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Section 2: Landfill Tax and the Landfill Tax Credit Scheme

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Our work under Section 2 of the Exchequer and Audit Departments Act 1921

Introduction

1. The Comptroller and Auditor General (C&AG) is the appointed auditor of Her Majesty's Revenue and Customs (HMRC), and its two predecessor departments, Inland Revenue and HM Customs and Excise. Under the Exchequer and Audit Departments Act 1921, he is required to:

"...ascertain that adequate regulations and procedure have been framed to secure an effective check on the assessment, collection, and proper allocation of revenue, and... shall satisfy himself that any such regulations and procedure are being duly carried out. **(Section 2(1))**

....shall make such examination as he thinks fit with respect to the correctness of the sums brought to account in respect of such revenue as aforesaid, and shall... present to the House of Commons a report on the results of any such examination. **(Section 2(2)).**

2. The results of our Section 2 work are communicated in reports to management throughout the year, with some topics being contained in the C&AG's Report to the House of Commons.
3. In October 2004, we provided HM Customs and Excise management with our 2004-05 Section 2 audit strategy, which identified the topics we proposed to review. This report contains the results for one of the topics we examined.

Scope

4. Our audit procedures are designed to meet the objectives set out for the C&AG in Section 2 of the 1921 Act, and are carried out in accordance with Auditing Standards issued by the Auditing Practices Board.
5. Our audit procedures are not designed to include a detailed review of all aspects of control systems and cannot be relied upon to disclose all errors or instances of non-compliance or control weaknesses and failures that might exist. Responsibility for the implementation of our recommendations, and the effects of implementation, rests with HMRC management.

Purpose of this document

6. This document is and remains the property of the National Audit Office. It contains information which has been obtained by the National Audit Office under statutory powers solely to discharge the C&AG's statutory functions and has been prepared as the basis for an official document, some of which may be presented to the House of Commons in due course.

Acknowledgements

7. We would like to thank staff at HMRC and Entrust for their help and co-operation in undertaking this study.

Executive Summary

Consolidation in the waste management industry has led to a reduction in the Landfill Tax trader base since the introduction of the tax in 1996. 80% of the Landfill Tax yield is now collected from Large Business Service (LBS) traders, though the locus of assurance for the tax is provided by Environmental Taxes teams within Local Compliance (LC). Assurance of large traders relies upon good practical co-operation between LBS and LC. However, IT difficulties and uncertainties over future resource availability hamper this co-operation from reaching its fullest potential. For instance, we found that assurance officers were not always aware of the availability of support and advice from the Environmental Taxes Unit of Expertise.

Liaison with environmental protection agencies works well on strategic matters, but, at least in England, local operational liaison is of variable quality. The Landfill Tax Credit Scheme was revised in April 2003. Projects to support recycling and research into sustainable waste management can no longer be funded by credits after that date.

A number of organisational changes have also occurred at the scheme regulator, Entrust, which has responded pro-actively to concerns raised by the Committee of Public Accounts in its report of July 2002. Two initiatives aimed at streamlining the scheme's operation and widening accessibility, Small Grants and Environmental Body Certification, have been introduced. Entrust has made efforts to improve the transparency of its operations, but it might consider how to better publicise these efforts, given the public nature of its function. Entrust's compliance work has undergone substantial changes recently with the introduction of a regulatory risk model to target the application of compliance work.

HMRC oversight of Entrust appears to be productive. Entrust, however, have expressed concerns that they lack sanctions, other than withdrawing accreditation, to deal with non-compliance by Environmental Bodies. HMRC are reluctant to extend regulatory powers in this area.

Distributive Environmental Bodies are increasingly used by major landfill operators to channel their contributions. The monitoring procedures they have over the projects they fund are seen by HMRC as enhancing the scheme's credibility. DEBs have also made constructive contributions towards the development of the scheme. Entrust might consider whether it could refocus its compliance activity towards assessment of the effectiveness of DEBs'

controls as more DEBs achieve Environmental Body certification.

We recommend that:

On Landfill Tax:

- Assuming that the largest landfill operators remain within LBS, managers in LBS and RBS should jointly review the effectiveness of the current arrangements for the assurance of Landfill Tax towards the end of 2005-06.
- Developments in IT provision for Excise staff should take into account the need for excise officers concerned with Landfill Tax assurance to communicate and share information with National Business Managers with overall responsibility for major traders in the most efficient way.
- Once concluded, the Memorandum of Understanding with the Environment Agency should be supported by regional arrangements to provide contact details to assurance officers and the ability to call on expert external advice. MoUs should also be concluded with the Scottish Environment Protection Agency and the Environment and Heritage Service (Northern Ireland).
- LBS and RBS should investigate their current training requirements for Landfill Tax, and submit a composite request to Tax Policy.

On the Landfill Tax Credit Scheme:

- Entrust consider whether they can address the perception of a lack of transparency about the way in which the scheme is regulated, through the provision of more corporate information on the Entrust website.
- Entrust's compliance team explain to inspectors the selection criteria for compliance activity on Environmental Bodies, and where necessary provide one-to-one sessions for inspectors to discuss their development needs and seek resolution to individual concerns
- Entrust's compliance work should look to cover Distributive Environmental Bodies' systems and controls, in addition to individual projects.

