Comptroller and Auditor General's Standard Report on the Accounts of the Inland Revenue 2001-02

Issued under Section 2 of the Exchequer and Audit Departments Act 1921 as amended by the Government Resources and Accounts Act 2000

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Comptroller and Auditor General
8 November 2002

Executive Summary

1. Section 2 of the Exchequer and Audit Departments Act 1921 requires me to examine the accounts of the Inland Revenue on behalf of the House of Commons to establish that adequate regulations and procedure have been framed to secure an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out; to examine the correctness of sums brought to account; and to report the results to the House of Commons.

2. During 2001-02, the National Audit Office examined both new and existing systems. As regards new systems, the National Audit Office examined management of debts and tax returns and the Children's Tax Credit. Reviews of existing systems included aspects of Pay as you Earn (PAYE), Corporation Tax and the Working Families' and Disabled Person's Tax Credits. The National Audit Office also reviewed the Inland Revenue's management of risk associated with their information technology infrastructure.

3. No system can ensure that all taxpayers and potential taxpayers comply with their obligations. As part of the Department's Public Service Agreement targets they aim to improve the number of individuals and businesses who do comply. Subject to recognising that it is not possible to secure full compliance and other specific matters raised in this report, the work undertaken by the National Audit Office provided assurance that the Department's regulations and procedure continued to provide an effective check over the assessment, collection and allocation of tax. My financial audit report on the Department's Trust Statement for 2001-02 records that I was also satisfied with the correctness of sums brought to account.

4. Parts 2, 3 and 4 of this report look at significant developments in Internal Controls, Tax Credits and Debt Management. The main points arising from these examinations were:

   - The Departmental Accounting Officer's Statement on Internal Control reflects Treasury requirements and describes a number of control mechanisms and initiatives. It sets out some areas where continuing development of control arrangements is needed during 2002-03. I welcome the Statement on Internal Control and note the importance of the Department's emphasis on improved management information, which should help them better to target effort and to demonstrate achievements. I note also the importance of Internal Audit being able to continue to provide reliable and sufficient assurance on the quality of the Department's work.
   - I have examined tax credits in previous years and again this year I note the problem the Department experienced in reconciling the amount of tax credit paid via employers with that actually authorised by the Department. The results of the further special exercise by the Department are disappointing in respect of 2001-02 and will need to be improved for 2002-03. It is important that the Department are learning the lessons from their experiences of current tax credits so as to minimise similar problems in the new tax credit schemes that are to operate from April 2003.
   - The Department's Receivables Management Service is a major new business stream that is taking a number of initiatives to transform tax collection and debt management. I welcome the important new activities in this area and some early successes. I note however also the

importance of extending the initiatives to all tax streams and to all classes of debt. As the Receivables Management Service develops over the next years I will look particularly to enhanced management information capable of demonstrating much more comprehensively the achievements, particularly in debt management and tax collection.

Part 1: Scope of the Audit

1.1 Section 2 of the Exchequer and Audit Departments Act 1921 requires me to examine the accounts of the Inland Revenue on behalf of the House of Commons to establish that adequate regulations and procedure have been framed to secure an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out; to examine the correctness of sums brought to account; and to report the results to the House of Commons.

1.2 Figure 1 shows the net receipts of £148.7 billion in taxes and duties which the Inland Revenue (Department) collected in 2001-02, compared with previous years.

Figure 1: Inland Revenue: Tax and National Insurance receipts and Tax Credits 1997-98 to 2001-02

	Net Receipts[1] and Tax Credit Payments				
	1997-98	1998-99	1999-2000	2000-01	**2001-02**
	£bn	£bn	£bn	£bn	**£bn**
Income Tax	76.8	86.6	94.0	106.0[2]	**108.7**
Payment of Tax Credits (Working Families' and Disabled Person's)	-	-	(1.1)	(4.6)	**(5.7)**
Corporation Tax	30.4	30.0	34.4	32.4	**32.0**
Capital Gains Tax	1.5	2.0	2.1	3.2	**3.0**
Inheritance Tax	1.7	1.8	2.0	2.2	**2.4**
Stamp Duty	3.4	4.6	6.9	8.2	**7.0**
Petroleum Revenue Tax	1.0	0.5	0.9	1.5	**1.3**
Windfall Tax	2.6	2.6	-	-	**-**
Total tax receipts	**117.4**	**128.1**	**139.2**	**148.9**	**148.7**
National Insurance Contributions	48.9	52.9	58.7	62.7	**65.3**
Total	**166.3**	**181.0**	**197.9**	**211.6**	**214.0**

[1]These receipts are shown net after allowing for tax reliefs and allowances (for 2001-02 this includes Children's Tax Credits), and for repayments. Repayments totalled £13.2 billion in 2001-02.

[2]This figure has been restated since publication of the 2000-01 accounts to reflect updated information. The restatement resulted in £148 million increase in Income Tax and decrease in National Insurance contributions.

Audit approach

1.3 In order to review those systems which the Department have put in place to secure an effective check on the assessment, collection and allocation of revenue, the National Audit Office undertakes:

- examination of the Department's internal controls, including the development of governance arrangements;
- reviews of quality assurance work and other checks carried out by the Department on the tax systems;
- periodic in-depth reviews of existing systems and significant changes to them, and the evaluation of new systems;
- reviews of the Department's computer installations and networks and specific information technology applications; and
- test examinations of individual transactions and balances.

1.4 Figure 2 summarises the coverage of the work of the National Audit Office in 2001-02. The results of that work not detailed here have been notified to the Department in management letters.

Figure 2: National Audit Office examination of Inland Revenue tax systems 2001-02

	Aspects Examined	
General	• Examination of the Department's internal controls, including the development of governance arrangements and the Management Information available to support the Statement on Internal Control. • Internal Audit Office's review of the introduction of Area Management.	See Part 2
Tax Credits	• Payment and Accounting arrangements. • Changes to tax credit schemes.	See Part 3
Debt Management	• Receivables Management Service. • Receivables Telephony Centres. • Standardisation of procedures across the network offices.	See Part 4
Income Tax	• Operation of PAYE scheme. • Repayments of Self Assessed and PAYE Income Tax. • Collection of Student Loan repayments. • Other PAYE work.	
Corporation Tax	• Operation of Corporation Tax Self Assessment. • COTAX *(Corporation Tax IT System).* • Repayments of Corporation Tax.	

1.5 Information Technology is essential to the administration of taxes. Computers hold data on all taxpayers, process information received, and produce a range of outputs designed to assist the taxpayer and the Department to discharge their obligations accurately and efficiently. The National Audit Office therefore conduct regular examinations of how the Department manage the risks associated with the operation of these systems.

1.6 In 2001-02, National Audit Office coverage included examination of the main computer installations and a programme of reviews of the information technology infrastructure. These included the procedures for amending tax and other software and the transfer of data between systems and selected applications.

1.7 In addition to my examination of tax systems under Section 2 of the Exchequer and Audit Departments Act 1921, I also look at the economy, efficiency and effectiveness with which the Department have used their resources. The results of these Value For Money studies are published in separate reports to the House of Commons under Section 9 of the National Audit Act 1983. Since my last report on the Department's accounts, I have reported on the Department's progress in introducing electronic services (HC 492). I plan to report later in 2002-03 on External Fraud against Inland Revenue along with similar reports on Customs and Excise and the Department for Work and Pensions.

Statement on Internal Control

1.8 Each Accounting Officers is required to make a Statement on Internal Controls covering operational and policy-making systems in addition to financial systems. The Department produce separate but near identical Statements for the Resource Account and the account of taxes and duties. The Statements assert the Accounting Officer's responsibility for maintaining a sound system of internal control that supports the achievement of departmental policies, aims and objectives, whilst safeguarding public funds and departmental assets for which he is personally responsible. The Accounting Officer's assessment of the effectiveness of the system of internal control is based on the work of the internal auditors and reports from the Chair of the Audit Committee, and is also informed by regular reports and updates from senior managers.

1.9 The Statement for 2001-02 highlights two particular areas as needing improvement, namely tax credit payments and clearance of open tax records. The Statement is reproduced in full at pages 38 to 40 in this volume and developments in internal control are considered in Part 2.

1.10 The National Audit Office's work in 2001-02 provided overall assurance that the Inland Revenue's regulations and procedure continued to provide an effective check over the assessment, collection and allocation of tax. The National Audit Office have suggested in management letters to the Department some further improvements that could be made. The following parts of this report cover:

Part 2 Departmental Accounting Officer's Statement on Internal Control

Part 3 Tax credits operated in 2001-02 and observations for the new tax credits from 2003

Part 4 The Department's Receivables Management Service, including Debt Management

1.11 For 2001-02, the Inland Revenue prepared Resource Accounts and a Trust Statement and my report on those accounts fulfils my responsibility under Section 2(2) of the 1921 Act and I have given them unqualified audit opinions. The last Appropriation Account for the Inland Revenue was published in respect of 2000-01. All financial information concerning the Department's administration is now published in the Resource Account. Accordingly, for 2001-02 and future years, this report under Section 2(2) of the 1921 Act, is being published in the same document as the Resource Account and Trust Statement.

