

# HM Customs and Excise Losses to the Revenue from Frauds on Alcohol Duty

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL  
HC 178 Session 2001-2002: 19 July 2001



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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*  
Comptroller and Auditor General

National Audit Office  
18 July 2001

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**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: 020 7798 7400

Email: [enquiries@nao.gsi.gov.uk](mailto:enquiries@nao.gsi.gov.uk)



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## Front Cover Photograph

Customs officers destroying seized beer  
Photograph kindly supplied by HM Customs and Excise

# executive summary

## All taxes are subject to the risk of fraud and evasion

- 1 This Report examines the circumstances surrounding the known losses between 1993 and 2000, which were subject to Customs investigations, of alcohol duty worth £668 million from diversion onto UK markets, following the introduction of the Single European Market in 1993. Another £216 million was accounted for as revenue 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.
- 2 All taxes are subject to the risk of fraud and evasion, including smuggling. Given the need to balance countermeasures with the need for goods to flow freely, total prevention is not realistic and some loss is inevitable. There are no reliable estimates of the total level of loss from outward diversion fraud. Nevertheless, to tackle fraud, Customs seek to allocate their resources based on broad assessments of the risks. At the present time Customs see their highest fraud priority as tackling cigarette smuggling (where the published loss for 2000-01 was £2.9 billion).

## In 1993 the Single European Market simplified the movement of goods to make trade easier, but unintentionally led to an increase in excise fraud

- 3 The creation of the Single European Market in 1993 brought with it the removal of restrictions on the movement of goods between European Union Member States, with the aim of making trade easier. Among other things, the Single Market led to changes in the system for the movement of excise goods under duty suspension between authorised warehouses or traders in the European Union. Decisions on the controls needed in each country over the simplified system for commercial movements of excise goods were left to individual Member States. In the United Kingdom, Customs adopted a risk-based approach, removing many of their physical checks of goods and largely passing operational control over the system to the traders themselves.
- 4 Before 1993 traders were required to declare to Customs all excise goods destined for export and make them available for pre-export examination. Customs staff also visited the excise warehouses regularly to carry out physical checks. The abolition of internal border controls from 1993, and the continued removal of regular physical checks, led to the growth of excise fraud. Criminals acquired increasingly large consignments of alcohol intended for export and illegally diverted them on to the UK market without payment of excise duty or VAT (known as outward diversion fraud). A chronology of events showing how frauds grew following the creation of the Single Market in 1993, and Customs response, is set out in the Annex to this Summary.
- 5 In February 1994, the Committee of Public Accounts, following up the Comptroller and Auditor General's report on the Department's 1992-93 accounts, asked Customs whether there was any sign of increased fraud as a result of the Single Market arrangements. Customs responded that they had,



from the outset of the Single Market, recognised that the changes would give rise to new risks of fraud and that there would be people eager to exploit these opportunities. Customs added that they were watching very carefully for fraud arising, but that, at that time, there was no sign of increased fraud as a result of the new Single Market arrangements. Appendix A sets out extracts from reports by the Comptroller and Auditor General and the Committee of Public Accounts on the risks of fraud, including diversion fraud, and Customs' responses, following the introduction of the Single Market in 1993.

## Definitions

**The Duty Suspension System** - Under the Single Market, Member States are required to operate a system of duty suspension in order to facilitate alcohol trade. The system allows registered traders or warehousekeepers to produce, process, store and move goods without payment of duty. The system enables traders to time the payment of the duty due nearer to the time when they will sell on their goods. Duty becomes payable when the goods are released for consumption or are acquired by an unregistered individual.

**An excise warehouse** is one approved by Customs (under the Customs and Excise Management Act 1979 or the Alcoholic Liquor Duties Act 1979) for the storage of goods without payment of excise duty (i.e. duty is held "in suspense"). Customs have approved about 1,100 excise warehouses in the UK.

**Duty suspended revenue goods** are goods, such as alcohol and tobacco, where the payment of duty is postponed until they are released onto the UK market for consumption.

**Outward excise diversion frauds** are committed when duty suspended goods destined for export, or for another UK excise warehouse, are illegally diverted from an excise warehouse on to home or overseas markets, without payment of duty.

**Inward diversion frauds** are committed when duty suspended goods imported to an excise warehouse are illegally diverted on to the UK market, without payment of duty.

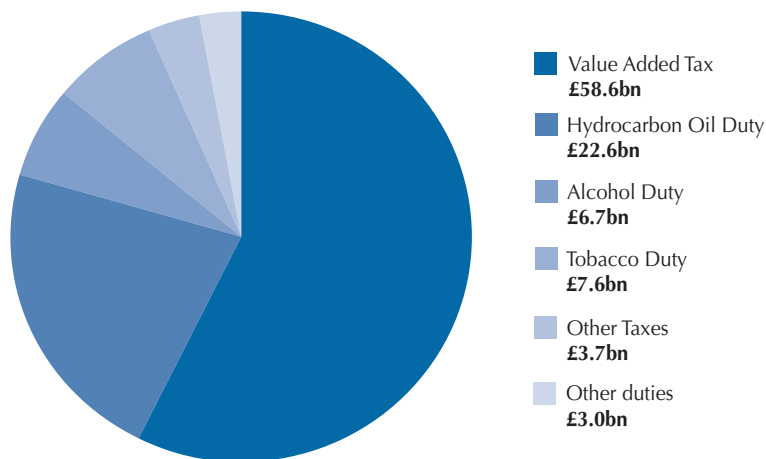
**Revenue losses** arise in cases where Customs raise an assessment for duty on a trader or an individual but the amounts cannot, or will not, be collected by Customs. The losses are calculated by totalling the revenue evaded and then deducting any cash subsequently collected or expected to be collected. The losses include excise duty and VAT. The average amount of duty lost on a diverted consignment of spirits (a 40 foot trailer load) is approximately £100,000, and on a similar consignment of high strength beer about £20,000.

Frauds between 1993 and 2000 led to alcohol duty evasion of £668 million from diversion onto UK markets, and another £216 million was accounted for as revenue lost from diversion onto overseas markets

- 6 By 1995, Customs became aware that the scale of alcohol diversion fraud was growing and by 1996 the recorded losses were significant. Customs' National Investigation Service recognised the emerging scale of diversion fraud, mainly through uncovering and investigating large fraud cases. The first investigation of UK diversion fraud was in August 1995. This fraud evaded revenue worth £19 million. In view of the seriousness of the trends, a briefing was given to the Customs Chairman in December 1995. In the event, estimates prepared by Customs in 2000 show that revenue evasion identified by investigations of alcohol diversion fraud grew rapidly from 1995-96 (see Figure 4 in Part 1).

- 7 Although large in themselves, the level of known losses from diversion fraud represent a small proportion of total revenue from alcohol duty. In 2000-01 HM Customs and Excise collected £6.7 billion from duty on alcohol, 6.6 per cent of the total revenue collected by the Department (**Figure 1**). Alcohol diversion duty losses identified from investigations between 1993-94 and 1999-00 represent some 1.4 per cent of the total revenue from alcohol duty over that period. The total level of loss from outward diversion fraud over the period is not known.

**1 Alcohol duty formed 6.6 per cent of total revenue collected by HM Customs & Excise in 2000-01 (unaudited)**



Customs short term response to diversion fraud was to protect the revenue by investigating cases with the aim of convicting the perpetrators

- 8 A key approach of the National Investigation Service to tackle diversion frauds was to protect the revenue by identifying the principals behind the fraud and collecting sufficient evidence to secure their conviction. The main method of achieving this was identifying suspect consignments and allowing fraudsters to move goods from excise warehouses whilst under observation (known as "letting loads run"). Selected consignments would be followed and when enough evidence was obtained the perpetrators would be arrested. An unavoidable consequence of this method was that arrears of duty would build up during the course of the investigation. The National Investigation Service considered that "letting loads run" was justifiable if it led to successful prosecutions and arrears of duty were recovered through confiscation orders from the Courts.
- 9 Even with the benefit of hindsight, it is difficult to determine whether a policy of greater disruption of alcohol diversion frauds between 1995 and 1998 would have led to a lower level of revenue losses. Customs investigators at the time found that where suspect consignments were intercepted at an early stage to disrupt fraudulent operations, fraudsters just moved to another warehouse to commit further frauds. And if a consignment under surveillance was stored for a period within the time limits for export, Customs did not have any legal power to disrupt the activity.
- 10 The Department identified around 130 cases of outward excise diversion fraud between 1994 and 1998. Over 100 successful prosecutions were made, a total of over 200 years in sentences were passed on those involved in the frauds and the Courts confiscated more than £23 million.

## Over the longer term, Customs sought to tighten the controls over the duty suspension system

- 11** The identified losses of revenue arose mainly because fraudsters were able to take advantage of weak controls over the movement of alcohol to and from excise warehouses. The National Audit Office issued a report to Customs in July 1996 on controlling excise and inland Customs traders. The report highlighted the risks to the revenue from Customs' approach to handling traders and excise warehouses and was followed up in our Reports on the Department's 1996-97 and 1997-98 Accounts (see Appendix A). A Customs Internal Audit Report of April 1996 also highlighted the weaknesses in the movement system and the increased numbers of fraud cases. The weaknesses in the warehousing controls included:
- the difficulty of detecting fraudulent export documents;
  - the reduced level of Customs' checks of excise warehouses, brought in following the Single Market;
  - incomplete records of the movement of duty suspended goods;
  - non-compliance with regulations by traders;
  - failure to impose appropriate sanctions (such as deciding whether to invoke guarantees against losses).
- 12** In response to management concerns and the reports from the National Audit Office and Internal Audit, Customs took action to strengthen controls to tighten up the weaknesses in the system. The level of alcohol diversion fraud fell significantly after 1997-98 (see Figure 4 in Part 1). Examples of the measures taken include:
- targeting consignments diverted onto the home market in order to disrupt fraudulent activities (from 1996-97);
  - encouraging warehousekeepers to obtain guarantees from the owners of the goods or hauliers;
  - requiring warehousekeepers and the owners of goods to be registered;
  - taking part in an European Union wide Early Warning System for certain consignments of spirits and cigarettes from warehouses.
- 13** In 1997 Ministers commissioned a review to look at the effect of alcohol and tobacco fraud, smuggling and cross-border shopping on the Exchequer and on industry revenue. The report of the Alcohol and Tobacco Fraud Review made some 90 recommendations, 31 of which related primarily to diversion fraud (Appendix B). Customs state they have implemented 18 of these recommendations (although six of these require further action by the European Union pending computerisation). Areas where further work is still needed relate primarily to reforms to the European Union-wide System for the Exchange of Excise Data (which stores the names of approved warehouses), recording of vehicle registration numbers, unique numbering of duty suspension movement records, marking of products and measures aimed at wholesale and cash and carry outlets.



## Concerns about Customs' handling of the evasion of alcohol duty led to an independent enquiry

- 14** Customs' Chairman commissioned an internal review of the handling of the alcohol duty losses which reported in May 2000. The review highlighted the serious weaknesses in the Department's control of excise duty collection, in particular the mechanisms for releasing dutiable spirits and wine from excise warehouses. The review concluded that there had been significant revenue losses, principally in the three years after 1995.
- 15** Customs' Chairman reported the results of the review to the Paymaster General, Dawn Primarolo, in June 2000. Following this, the Paymaster General commissioned an independent investigation, headed by John Roques, an ex senior partner of Deloitte and Touche, to look into the matter. Mr Roques presented his report to Ministers on 15 December 2000. It contained 65 recommendations to improve controls and the way that fraud is tackled in Customs. The recommendations of the Roques report and the Paymaster General's announcement are set out at Appendices C and D respectively.
- 16** Customs fully or partially accept 62 of the 65 recommendations made by Roques. Two recommendations are under consideration and one cannot be implemented because it breaches European Union legislation (details of recommendations accepted are in Appendix C). Key measures being taken include:
- a more rigorous approach to the approval of warehouses;
  - tightening the registration procedures for warehousekeepers and the owners of goods;
  - improving the information on the holding and movement of excise goods where the duty has not been paid;
  - improving the exchange of information with other European Union Member States;
  - increasing the checks on warehousekeepers' compliance with holding and movement regulations;
  - tightening controls on hauliers;
  - considering the use of fiscal marks on alcohol.
- 17** Some 42 of the recommendations had been implemented by July 2001 (details of the implementation of recommendations are in Appendix C). Implementation of the rest will take some time to achieve. For example, the timetable for the introduction of a single, monthly, mandatory legal declaration by warehousekeepers to replace the current series of forms has not yet been decided (Appendix C, Recommendation 11). Inspection visits to all Registered Excise Dealers and Shippers traders will not be completed until July 2002 (Appendix C, Recommendation 17). On the introduction of fiscal marking, no timetable has yet been set (Appendix C, Recommendation 27). Customs expect to launch a real time information management system for investigation cases by March 2003 (Appendix C, Recommendation 39).

## We have examined the actions taken and planned by Customs to deal with the threat of fraud

**18** We reported on the identified losses to the revenue from excise diversion frauds in our annual report of 2001 on Customs accounts of revenue (Appropriation Accounts 1999-2000, Volume 16, Class XVI Departments of the Chancellor of the Exchequer, Chapter 5). In that report, we undertook to report again to Parliament once we had received all the evidence on the causes and lessons to be learned in this case.

**19** Against this background we examined:

- How the frauds were undertaken and the action taken or planned to strengthen controls (Part 1).
- How Customs investigated the frauds and the action taken or planned to strengthen controls over future investigations (Part 2).
- The steps taken or planned by Customs to strengthen their general approach to tackling diversion fraud (Part 3).

**20** In undertaking this work we:

- reviewed Customs' own internal reviews on the identified revenue losses from excise diversion fraud and the findings of the Roques report;
- examined Customs' action plans in response to these reviews;
- interviewed officials within Customs, both in post and retired, who dealt with this matter; and
- reviewed relevant previous recommendations by the Committee of Public Accounts since 1993 (Appendix A).

**21** We are looking separately at the way that Customs are addressing the risks of fraud and evasion in other taxes and duties:

- in our report on hydrocarbon oil duty fraud, smuggling and the illegal use of rebated fuel, due for publication later this year;
- by covering Customs' systems and procedures on VAT registration and to ensure the payment of tobacco duty in the C&AG's Standard Report to be published later this year;
- through a wide-ranging review of the way that Customs, the Inland Revenue, the Department for Work and Pensions and the National Health Service tackle the major threat of fraud against the public purse.

## Overall conclusion

- 22 Given the need to balance countermeasures with the need for goods to flow freely, there is always likely to be some revenue evasion. The loosening of controls that followed the introduction of the Single European Market in 1993 led to fraudsters evading excise duty worth £668 million from diversion onto UK markets between 1993-94 and 1999-00, and another £216 million was accounted for as revenue lost from diversion onto overseas markets.
- 23 Following the introduction of the Single Market, Customs addressed the deficiencies in the system through a combination of fraud investigations and a tightening of controls. There were, though, weaknesses in their control of investigations and in their general counter fraud strategy.
- 24 As part of their ongoing dialogue with Customs, the Committee of Public Accounts and the National Audit Office raised concerns about excise duty fraud each year from 1994, culminating in the disclosure of losses in the National Audit Office report on Customs 1999-00 Accounts.
- 25 There are a number of areas where Customs could have responded to the frauds more effectively:
- When the frauds began in 1994, Customs did not have a high level strategy for how they should combat alcohol diversion fraud. Such a strategy was not completed until 2000. Dealing with the frauds at the time was seen as an operational matter largely within the National Investigation Service. The Service should have worked with other groups within the Department, such as policy teams, to address issues such as: the resources to be committed to anti-fraud work; authorisation for investigations and indemnities; deciding who to assess for lost revenue; and the division of responsibilities between the Service, Collections and Headquarters teams. The lack of a high level approach meant Customs took longer to draw up a co-ordinated response to the frauds.
  - Customs did not assess whether their policy of identifying suspect consignments and allowing fraudsters to move goods from excise warehouses under observation ("letting loads run") was a more effective way of tackling the frauds than disruption. "Letting loads run" unavoidably leads to the build up of arrears of duty, but with the intended objective of protecting the revenue by convicting fraudsters and recovering losses. The main alternative is to disrupt fraudulent activity as it is discovered, which protects potential revenue loss but is less likely to lead to conviction of the perpetrators. However, even with the benefit of hindsight, it is difficult to determine whether a policy of greater disruption would have led to a lower level of revenue losses.
  - Customs had inadequate management information on the levels of fraud as they first arose in 1994 and on the outcome of investigations. This meant that the first signs of significant losses from fraud were not fully appreciated. Customs did not know the full extent of the losses from the frauds investigated until a special exercise to identify them was carried out in 2000. Losses from any frauds which have not been investigated or identified are unknown.
  - For a number of investigations, Customs did not issue assessments against the fraudsters for the duty lost. As a consequence, Customs did not note the extent and circumstances of the identified losses in their accounts until 2001, a considerable time after the losses occurred.



- 26 The actions now planned by Customs should result in:
- tighter controls against fraud;
  - improved management of investigations of fraudsters; and
  - a better strategic approach to countering fraud.
- 27 Underpinning these improvements, we consider four initiatives are crucial. These are:
- developing an approved anti-fraud strategy, with explicit recognition that there is going to be a level of revenue loss if trade is to be facilitated (because this requires looser controls), an estimate of the unavoidable level of loss and an estimate of the risks (and the relative attractiveness and potential gain to fraudsters of different types of fraud);
  - developing and publishing reliable estimates of revenue "leakage", to give earlier warning that fraud risks may be maturing. Customs already publish such estimates for tobacco and some alcohol smuggling figures. Extending such estimates to cover all indirect taxes would provide a starting point for measuring the effectiveness of Customs and help indicate where resources should be targeted;
  - developing systems to give management information on anti-fraud activities, including the progress of investigations, and to provide anti-fraud intelligence;
  - ensuring the unification of anti-fraud resources under a single command works effectively, both internally and with other parts of the Department.