- HMRC should explore with Entrust how current regulatory powers can be used more pro-actively.
- HMRC and Entrust should discuss the value of resuming neutral publicity for the Landfill Tax Credit Scheme.
- Entrust should require projects to display the LTCS logo.

Landfill Tax and the LTCS

Introduction

Scope of the report

8. This examination covers the collection and protection of Landfill Tax revenues and the operation of the Landfill Tax Credit Scheme, including the role of Entrust, the scheme's private sector regulator. Our examination also considered the response by HMRC and Entrust to previous findings and recommendations made by the National Audit Office and the Committee of Public Accounts and reported in the C&AG's Standard Report of 1999-2000, and the Committee of Public Accounts' 47th Report of 2001-02. We have used those findings as a baseline for the examination of subsequent developments of the scheme.

History and purpose of Landfill Tax

9. Landfill Tax was introduced on 1 October 1996 as a tax on the disposal of waste through landfill. It is levied on landfill operators by weight of refuse disposed in landfill sites. There are two rates of the tax: a standard rate of £15 per tonne in 2004-05 (the 2005-06 standard rate is £18 per tonne), applied to active waste, and a lower rate of £2 per tonne, applied to inactive or inert waste.
10. The Landfill Tax (Qualifying Material) Order specifies the types of waste to be treated as inactive or inert. These include soil, brick and stone, as they do not decay, pollute groundwater, or contaminate land. All other waste, such as household waste, is treated as active. Exemptions from landfill tax include one for waste cleared from contaminated sites.
11. The aim of the tax is to encourage the disposal of less waste; to recover more value from waste through recycling and composting, and to stimulate moves to more environmentally friendly waste management methods. In pursuit of these aims, the standard rate is due to escalate to £35 per tonne in the medium to long term.
12. Consolidation in the waste management industry has led to a reduction in the population of traders registered for Landfill Tax. In 1999-2000, the trader population was 828, falling to 516 at the end of February 2005. This is expected to fall further. Total receipts of Landfill Tax in 2003-04 were £607m, net of credits. The tax was raised on declared

tonnages of 47,265k of waste at the standard rate, 13,950k at the lower rate, and 15,533k of exempt waste.

Development of the Landfill Tax Credit Scheme

13. The Landfill Tax Credit Scheme was introduced at the same time as the tax. It allows operators to claim tax credits for contributions they make to approved Environmental Bodies (EBs) for environmental improvement works in the vicinity of landfill sites. The recipients spend the contributions which meet one of the objectives specified in the Landfill Tax Regulations. Operators can claim a credit for 90% of the contributions they make, capped at 6.0% (from 01/04/2005) of the operator's total Landfill Tax liability. The total value of credits which can be claimed across the entire scheme was capped at £47m in 2003-04 values and £48.3m in 2004-05. Credits actually claimed in 2003-04 amounted to £45.8m.

Entrust

14. Overall responsibility for the Landfill Tax Credit Scheme sits with HMRC, but the scheme is regulated by Entrust (Environmental Trust Scheme Regulatory Body Ltd), a not-for-profit, private sector company limited by guarantee. Entrust's duties as regulator of the scheme are set out in the Landfill Tax Regulations. In addition, Entrust works to specific Terms of Approval set out by HMRC.
15. Entrust is funded by a 2% levy on all contributions, and a £100 enrolment fee for EBs. They maintain the EB register, and scrutinise all proposed projects for compliance with scheme regulations. The company also have a team of inspectors who assess compliance by EBs and projects on an ongoing basis.

Previous work by the National Audit Office and the Committee of Public Accounts

16. The Comptroller & Auditor General's (C&AG's) Standard Report of 1999-2000 examined the operation of the Landfill Tax Credit Scheme, focusing on Entrust's role as regulator, monitoring of Entrust by the former HM Customs & Excise, and the impact of the scheme. It concluded that there were some significant weaknesses in the design of the scheme and in the arrangements for its regulation by Entrust.

17. In summary, these weaknesses were:

- The over-complex nature of the scheme, possibly resulting in high transaction costs for stakeholders and the suspicion that there might be irregularities in its operation.
- The risk that Entrust's board may be perceived to be biased against certain types of scheme and EB, because of the large grouping of waste management representatives on the board, and because the waste management industry funds the scheme.
- The risk that EBs may not be compliant with Entrust's requirements for regulating the scheme.
- The risk that Entrust is only able to undertake superficial examination of projects, given the mismatch between project numbers and its staffing levels.

18. The report made a number of recommendations to address these weaknesses:

- One department should be given lead responsibility for the effective operation of the scheme.
- Regular benchmarking of Entrust's administrative costs should be built into Customs' oversight.
- Customs and Entrust should increase the percentage of funds committed to projects within two years; at the time of the Committee's hearing, over £120m of tax credits were unspent, and 35% of funds were uncommitted to projects.
- Customs should ensure that Entrust have a range of sanctions available to them to deal with issues of non-compliance with regulations arising in EBs.
- The Committee welcomed changes to the governance of Entrust which were already underway at the time of the hearing, in particular the change in board membership to produce wider representation from outside the waste management industry.