Part 2: Statement on Internal Control

Introduction

2.1 This part of my report examines the Accounting Officer's Statement on Internal Control and the main elements of the Department's control framework.

The Statement on Internal Control

2.2 As part of the continuing development of Corporate Governance, the Treasury introduced a requirement for departmental Accounting Officers to make a statement in their 2001-02 accounts on all of the organisation's systems of internal control. The statement is required to cover operational and policy-making systems in addition to financial systems. In previous years, the Accounting Officer's statement was only on internal financial control systems. I am required to review the Statement on Internal Control and to report if it does not meet the requirements specified by Treasury, or if it is misleading or inconsistent with other information I am aware of from my audit.

2.3 The Accounting Officer's Statement on Internal Control is included in the Trust Statement accounts (see pages 38 to 40). It acknowledges that the Accounting Officer is responsible for ensuring that the Department maintain and operate a sound system of internal control that supports the achievement of the Department's policies, aims and objectives whilst safeguarding the public funds and departmental assets for which the Accounting Officer is personally responsible.

2.4 There is no requirement for the accounts or the Statement on Internal Control to make an assertion about the extent of tax evasion or tax uncollected. These topics are, however, an important focus of Departmental actions and Target 1 of the Public Service Agreement is to improve the number of individuals and businesses who comply with their obligations. For example they aim to get 90.5 per cent of IT Self Assessments filed by the due date and 50.6 per cent of employers to pay over tax and NI contributions by the due date each month. No system can ensure, however, that all taxpayers and potential taxpayers comply with their obligations.

The Control Framework

2.5 The Statement on Internal Control lists the main elements of the Department's control framework as:

- the control environment (including a clear departmental committee structure and a new accountability framework);
- risk management processes (including assignment of responsibility to individual directors);
- control activities (being comprehensive procedures covering all aspects of the business);
- information and communication (including indicators for performance measurement and senior management actively communicating their agenda to staff); and
- monitoring (including internal audit, an external and independently chaired Audit Committee and a broad-based Quality Programme).

2.6 The Department’s Internal Audit Office provide the Accounting Officer with an independent and objective opinion on the effectiveness of risk management, control and governance. They provide specific Assurance Reports twice a year to the Departmental Audit and Security Committee, which the National Audit Office regard as a very valuable and important part of the formal reporting cycle of corporate governance and risk management matters.

2.7 During 2002-03 the Department established a Departmental Finance Committee chaired by a Deputy Chairman to oversee the deployment of financial resources, including recommending and monitoring departmental budgets. The Department also established a new accountability framework from 1 April 2002 for operational areas. The National Audit Office view this and the Departmental Finance Committee as particularly important developments from the point of view of financial control and the National Audit Office will pay close attention to the continuing development of accountability arrangements for other areas of the Department during 2002-03.

2.8 The Accounting Officer says in the Statement that some of the risk management processes and accountability arrangements are still being developed. He highlights continuing work to enhance the information that the Department have on Tax Credit payments made via employers, and to improve the clearance of open tax records.

2.9 The Accounting Officer’s Statement on Internal Control complies with Treasury requirements and helpfully sets out in a public document the Accounting Officer’s view on the control framework. Under Treasury's current requirements, the Department have until 1 April 2003 to complete all development work necessary for a full statement on internal control to be made for 2003-04.

Management Information Systems

2.10 Reliable, relevant and timely information enables management to decide how best to target resources to achieve departmental policies and enables management to demonstrate how well the Department have performed against targets.

2.11 The National Audit Office examination of the Department's systems for administering and collecting taxation considered the provision of high level information to senior management. For those main business streams reviewed, there were a number of instances in which the management information available did not satisfy existing and emerging business needs.

2.12 For Corporation Tax, the Department are currently unable to make effective use of the data they hold. Many of the current reporting processes on the main IT system (COTAX) were inherited from a previous system which was introduced in the mid 1990s. The Department have targets to improve company compliance in filing tax returns and paying tax. However the Department cannot extract from the COTAX system the information they need to understand their taxpayers’ behaviour and influence the taxpayer. The Department acknowledge that management information systems in the Corporation Tax area need to be enhanced. In March 2002, the Chairman of the Board approved a programme of improvements, which includes enhancements to the COTAX system and delivery of data to the Department’s Corporate Data Warehouse – a central repository of shared information – which are intended to enable regular reporting and information on performance. The Department plan that these comprehensive enhancements will be in place by April 2003.

2.13 The Department have some readily available information on Self Assessment filing rates, but there are difficulties in measuring paying performance for Self-Assessment and in reliably measuring paying and filing performance for PAYE. Many of the problems are related to the complexity of interrogating some of the tax computer systems. The Department are developing improvements to management information systems and interrogation techniques, which should be in place by mid-2003.

2.14 Internal Audit Office recently reviewed the Department's Public Service Agreement and Service Delivery Agreement targets for 2001-02 and 2002-03 (shown at Appendix 1 to this report). Internal Audit were concerned that the additional information required to support the enhancements to Public Service Agreement Target 1 for 2002-03 (regarding improvements in the number of individuals and businesses who comply with their obligations) will not be available due to absence of adequate management information. The National Audit Office share this concern.

2.15 The Department require independent validation of reporting results against Public Service Agreement targets. The Internal Audit Office are to carry out that independent validation exercise.

2.16 The Department are aware of deficiencies in their management information systems and their reporting of performance against targets. Internal Audit Office's recent report on Public Service Agreement and Service Delivery Agreement targets indicated that in the past, when systems were being developed, management information had not always been afforded the priority to ensure that it was not sacrificed if delivery and cost pressures arose. The National Audit Office share the Department's concern that on occasion in the past management information appears to have suffered where the Department faced difficult decisions about prioritising work.

2.17 The Department have taken steps to improve their management information, through the continued exploitation of the Corporate Data Warehouse and its associated infoNET management information delivery service. A Management Information Unit is now in place to assist Departmental business streams and organisational units across the Department, providing user support and a telephone helpline. The Department have also created a new Information Director post with responsibility for provision of internal information. The first Director has been appointed and took up post in September 2002. In addition the Departmental Board commissioned in September 2002 work to identify how the provision of performance information can be improved.

The Quality Programme

2.18 The Department have a well established and broad-based Quality Programme which provides information on performance across the Department at an individual case level. The main features of the programme are:

- *Quality Assurance* processes to help staff carry out their work properly;
- *Quality Control* processes of on-going peer and management review as the year progresses; and
- *Quality Monitoring Exercises* performed by independent validators towards the year-end.

2.19 The National Audit Office examined the Quality Programme for a number of Departmental business streams. This provided some assurance that the Department maintain and operate a sound system of monitoring. The National Audit Office identified minor weaknesses in the system which were notified to the Department in management letters. The reliability of the Quality Programme will remain an important element of the Department's sources of assurance about its systems.

2.20 For Quality Monitoring Exercises, the Internal Audit Office check the work of the independent validators. They look at independence; guidance and training materials; and standards of validation work. For 2001-02, Internal Audit's level of coverage was very high. For some business streams, every area office in England and Wales was visited. Ongoing changes to the Department's management structure will make it difficult to sustain this level of coverage in future years. The Internal Audit Office are currently looking at ways of rationalising the number of offices visited without compromising the overall assurance provided on standards of work.

Conclusions

2.21 The Department are continuing to strengthen the control environment in order to support a full Accounting Officer's Statement on Internal Control for 2003-04. **As the Department recognise, they must continue to monitor the effectiveness of new processes and arrangements introduced, so as to ensure that benefits to the taxpayer are maximised.**

2.22 The Department recognise the need to tackle the problems of inadequate management information and are committed to introducing improvements. **They are concerned that although there will be improvements in the medium term, inadequate systems remain over the short term. This may affect the Department's ability to decide how best to target resources to achieve their objectives and to demonstrate how well they have performed against targets.**

2.23 The Departmental Internal Audit Office's review of Quality Monitoring Exercises is important in providing assurance on standards of work across large areas of the Department's activities. The extent of Internal Audit's work has been rationalised as a consequence of ongoing Departmental restructuring. **The Department should regularly analyse the results of Internal Audit's review of the work of the independent validators, to ensure that the value of that work is not compromised and that it provides reliable and sufficient assurance as to the quality of Departmental work.**

Part 3: Tax Credits

3.1 This part of my report examines three tax credit schemes operated by the Department in 2001-02. It includes a description of the schemes; a review and follow-up of previous findings; and observations applicable to the new tax credits to be introduced in April 2003.

