Comptroller and Auditor General

Annual Report

2006

(Prn.A7/1596)

Comptroller and Auditor General

Annual Report

2006

Presented pursuant to Section 3(11) of the Comptroller and Auditor General (Amendment) Act, 1993

Dublin

Published by the Stationery Office
To be purchased directly from the
Government Publications Sales Office,
Sun Alliance House, Molesworth Street, Dublin 2
or by mail order from
Government Publications, Postal Trade Section,
51 St. Stephens Green, Dublin 2
(Tel: 01-6476000, Fax: 01-6476843)
or through any bookseller.

(Prn.A7/1596) Price €8.00

The report was prepared on the basis of information, documentation and explanations obtained from Government Departments and Offices referred to in the report.

Drafts of relevant segments of the report were sent to the Departments and Offices concerned and their comments requested. Where appropriate, these comments were incorporated into the final version of the report.

© Government of Ireland 2007

Report of the Comptroller and Auditor General on the Accounts of the Public Services — 2006

I am required under Article 33 of the Constitution to report to Dáil Éireann at stated periods as determined by law. Under Section 3 of the Comptroller and Auditor General (Amendment) Act, 1993, I am required to report to Dáil Éireann on my audit of the Appropriation Accounts of Departments and Offices and the accounts of the receipt of revenue of the State not later than 30 September in the year following the year to which the accounts relate.

I hereby present the report for 2006 in accordance with Section 3 of the aforementioned Act.

JOHN PURCELL

Comptroller and Auditor General

12 September 2007

Table of Contents

CHAPTER 1 1

GENERAL MATTERS 1

1.1 FINANCIAL OUTTURN 2
1.2 EXCEPTIONS TO GENERAL PROCEDURES IN PUBLIC PROCUREMENT 3
1.3 AGENCY SERVICES 9

CHAPTER 2 13

TAX FORECASTING 13

2.1 FORECASTING OF TAX RECEIPTS 14

CHAPTER 3 21

REVENUE 21

3.1 REVENUE ACCOUNT 22
3.2 TAX WRITTEN OFF 23
3.3 OUTSTANDING TAXES AND PRSI 25
3.4 REVENUE AUDIT PROGRAMME 27
3.5 PROSECUTIONS 30
3.6 SPECIAL INVESTIGATIONS 31
3.7 CONTROL OF ALCOHOL TAX WAREHOUSES 34
3.8 STAMP DUTY ON PROPERTY TRANSACTIONS 41
3.9 PASSENGER CONTROLS AT AIRPORTS 46
3.10 ASPECTS OF RENTAL INCOME TAXATION 54

CHAPTER 4 61

OFFICE OF PUBLIC WORKS 61

4.1 DISCREPANCIES AT TWO HERITAGE SITES 62

CHAPTER 5 65

PRISON SERVICE 65

5.1 THE MANAGEMENT OF SICK LEAVE IN PRISONS 66

CHAPTER 6 77

DEPARTMENT OF ENVIRONMENT, HERITAGE AND LOCAL GOVERNMENT 77

6.1 CONTRACT TERMINATION COSTS 78

CHAPTER 7 93

DEPARTMENT OF EDUCATION AND SCIENCE 93

7.1 THE PUBLIC PRIVATE PARTNERSHIP PILOT SCHOOLS PROJECT – FOLLOW UP 94
7.2 PREFABRICATED SCHOOL ACCOMMODATION 99

CHAPTER 8 103

DEPARTMENT OF TRANSPORT 103

8.1 INTEGRATED TICKETING SCHEME – UPDATE 104

CHAPTER 9 109

DEPARTMENT OF SOCIAL AND FAMILY AFFAIRS 109

9.1 OVERPAYMENTS 110
9.2 PROSECUTIONS 113

9.3 Payment of Child Benefit by Electronic Funds Transfer 115
9.4 One Parent Family Payment Scheme – Control Activity 120
9.5 Advance payment of grant to Sustainable Energy Ireland 126

CHAPTER 10 129

HEALTH SERVICE EXECUTIVE 129

10.1 Control and Sanctioning of ICT Expenditure 130

CHAPTER 11 143

NATIONAL TREASURY MANAGEMENT AGENCY 143

11.1 National Debt 144
11.2 Savings Bank Fund 145

Chapter 1

General Matters

1.1 Financial Outturn

The publication *Audited Appropriation Accounts 2006* (Prn.A7/1594) includes a summary which shows the amount to be surrendered as €878.15m. This is arrived at as shown in Table 1.

Table 1 Outturn for the year 2006

	€000	€000	€000
Estimated Gross Expenditure			
Original Estimates	43,732,023		
Supplementary Estimates	480,571		
Deferred Surrender 2005	289,268	44,501,862	
Deduct: -			
Estimated Appropriations-in-Aid			
Original Estimates	3,998,524		
Supplementary Estimates	24,915	4,023,439	
Estimated Net Expenditure			40,478,423
Actual Gross Expenditure		43,479,793	
Deduct: -			
Actual Appropriations-in-Aid		4,038,661	
Net Expenditure			39,441,132
Surplus for the Year			1,037,291
Deferred Surrender 2006			159,135
Amount to be Surrendered			**€878,156**

The amount to be surrendered represents 2.17% of Estimated Net Expenditure as compared with 2.12% in 2005.

Extra Exchequer Receipts

Extra Receipts payable to the Exchequer as recorded in the Appropriation Accounts amounted to €393,249.

Surrender of Balances of 2005 Votes

The balances due to be surrendered out of Votes for Public Services for the year ended 31 December 2005 amounted to €775m. I hereby certify that these balances have been duly surrendered.

Stock and Store Accounts

The stock and store accounts of the Departments have been examined with generally satisfactory results.

1.2 Exceptions to General Procedures in Public Procurement

A significant proportion of day-to-day Government spending is accounted for by procurement of goods and services by Departments, Offices and Agencies. These activities are governed by EU and national legal and regulatory requirements. Practical guidance on the application of these norms is found in circulars and correspondence relating to ethical considerations, good governance and procurement best practice. In addition, an *eTenders* website is available to facilitate Departments and Offices in the application of these rules.

The most important source of guidance is *Public Procurement Guidelines – Competitive Process,* issued in 2004 by the Department of Finance which updated and replaced earlier 1994 guidelines.

The guidance emphasises the need for the public procurement function to be discharged honestly, fairly, and in a manner that secures best value for public money. Contracting authorities must be cost effective and efficient in the use of resources while upholding the highest standards of probity and integrity. Management in Government Departments and Offices is expected to ensure that there is an appropriate focus on good practice in purchasing and, where there is a significant procurement function, that procedures are in place to ensure compliance with all relevant rules.

In general, a competitive process carried out in an open, objective and transparent manner can achieve best value for money in public procurement and comply with the principles[1] set out in the EU Treaty and EU Directives on public procurement. EU Directives set thresholds and describe the circumstances in which different types of competitive processes should be used in Public Procurement.

The Guidance states, "It is a basic principle of public procurement that a competitive process should be used unless there are justifiably exceptional circumstances. The type of competitive process can vary depending on the size and characteristics of the contract to be awarded and the nature of the contracting authority."

For contracts or purchases below EU threshold values and not part of a "draw down" or framework contract, less formal procedures may be appropriate as follows

- Supplies or services less than €5,000 in value might be purchased on the basis of verbal quotes from one or more competitive suppliers
- Supplies or services contracts between €5,000 and to €50,000 in value might be awarded on the basis of responses to specifications sent by fax or email to at least three suppliers or service providers.

The values and procedures may be adapted as appropriate to suit the type of contracting authority and the nature and scale of the project[2]. Reasons for procedures adopted, including procedures where a competitive process was not deemed appropriate, should be clearly recorded. All contract award procedures should include a verifiable audit trail.

[1] Non–discrimination, equal treatment, transparency, mutual recognition, proportionality, freedom to provide service and freedom of establishment.
[2] The Guidelines state "It may be appropriate for contracting authorities to adapt or supplement these guidelines with more detailed internal procurement procedures relevant to the activities of an individual contracting authority."

Department of Finance Circular 40/02

Department of Finance Circular 40/02 provided for revised procedures to be applied, from January 2003, in the Central Government sector where it is proposed to award contracts which exceed €25,000 in value (exclusive of VAT) without a competitive process. Prior to 2003, exceptions to the general rule requiring a competitive process were examined by a committee comprising representatives of the Department of Finance and major purchasing Departments e.g. Office of Public Works. This committee is known as the Government Contracts Committee. Under the new arrangements proposed contracts exceeding the limit which were not subject to a competitive process were required to be reviewed within the Departments/Offices by the Internal Audit or by an appropriate senior officer who was not part of the procurement process. A supplement to the Circular, providing guidance for officers reviewing proposed contract awards, was issued by the Government Contracts Committee in July 2003.

The Circular also provides that

- Accounting Officers should complete and submit an Annual Return in respect of such contracts to the Comptroller and Auditor General by 31 March of the following year. The returns should give details of the subject or purpose of the contract, its value and the reasons for not having a competitive process. A copy of the return is to be sent to the National Public Procurement Policy Unit of the Department of Finance at the same time.
- Each Department/Office should maintain an up-to-date central register of such exceptional purchases and contracts.
- Each Department/Office should designate a Procurement Officer to collate the information on these contracts and to be a contact point with the Government Contracts Committee. The earlier 1994 Guidelines provided that the Procurement Officer would "ensure that all matters related to procurement of works, supplies and services and the disposal of property and equipment are in accordance with legal and administrative requirements".

Interestingly, the Health Service Executive, which is funded by a separate Vote, is not required to submit an annual return to me of contracts exceeding €25,000 that were not subject to a competitive process even though that body is one of the major State purchasers of supplies and services. However, the Department of Finance has recently informed me of its intention to apply this requirement to the HSE for the future.

Audit Findings

As required by the Circular, all 35 Departments and Offices submitted returns to me in respect of 2006. In 11 cases, the Departments or Offices indicated that they had not entered into any contract greater than €25,000 without having a competitive process. The returns from the remaining 24 Departments and Offices showed that they had concluded 195 such contracts to a total value of more than €44m without recourse to competitive tendering.

Over 40% of this value is accounted for by 5 contracts concluded by the Department of Defence in respect of purchases associated with its fleet of aircraft – €18.9m. Operational confidence, reliability and safety as well as the proprietary nature of the goods and services involved are at the core of the inability of the Department to use a competitive process for these purchases.

In another case, the Department of Education and Science indicated it had entered into a contract with a benefactor who had offered to transfer to the parish involved a 5.2 acre site and to design and build a new 16-classroom school at a fixed cost of €4.02m. As part of the proposal, ownership of the existing school site would transfer to the benefactor. The estimated cost of building the school was €10m. The

Department correctly sought alternative proposals for the provision of the school through the Government's eTenders Website prior to accepting the offer.

Table 2 shows by Department the value of the remaining contracts disclosed in the departmental returns.

Table 2 Value of Contracts awarded by Departments/Offices Reported under Circular 40/02

Department/Office	Cases	€m
Garda Síochána	52	5.761
Revenue	23	2.933
Office of Public Works	22	2.753
Transport	6	1.646
Justice Equality and Law Reform	8	1.513
Enterprise, Trade and Employment	16	1.219
Communications, Marine and Natural Resources	17	1.435
Agriculture and Food	4	0.768
Social and Family Affairs	8	0.761
Environment, Heritage and Local Government	7	0.519
Defence	5	0.278
Other (including the Department of Education and Science)	24	2.157
Total	**192**	**€21.743m**

Table 3 sets out the main reasons given in the returns why competitive processes were not used in placing these contracts. While the reasons given were sometimes complex and uninformative, I have attempted to place them in categories which best give an understanding of the underlying circumstances in which the contracts were concluded.

Table 3 Reasons Cited for Departure from Use of Competitive Process

Reason	Number of Cases	Value of Contracts €m
Proprietary Goods	73	9.604
Only Suitable Supplier	32	3.308
Expert /Recent Experience	31	3.739
Extension/Rollover of Contract	15	1.209
Security Considerations	15	2.342
Urgency	15	0.855
Other	11	0.686
Total	**192**	**€21.743m**

Issues Arising

The opt out of the competitive process, provided for in Circular 40/02, is designed to be a refuge of last resort, where compliance with the guidance set out in the *Public Procurement Guidelines – Competitive Process,* would be disadvantageous for Departments or Offices in carrying out their functions in the most effective and efficient manner. It is clear that circumstances arise where it is necessary to resort to procurement by

non-competitive processes for reasons of urgency, security or genuine lack of suitable providers of goods or services. However, it is incumbent on the Departments and Offices to ensure that they have in place processes to identify in a timely manner their procurement needs so as to avoid resorting to urgent purchases. Equally, it is important that they avoid identifying their needs by reference to brand products. Specifications should, where possible be described in generic terms so as to encourage real competition which should lead to better prices, quality and innovative offerings from the market. While the results of many procurements may be the purchase of brand products or services, the procurement process should be characterised by efforts to ensure that "brand capture" does not result in future streams of payments over which Departments and Offices have little or no control.

While it is important that Departments and Offices have sufficient flexibility to carry out their functions, the risk posed by inappropriate use of the discretion exceptionally allowed in the guidance can best be countered by ensuring that there is a properly functioning and independent *a priori* evaluation of proposed procurements which do not meet the competition norms.

My review indicated that, in general, Departments and Offices comply with the requirement to review proposals to enter into contracts without a competitive process and to maintain central registers of such contracts. There were a number of instances where this compliance was of an informal or random nature.

Proprietary Goods

Generally speaking, purchases in this category comprise named products or exclusive services. In some instances these procurements include maintenance of previously acquired goods or services, upgrades, additional purchases, etc. This accords with EU Directive 2004/18/EC which allows contracting authorities to award public contracts by a negotiated procedure when, for technical or artistic reasons, or for reasons connected with the protection of exclusive rights, the contract may be awarded only to a particular economic operator. Procurement of so-called proprietary goods arises when specific branded goods are selected to meet a need. It can also arise when there is a desire to restrict the number of different products in use for simplicity of maintenance, carriage of spares etc. It is clear that the advantages of a competitive process cannot be achieved where Departments and Offices specify proprietary goods as this may result in a risk to achieving value for money. Of the 73 instances contained in the departmental returns, 44 were in respect of purchases by the Garda Síochána to a value of €5.292m. These consisted overwhelmingly of additions to or support for Garda computer and communications systems. The proprietary goods purchased by other Departments were also predominantly IT related.

These results confirm the importance of considering whole life costs and in particular the cost of future additions when planning all IT procurements.

Only Suitable Supplier and Expert or Recent Experience

These categories include both procurements where there is only one suitable supplier and procurements where Departments and Offices have previously used the services of individuals or firms in the recent past or have identified, without recourse to competitive processes, persons or firms whose expertise coincides with their requirements. The latter cases do not imply that is there is not a suitable alternative to the supplier selected.

This group includes procurements where, on the face of it, there is a self-evident case for the choice made. For example, the Department of Social and Family Affairs entered into a contract estimated to cost between €200,000 and €340,000 with the Northern Ireland provider of Smartcards as part of the All Ireland Free Travel Scheme to enable pensioners to avail of free travel in the North. Another example was the purchase by the Revenue Commissioners of three Drug Detection Dogs and the training of their handlers at a total cost of €50,674.

However, notwithstanding these examples, failure to go to the market on a regular basis may limit the market with the inherent risk of reducing the possibility of achieving value for money in these purchases.

Extension/Rollover Contracts

A number of the arrangements which were extended or rolled over during 2006 had been in place for several years. Justifications put forward for continuing the arrangements included

- Experience gained from prior involvement
- Contractor best placed to provide for requirements without undue extra cost to the Exchequer
- Not possible to go to the market due to staffing difficulties
- Service provided suited needs in the past.

One third of the value of this category is accounted for by a contract rolled over by the Department of Agriculture and Food. The Department was required to take over the storage of sugar following the restructuring of the sugar market in 2006 and took the view that it was the intention of the regulations that the existing Irish Sugar Ltd. storage contract with the firm in question be continued by the Department and that this was the prudent and most cost effective way of dealing with the issue. The cost in 2006 was €381,000.

Almost all of the contracts in this category are for the provision of services.

The key risk that arises in this category is that failure to test the market on a regular basis may lead to poor value for money being achieved.

Urgency

Significant examples of urgency were the temporary recruitment by the Departments of Agriculture and Food and Community, Rural and Gaeltacht Affairs of a project manager and a business administrator, respectively, arising from the unexpected resignation of their predecessors. The costs were €132,000 and €109,000.

While there can be ample justification for using urgency as a reason for not using a competitive process in some engagements, there is an absolute necessity for independent reviewers to ascertain the underlying circumstances giving rise to the urgent need for procurement and to confirm whether alternative planning arrangements would have obviated the need to resort to non-competitive processes in similar situations.

Exceptional Circumstances

Two returns illustrated unusual circumstances where specific technical or operational skills/knowledge were required and tenders were not sought.

- Following a decision by Enterprise Ireland (EI) to disengage from the provision of certain services to the Irish Offshore Sector, the Department of Communications, Marine and Natural Resources concluded a contract without a competitive process with a company, the principal of which had been engaged in the particular line of work with EI as an employee prior to its disengagement. He took a career break from EI to set up and head the company. The estimated value of the contract, spanning five years from 2004 is €500,000.
- The Director of Public Prosecutions had an urgent need to review the manner in which internal management control procedures in the Office had operated arising from a decision in a particular case having taken longer than acceptable to issue. The Director engaged the Chairman of the Office's Audit Committee without competitive tender to undertake this review as his skill set was considered

to uniquely qualify him to undertake this review expeditiously. In addition to his wide experience of organisational processes, he also was considered to have a detailed knowledge of the Office and its management control procedures from his role as Chairman of the Audit Committee. The contract cost €28,000.

Although exceptional circumstances came into play in both cases, the way in which the difficulties were addressed was less than ideal.

1.3 Agency Services

The Office of Public Works (OPW) acts as agent for other Departments and Offices in the purchase of sites and buildings, the procurement and management of construction type contracts, and the maintenance of public buildings. *Public Financial Procedures* (PFP) provide that OPW requests advances from any Department or Office (as principal) prior to entering into contracts or meeting any costs. The costs are charged to a Department's Appropriation Account when the amounts involved have been certified by OPW as having been duly disbursed by it. Where it may be some time after the end of the financial year before OPW can determine the precise amounts disbursed, a Department may, in order to close its Appropriation Accounts on 31 December, charge an agreed estimated amount in respect of agency services.

If expenditure is not significant OPW as agent may make payments in respect of the service from its own voted moneys on a suspense basis. OPW should secure recoupment from the Department concerned within the year in which the payments have been made.

These rules derive from the cash based accounting system statutorily used by Government Departments and Offices under which Dáil Éireann annually votes the sums to be made available for each service. Under this system, amounts not spent in any year are required to be surrendered to the Exchequer[3]. Each year, I confirm that the amounts for surrender recorded in the Appropriation Accounts for the previous year have been duly surrendered.

Audit Examination

The Appropriation Account for Vote 10 – Office of Public Works shows in its Statement of Assets and Liabilities, net credit balances in suspense accounts amounting to more than €48m at 31 December 2006. This amount consists primarily of unspent balances (mostly advances) from clients totalling €62m, partly offset by amounts due from them totalling €14m for agency services provided without prepayment. The Appropriation Accounts of Departments and Offices that made advances to OPW should reflect, in their Statements of Assets and Liabilities, corresponding debit balances.

As part of my audit of the 2006 Appropriation Accounts, I selected for examination a sample of the significant credit balances recorded by OPW. Examination of the underlying transactions in this sample indicated that the amounts shown in the suspense accounts of Departments/Offices providing the advances did not agree with the corresponding amounts shown in the OPW suspense accounts.

Table 4 Comparison of OPW and Departmental Suspense Account Balances 31 December 2006

Department/Office	OPW Credit Balances €m	Departmental Debit Balances €m
Department of Education and Science	31.969	nil
Department of Finance	3.193	nil
Department of the Environment, Heritage and Local Government	2.325	1.340
Office of the Revenue Commissioners	1.207	0.783
Department of Agriculture and Food	1.619	nil

[3] Except where the Minister for Finance has authorised a deferral of such surrender under Section 91 of the Finance Act 2004.

In the light of the variations between these balances, I sought the views of the Accounting Officers concerned.

I also asked them to outline the procedures in place to ensure that the appropriate expenditure was charged to their respective Appropriation Accounts at the proper time.

Department of Education and Science

The Accounting Officer, Department of Education and Science said OPW acted as agent for the Department in the sourcing and purchasing of sites for schools, management of the asbestos remediation programme in schools and the provision, maintenance and furnishing of its office premises network. For many years, the Department charged amounts advanced to OPW for these services directly to the Appropriation Account. The Department was unaware that it was in breach of prescribed procedures. Its payments to OPW in respect of the site acquisition and asbestos remediation programmes were made in respect of multi-annual rolling programmes of work. The Department complied with requests from OPW for payment prior to work commencing and charged these payments to the Vote subheads rather than to suspense as required. It also believed that building and remedial work were fixed sum contracts and as such did not anticipate there would be credit balances remaining in OPW suspense accounts.

She informed me that while the Department received and examined annual statements for site acquisition and asbestos remedial work it did not in other cases obtain annual certificates of expenditure from OPW. The Department and OPW liaise regularly on the management of the Department's site acquisition programme and OPW supplies the Department with monthly progress reports. In regard to the office premises the Department liaises with both the OPW architect and the contractor to ensure work is completed to the required specification.

While pointing out that the problem highlighted by my audit was one of accounting treatments and conventions rather than improper use of funds, the Department accepted that it needed to review its procedures in consultation with OPW. It would be necessary for the Department to obtain the assistance and agreement of OPW to the preparation, on a timely basis, of quarterly statements on the transactions on each account in order that the appropriate charges might be made to the Vote for agency services in the future.

She added that arrangements had been initiated, internally and with OPW, to ensure compliance with the correct procedures.

The Appropriation Account for Vote 26 – Education and Science – has been amended to reflect the correct charges for OPW agency services, in respect of site acquisition and asbestos work, involving some €30.3m in 2006. This increases the surrender to the Exchequer from €36m to €66m.

Department of Finance

The Accounting Officer, Department of Finance informed me that in the case of his Department the advances made to OPW were charged directly to the relevant subhead of the Vote for Finance and not to suspense as required. A certificate had not been obtained from OPW to support the charge to the Vote.

He indicated that two items making up the OPW balance for his Department did not relate to projects chargeable to Vote 6 – Finance.

He agreed that the correct procedures had not been adhered to in respect of these transactions. The 2006 Appropriation Account for the Vote had been amended to reflect the appropriate charge. As a result the amount to be surrendered to the Exchequer in this case has increased by €2.3m to €16.5m.

He was satisfied however, that on-going and continual liaison with OPW architects for all projects ensured appropriate signoff on completion of jobs and that no loss of public funds occurred as a result of the accounting treatment of these transactions.

He went on to state that when these matters were drawn to his attention he availed of the opportunity to remind staff of the Department of the importance of complying with *Public Financial Procedures*. As the matter had relevance beyond his Department he indicated that he had written to all Accounting Officers reminding them of the correct procedures to be followed in this matter.

Department of the Environment, Heritage and Local Government

The Accounting Officer, Department of the Environment, Heritage and Local Government in her response agreed that the OPW balance did not accord with the corresponding balance recorded by her Department. The Department had been in touch with OPW and confirmed that some balances go back a number of years. It was the Department's belief that one credit balance for €511,000 described as relating to the Custom House was incorrectly held as an advance for works that had been completed for some time. A definitive reconciliation of payments made to OPW would be carried out to address disparities between the Department's suspense account balances and those of OPW. She has instructed that guidelines be issued to all staff involved on the financial and accounting procedures to be observed in making inter-agency payments, and to ensure that a full reconciliation is effected at year-end.

In general, payments made to OPW were correctly charged to suspense accounts but it had come to light that two payments amounting to €200,000 which should have been charged to suspense accounts had been charged directly to Vote expenditure. In addition, there were further payments to OPW charged to Vote expenditure where it was not possible in the time available to verify beyond doubt that the full amounts were correctly chargeable in 2006. As the combined amounts were not material to the Department's overall expenditure, there was no requirement to amend the Vote.

Department of Agriculture and Food

The Accounting Officer, Department of Agriculture and Food, informed me that the nature of the services for which advances had been paid is such that final statements had not issued in the year in which the advances were made. In these circumstances, the practice has been to charge these amounts to the relevant subhead in the Department's Vote.

Bearing in mind that amounts charged to the Vote in this way are immaterial in the context of the total Vote expenditure in the year and that the difference between OPW records and those of the Department has been reconciled to my satisfaction, I have not insisted on a change to the Appropriation Account as presented.

However, in future, the Department should change its practice and charge the advances to a suspense account in the first instance. The charge to the Vote can only be made when OPW confirms its inability to give, on a timely basis, a definitive amount for expenditure incurred within the year and has agreed with the Department an estimate of the sums spent on the service.

Office of the Revenue Commissioners

The Accounting Officer of the Office of the Revenue Commissioners informed me that advances made to OPW were charged in the first instance to suspense accounts and that these suspense accounts were correctly discharged on the basis of disbursement certification by OPW. The difference between the amounts recorded by OPW and the Revenue Commissioners has been reconciled to my satisfaction.

Office of Public Works

The Accounting Officer of the Office of Public Works, in response to my enquiries, informed me that his Office managed a wide range of services on behalf of client Departments and Offices involving several hundred accounts and expenditure in excess of €75m a year.

As a general principle, OPW opens a separate account for each project and does not normally offset a credit balance in one account against a debit balance in another belonging to the same Department until projects have been completed.

As agency work typically involves contracts between OPW and external contractors, OPW required that clients maintain their accounts in credit so as to ensure that there were always sufficient client funds available and accessible to meet payment demands. These funds are held in an interest bearing account with the Central Bank. The Appropriation Account for Vote 10 – Office of Public Works – for 2006 showed a credit balance in its account with the Central Bank of €122m (€89m when outstanding cheques were taken into account).

The Accounting Officer stated that OPW Business Units regularly briefed client Departments on the status and progress of projects, including the financial position. He cited as an example, the service OPW provided for the Department of Finance for the procurement of crèches at various Government offices. He pointed out that a monitoring committee representing the Department and OPW met regularly to plan, discuss and monitor all aspects of the management and delivery of the programme, including the financial dimensions.

In the case of the Department of Education and Science, OPW provided a hugely important and complex service to the Department – the acquisition of school sites. OPW had a longstanding prudent policy of seeking and accepting funding from the Department only when the finalisation of the legal stages of acquisition was imminent. He said that there was no doubt that in the event of funding not being available immediately on close of sale some deals would fall through. The balance on this account, €23m at 31 December 2006, was reduced to €12.4m by end January 2007 and to €8.6m at end June 2007. OPW provided annual financial statements to the Department of Education and Science.

He added that OPW took a conservative and careful approach to reducing balances to zero and closing suspense accounts. They preferred to keep accounts open until it was clear that there would be no further costs payable.

The Accounting Officer also informed me that, notwithstanding the arrangements already in place for the supply of information to clients, he had decided to introduce a formal procedure of regular notification of project financial statements to client Departments.

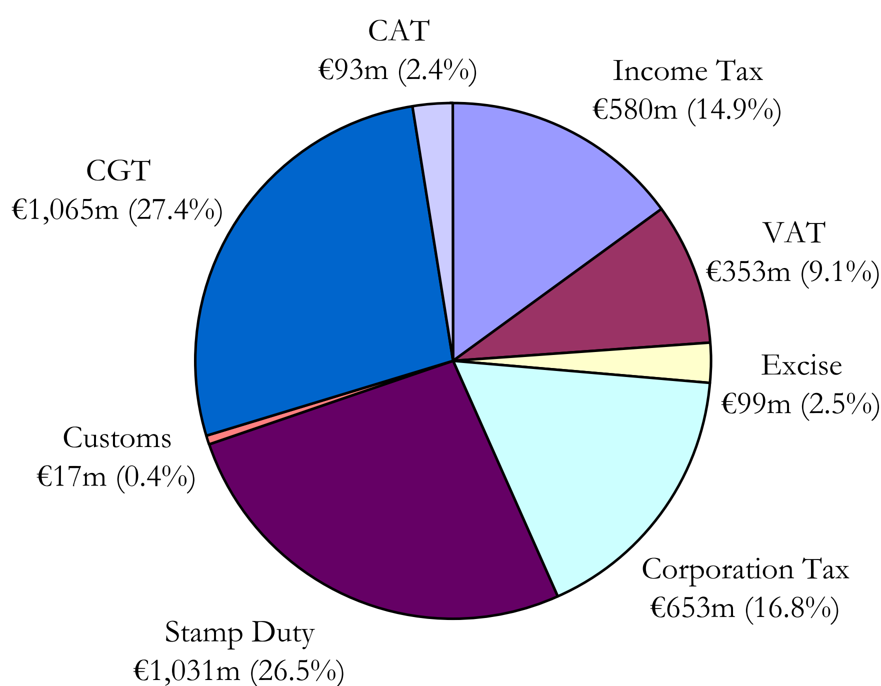
Chapter 2

Tax Forecasting

2.1 Forecasting of Tax Receipts

The Department of Finance prepares estimates of tax receipts each year with the assistance of the Revenue Commissioners. The final estimate, which takes account of changes introduced in the Budget, is presented on Budget day each year and is known as the Post-Budget Estimate. Details of the actual tax collected each year are published in the Revenue Annual Report. The amounts transferred to the Exchequer by Revenue, as opposed to the actual amounts collected, are published in the monthly Exchequer Statement and the annual Finance Accounts. The total Exchequer receipts for 2006 (€45.5 billion) exceeded the forecast (€41.65 billion) by almost €3.9 billion or over 9%.

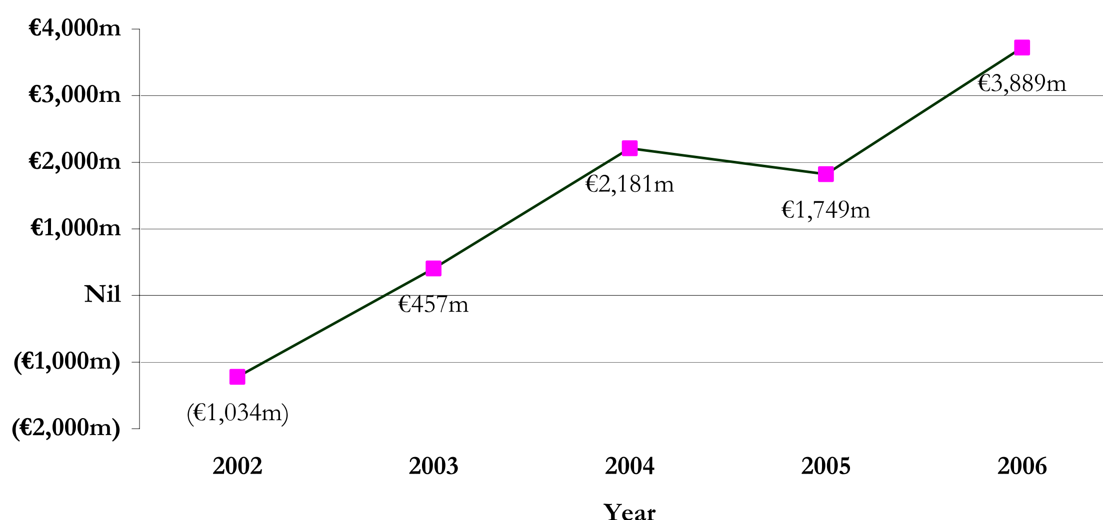
Figure 1 Contribution of each Tax to Total Excess over Forecast 2006[4]



In my 2001 Report, I highlighted the taxation shortfall against forecast of over €2.5 billion that occurred in 2001. While there was also a shortfall in 2002, it was somewhat lower at just over €1 billion. Since 2002, the trend has been for actual tax receipts to exceed forecast as can be seen in Figure 2. While PAYE contributed €763m and €730m to the shortfalls in 2001 and 2002 respectively, actual PAYE receipts in 2006 were within €155m of the forecast.

[4] Excludes levies.

Figure 2 Variation against Forecast 2002 to 2006



I asked the Accounting Officer of the Department of Finance what were the reasons and underlying factors for the large surplus in each of the years 2004, 2005 and 2006. In reply he confirmed that Exchequer tax revenues in each of the last three years had significantly outperformed their Budget day targets. In 2004, tax revenues were 6.5% ahead of target. In 2005, receipts were 4.7% ahead of target and, in 2006, tax revenues were 9.3% ahead of target.

However, he pointed out that focusing on the major tax-heads – VAT, income tax, corporation tax and excise duty – which, in the years 2004, 2005 and 2006 have accounted for around 85-90 % of total taxes and excluding the impact of receipts from Revenue's special investigations, tax revenues had been close to target, particularly in 2004 and 2005.

He provided me with the following analyses of the surpluses for 2004, 2005 and 2006.

2004

The 2004 Budget day target for tax revenues was €33,400m. The actual outturn was €35,581m giving an overall tax revenue surplus of €2,181m. The individual tax-head breakdown is in Table 5.

Over half of the excess in 2004 came from stamp duties and capital gains tax, a reflection of the continued strength of the asset market, particularly the property market that was not foreseen by any commentators at the time of the 2004 Budget. The prudent nature of the tax forecasts for these particular tax-heads in 2004 reflected that view.

Included under the income tax heading were receipts of €673m in respect of the main Revenue special investigations in 2004, the Offshore Assets Group and Bogus Non-Resident Account investigations. Receipts from these sources were forecast at €150m, giving an excess over target of €523m. This represented almost one quarter of the total excess. By their nature, receipts from this source could not be forecast with any degree of accuracy.

Excluding these special investigations moneys, receipts from the major tax-heads, VAT, income tax, corporation tax and excise duty, that accounted for almost 90% of total taxes in 2004 were just 1.4% ahead of target.

Table 5 2004 Exchequer Tax Revenue – Outturn v Forecast

	2004 Forecast €m	2004 Outturn €m	+/- €m	+/- %
Customs Duty	137	173	+36	+26.3
Excise Duty	4,864	4,928	+64	+1.3
Capital Gains Tax	851	1,516	+665	+78.1
Capital Acquisitions Tax	150	190[5]	+40	+26.7
Stamp Duty	1,600	2,088	+488	+30.5
Income Tax	10,077	10,651	+574	+5.7
Corporation Tax	5,348	5,332	-16	-0.3
VAT	10,368	10,693	+325	+3.1
Levies	5	10	+5	–
Total	**€33,400m**	**€35,581m**	**+€2,181m**	**+6.5%**

2005

The 2005 Budget day target for tax revenues was €37,505m. The actual outturn was €39,254m, giving an overall tax revenue surplus of €1,749m. The individual tax-head breakdown is provided in Table 6 below.

Table 6 2005 Exchequer Tax Revenue – Outturn v Forecast

	2005 Forecast €m	2005 Outturn €m	+/- €m	+/- %
Customs Duty	170	226	+56	+32.9
Excise Duty	5,075	5,233	+158	+3.1
Capital Gains Tax	1,500	1,960	+460	+30.7
Capital Acquisitions Tax	180	249[6]	+69	+38.3
Stamp Duty	2,085	2,725	+640	+30.7
Income Tax	11,105	11,266	+161	+1.4
Corporation Tax	5,760	5,492	-268	-4.7
VAT	11,625	12,089	+464	+4.0
Levies	5	14	+9	–
Total	**€37,505m**	**€39,254m**	**+€1,749m**	**+4.7%**

As in 2004, a large proportion of the excess in tax revenues in 2005, almost 63%, came from stamp duties and capital gains tax. Once again this was due to the continued strength of the asset market, particularly the property market in the latter half of the year.

18% or €313m of the total excess was due to a greater than expected yield from Revenue's main special investigations. The main tax yielding investigation in 2005 was the Single Premium Insurance

[5] Includes a minor amount in respect of Residential Property Tax.
[6] Includes a minor amount in respect of Residential Property Tax.

Investigation. Receipts from the main investigations in 2005 were forecast at €200m. The actual yield was €513m.