Landfill Tax

Responsibility for assurance – Large Business Service is now responsible for assuring the bulk of the Landfill Tax liability

19. The locus of Landfill Tax assurance within HMRC has traditionally been the Regional Business Service (RBS), now part of Local Compliance, which contains all specialist assurance capability, as well as the Environmental Taxes Unit of Expertise in Newcastle-upon-Tyne. We spoke to assurance officers and local managers in the North and South regions, and found that there is a small Landfill Tax community, with a high degree of informal contact on matters of common concern.
20. As at the end of February 2005, figures provided to us by Excise Group showed that 803 assurance events had been carried out so far during 2004-05, with an average Net Additional Liability (NAL) yield of £602 per event. This figure, however, conceals wide variations; in Northern Ireland, the average NAL yield was £5,319 per event; in Wales the average result was a £280 repayment per event. This reflects the different sizes and types of businesses assured in different regions.
21. Since July 2004, responsibility for assurance of the largest four Landfill Tax traders – Biffa, Onyx, SITA, and Waste Recycling Group – has lain with the Large Business Service (LBS), divided between two National Business Managers. Between them, these operators are responsible for 80% of the Landfill Tax liability. A further 40 medium sized operators assured by RBS contribute another 10%.
22. The LBS staff we spoke to are keen to develop their own expertise in the tax, but currently rely on RBS assurance officers to carry out work on their behalf. These arrangements are working well because of the goodwill of those involved. The debate about how the tax should be assured in the long term is affected by the fact that, from the perspective of the new, single tax department, some or all of the largest Landfill Tax operators may fall out of the LBS remit. As a result there is a risk of a lack of clear ownership for the assurance programme, and potential concerns over the availability of assurance resources.
23. In south region, the responsible manager told us of pressure to reduce the amount of resource being used on LBS work. Across RBS, we

understand that an evaluation will be undertaken to assess the value for money in terms of yield of RBS work for LBS.

Recommendation 1

We recommend that, on the assumption that any landfill operators remain within LBS, HMRC should review the effectiveness of the current arrangements for assurance of Landfill Tax in these traders towards the end of 2005-06.

IT issues

24. The principal IT system used by Landfill Tax assurance officers is the Landfill Tax element of the New Tax Database. Officers we spoke to were happy with the usability of this system; they told us that it provided them with ready access to all the information they required for their work with traders.
25. IT difficulties arise, however, as a consequence of the transfer of Landfill Tax assurance to LBS. National Business Managers are accustomed to using Electronic Folder to communicate trader-specific issues to their teams; most RBS Excise staff do not have access to the system, which makes communications inefficient. Currently, officers work around these problems with e-mail
26. Excise access to Electronic Folder is a long-standing issue in the department. We understand that its roll-out has now been suspended while work on a new strategic information system is developed.

Recommendation 2

We recommend that as part of any future IT developments, HMRC should ensure that Landfill Tax assurance staff have the ability to communicate with each other in the most efficient way. New provision should allow communication to be conducted with at least as much ease as would be possible if all staff had current access to Electronic Folder.

Access to technical expertise – liaison with environmental protection agencies

27. The nature of the Landfill Tax regime means that the main assurance issue is the definition of waste as either active or inert. Resolution of doubt in this area frequently requires scientific judgement. Some officers we spoke to were concerned at having to rely on analysis provided by traders themselves, and questioned

whether HMRC was sufficiently resourced in this area. The commercial nature of the sector, where landfill operators closely monitor both quantity and type of waste so that they are able to charge those using their facilities, means that operators have little interest in such mis-description, since active waste commands a higher charge.

28. The Unit of Expertise told us that the budget they held for scientific referral was underspent, which suggests either a reluctance on the part of assurance officers to use the facility, or else a lack of knowledge of what is available. To obtain technical advice, some assurance officers liaise closely with inspectors from the three environmental protection agencies of the UK. These inspectors visit landfill sites much more frequently than HMRC officers, and can also share more detailed information on traders' activities. This liaison operates on an ad hoc basis, however, and not all officers have succeeded in locating relevant contacts.
29. National level liaison between HMRC staff and the agencies is well-established and productive. Staff told us that liaison frequently concerned itself with specific technical issues, such as the liability attaching to different types of waste. However, there are also meetings to highlight trends and potential problems, giving a useful background to understanding the wider issues for both HMRC and the environmental protection agencies.
30. The Utilities Trade Sector consultant believes that a national MOU would help to improve understanding. Currently, he is pursuing a national Memorandum of Understanding with the Environment Agency, but, at the time of our visit, was having difficulty in identifying a counterpart in the agency who could progress the matter.

Recommendation 3

We recommend that the Memorandum of Understanding, once concluded, should be supported by regional MoUs concerning the provision of contact details to assurance officers and the ability to call on expertise. MoUs should also be concluded with the Scottish Environment Protection Agency and the Environment and Heritage Service (Northern Ireland). Any memoranda should be kept simple and straightforward.