# Annex A

## Excise diversion frauds - chronology of events

<b>January 1993</b>	Creation of the Single European Market.
<b>April 1994</b>	Committee of Public Accounts report notes that Customs say that they have not detected any sign of increased fraud as a result of the Single Market. The Committee urges Customs to remain vigilant in the face of the acknowledged risks.
<b>August 1995</b>	First investigation of UK diversion fraud. Customs subsequently carry out more investigations of suspected frauds, using the method of "letting loads run" - identifying suspect consignments and allowing the fraudsters to move the goods whilst under observation, with the aim of protecting the revenue by identifying the principals behind the fraud and collecting sufficient evidence to secure their conviction.
<b>April 1996</b>	Customs' Internal Audit report highlights the rising level of fraud and the barriers to the effective operation of the duty suspension system.
<b>July 1996</b>	National Audit Office report to Customs on controlling excise and inland Customs traders highlights risks to the revenue from Customs' approach to handling traders and excise warehouses.
<b>August 1996</b>	Committee of Public Accounts report notes Customs' view that commercial fraud is a greater concern in terms of lost revenue than smuggling and the absence of usable estimates of revenue losses. The Committee looks to Customs to seek improved intelligence and to adopt appropriate counter measures.
<b>1996-97</b>	IMPEX (Import/Export) teams introduced to disrupt fraudulent activities.
<b>1997</b>	High Level Group on Alcohol and Tobacco Fraud set up in Europe to consider all aspects of alcohol and tobacco fraud.
<b>April 1997</b>	130 extra staff years allocated for IMPEX teams.
<b>October 1997</b>	Commissioner's direction allowed any officer to impose immediate conditions or restrictions on the removal of goods from a third party warehouse, thereby preventing/delaying the despatch of suspect movements.
<b>1998</b>	The Excise Duty Point (External and Internal Community Transit Procedures) Regulations 1998 provided a duty point where excise goods were moving under Community Transit Procedures and there was an irregularity or offence in the UK.
<b>July 1998</b>	Customs' Alcohol and Tobacco Fraud Review published.
<b>October 1999</b>	Warehousekeepers and Owners of Warehoused Goods Regulations 1999 provided for registration of both warehousekeepers and owners, allowing easy identification of those with an interest in goods involved in suspect movements.
<b>May 2000</b>	Departmental review of the events relating to Customs' investigation of excise diversion frauds between 1995 and 1998.
<b>1 June 2000</b>	Customs inform Paymaster General of the weaknesses in the control of excise duty collection.
<b>30 June 2000</b>	Paymaster General announces a full independent investigation into the collection of excise duties by John Roques, ex senior partner from Deloitte and Touche.
<b>8 February 2001</b>	Paymaster General informs Treasury Sub-Committee that Roques's work is not yet complete and that she will report fully on excise diversion when outstanding areas of work have been finalised.
<b>9 February 2001</b>	National Audit Office report on Customs Appropriation Accounts 1999/2000 records the extent of excise diversion losses.
<b>Note:</b>	Committee of Public Accounts Reports mentioned above examined reports by the National Audit Office on Customs Appropriation Accounts for the relevant year.

# Part 1

## How the frauds were undertaken and Customs' response

1.1 This part of our report looks at the arrangements for moving excise goods established with the creation of the Single European Market in 1993, the weaknesses in these arrangements that allowed frauds to be committed, and Customs' actions to reduce the level of frauds.

### Revised arrangements for moving excise goods were established with the creation of the Single European Market in 1993

1.2 One of the principles of the Single European Market, implemented on 1 January 1993, is that goods may move freely within the European Union. Under the regulations introduced by the Single Market, traders producing or dispatching excise goods for export, such as alcohol, are not liable for duty if they can show that the goods have been exported outside the European Union or have been sent to an approved (excise) warehouse within the European Union. Duty is deemed to be suspended; it becomes payable if the goods are released onto the market for consumption or export evidence is not obtained within a certain timescale. The suspension of duty is a concession granted to facilitate business.

1.3 The duty suspension system applies while goods liable to excise duty are being:

- produced or processed;
- stored in an excise warehouse;
- moved from one excise warehouse to another, or to an approved person;
- moved from an excise warehouse for export outside the European Union.

1.4 The point of duty liability occurs when goods are released for consumption or are acquired by an unregistered individual, or when goods are found to be missing from an excise warehouse or during transit. Excise duty is levied by the Member State in which the goods leave the duty suspension regime. Where goods are lost or diverted before they reach their declared

destination, but there is no evidence as to where the irregularity took place, the duty point is deemed to have arisen in the dispatching Member State, which must then calculate and collect the excise duty due.

1.5 Excise goods can arrive at the warehouse from various sources including from other UK warehouses, from other European Union warehouses or from imports from outside the European Union. The goods can be removed from the warehouse for a number of reasons (**Figure 2**).

1.6 From January 1993, the Single Market removed restrictions on the movement of goods and people between European Union Member States. Decisions on the controls needed in each country over the simplified system for commercial movements of excise goods were left to individual Member States. In the United Kingdom, Customs adopted a risk-based approach, and continued to remove many of their physical checks of goods and largely passed operational control over the system to the traders themselves. Before 1993, all excise goods destined for export had been declared to Customs and made available for pre-export examination. Customs staff had also visited the warehouses on regular basis to carry out physical checks.

1.7 Those allowed to hold duty suspended goods must be approved and registered. In order to obtain authorisation from Customs, traders must satisfy the Department that they will provide sufficient physical and financial security, and adequate management and supervisory controls to safeguard the storage of duty-unpaid goods.



## 2 There are various reasons why goods may be removed from an excise warehouse



\* Subject to certain restrictions, diplomats may withdraw goods from warehouses (free of duty and VAT) for the official use of their mission or for the personal use of entitled individuals and their dependants.

1.8 Under these arrangements the warehousekeepers are key in checking that the movement of excise goods where the duty has not been paid are legitimate (Figure 3). A key aspect of the system was the record showing the movements of duty suspended goods - the Accompanying Administrative Document.

### Under the terms of the Customs' approval the main responsibilities of a warehousekeeper are to:

- secure the goods while they are being stored;
- raise and maintain accounts promptly and accurately;
- control effectively all operations' receipts and removals;
- examine critically all losses such as from breakages;
- investigate and report all indications of irregularity;
- submit returns to Customs as required;
- observe all the conditions of the Customs approval;
- account for any duty due on goods removed from the warehouse for consumption in the UK.

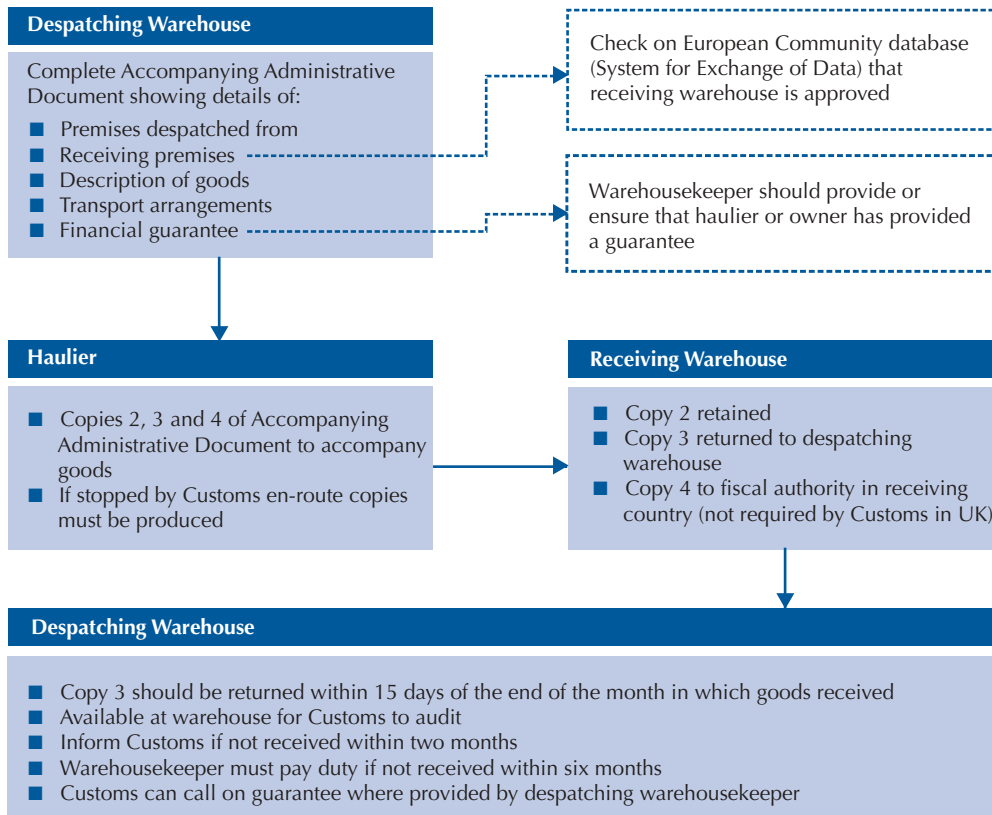
### The movement system introduced in 1993 had a number of weaknesses

1.9 The losses of revenue arose mainly because fraudsters were able to take advantage of weak controls over the movement of alcohol to and from excise warehouses. A Customs Internal Audit Report of 1996 highlighted the weaknesses in the movement system introduced in 1993 and the increase in the numbers of fraud cases. The weaknesses in the warehousing controls included:

- the difficulty of detecting fraudulent export documents;
- the reduced level of Customs' checks of excise warehouses;
- incomplete records of the movement of duty suspended goods;
- non-compliance with regulations by traders;
- failure to impose appropriate sanctions.

1.10 Accompanying Administrative Documents - the key records of movements of duty suspended goods - were supposed to be completed by the warehousekeeper and a copy returned to the despatching warehouse by the receiving warehouse to show that the movement of the excise goods had taken place. However, in the majority of the frauds, the receipting stamps on the Accompanying Administrative Documents were forged. More sophisticated forgery techniques meant that it was almost impossible for warehousekeepers to detect whether stamps were genuine.

### 3 The system for moving excise goods within the European Union where duty has not been paid



1.11 Furthermore, in implementing the Single Market, Customs chose to completely remove their regular presence at the warehouses from January 1993. Their controls over the system for moving excise goods became based on risk assessment techniques which helped to target areas for audit work. Customs ended their routine involvement in the movement of duty suspended goods and were therefore no longer aware of individual movements of goods at the time they occurred, except where warehousekeepers notified them via Early Warning System arrangements (see paragraph 1.24 below).

1.12 Customs could become aware of potentially irregular movements as a result of audit activity or information received from warehousekeepers who had detected potential irregularities. And Customs staff cross-checked a small proportion of movement records (Accompanying Administrative Documents) when they visited a warehouse. The number checked varied according to the volume of movements and the perceived risk at individual warehouses. However, as even legitimate documents could take up to six months to be returned, and visits by Customs to check documentation might not have taken place for some time afterwards, any diversion frauds that occurred could take some time to detect. This meant that by the time any audit took place the fraudsters would have disappeared.

1.13 Prior to despatching the goods the consigning warehousekeeper is required to ensure that the receiving warehouse is duly approved in the Member State concerned. An European Union wide database, the System for the Exchange of Excise Data (SEED), contains details of approved warehouses. The despatching warehouse should check this database to ascertain that the receiving warehouse is approved. There are over 20,000 approved warehouses on the database. The database, however, lost the confidence of traders because Member States varied in the extent to which they kept the information up-to-date. It was also straightforward for fraudsters to obtain the details of a legitimate warehouse in another Member State for the purposes of completing the Accompanying Administrative Document. Customs are working with the European Commission and other Member States to migrate SEED onto a central system in Brussels which will offer real time access to up-to-date information from all Member States. It is planned that this development will be ready by the end of 2002.

1.14 Excise goods were moved from the warehouse under guarantees which could be provided by the warehousekeeper, the haulier or the owner of the goods. When the Single Market was created in 1993, guarantees were compulsory for all intra-European Union movements of duty suspended alcohol and tobacco. The guarantee covered the amount of duty that was likely to be suspended in a single consignment. Customs could call on these guarantees where the principal failed to pay an assessment of duty owed and revenue was therefore lost.

### Examples of a guarantee provided by a warehousekeeper

The level of a guarantee for a trader dealing wholly in beer is set at the maximum amount of duty which could be suspended on a single consignment of beer. A trader dealing in mixed goods including spirits is required to provide a guarantee based upon the highest amount of duty which could be suspended in a single consignment of spirits. The number of consignments is not taken into account.

1.15 Guarantees, which had been introduced before the Single Market was created, were intended to cover "occasional" or minor losses, such as the theft of a lorry load where the owner was unable or unwilling to pay the duty owed. Guarantees were not intended to underwrite revenue lost through organised diversion fraud or prevent the smuggling of excise goods. In alcohol diversion fraud cases where Customs considered that the warehousekeeper should be assessed for revenue losses, the amounts involved were so substantial that they far exceeded the financial guarantees provided. Customs could have required traders to provide greater levels of security where they suspected fraud. However, Customs were only likely to identify cases where this would be appropriate after the losses had already exceeded the guarantee. The Roques report recommended that there should be more routine use of invoking guarantees by Customs who should treat irregularities as absolute offences which are dealt with immediately (Appendix C, Recommendation 9).

1.16 Before 1995, a guarantee was required for both premises (for goods in storage) and for goods in transit. In 1995, following a review of trader security, Customs withdrew the requirement for a guarantee for premises and for intra-UK movements. Instead guarantees were only necessary where they were a statutory requirement (such as intra-European Union movements) or where a trader posed a significant risk. Customs now propose to reintroduce mandatory movement and premises guarantees, a move which was supported by the Roques report (Appendix C, Recommendation 10).

### In 1995 Customs started to take action to reduce alcohol diversion fraud through investigations, disruption of fraudulent activities and tightening of controls

1.17 In February 1994, the Committee of Public Accounts, following up the Comptroller and Auditor General's report on the Department's 1992-93 accounts, asked Customs whether there was any sign of increased fraud as a result of the Single Market arrangements. Customs responded that they had, from the outset, recognised that the changes would give rise to new risks of fraud and that there would be people eager to exploit these opportunities. Customs added that they were watching very carefully for fraud arising but they noted that, at that time, there was no sign of increased fraud as a result of the new Single Market arrangements. Extracts from reports by the Comptroller and Auditor General and the Committee of Public Accounts on the risks of fraud following the introduction of the Single Market, and Customs' responses, are given in Appendix A.

1.18 In 1995 Customs staff began to discover that illicit goods of both alcohol and tobacco products were on sale in all areas of the country. Criminals were acquiring increasingly large consignments of alcohol intended for export, and travelling in duty suspension, and illegally diverting them on to the UK market without payment of excise duty or VAT (known as outward diversion fraud). Most of the frauds involving alcohol were diversions of goods despatched from excise warehouses to other Member States - mainly Spain, Italy, France and Germany. In practice, the goods rarely left the UK and normally entered the secondary wholesale market in bulk. The last owner of goods in the UK and the seller of the diverted goods were traders who would vanish as soon as Customs showed any interest in their fraudulent transactions.



### Example of an excise diversion fraud

This operation involved the outward diversion of beer and spirits from a UK warehouse between 1995 and 1997. The alcohol was purportedly destined for export using a number of front companies but was diverted to customers within the UK. Owing to the complexity of the network of front companies which had been established by the fraudsters, and having little more than a first name to go on, the investigators had to identify and gather evidence against numerous participants and businesses before being in a position to make the arrests. The two principals were eventually convicted and jailed along with three others, who also received custodial sentences, totalling 21 years altogether. Revenue losses after seizures were in excess of £29 million. Confiscation orders were awarded by the court totalling £476,000.

alcohol, 6.6 per cent of the total revenue collected by the Department. Known alcohol duty losses from diversion between 1993-94 and 1999-00 represent some 1.4 per cent of the total revenue from alcohol duty over that period.

### In response to the weaknesses, Customs tightened the controls and the level of alcohol diversion fraud fell significantly after 1997-98

1.21 The National Audit Office issued a report to Customs in July 1996 on controlling excise and inland Customs traders. The report highlighted the risks to the revenue from Customs' approach to handling traders and excise warehouses. A Customs Internal Audit Report of April 1996 highlighted the weaknesses in the movement system and the increased numbers of fraud cases. In response to the Internal Audit Report, Customs took action to strengthen controls and to tighten up the weaknesses in the system and the level of alcohol diversion fraud fell significantly after 1997-98 (see [Figure 4](#)). Examples of the measures taken include:

- targeting consignments diverted onto the home market in order to disrupt fraudulent activities;
- encouraging warehousekeepers to obtain guarantees from the owners of the goods or hauliers;
- requiring warehousekeepers and the owners of goods to be registered;
- taking part in an European Union wide Early Warning System for certain consignments of spirits and cigarettes from warehouses.

1.19 By 1995, Customs' National Investigation Service recognised and quantified the emerging scale of diversion fraud, mainly through uncovering and investigating large fraud cases. The first investigation of UK diversion fraud was Operation Fluke in August 1995. Fraudsters in this case evaded revenue worth £19 million. In view of the seriousness of the trends in diversion fraud, a briefing was given to the Customs Chairman in December 1995. In the event, the level of revenue evasion resulting from alcohol diversion fraud grew rapidly from 1995-96 ([Figure 4](#)). Some £350 million of the losses (nearly 40 per cent of the total) occurred at one warehouse.

