers and examined supporting documentation, including performance data, at the Department's headquarters branches to establish their VAT assurance policies and operational requirements taking into account the ongoing expenditure review trials. This theme was pursued during visits between August and November 1997 to the following collections and local offices.

Collection	Local Offices
London Central	London central office
South London and Thames	Southbank
Scotland	Edinburgh*, Aberdeen
Eastern England	Nottingham, Luton*
Central England	Birmingham, Coventry*
Northern England	Middlesborough, Halifax

* These offices also undertook second stage expenditure review trials to test how well best practices identified under the first stage trials work together.

A.3 The collections and local offices were selected judgementally to give a reasonable cross section of all types of business activity. We also examined a random sample of 294 VAT assurance visit reports, approximately 30 at each local office, covering the 14 month period from April 1996 to June 1997. The file examination consisted of a review of the:

- reasons for the visits;
- collection of trader information and credibility assessments;
- identification of risks at the traders' premises;
- nature and depth of assurance tests undertaken against identified risks;
- reporting of the outcome of the visit including assessments raised;
- evidence of management review of visit reports.

Where appropriate, we examined quality assurance visiting reviews undertaken by local offices at their own initiative.

Questionnaire

A.4 Arising from their analysis of the Department's performance data we issued a questionnaire to the heads of all 54 local offices responsible for VAT assurance work. The questionnaire sought information about local offices' organisation and priorities and how they had dealt with competing priorities; staff training and competencies; visit selection procedures; and the use made of Departmental intelligence in the assurance process.

Focus Groups

A.5 With the Department's co-operation, we appointed a consultant to lead six focus groups in three locations, London, Leeds, and Bristol. VAT assurance officers from 11 of the 14 collections attended these meetings. Their level of experiences ranged between four years and 25 years, with the majority having well over 10 years experience and a sizable proportion more than 20 years experience. Respondents included officers who worked in specialist and general trade areas and included representatives from both urban and rural offices. Some participants had experience of delivering training or being within training programmes and a there was a cross-section of participants from both those offices that had been involved as trial sites in the Revised Assurance Process project and those that had not.

A.6 The objective of the meetings was to gain an understanding about, rather than any precise measurement of, the following issues:

- *attitudes to assurance*
  - understanding and interpretation of assurance
  - identifying problems and issues associated with gaining assurance
- *trader visits*
  - visit preparation
  - the visit
  - completing visits in office
- *training and support*
  - attitudes to training and support available
- *staff suggestions for improvements.*

A.7 We provided the Department with a copy of the consultant's report.

Source data used for analytical purposes

A.8 Data used for analytical purposes came from several sources within the Department. The main criteria for its use were the ability to present consistent data over a period of time. There is therefore consistency of data within charts, but there may be minor inconsistencies between them.

A.9 For figures 2 to 4 (excluding figure 2b), the primary data source was a summary print used by the Department derived directly from their VAT trader database. This data allowed us to distinguish, in overall terms, between large VAT traders and non large VAT traders, the numbers of visits undertaken and additional revenue detected. Whilst this data excludes data relating to some traders deregistering, it gives the most consistent representation of the outcome and trends of the Department's activities for non large traders over the timescale reviewed.

A.10 As this data could not provide sufficiently accurate information on which to measure the impact of the “Spend to Save” initiatives, steps were taken to report the outcome of audits from the VAT operational planning system which feeds these details into the trader database system.

A.11 Figures 2b and 9 – data used was based on data reported in the Department’s annual report and adjusted, to smooth the changes in the trader population or to omit staff years and costs allocated to large trader work.

A.12 Figures 5 to 11(excluding 9) are based on management information used by the Headquarters’ Compliance Directorate. This data was derived from databases either, downloaded from the VAT trader database above, or the VAT operational planning system that records staff activity. As 1993-94 was a transitional year in the Department’s approach to risk analysis and management using the local visits selection system, 1994-95 is the first year of consistent and comparable data regarding trader visits by risk groups. Visiting totals reflect assurance visits only and exclude for example miscellaneous visits or credibility visits that are present within figures 2 to 4 above.

Appendix B: The Department's approach to prioritising trader risks

B.1 Risk analysis has been the basis of the Department's targeting systems for the selection of VAT traders for assurance audits since the early 1980s. The Department's methodology has been adopted by a number of other countries and benchmarked in co-operation with the Australian Tax Office. Over the last 15 years the analysis has become more comprehensive and more reliable and is based on traders' past performance. Currently the whole of the trader population is subject to a risk analysis programme twice a year, which examines 29 different data items including, turnover, trade classification and visit related information.

B.2 The risk established during the risk analysis is fed into a computerised system, known as the Local Visit Selection system, which converts the risk to a points score. The selection system allocates all registered traders for assurance planning and measurement purposes to one of the following 12 trader groups depending on their risk characteristics and indicates the assurance approach applicable to a particular group of traders.

B.3 The Local Visit Selection system was introduced in 1993 specifically to allow local managers the responsibility of selecting traders for audit visits, and to support the cultural changes brought about by Next Steps and the People Initiative. Within each trader risk group the level of risk is combined with the elapsed time since the trader was last audited and traders are listed in descending order of risk. The assurance staff, particularly the Sift teams (**paragraph 3.5**), use the system of trader groups and the order of traders within them, together with their local expertise, to determine the nature and timing of their assurance activity. The system also suggests the grade of officer and approximate audit duration required to assure the tax against the assessed risk.