31. An important issue for assurance officers arises from the exemption from Landfill Tax for waste cleared from contaminated sites. To obtain the necessary certificate of exemption from HMRC, remediation firms must submit a detailed application before the work commences. Under a new system in place since 1 April 2005, the application is subject to three stages of sift – at the Unit of Expertise, and at the two regional sift teams responsible for the site location and the applicant's head office.
32. Assurance officers we spoke to considered that regional sift teams had little experience in Landfill Tax, since they regularly consulted assurance officers themselves for advice. They were concerned at the time-consuming nature of the new process, which they said risked breaching customer service standards. The Unit of Expertise acknowledged that the system was unpopular with assurance officers, but that its aim was to achieve consistency in the handling of applications. Staff there told us that the procedure would be reviewed for effectiveness in due course.

Training

33. Officers we spoke to were happy with the quality of training courses and Guided Learning Units on Landfill Tax in general and the contaminated land issue specifically. There did appear to be a problem with availability of courses, which caused problems for staff in LBS who wished to become proficient in the tax, and for succession planning in RBS South, where two experienced officers are due to retire in the next eighteen months.
34. Whilst acknowledging the importance of 'on the job' training in the tax, Tax Policy told us that they would be happy to make special arrangements for training if they received a request.

Recommendation 4

We recommend that LC and RBS should investigate their current training requirements in Landfill Tax, and produce a composite request.

Avoidance and evasion

35. HMRC regards the major operators as compliant, although they will attempt to avoid the tax on technical grounds. A major success for the operators has been the 2002 'Parkwood' judgement, which allows exemption from Landfill Tax for recycled material.
36. The industry has consolidated to such an extent that one-site operators who are prone to error and evasion are insignificant in yield terms. Large operators have extensive control systems in place to protect revenue at their sites. These systems also guard against the suppression of loads subject to Landfill Tax.
37. Unlicensed sites and fly-tipped waste are both outside the scope of Landfill Tax. This is the case even when failure to obtain a licence from the environmental protection agency is clearly a means of evading the tax. HMRC has no enforcement powers against either the operators of unlicensed sites or fly-tippers but other agencies do have powers to deal with these matters. For example, the environmental protection agencies and local authorities tackle fly tipping.

Operators' views

38. We spoke to a representative of the Environmental Services Association, with whom HMRC hold regular liaison meetings. We were told that the sector had no difficulties with the tax, nor with the way that HMRC assured it. This lends support to the HMRC's view that the waste management industry supports the tax as a tool to encourage a switch to recycling. Such an aim accords with the sector's own strategic thinking.

The Landfill Tax Credit Scheme

Background

39. The Landfill Tax Credit Scheme (LTCS) allows landfill operators to reduce their Landfill Tax liability by making contributions to approved EBs in support of projects with defined environmental benefits. Project objectives are prescribed by the Landfill Tax Regulations.

OBJECT A – activities to reclaim, remediate or otherwise bring land back into social, environmental or economic use

OBJECT B – activities to reduce, mitigate, or prevent pollution on land where the pollution has been caused by an activity which has now ceased

OBJECT D – providing and maintaining public amenities and parks within the vicinity of a landfill site

OBJECT DA – conservation or promotion of biological diversity through (i) the provision, conservation, restoration or enhancement of a natural habitat; or (ii) the maintenance or recovery of a species in its natural habitat in the vicinity of a landfill site

OBJECT E – restoration or repair of buildings that are for religious worship or of architectural or historical interest in the vicinity of a landfill site

OBJECT F – the provision of administrative, financial or other similar services to environmental bodies enrolled with Entrust

40. Since 1 April 2003, the scheme has been reduced in scale, with the removal of projects in the areas of recycling and research into sustainable waste management (the former Objects C and CC) from its scope. Object DA was added in October 2003. Additionally, the cap on the total level of contributions which could be made under the scheme was reduced from £150m to £47m. Contributions made before 2003-04 ('Old Scheme' contributions) can still be spent on Object C and CC projects.
41. At the time of our visit to Entrust in March 2005, there were 2770 enrolled EBs, of which 1105 were not in receipt of any tax credit funding. Most EBs do not receive contributions directly from landfill operators. Instead, they receive 'transfers' from Distributive Environmental Bodies (DEBs), which the major

landfill operators use as channels for their contributions.

Examples of LTCS-funded projects

Portmoak Moss Raised Bog Restoration Project – Value of LTCS contributions £96,897

The Woodland Trust received contributions from SITA Environmental Trust to assist in the restoration of an area of natural bog in Scotland. The work involved the removal of conifers which had been planted on the site, and the blocking of ditches. This allowed water levels to rise and recreate the bog.

The Bungalow Toy Library – Value of LTCS contributions £25,000

The Bungalow Toy Library, located in Blaby, Leicestershire, provides educational and quality toys and equipment to its members, as well as a place for members to socialise and their children to play. Funding from the SITA Environmental Trust has saved the library from closure, and also allowed it to provide an Outreach Delivery Service to rural groups, families with special needs and families on low incomes.