Tax Credit Schemes Operated in 2001-02

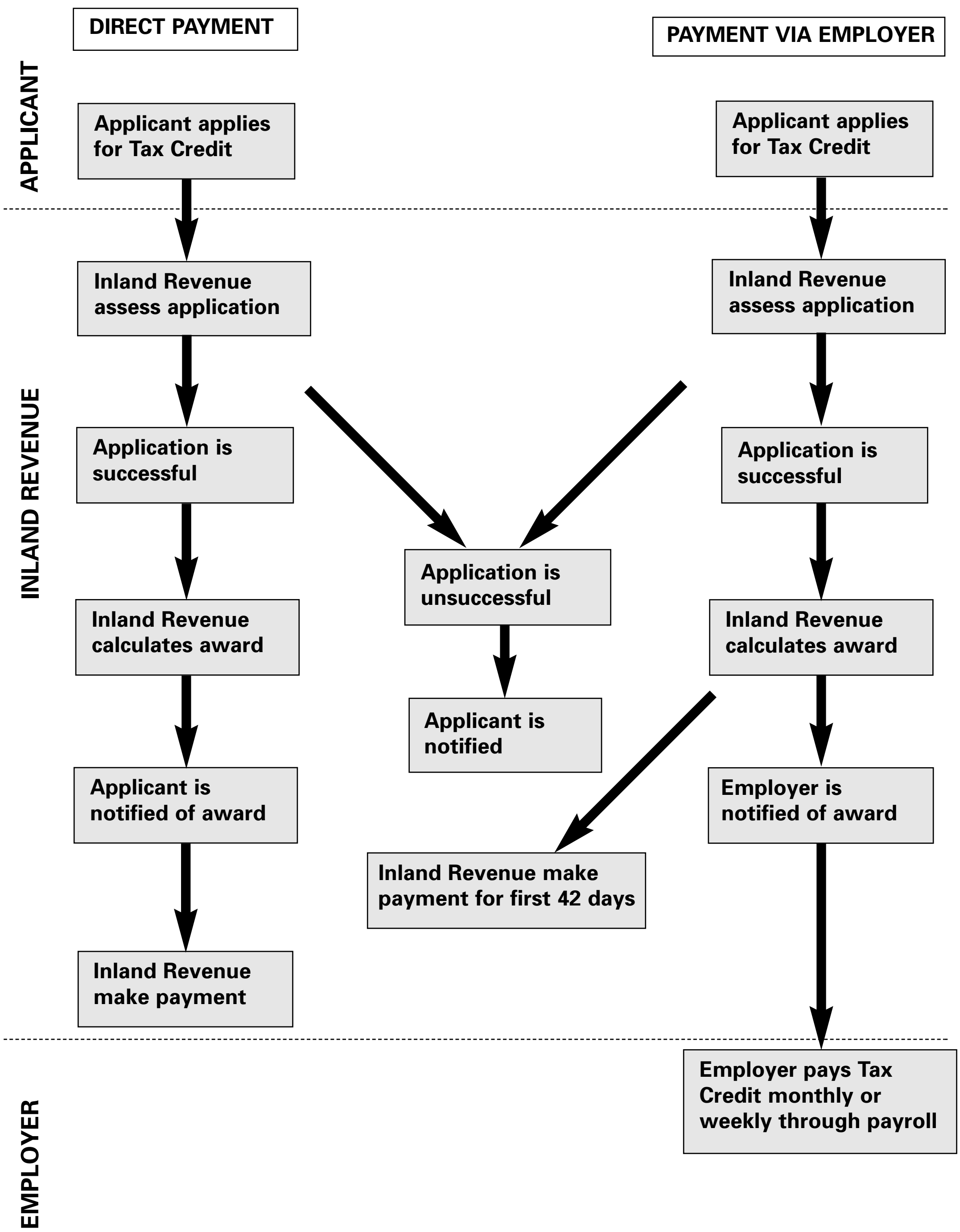
3.2 Three tax credits operated in 2001-02 were the Working Families' Tax Credit; the Disabled Person's Tax Credit; and the Children's Tax Credit. The schemes for Working Families' and Disabled Person's Tax Credit were introduced in October 1999 as part of the Government's programme of reforms to make work pay. The Children's Tax Credit is somewhat different as it is a tax allowance which was introduced in April 2001.

Working Families' Tax Credit and Disabled Person's Tax Credit

3.3 Working Families' Tax Credit is available to couples with children and single parents who work more than 16 hours per week but who are on low incomes. Similarly, Disabled Person's Tax Credit is available to people with disabilities who are in work but have low incomes. For both schemes, the tax credit is designed to act as an income top-up. The amount payable is based on the net weekly income of the applicant and comprises a basic entitlement, plus additions, for example, for children and childcare costs where appropriate. Awards are reduced by 55 pence for every pound of income in excess of a prescribed threshold.

3.4 Working Families' and Disabled Person's Tax Credits are paid to recipients either by automatic credit transfer, order book, girocheque, or via their employer. In 2001-02, the Department paid out some £3.44 billion through credit transfer, order book or girocheque and some £2.2 billion via employers. Figure 1 below shows the process through which an award and payment of tax credits is made.

Figure 1: Main Stages in the administration of Working Families' and Disabled Person's Tax Credits



3.5 Since their introduction, these tax credits have made a considerable impact on claimants, see Figure 2 which is based on the Inland Revenue's Quarterly Enquiry for February 2002. Figure 3 shows the changes in the average value of awards and the number of recipients since the introduction of the Working Families' and Disabled Person's Tax Credits in 1999.

Figure 2: Impact of Working Families' and Disabled Person's Tax Credits

In February 2002 1.349 million people were in receipt of Working Families' and Disabled Person's Tax Credits;

The average award was £83 per week;

1.331 million recipients had children and 2.53 million children were in recipient families;

33,000 disabled workers received Disabled Person's Tax Credit, of whom 15,000 had children;

763,000 families benefited from a supplement for working more than 30 hours per week;

162,000 families benefited from the childcare element of the tax credits, averaging £39 per week; and

The average gross earnings of the main earner in all recipient families was £172.

Figure 3: Average Value of Weekly Award and Number of Recipients

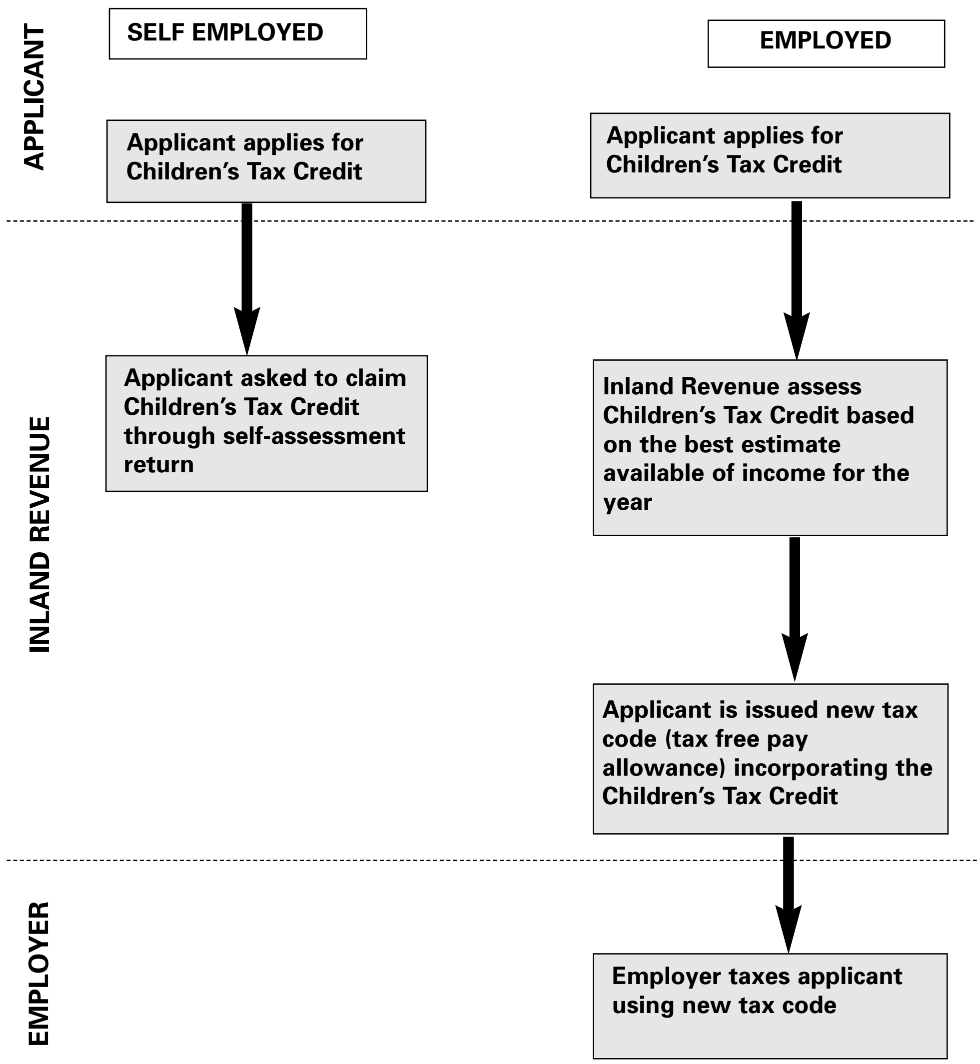
	1999-00		2000-01		2001-02	
	Weekly Award (£)	Recipients	Weekly Award (£)	Recipients	Weekly Award (£)	Recipients
Working Families' Tax Credit	72	1,057,000	80	1,225,000	83	1,316,000
Disabled Person's Tax Credit	69	20,992	73	27,932	77	32,777

Source Figures 2 and 3: Inland Revenue Quarterly Enquiry, February 2002

Children's Tax Credit

3.6 Children's Tax Credit is administered as a tax allowance. This means that its value to a recipient is dependent on the income and other taxable circumstances of the recipient. It is available to couples and single parents who look after a child who lives with them and is aged under 16. One tax credit is available per family, regardless of the number of children in the household. The Department estimated that in 2001-02, 4.6 million taxpayers were eligible for Children's Tax Credit and 3.3 million people received an average of £502 through the PAYE system. Since self employed returns are not yet all received and processed, the Department cannot know how many of these people also benefited from this tax credit.