B.4 The numbers of traders allocated to the trader groups 2 to 5 was set at the inception of the Local Visit Selection system but over time there have been slight variations in the numbers of traders in groups. The basic format, however, has been retained to allow for comparison of results on a year on year basis. For risk assessment purposes trader groups 7 to 12 are subsets of trader groups 1 to 6. Since the introduction of the system the total number of registrations allocated to trader groups 1 to 5 has remained fairly stable at around 1.6 million, with approximately half being classified as trader group 2 Low Risk.

Trader group	Description	No of traders* 000s
1. New Registrations	Traders for whom a completed assurance visit has not been recorded	530
2. Low Risk Traders	Traders assessed as representing a low revenue risk	670
3. Medium Risk Traders	Traders assessed as representing a medium revenue risk	169
4. High Risk Traders	Traders assessed as representing a high revenue risk	180
5. Exceptional Risk Traders	Traders assessed as representing an exceptional revenue risk	33
6. 999 Traders	Large Traders identified by the parent business centre for continuous control	2
7. Corporate Group Traders	Traders designated as belonging to a corporate group of companies	-
8. Branches	Self Accounting Branches	15
9. Insolvent	Traders recorded as insolvent	62
10. Deregistered	Traders with cancellation of registration recorded but not redundant	136
11. Missing Traders	Traders recorded as missing	17
12. Unvisited Traders (set up in response to the expenditure review)	Traders who have had at least one sift but have not yet had an audit visit	74

* As at June 1999.

Appendix C: Primary documentation held on trader folders

CONTROL VISIT ACTION SHEET covering:

Visit Preparation
Trader Report (records of profits, tax, ratios, tax balances)
Last Audit Report (matters outstanding)
Previous Rulings (exemptions, trade schemes etc)
Credibility Queries.
Other notes
Pre Visit Action (Bookings/Appointments)
Matters Outstanding
Post Visit Action on matters outstanding

Form 465A
SUMMARY OF TRADING ACTIVITIES AND RECORDS covering:

Basic trader information including:

Main business and any related activities
Principle inputs and outputs including services from abroad and tax points
Schemes and methods adopted
Departmental Notices issued
Trader records maintained and whether computerised or not
Structure of business
Special or unusual features

Form 465B
REPORT ON VISIT TO TRADERS covering:

Annual Accounts examined
Rulings given
Action taken on risk analysis
Irregularities found - particulars of misdeclarations, assessments made
Conclusions and comments on credibility
Matters for consideration on next audit
Trader compliance points

TRADER SIFT HISTORY DOCUMENT covering:

Decisions about trader’s compliance
Influential risk factors
Recommended assurance action

Appendix D1: Data supporting Figures 8a & 8b

Number of traders and audits by risk groups and the percentage of audits by risk group 1994-95 to 1998-99

Trader Groups in risk order	2 –Low risk	3 –Medium risk	1 –New traders[1]	4 –High risk	5 –Exceptional risk	Total
1994-95						
No. of Traders	744	289	348	198	21	1600
No Audited	57	60	99	83	11	310
% of Audits	18	19	32	27	4	100
1995-96						
No. of Traders	764	241	359	188	18	1570
No Audited	54	46	65	64	10	239
% of Audits	23	19	27	27	4	100
1996-97						
No. of Traders	754	216	383	182	27	1562
No Audited	32	26	49	47	10	164
% of Audits	20	16	30	29	6	100
1997-98						
No. of Traders	744	189	434	181	21	1569
No Audited	27	19	46	43	11	146
% of Audits	18	13	32	29	8	100
1998-99						
No. of Traders	720	159	507	180	37	1603
No Audited	22	15	53	41	15	146
% of Audits	15	10	36	28	10	100

Note: 1. Traders in risk group 1 include a mix of risk, which is on average greater than that of risk groups 2 and 3.

Source: HM Customs and Excise

Appendix D2: Data supporting Figures 10a & 10b

Staff utilisation for 1994 and 1998 changes to major areas

There has been a total reduction in the deployment of assurance staff days of 53,000 between 1994-95 and 1998-99. Direct audit time declined between 1994 and 1998 from 73.7 per cent to 62.3 per cent

	Direct staff days: 000s				Indirect staff days: 000s			
Main task classification	**1994**	**1998**	**Days change**	**% change**	**1994**	**1998**	**Days change**	**% change**
Assurance Audit	443	287	(156)	(35)	159	194	35	22
Trader sifts	-	42	42	-	-	-	-	-
Miscellaneous Audit	18	21	3	16	5	13	8	160
Repayments desk checked	11	16	5	45	-	-	-	-
Computer & accounts support	5	4	(1)	(20)	9	9	0	0
Registration & deregistration	7	4	(3)	(43)	*	*	*	-
Trader education	-	2	2	-	*	6	6	-
Tax avoidance	-	*	-	-	-	6	6	-
Totals	484	376	(108)	(22)	173	228	55	32
% of total time	74%	62%			26%	38%		

** Days recorded less than 1,000*

Source: HM Customs & Excise

Reports by the Comptroller and Auditor General, Session 1999-2000

The Comptroller and Auditor General has to date, in Session 1999-2000, presented to the House of Commons the following reports under Section 9 of the National Audit Act, 1983:

Improving VAT Assurance..HC 15