1.20 Although large in themselves, the level of known losses from diversion fraud represent a small proportion of total revenue from alcohol duty. In 2000-01 HM Customs and Excise collected £6.7 billion from duty on

#### 4 The level of revenue evaded from alcohol diversion fraud grew rapidly from 1995-96

Amounts in £ million	93/4	94/5	95/6	96/7	97/8	98/9	99/00	Total
Revenue evaded due to excise diversion onto UK markets	0.2	9.3	85.0	208.5	339.0	12.6	13.4	668.0
<i>Cumulative total revenue evaded each year</i>	<i>0.2</i>	<i>9.5</i>	<i>94.5</i>	<i>303.0</i>	<i>642.0</i>	<i>654.6</i>	<i>668.0</i>	
Revenue evaded due to excise diversion onto overseas markets <sup>1</sup>		37.0	52.7	126.3				216.0
<b>Total losses each year</b>	<b>0.2</b>	<b>46.3</b>	<b>137.7</b>	<b>334.8</b>	<b>339.0</b>	<b>12.6</b>	<b>13.4</b>	<b>884.0<sup>2</sup></b>

- Notes:
1. Under European Union regulations, duty losses from excise goods diverted onto overseas markets must be accounted for in the country where the excise warehouse from which the goods were diverted is located.
  2. An analysis of identified revenue evaded by financial year was previously published in the C&AG's Report "Appropriation Accounts 1999 - 2000, Volume 16: Class XVI, Departments of the Chancellor of the Exchequer: HM Customs and Excise" (HC 25-XVI) in February 2001 using the most up to date information available at the time. That information has since been analysed further by the Department and the results above provide a revised allocation of the revenue evaded in the different years.

Source: Customs & Excise

- 1.22 From 1996-97 Customs staff in the newly-formed regional offices working in IMPEX (Import/Export) teams targeted consignments diverted onto the home market. They sought to disrupt these fraudulent activities. In 1997 Customs were allocated 130 staff years to be used in IMPEX teams under the last Government's Spend to Save initiative. The teams were responsible for identifying cases where duty had not been paid on goods and tracing them back to the originating warehouse.
- 1.23 In 1997 Ministers commissioned a review to look at the effect of alcohol and tobacco fraud, smuggling and cross-border shopping on the Exchequer and on industry revenue. The terms of reference for the review are set out [below](#).

The terms of reference for the **Alcohol and Tobacco Fraud Review** were:

To conduct a review which looks at the effect on the Exchequer and on industry revenue of alcohol and tobacco fraud, smuggling and cross-border shopping, also looking at health and law and order issues in relation to these activities, with a view to presenting options to Ministers for addressing these issues, in partnership with industry, by 31st December 1997. This will be achieved by:

- identifying the direct and indirect effects, including health, law and order and competition law, of commercial fraud, smuggling and cross-border shopping;
- assessing the contribution to these issues of a wide range of factors such as the relaxation of border controls as a result of the Single Market; pricing structures; tax rates; transport costs; marketing; changing consumer tastes and competition law;
- identifying and costing possible measures to address these issues.

- 1.24 The report of the Alcohol and Tobacco Fraud Review in July 1998 made 90 recommendations. 31 related primarily to diversion fraud (Appendix B) and Customs state they have implemented 18 of these (although six require further action by the European Union pending computerisation). In particular:

- Customs made it clear to warehousekeepers that it was in their commercial interests to protect themselves from being liable for the duty by ensuring that goods where the duty had not been paid were moved under guarantees provided by the owners of the goods or hauliers;
- Since 1999 Customs have required warehousekeepers and the owners of goods held in the warehouse or their representatives to be registered with them.

- Since April 2000 an European Union-wide Early Warning System has operated for certain consignments of spirits and cigarettes from warehouses (consignments exceeding: 2,000 litres of pure alcohol; 1,200 litres of spirits, liqueurs and other spirituous beverages; or 500,000 cigarettes). The UK, France, Belgium, Italy, Sweden and the Netherlands operate the System. Up to 24 hours before, and not later than the time of despatch, warehousekeepers send their customs authority a copy of the Accompanying Administrative Document for consignments which meet certain risk criteria. Some of these consignments are then referred to the customs authority in the importing member state. However, not all member states are taking part in the scheme, and not all of those involved in it respond to the requests for information.

- 1.25 Further work is needed to fully implement 11 of the remaining 13 recommendations (Appendix B). Seven relate primarily to reforms to the European Union-wide System for the Exchange of Excise Data (which stores the names of approved warehouses), recording of vehicle registration numbers, unique numbering of Accompanying Administrative Documents, marking of products and measures aimed at wholesale and cash and carry outlets. Customs consider that two recommendations are unlikely to be implemented at present. The recommendation on imposing consistent and appropriate penalties for non-compliance across the European Union is unlikely to secure the agreement of all Member States (Appendix B, Recommendation 13). And the use of electronic intelligence packaging for alcoholic products is not commercially viable at the current time (Appendix B, Recommendation 29).

## Concerns about Customs' handling of the evasion of alcohol duty led to an independent enquiry

- 1.26 In 2000, Customs' Chairman commissioned an internal review of the handling of the alcohol duty losses. The review identified the serious weaknesses in the Department's control of excise duty collection, in particular the mechanisms for releasing dutiable spirits and wine from excise warehouses. The review concluded that there had been significant revenue losses, principally in the three years after 1995.

- 1.27 Customs' Chairman reported the results of the review to the Paymaster General, Dawn Primarolo, in June 2000. Following this, the Paymaster General commissioned an independent investigation, headed by John Roques, an ex senior partner of Deloitte and Touche, to look into the matter. Mr Roques presented his report to Ministers on 15 December 2000. It contained 65 recommendations to improve controls and the way that fraud is tackled in Customs.

## Customs have taken or now plan fresh action in response to the Roques report

1.28 Customs intend to take further action to tighten controls in response to the Roques report. Of the 65 recommendations in the report, 21 relate to how the frauds were undertaken. The key recommendations and actions Customs are taking forward include:

- taking a more rigorous approach to the approval of warehouses who can hold excise goods where the duty has not been paid, and further tightening the registration procedures for warehousekeepers and the owners of goods, through clearer instructions on approval criteria, revoking approvals where approval conditions are not complied with, revised timescales for processing applications and maintaining local input to authorisation procedures (Appendix C, Recommendations 1 to 5);
  - improving the information available to Customs on the holding and movement of consignments of excise goods where the duty has not been paid which will enable them to analyse trends and patterns generally and at individual warehouses. Customs are also looking to improve the exchange of information with other European Union Member States. This involves computerising the exchange of Accompanying Administrative Documents between them. Each Member State is required to develop their own national system. The Roques report was concerned that some of this work could take at least five years to implement and suggested ways in which progress could be made more quickly such as entering a partnership with other Member States to develop a core solution (Appendix C, Recommendations 8 and 13);
  - increasing resources allocated to checking on whether warehousekeepers are complying with the requirements on the holding and movements of excise goods (Appendix C, Recommendations 20 to 22);
  - considering ways in which they can bring hauliers under tighter control. Customs do not currently have a means of authorising hauliers even though they can provide guarantees for the movement of excise goods. However, registration of hauliers, will not, on its own, be sufficient. Customs plan to make fraudsters more identifiable and accountable by making the providers of guarantees liable for the duty on the goods if they go astray, introducing a database to record the traders, including hauliers, who provide guarantees, and encouraging warehousekeepers to use their own guarantee only when they are certain about a load (Appendix C, Recommendation 25);
  - looking into whether it is cost effective to introduce fiscal marks on alcohol so that it is easier to identify illicit goods diverted onto the home market (Appendix C, Recommendation 27); and
  - raising the profile of excise diversion fraud and ensuring that assurance staff and managers reintroduce physical checks at all excise warehouses. Staff have also been instructed to issue assessments in all instances where irregularities result in underpayments of duty. Failure to pay assessments will result in the calling in of guarantees. Stricter guidance has been issued regarding the acceptance of alternative evidence for undischarged movements (Appendix C, Recommendation 7).
- 1.29 Because of the scope for fraud and the large amounts of revenue at stake, the Roques report also looked at whether the arrangements for holding and moving without the payment of duty should be withdrawn. The Report concluded that to do so would be harmful to the trade because of the extra costs it would impose on businesses.
- 1.30 In total, Customs have accepted in full 13 of the 21 recommendations relating to improving the holding and movement system, and for a further five a modified approach has been adopted. Two recommendations, on the requirement for warehousekeepers to give prior notification of movements (Recommendation 8) and tax stamps for spirits (Recommendation 27), are still under consideration. One recommendation cannot be implemented, since doing so would contravene European law (Appendix C, Recommendation 15). This recommended that Customs assess warehousekeepers for duty on undischarged Accompanying Administrative Documents in all cases where they are unable to recover it from the guarantor (where this is different). The recommendations, and Customs' response, are listed in Appendix C.

# Part 2

## How Customs investigated the frauds and the action taken or planned to strengthen controls over future investigations

2.1 This part of our report looks at the National Investigation Service's investigation of the frauds and Customs' success in recovering the revenue lost.

### The National Investigation Service investigated a series of frauds and took effective action in many cases, leading to prosecutions and recoveries

2.2 The National Investigation Service was at the forefront of Customs' response to alcohol diversion fraud, mainly through uncovering and investigating large fraud cases. The first investigation of UK diversion fraud was Operation Fluke in August 1995, where criminals evaded revenue worth £19 million. Between 1995 and 1998 the National Investigation Service dealt with a total of 72 cases of outward excise diversion fraud. Customs staff in regional offices investigated a further 58 cases. Over 100 successful prosecutions have been made with a total of some 200 years in sentences passed on those involved in the frauds and the Courts have confiscated around £23 million. There are a further eight cases before the Courts, excluding appeals. Three operations and their outcomes are described [overleaf](#), illustrating the different types of cases investigated.

### The methods used by the National Investigation Service carried the risk that revenue would be lost

2.3 A key approach of the National Investigation Service to tackle diversion frauds was to identify the principals behind the fraud and collect sufficient evidence to secure their conviction. This was the policy adopted between 1995 and 1998. The main method of achieving this was identifying suspect consignments and allowing fraudsters to move goods from excise warehouses whilst under observation (known as "letting loads run"). Selected consignments would be followed and when enough evidence was obtained the perpetrators would be arrested. The Roques report concluded that "letting loads run" was necessary in individual cases to ensure that sufficient evidence could be assembled to mount a

successful prosecution. However, an unavoidable consequence of this method was that unrecoverable arrears of duty could build up during the course of the investigation. In some cases, once the fraudulent activity had been stopped, the National Investigation Service conducted retrospective investigations and identified further instances where goods had been diverted and duty evaded.

2.4 However, at the time the alcohol diversion frauds were occurring, Customs did not assess whether their policy of identifying suspect consignments and allowing fraudsters to move goods from excise warehouses under observation ("letting loads run") was a more effective way of tackling the frauds than disruption. "Letting loads run" inevitably leads to the build up of arrears of duty, with the intended objective of protecting the revenue by convicting fraudsters and recovering losses. The main alternative is to disrupt fraudulent activity as it is discovered, which protects potential revenue loss but is less likely to lead to conviction of the perpetrators.

2.5 Customs' Internal Audit have attempted to distinguish between the losses which arose during the course of investigations, where cases were "allowed to run", and losses which came to light as a result of a retrospective investigation after a case had been "knocked". They were unable to do so due to the lack of detailed information available, but one estimate was that assessments had not been made on 59 per cent (£397 million) of total identified losses.

2.6 Even with the benefit of hindsight, it is difficult to determine whether a policy of greater disruption of alcohol diversion frauds between 1995 and 1998 would have led to a lower level of revenue losses. Customs investigators at the time found that where suspect consignments were intercepted at an early stage to disrupt fraudulent operations, fraudsters just moved to another warehouse to commit further frauds. And if a consignment under surveillance was stored for a period within the time limits for export, Customs did not have any legal power to disrupt the activity.

## Case studies of excise diversion fraud investigations

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### Operation A

This fraud was discovered when a Spanish excise warehouse denied receiving goods exported from a UK warehouse under duty suspension using Accompanying Administrative Documents. These documents had been returned to the UK warehouse certified with a false Spanish Customs stamp. This case also involved one of the principals in not only the excise duty fraud but also another fraud on the VAT input tax on the sales of the duty free goods through six fraudulent UK registered shell companies, which was investigated separately. This principal was convicted of the VAT offences and sentenced to six years and received a concurrent sentence for the excise offences. A co-defendant was sentenced to three and a half years for excise fraud and a confiscation order for £583,000 was awarded against him. The loss to the revenue was £5.5 million net of the confiscation order and a separate amount of VAT of £4.5 million which is still being pursued.

### Operation B

This operation involved both inward and outward diversion of duty free spirits. Loads were allowed to leave UK excise warehouses for export but within a short time the goods were being off-loaded to cash and carry outlets in this country. Front companies were used to facilitate the fraud with new front companies set up while the fraud continued. The investigation lasted nearly a year as the officers were hampered by the complexity of the fraud and by the difficulties they encountered in obtaining crucial evidence in France. In the end over 600 officers were deployed to "knock" the case and a total of 13 defendants were convicted for conspiracy to cheat the revenue, receiving sentences ranging from ten years to 16 months. The loss to the revenue was £33.7 million excise duty and VAT for both inward and outward frauds, net of confiscation orders of £0.74million.

### Operation C

This was an outward diversion fraud during 1997 when 107 consignments of spirits and beer were removed from a UK excise warehouse destined for Barcelona and travelling under Accompanying Administrative Documents. The documentation was returned to the warehouse certified with false Spanish Customs stamps. Although some of the loads were seized, the net revenue loss was over £8 million. There was a cigarette smuggling aspect of the case for which there was no revenue loss. Three convictions were achieved for this last aspect only, with sentences totalling six years and seven months being handed down. The indictments for the alcohol diversions were not proceeded with on legal advice and remain on file.



## Authorisation to "let loads run" was not taken at an appropriate level

2.7 In 1996 senior staff in Customs became concerned at the conduct of the investigations because of the high level of revenue losses. But it was not until 1998 that Customs took action to bring outstanding investigations to a conclusion. In 1999 Customs introduced a system of authorisation levels within the National Investigation Service to ensure that decisions were taken by an appropriately senior person before consignments of diverted or smuggled goods were allowed to proceed without interception. Thus the Chief Investigation Officer, who headed the National Investigation Service, was required to authorise all cases where the extent of fraud was likely to be over £1 million, with approval at Director-level (i.e. a Board Member) required where losses were likely to be over £3 million. The Roques report recommended that the level at which Director approval was required to put revenue at risk was reduced to the level at which Director approval was required to write-off or remit debts, (i.e. £1 million) (Appendix C, Recommendation 29). This recommendation has been implemented and should reinforce the need to consider significant operational decisions at the strategic (i.e. Board) level.

2.8 The co-operation of warehousekeepers with Customs' investigators, both in alerting them to possible fraudulent consignments and in letting consignments leave the warehouse under surveillance, was an essential part of "letting loads run". However, because they could have become liable for duty on these consignments, some of these warehousekeepers were given either explicit or implicit indemnities, meaning that they would have no liability for the duty evaded in those cases where the liability would properly have fallen to them. It is estimated that, in total, warehousekeepers were indemnified for 53 per cent (£355 million) of the £668 million revenue evaded through diversion on to the UK market. The indemnities meant that warehousekeepers had no liability for the duty evaded. In some cases, the indemnities were written, but most were verbal or implied. At the time they were given, Customs did not have a clear policy on the use of indemnities. From 1999, however, any proposal to indemnify a warehousekeeper had to be approved by senior policy staff in Customs. And Customs issued guidance to staff in April 2000 on the circumstances in which indemnities could be provided to traders.

## Customs did not raise assessments against the fraudsters for the duty lost

2.9 In a large number of investigations, Customs did not issue assessments against the fraudsters for the duty lost. It is estimated that assessments were not made on 59 per cent (£397 million) of the total identified losses (£668 million) caused by fraudulent diversion on to the UK market. As a consequence, Customs did not note the extent and circumstances of the losses in their accounts until 2001, a considerable time after the losses occurred. The Roques report recommended that guidance be issued to staff on procedures for raising assessments to safeguard revenue (Recommendation 14, Appendix C).

## Customs have had limited success in recovering the revenue lost

2.10 Customs recovered some £48 million of the total revenue evaded. The identified revenue evaded and the subsequent recoveries are set out in [Figure 5](#).

### 5 The total identified revenue evaded and subsequent recoveries

	Excise Duty £m	VAT (estimated) <sup>1</sup> £m	Total £m
National Investigation Service Cases	516	95	611
Regional Office cases	49	8	57
<b>Total revenue evaded</b>	<b>565</b>	<b>103</b>	<b>668<sup>2</sup></b>
Recoveries	Confiscation £m	Cash £m	Total £m
Amount recovered	25	23	48
<b>Net losses</b>			<b>620</b>
Revenue evaded due to excise diversion onto overseas markets			216
<b>Net losses</b>			<b>836</b>

- Notes:
1. This is an estimate of the VAT evaded. This is because goods may have been sold to consumers and VAT may have been charged and paid over to Customs by the retailer who purchased the diverted goods either knowingly or unknowingly from the fraudster.
  2. This figure includes two cases of £179 million and £37million which arose from diversion onto overseas markets where duty would have been due in the country of import had the goods not been fraudulently diverted.

- 2.11 Customs found it difficult to recover the amounts due partly because of the indemnities provided to some warehousekeepers, and partly because assessments were not raised against some warehousekeepers due to considerations of equity (for example, where they had not been directly involved in the fraud). The amounts evaded far exceeded the guarantees provided by warehousekeepers, which, as noted in paragraph 1.15 above, were not intended to underwrite revenue lost through organised diversion fraud.
- 2.12 In 1998 Customs carried out a review of the relevant legislation governing their ability to assess fraudsters (the Excise Goods (Holding, Movement, Warehousing and REDS) Regulations 1992). The review identified a number of deficiencies with the way that the European Directive had been implemented into United Kingdom legislation. The deficiencies included that the 1992 Regulations made it impossible to assess fraudsters (mainly the owners or transporters of goods) for arrears of duty without also assessing the warehousekeeper, who under the legislation was jointly and severally liable for the lost revenue. In cases where the warehousekeeper had been indemnified, therefore, it was not possible to raise assessments. Customs have recognised that the regulations need to be amended to address the weakness and aim to put new legislation in place by March 2002.