Sandiacre Methodist Church, Nottingham – Value of LTCS contributions £15,091

The church received contributions from Biffaward to enable the complete refurbishment of its toilets, including the provision of a disabled toilet and baby changing facilities.

Cricklade Skateboard Park – Value of LTCS contributions £10,295

Community First in Cricklade, Wiltshire, received contributions from Biffaward towards the provision of a facility for rollers and skateboarders.

Developments in Entrust's organisation and the operation of the LTCS

42. Entrust has made significant changes to its structure and manner of operations since we last examined the LTCS. The composition of the company's board has changed completely since our finding in 1999-2000 that it was overly dominated by the waste management industry. There are now no representatives of waste management companies on the board. All members are non-executives with the

exception of the Chief Executive, who has been in post since 2003.

Background of Entrust Board members

- Retired English Nature Grants Officer
- Chartered Accountant – Independent Financial and Management Consultant
- Former bank director
- Lawyer – Consultant in environmental law and policy
- Surveyor – experience of regeneration and PFI
- Member of House of Lords, former county councillor, member of CfIT
- Chartered Accountant – Director, Member of Auditing Practices Board, University Governor

43. The reduction in the scale of the LTCS since April 2003 has brought with it a corresponding shrinkage of Entrust's operations. The former area offices have been closed, and all administrative activity is now carried out at the head office in Sale. In addition, compliance inspection work, some of which was formerly contracted out, is now all carried out in-house by a team of eight home-based inspectors. Entrust's latest published accounts (for 2003-04) show average staff numbers of 22 (not including directors) and running costs of £2.1m.

44. In response to PAC criticisms of the scheme, specifically its complexity, lack of transparency and accountability, together with the difficulty of demonstrating the value for money achieved, Entrust sought to develop ways to simplify the scheme's operation, whilst maintaining its integrity, and to improve the focus of its compliance work.

45. **The Small Grants Scheme** – The scheme was fully introduced on 1 April 2005, after a 5 month trial period. Key to the scheme is the introduction of simplified procedures for projects which require contributions of less than £15k. Those responsible for projects can now approach funders directly for contributions. The projects are pre-assessed and registered by EBs themselves; Entrust will sample and check a proportion of applications.

Eventually, Entrust expect 65-75% of applications for funding to use the scheme.

46. **Environmental Body Certification** – Again effective from 1 April 2005, Certification aims to set a consistent framework for the operation of EBs. In return for providing evidence of their satisfactory performance against a series of criteria related to their operations and governance, EBs can now qualify for 'lighter touch' regulation. Entrust are aiming for 65-75% of contributions to pass through certificated EBs.

47. Certification requires EBs to provide evidence in the following areas:

- Applicable Law – commitment to comply with Landfill Tax Regulations and all relevant legislation appropriate to the EB's status – e.g. company or charity law- as well as holding of adequate insurance and compliance with the Data Protection Act.
- Regulatory Processes and LTCS Core Processes – compliance with Entrust requirements for enrolment as a body and for registration of projects, as well as ongoing compliance with regulatory and financial reporting requirements for EBs.
- LTCS Funding Arrangements – observance of Guidelines for Funders of Voluntary Organisations with respect to facilitating access to funding; processing of applications; decision making processes; selection criteria; payment procedures; ongoing monitoring and evaluation of funded projects; obligation on recipients to disseminate the source of their funding; and clarity in changes to funding criteria
- Conduct of Business – adherence to Nolan principles; observance of propriety by directors; aiming for ISO 9001 and 'Investors in People' status; avoidance of repetitive transfer of LTCS monies; lack of landfill operator and local authority influence; open procurement policy.

48. Underpinning these developments is the rollout of 'Entrust On-Line' from April 2004. The system allows prospective EBs to apply for enrolment, register projects and supply all financial information over a secure internet connection. Entrust has also transferred all its pre-existing paper-based records into the system.

49. The processes for enrolment and project registration now have the additional benefit of automatically generating a risk rating based on the response to questions which have to be answered as part of the on-line procedure. The ratings are then used to direct compliance inspection activity in accordance with Entrust's regulatory risk model – Project Audit and Compliance Evaluation (PACE). The project also permits an assessment of the value for money afforded by projects by measuring them against DEFRA Quality of Life indicators.
50. Take up of Entrust On-Line has been swift, and Entrust are to be commended for managing the transition and rapidly incentivising greater use of on line services. At the time of our audit visit, the number of EBs with On-Line accounts was approaching 200 with more than 50% of scheme contributions being reported electronically. Entrust's target is for this percentage to reach 75%. However, our visits to two small EBs with Entrust compliance inspectors did reveal a lack of awareness of Entrust On-Line, despite the publicity given to it in the quarterly Entrust newsletter.
51. The changes Entrust has made show a promising readiness to address previous adverse commentary on the LTCS. Whilst it is too early to judge the ultimate success of the Small Grants Scheme, EB Certification, and Entrust On-Line, these initiatives do have the potential to improve the user-friendliness of the LTCS and enhance the benefits which the scheme produces.
52. We examined a sample of EB enrolment applications and project registrations, and confirmed how Entrust On-Line ensures that all necessary steps in these processes are covered. In discussions with representatives of one of the largest DEBs, we found satisfaction with the way in which Entrust On-Line was working. Indeed, several major DEBs had contributed their suggestions to the development of the system.
53. A key factor in the operation of the scheme is the credibility and effectiveness of Entrust as a regulator. We sought the views of the Association of Distributive and Environmental Bodies (ADEB); examined the means by which HMRC exercises oversight of Entrust, and also looked in detail at Entrust's own compliance activity in EBs.
54. Whilst acknowledging the positive changes which Entrust had made in the recent past, representatives of ADEB expressed some concern to us over a lack of transparency of Entrust's governance and operations, particularly the level of its administration costs. They appeared unaware of the level of oversight exercised by HMRC, which is discussed in some detail below.
55. We consider that this concern may result from the paradox that Entrust carries out a public function in regulating a statutory tax credit scheme, yet has the status of a private sector company. Stakeholder anxieties might be better addressed if Entrust were unambiguously to accept current public sector standards of accountability and transparency.