Figure 4: Main Stages in the administration of Children's Tax Credits



Working Families' and Disabled Person's Tax Credits: Audit Findings 2000-01

3.7 For 2000-01, the National Audit Office reviewed the accuracy of tax credit awards; compliance by tax credit applicants; and the arrangements for payment of Working Families' Tax Credit and the Disabled Person's Tax Credit.

3.8 In 2000-01 the Department estimated the gross rate of errors in the accuracy of awards made by them as being 1.22 per cent, which was low in proportion to the total value of monies handled. Some £27.2 million was potentially overpaid and £30.4 million potentially underpaid to individuals. In 2001-02, the rate of errors made by the Department has increased to 1.73 per cent suggesting some £53 million was potentially overpaid and £42.6 million potentially underpaid to individuals. Even small errors could be significant to the recipients but the Department do not have information on the range and frequency of significant individual underpayments. The Department's processes and information to customers encourage claimants to check their awards and contact the Department about errors.

3.9 When examining the extent to which applicants complied with the rules in 2000-01, the National Audit Office were satisfied that the Department had developed an approach which achieved detection and reduction of non-compliance.

Tax Credit Payments Via Employers

3.10 For 2000-01, I reported that in-year employer compliance work did not enable the Department to evaluate the level of error in tax credit payments by employers. Hence, they could not provide sufficient assurance that employers were paying across the amounts awarded by Inland Revenue. The Department estimated that they had paid out tax credits of some £1.395 billion through employers. The Department had improved the way in which they recorded the results of the work done by the employer compliance teams, and had strengthened the way tax credits were examined by Inland Revenue Employer Compliance Officers. New systems in development during 2001-02, should result in better assurance over amounts paid via employers for 2002-03 and subsequent years.

3.11 In May 2002 the Chairman of the Inland Revenue reported to the Public Accounts Committee (PAC Paper 163), that employers' end of year tax returns for 2000-01 did not provide sufficient quality of information to allow a full reconciliation between tax credits awards notified by the Department and the amounts paid out by employers. The Department believe this to be due, in part, to confusion amongst employers as to the correct way to complete the end of year tax return, which had been altered from that of previous years. There were also a number of errors made by the Department in recording the scheme reference number of the employer making the payment.

3.12 To address this problem, in early 2002, the Department had undertaken a special exercise to identify instances where the information provided by employers as to payments in 2000-01 did not match awards made by the Department. This identified a number of discrepancies. They then investigated the 25 largest discrepancies from the 90 over £100,000, and a further 25 discrepancies chosen at random from those below £100,000. The Department were satisfied that the results of these investigations did not generally suggest that the discrepancies arose from any reason other than error, or the complexity of reconciling records, particularly for employers with multiple payroll schemes. Since then the Department have improved their own processes and amended the design of employers' end of year tax returns for 2002-03 and provided further support to employers in completing the returns.

3.13 Tax Credit expenditure is shown in the Department's Trust Statement Account for 2001-02 as a statistical estimate. This is because the timetable for processing the employers' end of year tax returns runs from July to October and hence the Department were unable to corroborate the estimate before the Trust Statement Account was signed.

3.14 To provide further support for their estimate, the Department carried out additional work in respect of payments made by employers in 2001-02. A substantial sample of tax credit awards was traced through to the statutory return from employers for individual employees, to compare the amount employers report as paid with that authorised. The Department also traced back to original awards from a substantial sample of forms employers submitted summarising pay, the Income Tax, National Insurance, tax credits and etc for each employee. This was to ensure that tax credits payments which employers report as made were in respect of valid awards authorised for payment by the Department. The work was continuing at the end of October 2002 and the initial results of the two parts of this work suggest that the Department's basis for estimated figures in the accounts was reasonable for 2001-02.

3.15 However, these early results also indicate that some of the discrepancies may not be the results of genuine error and the Department will be analysing the results to determine how to focus their employer compliance work on the trends identified.

Children's Tax Credits: Accuracy and Compliance in 2001-02

3.16 Children's Tax Credit is different from other tax credits mentioned in this report as the credit is part of the taxpayer's allowances. When applications for Children's Tax Credit are processed there is no verification that the child exists, and no requirement for the applicant to provide the Child Benefit reference number, for example. This approach is consistent with other tax allowances and the statutory framework for making claims where the Department carry out sample checks later as part of their enquiry processes rather than requiring evidence or supporting documentation in advance.

3.17 The Department's compliance team examined applicant compliance in the 2.4 million applications processed at the Department's central location. The compliance team examined a sample of 800 applications so as to validate the information supplied by applicants. A fundamental part of this validation was to request Child Benefit details from the applicant which could be matched to the Department for Work and Pensions records. The Department found that:

- In 95.1 per cent (761) of cases applicants provided details of the child for whom they were claiming and these matched the details held on the Child Benefit database, verifying the application;
- In 2.1 per cent (17) of cases applicants' circumstances had changed, but this did not affect their entitlement;
- In 1.8 per cent (14) of cases there was no response to the Department's enquiry and Tax Credit was withdrawn. The Department assumed that overpayments of the maximum of £520 arose in each case; and
- In the other 1 per cent (8) of cases applicants have responded and it has been confirmed that overpayments were between £366 and £520.

3.18 The Department estimate that these errors could mean that some £21 million has been overpaid across the 2.4 million applications centrally processed. The estimated error does not cover some 2.2 million applications processed at tax offices as these were not examined by the Department. They have no reason to believe that error rates are likely to be greater or lesser in tax offices than at the central processing location.

3.19 In addition to reviewing the results of the Department's work, the National Audit Office tested a sample of 100 applications to assess how accurately awards had been made through the taxpayer's coding notice. They found that:

- In 93 per cent of cases applications had been accurately processed in terms of calculating and notifying the right tax code for both 2001-02 and 2002-03;
- In 6 per cent of cases the applicant had not received tax credits in respect of 2001-02 because the claim was not received in time for the Department to process it and for the employer to operate a new tax code for the last pay date of the year. Normally a backdated payment should have been made, but in the cases examined this had not happened.
- In one case two people applied for and had both been awarded tax credit in respect of the same child. The full significance of this finding will not be assessed by the Department as they do not plan to carry out any work to identify other such instances because these tax credits are stopping in March 2003.

Tax Credit Accounting Estimates

3.20 Working Families' and Disabled Person's Tax Credits are accounted for in accordance with the Organisation for Economic Co-operation and Development (OECD) definitions for national accounts. They are disclosed in the accounts as "negative tax" to the extent that they are less than the income tax liability of the family unit. They are shown as "public expenditure" when they exceed the income tax liability. However, for Children's Tax Credit the accounts do not need to reflect the tax impact as this credit is solely a tax allowance. The Department estimated Children's Tax Credit at £2.1 billion for 2001-02 which allowed for some eligible taxpayers not applying for the credit at all; the total awarded credit not being fully used where a recipient earned less than their personal allowances as increased for the credit; and higher income taxpayers being subject to abated allowances which taper to nil if taxable income exceeds £41,735.

New Tax Credits (From April 2003)

3.21 Children's, Working Families' and Disabled Person's Tax Credits will be replaced from April 2003 by the Child Tax Credit and the Working Tax Credit under the Tax Credits Act 2002. The new Child Tax Credit, (which is distinct from Children's Tax Credits), is a Tax Credit for couples and individuals with responsibility for one or more children or young people. The new Working Tax Credit is for people in paid work of at least 16 hours per week. The amount of credit received will be based on the claimant's annual income and their current circumstances. The main elements of Child Tax Credit and Working Tax Credit are shown in Figure 5.

Figure 5: Main Elements of Child Tax Credit and Working Tax Credit

Child Tax Credit	Working Tax Credit
• a family element payable to a couple or individual with responsibility for one or more children or young people • a higher family element where there is at least one child in the family under the age of one • a child element for each child in the family • a higher child element if the child has a disability, which is higher again if the child has a severe disability • a family who are not in work and have income of less than £13,000 would receive a Child Tax Credit award of £1,990 a year if they have one child or £3,435 if they have two children.	• a basic element • an element which is paid to couples and single parents • an element which is paid if working hours are a total of 30 hours or more per week • a disability element which is for one or both partners in a couple who are working at least 16 hours and have a disability • a severe disability element for an adult with a severe disability – the person does not have to be the person working if the claim is a joint one • a child care element which is paid to help households with costs of formal childcare • a 50 plus element which is time-limited for people aged 50 or over returning to work after a period on benefits • a single individual without children, working full-time, with income of £7,500, would receive a Working Tax Credit award of £1,245 a year

3.22 The Child Tax Credit and the childcare element of the Working Tax Credit will be paid direct to the main carer for children in the family, through automatic credit transfer to a bank account. The Department are working with other Departments and the universal banking programme to ensure that suitable facilities are available to all those who need accounts. Apart from the childcare element, Working Tax Credit will be paid to employees with their wages by employers.