### Customs have accepted all of Roques's recommendations on investigations

- 2.13 Customs have accepted all of the five recommendations made by Roques on investigations (Appendix C). Three have already been implemented and two more are due for implementation by March 2002.

# Part 3

## The steps taken or planned by Customs to strengthen their general approach to tackling diversion fraud

### 3.1 This Part of our report looks at:

- How Customs' have adjusted their management structure to the excise diversion frauds (paragraphs 3.2 - 3.3);
- Customs' estimates of the receipts from duties and the level of fraud (paragraphs 3.4 - 3.9);
- Other areas that may be at risk from fraud on alcohol duty (paragraph 3.10);
- Improvements needed to Customs' financial information systems (paragraphs 3.11 - 3.12); and
- Improvements needed to Customs' intelligence information systems (paragraphs 3.13 - 3.14).

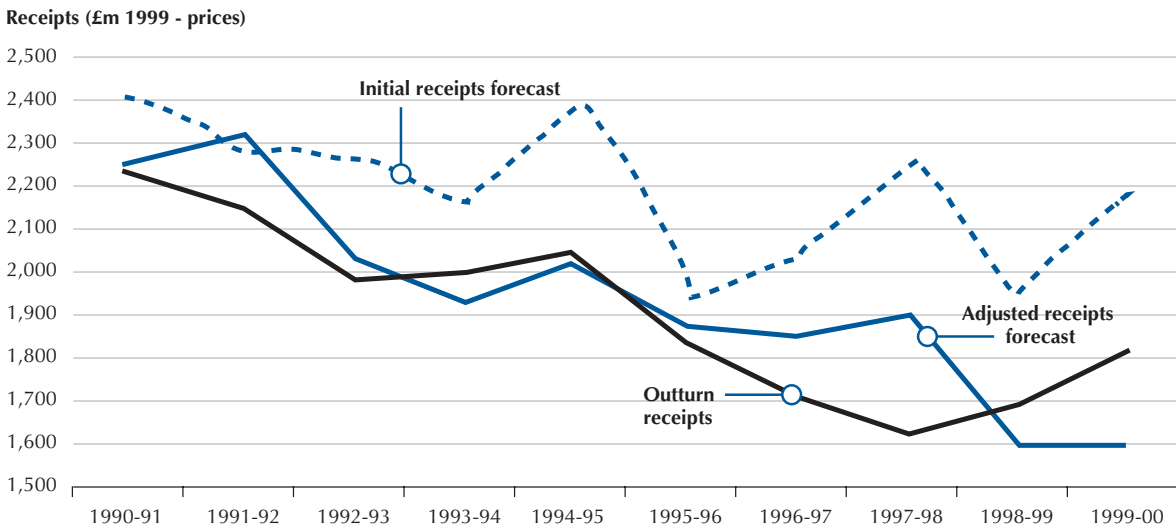
### How Customs' have adjusted their management structure to the excise diversion frauds

- 3.2 The Roques report recommended that there should be a clearer management structure to clarify lines of responsibility, and that there should be a revised remit for the Board to reinforce its responsibilities in respect of the collection of duties and the enforcement of the relevant tax regimes (Appendix C, Recommendations 40 and 41).
- 3.3 In April 2001 Customs was reorganised into two core units, Business Services and Taxes and Law Enforcement (Appendix E). The regional management structure (Collections) was subsumed into these units, which is supported by four central functions (Finance, Legal, Logistics and Human Resources). The changes were intended to create greater clarity and focus around Customs' core activities and these changes should address these recommendations. Customs Board adopted a revised statement of its role and objectives in July 2001.

### Customs' estimates of the receipts from duties and level of fraud

- 3.4 Customs publish revenue forecasts of all taxes and duties collected by the Department twice a year. The forecast for alcohol duty is based on the previous level of receipts plus an estimate of the likely change in receipts based on consumption patterns and other factors, such as any change in duty rates. The forecast does not derive from, or attempt to assess, what could be collected if there was no fraud. Though Customs have now estimated "leakage" - the level of loss from alcohol duty fraud and smuggling - the information available at the time of the frauds was insufficient to enable them to monitor accurately either their performance in collecting the revenue or their success or failure at tackling the problem of fraud. Receipts forecasts for alcohol duty from 1990-91 are shown in [Figure 6](#).
- 3.5 Inadequate information at the time of the frauds meant that Customs considered that the falling receipts from spirits duty (Figure 6) indicated a fall in consumption. The possibility that an external factor such as fraud might be having an impact on the outturn was discounted as an explanation despite evidence from elsewhere within Customs which suggested otherwise. Customs considered the estimates of the revenue evaded were not robust enough to provide a reliable indicator of the scale of fraud.
- 3.6 Customs have reviewed the threats to the revenue from alcohol duty and concluded that the current risk to the revenue is from inward diversion fraud and the smuggling of alcohol. Their estimates suggest that in 1999-00 alcohol fraud cost some £800 million in lost revenue including excise duty and VAT ([Figure 7](#)). The lost revenue represented 7 per cent of the total tax receipts actually collected from alcohol, mainly through alcohol being imported into the UK without the payment of duty. Customs are working on estimates of the level of fraud on VAT and hydrocarbon oils duty.

**6 Customs attributed the reduction in spirits duty receipts from 1994-95 to falling consumption rather than fraud**



Note: "Initial receipts forecast" represents outturn receipts together with a forecast of receipts generated by a model. "Adjusted receipts forecast" represents the final published forecast, which adds the manual adjustments to the initial receipts forecast.

**7 Shows that the level of revenue loss from alcohol duty fraud in 1999-00 was highest on spirits**

	Revenue Collected £m <sup>1</sup>	Estimated fraud £m	Percentage £m %
Spirits	2,800	500	18
Beer	5,600	200	4
Wine	2,900	100	3

Note: 1. "Revenue collected" represents duty and VAT collected in 1999-00.

Source: Customs & Excise

Customs officers operating in the tourist lanes at principal Channel crossing points has been increased by about two thirds.

3.9 In response Customs have devised an operational plan to counter the frauds on alcohol, particularly those on spirits. The plan proposes that Customs staff should intervene more often to disrupt the flow of illicit goods and the means of transporting them. They intend that this approach will increase Customs' detection rate from its current levels. Customs are currently looking at the costs of implementing a full scale strategy and its likely effectiveness at reducing the level of fraud.

3.7 A key message of the Roques report was the need for the revenue forecasting process to incorporate estimates of leakage, as an aid to the timely detection of problems affecting revenue streams. Roques also believed that such estimates needed to be published to help ensure that sufficient resources were allocated to countering the incidence of fraud.

3.8 The Roques report concluded that disruption methods being used successfully in the Tobacco Strategy needed to be extended to tackle the frauds on alcohol duty. For example the new x-ray machines at ports could assist Customs in detecting smuggled alcohol as well as tobacco products. But the Roques report noted that at Dover there was too little space to carry out interceptions and that this needed to be addressed urgently by Customs and that additional staff may also be needed (Appendix C, Recommendation 23). Customs have implemented this recommendation. The number of

**Other areas that may be at risk from fraud on alcohol duty**

3.10 As Customs toughen up on well established fraud methods, determined fraudsters will move on to test other aspects of the system. Other areas where alcohol duty may therefore be at risk from fraud include the occasional importer scheme and REDS (the system for Registered Excise Dealers and Shippers). Under the REDS system, traders are registered with Customs to obtain excise goods commercially under duty suspension arrangements from other European Union countries. REDS traders must account for the duty when the goods are received in the UK. The Roques report recommended that Customs should carry out a full analysis of the risks in these two areas (Appendix C, Recommendations 16 and 18). In response, Customs are examining how relevant controls can be tightened up and intend to have consequential changes to the system in place by March 2002.

## The improvements needed to Customs financial information systems

- 3.11 The Roques report concluded that Customs' had limited management information on revenues and that there was insufficient information on trends in the leakage of revenue lost to fraud. The Report also concluded that costs were actively managed and controlled. Customs' Finance and Planning Division has responsibility for monitoring expenditure and budgets on costs. In April 2001, the Principal Finance Officer took over responsibility for monitoring revenues from tax raising business directors, adding this to his responsibility for monitoring and reporting expenditure and costs.
- 3.12 The Roques report found that there were a number of qualified accountants within the Customs' Divisions dealing with revenues and expenditure, but a lack of professional accounting experience at a suitably senior level which had contributed to the limited management information available. The report therefore recommended that Customs should recruit a qualified accountant for the role of Finance Director, with responsibility over all financial areas (Appendix C, Recommendation 55). Customs' Principal Finance Officer now has responsibility for revenue as well as for expenditure. He is supported by a newly appointed Accounting Adviser who has had Finance Director experience in the private sector and who advises on analysis of and accounting for revenue and on control and stewardship of costs. Roques also recommended that Accounting Services Division, Analysis Division and the Finance Division should be merged (Appendix C, Recommendation 56). These divisions have now been brought together under the Principal Finance Officer in the Finance and Strategy Directorate.

## The improvements needed to Customs intelligence information systems

- 3.13 Staff at ports and airports have the best chance of identifying and stopping the illegal importation of duty suspended alcohol which is to be diverted to home use. But they need to make good use of intelligence to stop illegal consignments. Operational teams take account of commercial information, such as manifest details, and intelligence from sources such as other member states (e.g. about suspect consignments of hauliers), Investigation, Central Intelligence or local intelligence teams. However, this collation and evaluation work is generally done manually. Roques recommended that Customs urgently reviewed the current information technology for intelligence purposes at ports to better facilitate the work of front-line officers (Appendix C, Recommendation 64). The Department are promoting the use of electronic knowledge management in all work streams, including intelligence. A pilot is being run in knowledge management within Law Enforcement. In addition, Customs plan to complete a review of the current information technology for intelligence purposes by autumn 2001.
- 3.14 If front-line staff had the use of an expert system to automatically assess manifest information against criteria for a suspect consignment, it could free up time for officers to identify other criteria through risk testing and this could improve results. Roques recommended that Customs should examine the potential benefits of expert systems (Appendix C, Recommendation 65). The Department consider that there may be scope for use of expert systems, particularly in intelligence areas. The Department plan to commission an external review of expert systems once the new information technology infrastructure is in place in October 2001.



# Appendix A

Comments by the Committee of Public Accounts and the National Audit Office on diversion fraud and the effect of the Single European Market, and Departmental responses

## Findings and recommendations of the Committee of Public Accounts and the Comptroller and Auditor General

## Treasury Minute response

### ON THE 1992-93 ACCOUNTS

Committee of Public Accounts 19th Report 1993-94, "HM Customs and Excise: Account Matters", APRIL 1994  
The Committee's Report was based on the Comptroller and Auditor General's Report, Appropriation Accounts (Volume 12: Classes XVIII to XX), 1992-93, HC 11-XII, 1993-94, DECEMBER 1993

#### Key points from the Committee's Report were:

36. The Department told us that there was no sign yet of increased fraud as a result of the new Single Market arrangements. However, they recognised that the Single Market changes had given rise to new risks of fraud and that there would be people eager to exploit these opportunities. They were watching out very carefully to try to stop them.
39. We note that the Department have not so far detected any sign of increased fraud as a result of the new Single Market arrangements. But we urge them to remain vigilant in the face of the acknowledged risks. We are concerned at the amount of illegal cross-border trading in excise goods and support the Department's determination to stamp this out.

47. The Department is watching very carefully for new types of fraud arising as a result of the Single Market. The Department is committed to the fight against fraud and is working towards ever more effective strategies, both domestically and in the Union. This includes developing a European anti-fraud strategy and supporting the Commission's anti-fraud strategy work programme, which closely reflects the UK practice of concentration on high risk sectors and audit based controls.

*Treasury Minute on the 19th Report from the Committee of Public Accounts 1993-94, CM 2602, June 1994*

## Findings and recommendations of the Committee of Public Accounts and the Comptroller and Auditor General

## Treasury Minute response

### ON THE 1993-94 ACCOUNTS

Committee of Public Accounts 20th Report 1994-95, "HM Customs and Excise: Appropriation Accounts 1993-94", MAY 1995  
The Committee's Report was based on the Comptroller and Auditor General's Report, Appropriation Accounts (Volume 12: Classes XVII to XIX), 1993-94, HC 100-XII 1994-95, FEBRUARY 1995

#### Key points from the Committee's Report were:

18. We reiterate the support we gave last year for the Department's determination to counter bootlegging. We note the modest increase in resources devoted to this task and the changes in hand to increase effectiveness. We look to the Department to keep the situation on bootlegging under careful review and to take further steps as necessary to keep on top of this problem.
20. In 1994 the Department undertook a fundamental expenditure review of all their activities. The aim was to achieve better value for money, to improve the service provided and to reduce burdens on business. The Department said that, as a result of the review, they would be focusing their efforts on the most complex areas of their work where the risks were highest. They would be doing less routine work where the risks were low.

41. The Department welcomes the Committee's support. The situation is under constant review and such steps as necessary, including for example the redeployment of staff to areas of particular risk, are and will continue to be taken as appropriate.
43. The Department notes the Committee's comments. Action has been taken to begin the shift of Departmental effort to areas of work with greater risk and complexity, and good progress is being made in developing an evaluation framework. The framework will comprise a range of measures which will enable the Department to track operational effectiveness and monitor the

Findings and recommendations of the Committee of Public Accounts and the Comptroller and Auditor General	Treasury Minute response
<p>21. The Department told us that full implementation of the review would lead over five years to a reduction in staff of 4,000, some 16 per cent of staff currently in post. The changes were expected to generate savings totalling £182 million over the five-year period, with further annual savings thereafter. The staff reductions were to be implemented in phases and the Department intended to review the effects of the first phase before proceeding further. They would not rule out reversing the first tranche of cuts if these were found to be damaging. But they thought it unlikely that this would be necessary.</p> <p>35. We note that, following their fundamental expenditure review, the Department will be refocusing their efforts on the most complex areas of their work where the risks are highest. If fully implemented, the review is expected to lead, over the next five years, to a reduction of 4,000 staff and savings of £182 million. We endorse the Department's intention to monitor the impact of the first phase of this strategy very closely before proceeding further.</p>	<p>impact of the first phase of the strategy very closely. It will inform the decision whether to proceed further with certain aspects of the Change Programme implementing the Fundamental Expenditure Review strategy.</p> <p><i>Treasury Minute on the 20th Report from the Committee of Public Accounts 1994-95, CM 2990, October 1995</i></p>
Findings and recommendations of the Committee of Public Accounts and the Comptroller and Auditor General	Treasury Minute response
<p><b>ON THE 1994-95 ACCOUNTS</b></p> <p>Committee of Public Accounts, 35th Report 1995-96, "Appropriation Accounts 1994-95, Class XVII, Vote 4 HM Customs and Excise: Account Matters", AUGUST 1996</p> <p>The Committee's Report was based on the Comptroller and Auditor General's Report, Appropriation Accounts (Volume 12: Classes XVII to XIXB), 1994-95, HC 15-XII 1995-96, JANUARY 1996</p>	
<p><i>Key points from the Committee's Report were:</i></p> <p>5. The Department confirmed that there is no general agreement about the level of excise smuggling, and that they place no reliance on earlier estimates of the impact on the level of duty. The Department accepted the need to measure the extent of the problem, but emphasised that, by its nature, measuring illegal activity is extremely difficult.</p> <p>6. The Department pointed out that, apart from handrolling tobacco where there was a very serious problem, it was very difficult to discern any effect of smuggling on the overall level of excise duty receipts. They told us that commercial fraud was a greater concern in terms of lost revenue. This involved misusing documentation to avoid duty on the commercial movement of goods, rather than abusing the arrangements for personal importation of such goods. The Committee received confirmation of this concern from the European Court of Auditors during discussions in the course of its recent visit to the Court.</p> <p>7. The revenue value of seized goods has continued to increase. The figure for 1994-95 was £6 million, three times that for the previous fiscal year. The Department confirmed that the figure for resources devoted to excise verification work were equivalent to 239 staff years in 1994-95, which had been increased to 251 staff years for 1995-96. Furthermore, 20 extra staff were deployed at Dover in the three months running up to Christmas 1995 and will be employed there on a more permanent basis in 1996-97.</p> <p>8. The Department said that their deployment of resources was not affected by the lack of an estimate of the level of excise smuggling. They informed us that resources deployed were more than would be justified simply on the basis of the effect on revenue and that, for the same cost, they could</p>	<p>40. HM Customs and Excise (the Department) notes the Committee's comments and last month published estimates of the extent of smuggling of alcoholic drinks and tobacco products from other EU countries. These estimates took account of discussions with representatives from, and analyses produced by both the alcohol and tobacco industries.</p> <p>41. The Department notes the Committee's comments. The Department published estimates last month, and will continue to monitor the position carefully. The resource deployed on Single Market related excise work has, during 1996, been further increased by an additional 25 staff allocated to Dover bringing the total resource to 296.</p> <p>42. The Department agrees with the Committee's recommendation. As the Committee is aware, the Department has formed an 'Excise Alliance' with the various associations representing those involved in the production, storage haulage and sale of alcohol and tobacco including the British Vehicle Rental and Leasing Association. The Alliance provides for a combined effort in countering fraud by exchanging high-level</p>

## Findings and recommendations of the Committee of Public Accounts and the Comptroller and Auditor General

## Treasury Minute response

undoubtedly get a better yield from other activities. However, they emphasised that this was not just a matter of revenue protection; they had wider responsibilities to provide a deterrent and to protect legitimate trade from being undercut.