Excluding these moneys, receipts from the major tax-heads, which accounted for 87% of total taxes in 2005, came in just 0.6% above target.

2006

The 2006 Budget day target for tax revenues was €41,650m. The actual outturn was €45,539m, giving an overall tax revenue surplus of €3,889m. An individual tax-head breakdown is provided in Table 7.

Table 7 2006 Exchequer Tax Revenue – Outturn v Forecast

	2006 Forecast €m	2006 Outturn €m[7]	+/- €m	+/- %
Customs Duty	240	257	+17	+7.1
Excise Duty	5,490	5,589	+99	+1.8
Capital Gains Tax	2,035	3,100	+1,065	+52.3
Capital Acquisitions Tax	260	353[8]	+93	+35.8
Stamp Duty	2,685	3,716	+1,031	+38.4
Income Tax	11,810	12,390	+580	+4.9
Corporation Tax	6,030	6,683	+653	+10.8
VAT	13,095	13,448	+353	+2.7
Levies	5	3	-2	–
Total	**€41,650m**	**€45,539m**	**+€3,889m**	**+9.3%**

As in the previous two years, a significant proportion, €2.1 billion or 54%, of the overall excess came from stamp duties and capital gains tax that continued to benefit from buoyancy in the asset market and, in particular, the property market. Again, this level of activity was not anticipated by forecasters generally.

The corporation tax surplus of €653m was partially due to some unexpectedly high payments from a small number of large companies and partially due to some new companies paying significant amounts of tax for the first time.

Income Tax also performed above expectations, coming in €580m or 4.9% ahead of target. The bulk of this excess arose on the non-PAYE side.

Excluding the impact of special investigations receipts which were not as significant in 2006 as they were in 2004 and 2005 and which actually came in below target in 2006, the major taxes which together accounted for 84% of actual tax revenues in 2006, were 4.8% ahead of target.

[7] The 2006 tax revenue outturn is taken from the end-December Exchequer Returns and may be subject to change in the 2006 Finance accounts, to be published later in 2007.
[8] Includes a minor amount in respect of Residential Property Tax.

Review of Forecasting Performance

In October 2005, the International Monetary Fund (IMF) published an analysis of Ireland's track record on forecasting the fiscal balance.[9] On the revenue side the analysis found that stronger-than-expected economic growth and buoyant asset price developments were the main reasons for the overshooting of tax revenue. In terms of economic growth forecasts, upon which the tax forecasts are based, it was outlined that Department of Finance forecasts were not dissimilar to those of other institutions, and the difficulty in forecasting economic growth in a period of strong economic growth was highlighted. The IMF recommended the continuation of what it called the "prudent approach" to budget forecasts given the risks that asset developments may not continue to contribute significantly to large upside surprises. It also stated that the institutional framework for fiscal policy and budget forecasting practices in Ireland are relatively strong compared with other countries.

The Accounting Officer informed me that many factors can affect the outcome of a tax revenue forecast that is subject to an appreciable degree of uncertainty. He stated

- Tax revenue is a product of the level of economic activity, and forecasting economic activity is not an exact science. Budget tax forecasts are made at a time when reliable economic data on the current or forecast year is not available. Economic data for previous years published by the Central Statistics Office (and similar statistical bodies elsewhere in the world) is subject to regular revision for a number of years after the end of the year in question.
- The actual composition of economic activity is also a key factor and this, likewise, is difficult to predict in advance.
- The actual outturn for current year tax receipts is not known at the time that Budget tax forecasts have to be made and also has to be estimated.
- The impact of once-off or extraneous factors e.g. special investigations receipts, from year to year can be significant.
- The effect of structural changes in the tax system that can sometimes impact on taxpayer behaviour with unforeseeable results on tax revenues in the short term.

Improving Forecasting

In response to my enquiry as to what action has been taken or is planned to improve the accuracy of budget forecasting, the Accounting Officer informed me that a Direct Tax Base Working Group, an informal group made up of officials of the Department of Finance and the Revenue Commissioners, was set up with the approval of the Minister for Finance in mid-2002. The original purpose of the group was to build on the earlier analyses of shortfalls in direct tax revenue in 2001 and 2002 and to examine issues that may have an impact on the tax yield from direct taxes, including income tax, for the purpose of improving the tax forecasting methodology. The work of the group is ongoing.

The Tax Forecasting Methodology Review Group, chaired by a senior economist on secondment to the Department of Finance from the Central Bank and comprising representatives from the Department of Finance, the Revenue Commissioners, the Central Bank, the Economic and Social Research Institute and the European Commission, was set up in December 2006. The terms of the reference for the group are

- To review the existing tax forecasting methodology
- To examine the reason for the tax forecast divergences

---

[9] IMF Selected Issues paper, July 2005 *Favourable Fiscal Outturns: Is It Just the Luck of the Irish?*

- To analyse the information bases on which forecasts are made
- To review the structural parameters of tax elasticities
- To look at the experience in other relevant jurisdictions and
- To make recommendations for changes to the methodology, where appropriate.

The group first met in January 2007 and has met five times so far. The group has examined a range of issues. These include

- The existing approach to tax forecasting
- The performance of the tax forecasts produced by the Department since 1998
- Revising the forecasts based on the most-up-to date economic data available
- Accounting for one-off receipts and recent property market performance
- Examining the long-run aggregate tax elasticity and
- Examining the tax forecasting methodology of other institutions.

He also informed me that, in order to concentrate resources on the work of this group, it had been agreed that the Direct Tax Base Working Group would postpone its work until after the Review Group had reported. This is expected some time during Summer 2007 and it is expected that its report will be published in due course.

Chapter 3

Revenue

3.1 Revenue Account

Basis for Audit

An account showing all revenue received and paid over to the Exchequer by the Revenue Commissioners is furnished to me annually. I am required under Section 3 of the Comptroller and Auditor General (Amendment) Act, 1993 (the Act) to carry out such examinations of this account as I consider appropriate in order to satisfy myself as to its completeness and accuracy and to report to Dáil Éireann on the results of my examinations. The results of my examinations have been generally satisfactory.

I am also required under Section 3 of the Act to carry out such examinations as I consider appropriate in order to ascertain whether systems, procedures and practices have been established that are adequate to secure an effective check on the assessment, collection and proper allocation of the revenue of the State and to satisfy myself that the manner in which they are being employed and applied is adequate. Sections 3.7 to 3.10 refer to matters arising from this examination.

Revenue Collected

Revenue collected under its main headings in 2006 is shown in Table 8.

Table 8 Revenue Collected[10]

	2006 Gross Receipts €m	2006 Repayments €m	2006 Net Receipts €m	2005 Net Receipts €m
Income Tax	15,450	3,075	12,375	11,340
Value Added Tax	17,809	4,358	13,451	12,126
Excise	5,834	138	5,696	5,391
Corporation Tax	7,271	586	6,685	5,503
Stamp Duties	3,674	42	3,632	2,673
Custom Duties	261	6	255	226
Capital Acquisitions Tax	355	12	343	249
Capital Gains Tax	3,134	35	3,099	1,982
Total	**€53,788m**	**€8,252m**	**€45,536m**	**€39,490m**

Of the net receipts of €45,536m, a total of €168m was paid during 2006 under Section 3 of the Appropriation Act, 1999, as amended, from the proceeds of tobacco excise to the Vote for the Health Service Executive. €45,536m was paid to the Exchequer which represented a prepayment of €418m. The amount prepaid at the end of 2005 was €250m.

[10] Total gross collection amounted to €62.3 billion as levies and fees such as PRSI (€8.4 billion), Health Levy (€169m) and Environmental Levy (€19m) are collected for other Departments.

3.2 Tax Written Off

The Revenue Commissioners have furnished me with details of the €120m of taxes and PRSI written off during the year ended 31 December 2006. Details of the total amount written off and the distribution according to the grounds of write-off are shown in Table 9 and Table 10.

Table 9 Taxes Written Off

Tax	2006 €000	2005 €000
Value Added Tax	45,253	48,433
PAYE	21,623	23,992
Corporation Tax	3,505	15,431
Income Tax	14,181	23,839
Capital Gains Tax	799	2,264
Other Taxes[11]	10,486	4,653
PRSI	23,799	24,689
Total (€000)	**119,646**	**143,301**

Table 10 Grounds of Write Off

Grounds of Write Off	2006 No. of Cases	2006 €000	2005 No. of Cases	2005 €000
Liquidation/Receivership/Bankruptcy	592	46,313	1,263	69,928
Ceased trading – no assets	2,106	44,438	2,032	34,981
Deceased and Estate Insolvent	162	1,762	132	1,340
Uneconomic to pursue	4,644	8,829	60,911	19,358
Unfounded Liability	120	686	187	2,160
Cannot be traced / Outside Jurisdiction	644	12,391	588	9,680
Compassionate Grounds	179	1,865	206	1,627
Uncollectible due to financial circumstances of taxpayer	306	3,177	439	4,225
Examinership	6	185	4	2
Totals	**8,759**	**€119,646**	**65,762**	**€143,301**

In 2006, approximately €1m, consisting of cases with balances of less than €1,000 which were considered uneconomic to pursue, was written off on an automated basis. Cases under general investigation, potential

[11] The other taxes heading includes Relevant Contracts Tax of €9.5m and automatic write off under all taxheads of €1m.

Ansbacher cases and cases under the control of the Criminal Assets Bureau are excluded from all write off procedures. The largest single amount written off in 2006 was €2.3m in respect of Employer's PAYE/PRSI and Relevant Contracts Tax owed by a construction company which had gone into liquidation. There were four other cases where the amount written off was greater than €1m.

The Internal Audit Branch in Revenue undertakes an annual examination of tax write offs. The 2006 audit examined a sample of 204 cases representing 33% (€39m) of the value of non-automated write offs (€118m). Internal Audit was satisfied that all amounts were written off in accordance with the criteria prescribed with one exception. In this case, a repayment of VAT of €39,679 on a property lease transaction was made to the lessee prior to the write off of a matching liability of the lessor. In the particular circumstances the correct procedure should have been to offset the repayment due to the lessee against the liability of the lessor. The repayment has since been recovered and the write off reversed. Internal Audit also examined the results of the five automated write off runs and confirmed the correct application of the authorised selection criteria for each run.

I have examined a sample of cases representing over 12% of the value written off through a review of the procedures followed and of supporting reports and records with a focus on high value cases. The results indicated that, in general, the authorised procedures were followed.

3.3 Outstanding Taxes and PRSI

Table 11 reflects activities and transactions in the twelve month period ended 31 March 2007. Table 12 sets out an aged analysis of the balance outstanding at 31 March 2007. The tables were prepared on the basis of information furnished by the Revenue Commissioners.

Table 11 Outstanding Taxes and PRSI

						Analysis of Balance at 31 March 2007	
Balance at 31 March 2006	**Tax or Levy**	**Net Charges Raised**	**Paid**	**Written Off**	**Balance at 31 March 2007**	**Under Appeal**	**Available for Collection**
€m		**€m**	**€m**	**€m**	**€m**	**€m**	**€m**
227	VAT	12,288	12,279	40	196	74	122
137	PAYE	10,282	10,269	15	135	7	128
165	PRSI	7,775	7,764	16	160	2	158
276	Income Tax (excluding PAYE)	3,030	3,017	12	277	68	209
–	DIRT	306	306	–	–	–	–
161 [12]	Corporation Tax	5,202	5,217	2	144	65	79
141	Capital Gains Tax	3,393	3,375	1	158	89	69
3	Capital Acquisitions Tax	343	343	–	3	–	3
8	Abolished Taxes	–	–	–	8	–	8
37	Relevant Contracts Tax	64	66	9	26	10	16
1,155	**Total Debt**	**42,683**	**42,636**	**95**	**1,107**	**315**	**792**
2%	**Debt as a % of gross collection** [13]				**1.8%**	**0.5%**	**1.3%**

[12] This opening balance is €70m greater than the closing balance shown in Table 5 of my 2005 report owing to the necessity for a technical adjustment.
[13] Gross collection in 2005 was €54,157m and in 2006 was €62,330m.

Table 12 Aged Analysis of Debt at 31 March 2007

Tax	Total tax outstanding at 31 March 2007	Amounts outstanding for 2006	Amounts outstanding for 2005	Due for 2002 to 2004	Due for earlier periods (i.e. > 5 yrs old)
	€m	€m	€m	€m	€m
VAT	196	23	26	126	21
PAYE	135	77	17	27	14
PRSI	160	99	22	27	12
Income Tax	277	3	75	71	128
Corporation Tax	144	52	6	35	51
Capital Gains Tax	158	10	30	21	97
Capital Acquisitions Tax	3	–	–	–	3
Abolished Taxes	8	–	–	–	8
Relevant Contracts Tax	26	7	3	16	–
Total	**€1,107m**	**€ 271m**	**€179m**	**€323m**	**€334m**

3.4 Revenue Audit Programme

Overall Audit Programme

In a self-assessment system, returns filed by compliant taxpayers are accepted as the basis for calculating tax liabilities. The validity of returns is established by the auditing of a selection of cases either through reviewing and seeking further verification of particular details or by the examination of documents and records at a taxpayer's premises. The type of intervention by Revenue depends on whether the risk is perceived to relate to one or more tax or duty headings or to specific issues or transactions. Assurance Checks are not audits but interventions that may involve tests, verification checks, desk examinations, visits to premises, searches, site visits and telephone contacts for supporting documentation.

The outcome of the 2006 programme of Revenue audits together with assurance activity is summarised in Table 13.

Table 13 Revenue Audit and Assurance Activity

Category	2006		2005	
	Number completed	Yield €m	Number completed	Yield €m
Comprehensive Audits	4,127	436.2	5,077	323.3
Multi Tax/Duty Audits	1,757	56.2	1,220	52.3
Single Tax/Duty Audits	6,305	133.5	6,173	122.8
Single Issue/Transaction Audits	1,437	23.8	1,744	26.6
Total Audits	**13,626**	**649.7**	**14,214**	**525.0**
Assurance Checks	176,064	42.1	98,981	50.4
Total Interventions	**189,690**	**€691.8m**	**113,195**	**€575.4m**

A significant feature of the 2006 programme was a national compliance project in the construction sector. A total of 3,872 audits with a yield of €116m and 45,423 assurance checks with a yield of €21m were completed as part of the project. Included in these assurance checks were 1,615 site visits which identified 1,188 individuals who were not registered with Revenue, 447 sub-contractors who were re-classified as employees and 2,479 additional VAT or employer registrations. 55 cases were identified for possible prosecution activity.

Comprehensive Audits

The yield of €436m from the 4,127 comprehensive audits completed includes interest charges of €187m and penalties of €110m. The highest settlements were €6.4m for Income Tax and €22.17m for Corporation Tax. Comprehensive audits were completed in 217 bogus non-resident account cases with settlements totalling €29m, in 595 offshore assets cases with settlements totalling €92m and in 766 life assurance product cases with settlements of €89m[14].

[14] Some of the yield in these special investigation cases was collected in earlier years.

Risk Analysis System

A risk analysis system (REAP) was piloted in four Revenue Districts in 2005 and was introduced in all Districts in 2006. The system analyses the information available on taxpayers by running a set of queries or rules through a database of taxpayer information, scoring the results and ranking the cases according to those scores. The rules have been derived from the knowledge and experience of Revenue auditors and are refined to take account of new risks and data sources. Based on the system ranking, District officers analyse and assess the risk in each case to select suitable cases and decide on the appropriate intervention. The facility to record that a case was selected for audit using the REAP system only became available during 2007 and therefore the results of such audits for 2006 are not separately available.

Random Audits – Taxpayer Compliance Testing Programme

Revenue introduced the Taxpayer Compliance Testing Programme in 2005 to replace the Random Audit Programme. The purpose of the programme is to measure and track compliance with tax legislation and to ensure that all taxpayers run the risk of being selected for audit. 410 cases were selected for audit under the 2005 programme. 62 cases were dropped where the taxpayer had ceased trading, had never traded, was deceased or not available for health reasons or where the case was under enquiry or had recently been audited.

Over 99% of the 348 caseload has been finalised. While no additional liability was established in 232 of the 346 cases finalised, settlements totalling €1.4m were agreed in the other 114 cases. The average yield from all the cases finalised was therefore €4,100. Audits have not yet been finalised in 2 cases. The outcome of the cases finalised to date is summarised in Table 14.

Table 14 Taxpayer Compliance Testing Programme 2005 - Finalised Cases by Size of Additional Liability

Additional Liability	Number of Cases Finalised	% of Finalised Cases
Nil	232	67%
< €2,000	27	8%
€2,001 to €5,000	31	9%
€5,001 to €10,000	21	6%
€10,001 to €20,000	18	5%
€20,001 to €50,000	13	4%
> €50,001	4	1%
Total	**346**	**100%**

402 cases have been selected for audit under the 2006 programme. 274 of these have been finalised as at 30 June 2007, 196 of which had no additional liability and 78 had additional liabilities totalling €431,905. An additional €158,410 was recovered for periods other than the period targeted for audit. The outcome of the cases finalised to date under the 2006 programme is summarised in Table 15. 401 cases have been selected for audit under the 2007 programme.

Table 15 Taxpayer Compliance Testing Programme 2006 - Finalised Cases by Size of Additional Liability

Additional Liability	Number of Cases Finalised	% of Finalised Cases
Nil	196	71%
< €2,000	36	13%
€2,001 to €5,000	18	7%
€5,001 to €10,000	13	5%
€10,001 to €20,000	7	2%
€20,001 to €50,000	3	1%
> €50,001	1	1%
Total	**274**	**100%**

It is too early to draw conclusions from the results of the programme to date about levels of underpayment of tax among the taxpayer population as a whole. The fact that the selection methodology is still being refined to ensure that it can be used as a sound basis for extrapolation also militates against the validity of any such exercise at this time. Firm conclusions must await the bedding down of the methodology and emerging trends over a number of years.

3.5 Prosecutions

Under Revenue's prosecution strategy, Regions and Divisions forward cases to Investigation and Prosecutions Division (IPD) for investigation with a view to criminal prosecution where there is prima facie evidence of serious revenue offences having been committed. Within IPD, these cases are further evaluated by the Prosecutions Admissions Committee before commencement of the resource intensive criminal investigation work that can take several years before reaching the Courts. In 2006, 33 cases of serious tax evasion were referred to the Division for consideration and 16 were accepted for investigation with a view to prosecution. The comparable figures for 2005 were 91 referred and 30 accepted.

Convictions were obtained in the three cases decided in court in 2006

- A building contractor received a six months sentence (which was suspended for two years) and a fine of €3,200 for submission of incorrect VAT returns.
- A ground works contractor was fined a total of €2,040 for various offences relating to VAT and Income Tax returns.
- Fines of €33,782 were imposed on a petrol station owner for submitting incorrect VAT returns and evading excise duty on oil.

81 cases of serious tax evasion were on hands in the Investigations and Prosecutions Division at the end of 2006. The status of those cases at the end of May 2007 is shown in Table 16.

Table 16 Status of Serious Tax Evasion Cases

Status	Number of Cases
Under investigation	28
Decision not to prosecute	7
With the Revenue Solicitor's Office	4
Submitted to the DPP	10
Directions issued by DPP to prosecute	14
Bench warrant issued	1
Cases before the court	13
Convictions obtained	4
Total	**81**

In addition, there were 3 convictions for serious Customs and Excise evasion in 2006.

3.6 Special Investigations

Table 17 sets out the payments made to the end of May 2007 as a result of each of the Special Investigations being carried out by Revenue. A short summary of progress to date in the investigations follows.

Table 17 Payments arising from Special Investigations

Investigation	Cases Involved	Payments to Date €m
DIRT — Look Back Audits (financial institutions)	37	225
DIRT — Underlying Tax		
Voluntary Disclosure Scheme	3,675	227
Post Voluntary Disclosure Investigations	c. 8,500	402
NIB	465	59
Ansbacher	289	76
Pick Me Up Schemes	71	0.8
Mahon Tribunal	27	32
Moriarty Tribunal	18	8
Offshore Assets	14,374	870
Undisclosed Funds – Life Assurance Products	5,276	430
Total		**€2,329.8m**

Underlying Tax on Bogus Non-Resident Accounts

A total of 3,675 taxpayers paid €227m under the Voluntary Disclose and Pay Scheme whereby underlying tax relating to funds deposited in bogus non-resident accounts was required to be paid by 15 November 2001 to avail of the incentives of a cap of 100% on interest and penalties and an undertaking not to prosecute or publish details of the settlement. Revenue selected 268 of these cases for liability review. 210 of these were accepted as being correct, additional payments of €6,184,408 were required in 55 cases. Payments on account of €847,749 have been received in the remaining three open cases. All cases were reviewed for eligibility and 18 cases have been deemed to be ineligible. 15 of these have been settled with additional liabilities of €2,101,260. One of these cases was prosecuted and received a two year suspended sentence. The remaining three cases are at various stages of investigation.

Revenue used their powers under Section 908 of the Taxes Consolidation Act, 1997 to obtain information from financial institutions to help identify bogus non-resident account holders who did not avail of the Voluntary Disclose and Pay Scheme. Eighteen orders under Section 908, seeking information on account holders from 26 financial institutions, were granted. At the end of May 2007, payments of €402m had been received from bogus non-resident account holders over and above the proceeds of the voluntary scheme.

Revenue estimates that the likely future yield from the DIRT underlying tax investigation will be of the order of €20m and will arise over the next couple of years.

Offshore Investments via National Irish Bank

Investigations have concluded in 432 of the 465 cases identified as having invested in an offshore investment scheme operated by National Irish Bank. Settlements totalling €52.4m have been made in 309 of these cases while the other 123 cases had no liability. Investigations are continuing in the remaining 33 cases and payments on account of €3m have been received from 11 of these. Over and above these amounts, National Irish Bank has paid €3.5m in respect of Capital Gains Tax on compensation it paid to certain investors. Revenue estimates that a further €2m should be paid and that the investigation will be concluded by the end of 2007.

Ansbacher Investigation

Cases directly involving Ansbacher type arrangements, as well as other cases involving offshore funds and deposits, are being investigated. There are 289 cases, comprising 179 cases on the High Court Inspectors' Report and 110 similar cases discovered by Revenue or listed in the Authorised Officer's Report.

Thirteen High Court orders have been obtained against financial institutions and third parties requiring the production of books, records and documentation. Over 250,000 documents have been received under the terms of the High Court Orders. Also, documentation has been received on foot of the June 2004 High Court order which allowed for access to certain documentation relating to clients of Ansbacher named in the High Court Inspectors' Report and those persons found by the High Court Inspectors to have failed to co-operate with their enquiry.

A total of 248 cases have been settled to date, 106 of which had total liabilities of €68.44m. This includes a settlement of €7.5m with a Cayman Islands based bank. The other 142 cases settled had no liability and include 69 non-resident cases covered by the provisions of Double Taxation Agreements, as well as 20 cases covered by the 1993 Amnesty provisions. Payments on account of €7.73m have been received in 16 of the 41 on-going cases. As some of the cases are likely to proceed to the Courts, it is not possible for Revenue to predict either the potential yield or the time frame to completion.

Pick-Me-Up Schemes

Pick-me-up schemes involved expenses for goods or services incurred by a political party being invoiced by the supplier to another trader who paid the supplier as a means of supporting the party. Such payments were not deductible for tax purposes, the VAT was not reclaimable and the invoices issued were not in accordance with the legal requirements. The investigation found a total of 71 cases that apparently avoided tax by engaging in "picking up" expenses, which were proper to political parties. 46 cases have been settled for a total of €562,328 including interest and penalties. Payments totalling €226,165 have been received in connection with ten other cases including Tribunal cases which are still to be finalised. It is proving difficult to conclude certain cases because of the age of the payments, which were made in the 1980s or early 1990s, and the lack of documentation and records gives rise to difficulty in confirming liability. It is not possible for Revenue to estimate with any degree of accuracy the final yield. However, it is not expected to amount to substantially more than has been received to date.

Tribunals

Matters disclosed at the Moriarty and Mahon Tribunals, which suggest that tax evasion may have occurred, are being investigated as they come to notice. Eighteen cases are being investigated as a result of the Moriarty Tribunal and three cases have been settled for a total of €7m. Payments on account of €1.4m have also been received in respect of two cases. Twenty-seven cases are being investigated as a result of the Mahon Tribunal and four of these have been settled for €26.5m; payments on account of €5.5m have also been received in respect of 12 cases.

The Moriarty Tribunal is nearing completion and it is not expected that further cases will arise. Revenue does not know if any additional cases will arise from the Mahon Tribunal or when that Tribunal will conclude.

Offshore Assets

This investigation is concerned with those who have not paid tax due on funds held in offshore accounts and investments. The voluntary phase of the investigation required taxpayers to give Revenue notice of their intention to make a qualifying disclosure by 29 March 2004 and submit a statement of disclosure and any payment due by 10 June 2004. The benefits of meeting these deadlines were mitigation of penalties, settlement details would not be published and there would be no prosecution. Disclosures were received from 13,651 taxpayers and €650m was received both from this phase of the investigation and from two earlier investigations.

As a follow-up to the voluntary phase, 14 High Court orders have been obtained requiring financial institutions to supply details of transactions by their customers relating to offshore operations. The information received has been analysed and those who availed of the voluntary disclosure scheme are excluded from further investigation provided their disclosure is compatible with the information obtained from the financial institutions. Challenge letters have been issued to over 1,500 taxpayers who failed to avail of the voluntary disclosure scheme. A further €220m has been received since the voluntary scheme, arising from reviews of the voluntary submissions and payments from some 723 taxpayers who did not avail of the voluntary scheme. A further series of High Court orders is to be sought in 2007 and 2008. The final yield from the investigation may approach €1 billion.

Life Assurance Products

Investigations into the use of life assurance investment products to hide undisclosed income or gains began in 2004. The voluntary disclosure phase of the investigation set a deadline of 23 May 2005 for those who invested undisclosed funds greater than €20,000 in such products to give notice to Revenue of their intention to make a voluntary disclosure. Full disclosure and payment was then required to be made by 22 July 2005. The benefits to the taxpayer in availing of the voluntary scheme were that the settlement details would not be published, there would be no prosecution and penalties would be mitigated in accordance with the Code of Practice for Revenue Auditors. About 10,000 notices of intention to make disclosures were received and some 5,150 taxpayers made payments of €417m under the voluntary scheme.

The second phase of the investigation involves identifying those who did not avail of the voluntary scheme. Revenue used new powers provided in section 140 of the Finance Act 2005 which allows it to sample the information held by a life assurance company that relates to a class or classes of policies and policyholders, where there are circumstances which suggest that such policies have been used to invest untaxed funds. The information obtained can only be used to assist in making an application to the High Court for an order to have wider access to the information. Revenue has completed the sampling work in 14 assurance companies. The information gathered from that work and from the voluntary disclosures is being used to assist in applications to the High Court for orders directing assurance companies to furnish details on individual policyholders and policies to Revenue (11 orders were applied for and granted in July 2006 and a further three in March 2007). The information received on foot of these orders is being used to target taxpayers for enquiry. The first tranche of 5,300 enquiry letters issued in March 2007 and a further tranche of letters is scheduled for issue in September 2007. Revenue has received €13m from 126 taxpayers in the course of these follow up enquiries. Revenue expects this investigation to be substantially progressed by the end of 2007 and the final yield is estimated at €500m.

3.7 Control of Alcohol Tax Warehouses

Introduction

Excise duty is levied on excisable products – alcohol products, mineral oils and tobacco products. The rates of duty are set nationally. Total excise duties collected in 2006 on alcohol products amounted to €1,078m (€1,038m in 2005).

Excise duty is payable at the time of production in Ireland or importation into Ireland. However, if the product is held in a tax warehouse, payment of the duty is suspended until it is released for consumption onto the home market. A tax warehouse is a premises approved by Revenue where excisable products can be produced, processed, held, received or dispatched under a duty suspension arrangement by an authorised warehousekeeper in the course of business. There are 177 approved tax warehouses in Ireland and 122 of these are authorised to operate duty suspended arrangements for alcohol products. Revenue also grants approval to traders who operate as tenants in tax warehouses thereby allowing them to operate the duty suspension system. There are 286 traders approved as tenants and 247 of these deal in alcohol products.

European Union

With the introduction of the Single European Market in 1993, an EU-wide control and movement system for excisable products was introduced. Each Member State determines the rules for the production, processing and holding of excisable products subject to the provisions of EU directives. As excise duty does not become payable until goods are released onto the market for consumption, duty is suspended on goods sent from a tax warehouse in one Member State to a tax warehouse in another. Goods moving between Member States under these arrangements must be accompanied by a document known as an AAD (Administrative Accompanying Document). This document is completed by the dispatching warehouse. The receiving warehouse signs the document and returns it to the dispatching warehouse as proof that the goods were received. Similarly, duty is not payable on goods transferred between tax warehouses in Ireland.

The System for Exchange of Excise Data (SEED) is an EU wide database of excise warehouses. Each approved warehouse is given a reference number by the Revenue administration of the country in which it is situated. The dispatching warehouse can therefore check whether the receiving warehouse is an authorised tax warehouse. Its usefulness as a control depends on it being kept up to date by all Member States.

Revenue System of Control of Tax Warehouses

The warehousekeeper is responsible for the control and security of products stored or being moved under duty suspension. Revenue controls the operation of tax warehouses by means of

- An approval process for warehouses, warehousekeepers and tenants
- On-going administrative control including supervisory visits and checks and review of monthly stock returns
- Regular audits.

Approval

To obtain approval, applicants must satisfy a number of specified criteria, for example that there is an economic need for the warehouse, that it is secure, complies with Health and Safety requirements and will be operated in a way which will enable Revenue to achieve satisfactory levels of control. In all cases Revenue officers visit the applicant at the proposed premises.

Checks are also carried out of the applicants' tax compliance history, of Company Registration Office records, enquiries are made with Revenue's Investigation and Prosecution Division and tax clearance certificates are sought. Revenue does not seek Garda clearance for applicants.

I enquired why no Garda clearance checks were carried out. The Accounting Officer informed me that Revenue carried out detailed checks on applicants drawing on the extensive information it holds. In the case of non-residents, tax administrations in other countries were consulted. He stated that, given the depth of information that Revenue already obtained, the usefulness of Garda checks was not certain. However this was something that would be looked at in the context of a current review of the tenant warehousekeepers approval system.

I also asked whether control would be improved if approved warehousekeepers and tenants were required to provide tax clearance certificates on an on-going basis. I was informed that, in addition to formal authorisation, every warehousekeeper must hold an excise licence for the activity in the warehouse and that the granting of these annual licences was subject to tax clearance. Formally specifying tax clearance as a requirement for warehousekeeper approval, and making failure to obtain tax clearance a ground for revocation of authorisation, was one of a number of options for strengthening of the law on warehousing that was being considered.

Administrative Control

A Revenue control officer is assigned responsibility for the supervision of each approved warehouse.

Each warehousekeeper is required to submit a monthly stock return to Revenue detailing all goods movements. Control officers examine returns for accuracy and any deviations from normal activity. Dutiable deliveries are checked to the supporting documentation and spot checks are carried out on duty suspended movements to other EU countries and on third country movements.

Supervisory visits by control officers may entail physical inspection of the premises and procedures. In general, storage and distribution warehouses are visited at least quarterly and manufacturing warehouses at least monthly. Instructions to control officers provide for a full stocktaking to be carried out every 12 months but they can be carried out less frequently having regard to staff resources. However, they must be carried out every three years.

Warehouse Audits

Periodic audits of warehouses by Revenue officers, other than the control officer, are also an important control. Audits involve

- Ensuring proper records are maintained and the conditions of approval are being complied with
- Statistical checking of volume of trade with duty declarations and stock levels
- Sample checking of transactions between accounts records and duty declarations
- Physical stock checks and challenges
- Checking warehouse records for a sample of tenants to the tenants' own commercial records.

The Drinks, Tobacco and Multiples Unit (DTM) of Revenue's Large Cases Division (LCD) is responsible for the major warehouses dealing in alcohol products. A separate audit section of the DTM Unit carries out audits of the warehouses controlled by the Unit. Warehouses are selected for audit based on an assessment of risk. When the audit based system of control of warehouses was introduced the intention was that each warehouse would be audited every 6 months. The current general objective is that each warehouse be audited every two years. There were 53 audits carried out in the period 2004-2006 by the Large Cases Division, from which there was no yield.

In 2005 the audit section of DTM took on responsibility for customs audits for other LCD Business Units as well as providing a mentoring services to other units in relation to customs. The provision of mentoring is due to end in 2007. This diversion of resources to other activities has reduced the number of audits of tax warehouses. Of the 33[15] warehouses authorised for alcohol products and controlled by DTM Unit, 17 were audited in 2004, 15 in 2005 and 8 in 2006. In the years 2004 to 2006, 16 of the 33 warehouses had not been audited within the planned two-year cycle.

The Accounting Officer informed me that operational policy on audit frequency and coverage is reviewed on an ongoing basis, and, based on current risk analysis, risk assessment and risk management techniques, the current level of audit was considered to be satisfactory. Full stock takes were carried out at least every three years and, in the case of some of the larger warehouses, more frequently. He also stated that, unlike some other jurisdictions that rely solely on audit as a form of control, the Irish system incorporates control officers who scrutinise and supervise activities on an ongoing basis. Given these safeguards, and the low levels of risk as evidenced by the minimal yields from audits, he was generally satisfied as to the frequency with which audits are carried out.

Bond

A bond is required to cover the duty perceived to be at risk rather than the total potential duty liability. Warehousekeepers can provide separate bonds or guarantees to cover specific procedures such as goods dispatched to tax warehouses in other EU countries. A minimum bond level of €127,000 is required for storage and distribution warehouses. Bonds are not usually required for tenant warehousekeepers as the risk is considered to be covered by the warehousekeeper's bond.

While regard is had to various criteria in setting bond levels, there is no risk based formula with weightings for different risk factors used to calculate bond levels. Such a method of setting bond levels would be more transparent and allow for a more structured periodic review of bonds. Revenue considers that current bond levels are adequate based on knowledge of traders and assessment of risk and taking account of the well-established record of tax compliance that most of them possess.

The Accounting Officer informed me that the role of bonds as a mechanism for excise control is also to be reviewed. He stated that many low-tax Member States pitch the level of their bonds to their own rates, with the result that they are completely inadequate to cover the risk for consignments moving to this country. Revenue was conscious of the important role that the provision of appropriate financial security played in the overall system of monitoring and control of excisable products under duty suspension. While providing appropriate safeguards against default or fraud, a bond system must also avoid imposing excessive financial burdens on excise traders, the vast majority of whom were tax compliant.

[15] Responsibility for the administrative control of 5 of these warehouses has been devolved to other Revenue Divisions.

Risks

As duty on goods held or moved under duty suspension arrangements has yet to be paid, there is a risk of loss of revenue. Duty will not be collected if goods are fraudulently removed from the duty suspension system. There is a loss to the Irish Exchequer if such goods are released onto the Irish market. If goods are fraudulently released onto the market in another EU country, there is a loss of revenue in that country. There are several types of fraud that can occur when goods are held or moved under duty suspension, including

- Outward Diversion Fraud – duty suspended goods being purportedly transferred to a tax warehouse in another EU country but are diverted onto the market without payment of duty
- Inward Diversion Fraud – duty suspended goods being purportedly transferred from a tax warehouse in another EU country to an Irish tax warehouse but are diverted onto the market without payment of duty
- Inland Diversion Fraud – duty suspended goods moving between warehouses in Ireland but diverted onto the market.

Administrative Accompanying Document (AAD)

The system of movement between EU countries is underpinned by the AAD document. The dispatching warehouse satisfies itself that the receiving warehouse is an authorised warehouse and completes the AAD. This is not discharged until the dispatching warehouse receives a signed copy from the warehouse in the other Member State as proof that the goods arrived. The AAD system is open to abuse in a number of ways, not all of which require collusion between the parties to the movement of goods.

As even genuine AADs can take some time to be returned to the dispatching warehouse, it can take a considerable time to identify fraud.