Observations for the New Tax Credits

3.23 The National Audit Office's work on old tax credits and attention by the Committee of Public Accounts over the last two years suggest the following important considerations for the Department's new tax credit systems. The National Audit Office will examine in some detail the arrangements in place as part of the audit in respect of 2002-03 and 2003-04. Management of the new tax credits should benefit from the valuable experience and lessons learned by those managing the previous tax credit schemes.

Take Up Levels

3.24 One measure of the success of the new tax credits will be take up compared to expectations and need. The Department told the Committee of Public Accounts in May 2002 that only when the Department had been able to finalise their analysis of the Family Resource Survey results would they be able to estimate need and therefore estimate percentage take up achieved. Take up of new tax credits will be largely dependent on publicity for the scheme and support for applicants. The Department have a major programme of contact with likely applicants and are taking this issue very seriously.

Transitional Arrangements

3.25 The replacement of the existing tax credits with new tax credits from April 2003 means that it is inevitable that there will be some overlap of applications for tax credit schemes. The Department have arrangements to ensure that applicants have the maximum appropriate information and understanding possible. They are also paying attention to helping employers in changing from the existing to the new schemes.

3.26 Awards made for Working Families' and Disabled Person's tax credits run only to the end of the 2002-03 tax year regardless of the start date, rather than the former arrangement of 26 weeks from the date of the award. This is designed to ensure that claimants do not receive overlapping payments of the former and the new tax credits. Those recipients of the existing tax credits whom the Department expect to be eligible for the new tax credits received information packs from September 2002.

3.27 From September 2002 awards of old tax credits are being made by direct payment rather than via employers. This avoids employers having to account for different tax credits in the same year. This will also help the Department and employers to concentrate on ensuring that arrangements for the new tax credits are in place for payment in April 2003.

Managing information on changes in circumstances

3.28 The new Working Tax Credit and Child Tax Credit awards will run for a full year or from the date of the award to the end of the tax year. There is a statutory requirement for recipients to disclose significant changes in circumstances which may affect their award during that period. It is critical that the Department have adequate systems and procedures in place to encourage recipients to notify changes, and to be able to capture and process notifications of changed circumstances quickly and accurately.

3.29 The Department need to ensure that their Applicant and Employer Compliance Teams are able to detect and quantify potential fraud and other non-compliance where recipients fail to notify changes in circumstances. Further, the Department need to ensure that they can monitor effectively the risks and financial consequences of failure to notify change in circumstances, and the cost of enforcing compliance.

Management Information on the new tax credits

3.30 Good management information is essential to support the Department's introduction of the new tax credits. Systems based around the Department's Corporate Data Warehouse are being developed and once implemented are intended to provide comprehensive coverage of new tax credits' management information requirements.

3.31 It is not practical to expect a precise reconciliation between notifications for payments of new tax credits to be made via employers and employer end of year tax returns. Nevertheless, the Department recognise that they need to ensure the system can give reasonable assurance that what is intended to be paid is paid by the employer, and that the tax deducted by employers but not paid over to the Exchequer has been properly used to pay tax credit recipients.

3.32 The Department will also need management information on the number of employers paying tax credits who have been visited by the Department's employer compliance teams and details of the teams' findings. The Department will need to be able to extrapolate the overall value of erroneous payments by employers to inform consideration of the financial accuracy of the new tax credits.

Internal Controls

3.33 The National Audit Office noted that for the old tax credits, the system development timetable proved insufficient for the implementation of an effective control framework over some aspects of the operation of these tax credits. The Department must ensure that the control framework for new tax credits is as fully developed as possible and that "descoping" in respect of controls is kept to a minimum.

Conclusions

Existing Tax Credits

3.34 The Department's quality assurance work has indicated that the level of errors made during the processing of applications is low in proportion to the aggregate amount paid. At the individual level, however, an error may be significant, especially to those who have received less than their entitlement. **In the light of the rise in the error rate from 1.22 per cent in 2000-01 to 1.73 per cent for 2001-02, the Department need to strengthen analysis of the quality assurance results so as to identify and address types of error most likely to lead to significant under- or over-payments.**

3.35 The Department carried out additional work on a substantial sample of tax credits award notifications and employee end of year tax returns to confirm the estimate for payments via employer in 2001-02. **The results are disappointing in respect of that year. The Department must repeat this exercise for 2002-03, the last year of Working Families' and Disabled Person's Tax Credits, to ensure that their estimate in the accounts is also supportable.**

3.36 The Department believe that problems with reconciliations between end of year tax returns and award notifications were partly because employers were confused over how to complete them. **Hence, the Department must continue to improve the nature of employers' end of year tax returns and also continue to step up their educational work with them. This should improve accuracy of completion so that the returns can be used for reconciliation purposes when new tax credits are introduced.**

3.37 The National Audit Office found that in a number of cases applicants who had applied for Children's Tax Credit towards the end of 2001-02 and start of 2002-03 did not receive credit for the former year as it was too late for a revised code to be given to their employer. **Where the Department clear taxpayers' records on the PAYE system for 2001-02 they should ensure that any Tax Credit due for 2001-02 is paid.**

3.38 The Department did not require Child Benefit details when they processed claims for the Children's Tax Credit with the result that corroborating information was not readily accessible. However, the Department will require Child Benefit details in respect of applications for the new Child Tax Credit to be introduced in April 2003. **The Department should ensure that when designing new systems and application forms, where information can reasonably be supplied, it is requested and utilised.**

New Tax Credits

3.39 There are a number of important aspects of the new tax credits that the Department must take into account when finalising the systems and procedures, and controls over them**. The Department should pay particular attention to transitional arrangements; management of information about changes in circumstances of tax credit recipients; development and use of management information; and building sufficient controls into the new arrangements.**

Part 4: The Department's Receivables Management Service

Introduction

4.1 This part of my report considers the work of the Department's Receivables Management Service, a new business stream created on 1 April 2001 to combine the collection of taxes and debt management services. The Receivables Management Service are responsible for receiving, accounting for and recovering £200 billion from individual taxpayers, employers and companies. The initiatives described in this part of the report aim to transform collection and debt management services.

The Receivables Management Service

4.2 The Receivables Management Service are responsible for collecting and accounting for all debt that is legally due and payable (apart from Stamp Duty and Valuation Office Agency receipts). They also pursue individuals and companies for tax returns. The processing and accounting for tax payments and sending out routine demands are part of the Receivables Management Service's responsibility, but the processing of tax returns is not.

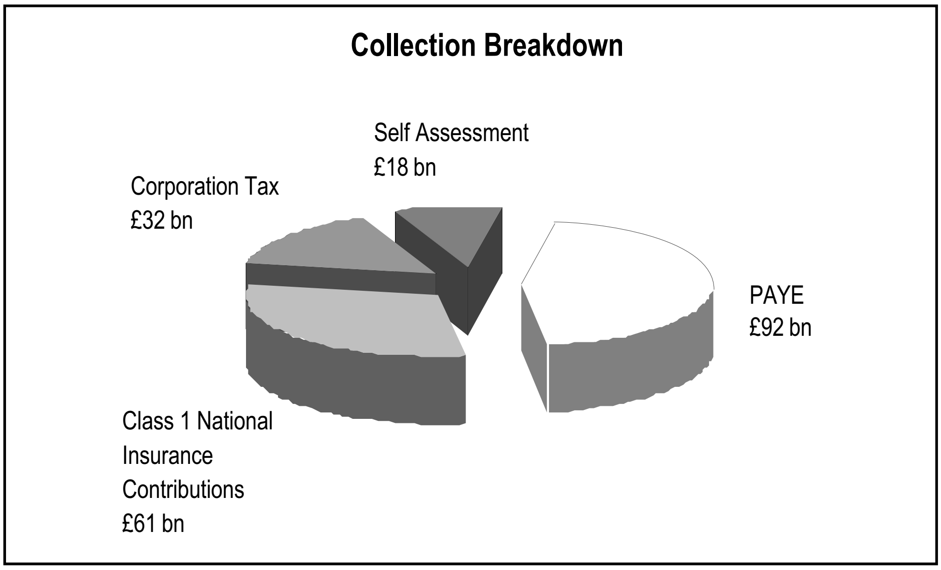
4.3 The Receivables Management Service collect three types of debt:

- Self assessed debts: those that the taxpayer quantifies and notifies to the Department. This includes some Income Tax and all Corporation Tax;
- Assessed debts: those calculated by the Department, including debts due from tax case determinations, penalties, interest and surcharges, and contract and non-contract settlements; and
- Debts collected on behalf of the Department by employers and other third parties, including Pay As You Earn (PAYE), National Insurance Contributions, and Student Loan deductions.