Recommendation 5

We recommend that Entrust consider how it can address perceptions of a lack of transparency, for example, through publicising the extent of HMRC oversight, posting corporate information and statutory accounts on its website with a commentary. Entrust needs to bear in mind that information about the working of the scheme and its regulation held by HMRC, is potentially disclosable under the Freedom of Information Act.

56. Entrust's activities as regulator of the LTCS are governed by Terms of Approval agreed with HMRC. These set out Entrust's responsibilities for enrolling EBs and registering projects, as well as carrying out compliance activity. The Terms of Approval also set out the arrangements for the funding of Entrust's running costs by means of the 2% levy on contributions and the EB £100 enrolment fee. They also require Entrust to pass details of contributions received by EBs to HMRC each month.
57. We found that HMRC exercises close oversight of Entrust in a number of ways, all of which are set out in an annual Assurance Plan. Policy staff have observer status at Entrust board meetings, where their input is available into strategic planning issues. HMRC also holds 'checkpoint' meetings at roughly bi-monthly intervals with the Chief Executive and senior staff of Entrust, in order to discuss current issues, evaluate performance, and enable Entrust to plan its activity.
58. Additional ad hoc meetings are also held. For example, we were present when Entrust compliance staff presented the regulatory risk

Credibility of Entrust – HMRC oversight – Entrust's compliance activity

53. A key factor in the operation of the scheme is the credibility and effectiveness of Entrust as a regulator. We sought the views of the Association of Distributive and Environmental Bodies (ADEB); examined the means by which HMRC exercises oversight of Entrust, and also looked in detail at Entrust's own compliance activity in EBs.

model for HMRC comment. It was clear that Entrust was able to benefit both from the input of HMRC contacts on this specific issue, and from an open and trusting relationship generally.

59. Further elements of the Assurance Plan are a minimum sample of 5% each of EB enrolments and project registrations to check that Entrust is applying eligibility criteria effectively. HMRC also examine Entrust's compliance activity by accompanying each inspector on one visit, examining 5% of visit reports, reviewing the Entrust audit plan and holding quarterly meetings with the Compliance Manager. Additionally, officers from the Environmental Taxes Unit of Expertise undertake a monthly reconciliation of Landfill Tax Credits claimed by operators to contributions notified to Entrust by EBs. The Unit now has full access to Entrust On-Line to facilitate this task.
60. In 2004, HMRC undertook an exercise to benchmark Entrust's procedures and costs against those of the Charity Commission. It concluded that HMRC were satisfied with Entrust's current performance and there were some indicators of good practice.
61. We accompanied two Entrust compliance inspectors on visits to small EBs in receipt of transfers from a major DEB. What emerged strongly from these visits was the fact that the DEB had its own extensive project supervision procedures in place. The project representatives we spoke to were keenly aware of the strong interest the contributing landfill operator had in managing the reputational risks which would result from failed projects, and how this impacted on their projects through regular supervision activity. By comparison, Entrust's compliance activity was experienced much less frequently.
62. At the time of our visit, Entrust was refining PACE, its regulatory risk model, to address compliance risks as well as financial ones. Inspectors we spoke to expressed frustration at not being privy to the reasoning behind the risk rating given to the projects they were assigned to inspect. They were also unhappy about being sent to unfunded projects which by definition present no financial risk to the scheme. (Entrust's present compliance plan provides for activity on all unfunded projects in the highest risk category, and on 1% of unfunded projects in the lower categories.) Some inspectors also said that they felt isolated,

relying on ad hoc support from colleagues to develop their skills.

63. Our observations suggest that some Entrust inspectors need to approach project representatives with more confidence and focus. A better understanding of the criteria behind individual risk rankings might contribute to achieving this.
64. We understand that the current project focus of PACE results from the need to concentrate compliance activity on the remaining high-risk Object C and CC projects which continue to receive 'Old Scheme' contributions. As these projects are completed, a focus on EBs rather than projects might become more appropriate. The dominance in funding terms of major DEBs suggests that Entrust might fruitfully refocus its regulatory activity on assuring that DEBs' own supervisory procedures are working effectively, thus giving more efficiently-realised assurance over a much larger number of projects. To develop the Small Grants Scheme and EB Certification to their fullest potential, Entrust will in any event need to undertake a programme of verification of the representations given by participating EBs.