Another control is the issue of a movement verification request to the Revenue authorities of another Member State. This involves Revenue requesting the relevant authorities to confirm that a consignment dispatched from a tax warehouse in Ireland arrived at the tax warehouse in the other Member State. This is a useful control but is dependent on a speedy response. Even when a prompt response is received it may be too late, as the goods and the perpetrators of the fraud may have disappeared.

I enquired as to the number of undischarged AADs and the related value of duty involved in each of the years 2004, 2005 and 2006 and whether the duty had been recovered from the dispatching warehousekeeper in all of these cases. In his response the Accounting Officer informed me that at present no actual records of undischarged AADs was maintained by Revenue. However with the introduction of a planned new electronic system, EMCS, a database register of all electronic AADs showing their current status will be created.

Electronic Movement and Control System (EMCS)

Due to the high level of fraud in Member States and the corresponding loss of revenue, especially in the case of tobacco and alcohol, the EU Council of Economic and Finance Ministers in 1998 endorsed a report recommending the setting up of a computerised trader-to-trader link via member states' tax administrations. A feasibility study concluded that the computerisation and replacement of the AAD with an electronic system was feasible. A 2003 decision of the European Parliament and the Council of the EU provided the legal basis for the development of the system known as the Electronic Movement and Control System (EMCS). Each member state is developing its own system based on EU standard requirements. The EMCS is expected to be operational by mid 2009 and is intended to improve the monitoring of movements of duty suspended goods by

- Simplifying duty suspended movements by electronic transmission of the AAD rather than as a paper document
- Securing the movements of goods by checking traders' data before the goods are dispatched and ensuring a quicker return of evidence that goods arrived at their intended destination
- Monitoring the movement of excisable goods by providing real time information and allowing checks during movements.

The system will be capable of computerising domestic movements.

The Accounting Officer informed me that experience shows that the intra-Community movement system had been reasonably effective and it is expected that it will be significantly improved when it is fully computerised in 2009.

Alcohol Duty Frauds in the UK

From the mid 1990s diversion fraud began to be recognised as a growing problem in the UK. Between 1993 and 2000, it was estimated that revenue lost in fraud cases investigated amounted to stg£668m[16], representing 1.45% of total alcohol duty over the period. The UK was particularly susceptible to diversion fraud because it, like Ireland, had a high excise duty regime, unlike many other EU countries. The removal of a Customs presence in tax warehouses was identified as an important factor in failing to prevent the frauds. In the majority of the frauds, the receipting stamps on AADs were forged.

Frauds Identified in Ireland

Case details

In 2003, two diversion frauds, perpetrated by tenant warehousekeepers, were discovered. In the first case, the ownership of a company, which had approval as a tenant, changed. In response to a movement verification request, the Spanish authorities informed Revenue that a consignment of goods was not received in a Spanish warehouse. Subsequent verification requests established that 9 out of 25 consignments were not received in the Spanish warehouse. It also came to light that the Spanish warehouse had a previous history of infringements. Revenue was not notified of the change of ownership of the tenant company, despite a requirement that it be advised when there is a change of effective ownership or controlling interest where the warehousekeeper is a limited company. The Alcohol Products Tax, Regulations, 2004, introduced a regulation that, where there is a change of ownership or control, the approval ceases.

In the second case, approval was granted to a tenant, about whom Revenue had suspicions, because legal advice was obtained to the effect that approval could not be refused solely on the grounds that a person might commit fraud. The Spanish authorities, in response to a movement verification request, informed Revenue that a consignment had not arrived at a Spanish warehouse. The following day, the UK authorities contacted Revenue to state that they had detained a consignment sent by the Irish tenant to a Spanish warehouse and sought confirmation that the Irish warehouse was approved. The UK authorities also informed Revenue that the Spanish warehouse was no longer authorised. However, it was still showing as authorised on the Irish SEED database. Further movements from the tenant were stopped. Copies of all AADs relating to 55 shipments by the tenant to two Spanish warehouses were sent to the Spanish authorities for confirmation and investigation. None of the consignments were received.

[16] Source: UK National Audit Office Report *Losses to the Revenue from Frauds on Alcohol Duty* July 2001.

Outcome

Revenue considers that none of the goods involved in these frauds were diverted onto the Irish market but, if they had been, the loss to the Irish exchequer would have been approximately €16.3m. However, there was a loss of duty in the country in which the goods were ultimately sold, which Revenue considers was most likely to be the UK. In neither of the two cases of fraud was the duty on the missing consignments paid or the bond estreated. The investigation is effectively closed in Ireland. No duty has been recovered. There are unlikely to be any prosecutions in this jurisdiction because of lack of evidence. However, Spanish authorities have taken criminal proceedings against the directors of the Spanish company involved.

I have been informed that developments to the SEED system were implemented in July 2006 and that Revenue regularly reviews and updates the database from an Irish perspective. As the database is a Community one, it is also dependent on other Member State administrations for input, and delays can occur that are outside Revenue's control. A one-week delay in updating the system presently applies but this is an improvement from the monthly EU updates previously available. A further development of the system is scheduled for May 2008. This will reduce the delay to a few days at most.

I enquired why the bond in both fraud cases was not estreated and whether it was considered that the effectiveness of bonds in securing revenue at risk and acting as a deterrent was undermined if bonds are not estreated in cases of fraud. The Accounting Officer informed me that the traders involved in the frauds were given warehousekeeper approval, despite Revenue's reservations as to their suitability, because the legal advice was that there were insufficient grounds for refusal. The landlord warehousekeeper was not informed of those reservations, because to do so would have left Revenue exposed to a claim for defamation. The landlord, therefore, assumed the tenant's bona fides on the basis of the Revenue approval.

In the circumstances, and taking considerations of natural justice into account, it was considered draconian to penalise a legitimate trader who was innocent of any knowledge or involvement and had derived no financial benefit from the frauds. Furthermore, it was considered that estreating the bond in these cases would, at best, have recovered only a part of the tax liability and could have put the business of the landlord warehousekeeper at risk.

Finally he informed me that the practice of giving warehousekeeper approval to tenants in a tax warehouse, and the control requirements imposed on persons who receive such approval, are currently being reviewed.

Revenue Response to the Frauds

Arising from concerns in relation to these frauds, a number of proposals will be made in 2007 to Revenue's Management Advisory Committee. Under these proposals there will be no tenants as they now exist. Instead, approved warehousekeepers will be required to risk rate owners of goods who want to store them in their warehouse, advise their bond provider and provide evidence to Revenue that the bond provider has been informed of the full details and that the underwriter accepts the liability. The owner of the goods will be required to formally register with Revenue and will normally be restricted to storing goods to be released for home consumption only. The implementation of these proposals would require legislative change.

I have been informed that a number of options for the modification of the system of approving tenant warehousekeepers are under consideration. A decision as to any action to be taken will be made in the near future. It is likely that any change to the existing system would require the amendment of section 109 of the Finance Act, 2001. This would be undertaken in tandem with the envisaged strengthening of the provisions for approvals and revocations.

Revenue established an Excise Risk Group in September 2005 to identify the risks to revenue in relation to excise duty and to make recommendations on the level of excise checks. The Group reported in January 2006. The main risks identified in relation to duty on excisable products were the approval process and the scope for fraud in the AAD system. The report is currently being implemented on a phased basis in all Regions and appropriate Divisions of Revenue.

I asked the Accounting Officer if consideration been been given to introducing a system of tax stamps for spirits as provided for by EU Directive. He informed me that tax stamping of spirits was introduced in the UK in July 2005 despite strong opposition from the trade. This was in response to significant excise losses from smuggled spirits on the UK market. However he stated that there was no evidence that the threat posed to tax receipts in Ireland by illegal sales of untaxed spirits was such as would warrant the introduction of tax stamps. While a number of publicans have been successfully prosecuted for such offences in the last few years, there was no indication that the problem is widespread or increasing. In current circumstances the introduction of tax stamps was considered to be disproportionate in terms of the risks involved and the burden to the legitimate trade in operating a stamping system.

Accounting Officer – General Observations

The Accounting Officer informed me that

- Despite fears that the abolition of customs control of imports in 1993 would lead to widespread fraud, the warehousing system had continued to be effective and there had been very few instances of fraud over the years. The vast majority of tax warehousekeepers were compliant and their number small enough to allow for adequate monitoring and control.
- He believed that the system of control was satisfactory and struck a reasonable balance between protection of revenue and facilitating legitimate trade. While there was no single corporate performance indicator for monitoring the effectiveness of the system, its effectiveness was evidenced by the nil yield on 53 audits carried out by our Large Cases Division between 2004 and 2006 and by the rarity of instances of fraud.
- There would, however, always be a risk of fraud where excisable products were being moved under duty suspension. For that reason, Revenue was committed to reviewing control systems and processes on an ongoing basis, taking account of best practice throughout the EU, and would effect modifications or enhancements where the need arose.
- The two frauds referred to had prompted a re-examination of certain aspects of control requirements and procedures. In particular, the practice of authorising tenants as warehousekeepers in a warehouse, and the responsibilities to be imposed on them, were being reviewed and proposals for change, with supporting legislation as required, would be made in the near future.

3.8 Stamp Duty on Property Transactions

Introduction

Stamp Duty is a duty payable on a wide range of legal and commercial documents, referred to as instruments, including conveyances of property. The rate may be either *ad valorem* or fixed. The First Schedule to the Stamp Duties Consolidation Act, 1999 lists the types of instruments liable to duty and the rate applicable. The Act also sets out how Stamp Duty is to be collected and denoted and the person liable to pay the duty. The legislation is premised on a self-certification approach to drafting instruments for presentation to Revenue's Stamping Offices. The self-certification approach is reinforced by the provision in the Act that instruments not properly stamped are not admissible in evidence in civil proceedings.

Instruments which must be stamped are presented, accompanied by the correct amount of stamp duty due, to a Stamping Office and examined by a Revenue officer to establish the particulars therein affecting stamp duty. In general, stamp duty is assessed and calculated and reliefs granted based on the information and certification contained in the instrument. Assessment/calculation and stamping (receipting) for stamp duty is processed by and recorded on Revenue's Stamp Duty Administration System (SDAS).

In the vast bulk of cases, copies of instruments are not retained and the SDAS electronic record is the only data retained. Roughly half of the entire number of stamp duty transactions is conducted over the public counter and the other half by post. Paper files are only retained in relation to adjudication or complex cases, refund cases, penalty mitigation cases and for all postal cases in which there were issues to be addressed.

In 2006, stamp duty relating to property transactions accounted for approximately 82% of total net stamp duty receipts of €3,632m.

Stamp duty receipts from property transfers in the period 2001-2006 are set out in Table 18.

Table 18 Total Stamp duty receipts from Property Transfers (€m)

2001	2002	2003	2004	2005	2006
671	666	1,075	1,461	2,002	2,989

In the case of property transactions, the rate and amount of duty payable is determined by

- The price paid for the property or the assessed market value
- Whether the purchaser is a first time buyer, an owner occupier or investor
- Whether the property is new or second-hand
- Whether the property is residential or non-residential
- Whether the size of the total floor area exceeds 125 square metres and
- Whether, in relation to new property, a building agreement exists.

Revenue Audit of Compliance in Dublin

A dedicated stamp duty audit section was established in 2002. This carries out audits relating to stamp duty in respect of properties purchased by Dublin-based taxpayers. There were 10 staff deployed in the section at the end of April 2007.

In 2006 the section carried out an audit project in relation to stamp duty on property transactions conducted in 2003. The audit sought to establish whether those availing of owner/occupier full or partial exemption had rented the property within 5 years of purchase or were investors. In such cases the purchaser is liable to pay Revenue the difference between the duty paid, if any, and the duty liable had the relief not applied, along with any interest that may be due. The project examined a database containing in excess of 65,000 cases. Incomplete records were excluded. The data was specific to new house purchases only.

A matching exercise was carried out between the SDAS and Revenue's Common Registration System (CRS). A total of some 5,500 cases from the Dublin region was extracted where the purchaser's recorded address differed between the SDAS and CRS and where the purchasers availed of full owner/occupier relief on stamp duty for new property.

A random sample of 1,000 of these cases was selected. An inquiry letter issued to each purchaser requesting information on all property owned within the previous five years. Revenue received a reply in approximately 90% of cases. Where no reply was received, Revenue visited the addresses in question - 102 visits were necessary. Further enquiries were necessary in 35 of these cases. On examination of the 898 replies received, further investigation was necessary in 105 cases making a total of 140 requiring further audit. A total of 31 of these cases were later found to be satisfactory.

An estimated €1.2m in stamp duty, penalties and interest charges was assessed in respect of the remaining 109 cases, comprising 94 clawback cases as the property had been rented within five years of purchase and 15 cases where investors had incorrectly claimed relief.

As results in approximately 11% of the sample of 1,000 cases selected for the purposes of the stamp duty audit project were found to be unsatisfactory, I asked was consideration given to increasing the sample size and, if not, why not. I also asked if consideration had been given to conducting a similar exercise for more recent years. The Accounting Officer informed me that the results of the pilot sample were analysed and reported upon by the Capital Accounts and Audits Division (CAAD). This report was submitted to the Operations Management Group (OMG) in May and a steering group had been set up to scope a potential risk focussed national project taking account of the Dublin claw back cases, data matching possibilities to narrow the target range and resource implications. This group had very recently furnished recommendations to the OMG which is now considering the matter.

He also informed me that, in Dublin, CAAD carries out post-stamping audits to support the stamp duty compliance programme. In other regions, stamp duty compliance issues were addressed if they arose in the course of general audit programmes. Most Revenue audits were carried out as a result of risk-profiling the taxpayer looking at all available risk factors as opposed to focusing in the first instance on a particular tax or scheme of exemption/relief within that tax.

In 2003, a working group in Revenue was convened to devise suitable audit triggers for stamp duty risk assessment. As a result, a list of 31 triggers was agreed that would form the basis for risk profiling, risk analysis and an audit programme for stamp duty in the future. 10 were identified as occurring most frequently and/or carrying the greater risk of loss of stamp duty. Certain triggers were checked at the processing stage (when deeds are presented for stamping) while others were checked in post-stamping audits.

The audit undertaken by Dublin Region's CAAD was a logical follow on from this work to target those who claimed owner occupier exemption on new residential properties.

I also asked what action was taken by Revenue to validate replies received in response to questionnaires issued. I was informed that, in the first instance, Revenue applies the presumption of honesty to all responses unless there is reason to believe otherwise. Where any suspicions arose they were fully pursued.

At the time of my audit examination it was noted that there was a proposal to devolve responsibility for stamp duty audit from CAAD to Districts in the Dublin region.

Data Management

A form ST21 (an abstract of the instrument) must accompany deeds of transfer of land and buildings only. The ST21 contains details of the parties concerned, including Personal Public Service (PPS) numbers and addresses, the location and a description of the property and the consideration paid. There is no provision on the form to record the amount of duty paid.

This form's main purpose is to provide certain specific data from property transfers for other Revenue areas. It is not used to calculate the stamp duty payable or to establish any particulars, which may affect stamp duty.

ST21 forms are forwarded to a private company for entry on the SDAS.

An analysis of the SDAS database for 2005 carried out by Revenue, at the request of this Office, in May 2007 noted that there were 268,606 purchasers in total. Of these

- 3,720 had no name included
- 75,074 had no address
- 22,865 had an invalid PPS number
- 49,931 had no PPS number.

Revenue did point out that names, addresses and PPS numbers are not required in all cases to assess duty.

Moreover, in a recent report, on an unrelated subject, provided to Revenue, consultants noted that, of 400 randomly selected ST21 forms, no information was available on 50 of the transactions.

In the light of the results of the analysis of the ST21s for 2005, I asked the Accounting Officer if he was satisfied with the accuracy and completeness of information on the SDAS. He informed me that SDAS records all the relevant information on which stamp duty is calculated and assessed in respect of every document presented. He was satisfied that the information on SDAS accurately and completely reflects the processing casework in each record.

He stated that Revenue practice was to check ST21s for completion of relevant fields as well as validity of tax reference numbers since January 2006. Furthermore in 2005, Revenue issued instructions and advised the legal profession that incomplete or illegible ST21s would no longer be accepted. While it was accepted that all of the information that was required on the form may not have been accurate and complete for 2005 and prior years, Revenue did not consider that this posed any high level risks. The data was informational only and had no role to play in the assessing and collection of stamp duty. He stated that at present Revenue had no plans in place to identify and capture valid PPS numbers for 2005 where none were presently available. Since 2006, a system had been put in place to ensure that the PPS number is on

the ST21 and was valid. Initiatives had been put in place to address some of the concerns regarding the completeness of ST21s.

He informed me that the data was captured and made available to other areas in Revenue who were obviously interested in such financial information from a risk profiling point of view. Finite resources meant that a 100% check was not always possible. Nonetheless it was considered that the checking level was adequate. The primary focus of the Stamping Offices was to ensure that the relevant instruments were correctly stamped and the correct amount of duty was assessed and paid.

Returned ST21 Forms

Forms that cannot be processed by the private company are returned to Revenue. These are referred back to the relevant stamping areas for attention.

The main reasons given for the return of documents to Revenue by the company are the absence of or duplicate identification numbers. In the absence of the numbers it is not possible to link the information on the ST21 with the SDAS.

The number of documents returned in recent years was

- 2003/4 – 6,500 documents returned
- 2005 – 4,360 documents returned
- 2006 – 334 documents returned (to May 2007).

In view of the potential value to Revenue of the information contained in ST21 forms, I asked what action is taken with documents returned by the contract company to Revenue. I was informed that, due to pressure of work and other priorities in Revenue, no action had yet been taken to address the ST21s returned by the company. The main priority for staff involved in what essentially was a customer service activity was to assess the liability by reference to the information provided in the deed. The risks associated with not processing this small number of forms were considered to be low.

Improvements Made or Planned

The Accounting Officer stated that some central points and issues raised by my staff had already been identified within Revenue and improvements made

- Data capture of ST21s was fully operational with ongoing improvements
- Districts had better access to IT systems to assist in identifying the correct PPS numbers
- An updated audit capability had been introduced
- Significant progress had been achieved in the elimination of deposits.

In addition, improvements have been made in response to concerns expressed by solicitors at the proliferation of Revenue certificates that can apply. Inclusion of incorrect certificates results in a high percentage of deeds being rejected at processing or indeed, being processed incorrectly. Dublin Stamping District has designed an intuitive, user-friendly web routine that allows solicitors to navigate to the correct certificates to be included in deeds, depending on the nature of clients' transactions. The web routine was launched in April 2007 and has been well received by the Law Society. Increased usage of this web routine will result in fewer incorrectly certified deeds being presented for stamping.

The following improvements were planned

- Revenue was continually reviewing its compliance intervention programmes and planned to extend compliance checking of elements of stamp duty that appeared to show the biggest risks using better risk triggers
- Revenue was currently engaged in a process of planning the introduction of a self-service e-stamping system that would simplify and modernise the entire administration of stamp duty. As part of this project, a stamp duty return would be designed and would be required for every stampable instrument. Completion of the proposed stamp duty return would be mandatory while simplicity of design would assist in the processing of the information. Inclusion of stamp duty in the Integrated Taxation Systems (ITS) would also ensure that the data captured through the e-stamping process would be available to other Revenue systems to assist whole case management audit and compliance operations.

Some issues arising from Revenue's Dublin audit and my audit had signalled the need for procedural improvements and the following would now be introduced

- Floor area certificates would be sought as part of the standard approach to audit enquiries where relevant to exemption claims made
- Publicity and information around owner/occupier reliefs and clawback situations would be extended.

Accounting Officer's General Comments

Management and control over the stamp duty system must take the following into consideration

- There is a large necessary element of reliance on honest reporting in all taxes and duties.
- The customer service and collection system works efficiently and effectively and delivers a quick turnaround of cases with relatively low staffing.
- Customer Service principles and the accurate assessment and accounting for stamp duty receipts are the priorities in the Stamping Offices. This has been achieved, during periods where there has been huge volume of transactions in the unprecedented booming property market and a buoyant economy, with finite resources.
- Resources were allocated to areas of highest risk but efforts were made to cover all risk areas to an appropriate level. Stamp duty audit of residential property transactions fell, in general, into the low risk category. Audit results backed this up. There were some particular issues of concern, for example, around clawback situations, that are by their nature difficult to police. But these had to be addressed in a proportionate way. A balanced view needed to be taken between a necessarily limited compliance resource and risk based prioritising of taxpayers with higher tax yields.
- In the case of stamp duty on property, the purchasing taxpayer had the added incentive to report and self-certify honestly because title to property depends on the instrument being properly stamped. Insufficiently stamped instruments are not admissible in evidence.
- Realistic and worthwhile improvements to control and audit stamp duty were planned. E-stamping, a major strategic project in which internet technologies and solutions would be employed to re-engineer all aspects of the assessment and collection of stamp duty, was part of that solution. This would streamline processing, provide an electronic record of each case within ITS for better risk analysis and would free staff from processing for control.

3.9 Passenger Controls at Airports

Persons arriving in Ireland from another country may be liable to pay duties and tax on goods purchased abroad. Customs duties may be charged on goods imported from outside the European Union. The rate of duty depends on the precise nature of the goods and is set by the EU. The Customs and Excise Tariff of Ireland sets out customs duties chargeable. Subject to certain exceptions such as goods for personal consumption, excise duty is payable on all excisable products imported into Ireland regardless of origin. Rates of duty are set nationally and different rates apply to each category of excisable product. As a general rule, imported goods are liable to VAT at the point of entry into Ireland at the same rate as applies within Ireland.

The amount, if any, of duty and tax to be paid by persons arriving in Ireland with goods purchased abroad depends on whether

- The goods were purchased in an EU Member State or in a country outside the EU - a third country [17]
- The goods are for personal or commercial use.

Goods imported for commercial purposes are liable to customs duty (if imported from outside the EU), excise duty (depending on type of goods) and VAT.

There is a wide range of goods that cannot be brought into Ireland and other goods can only be brought in subject to certain restrictions. Examples of prohibited goods include controlled drugs, explosives, firearms, obscene books and videos and certain animals and plants.

Passengers Arriving from EU Countries

Since the establishment of the Single European Market in 1993, passengers arriving from countries within the European Union do not have to make a customs declaration on arrival in Ireland as tax and duty are not payable on goods brought in provided they are for the passenger's personal use. In the case of alcohol and tobacco products, Revenue have set indicative quantities of these products that, if not exceeded, will be regarded as for personal use provided there is no indication or suspicion of commerciality. If these quantities are exceeded, the passenger must prove that the goods are for personal use.

There are separate limits on the amount of tobacco products that can be brought into Ireland for personal use that have been purchased in certain EU countries.

Persons travelling between EU countries cannot purchase goods duty and tax free except for immediate consumption on board ferries or aircraft. Duties and/or taxes must be paid on any such goods still held on arrival in Ireland.

Passengers Arriving from Third Countries

Passengers arriving in Ireland from a third country are obliged to make a customs declaration at the point of entry. Passengers are permitted to bring in goods for personal use free of duty and tax provided the combined value of the goods does not exceed €175 (€90 in the case of persons under 15 years). In addition, tobacco products, alcohol and perfumes can be brought in free of tax and duty subject to certain limits.

[17] Although the Canary Islands and the Channel Islands are part of the customs territory of the EU, they are outside the EU fiscal territory and the customs allowances for outside the EU apply. They are treated as third countries throughout the rest of this document.

Customs Declaration effected by Colour of Exit Channel

Three Irish airports have been authorised by Revenue and approved for air traffic with third countries and in which customs controls on baggage can be carried out – Dublin, Shannon and Cork. There are three customs channels at each of these airports and the functions of each are

- Red Channel – passengers go through this channel if they are arriving from outside the EU and have goods to declare on which tax and/or duty is payable. By entering this channel they are making a customs declaration to that effect and Customs officers will collect the amount due.
- Green Channel – by entering this channel, passengers arriving from outside the EU are making a declaration that they have no goods on which duty and/or tax is payable. Customs officers may stop passengers going through the green channel and examine their baggage.
- Blue Channel – this channel is for passengers arriving from a country within the EU. They are not required to make a customs declaration. Customs officers may not stop passengers going through the blue channel unless they suspect they are not arriving from an EU country or that they have prohibited goods or are involved in commercial smuggling of goods. Passengers' baggage on intra EU flights is given a green-edged label to assist in identifying it as arriving from another EU country.

Passengers who exceed the relevant limits are liable to have the goods seized and are also liable to be prosecuted. Except in the case of prohibited goods, the goods may be released on payment of the taxes and duties due as well as any penalty imposed.

Transfer Passengers

Passengers who arrive in Ireland from a third country via an EU country must make a customs declaration by entering either the green or red channel unless all of their baggage was cleared by the Customs Authorities at the first point of arrival in the EU.

Growth in Air Travel

Table 19 shows the dramatic increase in air travel which has occurred in recent years. It also shows that over 75% of all air passengers travel through Dublin Airport. In 2006, approximately 10.7m passengers (9.3m in 2005) arrived in Dublin Airport. The predominant importance of Dublin Airport, from a customs compliance perspective, is also demonstrated by the number of Revenue seizures at airports which show that in 2006 over 80% of these were in Dublin Airport and represented approximately 90% by value of airport seizures.

Table 19- Airport passenger (arrivals and departures) numbers 2001-2006 (millions)

Airport	2001	2002	2003	2004	2005	2006
Dublin	14.33	15.08	15.86	17.14	18.45	21.20
Cork	1.78	1.87	2.18	2.25	2.73	3.00
Shannon	2.40	2.35	2.40	2.40	3.30	3.60
Total	**18.51**	**19.30**	**20.44**	**21.79**	**24.48**	**27.80**

Accordingly my audit examination focused primarily on Dublin airport.

Revenue Presence at Dublin Airport

Revenue's Dublin Airport District (the District) is responsible for the enforcement of customs regulations for both passengers and cargo arriving in the Airport and for the facilitation of trade. The District currently has a staff complement of 71. 39 staff are involved in enforcement activities – 3 of whom deal with management and administrative duties – and 32 deal with trade facilitation and the control of commercial cargo. Most enforcement staff operate in the passenger terminal. An extra 14 staff are to be appointed shortly who will increase regular enforcement operational resources to 50. New rosters are to be implemented to allow for greater customs presence at highest passenger throughput times.

The responsibilities of the District are, in relation to Dublin Airport, to

- Collect all import duties
- Enforce prohibitions and restrictions
- Prevent, detect and seize controlled drugs at importation/exportation
- Implement import and export controls
- Facilitate trade and commercial cargo.

The District is also responsible for Revenue activity at 3 aerodromes in the Dublin area, Weston, Newcastle and Trim.

The Accounting Officer informed me that he was satisfied that the level of resources now available in Dublin Airport (and indeed in Cork and Shannon) was sufficient to implement the necessary controls at passenger terminals in an effective and efficient manner. This was kept under regular review. He stated that Revenue had recently carried out a review of enforcement staff numbers and that extra staff were in the process of being assigned to the areas of greatest risk.

Activity Levels

Precise figures are not available but it is estimated that approximately 790,000 or 7.4% of passengers arriving in Dublin Airport in 2006 arrived from third countries and were required to make a customs declaration *i.e.* exit through the green or red channel.

In 2006, tax, duty and penalties of €38,202 (€18,441 in 2005) were collected at Dublin Airport from passengers arriving from third countries who either declared personal goods at the red channel or were stopped at the green channel and found to be in excess of the relevant limits. Details of seizures at Dublin Airport in 2005 and 2006 are set out in Table 20.

Table 20 Dublin Airport seizures 2005 and 2006

Type	2005		2006	
	Number	Value €	Number	Value €
Tobacco	1,794	5,577,179	1,951	6,875,776
Drugs	181	4,842,933	178	7,225,480
Alcohol	4	773	2	9,013
Cash	9	258,684	6	605,315
Prohibited/Restricted Goods	37	n/a	47	n/a
Counterfeiting (cheques, etc.)	n/a	n/a	6	619,464
Total	**2,025**	**€10,679,569**	**2,190**	**€15,335,048**

Focus of Work of the District

In practice, staff attention is prioritised to detect smuggling of drugs and other prohibited goods, tobacco/cigarette smuggling and cash imports and exports under the Proceeds of Crime Act, 2005.

I asked the Accounting Officer if the emphasis on the targeting of drugs and tobacco smuggling posed a risk that the abuse of the personal goods limits might not be adequately monitored. In reply, he informed me that the EUROPOL Organised Crime Threat Assessment (OCTA) urges all Member States to direct their law enforcement resources at tackling organised criminality and therefore, Revenue's enforcement resources were rightly primarily directed at addressing the two major threats specific to Dublin Airport, namely drug smuggling and organized cigarette smuggling. He also stated that the tax at risk due to organized cigarette smuggling dwarfed any slippage on small-scale personal smuggling. Historically, Dublin Airport was always considered high-risk in respect of both drug and fiscal smuggling. The detection record over the years clearly proves the significance of Dublin Airport as a prime enforcement location which targets the highest risk in respect of passenger movements.

However, Revenue did mount periodic examinations of flights where the abuse of personal goods limits may arise and the results of these indicated that there was no major risk involved. It was not a major risk to revenue or to society compared with the social and fiscal impacts of drug trafficking and organized cigarette smuggling.

Operational Controls

The Blue and Green Channels are simultaneously manned by Customs officers dependent on passenger levels, perceived risk and resource levels with separate interview rooms available if more rigorous interventions are required. There is an unmanned gate midway through the Red Channel that is locked and passengers with something to declare press a bell to get officer assistance. All channel partitions are transparent and officers can easily spot suspicious movements at each channel. Other physical controls include dedicated storage rooms for seizures, specialist baggage and undercover officers and trained sniffer dogs. Broad surveillance is maintained through a CCTV system, strategic location of officers and viewing rooms with mirrored glass panels. The experience of Customs officers is important in identifying suspicious passenger activity. There is an administrative support unit to allow officers concentrate on core activity.

Certain activities and routes are prioritised and targeted. This is done by collection of intelligence from many sources (e.g. Interpol bulletins, the Investigations and Prosecutions Division (IPD) of Revenue, Revenue staff nationally and in other jurisdictions) and risk profiling of individual flights and passengers.

Such profiling is also informed by periodic targeted blitzes on certain routes. However, my review noted that these activities and their outcomes were not systematically recorded.

A blitz was carried out in relation to passengers returning from shopping trips to the USA in the period September to December 2006. The District estimated, as a result of this and on-going interventions, that there was no significant revenue evasion issue. Interventions by officers in the green channel in November and December 2006 resulted in the identification of only four passengers from transatlantic flights carrying goods in excess of the limits. One of these cases involved the confiscation of 2,400 cigarettes. In the other three, goods (clothing and a musical instrument) with a total of value of €3,484 were detected and duty, VAT and penalties of €2,062 were collected. However no records are currently maintained of the numbers of passengers challenged by Customs officers in the Green Channel. In the same period, 12 transatlantic passengers declared goods (value €15,740) in the Red channel in excess of the limit and paid €4,180 in tax and duty.

I asked the Accounting Officer if he considered that collection of data on the number of customs challenges and its analysis would assist in improving control and facilitate the targeting of scarce resources. In his response he informed me that, since my audit review, Revenue had commenced keeping detailed data on passenger challenges as part of a risk testing exercise. These are controlled exercises set up to test whether certain flights and passengers from certain locations pose a significant risk of smuggling. These exercises are conducted as part of planned periodic controls or on receipt of information indicating an increased risk from identified locations. However, Revenue did not consider that the collection and analysis of data on every single challenge conducted would improve effectiveness in better identifying risk and improving control. He felt that such activity would lack focus and could be considered to be wasteful of a very scarce and valuable enforcement resource. He also stated that Revenue kept detailed data on passenger challenges where detections have been made or where the officer is still suspicious despite the lack of a success on a specific intervention.

He felt that Revenue's approach had proven to be a very effective risk analysis method in improving the quality of targeting and had proven to be an efficient use of scarce enforcement resources. Analysis of the outcomes of Revenue's successes, combined with the strategic and tactical intelligence garnered from other sources both nationally and internationally, completed the intelligence cycle. It was only through systematically doing this that Customs could seek to keep up with the constantly changing facets (routings, modus operandi, concealments) of smuggling and organised crime. Best international practice in improving the quality of targeting is to constantly refine risk analysis and profiling through regular risk testing and evaluation.

Opportunities for Enhancing Controls

As in other areas of revenue collection, preparation of estimates of losses from fraud, evasion and non-compliance enables risks to be assessed, strategies developed to tackle those risks and the success of those strategies to be measured. The preparation of such estimates is difficult and a relatively untested area, although estimates of indirect tax losses have been prepared in the UK for some years now. The preparation of such estimates would make many of the targets set in the District business plan more meaningful. The Accounting Officer informed me that such estimates are inherently difficult and untested. While they would be informative, there would be little point in attempting to produce them if, at best, they would be unreliable and, at worst, misleading.

Risk identification and targeted actions are the most effective use of resources. However, as the results of targeted actions have not, to date, been formally documented and analysed, their use in informing future risk identification is not being fully exploited. Dissemination of the results has to date been dependent on verbal communication and the retained knowledge of individuals.

Flight and passenger numbers are an essential source of data for risk identification and targeting. Flight schedules and aircraft capacity are supplied by the Airport Authority on a weekly basis. Actual passenger

numbers and names are not automatically available. The District is not routinely entitled to information on passenger names due to data protection issues. Such information would provide useful management data to inform risk profiling.

I asked whether the Accounting Officer considered that the receipt of enhanced passenger data would improve control. In reply he informed me that passenger data was an essential tool for risk analysis of passenger behaviour patterns that could be an indicator of possible smuggling activity. Timely routine access to the enhanced passenger data, in airline systems, including historic data, would certainly enable more targeted and better quality interventions. The provision of pre-arrival information to Customs for the purposes of preventing, detecting or investigating (smuggling) offences etc. met the requirements of Section 8, Data Protection Act 1988 in full. However the provision of such information was not obligatory. This matter was being considered as part of the e-Borders directive, currently being progressed at EU level.

I enquired whether formal streaming of flights, perceived to represent a greater than usual risk, through customs would improve control. In response, the Accounting Officer agreed that it would but also stated that controls need to be balanced against the facilitation of the legitimate traveller and the efficient running of the Airport. Currently Revenue had a very good working relationship, which is reinforced by Memoranda of Understanding, with the Airport Authority, airlines, and other service providers. They co-operated fully with requests from Revenue staff regarding delivery of baggage on particular carousels when such action was required. He felt that the implementation of a system for the streaming of passengers was not practical in Dublin Airport due to the volume of concurrent flight arrivals and the open aspect of the baggage collection hall.

Intelligence, Risk Analysis and Profiling (IRAP) Unit

The District established this Unit in March 2007. Its main functions are to introduce a risk management structure to evaluate and maximise the use of all information in order to target smuggling, fraud and other areas of non-compliance.

I enquired when it was considered that the results of the improved targeting of resources, arising from the establishment of the IRAP Unit, would become evident and how it was proposed to measure the improvement. In response, the Accounting Officer informed me that, since its establishment, it had already had considerable success in the area of cigarette smuggling at Dublin Airport. It had identified a recent major organised cigarette smuggling attempt from a Baltic State and developed a robust and successful strategy for countering it. The result of this IRAP led intervention was the seizure over a two week period of cigarettes with a value in excess of €600,000, the disruption of the organised supply in the state and the arrest, prosecution and conviction of the two principal organisers. The measure of IRAPs success would be the number of serious smuggling threats, especially organised threats, it identified and succeeded in eliminating. The unit would achieve this through employing better intelligence gathering and dissemination methods, employing better and more imaginative profiling and risk analysis methodologies. It would also ensure that enforcement resources were better focussed on eliminating the most serious risks.

It was intended that all targeted actions would in future be fully documented and employed by the IRAP unit in shaping future risk actions.

Also in current development was a risk template. The purpose of this template would be to aid risk profiling so that resources could be appropriately applied. It would consolidate all risks for Customs activity at Dublin Airport and it was expected that this would be constantly reviewed and updated to maintain its relevance as a result of changing circumstances.