4.4 Within the assessed debt category, there is an element known as "Legacy Debt". This debt relates to tax years prior to the introduction of Income Tax Self Assessment in 1996-97, and is covered in paragraphs 4.19 to 4.23. When any type of debt is under appeal by taxpayers, the tax assessed is said to be "stoodover", is not collectable and collection cannot be enforced. The debts do not become the responsibility of the Receivables Management Service until the appeal has been completed. Total standovers amounted to approximately £27.3 billion at October 2001, much of which, once relevant enquiries are complete, is likely to be cancelled as not due.

4.5 Annually, the Receivables Management Service maintain some 1.5 million employer, 9.1 million Self Assessment, and over 1 million Corporation Tax accounting records on very large computer systems. They collect a total of around £200 billion of taxes and National Insurance Contributions each year. Figure 6 shows the breakdown of annual receipts for 2001-02. The Department do not know the amount of outstanding debt at any tax year end, as the collection account year ends in October.

Figure 6: Amounts collected by the Receivables Management Service during 2001-02



4.6 The Receivables Management Service pursue annually more than 20,000 overdue employers' end of year returns and approximately 900,000 overdue Self Assessment returns. They also handle debts relating to company liquidation, bankruptcy and other debts such as:

- Interest and penalties, e.g. National Minimum Wage penalties
- Self Employed National Insurance Contributions
- Working Families' Tax Credit and Disabled Person's Tax Credit
- Overdue Student Loan repayments

4.7 Prior to the formation of the Receivables Management Service, the debt management function and responsibilities were dispersed across the Department. This led to inconsistencies in the pursuit of debt and a lack of common goals and objectives. The Receivables Management Service provides a "start to finish" debt management function, and consists of three Receivables Telephone Centres, 150 local recovery offices and 11 associated group offices, three specialist offices dealing with insolvencies and the Accounting and Payments Service (formerly the Accounts Offices at Shipley and Cumbernauld). Approximately 7,000 staff are employed within the Receivables Management Service, representing around 10 per cent of the Department's total employees.

4.8 As a single business stream, the Receivables Management Service are able to transfer work between its various locations to manage any backlogs or peak time workflows more effectively. Their aim is to integrate all collection and debt management, including several separate systems and processes. They have begun this process with new computer and telephony systems.

Integrated Debt Management System

4.9 The Integrated Debt Management System was introduced in November 1999, in response to the 1994 Fundamental Expenditure Review of the Department's Collection Service, which compared their debt management processes with best practice in the private sector. The aim of the system is to improve efficiency, reduce costs and tax arrears and to increase tax flow.

4.10 The Integrated Debt Management System is a major strategic project, intended to provide comprehensive, new debt management processes. It will eventually automate all recovery and enforcement processes where appropriate. At present it covers the major tax streams (PAYE, Corporation Tax, Class 1 National Insurance Contributions) with the exception of Self Assessment. Interfaces with other systems supporting individual tax streams enable some integration and the transfer of information.

4.11 The Receivables Management Service intend to enhance the Integrated Debt Management System in 2002-03, introducing risk assessment in the pursuit of debts and improving management information to demonstrate their achievements and support the best use of resources. The new enhancements will also, through an interface with the County Court Bulk Centre, significantly improve the enforcement and issuing of summons to defaulting taxpayers and companies. The eventual aim is for all debts to be progressed on the Integrated Debt Management System, including Self Assessment and all classes of National Insurance Contributions.

Levels of Debt and Trends

4.12 In 2003-04, the Inland Revenue must produce an accruals based account (showing taxes collectable as well as actually collected), as part of the government-wide project to produce Whole of Government Accounts. The amount of tax debt will be required for those accounts, and could be the largest single debtor figure in government. It is therefore essential for the Department to collate details of debt, and increase their management information.

4.13 Currently the Department estimate debt levels at 31 October for most tax streams for historical reasons. The Department have no reliable measures of the level of debt by tax stream or overall, nor trends in these figures. The Department faces a challenging task in producing debtor figures for an accruals based account and for their management purposes, although enhancements to their management information systems will result in more data being available than previously.

Recent Receivables Management Service Initiatives

4.14 The Receivables Management Service have a number of initiatives at various stages of implementation which are aimed at improving collection and debt management services.

a) Recovery and Enforcement Procedures Extension

4.15 The Recovery and Enforcement Procedures Extension initiative was introduced into local recovery offices during 2001. It prioritises and speeds up the processing and clearing of the most recent debt. The Department believe that giving priority to the most recent debt leads to more taxpayers fulfilling their obligations, maximising receipts and returns submitted and reducing the likelihood of future non-compliance. They also consider that with the most recent cases cleared, more time is available to process the backlog of older cases, with a view eventually to eliminating it.

4.16 Under this initiative, procedures for PAYE and Self Assessment debts are standardised, creating a greater consistency of methods used. Flowcharts detail the actions to be taken on the debt, dependent on its type, age and value. The initiative is being extended to cover other debts such as Corporation Tax, with implementation during 2002-03.

4.17 The National Audit Office visited local recovery offices where this initiative had been implemented for several months. The initiative has had a positive impact on the standardisation and streamlining of cases, with some evidence of new cases being cleared more quickly, and staff having detailed guidelines to follow.

4.18 The National Audit Office noted at some offices visited, that insufficient resources were available to deal with the initiatives and other workloads. At these offices, only the newer debts were cleared, leaving debts arising before the initiative unactioned for long periods, and leading to further delays in clearing the backlog. The Internal Audit Office also identified this issue in their review of the Receivables Management Service in 2001-02. The Department told the National Audit Office that they had always recognised that there would be a temporary build up of work on older debts as the initiative was introduced. But, by introducing new, more efficient processes for new debt, they expected to release resources to deal with the older debts not yet within the new process.

b) Legacy Debt

4.19 When the Receivables Management Service were created, they inherited a backlog of income tax "Legacy Debt". They undertook a review which concluded that the majority of these debts could be collected cost effectively. In June 2001 they began to tackle them by reviewing all legacy debt cases, which were manually maintained. The second phase began in December 2001, with the aim of settling every debt, by:

- collecting the tax;
- writing it off under existing rules; or
- having appropriate recovery action underway.

The National Audit Office examined progress in clearing legacy debts and the conclusions of the Internal Audit Office's evaluation of this initiative.

4.20 The Department made the pursuit of the debts a high priority, and committed significant resources to these cases. At 31 March 2001, total legacy debt stood at £619 million, but by 31 March 2002 this had fallen to £478 million. Of this reduction, the Legacy initiative accounted for £59 million in receipts and £105 million in remissions or write-off. The level of legacy debt during this period was also affected by the transfer of standovers into the collectable pool. The legacy debt remissions from November to March (£105 million) were high compared to the total of all debt remissions over the previous 12 months to October 2001 (£507 million). The Department's view was that a one-off rise in remissions was inevitable as they cleared out old debts which could no longer be pursued cost effectively. The amount of debts written off will also be a fundamental element in the preparation of the Whole of Government Accounts in 2003-04.

4.21 The age profile of the debt cases remaining to be cleared as at 31 March 2002 (excluding standovers) is shown in Figure 7. The age of these debts is calculated from the time when the Department regard the debt as collectable, after release from standovers if applicable. This figure shows that some 50 percent of debts are over three years old.

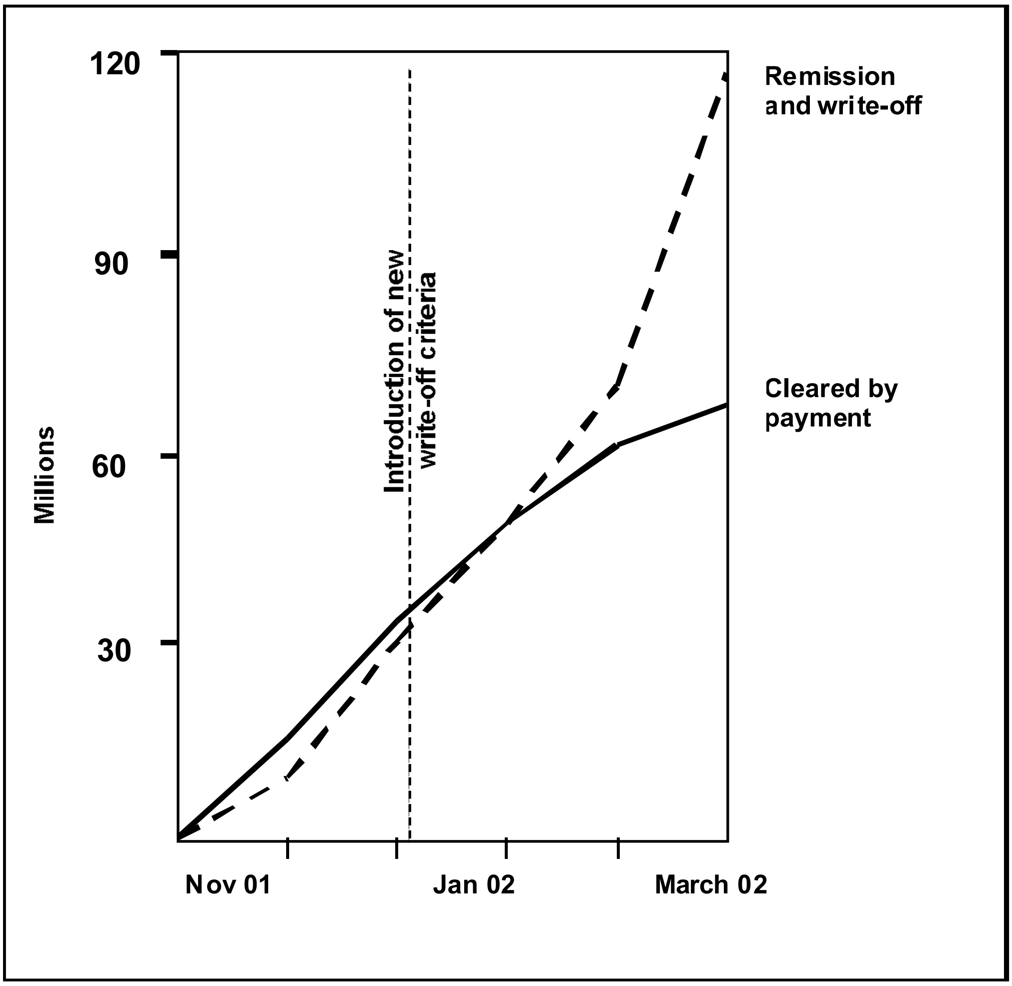
Figure 7: Analysis of Age of Legacy Debt Cases showing that some 50 percent are over three years old