16. We note that a joint working group of the Department and the alcoholic drinks industry had estimated that the level of legitimate cross-border shopping in alcoholic goods represents between three and five per cent of the domestic market. It is, of course, more difficult to measure levels of illegitimate business but we consider the Department need to do more to arrive at reasonable estimates of revenue losses from the evasion of duties.
17. We note that resources devoted to excise verification work increased from 239 staff years in 1994-95 to 251 in 1995-96, and that 20 additional staff were to be deployed on a permanent basis at Dover in 1996-97. We note also that the revenue value of seized goods increased threefold, to £6 million in 1994-95. We are however concerned that, in the absence of usable estimates of revenue losses, the Department are unable to determine whether the increased level of seizures reflects greater success or a worsening of the problem.
18. We recommend that the Department give a high priority to working with the licensed trade and the vehicle hire trade in order to enhance their ability to detect and deter excise smuggling and deploy their resources according to the pattern of risk.
20. We share the Department's concern that both excise revenue and legitimate trade are being placed at risk by commercial fraud involving the misuse of the documentation for excisable goods. We look to the Department to seek improved intelligence in this area, and to adopt appropriate counter measures in co-operation with other European agencies.
39. We asked the Department if they had made any assessment of how much additional revenue they might have been able to raise using the greater efficiency predicted by the reviews, without reducing staff numbers. The Department told us that they had not made this calculation, and that Ministers were satisfied that what they were proposing to do should achieve a more effective and efficient deployment of staff such that the revenue should not suffer. If that judgement turned out to be incorrect then they would wish to think again.
45. We note that the projected staff reductions of 4,188 arising from the Department's Fundamental Expenditure Reviews were approved by Ministers on the basis that revenue yield would be maintained. We urge that, before further phases of staff reductions take place, the Department should be satisfied that this objective is being achieved.
46. We note that the Department are closely monitoring the impact of changes arising from these reviews, and that they have given increased priority to the gathering of intelligence through the redeployment of 200 staff to that activity. We emphasise that we would wish to see a positive impact of these changes on the effectiveness of anti-smuggling activities before the second phase of staff savings is implemented.

information and intelligence on excise smuggling and fraud. Several useful initiatives are currently under discussion.

44. The Department notes the Committee's comments and agrees that this problem requires continuing attention. The Department is continuing to seek improvements in its intelligence network which includes mutual assistance with other Member States' fiscal authorities as well as looking to the legitimate trade, and Excise Alliance, to collaborate in identifying fraud. The Department has also made representations to the European Commission who have now placed the fraud issue firmly on their agenda.
48. The Department notes the Committee's comments. Initial trials relating to this part of the Fundamental Expenditure Review are currently being evaluated. A comprehensive evaluation report of all the relevant factors will be submitted to Ministers to enable them to decide whether to move to the next phase of staff reductions planned for 1998-99.
49. The Department notes the Committee's comments. The increase of 200 posts in intelligence and investigation over the next three years will together with a unified national intelligence network, ensure that intelligence has a better focused direction and positive impact on the investigation and anti-smuggling effort in combating drugs smuggling and fiscal fraud.
50. The impact of all the changes on anti-smuggling activity will be monitored for a full year up to 31 March 1997, with the emerging picture to be advised to Ministers in the Autumn this year. At the end of the period a comprehensive evaluation report will be submitted to Ministers.

*Treasury Minute on the 35th Report 1995-96 - Appropriation Accounts 1994-95: Class XVII, Vote 4 HM Customs and Excise: Account Matters, CM 3384, October 1996*

## Findings and recommendations of the Committee of Public Accounts and the Comptroller and Auditor General

## Treasury Minute response

### ON THE 1995-96 ACCOUNTS

Committee of Public Accounts, 16th Report 1997-98, "HM Customs and Excise: Appropriation Accounts Matters 1995-96", FEBRUARY 1998

The Committee's Report was based on the Comptroller and Auditor General's Report, Appropriation Accounts (Volume 12: Classes XVII to XIX), 1995-96, HC 11-XII, 1996-97, JANUARY 1997

#### *Key points from the Committee's Report were:*

29. The Department estimated that the annual value of the revenue evaded through smuggling was £770 million. Of this £425 million was accounted for by hand-rolling tobacco. These figures did not include amounts for commercial fraud or the smuggling of commercial scale consignments.
30. The Department confirmed that hand-rolling tobacco was by far the biggest problem as it is compact, easy to conceal, of high revenue value and has a ready market. In terms of the percentage of overall revenue, the value of smuggling of other excise goods was not large. Nonetheless, the Department were not complacent about smuggling, and the deployment of excise verification officers to combat the threat was to be increased from 240 at the beginning of 1995-96 to about 330 for 1997-98. Extra staff had also been put into the Department's investigation and intelligence divisions to deal with excise fraud generally, and the Department was working closely with the trade through the Excise Alliance.
32. The Department believed that their enforcement staff had done well in tackling bootlegging as well as commercial fraud which involved some large sums. The commercial frauds involved were quite complex, however, and in the Department's view the overall impact was almost impossible to estimate.
34. We note that the Department conducted, for the first time, a survey from which they estimated the value of the revenue evaded through smuggling at £770 million per annum. We recommend that, in order to guide the deployment of excise verification officers and maximise their impact on the problem of smuggling, the Department should continue to evaluate the impact of excise smuggling, and compare it with the number and value of seizures made.

18. The Department carried out another survey in 1997. This estimated that the annual revenue (excise duty plus VAT) evaded through smuggling of excise goods was £950 million in 1997, an increase of about 5 per cent on the revised 1996 figure, broadly in line with the growth in tax revenue. The 1996 figure has been revised from £770 million to £900 million as cross channel traffic grew faster in 1996 than was previously assumed. The total amount involved represents less than 5 per cent of the estimated total UK revenue receipts from alcohol and tobacco in financial year 1996-97. The Department have recently completed a review of alcohol and tobacco fraud and smuggling, the findings of which are now with Ministers.
19. In 1996-97 the Department made approaching 7,000 detections with a total revenue value of £29.4 million and have increased the number of Excise Verification Officers to 330, principally deployed at Dover.

*Treasury Minute on the 16th Report 1997-98 - Her Majesty's Customs and Excise: Appropriation Account Matters 1995-96 , CM 3936, April 1998*

## Findings of the Comptroller and Auditor General

### ON THE 1996-97 ACCOUNTS

Comptroller and Auditor General's Report, Appropriation Accounts 1996-97 (Volume 16: Class XVI), HC 251-XVI, 1997-98, FEBRUARY 1998

*NB. The Committee of Public Accounts did not take evidence on Customs' 1996-97 Accounts*

*Key points from the Comptroller and Auditor General's Report were:*

27. In addition to their general assurance work the Department put considerable effort into pursuing cases of fraudulent evasion. The immediate operational priorities of this work are to halt as soon as possible the progress of major frauds, and secure the conviction of major offenders and the recovery of proceeds. The ultimate financial impact of each case is difficult to assess:
  - i. the amounts of money recovered from fraudsters may not become clear for a number of years;
  - ii. although the progress of a major area of fraud has been prevented, the specific recovering from individual fraudsters may be an insufficient indicator of the scale of the impact achieved; and
  - iii. the extent to which the fraud displaced legitimate activity may be hard to assess and the amount of revenue evaded may differ from the actual revenue lost.
30. Alongside the immediate operational priorities for the fraud case load the Department have wider objectives to protect the integrity of the regimes involved, and to enhance trader compliance. These wider effects may be achieved in a number of ways:
  - i. legal changes to the structure of the regime to prevent future occurrence of the problem;
  - ii. establishing that particular arrangements are an abuse and providing the basis of future rulings against such arrangements;
  - iii. increasing awareness so that in future the problem can be recognised earlier and addressed through enhanced assurance work; or
  - iv. continuing investigation and prosecution action to provide both preventive and deterrent effects against recurring forms of fraud and evasion.
35. A network of IMPEX groups was established throughout the regional organisation, bringing together formerly separate working groups concerned with export fraud and excise movement offences. To provide national co-ordination, a national steering group and a national working group have been established. Further specific targets have been set for IMPEX, including the identification of £35 million revenue evaded through illicit diversion of alcohol products and the assessment of £20 million unpaid duty in relation to Registered Excise Dealers and Shippers.

### ON THE 1997-98 ACCOUNTS

Comptroller and Auditor General's Report, Appropriation Accounts 1997-98 (Volume 16: Class XVI), HC 1-XVI, 1998-99, FEBRUARY 1999

*NB. The Committee of Public Accounts did not take evidence on Customs' 1997-98 Accounts*

*Key points from the Comptroller and Auditor General's Report were:*

67. As the majority of taxes and duties are based on trader declarations or self assessment, the Department carry out assurance work to verify that traders are complying with their legal obligations across all taxes and duties and paying the right tax at the right time. One of the major themes of the Department's fundamental expenditure review announced in 1994, and the more recent spend to save initiative, was the targeting of this work to areas of greatest risk. The Department have put considerable effort into devising and introducing changes in their assurance methods to address this objective, and their development work in this area is expected to continue over the next few years.
68. Recent developments have included the Department's response to the Comptroller and Auditor General's Report to Parliament on Checking Large Traders VAT Liability (HC368, March 1997) and the subsequent report of the Committee of Public Accounts (HC445, March 1998), and to a report the National Audit Office made to the Department in July 1996 on Controlling Excise and Inland Customs Traders. In both areas the Department have generally made good progress but at the time of the National Audit Office's examinations, there remained some procedural weaknesses in the Department's documentation and review of systems examinations.



### Findings of the Comptroller and Auditor General

100. Given that fraudulent drawback claims may be associated with increased diversion fraud, the IMPEX initiative has been expanded to cover suspect removals from warehouses. Diversion fraud occurs when goods intended for export are diverted back onto the home market without payment of UK duty and VAT. In April 1998, the Department began a programme aimed at identifying and challenging suspect removals from warehouses, which the Department had identified as a high risk area. In 1997-98, against a target of £35 million, IMPEX teams detected £181.8 million of revenue evaded by tackling the illicit diversion to home use of alcohol products. They also detected £4.7 million revenue evaded on tobacco products.

#### ON THE 1998-99 ACCOUNTS

Comptroller and Auditor General's Report, Appropriation Accounts 1998-99 (Volume 16: Class XVI), HC 11-XVI, 1999-00, FEBRUARY 2000

*NB. The Committee of Public Accounts did not take evidence on Customs' 1998-99 Accounts*

*Key points from the Comptroller and Auditor General's Report were:*

- 97 Subject to proper approval and the production of the correct documentation, traders can legitimately store and move excise goods without payment of duty. If these 'duty suspended' goods are sent for export from the UK, or to another approved UK excise warehouse, then no duty is payable. Excise duties only become payable when the goods are sent for consumption on the home market. An initiative known as IMPEX was set up in 1996-97 to address the increasing fraudulent abuse of warehousing and transit arrangements for duty suspended goods.
- 98 During 1998-99, IMPEX teams detected £243.5 million of duty evaded (£238.2 million for alcohol and £5.3 million for tobacco) against a target of £85 million. This result reflects the increase in excise smuggling, as well as the success of using risk profiling to target the IMPEX effort.
- 99 As one of a range of measures to tackle alcohol and tobacco fraud, the Department are setting up a register of owners of goods in duty suspension. Legislation has been introduced requiring all warehousekeepers and owners of goods in duty suspension to be registered on a UK database. The database is referred to as ARIES (Approvals Risk Information for the Excise System) and was completed on 1 October 1999. The system will then be developed to capture information on all movements of duty suspended goods within and out from the UK based on documentation and computer records already maintained by traders. It is expected that this further capability will be introduced in April 2000. The final step in developing this system will be to incorporate a risk analysis function so that suspicious movements can be more easily targeted. This latter function is unlikely to be ready before the end of 2000.
- 100 To assist in the identification of suspect movements of goods throughout the European Union, a commitment has been made by delegates of the member states to the Excise Committee of the European Commission to put in place an early warning system by 1 April 2000. It is intended that the system, once in place, will identify suspect shipments at their point of origin and relaying this information to a co-ordination point within the country of destination who will commission appropriate assurance activity.
- 101 The early warning system is an interim measure prior to the development of an EU-wide computer system, known as the Excise Movement Control System (EMCS), to track all duty suspended excise goods movements. The system will not be ready for a number of years. The project is currently being scoped by Alcatel on behalf of the European Commission.

#### ON THE 1999-00 ACCOUNTS

Comptroller and Auditor General's Report, Appropriation Accounts 1999-00 (Volume 16: Class XVI), HC 25-XVI, 2000-01, FEBRUARY 2001

*NB. The Committee of Public Accounts have not yet taken evidence on Customs' 1999-00 Accounts*

*Part 5 of the Comptroller and Auditor General's report examined losses to the revenue from excise duty diversion fraud (paragraphs 5.1 to 5.15). The conclusions are set out below:*

- 5.15 There has been a serious breakdown of controls within Customs which has led to a substantial loss of revenue. 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.
- 5.16 I shall report separately to Parliament on the causes and lessons learned in this case.

# Appendix B

Customs' Alcohol and Tobacco Fraud Review 1998: Recommendations relating primarily to diversion fraud and Customs' response

## Customs' Implementation of the Alcohol and Tobacco Fraud Review Recommendations 6 to 36 (which relate primarily to diversion fraud)

Status based on Customs' assessment at November 2000	Total
Implemented	18: Recommendations 6-12, 19, 22, 23, 26, 27, 30-32, 34-36
Timescale to be decided or to be implemented over the longer term	11: Recommendations 14-18, 20, 21, 24, 25, 28, 33
Likely not to proceed	2: Recommendations 13, 29
<b>TOTAL</b>	<b>31</b>

No	RECOMMENDATION	STATUS based on Customs' assessment at November 2000
6	<i>For the Accompanying Administrative Document system, the Commission should be asked to computerise the excise movement (Accompanying Administrative Document) system throughout the European Union.</i>	<b>Implemented</b> Recommendation couched in terms of influencing the outcome of the European Union High Level Fraud Group on fraud which reported prior to the Alcohol and Tobacco Fraud Review. Recommendation is being actively pursued. Alcatel, the company chosen to look at the proposal, has produced a feasibility study putting forward two options for consideration by the European Commission and Member States. This is a longer term option. In anticipation of a computerised system the Early Warning System was introduced from April 2000. This involves Member States notifying the authorities in other Member States of selected movements of excise goods before the movement takes place. This should allow the receiving Member States' authorities to take appropriate action.
7	<i>Tighten and standardise the Accompanying Administrative Document system throughout the European Union, requiring the use of the existing optional Copy 4 of the Accompanying Administrative Document.</i>	<b>Implemented by other means</b> Recommendations 7 to 12 are couched in terms of influencing the outcome of the European Union High Level Fraud Group on fraud which reported prior to Alcohol and Tobacco Fraud Review. The High Level Fraud Group has recommended computerisation of the movements system across the European Union.
8	<i>Develop a system to provide warehousekeepers with confirmation of acceptance of movements by receiving warehousekeepers using a language neutral form of fax and consider also the use of E-mail/Internet/Intranet.</i>	<b>Implemented by other means</b> See comment against Recommendation 7.
9	<i>Set a time limit for movements to be completed within 4 to 8 days (depending on distance) and require vehicle registration numbers, proprietor's name and routings to be listed.</i>	<b>Implemented by other means</b> See comment against Recommendation 7.

No	RECOMMENDATION	STATUS based on Customs' assessment at November 2000
10	<i>Require return of receipt from consignee to fiscal authority within 15 working days of date of despatch.</i>	<b>Implemented by other means</b> See comment against Recommendation 7.
11	<i>Requirement for trade to issue pre-numbered Accompanying Administrative Documents (using sets of sequential numbers issued by the fiscal authority in each Member State or blocks of sequential numbers devised by the trade but approved by Customs).</i>	<b>Implemented by other means</b> See comment against Recommendation 7.
12	<i>Accompanying Administrative Documents to show vehicle registration numbers and expected time for the journey.</i>	<b>Implemented by other means</b> See comment against Recommendation 7.
13	<i>Each Member State to impose consistent and appropriate penalties for non-compliance.</i>	<b>Likely not to proceed</b> UK position, which is to proceed cautiously in view of the sensitive read across to the criminal sanctions regime, was represented at an European Union-wide seminar in Logrono, Spain, on 15 October 1999. Initial impression is that progress will be difficult. The introduction of a consistent penalty system across the European Union will be difficult to implement as it will require the agreement of all Member States. As each Member State taxes excise products at different rates, if at all, obtaining universal agreement for consistent penalties across the European Union will be almost impossible. Therefore this recommendation will not be progressed any further.
14	<i>Propose a means of compelling all Member States to keep the System for the Exchange of Excise Data (SEED) up to date and accurate.</i>	<b>Progressing</b> Much work has taken place to improve the integrity of the UK database. Paper currently being drafted (completion date 31/12/00) on the problems associated with the System for the Exchange of Excise Data and movement verifications setting out the UK's proposals for European Union-wide improvements which will incorporate Recommendations 14 to 18. Review of the System for the Exchange of Excise Data due for completion 31/03/2001, including report to Feb 2001 Excise Committee, for take up of similar functionality across the European Union. An updated SEED database is currently under trial internally on the Departmental Intranet site. The UK version of SEED has been designed to incorporate the aims of recommendations 14 to 17. UK Customs are represented on the Ad Hoc Working Group in Europe concerned with the development of SEED and other systems across the European Union.
15	<i>Propose a means of ensuring that all the System for the Exchange of Excise Data fields are completed by all Member States.</i>	<b>Progressing</b> See comment against Recommendation 14.
16	<i>Propose that all Member States should allow specified on-line trader access to the System for the Exchange of Excise Data with the possible exception of those countries with data protection restrictions (Germany and the Netherlands).</i>	<b>Progressing</b> See comment against Recommendation 14.
17	<i>Develop an European Union-wide guarantee database as part of the System for the Exchange of Excise Data.</i>	<b>Progressing</b> See comment against Recommendation 14.