Other Airports and Aerodromes

Revenue approval is required for aerodromes[18] that handle intra-EU and third country traffic. The terms of approval for aerodromes handling third country traffic require that 24 hour prior notice be given to Revenue of each intended departure to or arrival from a third country. At July 2007 there were 24 licensed aerodromes in the State.

Control over aerodromes is exercised by means of risk assessed inspection visits. Table 21 shows the number and results of such inspection visits in the years 2005 and 2006.

Table 21 Inspection Visits 2005 - 2006

	2005	2006
Visits	243	280
Cigarettes seized[19]	13,670	1,780
Value of drugs seized[20]	€57	€140
Value of other seizures[21]	€18,028	€54,694

The Dublin Airport District makes visits (both routine and surprise) to the 3 aerodromes for which it is responsible on the basis of passenger activity and perceived risks. In 2006 fifteen visits, twelve planned and three unplanned (ten and six respectively in 2005), were made to the largest of the aerodromes and one annual visit was made to each of the others in 2005 and 2006.

A review of customs controls in place at licensed aerodromes was carried out in January 2007. The principal focus of the review was to examine the controls in place at smaller public licensed aerodromes to prevent the smuggling of prohibited goods, particularly drugs. The review team made several recommendations for improving controls that were accepted and these are currently being implemented. Following on from these, Revenue had drawn up an implementation plan covering diverse areas including visits to aerodromes, risk rating, the issue of approvals, guidance for staff, training and deepening of co-operation with other agencies. I was informed that Revenue regions are giving the control of smaller aerodromes specific attention in their business plans for 2007.

Summary

In summary, the Accounting Officer stated that the review of Customs controls initiated in late 2006 had found that

- The risk based approach being adopted was a sound one, and indeed the only appropriate one, in the circumstances
- Intelligence and related risk ratings rely on timely information and need to be reviewed regularly
- Ireland's approach is in line with the methodology adopted by other EU administrations in similar circumstances and

[18] Revenue use the term aerodrome to include all airports and aerodromes other than Dublin, Cork and Shannon.
[19] All seized in Kerry airport.
[20] All seized in Waterford airport.
[21] All seized in Knock airport.

- The increase in the volume of international air traffic requires a corresponding increase in Revenue activity.

He was satisfied that the information gathered from controlled test exercises and from passengers, where detections were made, combined with the strategic and tactical intelligence garnered from other sources both nationally and internationally provided a good quality intelligence for identifying smuggling threats which in turn enabled Revenue to target resources in the right areas.

3.10 Aspects of Rental Income Taxation

Background

Under various provisions of the Taxes Consolidation Act 1997 (the Act), income earned by individuals from the letting of residential property is taxable under self-assessment. Rental income earned by companies is assessable for Corporation Tax. The taxation yield on rental income from individuals and companies from 2000 to 2003 is shown in Table 22 below.

Table 22 Taxation Yield on Rental Income 2000 - 2003

Tax Year Ended	Individuals €m	Companies €m	Total €m
05/04/2000	137	80	217
05/04/2001	152	88	240
31/12/2001	140	103	243
31/12/2002	204	117	321
31/12/2003[22]	255	120	375

Information Shared by Government Departments with Revenue

Under section 910 of the Act, Revenue is entitled, for the purpose of the assessment and collection of taxes, to request in writing from Ministers details of payments made by that Minister's Department to persons or groups of persons that Revenue specify. This section was subsequently amended by section 208 of the Finance Act 1999, to empower Revenue to request information from any body established under statute. Currently, Revenue receives information regarding rental income from, amongst others, the Department of Social and Family Affairs and the Department of Environment, Heritage and Local Government in respect of the rent supplement scheme and the rental accommodation scheme.

Rent Supplement

Rent supplements are payments to assist in the provision of accommodation to eligible persons living in private rental accommodation who are unable to meet the cost of accommodation from their own resources and do not have alternative sources of accommodation available. Community welfare officers in each Health Service Executive (HSE) administrative area carry out assessments of claimants' eligibility for the scheme. While claims for payment of rent supplement are processed and administered by HSE staff, the Department of Social and Family Affairs is responsible for policy, legislation, the provision of funding and payment to recipients. Payment is either made directly to tenants or to a nominated payee, *i.e.* the landlord or the landlord's agent for the property.

Each year Revenue requests and receives a file from the Department containing details of rent supplements paid during the previous tax year. The file received contains the following information

[22] 2003 is the latest year for which details are available.

- Tenant's PPS number
- Tenant's name and address
- Landlord's name, address, and telephone number or agent's name, address and telephone number
- Amount of rent supplement paid
- HSE administrative area handling the tenant's claim.

When the file is received, a programme is run that attempts to match the data provided with existing Revenue taxpayer information. A match is sought on landlord name and address. The entire file of both matched and unmatched records is then stored onto Revenue's Integrated Business Intelligence (IBI), a stand-alone system containing various databases.

Information was provided to my Office by both the Revenue Commissioners and the Department of Social and Family Affairs in respect of their exchange of data relating to rent supplement payments for the year 2005. This information is summarised in Table 23.

Table 23 Data Exchanged in respect of Rent Supplement Payments 2005

No of Records Exchanged	Representing	Number of Landlords/Agents	Expenditure €m
77,633	Landlords resident in Ireland	43,215	302
1,465	Landlord outside Ireland	916	3
12,635	Agents Recorded[23]	5,276	49

The information supplied by the Department to Revenue did not specify whether payments were made directly to tenants or to a nominated payee.

Although 2005 scheme expenditure amounted to €368m, the file initially forwarded by the Department only detailed payments amounting to €354m. Data in respect of the balance of €14m was incomplete and clarification had to be subsequently sought by the Department from the HSE. Details were later forwarded to Revenue.

As no landlords' PPS numbers are provided on the file received, Revenue attempts to match landlords' names and addresses to existing taxpayer details held on its systems. I requested details of the number and value of payment records received from the Department of Social and Family Affairs for 2005 that were not matched to taxpayer records on Revenue's systems. The Accounting Officer informed me that there were 52,792 records with a value of €197,472,733 not matched to taxpayer records. This amounts to approximately 56% in monetary terms. He stated that Revenue was currently in the process of putting a project in place that will examine the best approaches to take in dealing with unmatched cases.

Revenue has informed me that the 2006 data had only been received in mid June and that the matching of payments to records would now be scheduled. It would not be possible to risk assess this data until the details of the 2006 Income Tax returns have been loaded into the Risk Evaluation Analysis and Profiling system (REAP). This process would not be finished until approximately May 2008.

I asked the Accounting Officer if Revenue had requested landlords' PPS numbers be supplied by the Department of Social and Family Affairs when making a request for information under sections 910 and

[23] Landlord detail not shown on record.

208 of the Finance Act, 1999 and, if so, what had been the Department's response. He informed me that, as the requirement that certain public bodies request tax reference numbers was only introduced in the 2007 Finance Act, the information had not been requested for 2006 payments. However landlord's PPS numbers would be requested for 2007 payments under Section 910.

The Accounting Officer of the Department of Social and Family Affairs stated that the application form for rent supplement does not currently seek details of the landlord's PPS number as this information is not germane to the decision making process related to the qualification criteria for entitlement to this payment. He also stated that the new legislative provisions present a number of operational issues for the HSE who administer the scheme and that there may also be IT development issues for the Department in capturing landlord/agent PPS data. In that regard, officials from the Department had recently met with Revenue to commence discussions on these and other matters arising in complying with the proposed arrangements in the future.

Section 1041 of the Act requires tax be deducted at the standard rate from rent payable directly to non-resident landlords. However the Department of Social and Family Affairs does not deduct any tax from such payments. When I queried this, the Accounting Officer of the Department informed me that initial enquiries indicated that, to provide for tax deduction on the Department's computer system at source for rent supplement payments, would involve considerable development work and would need to be considered in the context of the Department's future programme of IT modernisation and development. In addition, operational issues that would arise for the community welfare service who administer the scheme would also need to be considered. He stated that the Department provided Revenue with payment details relating to rent supplement on an annual basis and in the format requested by them. Revenue had not indicated until recently that it found the current arrangements unsatisfactory. Revenue is in ongoing discussions with the Department on this matter.

I enquired what policies and procedures are employed by Revenue to ensure compliance by Government Departments, State Agencies and individuals with the provision of section 1041 of the Act which requires that tax be deducted from rent payable to a non-resident landlord. The Accounting Officer informed me that these procedures were specified in a December 2000 Revenue publication and staff instructions. He also stated that the obligation is on the tenant or agent (as the case may be) to make the required deduction and payment to Revenue. Where non-compliance is detected, tax is recovered together with interest/penalties, where appropriate.

Rental Accommodation Scheme

The Rental Accommodation Scheme commenced in 2005. Its aim is to transfer rent supplement recipients who have long-term housing needs to local authorities over a four-year period. The scheme is administered by local authorities and is a collaboration between the Department of the Environment, Heritage and Local Government and the Department of Social and Family Affairs. The local authority pays the rent. In order to be eligible for the scheme, the landlord must be tax compliant.

The Department of Environment, Heritage and Local Government forwards an annual file to Revenue containing details of rent allowance scheme payments made by each local authority in the previous tax year. The information provided consists of

- Landlord/agent's name
- Landlord/agent's PPS number
- Landlord/agent's contact address
- Address of rented property
- Total paid.

The data file of payments for 2006 was sent to Revenue. It was incomplete in that it did not contain information from six local authorities.

Payments under the scheme are made to charitable organisations, housing associations and landlords, a small percentage of whom are non-resident, agents and companies. An analysis of the payments is shown in Table 24 below.

Table 24 Analysis of Payments made under Rental Accommodation Scheme in 2006

Payment Details	Amount €	Amount as % of Total Payments
Payments made to charitable organisations	1,098,753	30%
Payments for which PPS details are not provided or incomplete	893,892	24%
Payments with valid PPS details provided	1,674,270	46%
Total	**€3,666,915**	

I asked the Accounting Officer for details of the number and value of 2006 payment records received from the Department that were not matched to taxpayer records on Revenue's systems. In reply I was informed that a matching exercise had not been carried out on this data. Details of 2006 payments submitted by the Department could not be referred to Revenue's computer systems division, as the data was not received in a standard format.

I also asked him what action Revenue had taken to obtain information from the Department in respect of those local authorities that did not submit a return of payments made under the scheme for 2006. He informed me that Revenue has pursued the Department for the outstanding returns and had since received returns for three of the local authorities, via the Department.

It is recognised that the Rental Accommodation Scheme is in its early stages and that the extent of tax at risk might not merit prioritisation by Revenue at this juncture. However, it is important that proper matching and follow-up mechanisms are put in place to make full use of the information provided as resort to the scheme is scheduled to increase in the coming years.

Third Party Returns Made by Letting Agents

If a landlord appoints an agent to manage property and collect rent, the agent is a collection agent on behalf of the landlord and, as such, is chargeable to tax on the rents received. The agent must account for the tax due under self-assessment. Under section 888 of the Act persons who, as agents, are in receipt of rents are required to submit an annual return to Revenue (form 8-3) unless the beneficiary is not resident in the State. Such a return is known as a third party return. On this form the agent provides the address of the rented premises, the name, address and PPS number of the owner and the amount of rent received.

I asked the Accounting Officer how Revenue utilised the information received from agents on form 8-3. In reply he stated that this information is gathered at district level and how it is used is a local decision dictated by work priorities. There is no formal cross-referencing but matched information is available through IBI and can be cross-checked on a case-by-case basis as required.

Private Residential Tenancies Board

Section 11 of the Finance Act, 2006 amended the Taxes Consolidation Act, 1997 to allow landlords to treat mortgage interest on rental properties as an allowable expense for tax purposes. Entitlement to this relief is conditional on compliance with the registration requirements of the Private Residential Tenancies Board (PRTB) Act 2004. This Act requires landlords to register details of all tenancies within one month of commencement. Certain types of dwelling are exempt from registration. The registration form requires the provision of landlord and agent PPS numbers.

Interest relief on borrowings is netted against rental income to arrive at net rental profit for each year. As only the net rental profit is recorded on Revenue's computer systems, no statistics are available on the number of landlords claiming mortgage interest relief and the total cost of this relief. I asked why Revenue did not have this information available. I was informed that figures on loan interest in respect of borrowings employed for the purchase, improvement or repair of rented residential properties are not separately identified from other allowable loan interest which can be set against other rental income and for this reason the information referred to cannot be accurately assessed.

Revenue requests and receives information from the PRTB on tenancies on a case-by-case basis only. Section 127 of the Residential Tenancies Act 2004 precludes the disclosure of the register to any person or body and has not been updated to reflect the registration requirements of section 11 of the Finance Act 2006. Legislation is currently at committee stage to allow for information sharing.

Maximising the Value of Information Received

In response to my general inquiries about maximising the value of the data received from other State agencies on rent payments to landlords and related information under various schemes, the Accounting Officer made the following points

- Revenue decided on a particular course of action to manage compliance risks at a time of rapid expansion of the case base. Resources were directed at cases where evidence suggested the risk of tax evasion was greatest.
- This had led to the establishment of a computerised risk ranking of its self-employed and corporate base – REAP.
- The fourth REAP run has just been completed.
- REAP is now being enhanced with the addition of data from Revenue's own records and from third party sources. Rental information is part of this process and is a priority. Matched data from the rent supplement scheme was included in the latest risk run.
- As regards unmatched cases, Revenue's intention is to seek legal authority to require tax identifiers on the most valuable returns – where such a requirement does not place an unreasonable or disproportionate burden on the provider. The process now underway, of evaluating all third party returns in the light of their potential contribution to REAP, or other systems-driven intervention, will identify the most valuable returns. In the meantime, the most significant unmatched cases can be screened and matched using long-standing manual processes. Revenue plans to look at more systematic ways of doing this over the next couple of years.
- Two recent pieces of legislation were relevant to the future of third party information provision and processing. The first of these is Section 125 of the Finance Act 2006 which is enabling legislation for the automatic reporting of certain payments made by or through financial institutions, Government Departments and other public bodies, including the provision of a tax reference number in appropriate circumstances. Regulations under this section will require the consent of the Minister for Finance. Section 123 of the Finance Act 2007 provides that certain public bodies making payments in

the nature of rent or rent subsidy will be required to include the landlord's tax reference number when making information returns to Revenue. The section also provides that a broad range of third party information returns (including rent returns by letting agents) can be required to be supplied in an electronic format specified by Revenue.

- Revenue wants a system that will get third party data in a format that can be readily used.
- This approach would allow Revenue to create rules and scores around the most useful third party data in the REAP system.
- The Operational Policy and Evaluation Division had included this project in its business plan for 2007. Delivering this strategy would spill over into 2008 and beyond.
- Revenue can get most value from third party information to the extent that it enriches its REAP profiles or can be part of resource-efficient, systems-driven compliance programmes based on apparent mismatches *vis-à-vis* its assessing or PAYE data for returned income or gains.

Chapter 4

Office of Public Works

4.1 Discrepancies at Two Heritage Sites

Background

The Office of Public Works (OPW) manages 747 Heritage Sites and 19 Historic properties of which 89 are open to the public on a seasonal or annual basis. The Heritage Service within OPW has responsibility for the conservation and presentation of built heritage sites and the provision of safe public access to them.

The public are charged admission at 50 of the 89 sites. In 2006, over 2.2 million people visited OPW staffed heritage sites. The income generated from admission fees and sales over the last three years is shown in Table 25.

Table 25 Income at Heritage Sites

	2006 €m	2005 €m	2004 €m
Admission Fees	5,274	4,307	4,118
Tour Operator Receipts[24]	397	536	579
Heritage Cards	370	397	361
Publications/Postcards	480	415	461
Total	**€6,521m**	**€5,655m**	**€5,519m**

OPW procedures require each heritage site to make a weekly return to its Visitor Service Section including

- Details of cash received for admission fees and sale of heritage cards and publications
- Details of cancelled tickets, heritage card returns, *etc.*
- A bank stamped copy of the receivable order reconciled to the return.

The original receivable order is transmitted to the Accounts Division where details are recorded in the ledger under Appropriations-in-Aid. Visitor Service Section is required to confirm, on a weekly basis, bank receipt details, as recorded by Accounts Division, with the weekly returns from the various heritage sites.

Discrepancies at Two Sites

In the first of these cases, concerns with the operation of controls first emerged in July 2006 when Visitor Service Section discovered discrepancies between the weekly returns and bank lodgments at a particular heritage site. The OPW Internal Audit Unit was requested to reconcile the returns against lodgments made by the site for 2004, 2005 and up to June 2006. The site was open for 44 weeks during this time and discrepancies were found in 25 of these weeks – no lodgments had been made in 17 of these. The first irregularity was pinpointed to have occurred in August 2004 and, although the sum missing has yet to be fully determined, it has been estimated to date to be in excess of €11,000. An Garda Síochána were informed and investigations are ongoing.

[24] Tour operator receipts are accounted for centrally and are not part of local heritage receipts.

In the second case, an unusually large cash lodgment was made by another heritage site in October 2006. This warranted investigation as the requirement to make weekly returns and lodgments had been put in place to prevent the accumulation of large sums of money and limit the risks to security, error and misappropriation. It emerged that the lodgment was an accumulation of receipts from mid July 2006 to mid September 2006 and was in fact in order. However a detailed examination of returns for this site, going back as far as 2004, when OPW took over the particular heritage responsibilities from the Department of the Environment, Heritage and Local Government, indicated that receipts, due to be lodged between July and December 2005 amounting to €21,831 were missing. This irregularity is at present under investigation by An Garda Síochána.

A common theme emerging from these cases was failure to lodge moneys on a weekly basis as required and the failure by Visitor Service Section to detect this in a timely manner.

As a result of these incidents the Office of Public Works engaged a consultant to review its cash handling procedures. The review focussed on the systems, procedures, and controls underpinning the handling and bringing to account of its non-invoiced receipts. This review included both the Heritage Service and other operations within OPW. The consultant's recommendations, which essentially endorse the enforcement of present procedures, are currently being acted upon.

The Internal Audit Unit also reviewed procedures within the Heritage Service and reported in August 2006, making 11 recommendations. Significant concerns raised were; management failure to complete and sign off on risk assessment issues in the Heritage Service; and the failure to enforce existing procedures. The review also noted that only weekly returns for 2006 were being examined and that returns for 2004 and 2005 had not been examined. It recommended that the 2004/5 returns should be examined as soon as possible.

As I was concerned that the delay in detecting these defalcations was brought about by the failure to enforce existing controls and procedures, I sought the views of the Accounting Officer.

Office of Public Works Response

The Accounting Officer stated that in May 2004, responsibility for the management of significant aspects of the Heritage Service returned to OPW from the Department of the Environment, Heritage and Local Government. Certain other functions had at that stage already been allocated to the Department of Community, Rural and Gaeltacht Affairs leaving a limited pool of resources to ensure continuity in the tasks required. The transfer to OPW ultimately excluded responsibility for key aspects of policy and particular Heritage functions including National Parks, certain Historic Properties, parts of Architecture and the entire Archaeological Service. The final transfer to OPW included general day-to-day responsibility for the management of a large number of Heritage sites nationwide, including management of the Guide Service and the delivery of visitor services at certain sites within the portfolio.

This split of the Heritage function resulted in a dilution in corporate knowledge and the diversion to other Departments and areas of certain key and experienced personnel and resulted in a situation where there was considerable disruption in the continuity of staff within the Heritage Service. He stated that ongoing consistent management of the function throughout the entire portfolio was difficult to achieve as more experienced staff were either transferred out of the area or diverted to other functions. Steps have since been taken to significantly increase staffing levels in Visitor Service Section to enable the necessary levels of scrutiny and control to be consistently and properly applied.

He stated that it was clear from the internal and external examinations carried out, that the procedure for the recording and checking of returns from heritage sites was not in itself fundamentally flawed and did, in fact, result in the detection of the anomalies.

He added that there was a general requirement that staff dealing with incoming returns check the returns received against a list of sites actually open for visitors. If any open site had not made a return for the week in question, staff were required to bring this to the attention of management for action.

He was gratified that the external consultants had independently endorsed the OPW procedures now in place and that these had been embedded into normal operational practice within the Visitor Service. He was also satisfied that the planned enhancement of staff resources and the delivery of a structured training programme would contribute to a more robust system for managing these activities more efficiently.

The Accounting Officer confirmed that the Internal Audit Unit's recommendations had already been implemented or were being prioritised. He provided me with a status report on progress in this regard.

Chapter 5

Prison Service

5.1 The Management of Sick Leave in Prisons

Background

In my report on the Appropriation Accounts for 2002, I commented on the management and cost of Sick Leave in Prisons, highlighting that total sick leave days availed of in 2002 were 60,544 equating to 19 days per Prison Officer availing of sick leave in that year and costing an estimated €8.6m in additional overtime.

Consideration and Follow Up

The matter was considered by the Public Accounts Committee on 5 February 2004 and the Committee, in its June 2005 Report made the following findings

- Available statistics point to some abuse by staff of sick leave privileges
- A determined effort has been made by the Department and the Prison Service to address the problem of sick leave
- The Prison Service does not have adequate information or research into the causes of sick leave and is working to resolve this
- There has been significant investment in information technology, which is expected to improve the quality of management information on sick leave and human resource management
- Migration to an annualised hours system would remove the incentive element of the link between sick leave and overtime.

The key general recommendations of the Committee were

- There should be more monitoring and evaluation of the causes of sick leave in the prison service
- The factors leading to high levels of sick leave in some locations should be tackled.

These recommendations were subsequently considered by the Department of Justice Equality and Law Reform who advised the Minister for Finance that the key recommendations were accepted.

2006 Examination

In the course of my audit of the 2006 Appropriation Accounts I noted that the Prison Service had calculated the average sick leave per Prison Officer in 2006 as 26.36 days[25]. In view of the apparent significant deterioration in the position since my 2002 Report I decided to examine the matter further. The objectives of my 2006 examination were to establish what changes had occurred in the incidence and management of sick leave since 2002, and to review the actions taken on foot of my earlier findings and the subsequent discussions and recommendations by the Public Accounts Committee and the response of the Department and the Prison Service. The audit findings are based on the information collected through

[25] Figures for the years 1997 to 2002 were prepared on the basis of officers actually availing of sick leave in those years whereas the figures for the years 2003-2006 provided by the Prison Service are based on staff numbers actually serving at the end of the years in question. This has the effect of somewhat understating the 2003-2006 figures by comparison with those for earlier years.

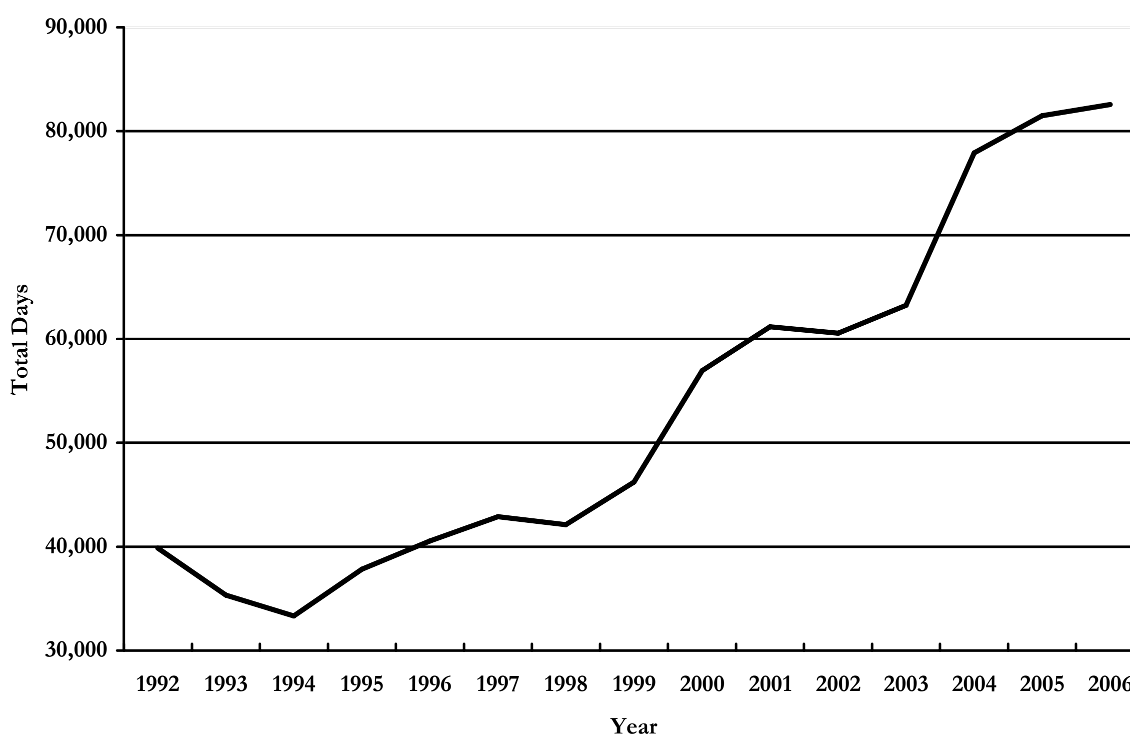
document analysis, an initial audit questionnaire, review of Internal Audit Reports, and interviews with senior management in the Prison Service.

Increase in Overall Level of Sick Leave since 2002

Figure 3 illustrates the trend in Prison sick leave over the last 15 years. Updated data provided by the Prison Service indicates that the annual level of prison sick leave increased from 19 days per staff member in 2002 to 26.36 days in 2006. The bulk of this occurred between 2003 and 2004 when sick leave days per staff member increased by almost 25% from 19.97 days in 2003 to 24.98 days in 2004. Total sick days increased from 60,544 in 2002 to 82,580 in 2006.

Sick days recorded include rest days falling within a period of sick leave and do not therefore reflect the actual number of working days lost. It should also be noted that the number of Prison Officers increased from approximately 2,300 in 1992 to almost 3,150 at end 2006.

Figure 3 Trends in Prison Sick Leave 1992 - 2006



The Prison Service has stated that it was always understood that sick leave was a major contributing factor to the overtime problem in the Prison Service, and that priority had been given to concluding negotiations on implementing organisational change and eliminating overtime. While senior management was conscious of the ongoing increase in sick leave, no in depth analysis was done as all attention was focused on a successful conclusion of the change process. The significant increase in 2004 may have been attributable, in part, to the efforts to effect radical change as tensions were high and staff were being conditioned to the impending change. The standard sick leave regulations were followed and available sanctions continued to be used but it was considered that from a 'political' point of view the time was not right for a concentrated crack down on sick leave.

Analysis of Sick Leave Patterns by Location

The 25% increase in sick days taken between 2003 and 2004 across the Prison Service as a whole did not occur uniformly in different prisons as can be seen from Table 26. Certain prisons show a markedly higher incidence of sick leave taken per prison officer employed than others. There was an improvement in Beladd, Training Unit, and the Curragh (which closed as a prison in January 2004). However, all other prisons showed a deterioration that ranged from 3% in Cork, through 18% in Mountjoy (where the largest number of sick days occurred), to 208% in the Building Service. The prisons displaying sick leave trends above the average *e.g.* Cork and Limerick were also in that position at the time of the 2002 examination.

Table 26 Analysis of Changing Patterns of Sick Leave by Prison 2003 – 2006

	2003		2004			2005		2006	
Prison	**Total Sick Days**	**Sick Days per officer**	**Total Sick Days**	**Sick Days per officer**	**% Change per capita 2004/ 2003**	**Total Sick Days**	**Sick Days per officer**	**Total Sick Days**	**Sick Days per officer**
Curragh	1,002	14.31	20	1.82	-87%	0	0	0	0
Beladd	28	7.0	71	5.92	-15%	10	0.83	124	10.33
Training Unit	2,084	28.16	1,938	26.55	-6%	2,260	31.39	2,068	28.72
Prison Service Escort Corps	0	0	0	0	0%	42	0.58	2,805	17.92
Cork	6,675	30.07	8,069	30.92	3%	10,127	38.22	9,293	40.58
Wheatfield	6,524	20.61	6,749	21.56	5%	7,308	23.27	7,435	24.42
Castlerea	3,813	23.68	4,199	25.92	9%	3,691	23.66	4,120	25.83
Portlaoise	7,577	23.68	8,321	27.10	14%	8,953	29.55	10,533	35.71
Mountjoy	10,332	20.83	12,486	24.60	18%	11,765	24.18	10,867	21.71
Arbour Hill	1,718	14.26	2,054	17.86	25%	2,555	22.61	2,688	24.44
Midlands	5,914	17.76	8,773	22.58	27%	8,892	26.08	6,584	19.14
Loughan Hse	672	15.27	877	20.40	34%	1,007	22.89	521	11.33
Limerick	4,560	23.57	7,249	33.25	41%	7,643	35.88	7,601	35.35
Cloverhill	6,043	15.72	8,432	22.88	46%	7,751	22.08	7,030	20.62
St. Patrick's Institution	2,864	15.74	4,309	24.28	54%	4,783	25.99	5,947	30.04
Mountjoy/Female	1,285	15.21	2,204	24.76	63%	3,128	35.75	3,581	39.79
Shelton Abbey	447	10.90	995	27.26	150%	1,342	33.55	1,049	23.84
Fort Mitchell	1,473	15.67	531	40.85	161%	0	0	0	0
Building Services	219	8.76	648	27.00	208%	246	10.70	334	20.88
Total	**63,230**	**19.97**	**77,925**	**24.98**	**25%**	**81,503**	**26.48**	**82,580**	**26.36**

Introduction of Annualised Hours in 2005

In response to my inquiries the Accounting Officer told me that the proposal for Organisational Change in the Irish Prison Service 2005, which was negotiated between the Prison Officers Association (POA) and the Prison Service, with assistance from the Labour Relations Commission and the Civil Service Arbitration Board, resulted in a major change to working practices in the Prison Service.

The proposal was accepted in August 2005 by prison staff and was operational in all institutions by February 2006, with the rolling out of the annualised hours system. The deal aims to bring to an end the overtime culture among prison staff. Overtime working, which peaked at 2.1 million hours at a cost of €59.3m in 2002, has now been replaced with the new additional hours attendance system. The objective of the new arrangements is to reverse the old overtime culture of working as many hours as possible and to introduce a system of "smart" working. Staff are now contracted for a defined number of additional hours that cannot be exceeded in any year.

In lieu of the overtime lost, all prison officers were paid a bonus payment of approximately €13,000 per officer payable over a three year period. Following a decision of the Labour Relations Commission in October 2005 the first phase payment was made to staff on long-term sick leave. It also decided that this first phase payment was to be made to staff on suspension, in the event of, and at the time of their return to work.

Previously, an Officer could recoup the cost of taking sick leave by doing overtime; this is now not the case. Under the annualised hours system, if an officer fails to report when due for additional hours duty, the additional hours that officer was liable for are deducted from that officer. There is no opportunity to work back those hours or to be paid for them at a later date. Only in exceptional mitigating circumstances (*i.e.* an accident on the way to work) can the officer be given the opportunity to nominate an alternative day, so as not to incur a monetary loss.

Migration to an annualised hours system was intended to remove the incentive element of the link between sick leave and overtime. The Department, in its response to the Public Accounts Committee report indicated that an assumption of a 33% reduction in sick leave is built into the new system.

In response to my inquiries, the Prison Service explained that the assumption of a 33% drop in sick leave was adopted as a reasonable target having regard to experiences in other employments on the introduction of annualised hours and given the unique features of Prison Service employment. While specific sanctions were not provided in the event of the failure to achieve the assumed reduction of 33%, there was provision for regular review of the operation of the new arrangements and it was open to Prison Service management to raise the matter and take action to address it. Failure to achieve the expected reduction in sick leave would impact primarily on staff, as they have to provide cover from their additional hours allocation. The net effect of poor attendance is that staff will end up working more and more of their additional hours and the 'write-offs' (*i.e.* payment for hours not worked which is a unique feature of the annualised hours system) will not be achieved. The primary concern of management in relation to additional hours is that agreed budgets are not breached and there was sufficient leeway built in to ensure that did not happen.

The savings attributable to the expected 33% reduction in sick leave are included in the savings expected from the operation of the annualised hours system, which arise from the application of a budget of 1 million additional hours as opposed to the 2.1 million overtime hours used in 2003.

Other Actions to Reduce the Level of Sick Leave

My audit noted the following initiatives, which might be expected to make a contribution to reducing the incidence of sick leave in the medium term

- In January 2006, a Senior Psychologist was appointed to work with prison staff
- There are quarterly meetings with Governors to discuss actions to be taken in respect the cases identified in management reports of staff with a high level of certified or uncertified sick leave
- An Anti Harassment, Sexual Harassment and Bullying Policy for the Prison Service was adopted in March 2007
- Training for line managers is currently taking place to support those charged with implementing the Prison (Disciplinary Code for Officers) Rules, 1996 to assist with more effective and informed management of staff
- A Chief Welfare Officer was appointed in April 2007 with a view to developing the Employee Assistance Programme.

The Prison Service has provided details of further actions as follows

- Governors are encouraged to hold return to work interviews that ensure that the appropriate steps are taken whether through support or sanction. These take place in a number of prisons at present. Prisons HR are working with Governors on a sick leave protocol to ensure a common approach to the management of sick leave at local level, and to implement controls to ensure the protocol is followed.
- Management is working towards a more consistent application of the disciplinary sanctions available to control absenteeism. Officers are regularly and severely warned of the consequences of taking excessive sick leave or abusing the sick leave system. Up to the end of April 2007, 132 officers were on the Schedule of Leave without Pay, 94 had the privilege of payment for uncertified sick leave withdrawn and 14 were issued with notice that they were being considered for dismissal. Other sanctions imposed included deferral of increments and exclusion from promotion. One officer had recently been dismissed and a number had their probation terminated.
- Consultations were ongoing with the Department of Finance, Department of Justice Equality and Law Reform and the Office of the Chief Medical Officer on the establishment of an Occupational Health Unit dedicated to the particular occupational needs of prison staff.

Sick Leave Statistics for January – April 2007

The Prison Service has provided me with sick leave statistics for the four-month period of January to April 2007, together with similar information for the same period in 2006. Details are shown in Table 27. Total sick days for the first four months of 2007 as reported by the IPS have fallen to 22,765 from the equivalent 2006 figure of 24,893. The average sick days per officer for those four months has fallen from 7.99 to 7.17 *i.e.* a fall in excess of 10%. The Prison Service attributes the improvement to increased vigilance in tackling absenteeism together with the bedding in of the additional hours system. In the open institutions and the smaller prisons where the new arrangements were introduced first, the reduction in sick leave came about quite quickly. While a positive impact was slower to manifest itself in the larger institutions, nevertheless improvements were now becoming evident. The Prison Service considers that the full effect of the new system will not become apparent until the end of the second year of operation in February 2008, and has projected that annual sick leave days per capita will fall as far as 22.92 days per head in 2007.

Table 27 Comparison of Prison Sick Leave for period Jan-April 2006 with Jan-April 2007

Prison	Jan-April 2006		Jan-April 2007		% Variation in Sick Days per Officer
	Total Sick Days	Sick Days per Officer	Total Sick Days	Sick Days per Officer	
Arbour Hill	773	6.90	630	5.58	-19.22
Beladd	33	1.14	24	0.43	-62.34
Building Services Division	73	3.17	34	2.00	-36.99
Castlerea	1,276	8.13	1,100	6.83	-15.93
Cloverhill	2,260	6.67	1,703	4.99	-25.09
Cork	2,995	13.02	2,244	9.76	-25.08
Limerick	1,967	9.23	2,234	10.25	+10.97
Loughan House	282	6.71	124	2.70	-59.85
Midlands	2,174	6.39	2,050	5.91	-7.61
Mountjoy	3,308	6.92	2,990	6.02	-13.07
Mountjoy Female	838	9.52	1,143	12.84	+34.86
Portlaoise	2,916	9.72	2,418	8.03	-17.35
Prison Service Escort Corps	595	4.25	1,169	7.64	+79.78
Shelton Abbey	345	8.21	236	5.76	-29.93
St. Patrick's Institution	1,690	8.67	1,535	7.83	-9.64
Training Unit	653	8.95	534	7.42	-17.09
Wheatfield	2,715	8.59	2,597	8.80	+2.46
Overall Total	**24,893**	**7.99**	**22,765**	**7.17**	**-10.16**

Data Capture and Management

When I reported on the management of sick leave in 2002, data was captured and managed using a non-integrated HR system. In the context of discussions and replies to my 2002 report the Prison Service stated that

> *"..we have made a very good investment in information technology, including a computerised system for time and attendance which has been deployed in all of our institutions. We have a pretty good record system and we are beginning to derive the benefits of it.* [26]*"*

The Public Accounts Committee found that there had been significant investment in information technology which was expected to improve the quality of management information on sick leave and human resource management.