Age of debt	Percentage of total outstanding cases as at 31 March 2002
0-2 months	8.7
2-12 months	23.3
1-2 years	13.0
2-3 years	6.4
3-5 years	19.6
5-10 years	24.1
Over 10 years	4.9

Source: The Department

4.22 In December 2001, new one-off write-off criteria were introduced for certain cases, which led to a significant increase in the levels of legacy debt "remitted" or written-off. The new criteria were introduced as the Department considered some cases inherited by the Receivables Management Service to be so old that it was not reasonable or cost effective to pursue them further. The National Audit Office share Internal Audit's concern that the use of the new criteria could indicate a risk that the remissions policy may not be applied fairly or consistently across the Receivables Management Service, which may lead to loss of funds to the Exchequer. Figure 8 shows the impact of the new criteria upon the cumulative totals for debts cleared by payment and remission.

Figure 8: Clearance of Legacy Debt by Remission and by Payment from November 2001 to March 2002, showing the impact of the new debt write-off criteria



4.23 The National Audit Office also noted that new legacy debt cases were being transferred to local offices, mainly as a result of the release of appeals and standovers. For the four months December to March 2002 this amounted to some £58 million of Income Tax debts. The National Audit Office were concerned that this placed further pressure on the Department's resources employed to pursue these debts. The effect on workloads is dependent on the future rate and extent of release of recoverable debt from standovers. The Internal Audit Office's review of the Receivables Management Service in 2001-02 recorded a similar concern.

c) Receivables Telephone Centres

4.24 As part of the Department's modernising agenda, a Receivables Telephone Centre was introduced, enabling the Department and taxpayers to conduct their debt management affairs by telephone. They hoped the more direct approach would be more convenient for taxpayers and would bring efficiency gains to the Department.

4.25 With the introduction of the Integrated Debt Management System in November 1999, the former Inland Revenue Call Centre at East Kilbride went live as the Receivables Telephone Centre, using automated technology. With further enhancements of the Integrated Debt Management System, the Receivables Telephone Centre was able to handle PAYE underpayments and returns, Corporation Tax debts and legacy debts. The East Kilbride Receivables Telephone Centre later joined two other Centres (at the Accounts Offices in Shipley and Cumbernauld) in providing telephone support for Self Assessment cases. The introduction of telephony support for Self Assessment, called Receivables Individuals Telephone Automation, at all three sites now supports the processing of Self Assessment debt, providing a link between the telephone technology and a database of taxpayers owing tax.

4.26 The Receivables Telephone Centres and related initiatives have increased productivity significantly. The Department's estimates on the Centres' performance suggest that they could have prompted payment of around £1.9 billion in the first full year as a result of direct contact made. The Taxpayer Filing Initiative studied reasons why some taxpayers were not filing returns. Under this initiative, the Centres contacted taxpayers meeting risk criteria before the filing date to remind them of their responsibilities and offer assistance. This produced an increase, albeit unquantified, in filing rates of contacted groups compared to control groups.

4.27 The National Audit Office noted some concerns with regard to the Receivables Telephone Centres. At present, only the Centre at East Kilbride is able to work on employer PAYE debts (excluding the largest employers, who are contacted directly from local recovery offices) as it is the only site to have access to the Integrated Debt Management System. The project to extend this system to the other Centres stopped due to resources being used on other priorities. Now that PAYE debts from the largest employers are to be included in the Receivables Telephone Centres' workload and if only one site can receive these cases, there is a risk that this significant increase in cases will not be processed in a timely manner.

4.28 There is at present a lack of management information at the Receivables Telephone Centres. Some operational information is readily available, such as average number and length of calls, number of payment promises and proportion of contacts made. But, the Receivables Management Service is currently unable to measure reliably the performance and impact of the Centres on debt collection yields, paying and filing of returns. With no reliable information, the Centres are unable to demonstrate performance in terms of efficiency and effectiveness. They are committed to improving this situation, with the help of improved management information systems planned for late 2002-03 to measure effectiveness.

d) Joint Employer Remittance Initiative

4.29 In the 2000-01 management letter, the National Audit Office expressed concern over the number of employers paying monthly PAYE deductions to the Department after the statutory deadline (19th of the month). The rate of in-year payment compliance for PAYE (measured four days after the 19th to allow for the post) was 47.5 per cent in 2000-01 and 50.6 per cent in 2001-02. The Department were unable to estimate the loss to the Exchequer through these late payments. The reasons for non-compliance were wide-ranging. Furthermore, a system of reminder letters and other procedures had allowed considerable delay before recovery action was undertaken. This latter point was being addressed by the Receivables Management

Service, which reduced the number of reminders and speeded up the recovery process in the last year.

4.30 The Joint Employer Remittance Initiative was set up by the Department to review levels of compliance and the payment methods adopted by large employers. The review found that over 50 per cent of employers exercised their right to pay PAYE deductions by cheque. The Department believe employers were reticent to change their payment methods, due to the cashflow and interest advantages they gained through payment by cheque. The Department estimated that the Exchequer could have gained an additional £2 million in interest, from their initiatives to reduce late payments and payments by cheque by large employers.

4.31 Some progress has been made in improving compliance results, as illustrated by the slight increase in the compliance rate in 2001-02. The Department are considering further initiatives to improve compliance and to encourage employers to use electronic methods of payments.

Future Developments

a) Better Quality Receivables Management Services

4.32 At the start of 2001, the Department received the reports of two Better Quality Services reviews (part of the Modernising Government agenda). These reviews addressed Debt Management and Banking operations, in the Department and HM Customs and Excise. The reports made 109 recommendations, some of which were for combined services to be developed between the two departments. The Inland Revenue have developed action plans to co-ordinate their response to the reviews.

b) International Liaison and Benchmarking

4.33 The Department have been actively involved in international liaison throughout the development of the Receivables Management Service and they have an officer dedicated to this role. The main forum for liaison is the International Debt Management Committee, comprising members of the tax administrations of Australia, Canada, Japan, New Zealand and USA, as well as the UK.

4.34 The International Debt Management Committee facilitates the exchange of information and best practice between member administrations, focusing on wide-ranging subjects such as:

- establishing and updating international best practice;
- informing the thinking of Ministers and senior officials;
- reducing risk in major projects through shared experiences;
- sharing of information and ideas for new initiatives; and
- identifying opportunities for shared research and secondments for specific initiatives.

4.35 Departmental staff have visited Canada to study the implementation of the Government's receivables strategy there, gaining knowledge on call centres, risk profiling, and sophisticated data retrieval and matching techniques, which shaped the early development of the Receivables Management Service. Whilst benefiting from international developments, the Department have assisted other tax administrations through offering their experiences in debt management. Qualitative analysis of the differing tax regimes has successfully led to international developments being incorporated into national debt management initiatives in the United Kingdom.

4.36 Future plans include the sharing of research and development in risk-profiling for receivables work. An international filing study is currently being developed and co-ordinated by New Zealand, looking at tax return filing regimes, filing patterns, taxpayer behaviour and the responses of tax authorities.