Recommendation 6

We recommend that the compliance team at Entrust should consider giving more information to inspectors on the criteria for selection of EBs for visits. This might also include findings from previous visits.

Recommendation 7

The Entrust compliance management should hold regular one-to-one sessions with inspectors to identify development needs and seek resolution to individual concerns.

Recommendation 8

Following the move to certification, Entrust should shift the focus of its compliance work to the auditing of EBs 'and DEBs' systems and controls, rather than concentration on individual projects.

Sanctions

65. An unresolved issue for Entrust is the lack of sanctions for non-compliance with scheme regulations. The only power given to the regulator by the Landfill Tax Regulations is the drastic one of revocation of an EB's enrolment. We discussed extra sanctions which might be useful, such as fines, freezing of bank accounts, or the ability to halt work on a project.

66. HMRC's view is that there are clear sensitivities in giving a private sector organisation such powers. They believe that Entrust could avoid the need for more sanctions if they intervened more pro-actively with EBs.

Recommendation 9

We recommend that, as part of the regular assurance process, that HMRC undertake a focused exploration with Entrust on how current powers can be used more pro-actively. HMRC should also reconsider whether additional sanctions are required to allow Entrust to respond to PAC's previous concerns.

Uncommitted contributions

67. Some EBs receive their funding under agreements from DEBs. For long term projects contributions received by EBs are disbursed to projects in stages to reflect the percentage of work completed. Projects are not advanced further contributions until they have provided assurance to their funder that work is proceeding in accordance with the agreements in place. Waiting for projects to reach agreed milestones means that significant amounts of tax credit money are held by EBs pending the completion of work. The level of contributions passed to EBs but not committed to projects was a cause of major concern to PAC in 2001-02. This figure reached its peak of £210m at the conclusion of the 'Old Scheme' in March 2003. Entrust told us that the principal reason for the build-up is the long-term nature of the remaining Object C/CC schemes. All such projects will have to be completed by 2007-08. The current trend is for the level of uncommitted expenditure to reduce. As of May 2005, the figure stood at £183m.
68. Entrust have no control over the management of individual projects, and the funds allocated for the completion of the Object C and CC schemes are ring-fenced. Other than urging projects and their funders to complete outstanding work, there is little that the regulator can do, particularly if the project is proceeding in accordance with its funding agreement.
69. During 2004, HMRC conducted their own informal review of uncommitted funds, and were content that DEBs and EBs were not holding onto contributions unreasonably. We have reviewed HMRC's work which examined a sample of incomplete projects, and identified the reasons for unspent contributions. In no

cases were there concerns that the projects were causing EBs to retain uncommitted funds that they would not be able to draw down, as planned in the future.

70. With the requirement for Object C and CC projects to be completed by 2007-08, and a large amount of outstanding project work to complete there are potential inspection and assurance resourcing concerns for Entrust. Entrust must ensure that it is able to plan for this, and deal with the possibility of a significant amount of work at the end of the period.

Recommendation 10

We recommend that Entrust develop plans to manage the additional workload required to carry out inspections of major C and CC projects, as they are completed in the period through to 2007-08.

Dominance of the scheme by major DEBs

71. Major DEBs linked with landfill operators now dominate the scheme, accounting for 70% of contributions. HMRC told us that, overall, they see this dominance as an advantage, because of the resulting economies of scale in administration costs; the inability of DEBs to benefit from LTCS contributions themselves; the accumulation of skills in DEBs, allowing projects to concentrate on delivery; the experience of DEBs in generating, leveraging, and managing funds, and, as we have already noted, the scope afforded to Entrust to rely on DEBs' monitoring procedures.
72. Our discussions with Entrust revealed some ambivalence about the role of the DEBs. Whilst their input into the development of the Small Grants Scheme, EB Certification, and Entrust On Line has been welcomed and significant, Entrust appears somewhat unsure about relying on DEBs' project supervision procedures to a greater extent. Entrust will need to consider how to develop its organisational capacity to emphasise its role as regulator of the DEBs, whilst taking advantage of their clear commitment to the development of the scheme.
73. A possible disadvantage of the DEBs' dominance is that, in the absence of any Entrust publicity for the LTCS, sophisticated marketing operations by the major DEBs fills the gap. Observers may gain the impression that the DEBs are responsible for the

management and even regulation of the scheme.

Recommendation 11

We recommend that HMRC and Entrust should discuss the potential value of resuming neutral publicity for the Landfill Tax Credit Scheme.

Recommendation 12

HMRC should discuss with Entrust ways of encouraging projects to display the LTCS logo with the same prominence as that of their funding DEB.