My 2004 Annual Report[27] noted that the new HRMS (Human Resource Management System) system had not been successfully implemented in the Prison Service and a decision was taken to revert back to a previous DataEase system. This system is operated independently in 17 different locations throughout

[26] Public Accounts Committee meeting 5 February 2004.
[27] Page 49 Annual Report of Comptroller and Auditor General 2004.

the country. It is dependent on the input of the causes of sick leave by individual users at each prison and only reports on individual officers can be produced. Prison Service Headquarters does not generate summary management reports analysing the causes of sick leave across the Prison Service.

In the course of revisiting the incidence and management of sick leave, I noted that consultants had been employed in December 2005 to analyse the HR business process and define the requirements for a Human Resource Information System (HRIS). The consultants reported in April 2006 that there was a clear requirement to upgrade the current HR system and the main question was what choice would best meet Prison Service requirements.

In its response, the Prison Service confirmed that there had been major investment and improvement in management information systems over the last number of years including a

- Time and Attendance system which records the attendance and work patterns of all staff in the prisons up to, and including Deputy Governor, and has automated the calculation of hours worked, reports, and the input of details to the payroll process
- Prisoner Records and Information System providing all prisoner demographic details and access to records for the entire prison system and facilitating ease of transfer
- Prisoner Medical Records System giving a full view of a prisoner's medical history including appointments, reviews and medication.

The consultants examined the existing HR systems including DataEase, Time and Attendance, Corepay and Lotus Notes. Difficulties noted in the April 2006 report included the low level of integration between the systems and the degree of manual intervention to transfer data between the systems. Particular shortcomings were identified in the DataEase system in terms of controls, procedures and the production of management reports. Recommendations included the need for the streamlining of processes, the centralisation of the Time and Attendance system and a phased implementation approach.

The follow-up to the consultants' report was delayed by a number of significant changes and in particular the ongoing decentralisation process and consequent high turnover of staff at all levels. Currently, as a first step, the absence management and reporting issues are being examined together with the question of replacing the DataEase system. Consultations are ongoing with system developers.

The Prison Service action plan under *Towards 2016* contains a specific commitment to develop and put in place a new HRMS and commence roll-out across prisons in July 2008.

Monitoring and Evaluation of Underlying Causes of Sick Leave

It has been accepted by the Department that research into the underlying causes of sick leave and absenteeism was required. I inquired as to why little progress seems to have been made in this regard since 2002, and whether there had been any significant changes in the medical factors giving rise to sick leave since that date in comparison with those reported for the period 2000-2002.[28]

The Prison Service stated that research had not been prioritised in the period under review due to the focus on the negotiation and implementation of the new working arrangements. It was considered that the new system should be allowed to settle before undertaking the research in question. However, the Prison Service included the commissioning of this research as a key commitment in its Action Plan under the current National Agreement *Towards 2016*. Work was well under way to tender for consultants to undertake the project.

---

[28] See Table 4.5 of my 2002 Annual Report.

The aim of the research will be to examine absenteeism focusing on the causes of sick leave across each institution, patterns of absence, injuries on duty, the nature of the working environment, and the effects of shift work. It will also draw on international comparisons with prisons elsewhere. It is envisaged that the research will better inform management on how best to tackle and manage absenteeism with a focus on prevention, occupational health interventions, early warning systems and on the collation of statistics.

As regards changes since 2002 in the factors giving rise to sick leave, I was informed that no specific data was available as the DataEase system did not have the capacity to generate reports identifying the causes of absences. Another factor was that some absences were recorded as 'no cause stated'. However, it was stated that an increase in the number of absences citing various forms of stress had been noted.

Cost of Sick Leave

Absences on sick leave give rise to both direct and indirect costs. Direct costs consist of the payments made to individual officers when absent on sick leave. Indirect costs consist of additional payments made to officers who undertake the duties of their absent colleagues. I sought information on these direct and indirect costs for the years 2002 to 2006 and some related details. I also noted that while the total sick days in the prison system grew from 63,230 to 77,925 to 81,503 over the years 2003 to 2005, the number of days covered by overtime fell from 41% (2003) to 33% (2004) to 31% (2005).

The Prison Service stated that a breakdown of payments made to officers, when absent on sick leave, was not available. Overtime figures or sick leave overtime days were not available for 2006 due to the commencement of the annualised hours system in November 2005. With regard to the decrease in the number of days compensated by overtime between 2003 and 2005, it was stated that this should be considered in the context of the negotiations which were ongoing over that period. The Prison Service operated for the most part on increasing levels of overtime up to 2003 when annual overtime expenditure was running at about €59m. During the negotiations determined efforts were made to reduce overtime expenditure by the imposition of strictly controlled budgets and overtime reduced significantly in 2004 and 2005. In order to live within the allocated budgets, Governors were obliged to make serious cutbacks that would have involved not replacing absent staff. Services would have suffered as a consequence. It was recognised that such a situation could not be sustained indefinitely and that the required organisational change would have to be implemented.

General Response of the Accounting Officer

The Accounting Officer has informed me that any examination of sick leave, or indeed any other aspect of the management of the Prison Service over the period in question must be seen in the particular circumstances within which the Service was operating at that time. The Prison Service was a relatively recently established organisation in 2002. A decentralisation process took place between 2001 and 2002 to a new corporate headquarters for the Service in Clondalkin. The enormous turnover of headquarters staff and the impact of all of the changes including changes in personnel should not be underestimated.

He stated that at the time the new organisation was being established, priority attention was devoted to tackling the serious problem of escalating overtime costs, including the cost of replacing staff on sick leave. It was always understood that sick leave was a serious contributing factor to the overtime problem given that absences in a prison setting have to be covered. At the time, overtime was the accepted method of achieving that cover. Equally, the high level of overtime working was a serious contributing factor in the problem of high levels of sick leave. There were, of course, others factors giving rise to high levels of overtime working but it was a stark reality that sick leave and excessive overtime in the Prison Service were inextricably linked. This was a vicious circle that had to be broken to effect improvement.

He said that a change team was put in place within the HR Directorate at the Prison Service to address the overtime problem. The protracted and difficult process dominated the Service from 2001 to 2005 when agreement on a comprehensive organisational change was reached with the Staff Side. The agreement has

now been successfully implemented, and the number of extra attendance hours required to run the Service has been reduced by more that half *i.e.* from 2.1 million overtime hours to less than 1 million additional hours. As a consequence, savings of up to €30m per annum were now being realised.

He indicated that the Prison Service had met with a number of enterprises that had successfully implemented the annualised hours concept and had been assured that sick leave levels had fallen dramatically, some by as much as 50%. The Prison Service had factored in a 33% reduction in sick leave as a reasonable target when setting a viable additional hours budget for extra attendance under the new system. The system was introduced over a six-month period from September 2005 to February 2006, and all prisons have been operating the system for almost 18 months. After initial teething problems the system is now working well and within the agreed budgetary limits.

Simultaneously with the introduction of the new arrangements, a determined effort was made to reduce sick leave through a range of measures. He stated that while the impact on sick leave was patchy in 2006, significant improvements were evident in the first four months of 2007.

The Accounting Officer stated that during the period of the negotiations, the focus of attention had to be on the difficulties associated with the negotiations process rather than on the incidence of individual or institutional sick leave. In addition, there was a turnover rate of 85% in Prison Service headquarters staff over the past two years arising from the decentralisation of the Prison Service to Longford.

He pointed out that the absence of a proper HRMS was another factor that had contributed to difficulties in the management of sick leave. The Prison Service had been required to adopt the generic HRMS which did not meet the operational needs of the prisons, and particularly with the recording of Prison Officer sick leave. Following the decision in December 2004 to revert to the old DataEase system, it had to be updated with data not inputted in previous months which impacted on the availability of an accurate figure for absences for the intervening period. A number of human resource information system options were currently being examined, and a decision would be made shortly.

He considered that the sick leave problem had been tackled at its very root cause – the pernicious overtime system. A major change programme had been agreed, and sick leave was being reduced to more acceptable levels. That work was ongoing, and he had received the assurance of the Director General that the Prison Service was determined to meet the challenge and address the issues arising.

Summary

The level of sick leave in the Prison Service over the period 2002 – 2006 showed a further deterioration from the average level per officer of 19 days, which was the cause of Public Accounts Committee concern in 2004, to an average in excess of 26 days in 2005 and 2006. Most of this increase occurred in 2004 when the average moved from just under 20 days to almost 25 days. There are major variations across different prisons.

The period under review was a time of major change in the Prison Service with the negotiation and implementation of an annualised hours arrangement to replace overtime payments, and decentralisation of the Prison Service's headquarters initially to Clondalkin and later to Longford. These changes affected Prison Service management's ability to address the sick leave issues.

The Accounting Officer and the Prison Service have outlined the major contribution to the improvement of the sick leave situation expected from a combination of the new annualised hours system and the initiatives taken by prison management. Figures provided by the Prison Service for January to April 2007 show an overall reduction of 10% in per capita sick leave days which, if maintained, would give an annual average of the order of 23.7 days. Such a reduction would be the first major reversal of the trend of recent years shown in Figure 3. The Prison Service considers that the full effect of the new system will not be

apparent until the end of the second year of operation, and has projected that annual per capita sick leave will fall to under 23 days for 2007.

Options for the selection of a proper HRMS are currently being examined with a decision expected shortly. Work is also under way in order to seek tenders for a major research project into the underlying causes of sick leave in the Prisons Service, and to inform management on how best to deal with the issue.

Chapter 6

Department of Environment, Heritage and Local Government

6.1 Contract Termination Costs

Background

The Department of Environment, Heritage and Local Government (the Department) is the overall sponsor, manager and provider of funding for the Water Services Investment Programme.

Provision of schemes under the Programme is the responsibility of County and City Councils who are also the contracting authorities. Generally, Councils engage engineering consultants to design, plan, invite tenders for, and supervise construction.

The Limerick Main Drainage Scheme involved the planning and construction of an integrated collection, treatment and disposal system for both waste and storm water for Limerick City and environs at an estimated total cost of €130m.

My examination focussed on how one small part of this overall scheme, which was originally expected to cost less than €10m in 2000, ultimately will cost in the region of €83m as a result of the termination of a contract and the consequences of that action.

The key dates in these events are set out in Table 28 below.

Table 28 Key Dates

Date	Event
April 1997	Limerick City Council (LCC) selected Consultant Engineers to plan, design and supervise the scheme
26 February 1999	First of 20 Contracts in Scheme awarded
25 May 1999	Contract 3.6 awarded to UCL Construction Ltd
23 May 2000	Contract 4.2 awarded to UCL Construction Ltd
6 June 2000	Work commenced on Contract 4.2
March 2001	Contractor notified LCC of difficulties
2 May 2001	Engineer issued Notice to Contractor expressing concern at lack of progress
29 May 2001	LCC issued written warning to UCL
19 September 2001	LCC issued termination notice to UCL
5 November 2001	LCC expelled contractor and took possession of site
28 June 2002	Conciliator appointed
27 January 2003	Conciliator made first recommendation
12 February 2003	Conciliation findings rejected by LCC
10 July 2003	Arbitrator appointed
9 November 2003	Conciliator made final findings
February 2004	New contract awarded to replace 4.2
June 2005	Arbitrator made first award
November 2005	High Court Appeal
September 2006	Final Arbitrator award excluding costs

Planning and Design

Limerick City Council (LCC) appointed, as consultant engineers, a consortium of engineering firms for the design and construction phases of the entire scheme. The appointment was made on the recommendation of the City Engineer, on behalf of the Interview Board set up as part of the competitive procedure to select consultant engineers.

I asked the Accounting Officer of the Department what was the role of the City Engineer and if the choice of a consortium of engineering firms might have contributed to the difficulties subsequently encountered.

In reply she said that the City Engineer, with his staff, (in particular through a full-time Project Manager/Senior Engineer), was responsible for managing the delivery of consultant services and the procurement of the works contracts for the entire Limerick Main Drainage Project. Once a contract was awarded, the consulting engineer is appointed "Engineer" in the contractual sense, for the purposes of administering the Contract, while the City Council remains the "Employer". The City Engineer (and his staff) continued to have a monitoring role throughout the contract period, and gave advice to the City Manager on all major decisions required of the Employer, as well as reporting on the overall level of progress on the delivery of the contract.

It was quite common on larger projects for a consortium of firms to provide engineering services. The three firms in this consortium, two based in Limerick and one in Dublin, were among the leading consulting engineers in the country with significant specialist civil and structural engineering experience on water services and other major projects. Similar consortia of consulting engineering firms have provided, and continue to provide, engineering services on nearly all the major water services projects procured since the mid- 1990s.

Tendered Cost of Overall Works

Tenders were sought for 20 distinct parts of the overall scheme and 20 contracts were placed between 1999 and 2004. The total amount tendered for the 20 contracts was €188m. The final accounts for these contracts have not been agreed for all cases at the date of my Report.

Uniform Construction Limited Contracts

Two of the 20 contracts were awarded to Uniform Construction Ltd (UCL). The Abbey River contract (3.6) was awarded in June 1999 for an amount of €9,048,020, and was substantially completed by 31 March 2001 at a cost of €11,820,468. The North Interceptor Sewer – Contract (4.2) for €9,570,570 gave rise to the difficulties and substantial costs to the State examined in my audit.

North Interceptor Sewer – Nature of Work and Tendered Cost

The work involved the construction of the Northern Interceptor Sewer Upper from Watch House Cross, Ballynanty, going under the river at the Shannon Bridge, and meeting up with the Dock Road Tunnel at Bishop's Quay. The contract requirement was for the installation of approximately 2.6 kms of sewer by open cut and trenchless methods underneath the city of Limerick. Tenders were sought in 1999, and eight tenders were received ranging from €9,570,570 to €21,224,560. The two lowest tenders were €9,570,570 and €10,811,082, and the Minister approved LCC's acceptance of the contract of UCL in December 1999 for the amount of €9,570,570. The Contract Start Date was 6 June 2000, with a completion date of 6 December 2001.

Contract Disputes

In March 2001 UCL wrote to the Limerick Main Drainage Project Office in LCC, informing them that difficulties had been discovered in the path of their tunnelling, and it was likely that the natural ground was much lower than that indicated on the engineering drawings. UCL stated that it was self evident that significant additional costs to the contract would be incurred and progress would be severely delayed, and gave notice that they intended to claim payment of the additional costs involved and an extension of time for completion, commensurate with the delays caused to the completion of the works.

On 23 May 2001 LCC's City Engineer wrote to the Department advising that

- 64% of the time had elapsed with only 25% of the work completed
- Negligible progress had been made in the previous 3 months, and serious problems had arisen including road collapses
- The consultant Engineer's view was that conditions currently existing should not prevent the satisfactory construction of the tunnel and that the problems were due to over-mining which suggested inadequate control and monitoring of the operation of the micro tunnelling boring machine
- No tunnelling had taken place since 26 February 2001 and UCL were refusing to recommence until further investigations were carried out
- UCL claimed unforeseen ground conditions and artificial obstructions existed and would be seeking recovery of costs and all delays would be reflected in their claim
- Solutions offered by UCL of ground stabilization and lowering the tunnel would have significant cost implications
- LCC considered that UCL did not have the expertise to deal with the problem.

LCC put forward 4 options to deal with the situation

- Employ a specialist sub-contractor with UCL's agreement at a cost of €5.71m.
- UCL to put in place and maintain a management structure capable of doing the work satisfactorily. However, LCC believed that UCL would remain insistent on further investigations and ground treatments at a cost of €5m.
- Employ a specialist sub-contractor without UCL's agreement at a cost of €5.71m.
- Terminate the Contract at a cost of €6.9m. LCC added that if the contract was terminated, there was no doubt but that UCL would seek arbitration or some other legal recourse. However, if UCL were unsuccessful, their bond of €2.2m would be forfeited. LCC stated that the appointment of a new contractor would cost an additional €3.8m over present costs, but overall this would be the most attractive financial option.

LCC told the Department that, having discussed the matter with their consultants and solicitors, they were of the view that it was time to consider early termination of the contract.

These matters were discussed at meetings held in the consultant engineer's office, at the Department's offices and at the LCC's legal advisers' office in Dublin on 21 May 2001.

The legal advice was that the Engineer should clarify a previous warning. The Engineer warned UCL, in writing, that it was failing to proceed with due diligence on 29 May 2001.

On 12 June 2001 UCL wrote, denying that they were failing to proceed with the works with due diligence. They accepted that a serious delay had occurred with the tunnelling operation, but asserted that this was because of unforeseen physical conditions encountered. They suggested that they would seek to resolve the matter with the assistance of an independent third party, who would be a professional engineer, rather than embarking on the lengthy and expensive dispute resolution process which would inevitably follow the formal termination of the contract.

The Engineer issued a further written warning on 20 June 2001.

In early July, UCL provided a 39 page statement of the methodology for the next extended stage of tunnelling which was discussed at meetings over the following weeks. Approval was given on 2 August for the next section only. Tunnelling recommenced on 9 August, but had to be aborted almost immediately as the tunnelling machine could not be kept on line or level.

Pre-Termination Consultations with the Department

On 17 September 2001 the Minister was made aware of the situation. The key points made were that

- The City Manager had been advised that UCL should be given 7 days notice that they were being expelled from the contract.
- The contract was worth about €9.5m of the overall €188m tendered for the scheme.
- There had been discussions with the contractor over a number of months.
- The procedure being followed was in accordance with the General Conditions of Contract.
- It was now a decision for the City Manager. The matter was a contractual/legal one involving LCC, their consultants and UCL.
- The Department did not have a role in the termination process, and any approach to the Department would be responded to on that basis.
- If UCL were expelled, the bondsman would become responsible for putting another contractor in to complete the job. Any costs arising from consequent delays would also be the responsibility of the bondsman. Delays, should they arise, would not hold up other aspects of the scheme, as this part of the work was not on any critical path.

The file was noted as seen by the Minister.

Department's Evaluation of the Position

I asked the Accounting Officer if her Department considered the possibility that the UCL position had merit, and what independent consideration had it given to the question as to how LCC should seek to resolve its differences with UCL.

In her reply, the Accounting Officer said the Department's experienced Water Inspectorate reviewed the engineering and contractual advice received by LCC, and all proposals made by LCC on foot of professional advice at all stages leading up to termination, and during the entire conciliation and arbitration processes. The Engineering Inspectors, Senior Advisers and Principal Advisers in the Water Inspectorate involved during the entire course of this dispute, have each many years of experience in water services projects, preparation of contract documents, forms of contracts, construction methods, and conciliation and arbitration procedures, both in the public and private sectors, to an extent that would not be matched in the local authorities. Prior to termination, the advice and recommendations of LCC's

engineering advisers and specialist tunnelling and geotechnical advisers were critically examined through extensive review and questioning by the Engineering Inspector, in particular at meetings in May and September 2001.

As I was concerned by the apparent lack of clarity in the Department's role, I asked the Accounting Officer what part her Department had played in the decision to terminate the contract, and had the financial risks of termination been assessed.

In reply, she said that the Department was not a party to the contract, but that the Department's Engineering Inspector attended the meeting of 11 September 2001 between LCC and their consultant engineers, which concluded in the latter's recommendation to LCC to terminate the contract. The Inspector was satisfied that LCC was acting on the basis of expert engineering and legal advice, and that the decision reached was supported by a rigorous assessment of all the circumstances associated with the contract, and he reported accordingly.

A risk assessment of the financial consequences of contract termination carried out by LCC's legal and engineering advisers, was presented at the meeting of 11 September. The risk assessment addressed both the principle of the contractor's claims, and the quantum of the claims. The Department was satisfied that the rationale used was appropriate, and that the risk assessment findings were supported by the necessary analysis of the risks involved.

I also asked the Accounting Officer what was the Department's experience of contract terminations at that time, and was there a prescribed format for the evaluation of the risks involved.

She said that contract termination, by reason of contractor default or non-performance, is a very rare occurrence on water services projects, with no other case occurring since the mid-1970s. Other contract terminations have occurred, but these have all been as a result of the contractor going into liquidation or receivership. She also said that there was no prescribed format for the evaluation of risks in relation to termination of civil works contracts.

LCC Terminates Contract

LCC and its engineering and legal advisers met and corresponded with UCL and its advisers during September 2001, but these exchanges did not resolve matters, and the contract was formally terminated by the end of the month.

In a memo to the Minister, dated 19 October, it was stated that the Inspector had been in close touch with the Limerick Project from its inception, and was satisfied that neither the City Council nor its consultants had acted unreasonably or outside of contractual norms.

The Minister wrote to the contractor on 22 October, stating that, while the Department was the managing authority for the National Water Services Investment Programme, its function in relation to procurement of individual contracts was limited to ensuring that the contract process fully accords with national and EU procurement requirements. The Department was not a party to the contract, and it had no role or powers of intervention in relation to post-contract dispute resolution.

Following "without prejudice" discussions with the contractor in the hope of finding a resolution, LCC entered the site and expelled the contractor on 5 November 2001.

LCC also called in UCL's bond, which amounted to €2,392,649, at this time. When the bond was called in, the bondsman indicated that he was withholding payment pending the outcome of the arbitration. Now that the arbitrator has found that the contractor was wrongfully dismissed, the bondsman has contended that there is no case for paying the bond.

I asked the Accounting Officer whether the Department could have prevented LCC from terminating the contract, and she said that her Department could have advised LCC against terminating the contract, or that LCC were terminating the contract entirely at their own risk, but the Department could not have prevented LCC from legally terminating the contract. The Department, from its own review of all aspects of the history of the contract, did not form a view that would have warranted such advice to be given.

In reply to whether the Department considered making LCC liable for the financial outcomes of termination, the Accounting Officer said that she was at all times satisfied that LCC was acting in accordance with the best engineering and legal advice available to them. On that basis, there would not have been grounds for exposing LCC to the potential financial consequences of the termination.

Conciliation

In November 2001 UCL, through its solicitor, asked for immediate agreement to arbitration, conciliation/mediation, or another alternative dispute resolution procedure. Solicitors for LCC responded in February 2002, broadly welcoming this approach, notwithstanding that the contract did not provide for conciliation as such. In April, the UCL's solicitors put forward the names of 6 experts, any of whom might act as conciliator. LCC accepted the first of these, and on 28 June 2002 an agreement to conciliation between LCC and UCL was signed.

A key requirement of the conciliation agreement was that " the conciliator's recommendation shall state his opinion as to the entitlements of the parties and in this regard shall state his opinion as to what he considers an arbitrator, if appointed, is likely to find (including a finding as to the amount of compensation payable to any party by the other) based on the application of the terms of the contract and applicable principles of law." As is common with its use in the construction sector, the conciliation procedure was non-binding on the parties, and either party could refer the dispute to arbitration when the conciliation was concluded.

Conciliator's Recommendation Part 1

On 27 January 2003, the conciliator issued his Recommendation Part 1. He stated that, in his opinion, an arbitrator would find that the termination of the contract was wrongful and should be set aside. He was also of the opinion that an arbitrator would find LCC liable to pay damages to UCL. He had not estimated an amount yet, but it would be an amount which would put UCL in the same position as if the contract had not been terminated. UCL would be entitled to payment for all works carried out before termination. During the course of outlining the reasons for his recommendation, he stated that in his opinion an arbitrator would find that

- There had not been any improper or incompetent operation of the micro-tunnelling boring machine
- Ground stabilisation (or alternative enabling work) was necessary
- UCL was not guilty of any failure to progress work with due diligence
- Work was proceeding well and expeditiously at the time the contract was terminated.

In a report dated 11 February the city engineer summarised "Post Recommendation Events" as follows

- At a meeting on 30 January 2003 UCL noted that its claims amounted to €22.8m, but was prepared to accept an immediate settlement of €12.4m, to be accepted by noon the following day, or the amount would have to be increased to €15.9m.

- LCC had not changed its position regarding the termination, but acknowledged that it would be prudent to consider the offer. However, the €12.4m compared with a contract of €9.5m and LCC's valuation of completed works of €3.6m.

Rejection of Conciliator's Recommendation Part 1

On 12 February 2003 LCC City Manager wrote to the Department notifying them that LCC proposed

- Rejecting the conciliator's recommendations Part 1
- Advising the conciliator that there was no point in him proceeding with the remaining part of the recommendations
- Making a sealed offer following a financial and legal risk assessment in the likely event of arbitration.

On 14 February 2003 LCC issued formal notice of rejection of conciliator's recommendation to the Conciliator and UCL.

I asked the Accounting Officer how her Department had responded to LCC's proposal to reject the conciliation findings, and she said that it had considered the matter fully and raised no objection. She said that the Department was satisfied that due process, as provided for in the contract, should be followed so that, in accordance with the rigours of the arbitration procedure, UCL's claims would be tested in evidence and by cross-examination of witnesses. Conciliation was not provided for in the contract but was agreed to by LCC on the basis that it might lead to a speedier resolution.

On 10 June 2003 the contractor wrote to LCC City Manager summarising events to date and asserting that

- LCC had immediately rejected the conciliator's recommendation
- The contractor had sought to reach an amicable settlement but LCC had rejected all proposals
- The contractor was suffering serious and continuing losses
- UCL had no wish to be involved in litigation.

UCL copied this letter to the Secretary General of the Department.

The Secretary General, having consulted the Minister, replied on 20 June, indicating that LCC's decision to reject the conciliator's findings had activated the arbitration process, and noting his understanding that this decision was based on a thorough assessment of the issues, including the financial risks of the various courses open to LCC, taking account of relevant legal and technical advice. He concluded that, in these circumstances, it would not be feasible or appropriate for the Department to intervene in the process.

The Accounting Officer informed me that the Department had at that time received a copy of the Risk Assessment (February 2003) prepared by LCC and their advisers. This assessment had been prepared at the Department's request, and the Department had satisfied itself that the rationale used was appropriate, and the assessments made were based on proper analysis of risks.

New Contract

In June 2003, LCC sought tenders for completion of the outstanding works. Three tenders were received by the closing date, 21 August 2003. One was deemed non–compliant, and the amounts of the others were €20,376,218 and €22,695,981. The contract was awarded for the lower amount in February 2004, and was completed in July 2005, without difficulties at a final cost of c. €27m.

I asked the Accounting Officer how did the new contractor deal with the difficulties alleged by UCL and in particular

- Were ground consolidation measures of the kind said to be required by UCL undertaken?
- Was the tunnelling level and/or route changed from that originally specified?

In her reply, the Accounting Officer said that the new contractor carried out only a very limited proportion of the ground stabilisation measures that UCL claimed were necessary. It was also the case that the new contractor used the same tunnelling boring machine that UCL had been unable to use in a satisfactory manner. Ground stabilisation was carried out over a total length of 275 metres costing €800,000 plus VAT, as compared to the 945 metres claimed by UCL at an estimated cost of €5,853,267 plus VAT. This was at the contractor's risk under the completion contract, in the same way as LCC maintained it was on the UCL contract. This amounts to just 13.66% of the expenditure on ground stabilisation, which UCL claimed was necessary. She also said that the new contractor did not encounter any major difficulties, additional to those asserted by UCL, and the tunnelled sewer was constructed in accordance with the contract documents, on the same route and at the same level as originally specified in UCL's contract.

Conclusion of Conciliation and Start of Arbitration

Late in June 2003 the City Manager wrote to UCL, referring to the deep-rooted differences between the parties, and the very significant degree of dispute regarding the valuation of the claim. He suggested that arbitration seemed the best mechanism to resolve the differences. The President of the Institute of Engineers in Ireland (IEI) nominated an arbitrator on 10 July 2003, and the arbitrator was informed on 8 August 2003 that the parties had agreed that conciliation would have to be completed before arbitration could commence.

Conciliator's Final Findings

In the second and final part of his recommendation, dated 9 November 2003, the Conciliator found in favour of UCL, and stated that an arbitrator would be likely to award €25,423,263 (exclusive of VAT) being

- €5,548,712[29] in respect of works completed to the date of termination, in addition to €4,163,547 already paid by LCC
- €19,874,551 in respect of damages for wrongful termination of contract.

I asked the Accounting Officer how she satisfied herself that the Department had at all times monitored and given appropriate advice to LCC in respect of the conciliation proceedings, and in particular, was she satisfied with LCC's rejection of the conciliator's findings.

In reply, the Accounting Officer said that the Department had not raised any objection to the dispute being referred to non-binding Conciliation, with a view to an early resolution being achieved. Conciliation was not a provision in the contract at the time of award of the UCL contract, but had been introduced by the Department of Finance on Public Works contracts in January 2001. The Department, on learning of the Conciliator's recommendation, requested LCC to prepare an updated risk assessment. The Risk Assessment in November 2003 verified, to the Department's satisfaction, that there was no reasonable basis for accepting the Conciliator's Recommendation. The wider implications of the Conciliator's interpretation of certain contractual provisions for public works contracting generally were also factors that influenced the Department to raise no objection.

[29] This overall assessment totalling €9.7m was €6.1m greater than the LCC valuation of completed works of €3.6m.

Arbitration Hearings

A preliminary meeting of the parties took place in Dublin on 10 December 2003. Hearings occurred in 3 sessions: 19 July to 10 September 2004, 8 to 19 November and 7 December to 17 December 2004. The parties submitted their closing statements in writing around 20 January 2005, and replies to these statements on 14 February 2005.

Within their rebuttal to UCL's closing statement, LCC proposed a number of issues of law that should be subject to the Case Stated procedure. By letter dated 22 March 2005, LCC's solicitors submitted a list of issues that could be dealt with, without requiring alternative findings dependent upon the outcome of a Case Stated, and by letter dated 24 March 2005 solicitors on behalf of UCL submitted their list of such questions.

In June 2005, after considering the matters raised in this reference, the arbitrator sought guidance from the representatives of the parties, on his obligation to draft any part of the award as a Case Stated. The representatives of the parties responded, and the Arbitrator decided to issue a first interim award, confined to issues of fact previously sent to him.

Arbitrator's First Interim Award June 2005

The Arbitrator's findings covering liability and measurement issues ran to over 130 pages and found substantially in favour of UCL and found against LCC in the manner of its termination of the contract. He concluded that

- On the evidence, UCL had carried out its tunnelling operations in a competent manner
- From the evidence of experts, ground conditions necessitating treatment had been encountered and that those conditions could not have been reasonably foreseen by an experienced contractor
- At the time of the termination UCL was proceeding with all sections of the works with due diligence and that UCL was not either persistently or fundamentally in breach of contract.

He determined the value of measured works at the time of termination at €6,304,040[30] (exclusive of VAT). Consideration of damages for wrongful termination was left to the final award.

High Court Appeal

In July 2005, the Department notified the Office of the Attorney General of the Arbitrator's Interim Award, and sought independent legal advice on LCC's consideration of an appeal of the Arbitrator's findings to the High Court. The Department was concerned by the financial implications of the findings, the Arbitrator's interpretation of the contract, not only in this case, but also its general implications, given that this form of contract was widely used throughout the Public Sector, and the extent of the Arbitrator's criticism of LCC and its technical and legal advisers.

In reply the Office of the Attorney General indicated in August 2005 that

- It was doubtful if it would be possible to impugn the findings of the Arbitrator
- The grounds on which an Arbitrator's findings would be set aside or remitted by the Court would be very limited
- The findings of an Arbitrator are not public and therefore did not represent a precedent.

[30] This was over €3.4m less than the Conciliator's total valuation in respect of completed works.

LCC appealed the Arbitrator's award to the High Court on a number of points of law, but the Court ruled on 1 November 2005 that there were insufficient grounds to merit its intervention.

I asked the Accounting Officer why the advice of the Attorney General had not been sought at a much earlier stage.

She told me that the Department did not consider it necessary to involve the Attorney General up to that time, as LCC were being advised by one of the main construction law firms in the State, supplemented by experienced Counsel from the U.K. The Attorney General was subsequently consulted, because the Arbitrator's award had wider implications for other contracts, by virtue of some of his interpretations of the contractual provisions. It was also the case that the Department's inspectorate had a considerable body of knowledge of matters relating to contract conditions and dispute resolution, based on many years experience in capital project appraisal.

I also asked the Accounting Officer what advice her Department gave LCC in the light of its approach to the Office of the Attorney General. She informed me that LCC had been told that the advice of the Attorney General was being sought, and that the advice received had, with the agreement of the Attorney General, been communicated in full to LCC and their legal advisers. She further indicated that her Department sought an updated Risk Assessment (June 2005) from LCC, and agreed with the LCC assessment that such were the consequences of the award, and the unprecedented interpretation of contractual provisions in the award, that an appeal to the High Court was appropriate. A copy of the Arbitrator's Interim Award was also forwarded to the Chair of the Government Construction Contracts Committee.

Final Arbitration Award Excluding Costs

Arbitration hearings resumed on 2 November 2005 to consider the UCL claim for the recovery of damages for wrongful termination, and further hearings took place from 6 March 2006 to 23 March 2006. UCL had initially sought €82m at the commencement of the arbitration, but reduced this to €77m at the resumption of hearings in November 2005.

On 8 September 2006 the arbitrator published his final Award excluding costs.

He ruled that LCC was liable to pay €32,336,702[31] (inclusive of VAT) to UCL consisting of

- Loss of profit on the contract – €0.589m
- Consequential trading losses on two other contracts – €17.441m
- Loss of profits due to lost revenues between 2003 and 2010 – €10.417m
- Interest and financing costs – €3.89m.

New Forms of Contract

The matter was brought to the attention of the Government on 12 September 2006, and subsequently further advice from the Attorney General concluded that

- The extensive jurisprudence governing challenges to arbitral awards points very firmly to the view that the courts are reluctant to uphold a challenge save in the most manifest of cases.
- There is no prospect of any successful challenge to the preponderance of the award in this case.

[31] The Conciliator's award of €25.4m was **exclusive** of VAT.

The Minister again brought the matter to Government on 23 October 2006, indicating his intention to instruct LCC to explore the possibility of a negotiated all-in settlement, or failing this, to lodge €22m, which the Attorney General advised was the amount of the uncontested liability, with UCL's legal representatives. His Department would provide capital funding to LCC to pay the undisputed element of the award, to the extent that such funding could not otherwise be recouped by LCC from the professional insurances of its engineering consultants and legal advisers. The Minister also noted that the new Forms of Contract for civil buildings works, which were about to be launched by the Minister for Finance, also provided for termination, conciliation and arbitration. These provisions limited recovery, in a case of wrongful termination, to those amounts arising from the contract itself.

The Minister also proposed an early examination, by an independent qualified person, of the management of this case, to identify lessons for civil engineering management, and to recommend on how best to minimise risk of adverse outcomes in future cases.

I asked the Accounting Officer to outline the ways in which the new Forms of Contract differed from those governing the Limerick case with particular reference to

- Conciliation
- Arbitration
- The admissibility of claims for compensation on termination distinguishing between losses arising directly from the contract in question and consequential trading losses.

In reply, the Accounting Officer said that conciliation is now mandatory before a dispute can proceed to arbitration, and the Conciliator has to base his recommendation on the parties' rights and obligations under the contract. Conciliation remains non-binding, in that either party may still reject the Conciliator's recommendation and refer the dispute to arbitration.

Similar arbitration provisions apply, but new Arbitration Rules for the conduct of proceedings were published by the Department of Finance at the end of April 2007. While the rules are essentially identical to the IEI Arbitration Procedure 2000, which applied in the Limerick case, the new rules set more specific and shorter timeframes for the conduct of the proceedings. In relation to compensation, she said that were similar circumstances, as occurred in Limerick, to arise under the new form of contract *i.e.* a finding by an arbitrator of wrongful termination, the Contractor would only be entitled to recover costs, but not damages.