No	RECOMMENDATION	STATUS based on Customs' assessment at November 2000
18	<i>Propose a means of compelling all Member States to respond to movement verification requests within 30 days.</i>	<b>Progressing</b> See comment against Recommendation 14.
19	<i>A requirement for warehousekeepers who are consignors to forward a photocopy of the Accompanying Administrative Document to a central collation point within Customs at the end of the week in which goods are dispatched.</i>	<b>Implemented by other means</b> HM Customs & Excise are currently involved in two European Union initiatives surrounding the movement of goods in duty suspension between Member States. The Excise Movement Control System (EMCS) will provide for a computerised Accompanying Administrative Document to be produced which will be initiated by the consignor and be routed via the consignor / consignee MSA to the consignee. The development will preclude the need for recommendations 19 & 22 as they will be included in the functionality of the Excise Movement Control System. The Early Warning System (EWS) has already provided an interim system (until the Excise Movement Control System is delivered) to enable MSA to exchange data (usually photocopy of the Accompanying Administrative Document) about movements which fail specified risk criteria. The Early Warning System requires the authorised warehousekeeper to notify Customs 24 hours in advance of such a movement taking place.
20	<i>A requirement that where goods move under duty suspension warehousekeepers will record vehicle registration numbers and expected journey times and for the central collation point to select (on a risk basis) a proportion of these to be checked through the Secure Customs Enforcement Network (SCENT).</i>	<b>Progressing, will be implemented by other means</b> The aims of this recommendation will be achieved through implementation of the Excise Movement Control System (computerised movements system). Completion of the vehicle registration number will be a mandatory field within the system. Following the introduction of the Excise Goods (Accompanying Documents) Regulations 2001, which are expected to be laid before Parliament in October 2001, the Department will issue revised guidance to the trade (Public Notice 197). This will outline the warehousekeeper's responsibilities for completion and recording of Accompanying Administrative Documents.
21	<i>A requirement that where goods move under duty suspension warehousekeepers will number Accompanying Administrative Documents uniquely and maintain a record of numbers used.</i>	<b>Progressing, will be implemented by other means</b> The aims of this recommendation will be achieved through implementation of the Excise Movement Control System (computerised movements system). The allocation of a unique number will form part of the functionality of the system. See comment against Recommendation 20.
22	<i>A requirement for consignees (warehousekeepers, REDS traders (the system for Registered Excise Dealers and Shippers) or occasional importers) to forward Copy 4 of the Accompanying Administrative Document to the central collation point at the end of each week in which goods are received.</i>	<b>Implemented by other means</b> See comment against Recommendation 19.
23	<i>A one number national helpline for UK enquiries of the System for the Exchange of Excise Data with fully trained staff.</i>	<b>Implemented</b> As part of Customs' Modernisation Programme local Business Advice Centres will be replaced by five Regional 'Contact Centres' by April 2001. Glasgow, which receives the majority of the System for the Exchange of Excise Data enquiries from the trade, will be one. The result will be a single telephone number being used for these enquiries. There will be an extensive publicity campaign that will focus on the single telephone number, commencing May 2001.

No	RECOMMENDATION	STATUS based on Customs' assessment at November 2000
24	<p><i>A requirement for warehousekeepers to obtain from transporters of goods in duty suspension for each movement a statement that "they are aware of the status (duty unpaid) of the goods, and that they may face penalties if the goods do not reach their intended destination and that they will advise the warehouse of any change of instruction".</i></p>	<p><b>Progressing, will be implemented by other means.</b>  Working on a notice for hauliers, to be distributed to all known hauliers in the first instance, but thereafter handed out by Customs as need dictates. Also stricter application of rules on sealing of vehicles to emphasise the duty status of goods.  See comment against Recommendation 20 . The revised Public Notice 197 will inform hauliers of their responsibilities in respect of accompanying documentation for excise goods.</p>
25	<p><i>In consultation with the trade, further consideration be given to introducing a requirement for all alcohol and tobacco products to be made identifiable in stock records and commercial documentation until sold by retail outlets.</i></p>	<p><b>Progressing, will be implemented by other means</b>  A fuller report is in preparation. Customs believe that fiscal marks on tobacco products have largely achieved this aim for tobacco. We are to review use of fiscal marks for alcohols in 2001/02.  The pack mark introduced from 1 July 2001 clearly identifies the duty status of cigarettes and Hand Rolling Tobacco. We are also reviewing whether we can extend pack marks to alcohol products. See comment against Recommendation 28.</p>
26	<p><i>In consultation with the trade, further consideration be given to introducing a requirement that cigarettes and other specified tobacco products be marked "For sale in UK only" in a prominent position on the front of packets.</i></p>	<p><b>Implemented</b>  Chancellor announced in the Pre-Budget Report (9 November 1999) that from early 2001 cigarettes and hand-rolling tobacco sold in the UK must be marked "UK Duty Paid".</p>
27	<p><i>The handling and sale of unmarked cigarettes and specified tobacco products be made an offence.</i></p>	<p><b>Implemented.</b>  Chancellor announced in the Pre-Budget Report (9 November 1999) that there will be new offences and penalties for those caught handling or selling unmarked tobacco products.</p>
28	<p><i>Further consideration be given to requiring the marking of alcoholic products manufactured or packaged in the UK for export. This should be progressed in consultation with the trade and the findings reported to the Financial Secretary before the 1999 Budget. If it is decided that products should be marked "For export from UK only" the sale of those products in the UK should be made an offence.</i></p>	<p><b>Progressing</b>  Following the implementation of Recommendation 26 (tobacco pack marks) a project will be undertaken in 2001/02 to look at the feasibility and practical implications of fiscal marks for certain alcoholic products. Two submissions have been presented to the Financial Secretary to the Treasury for advice on consulting the trade. The Financial Secretary to the Treasury has requested further information on the developments/trials in other Member States in connection to Fiscal Marks on alcohol goods. A report will be submitted to Ministers later this year outlining our findings.</p>
29	<p><i>A joint trade/Customs working party be set up to consider the possible use of electronic intelligence packaging for alcoholic products.</i></p>	<p><b>Not likely to proceed at this time</b>  Consultation with the trade and suppliers of technology has taken place. The technology is too expensive to be commercially viable at present, although it may become affordable in a few years time. In the meantime, we continue to work closely with one revenue trader who is exploring possibilities. We are also represented on the project board of the governments "Chipping of goods" initiative (Home Office led, primarily aimed at reducing theft), which is seeking to support worthwhile pilot schemes.  Customs are currently monitoring a trial by a well known spirits manufacturer, who is "chipping" bottles of whisky during production runs.</p>



No	RECOMMENDATION	STATUS based on Customs' assessment at November 2000
30	<i>In consultation with the trade, further consideration be given to requiring all proprietors of goods who wish to move goods in duty suspension and, subject to legal advice, all transporters of goods in duty suspension to register with Customs and Excise.</i>	<b>Implemented</b> New regulations requiring that warehousekeepers and owners of goods in warehouse should be registered with Customs came in to force on 1 October 1999. (On legal advice transporters were excluded from the new regulations as to include them was seen as a restriction on trade - in particular in relation to foreign hauliers).
31	<i>Customs and Excise should set up a national register of such proprietors and, subject to legal advice, transporters for direct access by the trade.</i>	<b>Implemented</b> Register set up as a consequence of the new regulations (see Recommendations 30 & 32). Validation of the register, to establish whether all those that should be registered are registered, is currently underway.
32	<i>It be made a condition of the approval of warehousekeepers that they can only release goods in duty-suspension where the proprietor (and, subject to legal advice) the transporter are registered with Customs and Excise.</i>	<b>Implemented</b> New regulations requiring that warehousekeepers and owners of goods in warehouse should be registered with Customs came in to force on 1 October 1999. (Also see comment against Recommendation 30 regarding hauliers).
33	<i>It be made a condition of the approval of warehousekeepers that a named individual be made responsible for receipt and distribution of Customs and Excise information/requirements to all sites and to take responsibility for ensuring staff training in and awareness of the information/requirements.</i>	<b>Progressing, will be implemented</b> Customs are introducing a new condition in warehouse approvals making it clear that the Warehousekeeper should have proper systems in place to ensure prompt and appropriate distribution of Customs information and for providing appropriate training for bond staff. See comment against Recommendation 20 . The revised Public Notice 197 will notify warehousekeepers that a named individual must be accountable for the training in, and distribution of, HM Customs and Excise matters.
34	<i>In consultation with the trade, further consideration be given to registering and authorising wholesale/cash and carry outlets to deal in alcohol and tobacco products.</i>	<b>Implemented by other means</b> The Home Office White Paper on licensing outlines plans to licence traders for wholesaling alcohol, and that customs offences should be taken into account when granting or renewing licences. For tobacco, it will become an offence to sell unmarked tobacco, with a sanction of prohibition of sales of tobacco for up to six months. Martin Taylor recently endorsed this as a more cost-effective approach than a new licensing system.
35	<i>Consideration should also be given to requiring authorised wholesale/cash and carry outlets to display prominently at their counters all prices separately identifying the amount of duty included.</i>	<b>Implemented by other means</b> This recommendation was designed as part of the overall effort to raise the public profile of alcohol and tobacco fraud. The aims of this recommendation have been addressed by a number of publicity initiatives not the least of which was the publicity which formed part of the Tobacco Disruption Strategy as well as numerous other campaigns.
36	<i>Consideration should also be given, in consultation with the trade, to requiring all those who produce and sell alcohol and tobacco from import/production through to sales to retailers to print on their invoices "information about transactions will be passed to Customs and Excise for the purposes of preventing and detecting fraud".</i>	<b>Implemented by other means</b> See comment against Recommendation 35.

# Appendix C

## The recommendations in the Roques report and Customs response

### CUSTOMS' ACCEPTANCE OF THE ROQUES REPORT RECOMMENDATIONS

Status	Relevant part of the NAO report			Total
	Part 1: How the frauds were undertaken and Customs' response	Part 2: How Customs investigated the frauds and the action taken or planned to strengthen controls over future investigations	Part 3: The steps taken or planned by Customs to strengthen their general approach to tackling diversion fraud	
Accepted	<b>13:</b> Recommendations 1, 2, 6, 11-13, 19-22, 24-26	<b>5:</b> Recommendations 9, 10, 14, 29, 30	<b>35:</b> Recommendations 16-18, 28, 31-45, 47-54, 56-62, 64	<b>53</b>
Modified approach adopted	<b>5:</b> Recommendations 3-5, 7, 23	<b>0</b>	<b>4:</b> Recommendations 46, 55, 63, 65	<b>9</b>
Under consideration	<b>2:</b> Recommendations 8, 27	<b>0</b>	<b>0</b>	<b>2</b>
Not accepted	<b>1:</b> Recommendation 15	<b>0</b>	<b>0</b>	<b>1</b>
<b>Total</b>	<b>21</b>	<b>5</b>	<b>39</b>	<b>65</b>

### CUSTOMS' IMPLEMENTATION OF THE ROQUES REPORT RECOMMENDATIONS

Status	Relevant part of the NAO report			Total
	Part 1: How the frauds were undertaken and Customs' response	Part 2: How Customs investigated the frauds and the action taken or planned to strengthen controls over future investigations	Part 3: The steps taken or planned by Customs to strengthen their general approach to tackling diversion fraud	
Implemented by July 2001	<b>10:</b> Recommendations 1-5, 7, 20, 22, 24, 25	<b>3:</b> Recommendations 14, 29, 30	<b>29:</b> Recommendations 28, 31-37, 40-56, 59, 61-63	<b>42</b>
Due to be implemented by March 2002	<b>4:</b> Recommendations 6, 8, 21, 26	<b>2:</b> Recommendations 9, 10	<b>7:</b> Recommendations 16, 18, 38, 58, 60, 64, 65	<b>13</b>
Due to be implemented by March 2003	<b>0</b>	<b>0</b>	<b>2:</b> Recommendations 17,39	<b>2</b>
Timescale to be decided or to be implemented over the longer term	<b>6:</b> Recommendations 11-13, 19,23 23, 27	<b>0</b>	<b>1:</b> Recommendation 57	<b>7</b>
<b>Total</b>	<b>20</b>	<b>5</b>	<b>39</b>	<b>64<sup>1</sup></b>

Note 1. Roques report recommendation 15 was not accepted; the total number of recommendations to be implemented is therefore 64.

No	ROQUES REPORT RECOMMENDATIONS	CUSTOMS ACTIONS
1	<p><i>That all staff responsible for warehouse authorisations are issued with clear instructions about the need to ensure that applicants meet all the approval criteria (including giving definitions of criteria e.g. a "suitable person"). (para 3.7.1 of the Roques report)</i></p>	<p><b>Accepted</b>            Customs' internal guidance specifies the checks that are to be undertaken to ensure that applicants fully meet the criteria for approval. Supplementary instructions were issued in May 2001 which reiterate the requirements and reinforce the message that "authorisation" is to be based on risk and is not automatic.</p>
2	<p><i>That approvals should routinely be granted for a certain period of time before being reviewed to ensure that warehousekeepers are still fulfilling their obligations, and that conditions attached to the approval remain appropriate. Staff should revoke approvals where approval conditions are not complied with. (para 3.7.1)</i></p>	<p><b>Accepted</b>            Customs and Excise issued instructions to staff in May 2001 dealing with approvals. A full and comprehensive review of existing approvals is also being carried out this financial year. If it is found that some approval conditions are being breached, action will be taken to rectify this. For a minor breach it may only be necessary to vary the approval conditions to ensure future compliance; for a more serious breach it may be necessary to add new, tighter conditions and keep the position of the approval under review. Where it is clear that a breach of conditions has created an environment for fraud, or where the warehousekeeper has been involved in perpetrating fraud, the approval will be revoked.</p>
3	<p><i>That targets are abandoned for authorising applications within certain timescales. Applications should be processed as quickly as possible, compatible with ensuring that the applicant meets the criteria (usually by a visit to the warehouse when the authorisation is considered). (para 3.7.1)</i></p>	<p><b>Modified approach adopted</b>            Charter Standards require the Department to abide by certain limits of business activities, including excise approvals and authorisations. However, the undertaking to issue the approval or authorisation within 15 days only applies once they have received correct and complete details from the applicant. This should be sufficient time to do all the standard checks on the applicant and carry out the compulsory pre-approval visit to the site. Customs issued instructions to staff in May 2001 clarifying that the Charter Standards do not apply until the Department has received a complete and satisfactory application. They also reminded staff of the need to ensure that the applicant is a suitable person to be approved, and that this is more important than strict adherence to the Charter Standard timetable. The Department will consider whether this Standard impedes the proper consideration of authorisations and approvals and whether time limits should be extended, or abandoned altogether.</p>
4	<p><i>That local authorisation procedures are maintained. (para 3.7.1)</i></p>	<p><b>Modified approach adopted</b>            The approval of excise warehouses was centralised in Glasgow from 1 June 2001. This will ensure a standard approach to all such approvals. The staff at the centre will carry out a series of standard checks using information streams to which local staff may not have access. Local staff will continue to provide an expert resource to the approval process, including a compulsory pre-approval visit.</p>

No	ROQUES REPORT RECOMMENDATIONS	CUSTOMS ACTIONS
5	<p><i>That instructions are issued to local staff that "standard" approval letters should not be used. Staff should tailor all approvals according to what they find when they visit the warehouse prior to deciding whether approval should be granted. Staff should be given advice on the nature of conditions which can be applied in particular circumstances, to improve consistency in setting conditions. (para 3.7.2)</i></p>	<p><b>Modified approach adopted</b> Standard conditions applying to all warehouses are set out in a public notice. For convenience and to ensure warehousekeepers are aware of their obligations, it is the Department's practice to repeat the standard conditions in a letter, which specifies in appendices conditions which apply only to the particular warehouse concerned. Internal guidance already reflects this and supplementary reinforcing instructions were issued to staff in May 2001. Incorporated into these was advice on the nature of conditions that are to be applied in particular circumstances.</p>
6	<p><i>That the Department introduces urgent sanctions, such as the seizure of the vehicle or a heavy financial penalty, to deter hauliers from breaking the law. (para 3.7.3)</i></p>	<p><b>Accepted</b> The principal form of increased financial sanction will be a toughening of the approach to the seizure of heavy goods vehicles found to be involved in diversion fraud. This will apply to both tractor unit and trailer which combined are normally worth many thousand of pounds. To enable this policy to operate in an equitable fashion the Department:</p> <ul style="list-style-type: none"> <li>■ publicised in July 2001 to hauliers the actions they are expected to take to minimise the chances of their vehicles being used in fraud or smuggling of alcohol or tobacco and the seizure consequences if such actions are not taken;</li> <li>■ will determine and apply clear rules on the conditions, if any, under which vehicles may be restored at a charge (for example to lease owners); and</li> <li>■ will produce regular reports on the number of heavy goods vehicles seized and the terms on which any restoration is offered.</li> </ul>
7	<p><i>That, given the importance of the Accompanying Administrative Document in the current control arrangements, and in the pursuit of equity, guidance should be sent out to all Collections as a matter of urgency setting out what, exceptionally, constitutes acceptable alternative evidence of completion of a movement. (para 3.8)</i></p>	<p><b>Modified approach adopted</b> The guidance was issued in May 2001. It specified the exceptional circumstances under which alternative evidence may be considered and gave three specific examples of acceptable alternative evidence. To ensure consistency of approach and equity of treatment the acceptance of any other alternative evidence will be considered only after reference to and advice from the policy authority.</p>