Conclusions

4.37 The Integrated Debt Management System is intended to provide an automated, end to end process that is efficient and satisfies business information needs. Major tax streams such as Self Assessment and all classes of National Insurance Contributions are at present not covered by the Integrated Debt Management System. **The Department should extend this system to these tax streams as soon as is practical.**

4.38 More recent initiatives and systems introduced by the Department and the Receivables Management Service have focused resources on certain types of debt. The Legacy Debt initiative and the Recovery and Enforcement Procedures Extension initiative prioritise the pursuit of the oldest and most recent debts. **The Department should take the earliest opportunity to pursue and clear all other debts.**

4.39 The Receivables Telephone Centres are a further worthwhile initiative. But at present the Department are unable to measure fully the efficiency and effectiveness of the Centres in the collection of debt and/or the filing of returns. **The Department should continue to develop management information systems to enable them to measure the impact and performance of the Receivables Telephone Centres, and other initiatives.**

Appendix 1

INLAND REVENUE PSA and SDA Targets for 2001-02 and 2002-03

PSA Target	SDA	Target 2001-02 %	Target 2002-03 %
Deliver year on year improvements in the number of individuals and businesses who comply with their obligations and receive their entitlements.	**Compliance**		
	% of ITSA returns filed by the due date	90.5	90.5
	% of ITSA returns filed within 12 months of the filing date	96.4	96.4
	% SA taxpayers who pay by due date	-	target to be set
	% SA taxpayers who pay within 12 months of due date	-	94
	% of employers returns filed by the due date	-	target to be set
	% of employers returns filed within 12 months of the due date	-	95.2
	% of employers who pay by the due date	49.5	50.6
	% of employers who pay within 12 months of the due date	-	96.5
	% of individuals who submit accurate returns	68	70
	% of enquiries worked to a fully satisfactory standard	91	89
	% of our risk-based full enquiries which result in the detection of non-compliance	76	76
	Entitlements		
	WFTC/DPTC		
	% of WFTC applications processed within 5 working days	95	90
	% of DPTC applications processed in 5 working days	95	90
	% of WFTC applications calculated correctly	93	93
	% of DPTC applications calculated correctly	93	93
	NICs		
	% of notifications recorded by:		
	31 December 2001	90	90
	31 March 2002	98	98
	Repayments		
	% of repayments received in specialist repayment offices (IROs) dealt with within 20 working days	96	97
	% of tax repayments in IROs calculated accurately	94	96

PSA Target	SDA	Target 2001-02 %	Target 2002-03 %
Deliver year on year reductions in compliance costs that act as a barrier to the establishment and growth of small businesses.	To deliver more support (details are shown below) to achieve reductions, quantified where possible, in the volume and complexity of the obligations placed upon small businesses ● before they start up ● in the first 12 months of their life ● as they take on their first employee ● in the first 12 months as an employer Baseline compliance costs will be established by 1 July 2001 and targets, taking account of the baselining research work, will then be set.		
Ensure by 2005 that 100 per cent of services are offered electronically, wherever possible through a common Government portal, and a take-up rate for these services of at least 50 per cent.	% services offered electronically Plans include: ● rolling out Call/Contact centres (50 per cent of customer base to be covered by April 2002) ● providing E mail facility for customers to contact their IR Office by 2002 ● providing an electronic service for company tax, including filing of returns during 2002-03		50
Improve value for money achieving annual productivity gains of at least 2.5 per cent per year until March 2004, without detriment to accuracy or customer satisfaction	To deliver improvements in productivity, particularly through the provision of electronic services, the BQS programme and reductions in sickness absence. Key targets will be year on year improvement in productivity of at least 2.5 per cent in the number of : ● taxpayer cases dealt with per staff year ● Tax Credit decisions per staff year ● NI work items per staff year without detriment to accuracy or customer service.		 2.5 2.5 2.5
Achieve a 2.5 point improvement in customer service by 2004, as measured by an annual customer service index.	Using a new customer satisfaction survey from 2001, both in terms of what is measured and the customer groups included to reflect the changing customer base, to establish a baseline for a new customer service performance indicator during 2001-02 and enable targeting of year on year improvement from 2002-03.		

4.2 Where further amounts of taxes, duties and National Insurance Contributions are received in subsequent years or where amounts received in the current or earlier years are repaid, such items are recorded in the year of receipt or repayment.

4.3 The figure for Tax Credits paid via employers is estimated from information available at the time of preparation of this trust statement.

4.4 Working Families' Tax Credit and Disabled Person's Tax Credit are treated as negative tax to the extent that the tax credits are less than or equal to the income tax liability of the family unit and as public expenditure (referred to as payments of entitlement in the trust statement) to the extent that credits exceed the liability. This definition is consistent with OECD classification rules and international best practice for the calculation of net taxes and social security contributions.

5 Statement on Internal Control

This statement is given in respect of the trust statement.

As Accounting Officer for the Inland Revenue, I am responsible for ensuring that the Department maintains and operates a sound system of internal control that supports the achievement of departmental policies, aims and objectives whilst safeguarding the public funds and departmental assets for which I am personally responsible.

The Department's control framework is designed to manage rather than eliminate the risk of failure to achieve departmental aims and objectives. It can therefore provide only reasonable and not absolute assurance of effectiveness.

During the year ended 31 March 2002 (and up to the date of approval of the annual report and accounts) we have made significant progress in embedding risk management in accordance with the guidance set out in DAO (GEN) letter 13/00. Work on embedding risk management will continue in the current year (see details below).

As Accounting Officer I also have responsibility for reviewing the effectiveness of the system of internal control. The main elements of the Department's control framework are set out below.

5.1 Control Environment

(a) I have a clearly defined 'Statement of AO Responsibilities'.

(b) There is a departmental committee structure, with clear terms of reference and defined membership. There are four non-executive members on the Departmental Board, one of whom chairs the Audit Committee. The Audit Committee meets three times a year. The Departmental Management Committee (DMC) meets fortnightly to consider the plans and strategic direction of the Department.

(c) During 2001-02 we reviewed the accountability implications arising from the major organisational changes to the Department's operational areas, and on 1 April 2002 a new accountability framework came in to effect for operational areas. We will be looking at the accountability arrangements in the remaining areas of the Revenue during 2002-03.

(d) There is detailed guidance on standards of behaviour and conduct, diversity and equal opportunities on the Revenue's intranet. Internal Audit have carried out an extensive fraud awareness programme, which covered all parts of the Department.

5.2 Risk Management

(a) I am fully committed to embedding risk management throughout the Revenue so that we are able to meet the requirements embodied in DAO(GEN) 13/00. Work on this began in May 2000, and we have made the following progress:

- biannual workshops with DMC to identify, prioritise, and keep up-to-date the record of top risks to the Department's PSA targets and key objectives;
- ownership of the most significant risks by individual Board members, assignment of responsibility for managing them to individual Directors, and biannual report back to DMC on progress in managing these risks;
- we have launched a website on our intranet to increase awareness of risk management among all our staff.

(b) We have a substantial amount of work in progress aimed at continuously improving our risk management processes, including:

- formalising our risk management strategy;
- ensuring that processes for upward reporting of risks are extended to all areas of the Department;
- development of a Corporate Risk Register, which will inform DMC's biannual stocktake.

5.3 Control Activities

We have comprehensive procedures covering all aspects of the conduct of business. Financial procedures are set out in the Finance Manual and the Inland Revenue "Guide" for staff, which are available on our intranet.

5.4 Information & Communication

(a) We have started to develop a strategic Balanced Scorecard process, which will provide us with regular performance information on our key business drivers.

(b) We have a comprehensive range of indicators, against which we measure our performance. The results are validated by Internal Audit and published in our Annual Report.

(c) All of the Board members and Directors have been active in explaining to staff the detail and implications of the Revenue's transformation agenda through:

- personal participation in a programme of Modernisation Seminars;
- articles in internal publications;
- personal visits to local offices; and
- telephone open days for staff.

5.5 Monitoring

(a) The Director of Internal Audit reports regularly to the Audit Committee, to standards defined in the Government Internal Audit Manual. These reports include the Director of Internal Audit's opinion on the adequacy and effectiveness of the Department's system of internal control;

(b) The external independent Chair of the Audit Committee reports to me;

(c) There is a well established, broad-based Quality Programme, which is underpinned by a number of measures to raise awareness, such as quality launches and conferences;

(d) Assessments of compliance with the principal recommendations in the Cabinet Office report "Successful IT: Modernising Government in Action";

(e) Quarterly reports from the Adjudicator on the outcome of complaint cases.

My assessment of the effectiveness of the system of internal control is based on the work of the internal auditors, and reports from the Chair of the Audit Committee, and is also informed by regular reports and updates from senior managers.

In making my assessment, I also take account of the management letters and other reports made by the National Audit Office (NAO), our external auditors, and of the findings of the Committee of Public Accounts (PAC). Over the coming year we shall be working to address two particular areas, which have been identified as needing improvement:

- Tax Credit Payments made to our customers via their employers, through the payroll. We are seeking to enhance the assurance that the Department can give to the NAO and Parliament on tax credit payments made via employers, and are accordingly working with the NAO to improve our processes.
- Clearance of Open Tax Records where, whilst earlier difficulties relating to the interfaces between computer systems which hampered clearance of open tax records are now resolved, we have not been able to reach our targets to clear open records by the appropriate time. We have made open tax records recovery one of our top priorities, allocating extra money and increased support to this end, and are continuing to look for process improvements. Whilst we expect it will take time for the full benefits of this work to feed through, we are aiming to return to near normal levels of clearance for 2002-03.

Sir Nicholas Montagu KCB
Accounting Officer 23 October 2002