In her reply, the Accounting Officer also said that should a similar case arise again, there were a number of safeguards to address the situation in the new Forms of Contract. Firstly, risk allocation is more clearly defined, with the contractor carrying ground conditions risk. Secondly, prior to terminating a Contract, the Employer may seek an opinion from a Conciliator as to whether he has sufficient grounds for termination. Lastly, as referred to above, in the event of an arbitrator subsequently finding that the termination was wrongful, the contractor is entitled to his costs, but not damages.

She also indicated that the Department would appoint an independent examiner to review the history of the case, and make any necessary recommendations now that the report of the independent legal and engineering review, commissioned by LCC at the behest of the Department, is available.

Costs to July 2007

On 21 November 2006 LCC paid €22,100,420 which was funded by the Department to UCL. A further payment on 11 January 2007 was sought by LCC from the Department, for the balance of the award of €10,081,675. An amount of €6,081,675 was paid to LCC on that date pending LCC review of any

potential for recovery from consulting engineers and legal advisers. These payments brought VAT inclusive expenditure by the Department to date to €63,898,142[32] being

- Payments under the original contract €7,174,961
- Payments of LCC/Department expert/legal/witness expenses, etc. €11,161,288
- Payments under the arbitration award €28,182,095
- Payments under the completion contract €17,379,798

In response to my inquiries about the estimated final cost, the Accounting Officer said that costs had not been awarded by the arbitrator to-date. The final outturn cost of these events (costs incurred by LCC including the cost of the works carried out by UCL but excluding the cost of completion of the works by the new contractor) amount to c. €56m. The cost of the completion contract is a further c. €27m bringing the estimated total cost to c. €83m.

I asked the Accounting Officer what, if any, steps were the Department and/or LCC taking to seek recovery of awards from engineering or legal advisers or their insurers.

In reply she said that the Department has withheld €4m from LCC pending consideration by LCC as to whether they should pursue their engineering and legal advisers and their insurers arising from the outcome of this case. This matter is ongoing at the present time. LCC were advised by the Department to engage independent legal and engineering advisers to review the basis for the decision to terminate, whether the consequences of the decision to terminate were sufficiently considered, the conduct of the arbitration proceedings on LCC's behalf and whether any different steps should be taken when considering termination of future contracts in light of the arbitrator's award.

She also said that LCC engaged a solicitor and a consultant engineer, both widely experienced in construction contract law and disputes, to review the matter. Their independent review, which is now under consideration in relation to its conclusions, found that

- The engineer had grounds to find on 18 September 2001 that the contractor was not proceeding with due diligence and that, in the circumstances, the decision to terminate was a reasonable one to make and "even in hindsight may have been correct."
- LCC had made the decision to terminate carefully and had considered the serious consequences of termination for the contractor before making the decision and it would have been difficult to foresee that it was exposing itself to liability to the contractor by pursuing its claim on the bond.
- To have released the bond would have been a strange thing to do and would have exposed the employer to the risk that its claims would not have been met.
- At the time of termination there were, and still are, grounds for the view that an employer is not in breach of contract by terminating on a clause 63 notice that is subsequently reversed in arbitration. However, the Arbitrator did not discuss this argument in his award but obviously rejected it.
- The manner in which the Employer's case was advanced was well-founded, thorough, robust, well thought out and more than competent and that the pleadings and submissions made on the Employer's behalf were of a much higher standard than those made for the contractor.
- The arbitrator, in considering "due diligence", had given very little consideration to the 11 July programme, had not considered work on the shafts and that the arbitrator's decision to hold the

[32] This excludes UCL costs which have not yet been awarded, €4m withheld by the Department from LCC and final payment in respect of the completion contract.

employer responsible for the contractor's loss of bonding facility was questionable as the denial of further bonding facilities was an independent decision of the bondsman.

- The arbitrator should have applied (but did not) the rationale based on Matheson v. Canada case where the Courts (both at first instance and on appeal) rejected as too remote a contractor's claim for loss of profits on future contracts as a result of an unjustified termination and bond claim.
- LCC were fully justified in referring the arbitrator's decision to the High Court. However, the Court was confined under the Arbitration Act to reviewing how the arbitrator conducted the arbitration and that there was no manifest error in the award itself but the Court was not entitled to open up or review the case itself due to limitations imposed by the Arbitration Act.

Department's Policy on Dispute Resolution

Given the difficulties that arose in this case I asked the Accounting Officer to outline the Department's experience of, and policy in respect of, significant disputes (exceeding €5m) since 2000.

The Accounting Officer said that two cases relating to Cork Main Drainage had gone to Arbitration. The first involving three contracts, all with one contractor, was settled, following a risk assessment, for a total of €11.24m including VAT in respect of claims in dispute totalling €52.8m including VAT. The second concerned the Waste Water Treatment Plant Design Build Operate contract, where the contractor had submitted a claim for €24.83m. The arbitrator awarded the contractor nothing and awarded Cork City Council all costs in this case.

At present two other cases are at arbitration. The first concerns the Dublin Bay Submarine Pipeline where the contractor is seeking €40m in claims while the second relates to a social housing contract in Naas where the contractor is seeking in excess of €5m in claims.

As regards monitoring of such cases the Department had, since September 2002, required local authorities to prepare risk assessments at the outset and to update these risk assessments as proceedings progressed and any new factor or outcome had to be taken into consideration.

I also asked the Accounting Officer how the Department monitored the settlement of disputes, which did not proceed to formal conciliation or arbitration to ensure such settlements were cost effective and if guidelines had been issued on dispute resolution.

The Accounting Officer said that where settlements are within the terms of the contract (*i.e.* where claims relate to quantum only) and the project remains within the approved budget, the cost of any such settlement will be included in the final account report submitted to the Department for approval. At this stage the Department will decide whether the settlement is eligible for recoupment to the local authority or whether the local authority should bear the cost. The cost of such settlements cannot be readily extracted from the final accounts.

The Department had not issued guidelines with regard to resolution of disputes as the circumstances of disputes are distinctively different, and it not possible to provide generic guidelines to cover every situation.

Since September 2002 the Department limited the Exchequer's financial exposure by requiring the local authority to first notify the Department of the existence of a dispute and to prepare a risk assessment. If a potential escalation of legal and other costs incurring at conciliation and arbitration is identified, the local authority is requested to consider seeking a commercial settlement within the scope of the risk assessment so as to minimise the cost to the Exchequer. In addition, where a dispute proceeds to arbitration, a "sealed offer" is recommended to mitigate exposure to the costs the contractor incurs.

In regard to its oversight role as the overall sponsor, manager and provider of funding for the Water Services Programme, the Accounting Officer stated that the Department oversees projects throughout their lifecycles. In this respect it monitors progress and costs relative to approved project budgets and maintains close liaison with local authorities where any project is not progressing satisfactorily or where a problem has arisen such as a contractual dispute. The Department of Finance had in recent months published the new Forms of Contract for Public Works which will provide further general safeguards for the Exchequer and the Department.

Current Developments

The Department does not believe that there were failures by management in either LCC or the Department in this case or that the arbitrator's award could have reasonably been anticipated having regard to the robustness of the Employer's case. The independent review carried out by LCC at the Department's request has confirmed that it would have been difficult to foresee this outcome. The planned independent examination of this case will further consider and report on the lessons to be learned from the case. All necessary lessons from this case are being, and will be, taken into account by the Department in relation to its management procedures, guidelines and input into contract terms and dispute procedures.

The Department's position is to ensure that capital programmes are implemented in accordance with the Government's National Development Plans in a cost effective manner and to protect the Exchequer from any unnecessary financial risk. The new Capital Management Works Framework being developed and introduced by the Department of Finance contains an integrated set of contractual provisions, guidance material and technical procedures covering the public works project lifecycle from inception to final project delivery and review. The structure of this strategic framework is closely aligned with the Capital Appraisal Guidelines issued by Department of Finance. The framework is intended to encourage more cost-effective procurement and delivery of public works projects by sponsoring authorities and sanctioning authorities through the introduction of a more systematic approach to planning, capital budgeting, design cost control, construction contract management, construction cost control and dispute resolution. It is expected that the completed framework, which is in the course of development by the Government Construction Contracts Committee, will be published before the end of 2007.

Chapter 7

Department of Education and Science

7.1 The Public Private Partnership Pilot Schools Project – Follow Up

Background

The pilot programme of public private partnership (PPP) projects, approved by Government in 1999, included a 'grouped schools' project proposed by the Department of Education and Science. Following a selection process, a PPP Company was contracted in 2001 as the private sector partner to design and build five new second-level schools on publicly owned greenfield sites, and to provide the funding for the project. The contract also required the PPP Company to be responsible for the maintenance of the buildings and grounds over the 25-year life of the contract, and to manage and pay for all of the schools' premises services such as waste management, cleaning and security over that period. Total expenditure by the Department associated with the grouped school deal was projected to be €283m (including VAT), or an estimated €150m in net present value terms. All the schools were completed and handed over by the end of 2002 and were operating in January 2003. The schools contract was taken over by another PPP Company in July 2006.

Audit Approach

Having carried out an examination in 2004 on the deal concluded with the PPP Company for the provision and maintenance of the five schools[33], I decided that it would be worthwhile at this stage to establish how the arrangements provided for in the underlying agreements were working out in practice.

The focus of the audit approach was on

- Establishing that the payments and receipts under the contract were being calculated correctly and transacted properly
- The operation of the schools to the agreed service standards
- The delivery of contracted maintenance to the schools
- The action taken by the Department to ensure that performance difficulties were promptly resolved
- The extent to which third party use was being made of the school buildings.

Departmental files, papers and financial records were examined, and meetings were held with officials of the PPP Unit of the Department.

In order to assess how the schools were faring, a questionnaire was sent to the five school principals. Once these were completed, my staff visited the schools and discussed the issues arising with the principals.

Enrolments

Table 29 shows the planned number of pupils and the numbers actually enrolled in the schools in the years 2003-2006. The planned number of places included an estimation of future enrolment demand.

[33] VFM Report No. 48 *The Grouped Schools Pilot Partnership Project*.

Table 29 Grouped Schools with Planned and Actual Enrolments

School	Planned Pupils	Pupils Enrolled			
		2003	2004	2005	2006
Ballincollig (Co. Cork)	1,000	580	588	613	610
Clones (Co. Monaghan)	500	455	459	469	451
Dunmanway (Co. Cork)	700	635	630	593	566
Shannon (Co. Clare)	600	641	681	700	700
Tubbercurry (Co. Sligo)	675	542	511	507	512

Payments under the Contract

Payments to the PPP Company are made monthly by the Department on receipt of an invoice in respect of each school and a report from the company indicating that any problems that had arisen had been resolved or were being dealt with. An analysis of the aggregate annual payments in respect of the five schools for the years to 2006 is set out in Table 30.

Table 30 Analysis of Annual Schools Bundle PPP Payments 2003 to 2006

Payment Type	Projected	2003	2004	2005	2006
	€000	€000	€000	€000	€000
Facilities Management	1,156	1,338	1,371	1,409	1,465
Company Overheads	411	405	410	419	428
ICT Maintenance	406	789	798	810	396
Sinking Fund Deposit	557	592	605	622	642
Fixed Payment	7,592	7,197	7,141	7,156	7,158
Total Annual Payment (€000)	**10,122**	**10,321**	**10,325**	**10,416**	**10,089**

Payments comprise a fixed portion of about 75% relating to the cost of construction and fitting out of the schools, while the balance of 25% relates to facilities management (including building management and maintenance, cleaning etc.), maintenance of ICT (in years 1 to 3 only) and PPP Company overheads (insurance, management charges, risk management, bank agency fees, directors' fees etc.).

The audit concluded from the review of the Department's records and papers that the monthly payments were calculated correctly and processed and paid over in accordance with the terms of the contract.

Feedback from the Schools

The responses to the audit questionnaire, and the subsequent discussions with the principals of the project schools, raised some doubt as to the extent to which the required maintenance and management services are fully provided. That gives rise to the issue of whether the verification procedures, currently followed by the Department, provide adequate assurance regarding the full delivery of contract services for which annual payments exceeding €1.4m are made. There would appear to be insufficient communication between the Department and the project schools with regard to performance issues. While an abridged

version of the PPP Company's monthly report is sent to the schools, the Department does not seek a response or confirmation of performance from them.

There would appear to be a continuing lack of clarity regarding what is to be provided in the schools in some instances, and whether some amounts may be payable to the schools by the PPP Company. Particular instances, where concern was expressed by the principals, included the discontinuance of a three-way liaison committee, the low level of usage of the schools by the community, a lack of ventilation preventing the use of pottery kilns, a failure to provide energy management and efficiency reports to assist schools to reduce costs, and an extensive subsidence problem in the grounds of one school.

The Accounting Officer informed me, that one of the aims of the pilot programme of PPP Projects was to identify issues and problems encountered during the implementation of the projects, and to use the information and learning to develop PPP policy and enhance the process. The Department of Education and Science approached the operational phase of this pilot programme on the basis that, in order to make full use of the pilot programme, and to gain from the experience, it would work in conjunction with the schools and the operator to solve any difficulties that were encountered, rather than take the adversarial approach of dealing with issues on a rigid reading of the contract. While the overall experience of the Department has been a positive one, the Department acknowledges that some issues, which have arisen during the initial period of operation of the schools, resulted in less than satisfactory service for the schools on a number of fronts, though none of the schools have experienced difficulties which have resulted in any serious unavailability issues.

One of the lessons learned to date, was that, in order for the Department to be fully satisfied with the adequacy of the reporting arrangements, two further areas of reporting needed to be strengthened. The original contract required that the PPP Company would identify and agree with the Department any deductions that were required, as a result of any shortcomings on the services being provided. While there were no major unavailability issues which would have required deductions, there were a number of quality failures which, when taken in aggregate, could have resulted in deductions. The original PPP Company had not recorded any of these quality failures. Following the takeover of the contract by the current PPP Company in July 2006, it was agreed that a system would be developed, whereby any deductions required would be identified in the monthly reports. The PPP Company has notified the Department that this system has now been developed, and will commence with the August 2007 invoicing. A copy of the complete report will be forwarded by the PPP Company to the School Authority, and the Department will agree a protocol with each school principal, whereby the school will be asked to comment on the report each month. A further check is being put in place, where a member of the Department's technical and professional staff will visit each school on a quarterly basis, to gather feedback on the operation of the school building. These processes will be reviewed after a period. The company also agreed to develop a web based helpdesk, and access will be provided to each of the schools and to the Department. Any differences of opinion about the resolution of issues will be addressed in the monthly sign-off.

Action Taken or Proposed

The Department had been aware of the significant issues raised in the audit questionnaire. Many of the issues raised by the school principals in their response to the questionnaire were historic in nature and had either been addressed by the PPP Company or were scheduled to be addressed during the summer break. However, in order to ensure a complete picture in relation to all of the issues, the Department had requested information from the schools on the current status of each item raised. With regard to the particular matters

- A formal Liaison Committee comprising the five principals and representatives of the Department and the PPP Company met on a regular basis during 2003 and 2004 during the difficult bedding-in period. It became apparent to the Department at the end of 2004 that the matters being raised were more appropriate to the company helpdesk, and it was decided to allow the schools and the company

to meet locally and to use the helpdesk to meet day-to-day problems. The Department has now agreed to recommence the Liaison Committee meetings from September 2007.

- One of the objectives of the pilot schools project is to see better usage of schools outside of school hours. Each of the schools has a bank of 350 hours which can be utilised for either school usage or made available for community use with the schools keeping any income earned. The PPP Company is contractually required to use reasonable endeavours to identify potential for Third Party Use. While the opportunities for this are reduced by the additional 350 hours allowed free to schools under the contract, the PPP Company has agreed to establish working groups with each school to examine the options available to maximise the potential for community use in any of the periods not required by the schools.

- The schools are entitled to receive 50% of the profits from out of school hours non-educational activities. No school has received a payment. The present PPP Company has indicated that no such third party income[34] in excess of costs has been generated. The company has been asked to provide accounts to verify this.

- Under the contract, two classes of school equipment were provided by the PPP Company *i.e.* supply only, and supply and maintain. As the schools did not receive a detailed listing of the items appropriate to each category, the company effectively decides the matter in each instance. The Department is clarifying the matter, using its records and those of the PPP Company and, when it is resolved, will provide a list to the school principals.

- It was the practice of the original PPP Company to deduct any amounts due for work commissioned by the school principal which was outside the scope of the Contract from any income due to the school from vending machines placed in the school. The contract provides a guaranteed minimum income to each school from this activity of, on average, €2,800 in year 1 and increasing to €3,500 (indexed) from year 3. This has been discontinued since the current company took over the contract and steps are being taken by the company to ensure transparency in respect of guaranteed income in the future. A re-calculation of the guaranteed income provisions is currently being examined arising from a change in 2006 in the food dispensed, at the request of the schools, to a healthy options approach.

- The kilns supplied by the PPP Company are internally ventilated and the manufacturer had stated to the original PPP Company that exhaust flues were not required. Notwithstanding this, the general practice for traditional schools would be that a canopy would be provided to allow for ventilation. The current company has undertaken in conjunction with the Department to provide a canopy in each school. The work will proceed over the summer if practicable.

- The original PPP Company did not produce the required energy reports. The current PPP Company has engaged with the school principals in order to minimise energy usage. In this regard the company had requested last December that the schools provide them with copies of the previous year's energy bills. These are still awaited from some of the schools. The Department will raise this issue with the school principals.

- A particular problem exists at one school where subsidence of the school grounds has caused damage to sewage pipes, rainwater drainage, and to the sports field and basketball court. As the site of the school is low-lying the Department provided an extra amount in the Contract for the piling of the school building. This was completed successfully and the building is not prone to subsidence. There has been some ground movement around the building. Remedial work has been undertaken by the PPP Company at their expense, on a number of occasions. The PPP Company continues to monitor the situation and anticipates, based on professional reports received, that the subsidence will cease in 2-3 years.

[34] This excludes the astro-turf facility in Ballincollig where a different funding arrangement applies.

Future Developments

The Accounting Officer indicated that, as the Pilot Project has been in operation now for 4½ years, the Department is currently drafting Terms of Reference for a five-year examination of the project, which will be undertaken by independent consultants during 2008. The review will encompass an audit of the schools, a five-year review and adjustment of the running costs and an evaluation of the project to date. The rolling programme of Whole School Evaluation Reports includes the Pilot Schools in order to assess the impact of the PPP contract on the work of the school principal.

She also said that the Department maintains a record of the lessons learned in the Pilot Schools project and the experience gained has benefited the Department in the preparation for the next bundle of Schools Programme currently being undertaken and in the contracts for the National Maritime College and the Cork School of Music. The main contract improvements are

- The PPP Company will have responsibility for recording and signing off with schools on all equipment delivered to each school and for the development and maintenance of an asset register for each school.
- A web-based Helpdesk will be established with access for all relevant parties.
- A Service Requirements and Procedures handbook will be prepared by the PPP Company and provided to schools and to the Department.
- An Energy Management Policy will be prepared and agreed prior to the service commencement date and revised each year.
- Greater involvement of school principals at Preferred Bidder Stage.

Based on the experience gained from the pilot schools, all future projects of this kind will be standardised and the same area norms and IT provision will apply to all schools regardless of method of procurement.

7.2 Prefabricated School Accommodation

Introduction

The Planning and Building Unit of the Department of Education and Science is responsible for planning education accommodation requirements, and for managing the annual capital expenditure budget for the provision of new school buildings and the extension and refurbishment of existing buildings. Table 31 sets out details of expenditure on the provision of permanent and temporary accommodation at primary and post-primary level for the years 2000 to 2006. Traditionally the vast majority of rental of temporary accommodation is at primary level.

Table 31 Capital and Current Expenditure on Provision of School Accommodation 2000 to 2006

Year	Capital		Current
	Construction of Permanent Buildings	Purchase of Temporary Accommodation[35]	Rental of Temporary Accommodation[36]
	€m	€m	€m
2000	258	4.4	4.0
2001	318	9.1	6.1
2002	344	21.5	8.4
2003	327	25.8	9.4
2004	333	12.7	11.3
2005	501	6.5	15.7
2006	525	3.5	24.5
Total	**€2,606m**	**€83.5m**	**€79.4m**

The capital expenditure of €83.5m on the purchase of temporary accommodation includes the associated costs of site works, professional fees and other expenses. Approximately 750 schools are currently renting prefabricated buildings at an annual cost to the Department of the order of €24m in 2006.

In general, subject to the receipt of rental approval and the vetting and approval of tender details from the Department, each Board of Management is responsible for acquiring temporary accommodation. More recently, where the Department is the site owner, it procures accommodation directly rather than through the school.

Audit Review

During the course of a meeting of the Committee of Public Accounts it was suggested to me that the Department was renting prefabricated school accommodation when it appeared that purchasing was the more economic option. I undertook to examine the matter.

[35] Includes the rental of short term alternative accommodation where classes have to be decanted out of the existing school building for health and safety reasons during a building /refurbishment project.
[36] Includes some payments in respect of the rental of permanent buildings.

Based on discussions with the Department, it quickly became clear that central records and aggregated data on rentals were not maintained. Details of the number of rentals, dates of first rental, and cost and duration of each rental are retained only on manual individual files for each school. It was clear that it would be impractical from a cost point of view to conduct a comprehensive audit as planned. However, I examined a sample of files that showed that prefabs were being rented for long periods. For example, at one school, two prefabs rented in 1999 and a further three rented in 2000 were still being used. The total rental costs for these prefabs to the end of 2006 amounted to some €487,000.

In the circumstances, I sought information from the Accounting Officer as to

- The overall policy of the Department on expenditure on prefabricated buildings
- Whether guidelines had been prepared in relation to the breakeven point in terms of the length of rental period in order to establish when the balance of economic advantage changes from ongoing rental payments to outright purchase
- Whether a purchase option was included in rental contracts to take account of the possibility of extended rental due to changing circumstances
- Whether consideration is given to the relocation of prefabricated buildings, and
- Why comprehensive and readily accessible records were not maintained to facilitate both ongoing control and monitoring of expenditure, and overall policy review.

Accounting Officer's Response

Provision of Temporary Accommodation

The Accounting Officer stated that as part of the schools capital programme, the Department provided funding for temporary accommodation in the form of prefabricated buildings or the rental of existing buildings and rooms. The costs involved in the provision of temporary accommodation include site works, installation costs, professional fees and other expenses associated with planning and building requirements.

The policy of the Department on expenditure on prefabricated building accommodation in individual cases depended on whether

- The school had permanent recognition or was only provisionally recognised. It was the policy of the Department not to expend any capital funding on provisionally recognised schools. A rental option was adopted in those cases
- The need was deemed short-term (e.g. a short-term bulge in enrolments); the policy was generally to approve rental of accommodation in such cases
- The need was deemed immediate and no alternative accommodation was readily available.

She noted that the demand for very quick accommodation solutions in schools continued to rise as a result of the appointment of additional teachers for special education needs, language resource needs, demographic change, reduction in class size *etc*. The total number of extra teachers approved for the period 2000 to 2006 was 4,636. A significant number of those posts would have required the provision of temporary accommodation.

Purchase or Rental of Prefabricated Buildings

The Accounting Officer said that prior to 2003 the standard operating practice of the Department was that the question of whether prefabricated buildings should be provided by purchase or rental was decided on the basis of whether the need was short-term or long-term. Where the need was short-term, it was generally considered better value for money to approve the rental of prefabricated buildings; whereas if the need was considered long-term, purchase was the preferred option. However, in 2003 and onwards, the practice changed and, based on the experience gained in purchasing and re-locating prefabricated buildings, the rental option became the favoured method of providing such accommodation.

She noted that the policy change occurred at the same time as the introduction of the Permanent Accommodation Scheme. That scheme was intended to meet relatively small additional accommodation needs through the quicker provision of permanent classrooms, thereby avoiding situations where schools used temporary accommodation for long periods. 318 additional classrooms and 87 resource rooms had been approved under the scheme in the period 2003 to 2006.

Guidelines on the Relative Economic Advantages of Rental versus Purchase

The Accounting Officer acknowledged that the Department had not established guidelines on the relative economic advantages as between rental and purchase of prefabricated buildings. However, she confirmed that quantity surveyors in the Department had commenced a review of rental policy to include

- An evaluation of the 'breakeven point' in terms of rental period, when a comparison is made between the aggregate costs over the likely rental period and the outright purchase price coupled with associated maintenance costs and subsequent disposal costs
- The introduction of a formal mechanism based on this breakeven point that will inform the Department's decision whether to avail of an outright purchase or a short term rental option
- A revision to the terms of rental approval to incorporate a buy out option if, for example, the expected rental period of a prefabricated building is extended due to the delay in the delivery of the permanent building project
- Consideration of the most economic approach to procuring temporary accommodation, e.g. through a framework agreement or through draw-down contracts on a geographical basis
- Consideration of how a centralised inventory of prefabricated buildings can be developed and maintained in the Department.

She added that it was intended to prioritise this examination with a view to introducing the necessary changes as quickly as possible. She expected that, following the review of rental policy, the Department would be better informed to consider the question of breakeven points between rental and purchase of prefabricated accommodation.

Relocation of Prefabricated Buildings

The Accounting Officer informed me that the Department had examined the question of re-locating purchased prefabricated buildings in cases where the accommodation was no longer required at the original location. She said that factors taken into account included the age and condition of the prefabricated buildings, their suitability for dismantling, and the costs arising from the dismantling, transportation and re-erection of the buildings. Further issues included matching the actual need of the receiving school to available stock, timeframes and the provision of temporary storage.

She stated that for technical reasons, the demounting and reassembling of prefabricated accommodation was rarely economically viable. For example, in 2005/2006, 37 prefabricated building units were relocated to 17 primary and 4 post-primary schools. Following these relocations, the Department concluded that the efforts expended did not represent best value for money because, at best, the cost of relocating a prefabricated building was 50% to 60% of the cost of a new purchase. In addition, many schools resented receiving what they considered to be cast-offs, while the schools at the original location generally wished to retain the buildings for other purposes such as storage, indoor play areas or as resource rooms. Because of the poor value for money, it was only in exceptional circumstances that prefabricated buildings were now re-used.

Management Information

The Accounting Officer also informed me that as comprehensive information was only accessible from individual records held on school files, the current system did not lend itself easily to the evaluation of overall policy reviews. The Department is currently examining its Management Information Systems in the Planning and Building Unit with a view to the integration of existing information and the capture of desired management data in one central system. However, the implementation of such a system is one of a number of competing priorities in the IT area and must take account of IT capacity. Pending longer-term development work, the issue of improving rental information will be considered as part of the local annual programme for improving and adapting existing information systems in the Planning and Building Unit.

Chapter 8

Department of Transport

8.1 Integrated Ticketing Scheme – Update

Background

I referred in my 2005 Report to the project being managed by the Railway Procurement Agency (RPA) to deliver a multi-operator system of integrated public transport ticketing using smartcard technology. It outlined concerns that the way in which the Integrated Ticketing System (ITS) project had been managed had led to a lack of progress, termination of the initial procurement phase and the incurring of substantial nugatory expenditure.

In addressing these concerns the Accounting Officer detailed revised governance arrangements for the project, which were introduced in July 2006. The purpose of these arrangements was to ensure that the project progressed as expeditiously as possible and that the benefits of expenditure to date were realised.

New Governance Arrangements

The new governance arrangements for the project comprised the following measures

- Establishment of a new high level project board, known as the Integrated Ticketing Project Board (ITPB), charged with the successful delivery of the smartcard technology required for an integrated ticketing system within an agreed specification, timeline and budget. The board to comprise an independent chairperson, the CEOs of the RPA, Dublin Bus, Iarnród Éireann, Bus Éireann, a representative of private bus operators, a senior Department of Transport official and, as appropriate, a senior official of the Department of Social and Family Affairs (DSFA).
- The ITPB, being accountable to the Minister for Transport, was required to formally report on progress to the Minister in September 2006 and every three months thereafter.
- The establishment of a project implementation team to report to the ITPB and be responsible for the day-to-day development and implementation of the project.
- Review and possible amendment to the mandate of the RPA and
- The establishment of the Dublin Transport Authority.

The integrated ticketing project is concerned with the delivery of one coherent system of integrated public transport ticketing involving various transport companies initially in the Greater Dublin Area. Accordingly, the enhanced governance structure for the project is designed to recognise the independent statutory roles of the various stakeholders while ensuring a single focal point for all key decisions in relation to the project. The structure is intended to be interim in nature pending changes in public transport institutional arrangements in the form of the establishment of the Dublin Transport Authority.

Implementation of New Arrangements

I carried out a review of departmental papers relating to the project and confirmed with the Accounting Officer that the up-to-date position is as set out in Table 32.

Table 32 Progress on Implementing the New Governance Arrangements

Measure	Progress
New High-level Board (Integrated Ticketing Project Board, ITPB)	ITPB in place since July 2006 Includes CEOs of RPA, Dublin Bus, Iarnród Éireann, Bus Éireann, private bus operators' representative, the Department and attendance as appropriate from DSFA First meeting 25 July 2006 ITPB has met at least once per month since Appointed a professional advisor to provide independent expert technical support
Progress reports to Minister for Transport	3 reports to date (October 2006, December 2006 and May 2007)
Project Implementation Team (PIT)	A team, comprising representatives of all transport operator stakeholders, put in place. It generally meets fortnightly. Meetings take place with DSFA as required. The PIT reports to the ITPB and is responsible for the day-to-day management of the implementation process.
Review and possible amendment to mandate of RPA	The Department concluded that there was no need to amend the statutory basis for RPA's functions pending the establishment of the Dublin Transport Authority. The Department updated the RPA mandate, in April 2007 by issuing the document titled, 'Policy Principles Regarding Integrated Ticketing'.
Establishment of the Dublin Transport Authority	The Minister has announced the intention to establish a Dublin Transport Authority on a statutory basis. Responsibility for integrated ticketing will be transferred to the new authority on its establishment.

Recommendation of the Second Report of the ITPB

The second ITPB progress report to the Minister in December 2006 detailed the revised project scope, timetable and budget. The scope of the project was defined to be all scheduled services of Dublin Bus, of LUAS and of a named private coach operator as well as all Iarnród Éireann DART and suburban commuter services, along with a Bus Éireann pilot route serving the greater Dublin area. It would also accommodate the free travel scheme funded by the DSFA by way of a link-up with that Department's Public Services Card initiative.

In regard to the completion timetable, the report envisaged that the ITS would be launched initially on the services of Dublin Bus, LUAS and the private coach operator within 27 months of the decision to proceed with the project (*i.e.* end August 2009). Full integration would be achieved within four years.

The Accounting Officer informed me that the expected capital cost of the project would be €49.6m, of which €11.2m represented costs incurred to end December 2006, primarily on design development. This increase from €29.6m is due to the longer implementation period from 2005 to 2010 and the associated price inflation, increased contributions to transport operators to reflect the cost of integration and to stimulate private sector bus operator involvement, and inclusion of the technical requirements for the 'Free Travel' link-up with DSFA. The budget also includes increased provision for contingency.

The revised budget has been prepared on the basis of the best assessment of current market conditions. Final costs would not be known until tendering has taken place. The ITPB report provided a pre-tender estimate of the annual operating costs of the system and stated that the Project Board would consider the

means by which these were to be met. The Department has decided that operating costs would not be borne by the Exchequer. It envisages that these costs will be met through savings accruing to transport operators from participation in the integrated ticketing scheme and an adjustment to fares, as appropriate, sufficient to off-set the net cost of operating the ITS.

Concerns Raised by the RPA

In February 2007 a new chairperson was appointed to the Board of the RPA as well as being nominated as chairperson designate of the proposed Dublin Transport Authority. The following month the Board of the RPA, having considered the second ITPB progress report, raised the following concerns with the Department

- The need for formal approval for the project by the Minister and by the respective stakeholder boards
- The RPA's perception of a lack clarity on the arrangements for project governance
- The risks posed by the development of interim schemes
- The need for the signing of binding Heads of Agreement by all participants
- Uncertainty as to who would bear the operating costs of the scheme.

In response to my enquiries, the Accounting Officer informed me that on 19 April 2007, following discussions with the Chairperson and Chief Executive of the RPA, the Department responded to these concerns by way of a Memorandum to the Chairperson of the ITPB and copied to the CEO of the RPA. The Memorandum addressed each of the issues raised by the RPA. The RPA Board subsequently confirmed that it considered that the issues had been addressed to its satisfaction or that steps were being taken to finalise them.

Interim Smartcard Schemes

The first report of the ITPB, in October 2006, indicated that the Board had agreed to Dublin Bus introducing an interim smartcard from late 2007 on the basis that it was consistent with making progress on the full scheme. In November 2006, Iarnród Éireann obtained ITPB approval to develop its own interim smartcard scheme. This scheme would include an electronic purse facility. Early in 2007, Dublin Bus informally raised with the ITPB the possibility of linking its interim smartcard with the existing Luas smartcard and the one being considered by Iarnród Éireann. In. The Departmental Memorandum of 19 April 2007 to the Chairperson of the ITPB addressed the RPAs's specific concerns regarding interim smartcard schemes.

On 30 April 2007, the Department wrote to both Dublin Bus and Iarnród Éireann in relation to interim smartcard schemes informing them that

- The ITS should be the sole integrated ticketing mechanism for public transport ticketing
- There should be no initiatives on linking their interim schemes
- There should be no further enhancements of smartcard schemes without the approval of the ITPB and the Department.

In a letter to the Department on 15 May 2007, the Chief Executive of Dublin Bus reiterated his belief that " ….we need to look seriously at developing bus/rail and bus/Luas smartcards". He also pointed out that in due course there would be four smartcards in operation – the two existing Luas and the Private

Operator's Cards with Dublin Bus and Iarnród Éireann cards yet to be introduced. He suggested that "…. we should be exploring ways of offering combined products on these cards which will fit in with the ultimate development of the ITS to which everybody is committed."

The Department, in a high-level consideration of the pros and cons of this suggestion, stated, at the outset, that the integrated ticketing system needs to have the capability in the future to accommodate public transport operators outside Dublin, meet competition law requirements, facilitate various fare systems and act as a trusted agent of an independent transport authority. The Department noted that, in facilitating implementation of the full ITS, the approach informally suggested by Dublin Bus could, *inter alia,* deliver a measure of smartcard based integrated ticketing somewhat quicker than the full ITS and would cover approximately 95% of the current public transport market in Dublin for a marginal additional capital cost. Alternatively, if linking the interim schemes resulted in it being an alternative to the full ITS such a link-up would result in limited smartcard based integrated ticketing at a preliminary estimated cost of between €4m - €5m; would be operator driven resulting in appropriately pitched ticket products; and the costs of operating the system may be absorbed by the operators.

On the other hand, the Department considered that any further enhancements to interim schemes could increase the risk to the delivery of the overall ITS project. Both the Department and the RPA considered that linking interim systems could potentially delay the implementation of the full scheme; lead to confusion in the market place; divert scarce professional resources and result in some nugatory expenditure.

The Department also had to consider the possibility that the linking of the interim smartcard schemes would be seen as an alternative to the full ITS. In this scenario, the Department had even more fundamental concerns that the suggestion would potentially reinforce the dominance of the large (State) operators and raise problems from a competition perspective; be a closed technical platform not accessible to all parties; be at variance with the proposed requirements of the Dublin Transportation Authority in relation to fares, information and transport integration; be of no value to passengers who need to interchange between private bus and State operated services and would not be extendable to the rest of the State. Furthermore it would not contain an electronic purse resulting in a lower passenger take-up; have limited linkages to the DSFA Free Travel Scheme and question the reputation of the Department and the RPA.

In conclusion, the Department was firmly of the view that the ITS now proposed by the ITPB is the system that meets the Department's policy requirements and would complement roll-out of the public transport infrastructure under Transport 21, while being sufficiently neutral from a technical perspective to facilitate future decisions of the Dublin Transport Authority in relation to transport integration, fares policy, information provision and market regulation. The Dublin Bus proposal would not achieve this and, while, on the face of it had some short-term merit, it raised additional risks as regards timeliness, costs and technical resources.