No	ROQUES REPORT RECOMMENDATIONS	CUSTOMS ACTIONS
8	<p>a) <i>That all warehousekeepers, as a condition of their approval, be required to notify their local office of excise goods entering and leaving the warehouse 24 hours in advance of the event (or as soon as possible if less than 24 hours notice is given by the haulier).</i></p> <p>b) <i>Local staff should ensure that warehousekeepers understand that accompanying transit paperwork must be completed in full;</i></p> <p>c) <i>That the centre issues local staff with detailed instructions setting out the criteria for selecting goods to be checked. This should be augmented by local officers' knowledge of "their" warehouses;</i></p>	<p><b>Under consideration</b></p> <p>Some information is already available on goods entering and leaving warehouses:</p> <ul style="list-style-type: none"> <li>■ most warehousekeepers maintain records of consignments they know are to enter or leave the warehouse. Officers visiting the warehouse can use these records to select future consignments they may wish to check; and</li> <li>■ under the Early Warning System, EU warehousekeepers give specific prior notification of high-risk shipments of alcohol and tobacco. This prior notification enables officials in each Member State to decide, in advance, which consignments should be selected for checking. This system currently operates with trade consent, although changes will be made to the EU Directive to give the requirement a legal basis.</li> </ul> <p>However, the information is not available on every consignment, or on a routine basis:</p> <ul style="list-style-type: none"> <li>■ in the longer term (around 5 years), the proposed EU-wide system for computerising the exchange of AADs between Member States (the Excise Movement and Control System or EMCS) will provide officers with advance warning of all legitimate intra-EU consignments entering and leaving the UK. This is the real solution to this problem, but the time delay makes it necessary to consider interim solutions; and</li> <li>■ the Department is looking at the costs and benefits of asking warehousekeepers routinely to provide advance information on all goods entering and leaving the warehouse, and the value this will add to the information already available. A full report will not be ready until October, but early indications are that it is likely that Customs will require some warehousekeepers to provide additional information on receipts and dispatches, where that is necessary to protect the revenue. It will not be a blanket requirement and could be used, for example, to protect warehouses which are being quoted as the consignee on AADs, but which are not expecting the goods. It would also help port staff to target suspect consignments. Customs' solicitors will need to look carefully at the EU legislation and its implications as part of the review.</li> </ul> <p><b>Accepted</b></p> <p>Instructions were issued to staff in May 2001. In addition, each warehousekeeper will receive a written confirmation of their obligations which they will sign and return.</p> <p><b>Accepted</b></p> <p>Instructions will be issued by the end of July 2001 outlining selection criteria for examination of goods. Officers will be able to examine the trader's records and use the selection criteria to decide which consignments they should inspect.</p>



No	ROQUES REPORT RECOMMENDATIONS	CUSTOMS ACTIONS
	<p>d) <i>That warehousekeepers be required to notify Customs &amp; Excise if goods which have been booked into a warehouse are not delivered within 24 hours of the original booked time. (para 3.8.4)</i></p>	<p><b>Under consideration</b></p> <p>The Department accepts that such information will uncover certain inward diversion problems. However, it will not address the main problem, which relates to consignments which are not expected at any UK warehouse, although they travel with a completed AAD showing a recipient warehouse in the UK. The warehousekeeper is often unaware that these goods have been 'consigned' to his warehouse.</p> <p>Some consignments, those notified under the Early Warning System, are reported if they are not received. When the EU-wide Excise Movement Control System is fully operational, in around 5 years, this will also provide swift notification if the consignment is not received.</p> <p>In the meantime Customs is looking at the costs and benefits of asking warehousekeepers routinely to provide information on goods not received, and the value it will add to the information already available. A full report will be ready in October. Customs will need to look carefully at the EU legislation and its implications as part of the review.</p>
9	<p><i>That there should be much more routine use of invoking guarantees - for example, for recovery of duty on undischarged Accompanying Administrative Documents. The Department should treat irregularities as regulatory or absolute offences which are dealt with immediately. In addition, the current conflicts between UK and European Commission legislation on liability for the duty must be rectified as soon as possible. The prime objective should be to protect the revenue and seek redress where the Department is able to, within the framework of adequate legislation. (para 3.10.2)</i></p>	<p><b>Accepted</b></p> <p>If AADs are not returned, the goods detailed on that AAD become liable to duty. This duty would be collected, in the first instance, by raising an assessment against the person liable to pay the duty (usually the person who provided the guarantee for the movement). If the assessment were not paid, Customs would call on the guarantee to secure the duty. Existing instructions to staff concerning raising assessments were reinforced in May 2001, to ensure that assessments are raised against undischarged AADs. The Excise Duty Points (Duty Suspended Movements of Excise Goods) Regulations 2001, to be introduced in September 2001, will resolve the current conflict between UK and EC legislation.</p>
10	<p><i>That the Department's existing proposals aimed at tightening the guarantee system, which will help prevent a new area of fraud in third country movements, are implemented. (para 3.10.2)</i></p>	<p><b>Accepted</b></p> <p>The basic principles of a tighter guarantee system have already been agreed with the trade. However, the tighter system depends on the laying of the Excise Goods (Accompanying Documents) Regulations 2001. Customs expect the regulations to come into force in January 2002.</p>
11	<p><i>That the current series of forms are abolished and replaced with a single, monthly, mandatory legal declaration by warehousekeepers which incorporates a stock return, home use duty declaration and outstanding Accompanying Administrative Document summary. A prototype Departmental form has been developed but will need to be tested further. (para 3.11.2)</i></p>	<p><b>Accepted</b></p> <p>An initial study has shown that there would be value in a warehouse return which would give details of stock holdings, receipts, deliveries to home use, duty suspended movements and outstanding AADs. Customs will consult the trade and produce a Regulatory Impact Assessment shortly. In addition, to gain the full benefit from the return, it will be important that Customs have an IT system capable of processing the information (as envisaged by Recommendation 13 below).</p>

No	ROQUES REPORT RECOMMENDATIONS	CUSTOMS ACTIONS
12	<p><i>That, as with VAT, failure to comply with the time limit for completion of the form should carry a civil penalty, as provided for in existing legislation. (para 3.11.2)</i></p>	<p><b>Accepted</b> If a return is introduced (see 11 above) it will be mandatory with a civil penalty in place for failure to render that return.</p>
13	<p><i>That the Department develops a central database for processing the new returns to:</i></p> <ul style="list-style-type: none"> <li>■ <i>obtain management information about numbers of non-received Accompanying Administrative Documents;</i></li> <li>■ <i>monitor the value of duty being paid in respect of missing Accompanying Administrative Documents by trader and test the credibility of this information; and</i></li> <li>■ <i>monitor levels of stocks etc. in warehouses. (para 3.11.2)</i></li> </ul>	<p><b>Accepted</b> This will be essential to support any new return and provide data to underpin future policy decisions and assurance activity. Once Customs have established the scope of the new return, and a final decision has been taken to introduce it, the database can be developed to process the information and provide the necessary data. Customs estimate that this will take 12 months from the time the decision is taken to proceed with the return.</p>
14	<p><i>That Customs &amp; Excise issues guidance to local staff setting out in detail the legal provisions, policies and procedures for raising assessments so as to safeguard the revenue. (para 3.12.2)</i></p>	<p><b>Accepted</b> Detailed guidance was issued to staff in May 2001.</p>
15	<p><i>That the Department always assesses warehousekeepers for duty on undischarged Accompanying Administrative Documents where they are unable to recover it from the guarantor (where this is different). This is one of the prerequisites for being an authorised warehousekeeper, and is provided for in the law. This policy needs to be applied consistently across the Department to ensure that all warehousekeepers are treated equitably. (para 3.12.3)</i></p>	<p><b>Not accepted</b> This recommendation, if implemented, would run contrary to the relevant EU Directive on this point, which states that the person who provides the guarantee is the person who should be assessed for the duty. The current position in UK law is that Customs can also assess warehousekeepers where they are unable to recover duty from the guarantor. However, the Excise Duty Points (Duty Suspended Movements of Excise Goods) Regulations 2001, to be introduced in September 2001, will bring UK legislation into line with the EU position, to protect innocent warehousekeepers who do not allow their guarantees to be used for suspect movements (something Customs are keen to encourage).</p> <p>In the interim, instructions were issued to Customs staff in May 2001 requiring them to be diligent in their pursuit of duty in cases where AADs are not discharged.</p>
16	<p><i>That the Department undertakes a full analysis of the risks involved in the Registered Excise Dealers and Shippers (REDS) system. (para 3.13.1)</i></p>	<p><b>Accepted</b> A full review of the REDS system will be undertaken by Customs by the end of December 2001. Any necessary changes to the system will be put in train by the end of March.</p>
17	<p><i>That REDS traders [the system for registered excise dealers and shippers] are controlled more tightly by the Department to safeguard excise revenue. Visits should be arranged to all REDS traders and their systems evaluated (both accounting records and physical procedures such as their arrangements for delivery and receipt of goods). This information, together with the amount of revenue at risk should then be used to decide the level of both unannounced and routine visiting activity needed to control the revenue. (para 3.13.1)</i></p>	<p><b>Accepted</b> A visit programme has been put in place and will be completed by July 2002.</p>

No	ROQUES REPORT RECOMMENDATIONS	CUSTOMS ACTIONS
18	<p><i>That the Department undertakes a full analysis of the risks involved in the Occasional Importers system with a view to tightening the system. In particular, the Department should consider how to improve the flow of information between local advice centres (who issue the receipts) and staff at ports so that Occasional Importers can be targeted for interception. This may involve re-designing the application form/receipt so that port staff have the information they need to intercept. The Department should also consider reducing the time limit of official receipt. (para 3.14.1)</i></p>	<p><b>Accepted</b> A full review of the Occasional Importers system will be undertaken by Customs and will report by the end of December 2001. Any necessary changes to the system will be actioned by the end of March.</p>
19	<p><i>That Customs &amp; Excise undertake a review of all legislation with a view to consolidating it as much as possible. (para 3.15.2)</i></p>	<p><b>Accepted</b> The Department agrees that consolidation is desirable, but it would require a significant number of pre-consolidation amendments, needing substantial Parliamentary time. These proposals would therefore have to compete with other calls on the legislative programme.</p>
20	<p>a) <i>That excise officers should be given training on how to carry out physical checks at warehouses.</i></p> <p>b) <i>Officers should visit all excise traders periodically to carry out unannounced checks on goods entering and leaving the warehouse (the receipt and delivery systems) accompanying paperwork (including Accompanying Administrative Documents) and the security of the load. (para 3.19.1)</i></p>	<p><b>Accepted</b> Work is well advanced to improve warehouse training, and includes specific elements relating to the undertaking of physical checks by officers. Delivery of training began in June and will be completed by Oct 2001.</p> <p><b>Accepted</b> Visits and checks of this kind are now undertaken. Guidance was issued in May 2001.</p>
21	<p><i>That a significant number of additional resources are deployed on excise work to regain control of excise goods through more visits to warehouses and physical checks on consignments and paperwork. I recommend that, as a minimum, the 100 staff years of excise effort directed onto the Tobacco Strategy in April 2000 are re-instituted (through accretion and not through further diversion of existing resources) onto excise warehousing control with clear instructions about their role and responsibilities. (para 3.20.5)</i></p>	<p><b>Accepted</b> An additional 146 officers are to be deployed on excise warehousing controls in 2001/02.</p>
22	<p><i>That Import/Export verification officer (IMPEX) and excise controls teams be brought under the same local management (where this has not already been done) to promote the use of the full range of techniques to control excise warehouses, and to increase the total resource available to deal flexibly and effectively with all aspects of control of excise goods. (para 3.20.5)</i></p>	<p><b>Accepted</b> IMPEX activities in the assurance and anti-fraud fields are being standardised with the work of other assurance and anti-fraud staff. In addition, as part of the Department's restructuring, they are now under unitary Detection and Assurance management commands.</p>

No	ROQUES REPORT RECOMMENDATIONS	CUSTOMS ACTIONS
23	<p><i>That the Department seeks to obtain political support for something close to a zero-tolerance policy at ports and Eurorail. This would require significant additional resources to put into effect the seizure of both goods and vehicles when the importer could not satisfy Customs &amp; Excise that the goods were for personal consumption. (para 4.4.2)</i></p>	<p><b>Modified approach adopted</b> Anti-smuggling activities must be proportionate to the risk and reflect the legitimate expectations of the majority of passengers and freight transporters who do not smuggle, to travel without excessive delay or the imposition of unacceptable cost. 'Zero tolerance' in the sense of stopping every vehicle is an unrealistic goal.</p> <p>Customs never ignore smuggling when it is detected and take the appropriate action starting with seizing smuggled goods and involving more extensive action as the severity of the offence increases. Over the last twelve months the balance between control and facilitation at the channel ports in particular has been materially altered.</p> <p>The number of officers operating in the tourist lanes at short Channel crossing points has been increased by two thirds over the past 18 months to counter the relatively small scale smuggling of tobacco and alcohol across the Channel by foot and light vehicle passengers. This action is intended to curb the wider law and order and social problems which this smuggling has created and has been reinforced by a tough policy of seizing vehicles used to convey smuggled goods. In 2000-01 the number of vehicles seized by Customs and Excise rose almost 100% to 10,219.</p>
24	<p><i>That IMPEX staff and excise control staff are brought under the same local management, but that their role remains sufficiently flexible to enable them to change tactics quickly to respond to new trends in excise fraud. (para 4.6.3.4)</i></p>	<p><b>Accepted</b> See recommendation 22.</p>
25	<p><i>That detailed guidance be produced as soon as possible for IMPEX staff on the benefits of the register of owners, hauliers and warehousekeepers, and how it should be used and controlled. (para 4.6.5)</i></p>	<p><b>Accepted</b> Guidance was issued to all staff in May 2001.</p>
26	<p><i>That the Department continues to deploy sufficient resources to keep outward diversion fraud suppressed, otherwise there is a real danger that it will re-emerge as the Department tightens the screw on inward diversion. (para 4.6.6)</i></p>	<p><b>Accepted</b> In 2001/02 the 146 additional officers deployed on excise warehousing controls will be augmented by the redeployment of a further 82 officers to form a flexible, risk-reactive warehouse control force which will guard against both outward and inward diversion of excise goods.</p>
27	<p><i>That the Department moves as quickly as possible to introduce tax stamps for spirits, and associated sanctions, to protect both excise revenues and the UK's whisky production industry. (para 4.7.6)</i></p>	<p><b>Under consideration</b> The Department is undertaking feasibility research on the whole range of fiscal markings for spirits - including Tax Stamps.</p>
28	<p><i>That the Department focuses its attention on this area [hydrocarbon oil duty fraud], in order to avoid any further unexpected shocks if it is subsequently found that hydrocarbons smuggling and outward diversion are far greater problems than they are currently believed to be. (para 5.7.1)</i></p>	<p><b>Accepted</b> Customs have significantly increased activity in analysing, quantifying and tackling the threat in the oils sector. Operationally this has resulted in increased front-line resources in Northern Ireland and the running of a number of successful operations on the UK mainland. Continual evaluation of this enhanced activity is a key part of ensuring the Department retains a strategic overview of the fraud threat in the oils sector.</p>

No	ROQUES REPORT RECOMMENDATIONS	CUSTOMS ACTIONS
29	<p><i>That the level at which Director approval is required to put revenue at risk is reduced to the level at which director approval is required to write-off or remit debts, i.e. £1 million. This recommendation is based on my finding that the recovery levels of revenue put at risk in cases of outward diversion are minimal. (para 6.2.2)</i></p>	<p><b>Accepted</b> The levels at which managers may put revenue at risk and write-off debt have been synchronised.</p>
30	<p><i>That:</i></p> <ul style="list-style-type: none"> <li>■ <i>the legal status of indemnities should be clarified, either within the existing framework or through additional legislation;</i></li> <li>■ <i>written indemnities only are used to avoid the potential for misunderstanding caused by verbal indemnities; and</i></li> <li>■ <i>a separate, additional authorisation system to indemnify is put in place, as there is a greater risk to revenue where indemnities are granted than is otherwise the case. (para 6.2.2)</i></li> </ul>	<p><b>Accepted</b> The legal status of indemnities has been clarified. Indemnities are provided only for exceptional operational reasons, but where it is necessary to provide one it will be given in writing. Amounts indemnified will be in line with the levels of authority to put revenue at risk delegated to the person providing the indemnity. The Department will maintain a central record of all indemnities granted.</p>
31	<p><i>That the maximum potential revenue loss of £620 million is disclosed in the Trust Statement and Annual Report for 1999-2000, and that a write-off of at least £500 million is made in the year. (para 6.4.1)</i></p>	<p><b>Accepted</b> The Chairman's Trust Statement for 1999-2000 disclosed the losses and made appropriate block write-off provisions. The amount certified by the National Audit Office is £668m.</p>
32	<p><i>That clear guidance is issued concerning the authority and responsibility to remit and write-off, and the timeframe in which this should be performed: it should be re-emphasised that all losses need to be accounted for; responsibility for the action should rest with whichever party is best placed to make the decision and in cases of fraud, the presumption should be that this is the investigating officer; and losses should be remitted or written-off as soon as it is practical to make that decision and should then be reported in the financial statements in respect of the relevant year. (para 6.4.2)</i></p>	<p><b>Accepted</b> Instructions have been issued to all managers involved in the write off and remission of revenue setting out a revised management framework including clear levels of authority. In addition Customs have provided specific guidance to investigating officers on revenue management and the raising of assessments in investigation cases.</p>
33	<p><i>That it is very important that the strategies and the annual plans that evolve from the strategies are reviewed annually on a 5 year rolling basis to ensure that they remain effective. (para 7.3)</i></p>	<p><b>Accepted</b> Customs is updating and refining its investigation strategies to reflect changing circumstances. Strategies will be subject to continuous review.</p>
34	<p><i>That consideration should be given to the interrelations between the Drugs, Tobacco, Financial and forthcoming VAT and Alcohol strategies. I do not believe that any one of these strategies will succeed in isolation. (para 7.3)</i></p>	<p><b>Accepted</b> This is the Department's policy. Customs continuously assesses the inter-relationships between and threats posed to the various regimes so that resources can be monitored and deployed to best effect.</p>
35	<p><i>That each of the aforementioned strategies is communicated to all levels of staff within the National Investigation Service. It is clear, from my discussions with staff at various levels, that this has not yet been done or has not been done effectively. (para 7.3)</i></p>	<p><b>Accepted</b> The Investigation strategies are being communicated to all staff as they are implemented. Regional Investigation Managers are responsible for ensuring that all investigation staff are aware of the strategies.</p>



