

# executive summary

## Audit of the HM Customs and excise under Section 2 of the Exchequer and Audit Departments Act 1921

- 1 Section 2 of the Exchequer and Audit Departments Act 1921 requires me to examine the accounts of Customs and Excise to establish that adequate regulations and procedures have been framed to secure an effective check on the assessment, collection and proper allocation of revenue and to satisfy myself that any such regulations and procedures are being duly carried out. This report sets out the results of my examination in fulfilment of these requirements.
- 2 In April 2000, the Accounting Officer, Richard Broadbent who was appointed in February of that year, introduced a new management framework the aim of which was to clarify accountabilities, streamline decision-making and support the more rapid implementation of decisions. On 17 January 2001, the Department announced their reorganisation into two core activities: Business Services and Law Enforcement. Support functions will comprise logistics, finance and strategy, Human Resources and Legal and the new structure is to be in place by 1 April 2001.
- 3 During 1999-2000 I have performed examinations including reviews of the impact of corporate governance developments and the operation of the Landfill Tax Credit Scheme. I also annually review the operation of key accounting functions such as the VAT Central Unit and Credibility Unit for making VAT repayments as well as reviewing the operations of a selection of local offices.

### Excise diversion fraud

- 4 On 1 June 2000, Richard Broadbent, the Chairman of HM Customs and Excise, informed the Paymaster General, Dawn Primarolo, that a series of excise diversion frauds between 1994/1998 appeared to have been mishandled. He had commissioned an internal review to investigate the matter. The weaknesses in controls over the collection of duty and the failings of Customs' management had contributed to the loss of substantial amounts of revenue estimated at around £668 million from diversion onto UK markets. A further £216 million was lost resulting from diversion onto overseas markets where duty would have been due in the country of import had the goods not been fraudulently diverted. **Figure 10** provides the breakdown of these amounts.
- 5 Although Customs became aware of the threat of outward excise diversion frauds as early as 1994 they did not take effective action to curtail these frauds until 1998. About half of the revenue could have been protected if fraudulent consignments had been intercepted rather than letting the investigations continue in order to obtain sufficient evidence to prosecute those involved or if effective action had been taken earlier.
- 6 In the normal course of events my report would be published in the Appropriation Accounts volume containing details of Customs' administration costs and would also cover Customs' Trust Statement, my audit of which fulfils the requirement for me to be satisfied as to the correctness of revenues brought

to account. The Trust Statement for 1999-00 recording revenue receipts and payments and produced under the direction of the Treasury has now been signed by the Accounting Officer. Because of my continuing investigation into diversion frauds, I am as yet unable to conclude under Section 2 of the Exchequer and Audit Act 1921 either that:

- adequate regulations and procedures have been framed to secure an effective check on the assessment, collection, and proper allocation of revenue and to satisfy myself that any such regulations and procedures are being duly carried out; or
  - the sums brought to account in respect of such revenue are correct.
- 7 I propose to produce a further Report to Parliament on the causes and the lessons to be learned from the Department's handling of diversion frauds and on the action planned by Customs.

## Key accounting functions and selected local offices

- 8 I found that controls were operating satisfactorily in these areas but there are significant issues which I brought to the attention of management. These included:
- weaknesses in the way that departmental standards have been applied to some traders and which ensure that they have systems and procedures in place to record and pay taxes at the right time;
  - problems on re-payments to traders of default interest on underdeclarations of VAT;
  - the need to improve checks by Customs on consignments imported from outside the European Union which ensure that the correct amount of duties have been paid by importers;
  - the need for improved procedures to ensure that potential liabilities and provisions have been properly considered, recorded and reported in the accounts produced by the Department.

## Developments in corporate governance

- 9 In line with other central government departments, Customs produce a Statement on Systems of Internal Financial Control for their two accounts which record their administrative expenditure (the Appropriation Account records voted cash administrative expenditure and the Resource Account shows resources utilised on an accruals basis). This statement confirms that the Accounting Officer has satisfied his responsibility to ensure that effective management systems, including financial monitoring and control systems, have been put in place.
- 10 In June 2000, Treasury issued guidance extending this requirement to all accounts that have to be laid before Parliament for the 1999/2000 financial year. However, departments were allowed to defer the application of this guidance until the year ending 31 March 2001 if the required systems were not in place for the year ending 31 March 2000. The Department have chosen to extend the scope of their Statement on Systems of Internal Financial Control to cover their Resource Account. However, they do not plan to widen the statement to cover the systems in place for the assessment, collection and allocation of revenues until the 2000-01 financial year, because the timing of the Treasury's guidance meant that they were not in a position to retrospectively

seek evidence about the internal financial controls relating to revenue systems in operation throughout 1999-2000.

- 11 Most major organisations use an audit committee to enhance and evaluate the internal control systems in operation. The Treasury have issued guidance on the formulation of such committees in the public sector and have recommended they be set up. Customs and Excise are in the process of developing the role of their audit committee further. The National Audit Office have recently been invited to attend the Committee on a permanent basis.

## The operation of the Landfill Tax Credit Scheme

- 12 The operation of the Landfill Tax Credit Scheme and the Landfill Tax from which credits can be deducted has been the subject of considerable Parliamentary and media interest, especially about the effectiveness of the scheme and the projects paid for by contributions ie the tax foregone. The regulations for the scheme as well as the workings of the scheme itself are complex and payments for projects that fall within the scheme's rules do not count as public expenditure which makes external examination of the value-for-money achieved by the scheme difficult for anyone to assess. I have examined principally how Entrust regulate the scheme and Customs' monitoring of Entrust's activities as regulator of the Scheme. Although I am satisfied that Entrust fulfils its duties satisfactorily, I have made recommendations on the way Entrust can improve their review of projects and enrolled environmental bodies and in the way Customs monitor Entrust.