The Department considered that the possibility of linking the interim schemes had moved on and was not now as topical an issue as had been considered at the time. Commitments by Dublin Bus and Iarnród Éireann to the full ITS had alleviated its concerns.

Project Approval

In May 2007, the Department made the case, which it regarded as compelling, to the Department of Finance for investment in a smartcard based integrated ticketing system and sought sanction for the revised budget of €49.6m. In making its proposal, the Department stated that it was firmly of the view that the implementation of the Integrated Ticketing Project would significantly enhance the attractiveness of the public transport infrastructure and services being rolled out under Transport 21 and would contribute to the achievement of wider Government policy in relation to transport and sustainability. The Department also stated that the financial case for the project was supported by both the updated financial

analysis undertaken by the independent Technical Advisor and the outline business case prepared by the Project Director. These appraisals indicated that there was a positive Net Present Value for the project.

The Department of Finance sanctioned the proposal, subject to the following conditions

- The Department of Transport would continue to fully adhere to the Guidelines for the Appraisal and Management of Capital Expenditure in the Public Sector in respect of evaluation and management of the project, and would reappraise the project in the event that outturn costs were likely to increase or there was any reason to believe that the project benefits would not materialise.
- The capital cost of the project, including agreed contributions to the stakeholder companies and the cost associated with incorporating the Free Travel Scheme, would not exceed €49.6m.
- The full capital cost would be met from within the Transport 21 financial envelope.
- The ongoing current costs of the project would be met by the transport operator companies and not, in any form, by the Exchequer.

In conveying its approval for the project to the ITPB the Department attached additional conditions

- Each stakeholder company was directly responsible for delivery of its element of the overall system in line with the agreed management and monitoring framework for the project.
- The focus of the ITPB and the stakeholder companies should now be on delivery of the integrated ticketing system as set out in the Board's Second Report.
- The ITPB and the stakeholder companies should comply with Department policy in relation to interim smartcard schemes and their migration to the ITS as soon as practicable after its establishment.
- The ITPB should ensure that the costs associated with integrating the ticketing schemes of Bus Éireann's pilot project, and of Iarnród Éireann's greater Dublin area network, with the ITS are finalised as soon as possible.
- The ITPB should develop a detailed implementation plan setting out precisely how integrating ticketing is to be delivered within the committed timescales.
- A Heads of Agreement/Memorandum of Understanding between the stakeholders should be completed before substantive contractual arrangements arising from the 'build' procurement are concluded.

On 27 June 2007, a tender notice was published in the Official Journal of the European Communities to secure a supplier to develop, supply, test and integrate the complete back office and associated interfaces for the ITS. The date for submission of responses to the pre-qualifying stage is 30 July 2007.

The Accounting Officer informed me that the Department had introduced new monitoring and reporting arrangements in accordance with the Capital Appraisal Guidelines to reflect the revised governance arrangements now in place and the renewed emphasis on the delivery of the integrated ticketing project. A new Monitoring Committee, comprising the Department, the Project Board Chairperson, Project Director and others as appropriate was established. The first meeting of this Committee took place on 10 July. While the focus would be on delivery within the agreed programme and capital budget, if, at any stage, it appeared that outturn costs were likely to increase or that the expected benefits might not materialise, the Department would immediately undertake a reappraisal of this project.

Chapter 9

Department of Social and Family Affairs

9.1 Overpayments

The Department of Social and Family Affairs administers some 50 welfare schemes paid through Vote 38 and the Social Insurance Fund. Expenditure on assistance and insurance schemes was €7.02 billion and €6.11 billion respectively in 2006.

Tables 33, 34 and 35 outline overall expenditure on various schemes over the period 2002 to 2006, and for the same period, the amounts recorded as overpayments, the amounts of overpayments attributed to fraud or suspected fraud and the Department's cumulative record of recovery since 2002.

Table 33 Scheme Expenditure

	2002 €m	2003 €m	2004 €m	2005 €m	2006 €m
Social Insurance	4,198	4,649	5,081	5,460	6,106
Social Assistance	4,940	5,460	5,821	6,296	7,019
	€9,138m	**€10,109m**	**€10,902m**	**€11,756m**	**€13,125m**

Table 34 Number and Amount of overpayments recorded for recovery (Numbers shown in brackets)

	2002 €m	2003 €m	2004 €m	2005 €m	2006 €m
Social Insurance	9.72 (23,723)	10.60 (26,174)	12.12 (26,131)	11.02 (22,420)	11.20 (21,529)
Social Assistance	19.41 (15,084)	28.77 (17,459)	44.85 (20,000)	36.24 (17,126)	34.02 (18,216)
Total	**€29.13m (38,807)**	**€39.37m (43,633)**	**€56.97m (46,131)**	**€47.26m (39,546)**	**€45.22m (39,745)**

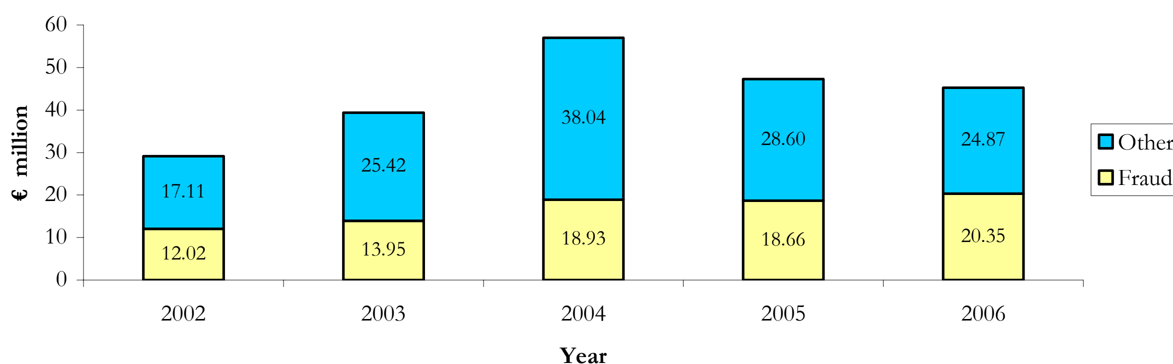
Table 35 Number and Amount of overpayments attributed to fraud[37] or suspected fraud (Numbers shown in brackets)

	2002 €m	2003 €m	2004 €m	2005 €m	2006 €m
Social Insurance	4.59 (8,121)	5.07 (9,606)	6.24 (10,771)	5.53 (8,587)	5.16 (7,877)
Social Assistance	7.43 (5,728)	8.88 (7,148)	12.69 (8,483)	13.13 (7,758)	15.19 (8,950)
Total	**€12.02m (13,849)**	**€13.95m (16,754)**	**€18.93m (19,254)**	**€18.66m (16,345)**	**€20.35m (16,827)**

[37] Estate cases where undisclosed means come to light are not classified as fraud/suspected fraud. The amount of overpayments recorded in respect of 258 estate cases in 2006 was €5.6m.

The amount of overpayments attributed to fraud or suspected fraud compared to total overpayments since 2002 is summarised in Figure 4.

Figure 4



The Department's record of recovery of overpayments during the period 2002 - 2006 is shown in Table 36.

Table 36 Department's record of recovery of overpayments 2002 to 2006

	2002 €000	2003 €000	2004 €000	2005 €000	2006 €000
Overpayments not disposed of at 1 January	65,452	70,621	85,953	115,993	131,250
Overpayments recorded for recovery	29,130	39,367	56,967	47,261	45,219
Less					
Overpayments recorded in prior years cancelled	(394)	(381)	(693)	(1,826)	(129)
Sums recovered in cash	(8,892)	(10,397)	(11,506)	(11,246)	(12,032)
Sums withheld from current entitlements	(6,734)	(6,521)	(8,332)	(8,715)	(10,509)
Net amounts written off as irrecoverable[38]	(7,941)	(6,736)	(6,396)	(10,217)	(4,259)
Overpayments not disposed of at 31 December (€000)	**70,621**	**85,953**	**115,993**	**131,250**	**149,540**

Of the €149,540,338 overpayments outstanding at 31 December 2006 - €31,017,804 dates from 2006; €29,724,801 from 2005; €36,224,296 from 2004 and €52,573,437 from earlier years.

A new Overpayments and Debt Management (ODM) computer system went live in November 2006 and is expected to be in use in all relevant areas of the Department by the end of 2007.

[38] Written off for accounting purposes.

The new system allows for

- Recording of overpayments details by frontline staff.
- Ongoing tracking of repayments including tracking of recovery by deduction from social welfare payments. This will require linking with the Department's legacy systems to allow for automatic transmission of data between systems.
- Production of management reports.
- Implementation of a new debt management strategy.

Expected benefits from the new system are

- The elimination of duplicate data entry of debt transactions
- Elimination of paper processing in reporting debt transactions
- More collaborative working
- More reliable and accurate debt information.

A major data clean up job was undertaken on the old overpayments system prior to migration to the new system. During this process it was decided to concentrate on the following categories of overpayments

- Cases where there had been recovery activity in the last 3 years
- Cases notified since 2000 where the outstanding debt exceeded €1,000
- Large fraud cases (in excess of €5,000) regardless of the time period.

On this basis approximately 121,000 cases were migrated to ODM. Following this work it was decided that debt that was considered to be irrecoverable, either because of its age or value, would not be migrated to the new ODM system.

The debt remaining on the old system amounts to approximately 200,000 overpayments with a value of some €82m, the vast majority of which is pre-2000 and for sums of less than €2,000. Approval is to be sought from the Department of Finance to write off these debts definitively – over 99% of these debts have already been written off for accounting purposes.

The changeover to the new computer system is to be complemented by the implementation of a new debt management strategy. The Accounting Officer informed me that the new strategy is planned for implementation in the second half of 2007. The overall goal of this strategy is to actively pursue the recovery of debt to maximise recovery levels, with due regard to value for money and with particular emphasis on recovery from people no longer dependent on welfare payments.

The main thrust of the new debt management strategy is give the Central Overpayments and Debt Management Unit a role in the pursuit of debt. The unit will concentrate on debtors no longer in contact with the Department, in particular debtors with large overpayments that were obtained fraudulently.

9.2 Prosecutions

Cases involving abuse of the system are considered with a view to taking legal proceedings. Prosecutions are taken against employers who fail to carry out their statutory obligations and persons who defraud the social welfare payments system. Prosecutions can either be by summary or indictment proceedings. Civil proceedings are taken to facilitate the recovery of scheme overpayments or the collection of PRSI arrears. Such cases are only taken where there is an expectation that the debtor has sufficient means to discharge the debt.

During 2006, 348 criminal cases (2005 - 412 cases) were forwarded to the Chief State Solicitor's Office (CSSO) for prosecution as shown in Table 37. Forty five cases were not deemed suitable for prosecution (2005 – 10 cases) due to the time elapsed since the offence.

Table 37 Criminal Cases forwarded to the CSSO

	2006	2005
Unemployment Assistance	169	197
Unemployment Benefit	113	153
Disability Benefit	20	19
One Parent Family Payments	16	19
Other Schemes[39]	7	10
Offences Committed by Employers	23	14
Total	**348**	**412**

A total of 256 criminal prosecutions (2005 – 256 prosecutions) involving social welfare recipients were brought to court in 2006. The total amount of overpayments assessed in these cases of persons who attempted to or obtained benefits/assistance fraudulently was €1,524,435 (2005 - €1,346,770). The results of these 256 court cases and the penalties imposed are given in Table 38.

At the end of 2006, the CSSO had 806 cases on hands awaiting prosecution.

Table 38 Results of Criminal Court Cases involving Social Welfare Recipients

	Unemployment Assistance	Unemployment Benefit	Disability Benefit	One Parent Family Payments	Other[40]	Total
Fined[41]	50	39	7	1	2	99
Community Service	5	3	0	1	1	10
Imprisoned	3	1	0	0	0	4
Probation Act	21	23	0	4	3	51
Suspended Sentence	8	6	2	0	0	16
Struck-out	5	4	2	2	0	13
Dismissed	0	0	1	0	0	1
Bound to the Peace	0	2	0	0	0	2
Liberty to re-enter	30	21	3	2	0	56
Withdrawn	1	0	0	3	0	4
Total	**123**	**99**	**15**	**13**	**6**	**256**

[39] Includes 6 cases involving the use of false PPS numbers (2005 - 4 cases).

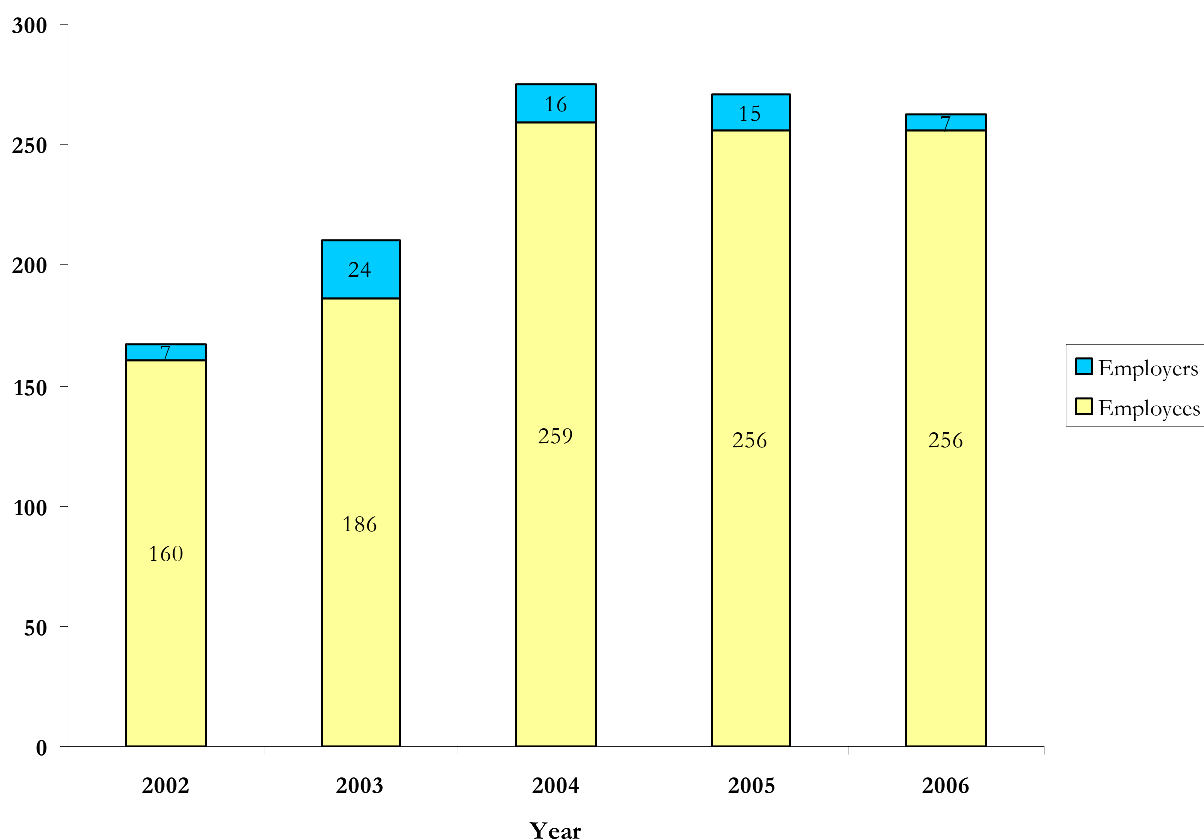
[40] Other 6: Disability Allowance 2, Invalidity Pension 2, Family Income Supplement 1 and false PPS Number 1

[41] Fines to the value of €72,321 were imposed by the courts (€56,525 in 2005 in 116 cases).

Prosecutions of 7 cases involving employers (2005 – 15 employers) were also finalised with 6 being fined[42] and 1 given the benefit of the Probation Act.

The number of prosecutions dealt with by the courts since 2002 is summarised in Figure 5.

Figure 5



Between 2002 and 2006 a total of 70 civil cases were sent to the CSSO for the pursuit of civil proceedings. In this period, 71 cases (including pre – 2002 cases) have been finalised. The breakdown per year is set out in Table 39.

Table 39 Civil Cases sent to the CSSO

	2002	2003	2004	2005	2006	Total
Sent to CSSO in the year	11	21	17	13	8	**70**
Finalised in the year	11	14	12	21	13	**71**

Of the 71 cases finalised, settlement was reached in 10 cases without going to court (this involved recovery of €122,096), 4 were finalised in court (decrees awarded), 18 cases were not pursued due to the circumstances of the debtor, 10 cases were statute barred and 29 made arrangements to repay the debts in instalments. There are 73 cases that have yet to be finalised.

[42] Fines to the value of €3,500 were imposed by the courts (€8,370 in 2005 in 14 cases).

9.3 Payment of Child Benefit by Electronic Funds Transfer

Methods of Payment

Child Benefit is a universal payment paid every month in respect of qualified children. The scheme currently has some 570,000 customers in respect of approximately 1.1 million children. The cost in 2006 was €2.056 billion.

There are two methods of payment of Child Benefit – Electronic Funds Transfer (EFT) and Personalised Payable Order (PPO) - and it is up to the claimant to specify a preference. The EFT method of payment provides for the monthly lodgment of payment directly to a bank or building society account specified by the claimant. The PPO method of payment involves the issue of the PPO book to a specified address and monthly encashment by the claimant at a nominated Post Office.

The EFT method of payment of Child Benefit was introduced by the Department in 1992. A Government decision in December 2004 directed all Departments to use EFT to the greatest extent possible.

The Department has taken a number of steps to maximise the number of customers receiving payment electronically. The increased use of electronic payments has reduced administrative work for the Department, delivered cost savings and provided customers with a wider range of outlets at which to receive their payments.

The overall level of welfare recipients paid by EFT doubled in the five years up to September 2006 to 37% and had risen to 42% by February 2007. It has been the preferred method of payment in recent years and is currently increasing at a rate of 1% per month.

The method of payment to Child Benefit claimants in February 2007 is shown in Table 40.

Table 40 Claimants' Payment Method

Payment Method	Number of Claimants	% of Claimants
EFT	273,771	48%
PPO	296,582	52%
Total	**570,353**	**100%**

Nationality of Claimants

The nationality of claimants on the Department's system is shown in Table 41.

Table 41 Nationality of Claimants

Country	PPO	EFT	Total
Ireland	208,333	164,328	372,661
EU	11,031	25,311	36,342
Non-EU	6,206	22,869	29,075
Other [43]	69,864	59,674	129,538
Unknown [43]	12	11	23
Blank [44]	1,136	1,578	2,714
Total	**296,582**	**273,771**	**570,353**

Non-EU claimants include 4,186 asylum seekers and 3,881 work permit holders paid by EFT.

Control Initiatives

Specific control initiatives undertaken by the Department in the Child Benefit area in recent years included a fraud and error survey, mailshots and reviews of claims.

Fraud and Error Survey

A fraud and error survey of Child Benefit claimants was commenced in May 2004. A sample of 500 Irish nationals and 500 foreign nationals was randomly selected. The survey involved the completion of a questionnaire by those selected and follow up home visits by Department inspectors.

The results of the survey indicated that the level of fraud was 2.6% among Irish nationals and 14.4% among foreign nationals. Table 42 shows the breakdown of the fraudulent cases detected by the survey.

Table 42 Fraudulent Cases detected by Survey

Reason	Irish	Non-Irish	Total	EFT	PPO
Whereabouts unknown	12	59	71	61	10
Child left State	0	8	8	7	1
Family left State	1	5	6	5	1
Total	**13**	**72**	**85**	**73**	**12**

The Accounting Officer has informed me that the survey indicated an overall fraud level of 1.66% in monetary terms, translating into a potential €31.6m exposure annually. It was his opinion that, while this represented a considerable sum in absolute terms, the amount must be viewed in the context of the overall expenditure on the scheme of over €2 billion. He stated that it compared favourably with other schemes and internationally.

He informed me that the control activity undertaken following the survey consisted of

[43] Nationality description as per system.
[44] No nationality recorded.

- In April 2006 a mailshot issued to all claimants with children under the age of 6 – approximately 259,000. This mailshot was issued to inform customers of the introduction of the Early Childcare Supplement. Some 9,000 forms were returned undelivered and follow-up action was taken in these cases. Some 100 cases have been terminated and a further 770 have had payment suspended pending completion of enquiries.
- In December 2006 a targeted mailshot issued to 322 EU nationals (non-Irish) where cessation of employment dates had been recorded by the Department. As a result of the follow-up investigations 12 claims were terminated.
- A mailshot was currently in the process of issuing to 1,000 EU nationals (non-Irish) who had a cessation of employment date recorded between December 2006 and April 2007.
- Social Welfare Inspectors, assigned to the Garda National Immigration Bureau, contact Child Benefit section regarding people about whom they had suspicions concerning residency or other qualifying conditions. On average 6-8 cases are identified each week and fully investigated. Suspected cases of fraud have their payment stopped immediately pending investigation.

Mailshots to all Claimants

Information leaflets informing customers of budgetary changes were issued to all claimants paid by EFT in the years 2002, 2003 and 2004. Following investigation of cases in respect of which mail was returned undelivered, 1,670 claims were terminated as the claimant was found to have either left the State or could not be located. Of these, 756 were Irish customers while 914 were foreign.

The Accounting Officer informed me that the Department makes use of mailshots both for information and control purposes. The control advantages and the frequency of using mailshots had, however, to be balanced against the cost and resource implications involved in terms of document preparation, postage costs, the work involved in processing replies and in dealing with non-replies. Between 2001 and 2005, a total of some 888,000 mailshot letters issued, of which 22,000 were returned undelivered and required investigation. As a result of the investigations, some 2,273 claims were terminated. There was a considerable administrative overhead involved in issuing and checking mailshots and this overhead had to be balanced against the control advantages that accrued. However, in view of the changing customer base of the scheme in recent years, the Department was considering how best the use of regular targeted mailshots might be increased and enhanced.

Reviews

There is no systematic review of claims. Reviews are undertaken only on receipt of information indicating changed circumstances that may affect eligibility to payment or alter the amount payable. The sources of information are notifications from claimants, Departmental inspectors, other sections in the Department, anonymous reports from the public and post returned undelivered. A total of 17,802 reviews, approximately 3% of claimants, was carried out in 2006 predominantly because of notified changed family circumstances.

The 17,802 control reviews led to the termination of 804 cases and reduction in rate in a further 751 cases, with estimated savings of €17.9m[45]. The breakdown between Irish nationals and foreign nationals is not known.

Overpayments, amounting to €3.24m, were assessed by the Department in 1,912 cases.

[45] As calculated by the Department.

The main reasons for overpayment were that the family had left the State (726), child had left the household (329) and child had left full-time education (234). Payment by EFT accounted for 56% of the overpayments.

In response to my inquiries as to why the Department had no systematic review process for claimants and particularly for claimants opting for payment by EFT, he informed me that traditionally the scheme had been regarded as a very low-risk scheme and a systematic review/control process would not have been regarded as necessary. The annual issue of mailshots to the claimant base would have acted as a form of de facto control and review measure. In recent years the claimant base had changed and, in line with this, the Department was planning a more formal and systematic review process for the scheme. As part of the Department's Action Plan commitments under *Towards 2016*, it had committed to drafting a review policy for each scheme. The review policy for Child Benefit would be drafted during the third quarter of 2007 and would take account of the control issues raised.

Risks and Advantages of EFT

I enquired what steps the Department was taking to manage the additional risks associated with the EFT method of payment. In response, the Accounting Officer maintained that the potential for fraud associated with any claim is primarily dictated by the risks associated with a particular claim, for example, the claim type and characteristics of the claim, rather than the payment method.

In view of the higher fraud levels, associated with payment by EFT, disclosed by the fraud and error survey and the reviews in 2006, I enquired whether any consideration had been given to limiting the availability of the EFT method of payment. The Accounting Officer informed me that there are significant overheads involved in the production of paper-based payment instruments. PPO books covered periods up to 12 months, and where there were changes to customer circumstances that affected the rates of payment, books had to be recalled and reissued to the customer. This was a time-consuming process.

Aside from the overheads associated with paper-based payment methods, there were a number of drivers for the Department in moving towards EFT and other electronic forms of payment. These included

- The cost of EFT payments which was nominal at about €0.01 per transaction whereas PPO orders cost on average €1.21 and cheques cost €0.60
- The growing use of electronic payments in business and society generally
- The increase in the use of electronic banking and debit/credit cards on a personal level
- The Department's customer service strategy of offering customers a payment option that suits their needs
- Customer-driven initiatives in payment delivery agencies such as the recent launch of the An Post "Postbank" venture, providing expanded EFT outlets at some Post Offices.

Additionally, concerns have been raised recently regarding the high quality forgery of cheques. Although no forgeries have been detected in relation to PPO books, advances in technology mean that such forgeries may become a reality in the near future.

He stated that, at this juncture, there was no specific group of customers to whom the use of the EFT payment method was restricted. In cases where fraud/abuse comes to light, however, which was attributed to EFT as a method of payment, the facility to be paid by the EFT method might be removed.

Enhancing Control

Given the changes in the claimant base of the scheme, the Accounting Officer stated that the Department was considering a more segmented approach to both the control and review of its claimload and also the availability of payment options to some groups. The Department was currently enhancing its IT systems under the Service Delivery Modernisation programme to record the certification of non-Irish customers in terms of residency and employment status as appropriate. This would further enhance the scheme control capabilities in terms of non-Irish customers. These enhancements would be in place during the third quarter of this year and, coupled with the review policy being drafted would enable the Department to better focus control and review activity on selected areas *i.e.* EFT payments, specific customer groups, etc.

9.4 One Parent Family Payment Scheme – Control Activity

Introduction

The One Parent Family Payment (OPFP) scheme, administered by the Department of Social and Family Affairs (the Department), is available to parents/guardians bringing up at least one child without the support of a partner. The claimant must be unmarried, separated, divorced or the spouse of a prisoner with earnings of less than €375 per week. The income/assets of the claimant are subject to a means test.

Under the scheme, claimants are obliged to notify the Department if circumstances arise that render them ineligible for payment or that affect the rate at which they are paid.

Table 43 Annual cost and number of claimants since 2002

Year	Cost €000	Number of Claimants
2002	613,035	79,195
2003	660,586	79,296
2004	694,835	80,103
2005	751,102	80,366
2006	834,262	83,081

Up to 2001 the scheme was administered by the scheme office in SWS Sligo (SWS Sligo) using a claims registration and payments issue system known as the Penlive system. Since then, in the context of the Department's Modernisation Programme, a process of transferring claims to the Department's local offices (LOs) has commenced. Recording in these offices is on a more modern computer system – ISTS. This system has a mandatory requirement for a deciding officer to set a review date which falls within the following 12 months.[46] In contrast, while the Penlive system has a facility to insert a review date, it is not mandatory.

41 of the 58 LOs are now processing new claims. In addition, existing claims have been transferred to 4 LOs and it is intended that all others will be transferred in the coming months. The number of cases being administered by LOs at the end of April 2007 was 28,697.

Departmental Control Activity

The Department's control programme for OPFP is influenced by the results of a fraud and error survey conducted in 2002/3 which showed that OPFP was highly susceptible to incorrect claiming. On the basis of the survey, it was estimated that 13.6% of the claims should not have been in payment while a further 15.8% should have been paid at a lower rate.

Table 44 summarises the outcome of particular control activities undertaken in this area between 2004 and 2006.

[46] Formerly 18 months.

Table 44 Outcome of Selected Control Activity 2004-2006

Year	Number of cases reviewed	Number of Terminations	Number of Reductions
2004	4,024	2,300	779
2005	5,059	875	2,898
2006	5,586	1,075	1,216
Total	**14,669**	**4,250**	**4,893**

The Accounting Officer emphasised that these outcomes were based on very focused control activities conducted in SWS Sligo and that it had been anticipated that they would yield a high percentage of terminations and reductions. The projects included

- An Earnings Review Project that matches earnings data from the Central Records System with OPF payments. Priority was given to the review of customers with earnings exceeding €19,500. An additional 120 cases have been finalised to date in 2007 resulting in 90 terminations and 21 reductions.
- A Child Benefit Matching Project which involves matching child dependant data from OPF customers on the Penlive system with child data on the Department's Child Benefit System. Where mismatches are identified, claims are targeted for review. 30 terminations and 12 reductions have resulted from cases finalised in 2007.
- General Register Office (GRO) that matches marriage data with OPF claimants on Penlive. 109 terminations have resulted from cases reviewed to end May 2007.
- Local Review Projects undertaken or dealt with by outdoor staff. So far this year 131 terminations and 16 reductions have resulted from these reviews.
- General Reviews of which a further 4,310 were completed in the period January to May 2007 resulting in 607 terminations and 1,612 reductions. The vast majority of these reviews involved issuing the customer with the self-declaration questionnaire and over 3,700 of the claims involved have been transferred to ISTS, and as a result, will be reviewed annually using the system generated review form.

Earnings Review

A major element of the control programme is review of earnings. A project was set up in 2003 to review the cases of Social Welfare claimants identified, as a result of the review of P35s, as having earnings in excess of scheme qualifying limits. The result of its work on the scheme is shown in Table 45.

Table 45 Outcome for OPFP of Earnings Review Unit Activity

Year	Terminations	Reductions	Assessed Overpayments	
			Number of cases	Amount €m
2003	322	172	503	6.7
2004	1,597	82	1,339	16.9
2005	572	94	357	5.6
2006	499	55	281	3.6
Total	**2,990**	**403**	**2,480**	**€32.8m**

The average overpayment was €13,300 per case[47]. 1,017 cases were awaiting review at the end of 2006.

Commencement of Employment Notifications

Another key element of the control programme is review of work undertaken on foot of notification of commencement of employment by the Revenue Commissioners (Revenue). Since 1997 the Department has systematically received information from Revenue on earnings and commencement and cessation of employment. There has been increasing usage of this Revenue data in recent years for control purposes through programmed matching with the Department's own client records.

A Commencement of Employment notification (COE) is forwarded by an employer to Revenue in respect of any employee starting employment. OPFP claims were included in the COE data matching exercise from September 2001.

This data matching exercise, to identify possible overlaps between employment periods and OPFP claims, is carried out monthly by the Department. Where an overlap is detected, and the employer details correspond with the Department's master file of employers, the Department writes to the employer. The Accounting Officer informed me that, due to resource constraints in SWS Sligo and the Department's decision to prioritise cases where the employer details were available, cases where employer details could not be matched were not followed up in that office prior to January 2007. He added that the numbers of cases where the employer's details were not available has dropped considerably since February 2007 when a problem in the notification programme was fixed.

Table 46 summarises the Department's activity in relation to overlap cases.

Table 46 Activity in relation to overlap cases 2004 to 2006

Year	No. of questionnaires issued to employers	No. of questionnaires returned	No. of cases referred to SWS Sligo	Weekly Earnings €160-€220 employed/no longer employed [48]	Weekly Earnings >€220 no longer employed	Weekly Earnings >€220 employed
2004	15,642	13,656	7,372	3,989	1,007	2,376
2005	14,491	11,687	6,891	3,456	890	2,545
2006	13,076	10,858	6,477	2,741	990	2,746
Total	**43,209**	**36,201**	**20,740**	**10,186**	**2,887**	**7,667**

My examination found that referring the matter to the employer to confirm employment details leads to an average delay of approximately twenty weeks in initiating a review of the case. The process of case referral to SWS Sligo for review and contact with clients does not commence until confirmation of overlap and details of earnings have been received from the employer. The Accounting Officer has informed me that referring the matter to the employer is necessary to obtain details of earnings and to establish whether employment is continuing because the COE notification received from Revenue provides details of the commencement of employment date only.

[47] As calculated by the Department.
[48] Cases with weekly earnings below €160 are not considered as they are eligible for full entitlement.

I also noted that there were no arrangements for the follow up of cases where employers failed to respond to the Department's inquiries. The Accounting Officer informed me that, in the case of claims administered by the LOs, where the employer does not reply, the case is forwarded to Social Welfare Inspectors for further investigation. Prior to January 2007, cases administered centrally were not routinely pursued due to pressures of work and resource constraints. The Accounting Officer has informed me that, with effect from January 2007, all cases in which a reply is not received from the employer are reviewed and a questionnaire is issued to claimants to establish employment status.

The Accounting Officer has informed me that the difference of 15,461 between questionnaires returned by employers and cases issued to SWS Sligo for review is represented by cases where the claimant was no longer in employment or had earnings of less than €160 per week. He stated that these cases did not warrant further action as this level of earnings would not affect the rate of payment received.

Referred Overlap Cases

Review of referred cases commences by issuing a questionnaire to the claimant seeking information on all aspects of the claimant's continued entitlement. The claim is suspended if the claimant fails to reply within 21 days.

Referred overlap cases are divided into three categories as follows

- Weekly earnings €160-€220[49], employed/not employed
- Weekly earnings in excess of €220, not employed
- Weekly earnings in excess of €220, employed.

Only cases involving continuing employment with earnings in excess of €220 were considered for review up to the end of 2006.

I asked the Accounting Officer why all claimants with overlaps identified from the data matching exercise were not reviewed in SWS Sligo. He informed me that SWS Sligo, due to the number of notifications involved and in order to maximise the use of available resources, prioritised activity on those cases where the earnings were likely to result in a termination or significant reduction in benefit. As a result, the section focused its work on cases where the customers were in ongoing employment with earnings in excess of €220 per week. He also informed me that all overlaps, on cases administered by the LOs, that affected the level of payment are pursued and, since January 2007, all cases in SWS Sligo identified as having earnings greater than €160 per week are reviewed.

He stated that, by its nature, the scheme raises significant control challenges in a number of aspects. The Department must use the resources available to best effect in addressing instances where claimants abuse the system and continue to claim payments to which they are not entitled. He was satisfied that, in present circumstances, the Department was doing all that it could in this regard. In relation specifically to the employment issue, he pointed out that for many employments where persons in receipt of OPFP are working, earnings would not be stable and would be subject to frequent fluctuations.

[49] This is an arbitrary cut off rate chosen by the Department.

Backlog and Outcome of Reviews Undertaken

The Department prioritised 7,667 (Table 46) cases for review in the years 2004-2006. Just over 5,500 of these had been finalised at end 2006, leaving a backlog of 2,155 cases to be addressed. The outcome of the cases finalised by end 2006 is shown in Table 47 below.

Table 47 Outcome of Cases Finalised

Year	Total reviewed	Terminations	Reductions
2004	1,488	564	703
2005	2,212	755	891
2006	1,812	583	1,052
Total	**5,512**	**1,902**	**2,646**

The Accounting Officer has informed me that additional staffing resources have been deployed to deal with the backlog of cases on hands. At the end of June 2007 the backlog of 2,155 cases has been reduced to 1,162.

The average weekly saving, calculated by the Department, from terminated cases was €156 in 2005 and €173 in 2006. The average weekly saving in reduced cases was €37 in 2005 and €44 in 2006.

Audit Sample

The matching of COE data to the Department's client records and review of cases where there was evidence of concurrent working and claiming was examined by my staff. A sample of 40 finalised cases, 20 termination and 20 reduction cases, from 2005 and 2006 was selected for detailed examination and analysis of the results. Claimants' records dating back to 2002 were examined in the selected cases.

It was noted that no overpayments had been assessed by the Department in any of these cases despite the fact that in practically all cases payments had been made to claimants when they were not entitled to them under the terms of the scheme. As I was concerned that significant sums to be recovered were being forgone, I sought the views of the Accounting Officer.

He informed me that revised decisions are made by Deciding Officers and that, where a revised decision is made by reason of a customer giving false or misleading statements or by reason of the wilful concealment of a material fact, the revised decision may take effect from the date of the original decision. However where a revised decision is made in the light of new evidence or new facts being brought to the attention of the Deciding Officer, the decision is effective from the date the Deciding Officer considers appropriate. Consequently the question of whether or not an overpayment arises is determined by the provision of the Social Welfare (Consolidation) Act, 2005 (the Act) under which the decision is made by the Deciding Officer.

The Accounting Officer has informed me that the question as to whether a decision to revise the rate of payment in a particular case should apply from a previous date and, consequently, whether an overpayment arises must be decided by the Deciding Officer having regard to the circumstances of the case. A delay in matching earnings data already available would be a factor to be taken into account in this regard.