No	ROQUES REPORT RECOMMENDATIONS	CUSTOMS ACTIONS
36	<p><i>That a review of the participants of each of the four committees is undertaken, as at present there appears to be some duplication of effort by members of the Corporate Management Group who appear to attend each of the 4 meetings. This must result in an ineffective use of management time and potential conflicts of interest in decision making between the different committees. (para 7.4.1)</i></p>	<p><b>Accepted</b> A new structure has been adopted. The Corporate Management Group has been replaced by the Law Enforcement Investigation Operating Committee (LEIOC) which is chaired by the Director Investigation and includes the Regional Investigation Managers. The Heads of Investigation Strategy attend for specific agenda items. The only committee to be retained is the Operations Board which reports to the Investigation Operating Committee.</p>
37	<p><i>That, as the National Investigation Service plan for 2000-2001 does not specifically refer to alcohol, a plan for alcohol is drawn up as soon as possible. Whilst I can accept that numerical measure may be helpful I believe that at present the outturns are so difficult to predict that the overall strategy should have a much higher priority than the achievement of numerical targets. (para 7.4.3)</i></p>	<p><b>Accepted</b> The Department has developed estimates of alcohol fraud which will be published later in the year along with the Department's strategy to tackle alcohol fraud.</p>
38	<p><i>That a review of the procedures surrounding Excise and Intelligence Research Team (EXIRT) is undertaken. It is vital that intelligence received is analysed, prioritised and developed quickly for hand over to investigation officers where necessary; a computerised system is implemented as soon as possible to assist with the smooth flow of information through EXIRT. This system will also be able to provide analytical information on the trends developing in excise and other fraud at an early stage; and all information and intelligence is passed to EXIRT, so that a) it is collated in one place, b) more effective use of resources can be made as operational teams can concentrate on operations and c) a proper risk assessment can be made prior to each case being undertaken.</i></p> <p><i>EXIRT should act as the focal point for the co-ordination of intelligence for the National Investigation Service as a whole. (para 7.4.4.1)</i></p>	<p><b>Accepted</b> EXIRT has been increased in size and divided into three teams, one dealing with tobacco operational intelligence, one with bulk cigarette shipment tracing and tobacco tactical intelligence and the last with all other excise intelligence, mainly hydrocarbon oils and alcohol fraud. This is yielding a more focused and quicker turn round of intelligence. The excise analytical effort has been co-located with the teams and provides strategic and tactical (trend) analysis. The analytical function also has the remit for horizon scanning of threats and opportunities. Computer systems are being acquired to enhance the operational intelligence capacity within the team. EXIRT is recognised as the co-ordination point of excise intelligence for the investigation activity. Pathways are being established with regional investigation offices to facilitate the two-way flow of intelligence. A review of arrangements is in progress and a final report is expected at the end of July.</p>
39	<p><i>That a real time information management system is urgently required. This system needs to be accessible by everyone and should require case officers to input relevant information on a timely basis. This should then result in management reports that contain sufficient information for all levels of management to act swiftly as and when required. (para 7.4.5.3)</i></p>	<p><b>Accepted</b> The Department is now developing the necessary systems and implementation will begin during the second half of the current financial year. In the meantime management information needs are met as a result of adjustments to the current management information system, supported by periodic checks that staff comply with management requirements. In addition, managers are provided with a monthly census of casework on hand.</p>
40	<p><i>That the Chairman ensures that all members of senior management, both at Board level and below, are made aware of their duties and responsibilities to keep their superiors informed of important issues. (para 8.2.5.5)</i></p>	<p><b>Accepted</b> Building on the management changes put in place in April 2000 the Chairman announced a restructuring into two business streams: Business Services and Taxes, and Law Enforcement. The day to day control of the two business streams rests with Operating Committees comprising the functional Directors. This has brought greater clarity to lines of responsibility and eliminated overlapping accountabilities.</p>

No	ROQUES REPORT RECOMMENDATIONS	CUSTOMS ACTIONS
41	<i>That the Board should have a statement of its role and objectives which includes a significant focus on the statutory objective of collection and management of the revenues through an appropriate reporting process. (para 8.2.6.1)</i>	<b>Accepted</b> The Board approved a statement of its role and objectives at its meeting in July 2001.
42	<i>That within the Board structure, either at Board level or at Management Committee level (subject to the supervision of the Board) there should be a body where collective discussion of business issues can take place, and collective solutions decided upon and line management be held accountable to the Board as a whole. (para 8.2.6.2)</i>	<b>Accepted</b> The Management Committee, a sub-committee of the Board, is the body for collective discussion of business issues and decision-making. Communication between the Management Committee and staff, and the accountability of staff to the Management Committee, is through individual Directors who are members of the Management Committee.
43	<i>That the benefits of a collective management ethic and collective approach to the discharge of all aspects of the responsibilities for the Commissioners needs to be emphasised by the current Chairman. (para 8.2.6.2)</i>	<b>Accepted</b> The Chairman announced a major new initiative in December 2000 to improve the Department's approach to management. The "Active Management" initiative has been promulgated to all managers and Directorate/Divisional action plans have been developed. In addition, new generic management objectives have been set for 2001/2002.
44	<i>That the Chairman should review carefully the role and structure of the Policy and Operations functions in order to ensure that they communicate effectively. This review should encompass investigation of whether the split between Operational Policy and Pure Policy remains an appropriate or valid one. (para 8.2.7.2)</i>	<b>Accepted</b> This recommendation has been implemented through the re-organisation of the Department announced on 17 January 2001. The Department no longer splits policy from operations; each of the two business streams, Business Services and Taxes and Law Enforcement, integrates policy within the operational decision-making process under the same Director.
45	<i>That efforts be made by the Chairman to promote suitable candidates who have operational experience to senior management positions, and if possible to the Board. In this way the Board and Senior Management will be able to bring to bear valuable operational experience to the wider management of the Department. (para 8.2.9)</i>	<b>Accepted</b> The Appointments Committee (the Board committee responsible for approving all senior appointments) will ensure that appropriate consideration is given to operational experience within the overall objective of finding the best qualified people for posts.
46	<i>That there be a Finance Director who should sit on the Board and the Management Committee. He would have overall responsibility for both analysis and accounting for revenue and for control and stewardship of costs. This Finance Director would be an experienced qualified accountant with relevant experience for the breadth and complexity of the role. I also recommend that he be supported by a Financial Controller who would have day to day responsibility for all aspects of the financial management and accounting. He should also be an accountant, with experience of a similar role within another substantial organisation. This I believe would address the inadequacy of the financial support documentation which was available to the Board in the past and would assist in Board discussion on all financial and accounting matters. (para 8.2.10)</i>	<b>Modified approach adopted</b> One aspect of the re-organisation announced on 17 January 2001 was the expansion of the role of the Principal Finance Officer, who will in future be accountable not simply for expenditure but also for revenue. He has taken over responsibility for the Department's 260 strong accountancy service, 15 of whom are qualified accountants. The role of Principal Finance Officer requires an in-depth understanding of public sector finances as well as accounting skills. For the present therefore a suitably qualified Accounting Adviser has been recruited from the private sector to advise the Principal Finance Officer on analysis and accounting for revenue and on control and stewardship of costs.

No	ROQUES REPORT RECOMMENDATIONS	CUSTOMS ACTIONS
47	<i>That the Chairman institutes a review of the Department's approach to document retention and destruction, including board papers, with a view to creating and implementing a coherent and comprehensive policy. (para 8.2.11)</i>	<b>Accepted</b> A clear departmental policy exists which will be reviewed in the light of the Department's knowledge management initiative.
48	<i>That the scope and remit of the Audit Committee be reviewed, and that its Terms of Reference provide to the Audit Committee a role in reviewing internal management systems and controls at all levels right up to Board level with a view to making recommendations for improvement, and ensuring compliance with best practice. (para 8.4.3)</i>	<b>Accepted</b> The Audit Committee was reconstituted in October 2000. New Terms of Reference, which take account of Treasury recommendations and private sector good practice, make it clear that the Committee has the responsibility for reviewing internal control and management systems, as well as directing the annual Audit Programme.
49	<i>That the future role and resourcing of Internal Audit be reviewed with a view to identifying the current strengths and weaknesses of the function and establishing how best any weaknesses may be addressed and the function strengthened and improved. (para 8.4.3).</i>	<b>Accepted</b> This has been implemented by means of a Better Quality Services review of the Department's internal audit function in August 2000 where areas for further development of Internal Audit work were identified .
50	<i>That, as the National Audit Office do not appear to have been present at many of the Audit Committee meetings, in future the Audit Committee should liaise more closely with the National Audit Office. (para 8.4.3)</i>	<b>Accepted</b> A representative of the National Audit Office now attends meetings of the Audit Committee.
51	<i>That the Audit Committee should meet four times a year. (para 8.4.3)</i>	<b>Accepted</b> This now happens. The revised terms of reference and greater responsibilities of the Audit Committee require it to meet four times a year in line with the timetables for audit activity, statement of internal controls and the production of financial accounts.
52	<i>That, in the light of my conclusions concerning lack of clear lines of responsibility, and lack of a properly functioning committee structure, a new management structure should be implemented comprising a two tier structure. At the head of the structure will be the Board of Commissioners. I recommend that a substantial proportion of the members of this Board should be drawn from outside the Department, which would therefore comply with best practice in terms of good corporate governance in the private sector. I envisage that the role of the Board of Commissioners will be primarily strategic. It will deal with the relationship with Treasury Ministers and delivering the targets required of them and on the overall direction of the Department. Ultimate power and responsibility will remain with the Board on a collective basis. However, they will then delegate their more detailed management and decision making role to a Management Committee, but they will receive regular full Board papers including the minutes of the Management Committee. As recommended above [Recommendation 41] the Board will operate with a revised remit which provides a more balanced set of objectives than previously. (para 8.7)</i>	<b>Accepted</b> In April last year a new Management Committee was formed with responsibility for managing the Department's business, thereby clarifying accountabilities and streamlining decision making. The Management Committee meets weekly. It provides reports to the Board for their quarterly meetings. The Board has overall responsibility for the strategic agenda of the Department. Candidates are being sought to increase the number of non-executives on the Board.

No	ROQUES REPORT RECOMMENDATIONS	CUSTOMS ACTIONS
53	<i>That below the Board of Commissioners there should be a Management Committee. This should be led by the Chairman as Chief Executive, and should include Directors of Finance, Information Systems and Human Resources as well as heads of business lines. The Management Committee will be the executive body responsible for much of the decision making and management of the Department as a whole. (para 8.7)</i>	<b>Accepted</b> In April 2000 a new Management Committee was established with responsibility for managing the Department's business. The Principal Finance Officer and the Director of Logistics are members of the Committee. The Human Resources Director provides advice to the Committee on a regular basis.
54	<i>That the Management Committee should meet at least monthly. It is essential in my view that this committee acts with collective responsibility, in particular for the major issues which confront the Department, and assists the Chairman to discharge his own personal responsibilities to the Treasury, the Public Accounts Committee and to Parliament. Individual Directors will be accountable to the Management Committee for the discharge of their line management functions. (para 8.7)</i>	<b>Accepted</b> The Management Committee generally meets once a week. Individual Directors are accountable for their respective business functions and related targets.
55	<i>That the Department should recruit a qualified accountant for the role of Finance Director, with responsibility over all financial areas. (para 10.5.1)</i>	<b>Modified approach adopted</b> See recommendation 46.
56	<i>That the Accounting Services Division and Analysis Division should be merged with the Finance Division in order to provide a single Finance function with overall ownership of and responsibility for all aspects of financial information and policy. (para 10.5.1)</i>	<b>Accepted</b> These divisions have now been brought together under the Principal Finance Officer in the Finance and Strategy Directorate.
57	<i>That development of an integrated revenue management accounting system should be a priority. (para 10.5.3)</i>	<b>Accepted</b> This is a Departmental priority. Development is underway and some elements will be in place by the end of the current financial year. Full implementation will take several years.
58	<i>That the Department should aim to develop and integrate management and financial reporting systems, and the systems for revenue management and accounting should be simplified. (para 10.5.3)</i>	<b>Accepted</b> A new set of monthly management accounts was established for the Management Committee in November 2000. More comprehensive revenue information being included from June 2001. Work is now under way to develop a new management information system to support the management accounts. This will be completed by 31 March 2002. The Department will simplify its revenue management and accounting systems by the introduction of a commercial accounts receivable package. A study of the options will be completed by 30 June 2001.
59	<i>That the monthly reporting on expenditure however should be combined with monthly detailed analysis of revenue receipts to provide a complete monthly management reporting pack. (para 10.5.3)</i>	<b>Accepted</b> Forecasts of revenue and cash flow are being used to compare out-turn with forecasts, analyse variances and explore reasons for significant differences. The revised management accounts now bring together revenue and cost information.

No	ROQUES REPORT RECOMMENDATIONS	CUSTOMS ACTIONS
60	<i>That the Department should continue to focus on introducing procedures in respect of resource accounting with a view to producing monthly management accounting for expenditure on an accruals basis. (para 10.5.3)</i>	<b>Accepted</b> Resource based information will begin to feature in the Management Accounts during the second half of 2001, with the target for full implementation for all expenditure from April 2002.
61	<i>That processes are put in place which facilitate close and effective working relationships between Central Intelligence officers in the Outfield and their operational colleagues. (para 10.6.4.2)</i>	<b>Accepted</b> The re-organisation announced on 17 January has placed the 13 Collection Intelligence Divisions and Central Intelligence under a single national structure, headed by a functional Director and supported by a regional management structure. This will improve coordination, both across regions and between regions and the centre. The new regional management structure has been carefully designed to align with counterparts in Investigation, Detection and Business Services so as to increase cross-functional engagement. Respective managers meet regularly for co-ordination. In addition, in each of the Intelligence regions (three plus the centre) one designated senior manager has the lead responsibility for co-ordination for the whole region for each subject area of the business (excise, drugs, etc.).
62	<i>That, in line with the Internal Audit Division recommendation, better national co-ordination of Outfield intelligence should be a high priority objective. (para 10.6.4.2)</i>	<b>Accepted</b> See recommendation 61.
63	<i>That the teams currently within Central Intelligence that are responsible for quantitative analysis should be merged with the Analysis Division, although it may be appropriate for these individuals to be included as a separate team within Analysis Division. (para 10.6.6)</i>	<b>Modified approach adopted</b> The Department accepts that there should be closer co-ordination between the CI teams and Analysis Division. Analysis Division, however, provides a service for many parts of the Department and Customs have concluded that merger as proposed would not lead to a better service. Nonetheless, overlapping responsibilities and duplication of effort have been eliminated through a new agreement on roles, responsibilities and co-operation.
64	<i>That an urgent review of the current information technology for intelligence purposes at ports be undertaken with a view to better facilitating the work of the Customs officers. (para 10.7.3)</i>	<b>Accepted</b> The Department is promoting use of electronic knowledge management in all its work streams, including intelligence. A pilot is underway. In addition, the Department will commission a review of the current information technology for intelligence purposes which will report during the summer of 2001.
65	<i>That as soon as it is appropriate a further study be undertaken into the benefits that could be derived from the use of expert systems. (para 10.7.3)</i>	<b>Modified approach adopted</b> The Department is now developing the information management systems it needs and, as explained in response to Recommendation 39, some elements of these new systems will be in place by the end of the current financial year.



# Appendix D

## The Paymaster General's announcement of an independent investigation into excise control regimes

### Customs Press Release 26/00 - 30 June 2000

#### PAYMASTER GENERAL ANNOUNCES INDEPENDENT INVESTIGATION INTO EXCISE CONTROL REGIMES

The Paymaster General, Dawn Primarolo, today announced that she has commissioned a full independent investigation into the collection of excise duties in HM Customs and Excise.

An internal Customs and Excise assessment, ordered by the new Chairman Richard Broadbent and received by the Paymaster General today, has identified serious weaknesses in the Department's control of excise duty collection, in particular the mechanisms for releasing dutiable spirits and wine from bonded warehouses. There have been numerous prosecutions, resulting in, for example, about one hundred convictions in one major group of cases. Nevertheless, the report concludes that there have been significant revenue losses, identified in the report as principally happening in the three years after 1995.

Dawn Primarolo said, " At the beginning of June the Chairman of Customs and Excise brought to my attention concerns about weaknesses in the control of excise duty collection and that he had initiated an internal enquiry. Following the results of that enquiry, which I have received today, Mr Broadbent and I have decided that this issue will be addressed immediately and thoroughly. A full independent investigation is the only appropriate course of action. Any weaknesses in the control regime and its application must be identified, rooted out and corrected quickly."

The National Audit Office (NAO) have been informed and are already working with HM Customs and Excise to quantify the losses and identify the weaknesses in the control regime.

The independent investigation announced today will consider:

- the policy, legislation, systems and resources within Customs & Excise relating to excise holding and movements to determine weaknesses and gaps including the efficiency of the current system of bonds and guarantees;
- how best to establish clear internal accountability for securing and protecting departmental revenue, and in particular whether there should be a single point of accountability within Customs & Excise for revenue cash management;
- how best to ensure that sufficient weight is given to protection of the revenue as a key criterion in Customs & Excise's handling of fraud investigations.

Any shortcomings in the systems and resources identified in the course of ongoing prosecutions, including Customs & Excise's response to these events, will also be referred to the investigation at the conclusion of those cases.

#### Notes for editors

The excise control regime is the arrangement by which Customs and Excise collect duty on goods such as alcoholic drinks.

Richard Broadbent took up post as Chairman of HM Customs and Excise on 1 February 2000.

There are a number of cases currently before the criminal courts or due to come before them in the coming months concerning excise diversion fraud emanating from bonded warehouses. One such trial is due to commence at Manchester Crown Court on Wednesday of next week, 5 July. Editors are reminded of the provisions of the Contempt of Court Act and of the need to ensure that no material is published which is capable of prejudicing the outcome of any of these trials.

This news release and other information about HM Customs & Excise can be found at our website: <http://www.hmce.gov.uk>.

# Appendix E

## Customs management structure

Customs introduced a new management structure from April 2001. This is set out below.