Conclusions

74. In spite of the small size of Landfill Tax revenues relative to those of other tax streams, Customs had succeeded in building up a small cadre of well-trained and knowledgeable staff to assure Landfill Tax revenues. It is important that during the transitional period, as departmental responsibilities are assigned within HMRC that resources can be secured to preserve this capacity, and that appropriate IT and training support arrangements can be agreed.
75. Entrust have responded positively to the adverse findings made by the Committee of Public Accounts in its report on the 1999-2000 Customs and Excise Standard Report, and much progress has been made. Entrust could, however, do more to raise awareness of the changes that have been made. Entrust should also ensure that they respond to ongoing changes within the scheme, and align their compliance work to take, more fully, account of consolidation within the sector and changes to arrangements for distributing tax-credit funding.
76. Both Entrust and HMRC will need to work closely to ensure that the regulatory regime can be applied proactively to offer greater control, where necessary, over non-compliant EBs. Both organisations should also look proactively at ways in which they can better exploit public awareness of the scheme and its benefits.

Annex 1 – Summary of recommendations and management's responses

Summary of recommendations and agreed actions				
Rec. number	Recommendation	Management Response		
1	We recommend that, on the assumption that any landfill operators remain within LBS, the Department should review the effectiveness of the current arrangements for assurance of Landfill Tax in these traders towards the end of 2005-06.	Accepted. We will review the effectiveness of the current assurance of landfill tax for LBS traders and the application of the LBS/LC co-operation agreement. If we find shortcomings we will recommend options to improve effectiveness.		
2	We recommend that as part of any future IT developments, HMRC should ensure that Landfill Tax assurance staff have the ability to communicate with each other in the most efficient way. New provision should allow communication to be conducted with at least as much ease as would be possible if all staff had current access to Electronic Folder.	Accepted. HMRC is due to begin piloting a new system for Electronic Document and Records Management, which if subsequently adopted as a wider departmental system should be capable of meeting the needs of Landfill Tax assurance officers for management of trader information. A business case will be put forward for implementation which will be considered alongside other areas of the business.		
3	We recommend that the Memorandum of Understanding, once concluded, should be supported by regional MoUs concerning the provision of contact details to assurance officers and the ability to call on expertise. MoUs should also be concluded with the Scottish Environment Protection Agency and the Environment and Heritage Service (Northern Ireland). Any memoranda should be kept simple and straightforward.	Accepted. HMRC will continue to pursue the establishment of central MoU's with the EA, SEPA, and the Environment and Heritage Service. Once these can be established then we will look to establish local MoUs to support the national ones.		
4	We recommend that LBS and RBS should investigate their current training requirements in Landfill Tax, and produce a composite request.	Accepted. We will review the effectiveness of the current assurance of landfill tax for LBS traders and the application of the LBS/LC co-operation agreement. If we find shortcomings we will recommend options to improve effectiveness.		

Summary of recommendations and agreed actions				
Rec. number	Recommendation	Management Response		
5	We recommend that Entrust consider how it can address perceptions of a lack of transparency, for example, through publicising the extent of HMRC oversight, posting corporate information and statutory accounts on its website with a commentary. Entrust needs to bear in mind that information about the working of the scheme and its regulation held by HMRC, is potentially disclosable under the Freedom of Information Act.	Accepted. HMRC will discuss this with Entrust to see what further information can be provided publicly that will aid transparency		
6	We recommend that the compliance team at Entrust should consider giving more information to inspectors on the criteria for selection of EBs for visits. This might also include findings from previous visits.	Accepted. HMRC are actively engaged in discussion with Entrust about possible ways of improving the focus of compliance inspectors. This will include ensuring that inspectors understand the criteria for visit selection.		
7	The Entrust compliance management should hold regular one-to-one sessions with inspectors to identify development needs and seek resolution to individual concerns.	Accepted. HMRC are in agreement with this recommendation and will speak to Entrust's compliance management about implementation		
8	Following the move to Certification Entrust should shift the focus of its compliance work to the auditing of EBs' and DEBs' systems and controls, rather than concentration on individual projects.	Accepted. This recommendation reflects the new compliance philosophy of Entrust and will be monitored by HMRC		
9	We recommend that, as part of the regular assurance process, that HMRC undertake a focused exploration with Entrust on how current powers can be used more pro-actively. HMRC should also reconsider whether additional sanctions are required to allow Entrust to respond to PAC's previous concerns.	Accepted. HMRC has discussed, and will continue to do so, ways in which Entrust can be more pro-active in its intervention with EBs. The issue of whether to extend the sanctions available to the regulator is one HMRC will keep under review.		

Summary of recommendations and agreed actions				
Rec. number	Recommendation	Management Response		
10	We recommend that Entrust develop plans to manage the additional workload required to carry out inspections of major C and CC projects, as they are completed in the period through to 2007-08.	Accepted. HMRC are happy that Entrust has developed plans to carry out its function with regard to C and CC projects as they are completed in the period through to 2007-08. HMRC will monitor this area through to the end of this period.		
11	We recommend that HMRC and Entrust should discuss the potential value of resuming neutral publicity for the Landfill Tax Credit Scheme.	Accepted. HMRC will consider, with Entrust, the value of resuming neutral publicity for the scheme.		
12	HMRC and Entrust should discuss ways of encouraging projects to display the LTCS logo with the same prominence as that of their funding DEB.	Accepted. HMRC will discuss with Entrust and other scheme stakeholders ways of encouraging the more prominent use of the LTCS logo.		