He also stated that not all cases coming to light as a result of COE matching are regarded as fraud cases and, in some circumstances, the Deciding Officer may decide that it would be appropriate that the revised decision would take effect only from a current date. In such cases, no overpayment arises.

It was the Department's experience that, in cases where the decision was applied from an earlier date and an overpayment raised, a large number of appeals were lodged against the overpayment. This delayed the process and absorbed a substantial number of staff resources, which would otherwise have been deployed on control work, in responding to these appeals.

New Review Policy

I enquired of the Accounting Officer if the Department had a comprehensive review policy for the scheme and, if so, how regularly it provided for all claims to be reviewed.

He informed me that the Department had introduced a formal review policy for claims administered in its LOs in May 2007. Furthermore, with effect from January 2007, all customers who were reviewed (including COE cases) were transferred to the ISTS system on completion of review. The ISTS system generated an annual review of all customers. In the context of the localisation of the scheme, enhanced control measures had been put in place, which included the issue of a questionnaire annually to ensure compliance. A further feature of the enhanced controls is the comprehensive review policy that provides for a face-to-face interview with each claimant once every three years.

Furthermore he assured me that, with effect from 1 June 2007, overpayments are assessed in SWS Sligo as warranted by the circumstances of each individual case. This brings it into line with practice in the LOs.

9.5 Advance payment of grant to Sustainable Energy Ireland

Background

Sustainable Energy Ireland (SEI), formerly the Irish Energy Centre, was set up in its present form by the Government in 2002 as Ireland's national energy agency. It operates under the aegis of the Department of Communications, Marine and Natural Resources. The Department of Social and Family Affairs' (the Department) relationship with SEI and its predecessor, the Irish Energy Centre, derives from recommendations made in the 1999 Green Paper on sustainable energy and approved by the Government at that time. These called for co-operation between the Department and the Department of Communications, Marine and Natural Resources in relation to fuel poverty.

Budget 2006 provided for a grant of €2m to SEI for fuel poverty research. The rationale for the grant was that, while the Department was making considerable payments to people to meet their heating needs through primary social welfare payments and the Fuel Allowance scheme, the benefit of these payments was considerably offset where people were living in poorly insulated homes. The grant to SEI was incorporated in the 2006 published Estimates as subhead W13 in the Miscellaneous Services subhead.

SEI's initial proposal for use of the grant was submitted to the Department in March 2006 and, following discussions, a revised proposal was submitted by SEI in July 2006. This proposal was approved by the Department.

The Budget grant was intended to complement the Fuel Poverty Action Research Project being carried out in Cork and Donegal in a joint operation funded by SEI and the Combat Poverty Agency. SEI proposed to utilise the grant by undertaking a project for owner occupied dwellings in Waterford city and county – an area regarded as vulnerable to fuel poverty. The work proposed included both insulation and heating measures. The grant was to cover the cost of setting up the project, arranging for remedial work to be carried out on approximately 460 houses, conducting research surveys, analysing the resultant data and submission of a formal report. Waterford was chosen because it provided a suitable population base for the project and also because SEI's main programme, the Warmer Homes Scheme, did not operate there.

Payment of Grant

Sanction was requested from the Department of Finance in August 2006 for full release of the €2m grant; it was received in early September and payment was made shortly afterwards. The bulk of the expenditure was to be expended on labour and materials required to undertake the remedial works. The grant was paid in one instalment as the project was viewed by the Department as a single, once-off programme. At the time of issue of the grant, it was anticipated that work on the programme would commence immediately. As it turned out, the research did not commence as quickly as expected and no expenditure on the project was incurred by SEI in 2006.

As *Public Financial Procedures* require that Departmental payment arrangements should have ensured that, prior to payment of the grant being made, expenditure would be incurred within the year, I asked the Accounting Officer why the grant was paid to SEI without any evidence that it was likely to be expended in 2006. I also requested a monthly schedule of all expenditure made to date by SEI on the project.

In reply the Accounting Officer informed me that he accepted that the correct process was not followed in regard to this payment to SEI. The grant should not have been paid until the work on the home improvements was about to commence. Furthermore, it would have been appropriate to pay these moneys to SEI on a phased basis as elements of the work were completed. The payment of the grant in

this instance was an exceptional event and payment of grants was no longer a feature of the Department's work to the same extent as in the past. Nevertheless, it was important that the correct procedures be followed in all cases of this kind. He stated that he was arranging for the grant disbursement process to be revised to ensure that staff are aware of the requirements in this regard.

He also informed me that, as at the end of June 2007, €145,553 had been expended on the project by SEI with a further €49,164 committed. The installation work was, at that stage, fully underway with an expected finish date of August 2007. Final invoices were expected to be processed in September 2007 and a report would be compiled in late 2007.

Appropriation Account

As this amount of €2m was charged to Subhead W in the 2006 Appropriation Account originally submitted to me for audit, it was necessary to amend the account by reducing the charge to the subhead and charging the amount to suspense pending expenditure in 2007.

Chapter 10

Health Service Executive

10.1 Control and Sanctioning of ICT Expenditure

General Arrangements

All the expenses of a Department paid from money provided by the Oireachtas are required to be sanctioned by the Minister for Finance. *Public Financial Procedures* provide that sanction may be either

- Specific – sanction related to a particular once off proposal or
- Delegated – general sanction to a Department or Office to deal with clearly defined cases without further recourse to the Department of Finance.

Public Financial Procedures also provide that where there is general delegated sanction in relation to a particular category of expenditure, it is the responsibility of the Department concerned to ensure that any expenditure falling within that category is properly covered by the sanction.

Upon its establishment on 1 January 2005, the HSE became subject to the requirement that it receive the sanction of the Department of Finance for all expenditure. The Minister for Finance sanctioned current expenditure by the HSE for 2006 up to a maximum amount of €11.8 billion – the amount of the Revised Estimate for 2006 – and expenditure on agreed capital projects up to a maximum of €555.5m.

ICT expenditure is subject to a particular sanctioning regime, which is set out in Circular 16/97 "New Delegation Arrangements for IT Related Expenditure (including Office Machinery)". Previous delegation arrangements in relation to IT-related expenditure were based in the main on preset spending limits set out in Administrative Budget Agreements. The intention of the Circular was to provide for a more coherent arrangement for delegation, within agreed spending limits, of IT-related expenditure, subject to appropriate controls being in place in Departments.

In order for the Department of Finance to operate the delegated sanction arrangement with a Department the following requirements must be met

- The Department must have a current ICT strategy covering the management of information, systems and applications and technical infrastructures. This should cover a period of 3-5 years. It must be updated regularly and the Department of Finance kept informed of updates.
- Formal project management and governance arrangements must be in place for all projects.
- A total figure for the Department's planned ICT expenditure in the following year must be provided by end-November (the Part I return).
- A detailed breakdown of planned current year ICT expenditure must be provided by end April each year (the Part II return). The planned figure must be within the amount agreed during the estimates/budgetary process.
- A detailed breakdown of actual previous year ICT expenditure must be provided by end April each year.
- A Succinct Impact Statement must be provided for any new ICT project and revised as appropriate during its lifetime.
- There must be adherence to guidelines on procurement and the expenditure of public moneys.

The expenditure information provided must be analysed between new projects, existing projects and non-projects. The costs associated with each must be further analysed over a number of headings such as hardware, software, telecommunications and consultancy.

In this context, "project" refers to business projects which aim to realise the objectives and business plans contained in the organisation's strategy statement. A typical example of a business project would be the improvement of Human Resource management, requiring the purchase and installation of a new personnel package.

Non-project expenditure is all ICT expenditure not associated with a specific business project and covers a wide range, including replacement of hardware and software, office machinery, telecommunications services, IT-related training, maintenance, consultancy and outsourcing. Typically, it would include the ongoing enhancement and maintenance of ICT infrastructure.

If the Department of Finance is satisfied, it will issue an Annual Delegation Certificate. Expenditure should only take place by the spending Department on the basis of an Annual Delegation Certificate or where specific sanction has been received for that expenditure.

Control and Sanctioning of ICT Expenditure in the HSE

The arrangements for securing sanction require the HSE to submit expenditure proposals to the Department of Health and Children. That Department is required to evaluate them and submit its analysis and recommendations to the Department of Finance.

In the early part of 2005 the HSE set about making the detailed ("Part II") return of its planned ICT expenditure for 2005 to the Department of Health and Children with a view to obtaining delegated sanction. In the event, discussions with the Department of Finance continued throughout the year so that sanction for project expenditure of €27.8m only issued on 16 November 2005. Sanction for non-project expenditure of €41m only issued in April 2006.

Arising out of its discussions with the Department of Health and Children and the HSE during 2005, the Department of Finance wrote to the Acting National Director of ICT of the HSE on 16 September 2005 setting out key governance and technical principles, which the HSE would be required to commit to as specific agreed goals as part of the delegation process.

The governance principles were

- One ICT Steering committee for making priority and activation decisions in relation to all major project proposals.
- One central source of decision making in relation to implementing ICT strategies, ICT plans and ICT projects who would also be the normal interface for Circular 16/97 purposes with the Department of Health and Children and with the Department of Finance (IS Director).
- Project boards for every significant project, reporting to the ICT Steering Committee and using a project management methodology chosen by the HSE and using the capital appraisal guidelines issued by the Department of Finance.
- Compliance with 16/97 delegation sanction requirements for all ICT spend, regardless of the source of funding.
- A peer review gateway process in place for all major projects.
- One central management point under the control of the IS Director for all purchases of hardware, software, telecommunications, ICT Development or advisory services in all of the HSE including hospitals, medical centres etc. under its funding control.

- No further delegation of ICT spending authority within the HSE.
- All hiring decisions in relation to ICT contractors and ICT consultants under the control of IS Director, regardless of funding sources.
- All tenders for ICT products or services to be approved and advertised by the IS Director and in compliance with a specific 16/97 sanction.
- All HSE developments to comply with central guidelines – actual or emergent.

The technical principles were designed mainly to ensure that the HSE's systems were, as far as possible, properly integrated and designed on a national basis and that shared platforms/services within the HSE, across the public service and with the private sector were maximised, as appropriate.

The Department's letter made it clear that the principles applied not alone to the HSE's own direct ICT expenditure, but also to expenditure in hospitals and other facilities under the HSE's funding control and extended both to administrative ICT systems and medical ICT systems.

Sanction of 2006 ICT Expenditure

In early 2006 the HSE commenced the process of seeking delegated sanction for 2006 ICT expenditure. It indicated in January 2006 that there were certain areas of expenditure that were traditionally outside the remit of ICT – such as telephony and communications generally, including the emergency services – but which came within the terms of the delegated sanction arrangement. It undertook to begin a process to validate and consolidate, where necessary, the 2006 planned ICT expenditure. However, on 9 June 2006, the Department of Finance withdrew delegated sanction arrangements with the HSE on the grounds that there were difficulties in verifying the actual ICT expenditure by the HSE in 2005 and in establishing the planned expenditure for 2006. The Department stated that the HSE would be required to obtain sanction for ICT expenditure in 2006 on a case-by-case basis.

The HSE made seven submissions in relation to planned expenditure for 2006. Table 48 shows a breakdown of each submission between new projects, existing projects and non-project expenditure.

Table 48 Submissions re ICT Expenditure 2006

	30.11.05	**31.03.06**	**28.04.06**	**16.08.06**	**13.10.06**	**01.11.06**	**10.11.06**
	€m	**€m**	**€m**	**€m**	**€m**	**€m**	**€m**
New Projects	31.8	18.7	18.7	63.1	112.9	32.6	25.8
Existing Projects	49.0	35.2	36.6	54.2	40.2	50.0	50.2
Non-Projects	45.1	51.9	52.0	62.7	58.4	58.4	58.4
Total	**€125.9m**	**€105.8m**	**€107.3m**	**€180.0m**	**€211.5m**	**€141.0m**	**€134.4m**

As the table illustrates, the level of planned expenditure under each heading fluctuated considerably over the period. In the event, the level of expenditure actually reported for the year differed from that planned in all three categories – €689,274 for new projects, €21.5m for existing projects and €63m for non-project expenditure.

On 11 December 2006, the Health Service Executive received sanction for ICT expenditure as follows: New Projects €5,525,848, Existing Projects €30,627,240 and Non Project Expenditure €58,426,044 for 2006 subject to the following general conditions

- All procurements should comply with General Procurement conditions set out in the Appendix to Circular 16/97.
- Formal and appropriate arrangements should be used for the control of business projects and the monitoring of compliance procedures.
- All projects should conform to the technical and information architectures being adopted by the HSE and the HSE should comply with the Governance and Technical Principles for ICT Developments detailed in the Department's letter of 16 September 2005.
- The HSE, when reporting actual expenditures in line with the requirements of Circular 16/97 should detail the source of all ICT expenditures in 2006.

On 21 December 2006, the Department of Finance sanctioned additional expenditure up to a maximum of €1,520,640 on ICT consultancy for PPARS. This related to production support, the delivery of a stable environment, and the automation of existing processes and it brought the total sanctioned for existing projects to €32,147,880.

Circular 16/97 Returns – 2006

As required by the provisions of Circular 16/97, the HSE made a return to the Department of Health and Children on 1 May 2007 giving a detailed breakdown of actual ICT expenditure for the year 2006. This return showed a figure for non-project expenditure in 2006 of €63,017,248 – an amount which exceeded the sanctioned amount of €58,426,044.

In the letter accompanying the return, the Head of ICT explained that there were difficulties in extracting the information required for the 16/97 returns from the consolidated reporting system, which produces the consolidated accounts, as it does not provide the level of detail required. The returns are completed by the local ICT functions and are amalgamated by the ICT Directorate for submission as a single return to the Department of Health and Children and the Department of Finance. Further difficulties arise within the various Health Areas, due to different coding and processing systems in use.

This return was examined in the course of the audit and was found to be deficient in a number of respects

- In a number of instances, significant amounts were either misclassified or were classified under one heading when seeking sanction but under a different heading when reporting the outcome.
- Some costs that did not come within the terms of the Circular were included in error and some costs were included twice.
- Some categories of expenditure were not analysed in the level of detail required by the return, as the general ledgers of some HSE Areas do not facilitate the breakdown of expenditure into the relevant categories.

In summary, it appeared that the inconsistencies of treatment of expenditure and the level of error were so significant as to greatly limit the value of the return for control purposes. This, in turn, called into question the basis of the original figures compiled for the purposes of seeking sanction.

Non-Compliance with Case-by-Case Sanctioning Requirement

Notwithstanding the requirement that ICT expenditure be sanctioned in advance on a case-by-case basis, the HSE issued requests for tenders for a number of projects without obtaining sanction. These were for

- Strategic ICT Consultancy (July 2006)
- Staff Scheduling & Time Management (October 2006)
- Asset Management System (October 2006)

The latter two requests for tender were issued without the approval of the Acting Director of ICT and were subsequently cancelled.

Requests for tenders continued to be issued in 2007 by agencies under the HSE's funding control, where sanction had not been obtained. For example, St. James's Hospital published a tender for an Emergency Department clinical information system in March 2007 and a tender for telephony services on 1 June 2007.

Unsanctioned Expenditure

The 2005 sanctions for ICT expenditure specifically excluded any developmental expenditure on the PPARS system, although as noted in my report to Dáil Éireann, *Development of Human Resource Management System for the Health Service (PPARS)* December 2005, significant expenditure had been incurred on the system in 2005. This expenditure remains unsanctioned.

The Accounting Officer confirmed to me in July 2007 that the figure of €63,017,248 for 2006 non-project ICT expenditure cannot be regarded as a final figure and that discussions are ongoing with the Department of Finance regarding the 2006 sanction.

Furthermore, I note that certain project expenditure charged to the 2006 Vote expenditure has not been sanctioned in accordance with the requirements of Circular 16/97 *viz.*

- €522,000 on miscellaneous projects authorised prior to 2005 in accordance with the procedures then in force in the former health boards but where payments were not made until 2006
- €1,103,000 in relation to the FISP accounting system, of which €422,000 related to expenditure incurred in 2005 but paid for in 2006 and charged to the 2006 Vote
- €4,634,000 on costs related to PPARS which were incurred in 2005 and accrued in the 2005 financial statements but paid for and charged to the 2006 Vote.

Audit Concerns

In view of the foregoing, I was concerned that

- The HSE did not have systems, procedures and practices in place that would allow it to control its ICT spend effectively and enable it to comply properly with the requirements of the Department of Finance in relation to the sanctioning of ICT expenditure
- The variations in the sanctions sought during 2006 appeared to indicate the absence of a coherent ICT strategy and a lack of linkage to the estimates/budgetary process
- ICT governance in the HSE may not comply with the principles set out by the Department of Finance in its letter of 16 September 2005.

I asked the Accounting Officer for information on

- The action taken by the HSE to enable it to comply with the Department of Finance's sanctioning arrangements in relation to ICT

- The circumstances in which the unauthorised requests for tenders referred to earlier had issued, and the action taken to prevent a recurrence
- The action taken to develop an ICT strategy and to put in place a supporting budgetary and management reporting framework
- Progress in implementing the governance and technical principles set out in the Department's letter of 16 September 2005.

Accounting Officer's Response

Action Taken to Comply with the Department of Finance's Sanctioning Arrangements in relation to ICT

During 2005 the HSE began to put in place arrangements for complying with the Department of Finance sanctioning requirements. The Acting National Director of ICT assumed overall responsibility in this regard and requested the ICT Departments of the former Health Boards to make the required submissions to him. Resources were assigned in his office to collate the information and prepare it for submission to the Department of Finance. These arrangements have continued and have been strengthened since then.

With the appointment of a new Head of ICT in November 2006 one of the existing Directors of Information Systems was assigned lead responsibility on an interim basis for the ICT Directorate's Programme Office, which included responsibility for submission of sanction requests to the Department of Finance. Therefore, from the outset, responsibility was assigned within the ICT Directorate to ensure that all expenditure sanctioning requirements were met.

During 2006, the arrangements that had been put in place within the ICT Directorate the previous year continued. On any occasion that the Acting National Director of ICT became aware of potential situations where unauthorised expenditure might occur he took steps to prevent it.

In 2007, the Head of ICT issued a number of communications to the management team within the HSE clearly advising of the requirements for prior sanction for all ICT-related expenditure. This was circulated to line managers within the HSE. It was also circulated, through the National Hospitals Office, to all the major voluntary hospitals that have significant expenditure on ICT.

An ICT Expenditure Review Group with senior ICT and Finance management representation was established by the Head of ICT and the Director of Finance in 2007. It includes representatives from Corporate Finance, Shared Services and the ICT Directorate. The group is undertaking a review of 2007 ICT expenditure transactions, both revenue and capital in the former health board areas. The Group will make recommendations on the following

- Coding of ICT expenditure in the accounting system having regard to the reporting requirements of the Department of Finance in relation to non-project expenditure
- ICT budgetary process
- Procedures for processing revenue and capital ICT expenditure
- Financial reporting of both revenue and capital expenditure.

It is anticipated that the Group will produce a final report by the end of September 2007 with a view to implementing recommendations where feasible before the end of the financial year. Some recommendations have already been put in place.

The HSE has developed a report to record capital expenditure and payments by project, by HSE Area, by pillar. This report is prepared manually. All HSE Areas prepared this report for December 2006. The reports were consolidated and the ICT capital payments figure was reported in the 2006 Appropriation Account.

However, the absence of a national financial system prohibits ICT revenue payment reporting. Different areas of the HSE are operating legacy financial systems which are not configured to provide the level of detail required in order to report ICT revenue payments under the specific categories identified as non-project type transactions. On completion of the recoding exercise for 2007, information will be available on an income and expenditure (accruals) basis for all non-project expenditure under the headings set out in Circular 16/97. Considerable further manual intervention will be necessary to restate these income and expenditure figures if they are required on a Vote basis. A business case is being developed to support the development and implementation of a national financial system which will meet the HSE's Vote reporting requirements as well as fulfilling the Department of Finance requirements under Circular 16/97.

Unauthorised Requests for Tenders

Of the five requests for tenders mentioned, three were issued by the HSE and two were issued by St. James's Hospital. The three HSE tenders date from 2006 and occurred because of a genuine lack of understanding of the requirements of Circular 16/97 by the personnel concerned.

As a result of changes to the HSE senior management team in mid 2006 and the requirement for the strategic development of the ICT and Procurement Directorates, tenders were issued for corporate strategic advice on ICT and Procurement in July 2006. It was recognised by both the Chief Executive and the HSE Board that the ICT Directorate needed to be strengthened and this was one of the actions identified to achieve this.

The two other unauthorised requests for tenders - for an Asset Management System and a Staff Scheduling & Time Management System - issued in the context of equipping/commissioning the new Cork University Maternity Hospital. The proposed Staff Scheduling & Time Management System was identified as an important requirement by the Commissioning Group for the new hospital, given the complexities around staff scheduling, where staff from a number of existing hospitals were transferring to work in the new hospital and would need to be scheduled for duty in an equitable fashion providing the correct skill mix across the units on a shift by shift basis. The Commissioning Group were concerned to have the new system in place in time for the opening of the new hospital and mistakenly thought that it would be in order to proceed with the procurement process in parallel with seeking approval for the expenditure.

The HSE ICT Directorate was not aware of the Commissioning Group's decision in this regard until after the procurement was advertised. At that point, the ICT Directorate raised the matter with hospital management and the procurement process was terminated without delay. The strict requirement to have sanction from the Department of Finance in place in advance of the commencement of the procurement process was not fully understood at hospital level at that time. This is now fully understood by all concerned arising from the action taken by the ICT Directorate at the time.

A letter was issued by the Head of ICT in 2007, through the HSE Management team, reminding all managers of their obligations with regard to ICT procurement and the serious manner in which noncompliance will be treated. In addition, the Procurement Directorate has appointed a nominated manager, who will have responsibility for all ICT procurements within the HSE. A senior member of the

ICT management team has also been nominated to authorise all ICT procurements prior to publication on eTenders.

Both of the St. James's Hospital procurements were initiated without the prior knowledge or approval of the HSE. In both cases, the HSE has taken up the matter with the Hospital and requested that the procurements be put on hold until the appropriate sanctions are put in place. The HSE continues to engage with the Hospital to bring it into line with the requirements for prior sanction in advance of initiating procurements. Both the Head of ICT and the National Director, National Hospitals Office are in discussions with the Hospital on this matter.

While there have been some difficulties with the voluntary and non-statutory sector in complying fully with requirements for prior sanction, it is important to recognise that in the acute hospitals sector alone there are 17 independent voluntary and non-statutory hospitals in total. The vast majority are complying fully with the sanction requirement, despite the significant change in practice for them and the perceived removal of flexibility for the operation of their services. There are several hundred voluntary agencies funded by the HSE.

Further work is required with the voluntary sector and a new service level agreement, which is being introduced in 2008 for voluntary and non-statutory bodies, will specify the requirement for compliance with the ICT sanction process.

Developing an ICT Strategy

The question of the HSE's ICT strategy must be seen in the context of previous work done in advance of establishment of the organisation. Upon its establishment on 1 January 2005 the HSE took over the responsibilities of 17 separate organisations. During 2004 significant ICT strategy development work had been completed by the Health Boards Executive (HeBE). This was expected to provide the strategic direction for all ICT development across the former health boards and other related agencies for the period 2005- 2011. This was set in the context of the National Health Information Strategy (NHIS), which had been published by the Department of Health & Children in 2004. In addition, an ICT strategy for Primary, Community and Continuing Care (PCCC) services had been further developed with the assistance of management consultants.

All this previous ICT strategy work had been done on a whole health system basis – *i.e.* a national approach was taken, as opposed to any individual organisation or region. The establishment of the HSE did not change the strategic context, rather it put in place a single organisational structure, which in fact would be expected to better facilitate the delivery of the strategic agenda. The focus, therefore, since the establishment of the HSE has been more on unifying the ICT organisational structure and establishing appropriate new governance arrangements rather than on fundamental review of other ICT strategy elements.

In this context the following actions have been taken

- In November 2006, a consultancy company was appointed to provide strategic ICT consultancy to the HSE. The purpose of this consultancy is to ensure that best in class strategies and approaches are implemented throughout the HSE. The consulting company worked initially with ICT management to review and assess the current state of ICT within the HSE and also within the voluntary and non-statutory healthcare sector and they have continued to be involved in the definition of the new ICT management structure and the identification of the major development priorities.
- Since November 2006, the HSE has put in place an ICT Steering Group. The key purpose/role of this group is as follows:

  "To oversee planning of, promote and prioritise HSE investment in ICT and control its implementation and deployment throughout the organisation via the ICT Directorate in a manner

> which assures related projects/processes are delivered as designed within agreed budgetary and timeframe parameters and that benefits (including transformation and business improvements) identified for such projects/processes are fully realised."

The ICT Steering Group which is chaired by the National Director, National Hospitals Office is effectively a sub-committee of the senior management team with some additional external expertise. ICT management has been reporting to this group on progress and on proposals for development.

- Following on the review of the current ICT status, a proposal for the organisation and structure of ICT within the HSE has been developed. The proposed structure has been discussed with the current ICT management team and it has been agreed with the CEO and the senior management team. This new structure represents a significant part of the overall ICT strategy.
- With regard to more immediate planning requirements, members of the current ICT management team have been assigned specific responsibilities until the new structure has been established, with a view to improving the coherence of short-term plans.
- As part of the new management structure it is proposed to have a Programme Office to provide an overview of all the ICT development activity across the organisation. Steps are under way to get this Programme Office in place even while the new organisation structure is being established. The position of head of the Programme Office has been advertised and, in parallel, tenders have been sought from appropriate consulting firms to establish the Office and get it operational. In parallel with this activity, a group within the ICT directorate has been developing a project lifecycle approach to be applied to all ICT projects.
- Since autumn 2006, the HSE has adopted the Transformation Programme, a significant package of business change projects and this whole programme represents the vehicle to deliver on the HSE business strategy. In parallel, the ICT Directorate has been developing a prioritised list of major projects to support the business. In keeping with the principle that the business strategy should drive the ICT strategy, the Transformation Programme has been decisive in developing this prioritised list. The selection of priority projects has been influenced also by previous ICT strategy work, as mentioned earlier (NHIS, HeBE's ICT Strategy, PCCC ICT Strategy). The ICT strategy work carried out by the Dublin Academic Teaching Hospitals has also been influential. The process of developing the priority list of major projects is ongoing.

It is recognised that the HSE needs to develop a comprehensive longer term ICT strategy covering a 5-10 year period. Given some of the recent difficulties within ICT in the health sector, priority is being given in 2007 to improving the manner in which ICT is organised and managed while progressing some major priority projects that have stalled in recent years.

It is planned to commence development of an ICT strategy in 2007 with a view to completing it in 2008. Based on evidence from other countries, such as Denmark and England, it is vital that the strategy development process is inclusive of all stakeholders and sets a direction for a significant period of time.

Governance Principles and Technical Principles – Current Status

The Accounting Officer said that the Head of ICT had reported to the Department of Finance in June 2007 on the progress made within the HSE on the implementation of the governance and technical principles. Significant progress had been made in 2007. At this point he could confirm that, as required by the governance principles, the following were in place

- *One ICT Steering committee*

- *One central source of decision making in relation to implementing ICT strategies, plans and projects i.e. the Head of ICT*
- *Project boards for every significant project using a common Project Management Methodology. A methodology implementation group, representative of voluntary hospitals in addition to the HSE, is currently being set up to develop guidelines for its usage within the health sector.*
- *A peer review gateway process for all major projects.*

  A peer review process is being put in place as each project that requires it emerges. In addition, peer review principles are being applied to projects that do not require external peer review.

- *No further delegation of ICT spending authority within the HSE.*

  In addition, the HSE is currently in discussions with the voluntary and non-statutory bodies as to the feasibility of including their ICT non-project expenditure within the HSE 16/97 return.

- *All ICT development staff and ICT operational staff under the control of the IS Director*
- *All hiring decisions in relation to ICT contractors and ICT consultants under the control of the IS Director, regardless of funding sources*
- *All HSE developments to comply with central guidelines.*

  The ICT Directorate is supporting any appropriate central guidelines as they emerge, *e.g.* Framework agreements, REACH and Data Centre project.

In relation to the remaining principles, the Accounting Officer reported as follows

- *Compliance with 16/97 delegation sanction requirements.*

  This is in place. Known and emerging difficulties with adherence by the wider health system are being addressed. The Expenditure Review Group has been set up to identify and resolve control and reporting difficulties

- *One central management point under the control of the IS Director for all purchases of hardware, software, telecommunications, ICT Development or advisory services in all of the HSE including hospitals etc. under its funding control.*

  Central management processes are in place for all ICT procurement contracts directly controlled by the HSE. There are issues which need to be dealt with in relation to the authority of independent and voluntary agencies, funded by the HSE, to enter into procurements without the approval of the HSE.

- *All tenders for ICT products or services to be approved and advertised by the IS Director and in compliance with a specific 16/97 sanction*

  All tenders for ICT within the HSE now come through a nominated senior manager in the ICT Directorate. It has also been agreed with the HSE management team that this arrangement will be extended to include all voluntary organisations funded by the HSE.

As regards the technical principles put forward by the Department of Finance, the Accounting Officer said that resulting from a strategic review of its ICT infrastructure, the HSE has identified that it needs to initiate a series of major projects to unify the healthcare ICT Infrastructure. One of the earliest programmes of work that will be needed is the completion of a single technology plan that will, *inter alia*, plan for a single technical (including networking), information and applications architecture for the HSE. It is intended that the technical principles espoused in the letter of 16 September 2005 will be fully reflected in the technology plan and the range of implementation projects that will give effect to it.

Action Taken – Accounting Officer's Summary

The Accounting Officer confirmed that the HSE is committed to full compliance with the requirements for control and sanction of ICT expenditure as set out in the Department of Finance Circular 16/97 and that it will continue to improve its internal systems, processes and procedures to address any weaknesses that exist in this regard.

The review of ICT undertaken in the first four months of 2007 has resulted in a number of recommendations which will improve the sanction process including

- New ICT governance arrangements have been put in place since the start of this year and these are in compliance with the principles set out by the Department of Finance letter in September 2005
- Implementation of a new organisation structure for ICT that has a strong corporate ICT division
- Introduction of a corporate ICT Programme Office that will assume responsibility for ICT performance management – including budgeting and reporting
- Working group to implement improvements in how ICT expenditure is planned, recorded and reported within the HSE to enable greater visibility of ICT expenditure.

The Accounting Officer said that it was important to set the issues and concerns raised during the audit in the overall context of the establishment and development of the HSE. Upon its establishment the HSE became immediately subject to the terms and conditions associated with Vote Accounting. The HSE had subsumed the roles of the former Health Boards, Eastern Regional Health Authority, Health Boards Executive, General Medical Services Payments Board, Health Services Employers Agency, National Disease Surveillance Centre as well as a number of other formerly independent statutory agencies. This resulted in a range of strategies, systems, processes, procedures and approaches having to be amalgamated into a single financial control and reporting system for the HSE. Reporting, in the manner required by Circular 16/97, has proved enormously challenging over the last two years in the absence of a single financial management system.

It is clear that the process within the HSE for compiling consolidated statements of planned and actual expenditure on ICT can be improved. However, it is important to state that while the HSE has experienced problems with compiling the consolidated statements he was satisfied that ICT expenditure has been appropriate and that value-for-money has been obtained.

While the audit raised some concerns about requests for tenders being issued without prior sanction of expenditure by the Department of Finance the small number of these must be seen in the overall context of the scale of the HSE's operation. Also, the majority of voluntary and non-statutory agencies, of which there are over one hundred, are complying with the revised ICT procurement rules.

A number of actions have been taken in 2007 to improve compliance on ICT tendering including

- Nominated ICT Senior manager to approve all ICT tenders in the HSE
- Nominated procurement manager responsible for coordinating all ICT tenders
- Letter to all line managers in the HSE highlighting consequences of non-compliance
- Compliance with circular 16/97 will form part of the formal service level agreement to be introduced between the HSE and voluntary / non-statutory agencies for all services in 2008.

A short-term plan/strategy for 2007/2008 has been put in place while a longer term strategy covering the next 5/10 years is developed. For 2007/2008 the priorities have been identified as

- Re-organisation of the former health board ICT structures
- Improving how ICT programmes and projects are managed through a series of actions
- Progressing critical programmes and projects, for example diagnostic imaging and laboratory management systems.

While there have been some difficulties, since the requirement for compliance with circular 16/97 was introduced two years ago, the Accounting Officer said that he was confident that the actions currently being progressed will not only improve compliance but are necessary so that the HSE has full oversight of its investment in ICT to support patient care.

Views of the Department of Finance

I also sought the views of the Accounting Officer of the Department of Finance. He indicated that sanction for ICT expenditure is still provided on a case-by-case basis and that this position will be maintained pending the establishment of new governance and accountability arrangements for ICT by the HSE. He said that, in addition to the new governance arrangements which are being put in place, it is also essential that the HSE develops an ICT Strategy which will inform its Administrative and Patient Care Systems development over the next number of years. This strategy should determine its work programme and priorities going forward, as well as allowing for improved planning and ensuring better value-for-money.

The Accounting Officer said that he was aware of the difficulties caused by lack of a proper Financial Management System and that he shared my concerns in this regard. He understood that the HSE is currently reviewing the position with a view to determining its immediate and longer-term requirements. He said that his officials would engage, as a matter of urgency, with the Department of Health and Children and the HSE on any proposals which they bring forward.

Chapter 11

National Treasury Management Agency

11.1 National Debt

The National Treasury Management Agency has the statutory function of borrowing moneys on behalf of the Exchequer and managing the National Debt on behalf of and subject to the control and general superintendence of the Minister for Finance.

Expenses incurred by the Agency in the performance of its functions are met from the Central Fund. The Agency incurred expenditure of €24.4m on administration in 2006 (€19.9m in 2005).

Under the provisions of section 12 of the National Treasury Management Agency Act, 1990 I am required to audit the accounts of the Agency and when making my statutory annual report on the Appropriation Accounts, to make also a report to Dáil Éireann regarding the correctness of the sums brought to account by the Agency in the year. The Agency's accounts for 2006 have been audited and the accounts, including an administration account and accounts relating to the National Debt, have been presented to the Minister who has laid copies thereof before both Houses of the Oireachtas.

I am satisfied that the accounts properly present the transactions of the Agency in 2006 and its balances at year end.

Table 49 shows the outturn for the National Debt in the five-year period 2002-2006.

Table 49 National Debt 2002 – 2006

	National Debt Outstanding €m	Debt Service Cost €m
2002	36,361	2,169
2003	37,610	2,277
2004	37,846	2,203
2005	38,182	2,238
2006	35,917	2,379

The composition of the National Debt[50] at 31 December 2006 is shown in Table 50.

Table 50 Composition of National Debt as at 31 December 2006

	€m
Medium/Long term Debt	31,816
Short term Debt	2,779
National Savings Schemes	4,910
Less: Domestic Liquid Assets	(3,588)
National Debt	**€35,917m**

[50] The National Debt is stated on the basis of nominal amounts of principal originally borrowed.

11.2 Savings Bank Fund

The audit of the Post Office Savings Bank is carried out on my behalf by the auditors of An Post subject to my right to carry out further audit tests which I consider necessary.

In 2007 they reported to me on their audit of the 2006 accounts. I accept their opinion that the accounts of the Post Office Savings Bank give a true and fair view of its transactions for that year-end and of its year-end balance.

In addition to managing the National Debt, the National Treasury Management Agency is responsible for the investment and management of funds remitted to the Exchequer by the Post Office Savings Bank. The Exchequer is responsible for the repayment to the Bank of all such funds and for meeting interest charges thereon.

The state of affairs of the fund at year-end is shown in Table 51.

Table 51 Post Office Savings Fund

	2006 €m	2005 €m
Liability in respect of funds due to depositors and creditors	1,551	1,489
Value of related investments held by Post Office Savings Bank Fund (at cost prices)[51]	1,561	1,499
Surplus at 31 December	**€10m**	**€10m**

[51] The market value of the investments held by the Fund was €0.6m less than their cost price.